Servicio de Estudios Económicos

Chile

BBVA

BCCh Watch

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July MPR: The Central Bank intensifies its monetary policy with a 25bp cut and unconventional measures

- **This is the seventh consecutive cut since the relaxation of monetary policy began in January.**
- **The MPR reached a new all-time low of 0.5% and is expected to remain at this level for a prolonged period, as the Board explained.**
- **The decision is the result of domestic factors: indicators of declining economic activity and easing inflationary pressures.**
- **In addition, in order to provide a more powerful monetary stimulus, complementary measures were introduced, which included a reduction in the supply of Central Bank paper.**

At its July monetary policy meeting the Board of the Central Bank of Chile decided to cut the monetary policy rate 25 basic points, in line with market expectations. This cut reduces the rate to 0.5%, which is a record low for the period since the introduction of a nominal monetary policy rate. In addition, the Board stated that the MPR would remain at this level for a prolonged period.

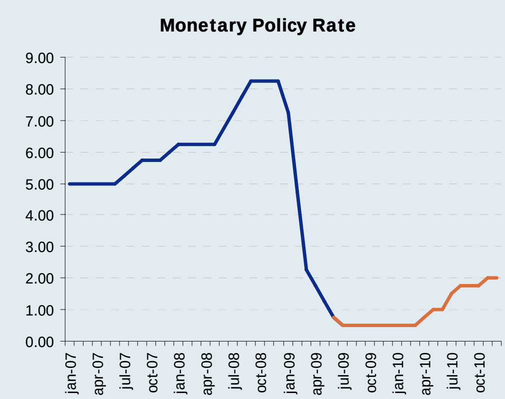
The main reason behind today's decision is the easing off of inflationary pressures, even if the change in June was positive (0.3%). However not only will twelve-month inflation remain below the lower bound of the Central Bank's target range, but, according to our forecasts, from September on it will become negative, finishing the year at -0.1%. It is worth noting that since October 2004, twelve month inflation has not fallen below 2%. In addition, cost pressures have reduced, in part due to the recent appreciation of the peso.

According to the analysis given to the Board (and the market) yesterday, the fall in activity during the second quarter will be deeper than anticipated in the last MPR; we agree with this analysis, which is an additional factor behind today's decision. The report after today's meeting confirms this view, whilst adding that credit conditions remain tight.

Given that the room for intensifying expansionary monetary policy has got smaller as the MPR has approached 0%, the need to increase the monetary stimulus has led the Board to announce unconventional measures. Hence, in line with the announcements of other Central Banks, the Central Bank of Chile announced complementary measures. In particular, the Board decided: i) To establish a Term Liquidity Facility for banks (90 and 180 days at the current MPR); ii) To adjust the issue plan for PDBCs (Bank of Chile promissory notes) for terms of less than one year; and iii) To suspend the issue of debt instruments for periods equal to or greater than one year, corresponding to BCP-2 and PDBC-360.

Appraisal: When announcing the cut, the Central Bank stated explicitly that the MPR had reached its minimum, and therefore the scope for using this tool to provide an expansionary stimulus has been used up.

We believe that the objective of affecting the long-term yield curve will be achieved given the emphasis of the announcement.



source: BCCh, BBVA forecast

Carola Moreno cmoreno@bbva.cl
Alejandro Puente apuente@bbva.cl