New Cycle of Capital Flows: A view from Chile

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Banco Central de Reserva del Perú – Reinventing Bretton Woods Committee
7th Annual Conference

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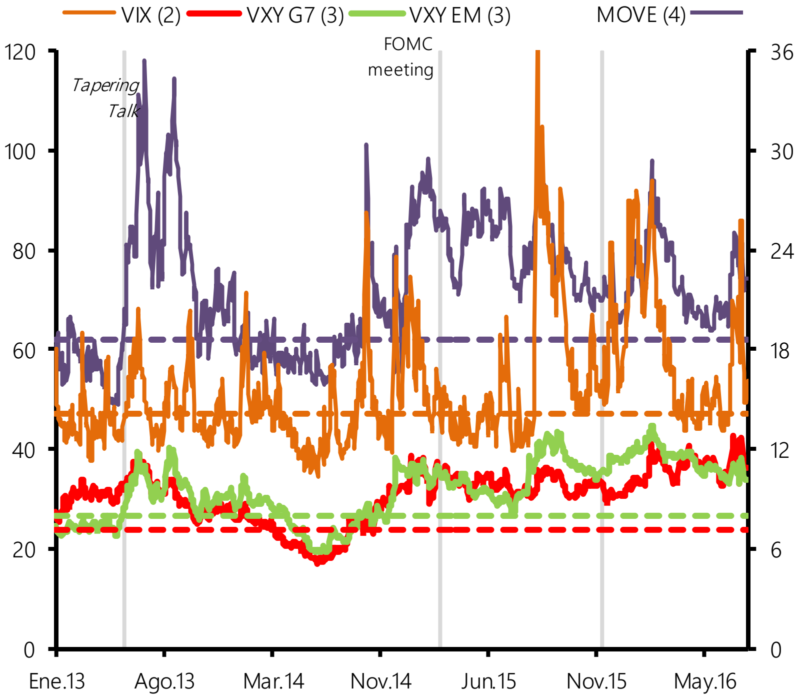
Agenda

- Disclaimer and introduction
- The heterogeneous response to global volatility
- The case of Chile: capital inflows and capital outflows
- Coming challenges

Introduction – Volatility remains prevalent

Volatility in global financial markets (1)
(percent; index)



(1) Dotted lines correspond to 2014 averages.
(2) VIX: One month ahead S&P 500 implicit volatility.
(3) VXY: Implicit exchange rate volatility w eighted by turnover.
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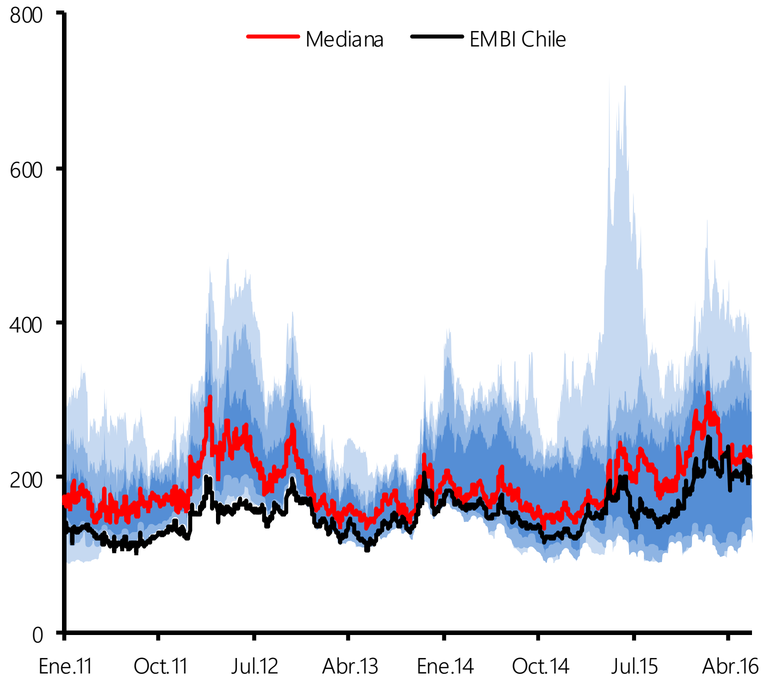
Source: Bloomberg.

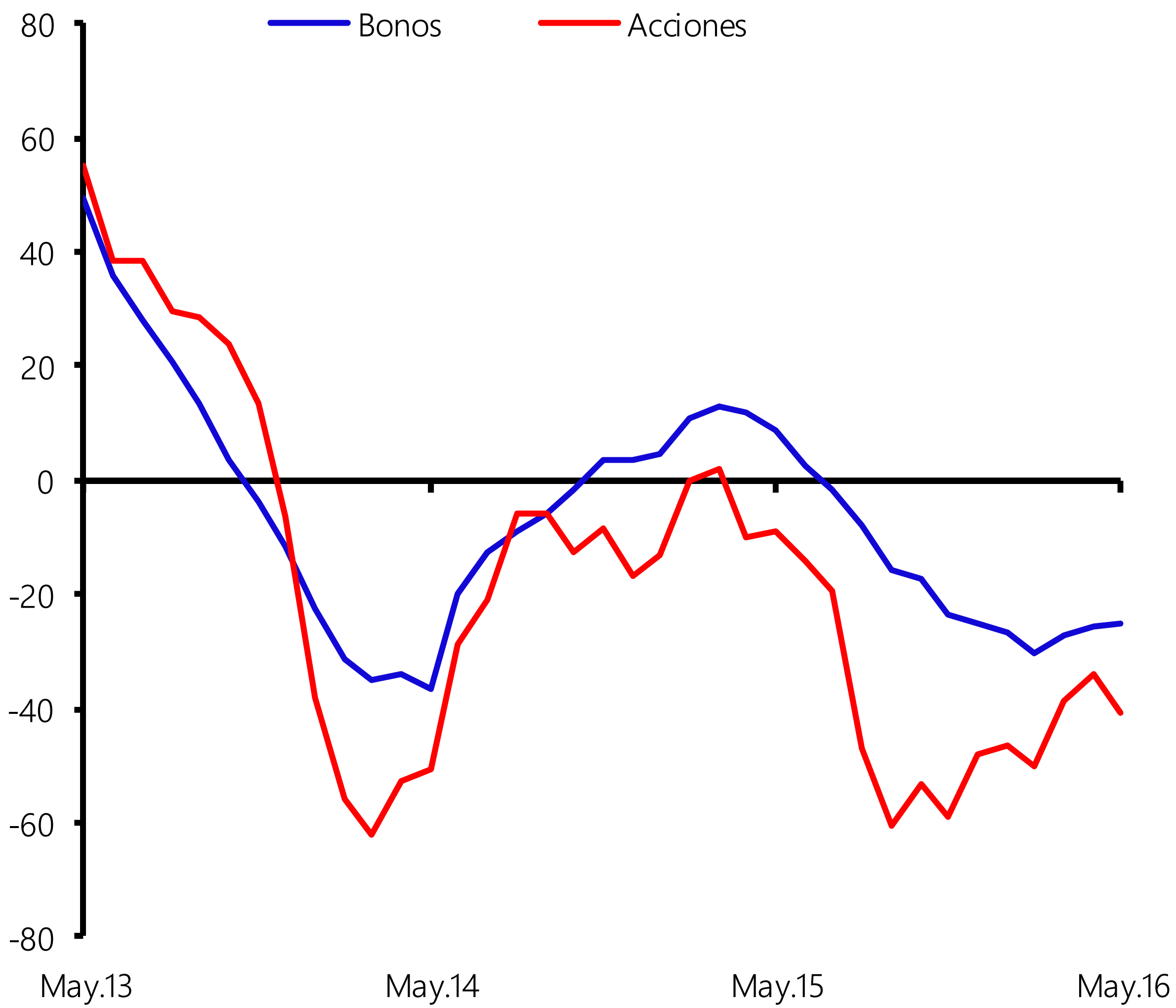
Sovereign spread in selected economies (*)
(puntos base)



(*) Includes Brasil, Chile, China, Colombia, Philippines, India, Indonesia, Lithuania, Malaysia, Mexico, Peru, Poland, Russia, South Africa and Turkey. Shades areas correspond to maximum, 90th percentile, 75th percentile, median, 25th percentile, 10th percentile, and minimum.
Source: Bloomberg.

Introduction – Volatility remains prevalent

Portfolio flows to emerging economies (*)
(miles de millones de dólares, suma móvil 12 meses)



Source: Central Bank of Chile, based on EPFR.

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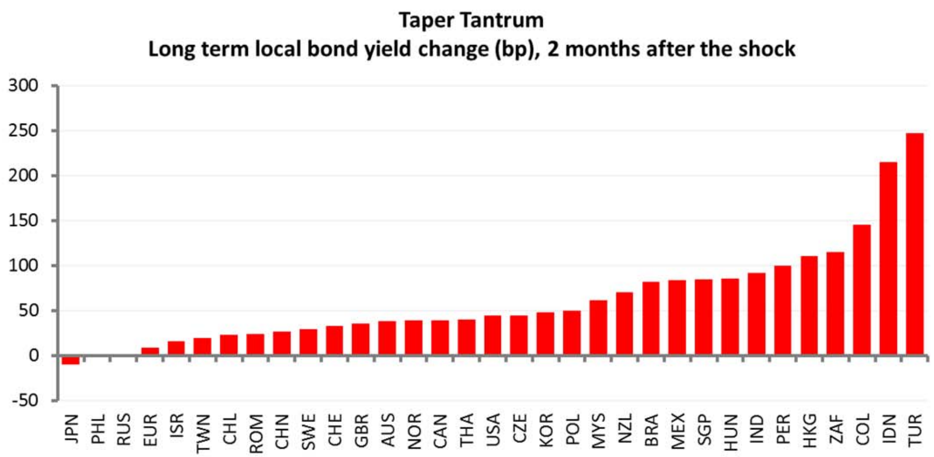
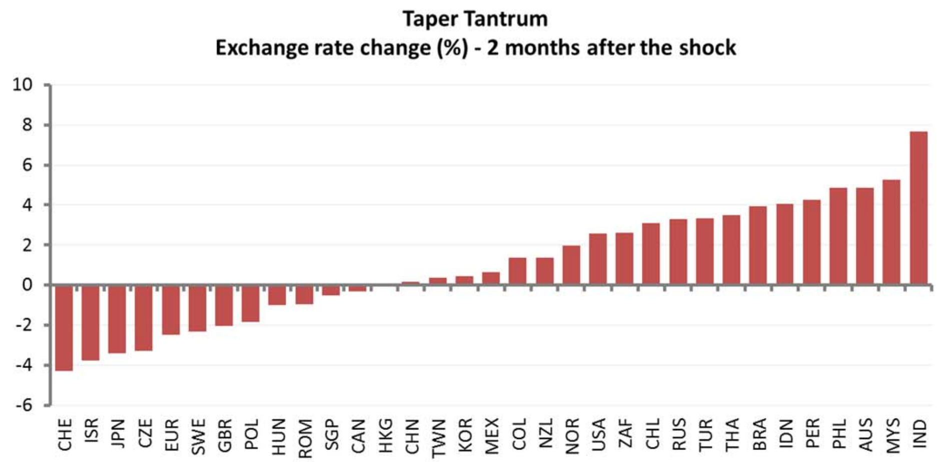
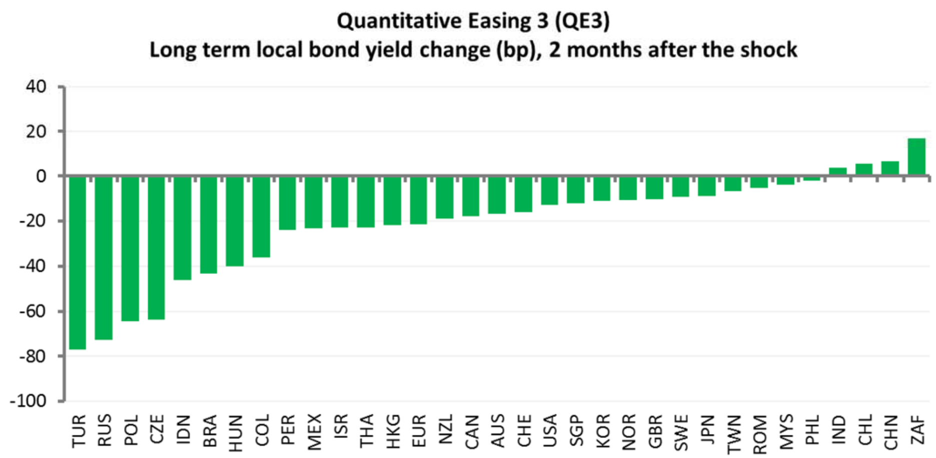
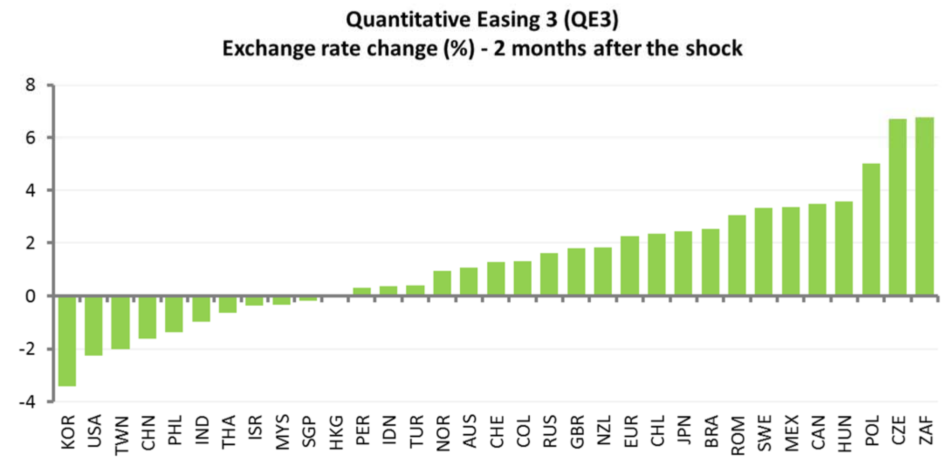
The heterogeneous response to global volatility



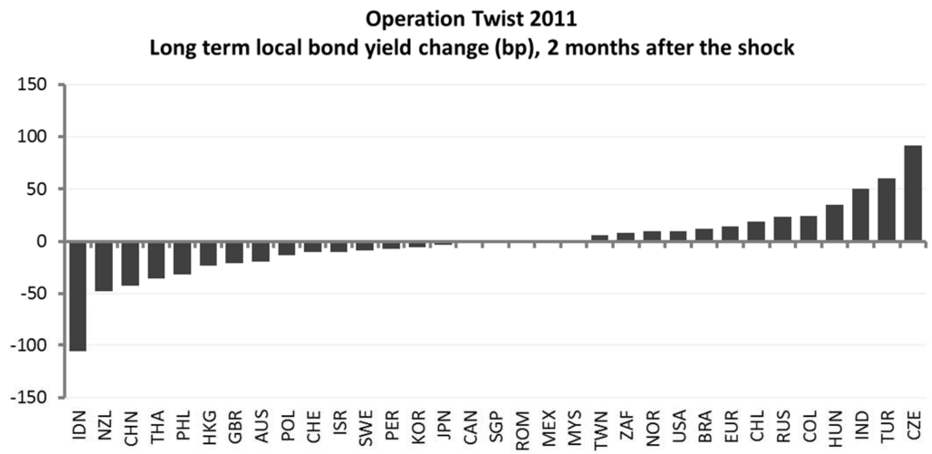


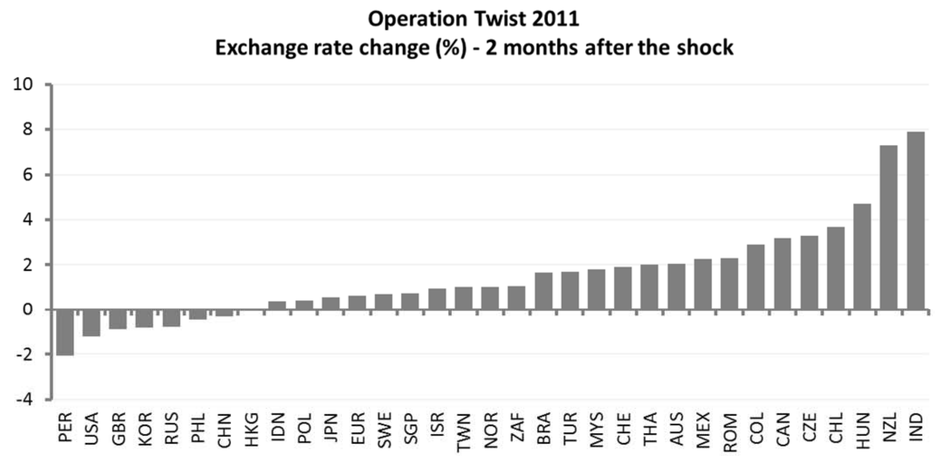


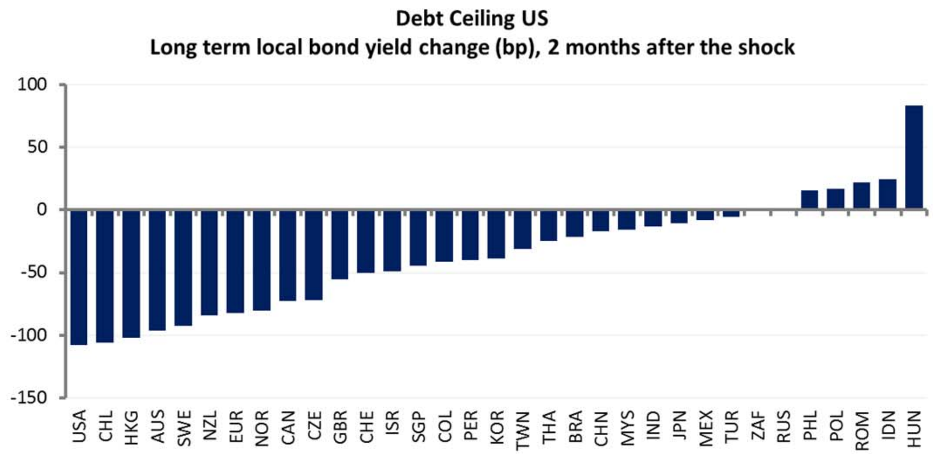


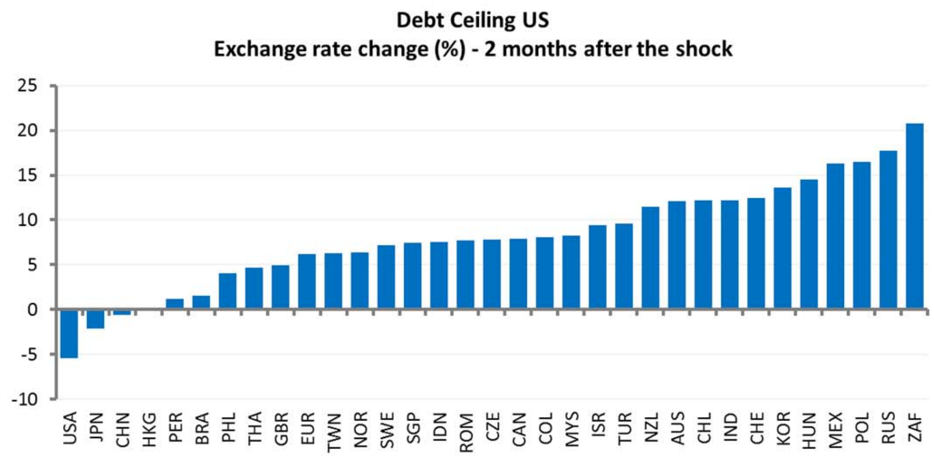
Source: Bloomberg

The heterogeneous response to global volatility





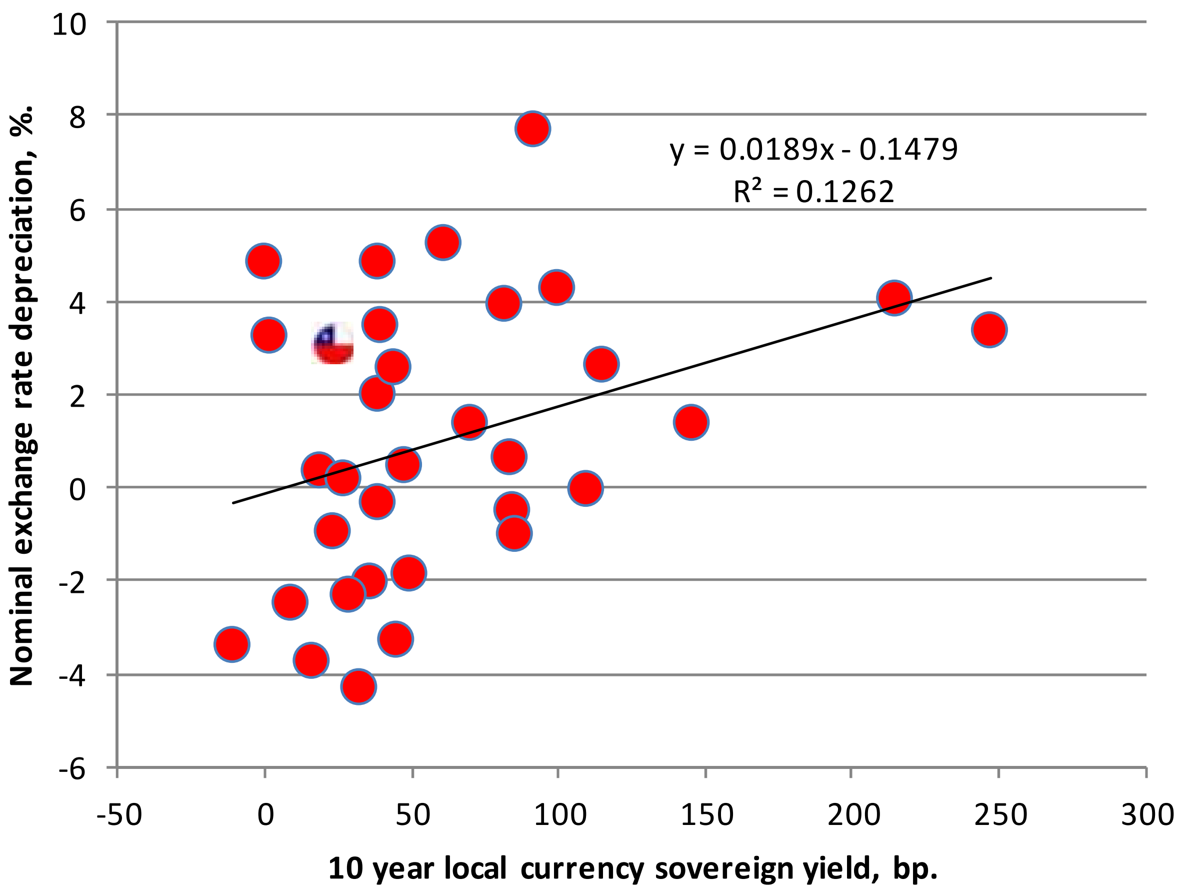




Source: Bloomberg

Taper Tantrum effects

Exchange rate and local yield responses 2 months after Taper Talk.

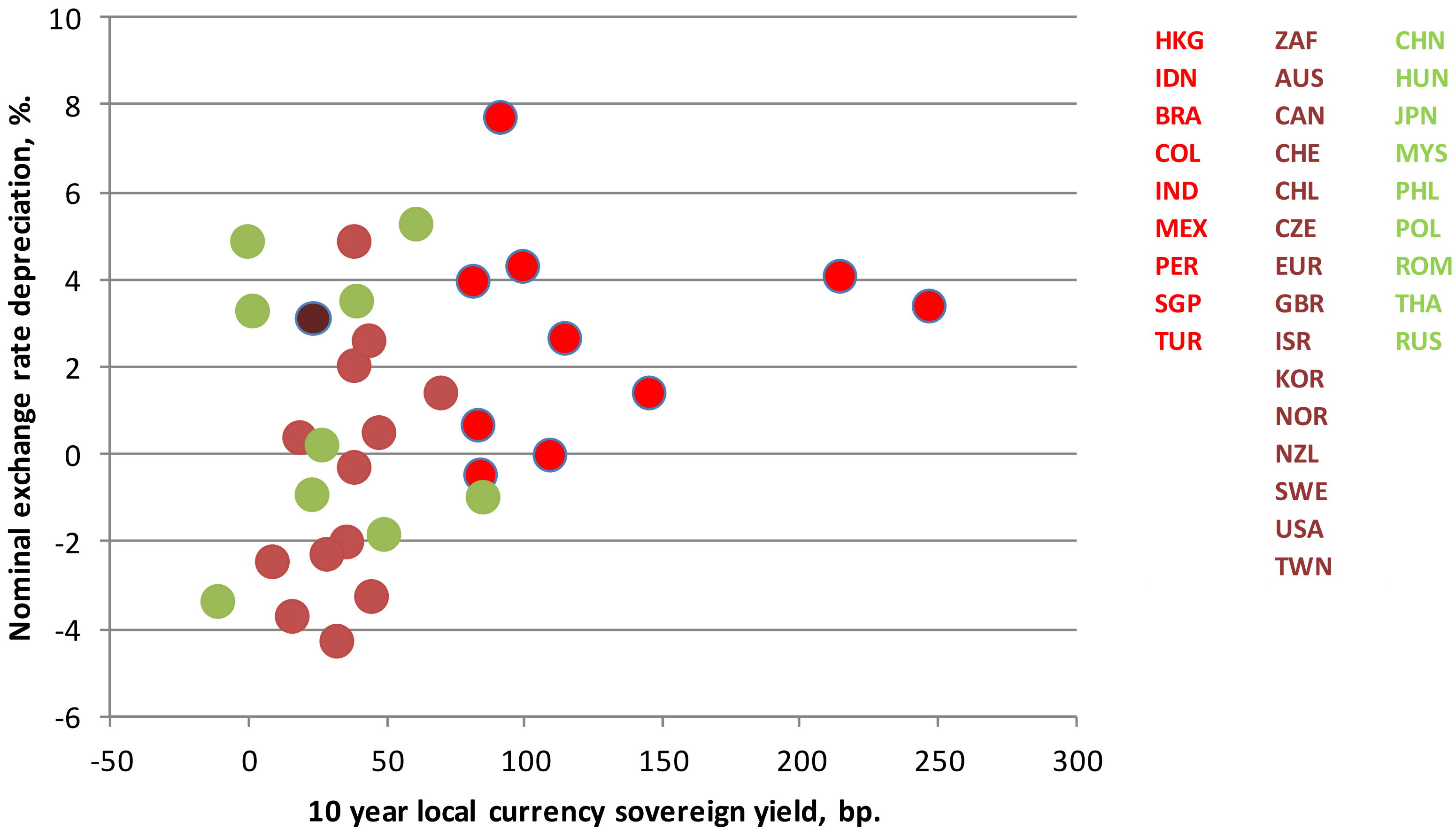


Source:

De Gregorio and García (2016), from Bloomberg and Cáceres, Carriere-Swallow and Gruss (2016), IMF WP 16/108

Taper Tantrum – Patterns of response

Clustering by ER and Yield responses to four episodes of global volatility
Exchange rate and local yield responses 2 months after Taper Talk.

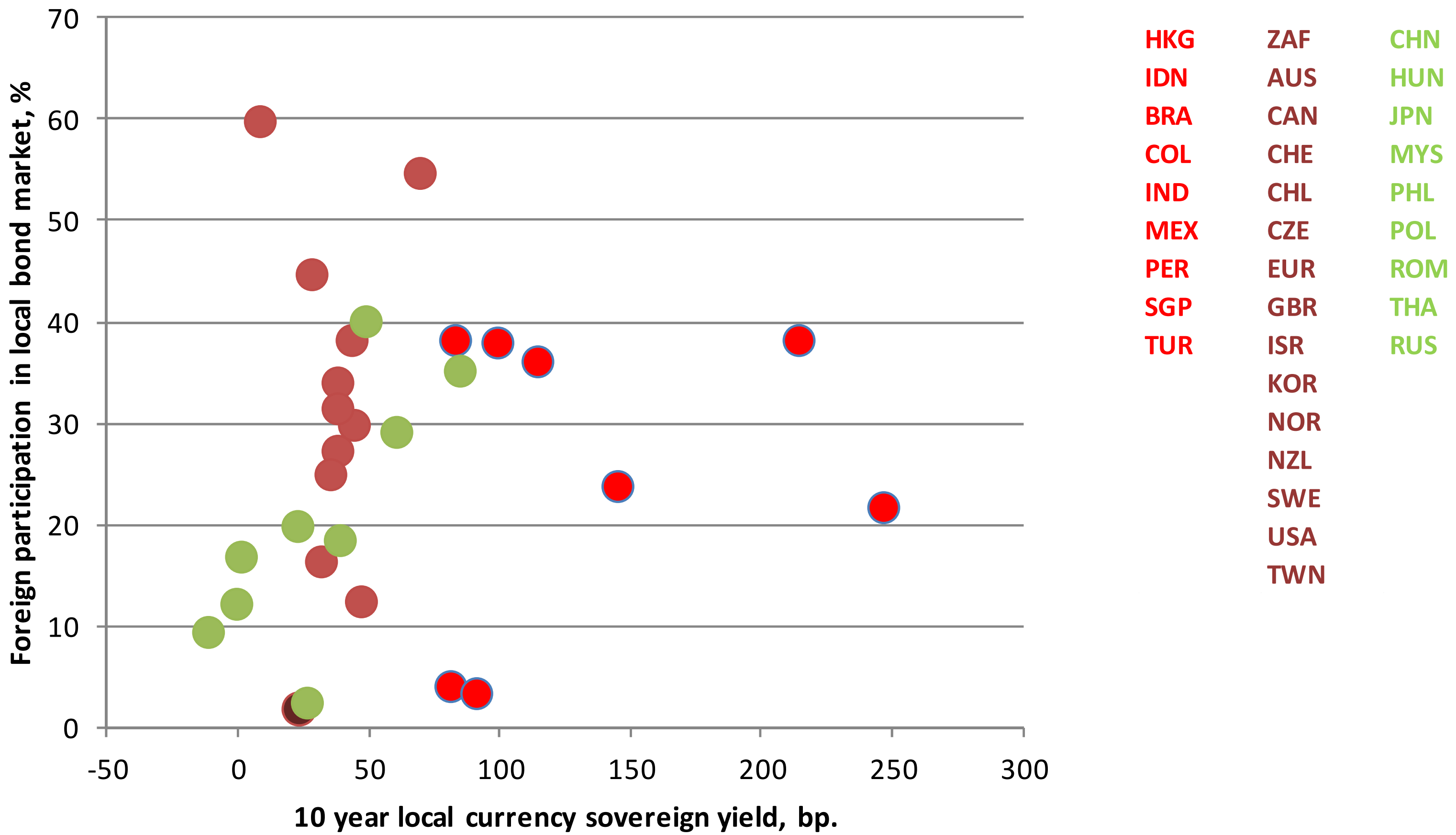


Source:

De Gregorio and García (2016), from Bloomberg and Cáceres, Carriere-Swallow and Gruss (2016), IMF WP 16/108

Hardly a link with financial integration

Clustering by ER and Yield responses to four episodes of global volatility
Foreign participation and local yield responses 2 months after Taper Talk.



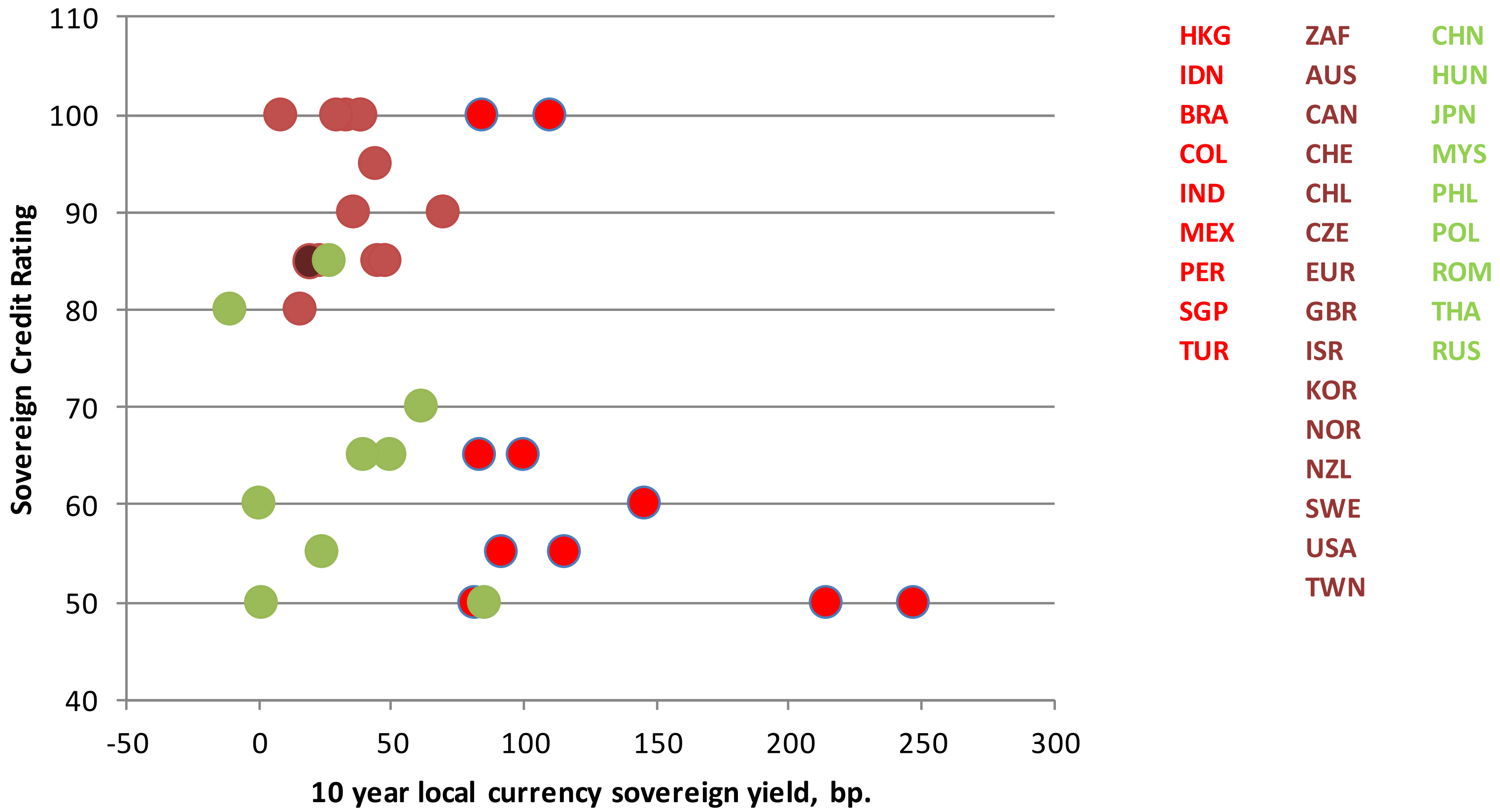
Sources:

De Gregorio and García (2016), from Bloomberg and Cáceres, Carriere-Swallow and Gruss (2016), IMF WP 16/108

Foreign Participation: Arslanap, S. and T. Tsuda (2012), (2014), IMF WP 12/284 and 14/39

But a strong link with fiscal fundamentals

Clustering by ER and Yield responses to four episodes of global volatility
Financial integration and local yield responses 2 months after Taper Talk.



Sources:

De Gregorio and García (2016), from Bloomberg and Cáceres, Carriere-Swallow and Gruss (2016), IMF WP 16/108
Sovereign credit rating: TER index (100=AAA, 50=BB+)

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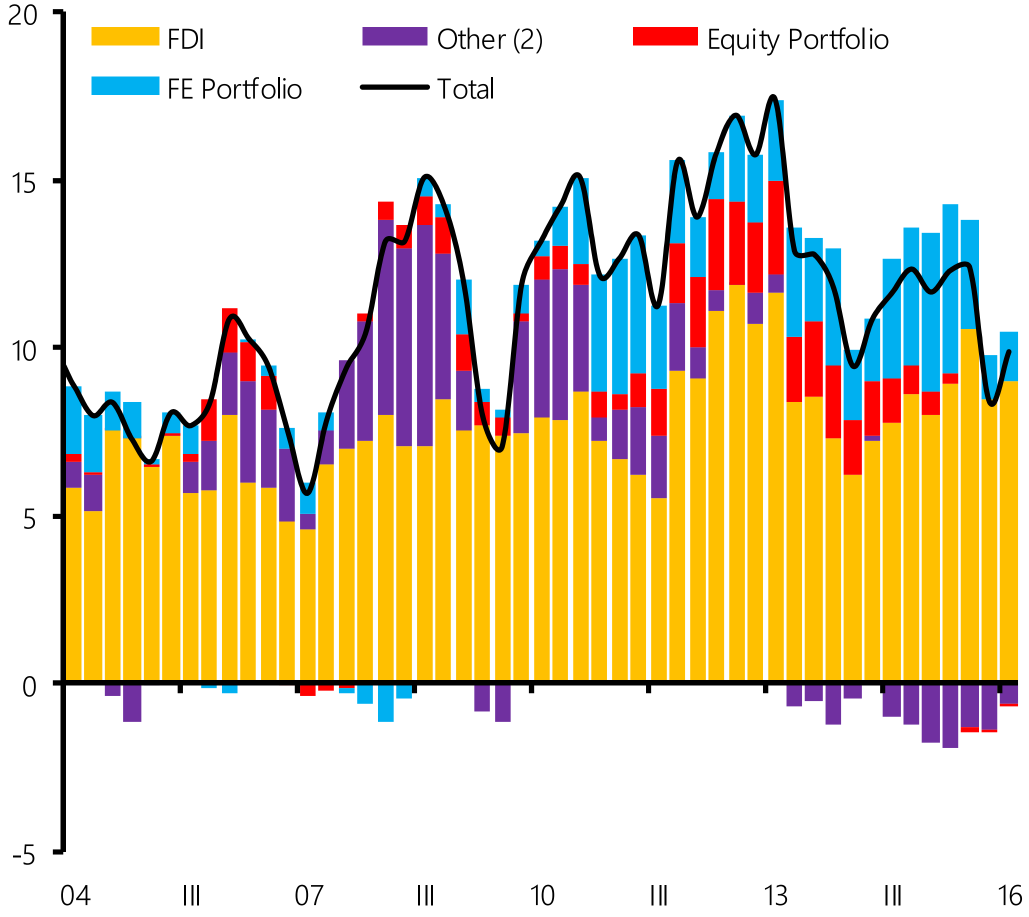
Capital flows to Chile have followed global patterns

Gross capital inflow s to Chile (1)

(porcentaje del PIB)



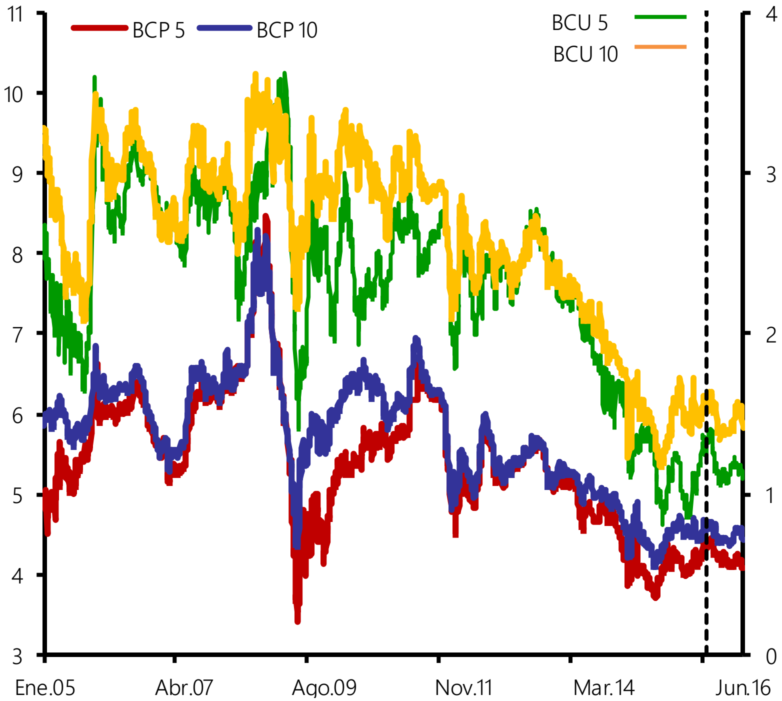
(1) Accumulated yearly flow . Does not include derivatives.

(2)Includes comercial credit, loans, deposits and other liabilities.

Source: Central Bank of Chile.

Local yields and monetary conditions have remained remarkably stable

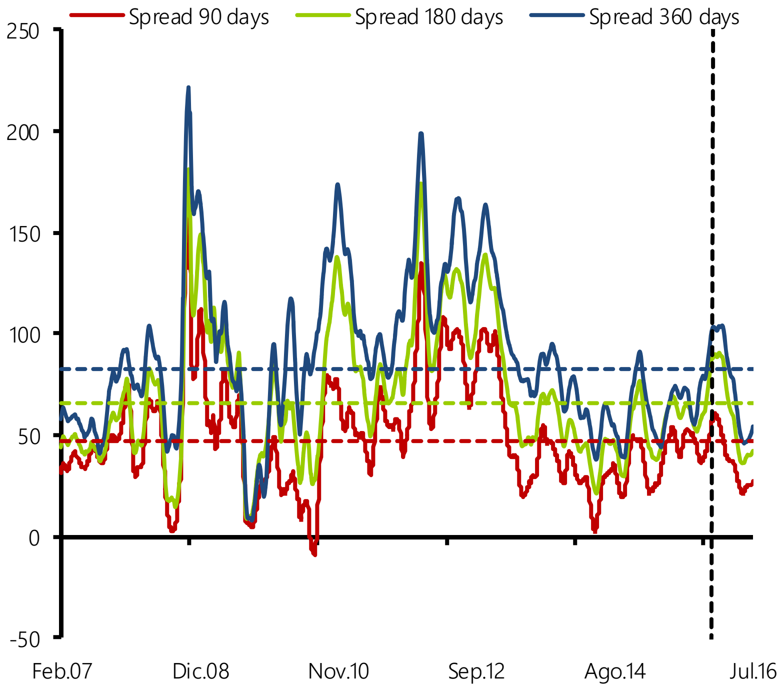
Long term local sovereign bond yields (1)
(percent)



(1) BCU: Indexed, BCP: nominal.

Source: Central Bank of Chile.

Peso money market spreads (1) (2)
(promedio móvil mensual, puntos base)



(1) *Prime-swap* interbank spread.

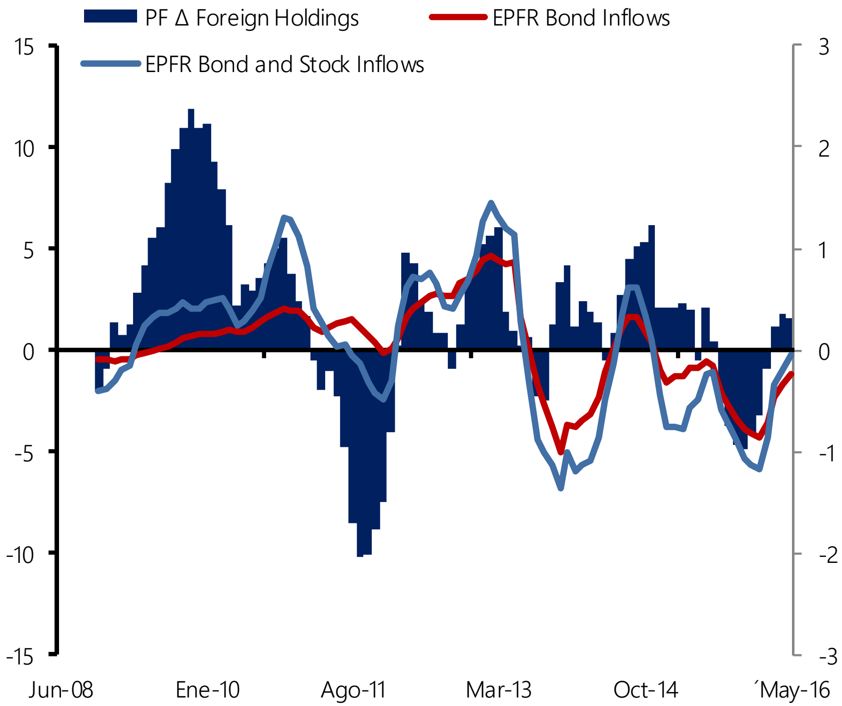
(2) Horizontal lines show 2005-2016 averages.

Source: Central Bank of Chile.

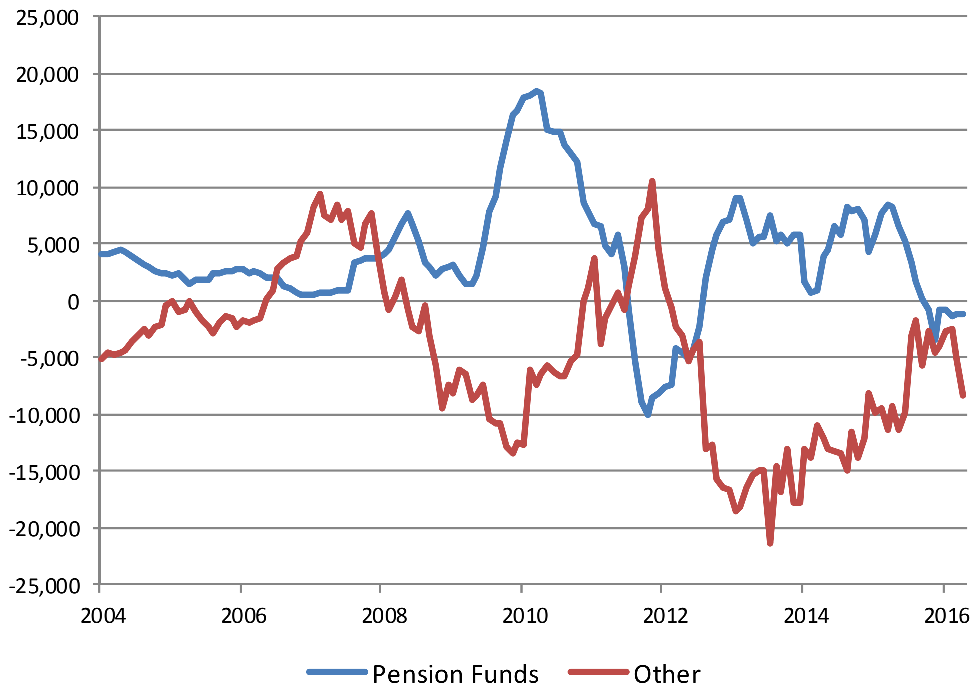
Portfolio shifts by institutional investors have been remarkably countercyclical

Capital Inflows and Pension Fund's Change in Foreing Holdings

(6 month m.a., USD bill.)



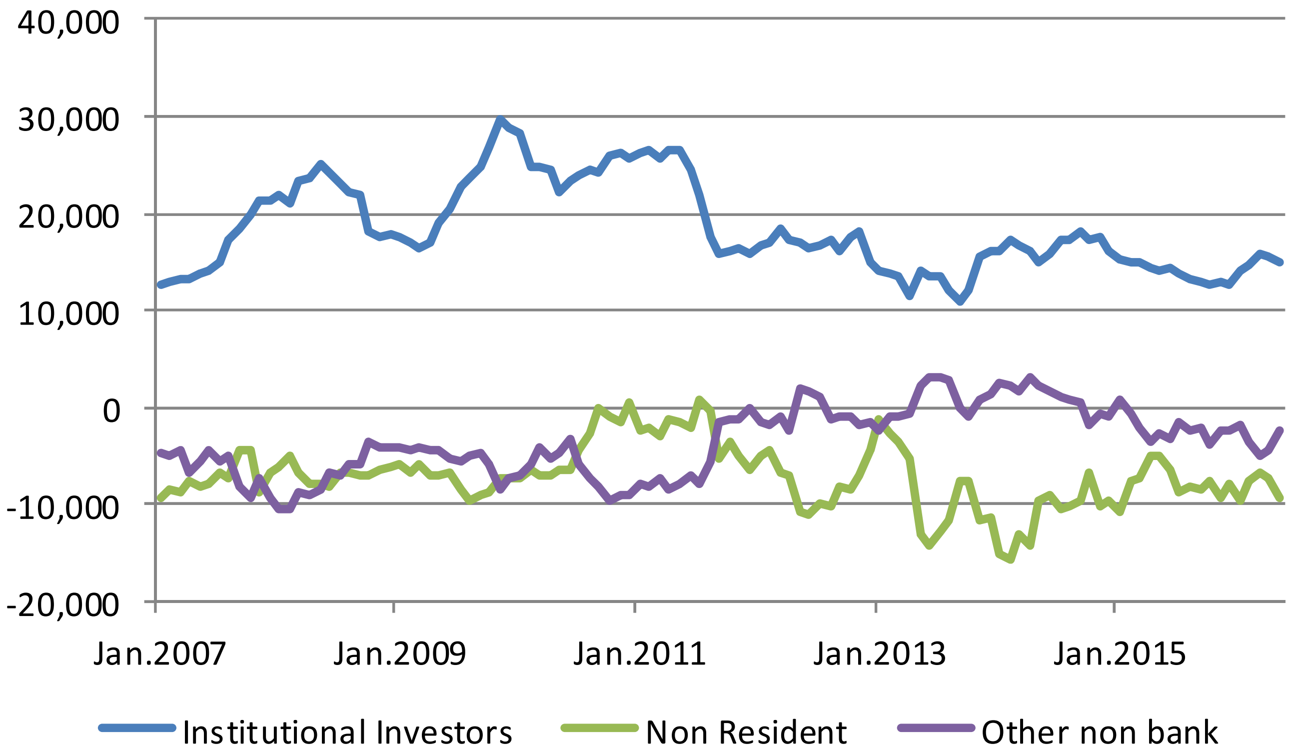
Financial Account of the Balance of Payments in Chile
(accumulated 12 month, USD mill.)



Source: Central Bank of Chile

Structural patterns in hedging forex risk

Forward USD notional position by agents (USD mill.)



Source: Central Bank of Chile

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Coming challenges

- Volatility in asset prices and capital flows will remain prevalent
- Policy responses and frameworks should aim at smoothing the domestic impact of volatility
- Rules (contrained discretion) are better than (unconstrained) discretion: IT, fiscal rule, flexible exchange rate
- Thus a sound and transparent macroeconomic policy framework will remain of paramount importance

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