MONETARY POLICY REPORT
FINANCIAL STABILITY REPORT

PRESENTATION BEFORE THE FINANCE COMMITTEE OF THE HONORABLE SENATE OF THE REPUBLIC*

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* Both the *Monetary Policy Report* of December 2017 and the *Financial Stability Report* of the second half of 2017 can be seen at http://www.bcentral.cl.

Introduction

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

Thank you for your invitation to present the vision of the Board of the Central Bank of Chile (CBC) about the latest macroeconomic and financial developments, prospects and implications for monetary and financial policy. This vision is detailed in our *Monetary Policy Report* (MP Report) of December 2017 and *Financial Stability Report* (FSR) of the second half 2017.

I would like to start by noting that these are the last institutional reports presented in the format that has prevailed since the time of the severe Great Financial Crisis. As we explained to the Honorable Senate last September, as from January 1st, the CBC will begin to apply a new calendar and format for the Monetary Policy Meetings as well as for the presentation of our two Reports.

In particular, the MP Report has been programmed for pre-established dates that will coincide with the monetary policy meetings of March, June, September and December of each year. Thus, the presentation to the Senate will no longer be an extensive description of the Report, to become an institutional appearance where the Bank's Board will deliver a synthesis of the messages in its reports, explain the reasons behind its policy decisions and answer the questions and comments that may arise. This will be a challenge for both parties. At the Board, we will try our best to be up to it.

Another element of change is that this is the last presentation to this Committee with the participation of Deputy Governor Sebastián Claro. It has been ten years since the current President of the Republic appointed him in her first presidential term and was approved by this Senate. Since then, Sebastián has served his position with commitment, capacity, accountability and team work, as I am sure you have observed. On behalf of the other Board members and the staff of the Bank, I want to take this opportunity to thank him for his enormous contribution to the Institution and the country.

Alongside these elements of change, however, many more continue. As usual, we come to report on the recent macroeconomic developments and share with you our vision about future prospects and risks facing the Chilean economy. This institutional continuity is important when we are only a few months away from a new Congress and a new Administration, a transition that always involves challenges and in which it is important for the newcomers to be familiar with the prospects for the economy.

In the past few months, domestic activity has evolved as expected. The stronger external impulse has consolidated, with still favorable financial conditions, trading partners that, on average, are somewhat more dynamic and better terms of trade.

Nonetheless, inflation has stayed below the forecasts of the September MP Report. Most of the difference is related to the more volatile items in the basket, as core inflation —which we

measure with the so-called CPIEFE[1]— is near expected levels. The projections that I will present to you in a moment assume that the convergence of inflation will take somewhat longer than we anticipated in the last MP Report.

This considers the effect of the recent surprises and the evolution of the exchange rate up to the Report's statistical cutoff. It also assumes that activity growth will gradually speed up its pace, from its bounded present levels to above potential in the second half of 2018, yielding the way to close the output gap that will help inflation to converge within the projection horizon.

In any case, there are still significant risks surrounding the baseline scenario depicted in this MP Report. On the one hand, some sectors still lag behind in the recovery process, especially some relating to investment. On the other hand, a scenario in which the economy does not return to higher growth rates in the coming months, can affect the recovery of growth in the medium term. In particular, because even though expectations have improved in general, they have done so by anticipating a better future economic performance rather than by current results.

In this context, we have held the Monetary Policy Rate (MPR) at 2.5% since May and we expect that, if the baseline scenario comes true, we will keep the monetary impulse near its current levels, to begin withdrawing it only once the economy begins to close the activity gap. Anyway, it is important to carefully monitor any downward deviations of inflation in the short term, because in the context of a weak economy, low inflation and some measures of medium-term inflation expectations remaining somewhat below 3%, the convergence of inflation could be affected, in which case it would be necessary to make the already expansionary monetary policy more so.

The financial conditions have helped to shape the macroeconomic scenario described above. Borrowing remains accessible and inexpensive, in line with the orientation of monetary policy. The local financial market has seen no major disruptive events and the internal and external payment systems have functioned normally. Non-financial companies maintain their levels of profitability and indebtedness, while the increase in household debt is concentrated in mortgage credit, which covers long periods, at fixed rates and with a prudent loan-to-value ratio, which keeps the financial burden fairly constant. For its part, in the residential real estate sector, sales of new homes stabilized and prices continued to rise, albeit modestly.

Nonetheless, some financial risks identified in past reports are still important. At the external level, the relevance of a long-term external rate rise scenario stands out. At home, the lost dynamism of recent years has reduced the financial strength of firms, eroding the quality of the commercial portfolio in certain economic sectors. Stress tests for the banking system show less capital leeway to confront adverse scenarios.

Likewise, issues are arising that should be considered in the analysis of risks threatening financial stability. A normalization of risk aversion in international markets could increase

[1] Consumer Price Index excluding food and energy components.

credit costs in emerging countries, including Chile. Locally, mitigating the deterioration of the commercial portfolio's quality by demanding greater guarantees rather than making provisions or capital aggravates the vulnerability to systemic events.

These risk factors make it possible to appreciate the importance of our coherent macroeconomic policy framework, where fiscal and monetary policy can operate counter-cyclically and the exchange rate acts as a buffer against external shocks. The need to update banking legislation is also evident, to incorporate modern standards of capitalization and mitigation of systemic and cyclical risks, as well as to have good systems of consolidated debt information, all of which are part of the legislative agenda now being discussed at the National Congress.

The Monetary Policy Report

Headline inflation has been more volatile in recent months, accumulating a negative surprise that placed it at 1.9% in October, close to 0.4 percentage points below the September forecast. The CPIEFE has evolved in line with projections although with significant ups and downs. As has been the trend of the last few quarters, its evolution has been closely related to the exchange rate (figure 1). The surprise in headline inflation came mainly from foodstuffs (particularly fresh fruits and vegetables), whose prices showed atypical behavior for the season, very different from historical patterns. As a reference, between August and October these prices —which represent 2.9% of the CPI basket— averaged an annual variation of around -9%, which compares with roughly +7% in the last ten years.

The baseline scenario assumes that headline inflation will remain around 2% during the first half of 2018, and will return to 3% during the first half of 2019, somewhat later than we expected in September. Core inflation will also remain low in the coming quarters, to converge to 3% in the second part of 2019, somewhat later than headline inflation (figure 2). The projected behavior of prices in the medium term is mainly based on a gradual closing of the activity gap, a process that is expected to begin during the second half of 2018. On this point, neither the recent data nor the projections of the baseline scenario have changed much from September.

In the third quarter, non-mining activity—used to estimate the gap—continued to show limited annual growth (which reached 1.7%), below the potential of the economy (which we continue to estimate around 2.5%) and aggregate GDP (2.2%). It is important to note that, as from this MP Report, for the purposes of the conjunctural analysis of activity and the measurement of the gap, the concepts of "natural resources GDP" and "other GDP" have been replaced by "mining GDP" and "non-mining GDP". A box in the Report explains the reasons behind this change. There we note that the sectors that we discounted from GDP until now (i.e. mining, fishery, and electricity, gas and water) are actually more volatile and less persistent. It is also shown that, in general, its relationship with the rest of the economy is limited. However, in line with the change that I have just commented, it is concluded that only the exclusion of mining activity has significant effects in the analysis of the dynamics of the aggregate economy, because of its important effects on the variance of growth. In such circumstances, and considering that broad measures are better to work with than narrow ones,

we adopted the distinction between mining and non-mining GDP to substitute for natural resources GDP and other GDP. Moreover, this change allows the analysis in the MP Report to be aligned with the publication of the mining and non-mining Imacec[2] that we introduced a few months ago.

Returning to the recent evolution of activity and demand, the sectoral composition of non-mining GDP shows better figures for sectors linked to consumption than those related to investment, particularly construction. On the demand side, while private consumption maintains annual increases of 2% to 3%, investment in construction and other works falls more than expected. The tradables-related expenditure lines, such as consumption of durable goods and investment in machinery and equipment, have strengthened further, supported by an appreciating peso over recent quarters and financial conditions favoring inventory restocking after several years of low growth (figure 3).

Consumption has performed in line with its fundamentals. On one hand, annual growth in total employment has been steady at around 2% for several months, outperforming salaried employment growth, especially in the private sector. On the other hand, real wages are growing in annual terms more than they did early in the year, mainly as a result of the low inflation (figure 4). This couples with interest rates remaining at record lows, a factor also put forward by qualitative sources such as the Banking Credit Survey and the Business Perceptions Report. This, despite still limited annual growth in credit in most categories (figure 5). Finally, confidence indicators show sustained improvement, although based more on the perception of the future performance of the economy than on the current situation (figure 6).

Over the course of the year, the better prospects for the world economy have consolidated. The developed economies, in general, are growing more than in previous years, as are several emerging ones (figure 7). Furthermore, global financial conditions are still favorable, partly because the main central banks continue to carefully and gradually withdraw their large monetary stimuli, helping to keep interest rates and term premiums low. In addition, capital has continued to flow to emerging markets and the prices of various assets are high.

Commodity prices, in general, remained above the levels foreseen in September, especially copper and energy sources (figure 8). The copper price rose 3.5% to USD 3.2 per pound during the period, to settle around USD 3.1 at the closing of this Report. This behavior is common to most metals, in a context of still high pressures coming from financial factors and improvements in some fundamentals. Among the latter, the increase in demand and perspectives is worth noting, something that has occurred thanks to increased global industrial production and the performance of the Chinese economy. This, combined with some stabilization in output, has gradually reduced inventories. Beyond recent movements, the weakening of the US dollar during the year has also been sustaining the copper price. Thus, the baseline scenario in this Report adjusts it to USD 2.95 and USD 2.75 per pound on average for 2018 and 2019, respectively. Regarding oil, the prices of Brent and WTI rose a

[2] An abbreviation from its Spanish *Indice Mensual de Actividad Económica*, literally Economic Activity Monthly Index.

significant 20% in the period, to near USD 63 and 56, respectively, explained largely by a somewhat more balanced market. Globally, actual and expected demand have increased, output has been contained and inventories have seen some depletion. The baseline scenario of this Report adjusts the projection for the average price of Brent and WTI upwards, placing it at around USD 59 and USD 56 per barrel in 2018 and 2019.

The combined effect of higher copper and oil prices and adjustments in the prices of other exports and imports have led to an improvement in the terms of trade, particularly this year. Thus, considering the period 2017-2019, the terms of trade will accumulate an increase of around 10%, which compares with the 7% estimate of last September.

Turning to our activity and demand projections, the baseline scenario assumes no major changes from September. This year, the economy will grow 1.4%, inside the range expected in September. For 2018, the growth projection in the 2.5% to 3.5% range is maintained. Part of the improvement with respect to 2017, particularly during the first half of the year, owes to the low comparison base of the mining sector. This same scenario assumes that non-mining GDP will have a more paced recovery. The gradual return to higher GDP expansion rates leans on a favorable external scenario, the end of the adjustment of mining and housing investment, the absence of significant macroeconomic imbalances and a clearly expansionary monetary policy stance. A working assumption is that in 2018 the economy will receive a fiscal impulse in accordance with the approved budget. Going forward, it is assumed that fiscal spending will follow a path of consolidation.

On the expenditure side, as I just said, some salient characteristics of recent quarters have been improved consumption and weaker investment, which have led to revisions to our baseline forecasts. In private consumption, the better numbers so far, especially the dynamism of durable consumption, translate into higher figures for this year and next. On the investment side, there is a clear difference between the behavior of the machinery and equipment and the construction and works components. The former, with a more favorable evolution, has responded to the necessary inventory replenishment after several years stagnant, and has benefited from the exchange rate appreciation and low credit costs. The latter has continued to contract beyond expectations, primarily because of reduced spending on building and engineering works, amplifying the drop in gross fixed capital formation (GFCF) estimated in September for this year. In addition, we estimate that this expenditure component will take somewhat longer to recover. Towards 2018, it is still assumed that the adjustment cycle of mining investment will come to an end and that it will very gradually begin to reflect the effects of the copper price rise. Meanwhile, non-mining investment is slightly revised down, mainly reflecting that the downsloping trend of housing investment has been longer than we thought before. With this, as a percentage of GDP, in 2018 the GFCF will reach 21.1% and 21.4% in real and nominal terms, respectively, compared with averages of 23% to 24% in 2013-2017.

About our external scenario, incoming data show improved performance of exports across sectors (figure 9). Still, examining numbers of the first half, we foresee that the export volumes will contract during the year. However, by 2018 they should recover thanks to improvements in the world economy, which coupled with better prices increase our estimated

trade balance for next year. The low comparison base due to the Escondida mine strike downtime early this year will also result in higher mining exports in 2018. Thus, in 2018, the current account deficit should be lower than we expected in September, close to 1% of GDP, similar to our 2017 projection. At trend prices, the current account deficit remains at 2.6% on average in 2017-2018 (table 1).

Aside from the scenario I have just described for domestic activity and spending, the convergence of inflation to the target also considers a mild depreciation of the real exchange rate that will cause it to converge from where it was at the closing of this Report to its long-term equilibrium within the projection horizon. The baseline scenario also contemplates that the prices of foods, particularly fresh fruits and vegetables, will return to their normal patterns, so their annual inflation will be rising over the course of 2018.

About monetary policy, the Board estimates that in the baseline scenario the surprises that have pulled inflation down below expectations do not compromise the convergence of inflation to the target. This, both because by their nature they should not propagate much, and because the arguments for the closure of the activity gap remain fully in force. In this context, as a working assumption, the baseline scenario does not alter the monetary impulse considered in the September MP Report. In other words, that the policy rate will remain stable and start rising towards neutrality only once the economy begins to close the activity gap. In any case, the Board recognizes that in the current scenario —with still limited activity growth, inflation staying near the lower bound of the tolerance range for several months and some measures of medium-term inflation expectations still short of 3%— any downward deviations of short-term inflation should be monitored with special care. The latter because the convergence of inflation could be affected, in which case it may call for even more expansionary monetary policy action.

As usual, there are risks to these projections, both internal and external. Abroad, how and how fast the developed world will carry out the withdrawal of their monetary stimuli is still a concern. So far the process has been implemented very carefully and has succeeded in keeping financial markets calm. However, the discrepancies that still exist between market expectations and the adjustment trajectory announced by the Federal Reserve as the most likely scenario continues to be a source of significant tension. There is also the fact that in different markets, prices are high by historical standards, which could see abrupt reversals if global financial conditions tighten more than foreseen.

Inflation in the developed world continues to draw our attention, as it has remained low despite stronger activity and higher energy prices. In addition, elements of uncertainty persist, in fiscal matters and commercial policy in the United States and political issues in Europe, compounded by growing geopolitical risks in Asia and the Middle East. In any case, we cannot rule out that, given the results of recent quarters, greater global growth may be observed, which could boost trade and trigger a more significant increase in global investment.

In the emerging world, like in recent years, the main source of risk remains the Chinese economy. On one hand, it still needs to resolve many imbalances in several crucial markets.

In addition, the nation recently began a monetary adjustment that is not free of risks, and there is uncertainty about the direction that the reform agenda will take after the Congress of the Chinese Communist Party and its impact on the economy. In any case, its growth deceleration has been somewhat milder than anticipated, so maybe its dynamism will hold longer.

The baseline scenario assumes that the copper price will decline gradually in the coming quarters. However, we do not rule out a sharper reduction because part of the recent increase may be related to financial phenomena. On the other hand, neither can we rule out a strengthening of copper supply and demand factors that would allow prices to remain high for longer, according to some market analysts.

Regarding domestic activity, we expect GDP to gradually regain faster growth. Several local factors pose risks to this projection. For now, the lack of synchrony between different expenditure components persists, with sectors (especially investment-related) that still lag behind in the recovery process. Lower than expected short-term dynamism could threaten the robustness and sustainability of the recovery of growth in the medium term. In particular, because the improvement in the consumer and business confidence indicators owes more to expectations of better conditions going forward than to the present situation, and because the financial market, within a generally favorable scenario, contains segments of greater vulnerability in consumer and commercial credit. In contrast, borrowing costs remain at record lows and international conditions have been better than we anticipated, which could add momentum to investment and speed up its recovery.

In this context, the Board estimates that the risk balance for both activity and inflation is unbiased. However, it reiterates its intention to monitor any possible downward deviations of inflation in the short term that could jeopardize its convergence to the target within the forecast horizon. Accordingly, the Board reaffirms its commitment to conduct monetary policy with flexibility, so that projected inflation stands at 3% over the two-year horizon.

The Financial Stability Report

In our FSR, we communicate every June and December the recent macroeconomic and financial developments that may influence the financial stability of the Chilean economy. As opposed to the MP Report, the FSR is not articulated around a baseline scenario, but rather focuses on the most significant risks threatening the financial system.

In this FSR, we note that in the second half of this year the Chilean financial system has suffered no major disruptive events and the data at hand indicates that the sector continues in a strong enough position to withstand the impact of stressful scenarios. We also observe that the internal and external payment systems have worked normally, while the traditional credit risk indicators have remained low up to this moment. However, some alternative risk measures show increases in certain sectors. As we warned in the MP Report, if the local economy's slowdown of recent years is further prolonged, this situation could deepen. In the external scenario, as usual, the risks identified in the MP Report's baseline scenario that I just

presented are very similar to those considered in the FSR, particularly those relating to a sharp increase in external interest rates and their impact on our local financial conditions.

The FSR notes that the good financial conditions abroad have been mirrored locally. Likewise, we emphasize that the cost of short-term bank financing has remained coherent with the MPR and that the cost of issuing long-term debt for companies and banks has been compressed lately. Interest rates on local sovereign instruments have also remained below their historical averages. However, compared with the previous FSR, there has been an increase owing, to a large extent, to lower demand for local sovereign bonds by pension funds, as a consequence of affiliates migrating to higher-risk funds. Meanwhile, in the course of this year, non-resident investors doubled their share in the local market, although within relatively low ranges compared to other emerging economies.

As I have just pointed out, steep rises in external interest rates are still a risk worth monitoring. In this sense, increases in the benchmark rate and the reduction in developed central banks' balance sheets would push up the term premiums, triggering a rise in local long-term rates. According to our estimates, this increase could amount to as much as 80% of the change observed in the external benchmark. In this context, potential changes in the assets managed by medium- and long-term debt mutual funds —the FM3s— are one vulnerability to be watched closely. This could become more complex if other market players —such as pension funds and non-resident investors— also liquidate their fixed-income positions, which could imply temporary disruptions in local debt markets, amplifying interest rate movements.

A normalization of risk aversion levels would have an impact on the cost of foreign credit to emerging countries, including Chile, above the possible increases in the base rate. In the face of such normalization, Chile's risk premium would tend to increase, affecting entities needing to refinance their short-term liabilities. About the financial situation of companies, their aggregate debt decreased in recent quarters, to 113% of GDP as of the third quarter of this year (figure 10). In one year it diminished 0.9% in real terms, explained mainly by the exchange rate effect in the valuation of the external component. This trajectory owes largely to the fact that the increases in corporate bond issuances observed since mid-2016 have not translated into more borrowing. On the contrary, the low cash flow assigned to investment suggests that these funds have been oriented to the refinancing of liabilities, consistently with the lower interest rates.

On the other hand, delinquency indicators, while still low, show a marginal deterioration with respect to the previous FSR. In the case of services, this increase has concentrated in some real-estate firms. As for the productive sectors, marginal rises are observed in several industries such as construction, transport and telecommunications, and electricity, gas, and water. Meanwhile, in others such as mining, trade, and manufacturing, the declines identified in the last FSR continue.

Residential market figures have shown more stability in recent quarters. After the adjustment process described in previous Reports, the sale of new homes in Santiago has remained stable for several quarters. At the same time, in the second quarter this year, the various home price

indicators —in the Metropolitan Region and nationwide— show positive but modest growth. Residential building activity remains weak and different sources of information see no recovery anytime soon. Moreover, the adjustment of the sector must be monitored before Law 20,958 on Contributions to Public Space comes into effect, aimed at making real estate projects accountable for the impacts they have on local mobility. Regarding housing credit, the stock of mortgage loans showed a rebound in the last quarter (figure 11). The number of bank mortgage debtors with more than one housing loan continued to grow, reaching 29% at the statistical close of this FSR. A subset of such debtors are investors who buy properties for rent.

Household financial indicators show no change in the risks identified in the last FSR, which are mostly related to the future evolution of the labor market. Since the last Report, bank mortgage debt increased, while consumer debt with banks decelerated, and accelerated with other sources. Thus, as of the second quarter this year, the aggregate debt of the sector stood at 45% of GDP (figure 12), placing Chile in the upper segment of a sample of emerging countries but below developed economies. However, the median financial burden has remained stable at around 20% of income due to lower interest rates. In terms of financial gaps, there was a greater use of credit and rolling lines, reflecting tighter conditions in some households. Non-compliance indicators have remained relatively stable at low levels for mortgage loans and have risen for consumer loans. In particular, consumer credit write-offs and delayed repayment of retail lending have both increased (figure 13).

Going forward, a deteriorating labor market would affect the sector, particularly those households with less financial capacity to face an income shock. Meanwhile, a scenario of higher rates would have a smaller impact on households' outstanding debts —as they are granted mostly at a fixed rate and long term— as opposed to new borrowing for buying a new home or refurbishing one. All in all, the aggregate impact of this scenario on the sector is greater if the macroeconomic effects of an in interest rate rise are factored in.

The banking system's financial indicators remain healthy, although capitalization is lagging behind international standards (figure 14). Banking stabilized profitability and solvency indicators, keeping liquid and currency mismatches within bounds, and without making significant changes in its dividend policies. In terms of credit risk, quality has deteriorated in the individual evaluation of the commercial portfolio, which has been covered with increased collateral. Although this strategy allows reducing the idiosyncratic risk of each bank individually, it causes vulnerability of the banking industry to systemic events that simultaneously reduce the payment capacity of enterprises and erode collateral value. This is a risk factor that must be monitored considering that 45% of total bank lending belongs to this category.

Stress tests indicate that an adverse scenario of a slight but prolonged fall in activity would pose a risk to banks comparable to one of a more severe scenario but with a faster recovery. Thus, in the adverse scenario described above, the fraction of banks that maintain their capital adequacy ratio (CAR) above 10% would represent 57% of the system's assets. Under the severe scenario, the figure would be 50%. There is a contrast with 2012, when the fraction

of banks with CARs over 10% accounted for 85% of the system's assets in the severe scenario (figure 15).

All this points to the need to enhance the sector's resilience via higher capital levels, a situation that has been acknowledged in other jurisdiction. Along these lines, the bill that modernizes banking legislation contributes to the strengthening of domestic banks' capital requirements.

As a matter of fact, one of the main milestones in terms of financial regulation was the sending to Congress of the bill that modernizes banking legislation. This incorporates international standards and expertise. One of its proposed tools is the cushion of counter-cyclical capital, which seeks to increase the resilience of the banking system to absorb potential losses and reduce the volatility of financial cycles. In this sense, it is essential to identify local financial cycles, taking into account not only external factors but also the idiosyncrasy of the Chilean banking system. These elements are addressed in a special chapter of this FSR.

Because the Central Bank of Chile will be in charge of implementing this policy, the Board will continue to focus its efforts on its proper application, taking into account both its benefits and the potential direct and indirect costs of this tool. However, these efforts depend on the approval of the bill.

Institutional advances

A year ago, when I presented these same reports before this Committee, I emphasized how important it is for a central bank to have the capacity to face new challenges. On that occasion, I stressed that the accumulated achievements of the Central Bank of Chile over the years did not suffice to take charge of the transformations that occur in the economy, markets, technology and society. Every central bank has the obligation and responsibility to anticipate these changes and respond to them in an organized, efficient and timely manner.

Accordingly, since 2004, and every time a new Governor assumes, the Bank prepares a strategic plan that accompanies it throughout his term and culminates in the first year in office of his successor. Early this year we began preparing the strategic plan for the next five years.

This time, we have sought to give our strategic plan a consultative, participatory and inclusive character. The aim is to reflect that the Bank is not an isolated entity, but works for the entire country and depends on the cohesive team of people that make it up. All this has translated into this new Strategic Plan being devised after completing more than 100 interviews with people from different areas that are external references for the Bank. Surveys were applied to regional and international reference groups and other central banks. Internal workshops were held where our staff participated, as well as planning workshops with the active involvement of the Bank's board members and chief officers, all with continuous communication of the progress and results of the process.

This process was concluded a few days ago with the approval of the Strategic Plan 2018-2022 by the Board. This plan, which is based on the Institution's strengths, recognizes future opportunities and risks and identifies a number of strategic initiatives to realize the Bank's vision as a reliable institution due to its technical nature and excellence in achieving the objectives that have been entrusted to it by law.

In particular, our 2018-2022 Strategic Plan identifies five focal points:

1) to strengthen the response capacity and the intellectual leadership of the Bank to comply with the institution's objectives defined in its Constitutional Organic Law, incorporating the reality of an increasingly complex environment.

2) to enhance understanding and dialogue of the Bank with its environment through strategic management of communications.

3) to strengthen the Bank's corporate governance in order to balance out risk tolerance and business process efficiency, thereby speeding up decision-making and encouraging innovation.

4) to improve the ability to understand, manage and incorporate technological changes to the Bank's integral work, both in the area of its own management and in the dimensions relating to its institutional objectives.

5) to be an employer of excellence, offering valuable proposals that inspire people and teams to deploy and develop their maximum potential, in a collaborative environment, with continuous learning, professionally and personally challenging; managing to attract and engage the best talents, aligned with the strategic objectives and principles of the Bank.

These five strategic focuses are translated into 21 lines of action that the Bank team will develop over the next five-year period. Of these, I would like to single out some that are especially relevant for the Bank's relationship with its environment.

In regards the two issues that bring us together today —monetary policy and financial stability— the Bank will begin to apply the new framework adopted recently for the formulation, adoption and communication of its decisions.

In the case of monetary policy, beginning on January 1st, the new calendar and structure of the Monetary Policy Meetings will take effect, improving the instances of communication. The same is true of the calendar and structure of the MP Report and the FSR. This will couple with a deepening of the analytical work in the macroeconomic and financial fields that will be reflected in both Reports. It will involve developing a new stage of the economic modeling agenda, applying microdata bases and developing new methodologies for financial risk identification.

The Bank will complement this by intensifying its dialogue with key market players and observers, in order to strengthen its capacity to identify and interpret new developments that influence the behavior of the financial sector and the economy at large.

Such dialogue with the outside world of both market players and regulators will also be part of a broader and more transversal effort to involve the technological dimension in the different areas of our work. Through several concrete initiatives, including technological laboratories and an observatory, we will enhance our capacity to comprehend, analyze and formulate hypotheses about the impact of disruptive technologies on the Bank's business model and financial intermediaries, adopting innovations that can help us maintain the quality and availability of the services provided by the Bank.

We also aspire to perfect the regulatory framework in a timely manner in order to advance in those areas that offer an opportunity to strengthen the financial system and mitigate risks in the event that some of these disruptive technologies become accessible to everyone in the financial industry.

Our 2018-2022 strategic plan also includes various initiatives to strengthen the Bank's insertion in its economic and institutional environment. I can mention some efforts to simplify regulations, ensure environmental and financial sustainability, active transparency and financial education. With this we seek to reflect that the Central Bank of Chile, despite being an autonomous institution of an essentially technical nature, is recognized as part of the society in which it must lead by example as an organization.

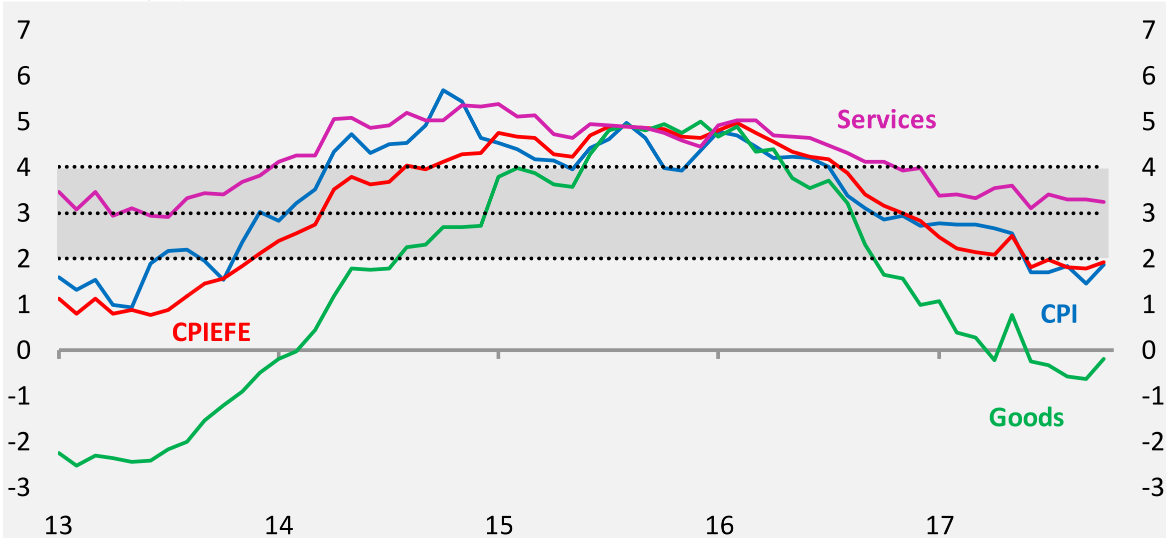
As we have said before, this Strategic Plan does not intend to reinvent the Bank or ignore its great achievements, but to recognize that the prestige gained is always exposed to new challenges and demands and that must be conquered day after day. Likewise, this is neither an exhaustive plan nor a list of the only relevant topics for the Institution, but a select set of actions that are necessary for achieving the expected results in the five focal points listed above.

This plan represents a commitment that includes all of us making up the Central Bank of Chile, to enrich our main asset as a public institution: TRUST. Trust is a mirror against which we can be appraised with the eyes of the rest of the country. That trust, more than norms and laws, is precisely what sustains the legitimacy and autonomy of our Institution.

Therefore, the new Congress and Administration that will assume their respective functions in March, will be met by a Central Bank that, using the competences and mechanisms granted by its Organic Law, will have updated its corporate agenda and will continue to be a crucial institutional player to generate the conditions of macroeconomic stability on which the country's progress is based.

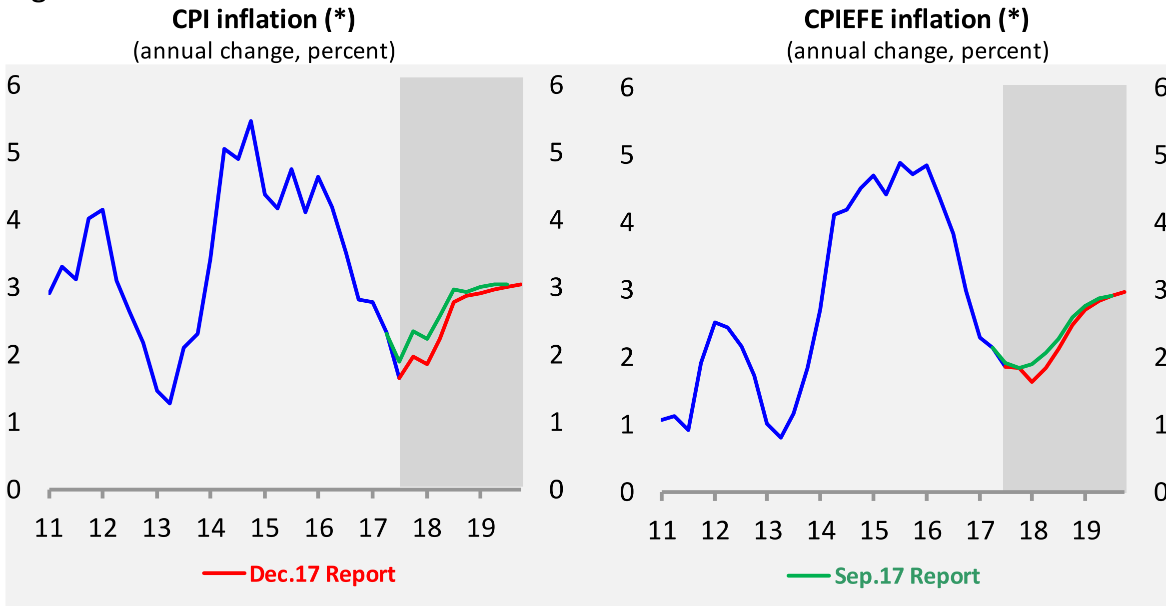
Thank you.

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



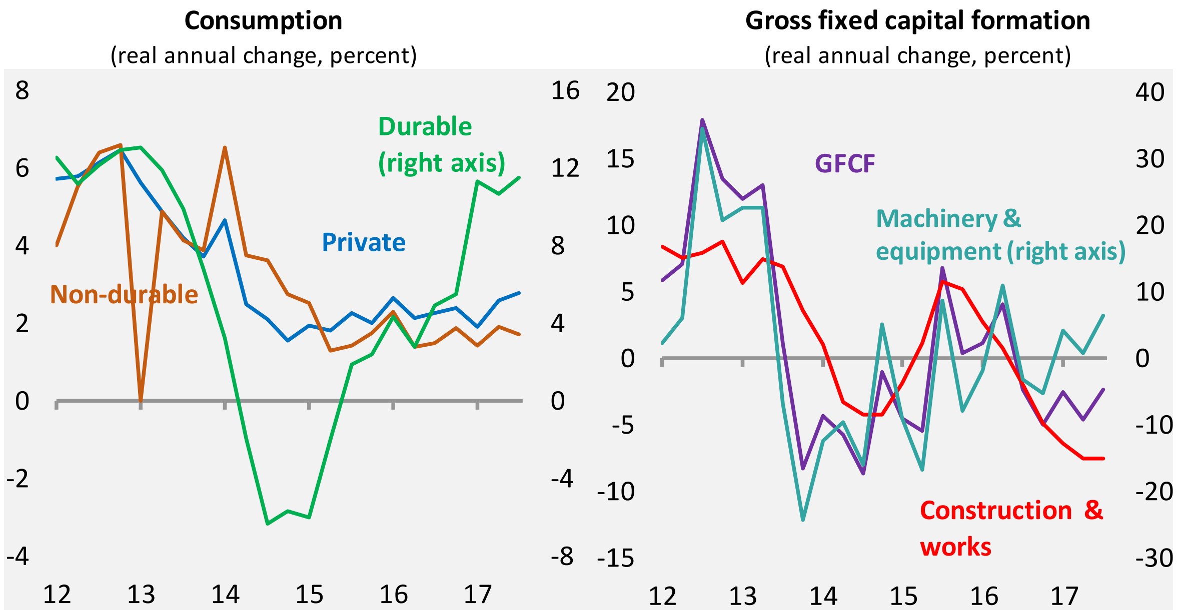
(*) As from January 2014 the new indexes with annual base 2013=100 are used, so they are not strictly comparable with previous figures.
Sources: Central Bank of Chile and National Statistics Institute.

Figure 2



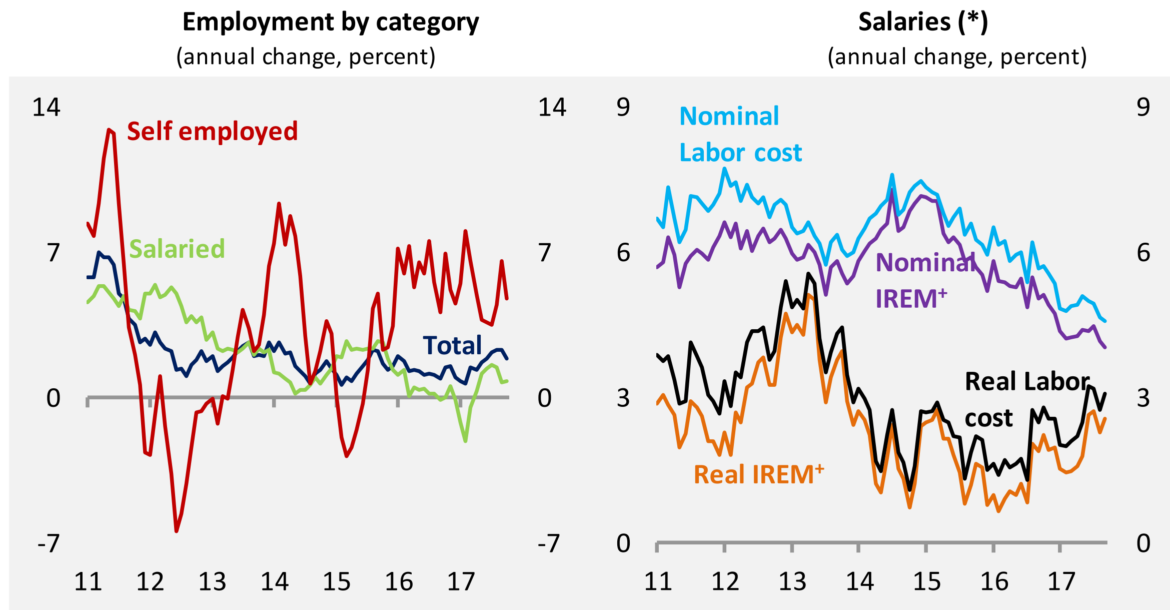
(*) Gray area shows forecast as from the fourth quarter of 2017.
Sources: Central Bank of Chile and National Statistics Institute (INE).

Figure 3



Source: Central Bank of Chile.

Figure 4

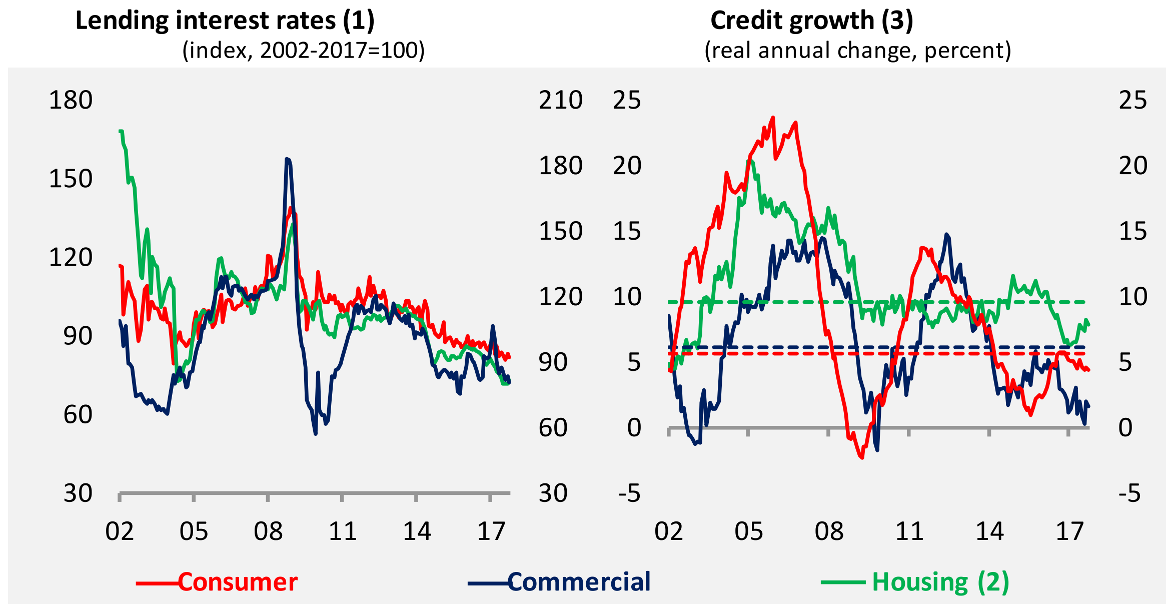


(*) Series spliced with base year 2016=100.

+Compensations index.

Source: National Statistics Institute.

Figure 5



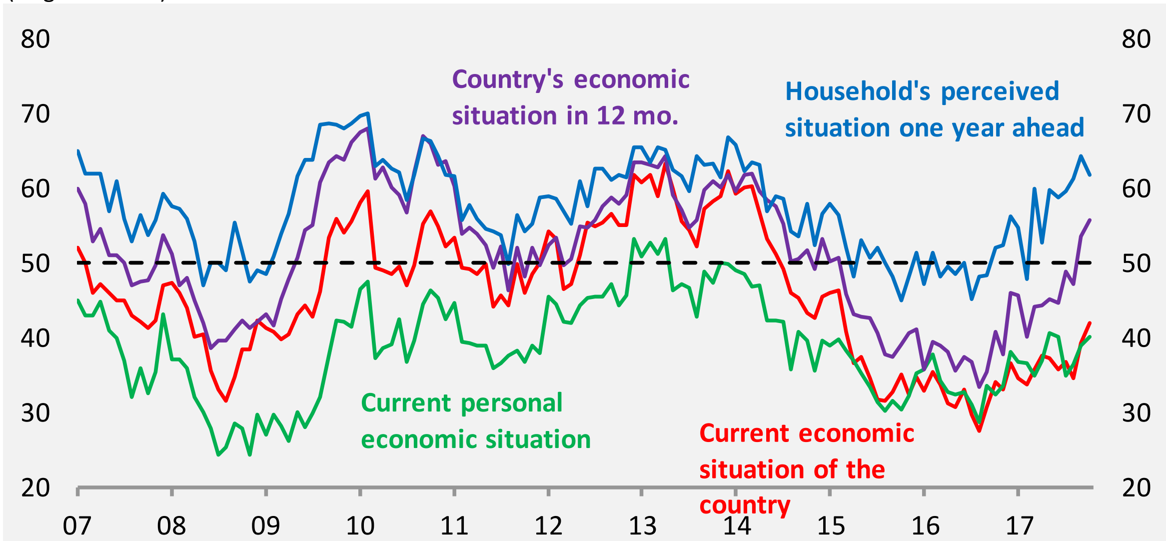
(1) Weighted averaged rates of all operations performed in each month. (2) Loans denominated in UFs. (3) Dotted horizontal lines show average of the last 10 years of each series.

Source: Central Bank of Chile using SBIF data.

Figure 6

Consumer expectations : IPEC (*)

(original series)



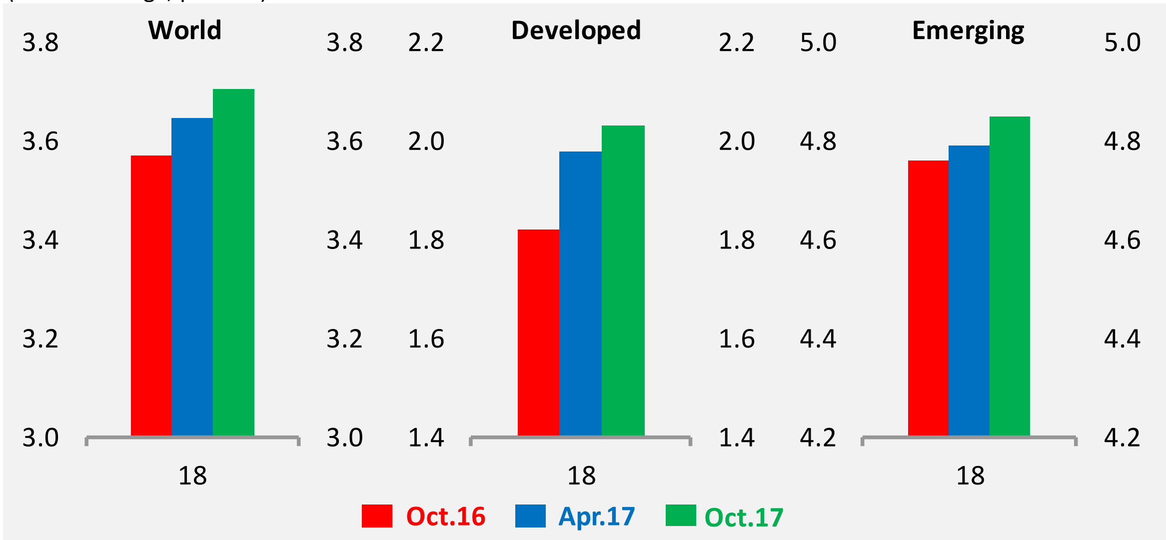
(*) Value above (below) 50 indicates optimism (pessimism).

Source: Adimark.

Figure 7

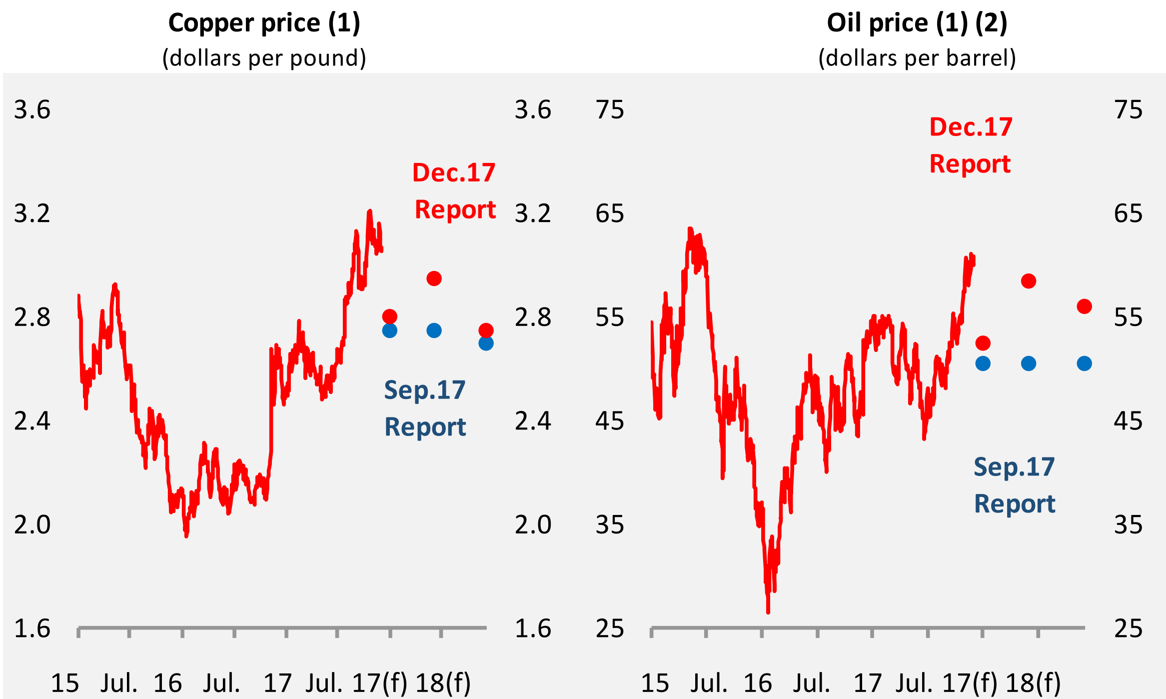
Evolution of 2018 growth outlook

(annual change, percent)



Source: International Monetary Fund WEO, October 2017.

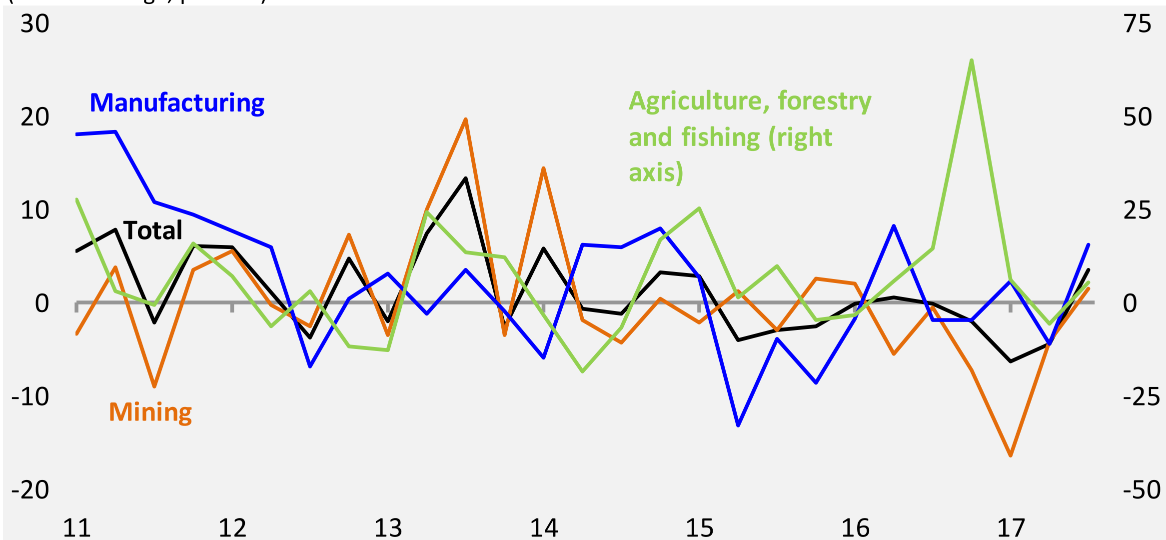
Figure 8



(1) The dots show projected oil and copper price for 2017, 2018 and 2019, respectively. (2) Simple average between Brent and WTI oil.

Sources: Central Bank of Chile, Bloomberg and Chilean Copper Corporation (Cochilco).

Figure 9
Volume exports of goods
(annual change, percent)



Source: Central Bank of Chile.

Table 1
Domestic scenario
(annual change, percent)

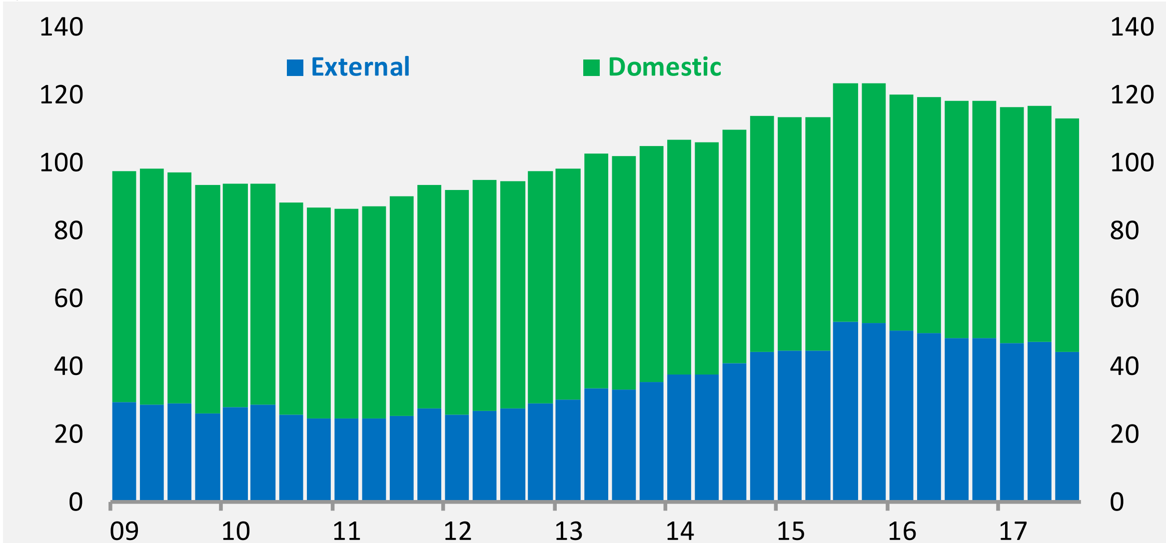
	2016	2017 (f)		2018 (f)	
		Sep.17 Report	Dec.17 Report	Sep.17 Report	Dec.17 Report
GDP	1.6	1.25-1.75	1.4	2.5-3.5	2.5-3.5
Domestic demand	1.1	2.6	3.1	3.9	3.7
Domestic demand (w/o inventory change)	2.0	1.7	1.6	2.9	3.0
Gross fixed capital formation	-0.8	-1.6	-2.5	3.2	3.1
Total consumption	2.8	2.7	2.9	2.8	3.0
Goods and services exports	-0.1	0.1	0.0	4.5	4.5
Goods and services imports	-1.6	4.6	5.8	7.4	7.3
Current account (% of GDP)	-1.4	-1.2	-1.1	-1.8	-1.2
Gross national savings (% of GDP)	20.2	19.8	20.0	20.2	20.5
Nominal gross fixed capital formation (% of GDP)	23.2	21.7	21.4	21.8	21.4

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

Figure 10

Total corporate debt (*)

(percent of GDP)



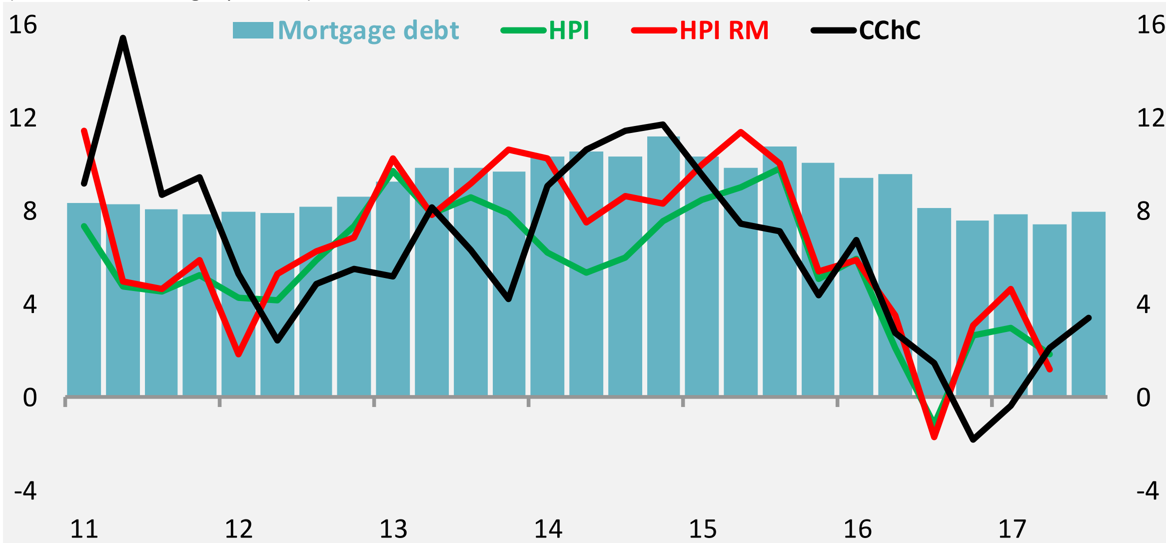
(*) Based on administrative information at the firm level. Includes non-bank financial entities.

Source: Central Bank of Chile using Achef, SBIF and SVS data.

Figure 11

Real house prices and mortgage debt (*)

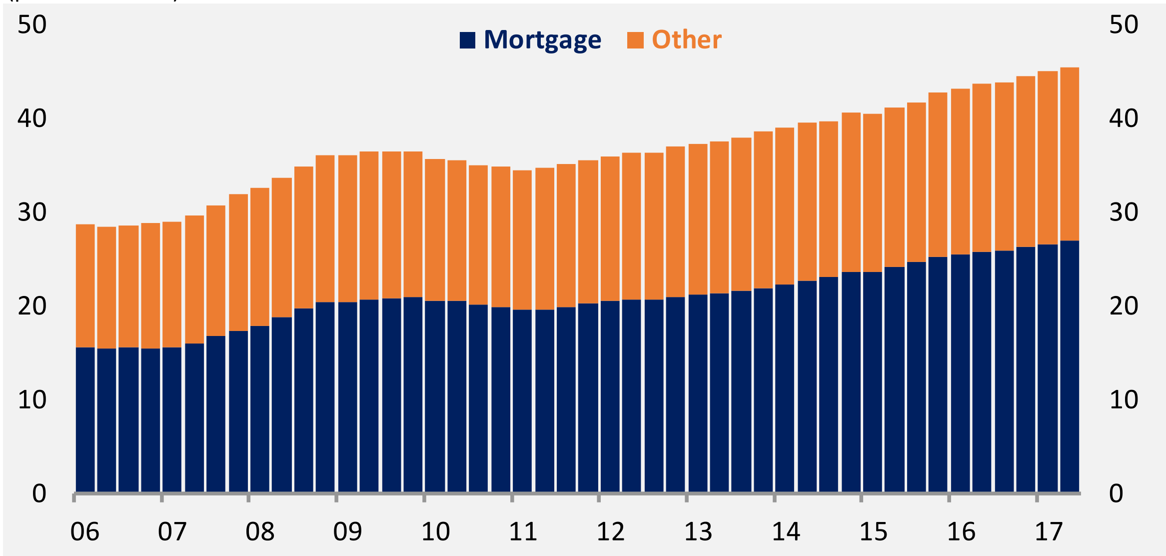
(real annual change, percent)



(*) House price index (HPI), stratified method. CChC hedonic model for new homes in Metropolitan Region (RM).

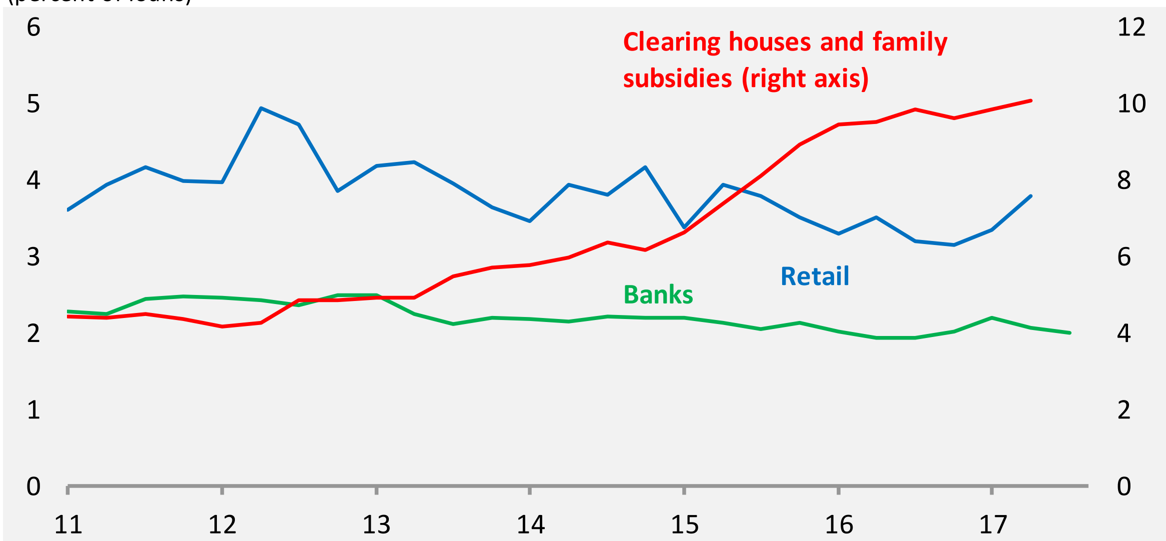
Source: Central Bank of Chile using SII, CChC and SBIF data.

Figure 12
Household indebtedness
(percent of GDP)



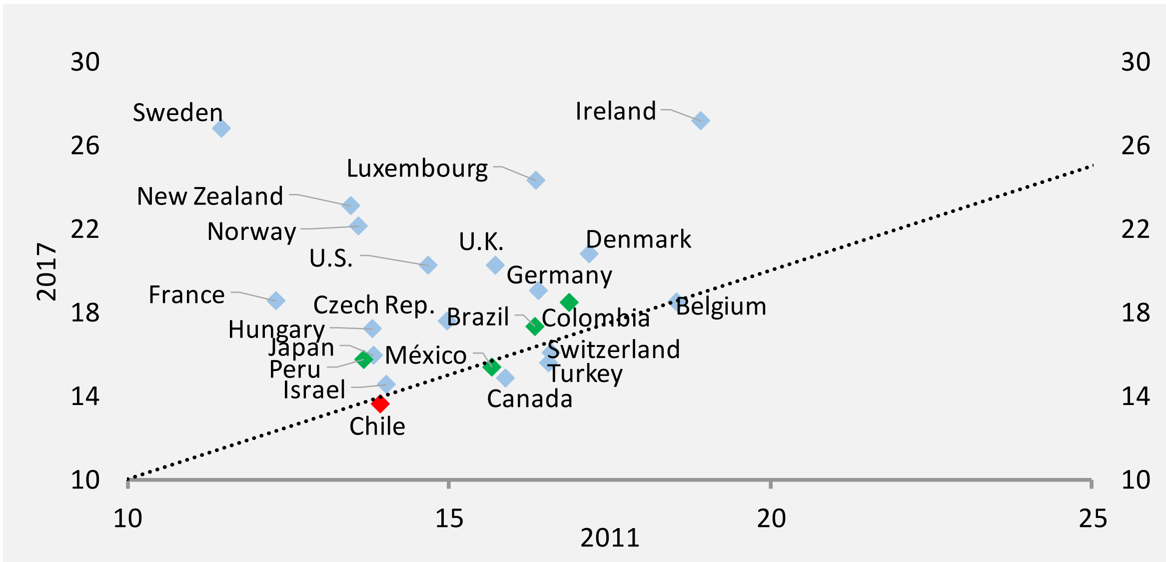
Source: Central Bank of Chile using SBIF, SUSESO and SVS data.

Figure 13
90-day delinquency rate
(percent of loans)



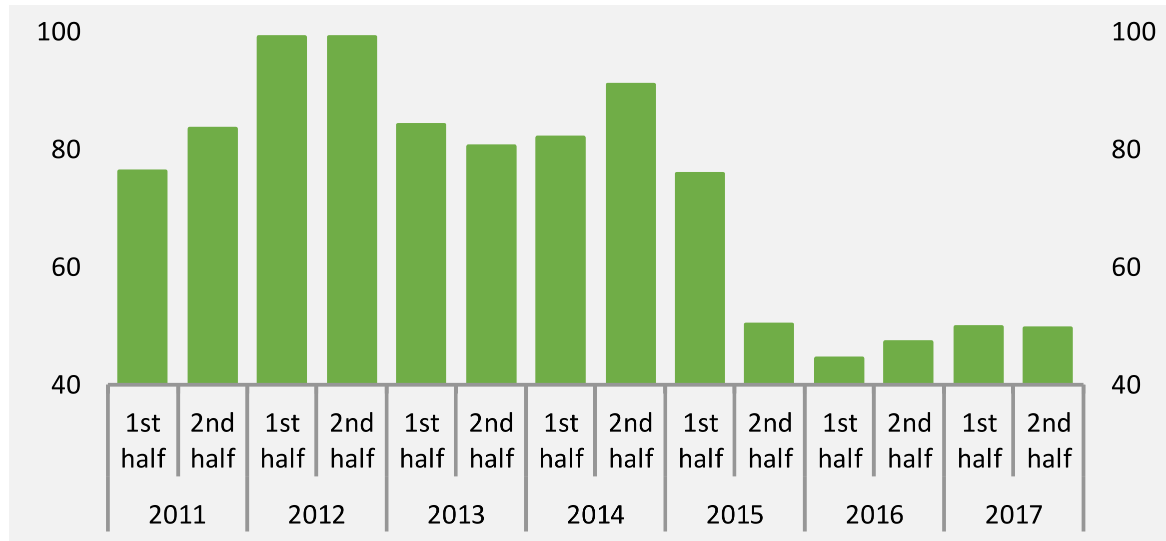
Source: Central Bank of Chile using SBIF, SUSESO and SVS data.

Figure 14
Capital adequacy ratio by country (*)
(percent)



(*) Dotted line marks 45-degree angle. Green diamonds correspond to Latin American countries (red for Chile).
Source: Central Bank of Chile using IMF (FSI) data.

Figure 15
Banks with CAR equal to or higher than 10% in stress scenario (*)
(asset share, percent)



(*) Results of stress tests presented in respective Financial Stability Reports.
Source: Central Bank of Chile using SBIF data.