

**WORKSHOP ON FINANCIAL MARKETS
AND MONETARY POLICY
OPENING REMARKS**

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On behalf of the Central Bank of Chile I would like to welcome you all to this workshop on the interactions between financial markets and monetary policy. We have put together a very interesting group of papers that are surely at the forefront of research in this area.

The episodes that started to unfold during the second half of 2008 reminded us once more of the central importance of financial markets for the functioning of the economy. As the crisis progressed and policy makers tried to mount a response that could mitigate the effects on the real economy, understanding which actions would have the bigger impact at the smallest possible cost become a key priority. At the same time, gauging how the traditional policy actions would affect the economy in a scenario of deep disarray of financial markets also become an important priority in Central Banks and Treasury Departments around the world. The collection of papers that will be presented here today try to illuminate different features of the policy dilemmas I just mentioned. They are then a very welcome contribution.

To some extent economists lacked a clear theoretical framework to understand the role of financial markets as both an originator and propagator of shocks when the crisis started. The paper by Professor Nobuhiro Kiyotaki from Princeton University along with his coauthor Mark Gertler builds a model whose aim is precisely to build such a model that can serve economists to describe the interactions between developments in financial markets and the rest of the economy. The framework proposed by Kiyotaki and Gertler is also used by them to estimate the likely effects that the set of actions undertaken by policy makers that have come to be known as unconventional monetary policy. Understanding the effect of these non traditional tools is surely an important issue and helps us to design better policies. The study of unconventional monetary policies is also the subject of the paper by Javier García-Cicco who analyses this issue estimating a model for the case of Chile.

As you are well aware, the prominence of unconventional monetary policies during the 2008-2009 crises was due to the fact that the interest rate that most central banks use as its main instrument were aggressively reduced towards levels very close to their effective lower bounds. The paper by Martin Bodenstein and his coauthors from the Federal Reserve studies how an economy reacts to foreign shocks when the interest rate is at its lower bound. This question is of particular interest to a country like Chile which is subject to frequent changes in the international scenario.

The papers to be presented by Luca Dedola from the European Central Bank and Óscar Jordá from the University of California-Davis are part of a very active literature that studies the determination of nominal exchange rates incorporating insights from recent

developments in the theory of financial markets. On line with developments on financial markets theory, the paper to be presented by Craig Burnside shed lights on a central discussion on the exchange rate dynamics theory. Along with his coauthors they offer an explanation for the forward premium puzzle in foreign exchange markets, their analysis is also consistent with opportunities of profitable carry trade strategies. Given the importance of the nominal exchange rate for an open economy like Chile, these papers are also a very important and relevant contribution.

As you can see this promise to be a very interesting conference and I invite you to engage in the discussion and seize the opportunity to learn from this very excellent group of researchers.

Finally I would like to thank Miguel Fuentes, Diego Saravia and Felipe Labbé for organizing what promises to be a very interesting workshop.

Thank you.