



Challenges to Monetary Policy

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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.



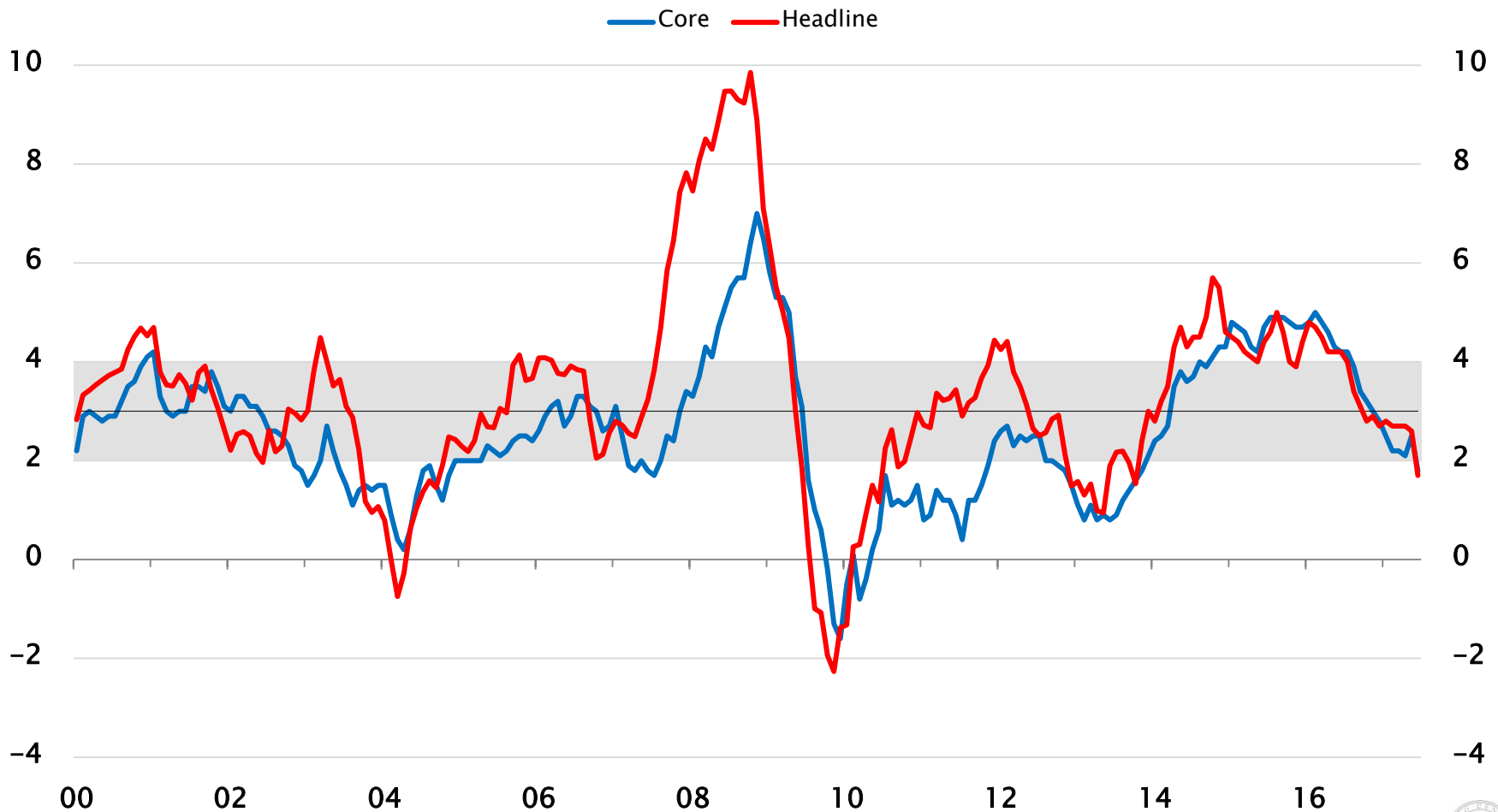
Key Issues

- Can Central Banks in small open economies conduct monetary policy focusing on domestic targets?
- Could this cause undesired (excessive) volatility in the Exchange Rate?
- Challenges: Fiscal and International Financial conditions



Inflation: volatile, but centered in CB target

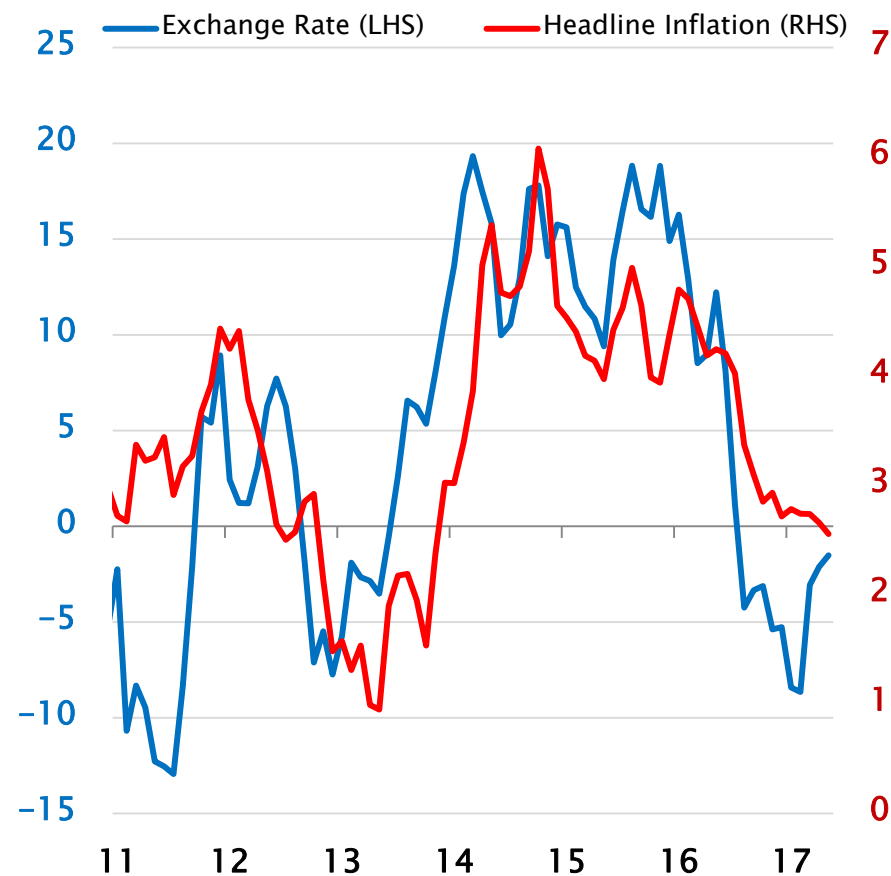
Chile: Headline & Core Inflation
Annual Variation, Percent



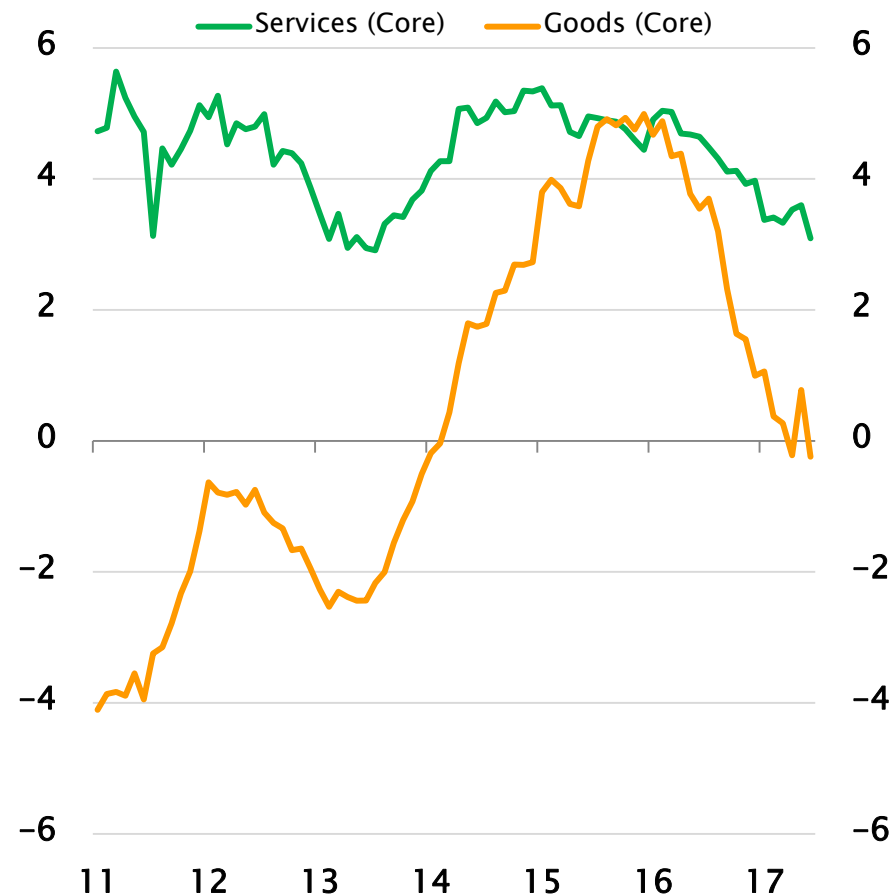


Inflation in Chile: strongly correlated with ER movements in the short term. Domestic factors play a role through non-tradables over a longer time horizon.

Exchange Rate* & Inflation
Annual Variation, Percent



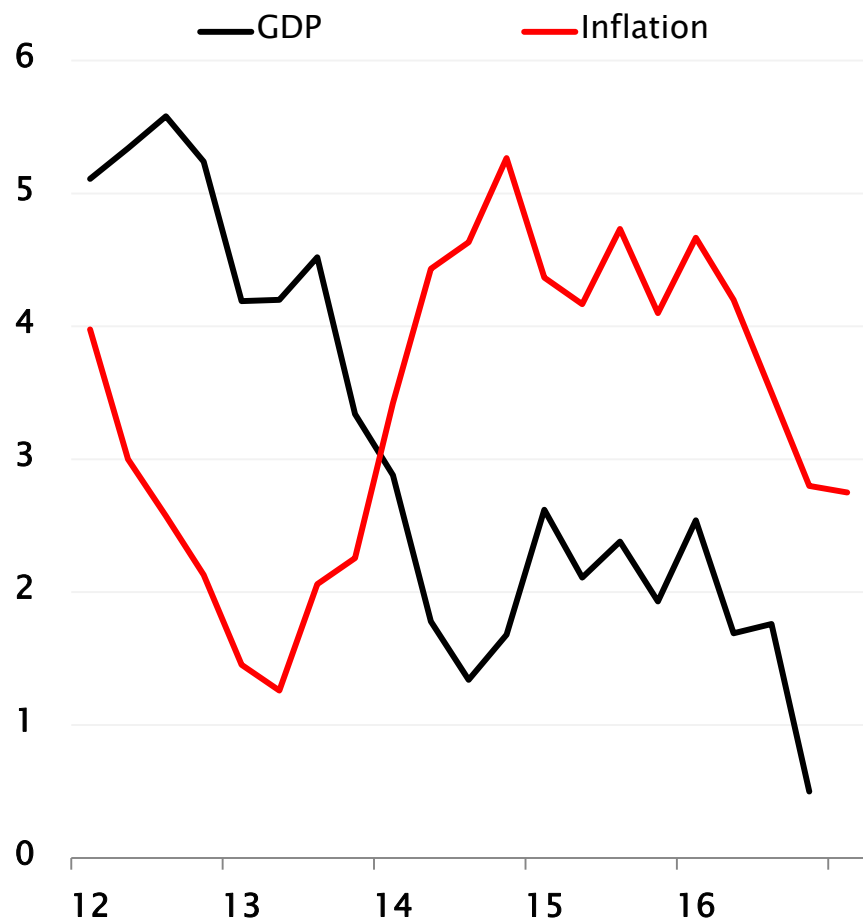
Goods & Services Inflation
Annual Variation, Percent



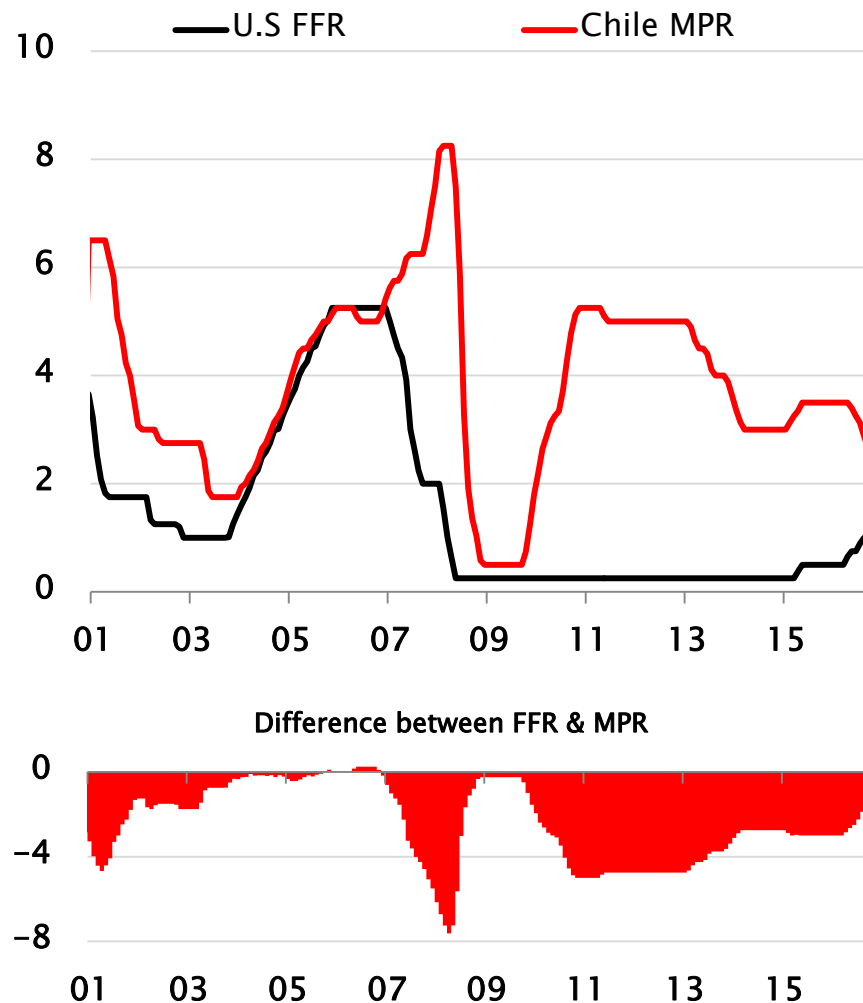


Facing a challenging domestic outlook of slowing growth and rising inflation in 2013, the Central Bank of Chile responded aggressively by easing monetary policy.

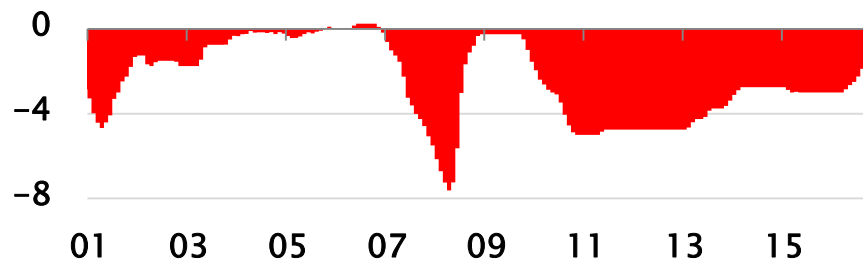
Growth & Inflation
Annual Variation, Percent



Monetary Policy Rates: U.S & Chile
Percent

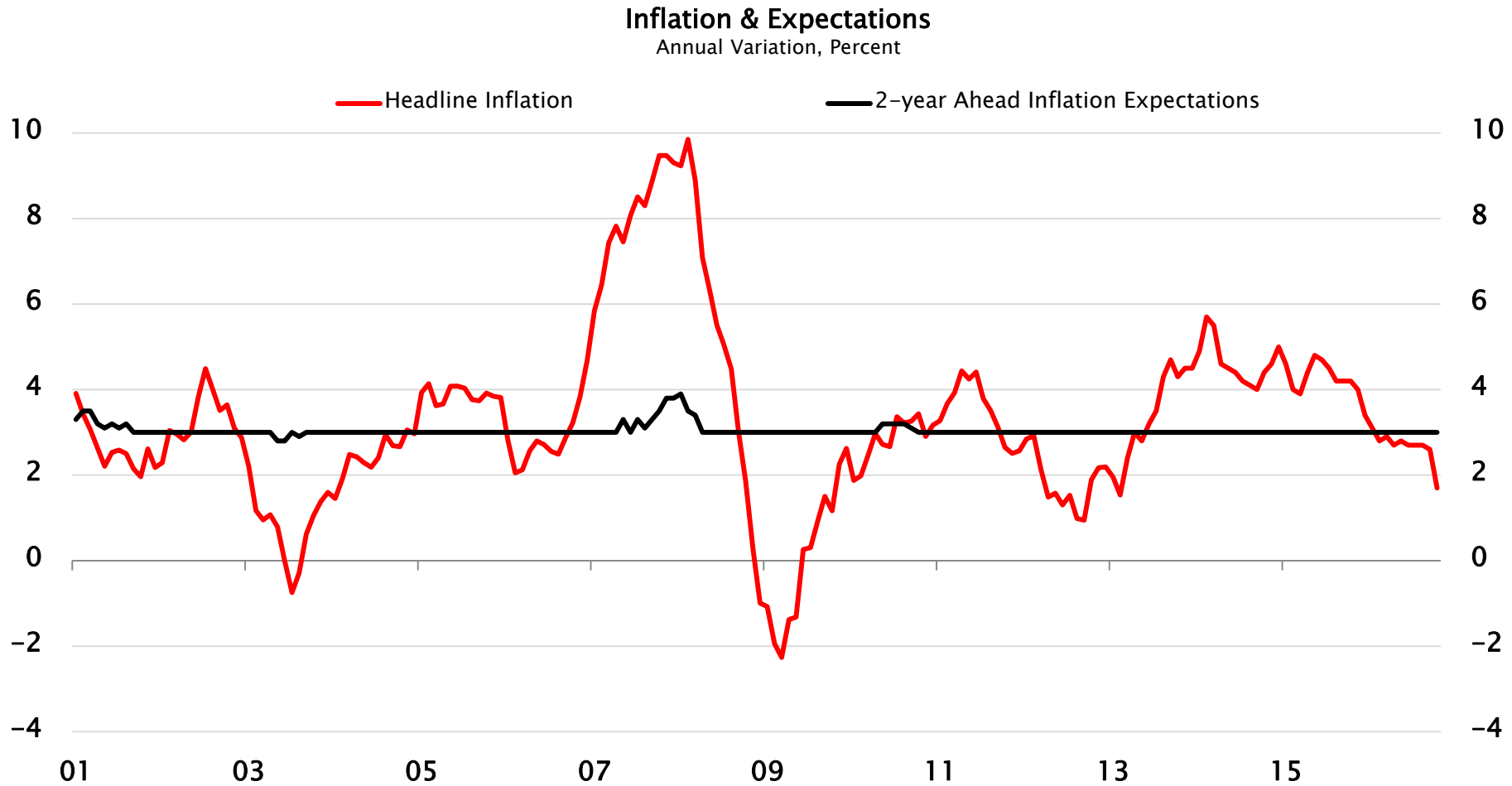


Difference between FFR & MPR





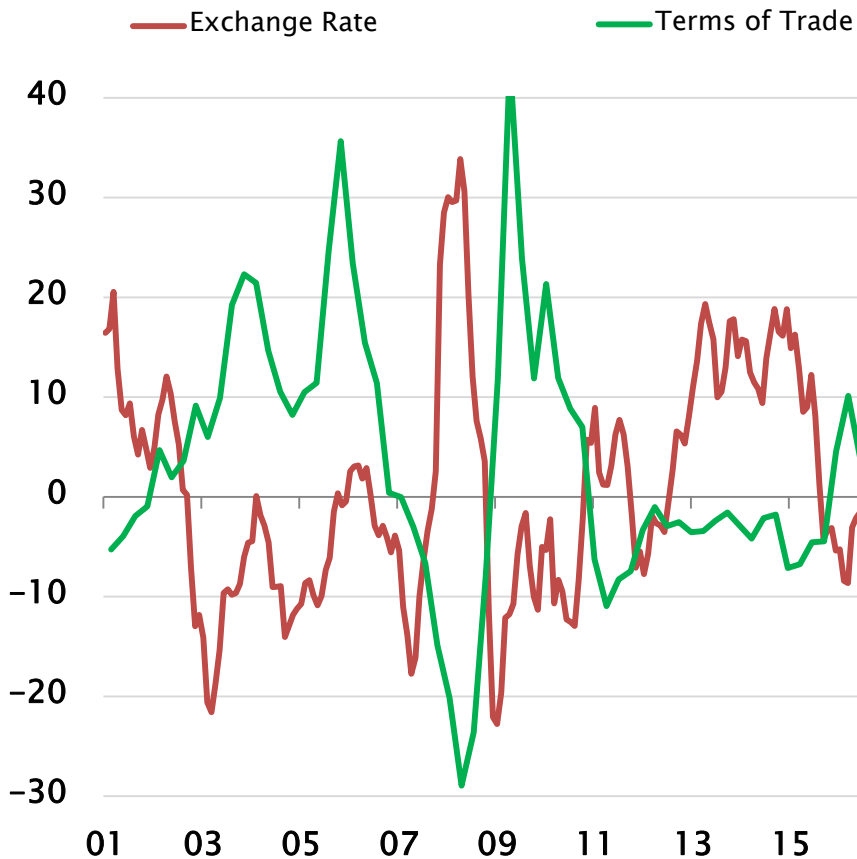
Countercyclical monetary policy was facilitated by well-anchored inflation expectations.



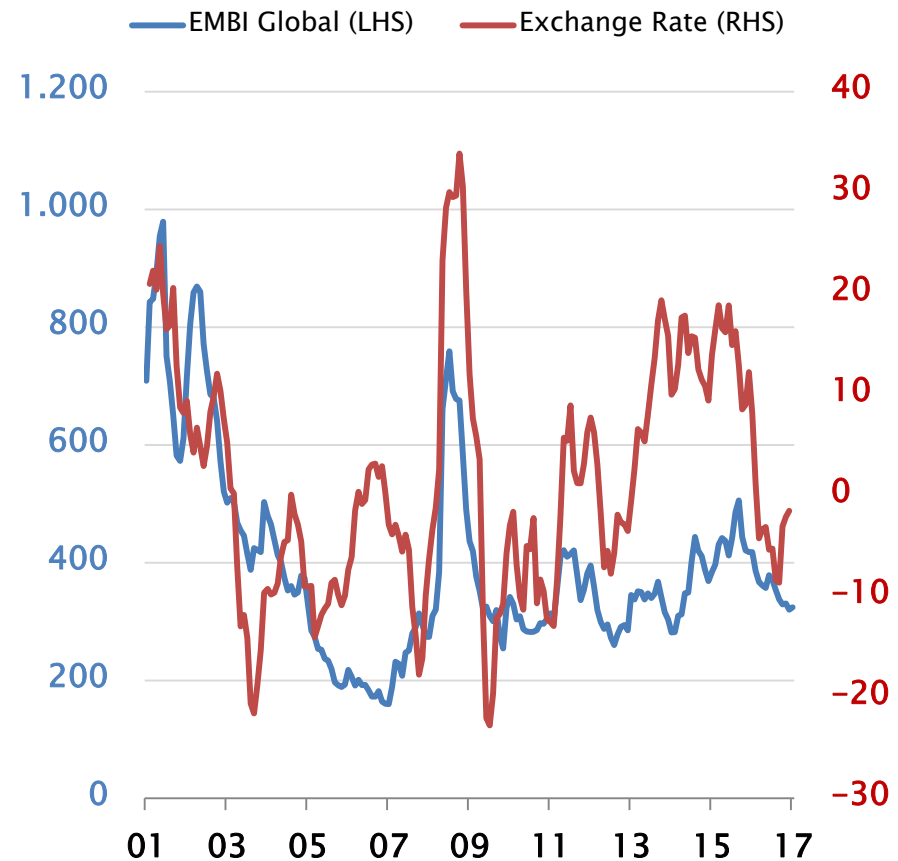


Exchange Rates have played a critical role in the adjustment process in Chile, helping absorb ToT shocks as well as episodes of heightened risk aversion.

Exchange Rate & Terms of Trade
Annual Variation (Percent)



Global EMBI & Nominal Exchange Rate
Index & Annual Variation (Percent)



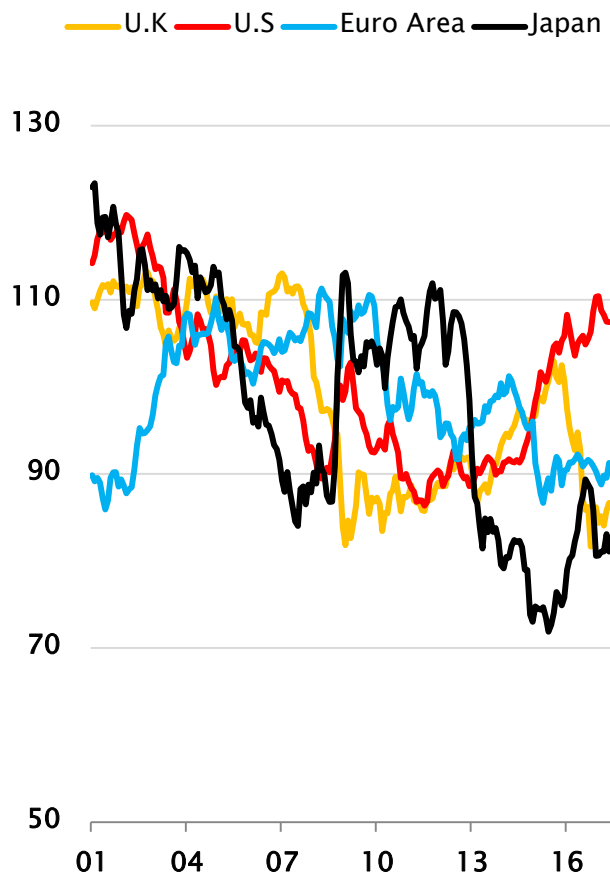


Despite of the role of the FX as a shock absorber in Chile, real and nominal FX volatility do not look excessive

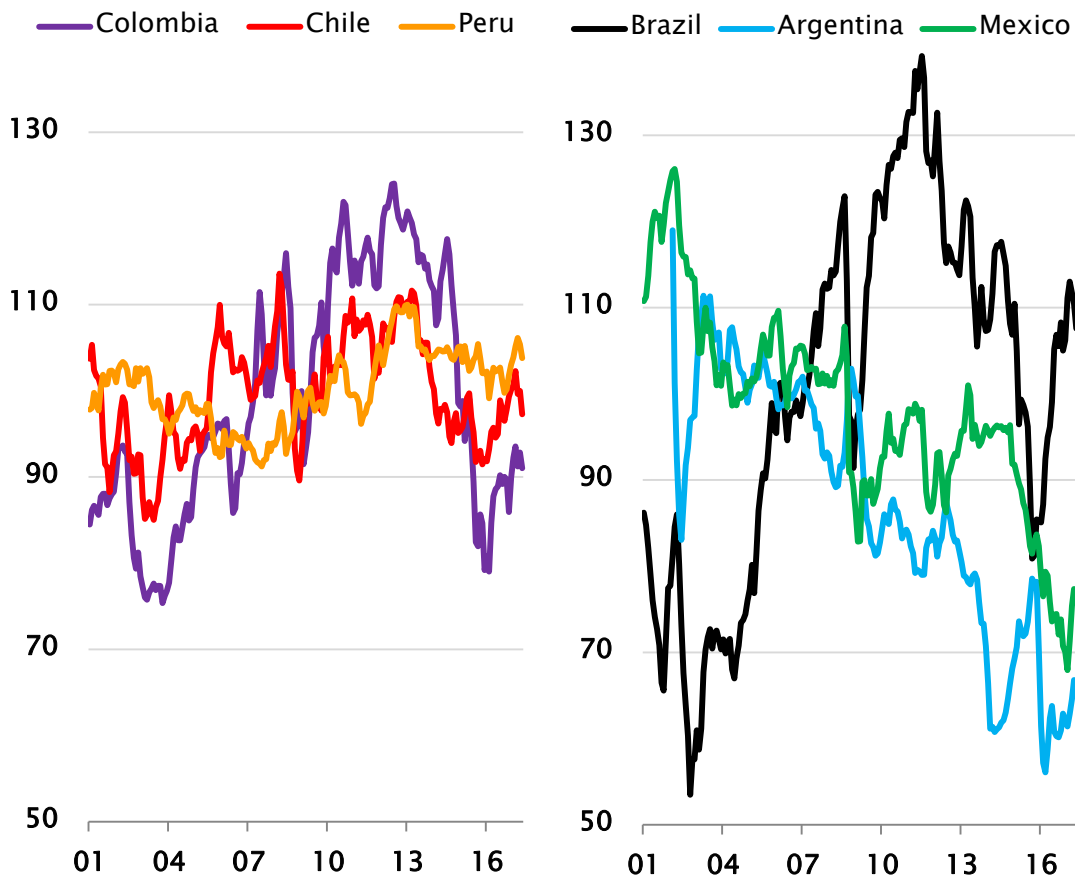
Real Effective Exchange Rates*

(Index, 2001–2015=100)

A: Select Advanced Economies

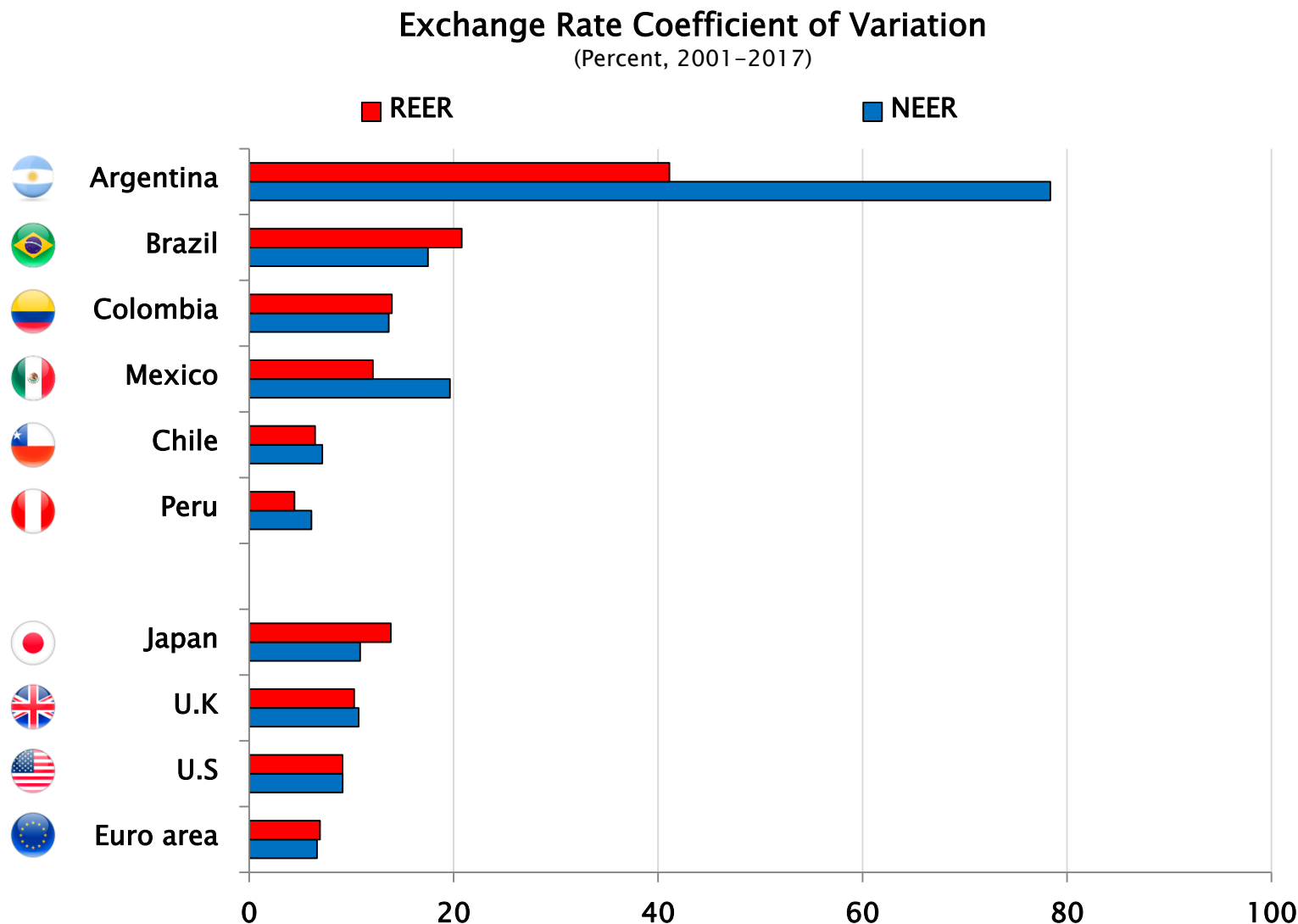


B: Select South American Economies





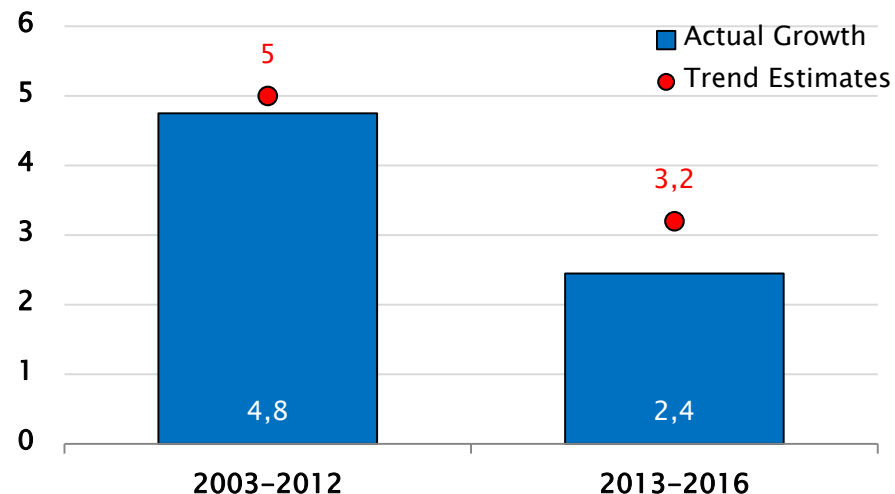
Despite the role of the FX as a shock absorber in Chile, FX volatility (real and nominal) (does not look excessive .



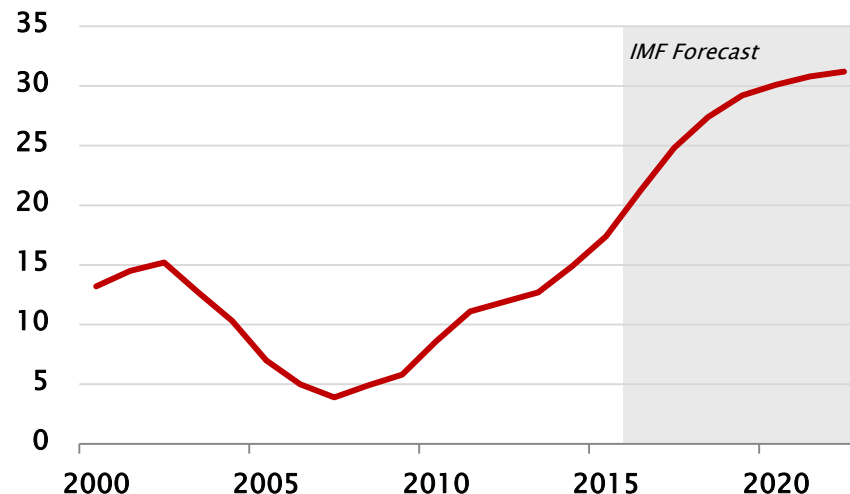


The medium term challenge on the fiscal side is maintaining a credible consolidation path amid expectations of slower growth and lower copper prices.

Chile: Average GDP Growth (Actual & Trend Estimates)
Annual Variation, Percent



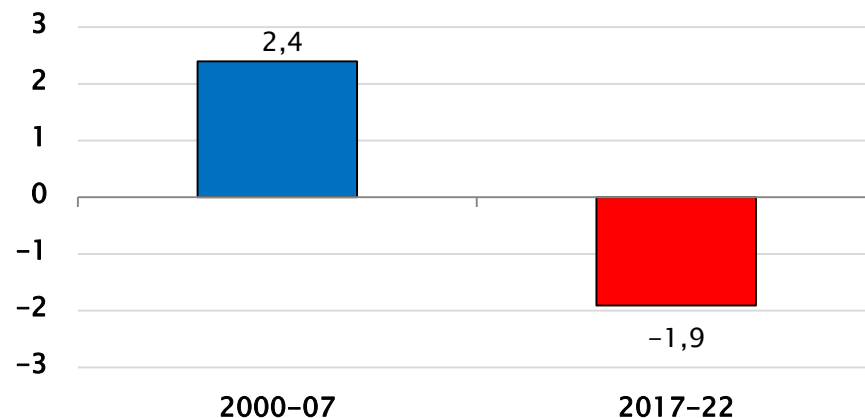
General Government Debt (Actual & Forecast)
Percent of GDP



Copper Price & Long-Run Estimates
USD per Pound

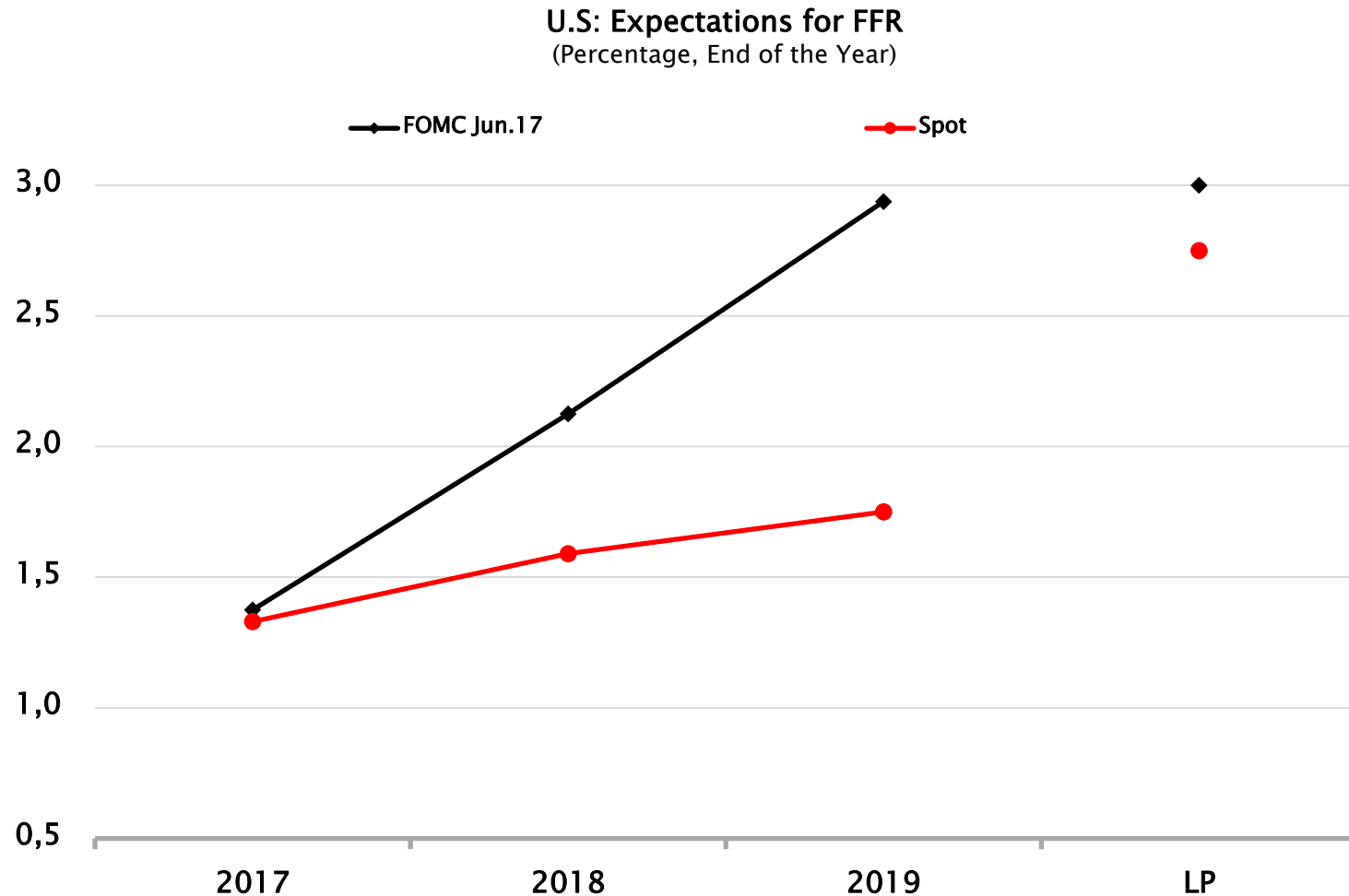


Overall Fiscal Balance
Percent of GDP





Looking ahead, tighter international financial conditions remain an important risk.





Key Issues

- **Can Central Banks in small open economies conduct monetary policy focusing on domestic targets?**
 - Yes, as long as there is CB credibility and no major domestic imbalances.
- **Could this cause undesired (excessive) volatility in the Exchange Rate?**
 - Apparently not, but this requires credibility and low vulnerability to financial flows.
- **Challenges: Fiscal and International Financial conditions**
 - They are challenging, but look manageable.