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Latam Daily: Brazilian CPI; BCCh Countercyclical Capital Buffer

- **Chile: BCCh issues update on countercyclical capital buffer setting**

The global market mood remains bound by Washington fiscal intrigue (with Fitch Ratings placing the US on negative watch) while tech sector gains support equity futures against the continuing risk averse tone (in futures, Nasdaq +1.8%, SPX +0.6%, Dow Jones -0.2%). WTI crude oil is down 2% against a better performance in the metals space with copper and iron ore gaining 0.7% and 0.3% respectively (but remaining quite beaten up). On the topic of commodities, Colombia's national hydrocarbons agency highlighted yesterday the dwindling of the country's oil and gas reserves—partly amid no new extraction permits in the country.

The USD is firmer against most major currencies, though the MXN is once again swimming against the current (+0.2%), normalizing from the 18 pesos zone where it traded at times on Tuesday and Wednesday and with its gains from the figure area unfazed by the slightly lower-than-expected H1-May inflation published yesterday (headline 6% vs 6.13% median, and core 7.49% vs 7.45% median). News on rail lines and bank acquisitions remains an important item to monitor for moves in Mexican assets, with the release of April international trade data at 8ET and Q1 current account at 11ET only a secondary consideration.

At 8ET, Brazil publishes inflation data for the first half of May. The median economist projects a slight acceleration in the headline year-on-year rate of prices growth, to 4.21% from 4.16%, and in the month-on-month reading to 0.64% from 0.57%. Over the past week or so—amid the advancement of the fiscal framework bills with more limits on spending than at first—markets have added to BCB cut expectations, to now see about 85bps in cuts over the next six months. The first reduction is not seen until late-Q3 or early-Q4.

—Juan Manuel Herrera

CHILE: BCCH ISSUES UPDATE ON COUNTERCYCLICAL CAPITAL BUFFER SETTING

On Tuesday, May 23, the central bank (BCCh) held its Financial Policy meeting, which activated the counter-cyclical capital buffer (CCyB) setting it at 0.5% of risk-weighted assets (RWA), due in one year.

The Board has activated the CCyB as a precautionary measure considering the higher external uncertainty environment. Although the macroeconomic scenario has evolved in line with expectations and the BCCh has acknowledged the high level of solvency of the banking system, there has been an increase in the risk of a severe external shock occurring. According to the BCCh, its activation will have limited and temporary effects on the evolution of credit considering the current level of capitalization. This tool is framed within the Basel III capital standards for the banking system.

- As of January 2023, the 0.5% requirement represents about USD 1.5 bn if the measure were to be taken immediately. However, the deadline is 1 year ahead, and the adjustment can be made through a reduction in slack and/or through a reduction in risk-weighted assets RWA.
- The BCCh expects banks to take advantage of their high levels of buffers estimated in the stress testing exercises, avoiding significant negative impact on credit flow. International evidence indicates that banks face new capital requirements by partially

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using their available buffers, although the medium-term banks tend to return to their original buffers. Other studies indicate that some banks raise their Capital Adequacy Ratios (CAR) to meet the requirement by reducing their RWA.

The objective is to rebuild the buffers to face shocks. According to the BCCh estimates, this macroprudential policy has a lower cost today. In its assessment, the effect on credit is of low magnitude.

The decision is aimed at financial stability, with little significant impact on credit and consequently, with little impact on monetary policy decisions. Along the same lines, no significant effect on the macroeconomic scenario is projected.

- Macroprudential policy settings are a complement to monetary policy. Therefore, this measure does not imply that the BCCh is seeking to generate a sharper adjustment of domestic demand through the credit channel. This higher capital requirement is a measure in response to the risk of a worsening external financial scenario. In our view, this decision does not have direct implications on monetary policy as the BCCh has stated that macroprudential measures are complementary and not a substitute for monetary policy decisions.

It cannot be ruled out that the BCCh will increase this requirement in the future. In fact, the Financial Stability Report points out that international experience shows central banks have opted to build up the buffer whenever possible, citing as an example the Bank of England (BoE), which stated its intention to maintain a requirement of around 1% in a standard risk environment.

Implications for monetary policy?

The Central Bank has been clear in pointing out that this higher capital requirement does not signal a specific monetary policy action. The separation between preventive measures on financial stability and those of monetary policy are clear for the BCCh. However, we highlight that among the justifications for the announced macro-prudential measure, it is indicated that financial conditions and the international scenario have worsened. In this context, we must remember that the BCCh in its last Monetary Policy Report indicated that *"the lower part of the rate corridor is related to a greater than expected deterioration of the international scenario."* If indeed, the BCCh has a diagnosis of worsening external conditions with respect to its baseline scenario, we could expect June's Monetary Policy Report to adjust downward the interest rate corridor. The next report will be released on June 19th.

—Aníbal Alarcón

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