

**Central Bank of Chile**  
**Santiago, 03 January 2011**  
**Press Release\***

The Board of the Central Bank of Chile has decided to start a program of foreign currency purchases aimed at strengthening its international liquidity position. The purpose of this initiative is to increase international reserves to a level that is comparable with those in other economies similar to Chile. Also, this intervention should smooth the effects of the exchange rate adjustment to which our economy has been subjected.

The risks in the external scenario are high. The global economy shows an unusual configuration, characterized by high commodity prices, low interest rates, a sluggish recovery of developed economies and a depreciated US dollar. Meanwhile, the emerging economies are growing strongly and their currencies are appreciating. Relevant risks include escalating financial tensions in Europe, persistent high unemployment rates in developed economies and sharper adjustments in some emerging economies that are facing inflationary pressures. Having additional reserves available will allow to better deal with the contingency of a significant deterioration of the external environment.

Foreign exchange markets are under stress and currencies are adjusting asymmetrically. There is also the risk that GDP growth decoupling between advanced and emerging economies will persist longer than expected, thus intensifying the pressure on the exchange rate. Accordingly, the effects of this measure, although temporary, should open room for smoother real adjustments in the domestic economy.

To implement this program, the Central Bank of Chile will hoard additional international reserves amounting to US\$12.0 billion over the year 2011, via periodic purchases of foreign currency starting on January 5<sup>th</sup> and through the end of December of 2011. This program will take the Central Bank's international liquidity position to the equivalent of 17% of GDP.

The monetary effects of this measure will be sterilized in order to keep a liquidity provision in pesos in the market in line with the target for the monetary policy rate. This sterilization will proceed through a mix of short-term liquidity instruments and long-term debt issuance, as established in the annual calendar that will be informed in due time. The first stage of this program, ranging from January 5<sup>th</sup> to February 9<sup>th</sup>, will

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\* The Spanish original prevails.

consist of daily purchases of US\$50 million in competitive biddings. The Central Bank of Chile will inform in due time of the next stages, which may be revised responding to market conditions.

The hoarding of international reserves entails important financial costs associated to the differential between the return on investments and the cost of financing them. The level proposed for the international reserves is consistent with the Central Bank's financial sustainability, although additional leeway is limited.

The Board of the Central Bank of Chile reiterates its commitment with the conduct of the monetary policy regime based on inflation targeting and a floating exchange rate. For an economy like Chile, which can encounter significant changes in external financial conditions and in the terms of trade, foreign exchange flexibility is an essential ingredient of its macroeconomic and financial stability. Conversely, rigid exchange rate schemes can impose unwanted costs in terms of volatility of growth, credit, interest rates and inflation. Within a volatile environment like that of the past few years, the inflation targeting regime with a flexible exchange rate has displayed its benefits in terms of allowing a smoother trajectory of the Chilean economy. In addition, our floating regime admits interventions in exceptional situations, like the one being announced in this statement.

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