Unconventional Monetary Policy in Chile
NACChamber Webinar Series
May 18, 2020

Speaker: Sergio Godoy
Email: sgodoyw@gmail.com

Outline

- Macroeconomic context and precedent
- Conventional Monetary Policy
- Unconventional Monetary Policy
- Next possible steps
- Asset pricing implications

Macroeconomic context

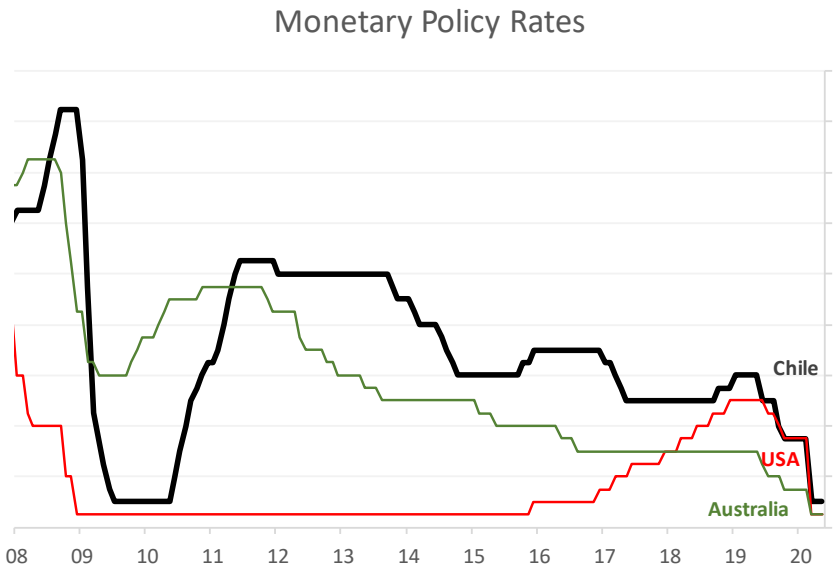
- Like in the rest of the world, the Chilean economy has entered in an apparently deep short-term recession, and the recovery is still uncertain.
- The economy is highly dependent on the global cycle, especially, on China.
- My current forecast is fall of 2020 GDP of closed to 3%, which is currently on the optimistic side of expectations. Moreover, inflation is also falling but my estimate is a slower disinflation process.
- In this context, the Central Bank of Chile (BCCh) decided to lower its policy rate to 0.5% and start implementing Unconventional Monetary Policy (UMP).
- This is not the first time. However, the nature of the UMP implemented now is different and the size and scope is much larger than the one implemented in the aftermath of the 2008-09 GFC.
- Complementary, the government is implementing an exceptionally expansionary fiscal policy that it will lead this year to the highest fiscal deficit in decades.

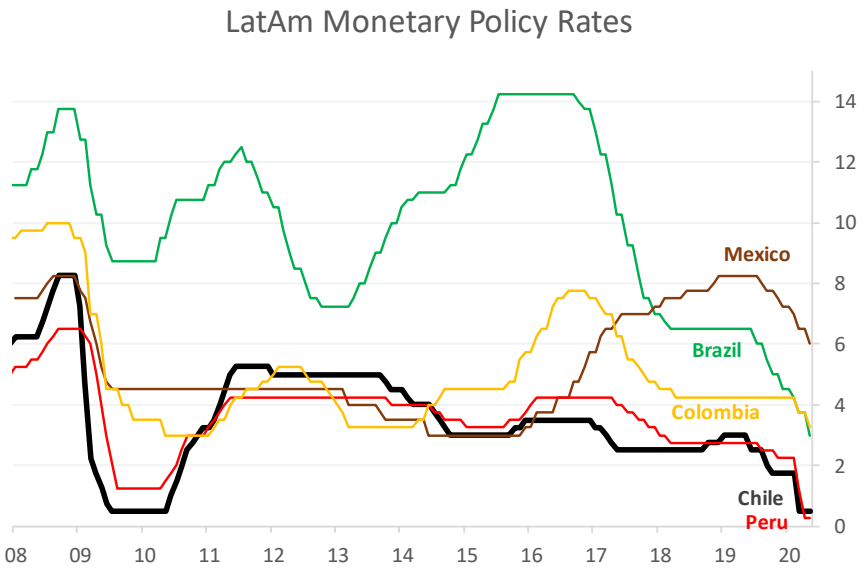
Historical precedents

- In the last Crisis, the BCCh also aggressively lowered its policy rate to 0.5% (see next slide).
- Moreover, it offered to commercial banks a short-term lending facility (Facilidad de Liquidez a Plazo (FLAP)), like the traditional Repos but with longer terms (up to 180 days).
- This facility was extensively used by banks and that amount at its maximum was up to USD 6,500 billions (or 25% of the BCCh´s balance sheet).
- The FLAP was sterilized by the BCCh by issuing short term bills.
- In addition, the BCCh stopped issuing long-term bonds during 2009.

Conventional Monetary Policy

- The exhibit shows the swift fall of the Chilean policy rate to closed to 0. This is similar to what happened in the developed countries. In Latam, only the Peruvian Central Bank has done something similar, so far.
- Moreover, in the aftermath of the previous Global Financial Crisis the Chilean policy rate stayed lower, like in developed world but unlike in Brazil and Mexico.





Chronology of the Monetary Policy steps

- The BCCh announced the beginning of the UMP on March 16th in a special meeting, when it reduced its policy rate in 75bp (from 1.75% to 1%).
- The UMP included the following: (1) a Bank Bond Purchase Program, (2) a Conditional Credit Facility for Increased Lending (Facilidad de Financiamiento Condicional al Incremento de Colocaciones (FCIC)), and (3) restarting the Central Bank Bond Purchase Program.
- These programs have been almost completely sterilized by issuing short term bills. This means that in fact all these programs are more akin to a yield curve and credit spread curve management.
- (3) was begun in the aftermath of social outbreak back in November 2019. I will provide more details on these programs in the next slides.
- On March 31st, the BCCh lowered again its policy rate in 50bp (from 1% to 0.5%), which is considered a "technical" minimum, that is, a threshold that will not pass. Moreover, it also provided a "forward guidance" that it will keep the policy rate low for extended time.

Unconventional Monetary Policy: BCCh Bond Purchase Program

- Back in November 14th, 2019, the BCCh initiated a programs for buying its own bonds.
- The BCCh is very much unique in the world because in the past had partially funded its asset by issuing bonds.
- Up to today, it has bought USD 5.6b (14,6% of the BCCh's balance in October) and around 66% of the current intended maximum bond purchase (USD 8.5b or 22% of the BCCh's balance in October).
- This shows that the BCCh still has some room to go. However, in my opinion, the next time this UMP option will not be available.
- The other consequence is that it has helped to "normalize" the balance sheet by getting out of bond financing.

Day	BCCh Bond Purchase Program		
	Indexed Bonds	Nominal Bonds	Total
	(USD millions)	(USD millions)	(USD millions)
November 2019	3,291.6	113.7	3,405.3
March 23, 2020	53.0	-	53.0
March 30, 2020	-	34.7	34.7
April 1, 2020	574.0	472.3	1,046.3
April 3, 2020	153.7	121.6	275.3
April 7, 2020	149.8	2.1	151.9
April 9, 2020	107.9	5.9	113.8
April 14, 2020	108.9	6.6	115.5
April 16, 2020	16.7	66.8	83.5
April 21, 2020	289.3	15.4	304.7
April 23, 2020	32.1	1.9	34.0
Total	4,777	841	5,618

Source: BCCh and own calculations.

Unconventional Monetary Policy: Bank Bond Purchase Program

- The BCCh has so far bought closed to USD 3.3b in bank bond (8,6% of the BCCh's balance in October).
- The current intended maximum bond purchase is USD 8b (21% of the BCCh's balance in October). However, since April 13 all auctions have been declared void.
- Basically, either bond spreads offered by the BCCh has not been attractive or market participants have not needed liquidity.
- This shows that the BCCh is interested in putting a cap on bond spreads.

Day	Banking bond program		
	Amount of bond offered by market participants (2)	Amount sold to the BCCh (3)	Bid-to-cover ratio
	(USD millions)	(USD millions)	(2) / (3)
March 20, 2020	1,124.9	309.2	**3.6**
March 23, 2020	1,901.7	856.8	**2.2**
March 24, 2020	1,950.9	1,270.7	**1.5**
April 2, 2020	1,242.8	855.2	**1.5**
April 6, 2020	9.9	9.9	**1.0**
April 8, 2020	0.7	0.7	**1.0**
April 13, 2020	-	-	
April 15, 2020	-	-	
April 20, 2020	-	-	
April 22, 2020	-	-	
April 27, 2020	-	-	
April 29, 2020	-	-	
May 4, 2020	-	-	
May 6, 2020	-	-	
Total	6,230.9	3,302.5	**1.9**

Source: BCCh and own calculations.

Unconventional Monetary Policy: FCIC

- The FCIC is a credit line open to commercial banks, inspired in the European TRLO, for unclogging the credit channel. It has a 1m maturity, renewable up to 4 years at interest rate equal to the policy rate.
- The BCCh has required collateral for FCIC (bank reserves, bonds or high-quality loans).
- The initial line was an amount equivalent to 3% of each bank's base portfolio of corporate and consumer loans at the end of February (USD 4.8b). On April 8th, the BCCh added an additional line of max 12% of the base portfolio (USD 19.2b).
- The size of line that a bank can tapped is conditional on actual loan growth and there is a bonus for SMEs' lending.
- Banks have applied to around US$16b, that is, nearly 67% of the available funds. This is equivalent to 42% of the BCCh's balance in October (with an intended maximum increase of 62.2% of the BCCh's balance in October)

Day	FCIC			
	FCIC amount applied (USD millions)	Collateralized by Reserves (USD millions)	Collateralized by Bonds (USD millions)	Interest rate
March 30, 2020	-	-	-	1.00%
March 31, 2020	2.4	1.2	1.2	1.00%
April 1, 2020	1,162.8	1,139.3	23.5	0.50%
April 2, 2020	293.8	293.8	-	0.50%
April 3, 2020	116.0	116.0	-	0.50%
April 6, 2020	567.1	567.1	-	0.50%
April 7, 2020	191.1	138.7	52.5	0.50%
April 8, 2020	858.1	840.3	17.8	0.50%
April 9, 2020	448.4	448.4	-	0.50%
April 16, 2020	2,562.3	2,500.6	61.7	0.50%
April 17, 2020	693.2	172.4	520.8	0.50%
April 30, 2020	4,948.8	215.7	4,733.1	0.50%
May 7, 2020	2,886.0	-	2,886.0	0.50%
May 14, 2020	1,294.7	423.2	871.5	0.50%
Total	16,025	6,857	9,168	

Source: BCCh and own calculations.

Unconventional Monetary Policy: a summary

- There has already been a sizeable increased in the BCCh's balance sheet closed to 50% of the balance at October 2019 (6.8% of 2019 GDP).
- It can potentially increase up to 83% (11.3% of GDP), but this depends critically the evolution of economy and inflation. Moreover, FCIC has a self correction mechanism embedded since its size will decrease if the BCCh start to hike its policy rate.
- Keep in mind that all programs are almost fully sterilize and, thus, they are akin to yield curve and credit spread curve management.

	BCCh Bond Purchase Program		
	(USD millions)	(% of Balance)	(% of 2019 GDP)
Current	5,618.0	14.6%	2.0%
Intended Maximum	8,481.0	22.0%	3.0%

	Banking Bond Purchase Program		
	(USD millions)	(% of Balance)	(% of 2019 GDP)
Current	3,302.5	8.6%	1.2%
Intended Maximum	8,000.0	20.7%	2.8%

	FCIC		
	(USD millions)	(% of Balance)	(% of 2019 GDP)
Current	16,024.8	41.6%	5.7%
Intended Maximum	24,000.0	62.2%	8.5%

	Total UMP excluding BCCh Bond Purchase		
	(USD millions)	(% of Balance)	(% of 2019 GDP)
Current	19,327.3	50.1%	6.8%
Intended Maximum	32,000.0	83.0%	11.3%

Source: BCCh and own calculations.

Next possible easing measures

- The BCCh has several options for easing more if it chooses to do it.
- On the bond purchase program:
  - It could initiate a non-banking enterprise bond program.
  - It could lower the spread offered in the Bond Purchase Program to make auctions more attractive.
- On the FCIC:
  - It could increase the scope of the FCIC by including mortgage loans.
  - It could lengthen the terms of this facility.
  - It could reduce the size of collateral.
  - It could temporally include non-banking financial institutions in this program (and in regular Repos).
- The BCCh could also sterilize less the UMP measures and, thus, increase its balance sheet.
- The BCCh could buy Treasury notes and bonds in the secondary market. However, this possibility is constitutionally ban (Article 109), but there is a bill in the Senate on this issue.

Asset pricing implications

- These measures has an impact on several Chilean asset prices, which are the following:
  - The first effect is keeping long-term interest rates at low levels.
  - The second effect is putting a cap on bank bond spread and, thus, containing the increase in credit risk due to the recession.
  - Together with the fiscal expansion, a third effect is appreciating the CLP and stock prices by accelerating the recovery of the economy. However, this depends on several other factors, such as pandemic control, reopening measures, social outbreak and global recovery.
- Finally, so far, the pricing in the swap curve shows a hike in the second semester of 2021. Moreover, the 10y swap rate is closed to 2.2%.
- This shows that financial markets (correctly) expect that current ultralow level of policy rate will not last for very long and, thus, the BCCh will have to think about an exit strategy the next year.
- This highly differs to what markets are expecting in developed countries. However. a final lesson from these countries' experience is that it is not easy to unwind these program.