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# Monetary Policy in Chile

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Central Bank of Chile  
January 21, 2016

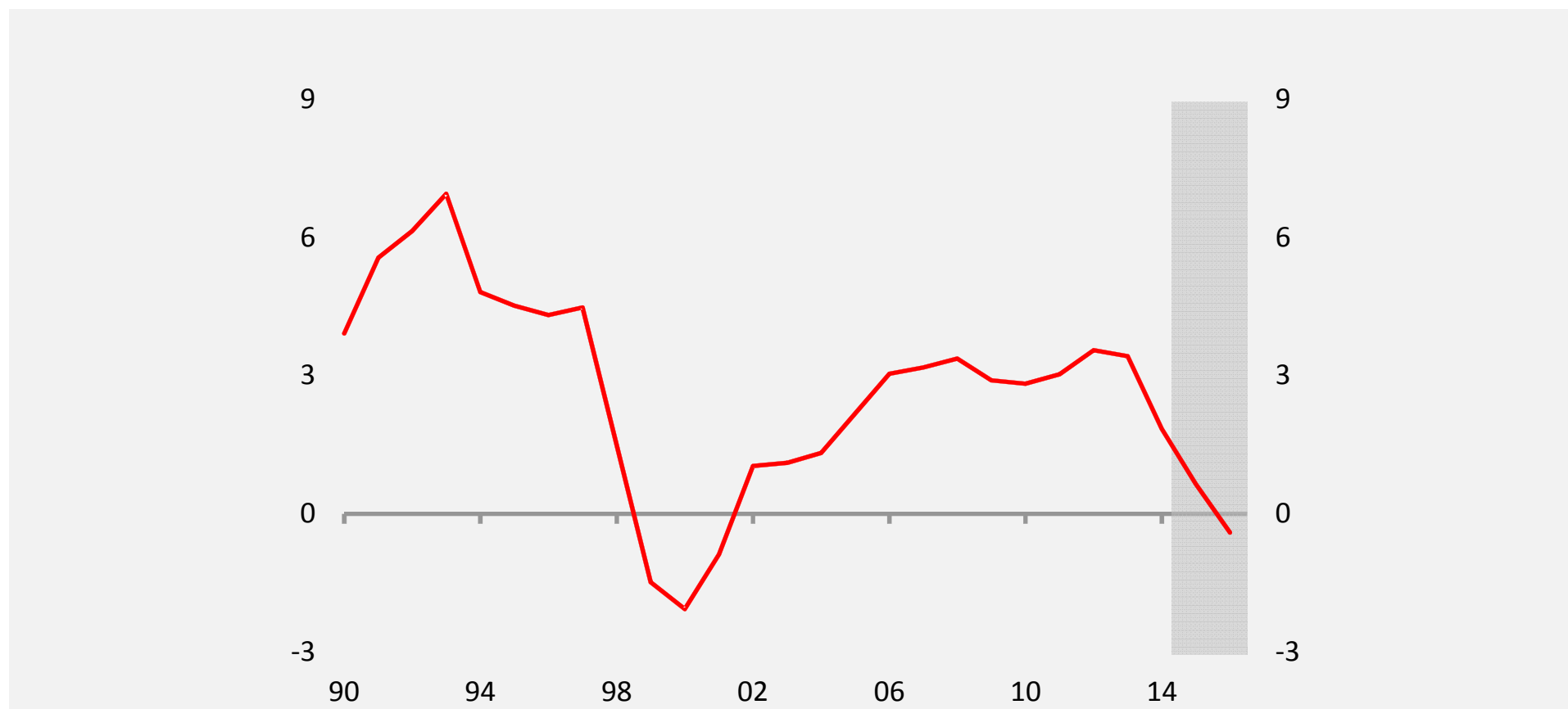


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1. An overview of monetary policy management in Chile since the 1990s
  2. What's next? Following the Fed?



## Chile has had two significant growth cycles since the mid 1980s.

Chile: Growth Differential vs. USA (1) (2)  
(percentage points)



(1) Promedio móvil de tres años.

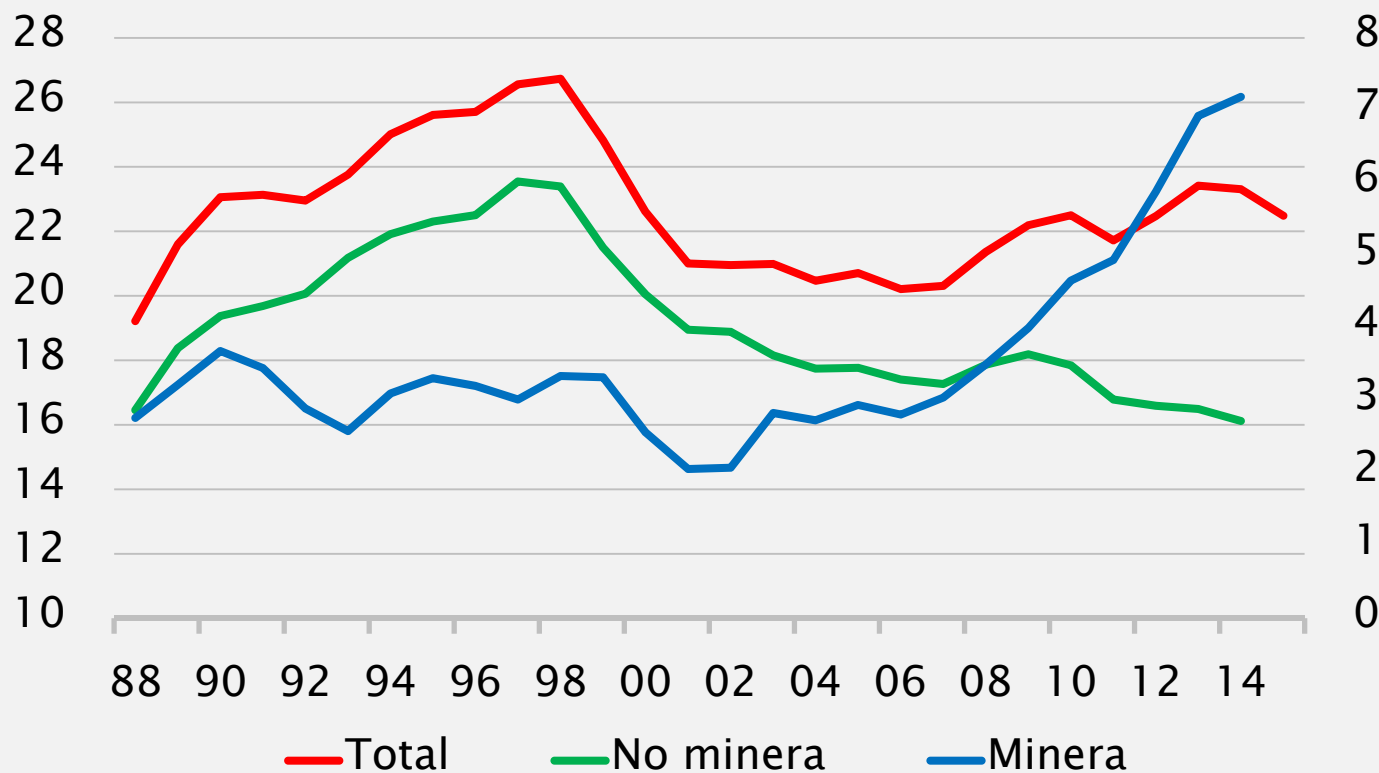
(2) Barra gris oscura en base a proyecciones 2015–2016.

Fuente. WEO Fondo Monetario Internacional.



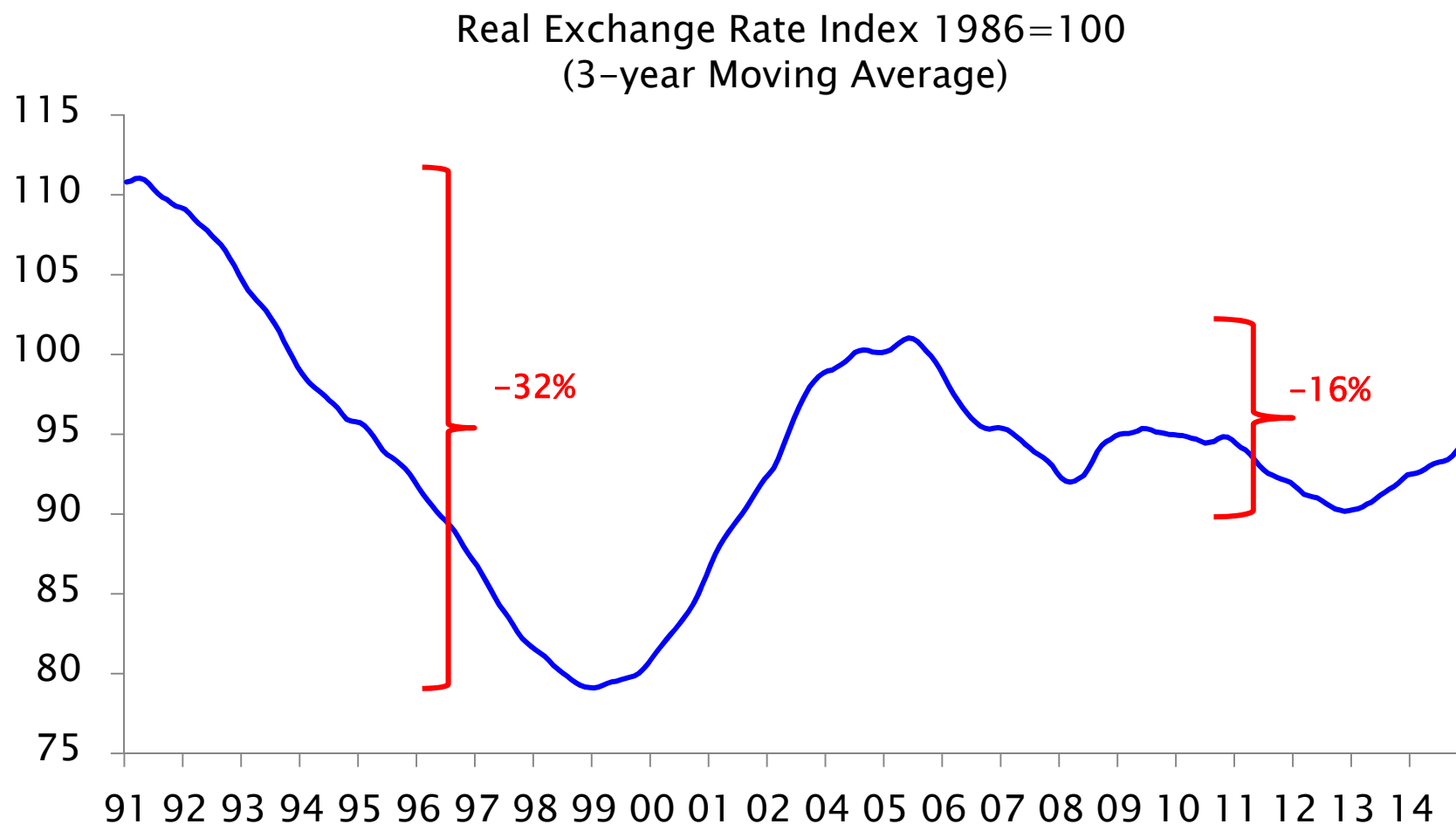
## The evolution of mining and non-mining investment reveals the nature of these cycles.

Investment Rate (1986–2015e)  
(percentage of GDP)





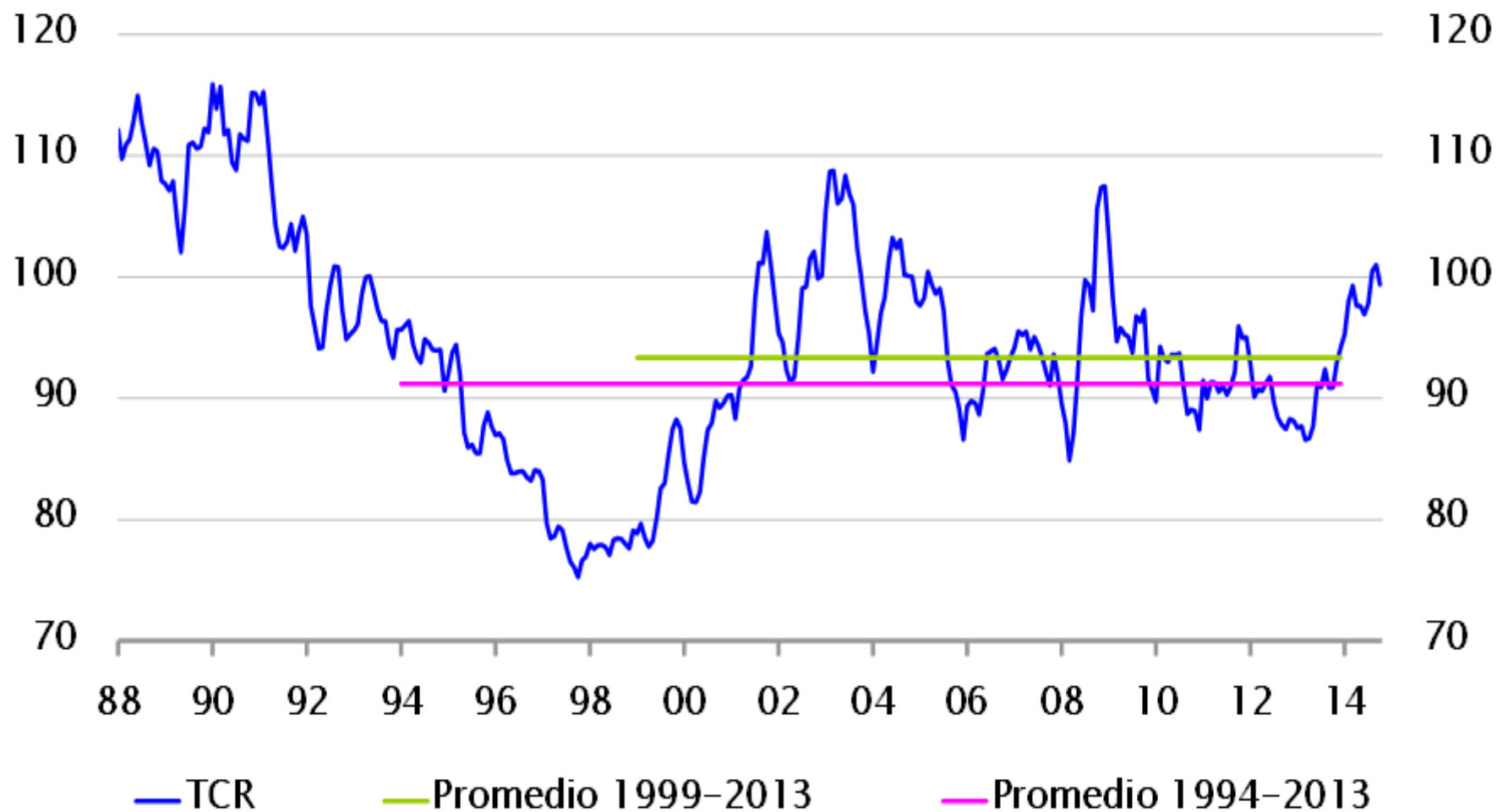
Overall, the trend of the Real Exchange Rate is similar in both episodes.



(\*) The exchange rate bands are the upper or lower limits of a range inside which the exchange rate is allowed to float. This system operated until September 1999.  
Source: Central Bank of Chile.

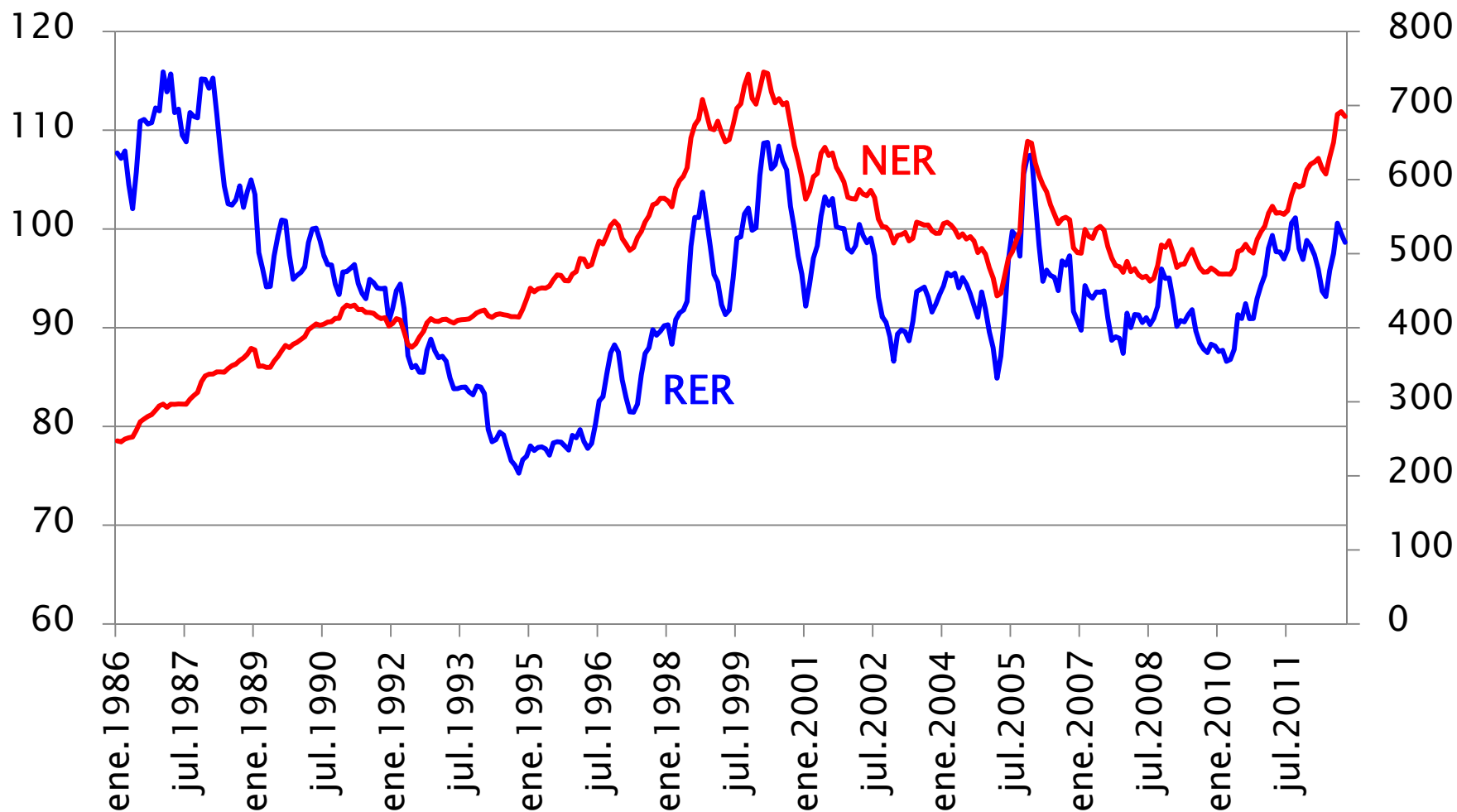


However, volatility has increased since the early 2000s.





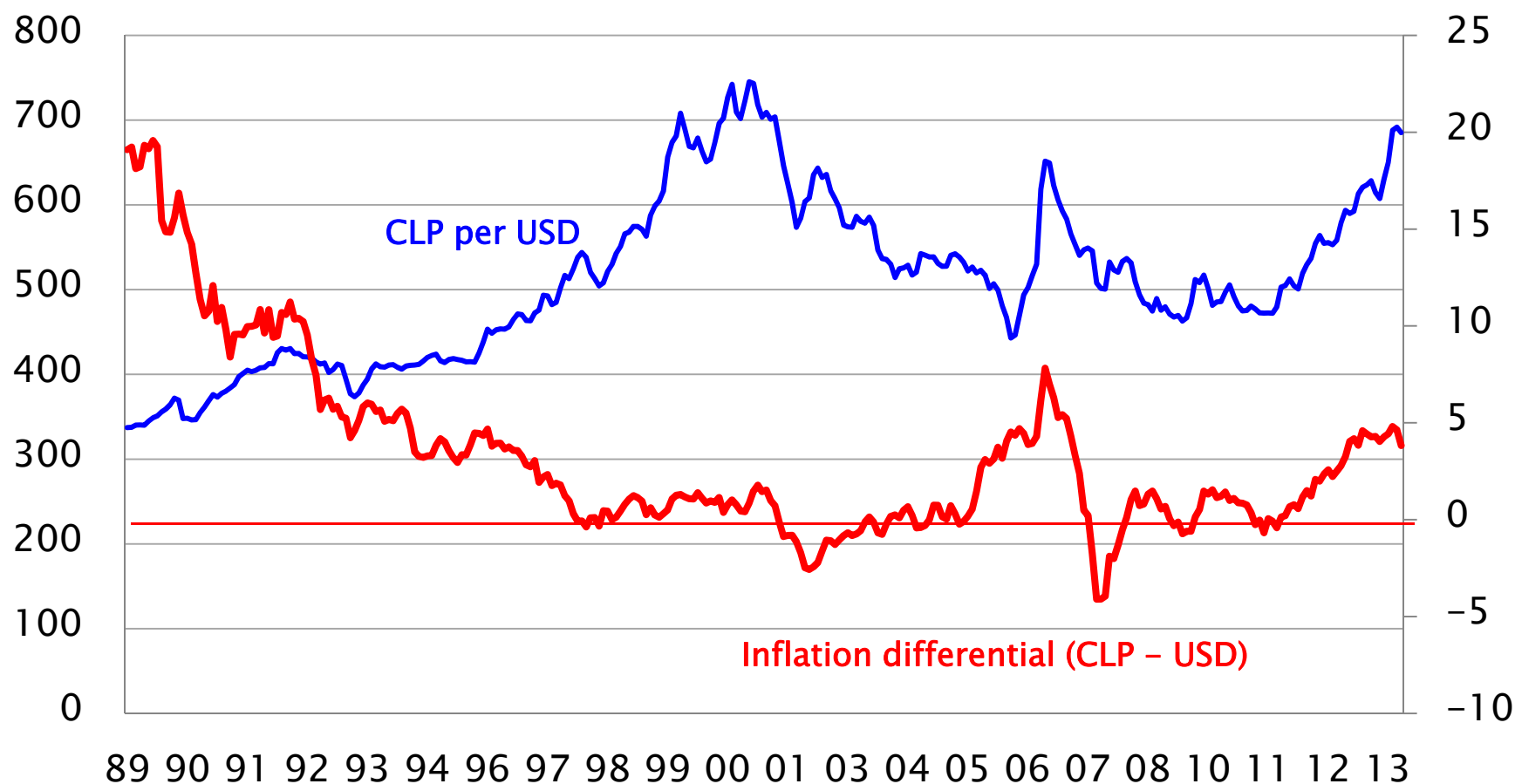
The path nominal variables (FX and prices) was quite different in both episodes.





In the 90s, the inflation differentials led to the strengthening of the peso in real terms.

Nominal Exchange Rate and Inflation Differentials



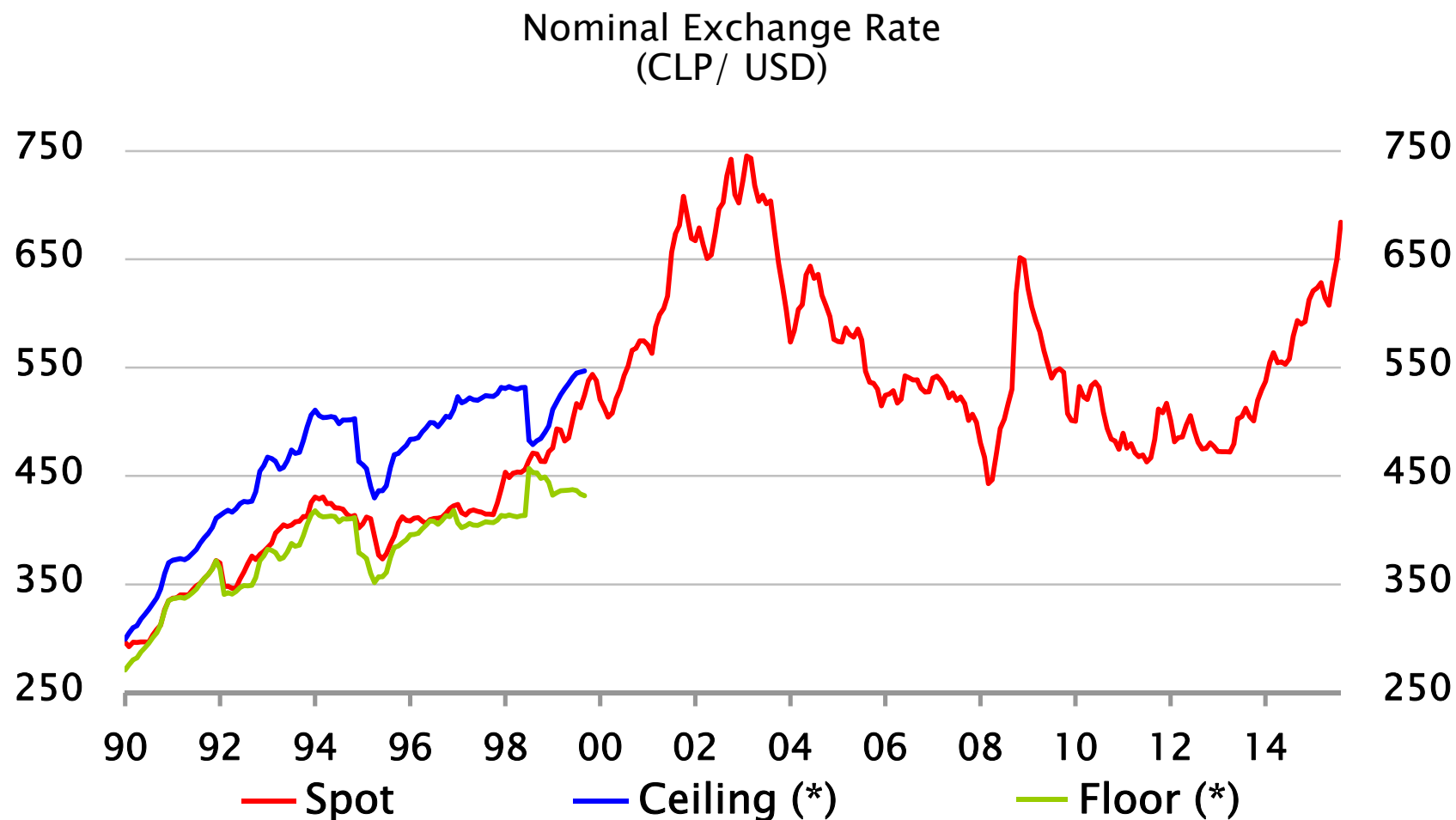
(\*) The exchange rate bands are the upper or lower limits of a range inside which the exchange rate is allowed to float. This system operated until September 1999.

Source: Central Bank of Chile.





... reflecting different FX and monetary policies.



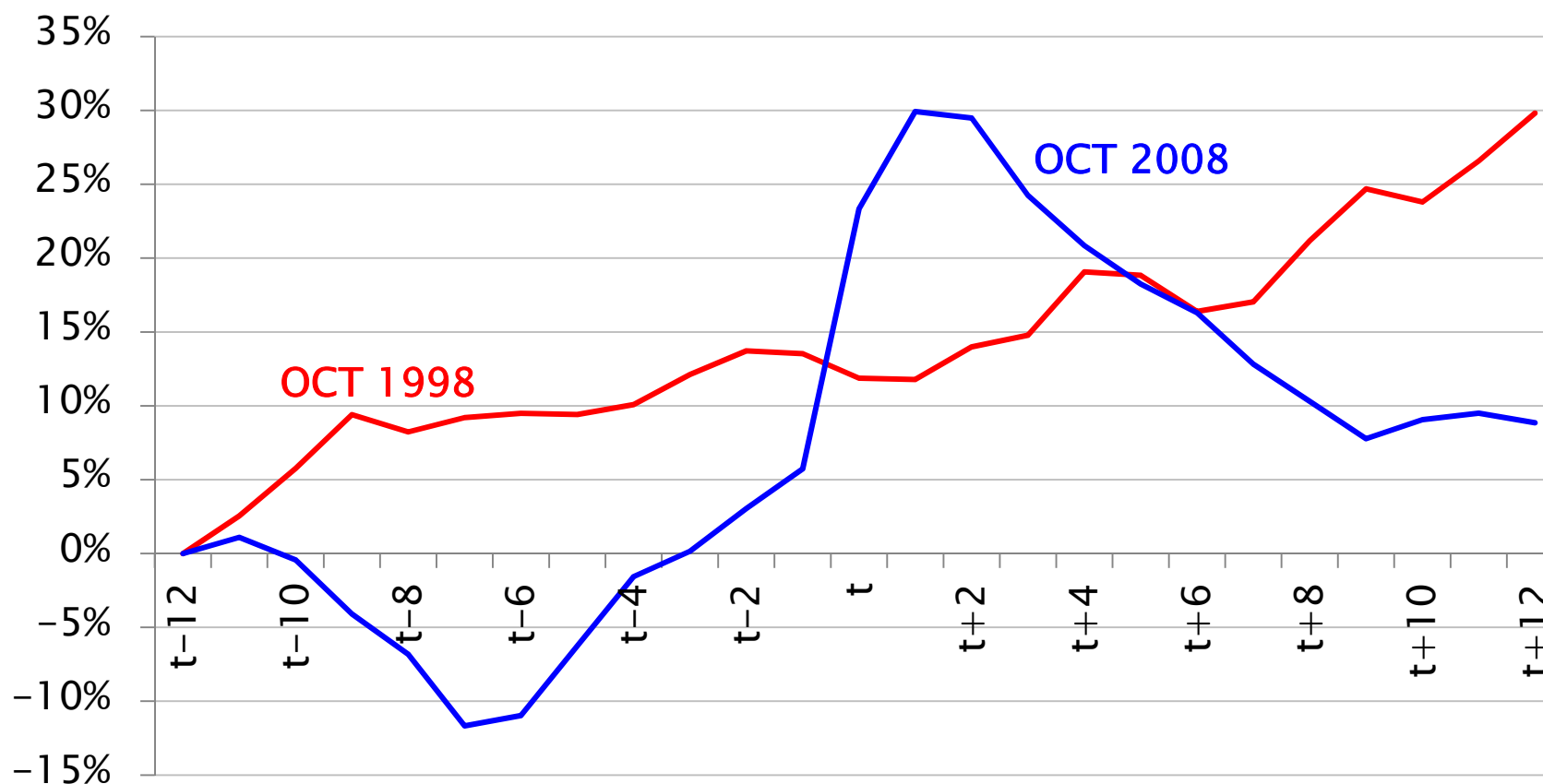
(\*) The exchange rate bands are the upper or lower limits of a range inside which the exchange rate is allowed to float. This system operated until September 1999.

Source: Central Bank of Chile.



# Fluctuations of the peso is currently the main buffer against external shocks

Cummulative deviation of CLP relative to 3-year MA trend  
(percent, monthly)

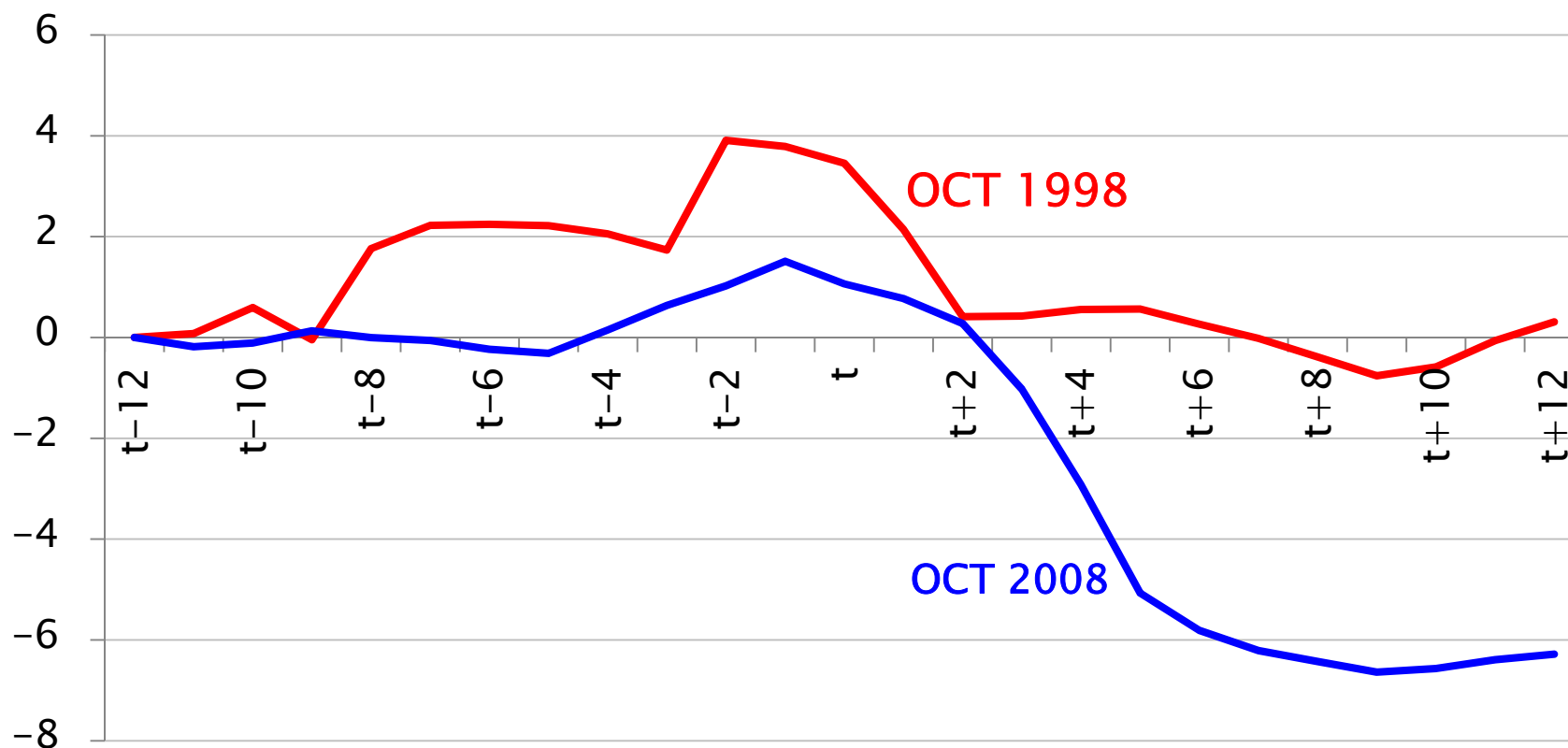


Note: In the pre-2001 period we nominalize the 90-day real rate using 12-month ahead inflation rates.  
Source: Central Bank of Chile.



## The differences in the FX regime is an image of the monetary policy reaction.

Cummulative deviation of nominal MPR relative to 3-year MA trend  
(percentage points, monthly)

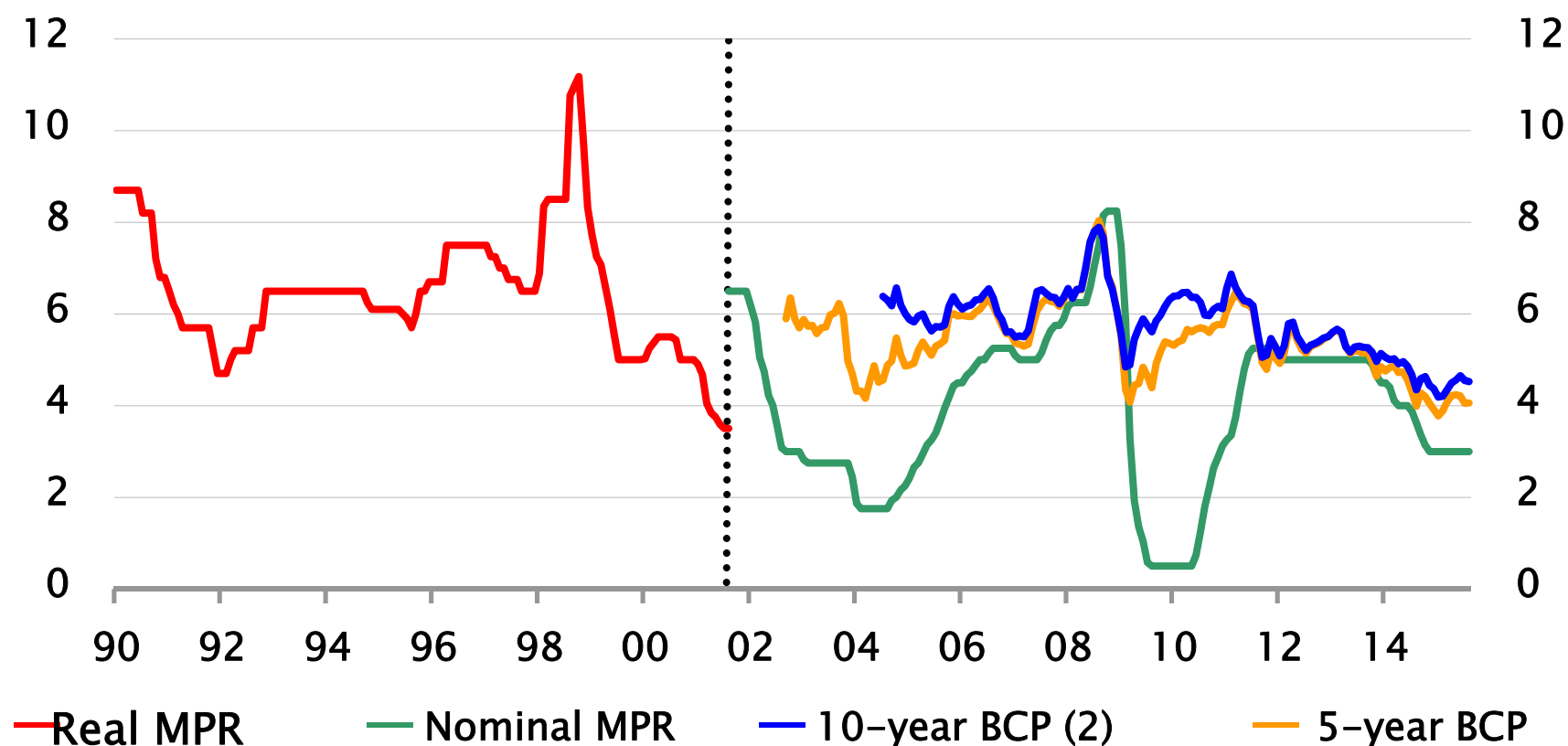


Note: In the pre-2001 period we nominalize the 90-day real rate using 12-month ahead inflation rates.  
Source: Central Bank of Chile.



## The sharp increase in short term rates during the Asian crisis reflects this strategy.

Monetary Policy Rate and Central Bank Instruments (1) (2)  
(percent)

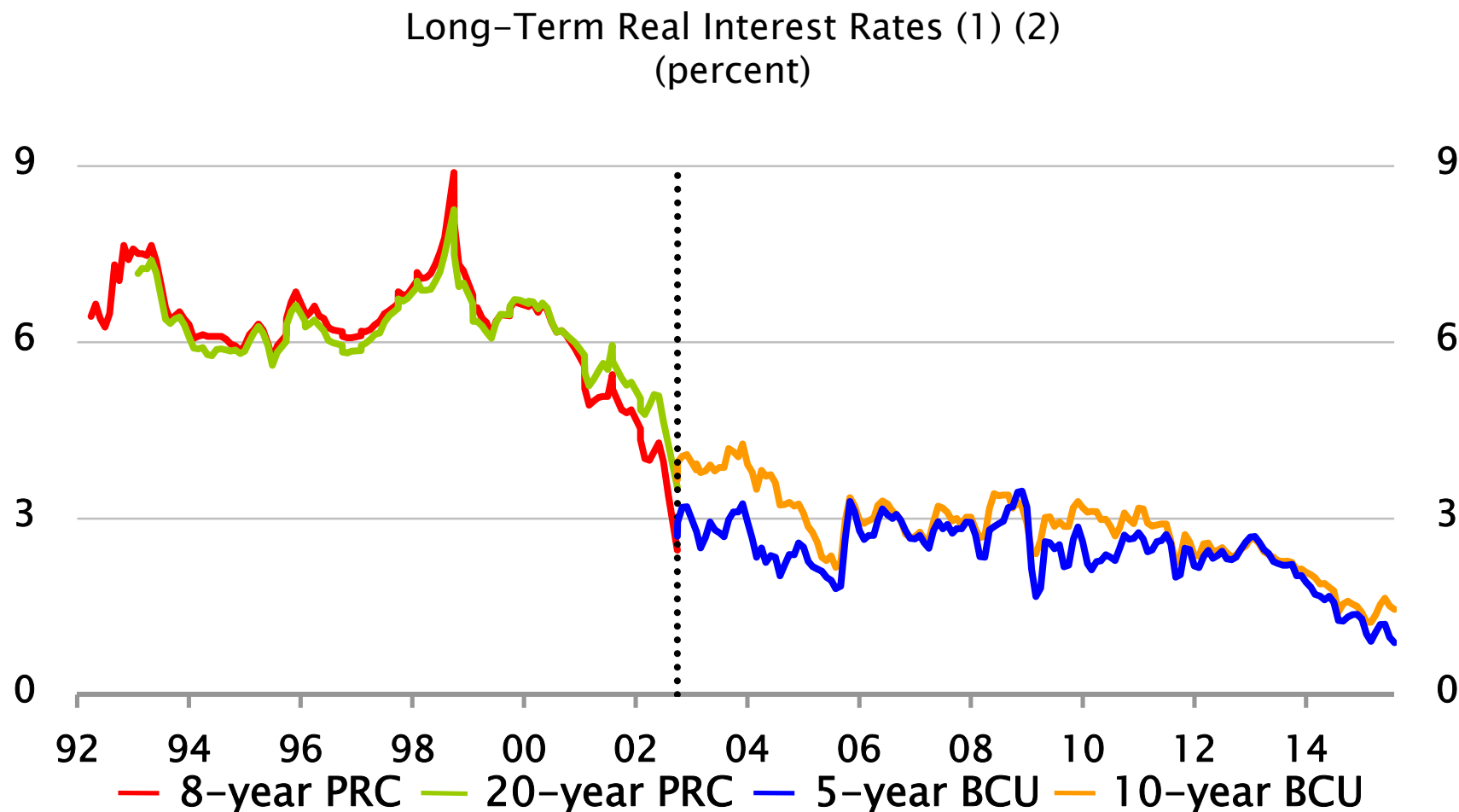


(1) Before June 1995: 90 day – PRBC rate. (2) BCP is a nominal bond that has semi-annual coupon of interest payments except for the last one which includes the interest payment and the principal.

Source: Central Bank of Chile.



Thereafter, a significant fall in the levels and volatility of rates – specially long term yields – has been observed.

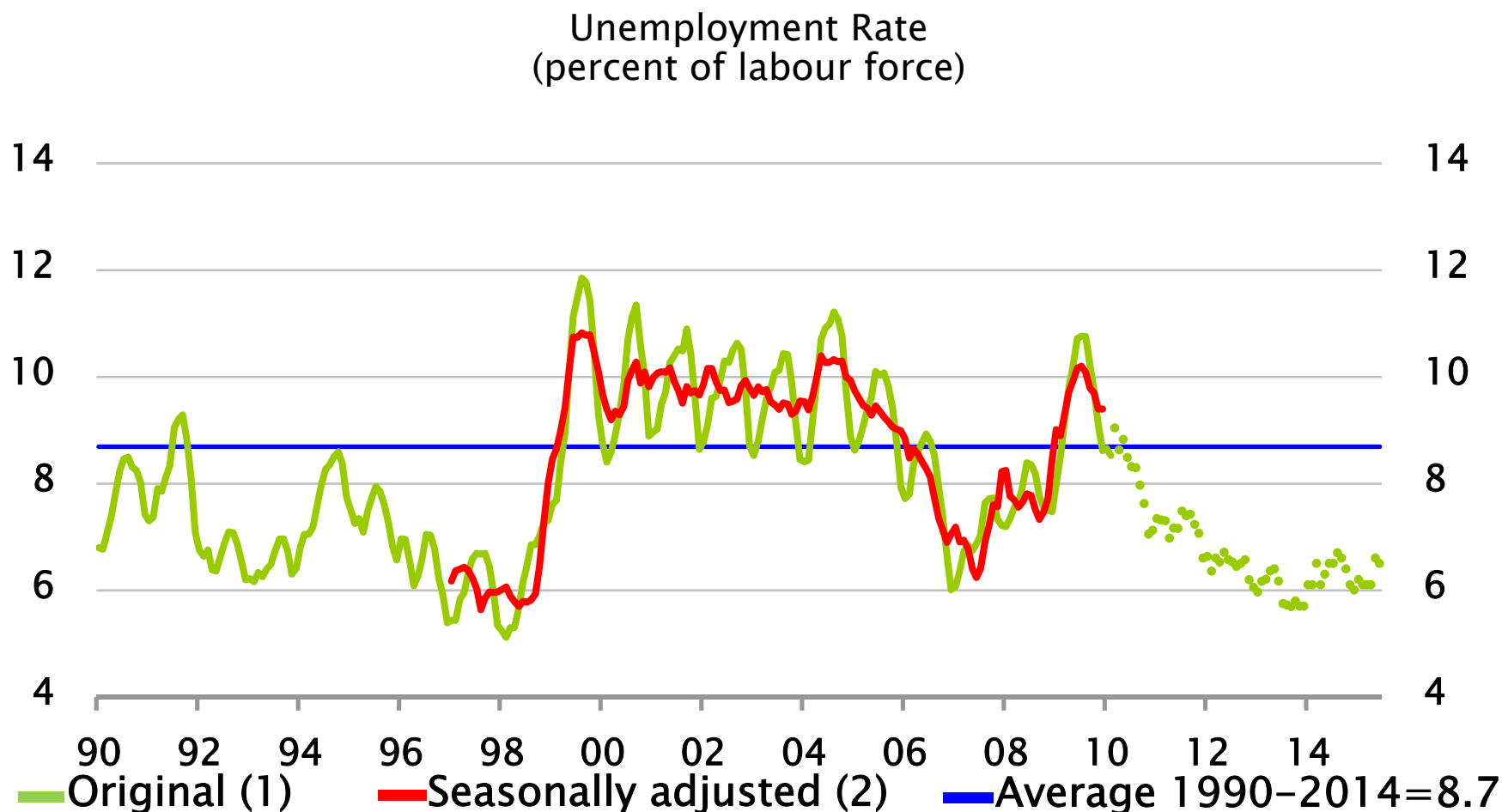


(1) PRC is a bond consisting of equal semi-annual payments (except for the last one), which may include interest payments and principal amortization. (2) BCU is a bond issued in UF, a CPI-indexed unit of account, with similar features to BCP.

Source: Central Bank of Chile.



The increase in unemployment at the end of the 90s was significant and persistent. This explains part of the regime change.



(1) Dots correspond to the New National Survey on Employment (NENE).

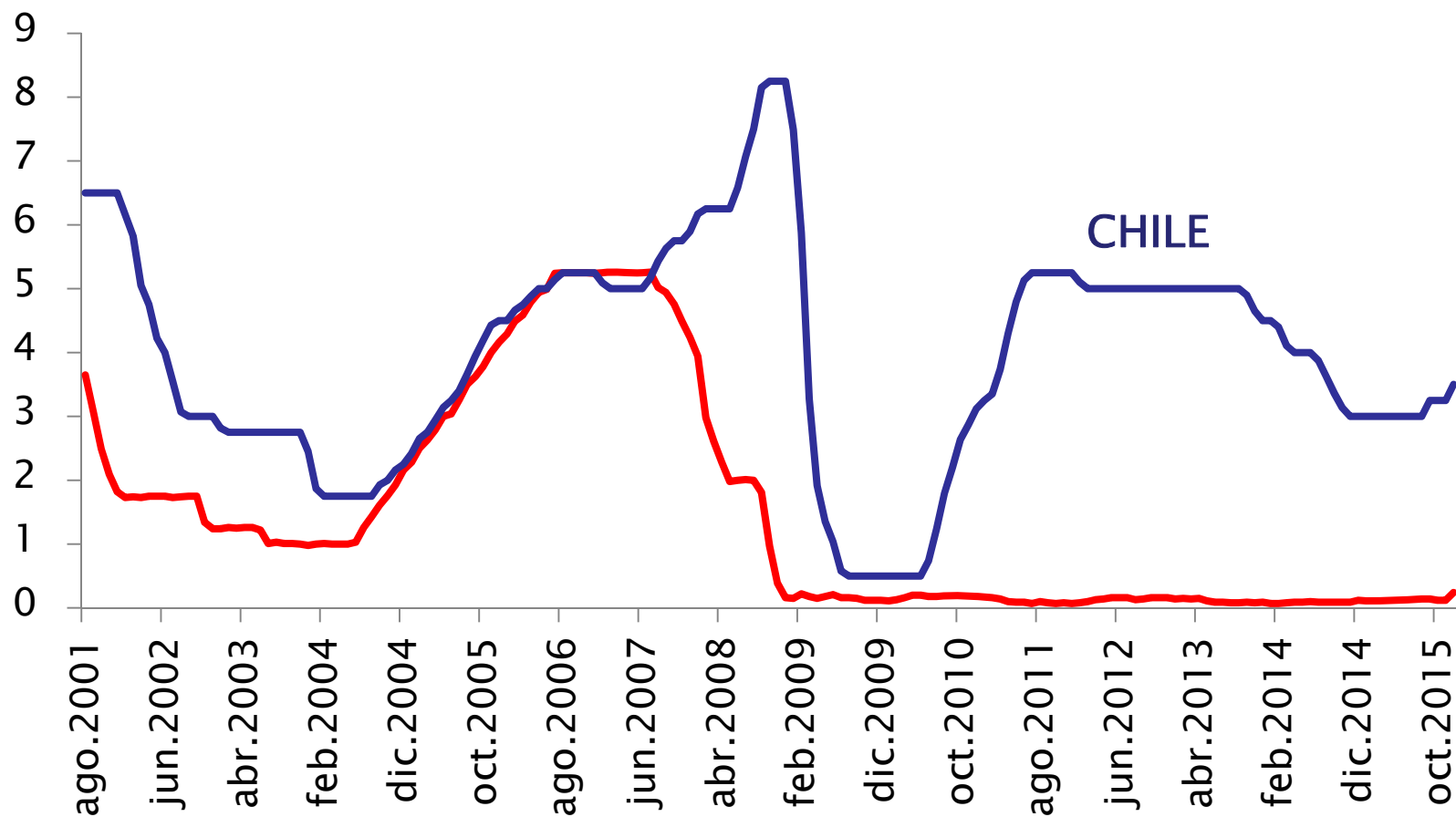
(2) Seasonally adjusted by the Central Bank of Chile.

Sources: Central Bank of Chile and National Bureau of Statistics.



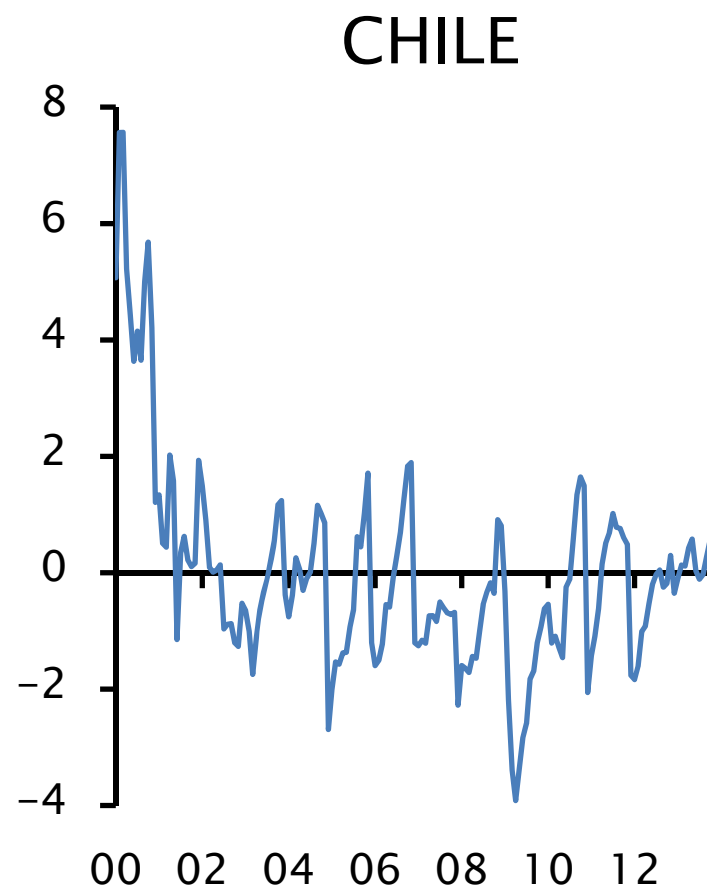
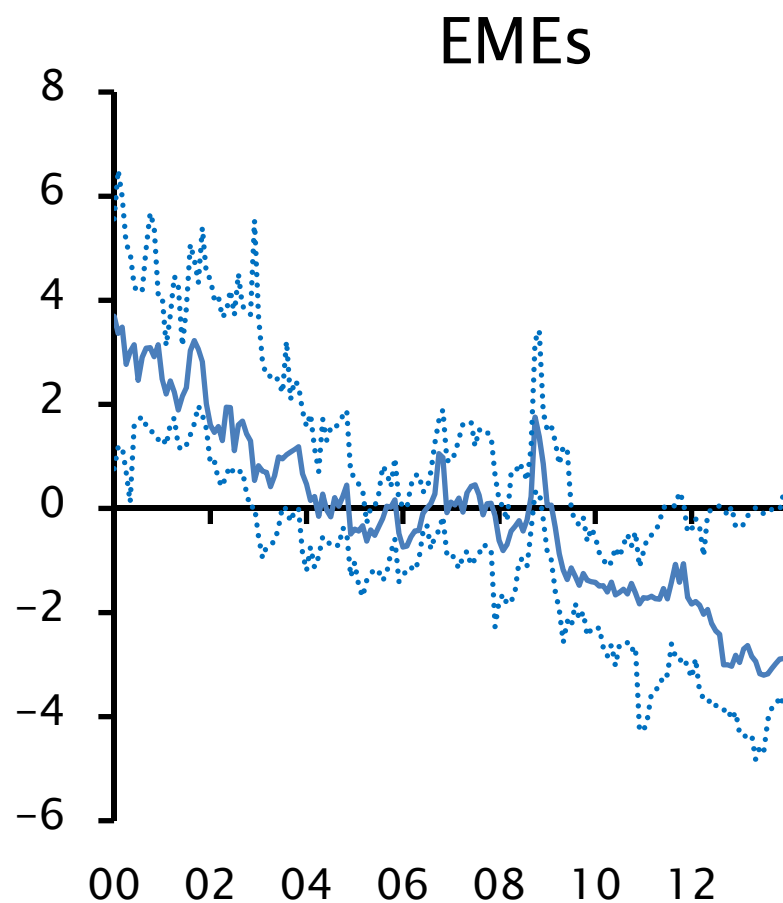
## What do short-term interest rate differentials suggest?

Monetary Policy Rates/Fed Funds Rate (percent)





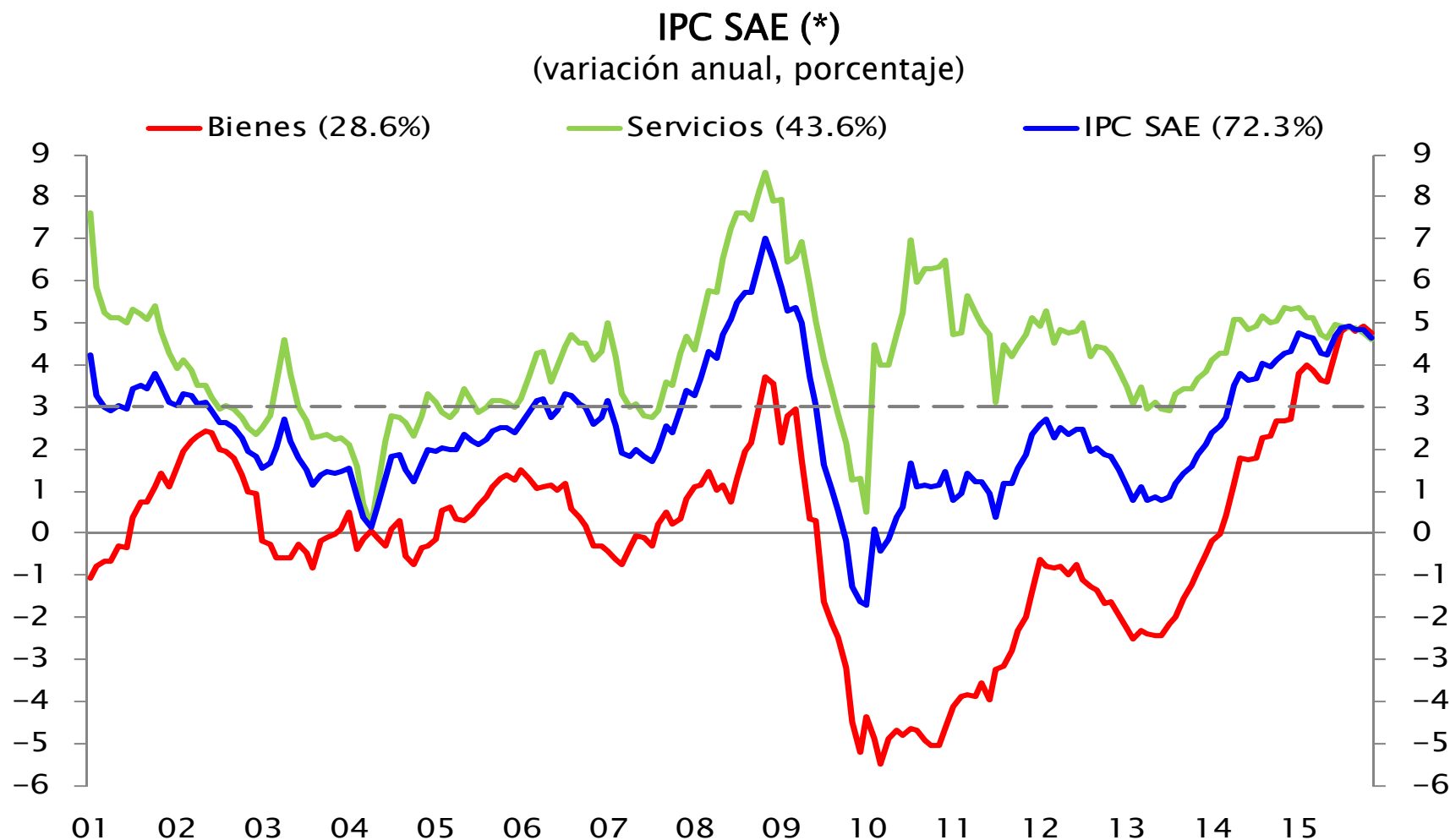
Relative to a Taylor–rule benchmark, other EMEs have followed Fed Fund rates more closely.







Short term rate are set according to inflation perspectives, which of course take into account FX dynamics.



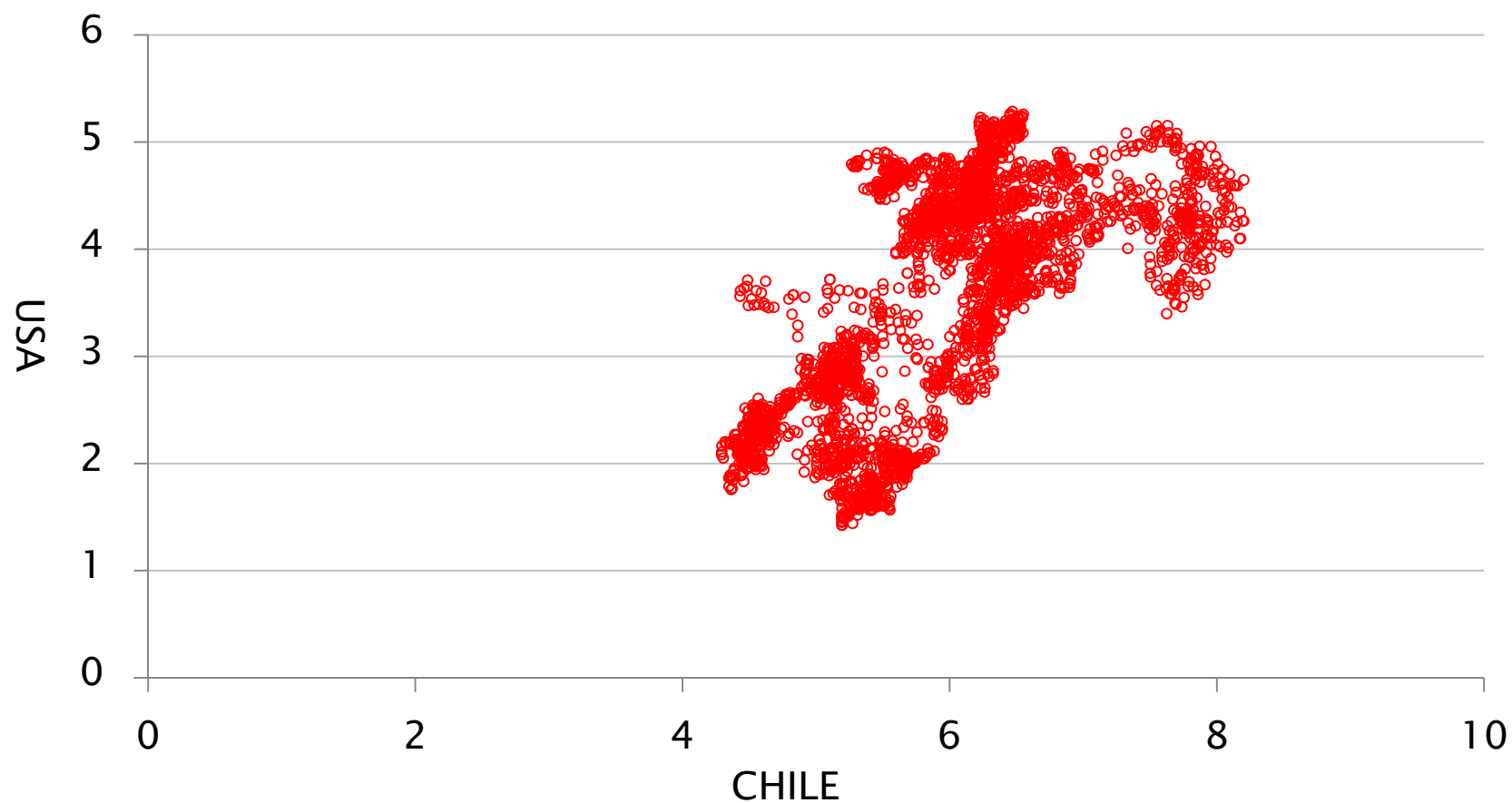
(\*) Entre paréntesis participación en la canasta del IPC 2013.

Fuentes: Banco Central de Chile e Instituto Nacional de Estadísticas.



In any case, long term rates are highly correlated.

10-year government bond rates

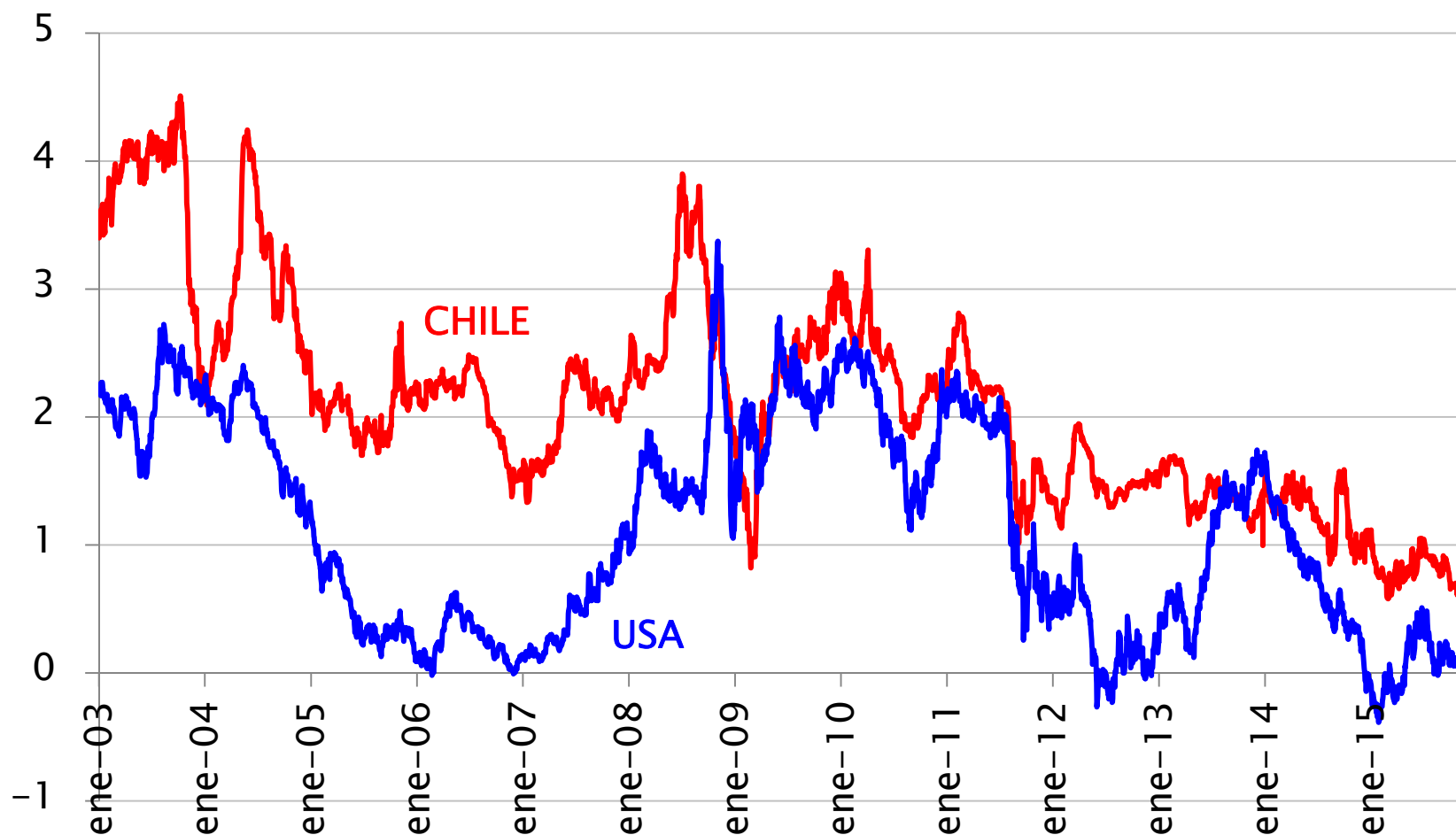


Source: Central Bank of Chile and Federal Reserve Bank.



This co-movement is specially strong in the term-premium component of longer term yields.

### Term premium of 10-year government bonds

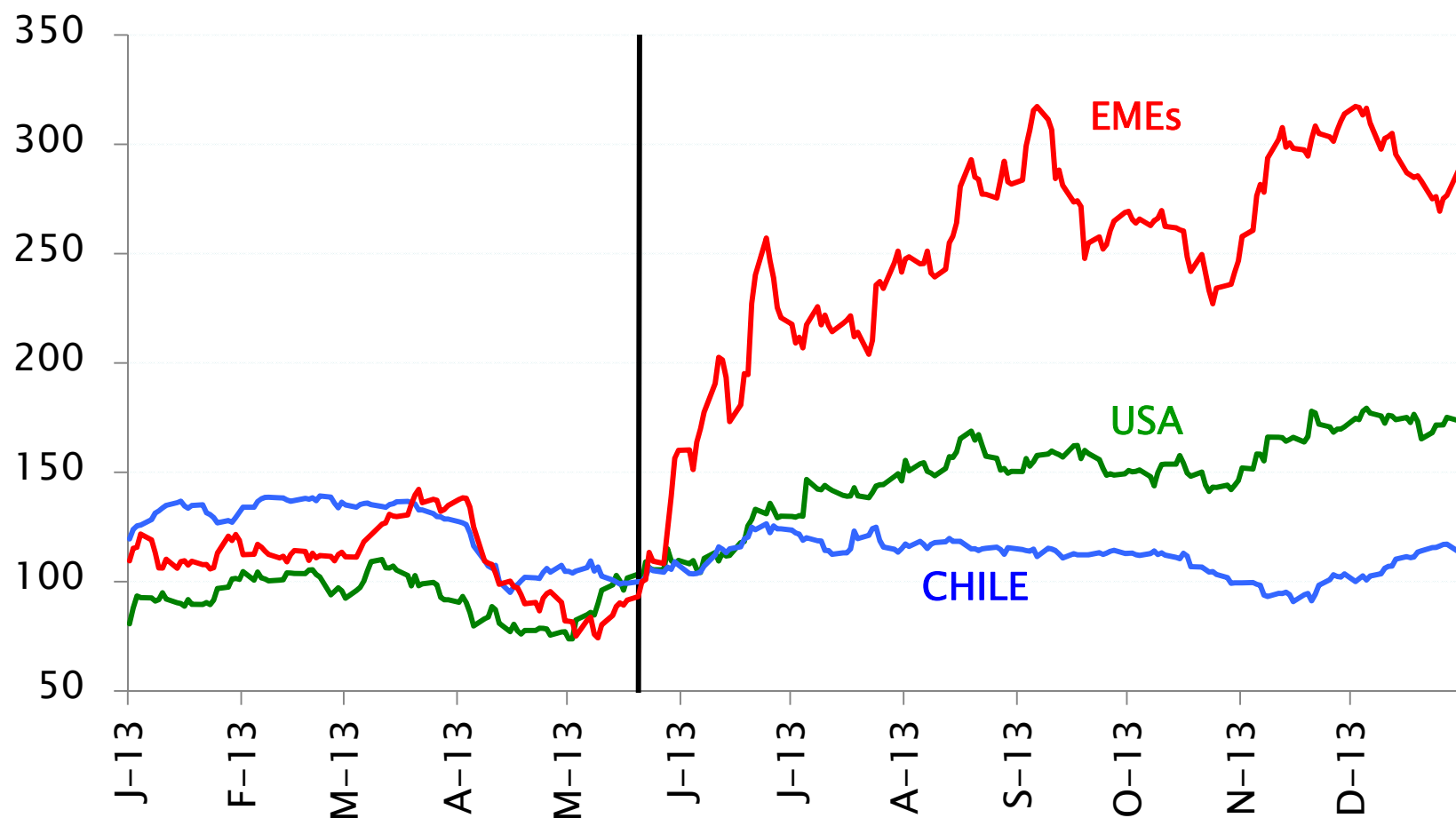


Source: Albagli et al, (2015)



However, there are exceptions. Bernanke's taper talk in may 2013 is one of those.

Term premium, 10-y gov Bond (Index May 21, 2013=100)

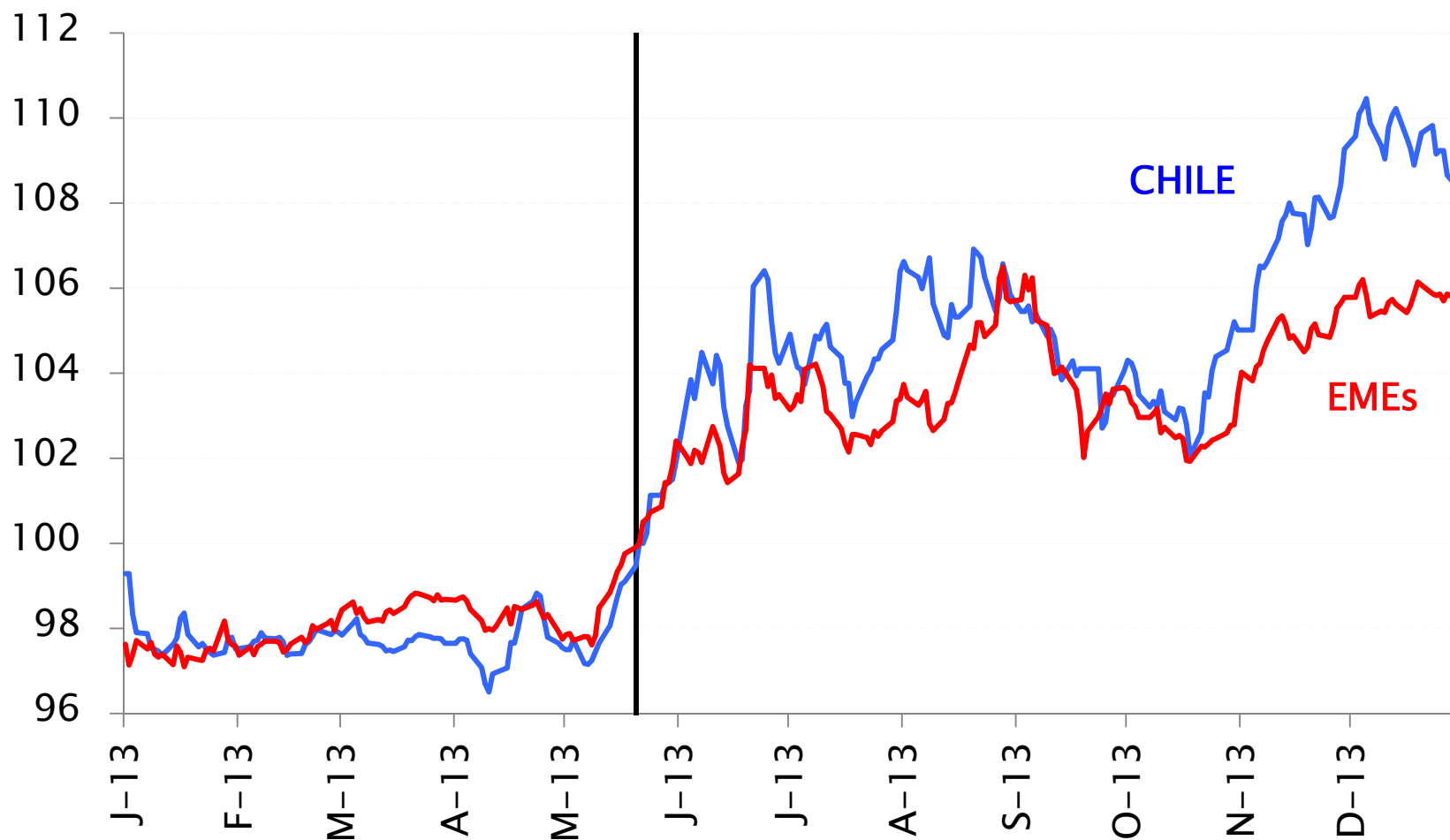


Source: Albagli et al, (2015)



Naturally, the depreciation of CLP was more intense.

Nominal Exchange Rate (Index May 21, 2013=100)

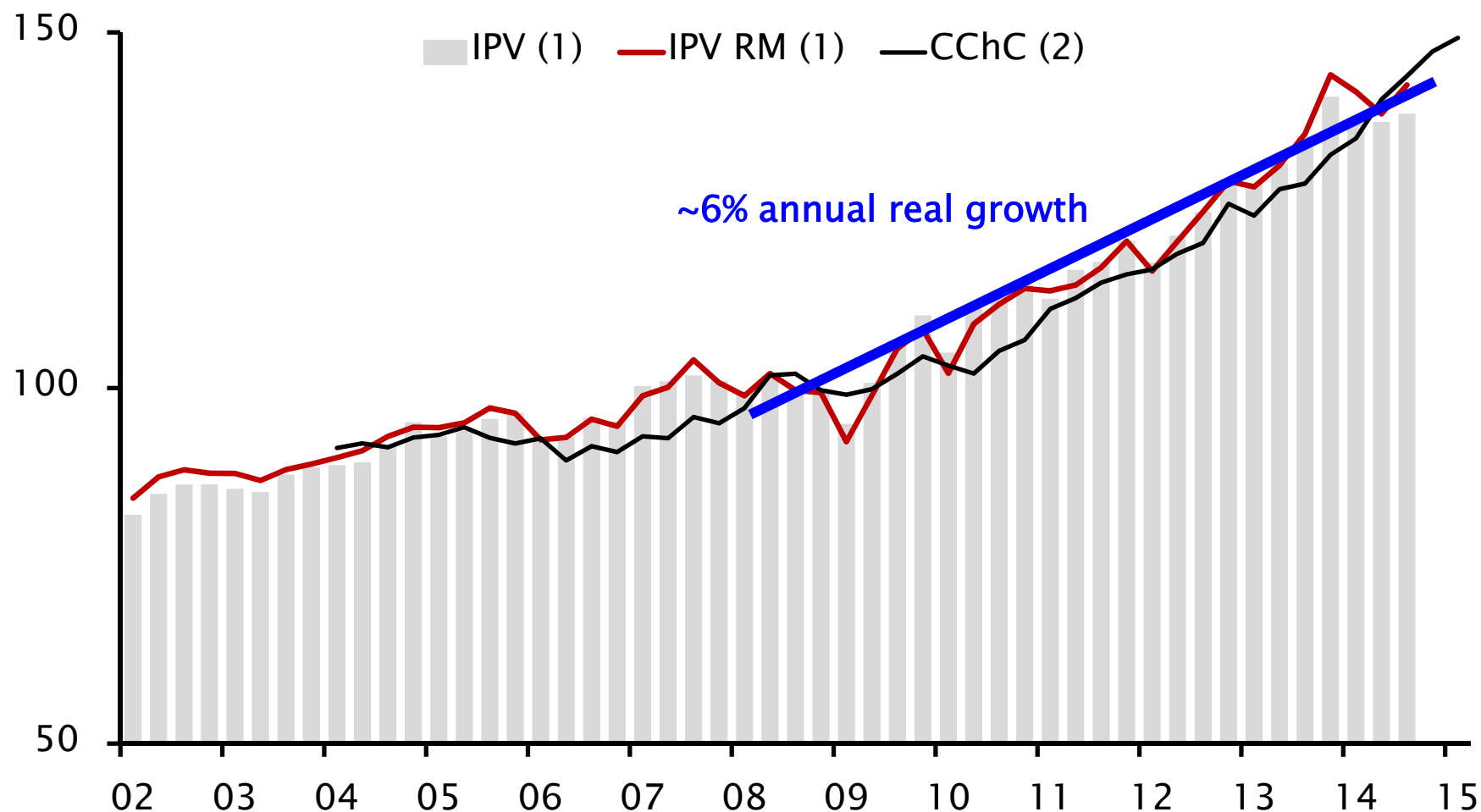


Source: Central Bank of Chile



## Beyond some short run fluctuations, a high correlation of long rates poses immense challenges for monetary policy in EMEs.

House prices, inflation-adjusted (Index 2008=100)



Source: Central Bank of Chile, SII and CChC