MONETARY POLICY REPORT
FINANCIAL STABILITY REPORT
PRESENTATION BEFORE THE FINANCE COMMITTEE OF THE HONORABLE SENATE OF THE REPUBLIC*

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* You may browse the *Monetary Policy Report* of June 2017 and the *Financial Stability Report* of the first half of 2017 at http://www.bcentral.cl

Introduction

Mr. President of the Senate's Finance Committee, senator Carlos Montes, senators members of this Commission, ladies, gentlemen.

Thank you for your invitation to present the vision of the Board of the Central Bank of Chile on the recent macroeconomic and financial developments, projections and implications for monetary and financial policy. This vision is detailed in our June *Monetary Policy Report* and our *Financial Stability Report* for the first half of this year.

In the past few months, the macroeconomic scenario has evolved in line with forecasts depicted in our March Monetary Policy Report. On one hand, inflation has brought no surprises, consistently with an exchange rate that has changed little since mid-2016 and gradually expanding capacity gaps. First-quarter activity growth was virtually flat in annual terms, largely affected by downtime in Escondida mining company, in a context of still very weak performance of sectors linked to construction investment.

In contrast, consumption shows a more stable outlook, driven by significant growth in demand for durable goods, which has offset the poorer performance of the other components. The external scenario, beyond recent volatilities, continues to signal higher growth in the developed world, with favorable financial conditions for emerging markets and commodity prices without major changes, after having begun a recovering in late 2016.

Thus, although important external and domestic sources of uncertainty remain, prospects for this year and next are in line with forecasts. Accordingly, the projections in the baseline scenario that I will be sharing with you in a moment, assume that monetary policy will remain expansionary throughout the projection horizon, so that inflation will fluctuate around 3% during much of the period, and activity will recover higher rates of expansion, especially towards the second half of 2017 and into 2018.

Let me now present the details of our vision about the macroeconomic scenario and estimates contained in our *Monetary Policy Report*.

The Monetary Policy Report

Recent evolution of the economy and our projections

The inflation outlook shows no substantive changes. Annual CPI variation has been at 2.7% since February, while core inflation—the CPIEFE—has decreased slightly (figure 1). The baseline scenario estimates that the real exchange rate will not change much and that capacity gaps will begin to close some time next year. In this context, core inflation will continue to decline for some months, to around 2%, to then approach values of the order of 3% towards the end of the projection horizon. The prices of the most volatile items (food and energy) will increase more than core inflation, so headline inflation will converge to the target sooner than the core measure. Thus, the baseline scenario continues to estimate that in the coming months headline inflation will decline to levels near the floor of the tolerance range, and will return to 3% at the end of the year and hover around this figure until the end of the projection horizon, mid-2019 (figure 2).

First-quarter data confirmed the strong impact of the Escondida strike on the sector's output, aggravated by reduced production in other mines (figure 3). Thus, mining activity fell by nearly 14% annually in the period, dragging along power generation and some local activities, according to various respondents to the May Business Perceptions Report (IPN) survey. Moreover, recovering former production levels has taken longer than expected, so the effect in mining output has extended into the second half. After considering these elements, the mining sector is projected to drop this year by nearly 2.5%, compared with the 1.5% increase we expected in March.

Other sectors' activity continues to show two trends. On the one hand, the weakness of construction activity and related services; on the other, the more stable performance of private consumption, driven strongly by growth in durable goods. Thus, first-quarter numbers showed a contrast between the fall in construction sectors and business and real estate services on one side, and growth in trade and the recovery of manufacturing lines that produce consumer goods on the other (figure 4). The improvement in investment in machinery and equipment—excluding uncommon transport equipment—is also worth noting, which, like durable consumer goods, has benefited from the need to replenish stocks after several years of low growth and exchange rate elements (figure 5). Finally, the greater execution of public spending contributed to increase government consumption, which also had a positive impact on activity.

The increased stability in consumption occurs in a context where consumer expectations, although still in pessimistic territory, have improved somewhat. The labor market continues to adjust as expected, with the unemployment rate low by historic standards, but with salaried employment still weak and still decelerating wages. The downturn of salaried employment has been echoed by a rise in self-employment. As we show in a box in the MP Report, considering workers of equal experience and skills, a person that is self-employed or works in the informal sector, earns around 20% less per hour than a salaried employee. If we consider that the informal and self-employed work fewer hours per week, their income ends up being 30% to 40% less. Although the share of non-salaried employment in total employment has risen in the past few months, it has not diverted far from its historic indicators. Actually, the figure for the last moving quarter, February to April 2017 (25.9%) is a perfect match to the 2010-2017 average and significantly lower than the average from 1986 (27%) and of periods of economic crises (figure 6).

Thus, the increase in self-employment has cushioned the decay of the labor market's impact on the wage mass. The reduction of inflation has also helped, leading the wage mass to grow a little above the forecast, returning to a range between 2.5% and 3% annually. However, as detailed in the FS Report of the first half 2017, the evolution of the labor market may be influencing the repayment behavior of households, which has seen some deterioration recently. All in all, we foresee that total, private and public, consumption will grow around 2.5% this year and 3% next year.

Another determinant of consumption, such as credit cost, shows that cuts to the monetary policy rate (MPR) have been passing through to the interest rates. Beyond specific fluctuations due to composition effects, interest rates on consumer, commercial and mortgage loans are in low levels (figure 7). Despite some marginal improvement, credit growth remains tight, with supply-side and demand-side constraints combined. The former matter more for consumer and mortgage loans, in particular because of the higher risk associated to the labor market and the increase in some delinquency indicators, plus the effects of regulatory changes in the real-estate market. Demand-side factor are especially important for companies, which attribute their low demand for credit to the shortage of investment projects (figure 8).

Considering the usual revision to the growth projection range for the current year that we must do in this MP Report, the Board estimates that GDP will expand between 1% and 1.75% in 2017, while for 2018 it foresees a range between 2.5% and 3.5%. The changes owe mainly to the fact that mining activity fell more than expected in the first months of this year and that its subsequent recovery has been slower, as the growth prospects for the rest of the sectors have not changed much. Thus, it is still believed that the return to growth rates in line with potential growth and closing gaps, is consistent with an economy that shows no major imbalances, a gradual dissipation of some of the factors that have hindered a better performance in the past few years—such as the sharp drop in mining investment in the last three years—and the recovery of confidence indicators. Plus a more expansionary monetary policy and a greater external impulse than in recent years. As for fiscal policy, it is assumed that the consolidation announced by the Government will continue (table 1).

On the external front, the data of recent months do not show great divergences with respect to forecasts. Developed economies continue to show signs of recovery in a context in which their inflation indicators have stabilized and their monetary policies remain highly expansionary. At the same time, beyond recent episodes of volatility, financial conditions remain favorable in perspective, particularly for emerging economies. This, together with still low risk premiums, stock markets that have held on to positive returns, capital flows that are sustained, as well as the withdrawal of the monetary impulse by the Federal Reserve that has caused no major disruption in the markets. As shown in a box in the MP Report, volatility indicators have remained low during the period, contrasting with persistently high political and economic uncertainty indices. The gap between these indicators has caused some concern, as it could indicate that markets are not properly reading the risks associated with the present economic and political environment. However, the fact that the two indexes capture elements other than uncertainty, could justify this situation, so they must be taken as complements. China's growth outlook remains stable, although incoming information has created doubts regarding its growth pace for the rest of the year and has increased preoccupation about the stability of its financial system, especially in a context of internal and external monetary normalization.

It must be noted that in Latin America, several economies have seen activity weaken beyond expectations, but lower inflation has allowed to normalize monetary policies faster, which should help regain better numbers. Brazil, the main economy in the region, is still in difficulties. Although short-term indicators continue to show signs of recovery, solutions are expected to be slow. Private projections point to GDP growing between 0.5% and 0.7% this year, after the recession of 2015–2016. Inflation has dropped further, which has allowed to continue normalizing monetary policy. In any case, political uncertainty is the biggest risk in the short term. In Argentina, activity shows incipient signs of recovery after the recession of 2016, while inflation has accelerated, posting 27.5% annually in April. The Argentinean Central Bank has raised the policy rate this year so far, and it now stands at 26.25%. In Colombia, activity weakened in the first quarter, but some rebound is expected in what remains of the year, to reach annual growth of 2.0%. Inflation began to decline in the middle of last year, so the Central Bank has further reduced its policy rate, which is now at 6.25%. In Peru, activity also weakened early in the year, affected by temporary shocks, like the El Niño phenomenon and to some extent also by corruption scandals that have paralyzed a few infrastructure projects. Also noteworthy is the weakness of domestic demand, which shrank 1% in the quarter. A different case is Mexico, where activity has outperformed expectations with growth of almost 3% annually. Inflation, however, continues to accelerate, reaching almost 6% in April, due to the depreciation of the Mexican peso and the increase in agricultural prices. The Central Bank has continued to reduce the monetary impulse, with its policy rate reaching 6.75%, i.e. a 100 bp hike since December (figure 9).

Thus, world growth is expected to average 3.5% in 2017–2018, with trading partners that will grow 3.3% in the same period, significantly matching the March forecasts. The copper price is also expected to remain at USD 2.55 per pound this year and USD 2.5 next year, and the oil price will average a little over USD 50 per barrel in the same time span (table 2).

In the baseline scenario, monetary policy will remain expansionary through the entire projection horizon. Estimates use as a working assumption that the trajectory will be consistent with the various measures of expectations as of the closing of the Report (figure 10). As always, it must be stressed that this is a working assumption, not a commitment. Therefore, the conduct of monetary policy and possible adjustments to the MPR will be contingent on the effects of incoming information on the inflation outlook.

Risk scenarios

Abroad, the main sources of uncertainty remain linked to the factors identified in previous MP Reports. On the one hand, there is the conduct of fiscal and monetary policy in the United States and its impact on the global economy and on financial conditions. Also uncertainty about the political environment. In Europe, recent election results have been dissipating some of the political risks, in a context where growth has consolidated and data has been higher than expected, so a new boost from the region on the global economy cannot be ruled out. China remains a concern, either because short-term data has cast some doubt on the future growth trajectory or because of imbalances in some markets that still need to be corrected. Latin America lags behind in the recovery of its economies and some of them still require fiscal and monetary adjustments and, to a lesser extent, of their external sector. Recent political developments in Brazil could generate greater effects on the financial conditions facing the region.

At home, inflation and activity have evolved in line with expectations, with no significant changes in prospects. The same is true of the labor market. However, after several years of slow growth, the risk remains that companies may need to further adjust their wage bills, especially if the expected recovery fails to occur, taking a toll on the wage mass and on expenditure. Conversely, both a stronger external impulse and improved expectations could prompt a stronger reaction from investment, especially in a context where monetary policy has become more expansionary and both external and local financial conditions are good.

In this context, the Board estimates that the risk balance is unbiased for both inflation and activity. Of course, this does not mean that we see no clouds on the horizon, but that the probability of occurrence is the same in one direction or the other. To the extent that these signal a change in the scenario going forward, the Bank will respond and adjust its decisions.

Our track record of the last year and a half provides a good example of how flexible our monetary policy is to respond to significant changes in economic conditions. In hindsight, monetary policy remained expansionary with a stable MPR between October 2014 and September 2015, despite the increase in inflation resulting from a sharp exchange rate depreciation, rightly interpreting that it was a transitory phenomenon derived from supply-side pressures on prices. Towards the end of 2015, a normalization process began, sustained on a scenario where growth was projected to equal potential, and with bounded capacity gaps. This adjustment, however, occurred gradually and prudently, with an increase of 25 basis points in the MPR in October and December 2015.

This prudence, accompanied by a vision focused on the future prospects of the economy, allowed the monetary policy orientation to be adjusted quickly when the macro scenario began to change. Indeed, the exchange rate appreciation and signs of weakening in the first half of 2016 led the Bank to revise its inflation and growth projections. As these adjustments revealed a new macroeconomic scenario, characterized by weak economic activity, greater exchange rate stability and a faster deceleration of inflation, the Bank successively adjusted its monetary policy options and bias, culminating in four 25-bp cuts in the policy rate in the last five months.

Thus, in response to changes in the medium-term macroeconomic scenario, the MPR has accumulated a decline of 100 bp since January of this year, to 2.5%. With this, the MPR is between 150 and 200 bp below its levels considered neutral. The speed with which we have made this reduction responds to our conviction that the medium-term inflation outlook was revealing a scenario that jeopardized the fulfillment of the policy goal. All this, because of the implications that the evolution of the macro scenario, in particular weak activity, had on them.

Considering the cuts already made, we believe that monetary policy is now highly expansionary and consistent with inflation at 3% over the projection horizon. Within this horizon we will see in the coming months that annual inflation will fall again, approaching 2%. We will also see months of poor activity, as shown by the latest Imacec. But the improvement in external conditions, the disappearance of specific factors that have affected activity and prices, and the monetary impulse itself, will allow the economy to regain more growth in the second half of this year and in 2018, with capacity gaps that will begin to close in the course of 2018 at the same time that inflation will converge to the policy target.

This, by the way, does not mean that the MPR will not be adjusted again, but that in the most likely scenario no new changes are needed, and that the most important thing will be to let the monetary impulse permeate the economy for as long as necessary in order that, combined with the other mentioned factors, it will generate a visible convergence to the policy target. Again, this is not a promise, it must be crystal clear that the Central Bank will not react to one-time events, but to discernible and material changes in the future macroeconomic scenario that could compromise compliance with its objectives.

The flexibility of Chile's monetary policy is a very important feature that responds to the macroeconomic policy framework of the country. In particular, because monetary policy is based on a forward-looking inflation targeting scheme. Also because the floating exchange rate allows it not to be tied to defending the exchange rate. The same as the commitment of public spending to the fiscal rule, which gives the Central Bank leeway to smooth out business cycle fluctuations that affect the achievement of the inflation target. The sum of these elements allows the Chilean economy to have a more expansionary monetary stance than other Latin American economies. In fact, in a cross-country comparison of the policy rates, the Chilean rate is the lowest by far in the region. Even deflated by inflation, the real effective MPR ranks also the lowest (figure 11).

Now let's take a look at the subjects we developed in our Financial Stability Report.

The Financial Stability Report

In the Financial Stability Report we publish on a semi-annual basis (every June and December), the recent macroeconomic and financial events that could affect the financial stability of the Chilean economy. In contrast to the Monetary Policy Report, the Financial Stability Report is not articulated around a baseline scenario, but focuses on the most important financial risks.

In this FS Report, we emphasize that in recent times the Chilean financial system has seen no major disrupting events, and the information at hand indicates that it is in a good position to withstand the impact of stress scenarios. Both domestic and external payment systems have operated normally, while credit risk indicators have remained low. However, recent developments indicate a gradual increase in the latter. One important risk is that, if the economic slowdown continues as it has for some years, this deterioration might deepen.

On the external front, the risks identified in the FSR are similar to those I just described for the Monetary Policy Report. Note that global uncertainty is still high, so going forward, the risks of revisions to the world economic outlook cannot be ruled out. Note also that possible increases in long-term interest rates in international markets, besides entailing a forex effect, might be transmitted to local rates and translate into higher funding costs for local agents.

As I just said, the cost of local short- and long-term financing reached record lows, in line with market expectations for the MPR and the environment of low long-term external rates. In this context, institutional investors made moderate changes in the composition of their portfolios. In particular, the assets in layer 1 mutual funds continued to grow relative to the other funds; Life insurance companies continued to increase their positions in real estate investment; and pension funds increased their exposure in local bonds. Also, at the statistical closure of this FS Report we did not observe any significant changes between the funds managed by the AFPs, in contrast to the significant transfer of affiliates to the E fund documented in the previous Report.

It is also worth noting that the financial position of local companies presents no big diversion from previous Reports, despite the fact that local economic activity has performed worse than expected. Total debt to GDP declined slightly, largely explained by external financing sources (figure 12). Meanwhile, the greater dynamism of bond issues has focused mainly on the refinancing of liabilities, while the growth rate of commercial loans remains low. The group of companies that report to the SVS increased their profitability at the end of 2016. However, about 70% of this increase has its origin in non-operational sources. Finally, those firms in productive sectors that do not report to the SVS and have no external debt, posted a decrease in their bank debt recently. This, combined with information from the Bank Credit Survey, reflect lower financing needs of these firms, which is consistent with the evolution of local economic activity.

The less dynamic economy has marginally affected the repayment behavior of firms, increasing the credit risk of the commercial portfolio. Although delinquency levels are fairly low, since the last FS Report some NPL indicators showed increases. This, coupled with the fact that the fraction of loans rated sub-standard remained relatively high, has worsened the quality of the commercial portfolio (figure 13). Going forward, a less favorable macroeconomic scenario would lead to some these credits being defaulted.

The evolution of the labor market has begun to reflect in deteriorated economic and financial indicators of households. Thus, since the last FS Report, bank consumer loans posted an increase in non-compliance. Meanwhile, mortgage default ceased to decline as it had for some years (figure 14). Meanwhile, households' aggregate indebtedness continues to rise, most of all the mortgage component (figure 15). Most recently, survey responses reveal an increase in the financial burden over income, which, together with the increased non-compliance in the consumer portfolio, calls for follow-up. Actually, any further deterioration in the labor market could deepen households' non-payment behavior.

The housing market continues to adjust. Sales of new homes in the Metropolitan Region have slowly recovered, while the prices of both new and used homes decelerated in the second half of 2016. At the same time, the launching of new projects has slowed, in line with the reduced growth outlook for the sector. All in all, different indicators of the residential real estate sector—including mortgage credit—show a slowdown, reflecting both the economic situation and the tax and regulatory changes discussed in previous FS Reports (figure 16). Lastly, cancelled home purchase agreements have remained bounded, but may increase in the face of a further deterioration of the labor market. This could affect real estate companies lacking sufficient cash flows to cover the costs of putting a cancelled sale unit back on the market.

It should be noted that although the economic outlook has deteriorated in recent years, the capitalization of the banking sector has not changed significantly. The system's capital adequacy ratio (CAR) stands at 13% since mid-2016, close to its historical average, but still below international standards. Stress tests show that the banks' capital gap has narrowed over the last few years. Thus, the fraction of banks with a CAR above 10% after a severe stress scenario would go from representing 85% of the system's assets in 2011-2014, to 50% in the last two years (figure 17). This is so because the banks that are most exposed to the economic slowdown have not adjusted their capital levels accordingly. In this context, the new General Banking Law would contemplate a gradual convergence towards the Basel III framework, which has implicit higher capital requirements for the banking system.

I would like to end this presentation with some thoughts.

Concluding thoughts

The two reports I just presented (i.e., the Monetary Policy Report and the Financial Stability Report) provide us with a full overview of the Chilean economy, that includes not only its most likely trajectory, but also the risks that might push it away from it. This illustrates the fact that monetary and financial policies are two important complements in Chile's macroeconomic policy scheme.

One important dimension of this short-term complementary nature is the transmission of changes in monetary policy to the cost of credit, and the spending decisions of individuals and companies rely on a sound and strong financial system. As I just commented, market interest rates are now at or very near record lows for the different types of loans, as well as for long-term instruments. This adequately reflects the transmission of the MPR cuts that we have made in recent months and, certainly, a monetary policy that has been kept expansionary for quite some time and will continue to be so in our baseline projection scenario.

However, this transmission of the expansiveness of monetary policy and external financial conditions would not be possible if it did not interact with a financial policy focused mainly on the proper functioning of the system and the access of the Chilean economy to the international financial markets.

There is a clear relationship between economic activity and the financial market's performance. On the one hand, economic activity has a direct impact on the results of the financial sector and possibly its stability; on the other, performance indicators of the financial sector can signal the future behavior of the economy.

In this sense, the incipient deterioration of the non-payment indicators of households and firms that this FS Report shows is important. Not only is it necessary for the cost of credit to be low, but also for households and companies to have access to it and to meet their financial obligations, because it is important not only for themselves but also for the soundness of the financial system as a whole.

The importance of this interaction between the functioning of the financial market and economic activity is not limited to the short term. As we have stressed on several occasions, Chile faces an important challenge in terms of improving productivity and medium-term growth. To this end, the support of a stable, deep, liquid, efficient and inclusive financial system is of the essence.

From a monetary policy standpoint, this is achieved by having stable, controlled inflation, in a context where the economy successfully smoothes business cycle fluctuations. From a financial policy perspective, there are many instances in which regulatory amendments can improve the efficiency and efficacy of the national financial system.

Considering a broad set of developed and emerging countries, Chile shows increasing levels of depth and access to its financial system according to various indicators, such as the loans to GDP ratio, market capitalization or number of bank accounts. However, there are always important challenges to be addressed, so we cannot overestimate the importance of recent or pending regulatory changes that will potentially help Chile to improve in this regard.

A first series of measures has to do with the Law that defines actions to boost productivity, including some initiatives to deepen the financial market. Among these, I can mention the amendments to the Constitutional Organic Law (LOC) of the Central Bank to perfect the regulations applicable to payment systems established in the country and recognize payment infrastructures in foreign jurisdictions involving local financial institutions. Other points include raising the limits for foreign investment of insurance companies, making it easier for international custodians to settle in Chile, expanding investment alternatives for the Pension Funds and the Unemployment Fund, as well as moving towards a risk-based model of supervision for such funds.

About financial inclusion, one noteworthy regulatory change has been the Law that allows non-bank entities to issue prepaid cards (Law No. 20,950—2016), aimed at promoting the development and massification of electronic payments and increasing financial inclusion, along with boosting competition in means of payment. Its implementation requires that the Bank (and the SBIF) issue the rules that will regulate this activity. These, besides regulating the implementation of prepaid cards, will incorporate another series of normative improvements on the payment system in general, which should contribute to favor the development, competition and incorporation of new technologies in the field.

A final change worth mentioning is the Law that will create the Financial Market Committee, which will bring about a very significant change in our country's financial regulation and supervision structure, and whose implementation poses a major challenge for public politics.

Despite these significant advances, big challenges await us. In the immediate future, a new draft for the General Banking Law has been sent to Congress, with a focus on three areas: Corporate Governance of the regulator, Basel III capitalization rules, and Banking Resolution. Progress in these three areas is of paramount importance. In particular, a greater convergence with the international standards on banking capital requirements defined by Basel III would solve a lag that has pulled back the banking system for several years. Equally important is to strengthen the security network of the financial system by improving the mechanisms to administer banks in financial problems (bank resolution). Once this project is sent by the Executive, it is desirable for it to receive the necessary attention and be able to advance in the formalities bypassing the political processes that will characterize the last months of this year.

Another much debated topic internationally are the potential effects of technological innovations in financial markets (*Fin tech*)[1]/. These innovations have the potential to trigger major changes in the financial system, which would provide great opportunities for the agents, but would also

[1]/ See paper by Carolyn Wilkins (2016), http://www.bis.org/review/r160622a.htm

threaten its stability and safety. Addressing this matter in a proper and timely manner is another challenge for financial regulators.

Likewise, an area with important recent developments is the regulation of derivatives markets. This is a significant point of interaction between the stability of the financial system, monetary policy and economic growth. In the context of a flexible exchange rate, access to forex hedging with the proper regulation and supervision is certainly important for the various players. Chile has made great advances in this area with a derivatives market that has increased as a fraction of GDP, being above the average of Latin America and other emerging economies. In this context, it is important to expand the information system of derivatives, which allows to further approve the internationally accepted standards to "Transaction Repositories", which are currently considered as important as other types of financial infrastructures, such as Central securities depositories, counterparty entities and payment systems.

Summing up, we believe that there is a series of legal changes that will enable the Chilean financial system to improve its efficiency and stability, providing the necessary tools for agents to make better decisions and foster growth. This, together with monetary policy oriented at keeping inflation stable over the medium term, is the best contribution the Central Bank can make to our country's development.

Dear senators,

In the second quarter of last year there was a change in Chile's economic scenario, with sluggish demand and lower inflationary pressures, that were particularly visible in low numbers for activity and prices at the end of 2016 and early 2017. As incoming data allowed to gauge the nature and magnitude of this change, the Bank adjusted its monetary policy by cutting the policy rate by 100 bp in five months. This adjustment was completed with a final cut of 25 bp in our monetary policy meeting last May.

The action of the Central Bank has meant accentuating the expansionary orientation of monetary policy, which has kept the MPR below its neutral levels for more than three years. This will cushion the effects of the business cycle downturn and ensure that we achieve the inflation target within the policy horizon. In fact, over the next several months this more expansionary monetary policy will permeate the economy, complementing the impact of better external conditions and the replenishment of inventories and capital, gradually speeding up the pace of economic activity and allowing inflation to converge to target. This will also prevent further deterioration of the labor market and financial compliance indicators.

Discerning about the change in the macroeconomic scenario, as well as the magnitude and speed of monetary tightening has been a major challenge for the Central Bank. We have addressed it with the conviction that monetary policy decisions must be based on projections that anticipate events rather than on the latest data or a backward-looking analysis. This approach allows decisions to be made in a timely manner and monetary policy to act whenever needed.

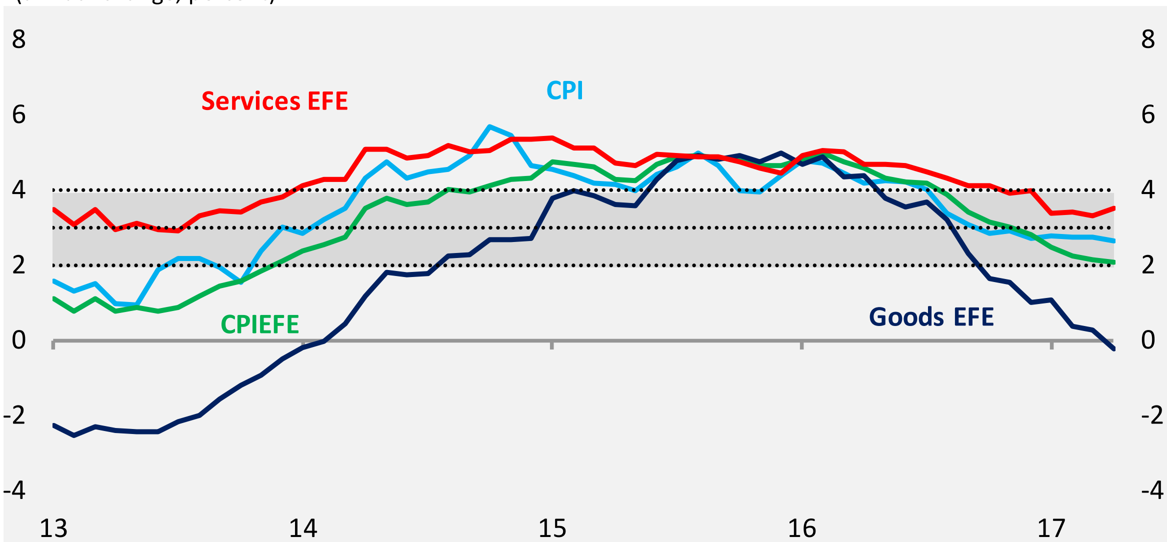
To the extent that a more forward-looking approach demands interpretations and opinions based on partial information, different opinions will inevitably exist. Moreover, this diversity is essential to feed the analysis and internal discussion required by institutional decisions.

Today I have shared with you two reports that reflect the institutional vision of the Central Bank on the macroeconomic picture, the outlook for inflation, the financial risks and the orientation of the policies that are our responsibility. These reports reflect how internal analyses and discussions operate in a shared vision and in institutional decisions. We have also tried to illustrate how the Bank's work on its two objectives of price stability and financial stability complement each other, strengthening our action in both dimensions.

We are convinced that this action will boost the country's economic stability, reducing the risk of volatility and financial turmoil. However, as we have argued in the past, the Central Bank cannot, using its toolkit, avoid or reverse cycles, drive long-term growth or replace responsible behavior of economic agents. This challenge involves other financial, economic and political players. We hope that the Bank's diagnosis and action will contribute to this community of purposes.

Thank you.

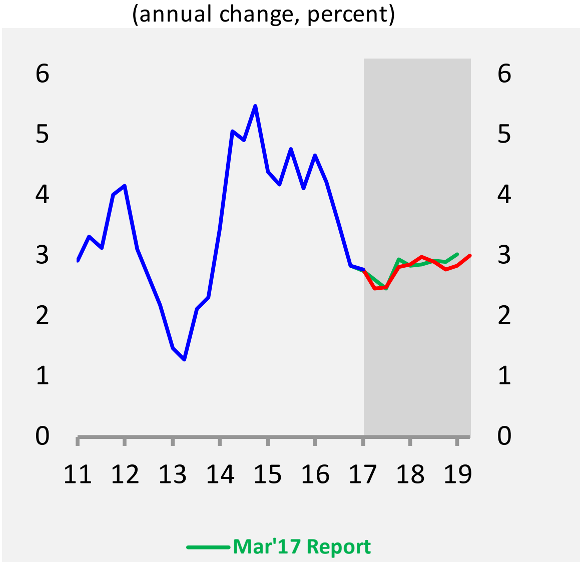
Figure 1
Inflation indicators (*)
(annual change, percent)



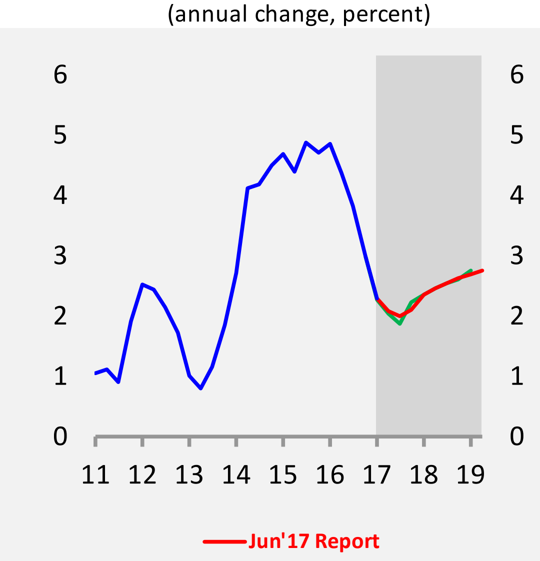
(*) As from January 2014 the new indexes with annual base 2013=100 are used, so they are not strictly comparable with earlier figures.
Sources: Central Bank of Chile and National Statistics Institute (INE).

Figure 2

CPI inflation (*)
(annual change, percent)



CPIEFE inflation (*)
(annual change, percent)

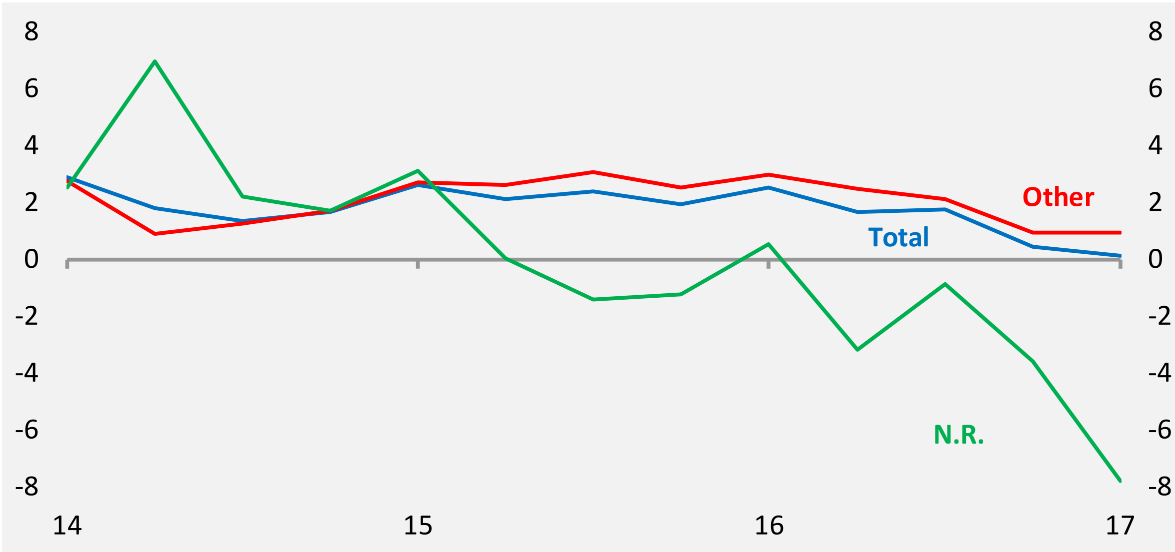


(*) Gray area shows forecast as from the second half of 2017.
Sources: Central Bank of Chile and National Statistics Institute (INE).

Figure 3

GDP

(real annual change, percent)

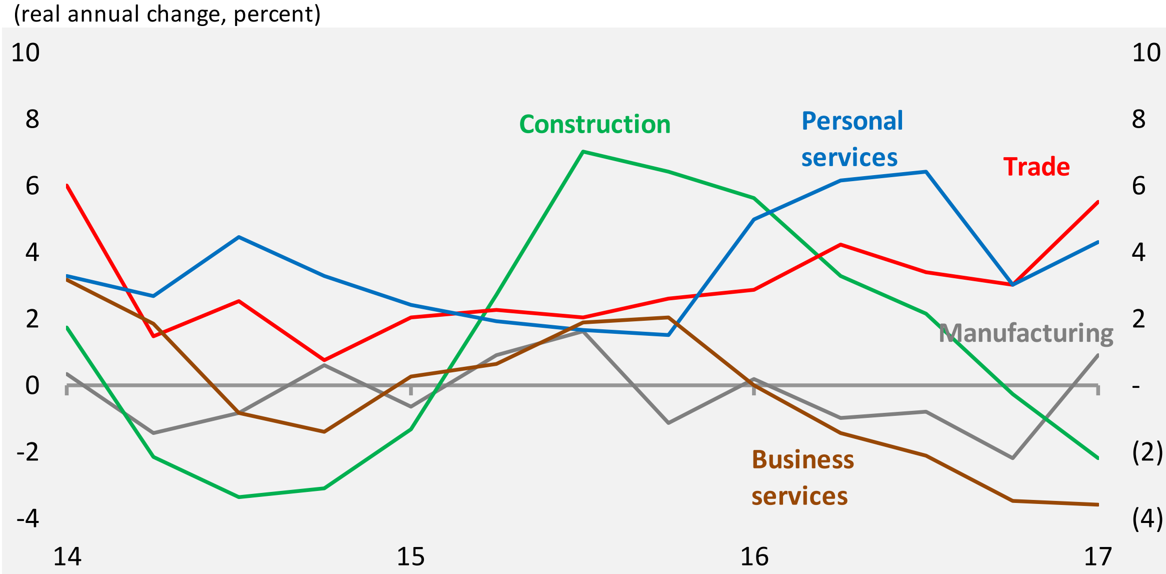


Source: Central Bank of Chile.

Figure 4

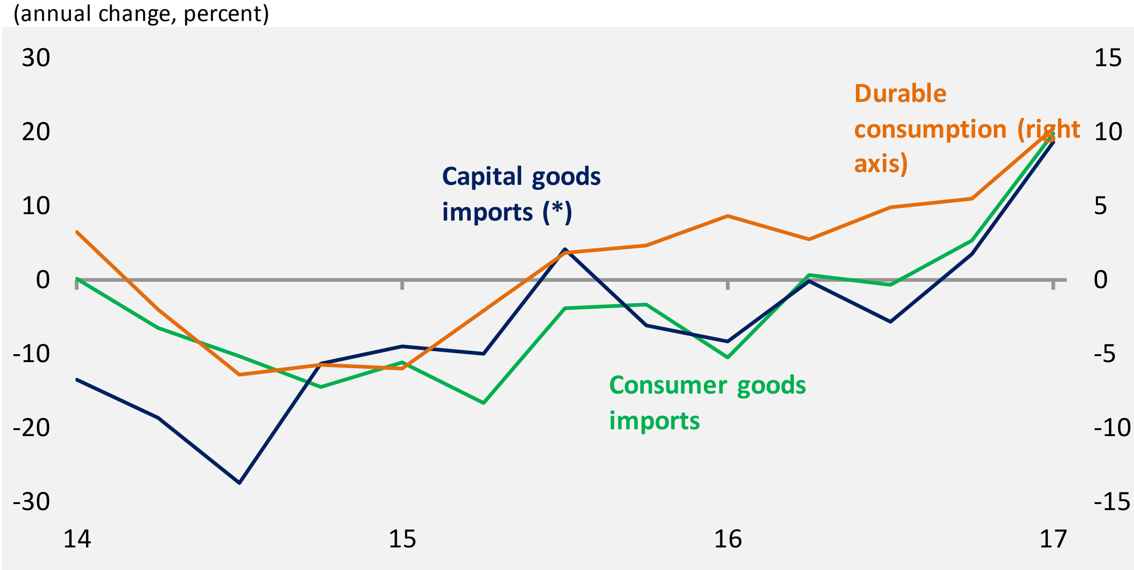
Economic activity

(real annual change, percent)



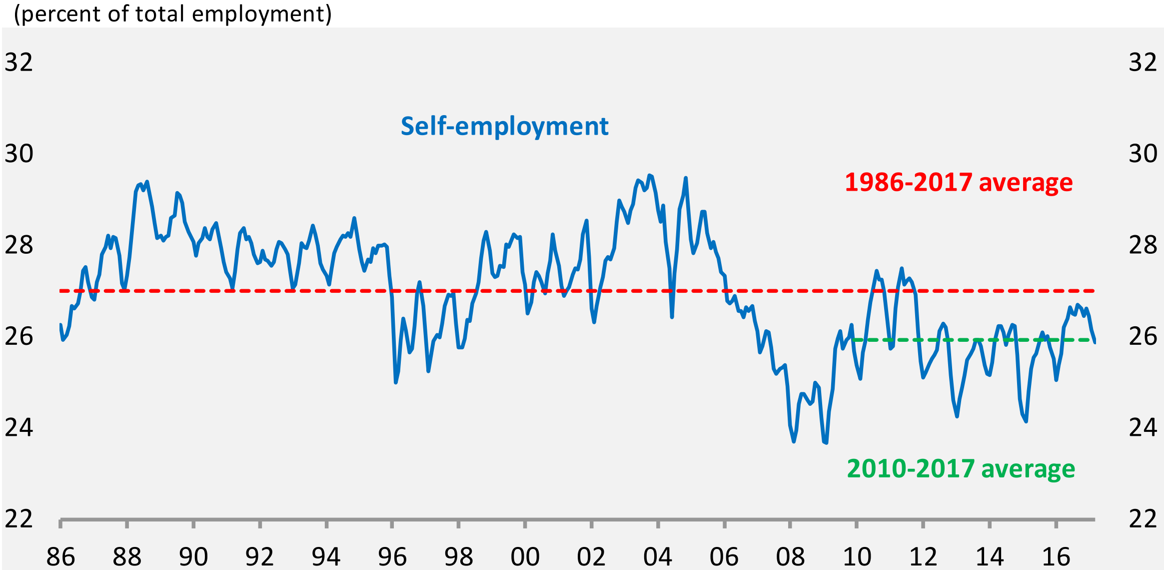
Source: Central Bank of Chile.

Figure 5
Durable consumption and imports
(annual change, percent)



(*) Excludes uncommon transport vehicles.
Source: Central Bank of Chile.

Figure 6
Evolution of self-employment
(percent of total employment)

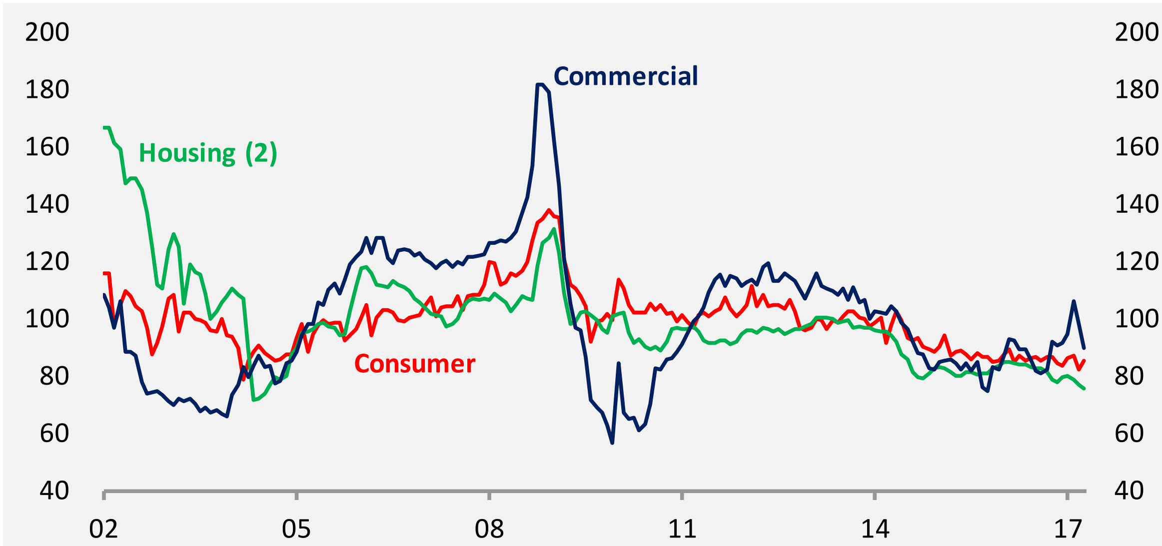


Sources: Central Bank of Chile and National Statistics Institute (INE).

Figure 7

Interest rate by type of loan (1)

(index, 2002-2017=100)



(1) Weighted average rates of all operations performed each month.

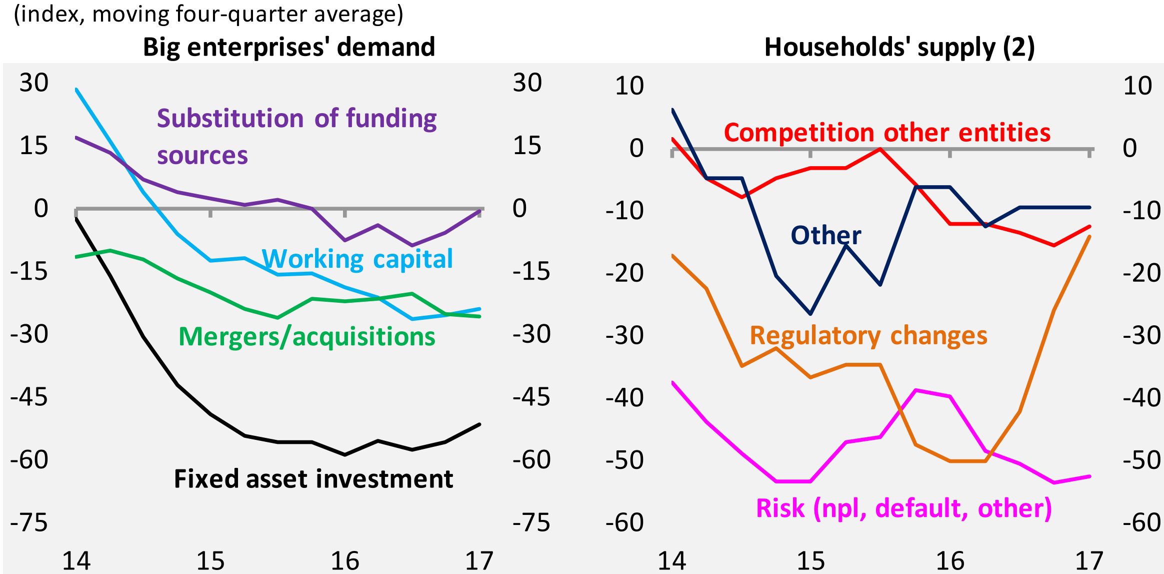
(2) Loans denominated in UFs.

Source: Central Bank of Chile using SBIF information.

Figure 8

BCS: causes behind changes in lending standards (1)

(index, moving four-quarter average)



(1) Index measures net relative importance attributed by banks to credit demand and supply determinants, respectively. For more detail, see Banking Banking Credit Survey. (2) Average between housing and consumer

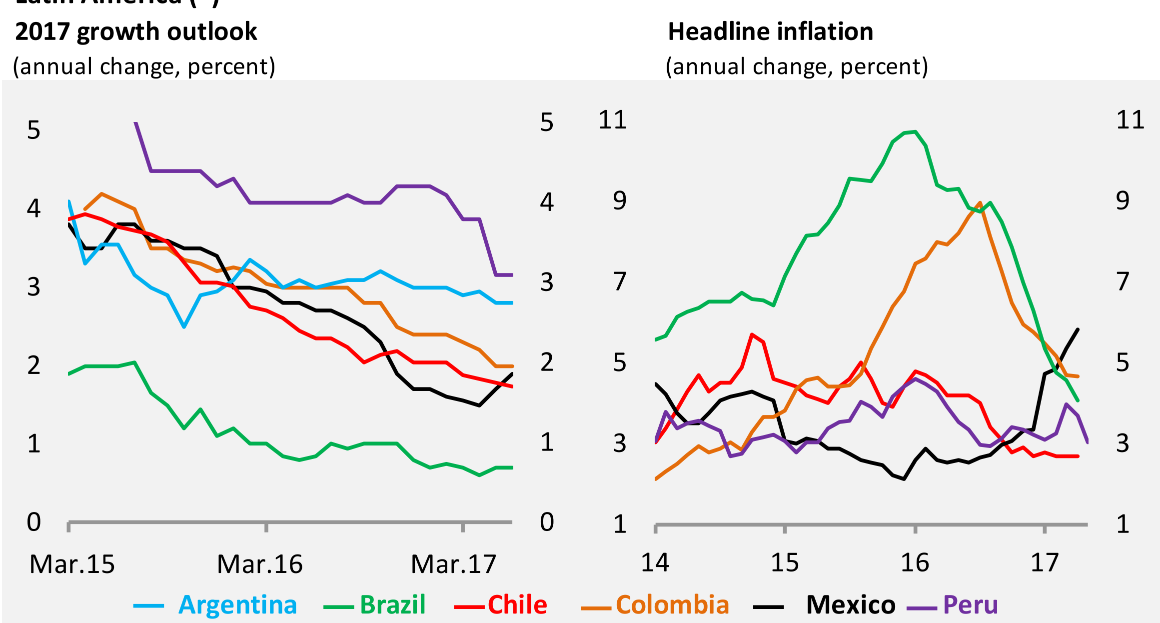
Source: Central Bank of Chile.

Table 1
External scenario
(annual change, percent)

	2015	2016 Mar'17 Report	2016 Jun'17 Report	2017 (f) Mar'17 Report	2017 (f) Jun'17 Report	2018 (f) Mar'17 Report	2018 (f) Jun'17 Report
GDP	2.3	1.6	1.6	1.0-2.0	1.0-1.75	2.25-3.25	2.5-3.5
Domestic demand	2.0	1.1	1.1	2.3	2.5	4.1	3.9
Domestic demand (w/o inventory change)	1.7	2.0	2.0	1.9	1.8	2.8	2.9
Gross fixed capital formation	-0.8	-0.8	-0.8	0.2	-0.9	3.0	3.0
Total consumption	2.4	2.8	2.8	2.5	2.6	2.8	2.9
Goods and services exports	-1.8	-0.1	-0.1	1.6	0.7	2.7	3.9
Goods and services imports	-2.7	-1.6	-1.6	4.3	4.3	7.2	6.6
Current account (% of GDP)	-2.0	-1.4	-1.4	-0.9	-1.0	-2.1	-1.9
Gross national savings (% of GDP)	21.4	20.2	20.2	20.3	20.2	20.5	20.3
Nominal gross fixed capital formation (% of GDP)	23.6	23.2	23.2	22.5	22.1	22.6	22.2

(f) Forecast.
Source: Central Bank of Chile.

Figure 9
Latin America (*)



(*) As per responses to Bloomberg survey.
Source: Central Bank of Chile.

Table 2

International scenario

	2015	2016 Mar'17 Report	2016 Jun'17 Report	2017 (f) Mar'17 Report	2017 (f) Jun'17 Report	2018 (f) Mar'17 Report	2018 (f) Jun'17 Report
				(annual change, percent)			
Terms of trade	-4.2	1.9	1.9	4.6	4.7	-0.5	-0.5
Trading partners' GDP	3.3	2.8	2.9	3.3	3.3	3.5	3.4
World GDP at PPP	3.4	3.0	3.1	3.4	3.4	3.5	3.5
World GDP at market ex change rates	3.0	2.3	2.5	2.8	2.8	2.9	2.9
United States	2.6	1.6	1.6	2.3	2.2	2.3	2.3
China	6.9	6.7	6.7	6.4	6.5	6.2	6.3
Eurozone	2.0	1.7	1.7	1.7	1.7	1.7	1.7
Latin America (excl. Chile)	-0.4	-1.8	-1.5	1.3	1.1	2.5	2.2
External prices (in US$)	-9.8	-2.7	-2.7	2.1	2.4	1.3	1.4
				(levels)			
LME copper price (US$cent/lb)	249	221	221	255	255	250	250
WTI oil price (US$/barrel)	49	43	43	50	50	50	51
Brent oil price (US$/barrel)	52	44	44	52	53	52	53
Gasoline parity price (US$/m3)	467	389	389	457	453	444	447
Libor US$ (nominal, 90 days)	0.3	0.7	0.7	1.5	1.5	2.4	2.5

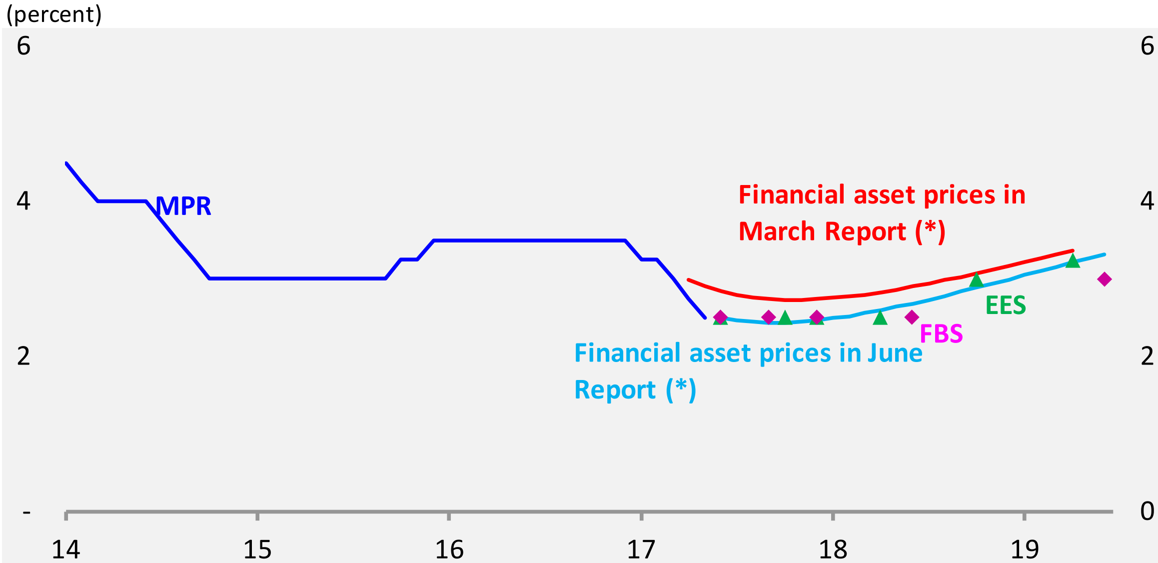
(f) Forecast.

Source: Central Bank of Chile.

Figure 10

MPR and expectations

(percent)



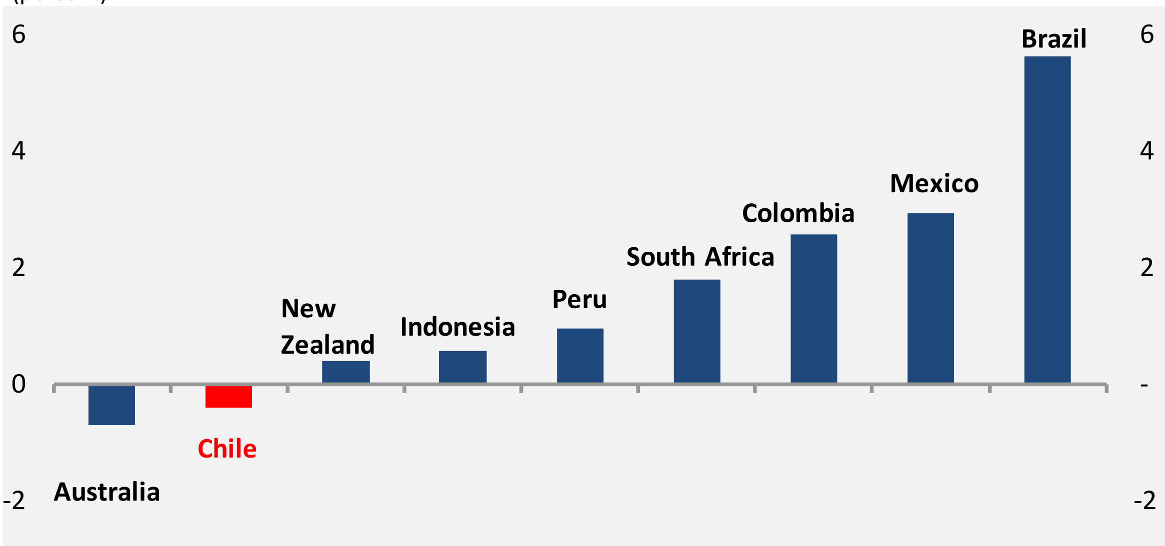
(*) Built using interest rates of swap contracts up to 10 years.

Source: Central Bank of Chile.

Figure 11

Real MPR (*)

(percent)

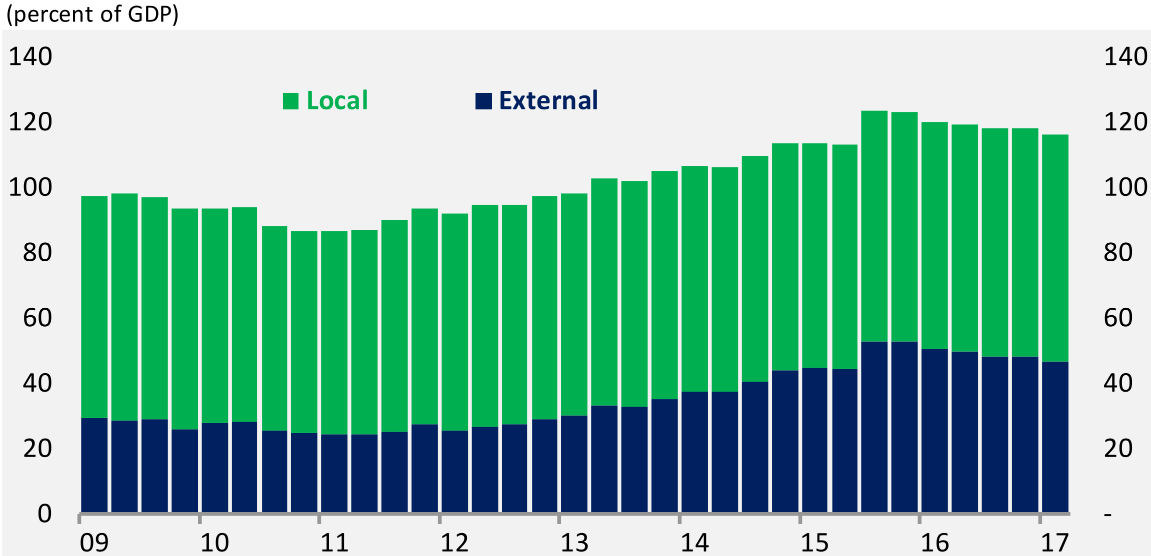


(*) Calculated as the current MPR minus expected inflation one year ahead.
Sources: the Central Bank of respective country.

Figure 12

Total corporate debt (*)

(percent of GDP)

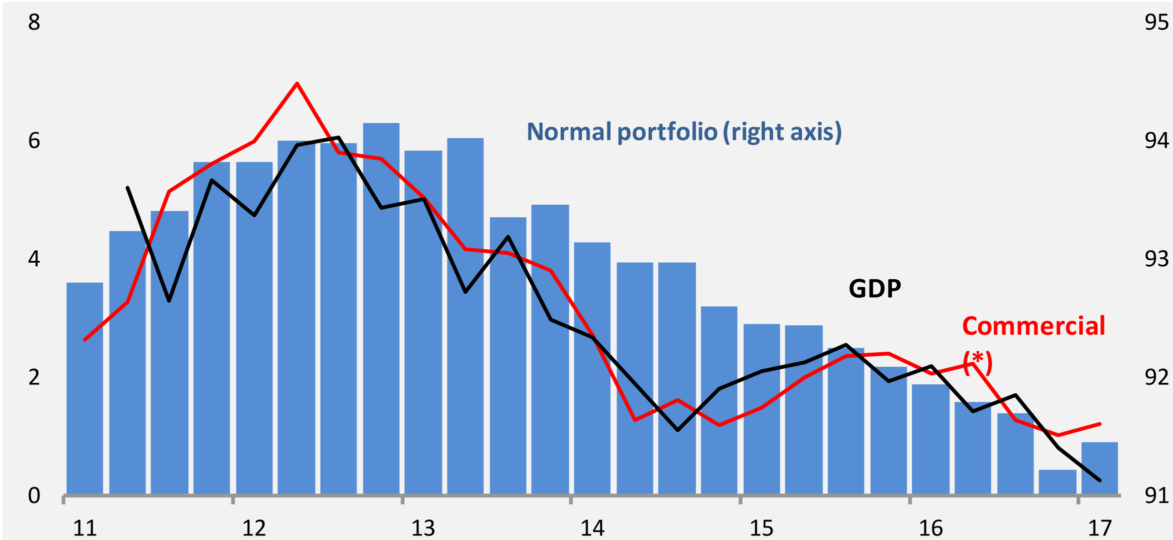


(*) Basado en información administrativa a nivel de empresas. Incluye entidades financieras no-bancarias.
Source: Central Bank of Chile using Achef, SBIF and SVS information.

Figure 13

Activity and commercial portfolio credit risk

(real annual change, percent share)



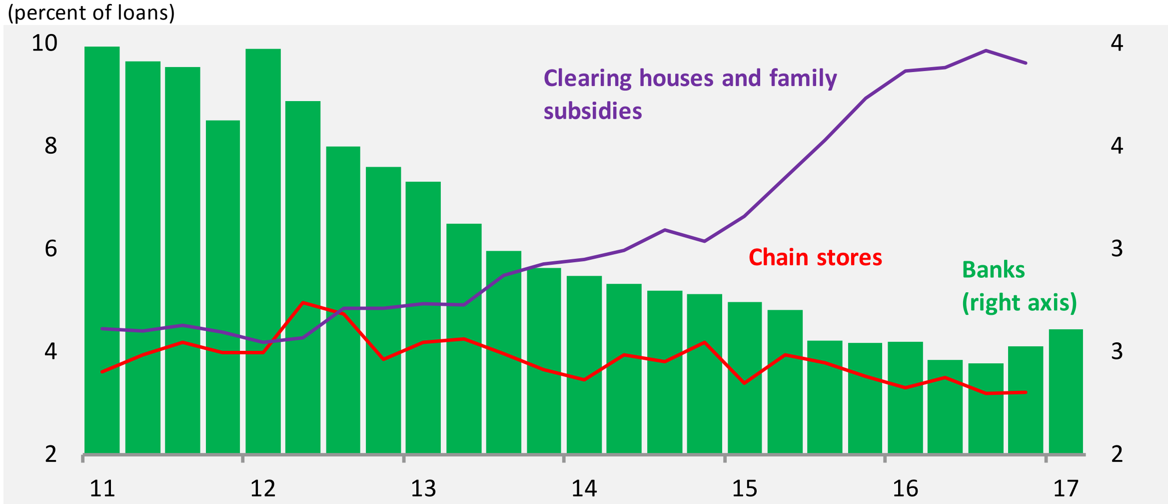
(*) Growth rate of commercial debt stock divided by two.

Source: Central Bank of Chile using SBIF information.

Figure 14

90-day delinquency rate

(percent of loans)

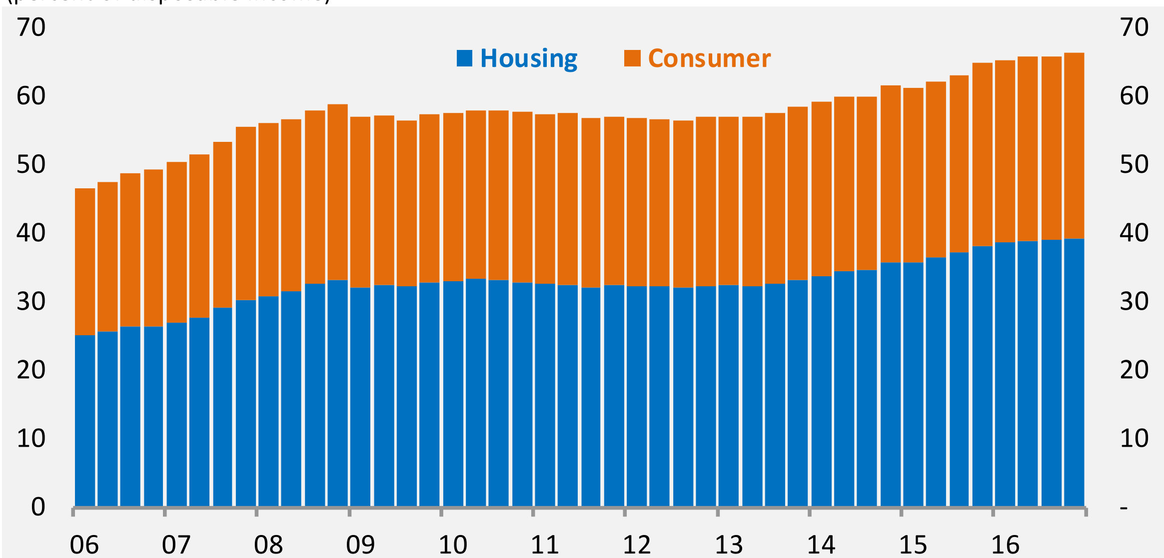


Source: Central Bank of Chile using SBIF, SUSESO and SVS information.

Figure 15

Household indebtedness

(percent of disposable income)

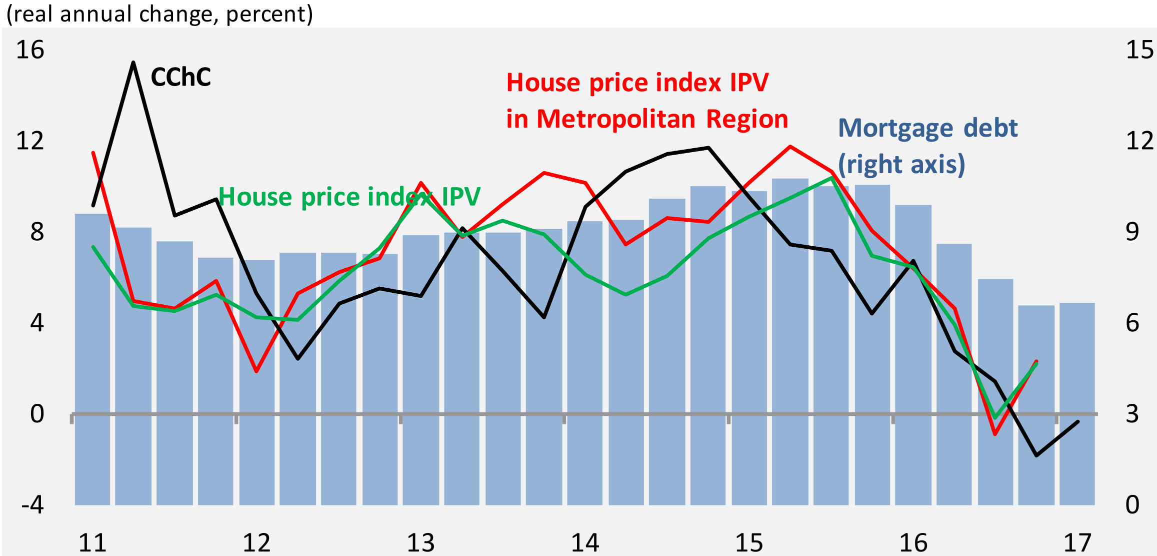


Source: Central Bank of Chile using SBIF, SUSESO and SVS information.

Figure 16

Real housing prices and mortgage debt (*)

(real annual change, percent)



(*) IPV stratified method. CChC hedonic model for new homes in Metropolitan Region (RM).
Source: Central Bank of Chile using SII, CChC and SBIF information.