

Santiago, December 22, 1998

Press Release

The Board of the Central Bank decided to lower the monetary policy interest rate by seventy basis points from an annual UF plus 8.5% to UF plus 7.8% in view of the achievement of inflationary targets and current-account deficit in 1998 and the reasonable certainty of fulfilling them again in 1999.

The Bank also decided to widen the floating exchange band to +/- 8% as from tomorrow. Other parameters of the exchange band remain the same as those defined on September 16 last, including a gradual widening of the band limits by 0.01375% daily.

Chile is better prepared now for a more flexible exchange regime because overall spending has slowed and the private-sector foreign-currency position is better balanced.

Adapting the Central Bank policies to the new circumstances means that the fiscal commitment for the year 1999 must be fulfilled. This is coherent with the aim of achieving inflationary and current-account targets which are essential for gradual and lasting economic growth.

The Bank's policies this year have aimed at substantially moderating aggregate spending growth because it had expanded strongly in the first quarter in a way totally incompatible with the difficult external situation. The policies essentially centered on monetary management but the Bank also prepared the ground for an orderly, gradual and non-inflationary adjustment of relative prices thereby effectively achieving a sustainable lower current-account deficit. This has been achieved with a real depreciation of the peso of around 5% since the end of 1997 and with an inflation rate in line with the target and certainly under control.

The slowdown of aggregate spending and economic activity in recent months, together with the rising exchange rate, have enabled this year's targets for inflation and current-account deficit to be met. Similarly, there is now a reasonable likelihood of the targets for 1999 - US\$4,000 million current-account deficit and 4.3% inflation - also being met, despite copper prices falling lower than forecast. There is thus room for a less restrictive monetary policy although other uncertain factors - the still unstable world environment and the unduly high growth of underlying inflation and of earnings - continue to exert limitations. The Board of the Central Bank thus decided today to reduce the monetary policy rate by seventy basis points from UF plus 8.5% to UF plus 7.8%. Similarly, liquidity credit lines are each lowered seventy basis points to 7.8%, 9.8% and 11.8% respectively.

At the same time, the economic cycle has entered into a new stage of controlled spending which requires an adaptation of Central Bank policies to these changed circumstances. In particular Chile is better prepared today to have an exchange regime that gives greater freedom to the exchange rate. The various currencies used by the financial sector as well as the productive sector are obviously more balanced now than at the beginning of the year. There are also efforts to deepen the derivatives and hedging markets. Thus, the Board of the

Central Bank decided as from tomorrow December 23 to widen the band so that the exchange rate can float $\pm 8\%$ around the reference exchange rate. Other parameters of the exchange band remain the same as those defined on September 16 last, that is the reference exchange rate will continue to be adjusted according to the domestic inflation target and the band limits will continue to widen as they do now by 0.01375% daily.

This greater freedom of the exchange rate does not do away with the need to keep a constant watch over both public and private spending and an ever-cautious attitude towards monetary policy but it also requires an extremely prudent fiscal policy. Hence the importance of the Ministry of Finance's commitment to seeing that the 2.8% growth of public spending established in next year's budget is not overstepped. The Central Bank has shown itself flexible in its policy handling during this difficult period and this has allowed the Chilean economy to face very damaging events that are beyond the authorities' control. The Bank will continue to seek a gradual but lasting recovery of economic growth by means of policies that preserve macroeconomic stability. To do so, it is essential to stick to the aim of reducing inflation according to the set targets and maintaining the current-account deficit at a sustainable level.