



# Monetary and Fiscal Policy Interactions

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(\*) The views expressed in this presentation are exclusively those of the author and do not necessarily represent the position of the Central Bank of Chile or its Board members.

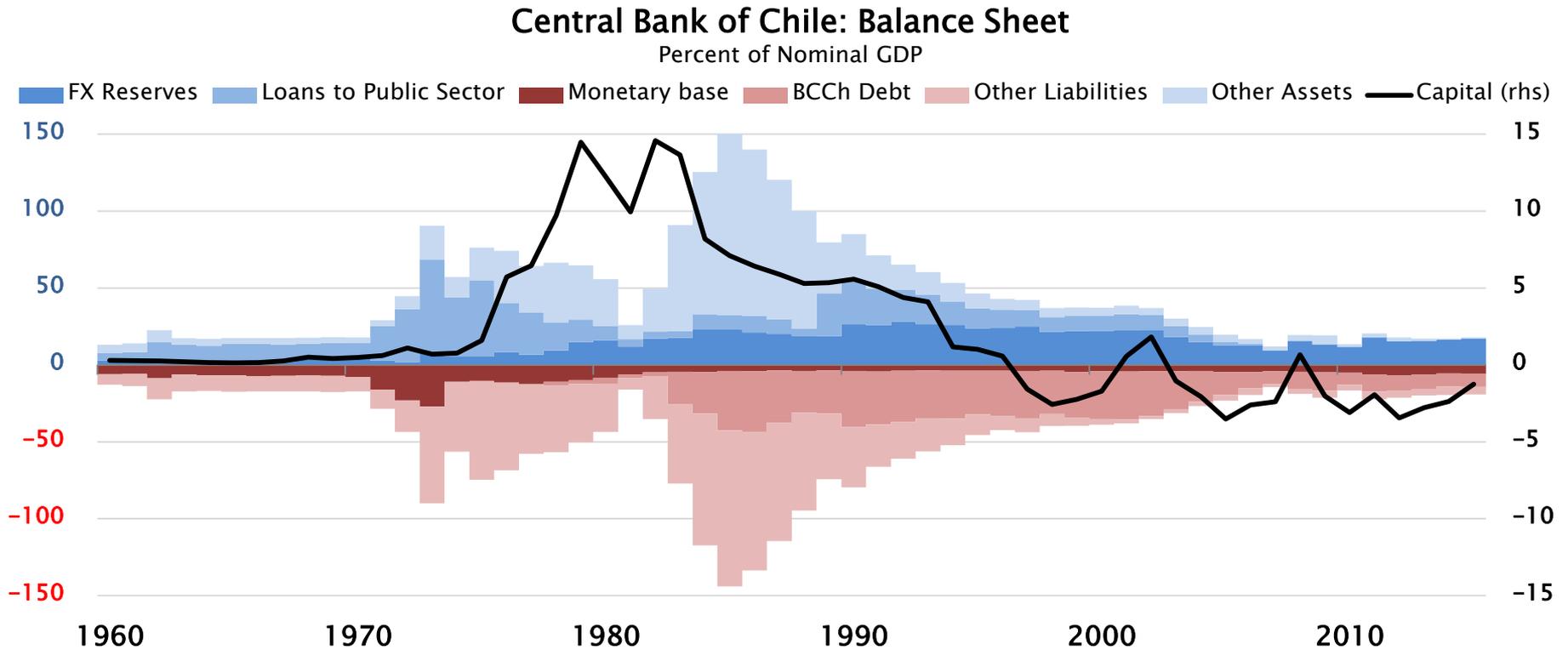


# Monetary and Fiscal Interactions in Chile and the size of the CBCh balance

- The end of Fiscal Dominance in the 1980's was essential for the achievement of monetary policy goals. However, the end of the “super cycle” of commodity prices presents some challenges for the coming years.
- The Debt Crisis of the 80s caused a huge expansion of the Central Bank's (CBCh) Balance Sheet that was eliminated in about a decade and a half. This was possible thanks to a systematic fiscal policy shift and new institutions such as the Copper Stabilization Fund and the Structural Balance Rule.
- The current size is about normal when compared to other LatAm economies, but the prohibition to buy public debt has forced the CBCh to issue its own debt for the sterilization of FX reserves, with a negative impact on its Net Worth.
- There is a large and growing demand for long-term safe and indexed debt coming from institutional investors, that helps to explain the relative stability of long-term interest rates in Chile during recent events of increased risk aversion.



# The size and composition of the Central Bank's balance sheet shows a telling picture of the Fiscal and Monetary interactions in the last half a century

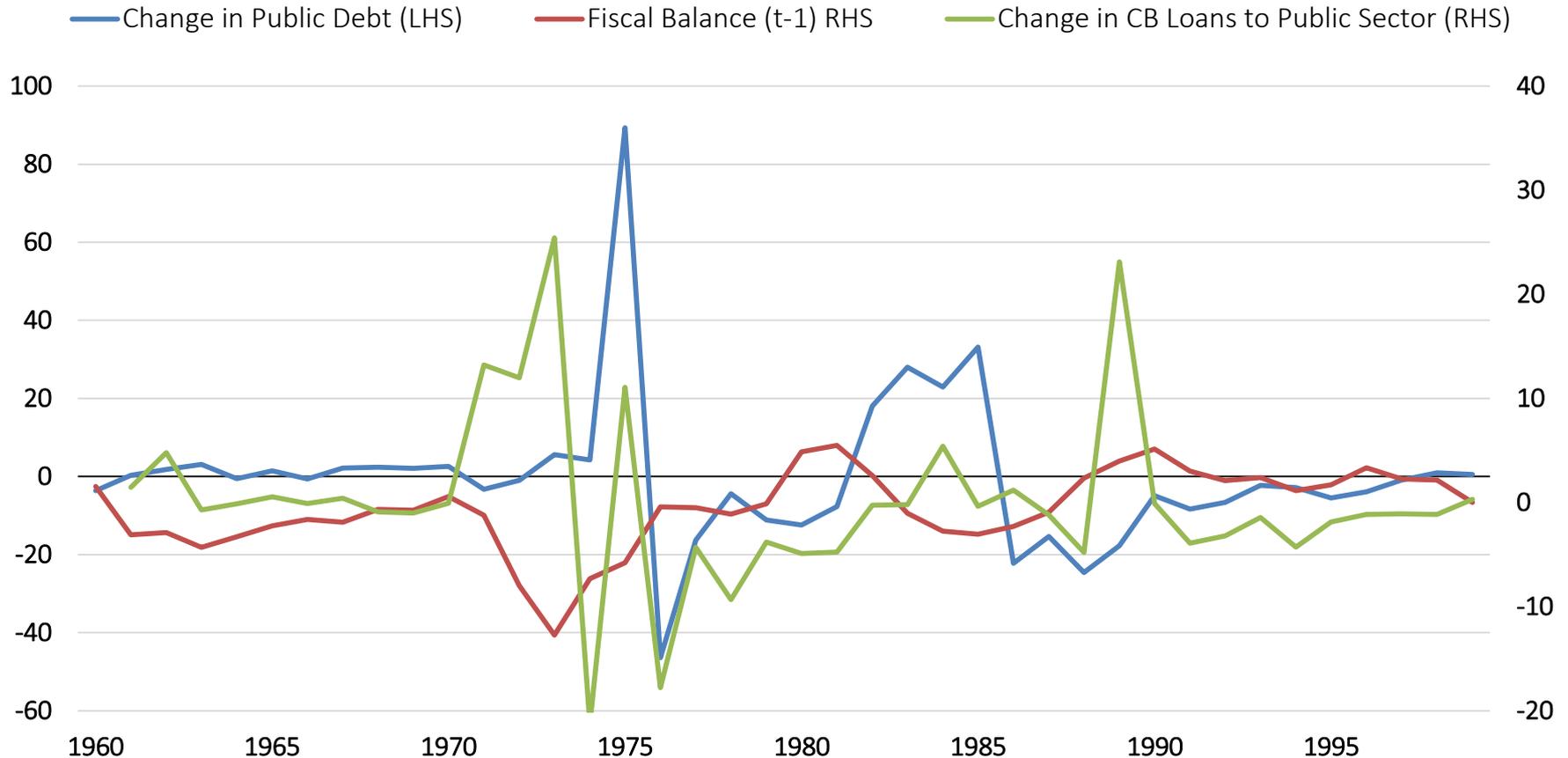


- Fiscal dominance in the 60s and 70s
- Huge impact of the Financial Crisis in 1982–83, with a lasting effect in the size of the CB balance sheet.
- CB Debt: A Chilean anomaly that began with the Debt Crisis and has continued as a consequence of sterilization without public debt transactions.



# Fiscal dominance in the 60s and early 70s, was followed by consolidation and a Financial Crisis. Starting in the late 80s fiscal discipline made a major contribution to MP success

Change in Public Debt, Fiscal Balance, and CB Loans to Public Sector  
Percent of GDP



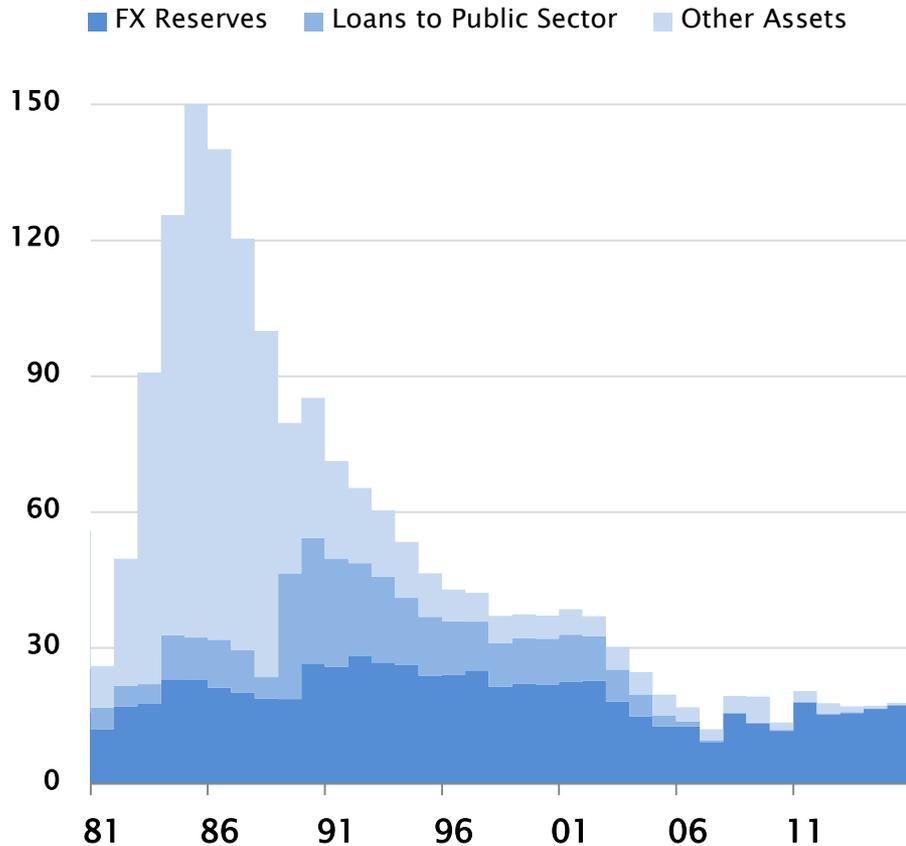
Source: Díaz, Luders, & Wagner (2016); IMF.



# Some interesting comparisons between the size of Central Banks' balance sheets

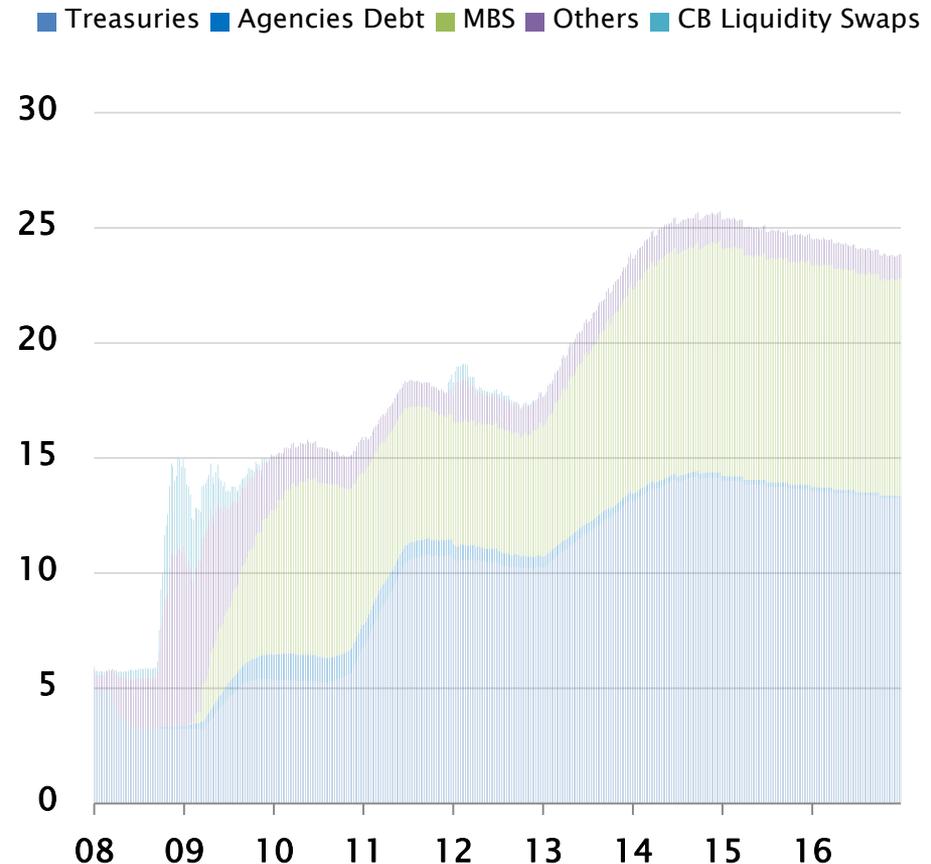
### Central Bank of Chile: Assets

Percent of Nominal GDP



### Federal Reserve: Assets

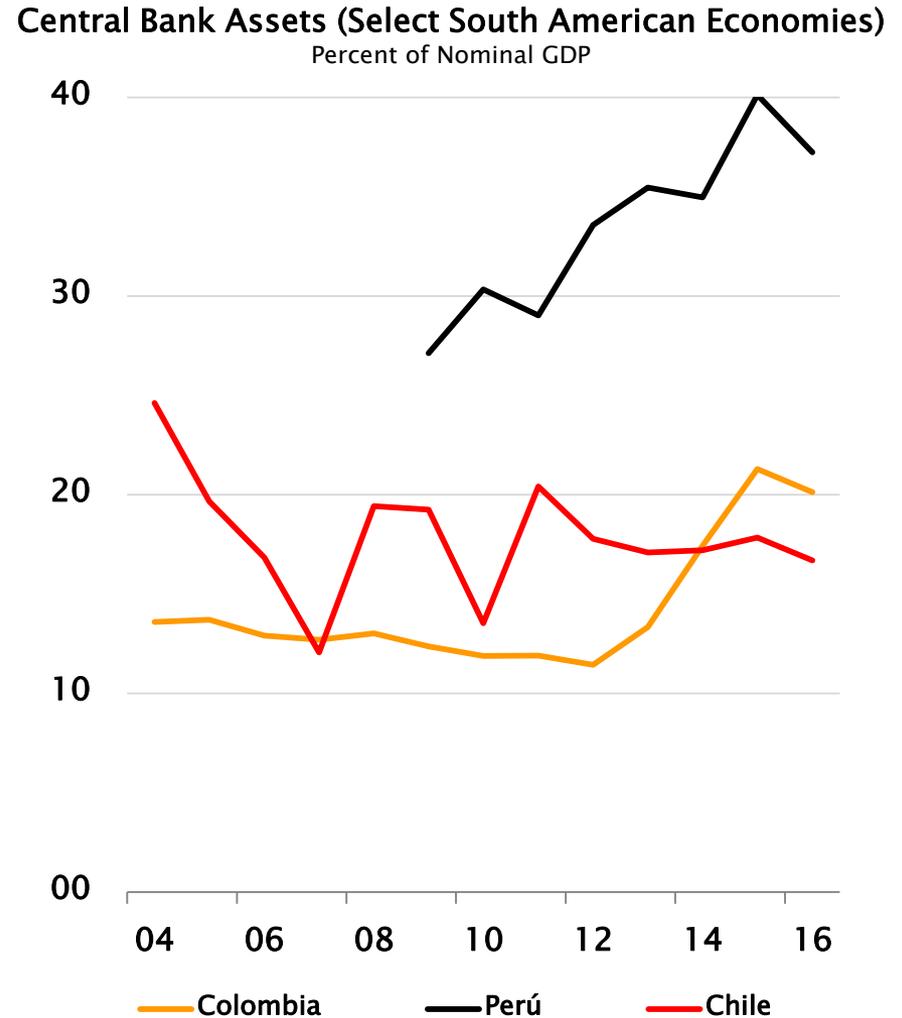
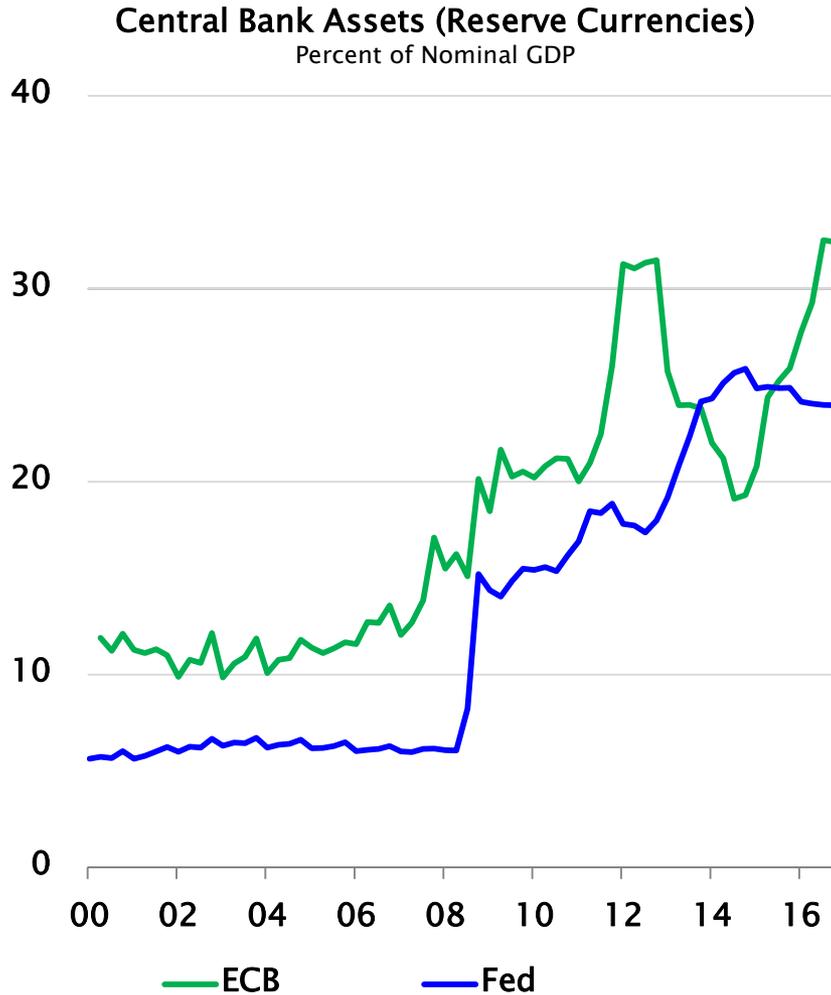
Percent of Nominal GDP



Source: Annual data for the Central Bank of Chile. Weekly data for the Federal Reserve approximated using four-quarter moving average nominal GDP.



# The size of the Balance sheet can change significantly and is not unusually large compared to other CBs in the region.



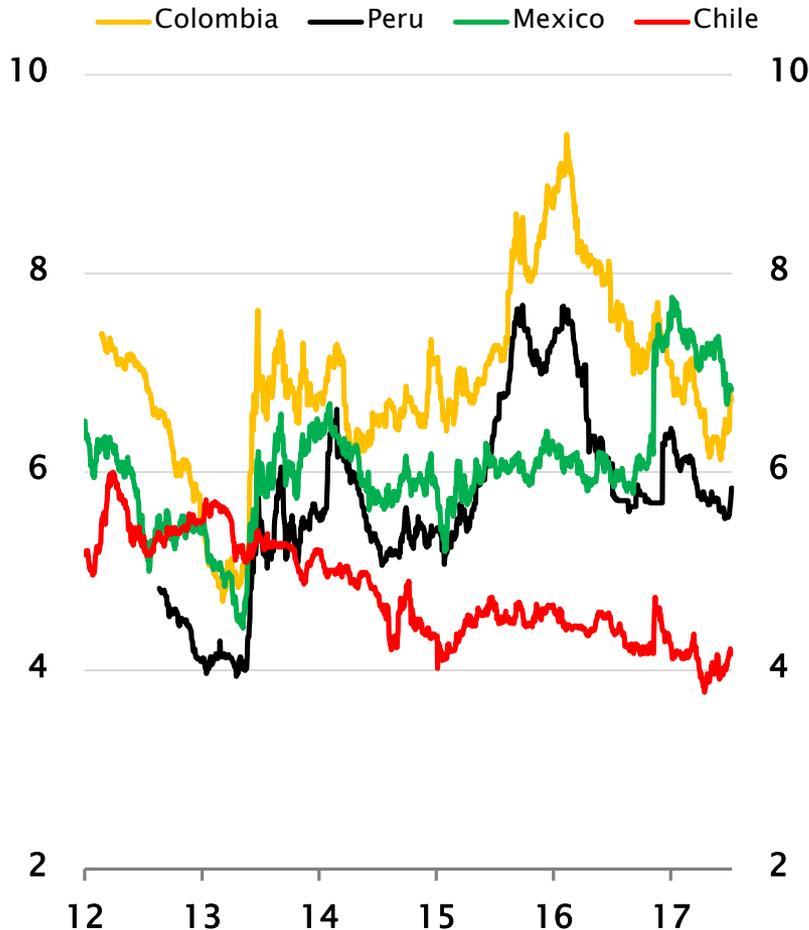
Source: Bloomberg.



One surprising feature of the Chilean Economy has been the relative stability of long term rates, that has not been at the expense of higher volatility in the exchange rate

### Ten Year Government Bond Yields

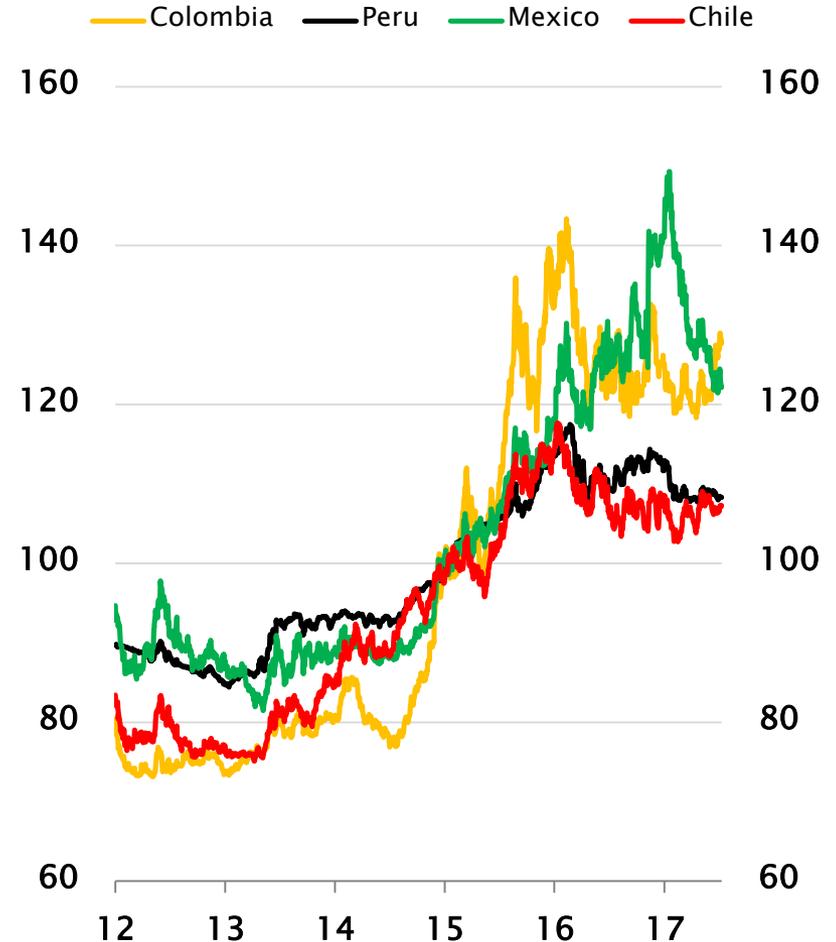
Nominal, Percent, Daily data



Source: Bloomberg.

### Nominal Exchange Rate

Relative to USD, Index, Jan.2015=100, Daily Data

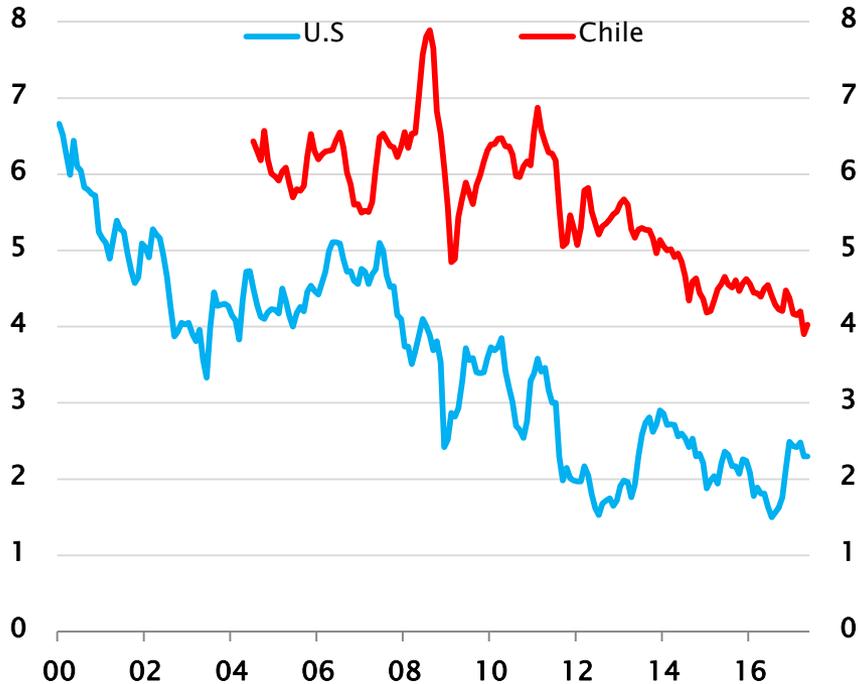


Source: Bloomberg.

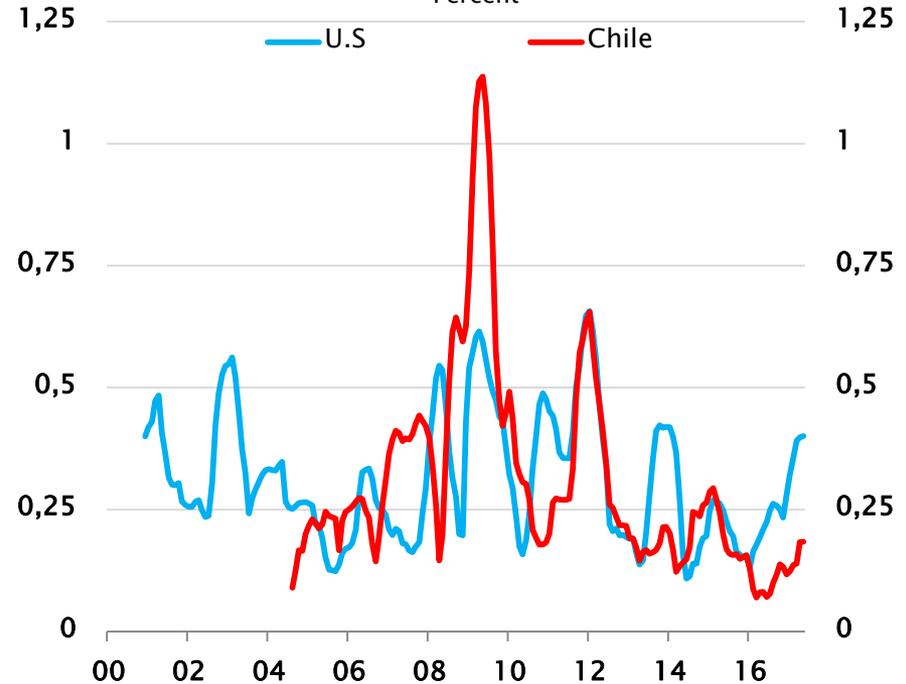


# Long-term interest rates remain at historically low levels. Volatility has been coming down and is lower than in the US

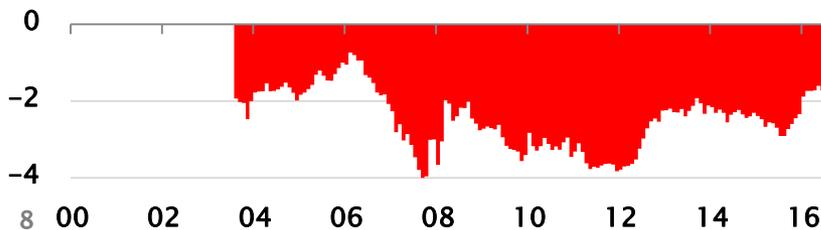
### 10-Year Government Bond Yields Percent



### 10-Year Government Bond Yields: Rolling 12m Standard Deviation Percent



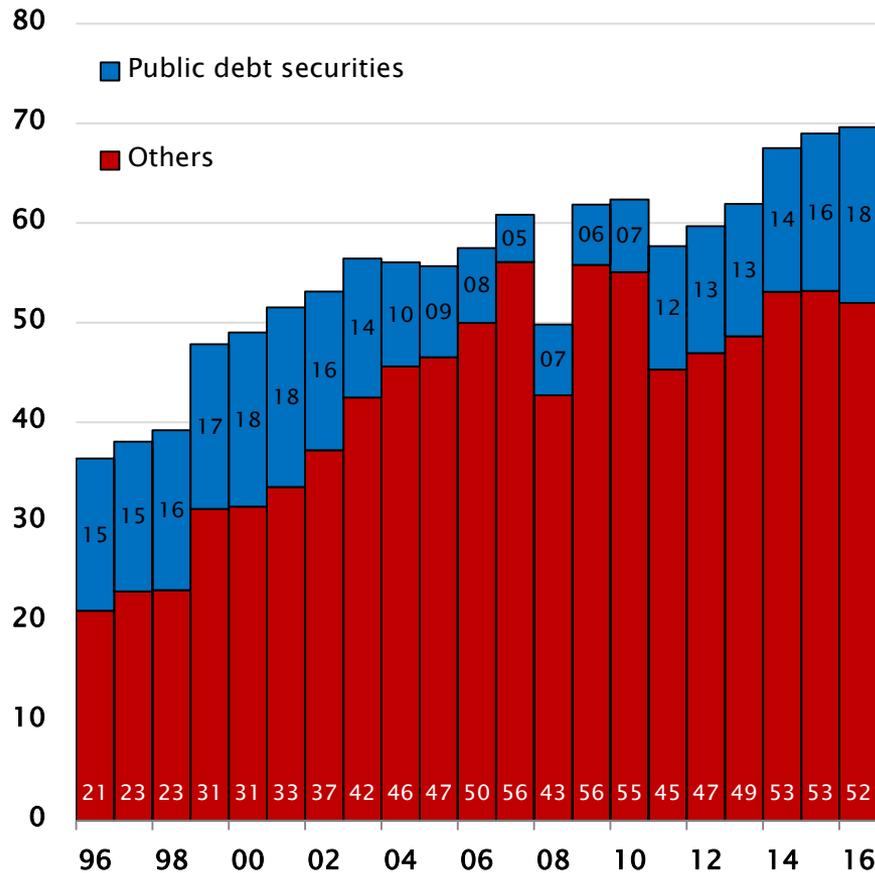
### Difference between 10Y U.S & 10Y Chile Percent





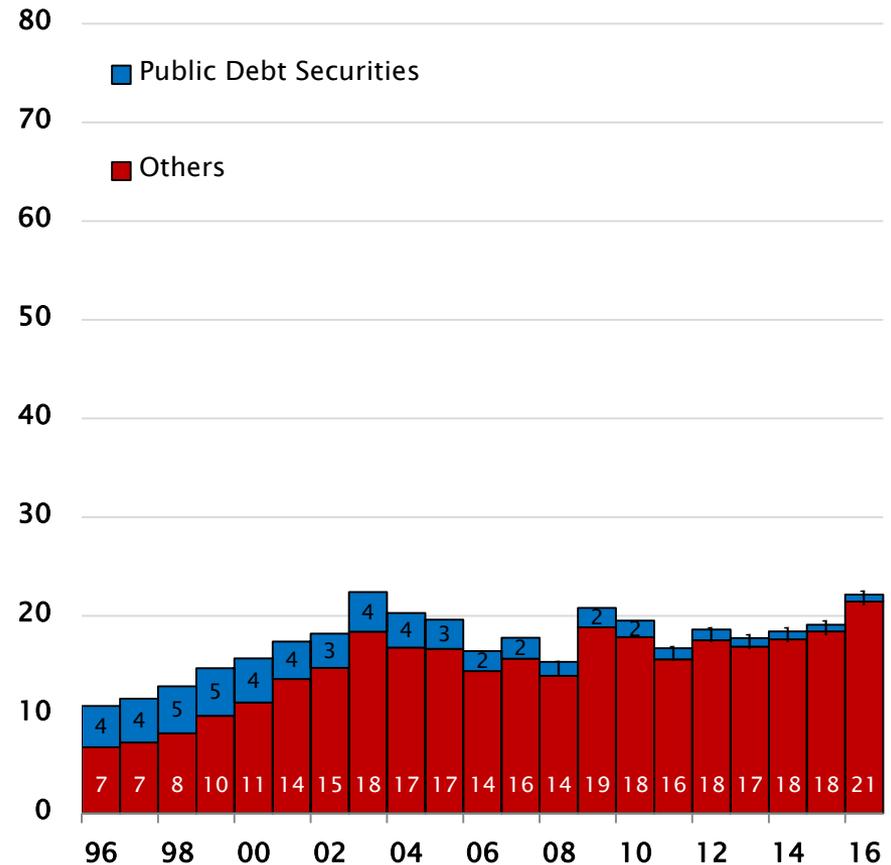
# Part of the answer might be in the large and increasing demand for long dated public debt coming from Institutional Investors.

**Total Pension Funds: Assets**  
Percent of Nominal GDP



Source: Superintendencia de Pensiones.

**Total Insurance Companies: Assets**  
Percent of Nominal GDP

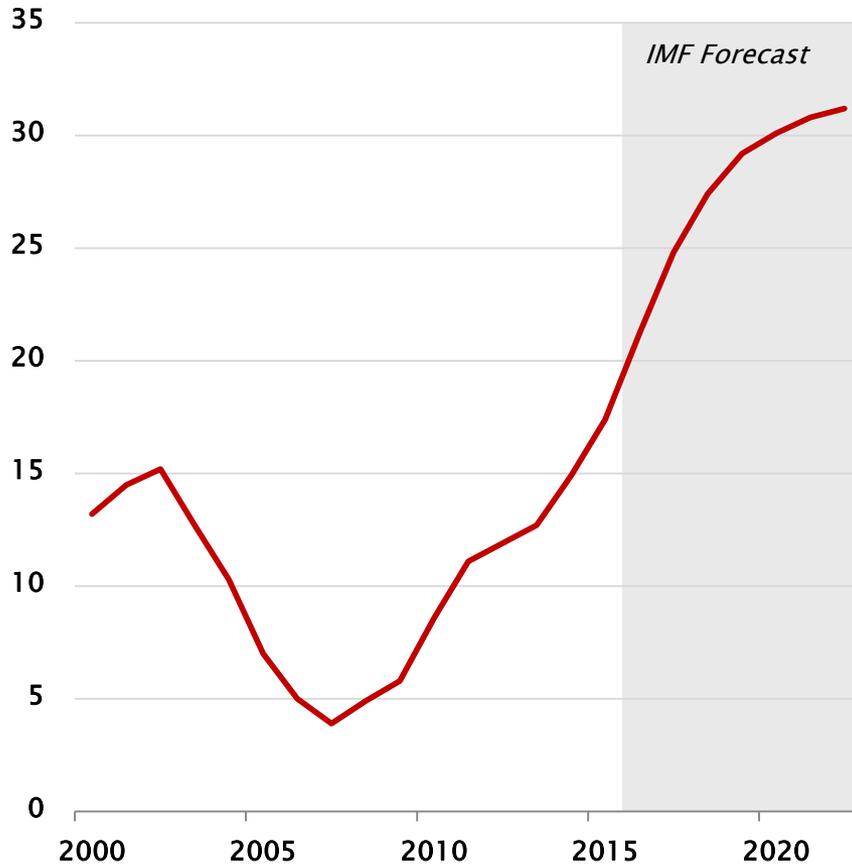


Source: Superintendencia de Valores & Seguros.

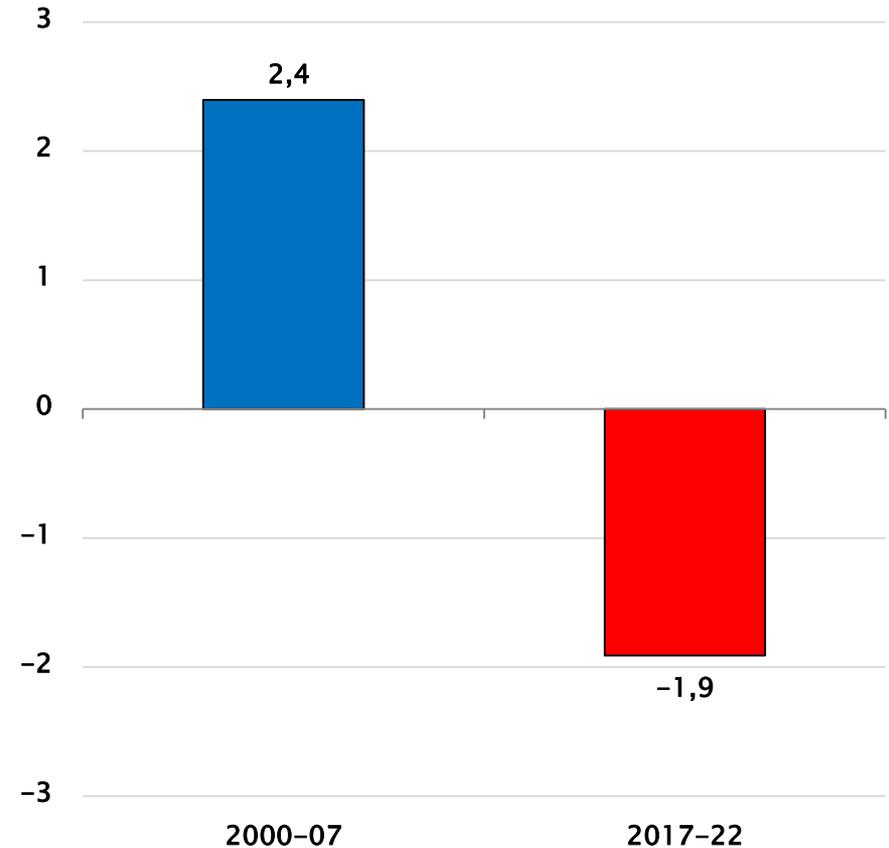


# The medium term challenge on the fiscal side is maintaining a credible consolidation path amid expectations of slower growth and lower copper prices.

Chile: General Government Debt (Actual & Forecast)  
Percent of GDP



Chile: Overall Fiscal Balance  
Percent of GDP



Source: IMF Fiscal Monitor, April 2017.