Central Bank of Chile
Santiago, 9 August 2007
Press Release*

In its monthly monetary policy meeting, the Board of the Central Bank of Chile decided to raise the monetary policy interest rate by 25 basis points to 5.5% (annual).

This decision is necessary for projected inflation around two years ahead to stand at 3%.

Although the external scenario relevant to the Chilean economy continues to be positive and world economic activity is still strong, risk premiums have increased, international financial markets are showing more volatility and credit conditions have become somewhat tighter. The prices of copper and oil remain high and gasoline prices have fallen. The prices of several food products remain high.

Beyond the performance of some specific sectors, output data available confirms important dynamism in the second quarter, above earlier projections and above trend. Domestic demand seems to have exceeded forecasts, salaried employment continues on the rise and internal financial conditions are still favorable.

CPI inflation has risen to almost 4%, much above projections in May's *Monetary Policy Report.* Increases in the prices of some non-perishable foods and of fuels have deepened, in combination with abnormal rises in the prices of several perishables, which are believed to be largely of temporary nature. The higher prices of non-perishable foods have also driven up core CPIX1 inflation (that excludes fuels, perishables and some regulated utilities). Alternative measures of trend inflation stand slightly above 3%, while labor costs remain well contained. In this setting of higher inflation due to various supply shocks, short-term inflation expectations have increased significantly, although for the longer-term they remain around 3%.

The Board believes that, in the most likely scenario, it will be necessary to continue increasing the monetary policy rate in coming months in order for projected inflation over the policy horizon to remain at 3%. As usual, the evolution of the policy rate will depend on incoming information and its implications on projected inflation. In particular, a scenario of strong specific price shocks requires special follow-up of both a possible propagation to other prices and of medium- and long-term inflation expectations.

* The Spanish original prevails.