



Current Developments and Prospects for the Chilean Economy

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Outline

- Current Developments
- Prospects



Current Developments

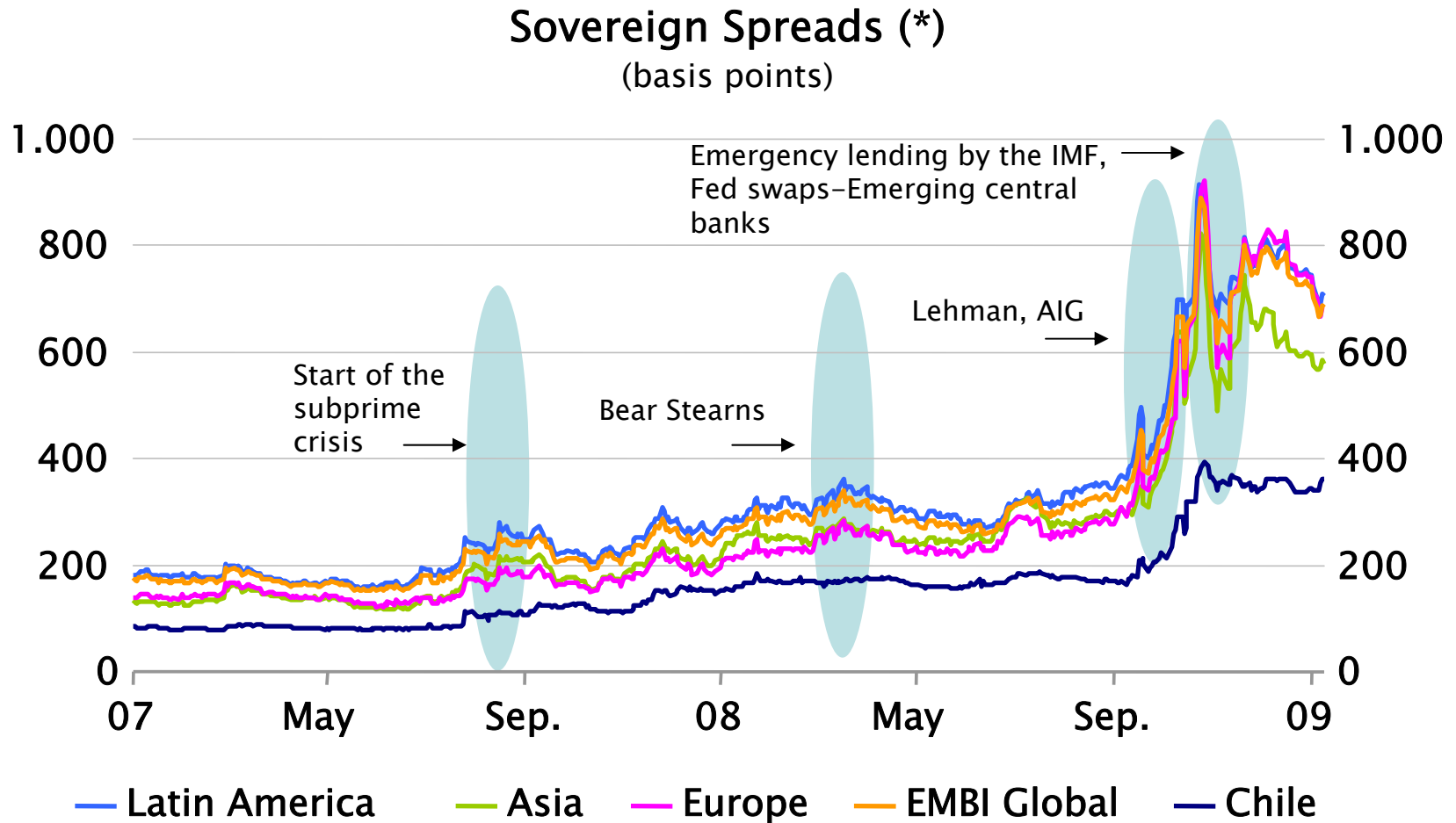


The overall Chilean economic outlook shifted drastically during the last quarter of 2008.

- Global growth prospects for 2009 showed a severe downshift, to figures not seen in decades.
- What began as a localized crisis in the US housing/mortgage sector, transmuted into a threat to global financial stability, with few precedents in contemporary history.



September turbulences were felt across emerging economies.

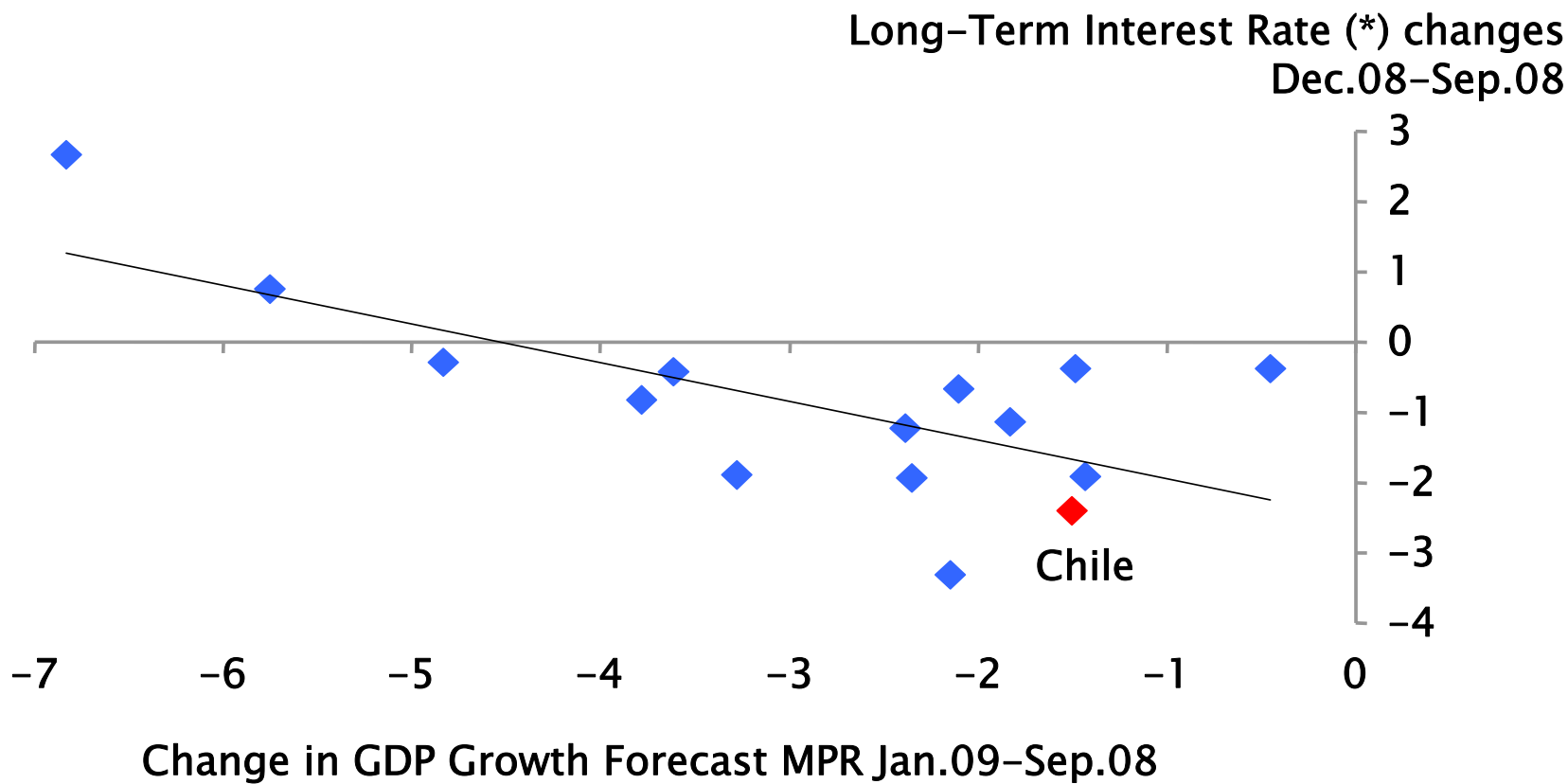


(*) Considers JPMorgan's Emerging Market Bond Index.
Sources: Bloomberg and JPMorgan.



Markets have shown a sharp differentiation across emerging economies in their responses to the global crisis.

Adjustments in GDP Growth Forecasts and Long-Term Interest Rates since September 2008 (percentage points)



(*) Considers JP Morgan's Government Bond Index (GBI) for 14 emerging economies. For Chile, it considers the BCP-5 rate.

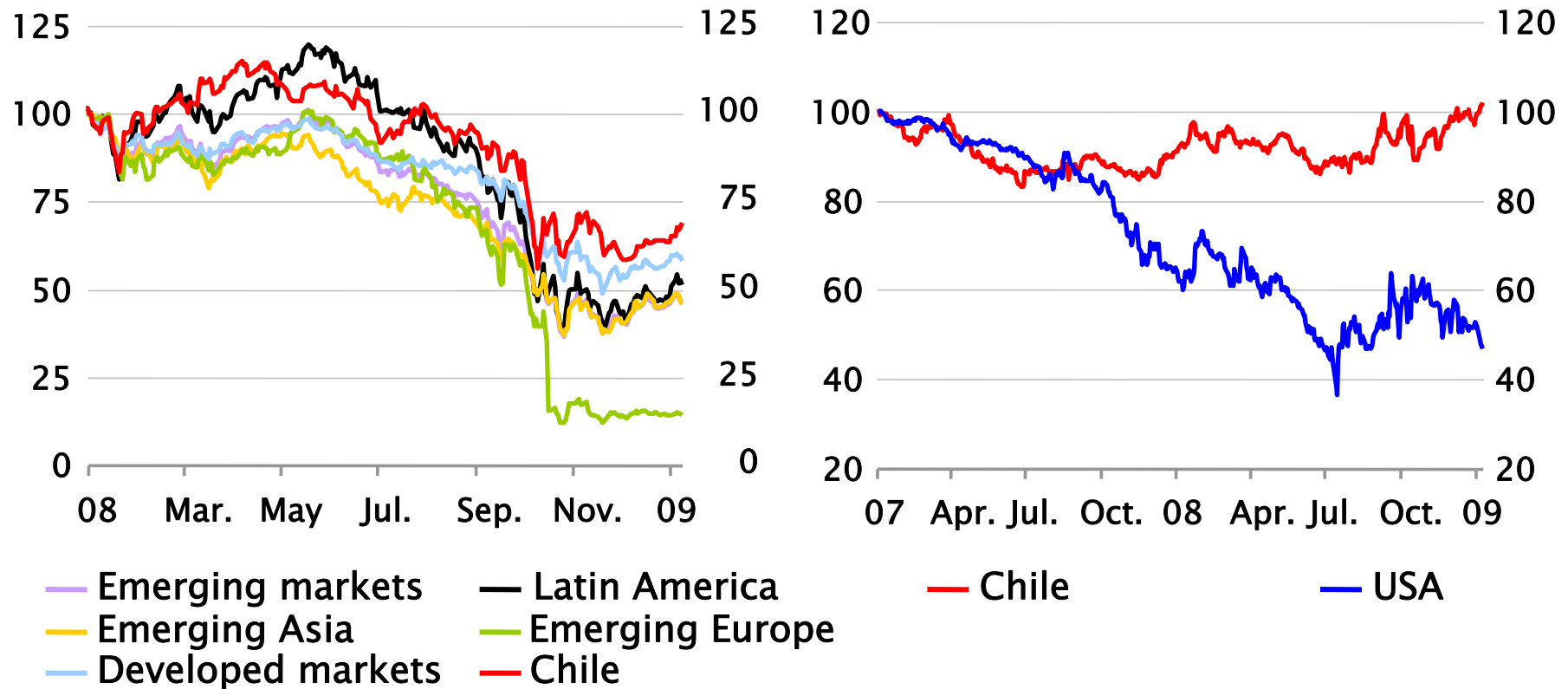
Sources: Central Bank of Chile and JP Morgan Chase.



Local stock market valuations have been resilient to the shock. Banking stocks have performed similarly to the broader market.

Stock Market Index and Ratio of Bank Index to Aggregate Stock Index (1) (2)

(index, January 2, 08=100; index, January 1, 2007=100)



(1) First figure shows the Stock Market Index considering the MSCI index. (2) Second figure shows the ratio of banking stock index/ total stock index: S&P 500 for the USA and IPSA for Chile.

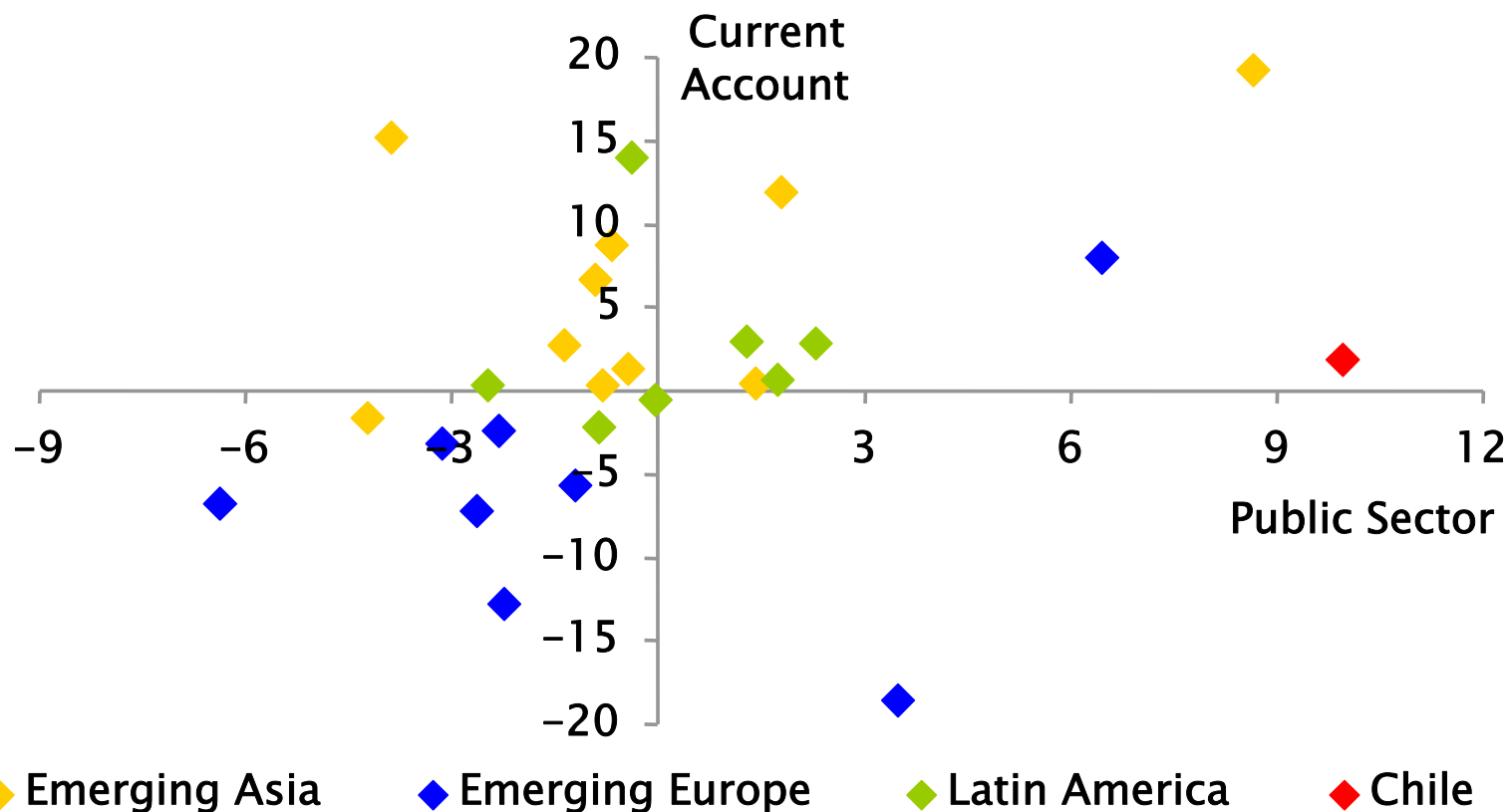
Sources: Bloomberg and Central Bank of Chile.



The current account and the fiscal balance posted significant surpluses in 2005–2008.

Current Account and Public Sector Balance (*)

(average 2005–2008, percentage of GDP)



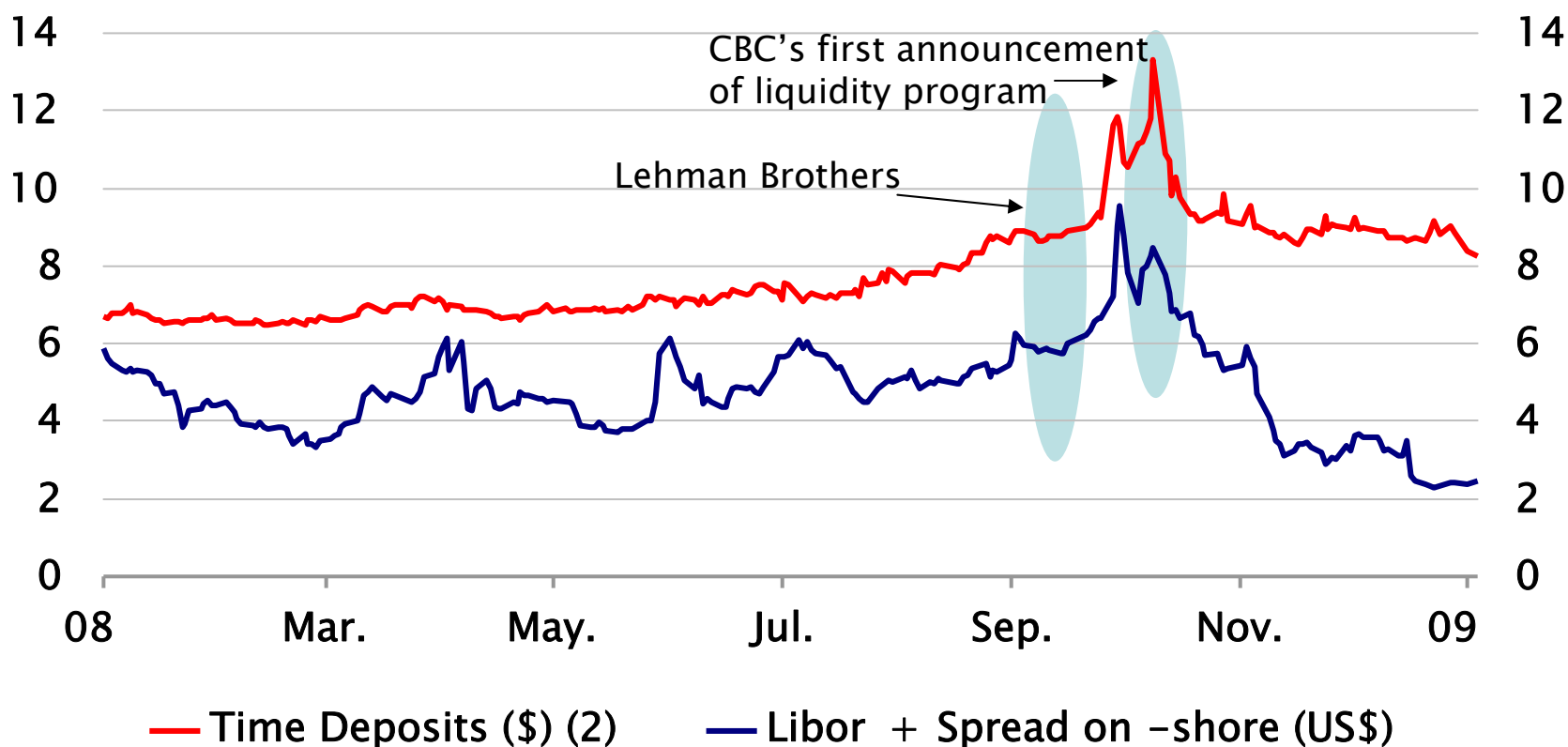
(*) Forecast for 2008.
Source: JP Morgan Chase.



Locally, external tensions were reflected in transitory money market and USD liquidity stress.

Domestic Market Rates in US\$ and CLP (1)

(percentage)



(1) 90 days. (2) Traded on the Chilean Stock Market.
Sources: Central Bank of Chile and Bloomberg.

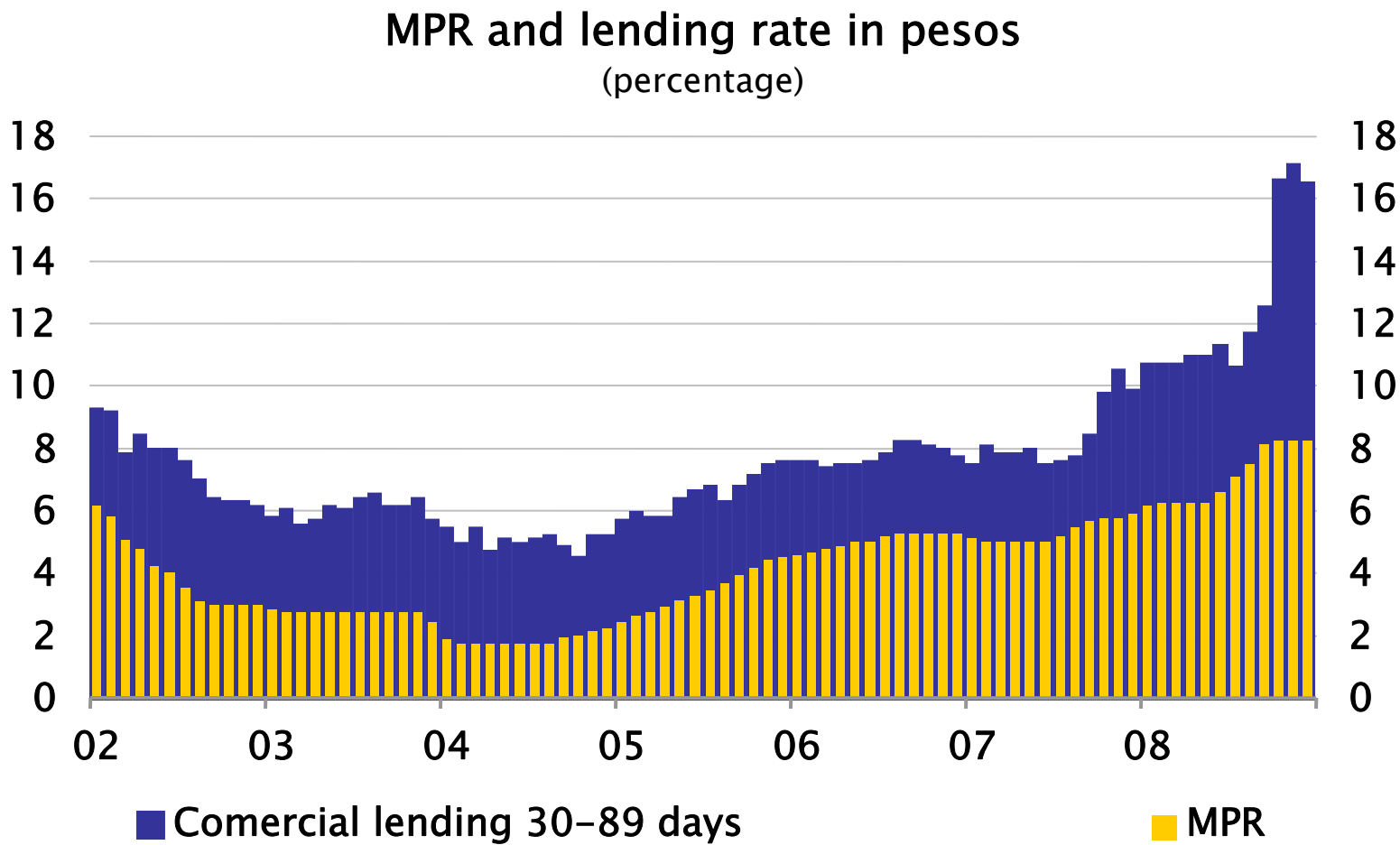


The Central Bank took a number of measures to ease domestic liquidity tensions

- Sept. 29th: Reserve accumulation program was terminated, USD repo 1 month operations announced (sales of USD spot + 1 month forward USD purchases, through competitive auctions)
- Oct. 10th: Broadening of eligible collaterals for money market operations (now encompassing CDs), USD repo program extended to six months.
- Dec. 10th: Extension of liquidity measures for all of 2009. Enhancement of liquidity facility through credit lines accepting a broader range of collateral for longer tenors.
- Complementary measures were taken by the Ministry of Finance.

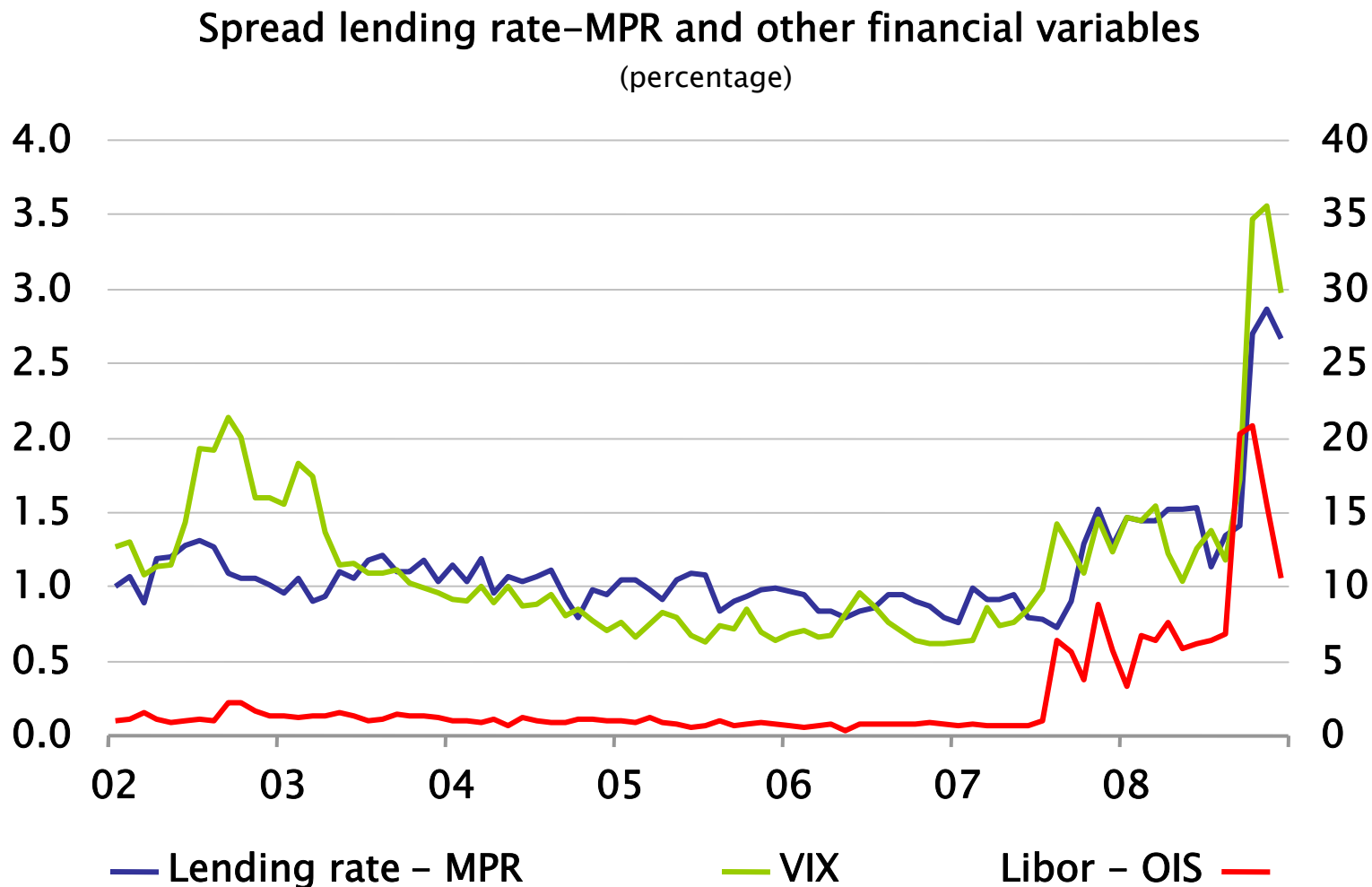


Short term lending spreads have doubled since September



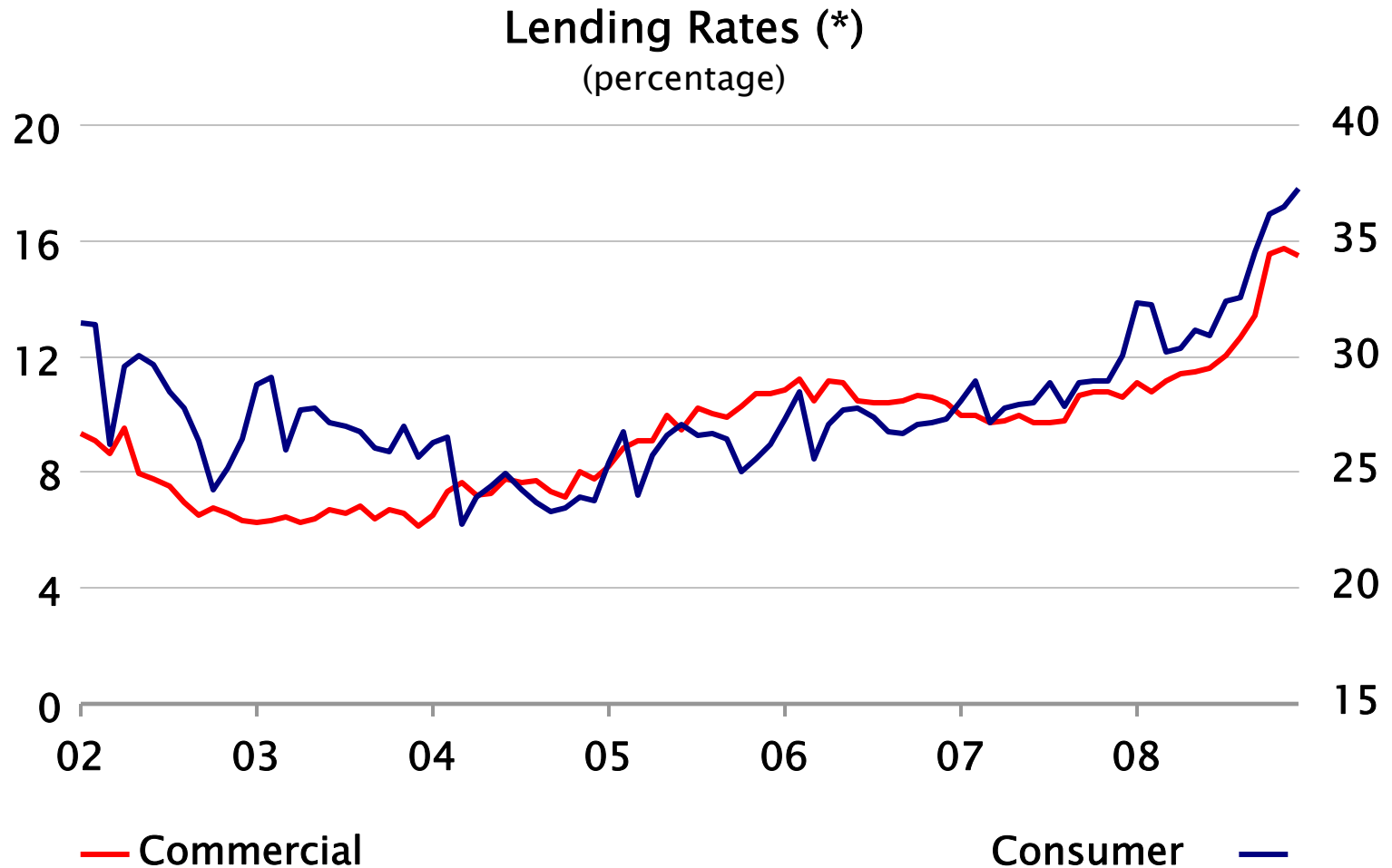


Higher lending spreads have coincided with increased turbulences abroad.





Credit conditions have tightened.

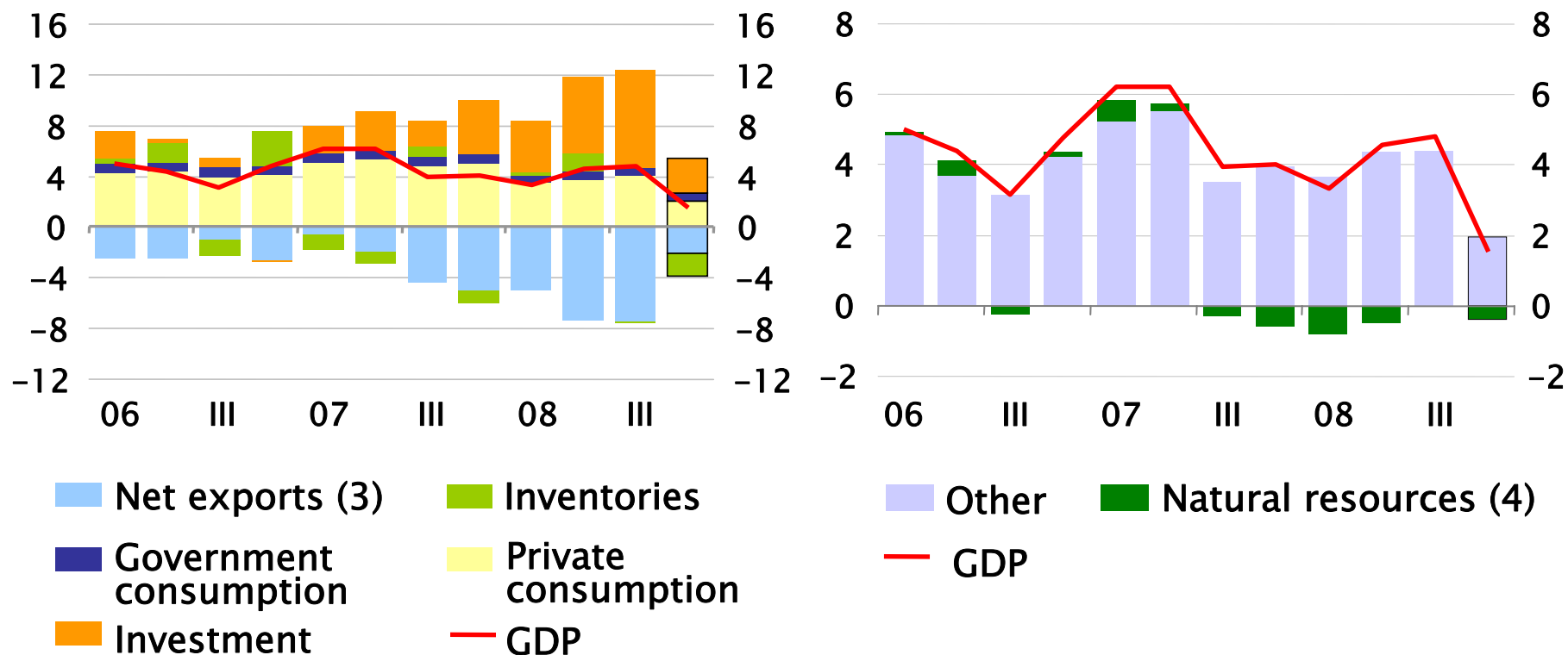


(*) Weighted average interest rate.
Source: Central Bank of Chile.



Growth and domestic demand decelerated significantly, particularly those components most sensitive to credit conditions (durables, machinery, inventories).

Contribution to GDP Growth (1) (2)
(real annual change; percentage points)



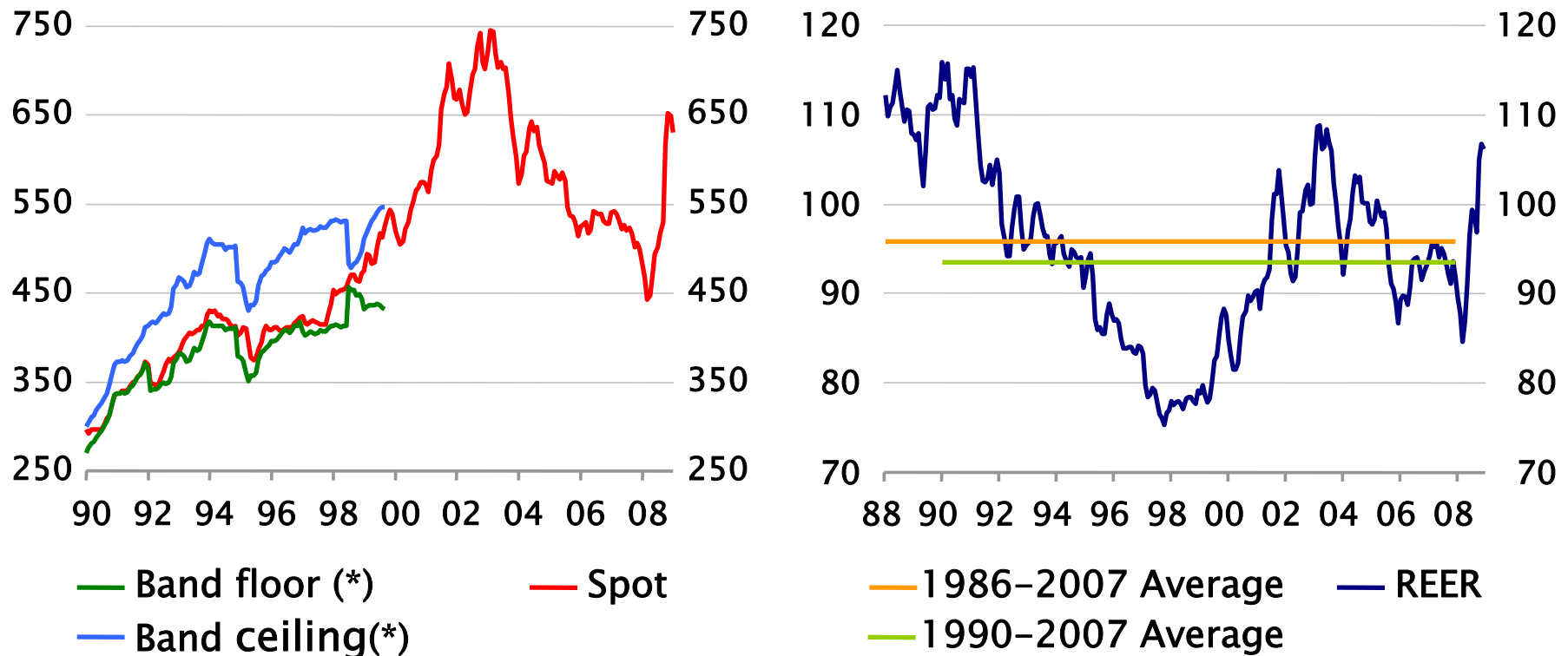
(1) Data published on November 24th, 2008. Data for 4Q08 projected, Monetary Policy Report, January 2009.(2) Contribution by sector corresponds to GDP at factor cost and bank charges. (3) Goods and services exports minus goods and services imports. (4) Corresponds to the sectors: mining, fishery and electricity, gas and water. Source: Central Bank of Chile.



The exchange rate has depreciated significantly in nominal terms. The real exchange rate is weaker than historic averages.

Nominal and Real Exchange Rate

(CLP/USD; index, 1986=100)

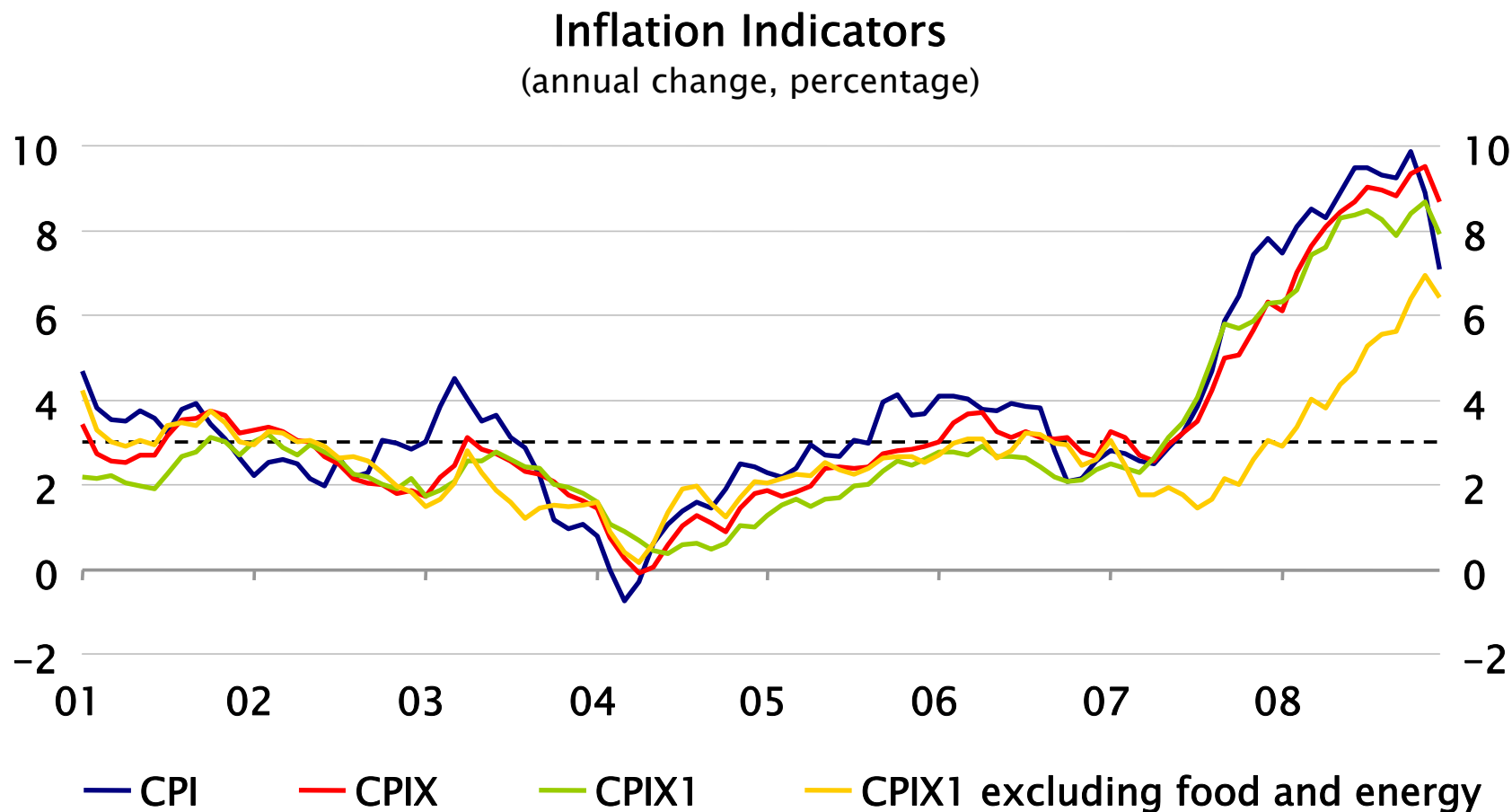


(*) The exchange rate bands are the upper and lower limit of a range inside which the exchange rate was allowed to float. This system operated until September 1999.

Source: Central Bank of Chile.



Monthly annual inflation has come down fast, particularly because of the significant drop in energy prices. Core inflation measures have stopped increasing.



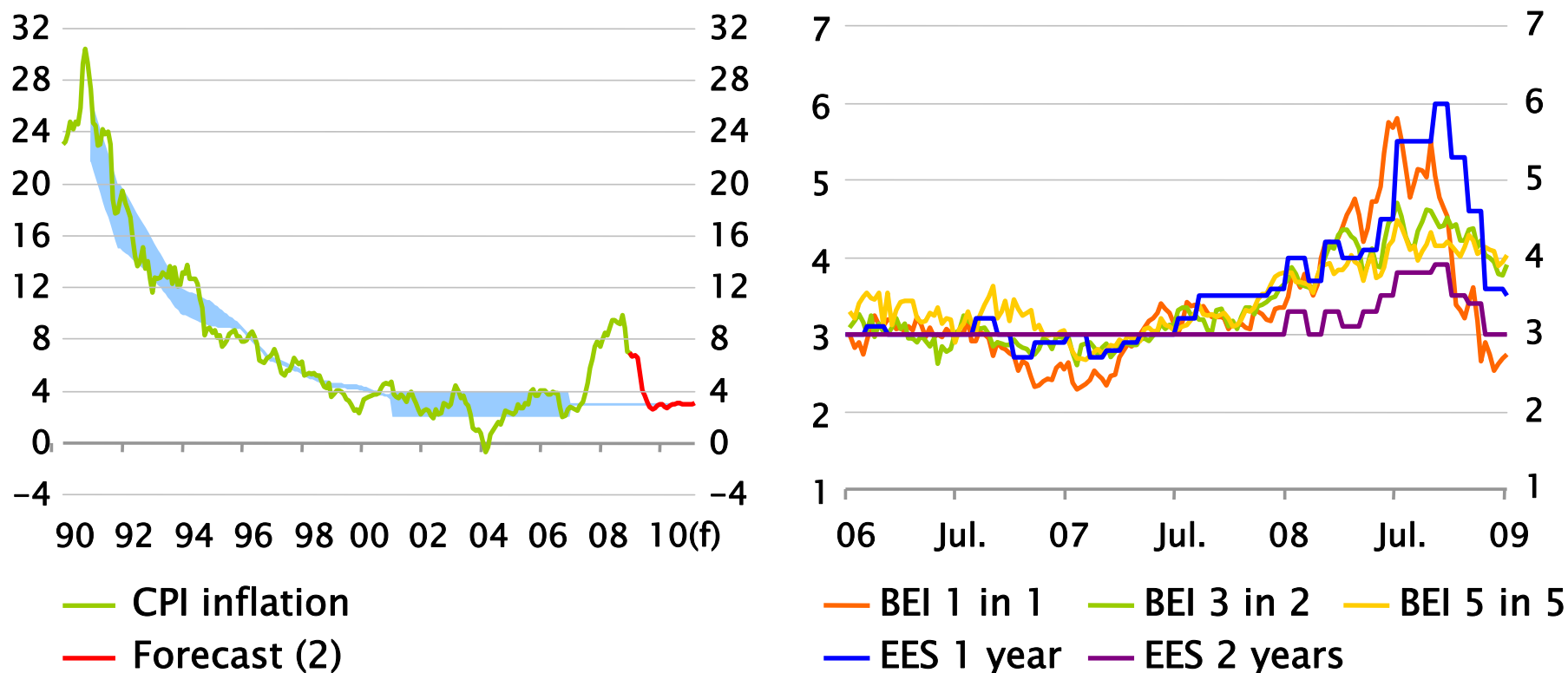
Sources: Central Bank of Chile and National Statistics Bureau.



Prospects for inflation and measures of expected inflation indicate a quick convergence to the target.

Inflation, Target Inflation and Inflation Expectations (1)

(annual change, percentage)



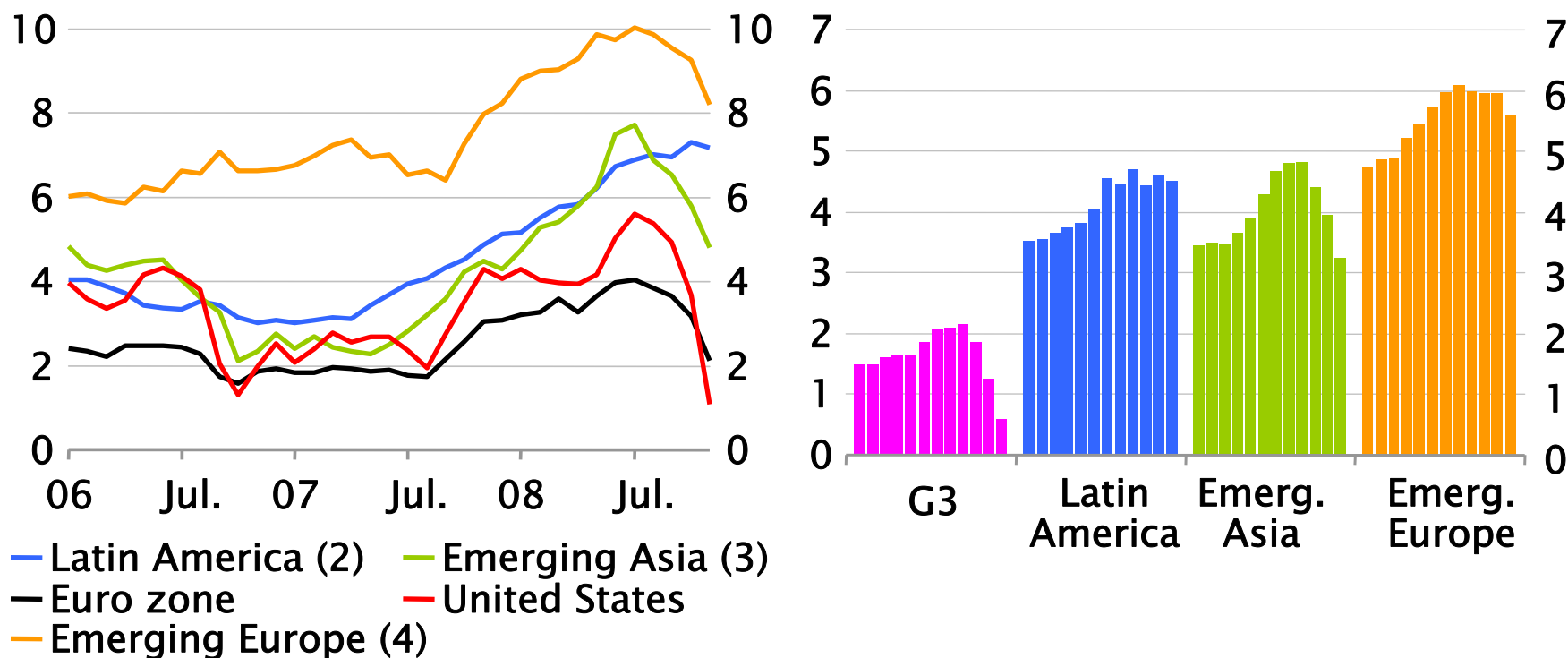
(f) Forecast, Monetary Policy Report, January 2009. (1) Considering breakeven inflation (BEI) based on forward instruments and the Economic Expectations Survey (EES). (2) The forecast considers a monthly frequency based on a quarterly forecast. Sources: Central Bank of Chile and National Bureau of Statistics.



The turnaround in expected inflation is a global phenomenon, with some exceptions.

Inflation Data and Inflation Expectation by Economic Area (1)

(annual change, percentage)

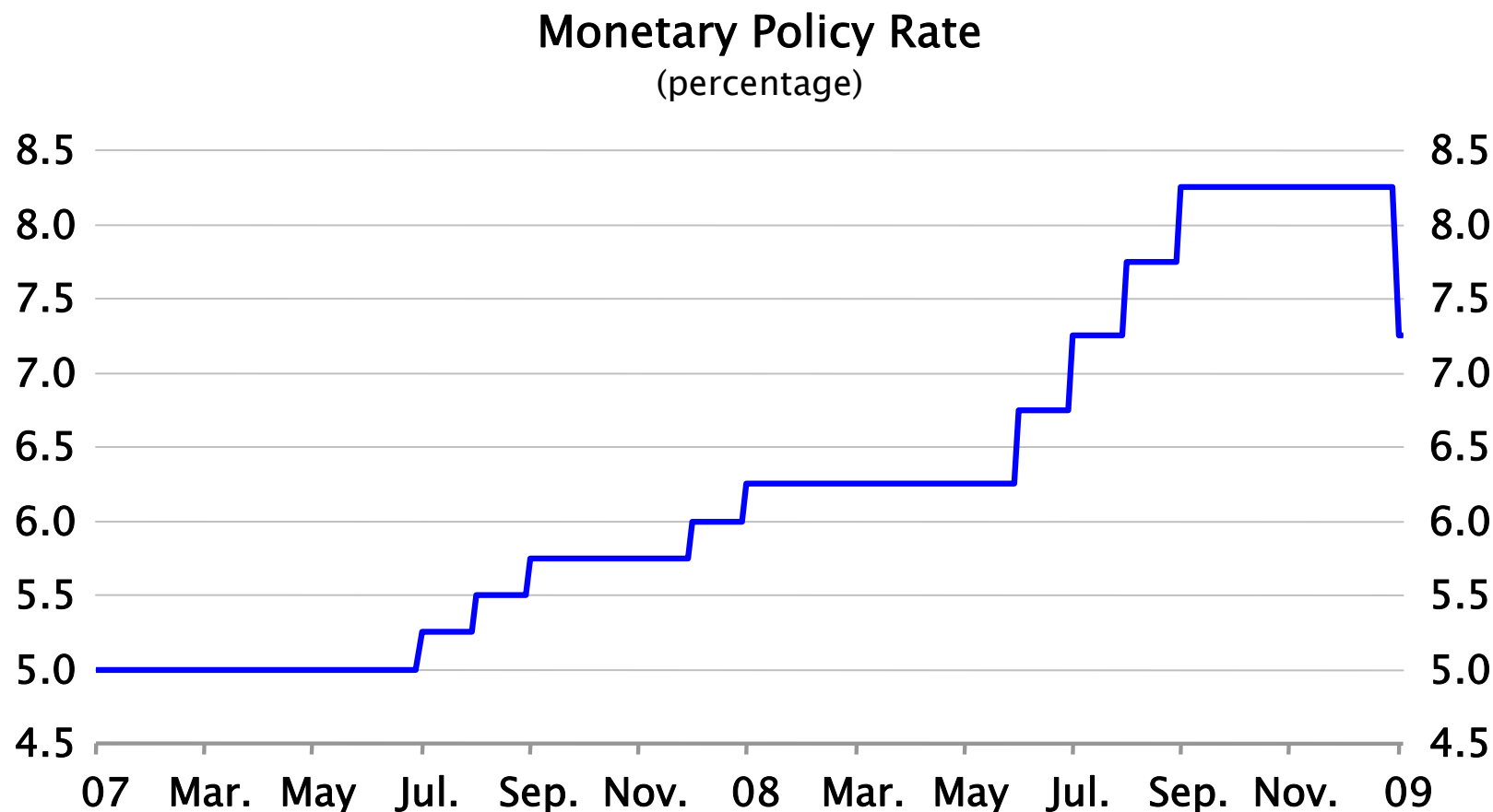


(1) Geometric average of the considered countries of each region. In the case of the inflation expectation figure, each bar corresponds to the average annual inflation projection for 2009, of each month since January 2008. (2) Brazil, Chile, Colombia, Mexico and Peru. (3) China, Indonesia, Korea, Malaysia, Singapore, Taiwan and Thailand. (4) Czech Republic, Hungary, Russia and Turkey.

Sources: Central Bank of Chile based on CEIC data and Consensus Forecasts.



In this context, the Board has started a monetary policy easing cycle.



Source: Central Bank of Chile.



Prospects



Growth prospects have been dramatically cut worldwide.

World Growth (*) (annual change, percentage)

	Aver. 90-99	Aver. 00-05	2007 (e)	2008 (f)		2009 (f)		2010 (f)	
				MPR Sep.08	MPR Jan.09	MPR Sep.08	MPR Jan.09	MPR Sep.08	MPR Jan.09
World	2.9	3.8	5.0	4.0	▼ 3.6	3.7	▼ 1.2	4.4	▼ 3.3
World at market parity	2.4	2.9	3.8	2.8	▼ 2.4	2.5	▼ -0.3	3.4	▼ 2.3
United States	3.1	2.5	2.0	1.6	▼ 1.2	1.0	▼ -1.8	2.8	▼ 2.0
Euro area	2.2	1.9	2.6	1.2	▼ 0.9	0.4	▼ -1.9	1.9	▼ 1.0
Japan	1.5	1.6	2.4	0.8	▼ -0.1	0.8	▼ -2.4	2.0	▼ 1.2
China	10.0	9.4	11.9	9.9	▼ 9.2	9.0	▼ 7.5	8.9	▼ 8.0
Rest of Asia	5.5	4.8	5.8	4.6	▼ 4.0	5.0	▼ 1.2	5.2	▼ 3.2
Latin America	2.7	3.0	5.6	4.3	▲ 4.7	3.8	▼ 1.2	4.2	▼ 2.7
Commodity exporters	2.7	3.1	3.3	1.6	▼ 1.2	2.2	▼ 0.2	2.9	▼ 1.8
Trading partners	3.1	3.1	4.8	3.5	▼ 3.2	3.1	▼ 0.4	3.8	▼ 2.7

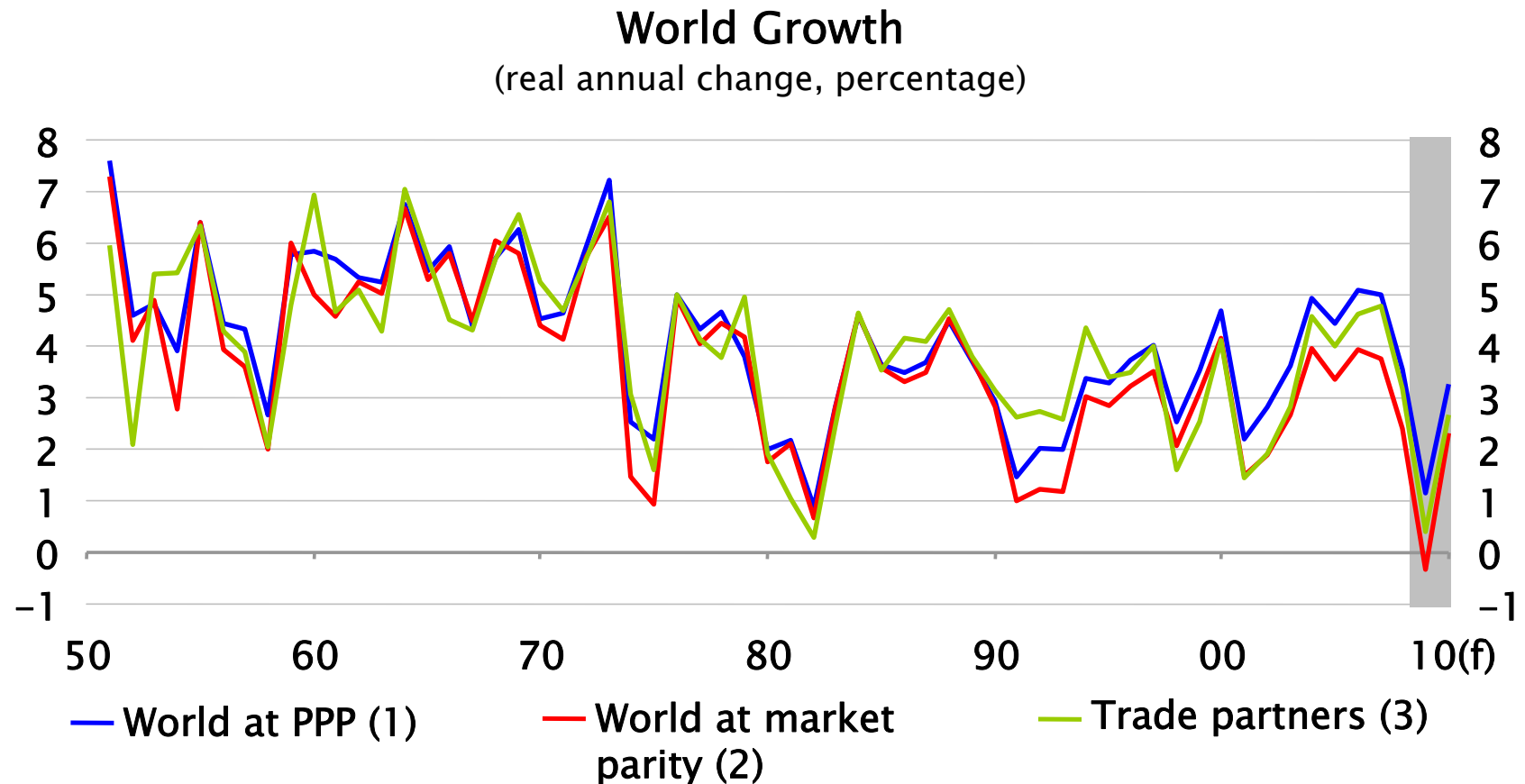
(*) Regional growth according to PPP weights published by the IMF in World Economic Outlook, October 2008.

(e) Estimate; (f) Forecast.

Source: Central Bank of Chile based on information from investment banks, Consensus Forecasts and IMF.



World growth in 2009 is expected to be the lowest in decades.



(f) Forecast. (1) Considers PPP weights of 1980 between 1950 and 1980. From 1980 on considers PPP weights of 2008. (2) Considers weights at market exchange rates of 1970 between 1950 and 1970. From 1970 on considers weights of 2008. (3) Considers weights of trade partners based of 1970 between 1950 and 1970. From 1970 on considers weights of 2008.

Source: Central Bank of Chile based on World Bank, Eurostat, IMF and Penn World Tables.



The sharp fall in commodity prices persists over the forecast horizon.

International Baseline Scenario Assumptions

(annual average)

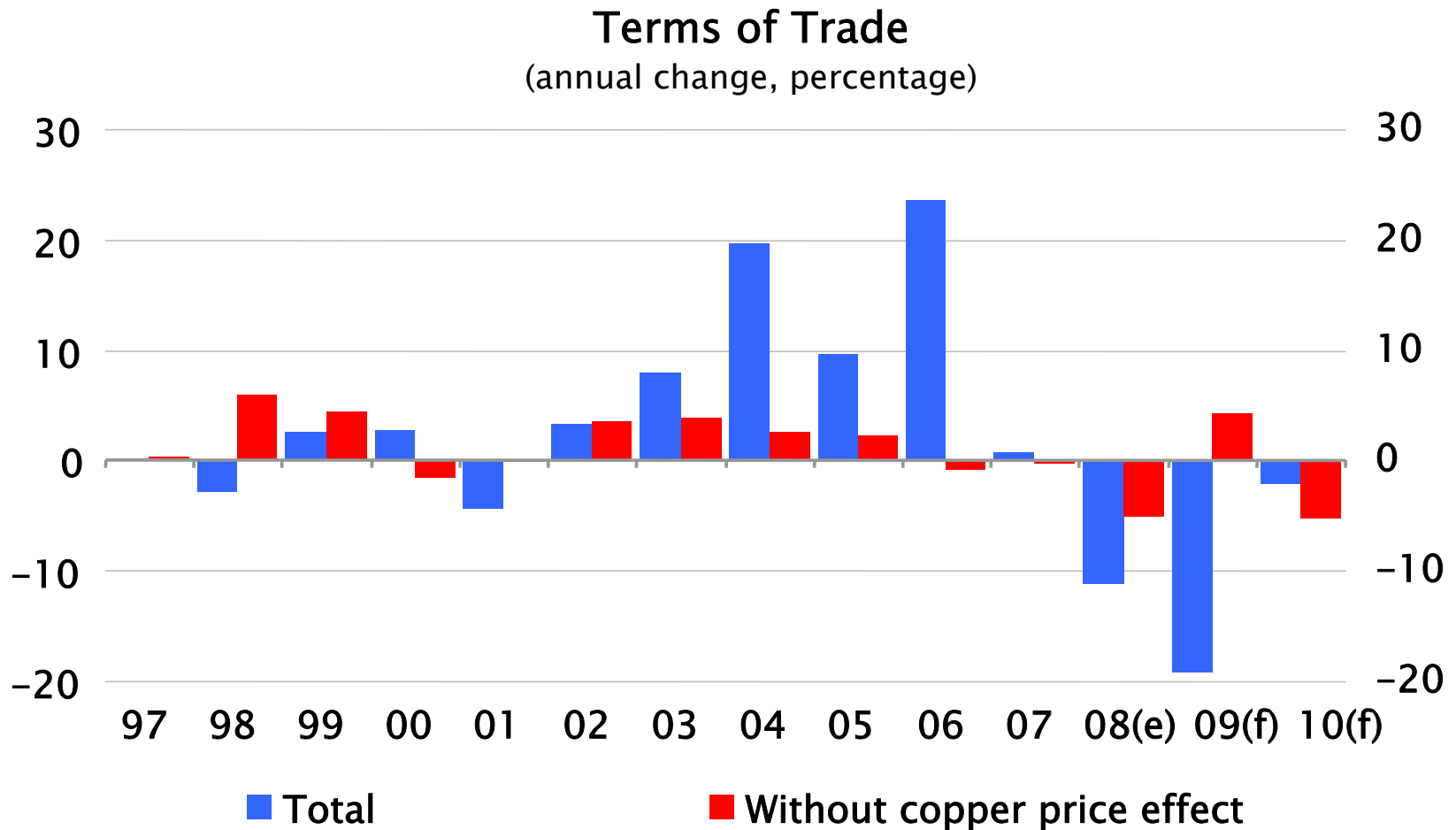
	2008 (e)			2009 (f)			2010 (f)		
	Sep.08	Nov.08	Jan.09	Sep.08	Nov.08	Jan.09	Sep.08	Nov.08	Jan.09
WTI oil price (US\$ /barrel)	115	105	100	116	70	50	115	80	60
LME copper price (US\$ cents/lb)	350	320	317	310	165	150	300	190	160
Terms of trade (annual change, %)	-5.9	-10.5	-11.1	-7.2	-18.2	-19.1	-4.3	-2.5	-2.0
External prices (US\$) annual change, %)	14.1	12.2	12.0	3.3	0.5	-0.8	2.8	4.8	5.5

(e) Estimate; (f) Forecast.

Source: Central Bank of Chile.



Terms of trade have been significantly affected by the price of copper. Noncopper ToT will actually increase in 2009 thanks to lower oil prices.

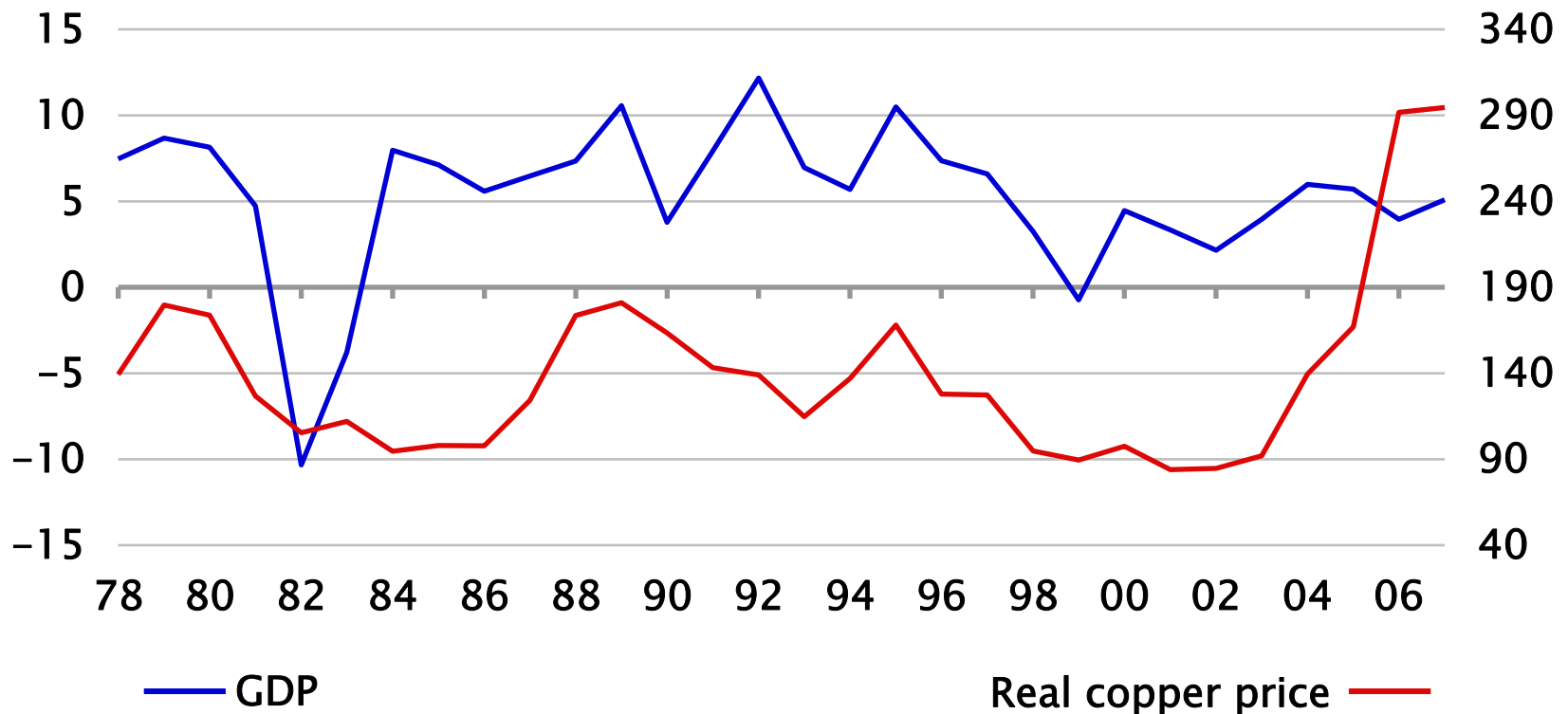


(e) Estimate; (f) Forecast. Monetary Policy Report, January 2009.
Source: Central Bank of Chile.



Chile's GDP growth has become increasingly insensitive to copper price booms and busts.

GDP Growth and Real Copper Price (*)
(annual change, percentage; US\$ cents per pound)



(*) Copper price deflated by U.S. Commodity PPI (2005=100).
Sources: Central Bank of Chile and Cochilco.



GDP growth in Chile is expected to reach 2–3%.

Economic Growth and Current Account

(annual change, percentage)

	2006	2007	2008 (e)	2009 (f)
GDP	4.3	5.1	3.5	2.0 – 3.0
National income	6.7	7.8	3.9	0.0
Domestic demand	6.4	7.8	8.5	0.7
Gross fixed capital formation	2.9	11.9	19.9	–4.5
Total consumption	6.4	7.4	5.0	2.5
Exports of goods and services	5.5	7.8	1.8	2.1
Imports of goods and services	10.5	14.3	13.4	–1.7
Current account (% of GDP)	4.7	4.4	–2.6	–4.6

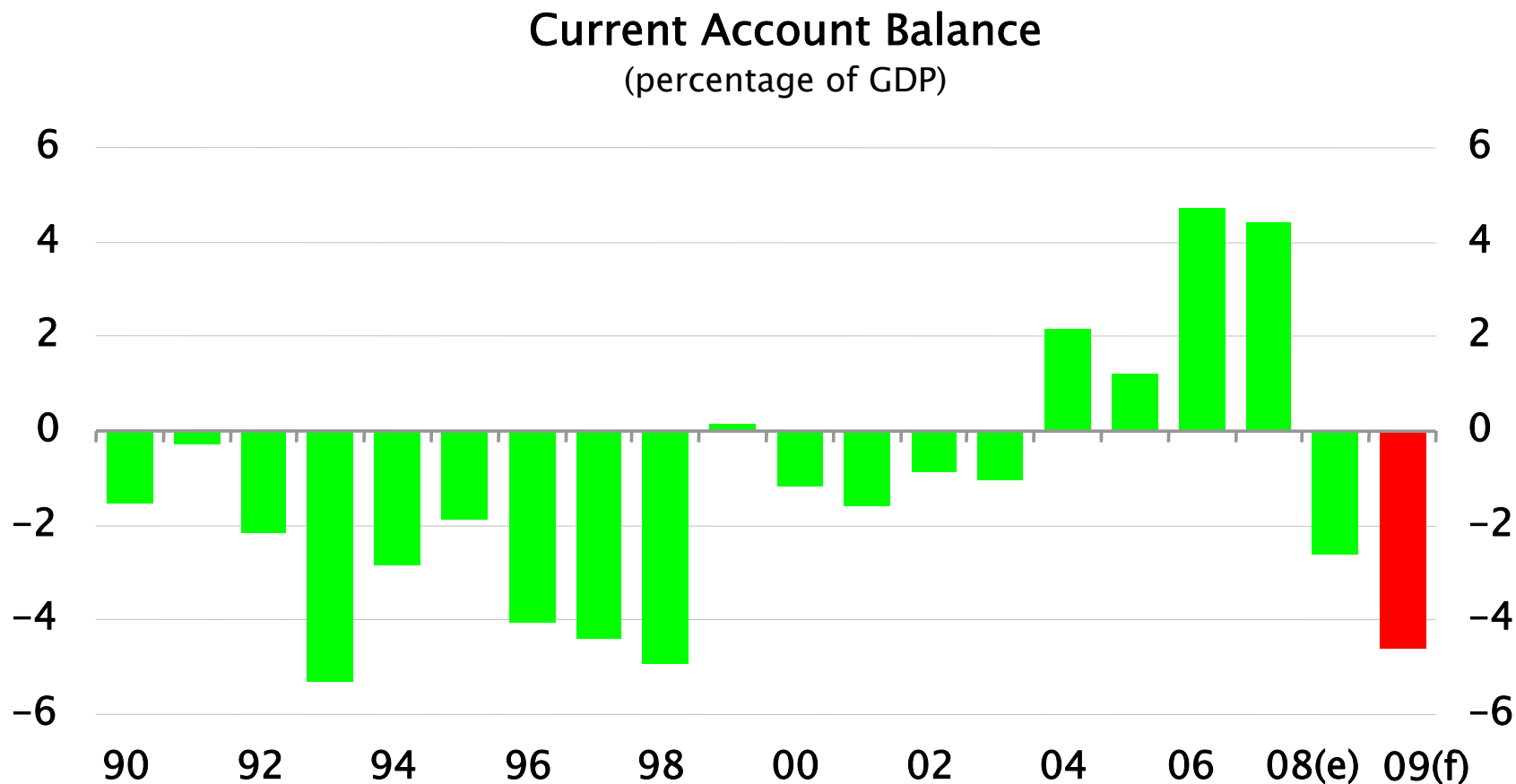
(e) Estimate.

(f) Forecast.

Source: Central Bank of Chile.



After several years of surplus, the current account should move into deficit.



(e) Estimate.

(f) Forecast, Monetary Policy Report, January 2009.

Source: Central Bank of Chile.

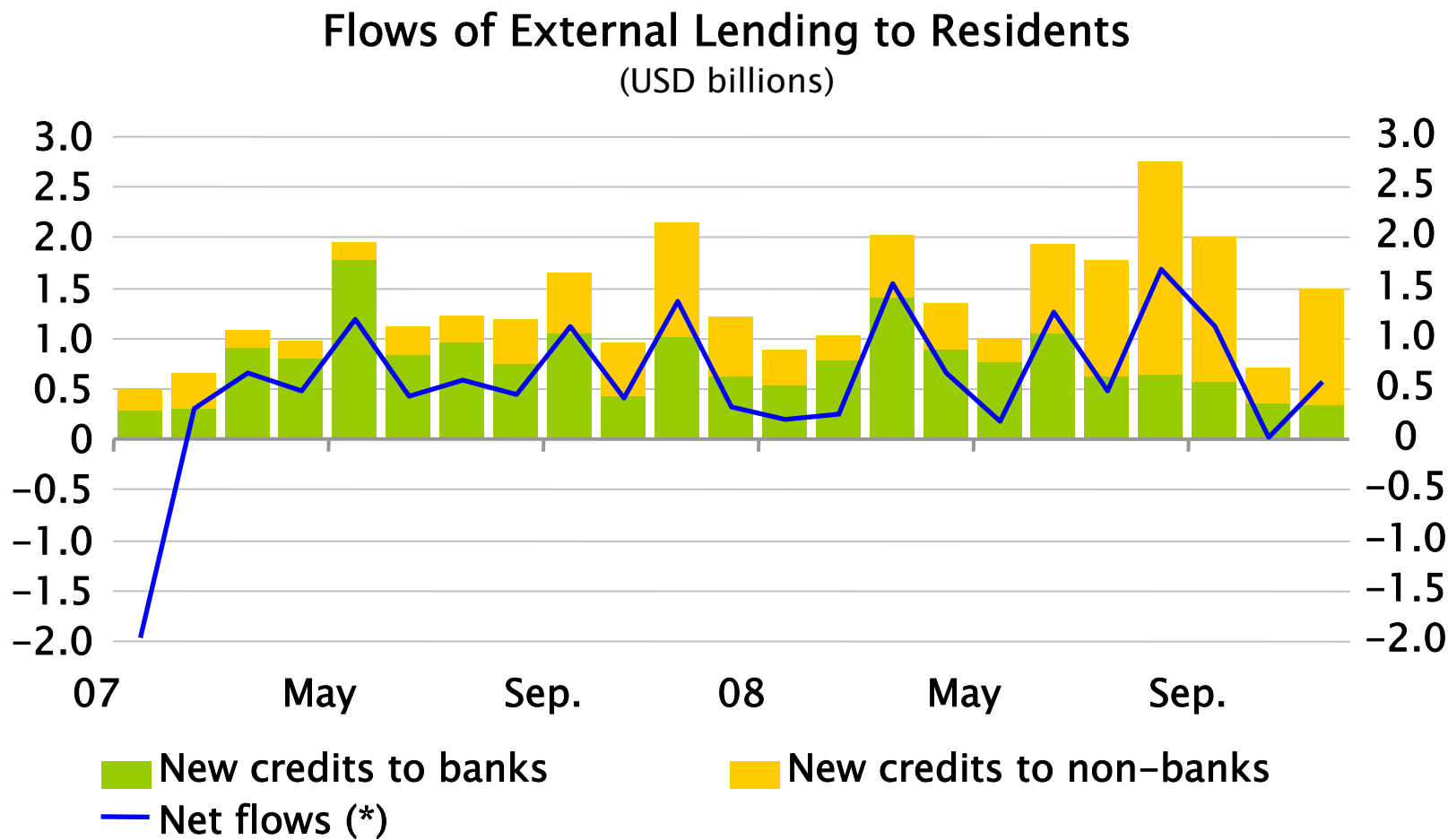


Domestic demand should experience a significant deceleration.

- Private consumption should expand at a moderate pace while investment is forecast to contract. The investment rate should remain high by historical standards.
- The forecast considers that the fiscal stimulus package has an incidence of around 1% in higher growth.
- The financing of the current account deficit comes significantly with drawdown of the Stabilization Fund for the financing of the expected fiscal deficit (government forecast: 3%). The baseline scenario considers that the remaining financial needs can be satisfied without mayor tensions. If the need arises, external liquidity is available to ensure a smooth adjustment.



Access to external funding by banks and corporations has remained open.

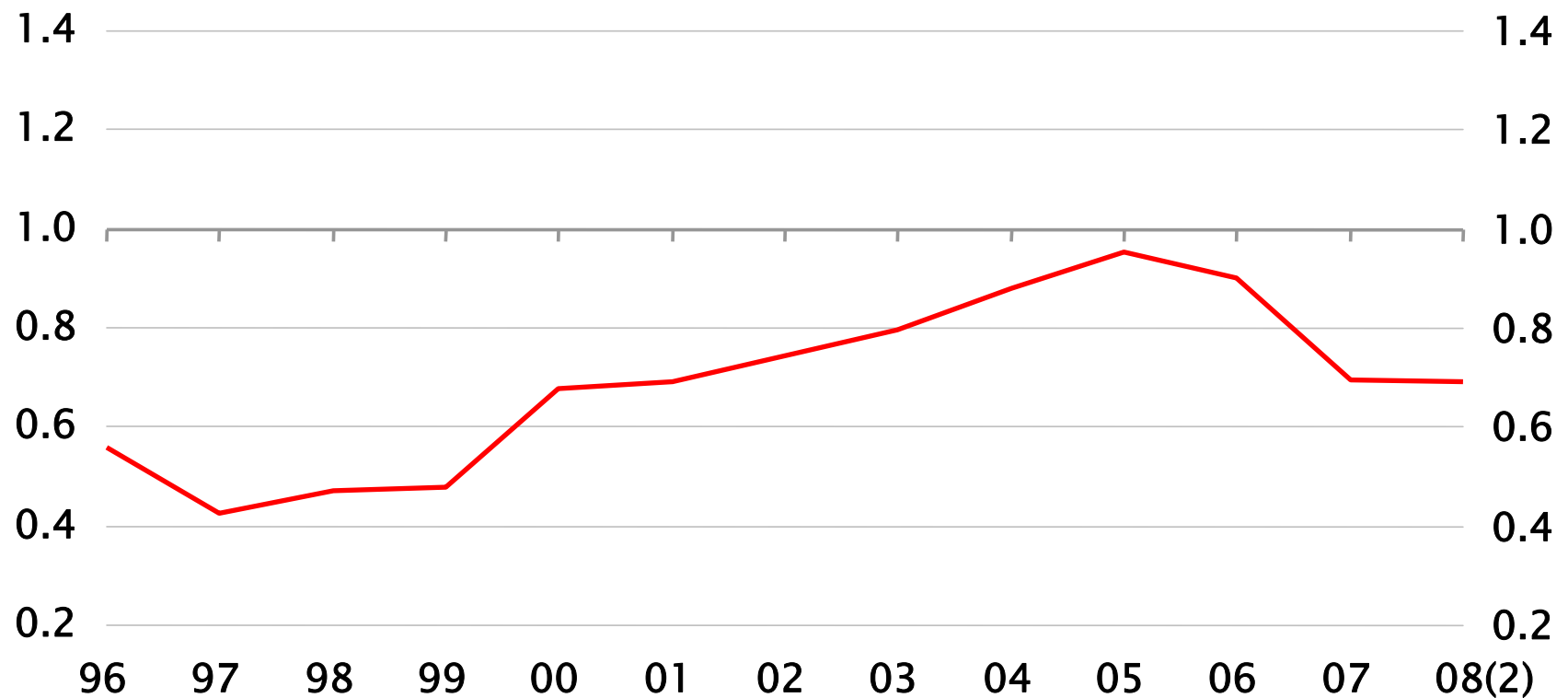


(*) Total new lending amount discounted by amortization made by banks and non-banks.
Source: Central Bank of Chile.



External liquidity in the SWF and IR are 50% higher than short-term residual external debt.

Short-Term Residual External Gross Debt/Assets in Foreign Currency (1)
(ratio)



(1) Considers Net International Reserves and the Economic and Social Stabilization Fund (ESSF).

(2) November 2008.

Source: Central Bank of Chile.



Inflation should converge quickly to target, hovering around 3% over 2010.

Inflation Forecast (annual change, percentage)

	2006	2007	2008	2009 (f)	2010 (f)
Average CPI inflation	3.4	4.4	8.8	4.5	2.9
December CPI inflation	2.6	7.8	7.1	3.1	
CPI inflation around 2 years (*)					3.0
Average CPIX inflation	3.2	4.0	8.4	6.3	2.6
December CPIX inflation	2.7	6.3	8.7	3.0	
CPIX inflation around 2 years (*)					2.8
Average CPIX1 inflation	2.5	4.1	7.8	5.4	2.7
December CPIX1 inflation	2.4	6.3	7.9	3.3	
CPIX1 inflation around 2 years (*)					2.5

(f) Forecast.

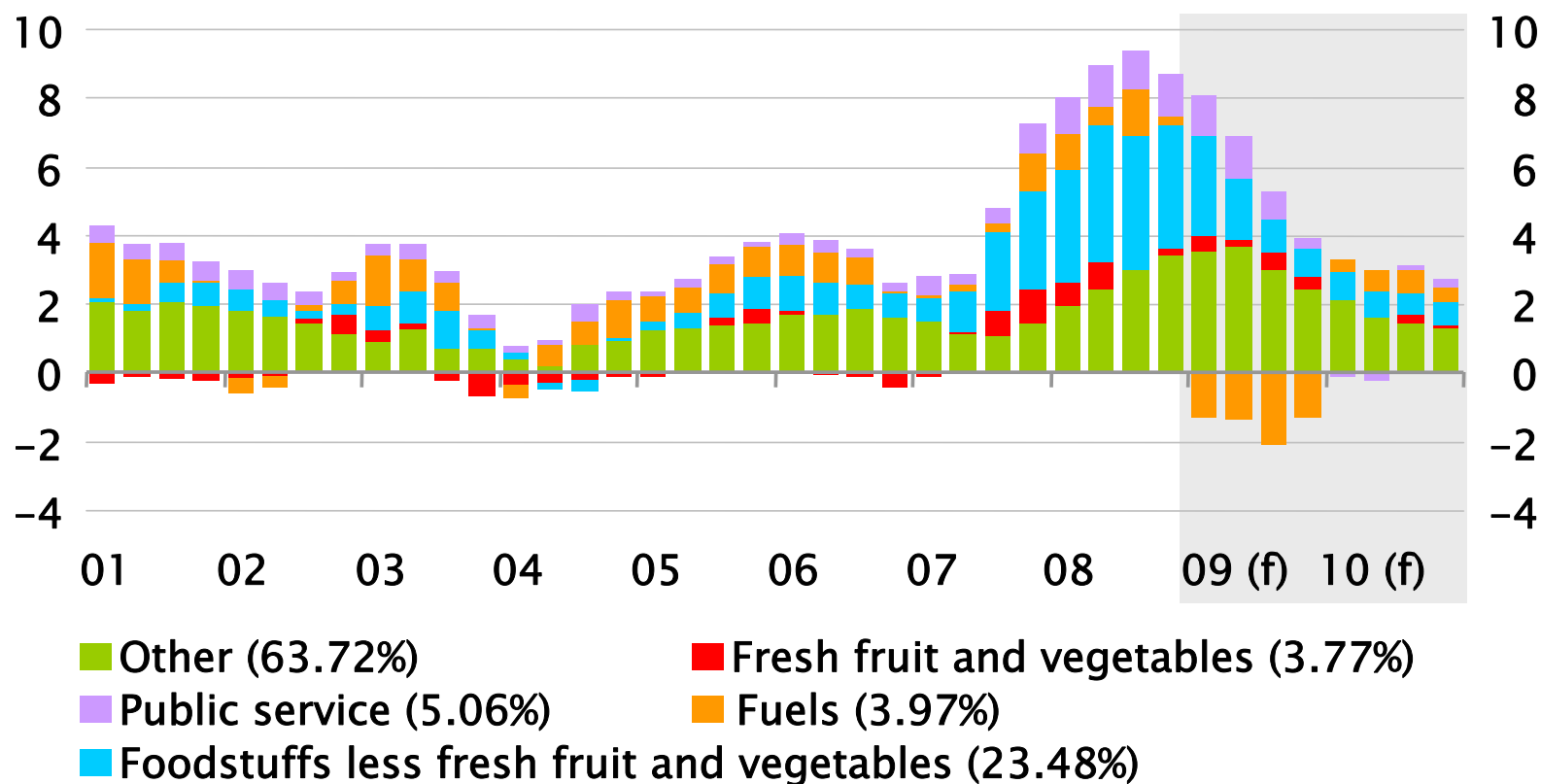
(*) Corresponds to the projected average inflation between the fourth quarter of 2010 and the first quarter of 2011.

Source: Central Bank of Chile



Baseline scenario considers a quick convergence of inflation to 3% target.

Incidence in annual CPI inflation (1) (2)
(percentage points)

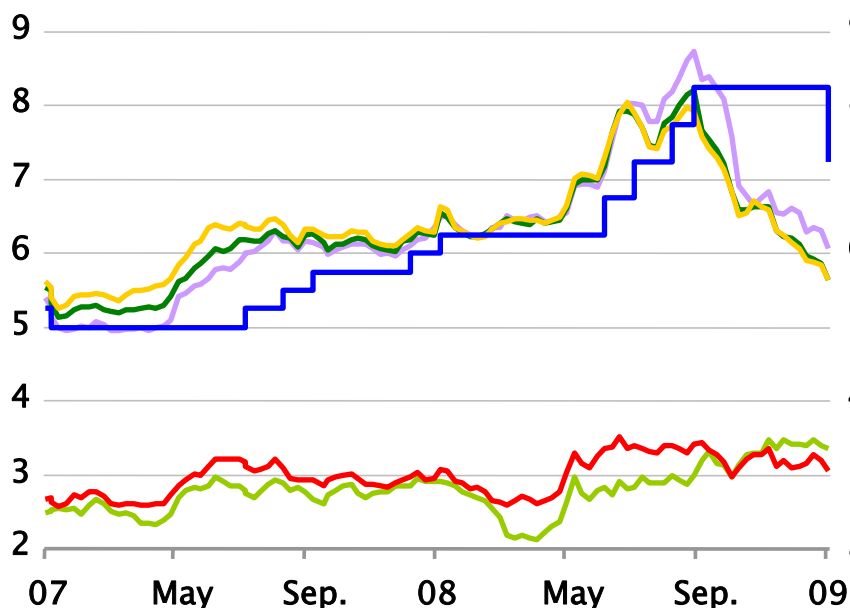


(1) Gray area denotes projected decomposition of inflation considered in the baseline scenario of the Monetary Policy Report, January 2009, from the first quarter 2009 on. (2) In parentheses, weight in CPI. Sources: Central Bank of Chile and National Statistics Bureau.

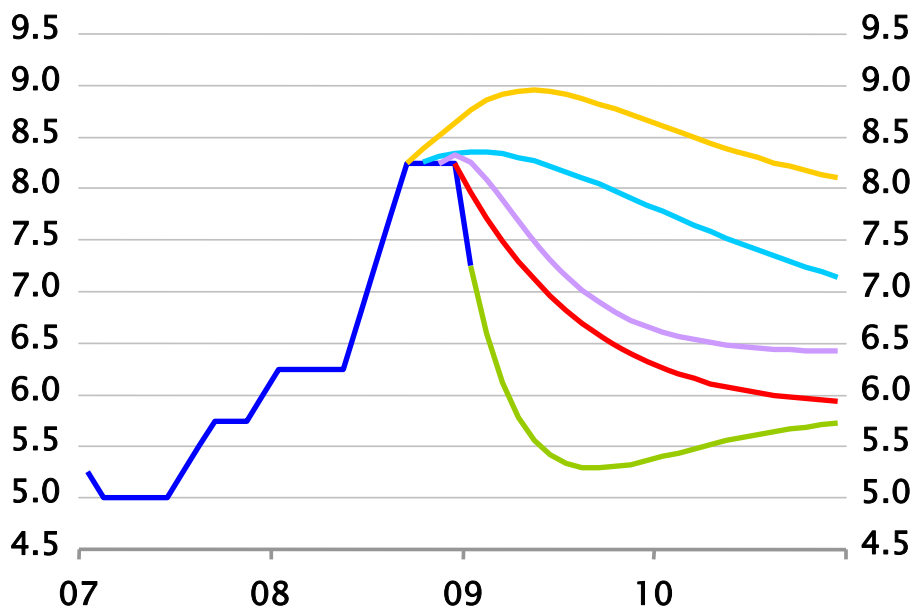


The baseline considers further easing of monetary policy, to a level for the MPR somewhat below what is priced in by markets in the short term.

MPR, Interest Rates on CBC instruments and Forward Curve (*)
(percentage)



— MPR
— BCP-2
— BCP-5
— BCU-5
— BCU-10
— BCP-10/BTP-10



— MPR
— Forward Sep. 08
— Forward Oct. 08
— Forward Nov. 08
— Forward Dec. 08
— Forward Jan. 09

(*) First figure based on weekly averages.
Source: Central Bank of Chile.



Snapshot

	2005	2006	2007	2008
Gross Domestic Product (billions of USD)	118.6	146.4	163.9	183.2 (*)
Real GDP growth (%)	5.6	4.3	5.1	3.5 (e)
Consumer prices (annual % change Dec/Dec)	3.7	2.6	7.8	7.1
Population (millions of inhabitants)	16.3	16.4	16.6	16.8
Exports of goods FOB (millions of USD)	41,267	58,485	67,644	67,800 (e)
Imports of goods FOB (millions of USD)	30,492	35,899	43,991	57,600 (e)
Current account balance (% of GDP)	1.2	4.7	4.4	-2.6 (e)
Foreign exchange reserves excl. gold (millions of USD, as of 31 Dec. of each year)	16,960.1	19,424.6	16,904.7	23,156.6
Foreign debt (% of GDP)	39.1	33.6	34.1	37.4 (*)
Average exchange rate (Chilean pesos per dollar)	559.9	530.3	522.7	521.8

(*) Considers the last twelve months up to 3Q08.

(e) Estimate.

Sources: Central Bank of Chile and National Bureau of Statistics.



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