



Global Adjustment and Policy Challenges for Central Banks in Emerging Economies

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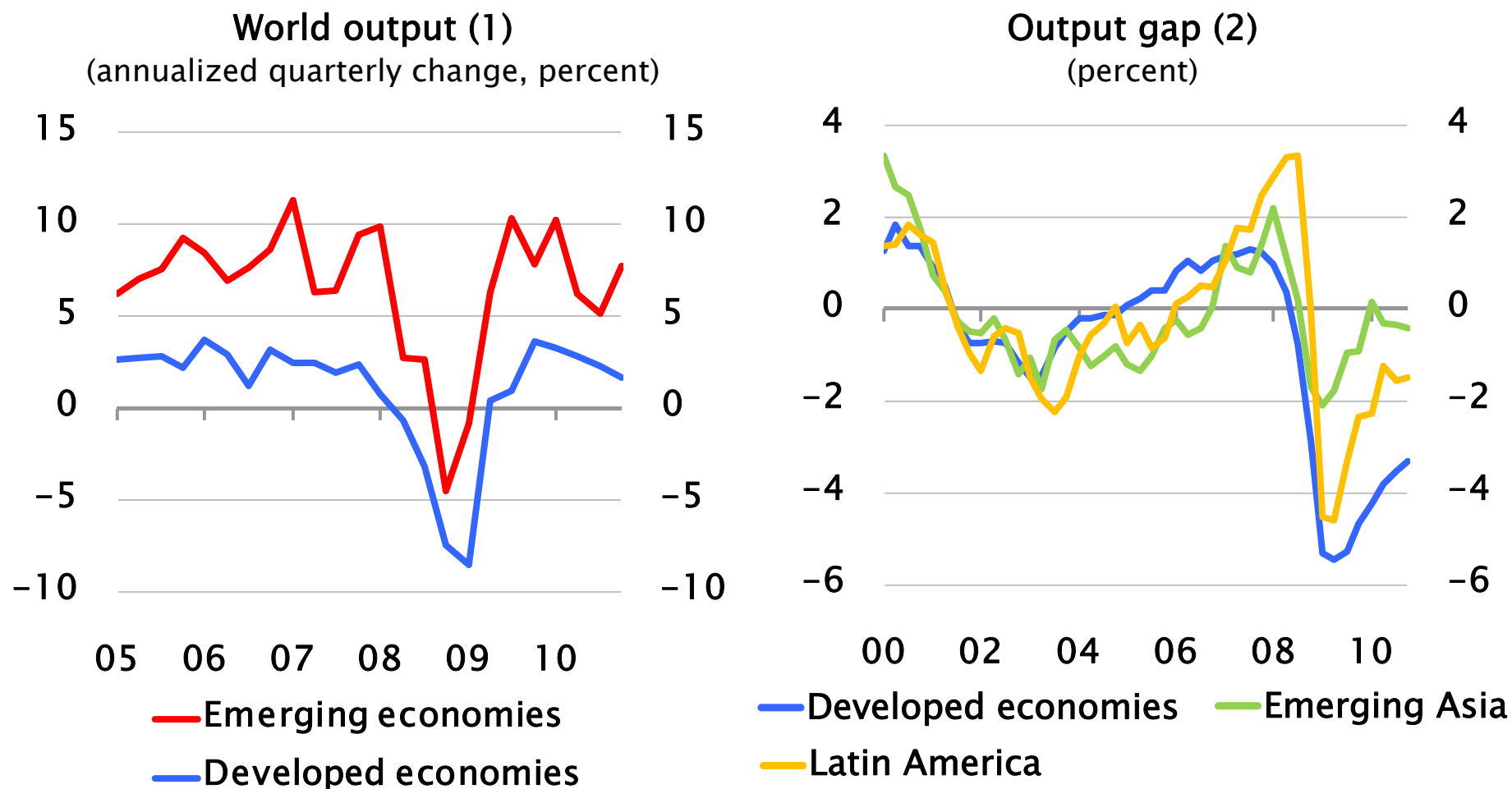


The recovery of the world economy is posing challenges to policy makers.

- The recovery has been characterized by asymmetries. While emerging market economies (EMEs) have grown strongly, developed economies grow, but still have significant excess capacity.
- This has caused tensions in EMEs having to deal with the appreciation of their currencies and managing the resumption of capital inflows.
- Another important challenge has to do with inflationary pressures in an environment of rising commodity prices and closing output gaps.



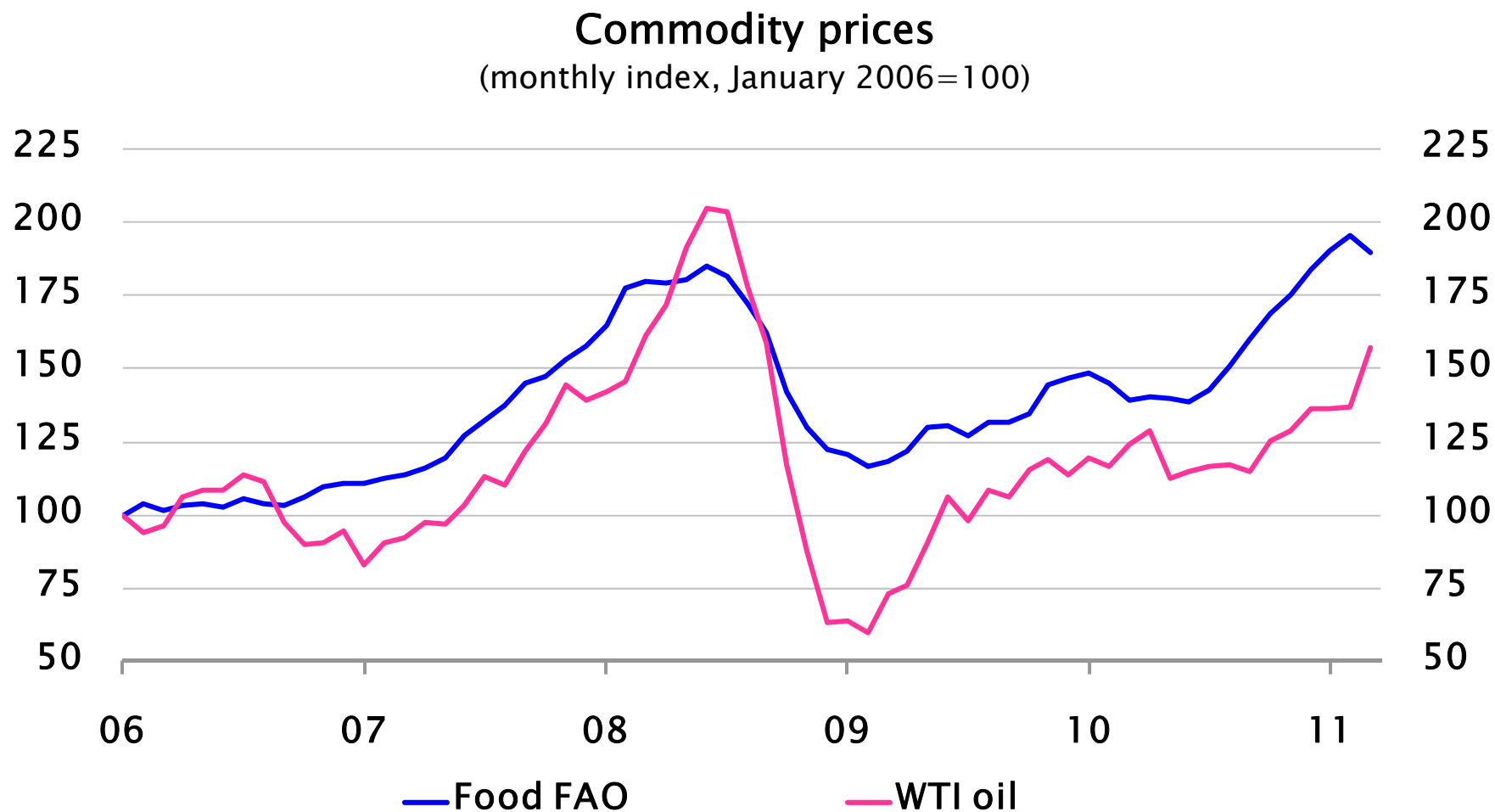
After suffering moderately during the global crisis, many EMEs have already reached full capacity and some of them may even be overheating.



(1) PPP-weighted regions. (2) Gap obtained with the HP filter, except in advanced economies, where OECD estimates were used. Sources: Central Bank of Chile based on data from Bloomberg, Consensus Forecasts, OECD, and the statistics offices of each country.

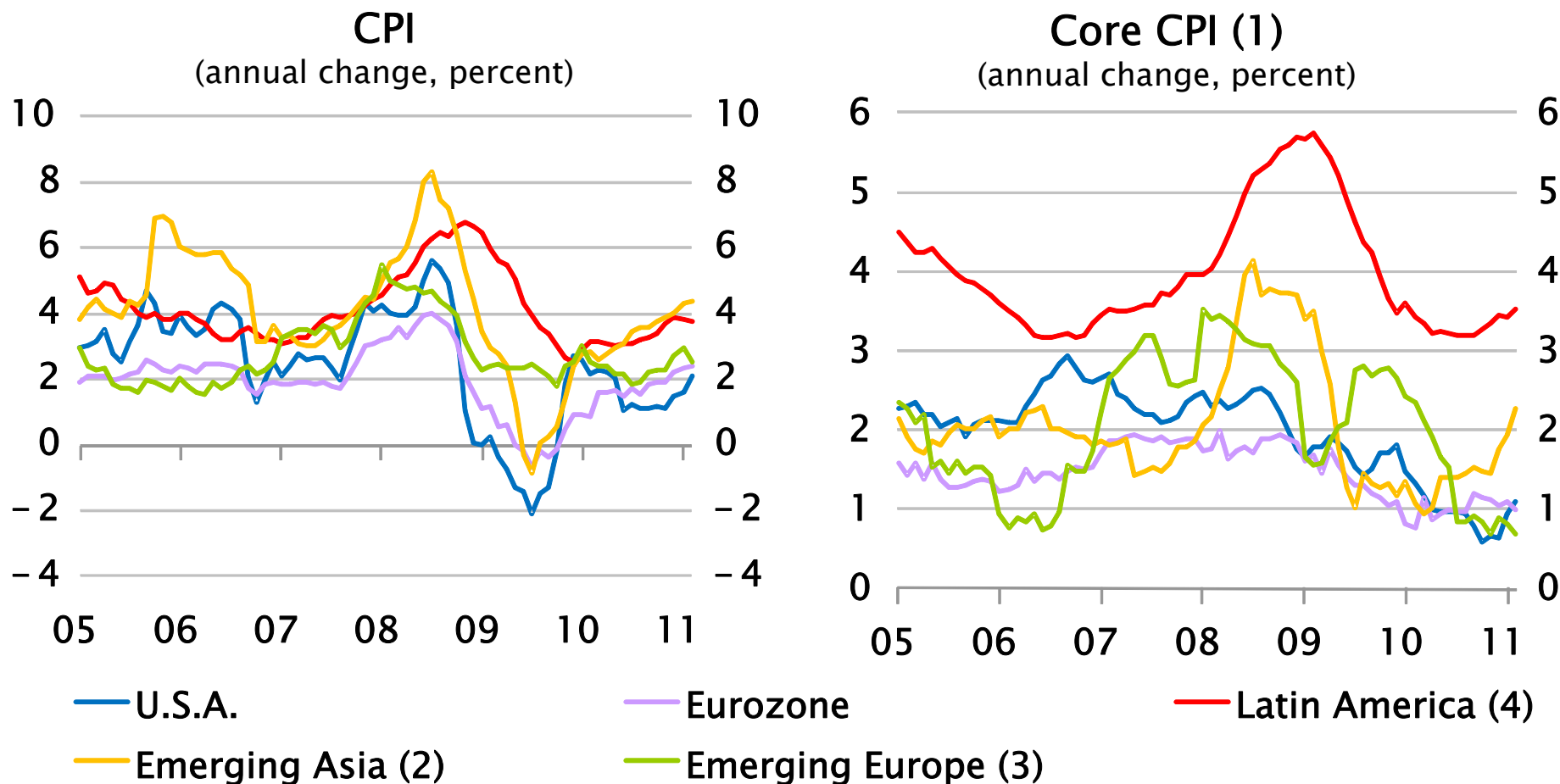


The buoyancy of EMEs has resulted in higher commodity prices.





Thus, EMEs are experiencing inflationary pressures. Meanwhile, propagation effects in advanced economies are limited due to negative output gaps.



(1) Uses definition of each country. (2) CPI includes China, Indonesia, Malaysia, South Korea and Thailand. Core CPI includes South Korea and Thailand. (3) CPI includes Czech Rep., Hungary, Poland and Russia. Core CPI excludes Russia. (4) CPI and core CPI include: Brazil, Colombia, Mexico and Peru.

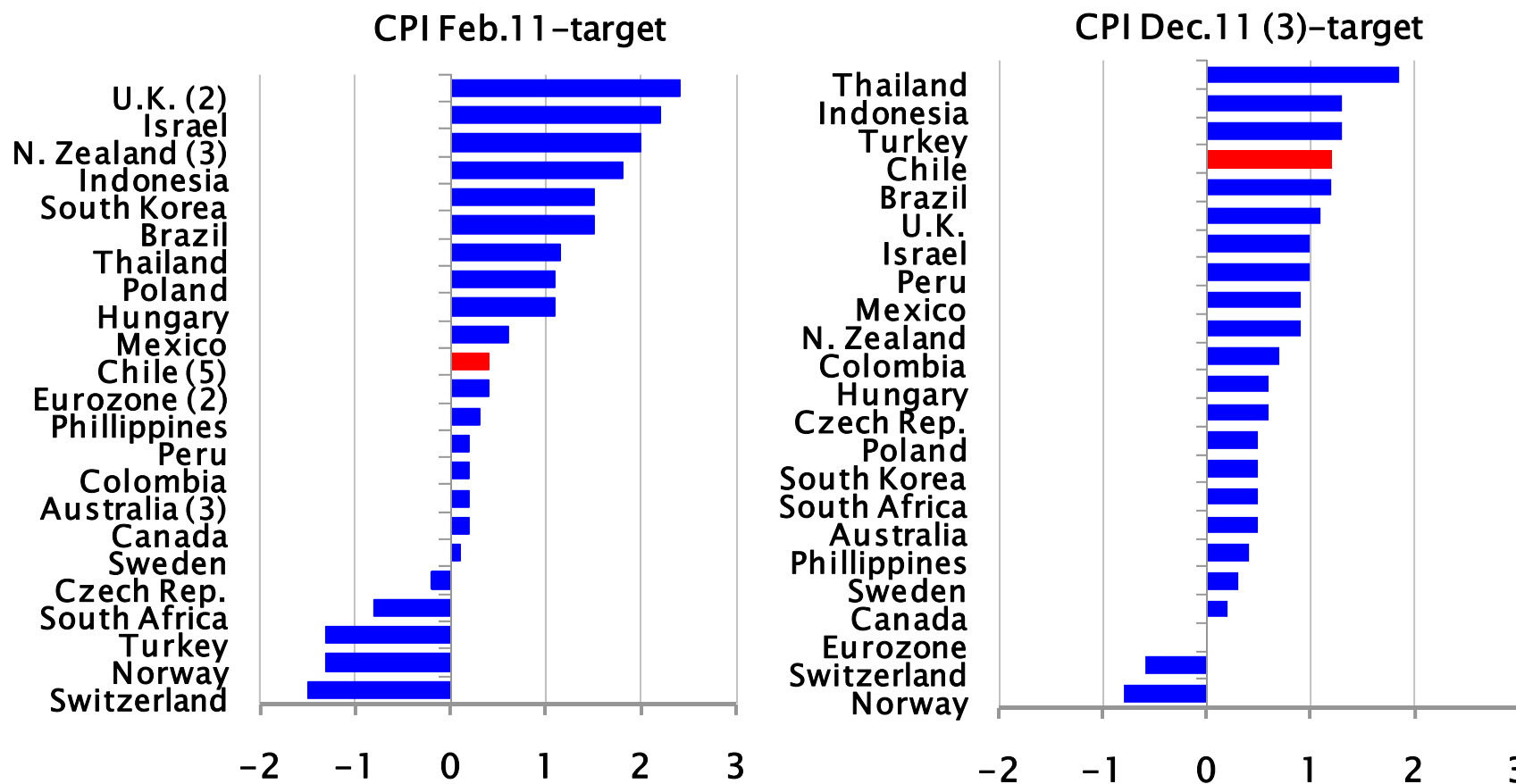
Sources: Bloomberg, CEIC Data and offices of each countries.



Inflationary expectations and risks have increased accordingly, and expectations are that in many countries inflation will deviate from its target.

Inflation deviations from target (1)

(percentage points)

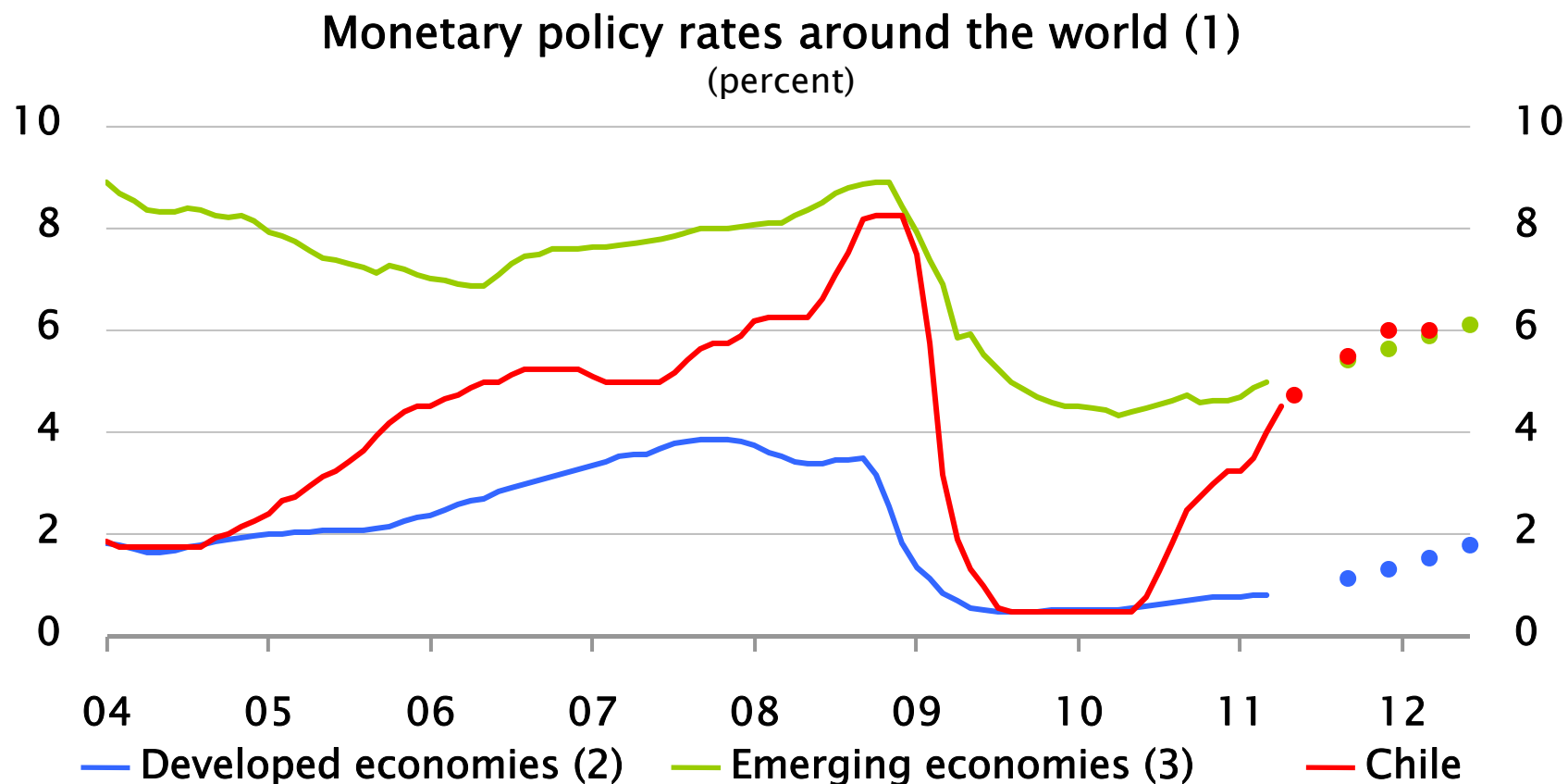


(1) In cases where the target has a range, the centre is considered. (2) Harmonized series. (3) Spot inflation at fourth quarter 2010. (4) Inflation projected by March's Consensus Forecasts. For Chile, baseline projection in March 2011's Monetary Policy Report. (5) Considers March CPI.

Sources: Bloomberg, Consensus Forecasts and central banks of each country.



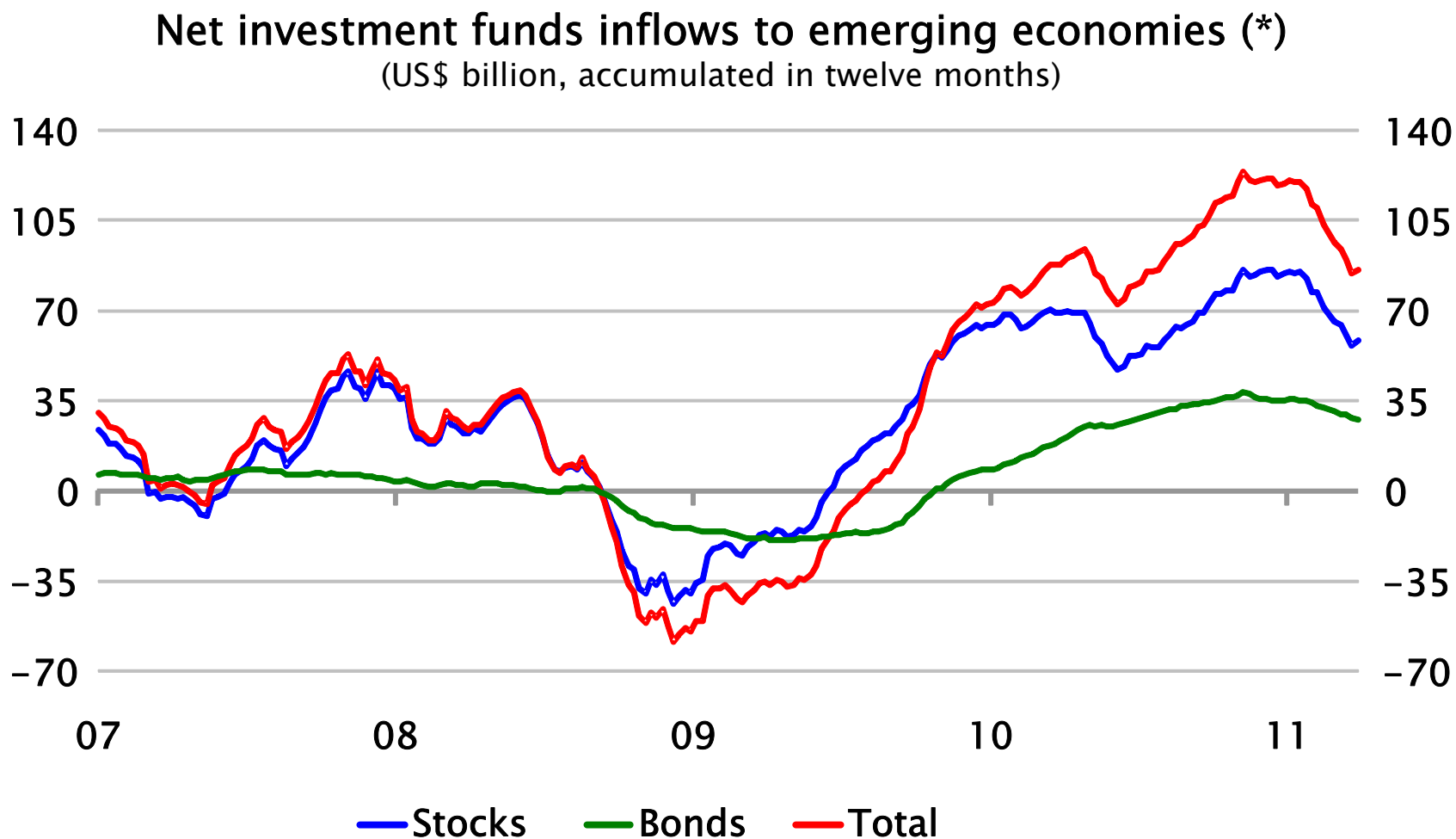
The two-speed recovery of the world economy is shaping an uneven monetary policy landscape.



(1) Solid lines represent a monthly simple average of the reference rates for each group of countries. Dots considers the median of Bloomberg's analyst survey between March, 19th and April, 8th of 2011, indicating expected Monetary Policy Rate (MPR) for September 2011, December 2011, March 2012 and June 2012. For Chile considers the EES for the expected MPR for May 2011, September 2011, December 2011 and March 2012. (2) Includes Canada, Euro area, Japan, Norway, Sweden, Switzerland, United States. (3) Includes Brazil, Czech Republic, China, Colombia, Hungary, South Korea, Mexico, Peru, Poland, South Africa, and Turkey. Sources: Central Bank of Chile and Bloomberg.



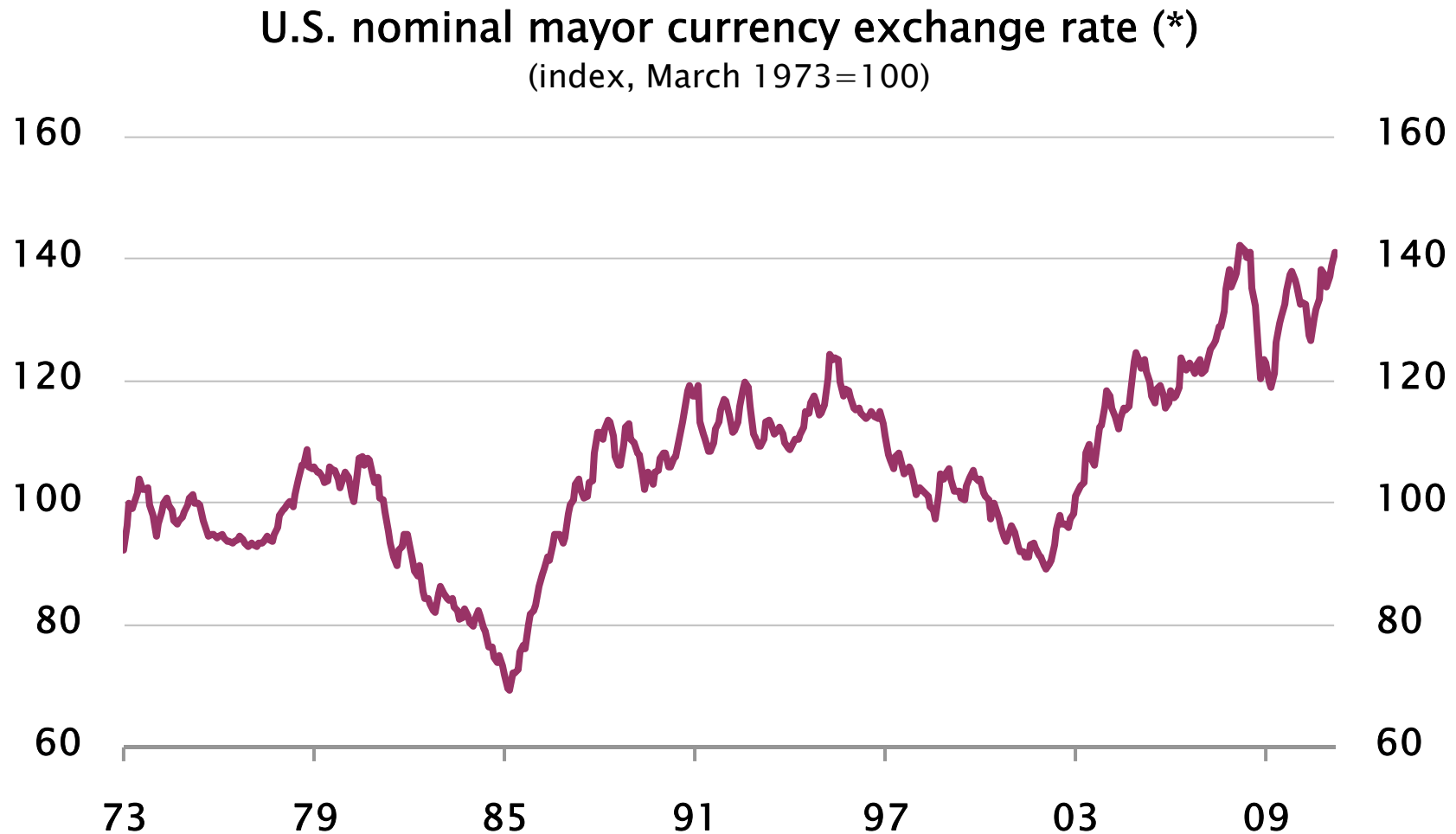
Also, the differences in growth rates, growth prospects and interest rates induce capital inflows to these countries.



(*) Corresponds to investment funds that invest in emerging economies.
Source: Emerging Portfolio Fund Research.



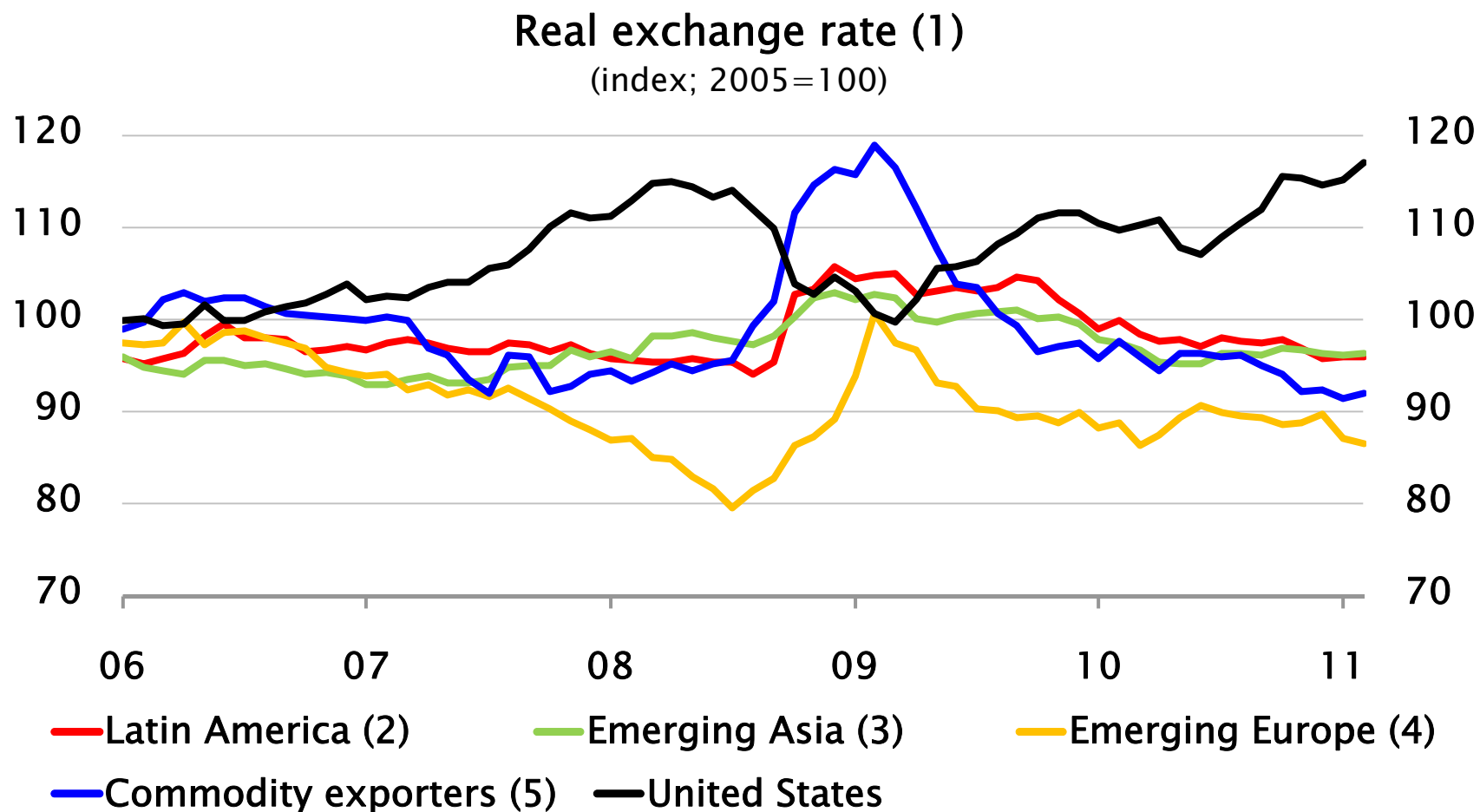
The US dollar has reached its lowest level in several decades due to its extraordinary monetary expansion in place, the shortage of domestic demand and the external imbalances.



(*) An increase indicates a depreciation of the dollar against main trading partners.
Sources: Bloomberg and U.S. Federal Reserve.



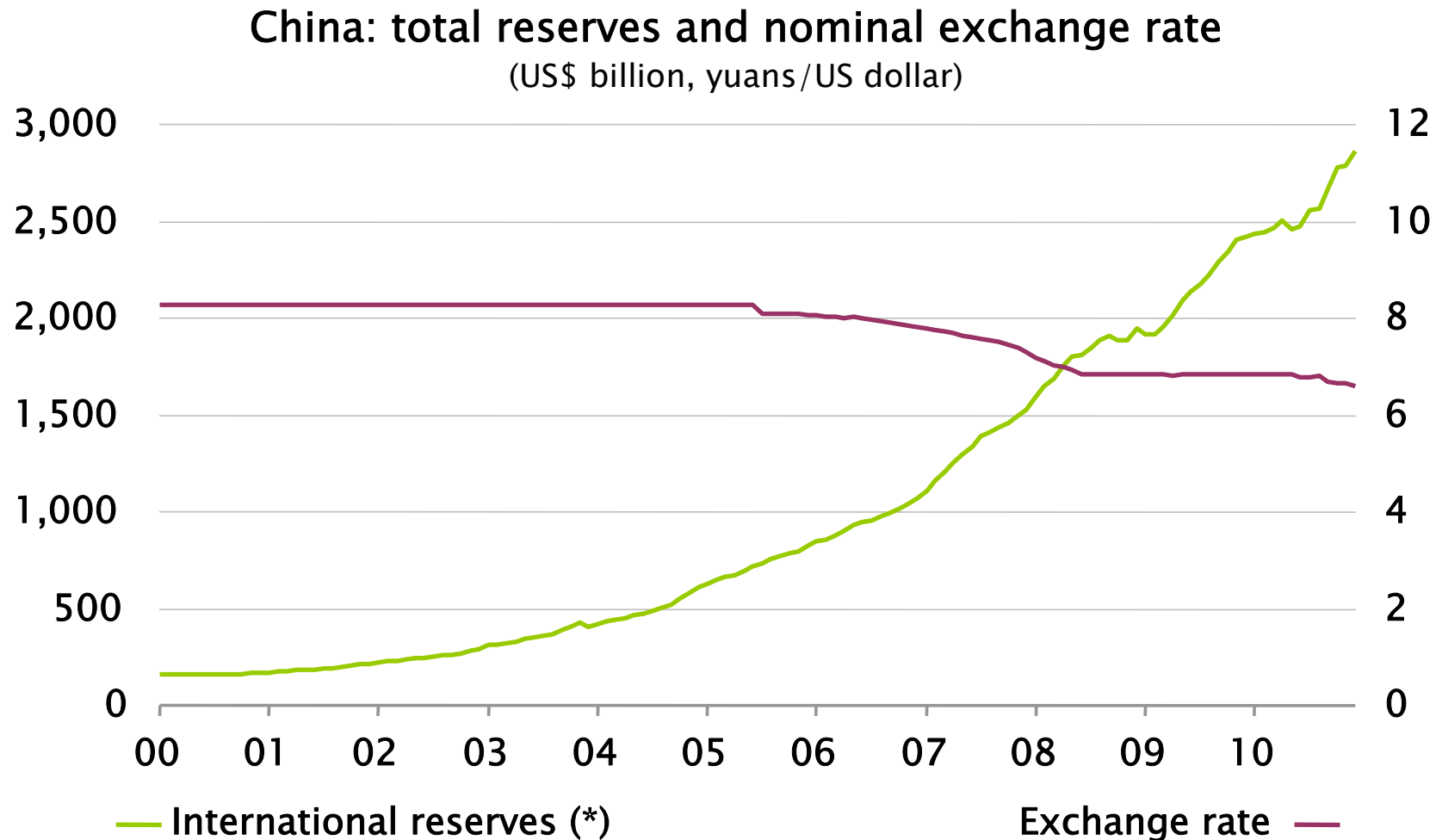
In contrast, most EMEs and commodity exporting countries' currencies have been appreciating.



(1) Simple average of the real exchange rate for each group of countries. An increase indicates depreciation.
(2) Includes Argentina, Brazil, Chile and Mexico. (3) Includes China, Hong Kong, Indonesia, Malaysia, South Korea, and Thailand. (4) Includes Hungary, Poland, Czech Republic, and Russia. (5) Includes Australia, Canada and New Zealand. Source: BIS.



China has decided to revalue its currencies gradually, something that has been achieved through massive reserve accumulation and limited financial integration, but also a large savings rate.

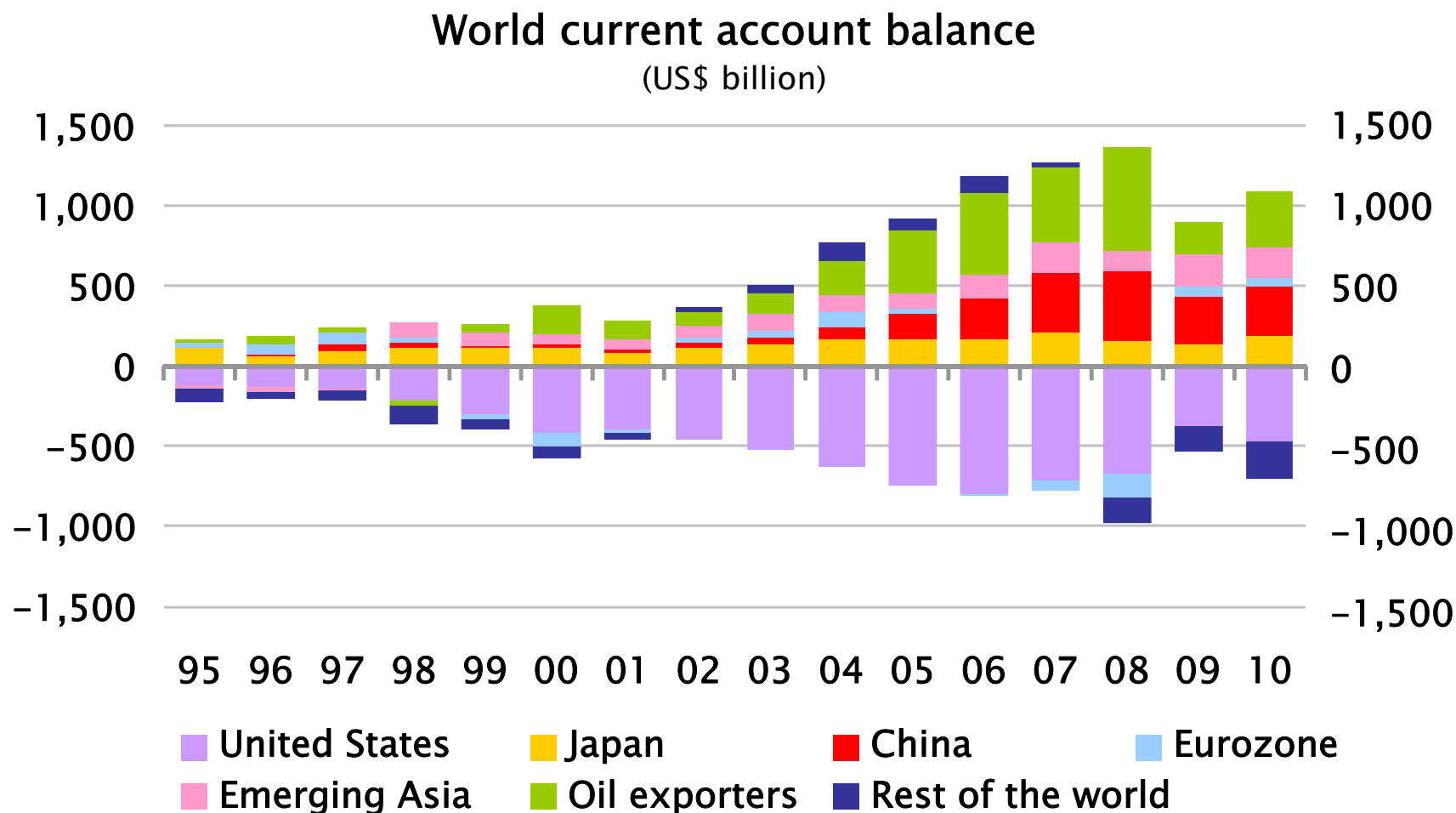


(*) Minus gold.

Sources: Bloomberg and International Monetary Fund.



Global rebalancing of the world economy needs countries in a strong cyclical position to direct domestic demand to imports, while countries with insufficient domestic demand have to increase exports.





In Chile, the CBC announced a foreign currency purchase program in early January.

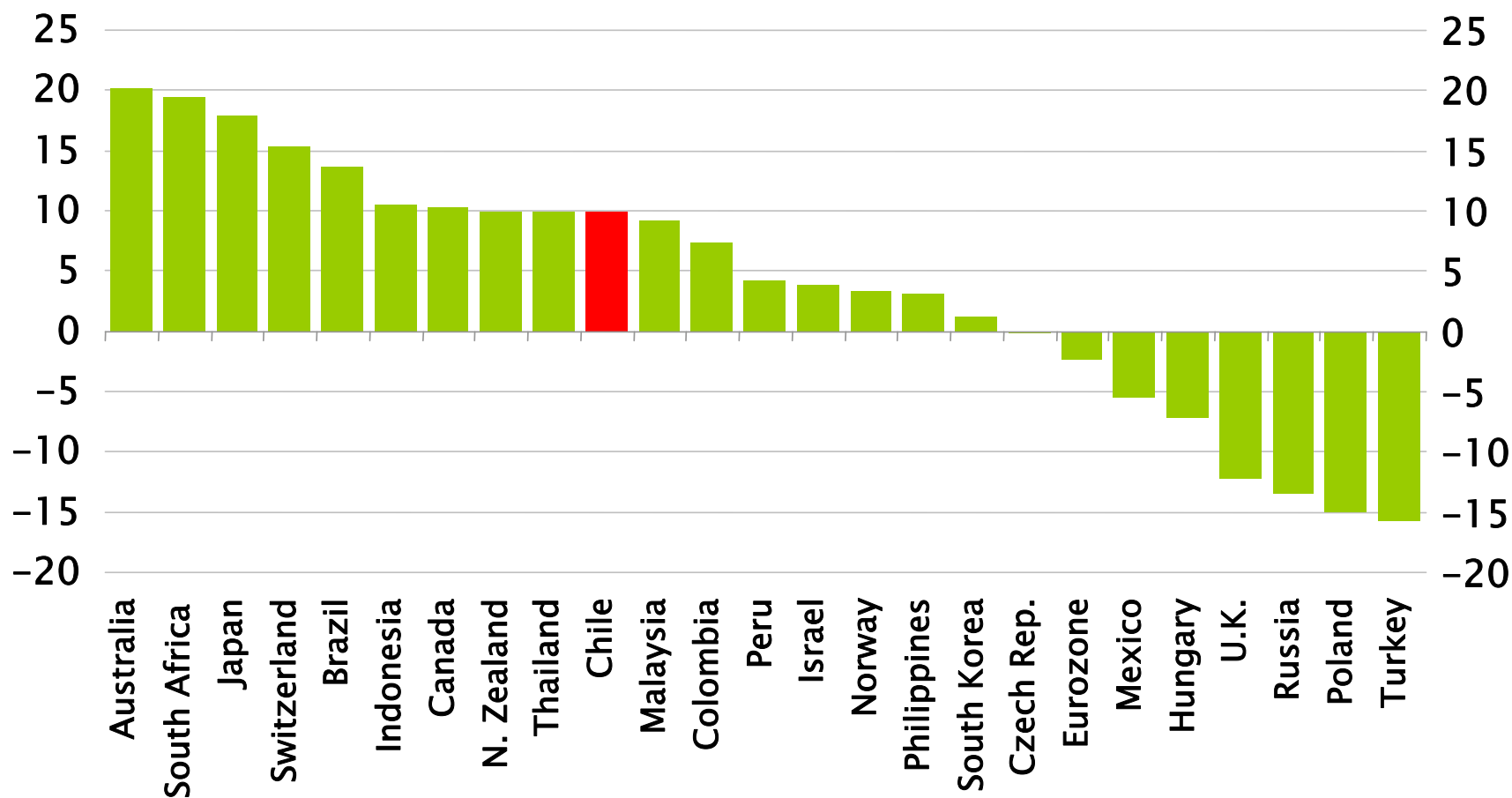
- Its purpose is to alleviate foreign exchange tensions and increase Chile's international reserves to match the level of other emerging economies. The program considers the purchase of US\$12 billion until December of this year.
- Three months into the program, the Bank has bought a little over 3 billion U.S. dollars.
- The major trends that have determined the appreciation of the currencies of most emerging economies are still present.
- A more debated tool is the use of capital controls, particularly in countries that are going through a period of important net capital inflows. This is not the case of Chile.



The peso appreciation against the U.S. dollar has not been very different from that of other commodity exporters or other economies having intervened or applied administrative measures in their forex markets.

Change in nominal exchange rate with respect to 2008 average (*)

(percent)



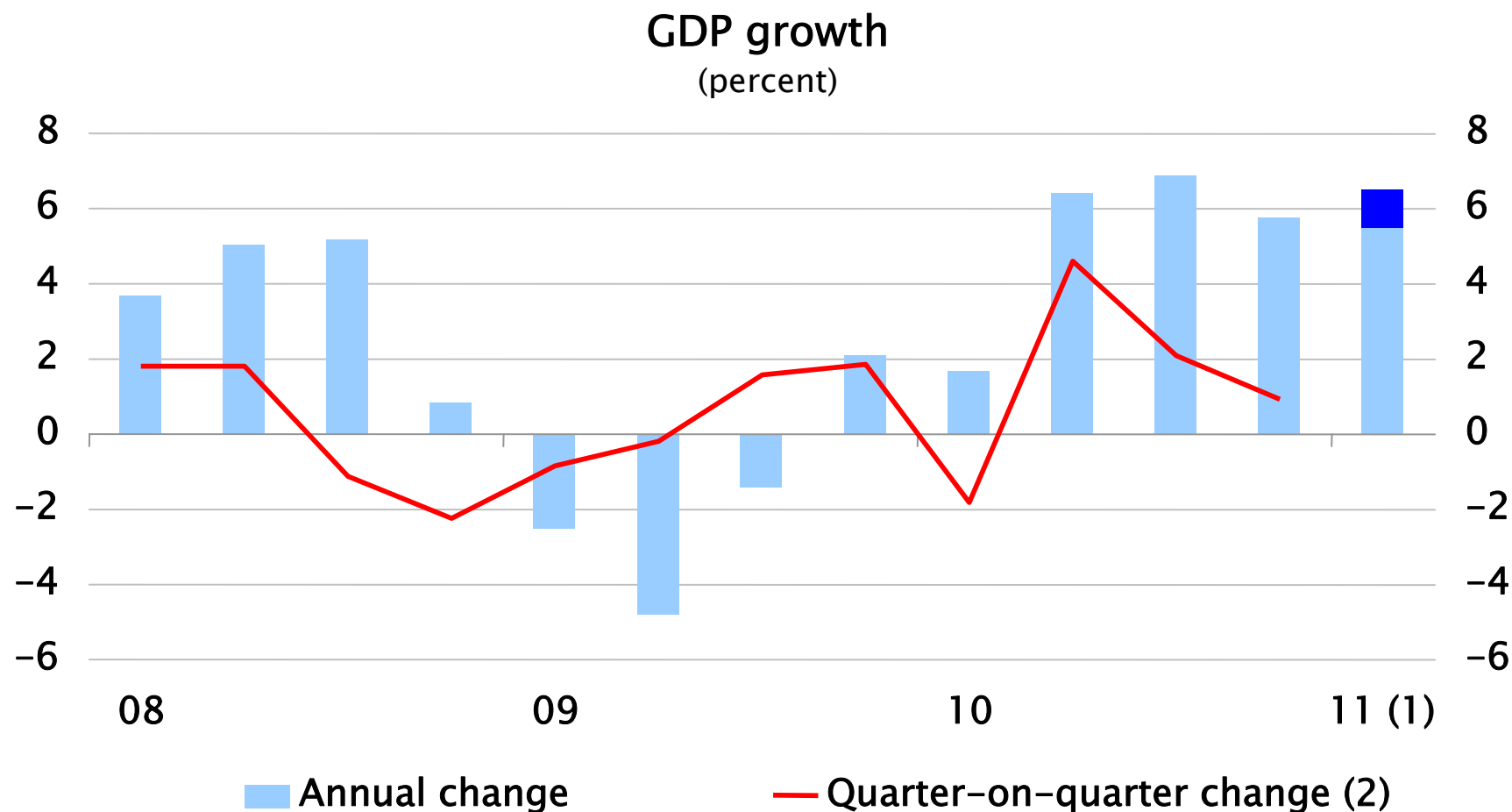


Despite all current tensions, the global economy is adjusting.

- Policy decisions in large countries have repercussions on the rest of the world. However, the main role for policymakers is to secure recovery and create the basis for sustainable growth.
- In EMEs containing in current inflationary pressures is essential to allow for sustainable growth. Delaying monetary policy adjustment may result in more severe adjustments in the future.
- Dealing appropriately with these challenges in order to build more resilient economies and reap the benefits of the great progress achieved during recent years in terms of macroeconomic and financial stability.



In Chile, GDP grew 5.2% annually in 2010, so output gaps are estimated to be closed.



(1) Dark blue shows growth range for GDP forecast for 2011 in Monetary Policy Report of March 2011.

(2) Seasonally-adjusted series.

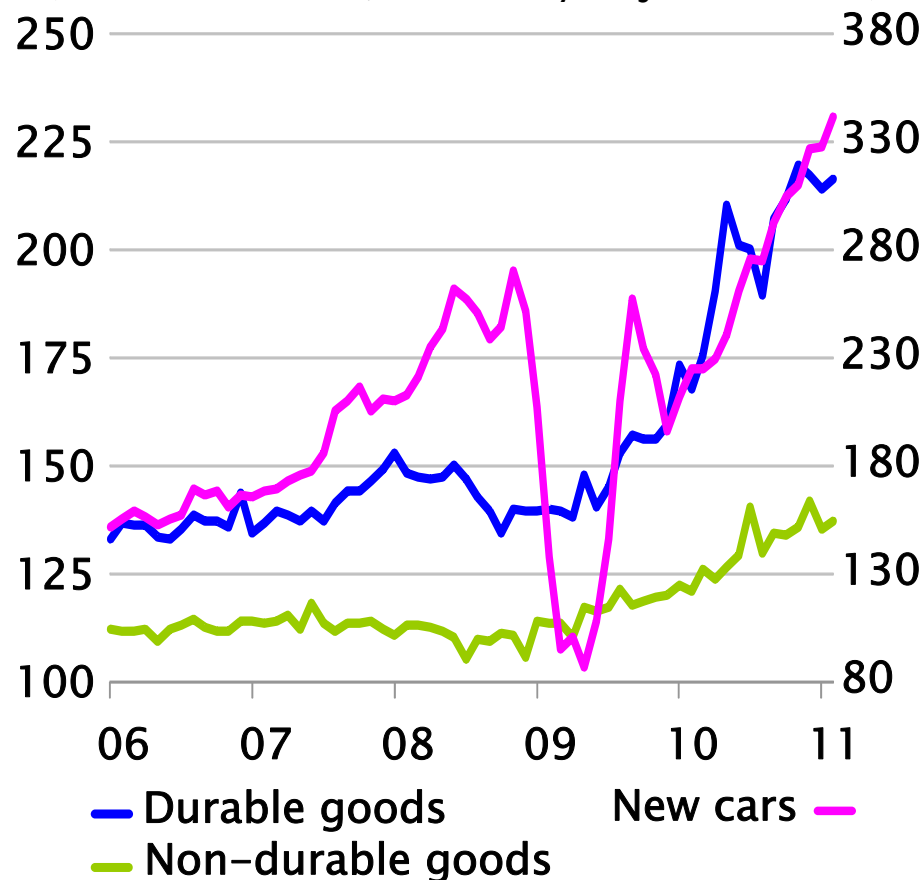
Source: Central Bank of Chile.



Domestic demand grew 14.6% in the fourth quarter of 2010, accumulating an increase of 16.4% in the year. Figures for the first months of 2011 show retail sales and imports of goods and services still in high levels.

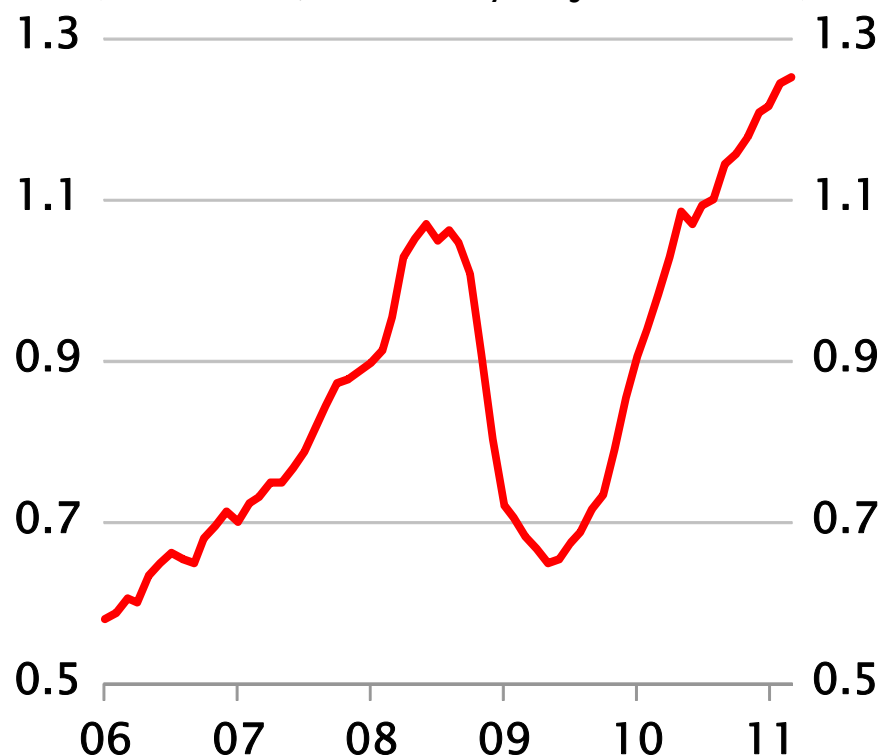
Retail sales and new car sales (1)

(index 2003=100, seasonally-adjusted series)



Consumer goods imports (2)

(US\$ billion, seasonally-adjusted series)



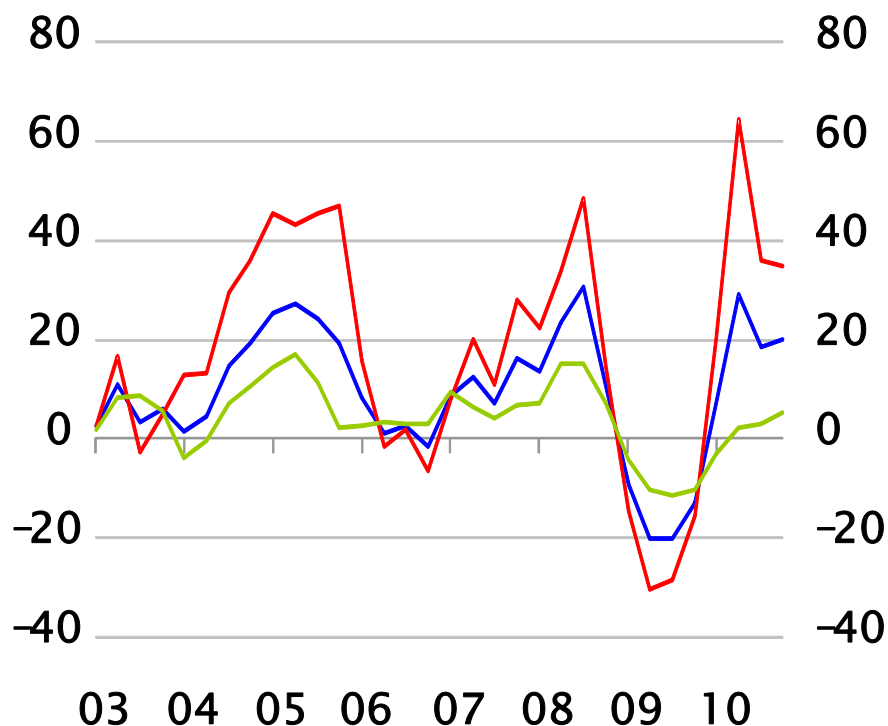
(1) Sold during moving quarter. (2) Moving quarterly average.

Sources: National Automobile Association of Chile, Central Bank of Chile and National Chamber of Commerce.



Investment grew strongly during the last quarter, led mainly by the machinery & equipment component.

Gross fixed capital formation
(real annual change, percent)



Capital goods imports (*)

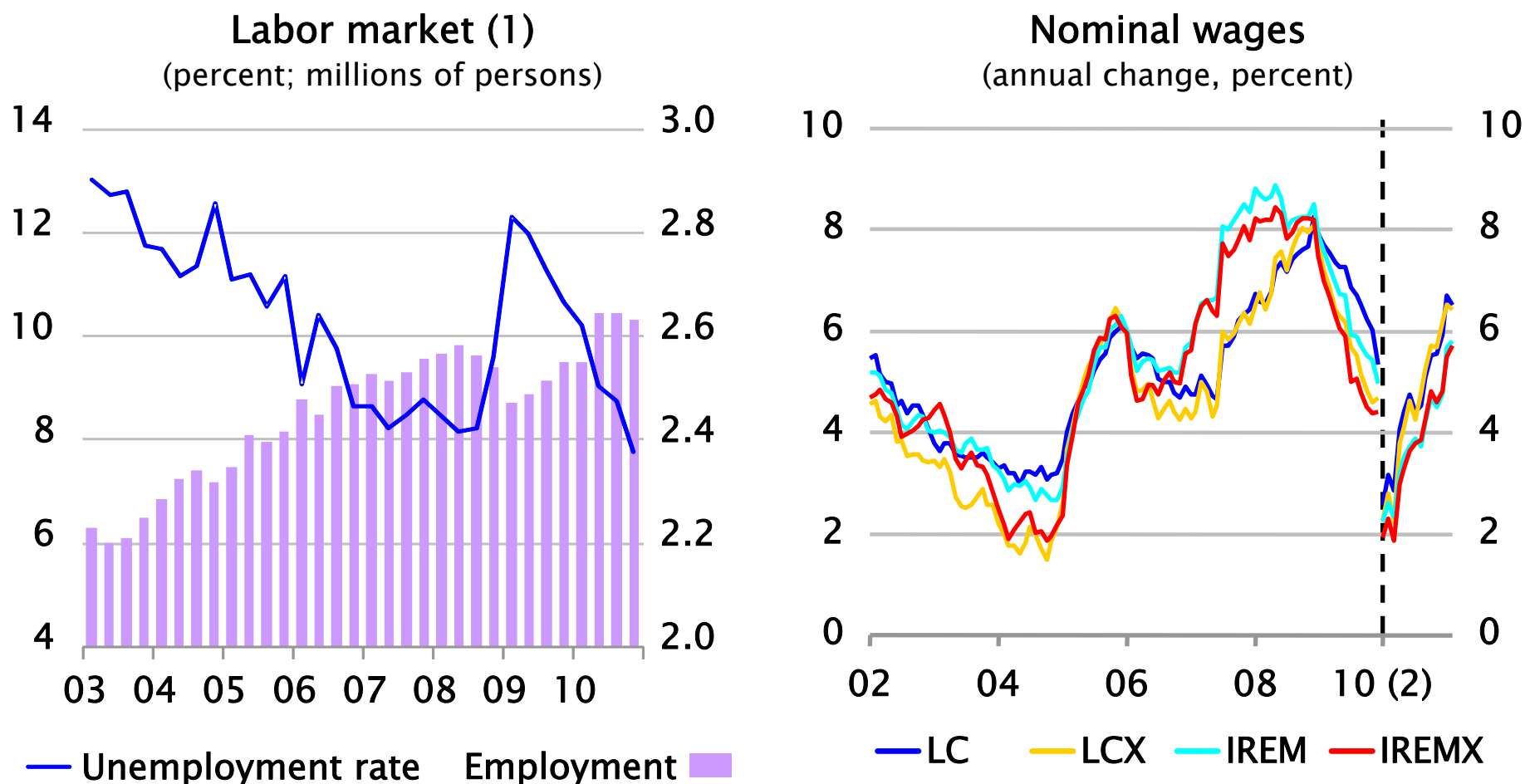
(US\$ millions, seasonally-adjusted series)



— Machinery & equipment — GFCF
— Construction and other works



Labor market gaps have narrowed, with a rapid increase in employment and higher wages.

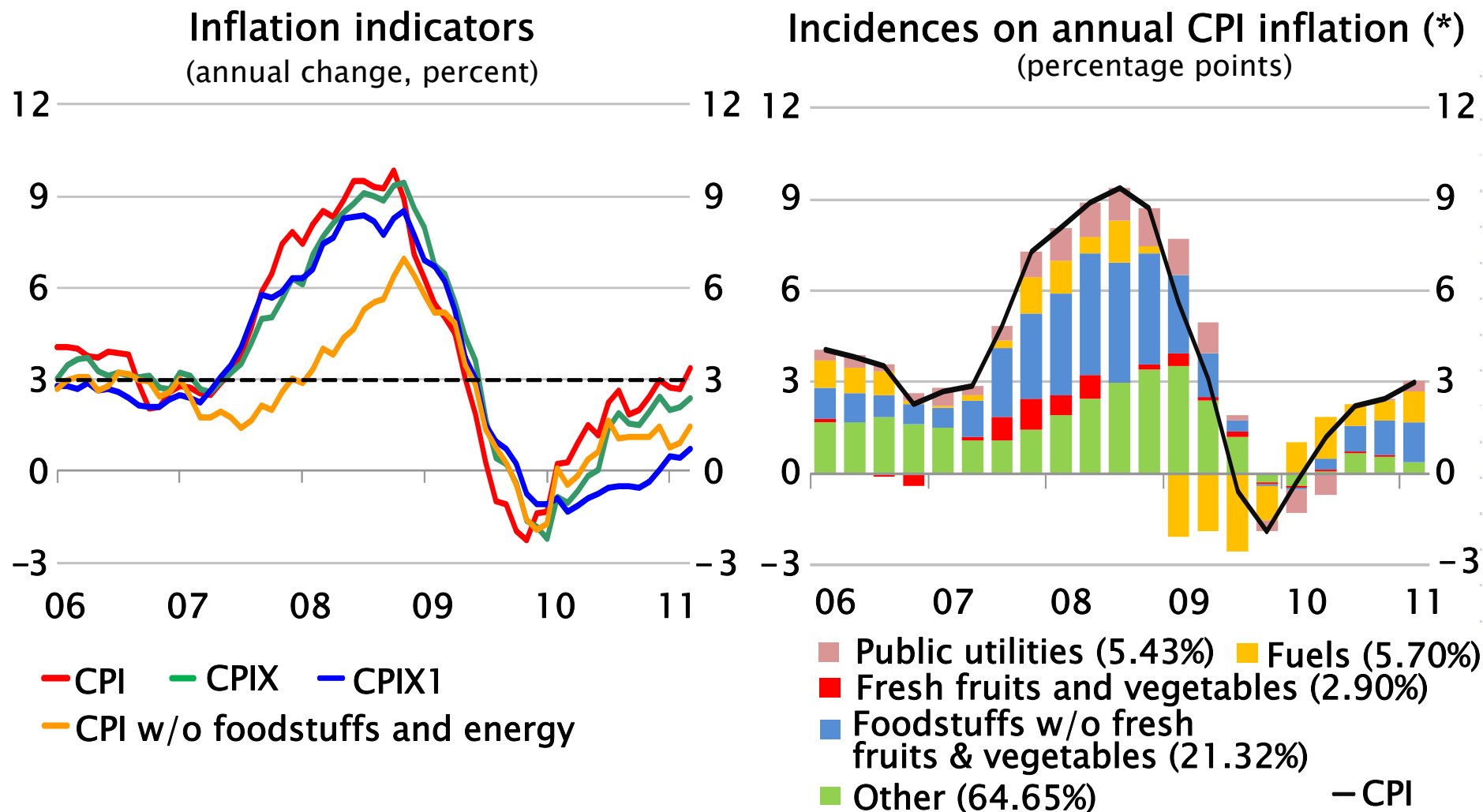


(1) Considers the Survey on Employment and Unemployment for Greater Santiago of Universidad de Chile. Seasonally-adjusted series. (2) As from last January 2010, new indexes with annual base 2009=100 are used, so they are not strictly comparable with previous figures.

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



In Chile, inflation has behaved as expected. Foodstuffs and fuels have been the largest contributors to inflation in the past few months.



(*) In parentheses, shares in CPI basket.

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



For 2011, the Board of the CBC foresees that the economy will grow in the range of 5.5% to 6.5%. This scenario is consistent with output gaps remaining closed over the projection horizon.

Economic growth
(annual change, percent)

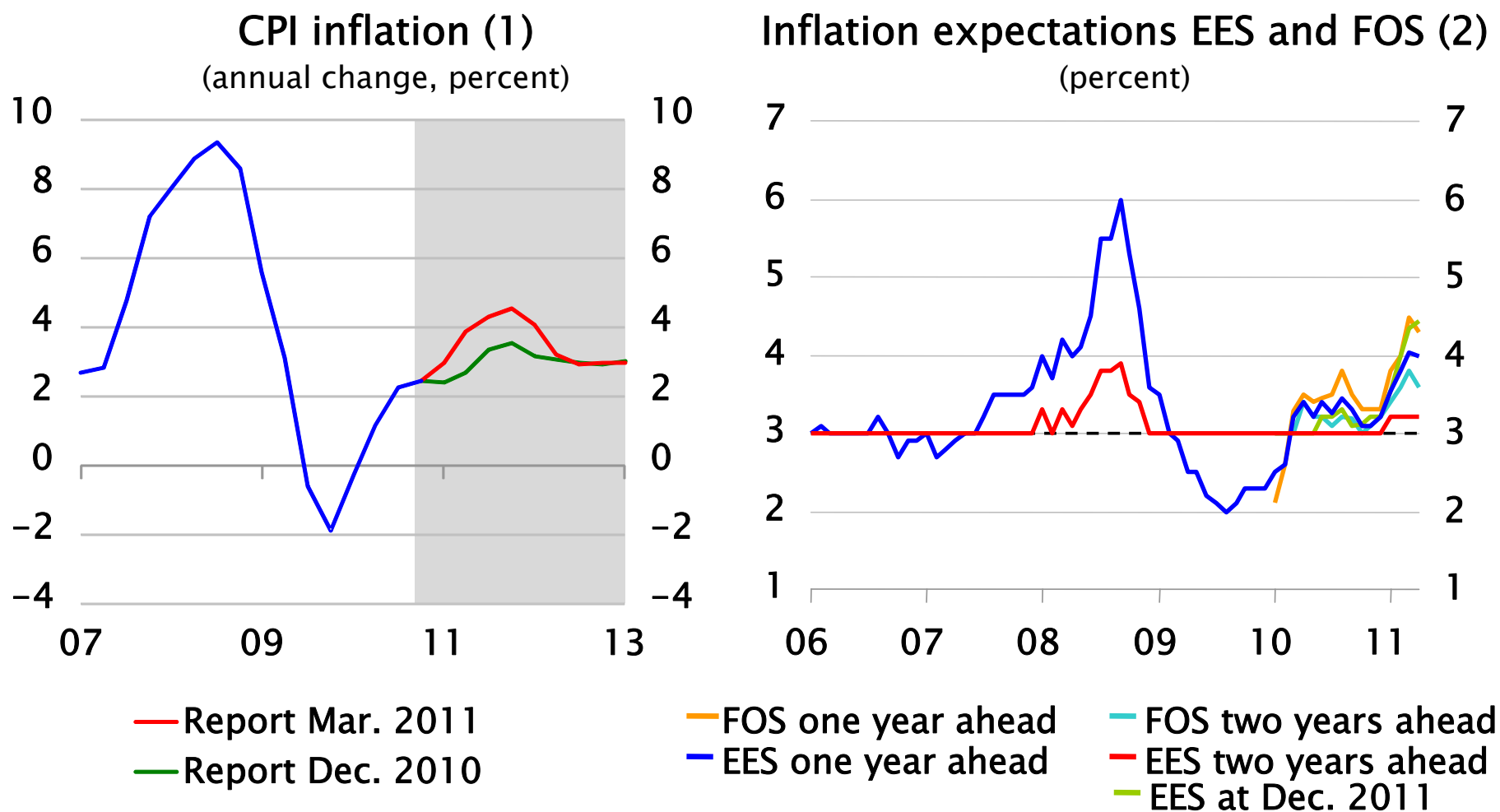
	2009	2010	2011 (f)
GDP	-1.7	5.2	5.5-6.5
Domestic demand	-5.9	16.4	7.6
Domestic demand (w/o inventory change)	-2.9	11.5	8.7
Gross fixed capital formation	-15.9	18.8	13.9
Total consumption	1.9	9.3	7.0
Goods and services exports	-6.4	1.9	6.8
Goods and services imports	-14.6	29.5	9.6
Current account (% GDP)	1.6	1.9	1.2

(f) Forecast.

Source: Central Bank of Chile.



It is foreseen that CPI inflation will go over the upper limit of the target range, largely due to the effects of the increased oil prices. Private inflation expectations are similar to those in the baseline scenario.



(1) Gray area, as from first quarter of 2011, shows forecast. (2) The FOS considers the survey of the first half of the month. Sources: Central Bank of Chile and National Statistics Institute (INE).