



Chile: the macroeconomic scenario

Rodrigo Vergara
Governor



Central Bank of Chile, May 2016


Introduction

Like many other emerging economies, Chile is facing a very complex international scenario that poses major challenges to policy makers.

The global economy has deteriorated: the commodity super-cycle came to an end and the extraordinarily expansionary financial conditions are fading away.

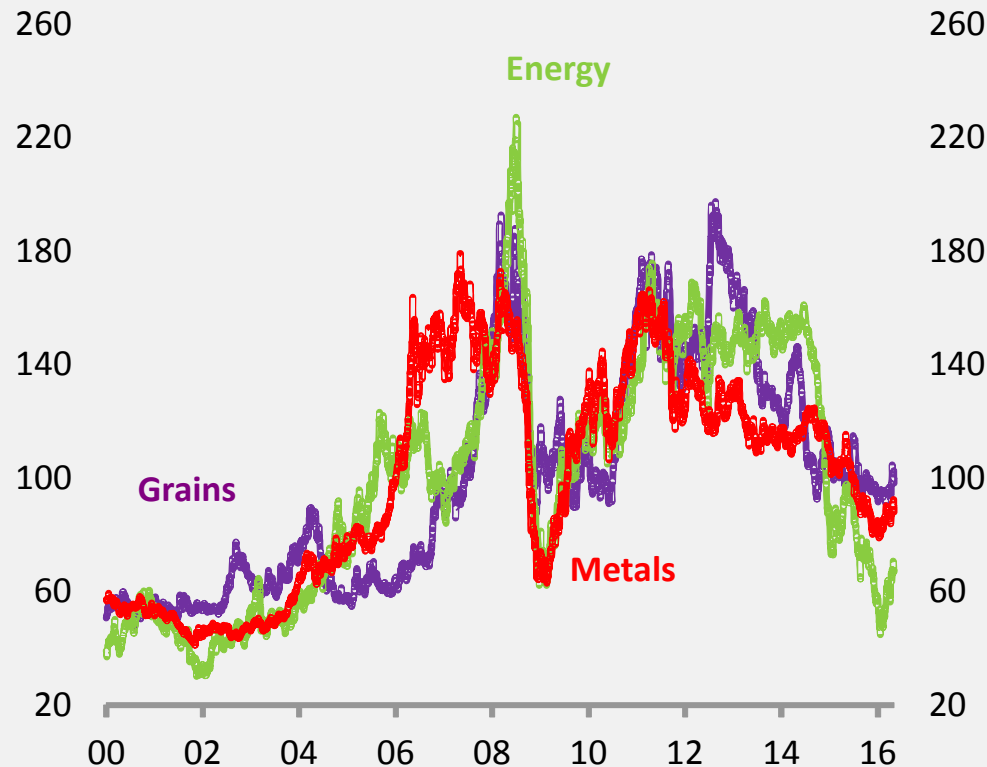
Chile has made a smooth, timely adjustment to the change in its external conditions. Domestic activity is undergoing a phase of economic slowdown in a context of above-target inflation.

The Central Bank of Chile has helped to smooth the business cycle by keeping an expansionary monetary policy in place.



For several years, Chile and other Latin American economies received a major impulse from abroad, in the form of large increases in commodity prices, among others. This has changed during the last years.

Commodity prices (*)
(index, 2000-2016=100)

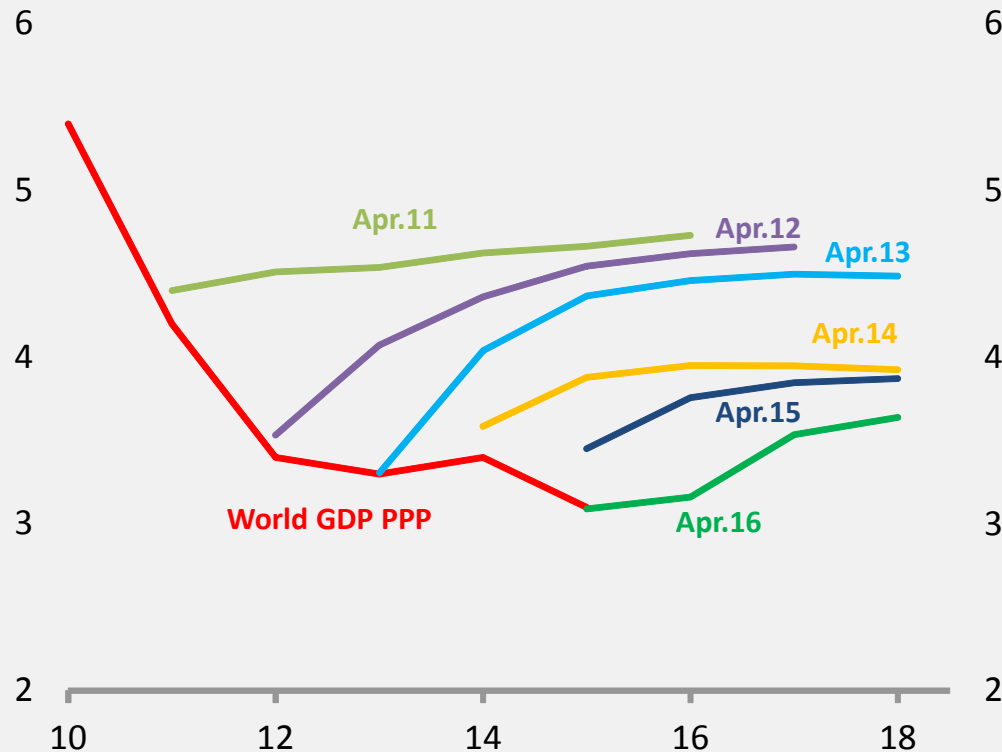


(*) Goldman Sachs aggregate index.
Source: Bloomberg.



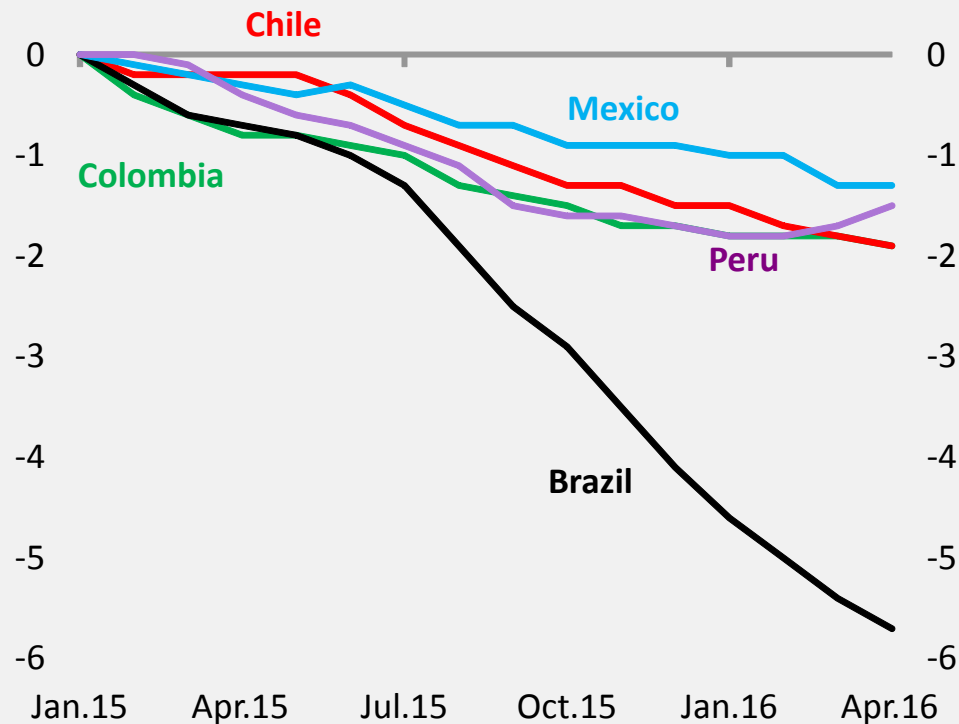
World growth has been disappointing.

World growth and forecasts' evolution (*)
(annual change, percent)



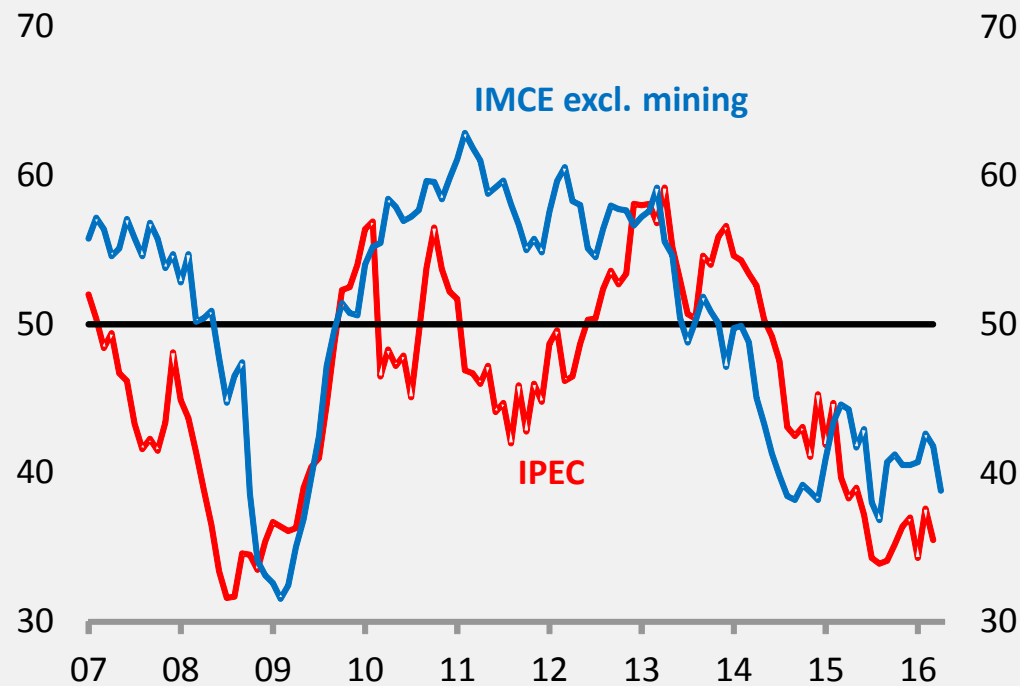
In this new scenario, but also because of idiosyncratic problems in some economies, the growth outlook for Latin America has been sharply revised downward.

Latin America: Change in the 2016 growth forecast
(percentage points)



Meanwhile, in Chile the expectations of consumers and businesses have remained pessimistic for quite some time.

Consumer (IPEC) and business expectations (IMCE)(*)
(index)



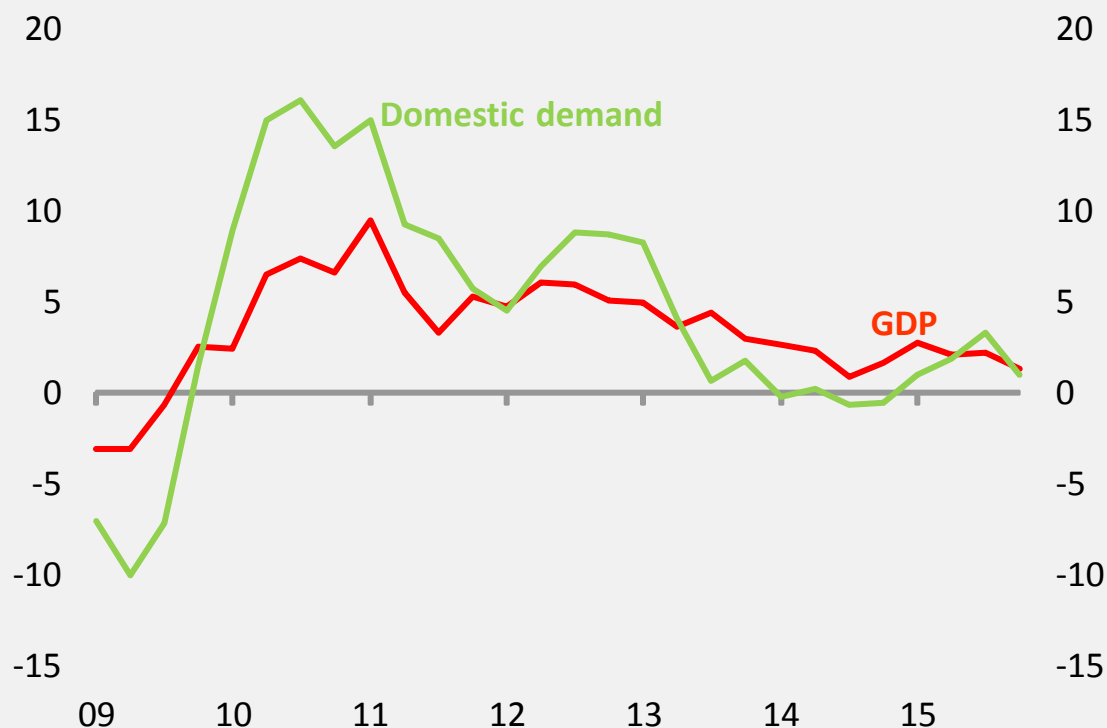
(*) A value over (under) 50 indicates optimism (pessimism).

Sources: Adimark and Icare/Universidad Adolfo Ibáñez.



In this context, Chile's domestic output and demand have decelerated and are growing slowly: around 2% in 2015.

GDP and domestic demand
(annual change, percent)



Our estimates for this year's GDP are in the 1.25% - 2.25% range, with a moderate recovery towards 2017: between 2% and 3%.

Domestic scenario
(annual change, percent)

	2014	2015 (e)		2016 (f)		2017 (f)
		Report Dec.15	Report Mar.16	Report Dec.15	Report Mar.16	Report Mar.16
GDP	1.9	2.1	2.1	2.0-3.0	1.25-2.25	2.0-3.0
Domestic demand	-0.3	2.3	1.8	2.6	1.5	2.6
Domestic demand (w/o inventory change)	1.1	2.0	1.3	2.5	1.5	2.3
Gross fixed capital formation	-4.2	0.7	-1.5	1.7	0.5	1.0
Total consumption	2.8	2.4	2.2	2.7	1.8	2.7
Goods and services exports	1.1	-1.7	-1.9	1.0	0.6	2.4
Goods and services imports	-5.7	-1.4	-2.8	1.6	-0.6	2.1
Current account (% of GDP)	-1.3	-1.7	-2.1	-2.6	-2.5	-2.0
Gross national saving (% of GDP)	20.9	20.0	20.4	19.1	19.9	20.2
Gross national investment (% of GDP)	23.0	22.0	22.7	21.9	22.6	22.1

(e) Estimate.

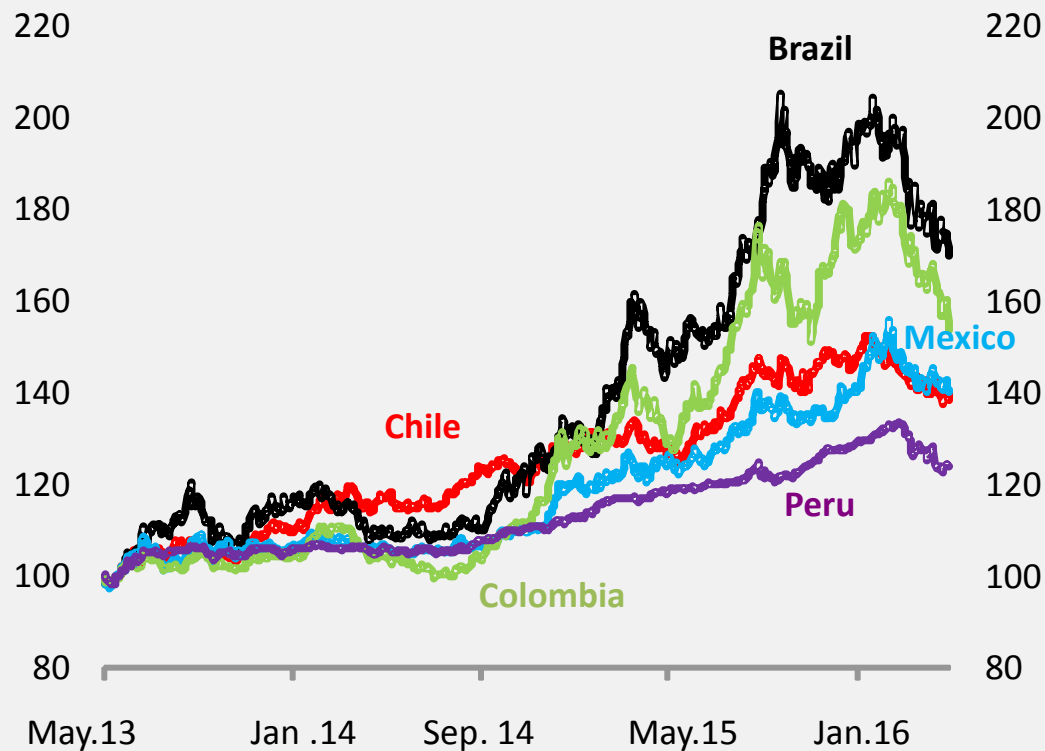
(f) Forecast.

Source: Central Bank of Chile.



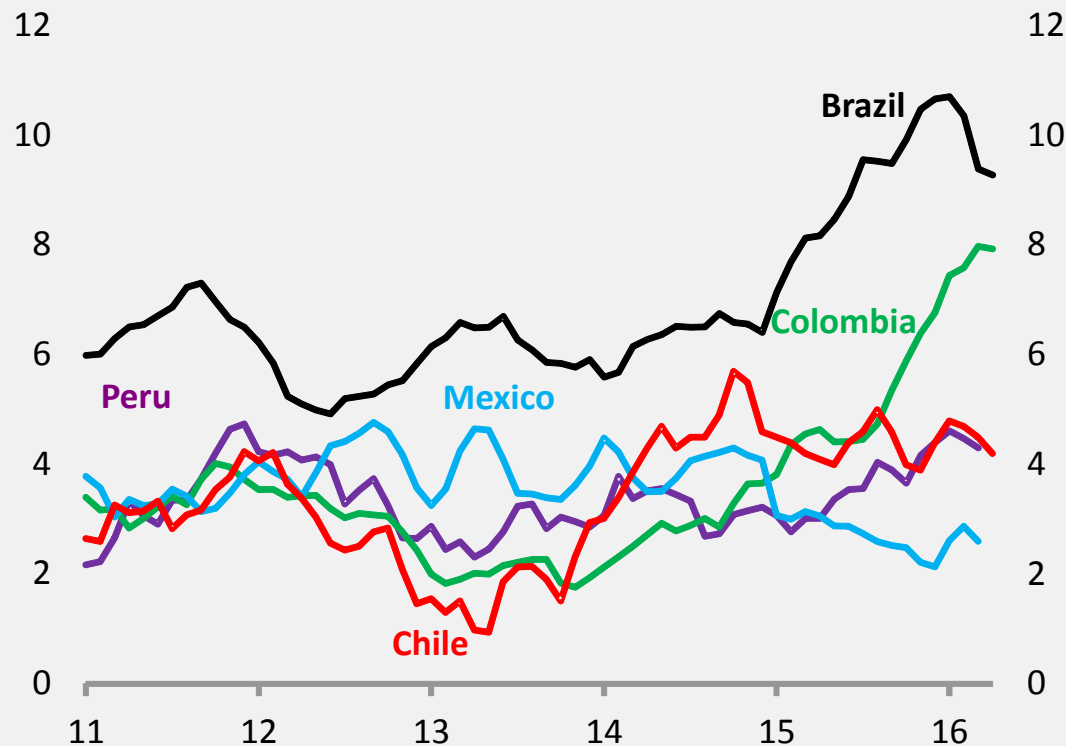
The change in external conditions drove a significant depreciation of the peso.

Latin America: Nominal exchange rate
(index, May 2013=100)



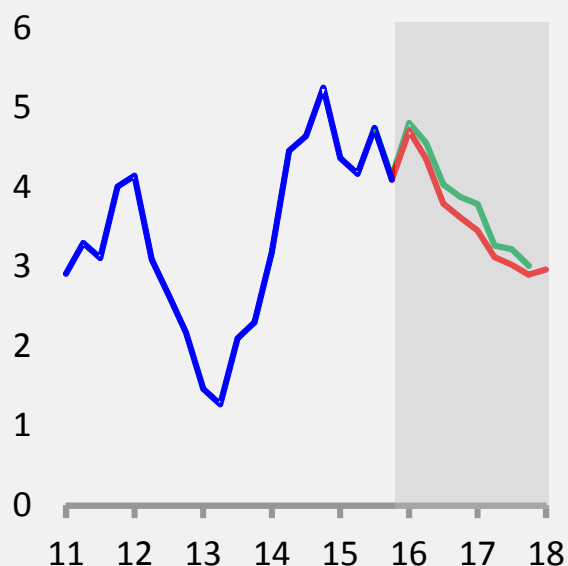
The counterpart of such depreciation has been that inflation in many countries of the region has been above the central banks' target ranges and has stayed there for longer than expected initially.

Latin America: Inflation (annual change, percent)



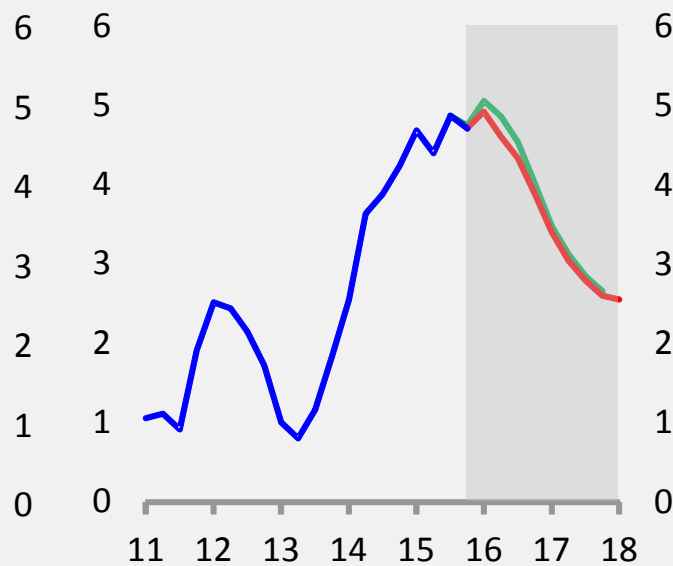
In Chile, inflation has remained above 4% for several quarters. We expect inflation to gradually converge to 3% over the coming quarters.

CPI inflation(*)
(annual change, percent)



— Mar. 2016 Report

CPIEFE inflation(*)
(annual change, percent)



— Dec. 2015 Report

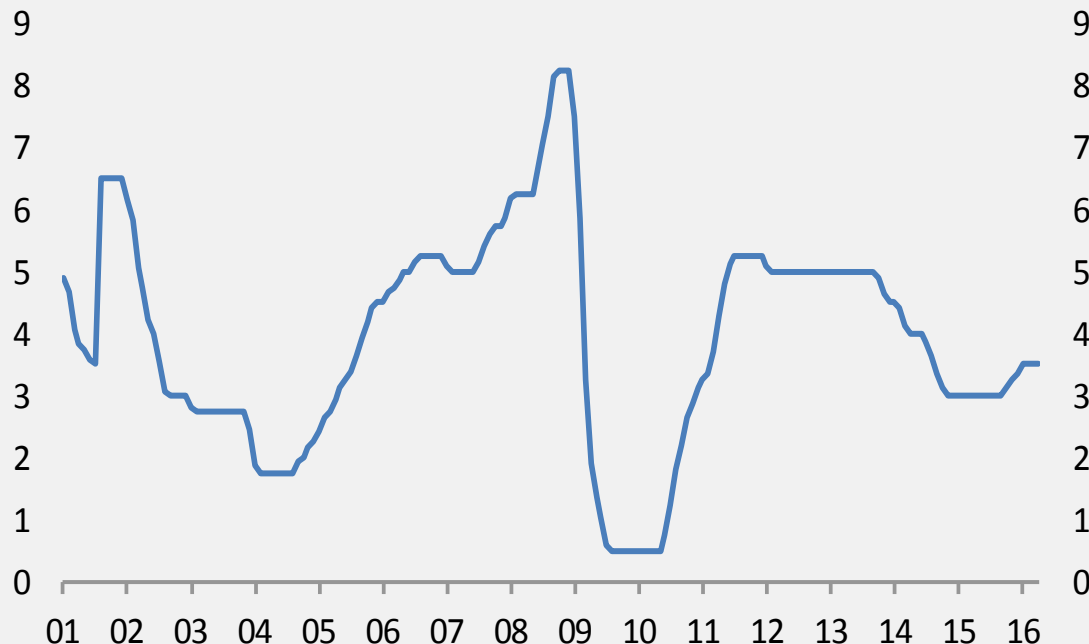
(*) Gray area, as from the first quarter of 2016, shows forecast.

Sources: Central Bank of Chile and National Statistics Institute (INE).



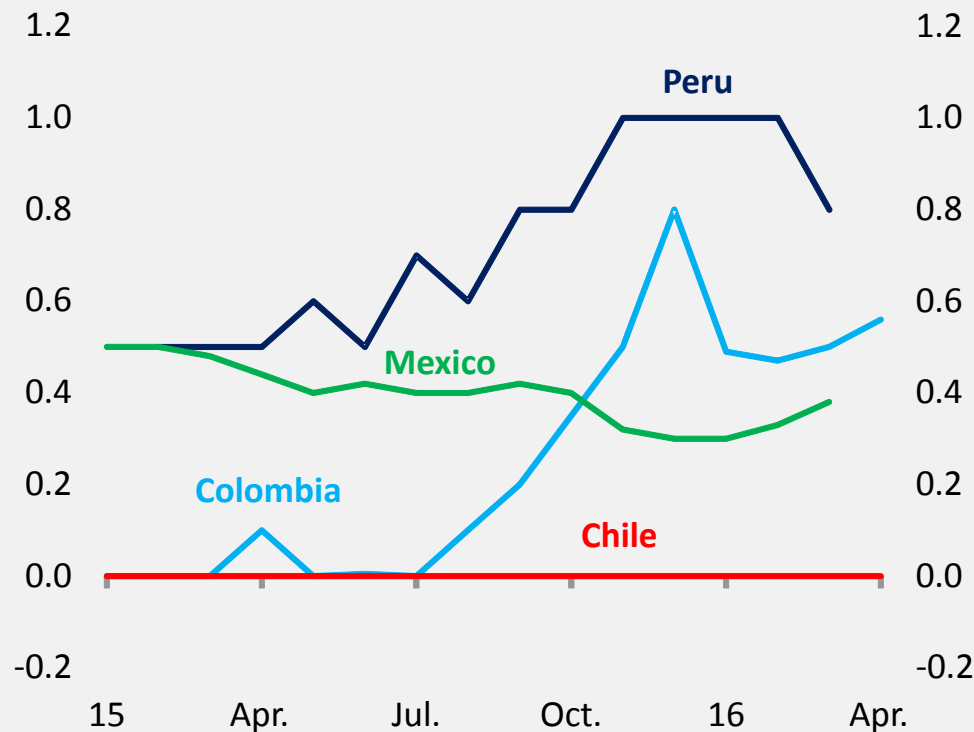
The Central Bank has contributed to the relative price adjustment necessary for dealing with the changed conditions inside and outside the country by applying an expansionary monetary policy and accommodating a significant depreciation of the peso.

Nominal monetary policy rate (MPR)
(percent)



The Central Bank's credibility and policy scheme has allowed for expectations remaining anchored to the target.

Deviation of expected inflation from the target (*) (percentage points)



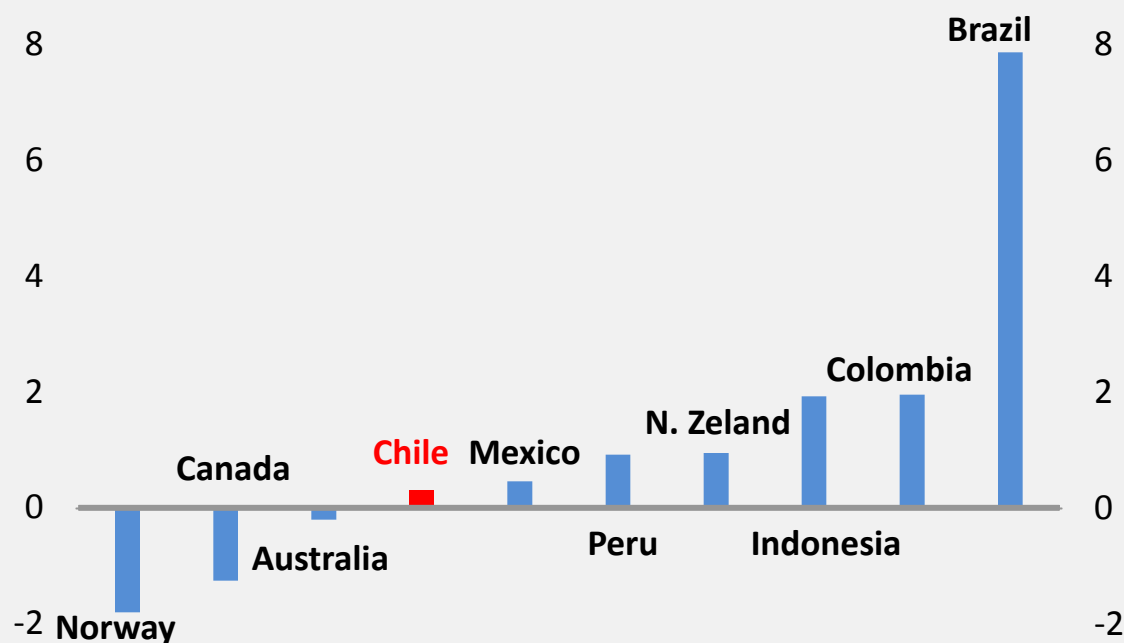
(*) Difference between inflation expected at December 2017 and target inflation for Peru and Mexico. For Chile and Colombia: difference between inflation expected two years ahead and target inflation.

Sources: Bloomberg and central bank of respective country.



Moreover, Chile's current MPR is among the most expansionary in Latin America and a group of comparable economies.

Real MPR (*)
(percent)



(*) Calculated as the current MPR less expected inflation one year ahead. Inflation expectations derived from market survey, except for Canada, Norway and New Zealand, where central bank forecasts are used.

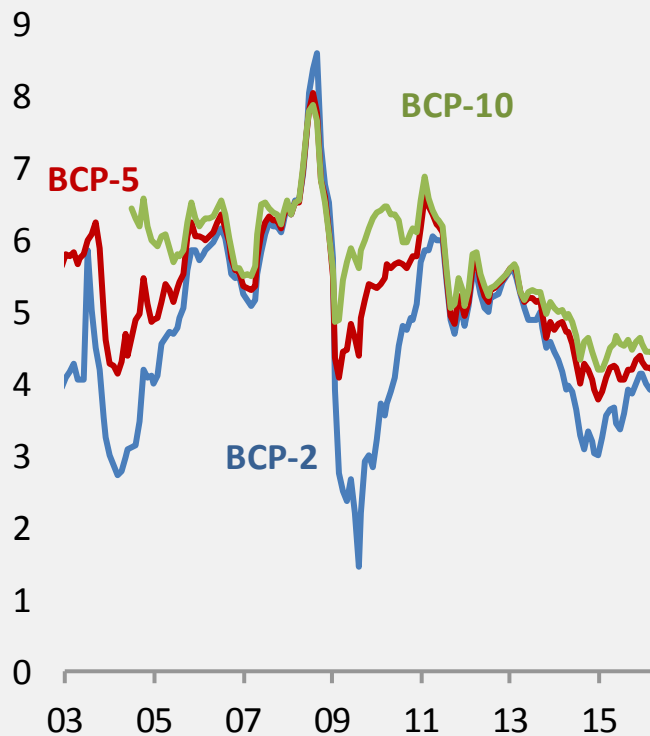
Sources: Bloomberg and central bank of each country.



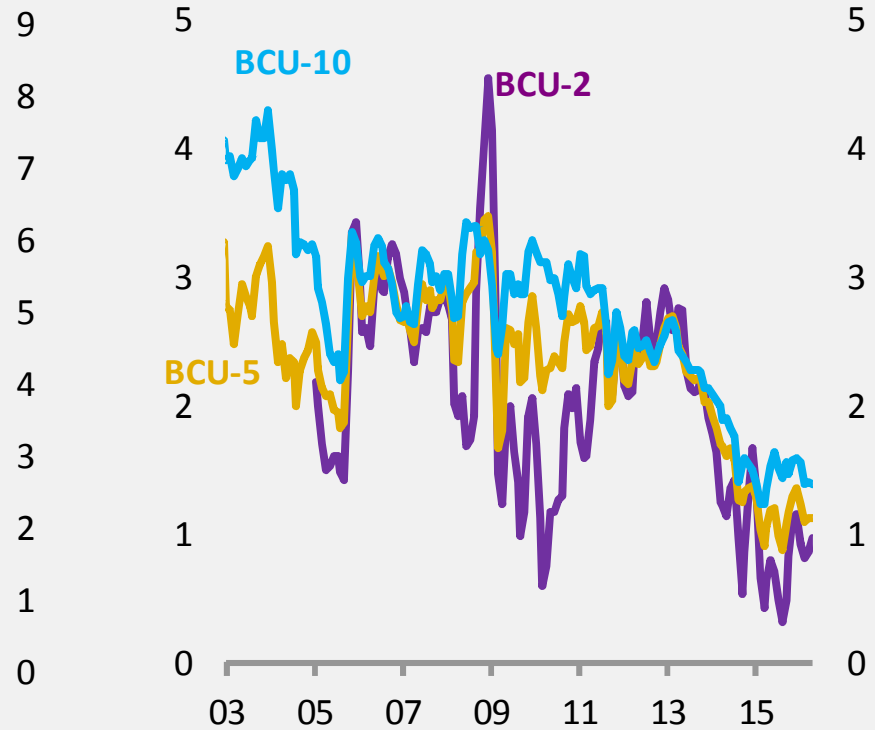
This expansionary monetary policy reflects in the low level of long-term interest rates.

**Interest rates on Central Bank of Chile documents
(percent)**

Nominal rates

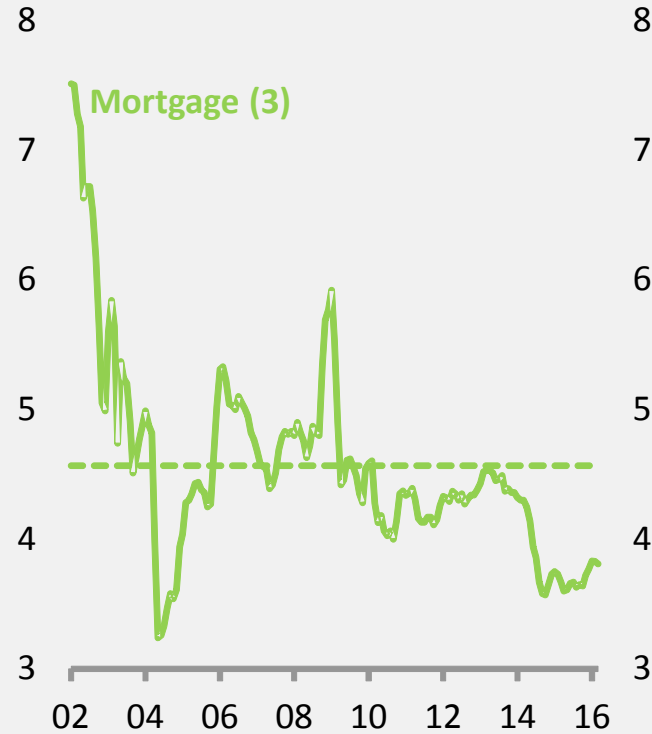
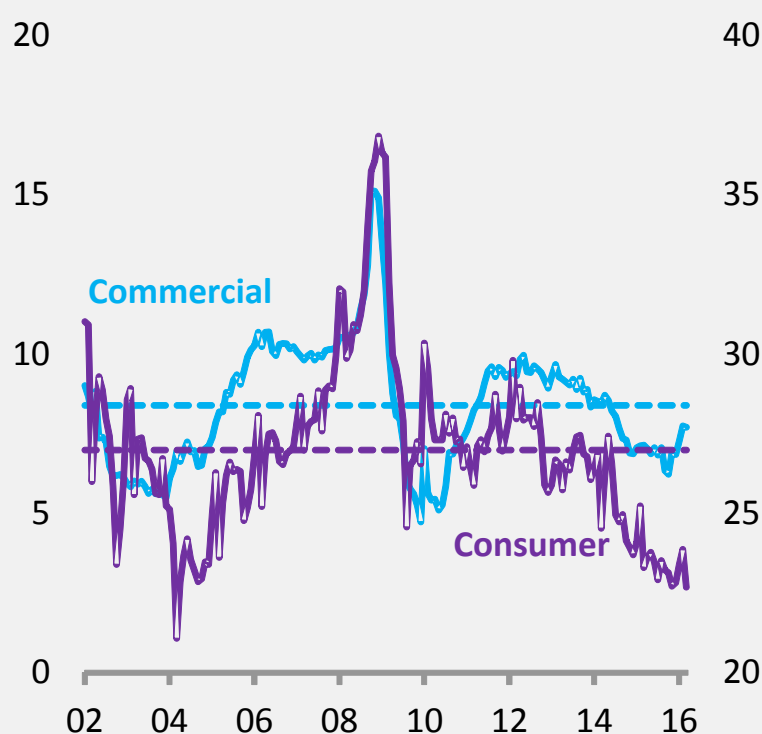


Real rates



It also reflects in lending rates, which have remained near historic lows.

Lending rates (1) (2) (percent)



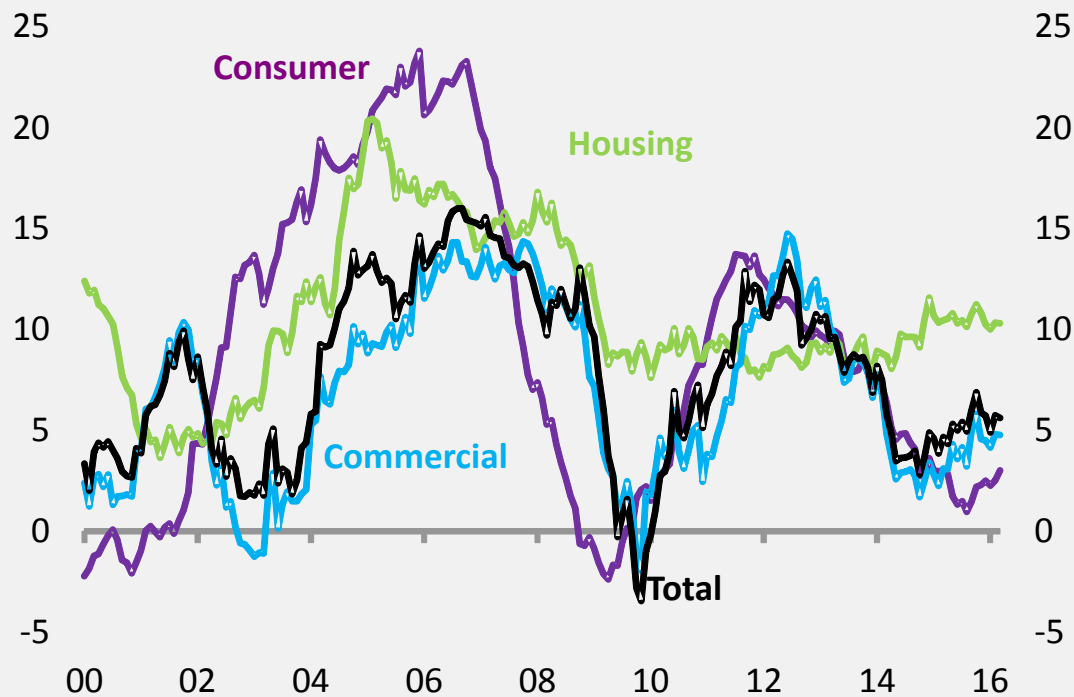
(1) Weighted average rates of all operations in the month. (2) The horizontal dotted lines indicate the 2002-2016 average for each series. (3) Mortgage interest rates are in UF.

Source: Central Bank of Chile, based on SBIF data.



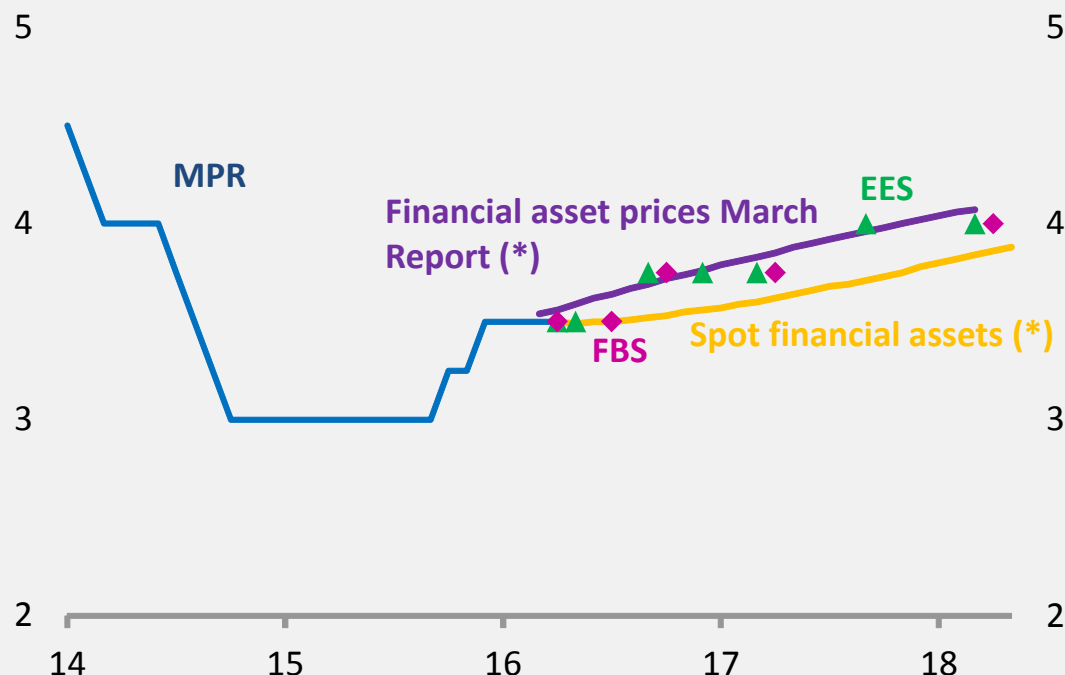
This has resulted in a real increase in credit which, although lower than it was in previous years, is significantly higher than the average expansion of the economy.

**Real annual growth rate of loans
(percent)**



In the most likely scenario defined in the last Monetary Policy Report, for inflation to converge to the target it is necessary to partially withdraw the monetary stimulus in place. Still, monetary policy will remain expansionary.

MPR and expectations (percent)



(*) Built using interest rates on swap contracts up to 10 years. Spot prices as of May, 5th 2016.
Source: Central Bank of Chile.



The Board estimates that the balance of risks is unbiased for both output and inflation.


International financial markets:

- Repeated volatility episodes (China; differential between market rate and Fed rate, and among G3).
- But also, the recent higher appetite for risk could go on.

World activity prospects:

- Doubts about China and the strength of US recovery; also, electoral debates in several countries and a possible shift to more protectionist policies.
- Impulse policies, particularly in the developed world and China, could be more successful in promoting greater global growth.

Latin America :

- Several countries need to make substantial, costly adjustments.
 - Complicated political issues in some of them.
 - Negative scenarios with effects on funding costs and external demand.
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The Board estimates that the balance of risks is unbiased for both output and inflation.

Output:

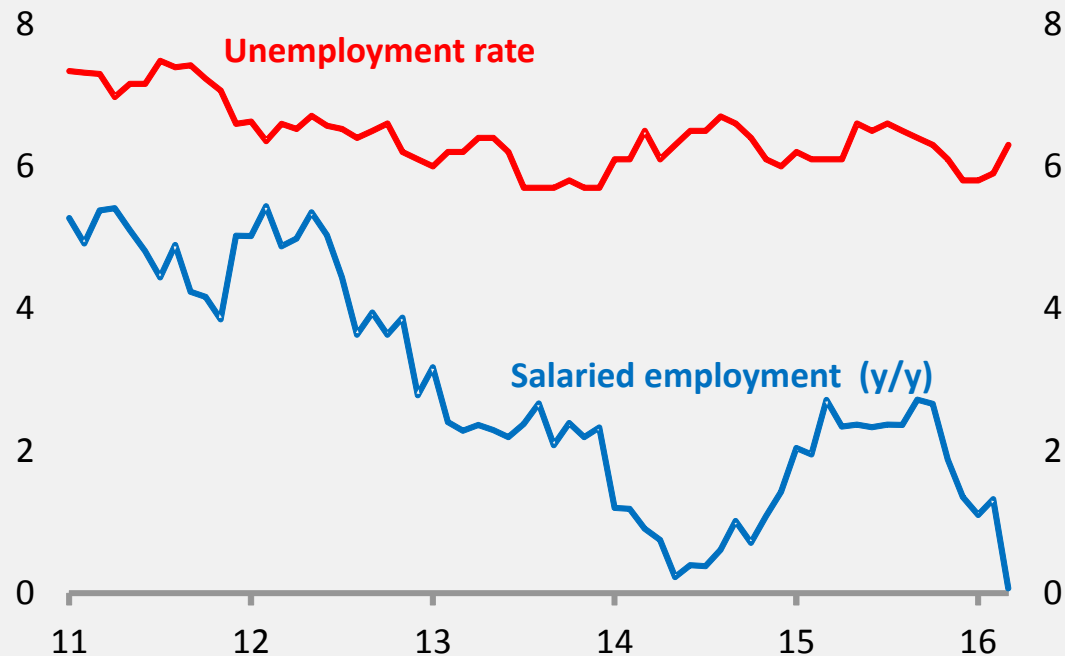
- Slower growth if the labor market deteriorates further and/or expectations become more pessimistic.
- Faster recovery: the economy is well balanced from a macro perspective, has a responsible fiscal policy, well-anchored inflation expectations and a stable, well-regulated financial system.

Inflation:

- Inflation has remained high for a long time, which might affect the velocity of its convergence to the target, because of both indexation effects and potential impact in the formation of expectations.
- Over the short term, its dynamics will continue to be closely tied to the evolution of the exchange rate, which will be determined by external scenarios, so there are risks in either direction. The recent appreciation of the peso could diminish inflationary pressures.

Lately, the labor market has shown a more latent weakness, which was one of the risks for domestic growth identified in the last Report.

Labor market (percent)



Aside from monetary policy, there are many elements complementing and reinforcing one another, putting the Chilean economy on a good stand to face present and future challenges.

An autonomous Central Bank and a floating exchange rate regime.

Fiscal policy has helped with a spending trajectory consistent with a fiscal rule and the government's commitment with pursuing a path of fiscal consolidation.

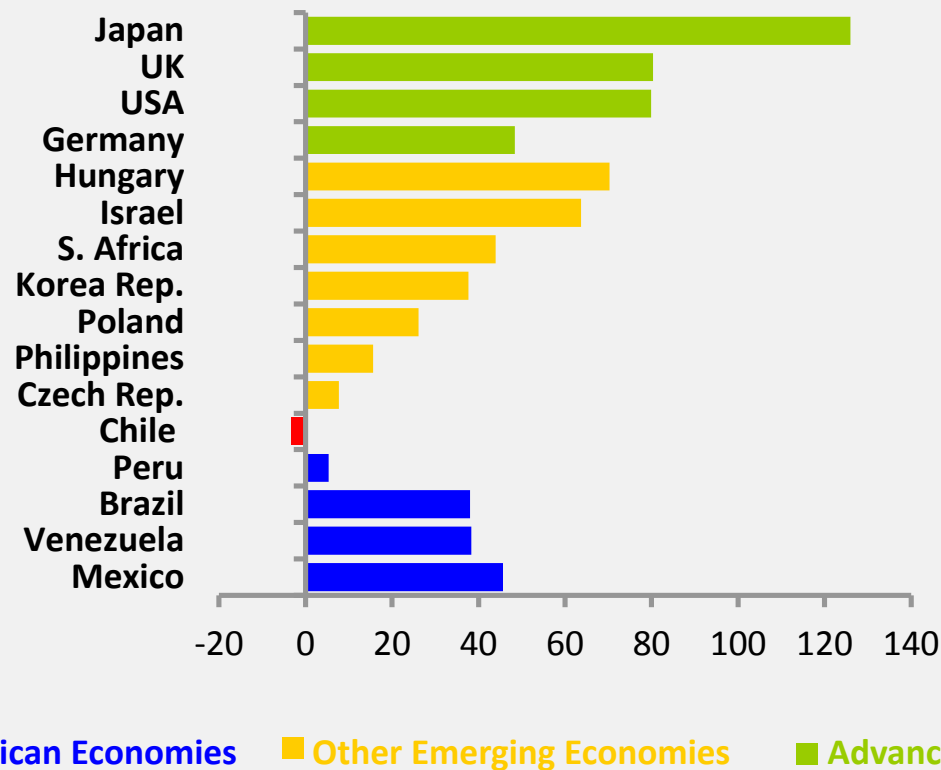
Our stable, well-regulated financial system has also played a part.

Plus, significant integration to international markets.



The fiscal rule allows us to have a responsible, predictable fiscal policy. This has granted us a very favorable position compared with other economies of the world.

Net Public Debt 2015 (1) (2)
(percent of GDP)

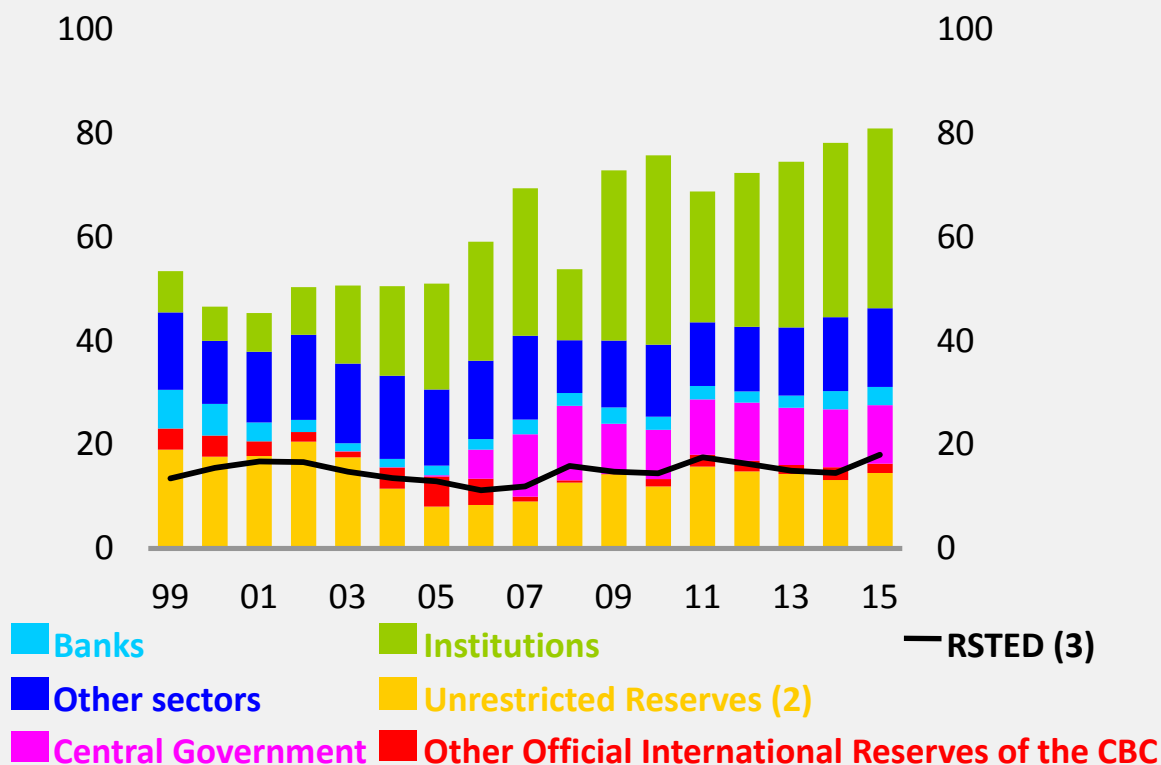


(1) Net Debt of the Central Government (excluding reserves, central bank debt and social security). (2) With the exception of Chile, data was estimated by WEO or, when not available, by Moody's. Sources: Central Bank of Chile, Bloomberg, IMF, Ministry of Finance of Chile and Moody's.



Chile has more liquid external funds available than it had in earlier low-growth periods.

Availability of net foreign financial liquidity (1) (percent of GDP)



(1) GDP at constant real exchange rate (index June 2015 = 100). External liquidity includes short-term loans, currency and time deposits, and portfolio investment. Excludes derivative positions. (2) Official reserves minus short-term commitments in foreign currency (BCX maturities, BCD, swaps). (3) Residual short-term external debt.

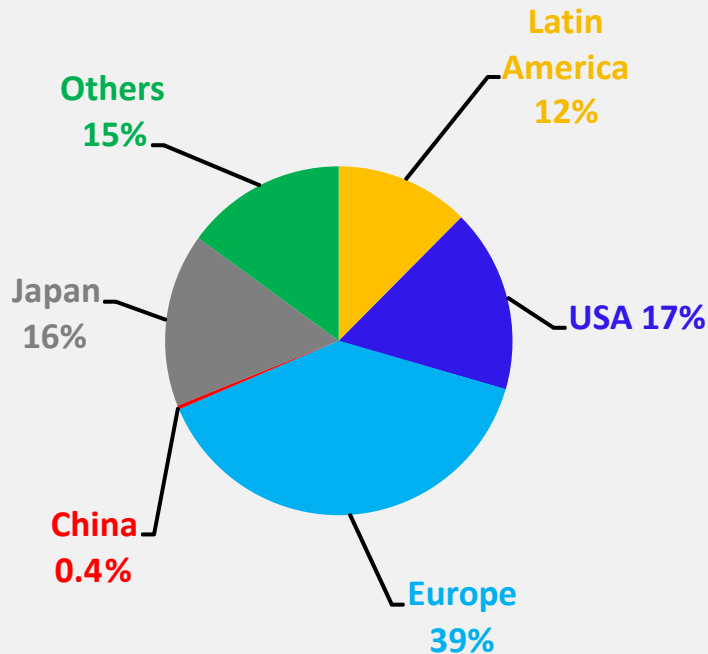
Source: Central Bank of Chile.



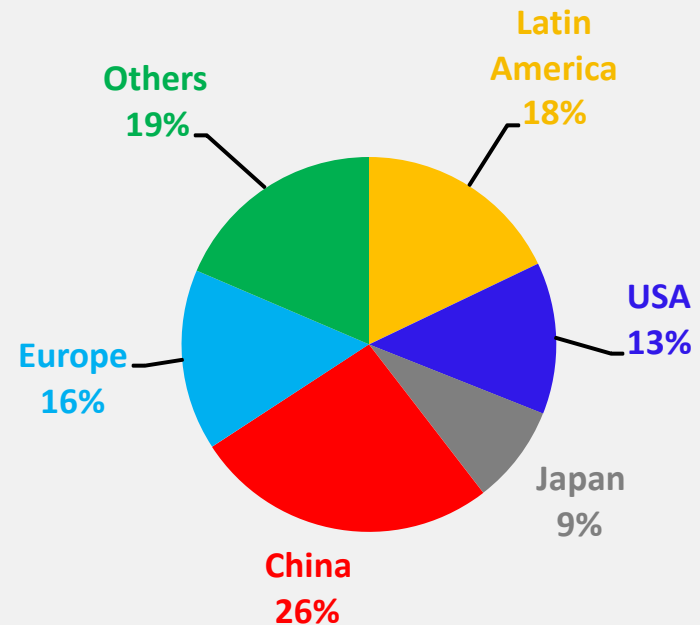
Chile has been integrated to financial and commercial markets. For example, it has diversified its exports destinations, which also helps to cushion economic cycles.

Exports destinations
(share of total exports)

1990

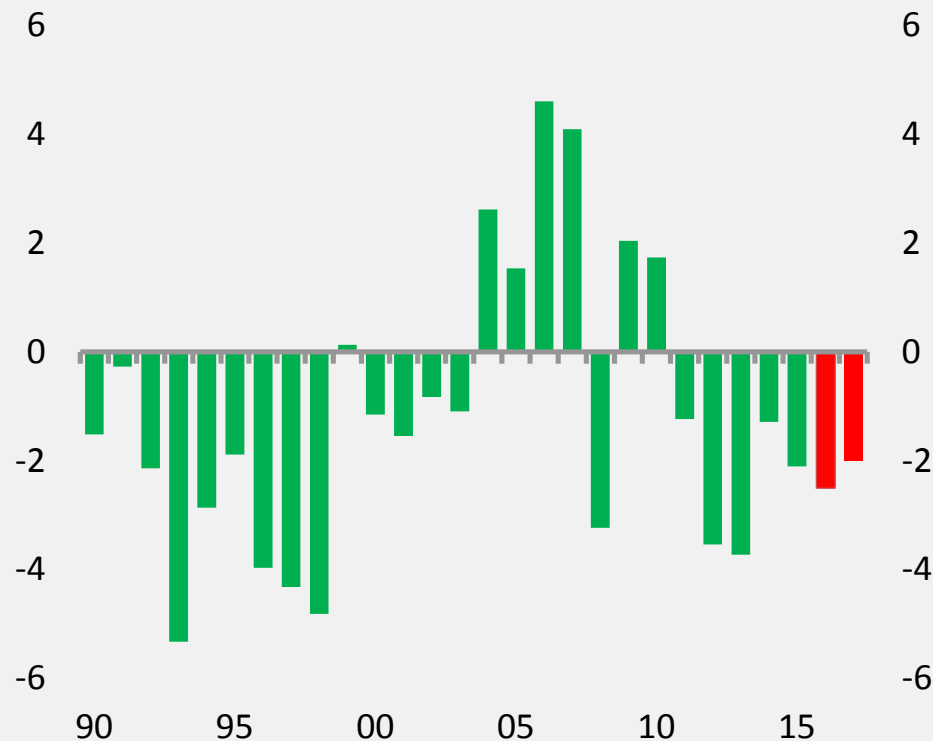


2015



As a result, the Chilean economy succeeded in making a timely and significant adjustment in response to the change in external and internal conditions.

Current-account balance (*)
(percent of GDP)

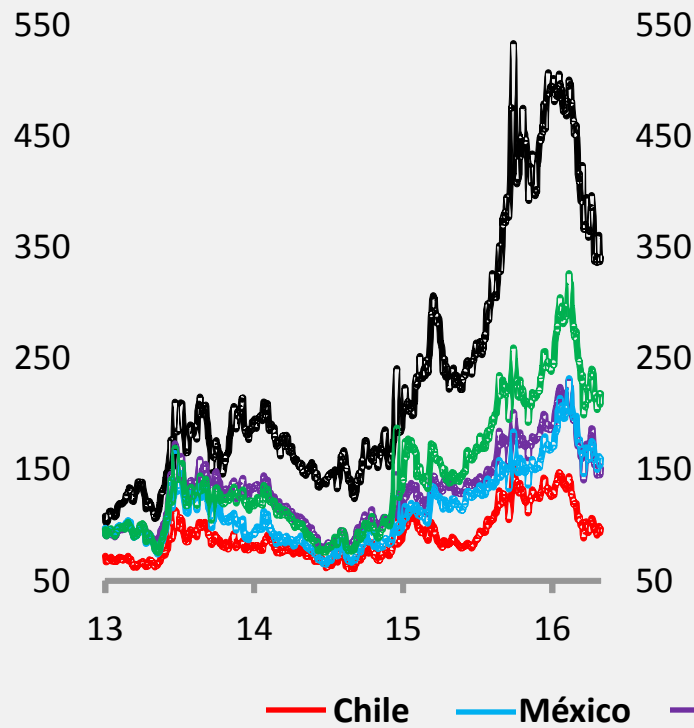


(*) Red bars correspond to forecast included in the Monetary Policy Report, March 2016.
Source: Central Bank of Chile.

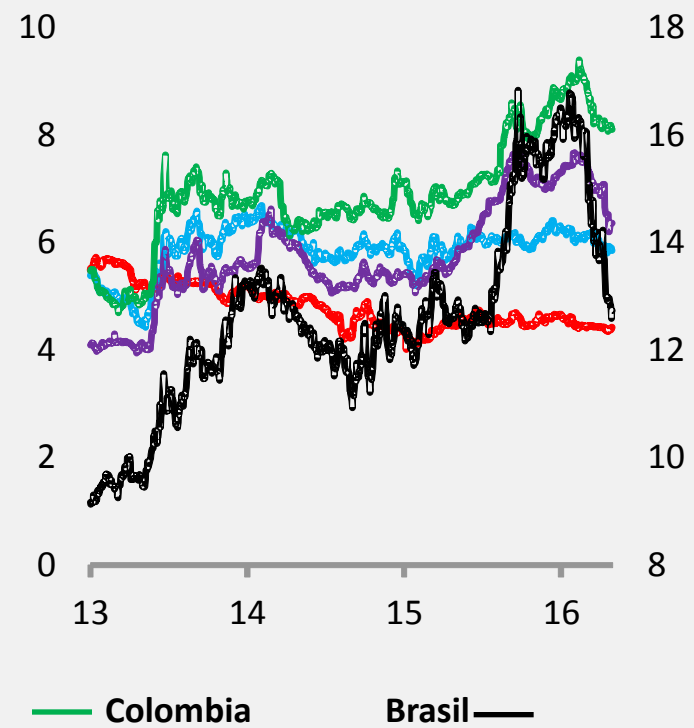


Our strong policy framework sets us apart from other economies in the region. In Chile, long-term interest rates have remained low and significantly stable.

Sovereign spreads (1)
(basis points)



Nominal 10-year government bond rates (2)
(percent)

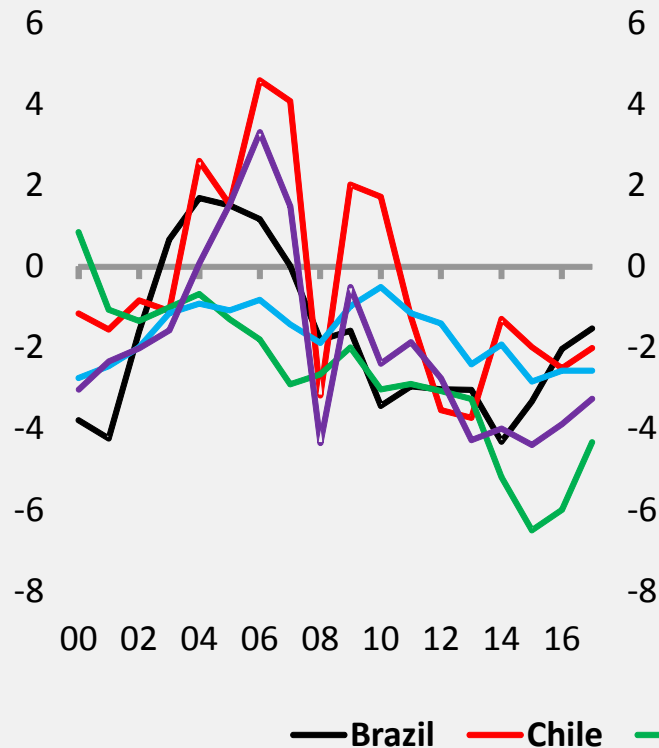


(1) Measured by five-year CDS spreads. (2) Includes Central Bank and Treasury bonds.
Sources: Central Bank of Chile and Bloomberg.

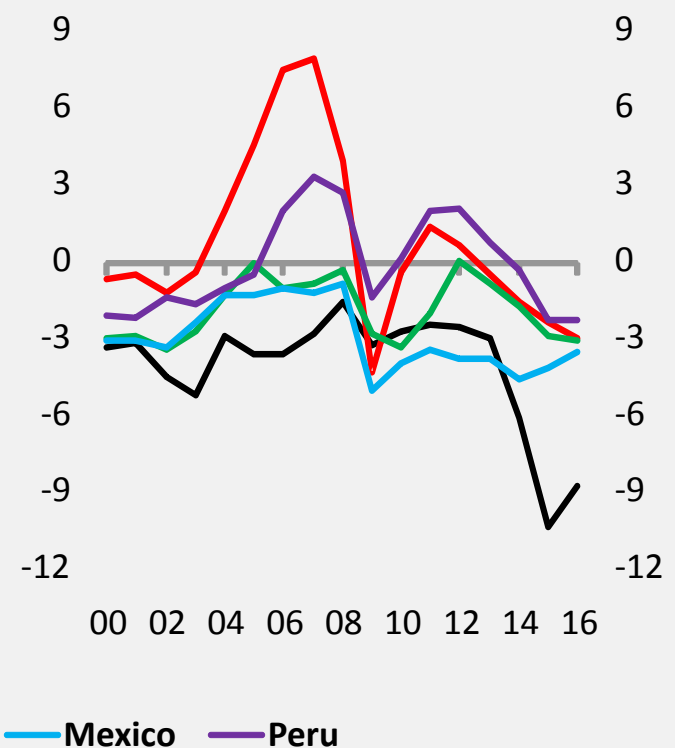


Many economies in the region have yet to make some complex adjustments requiring substantial funding.

Current account (percent of GDP)



Fiscal balance (percent of GDP)



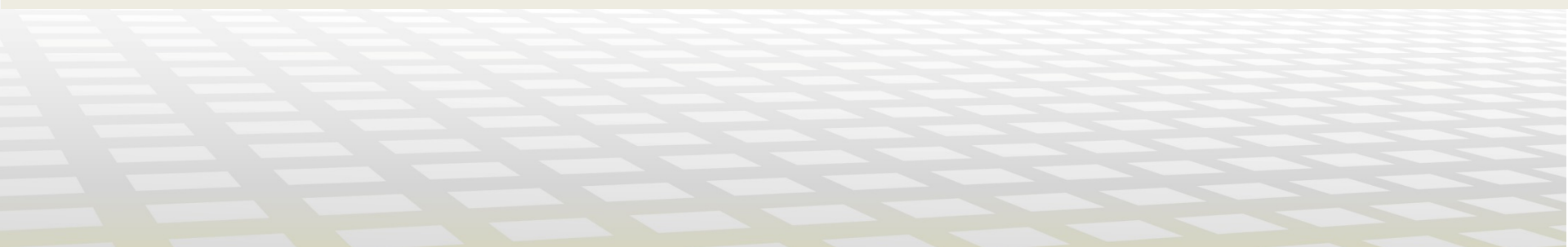
Conclusions

The emerging economies are dealing with a complex macroeconomic scenario.

The end of the commodity super-cycle and less favorable financial conditions pose a significant challenges for economic policies.

From a macroeconomic point of view, Chile is a very solid, stable and balanced economy.

Therefore, our economy is on a good stand to face the challenges posed by the external scenario and resume higher rates of growth.





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