Chilean economic outlook and recent financial market developments

Mario Marcel

Governor

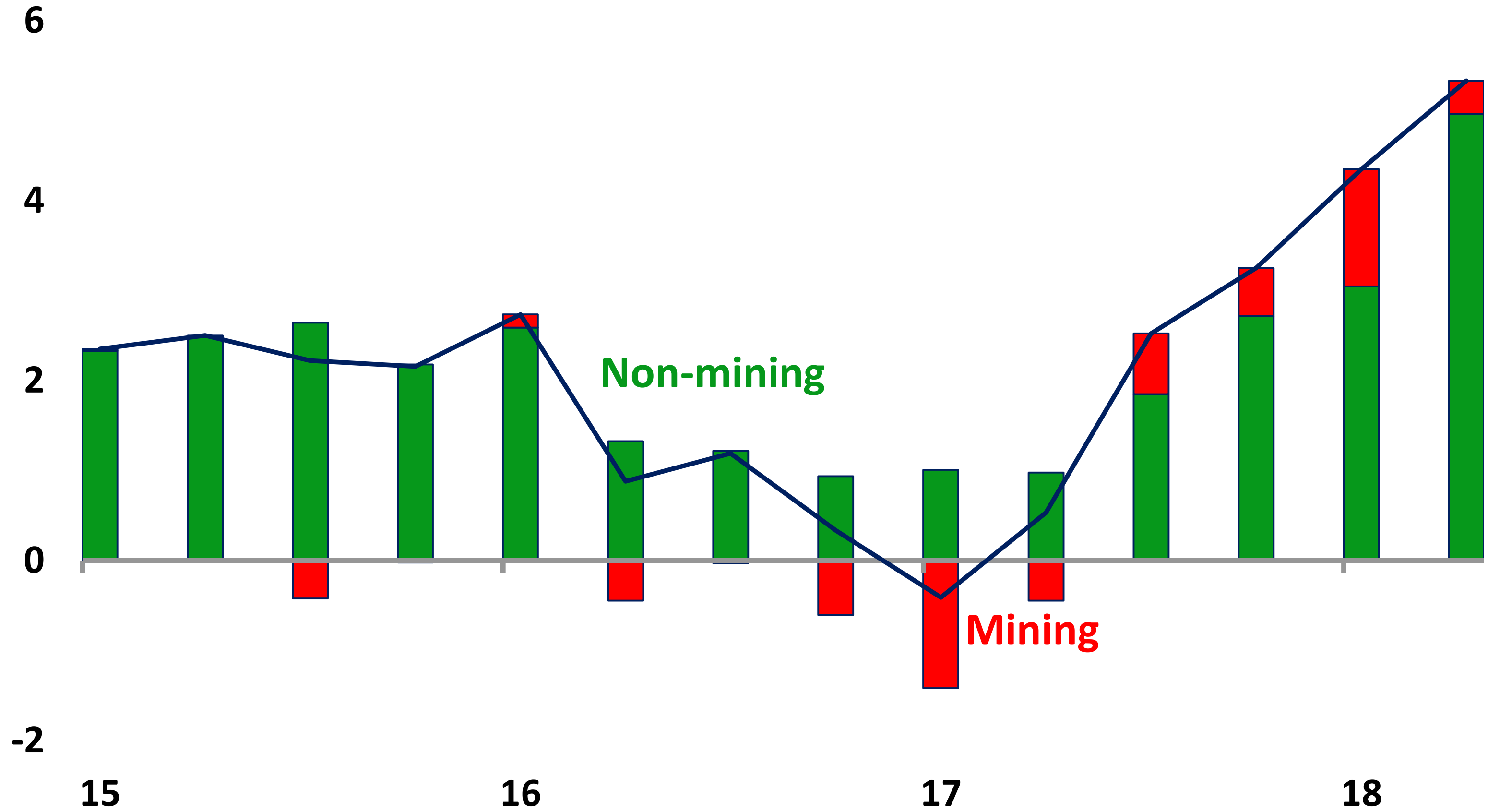
Central Bank of Chile

ChileDay, London, 6-7 September, 2018

Economic outlook

Annual GDP growth

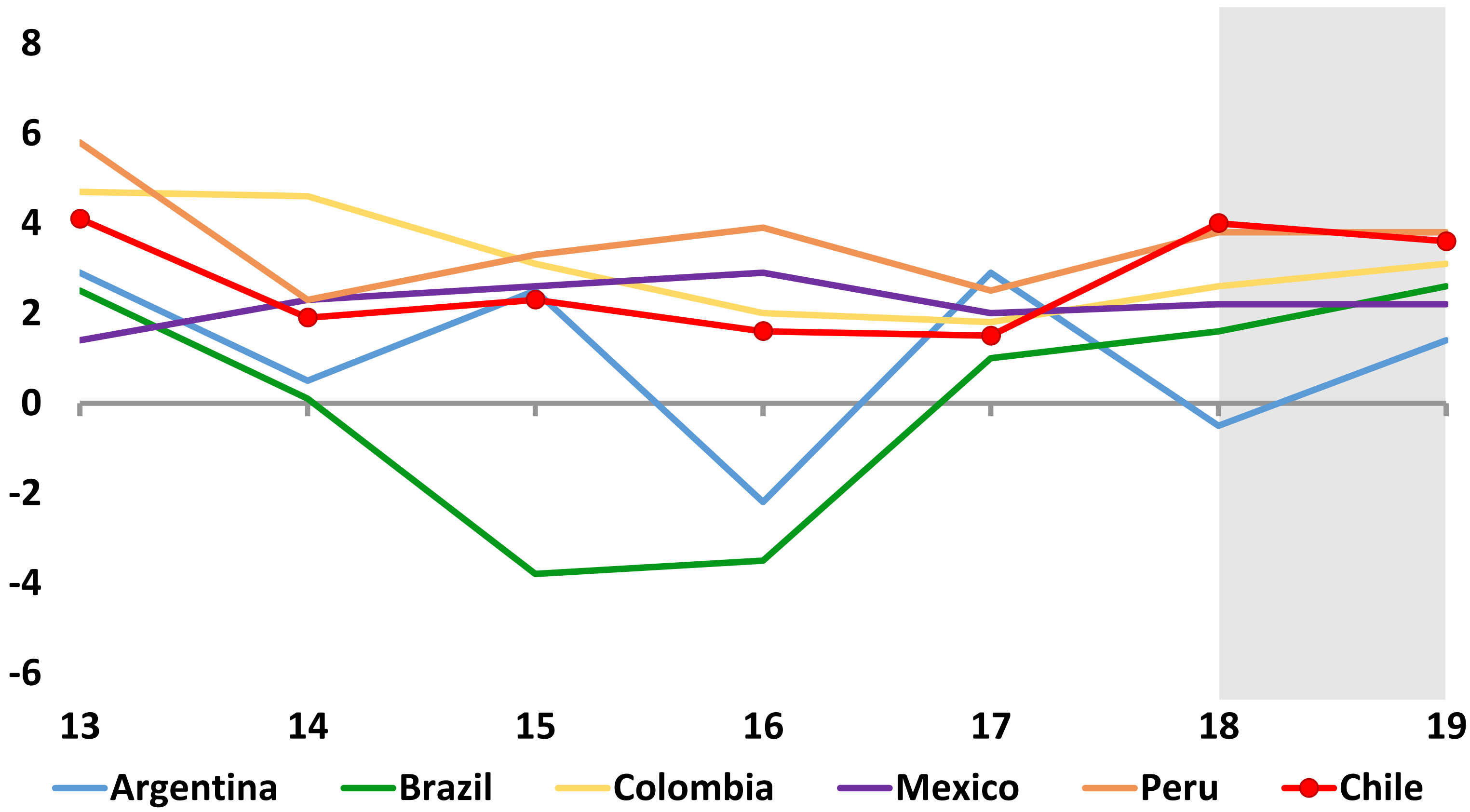
(contribution, percentage points)



Source: Central Bank of Chile.

GDP growth in Latin America (*)

(percentage points)

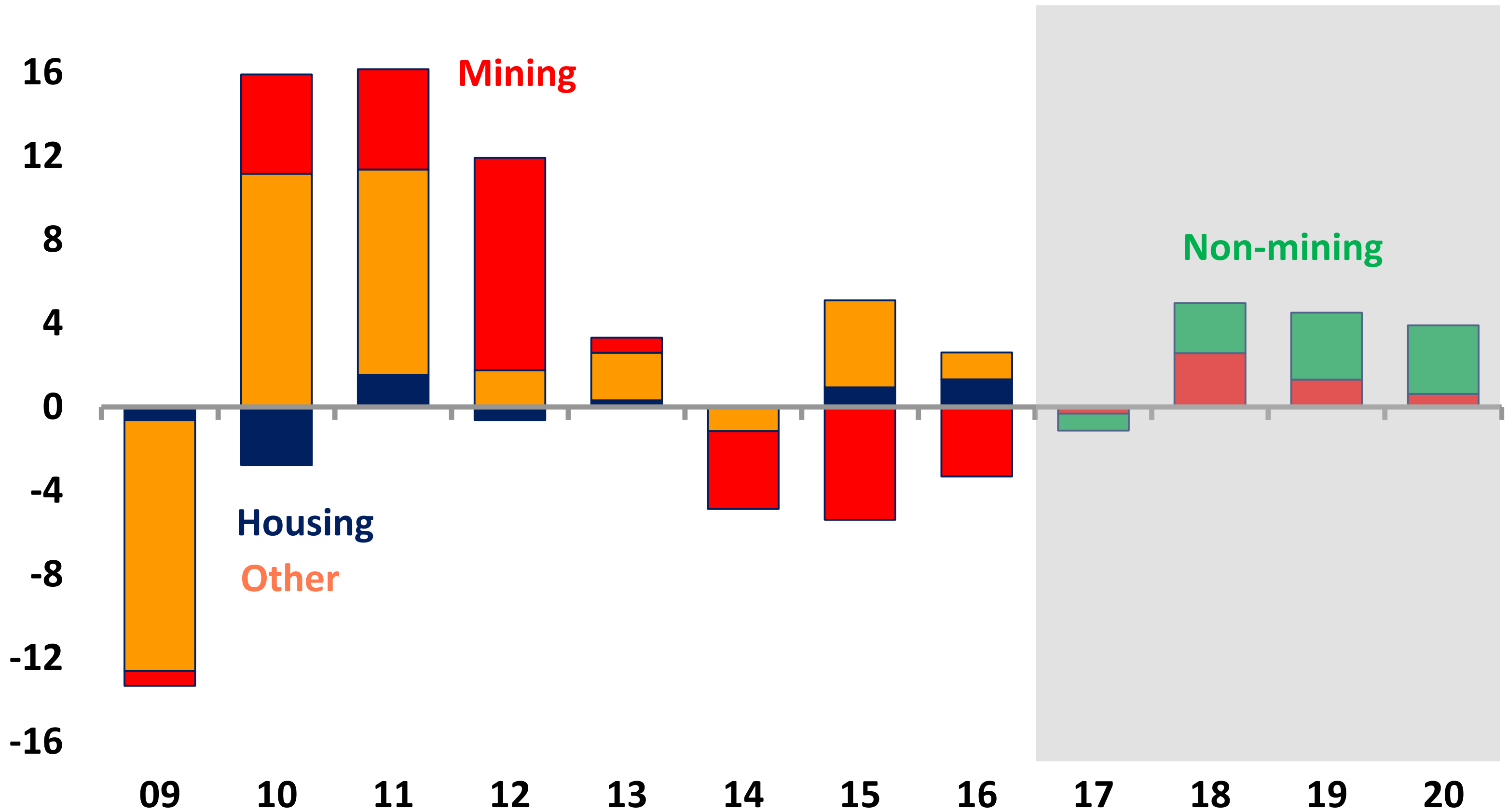


(*) Forecasts for 2018 and 2019.

Source: Consensus Forecasts.

Real annual contributions to Gross Fixed Capital Formation (*)

(percentage points)

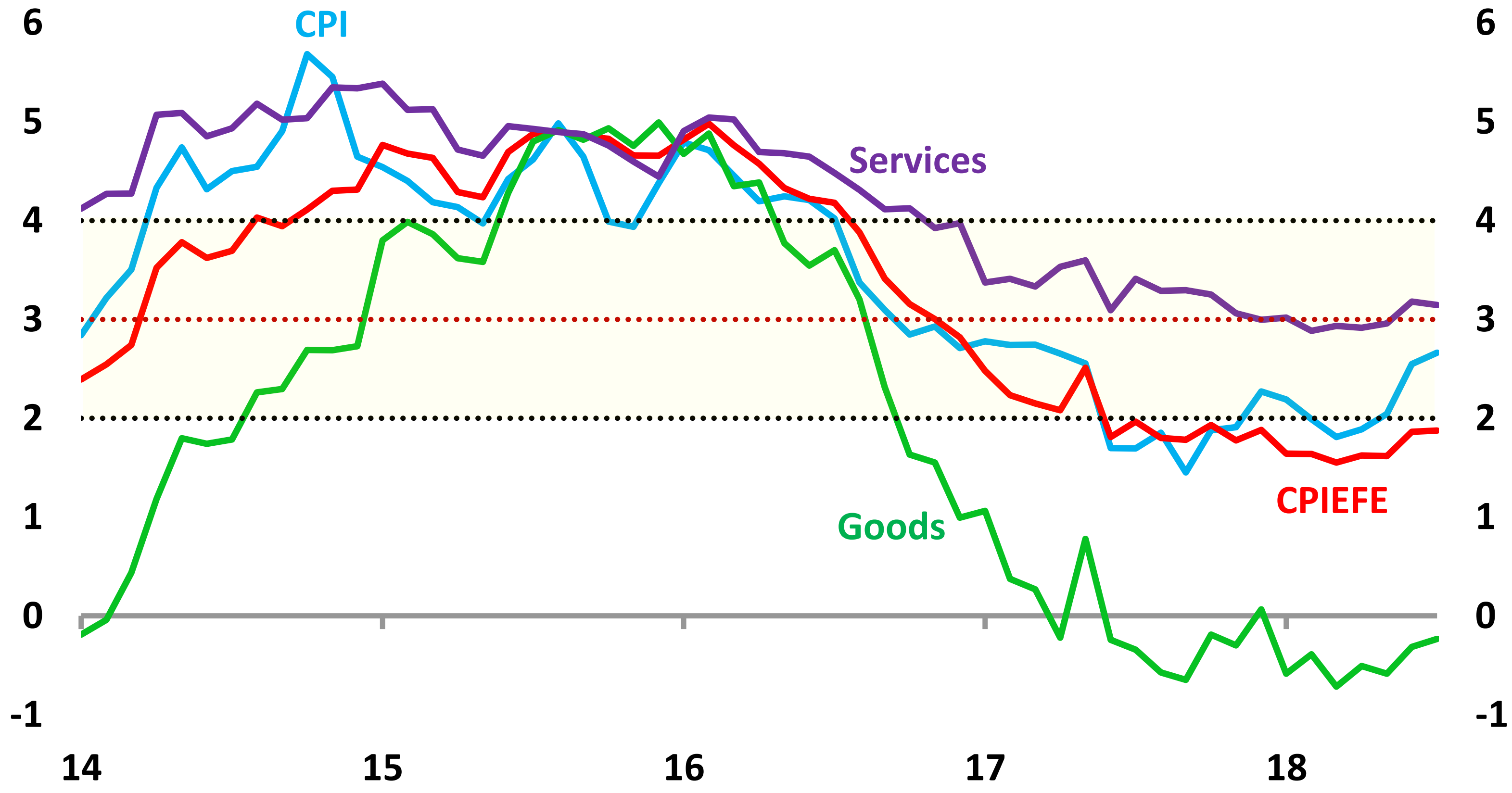


(*) For 2017 mining investment is estimated using FECU information. Housing investment uses household investment data taken from the National Accounts by institutional sector. The other GFCF component is a residue. Reported projections for the years 2018, 2019 and 2020 use forecasting models of the Central Bank and sectorial sources, including the Capital Goods Corporation's investment plans and cadastral surveys.

Source: Central Bank of Chile.

Inflation indicators

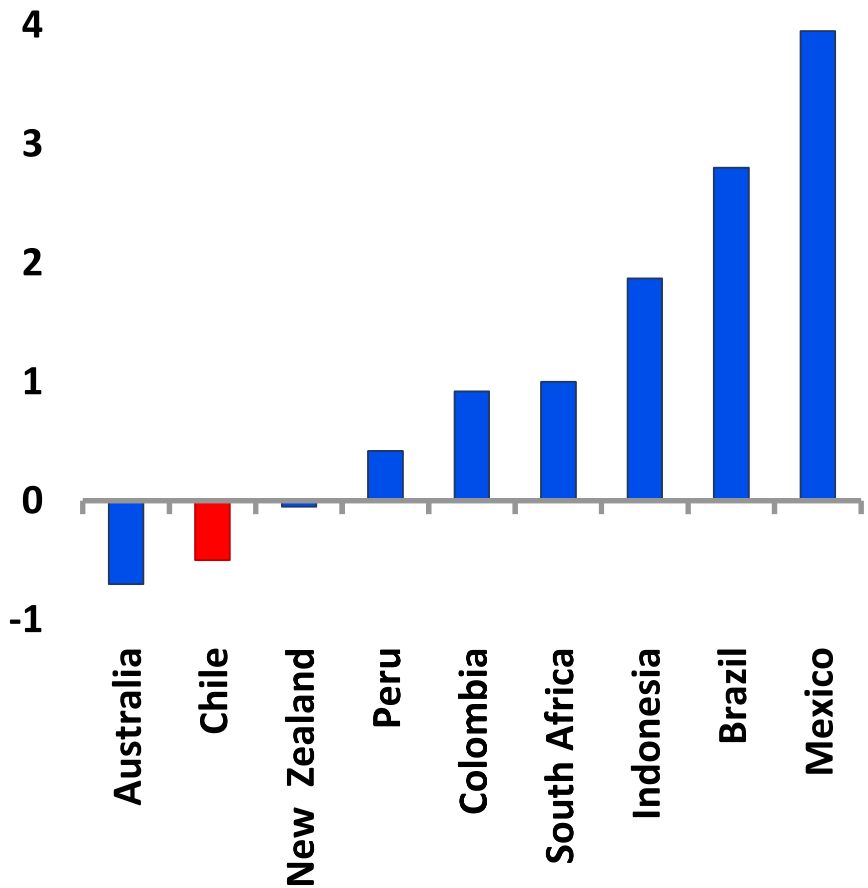
(annual change, percent)



Source: Central Bank of Chile and National Statistics Institute.

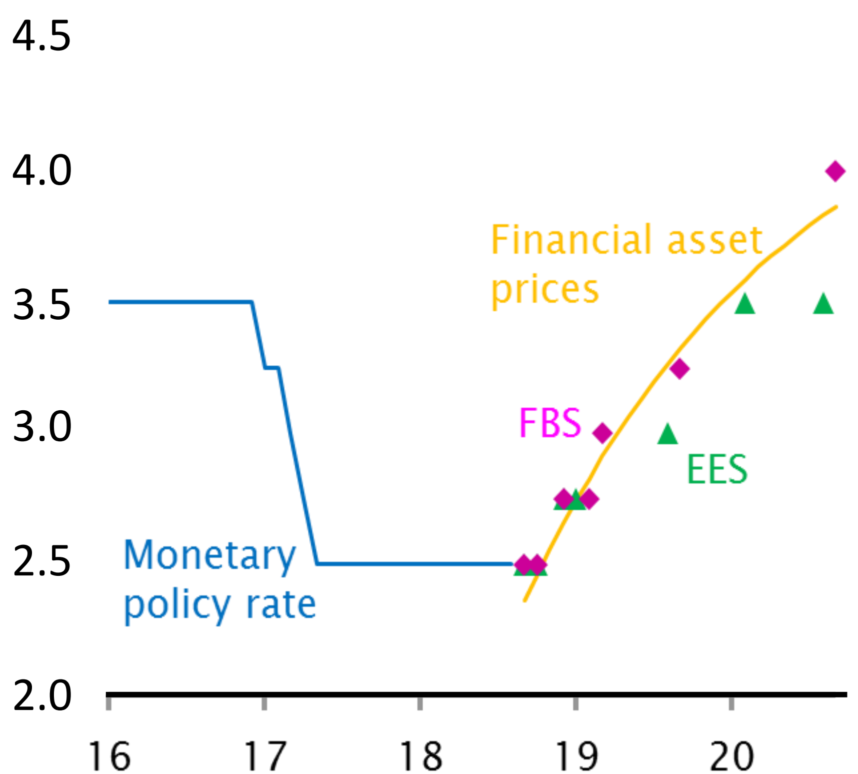
Real Monetary Policy Rate (*)

(percent)



Monetary Policy Rate and market expectations

(percent)

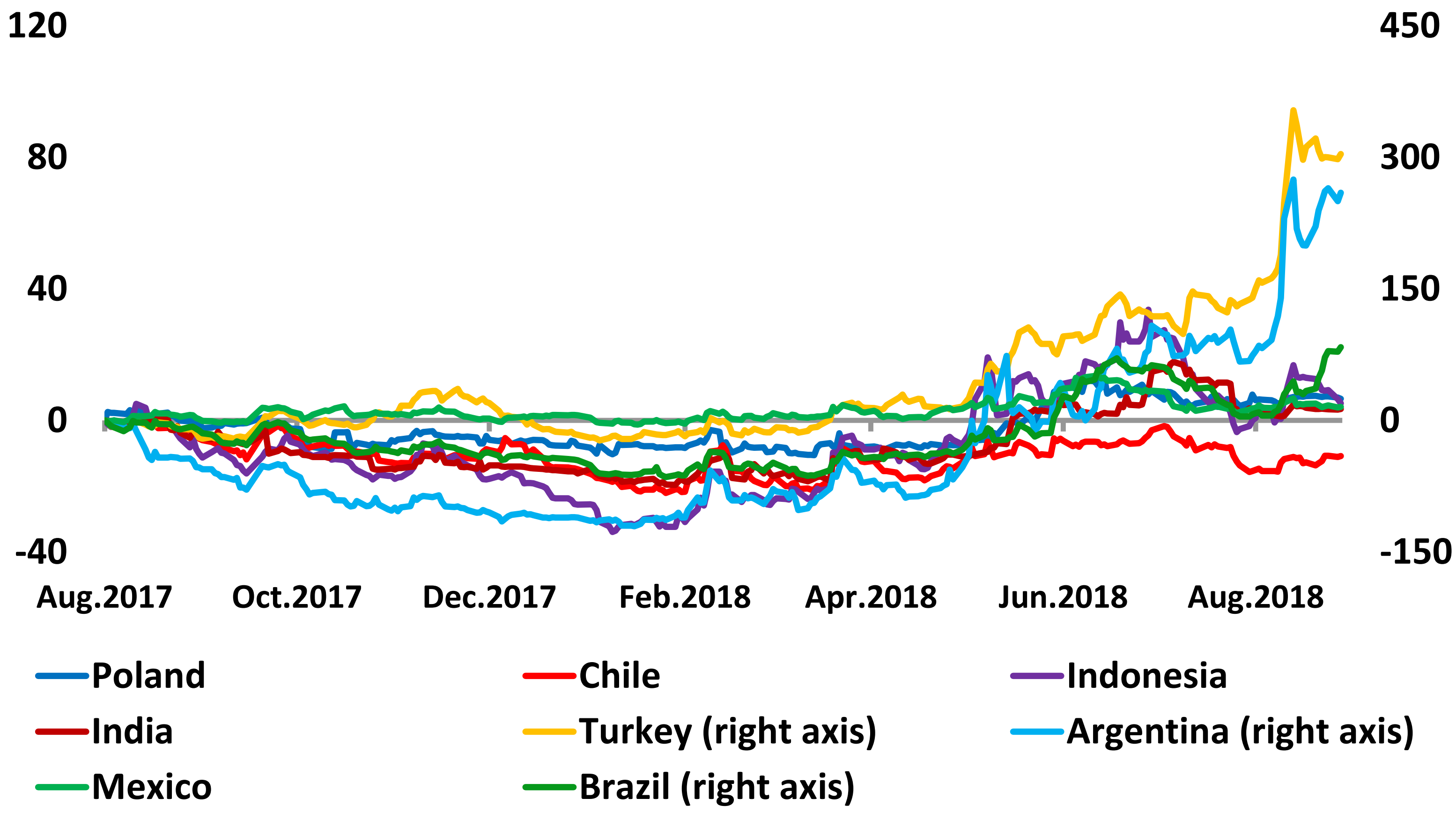


(*) Current monetary policy rate minus inflation expected one year ahead.

Source: Central Banks of each country.

Sovereign spreads (*)

(basis points)



(*) Accumulated change in CDSs since August 1st, 2017.

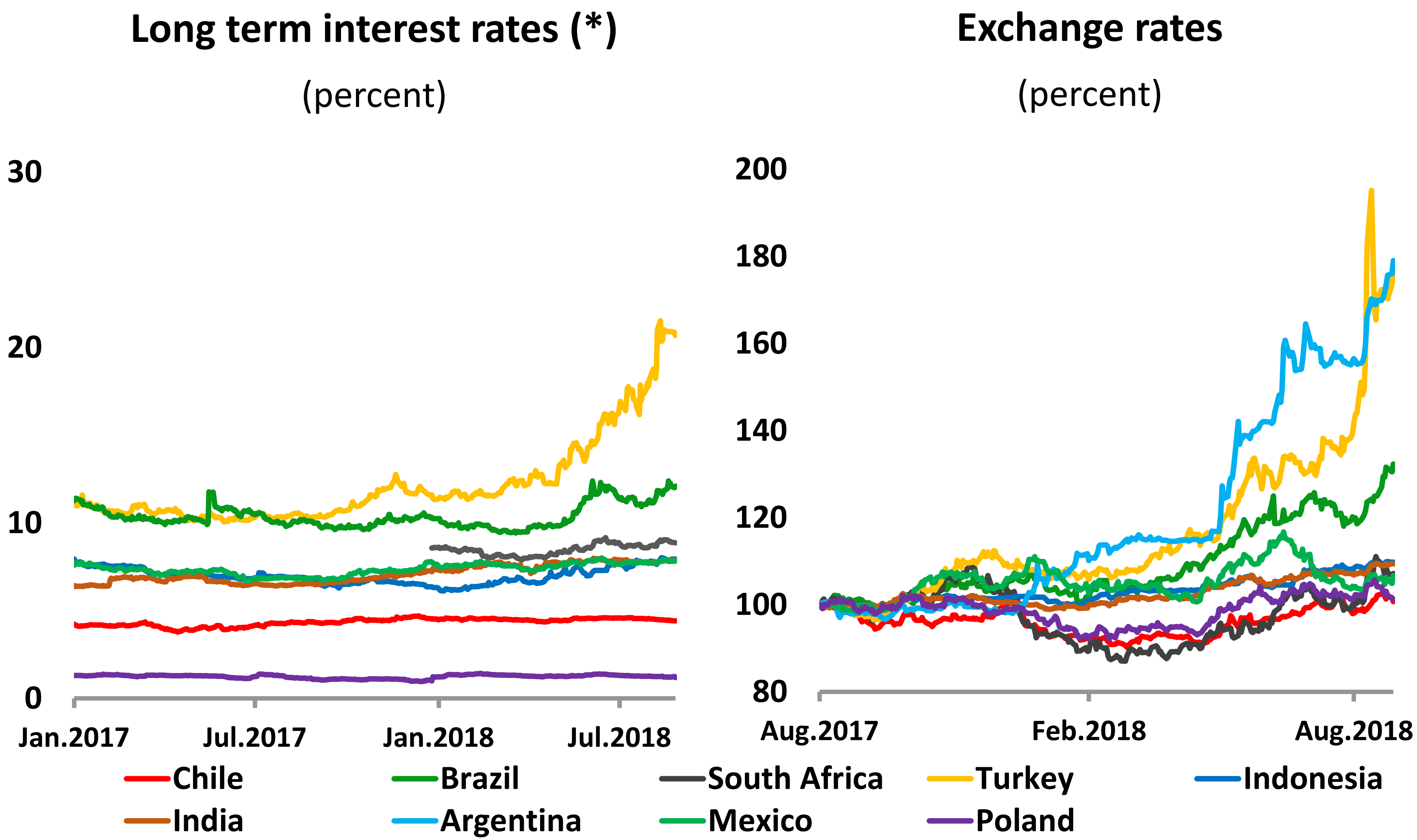
Source: Bloomberg.

Financial and macroeconomic outlook (1)

	Inflation (2)	Current Account	Gross Debt	External Debt	External Debt (change) (3)	Total Reserves	Fiscal Deficit
Argentina	31.0	-4.828	52.615	36.6	8.6	6.6	6.457
Brazil	4.5	-0.475	83.980	32.6	3.6	18.2	7.819
Chile	2.7	-1.477	23.593	65.5	7.1	13.3	2.718
China	2.1	1.372	47.790	14.0	-3.0	27.6	3.953
Colombia	4.8	-3.350	49.414	40.2	13.4	15.4	3.096
India	4.2	-1.961	70.200	22.4	-0.8	16.3	6.917
Indonesia	3.2	-1.703	28.913	34.7	1.8	12.5	2.490
Malaysia	0.9	2.979	54.157	65.0	-2.6	32.5	2.910
Mexico	4.8	-1.639	54.181	37.9	5.4	15.0	1.074
Peru	1.1	-1.262	25.507	35.7	1.6	29.0	3.050
Poland	2.0	0.047	51.382	71.8	6.3	21.6	1.744
Russia	2.5	2.635	17.437	32.9	4.1	28.3	1.465
South Africa	5.1	-2.265	52.673	49.6	8.3	14.5	4.547
South Korea	1.5	5.101	39.782	27.3	-2.8	25.3	-1.936
Thailand	1.6	10.821	41.882	33.0	-1.8	41.7	0.614
Turkey	17.9	-5.545	28.482	53.2	9.8	12.7	2.292

(1) All columns, except inflation, are measurements in relation to the Nominal GDP and consider the last available annual data.
(2) Corresponds to the annual variation of the month of July/August 2018, upon availability.
(3) Corresponds to the change between 2014 and 2017.

Sources: Bloomberg, International Monetary Fund, IIF, and the World Bank.



(*) 10-year government bonds, except for South Africa, where 9-year bond is used.

Source: Bloomberg.

Measures of foreign reserves

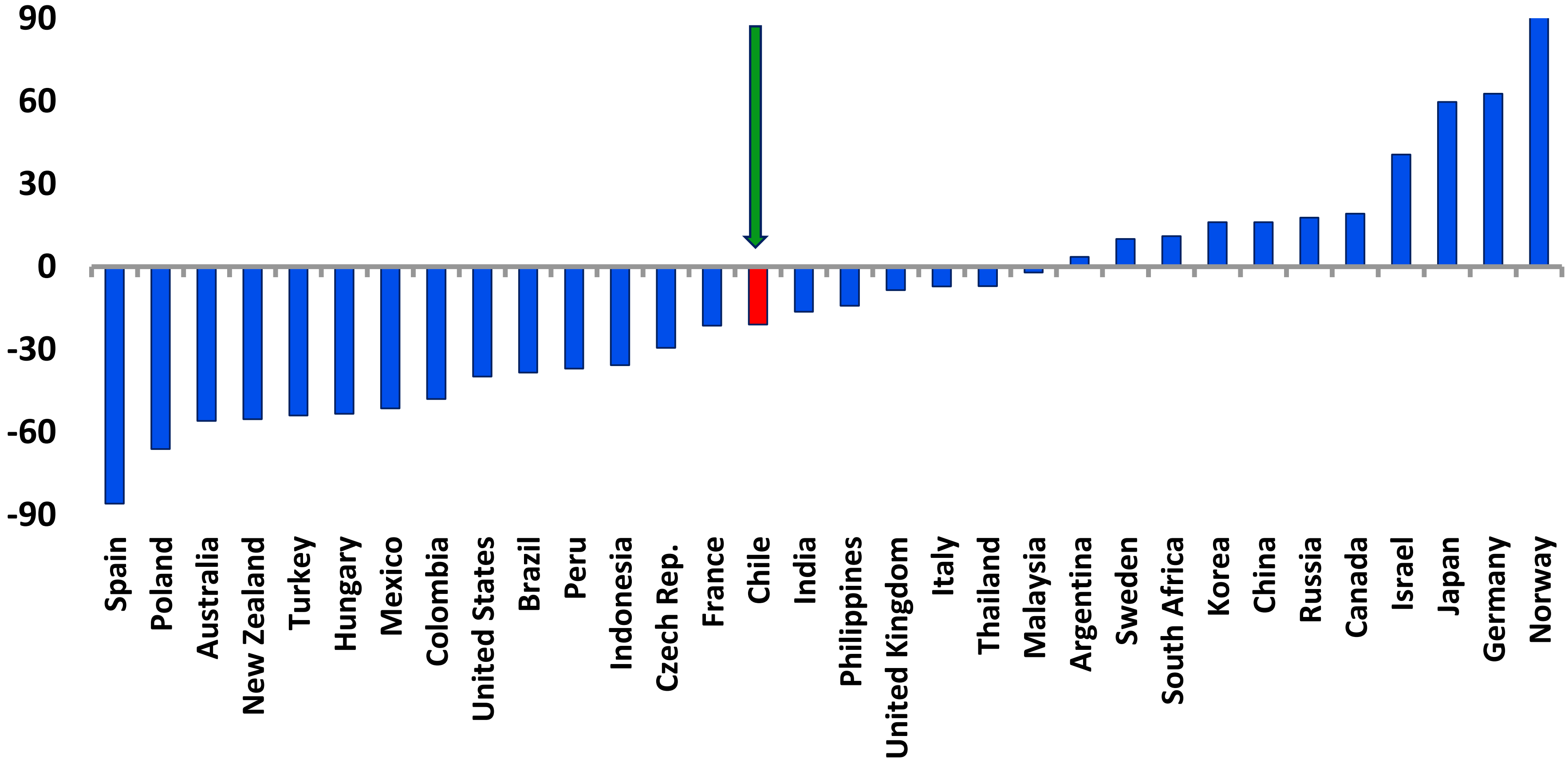
(percent, as of 2017)

	Reserves/ Imports	Reserves + Sovereign Funds/ Imports	Reserves/ Broad Money	Reserves + Sovereign Funds/ Broad Money	Reserves/ Short Term External Debt	Reserves + Sovereign Funds/ Short Term External Debt
Argentina	74.90	74.90	47.11	47.11	71.56	71.56
Brazil	242.42	242.42	47.06	47.06	687.06	687.06
Chile	61.81	118.49	19.49	37.37	72.69	139.35
Colombia	98.64	106.23	31.97	34.44	280.43	302.02
Mexico	39.19	40.61	37.34	38.70	299.16	310.05
Peru	156.95	177.39	73.17	82.70	595.15	672.65
Uruguay	183.98	183.98	165.96	165.96	230.31	230.31

Source: International Monetary Fund.

Net international investment position

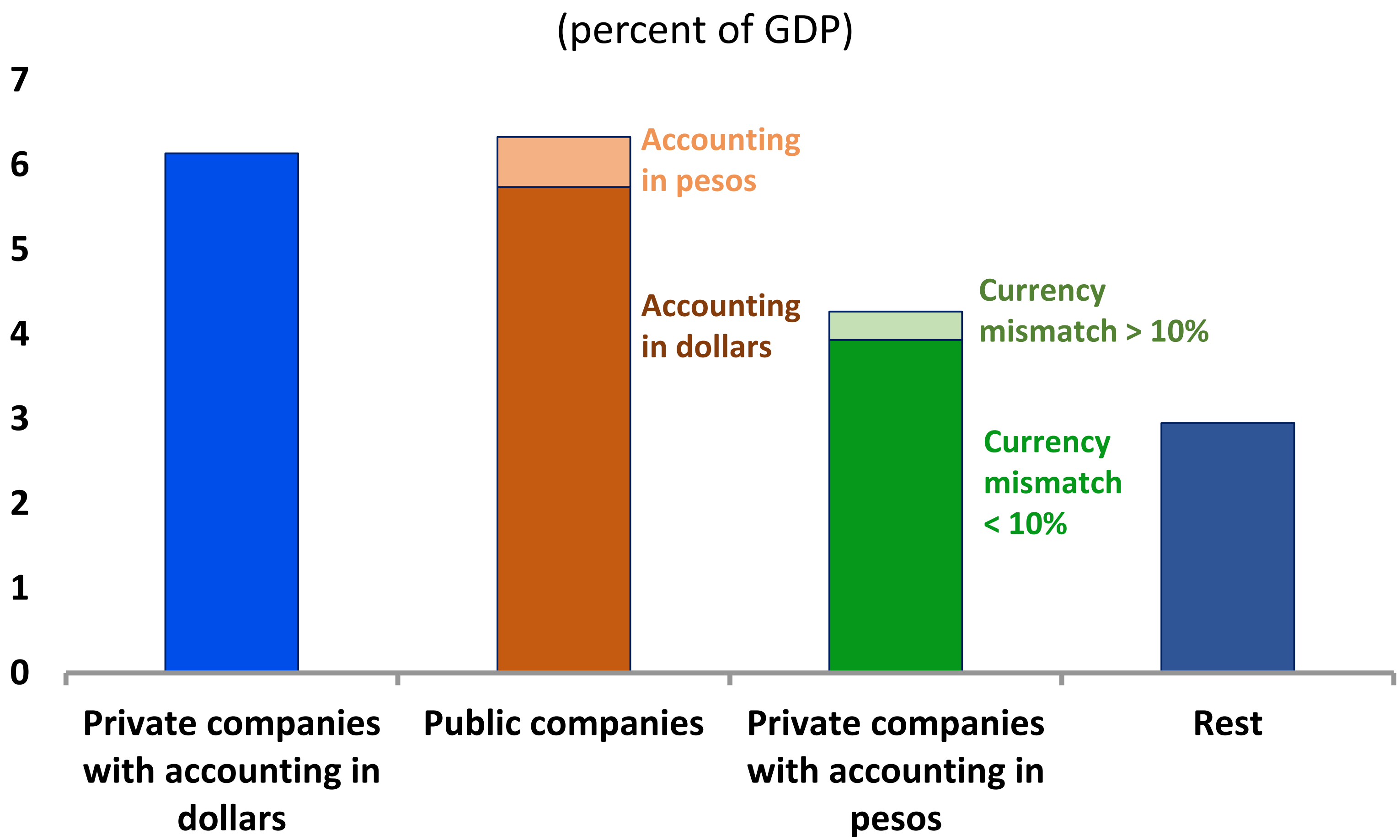
(percent of GDP)



(*) Data of 2017, except for Malaysia, Mexico, Brazil, Indonesia, Philippines and China, where data of 2016 is used.

Source: International Monetary Fund.

Characteristics of debt issued by companies reporting to the CMF (*)



(*) Data of 2017.

Source: Central Bank of Chile based on information from the Superintendence of Banks and Financial Institutions and the Financial Markets Commission.

Financial markets during selected sell-off episodes

	Apr/19 to Aug/30 (Current: ARG+TUR)			Jun/06/2015 to Aug/12/2015 (China)			May/21/2013 to Jul/23/2013 (Taper Tantrum)		
	NEER (%) (1)	CDS (bp)	10-year Sov. Rate (bp)	NEER (%)	CDS (bp)	10-year Sov. Rate (bp)	NEER (%)	CDS (bp)	10-year Sov. Rate (bp)
Argentina	91.08	498.25	--	2.17	0.00	--	4.05	-729.85	--
Brazil	22.60	134.53	261.8	11.61	61.10	87.9	8.54	36.42	88.5
Chile	13.90	9.62	11.1	8.32	27.02	-6.6	3.70	13.51	29.3
China	9.00	-1.62	4.0	2.86	18.65	5.0	0.11	52.09	33.0
Colombia	10.74	13.30	44.5	16.35	35.79	20.3	1.84	31.26	151.0
India	7.51	15.46	30.1	1.14	17.91	-9.0	7.85	--	81.0
Indonesia	6.60	23.12	132.5	3.39	32.88	7.4	4.48	47.69	178.6
Mexico	3.60	12.98	46.8	5.68	11.18	-20.8	1.29	26.50	96.6
Peru	2.69	12.09	32.0	2.17	17.01	63.0	5.01	28.66	93.0
Poland	9.16	14.79	-8.0	1.93	-2.67	-34.9	-1.81	6.62	32.0
Russia	12.10	27.56	13.4	17.27	17.73	--	3.43	27.54	73.2
South Africa	23.11	69.06	103.8	3.04	21.38	--	1.45	29.37	12.8
South Korea	4.44	37.41	-27.5	6.80	-0.50	-20.1	0.58	3.00	49.0
Thailand	4.76	-2.24	33.9	4.74	30.44	-27.8	4.12	21.78	42.4
Turkey	64.65	325.40	244.5	2.34	22.52	4.4	3.06	66.66	122.1

(1) Positive sign indicates a depreciation against the US dollar.

Sources: Bloomberg, International Monetary Fund, IIF, and the World Bank.

Recent financial market developments

Chile has undertaken several reforms aimed at improving efficiency and inclusiveness of its financial sector

- A free-floating exchange regime requires a robust and well-developed *FX derivatives market*
- **Two major developments in the Chilean market:**
  - *Central Counterparties* (CCPs). Traditionally, this market has been an OTC markets, but currently almost 50% of its transaction are cleared and settled through CCPs
  - New CBC regulations on recognition and regulation of derivatives framework agreements were issued, providing more certainty to participants
- For increasing transparency, the CBC is working on a *Trade Repository* for derivatives

⇨Foreign exchange regulations have been amended in order to facilitate non-residents participation in the local market

- A modification on an already open FX regime, increasing on non-residents participation in the sovereign-bond market
- A streamline process of the overall FX regulation framework will be conducted as part of the CBC's *Strategic Planning*

Institutional investors have been provided with more options to invest, increasing its portfolio of eligible investments

- **In 2010, the CBC increased the limit for investment abroad of Pension Funds from 60 to 80%**
- Last year, Pension Funds were allowed to invest in "alternative assets" (e.g. foreign private equity assets, foreign private debt, Chilean non-residential real estate for rent, among others)
- New eligible foreign markets for investment of Pension Funds
- Limits for insurance companies investment in foreign assets were also increased

A retail payments system that contributes to financial inclusion

- **A law allowing for the issuance of pre-paid cards was passed in 2016**
- Retail payments market should contribute to increase financial inclusion and ensure secure and efficient payments
- **The CBC introduced major changes to its retail payments regulations last year:**
  - Not FinTech-specific but FinTech-friendly regulations
  - A few new private initiatives already in place, and some others being developed
  - There is room for more progress, particularly on the expansion of the acquiring networks
  - The CBC will exert its regulatory powers in order to contribute to an increase in the use of electronic means of payments in the economy

Financial stability and macroprudential regulation

The CBC upgraded the regulatory framework for liquidity risk management, through a process started in 2015

- **The main goals of the regulatory change included:**
  1. Strengthen liquidity risk management policies in the banking sector, in line with international best practices
  2. Enhanced the information available to the supervisor and the market
  3. Introduce the quantitative measures of Basel III, as monitoring tools for the supervision of banks' liquidity, without establishing a specific regulatory limit:
     i. Short term measure ⇨ *Liquidity Coverage Ratio: LCR*
     ii. Long term measure ⇨ *Net Stable Funding Ratio: NSFR*
- This regulatory upgrade was built upon the regulatory framework that the CBC has had in place for liquidity risk management that considers restrictions on the short term maturity mismatches since 1998
- Last month, the CBC introduced LCR minimum requirements that will enter into force from January 2019 (2019: 60% ⇨ 2023: 100%)

The banking bill currently in Congress will upgrade the bank solvency requirements to those of Basel III

- **Upon approval of the New Banking Law, the regulatory framework will incorporate the latest innovations of the Basel Committee:**
    1. Enhanced definition of *Common Equity Tier 1 Capital* (CET1)
    2. Additional Tier 1 capital instruments (AT1) (*)
    3. Conservation capital buffer
    4. Countercyclical capital buffer (**)
    5. Systemic bank surcharges (*)
    6. Regulatory capital would have to cover for market and operational risks (*)
        - *Liquidity risk will be addressed with the existing regulation of the Central Bank on market*
    7. Supervisory powers will be enhanced with the adoption of a Pillar 2 framework
    8. The use of internal models for regulatory capital will be possible, under supervisory approval (*)

(*) Supervisor in charge with CBC engagement.
(**) CBC in charge with supervisor engagement.

Strengthening financial market infrastructures

In the past years, there have been major reforms to the Financial Market Infrastructures in Chile

- **Promoting development of central counterparties in Chile**
  - CCP for stock markets (2010) and stock exchange derivatives (2013)
  - CCP for OTC derivatives (2015)
- **Promoting compliance of Financial Markets Infrastructures (FMIs) with the PFMIs**
  - Five FMIs were assessed as part of an international *Review on Standards and Codes* (ROSC), conducted by the IMF and the World Bank in 2015-16
  - Chile has fairly developed payment, clearing, and settlement infrastructures
  - Although some shortcomings to be addressed were identified
- **Recognition of irrevocability and finality of payments through an amendment to the Organic Constitutional Law of the CBC enacted in 2016**

The CBC and the Financial Market Commission issued new regulations to improve the FMIs’ framework

- Developing of regulatory framework for the oversight of all systemically important payment systems (January 2018), explicitly requiring the adoption of PFMIs
- The Financial Market Commission issued a regulatory proposal (July 2018) that explicitly requires a complete observance of the PFMIs to CCP, Securities Settlement Systems (SSS) and Central Securities Depository (CSD)
- These regulations contributed to improve the rating for the Chilean Payment Systems in the last report of implementation monitoring of PFMI, recently published by CPMI/IOSCO
- New regulation to foster resilience and operational continuity of Large-Value Payment Systems (September 2018)

However, there are still challenges to overcome

- **Development of an *Integrated Information System of Derivatives* (Trade Repository-like entity)**
  - The ROSC assessment and the CPMI/IOSCO Monitoring Report highlighted the absence of a recognized Trade Repository (TR) in Chile
  - The CBC intends to implement a TR-like entity, following international standards and recommendations, through the implementation of an *Integrated Information System for Derivatives*
  - The CBC will expand its historical database of foreign exchange derivatives to all banking derivatives (FX and interest rate)
  - The system will also provide relevant information to the market
- **The draft regulation for this system will be published later this year for public consultation**

Strengthening governance of financial supervision

A law strengthening regulation and supervision of securities and the insurance sector was enacted in 2017

- **A new institutional framework for the securities and insurance supervisor is in place, transforming the *Superintendency of Securities and Insurance* (SVS) into the CMF:**
  - Improvements in governance: 5-person Board aimed at fostering independence and technical nature
  - The supervisor was granted additional investigative and enforcement tools
  - Enhancement of transparency and accountability standards
- **CMF retains the role of regulation and supervision of securities market and the insurance sector, with a broad mandate to promote market development and oversee financial stability (complementing the CBC's view)**
- **Other countries' experience show that this process is full of challenges:**
  - Integration of institutions with different cultures
  - Exploiting synergies
  - Restructuring and assuming new tasks usually needs resources, not necessarily included in the bill

Bridging gaps for a more robust financial market

Significant progress has been made but challenges remain

- **Despite all the progress, considering the evolving nature of financial markets and lessons from financial crisis still be adopted**
- Some challenges still remain and there is room for further regulatory improvements
- **Latest *Financial Stability Report* stressed the need to bridge some gaps in order to have a more robust financial market:**
    - Solvency requirements and risk management for the banking industry (draft in the Congress)
    - Resolution of financial institutions
    - Deposit insurance
    - Supervision of financial conglomerates
    - Risk-based capital requirements for insurance companies
    - Integration of debt information

Financial Sector Assessment Program 2020

A new assessment of the financial sector ("FSAP Update") will be conducted by the IMF and the World Bank in early 2020

- The last FSAP was conducted in 2011, and significant changes in the financial sector have taken place since then
- It will provide an objective assessment not only of progress, but also of areas that need improvement and gaps to fulfill the best international practices
- It may contribute to foster internal consensus on the need to undertake some reforms
- The adoption of FSAP recommendations may also contribute to have a financial sector better equipped to face shocks and vulnerabilities

Chilean economic outlook and recent financial market developments

Mario Marcel

Governor

Central Bank of Chile

ChileDay, London, 6-7 September, 2018