



THE FUTURE OF CHILE IN A COMPLEX ENVIRONMENT

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Structure

- Transformation of the Chilean economy and long-term performance
- Outlook for 2012–2013
- Chile facing a possible deterioration of the global situation



Transformation of the Chilean economy and long-term performance



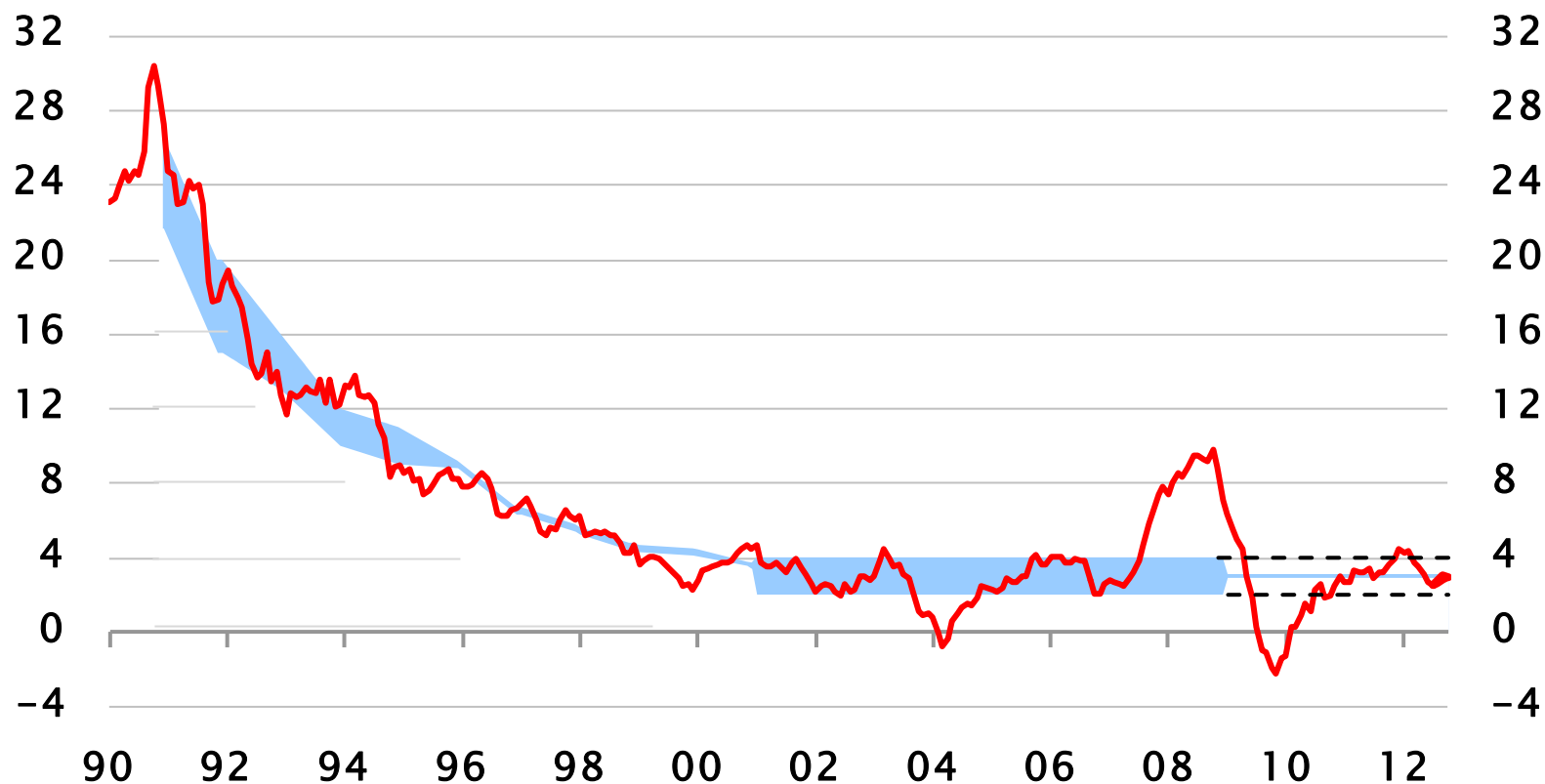
Introduction

- Two elements stand out in the evaluation of the Chilean economy from a medium to long-term perspective:
 - The long-standing effort to build economic institutions and create a good framework of economic policies.
 - Macroeconomic performance characterized by growth and stability over the past few decades, in clear contrast with its earlier history.
- The present-day framework of institutions and policies leans on mutually-reinforcing pillars.



An autonomous Central Bank, with an inflation–targeting regime with exchange rate flexibility has laid the foundations for low, stable inflation.

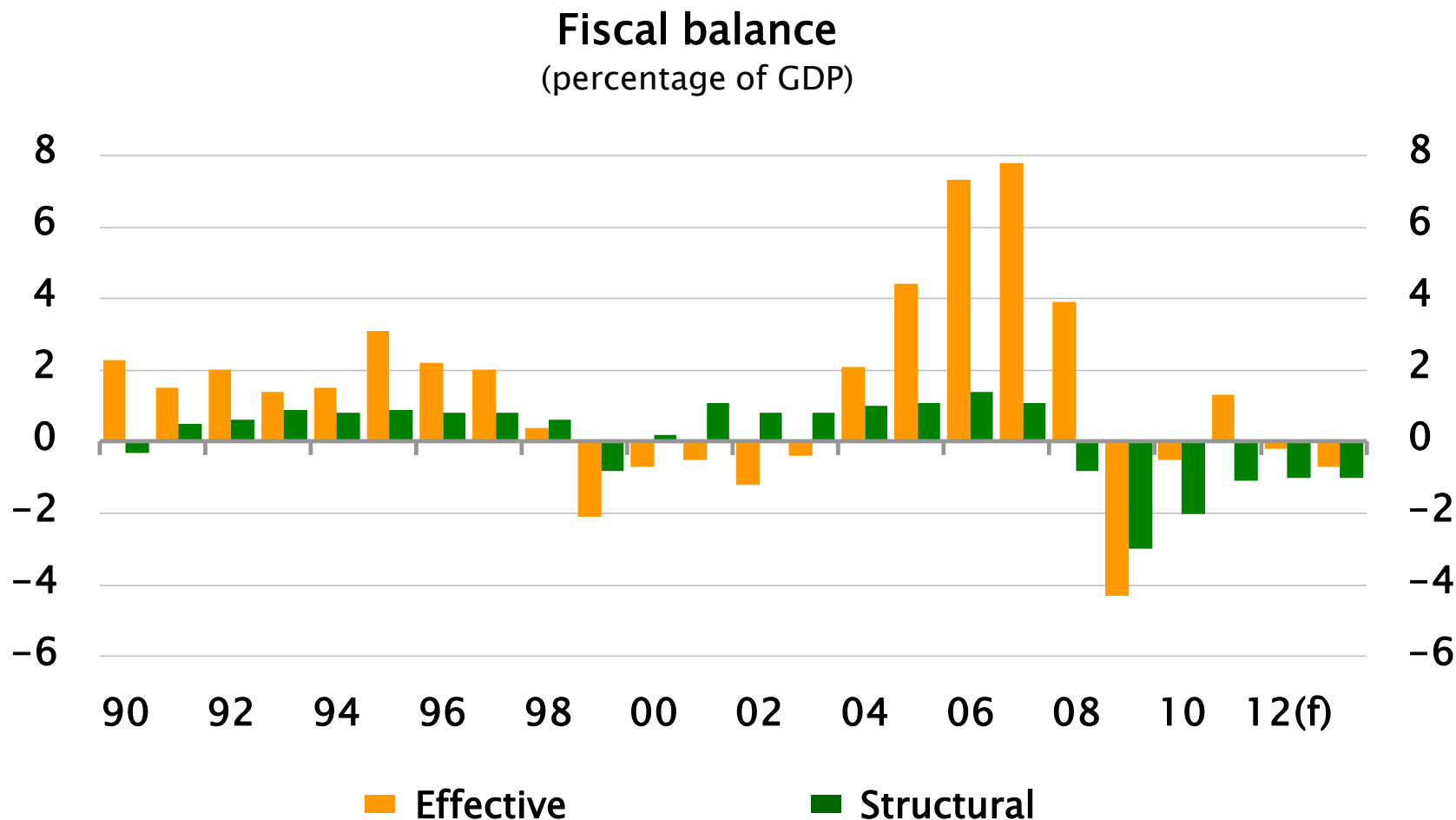
CPI inflation: target and actual figures
(annual change, percentage)



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



Serious, predictable fiscal policy has allowed accumulation of resources during good times, and the implementation of expansionary fiscal policies in bad ones.

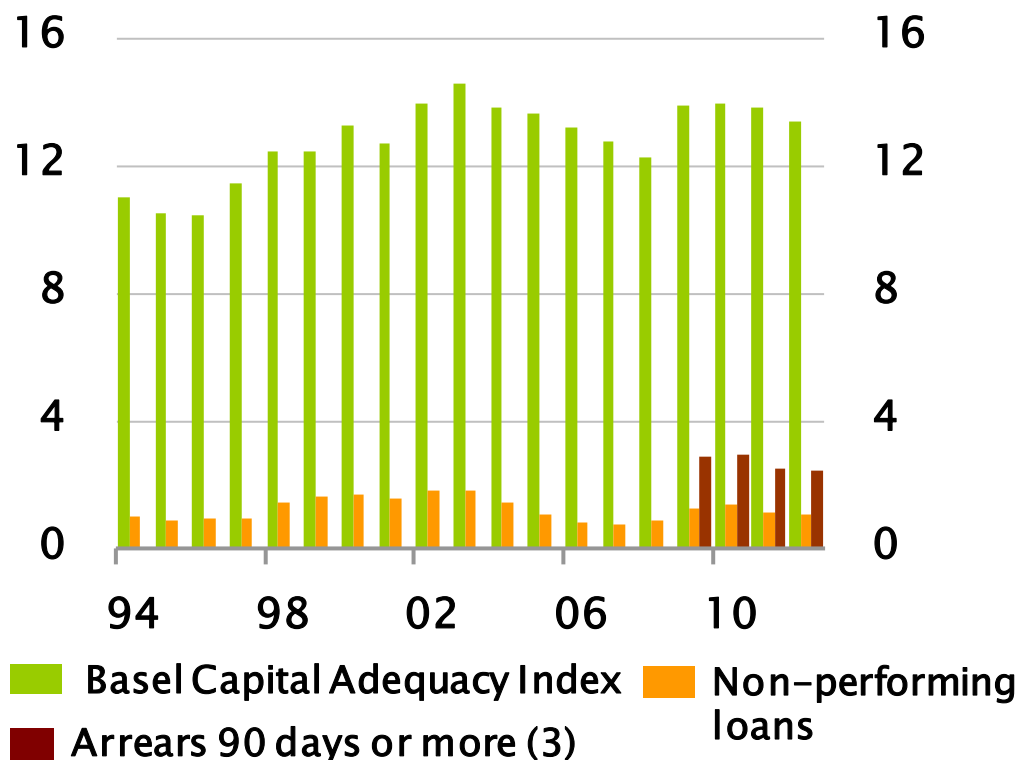


(f) Forecast. Report published by the Finance Ministry in October 2012.
Source: Finance Ministry of Chile.

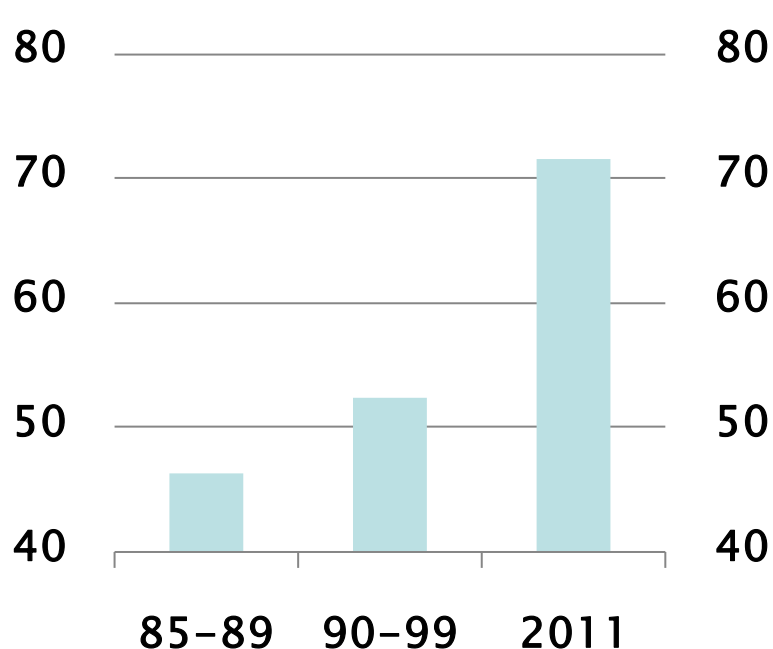


A sound financial system, well regulated and capitalized, subject to modern, prudential supervision, has translated into increased solvency and deepening of the banking industry.

Banking solvency (1) (2)
(yearly average, percentage)



Private lending
(percentage of GDP)



(1) As from January 2008, non-performing-loan figures are not strictly comparable with previous data, because under the plan to converge to International Financial Reporting Standards (IFRS), the banks modified the format of their financial statements. (2) Figures up to July 2012 for the Basel index, and up to September 2012 for the rest. (3) Since 2009, the Superintendence of Banks and Financial Institutions (SBIF) publishes a new credit risk indicator and considers total credit and not only delayed payments.

Sources: Central Bank of Chile and Superintendence of Banks and Financial Institutions (SBIF).



Increasing global commercial and financial integration has helped diversify exports basket and markets of destination.

Chilean exports by sector (percentage of total exports)

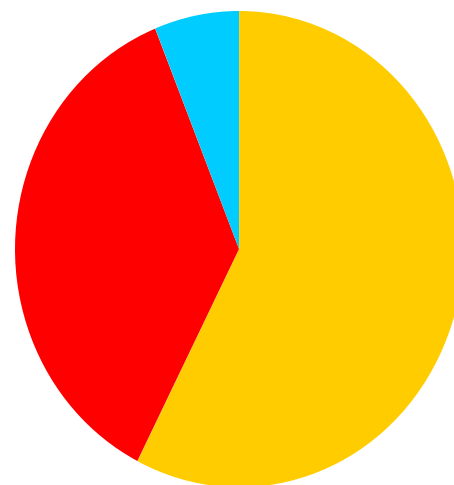
1960
(X/GDP=12.2%)



1980
(X/GDP=23.6%)



2003-11
(X/GDP=41.2%)



■ Mining

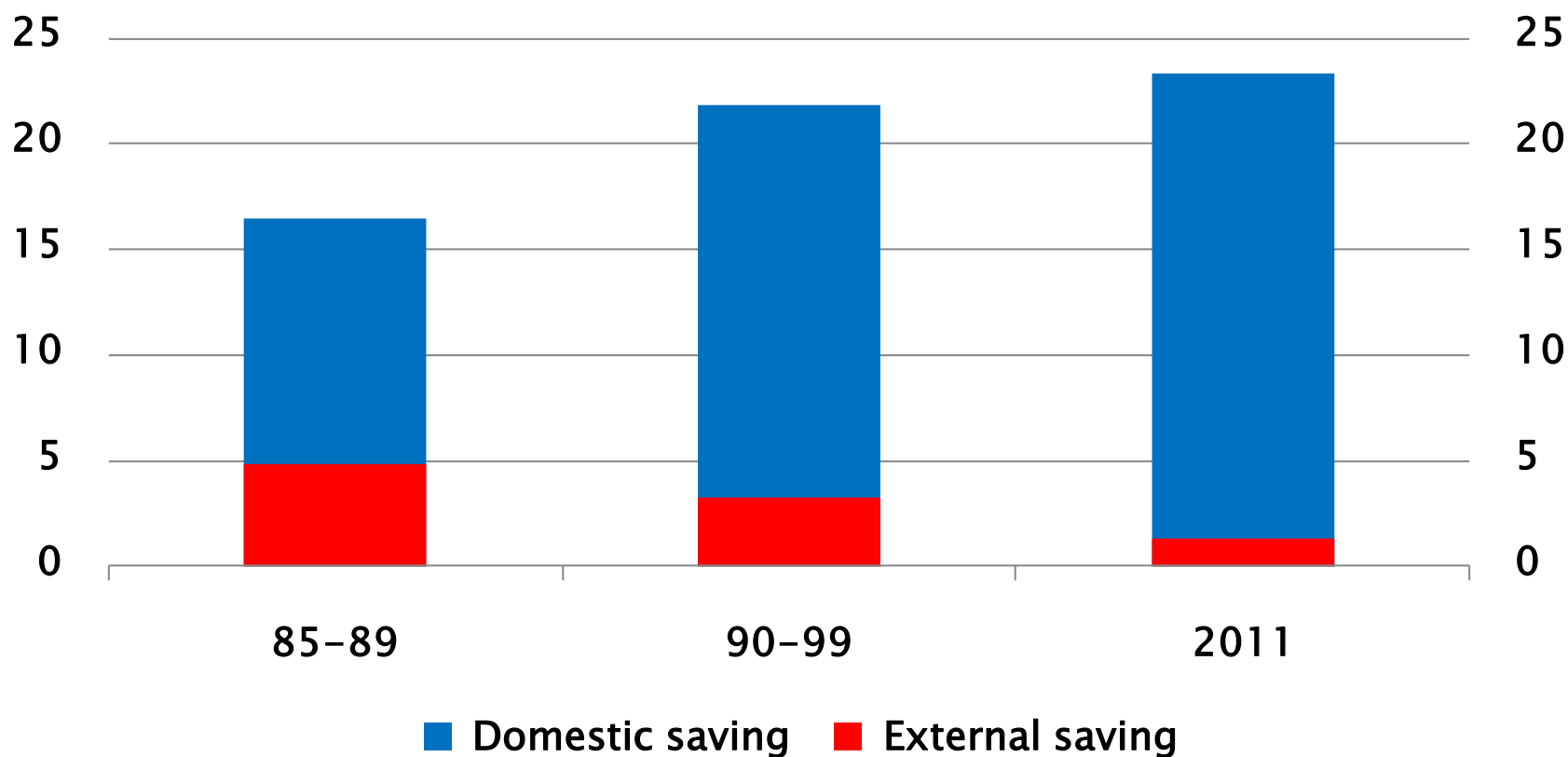
■ Manufacturing

■ Agricultural



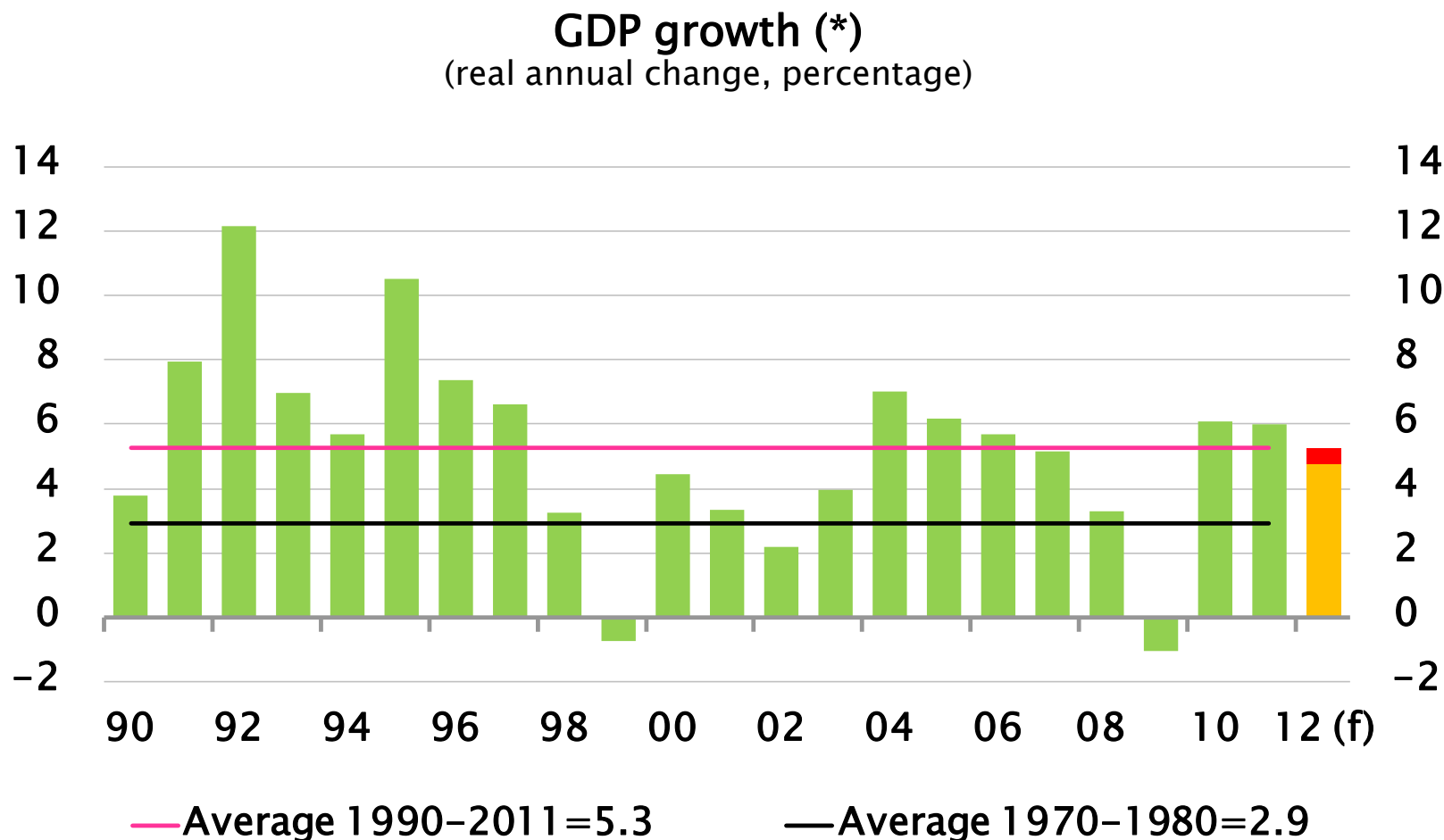
These policies have boosted investment, which today relies on external savings to a lesser extent than it did in the past.

Investment funding (percentage of GDP)





Thus, the economic policy framework adopted helped to increase and stabilize growth in the last decades.



(*) Data between 1970 and 2002 are estimated using former GDP calculation methodology, so they are not strictly comparable with the rest. (f) Forecast range between 4.75% and 5.25% included in *Monetary Policy Report* of September 2012. Source: Central Bank of Chile.



Outlook for 2012–2013



Summary

	2008	2009	2010	2011	2012 (f)	2013 (f)
Gross Domestic Product (billions of USD)	179.9	173.0	216.3	248.7	--	--
Real GDP growth (%)	3.3	-1.0	6.1	6.0	4.75-5.25	4.0-5.0
Consumer prices (annual % change Dec/Dec)	7.1	-1.4	3.0	4.4	2.5	3.0
Population (millions of inhabitants)	16.8	16.9	17.1	17.3	--	--
Exports of goods (millions of USD)	64,510	55,463	70,897	81,411	77,800	78,800
Imports of goods FOB (millions of USD)	58,436	40,103	55,572	70,619	73,600	78,700
Current account balance (% of GDP)	-3.2	2.0	1.5	-1.3	-3.2	-4.4
Effective Fiscal Balance (% of GDP)	3.9	-4.3	-0.5	1.3	-0.2	-0.7
Gross Central Government Debt (% GDP)	4.9	5.8	8.6	11.2	--	--
Foreign exchange reserves excl. gold (millions of USD, as of 31 Dec. of each year)	23,162	25,373	27,864	38,779	--	--
Foreign debt (% of GDP)	35.4	41.6	38.9	39.6	--	--
Average exchange rate (CLP per USD)	521.8	559.7	510.4	483.4	--	--

(f) Forecast. Growth, inflation, exports and imports y current account taken from September 2012's *Monetary Policy Report*. Actual fiscal balance corresponds to forecast published in *Public Finances Report* of October 2012. Sources: Central Bank of Chile, National Statistics Institute (INE) and Finance Ministry.



The world economic scenario depicted in our September *Monetary Policy Report* considered a weak global economy, with slow growth in developed countries and more dynamic emerging economies. This was behind persistently high commodity prices.

International baseline scenario assumptions

	2011 (e)	2012 (f)			2013 (f)			2014 (f)
		Report Mar. 12	Report Jun. 12	Report Sep. 12	Report Mar. 12	Report Jun. 12	Report Sep. 12	Report Sep. 12
Growth		(annual change, percent)						
Trading partners	4.1	3.8	3.6	3.5	4.2	3.9	3.8	4.3
World at PPP	3.8	3.3	3.2	3.1	3.9	3.6	3.6	4.1
United States	1.8	2.1	2.0	2.2	2.3	2.0	2.0	2.4
Eurozone	1.5	-0.3	-0.6	-0.4	1.0	0.3	0.3	1.7
Japan	-0.8	2.0	2.7	2.7	1.6	1.3	1.3	1.4
China	9.2	8.1	7.9	7.8	8.5	8.2	8.1	8.3
India	6.5	7.3	6.5	5.8	7.9	7.2	7.1	7.3
Rest of Asia (excl. Japan, China and India)	4.2	4.3	3.9	3.5	4.8	4.6	4.5	4.8
Latin America (excl. Chile)	4.4	3.6	3.3	3.0	4.0	3.7	3.4	3.9
		(levels)						
LME copper price (US\$cent/pound)	400	370	355	355	360	340	340	350
Brent oil price (US\$/barrel)	111	121	107	113	115	97	109	103
		(annual change, percent)						
Terms of trade	0.5	-5.3	-6.9	-7.4	-0.1	-1.5	-2.6	1.3

(e) Estimate. (f) Forecast.

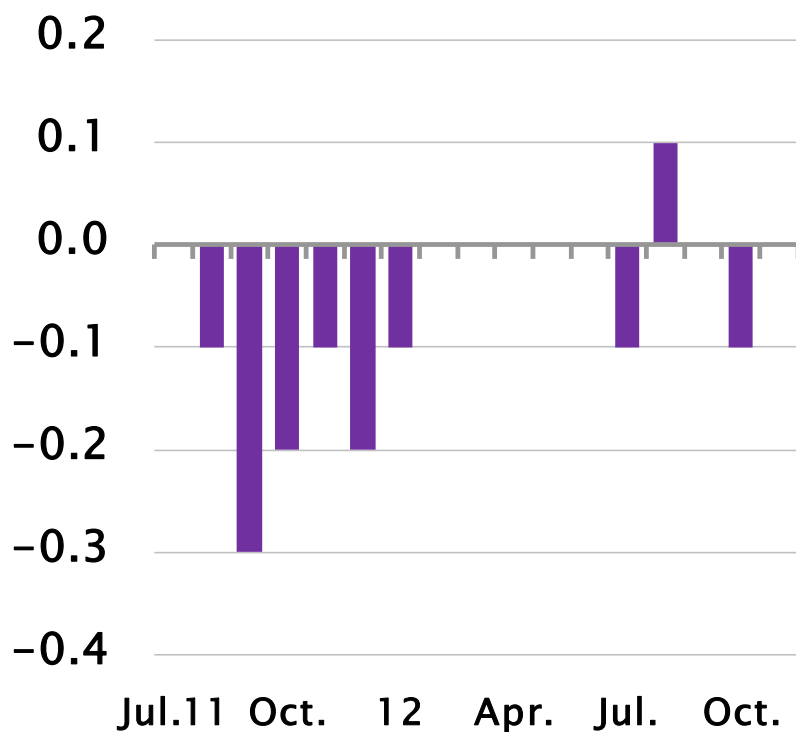
Source: Central Bank of Chile.



Since then, the market consensus has not changed its forecasts for world growth very much, and commodity prices have fallen somewhat.

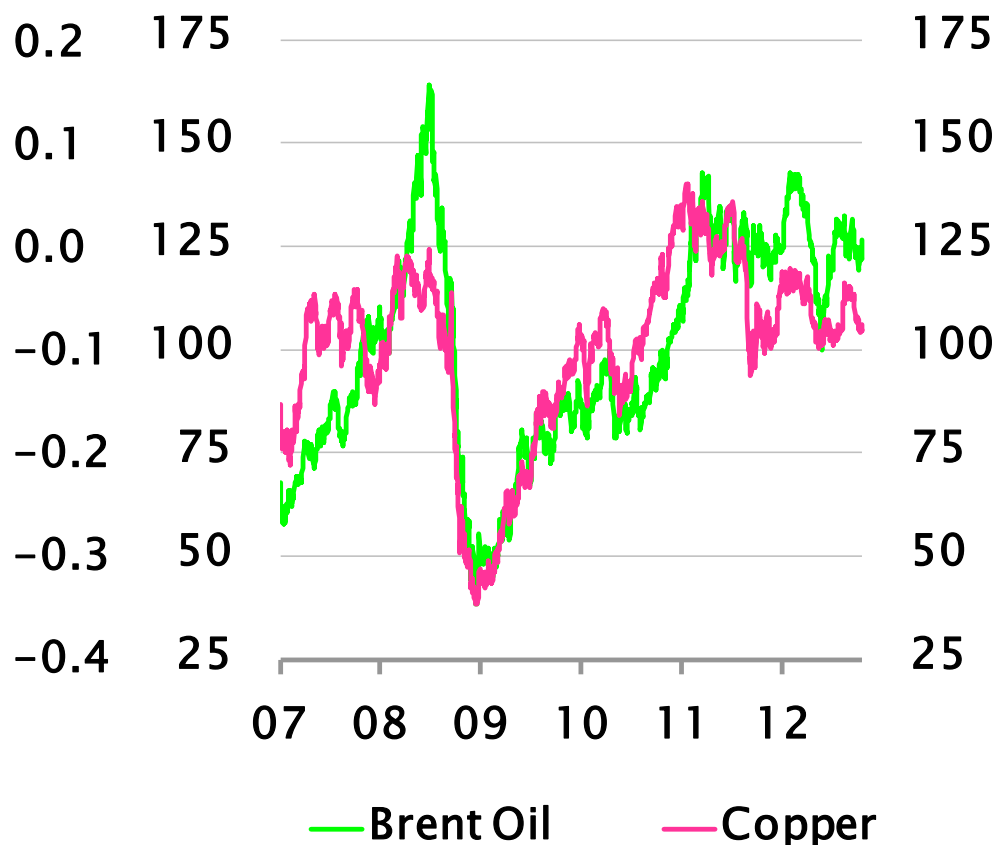
Change in world growth forecast for 2012

(percentage points)



Commodity prices

(index, 01.01.2007-19.11.2012=100)





The present macroeconomic scenario is very complex. Recent indicators confirm that there is a marked difference between domestic and foreign economic performance.

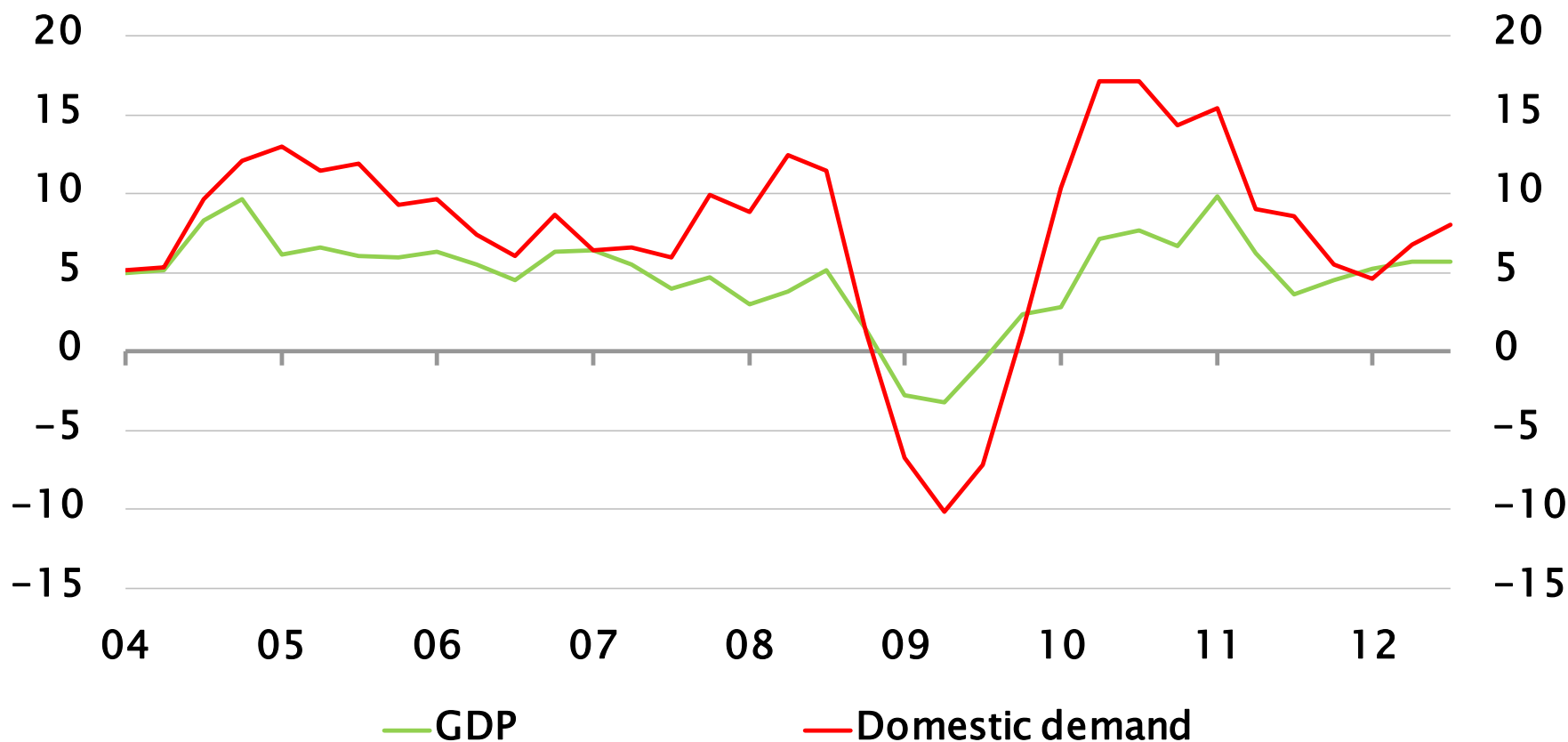
- In terms of economic growth, the world is still running at two speeds:
 - Emerging economies are stronger than developed ones. After having slowed down somewhat in the last few quarters, China, Brazil and others are now showing a return to faster growth.
 - The Eurozone and Japan are re-entering into recession, while the U.S. will grow moderately. This couples with important tensions in financial markets.
- In Chile, there are medium-term inflationary risks, due to exhaustion of output gaps and a persistently dynamic domestic demand.
- Chilean activity has outperformed that of other countries, particularly developed economies. But, given existing financial and commercial links, it is unreasonable to think that our country will be spared the effects of events abroad.
- The external scenario poses significant risks to the Chilean economy, as does the domestic situation.



The behavior of domestic output and demand in the last several months has exceeded previous forecasts. In the third quarter, demand continued to expand at a faster pace than activity.

GDP and domestic demand

(annual change, percentage)



Source: Central Bank of Chile.



On the demand side, it is worth noting the renewed strength of private consumption and gross fixed capital formation since the second quarter.

GDP and domestic demand

(annual change, percentage)

	2011.I	2011.II	2011.III	2011.IV	2012.I	2012.II	2012.III
GDP	9.9	6.3	3.7	4.5	5.2	5.7	5.7
Domestic demand	15.4	9.0	8.6	5.5	4.6	6.8	8.0
Total Consumption	11.8	8.9	6.2	5.6	4.4	5.1	5.9
Private consumption	12.9	9.6	7.2	6.0	4.9	5.4	6.4
Durable goods	42.1	19.6	21.4	15.8	14.2	11.5	12.8
Non-durable goods	10.2	8.2	5.1	4.5	3.9	4.8	5.8
Gross fixed capital formation	22.9	14.7	17.1	16.3	8.0	9.0	13.3
Construction and other works	13.4	11.7	11.0	14.6	10.9	10.0	8.8
Machinery & equipment	40.5	19.7	27.4	19.5	3.4	7.5	19.9
Goods and services exports	7.2	7.5	-0.7	4.9	5.7	0.9	-3.4
Goods and services imports	23.3	15.9	13.0	7.2	4.1	3.2	2.5

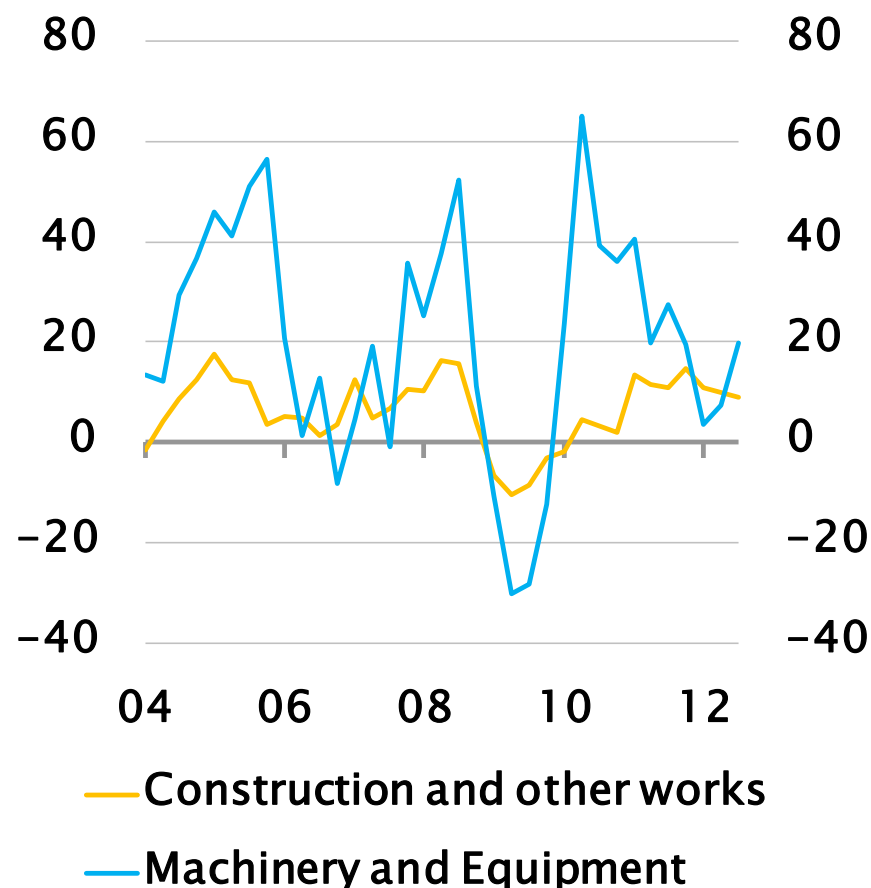


Private consumption has gained strength in all its components in the third quarter. In investment, machinery and equipment has been more dynamic.

Goods consumption
(annual change, percentage)



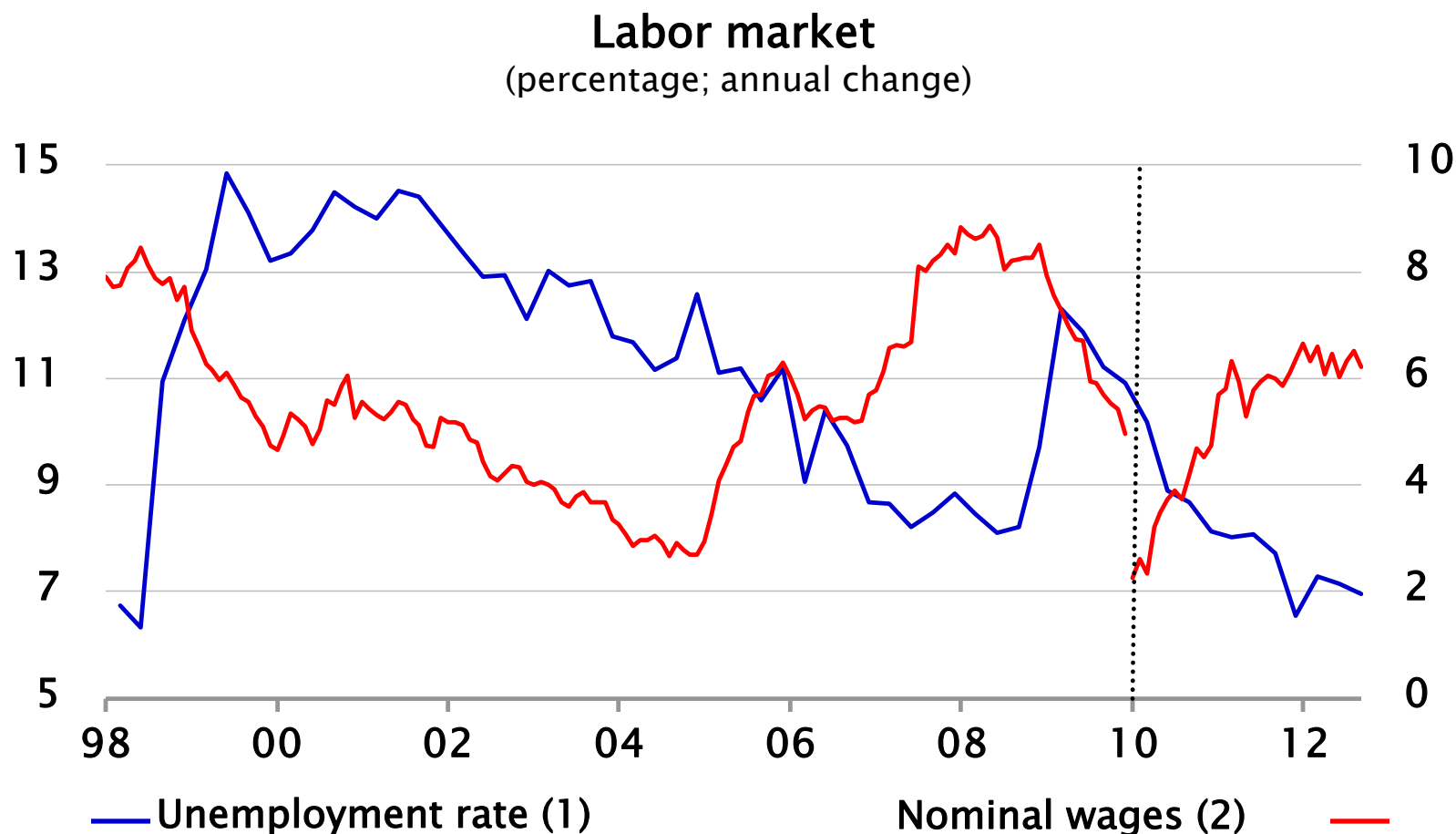
Gross fixed capital formation
(annual change, percentage)



(*) Includes Non-durables and Services.
Source: Central Bank of Chile.



The labor market has been tight for several months, as evidenced by the behavior of unemployment and wages.

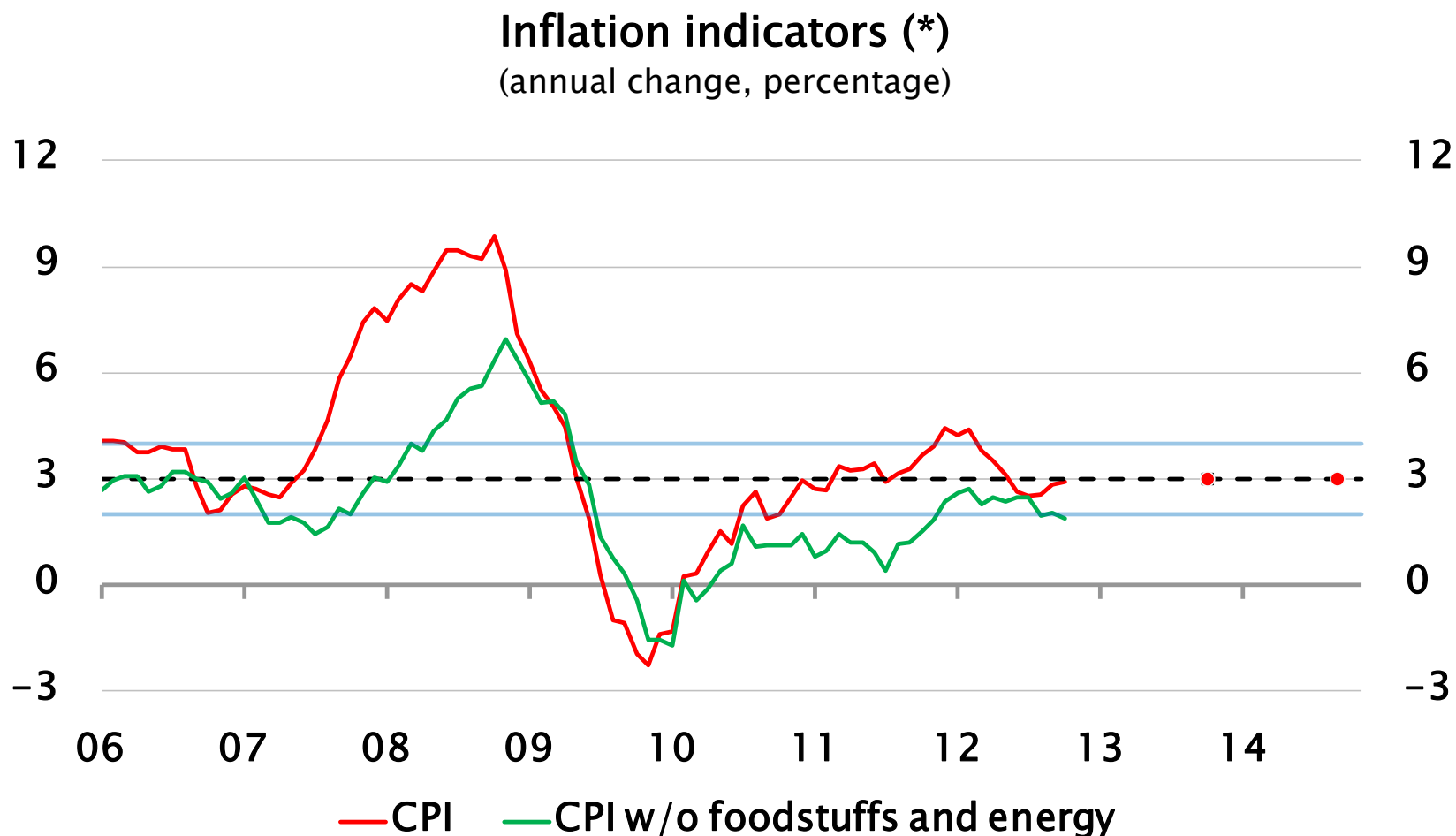


(1) Universidad de Chile Survey. Seasonally-adjusted series. (2) As from January 2010 (dotted vertical line) the new index with base year 2009=100 is used, so figures are not strictly comparable with earlier ones.

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



Inflation indicators are within the tolerance range, while market expectations remain at the target.



(*) Red dots show inflation expectations for October 2013 and 2014 in the Economic Expectations Survey.
Sources: Central Bank of Chile and National Statistics Institute (INE).

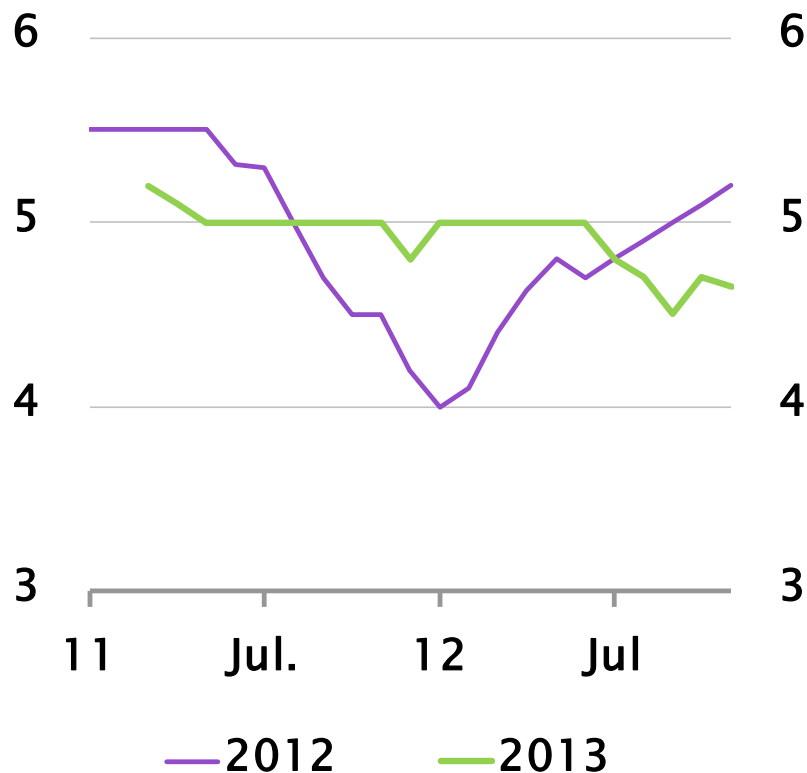


Market expectations point to GDP growth approaching 5% this year and next. Two years ahead, inflation is aligned with the target.

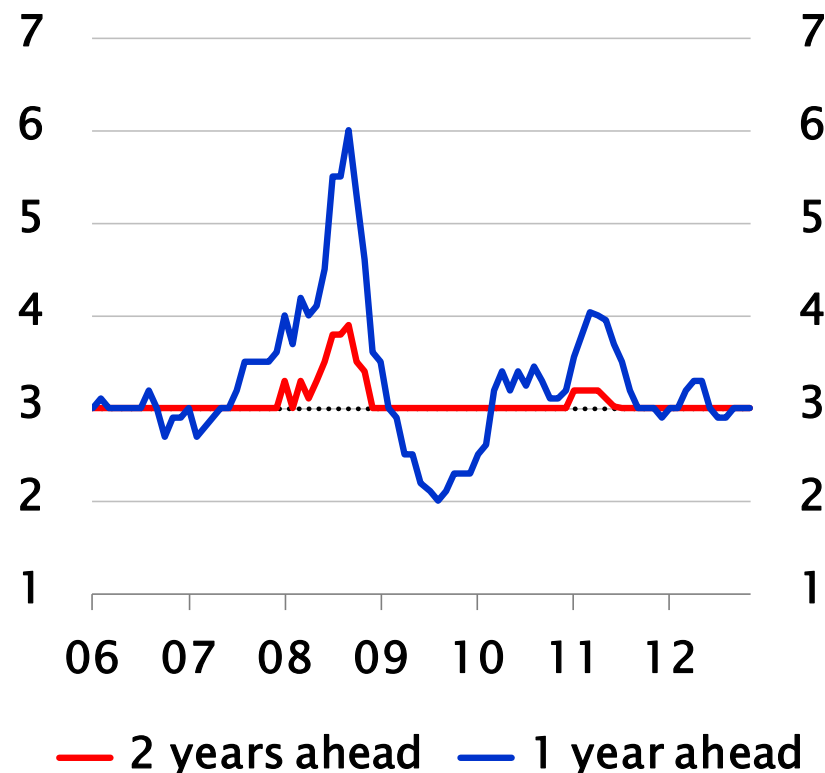
Economic Expectations Survey

(annual change, percentage)

GDP



Inflation

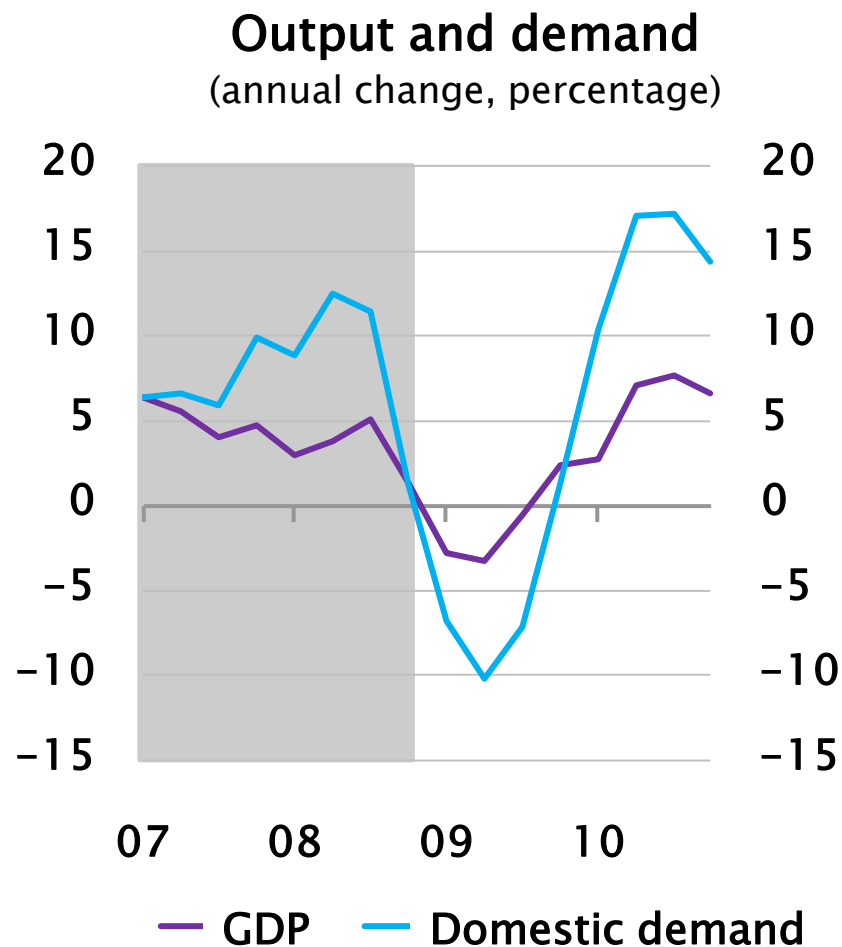
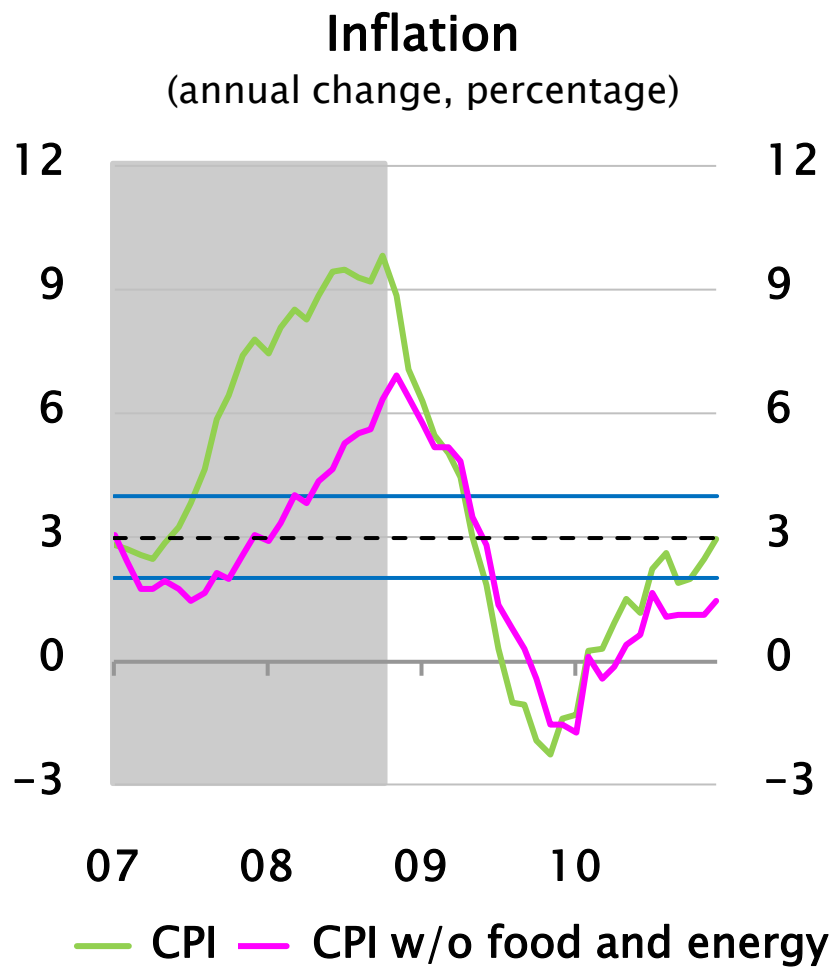




**Chile facing a possible deterioration of
the global situation**

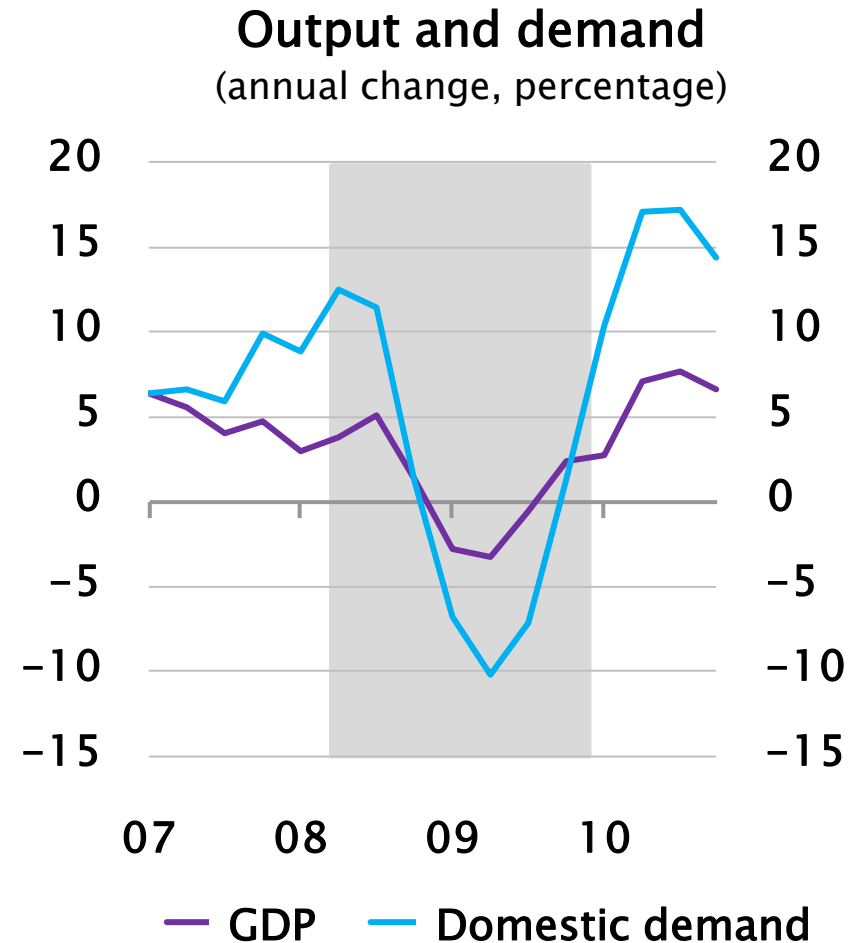
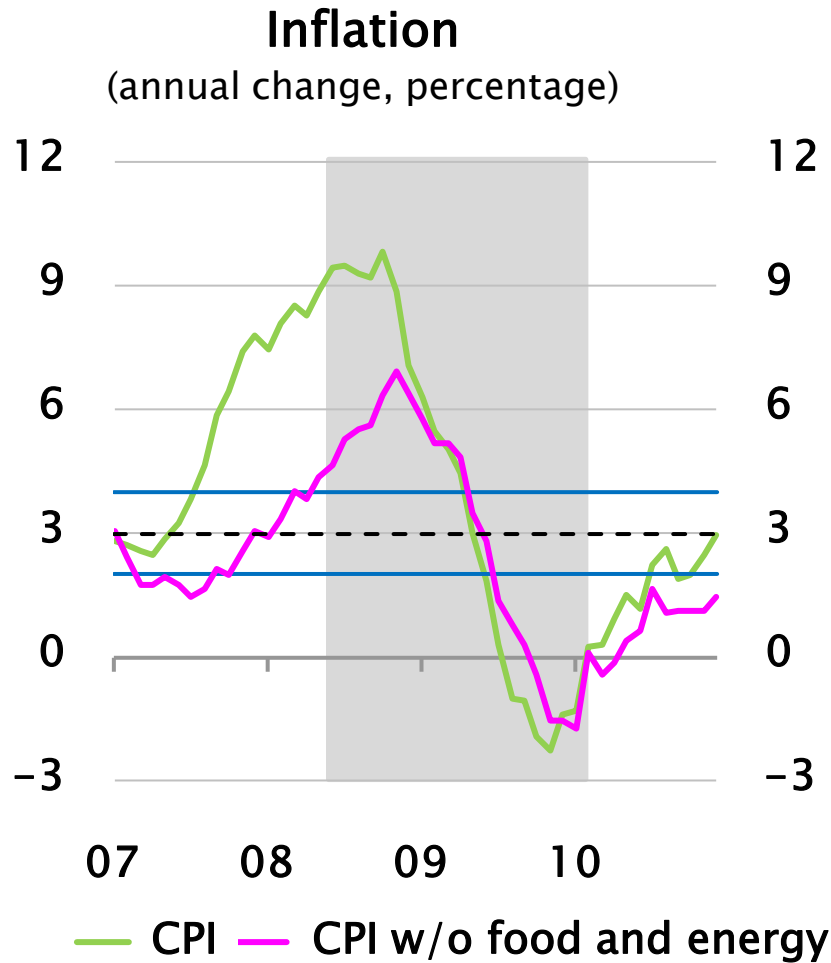


Chile had to endure the crisis of 2008 in the midst of a significant inflationary process, because of the effects of both increases in world commodity prices and closed domestic output gaps.



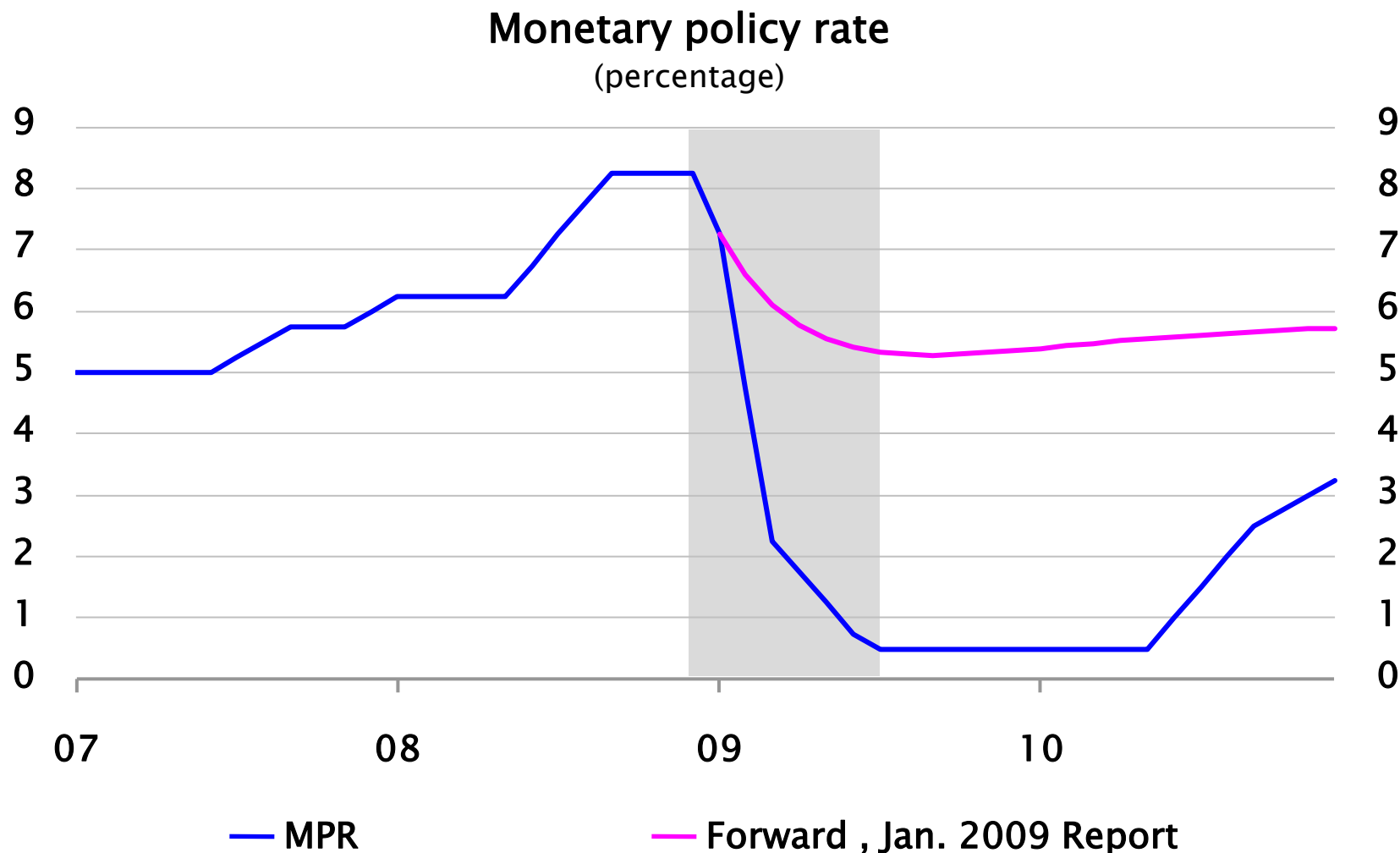


After the outbreak of the world crisis, domestic output and demand froze and inflation plummeted.





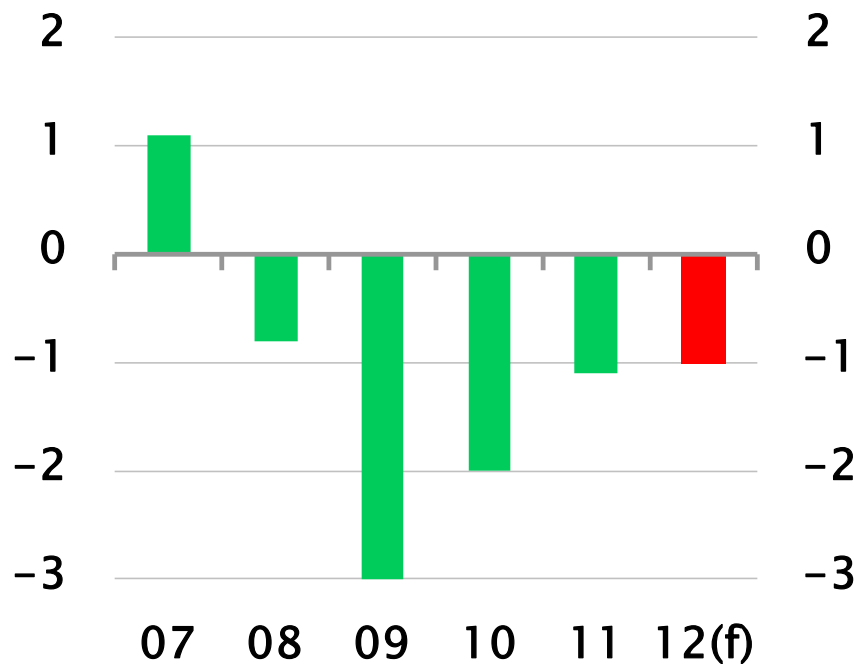
The policy framework in place allowed taking action to mitigate effects of the external crisis. The Central Bank of Chile lowered the MPR aggressively beyond market expectations, and implemented unconventional measures.



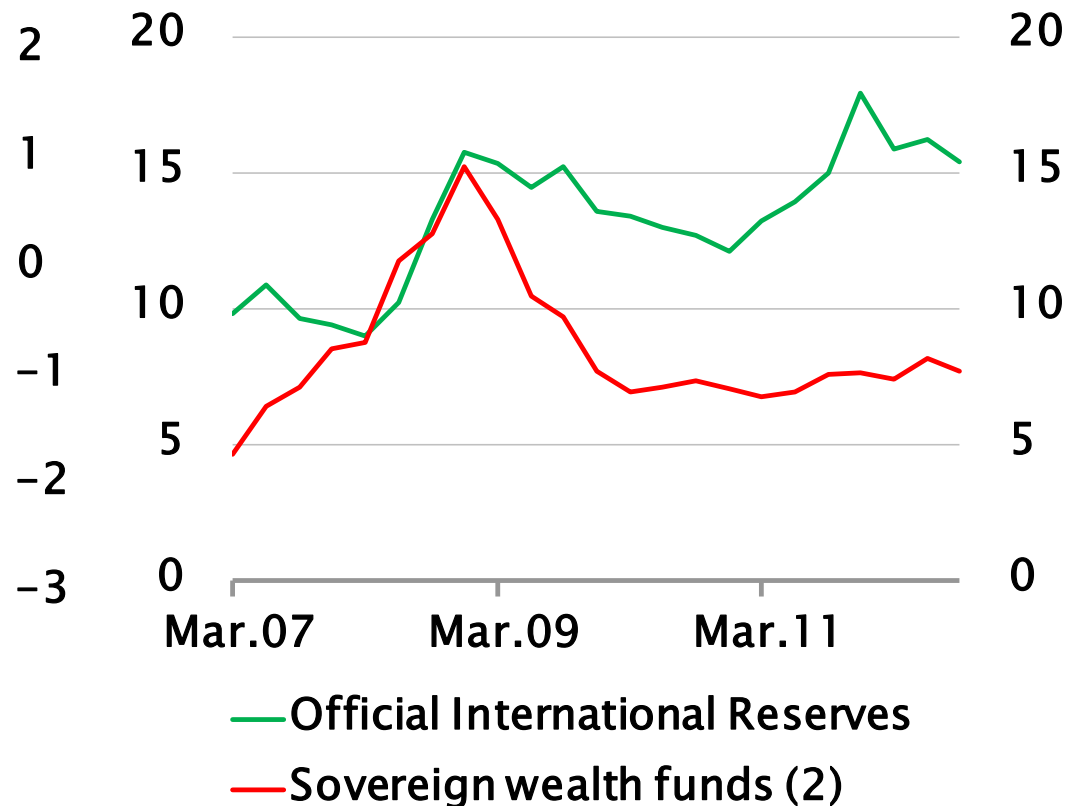


The government had the resources at hand to implement an important fiscal stimulus package.

Structural fiscal balance
(percentage of GDP)



FX reserves and SWF
(percentage of GDP)



(f) Forecast. *Public Finances Report*, October 2012. (1) Data up to September 2012. (2) Sum of Economic and Social Stabilization Fund (FEES) and Pension Reserves Fund (FRP).

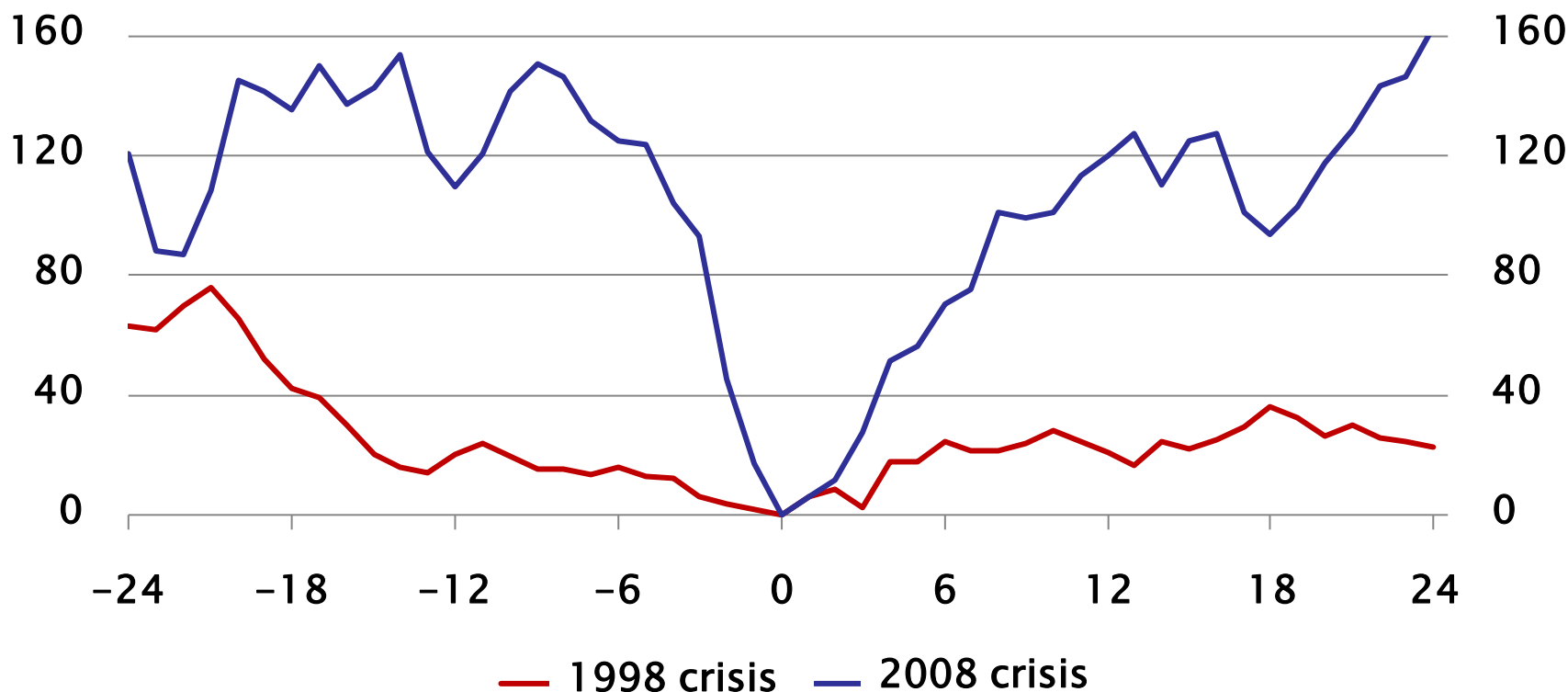
Sources: Finance Ministry and Central Bank of Chile.



The economy's recovery reflected the fact that, unlike during the Asian crisis, the copper price fell sharply, but recovered much faster.

Copper price (1) (2)

(index, lowest price during period =0, monthly figures)



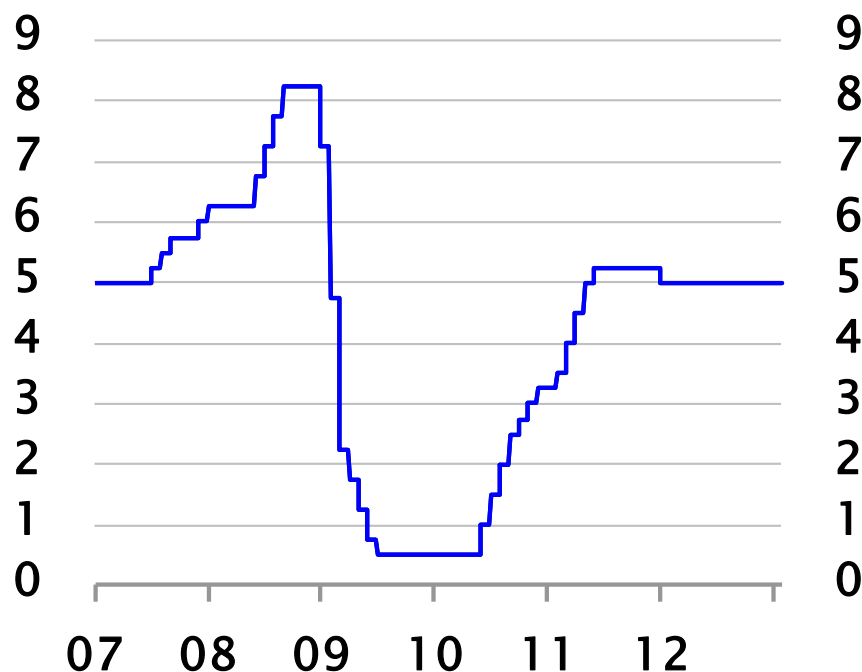
(1) Real copper price, deflated by United States PPI. (2) Month 0 is the month where the price hit minimum: March 1999 for the crisis starting in 1998, and December 2008 for the recent crisis.

Source: Bloomberg.

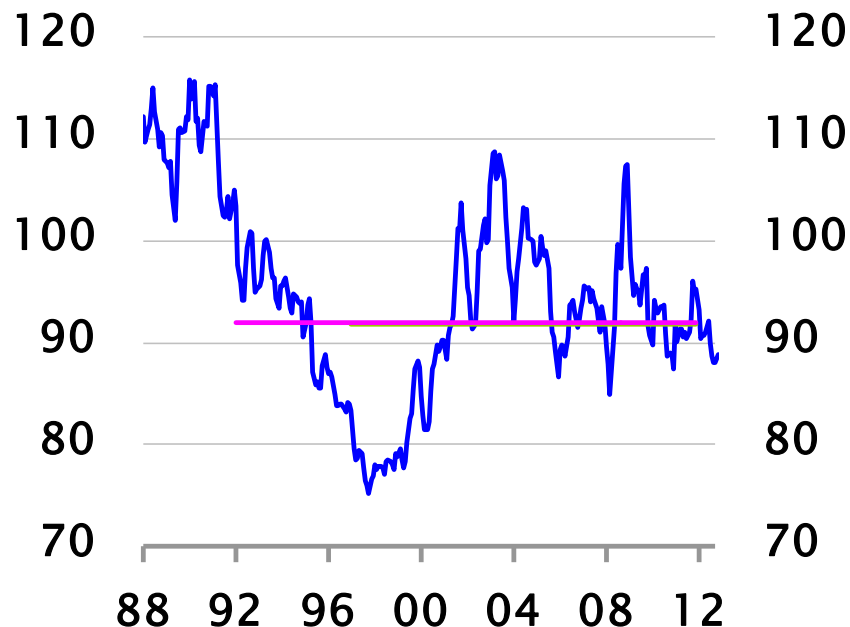


Today, facing further deterioration of the external scenario, there are instruments to mitigate consequences. There is room for monetary policy and the exchange rate can help absorb the shocks.

Monetary policy rate
(percentage)



Real exchange rate (*)
(index 1986=100)

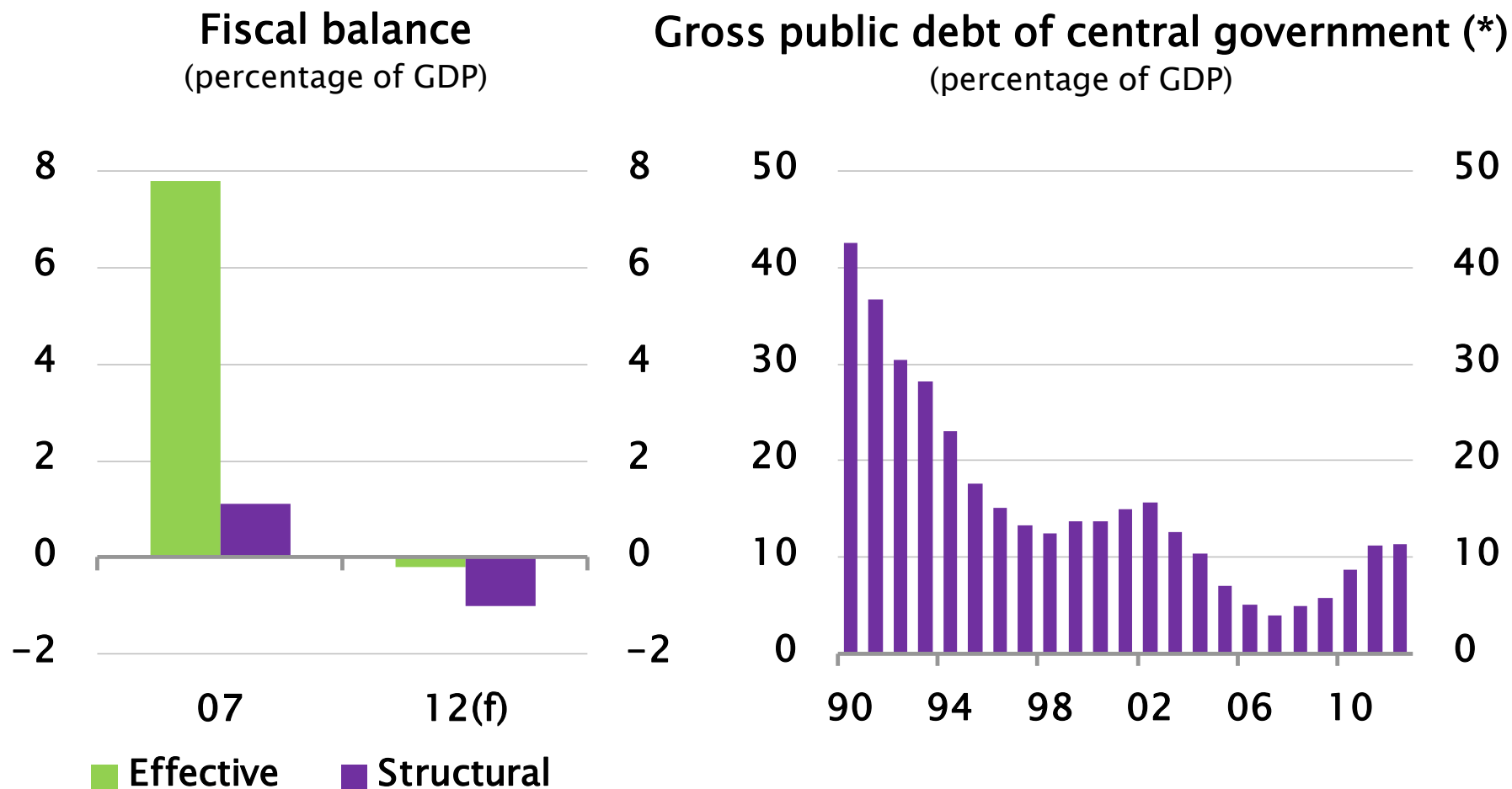


— Average 2007–2011
— Average 1992–2011

(*) Data up to October 2012.
Source: Central Bank of Chile.



There is also room for fiscal maneuvering, albeit more limited than during the crisis of 2008.

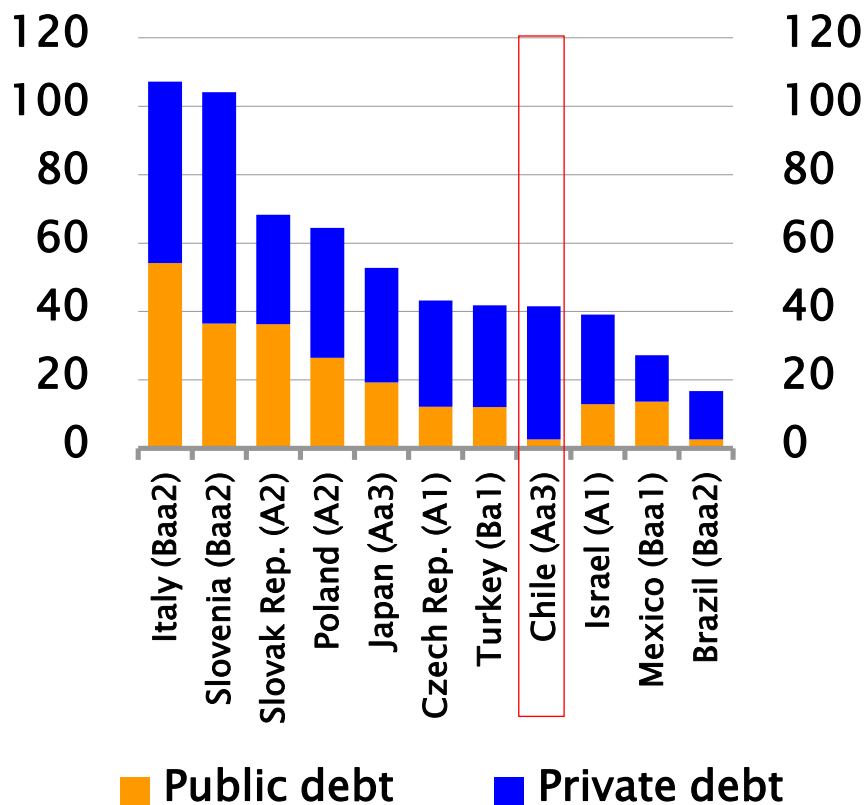


(f) Forecast included in *Public Finances Report*, October 2012. (*) For 2012, considers data up to June 2012.
Source: Finance Ministry of Chile.

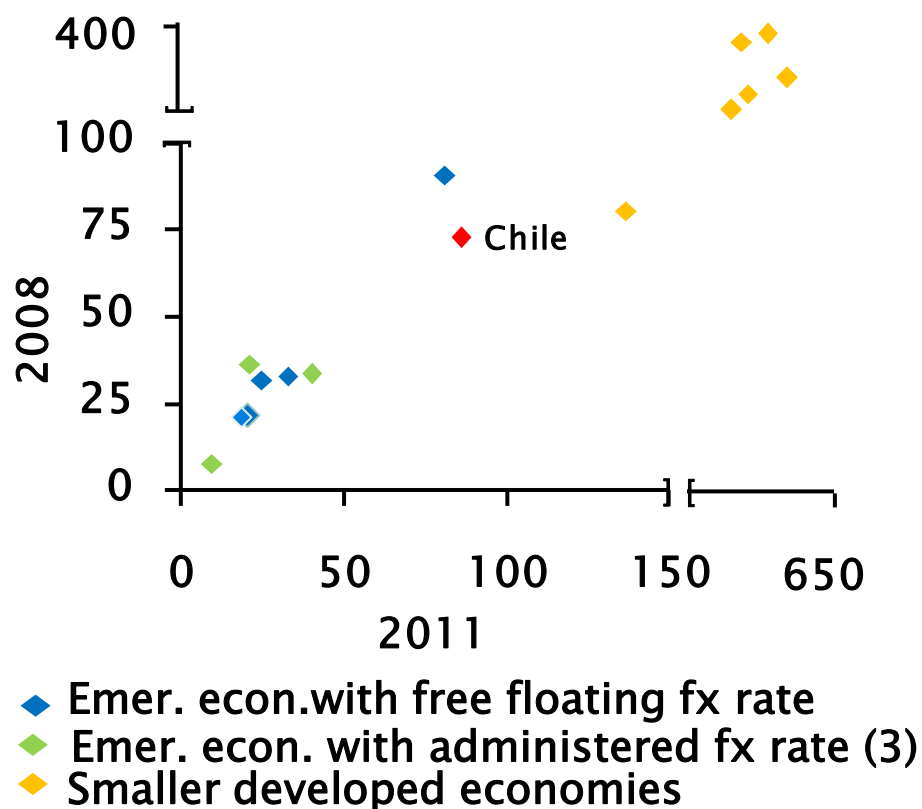


Other indicators also reflect good standing to confront more adverse scenarios. Low external debt and short-term debt level not so different from that of 2008.

External debt (1) (2)
(percentage of GDP)



Residual short-term external debt
(percentage of international reserves)



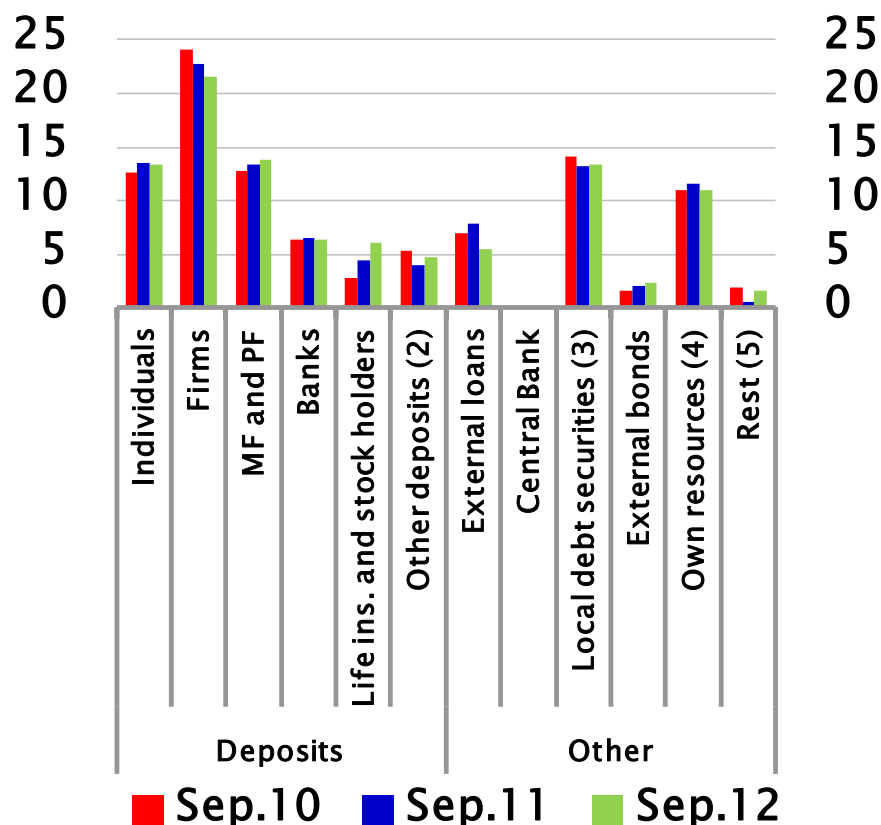
(1) For comparison purposes, public debt is defined as the debt of the consolidated government. (2) External debt at 2012Q2; in parentheses, Moody's risk rating. (3) Classification Ilzetzi, E., Reinhart, CM, Rogoff, K., 2009. Sources: Central Bank of Chile based on World Bank, IMF and Moody's.



The banking system has diversified funding sources and has reduced dependence on the most volatile ones. Corporate indebtedness remains stable.

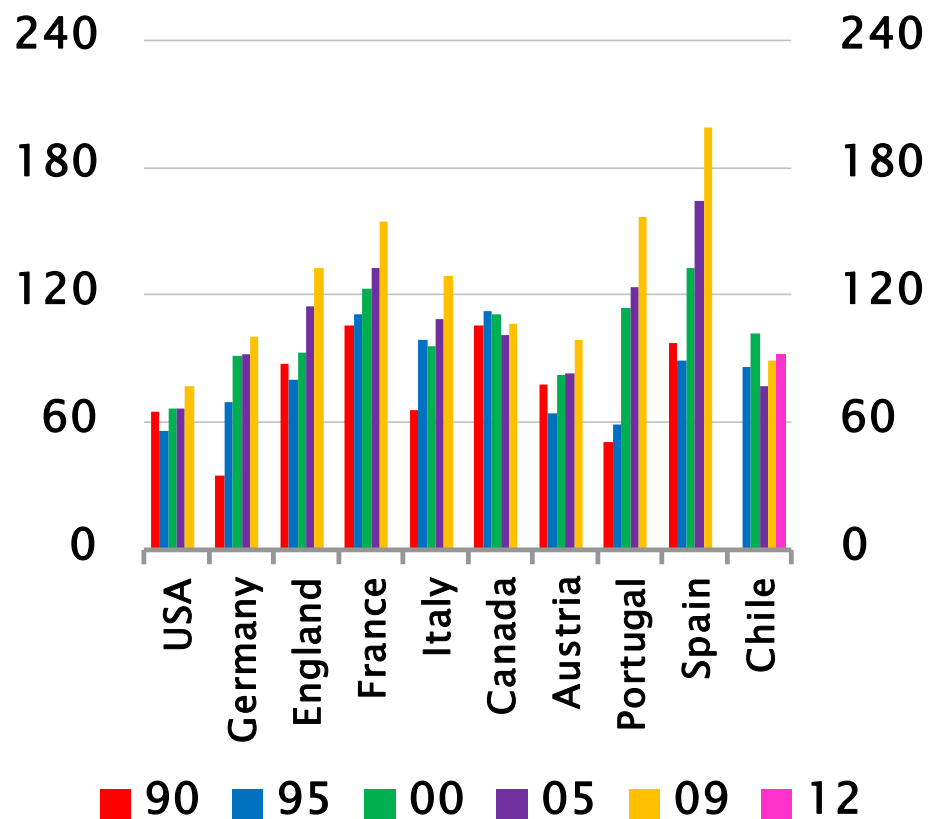
Sources of banking system funding

(percentage of total liabilities) (1)



Corporate debt

(percentage of GDP)



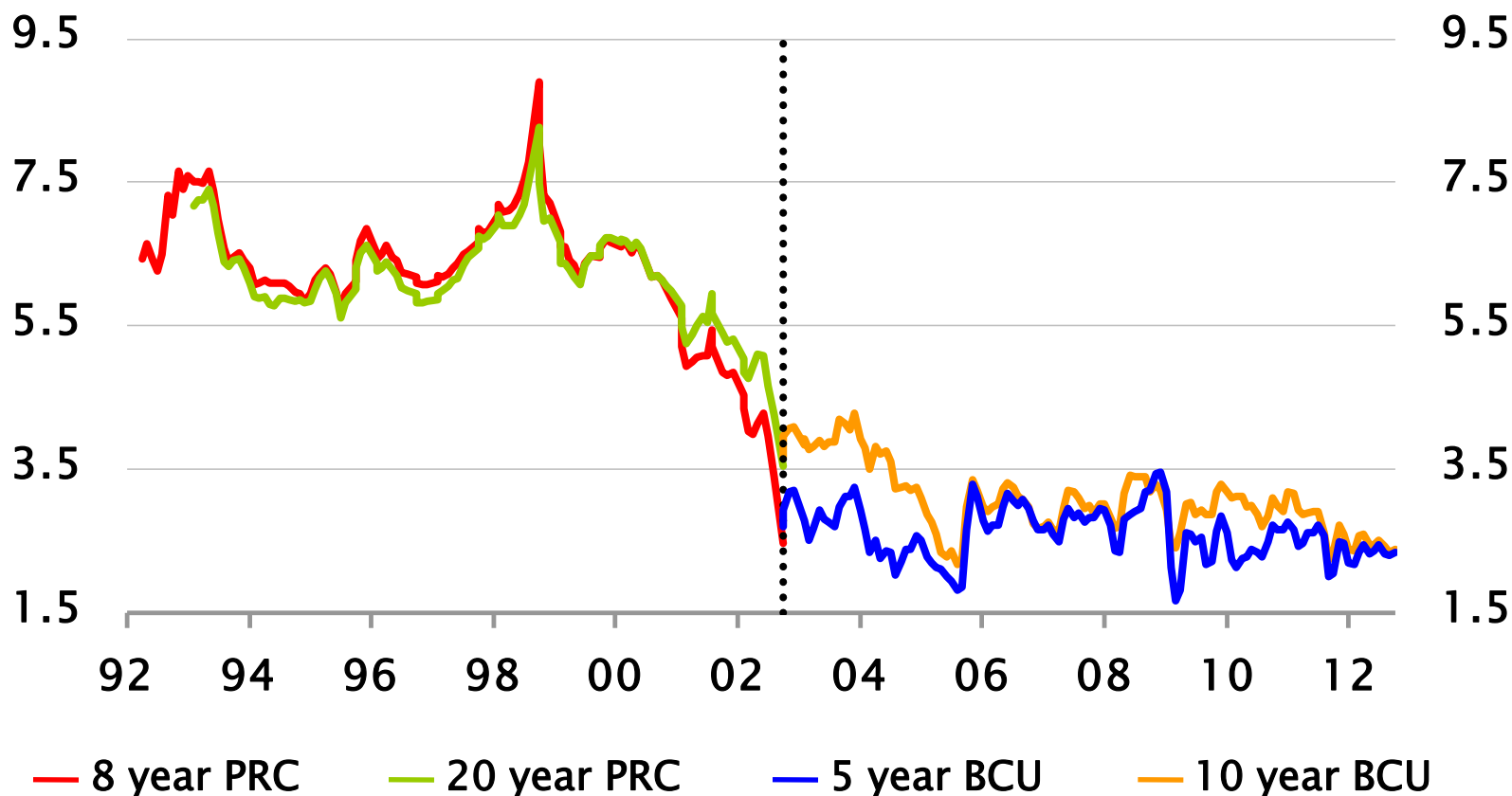
(1) Total liabilities net of contingent obligations and reasonable value of derivative instruments. (2) Public sector and external sector. (3) Bills, senior bonds and subordinate bonds. (4) Base capital, provisions, reasonable value net of derivatives and profits. (5) Residual compared with balance sheet data.

Sources: Central Bank of Chile based on data from the DCV, SBIF, SP and SVS. , Cechetti et al (2010).



Long-term interest rates have remained low from a historic perspective, despite developments abroad.

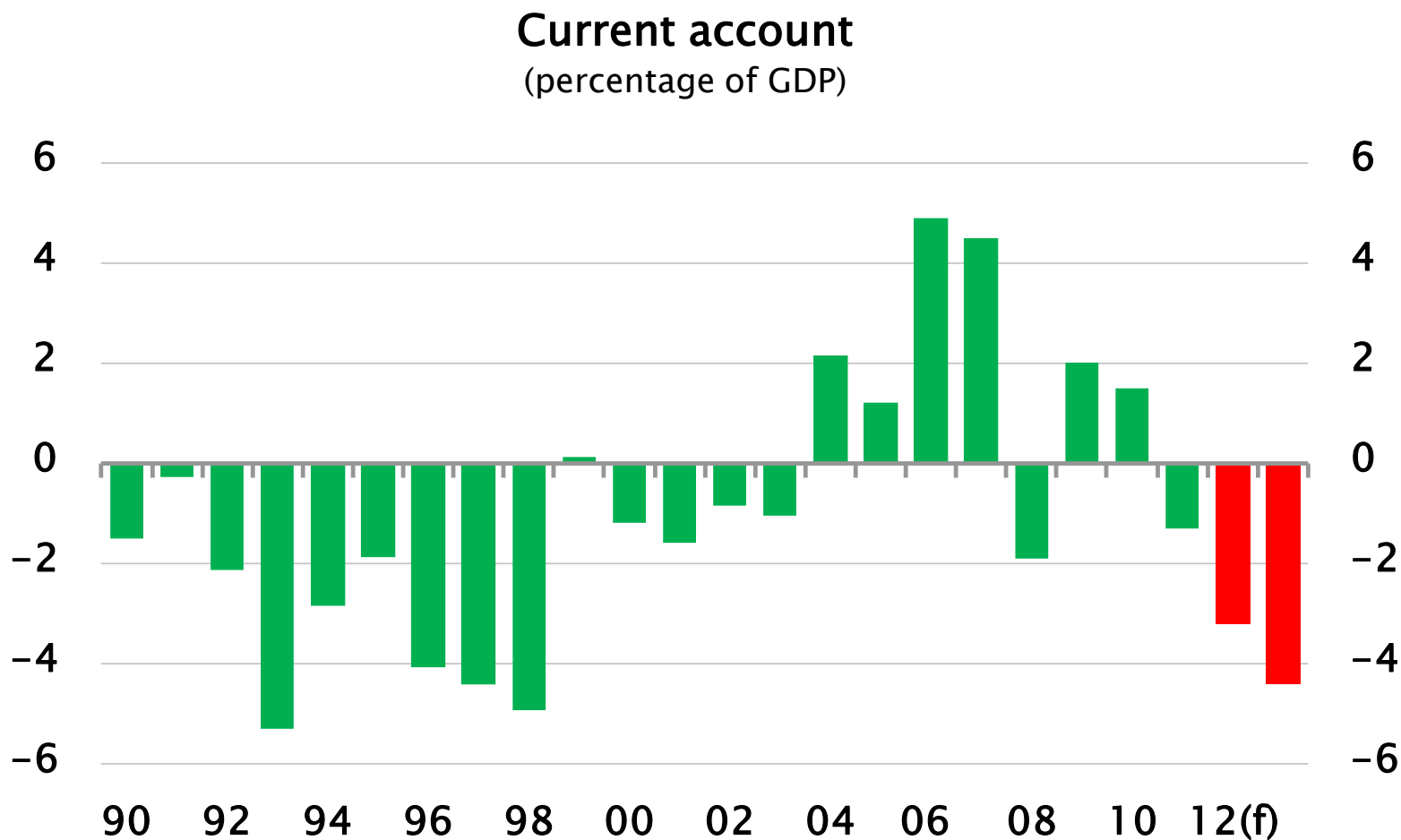
Real long-term interest rates (1) (2)
(percentage)



(1) PRCs are bonds of the Central Bank of Chile of equal twice yearly payments (except the last), which may include both interest and principal. (2) BCUs is a bond denominated in UF, an inflation-indexed unit of account. Source: Central Bank of Chile.



However, the deterioration of the current account, associated with sustained dynamism of domestic demand, puts a note of caution about a worsening of the external scenario, especially if coupled with falling copper prices.



(f) Forecast. *Monetary Policy Report*, September 2012.

Source: Central Bank of Chile.



Chile has strived for decades to improve its capacity to deal with adverse scenarios.

- Chile has the necessary tools to mitigate the effects of a further deterioration of the international scenario. Our country gave proof of its ability to act decisively and strongly when facing sharp changes in the macroeconomic scenario.
- There are factors that must be monitored closely, especially the evolution of the current account.
- Today there are high risks, both locally and abroad, which could call for policy responses in opposite directions. Therefore, monetary policy must be prudent.
- The Board reaffirms its commitment to conduct monetary policy so that projected inflation stands at 3% over the policy horizon. This is the best contribution we can make to the country's well being.



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