MONETARY POLICY REPORT PRESENTATION BEFORE THE HONORABLE SENATE OF THE REPUBLIC*

Mario Marcel
Governor
Central Bank of Chile
5 September 2018

*The September 2018 *Monetary Policy Report* can be downloaded at http://www.bcentral.cl. The Spanish original prevails.

Introduction

Mr. President of the Senate, senator Carlos Montes, honorable senators, ladies, gentlemen,

On behalf of the Board of the Central Bank of Chile (CBC), I am grateful for your invitation to present the *Monetary Policy Report* (IPoM). As usually in September of each year, this coincides with the report that, according to the Organic Law of the CBC, we must submit annually to the Senate. In compliance with this obligation, the *Monetary Policy Report* that I will be summarizing in a moment contains our view of the recent macroeconomic and financial developments in the Chilean and international economy, as well as their prospects and implications for the conduct of monetary policy. It also includes the Bank's financial results of the first half of 2018, the results of the management of international reserves and a summary of the main decisions adopted by the Board this year to date.

The *Monetary Policy Report*

Incoming data this year has been showing greater than expected economic growth, and inflation consolidating its prospects of convergence to the target, in a context of positive surprises in several areas, an upward revision of potential growth and a faster closing of the activity gap.

Annual headline Consumer Price Index (CPI) inflation remains below 3%, although it has sped up in recent months, reaching 2.7% in July. Core inflation, meanwhile, which excludes the more volatile prices in the consumer basket (*ie*. food and energy), remains below 2%. Both figures are in line with expectations.

Globally, the US-China trade conflict has intensified which, together with the cyclical state of the US economy and its divergence from that of other developed economies, has led to a global appreciation of the dollar and a fall in commodity prices. All this has affected hardest the emerging economies that are perceived as the most vulnerable. For now, global growth projections have had limited changes. In Chile, the exchange rate has again acted as a cushion that has protected the local financial market.

The Board of the CBC has continued to apply a clearly expansionary monetary policy, keeping the monetary policy interest rate (MPR) at 2.5% since May of last year. At yesterday's monetary policy meeting we held the rate unchanged and announced that the evolution of macroeconomic conditions makes it less necessary to maintain the current monetary stimulus, so that if the current scenario continues, the rate should begin to fall in the coming months. This will allow both headline and core inflation to converge to the target during 2019.

Because the normalization process is expected to proceed gradually, it can be anticipated that monetary policy will remain expansionary still for some time, probably making it the longest period of continued monetary expansion since the adoption of the current monetary policy regime. The CBC will be prepared to act countercyclically if downside risks materialize in the external sector.

Let me now turn to the details of our baseline scenario and the related risks we see.

In the second quarter, economic activity grew 5.3% annually, giving an important upward surprise with respect to June expectations (Figure 1). By sectors, the greatest differences were observed in non-mining activity, particularly trade, business services and manufacturing. Domestic demand also grew above expectations, reflecting a greater expansion of private consumption, an increase in inventory build-up and more dynamic investment in machinery and equipment.

This dynamism was largely maintained in July's monthly index of economic activity (Imacec). The non-mining component of this indicator posted an annual increase of around 4%, while its mining counterpart dropped by nearly 2% annually, due to some one-off adjustments in some operations.

About the labor market, for several quarters its recovery seemed to lag behind activity, mainly because private salaried employment—which typically has a closer link with the business cycle—was stagnant. This phenomenon was not entirely unexpected given that the lags with which activity affects employment are variable, but anyway advised some caution regarding the strength and durability of the economic recovery. In recent months we have been reviewing this diagnosis. On the one hand, private salaried employment is increasing at annual rates above 1%, something not seen for several quarters, and shows some dynamism in important sectors, such as construction and trade. On the other hand, evidence has been emerging that suggests that the effective growth of employment would be somewhat greater, since the labor market has been able to absorb a significant influx of immigrant workers. This figure is not yet captured by the employment surveys, which are based on population projections that have not yet been updated according to the 2017 Census. This leads us to evaluate that the lag we observed between employment and activity is beginning to dissipate (Figure 2).

At the same time that private salaried employment has increased, the unemployment rate has increased too, as exemplified by the figures from the *National Statistics Institute* (INE) employment survey for the May-July moving quarter. This is so because during the phase of low growth of 2015-2017 many people became self-employed, others worked fewer hours than desired and others simply quit the labor market because they could not find what they were looking for. In recent months, this process has been reversed, with the workforce growing around 2.5%, more than the 1.5% of the period 2015-2017. It is important that in the next few months the speed of job creation, especially salaried jobs, match and hopefully surpass the workforce's growth.

Every September, the CBC revises its potential growth estimates. This concept refers to the level of Gross Domestic Product (GDP) that is consistent with stable inflation around the target and, therefore, it is adequate for measuring the activity gap associated with short-term inflationary pressures. Along with this, from time to time we also make estimates of trend growth, a concept that is related to the medium-term growth capacity of the economy. At long terms, potential and trend growth rate converge to the same number; however, they tend to diverge in the short term due to transitory factors that alter productive capacity, such as temporary shocks to productivity and limitations to factor utilization.

On this occasion, our potential growth estimate has been revised upwards, which is to be expected in a context of recovering investment, higher growth and still well-contained core inflation. For 2018, the potential growth of non-mining GDP stands at 3.1%, which compares with our 2.7% estimate a year ago. For 2019, the potential growth of non-mining GDP is 3.2% (2.9% a year ago). Trend growth remains within the 3% to 3.5% range estimated in 2017 and will be reviewed next year, once the updated demographic projections from the Census are released. With this, potential and trend growth should converge sooner than expected.

Growth accumulated up to the second quarter of the year—even considering the higher potential growth—has narrowed the activity gap with respect to the forecast, and we estimate that it is near zero in absolute level (Figure 3). We must bear in mind that the activity gap is a non-observable variable, so calculating it will give an approximation that may vary over time. Every now and then a re-estimation may yield important differences with previous values, including different readings of its level and direction. A Box in our Report identifies the elements that explain these adjustments and consider both the revision that is made to the published data—until they are considered definitive—and the changes in the parameters and estimation methods.

For this reason, we consider other antecedents to assess the state of the capacity gaps. They all coincide that slack has been reduced but suggest that they still persist to some degree. For example, installed capacity utilization indicators continue to show space and core inflation has remained below 2% over the last year. On the other hand, the labor market may contain additional degrees of slack due to migrant inflows and increased labor participation of women and elderly workers. All considered, we evaluate that the inflationary pressures are consistent with the convergence of inflation to the target under our working assumption for the MPR.

The behavior of economic activity in the first half and underlying factors lead to an upward revision of the GDP estimate for 2018. In the baseline scenario of this Report, GDP will increase between 4% and 4.5% this year, which compares with the 3.25% to 4% range we estimated in June. This is consistent with lower 12-month growth rates in the second half, which respond largely to a tighter comparison base. For 2019 and 2020, the forecast ranges are similar to those considered in June. Thus, GDP will grow between 3.25% and 4.25% next year, and between 2.75% and 3.75% in 2020 (Figure 4). The lower growth expected in 2020 stems from the economy closing the gaps somewhat faster than expected and, therefore, growing around potential. Moreover, the impulse from abroad will contribute somewhat less growth at that horizon.

These projections represent a somewhat less favorable external scenario than in the previous Report, an MPR that will remain below its neutral level for several more quarters, investment outgrowing GDP, no major macroeconomic imbalances and the economy growing around its trend trajectory towards 2020.

Compared with June's Report, the baseline scenario adjusts the gross fixed capital formation (GFCF) of 2018 upwards but maintains the same gradual reduction in its expansion rates over the rest of the projection horizon. On the consumption side, we expect private consumption to grow at a similar pace as GDP during 2018, 2019 and 2020. This assumes that the durable component—largely its imported part—will decelerate from the first half of the year, affected by the depreciation of the peso. The support that household spending receives in the baseline scenario from the recovery of the labor market should help offset this effect (Figure 5).

One positive recent surprise has been the greater dynamism of investment, especially in machinery and equipment, which outperforms GDP growth in our projections for the period 2018-2020. The greater contribution that is foreseen for mining investment stands out, in line with the near 40% growth that it showed in the first quarter of this year. The new five-year plan announced by Codelco is added as background. In any case, generating conditions for the development of larger projects remains a challenge if we are to sustain high growth rates. This is especially relevant if one considers that the observed and projected currency depreciation in the baseline scenario will reduce spending on tradable goods, and that an important part of this greater investment is explained by capital replacement needs. On the construction side, activity shows more limited dynamism. With this, GFCF as a percentage of GDP—in both nominal and real terms—will reach 21.7% this year and will border 22% next year (Table 1).

Regarding fiscal policy, our working assumption is that in 2018 the economy will receive a fiscal impulse consistent with the current budget. From then on, we assume that the structural deficit will follow the path of gradual reduction defined by the authority.

Although the CBC is an independent organization and does not coordinate its monetary policy decisions with the government, it does need to anticipate the evolution of the fiscal position as part of the macro framework within which it makes its decisions. The operation of a structural rule and the establishment of a path with annual goals for it helps to provide more certainty to the formulation of monetary policy, while allowing the budget's automatic stabilizers to operate, letting monetary policy assume the main countercyclical role.

In the projections I have just presented, we estimate that the impulse the Chilean economy will receive from abroad will fall somewhat short of our June estimates, particularly because of lower terms of trade. In recent weeks, copper has approached its long-term levels faster than we thought. Therefore, our projections are down from June, to US$2.95 per pound this year, 2.85 in 2019 and 2.8 in 2020. For its part, the oil price has moved kind of erratically, but is still above the prices of the beginning of the year. Going forward, in our baseline scenario a downward trajectory is still considered, in line with market price futures. With this, the terms of trade will post a decrease of 1.2% this year, not the slight rise we expected in June. In 2019 and 2020, they will decline further.

Regarding financial conditions, in the developed world the divergence of their monetary policies persists, because of dissimilar evaluations of capacity gaps and the inflationary pressures that each face. While the Fed raised the fed funds rate by 25 basis points in June and has signaled two more increases this year and three the next—while continuing to downsize of its balance sheet—the European Central Bank extended its asset purchasing program and signaled that the benchmark rates will stay put for a while.

The trade dispute between the US and China has continued to escalate. So far, the tariffs applied by the US and the reprisals have been limited, but the conflict has not subsided, and the measures adopted are already having an impact on risk perceptions, and the markets are more sensitive to them. As detailed in a Box in this Report, the effects that these measures may have on the global economy are difficult to quantify, as they depend on the number of countries that would be directly and indirectly involved, the amounts levied, the sectors affected and the time during which the higher tariffs would be applied. However, there are some qualitative dimensions and certain transmission channels common to the different possible scenarios. For the economies directly involved, there would be a negative impact due to lower external demand and greater uncertainty, which would affect local consumption and investment decisions. The size of the impact is related to the importance of trade among those directly involved and their ability to divert it to other economies. In China, for example, the share of its exports to the US in terms of the growth of its overall economy has fallen by half (Figure 6).

In any case, we must consider that certain automatic stabilizers are at play. For example, the reduction in external demand induces a depreciation of the currency of the economy facing higher tariffs, making its products relatively more competitive. Conversely, in the economy imposing the tariffs, an appreciation of the currency should be observed. Except if this appreciation compensates the increase in tariffs, the higher prices of imported goods would temporarily push inflation up. In the case of the US, this greater pressure of imported costs would be added to the scarce gaps that the economy already presents, which could lead to greater current-account imbalances, higher inflation and additional pressures to speed up the pace of monetary normalization.

Special attention deserves the effects on financial markets and asset prices, especially in circumstances where the Fed continues to progress in normalizing its monetary policy. The uncertainty associated with the trade conflict contributes to reducing risk appetite, making capital flow out of emerging economies. So far, this adjustment has been selective and major effects have materialized in only a few vulnerable economies. For an economy with good fundamentals, such as Chile, one possible risk comes from a synchronized adjustment of emerging economies' asset prices, as it happened in the late 1990s or during the Global Financial Crisis. A scenario of greater uncertainty, tight financial conditions and an appreciated dollar is particularly negative for the prices of commodities, especially copper.

Fears about the effects of the trade war have been heightened by the further moderation of China's economic activity figures. The Chinese authorities again intensified fiscal and monetary stimuli, reversing some of the measures adopted during 2017 to limit indebtedness and promote more balanced growth. About the monetary stance, its Central Bank has led interest rates downward and granted liquidity to the banking market by cutting reserve requirements twice during 2018. In turn, it has allowed the currency to depreciate—close to 10% since March—without major interventions, partially offsetting the higher tariffs on Chinese goods. At the fiscal level, they have relaxed the limits of indebtedness of local governments, allowing them to issue debt at lower interest rates and eliminating restrictions on public-private partnerships with the aim of stimulating investment in infrastructure. Tax reductions have also been applied to companies and households for an amount of roughly 1.3% of GDP and the easing of environmental constraints, which already resulted in a rebound in industrial production during the first quarter.

How much room do the Chinese authorities have to further stimulate demand? One doubt refers to their level of indebtedness, which is three times their GDP, too high for an emerging economy, and originated in a poorly regulated segment of the financial industry. The same is true of their fiscal side, with a deficit that is high and would grow more if local governments were included. Finally, in a currency scheme that is still relatively rigid, expectations of a greater depreciation of the currency could trigger capital outflows, which in the past have caused significant losses of international reserves. Although some of these risks look less pressing than they did a couple of years ago, additional doses of stimulus applied to an economy that has accumulated imbalances, in a more uncertain context and with more stringent financial conditions, amplify the risks in medium-term horizons.

The effects of such a scenario could be brought home in Chile through several channels. An escalation of the conflict would certainly threaten our trading partners' growth, particularly China, by increasing medium-term risks, beyond the particular effects it may have on specific exporting sectors of our economy—depending on whether its products are complements or substitutes of the taxed products. It could also deteriorate financial conditions significantly in the emerging world. In addition, it could pull the price of copper below its long-term level. This external framework would worsen the terms of trade, depreciate the peso and lower prospects for growth, especially due to a downward adjustment in investment. The effects on inflation are not entirely evident. A depreciation would generate short-term upward pressures, while lower growth would widen the gap, generating disinflationary pressures in the medium term, a horizon that is more relevant to the calibration of the monetary impulse. The appropriate monetary policy response to this scenario depends largely on the magnitude and relative persistence of these shocks and their impact on inflation expectations. In any case, the Chilean economy has an economic policy framework that allows it to absorb external shocks and reduce their negative effects, particularly a flexible exchange rate and a monetary policy regime that, being based on a two-year inflation target, can act countercyclically.

In the current external picture, those economies perceived as having weaker macroeconomic fundamentals may undergo abrupt changes in the financial conditions they face. The recent experience of Argentina and Turkey are good examples of this. In particular, the currencies of these countries have lost more than a third of their value in the last month and a half. Both economies share high inflation, monetary policy making with less credible targets, in a still highly dollarized economy and a fragile external position, resulting from a high current-account deficit and limited reserves. One Argentina-specific vulnerability is its high fiscal deficit at 6% of GDP in 2017, which is difficult to contain with a public debt denominated in dollars that exceeds 30% of GDP and whose service becomes complex in the current circumstances. Turkey, for its part, became highly dependent on external financing to sustain growth above its potential for several years. By 2019, the overall Turkish economy's needs are estimated to approach 30% of GDP.

In Chile, the biggest reaction has come from the nominal exchange rate, while long-term interest rates have not been affected. At the statistical close of this Report (28 August), the peso/dollar parity was somewhat above CLP660, 5.5% higher than at the close of the previous Report. In the days that followed the peso has depreciated further vis-à-vis the dollar. However, in multilateral terms the depreciation has been milder, even with an appreciation against other emerging and commodity exporters' currencies, reflecting the greater relative strength of the Chilean economy. The real depreciation of the peso has been lower (near 1% since the previous Report). As a working assumption, the baseline scenario of this Report continues to assume that, in the course of the policy horizon, the real exchange rate will go back to its averages of the last fifteen to twenty years (Figure 7).

As for domestic credit, local financial conditions are still good, in line with the ongoing expansionary stance of monetary policy. Accordingly, the interest rates of many segments stayed low and credit growth remained limited. However, it is worth mentioning that commercial rates increased again, in a context where qualitative indicators report increased demand and more accommodating supply (Figure 8).

For the moment, the higher risk perception has translated into a limited revision to global growth prospects, with decelerating growth rates in 2019 and 2020. By blocs, the outlook for developed countries does not differ from that in the June *Monetary Policy Report*. Instead, in the emerging countries the downward adjustment in Latin America stands out, especially Argentina and Brazil. Add the expected slowdown in China (Table 2).

As I said at the beginning, the annual variation of the *Consumer Price Index excluding Food and Energy* (CPIEFE)—our measure of core inflation that deletes the prices of food and energy from the CPI—has remained below 2%, with annual inflation still negative for goods and persistently around 3% for services. The CPI has approached 3%, mainly driven by the behavior of the more volatile prices (Figure 9).

The peso depreciation has an effect on the revision of the short-term inflation outlook. By the end of this year, the annual variation of the CPIEFE is forecast to be at 2.7% (2.3% in June) and that of the CPI, at 3.1% (2.8% in June). Once both indicators converge to 3% during 2019, they will remain in the neighborhood until the end of the projection horizon (Figure 10). It is very likely that in September the annual CPI inflation rate will be temporarily above 3%, because of the low basis for comparison left by the unusual behavior of some foodstuffs in 2017.

Regarding monetary policy, we think that the evolution of macroeconomic conditions makes it less necessary to maintain the current monetary stimulus. Therefore, our working assumption for the MPR is that it will begin to increase in the coming months and by 2020 it will stand near its neutral level—*ie*. between 4% and 4.5%. This assumption is not essentially different from the forecast a few months ago, as it implies gradual increases in the policy rate associated with the recovery of the domestic economy. However, the fact that the figures confirm that the economy is expanding with relative strength for several quarters already, makes the start of the normalization process more imminent.

As always, this trajectory does not mean a commitment, as it is conditional on the materialization of the baseline scenario outlined here. New information modifying the projected inflation trajectory will entail changes in monetary policy implementation.

I wish to emphasize how important the work of monetary policy in recent years has been. As from 2013, we are facing a scenario of less favorable external conditions and where our economy has lost dynamism. A significant depreciation of the peso put pressure on inflation pushing it above 4%. The inflation-targeting scheme that guides our monetary policy and the credibility that the CBC has gained allowed us to think prospectively and apply a highly expansionary monetary policy to mitigate the lost dynamism of domestic and foreign demand and thus ensure that inflation would converge to 3 % within two years. Today, almost five years into the process, the evolution of macroeconomic conditions indicates that, finally, the economy no longer needs such an expansionary monetary stance, which is very good news, no doubt.

As usual, there are internal and external elements that could modify these projections. From the point of view of its impact on local activity, the balance of risks in the external scenario remains biased downward. The main risk continues to be an abrupt deterioration of financial conditions facing emerging economies, especially because markets seem to be more reactive to negative news. In this area, what happens in the US is still relevant, in terms of both the evolution of inflation and its outlook and the unfolding of the trade conflict. This situation has revived the fears about China, especially the risks implicit in the imbalances it maintains in several of its markets. In Europe, among other issues, the uncertainty surrounding Brexit is cause for concern.

In the context of normalizing global financial conditions, investors have drawn a line between the emerging economies they perceive as more vulnerable and those with more solid fundamentals. Chile meets the current situation with good macroeconomic indicators in terms of growth, inflation and the balance of its fiscal and external accounts. Moreover, our floating exchange rate makes it possible to cushion external shocks, and the monetary policy framework permits us to act countercyclically. This is feasible due to the low exposure to interest rate and exchange rate risks by the main economic agents.

On financial matters, one issue drawing attention in this conjuncture is the external debt. The Box in this Report, entitled “*Financial Volatility and External Debt*”, provides an in-depth analysis of this issue, particularly with regard to corporate debt. This analysis concludes that the risks of refinancing and exchange rate volatility for companies are limited, either because of the type of creditor (matrices of foreign investors), loan maturities or the absence of significant currency mismatches. Additionally, it should be kept in mind that an important part of the group of companies that report to the *Financial Market Commission* have investments abroad that are financed with debt taken in Chile. Therefore, analyzing Chile’s external debt as a proportion of GDP can be distorting, because part of the added value is produced outside the country. Using of financial indicators such as assets and net worth is more recommended for a financially more integrated economy such as Chile and a modern productive sector (Figure 11).

And, the flexible exchange rate plays a role in cushioning external shocks in Chile, unlike other emerging countries, precisely because both the corporate and the financial sectors have adequate hedging—and are monitored by their respective regulators on a permanent basis. In fact, since the adoption of exchange rate flexibility in 1999, the Chilean economy has lived through several periods of significant peso depreciation, like in 2008, 2013 and 2015, without causing any problems of mismatching in the corporate sector with dollar-denominated debt. In this way, our inflation-targeting monetary policy framework, floating exchange rate and deep financial markets are the key pillars of our country's macroeconomic design. In any case, the bias and probabilities of external risk scenarios reinforce the need for a small and open economy such as Chile to maintain deep-rooted macroeconomic foundations, particularly a path of fiscal consolidation, sustainable debt levels and adequate capitalization of the country's banking system.

At home, we estimate that the risks to activity are unbiased. The economy has brought positive surprises in good measure because the possibility of a more dynamic behavior of investment identified in previous reports has materialized, short only of a more significant response from large-scale projects and the real estate sector. For its part, although the labor market could take a little longer than expected to recover, the latest data tend to provide greater robustness to the employment, wage bill and consumption projections.

As for inflation, we estimate that the risks are unbiased. Although the risks in the international scenario and their negative implications have increased, the economy has shown more dynamism than expected and the short-term outlook for headline inflation has been corrected upwards. In this context, we consider that the current level of monetary stimulus is less necessary and may begin to withdraw it in the coming months. Thus, we reaffirm our commitment to conduct monetary policy with flexibility, so that projected inflation stands at 3% over the two-year horizon.

Institutional advances and challenges

As I pointed out at the beginning, this presentation to the full Senate has a special connotation. Indeed, the Constitutional Organic Act mandates the CBC Board to present at this time of the year an evaluation of the progress of the policies and programs of the current year, a report of those proposed for the following calendar year, the overall economic projections that sustain them, and a recount of the factors that can affect its balance sheet. In other words, it is not just about presenting the *Monetary Policy Report*, but a more complete account about the evolution of our institution.

However, today I wish to go beyond the usual institutional account. I would like in particular to recount the content and progress of the Bank's *Strategic Plan* that I anticipated on this same venue last year, as well as share some additional steps that we intend to take on the issue of institutional transparency.

Our *Strategic Plan 2018-2022* was prepared during the better part of last year and is currently in full implementation. Although this type of exercise was not new to our institution, this time it relied on an extensive process of external consultations, gathering of relevant information and internal deliberation unprecedented in the CBC, which is very innovative for the central banking community in general. This exercise was completed at the end of 2017 with the approval of the *Plan*. Below I summarize its main contents and advances.

This *Strategic Plan 2018-2022* updated the basic definitions of the CBC's institutional mission and vision. The latter in particular is defined as "being a reliable institution because of its technical nature and excellence in achieving the mandated objectives." This expresses the need for the CBC to be prepared to respond to the opportunities and challenges that are presented to it at the macroeconomic and institutional level, in the understanding that in today's world and society the citizens' and markets' confidence have to be earned day by day, beyond our past achievements.

Based on these definitions, the plan identifies five areas of priority:

- Maintain intellectual leadership in the areas related to the institutional mandates of the CBC;

- Strengthen the understanding and dialogue of the organization with its environment;

- Strengthen its corporate governance to balance out risk tolerance and the efficiency of its business processes;

- Improve ability to understand and incorporate technological changes into its tasks; and

- Consolidate the CBC as an employer of excellence, capable of attracting and engaging the best talent.

Accordingly, twenty-one lines of action were defined that will be developed over this five-year period, all of them described in the document in your hands. Below I summarize those that may be of greatest interest for you honorable senators, with their corresponding progress status.

Intellectual leadership. Since last January, we apply a new monetary policy communication scheme. To date, we have held six monetary policy meeting under this scheme, three of them accompanied by the respective publications of the *Monetary Policy Report* and subsequent presentation to the Senate. In addition, the CBC published the *Financial Stability Report* in May separately from the *Monetary Policy Report* and presented it to Senate's Finance Committee. This has allowed for a better communication of the messages of each report, which have been complemented with deeper analysis of issues of macroeconomic and financial relevance, such as trend growth (September 2017 *Monetary Policy Report*) and the new information technologies applied to the financial industry (*Financial Stability Report* first half 2018). In December of this year we will continue with this work, including a new offprint of the *Monetary Policy Report* that will analyze in detail several aspects of the labor market.

Institutional relations. During the first quarter we created a new Institutional Affairs Department in charge of diversifying and improving the quality of the CBC's communications, developing support programs for the community on issues of its competence and implementing the active transparency agenda of the CBC. It is worth noting here that the CBC began publishing the minutes of the monetary policy meetings of ten years back. In April we published the minutes of all the meetings from 2000 to 2007.

Governance. The new work scheme between the Board and senior management was developed and implemented as of March for the discussion and decision making of monetary and financial policy matters, as well as the separate inclusion of institutional administration issues. Additionally, in the second quarter, we approved a change in the organizational structure designed to generate greater flexibility, empowerment and responsibility of the CBC's divisions and areas. This adjustment also involved the creation of the strategic- and technological-risk Department.

Technology. A technological observatory was created intended to act as catalyst for enhancing knowledge and adopting important innovations for the CBC's fulfillment of its functions. The main objectives of the observatory are: (i) to agree on common principles and contribute, inside the CBC, to the coordination of the treatment of disruptive technologies, (ii) create networks with the external community to enhance know-how and identify opportunities and threats, and (iii) agree on the pillars of innovation to promote and contribute to knowledge in those areas. The pillars of interest that have been defined include: digital currencies of central banks, cryptoassets and financial stability, development of digital payments and technology of distributed records and their applications, technology and data management, cybersecurity and risks for the financial system, among other issues.

Employer of excellence. We have been working on strengthening the organizational culture and improving the value proposition for our staff in order to achieve effectiveness in attracting and retaining employees and developing their careers. To strengthen the internal career, we are developing an exercise to improve job description and assessment.

Hand in hand with the strategic initiatives just defined, the CBC has continued with its projects linked to the fulfillment of its permanent functions. These include, among others, the delivery of new statistical products, improved management of the cash cycle, modernization of the technological platform that supports the investment cycle of the International Reserves and the Sovereign Funds, and the incorporation of computer security measures based on high international standards.

Particularly noteworthy is the progress we have made in implementing Basel III regulations, mainly in terms of liquidity standards for the banking system and support for the discussion of the new *General Banking Act*. The latter will pose additional demands, particularly concerning the implementation of regulatory measures and macroprudential policies, such as the countercyclical capital reserve and the charge to systemic banks, for which the CBC has been preparing in recent months, reviewing international experiences and their applicability to Chile.

We intend to continue informing the Senate and the general public about the progress of our *Strategic Plan* and the operational agenda in the coming years. This is an expression of a broader will to increase the transparency of the operation and performance of the CBC, as an essential ground for the confidence in our institution that we wish to maintain and reinforce.

Let me stress here that the CBC's commitment with transparency involves not only compliance with the obligations mandated us by the Constitution and laws but has expanded further by way of agreements adopted by the Board throughout the years.

The CBC is governed by the principle of transparency in exercising its public function, enshrined in Article 8 of the Constitution, the bylaws of its own Constitutional Organic Act and the relevant legislation that has expressly included the CBC, such as Law No 20285 on Access to Public Information (2009), Law No 20730, which regulates the lobbying and management of private interests (2014), and Law No 20880 on public service probity (2016).

Still, the Board has added several transparency standards that go beyond the aforementioned norms. For example, last March we made available to the public a total of 96 minutes of past monetary policy meetings held during the period 2000-2007, a practice that will continue into the future years. We have also included as passive subjects of transparency all division directors, area managers and heads of departments that may have relevant decision-making powers, and we have supplemented the obligations of the Lobby Law with the publication on the CBC's website the weekly agenda of the Governor and all Board members. In addition, we have established an external Audit and Compliance Committee and an internal reporting channel to denounce situations of harassment or abuse.

From the perspective of using the powers inherent to an autonomous institution to strengthen transparency in more specific areas that are not covered by general legislation, the CBC is preparing some additional initiatives to implement over the next twelve months.

One, we want to raise the levels of information and guidance we give to the community regarding monetary policy decisions. In the coming months we will publish a manual with the macroeconomic projection models used by the CBC in formulating monetary policy. With this, the analysis carried out by the Board can be better understood and the sensitivity of the projections to certain key variables can be measured. Also, we will improve our communication about the future trajectory of the monetary policy rate in the *Monetary Policy Report*, in order to provide a clearer orientation to the market on how monetary policy can materialize in the baseline scenario of the Report. On the other hand, we will strengthen the risk analysis, articulating with more clarity alternative scenarios and their implications for monetary policy. In this way, we hope that the CBC will be at the forefront of the central banks in terms of transparency and quality of its orientation to economic agents and the overall population.

Two, in the next few months we also plan to take two essential steps in terms of financial stability. The first one implies broadening the analysis of risks facing financial stability, in order to input sources and areas of risks not yet considered in the *Financial Stability Report* analysis, including operational risks, particularly computer safety. The second step will be associated with the approval of the new General Banking Act and involves announcing in the course of 2019 the variables and parameters with which the countercyclical capital reserve requirement will be applied, which will become the most important instrument of macroprudential policy in Chile.

Three, in 2019 the Bank will prepare its first Social and Environmental Sustainability Report, examining how it complies with obligations of every entity forming part of a broader community. This Report will also give an account of the CBC's progress and challenges in terms of gender equality.

Lastly, notwithstanding the aforementioned initiatives, the Board of the CBC will hire an independent assessment of its performance in compliance with the two mandates of its Organic Act, that is, price stability and financial stability. For this purpose, a panel composed of four world-renowned experts in central banking will be convened. This panel will accumulate the relevant background in the course of the next few months and will issue a report with its assessments and recommendations in time to be presented in this same instance next year. This will be a concrete form of accountability for the way the CBC and its Board have complied with its legally-mandated obligations and responsibilities to society, which will acquire special connotation at the end of 30 years of autonomy of our institution.

This recount that I have presented before the Honorable Senate of the Republic, without being exhaustive, gives us a broad and general approach to the steps we are taking. It also expresses our ability to adapt to more uncertain and challenging scenarios, as well as the commitment we have to relieve the meaning and purpose of the CBC. In short, it is about fully assuming the responsibility with which we honor our constitutional mandate in the eyes of our country.

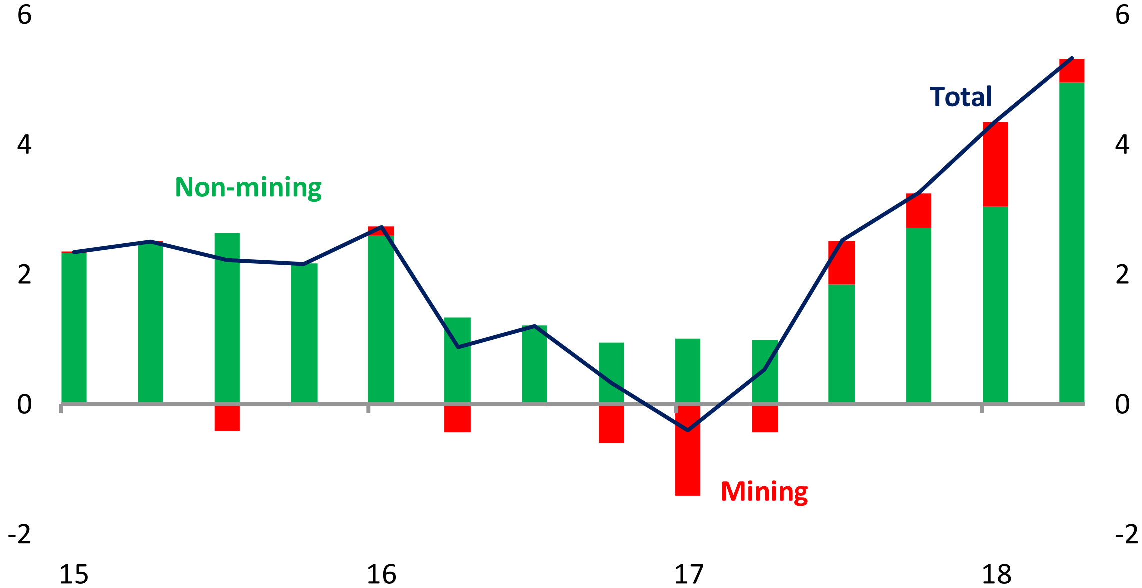
Thank you.

***

Figure 1

Annual GDP growth

(contribution, percentage points)

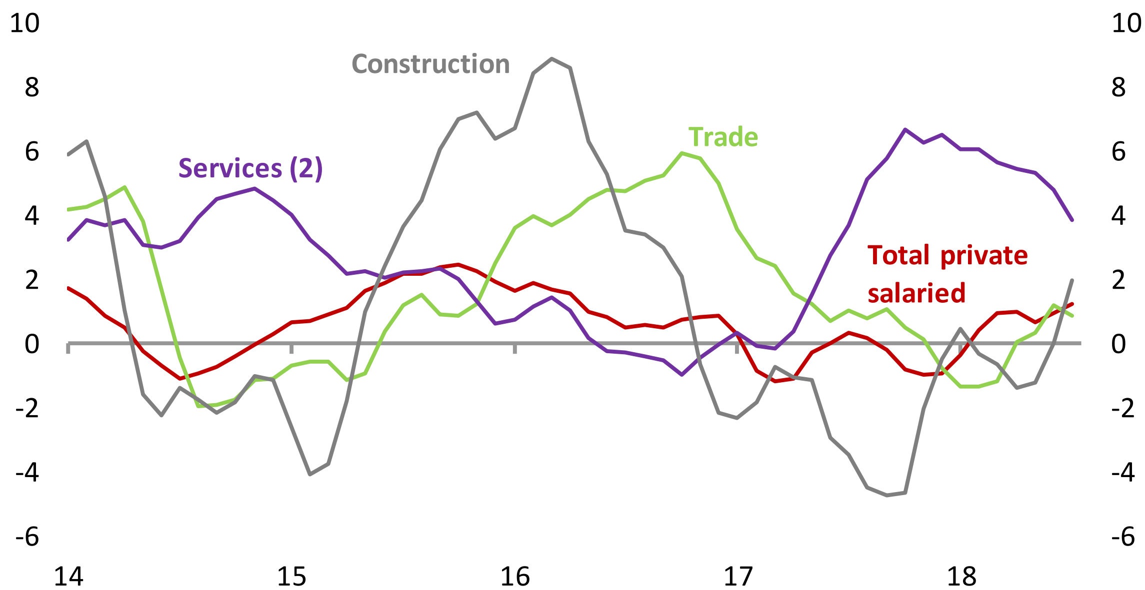


Source: Central Bank of Chile.

Figure 2

Employment creation (1)

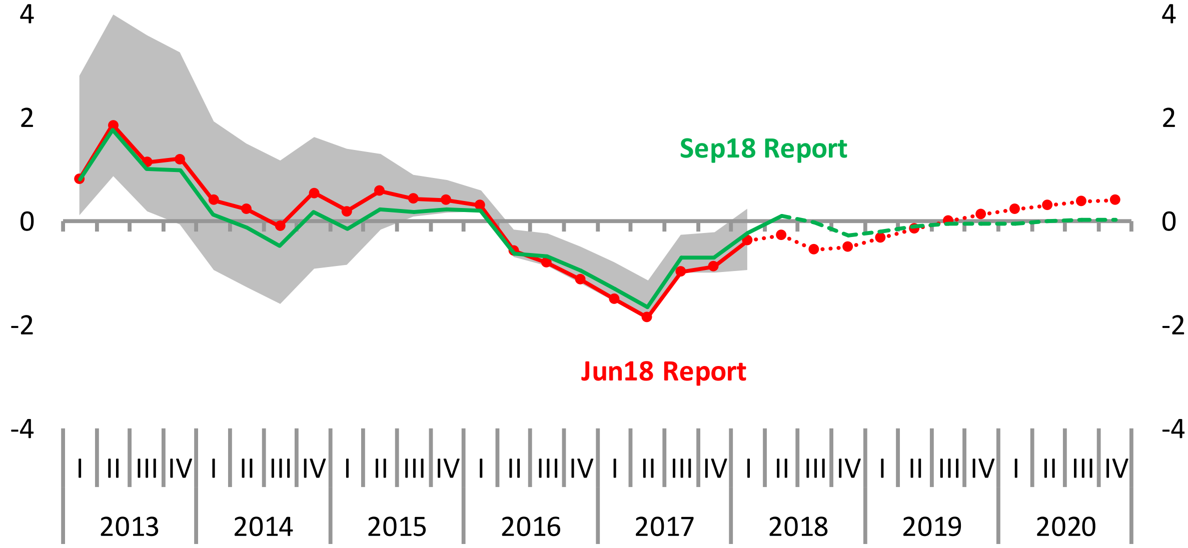
(annual change, percent)



(1) Quarterly moving average. (2) Communal and financial serivces.

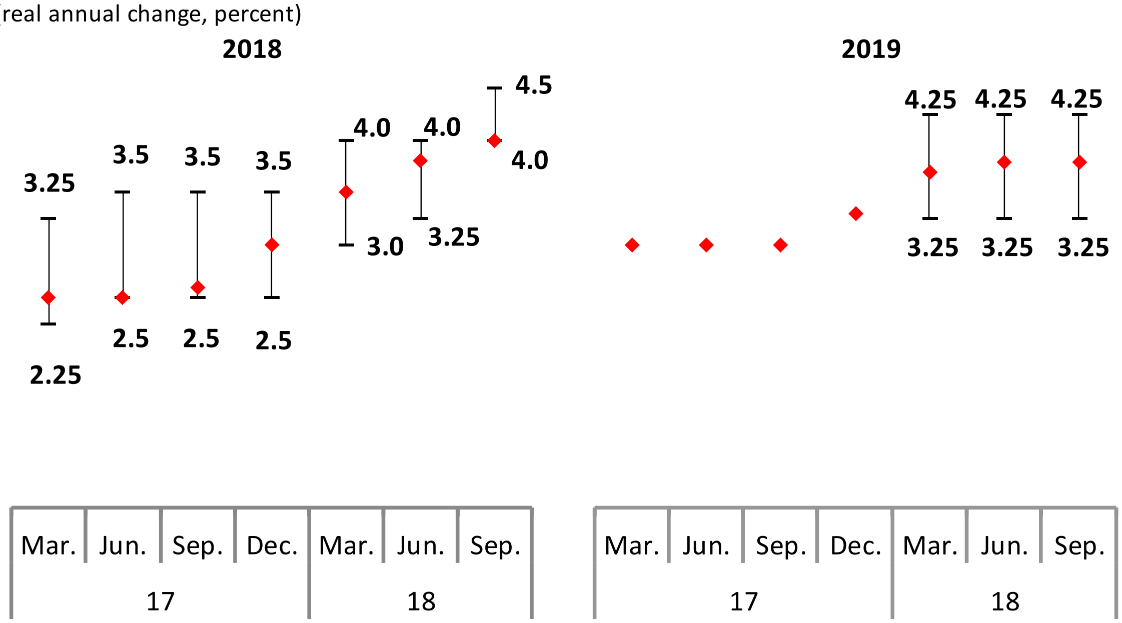
Sources: Central Bank of Chile and National Statistics Institute (INE).

Figure 3
Activity gap (*)
(percentage points)



(*) Gray area shows minimum and maximum gap estimates using different calculation methods for potential GDP (see Fornero y Zuñiga (2017)).
Source: Central Bank of Chile.

Figure 4
Growth forecasts (*)
(real annual change, percent)

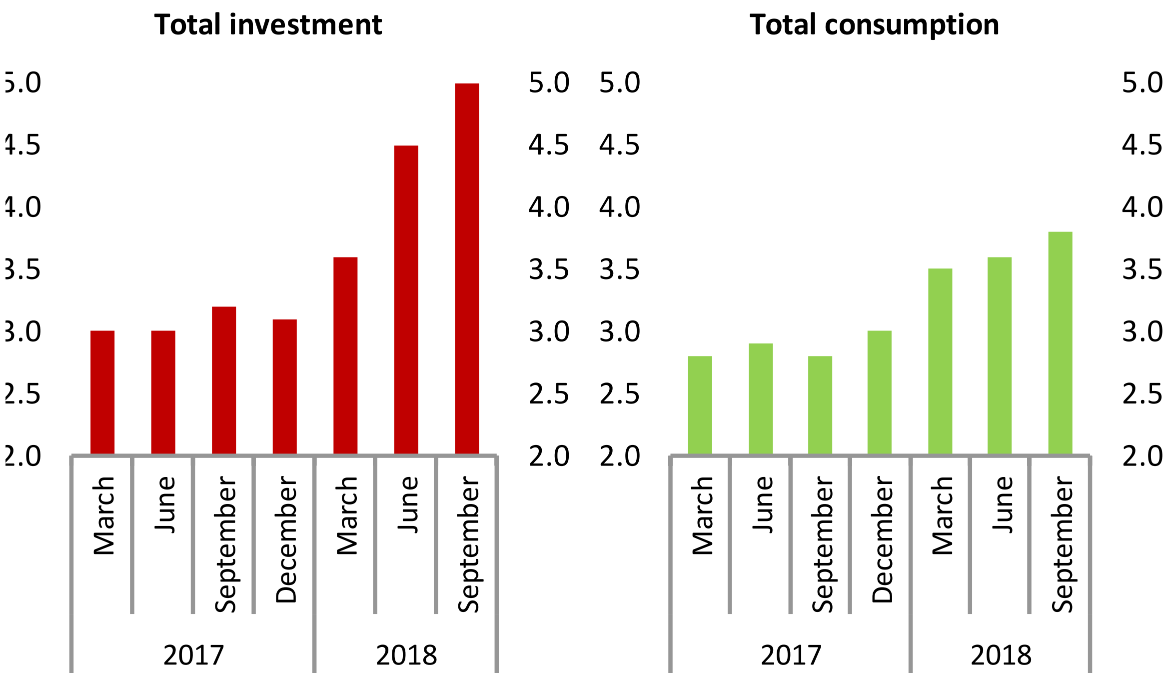


(*) The ranges show the range growth forecast in each MP Report. Red diamonds corresponde to Economic Expectations Survey at the respective statistical cutoff date.
Source: Central Bank of Chile.

Figure 5

Evolution of investment and consumption forecasts in Monetary Policy Reports

(annual change, percent)



Source: Central Bank of Chile.

Table 1

Domestic Scenario

(variación anual, porcentaje)

	2017	**2018 (f)**		**2019 (f)**		**2020 (f)**	
		Jun.18 Report	**Sep.18 Report**	**Jun.18 Report**	**Sep.18 Report**	**Jun.18 Report**	**Sep.18 Report**
GDP	1.5	3.25-4.0	4.0-4.5	3.25-4.25	3.25-4.25	3.0-4.0	2.75-3.75
Mining GDP	-2.0						
Non-mining GDP	1.8						
Domestic demand	3.1	4.1	4.6	3.9	3.7	3.5	3.3
Domestic demand (w/o inventory change)	1.8	3.7	4.1	3.6	3.7	3.6	3.7
Gross fixed capital formation	-1.1	4.5	5.0	4.5	4.5	3.9	3.9
Total consumption	2.7	3.6	3.8	3.4	3.4	3.5	3.6
Goods and services exports	-0.9	5.2	4.9	3.4	4.2	2.5	2.8
Goods and services imports	4.7	6.7	6.2	3.8	4.4	2.6	2.8
Current account (% GDP)	-1.5	-2.1	-2.2	-2.5	-2.6	-2.6	-0.3
Ahorro nacional bruto (% del PIB)	20.6	20.3	20.3	20.6	20.5	20.7	20.5
Gross fixed capital formation	21.6	21.6	21.7	21.9	22.1	22.2	22.4

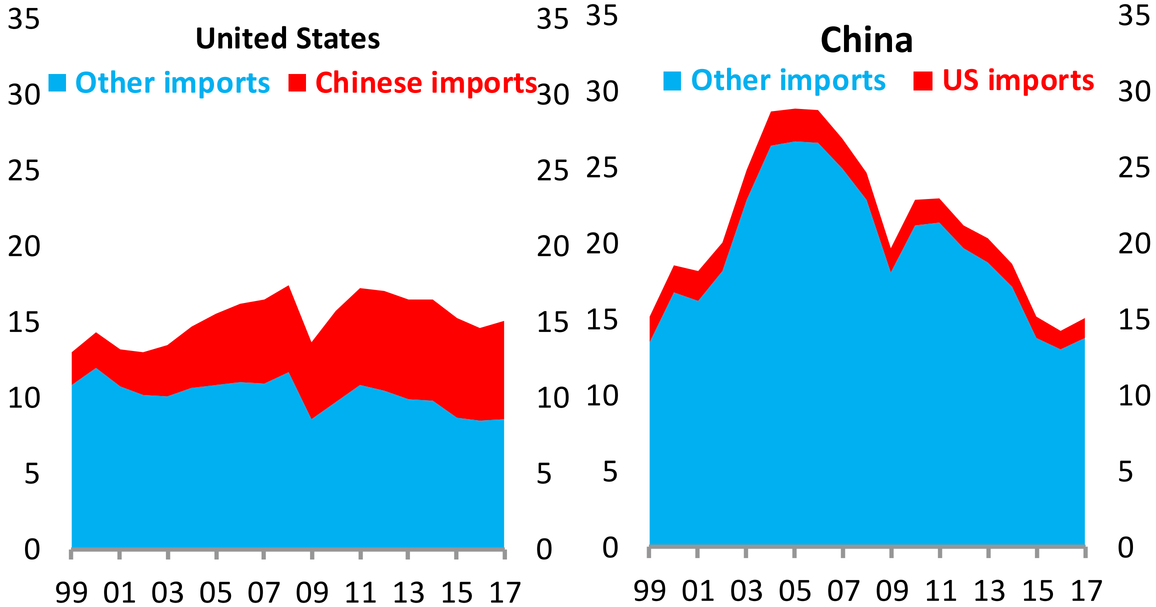
(f) Forecast.

Source: Central Bank of Chile.

Figure 6

US-China trade

(percent of each country's GDP)



Source: Bloomberg.

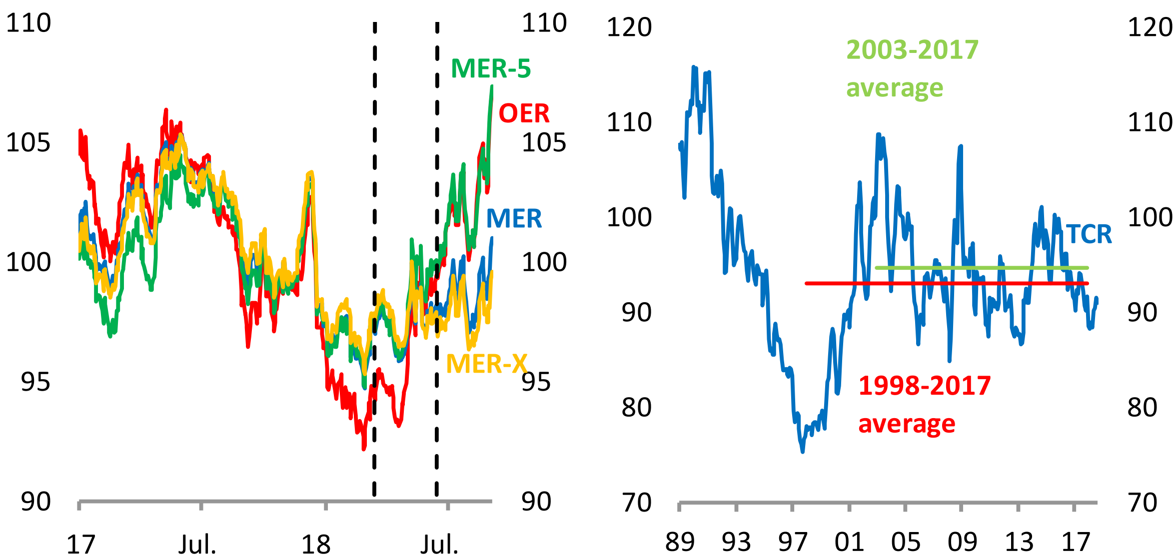
Figure 7

Nominal exchange rate and multilateral measures (1)

(index, 2017-2018=100)

Real exchange rate (2)

(index, 1986=100)



(1) Dotted vertical line shows punteada corresponde al cierre estadístico del IPoM de marzo y junio del 2018.

Source: Central Bank of Chile.

(2) August 2018 information covers up to the 28th.

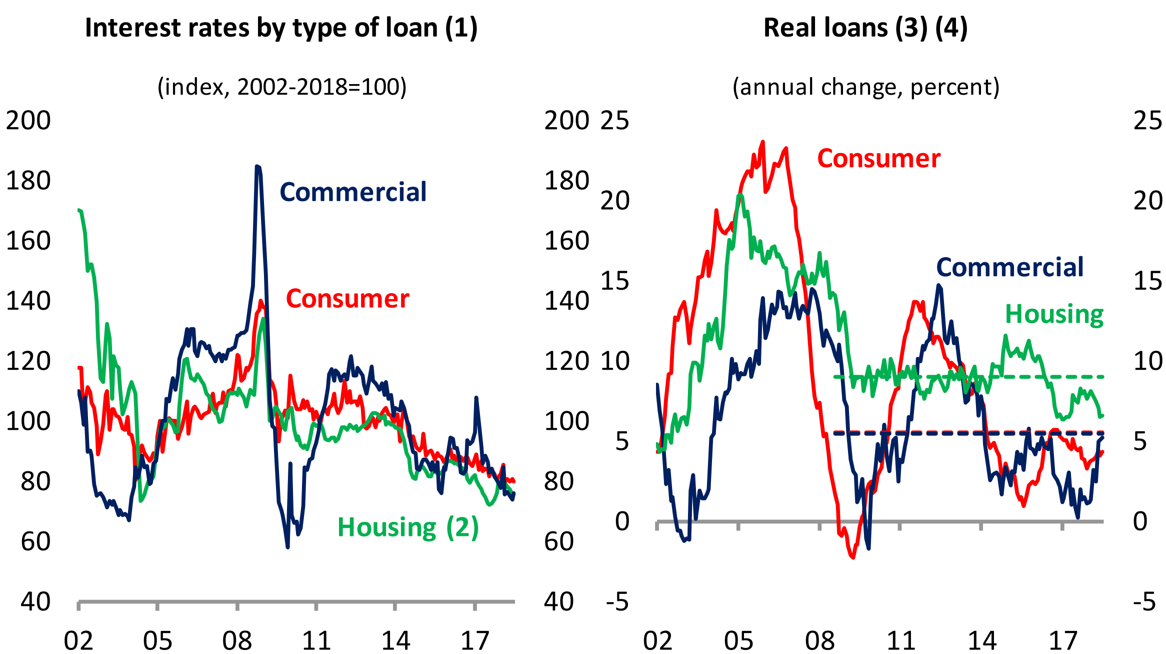
Source: Central Bank of Chile.

Table 2
World growth
(annual change, percent)

	2017	2018 (f) Jun.18 Report	Sep.18 Report	2019 (f) Jun.18 Report	Sep.18 Report	2020 (f) Jun.18 Report	Sep.18 Report
World at PPP	3.7	3.9	3.8	3.8	3.6	3.6	3.4
World at market exchange rates	3.2	3.3	3.1	3.1	2.9	2.9	2.8
Trading partners	3.7	3.8	3.6	3.6	3.5	3.4	3.4
United States	2.2	2.7	2.9	2.3	2.3	1.9	1.9
Eurozone	2.4	2.2	2.1	1.9	1.9	1.7	1.7
Japan	1.7	1.0	1.0	0.8	0.8	0.5	0.5
China	6.9	6.6	6.6	6.3	6.2	6.2	6.1
India	6.7	7.3	7.3	7.6	7.6	7.6	7.6
Rest of Asia	4.4	4.3	4.2	4.3	4.1	4.2	4.2
Latin America (excl. Chile)	1.1	2.1	1.3	2.5	2.1	2.6	2.6
Commodity exporters	2.7	2.3	2.3	2.2	2.2	2.2	2.2

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

Figure 8



(1) Weighted average rates of all operations performed in each month.
(2) Loans indexed to the UF.

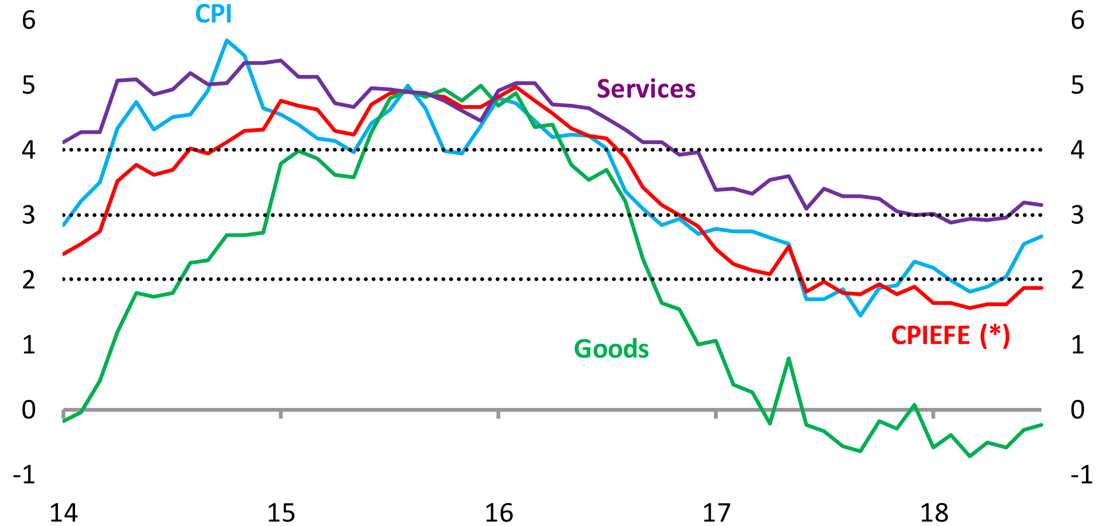
Sourcee: Central Bank of Chile using SBIF information.

(3) Real data built with splice of CPI annual base 2013.

(4) Horizontal dotted lines show average of last ten years of each series.

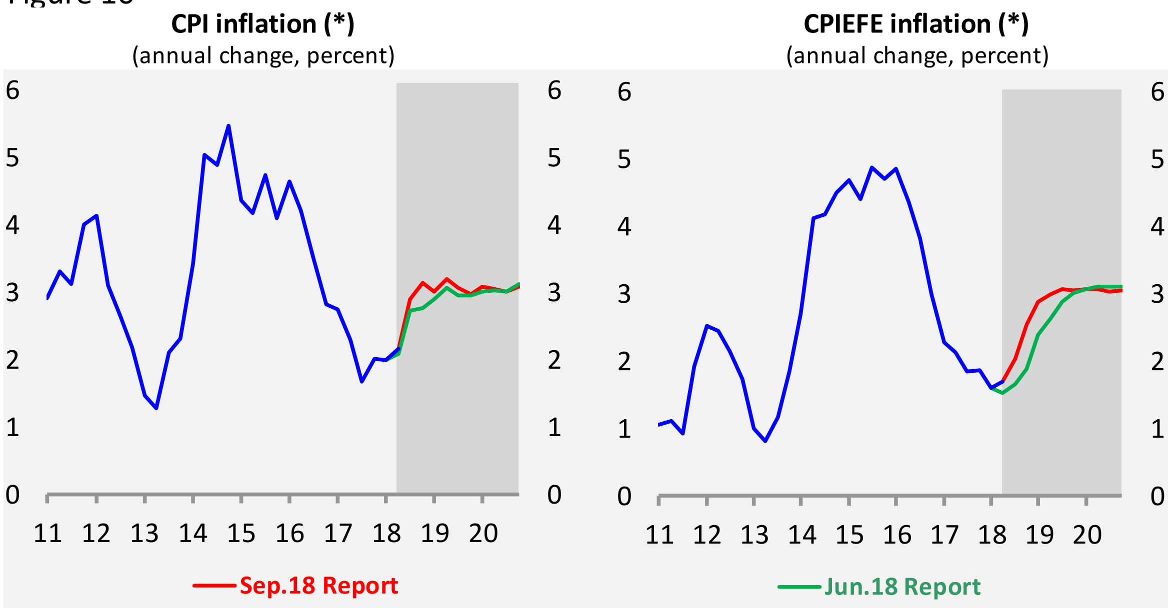
Sourcee: Central Bank of Chile using SBIF information.

Figure 9
Inflation indicators
(annual change, percent)



(*) For definition, see Glossary.
Sources: Central Bank of Chile and National Statistics Institute (INE).

Figure 10



(*) Gray area shows forecast as from third quarter of 2018.
Sources: Central Bank of Chile and National Statistics Institute (INE).

Figure 11

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

(percent of GDP)

(*) Information up to 2017.

Source: Central Bank of Chile using SBIF and FMC information.