

10th BBVA Latin America Conference in London:

Recent developments and medium-term outlook of the Chilean economy

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Agenda



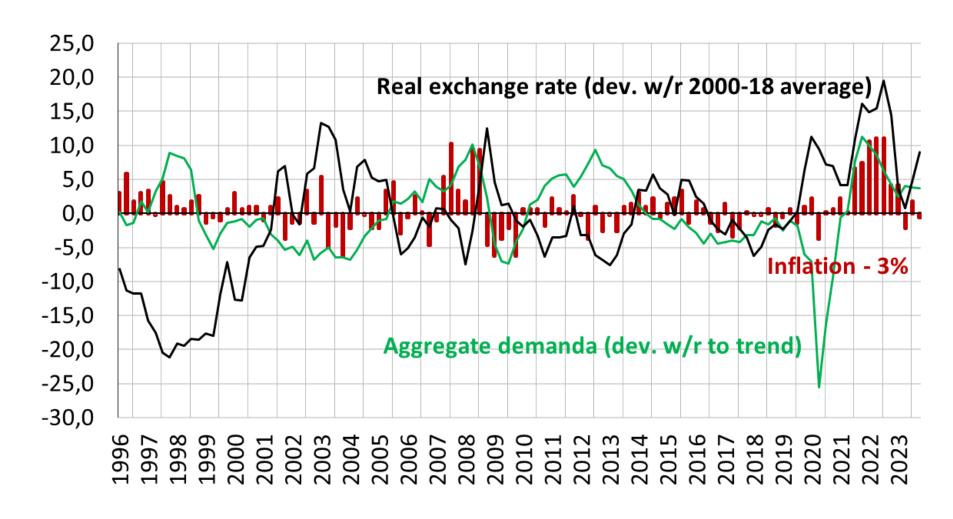
1. Recent evolution of the Chilean economy.

2. Consequences for interest rates and the real exchange rate.

Disclaimer: The views expressed here are my own and not necessarily those of other members of the Board or the staff of the Central Bank of Chile.

The rise and fall of inflation

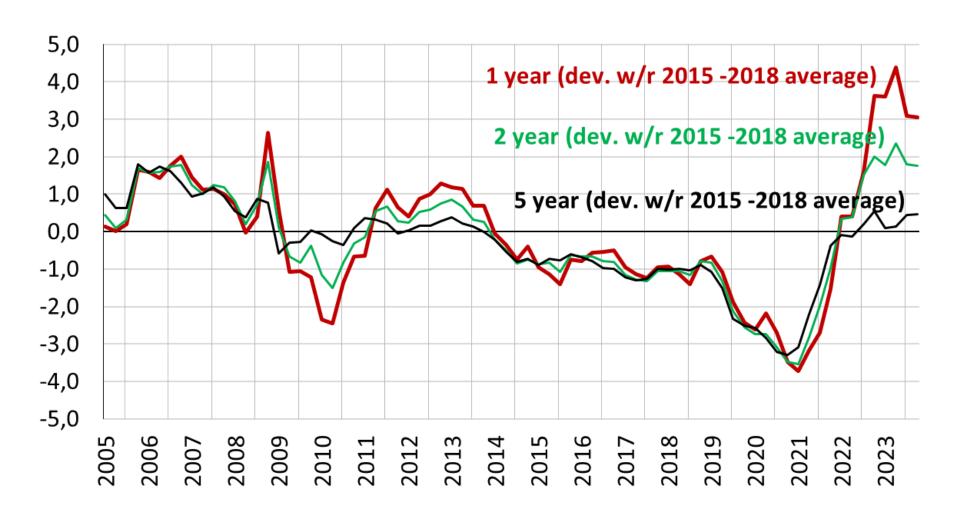




Notes: Inflation is measured as annualized quarter-on-quarter variation. The aggregate demand trend is a cubic trend using data from 1996 to 2023. The latest observation is the third quarter of 2023. Source: Central Bank of Chile and INE.

Monetary policy response (real rates)





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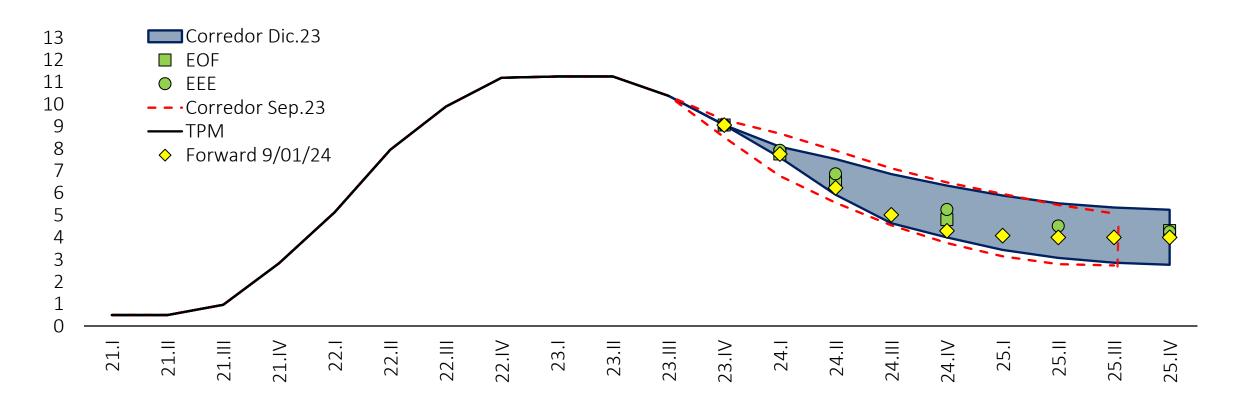
Medium term outlook



	2022	2023 (f)	2024 (f)	2025 (f)
	(annual change, percent)			
GDP	2,4	0,0	1.25-2.25	2.0-3.0
Domestic demand	2,3	-4,6	2,0	2,7
Gross fixed capital form	2,8	-1,9	0,0	2,4
Total consumption	3,1	-3,3	2,0	1,8
Private consumption	2,9	-4,6	2,1	1,8
Current account (% of GDP)	-9,0	-3,3	-4,0	-3,9
December CPI inflation	12,8	4,5	2,9	3,0
December core CPI inflation	10,7	5,8	3,2	3,0

MPR Corridor





Notes: The MPR Corridor is constructed following the methodology of Box V.1 of the March 2020 Report and Box V.3 of the March 2022 Report. For greater detail, see methodological note (graph II.9, Chapter II, December 2023 Report) . Includes EOF post RPM December 2023 and forward curve as of 01/09/2024. Source: Central Bank of Chile.

A simple decomposition of long-term yield



$$Y_{t}^{N} = \sum_{k=0}^{N} r_{t+k} + \mathbf{E}_{t}[\pi_{t,t+N}] + TP_{t,N}^{N}$$

$$TP_{t,N}^{R} + IR_{t}^{N} + CR_{t}^{N}$$

 Y_t^N : N periods nominal yield in period t.

 r_t : 1 period realyield in period t.

 $\mathbf{E}_{t}[\pi_{t,t+N}]$: Expected inflation for the period t to t+N in period t.

 $TP_{t,N}^N$: N periods nominal term premium in period t.

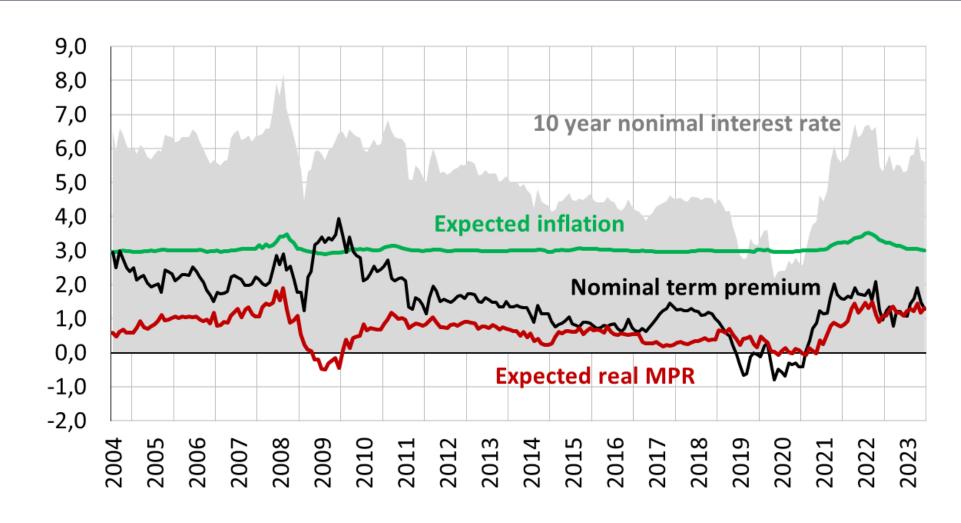
 $TP_{t,N}^R$: N periods real term premium in period t.

 $IR_{t,N}^{N}$: N periods inflation risk premium in period t.

 $CR_{t,N}^{N}$: N periods country risk premium in period t.

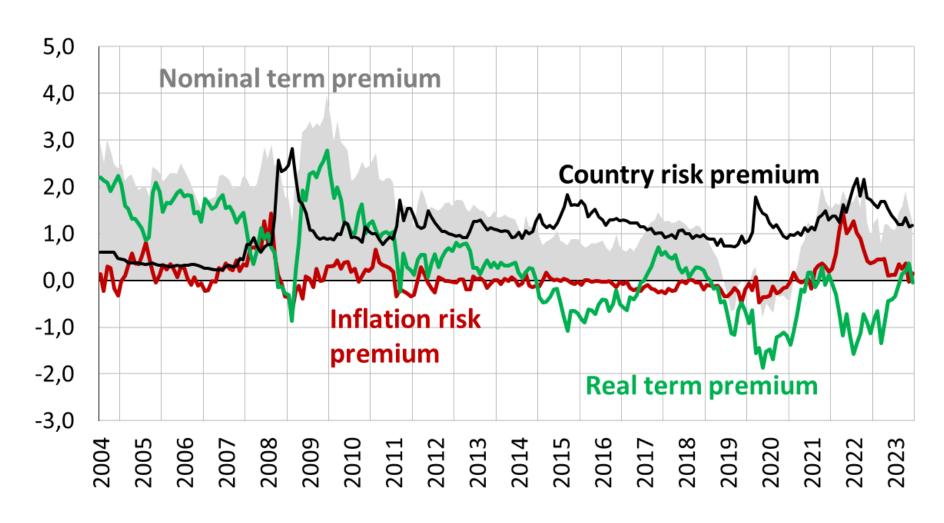
What's behind the increase in long-term interest rates?





What's behind the increase in long-term interest rates?





A simple decomposition of RER



$$q_{t} = -\sum_{k=0}^{N} (r_{t+k}^{*} - r_{t+k}) + Residual_{t}$$

$$CRP_{t,N} + q_{t,N}^{LP}$$

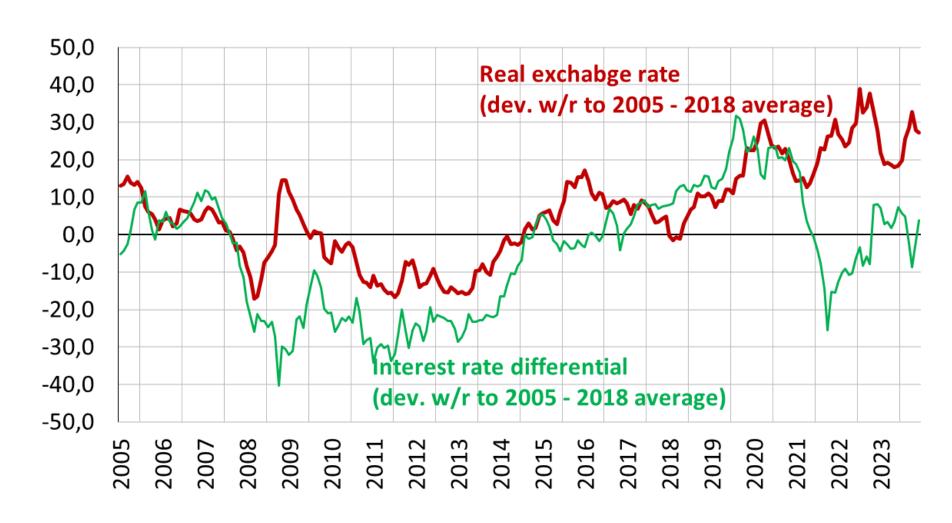
q_t : Real exchange rate.

 $q_{t,N}^{LP}$: Long-term real exchange rate..

 $CRP_{t,N}$: Currency risk premium.

Is the CRP too high? How much has LT RER changed?





Source: Author's calculation

Concluding remarks



- After a period of high inflation and an overheated economy, we are "getting back to normal."
 - ✓ The economy is expected to grow around trend (\approx 2%).
 - ✓ Inflation will reach 3% during the first part of this year.
 - ✓ At the end of this year, the MPR should be around neutrality (\approx 4%).
- After years of low productivity growth risks are skewed to the downside.
 - ✓ This will put pressure on fiscal finances.
- Int. rates will move close to their US counterparts (evolution of fiscal debt is also relevant).
- The currency risk premium (+ change in the long-term RER) seems high. Is there room for real appreciation in the medium term?
- Main question: how to increase trend growth?
 - ✓ Our contribution to this objective is to help have a stable economy.











Data appendix



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Y_t^N : BCP 10.
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 $TP_{t,N}^{N}$: Obtained using Adrian et al (2013).

 $\mathbf{E}_{t}[\pi_{t,t+N}]$: Obtained using the EEE, assuming inflation expectation is equal 3% after 3 years.

 $IR_{t,N}^{N}$: Inflation compensartion minus expected inflation.

 $CR_{t,N}^{N}$: 10 year CDS.

Adrian, T, R Crump and E Moench (2013): "Pricing the term structure with linear regressions", Journal of Financial Economics, vol 110, no 1, pp 110–38.