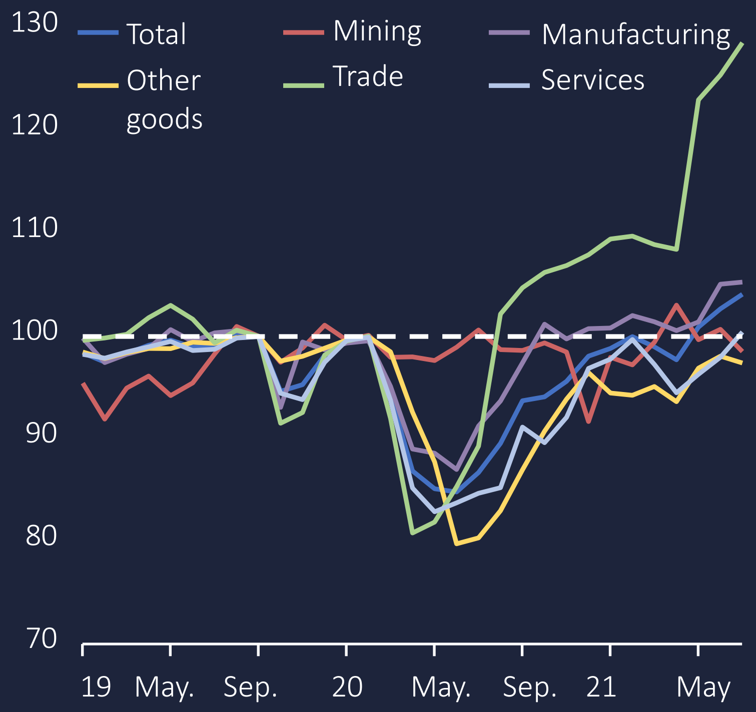
Monetary Policy and Economic Perspectives in Chile

XVI Monetary Policy Managers Meeting CEMLA and Banco de la República – September 13 and 14, 2021

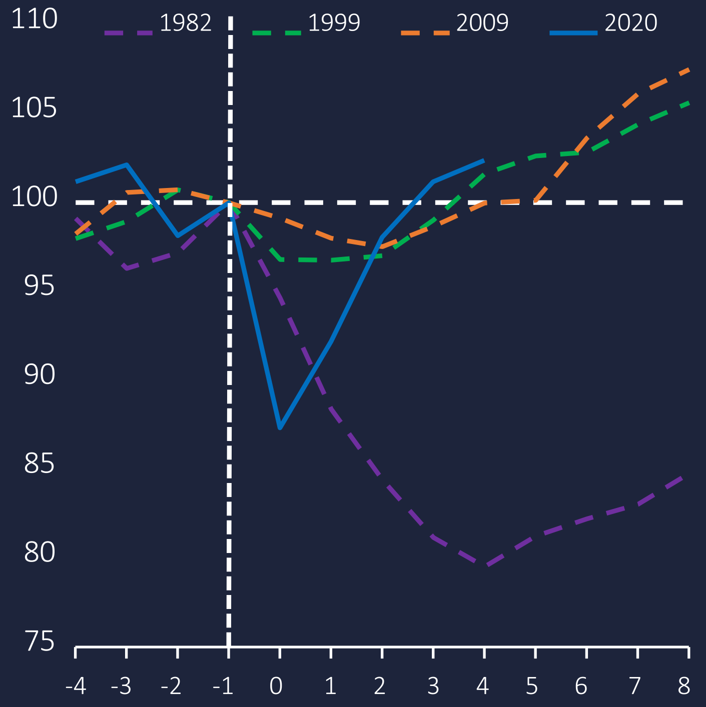
Miguel Fuentes, Manager of International Analysis

The Chilean economy has recovered its level prior to the outbreak of the social crisis and the pandemic with an unprecedented speed compared to past recessions.

IMACEC by sectors (1)
(SA levels, Sep-2019=100)



Total GDP in crisis episodes (2)
(SA series, index period *t*—1=100)



GDP growth 2020 and 2021 (f) (3)
(annual change, percentage)

(1) Source: Central Bank of Chile. (2) Respective zero periods: 1981.IV, 1998.IV4, 2008.IV, 2020.II. Source: Central Bank of Chile. (3) Source: September 2021 *Monetary Policy Report*, Central Bank of Chile.

According to counterfactual simulations based on Central Bank's models, this fast recovery was driven to a significant extent by policies put in place to weather the Covid-19 shock.

Effects on GDP of measures adopted during the Covid-19 crisis
(percent change with respect to same period, previous year)

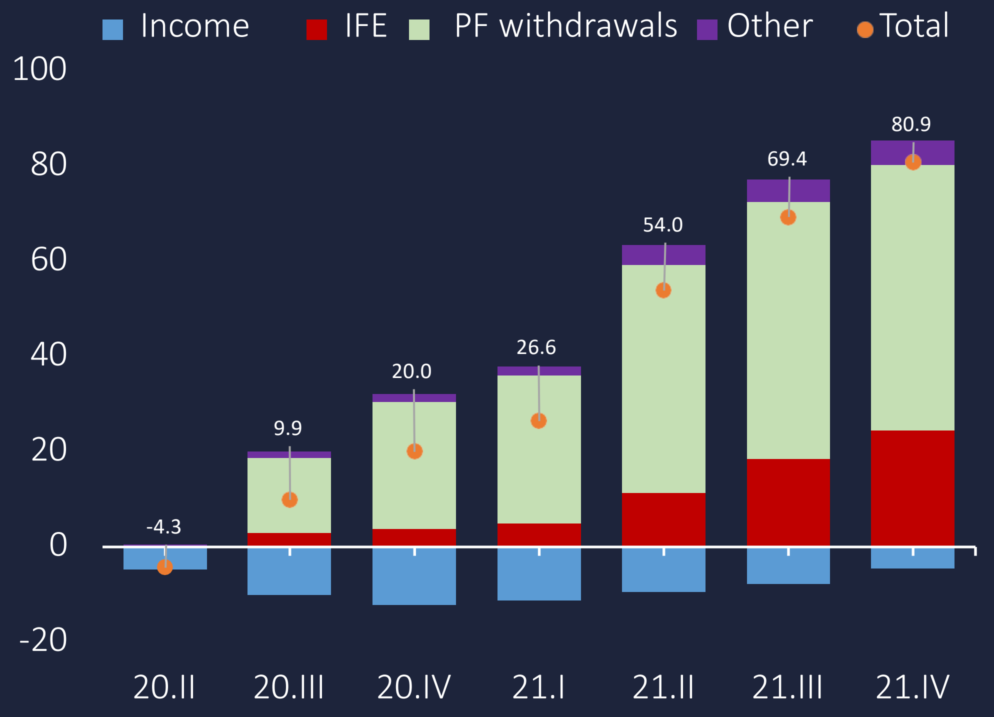
	2020	2021.H1
Conventional monetary policy (1)	[0.2 - 0.8]	[0.6 - 2,1]
Unconventional credit policies (2)	[2.2 - 4.8]	[2.7 - 4.4]
Fiscal policy	0.8	1.7
Total fiscal and monetary policy	**[3.2 - 6.4]**	**[5.0 - 8.2]**
Pension fund withdrawals	1.2	2.9
Total	**[4.4 - 7.6]**	**[7.9 - 11,1]**
Actual GDP	-5.8	8.7
Counterfactual GDP	**[-10.1 / -13.3]**	**[0.8 / -2.4]**

(1) Conventional monetary policy is MPR related. (2) Figures encompass monetary and sovereign guarantee policies that sought to stabilize financial markets, including the FCIC-Fogape program, bond purchases, and domestic- and foreign-currency liquidity programs. Source: Central Bank of Chile.

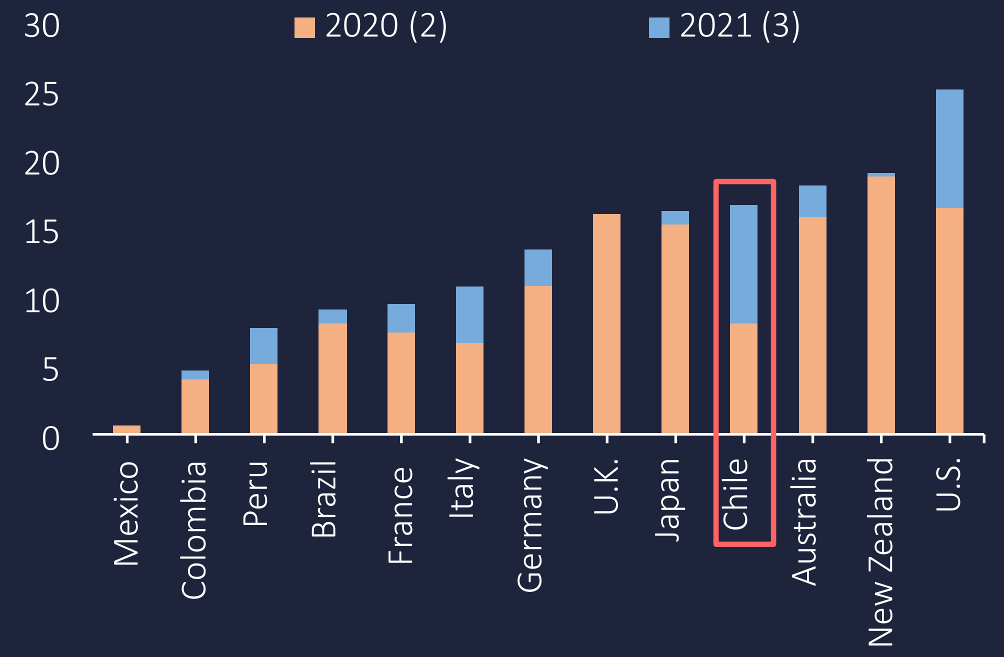
- Without domestic policy action, GDP contraction in 2020 would have more than doubled the actual figure
- Credit policies made the largest contribution to limit the impact of the crisis
- The impact of fiscal policy was far larger in 2021H1 tan in 2020
- Pension fund withdrawals contributed to boost demand and output, yet at a considerably larger cost
- External financial conditions, marked by an unprecedented policy response increased the impact and sustainability of local policies
- External and domestic policy responses jointly contributed to avoid the epidemic and economic crisis turning into a financial crisis
- Negative spillovers into the financial sector would have made the crisis far deeper and longer

The accumulation of massive pension savings withdrawals and fiscal transfers have significantly increased household liquidity.

Households' cumulative income and liquidity injections (1)
(billions of dollars)



Expenditures or revenues foregone by governments in response to Covid-19
(percent of 2020 GDP)

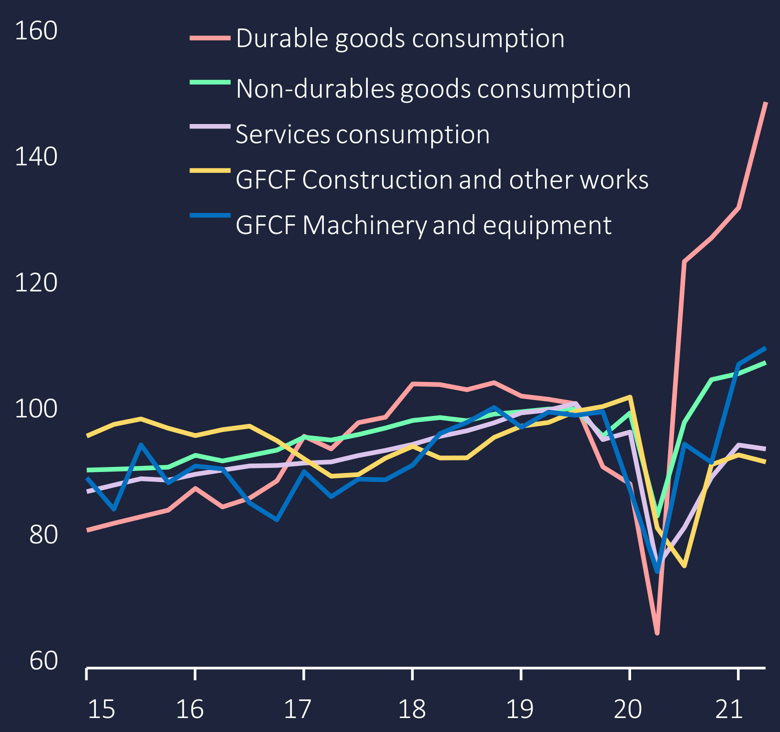


(1) For details on the methodology, see Chapter III in the September 2021 *Monetary Policy Report*. (2) Corresponds to IMF's *Fiscal Monitor* data for January 2021. (3) Difference between July and January 2021 delivery. Chile considers an additional 2.8% for IFE. Sources: International Monetary Fund, Chile's Ministry of Finance, Superintendence of Pensions, and Central Bank of Chile.

Private consumption has exceeded forecasts → household-support policies are having a bigger impact than expected.

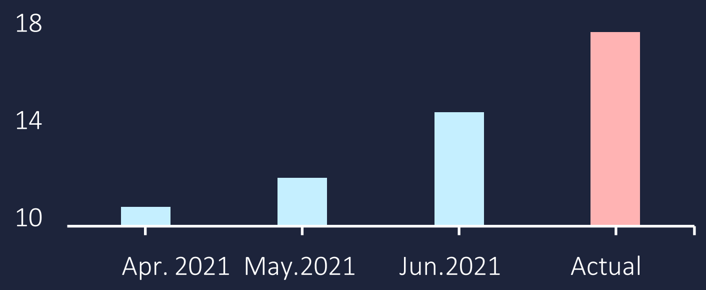
Domestic demand

(SA series; index, 2019 average=100)



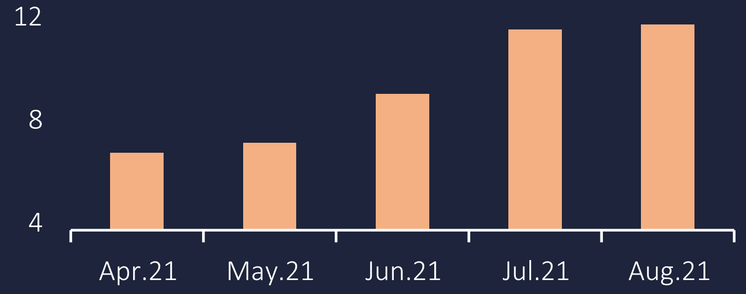
GDP 2021.II: actual vs market projection (1)

(annual change, percent)



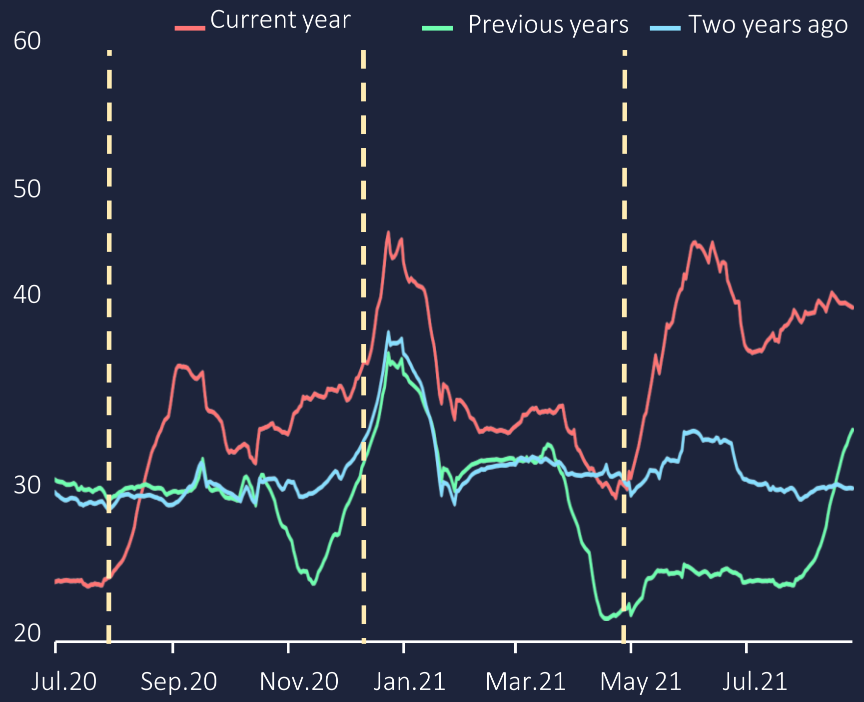
Private consumption 2021: market projection (1)

(annual change, percent)



Retail sales with digital invoicing (2)

(billions of CLP, 28-day moving average)

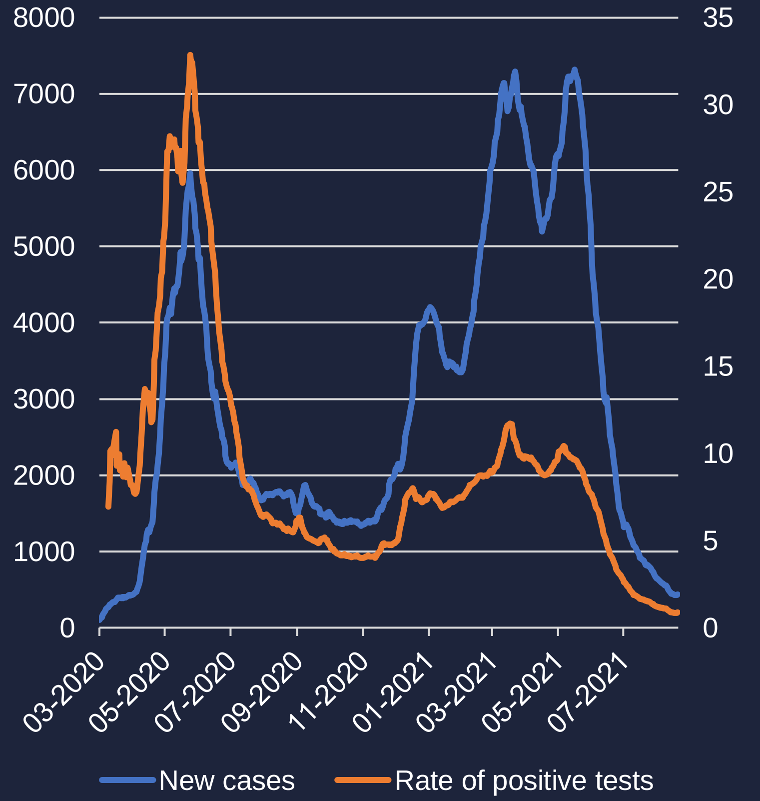


(1) Projections contained in Economic Expectations Survey. Source: Central Bank of Chile. (2) Dotted lines show projections of each *Monetary Policy Report*. The June and September projections use the structural parameters updated in the June 2021 *Monetary Policy Report*. Source: Central Bank of Chile.

Covid-19 appears to be under control aided by a successful vaccination effort

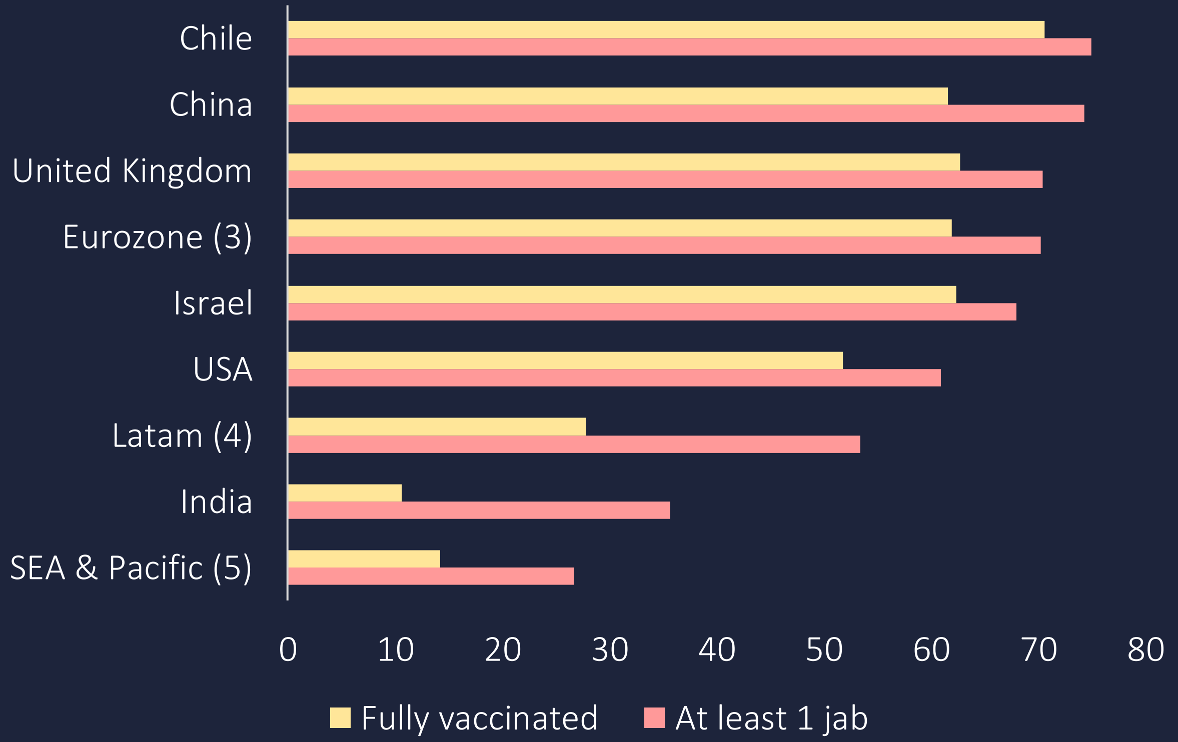
New cases and rate of positive tests (1)

(7 day moving averages, data as 12/09/21)



Vaccination progress (2)

(percent of population)

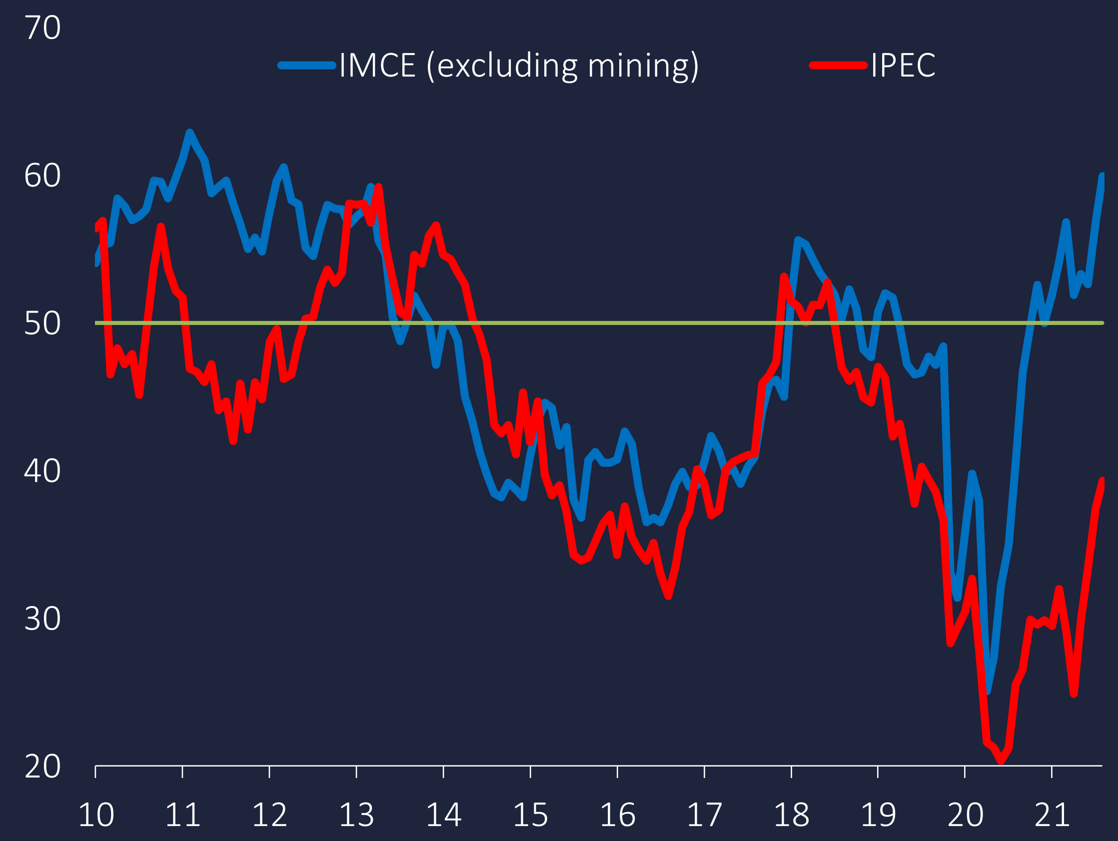


(1) (2) Percent of population with at least one dose. Information as of 31/Aug/21. (3) Population-weighted average for Germany, Spain, France and Italy. (4) Population-weighted average for Argentina, Brazil, Colombia, Mexico, and Peru. (5) Population-weighted average for Malaysia, Philippines, Indonesia, Vietnam, Thailand, Australia and New Zealand. Sources: Ministry of Health, Chile, Central Bank of Chile based on *Our World in Data* information.

Economic and health developments have driven expectations up, but uncertainty remains high

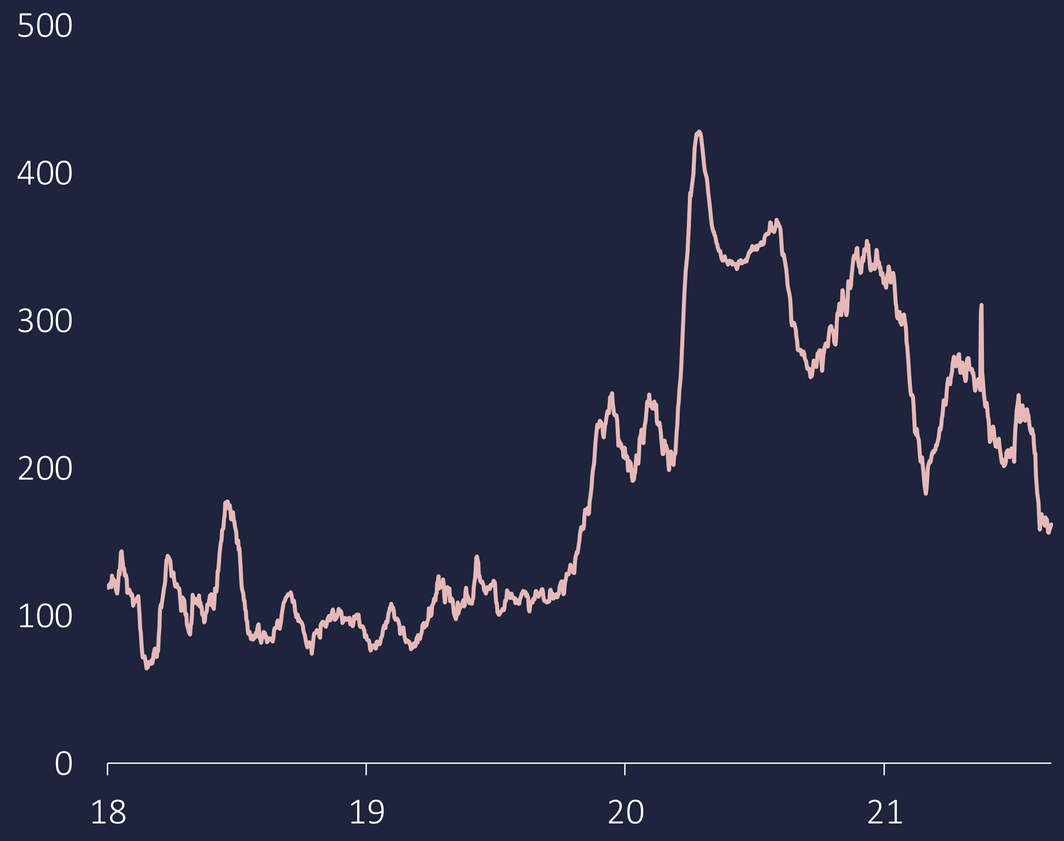
Consumer and businesses expectations (1)

(diffusion index)



Daily index of economic and political uncertainty (DEPUC) (2)

(index, 1 Jan. 2012=100)

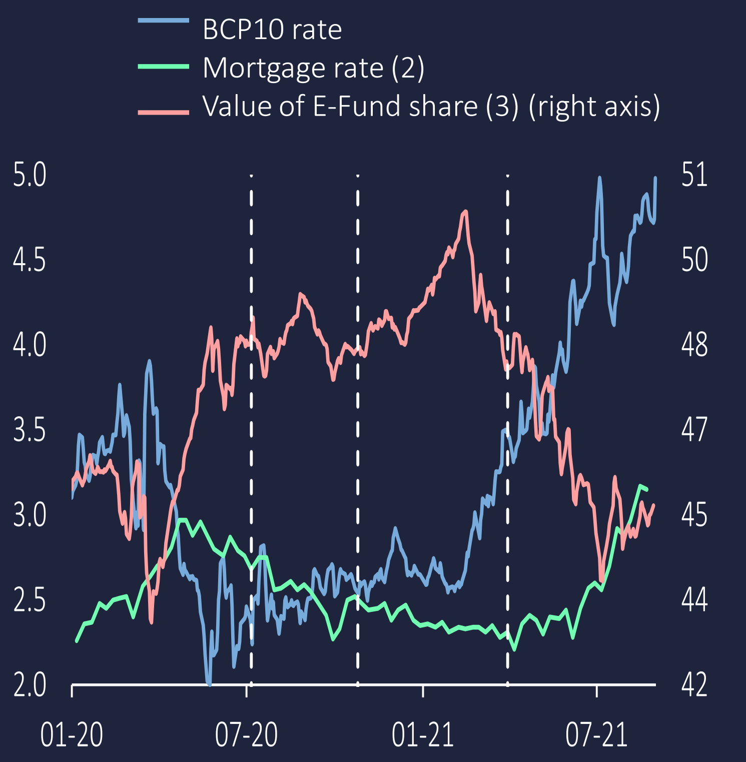


(1) Value below (above) 50 indicates pessimism (optimism). Source: UAI/ICARE and GfK/Adimark. (2) 30-day moving average. Source: Becerra and Sagner (2020).

The liquidation of long-term savings due to massive withdrawals of pension funds, coupled with the deterioration of the fiscal accounts, have worsened local financial variables. In this context, the CLP weakened the most in recent months.

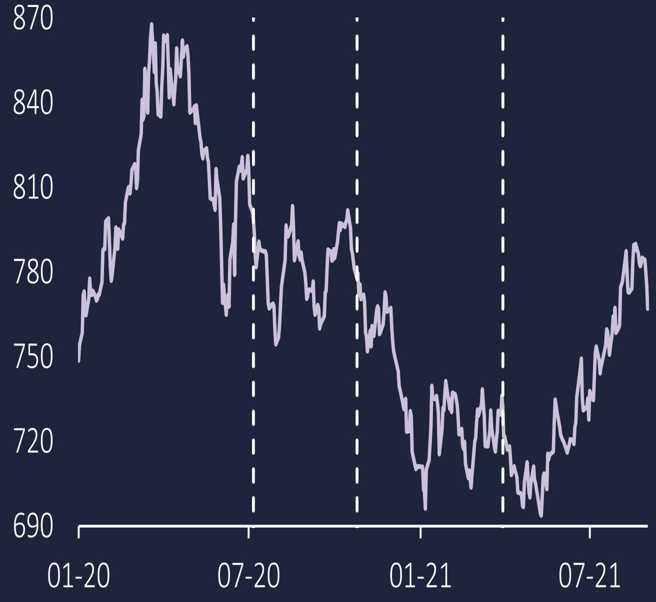
Interest rates and value of E-Fund share (1)

(percent; thousands of CLP)



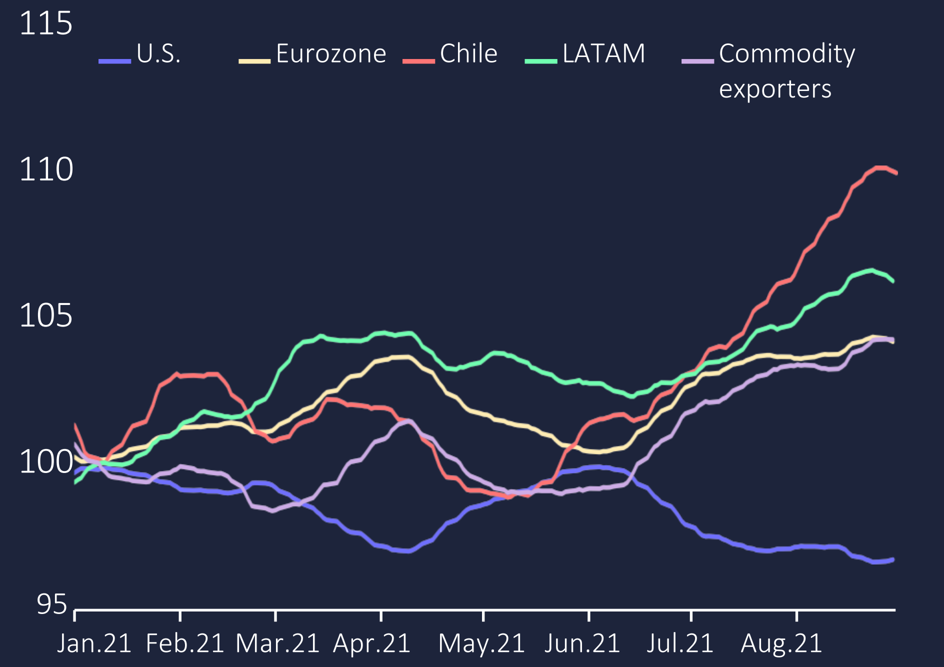
Nominal foreign exchange rate (1)

(CLP/USD)



Currencies (4)(5)

(index, 4/Jan/21=100)

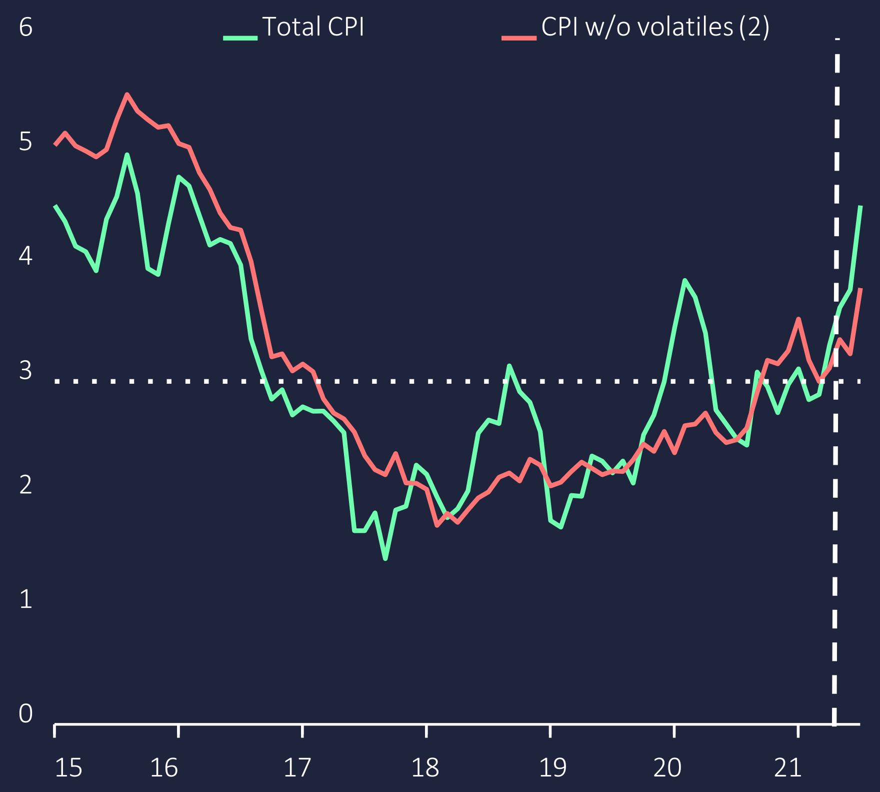


(1) Vertical lines indicate the beginning of the discussion in the House (approval of the idea to legislate) of the three Pension Fund withdrawals. (2) Weekly data. (3) Weighted average of the Pension Funds quota value according to respective asset values. Sources: Central Bank of Chile and Superintendency of Pensions. (4) 15-day moving average of respective indexes. (5) Latin America considers simple average between the indexes of Brazil, Colombia, Mexico, and Peru. Commodity exporters consider simple average between Australia and New Zealand. Sources: Central Bank of Chile and Bloomberg.

Headline and core inflation have accelerated, led by fuels and categories most affected by growing demand

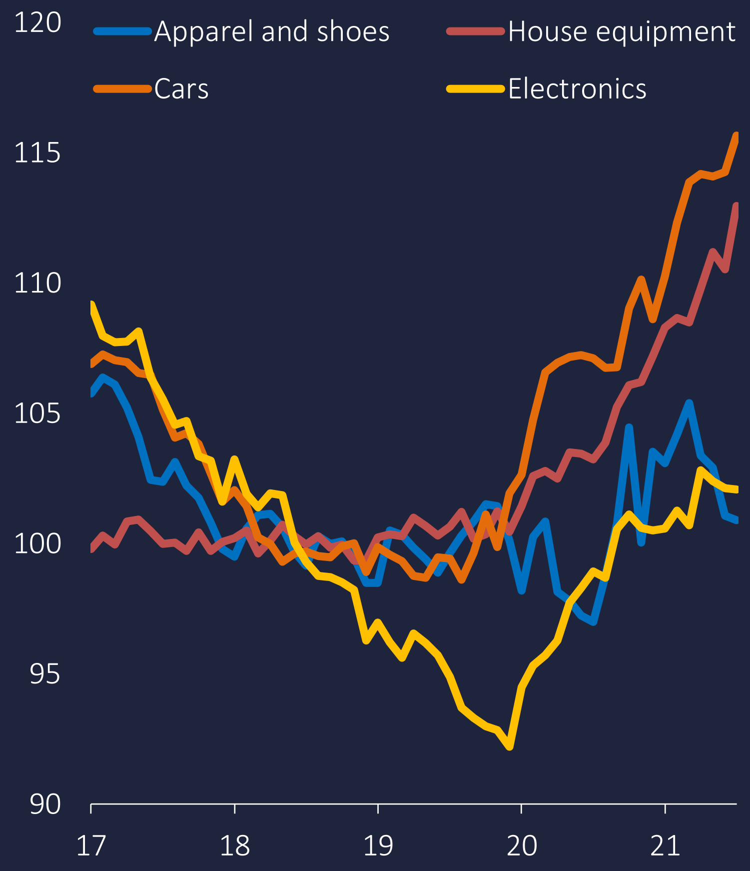
Headline and core inflation (1)

(annual change, percent)



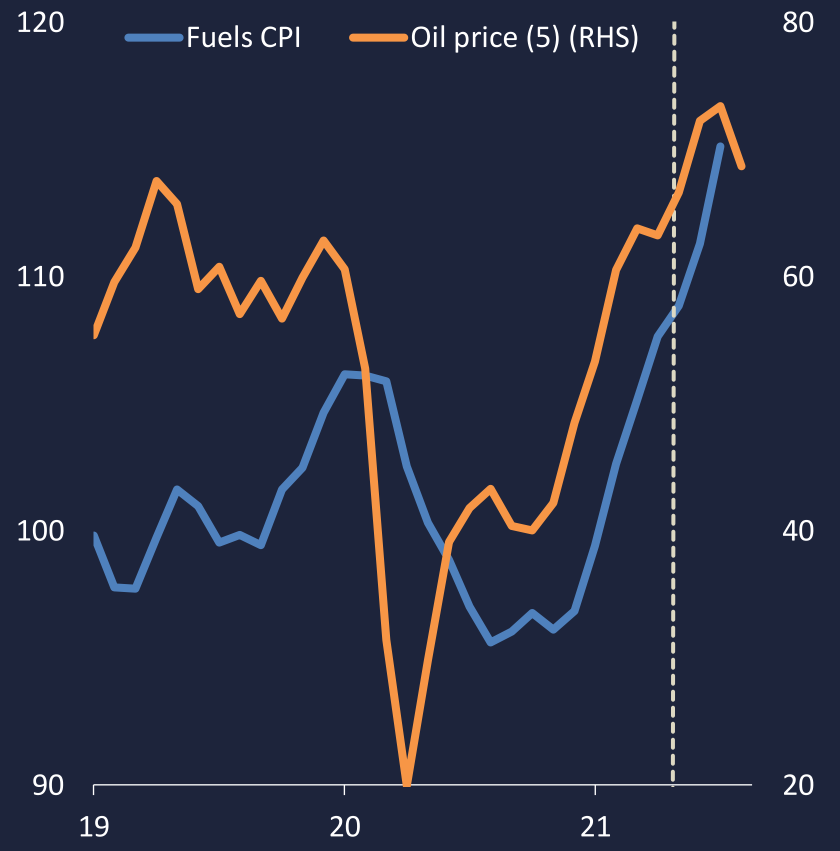
Items affected by higher demand (3)

(index, base 2018=100)



CPI of fuels and oil price (4)

(index, base 2018=100; USD per barrel)

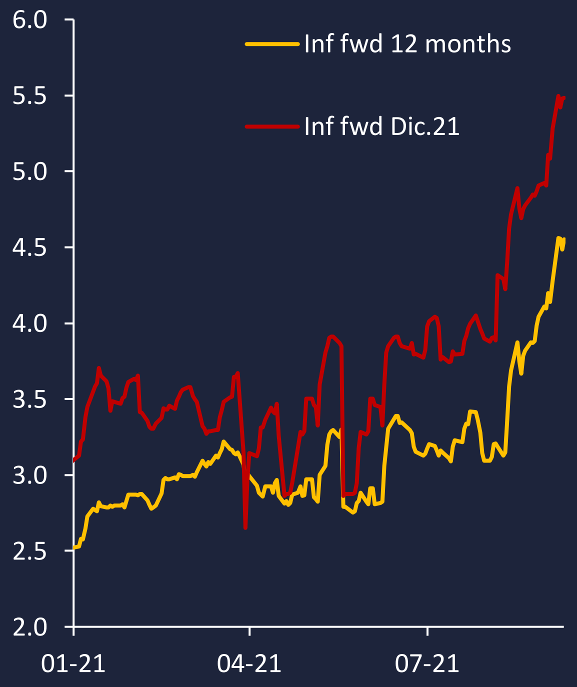


(1) Dashed vertical line indicates statistical cut-off of June 2021 *Monetary Policy Report*. (2) CPI without volatility has 65.1% share in total CPI basket. For more details, see Box IV.1 in December 2019 *Monetary Policy Report*. (3) It shows the evolution of the CPI price indices of the selected groupings of goods. (4) Dashed vertical line indicates statistical cut-off of June 2021 *Monetary Policy Report*. (5) Average price between Brent and WTI oil barrels. Sources: Central Bank of Chile, Bloomberg, and National Statistics Institute.

Short term (1 year ahead) inflation expectations have increased significantly. Two years ahead measures are above 3%.

Inflation forward

(annual rate, percent)

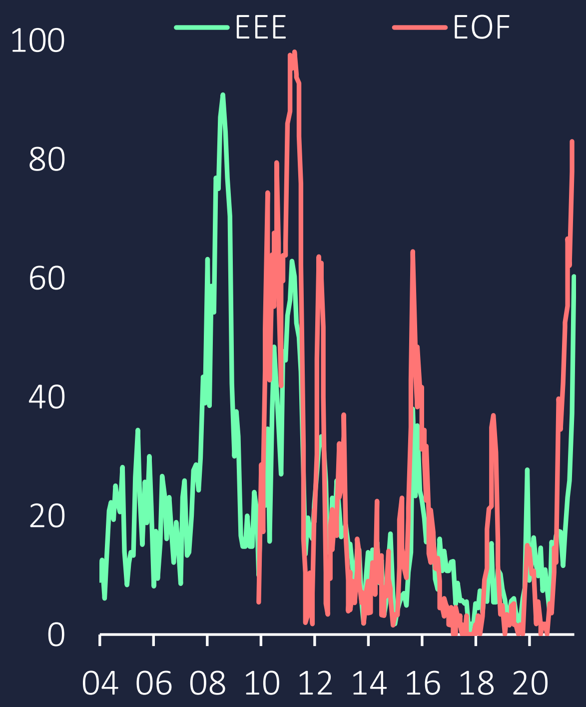


Surveys: inflation expectations (*)

(annual rate, percent)

Surveys: 2 years ahead inflation expectations above 3%

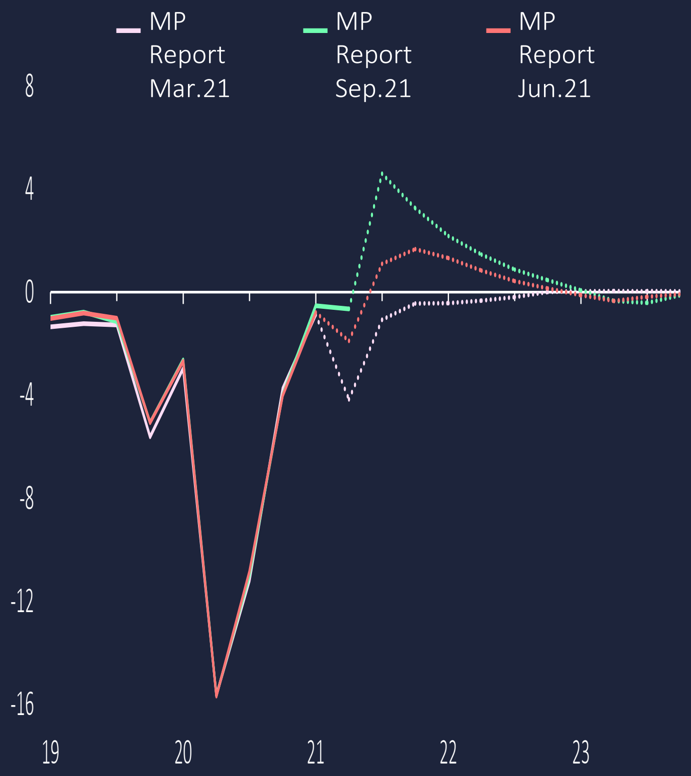
Share of answers (%)



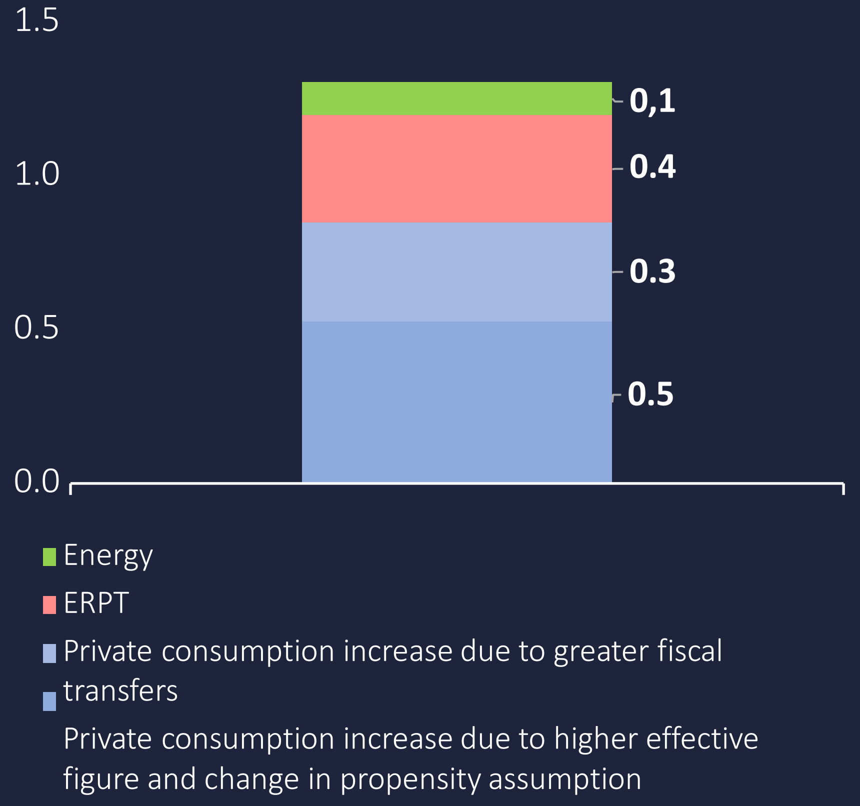
(*) For the FTS, the survey of the first half of the month is considered until February 2018. From then onwards, it considers that last survey published each month. In the months no survey is published, the last survey available is used. Source: Central Bank of Chile, ICAP and Tradition Chile.

Increase in demand due to a higher propensity to consume and extended fiscal transfers explain most of the upward correction in 2021 growth and inflation estimates.

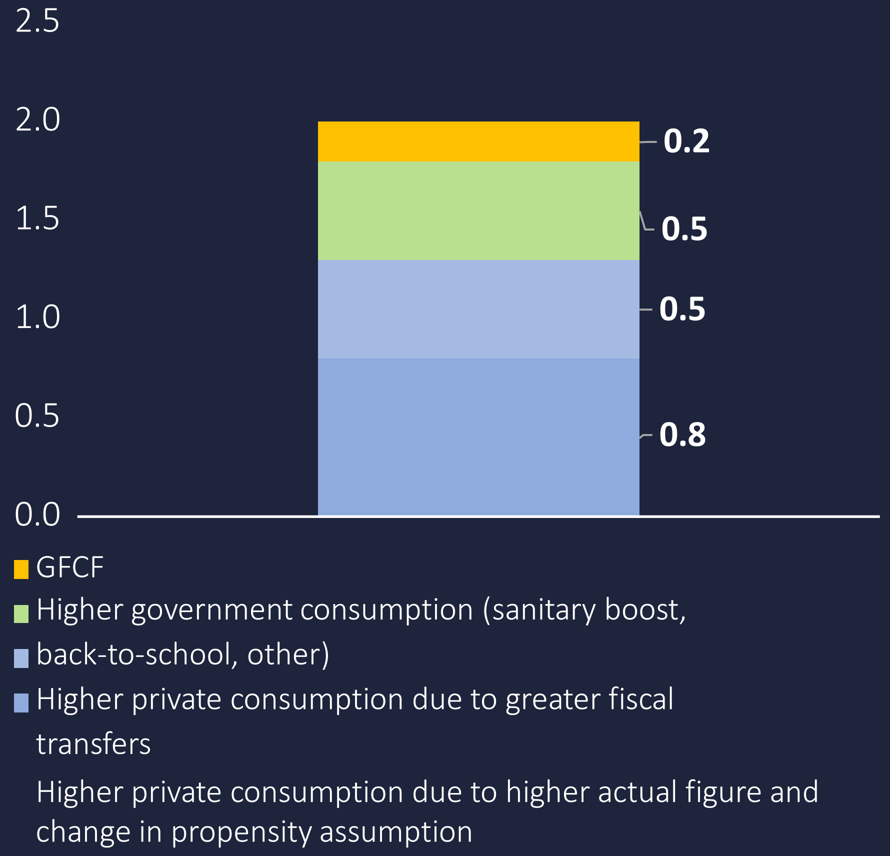
Activity gap (1)
(level, percentage points)



Contribution to revision to inflation forecast in December 2021 (2)
(percentage points)



Contribution to revision to 2021 GDP growth (3)
(percentage points)

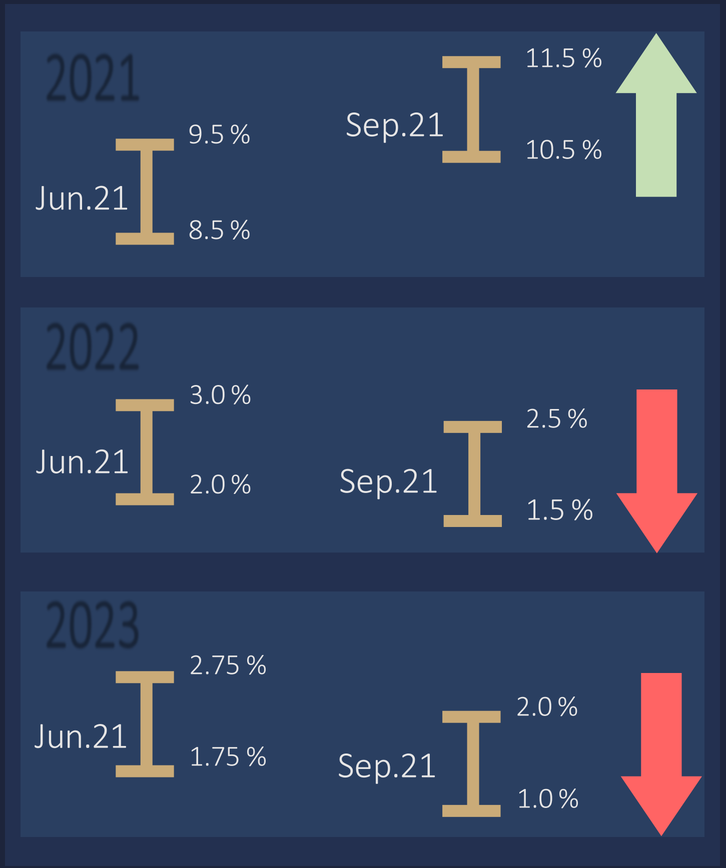


(1) Dotted lines show projections of each *Monetary Policy Report*. The June and September projections use the structural parameters updated in the June 2021 *Monetary Policy Report*. Source: Central Bank of Chile. (2) Built using the projections for total CPI inflation from the *Monetary Policy Reports* of June and September 2021. Sources: Central Bank of Chile and National Statistics Institute. (3) Built considering the midpoint of the *Monetary Policy Report* forecast range of June and September 2021.

In 2022 and 2023 the economy will slow down significantly. Consumption will moderate, in line with receding pandemic impacts and reduced economic policy momentum. Investment recovery is still expected to be sluggish, due mainly to idiosyncratic factors.

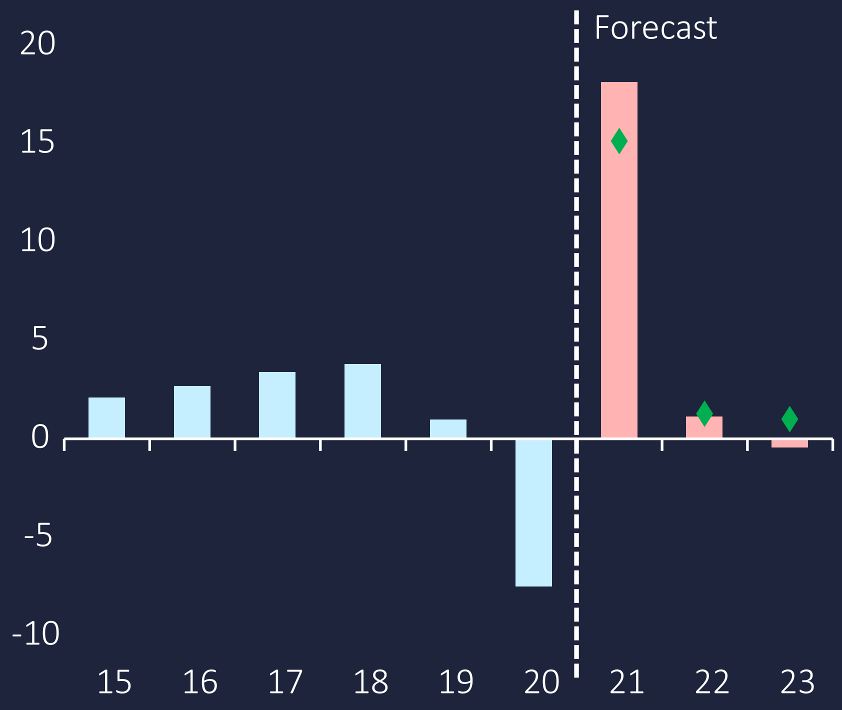
GDP growth forecast

(annual change, percent)



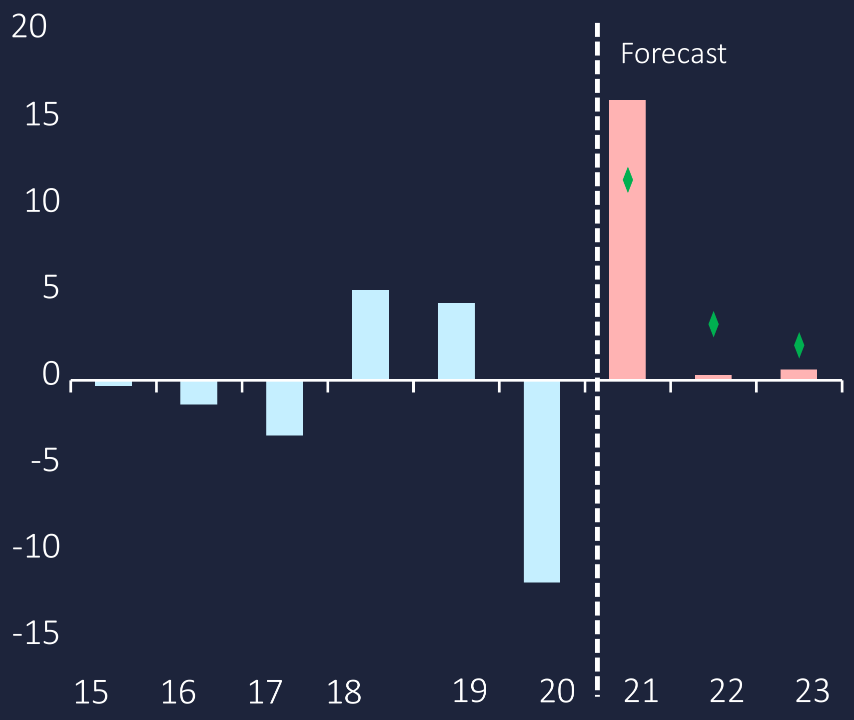
Private consumption (2)

(real annual change, percent)



Gross fixed capital formation (2)

(real annual change, percent)

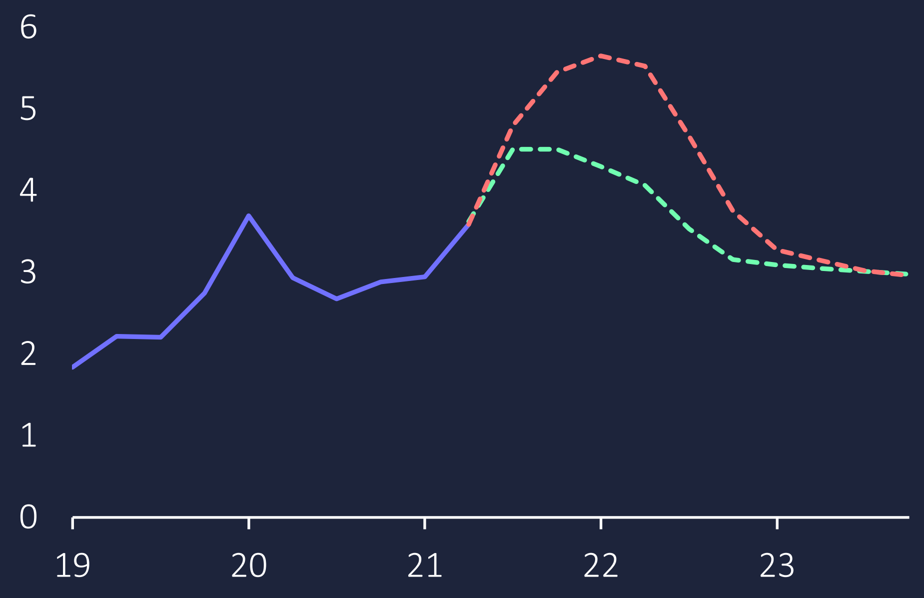


(f) Forecast. Considers midpoint of growth ranges contained in *Monetary Policy Reports* of June and September 2021. Source: Central Bank of Chile. (2) Diamonds indicate forecast in June 2021 *Monetary Policy Report*. Source: Central Bank of Chile.

Annual inflation will end this year at 5.7% and will be above 5% during 2022H1. Core CPI will peak around mid-2022.

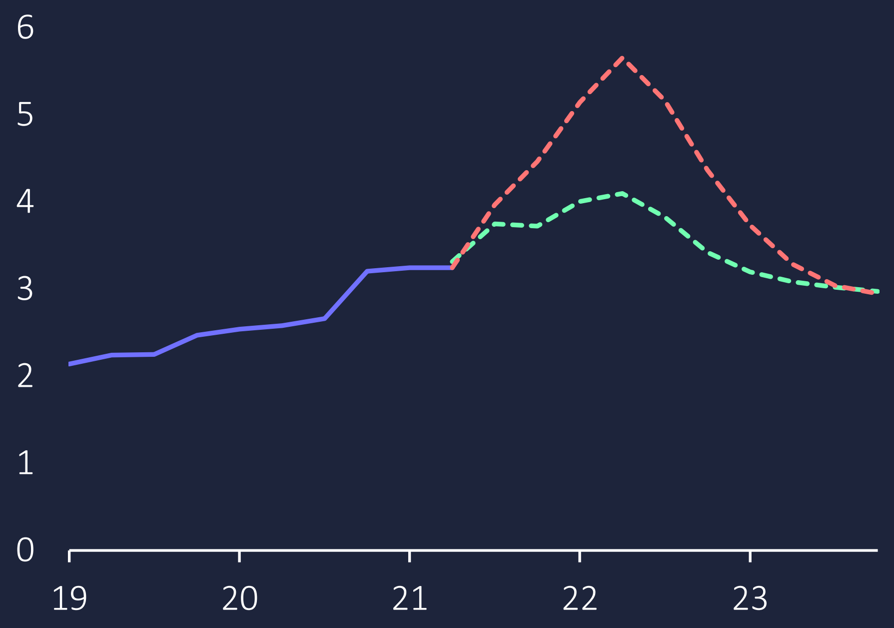
Inflation forecasts: Headline CPI

(annual change, percent)



Inflation forecasts: Core CPI

(annual change, percent)



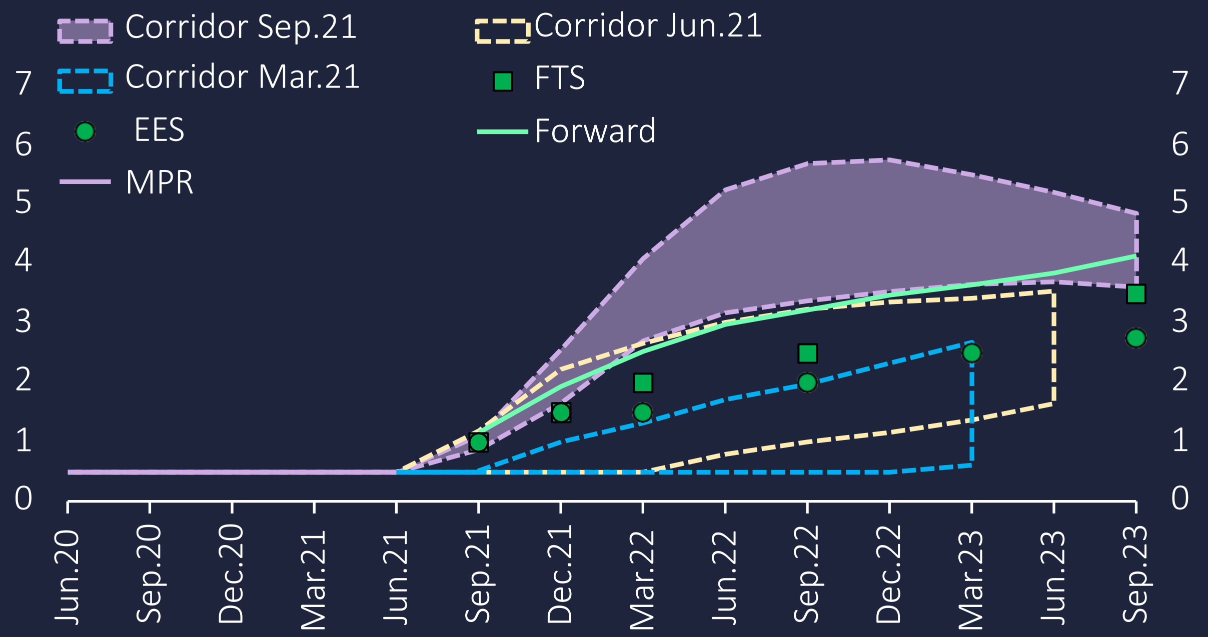
Effective — MP Report Jun.21 — MP Report Sep.21

(1) Dashed lines indicate forecast in respective *Monetary Policy Report*. (2) Measured by CPI without volatiles. Sources: Central Bank of Chile and National Statistics Institute.

The CBC Board raised the MPR by 75 basis points and, in the central scenario, it believes it will need to raise the MPR at a fast-enough pace to bring it towards mid-2022, to a figure like its neutral level.

MPR corridor (*)

(percent)



The CBC Board decided to intensify the withdrawal of monetary stimulus to avoid the accumulation of macroeconomic imbalances that could jeopardize the convergence of inflation to the 3% target.

This is so because a scenario has emerged in which the CBC Board has less room for maneuver, as a result of:

1. Rapid evolution of macroeconomic scenario
2. Inflation expectations dynamics
3. Sensitivity scenarios associated with higher pressures on prices

(*) The corridor is built following the methodology of Box V.1 of the March 2020 *Monetary Policy Report*. It includes the FTS of August 26, the EES of August 10 and the quarter's mean smoothed forward curve (statistical cutoff). The methodology corresponds to the extraction of the implicit MPR considering the forward curve on the interest rate swap curve up to 2 years, discounting the fixed rates for each term at the simple accrual of the CPI. Source: Central Bank of Chile.

Monetary Policy and Economic Perspectives in Chile

XVI Monetary Policy Managers Meeting CEMLA and Banco de la República – September 13 and 14, 2021

banco central Chile

Miguel Fuentes, Manager of International Analysis