CHILE IN THE NEW GLOBAL SCENARIO[1]

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Good morning. Thank you to InBest and the sponsors for organizing this event and for holding this Chile Day here in New York year after year. This is a special year for the Central Bank of Chile, as we celebrate our centenary. This anniversary finds us strengthened as an autonomous institution, with clearly defined objectives and a consolidated reputation. Our daily task is focused on maintaining a sound economy, with controlled inflation, a normal functioning of the payment system and a watchful eye on the behavior of the markets in its role of safeguarding financial stability.

This year, from a macroeconomic and financial standpoint, will be centered around the ongoing escalation of trade tensions, which has given way to a considerable increase in global uncertainty. This is a major challenge for a small, globally open economy like ours.

Part of the doubts focus on how the world economy will absorb the higher tariffs imposed by the United States. This includes their impact on trade flows, production and distribution chains and, consequently, economic growth, inflation, and the evolution of financial markets. All this, bearing in mind that these tensions are part of a world that was already dragging along other risks, such as the high level of sovereign debt and a complex and strained geopolitical scenario.

Over the last forty years, the Chilean economy has been building an institutional framework that has contributed to its stability and to becoming a reliable trade and financial partner. We are a small and open economy that has signed thirty trade agreements with economies that account for nearly 90% of the world's GDP, in addition to a wide range of trade and investment commitments. This is proof of our vocation of openness to the world, the only way to expand our markets and take full advantage of our comparative advantages, which has benefited us all these years.

[1] Presented as part of the Chile Day program, New York.

The new international landscape

First, let me briefly review what has been happening in the external scenario in the last few months and the doubts that have arisen. These are widely known and discussed issues, so I will be brief, even at the cost of omitting some aspects.

The global landscape has been increasingly uncertain for some time now. Just to recap the most recent developments, towards the end of last year we had major doubts about the evolution of monetary policy in the United States and the performance of the Chinese and European economies. In addition, the risk context kept us focused on high sovereign debts and geopolitical tensions.

Against this backdrop, highly disruptive trade tensions arose from the perspective of the global trade order that had been progressively reached after decades. These tensions grew as the weeks went by, until the announcements came on April 2nd.

These announcements were particularly relevant due to the magnitude and number of countries involved. In fact, they led to a sharp upswing in financial volatility, significant movements in asset prices and, in general terms, a considerable increase in uncertainty.

The latest weeks have brought some calm to the markets. However, it is still difficult to predict how this process will end after the pause and announced talks with different countries. Likewise, there are doubts as to how the changes in trade will be absorbed at the production and logistics level and how all these uncertainties will affect the world economy.

Today, if we use the estimates of different research centers, the tariffs charged by the United States would be somewhat higher than 15%, well above the 2.4% they were in 2024 and more in line with what was the case 90 years ago. This is no doubt an abrupt change in a short time, which will affect global trade and growth. For now, projections place the greatest impact in the United States, yet not exclusively.

Financial markets have absorbed the impact adequately, with important reactions in the first half of April. But there have been unusual movements, such as those of U.S. assets. The dollar weakened, the stock market fell, and long-term rates rose, while in the rest of the world and emerging markets interest rates fell and currencies appreciated. This time investors did not hedge in U.S. assets. And this time financial conditions did not tighten for emerging markets, which is what would have been expected in a global risk aversion event such as this. We will have to wait and see if these developments are sustained and how they impact the economy. For now, it is a work in progress.

However, it should be kept in mind that this news from the commercial and financial spheres is relevant. Uncertainty has increased considerably, and these kinds of scenarios are always a hurdle for investors and consumers to handle. How big an impact this will have on global spending is still a question mark but be certain that the effects will be negative. I will come back to this later.

Chile in the midst of trade tensions

Being a small, open economy, Chile is faced with many challenges in this scenario.

As I was saying, the combined global developments we have been witnessing have led to a negative perception about the future performance of the world scenario, especially the American economy (Figure 1).

The exposure of Chilean exports to the United States accounted for 16% of total shipments in 2024. The 10% tariff set by the U.S. places Chilean shipments at the lower limit of the announcements, with some products such as copper and timber being excluded for now. Our country remains committed to the free trade strategy it has pursued for the past three decades.

It's also important to emphasize also that local banks have a limited exposure to companies that could be directly affected by the tariffs imposed by the United States. As shown in a box in our Financial Stability Report we published on Monday, if we consider both, those companies that export to the United States and those that supply them with inputs, their debt with banks amounts to 2.7% of their commercial portfolio as of the end of 2024. This excludes sectors not affected by tariffs at the moment. In any case, we must bear in mind that this exposure becomes relevant when the entire portfolio of exporting companies and their suppliers is considered (17.1%). Nevertheless, we must not forget sectoral heterogeneity, as some sectors' sales abroad are the most significant component of their activity while for others this channel has no direct impact.

However, so far, the effects of the change in the global scenario on activity and inflation are still unclear. On the one hand, there will be lower external demand as our trading partners' growth slows. On the other hand, the uncertainty shock will affect the real economy. Nonetheless, the extent of these effects is unknown and for now it is not clear if they are being already internalized by activity, investment, or consumption.

Faced with uncertain scenarios, companies may become more cautious when making investment decisions, opting, for example, to maintain liquidity instead of investing in new projects. Uncertainty could also slow down hiring efforts and job creation, as well as limiting wage growth for employed workers. In households, economic uncertainty typically reduces consumption, especially of durable goods, and increases precautionary savings as individuals perceive greater risks in terms of job security and future income.

Financial markets did experience significant movements, although volatility has eased, and financial asset prices have recovered. In fact, financial conditions have reacted favorably in this episode. However, we cannot dismiss new situations in which markets will be stressed, nor can we rule out a less favorable performance of emerging markets.

Qualitative information collected in the Bank's Business Perceptions Report shows that companies continue to pay close attention to international conditions. However, their perception at the moment is one of concern, rather than a clearly negative assessment of their potential effects (Figure 2).

It is important to note that these events are occurring at a time when the Chilean economy has performed better than expected in recent months. Activity data from the beginning of the year show an economy growing somewhat faster than expected, although partly influenced by the performance of specific supply sectors, several of them linked to exports. Thus, GDP grew 2.3% annually in the first quarter of the year (Figure 3).

On the spending side, first-quarter data show a recovering trend for consumption and investment. Seasonally adjusted, consumption grew in all its components, led by goods. Gross fixed capital formation was stable in all its components at the beginning of this year (Figure 4).

It should also be considered that the Chilean economy managed to correct the significant macroeconomic imbalances that arose during the pandemic. The current account deficit, which came close to 10% of GDP in 2022, has been progressively decreasing, reaching 1.6% of GDP in the first quarter of this year. Similarly, the output gap, which was almost four percentage points in 2021-22, is now virtually closed (Figure 5).

The adjustment of macroeconomic imbalances —that monetary policy has enabled— has also been reflected in the evolution of inflation. After the high levels of 2022 (14.1% annually), in early 2024 it returned to figures consistent with the 3% target. Today it remains close to 5%, mostly reflecting one-off shocks, in particular the gradual unfreezing of the electric bills between mid-2024 and early 2025, after having been kept fixed since late 2019.

The inflation outlook in our latest IPoM sees inflation converging to the 3% target by early 2026. This will be supported by the high base of comparison and the unwinding of several cost shocks that affected our economy late last year (Figure 6). Recent data confirm the inflation outlook we outlined in the last Report, with two-year inflation expectations aligning with the 3% target.

Financial indicators also reflect an improvement in the overall health of the Chilean economy. Contextualizing: the increase in income and savings, along with the reduction in both short- and long-term rates, has led to a stabilization of indebtedness and a decrease in the financial burden. The bigger companies show a greater recovery of financial indicators, such as indebtedness, margins, and financial burden. However, certain sectors continue to lag (Figure 7).

As for the Chilean banking industry, it has sufficient provisions, guarantees and capital to withstand adverse events. The overall banking system has strengthened its capital in the process of implementing Basel III standards and has capital buffers available that enhance its resilience (Figure 8).

Summing up, the Chilean macroeconomic cycle shows a reduction in the vulnerabilities that could affect the economy's capacity to deal with trade tensions and other external shocks in comparison with recent past years. As I will show, this capacity is reinforced by the soundness of the country's macroeconomic and financial policy frameworks and the strength of its institutional structure.

The role of macroeconomic policies and the Central Bank

Over the past 40 years, Chile has strategically opted for commercial and financial openness, as is evidenced by its extensive network of bilateral and multilateral trade agreements. This has allowed it to substantially widen the group of destinations for our exports (Figure 9).

The agreements include free trade agreements (FTAs) with economies such as the United States, China and the European Union, as well as participation in the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP). These have enabled Chile to increase both the volume and variety of goods exported and to reduce its dependence on specific markets, thus boosting its resilience and economic stability.

This strategy is part of a macroeconomic policy framework that has been in place for more than twenty-five years. This derives from the Central Bank's dual constitutional mandate to ensure monetary stability and the normal functioning of the payment system. While the first one is expressed in the objective of keeping inflation low, stable, and predictable most of the time, the normal functioning of the payment system involves striving to safeguard the financial stability and robustness of the payment system.

This framework considers an inflation targeting regime with a flexible exchange rate since the year 2000, that has succeeded in overcoming different stressful situations and has strengthened the Bank's credibility. Its implementation is favorably complemented by a sustainable and predictable fiscal policy and a regulatory and supervisory framework that guarantees the stability, efficiency, and solvency of the financial system, as well as a broad degree of commercial and financial integration with the rest of the world.

This structure, which has been very successful in the past in terms of macroeconomic stability and economic progress, allows the economy to accommodate new global conditions and partially mitigate the impact of short-term volatility of trade flows and financial markets.

In the current circumstances, where there are costs coming from both the new tariffs and their uncertain future trajectory and final destination, the role of a strong institutional framework becomes even more important.

By nature, monetary policy cannot have real long-term effects, and therefore cannot counteract the potential effects of a permanent change in tariffs and the global trade architecture on economic activity, consumption, investment, and relative prices. But it does play a role during the transition, keeping inflation on target and smoothing short-term volatility. It is precisely our two-year target that seeks to be a smoothing factor in the cycle by bringing the economy back to trend within a prudent time frame.

The country's adjustment capacity has been enhanced by the floating exchange rate regime adopted in 1999. In the framework of financial integration, exchange rate flexibility is crucial for an independent monetary policy and to provide room for stabilizing inflation and activity when faced with external shocks.

This was important, for example, during the sharp fall in commodity prices in 2014 and 2015. During those years, unlike many other economies, Chile's Central Bank was able to adopt a countercyclical monetary policy, even in the face of a significant depreciation of the peso. The credibility of the inflation target played a key role, reducing the pass-through from the exchange rate to inflation and allowing for a faster recovery of activity without affecting price stability.

In any case, the steady increase in financial integration has interconnected markets with greater intensity. Today, more local and foreign players participate in our market, which is also shallower than it was a few years ago. In this context, the link between interest rates and currencies has increased. This is a relevant aspect of financial market performance and is part of the background that the Board constantly reviews in its assessment of the state of the economy, with its risks and vulnerabilities.

Aside from its advantage for the independent management of monetary policy, in the face of price and wage rigidities, exchange rate flexibility has facilitated the adjustment of relative prices to real shocks, averting persistent real exchange rate misalignments that might result in higher adjustment costs down the road.

The monetary policy scheme is complemented by the financial policy framework, reflecting the Central Bank's dual mandate. The Central Bank of Chile's financial policy approach is to continuously monitor the state of the financial system, identifying risks related to potential adverse shocks, the vulnerabilities that can amplify them, and the mitigators that can cushion their impact.

In 2019, the implementation of Basel III began in Chile, introducing greater resilience to the banking system, and which will end in December 2025. Chile's General Banking Law approved in 2019, hands over to the Central Bank the decision on the CCyB. This requirement is a precautionary macroprudential measure whose main objective is to strengthen the resilience of the banking system. The gradual construction of this requirement starting in May 2024 will allow for a capital buffer that can be fully or partially released in the face of severe stress scenarios, contributing to reduce the amplifying impact of credit on the economy and, subsequently, to its faster recovery.

It should be kept in mind that proper care for financial stability requires not only an already established scheme, but also continuous improvements. In this sense, as I said, by the end of the year Basel III standards will be fully implemented, increasing the soundness and resilience of the banking system. The banking system has made an orderly transition to the requirements of this new standard, using a variety of instruments to comply with the requirements imposed by the Law.

We have also made progress in developing instruments to improve liquidity management in the financial market, prioritizing the implementation of the Resilience Law. During the first half of the year, we will publish a new regulatory framework for back-purchase transactions (Repos) between banks and private counterparties and will allow the recognition of framework agreements for local and cross-border operations. This aims to increase the levels of legal certainty for carrying out this type of operations, including the treatment of default events, compensation processes, execution of collateral and payment of net balances (or close-out netting) of positions.

Liquidity management will be complemented by enabling new instruments that can be used as collateral in operations with the Central Bank —or between financial institutions. In particular, the use of self-securitized bonds issued by commercial banks, which have underlying instruments from their own portfolio (mortgage loans) and which comply with certain prudential conditions. In addition to these initiatives, the Financial Markets Commission has published a proposal for a regulatory change to reduce, under certain conditions, the risk weightings applicable to both repos and self-securitization transactions.

Another relevant regulatory initiative is to encourage the use of the Chilean peso in cross-border transactions, which has become known as the “internationalization of the peso”. This initiative seeks to facilitate greater participation by non-residents in Chilean currency and local financial instrument markets. To this end, the Central Bank initiated a process in December 2020 to eliminate restrictions on the cross-border use of the peso. This policy seeks to encourage greater use of the peso internationally, which in turn would contribute to financial stability by alleviating liquidity concerns during crisis episodes, reducing counterparty risks, offering new ways to manage exchange rate risk and lowering financing costs for local agents.

On previous occasions, I have mentioned the commitment and interest of the Central Bank in this objective, although we have been encountering frictions along the way, which have been gradually clearing up. Most recently, our tax authority established tax reporting requirements for these transactions through a simplified ID scheme, necessary to open correspondent accounts in pesos, and the CMF is reviewing the process for granting overdraft lines for these accounts.

With the achievement of these milestones, we understand that the last obstacles to advancing the peso's internationalization process have been resolved. Therefore, now is the time for the financial sector to offer the correspondent service necessary to continue the financial integration process.

Be aware that in the event of severe disruptions in international financial markets or sudden reversals of foreign capital flows, the Central Bank of Chile has the capacity to provide foreign currency liquidity to ensure the stability of the financial system.

Concluding thoughts

Although the move toward higher tariffs in the U.S. was expected by the market, the intensity and depth of the announcements made on April 2nd came as a big surprise.

The final outcome of this process remains unknown, as do its impacts on growth and inflation, in both the short and medium term. Nevertheless, the magnitude of the changes already implemented—even without the postponed tariffs—is highly significant. The overall structure of trade has undergone a substantial transformation. Tariffs are now higher than those that prevailed at the end of 1924. Still, the magnitude and timing of the change are aspects we will have to gradually assess.

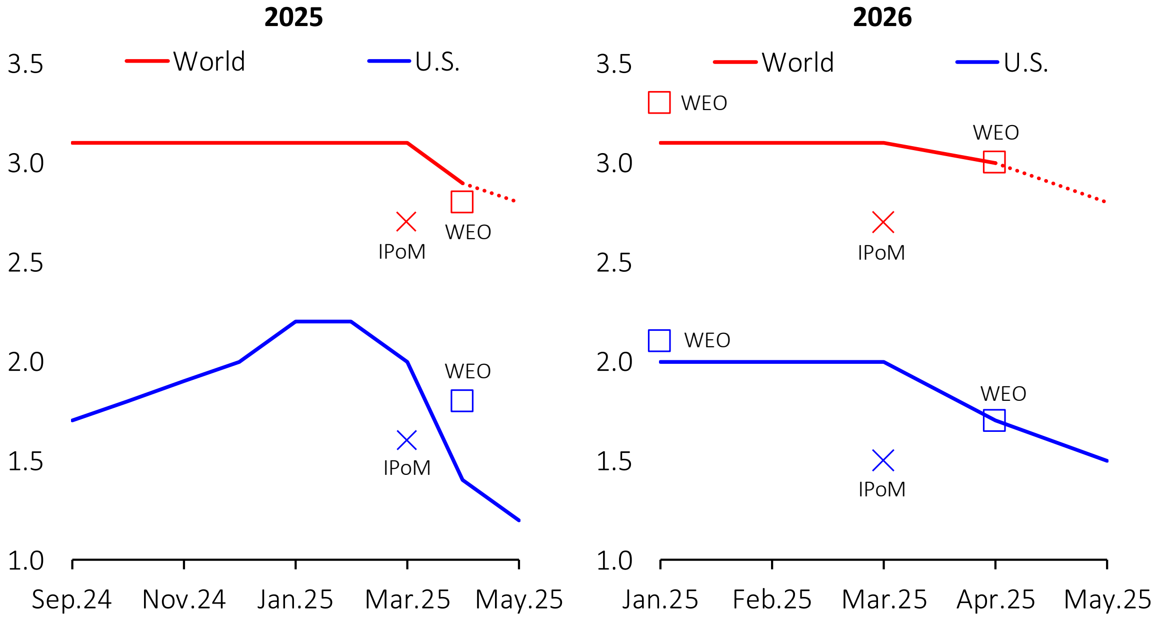
We must bear in mind that, like any change, this can cause distortions and costs, but it can also create opportunities. Beyond isolated sectoral cases, the abrupt contraction of global trade is a negative development. Chile will have to face this scenario by taking advantage of its economic and institutional capacity to manage uncertainty and volatility in the short term, adapting to the new reality in the long term. The Central Bank of Chile can help mitigate the costs of this transition by providing stabilization, controlling inflation, and safeguarding the stability of the financial system.

Thank you

Figure 1

Global and U.S. growth forecast (1)(2)

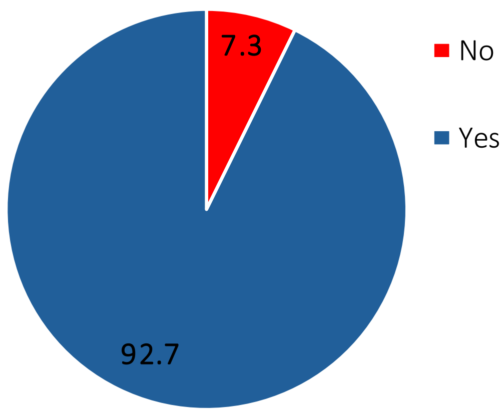
(real annual change, percent)



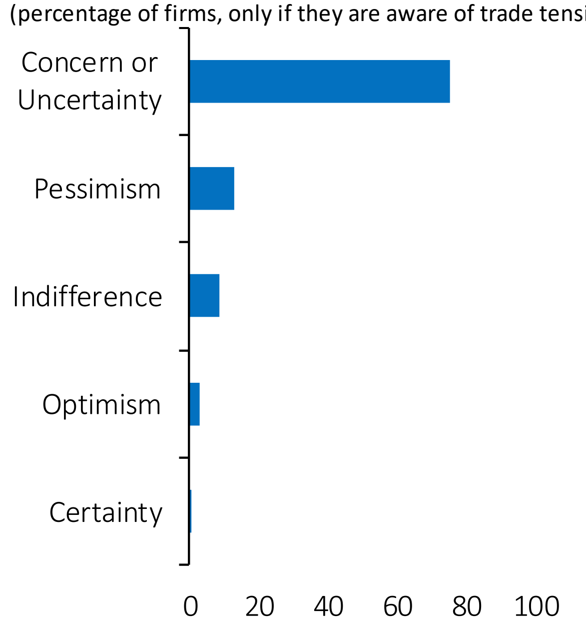
(1) Continuous lines correspond to data from Consensus Forecasts, calculated based on a sample of countries that represents, on average, 86% of the world economy, while dotted line represents 73% of the world economy. For the rest of the world, the weighted average between the growth of advanced economies weighted by PPP and the respective aggregate of emerging economies is considered. The projection for 2026 is available from January 2025. (2) Squares and crosses correspond to projections from the WEO and IPoM, respectively. Sources: Central Bank of Chile, Consensus Forecasts and International Monetary Fund.

Figure 2

a) During the last month, have you heard or read about global trade tensions?
(percentage of firms)



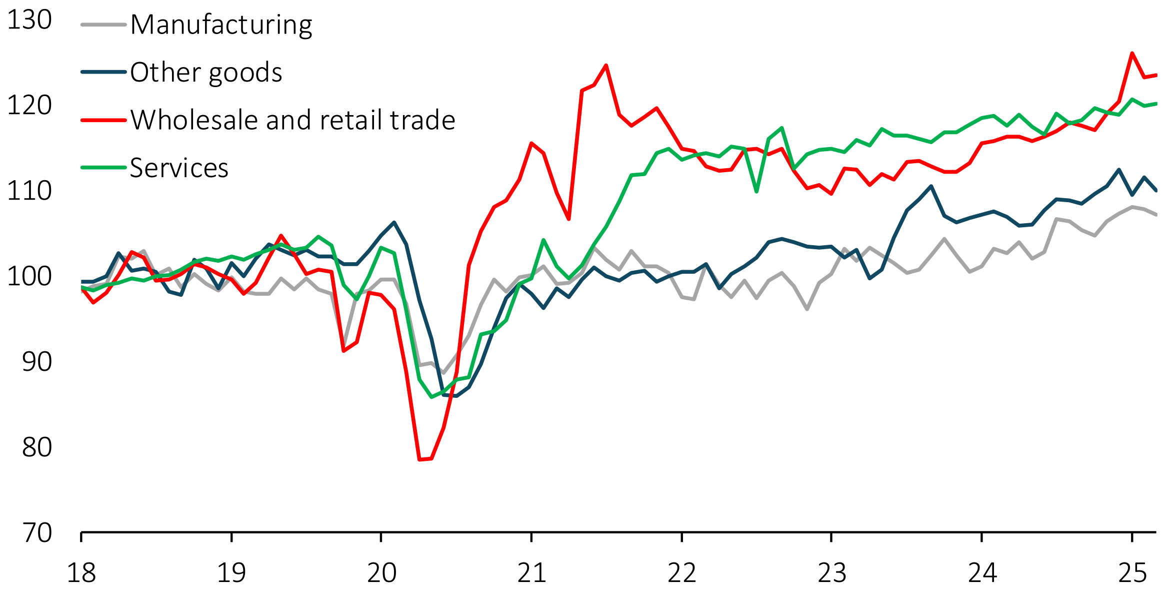
b) Which of the following sentiments best describes your firm's perception of potential tariffs increases?
(percentage of firms, only if they are aware of trade tensions)



Source: Business Perceptions Report, Central Bank of Chile.

Figure 3

Monthly activity (Imacec) (*)
(index, 2018 average = 100, real seasonally adjusted series)



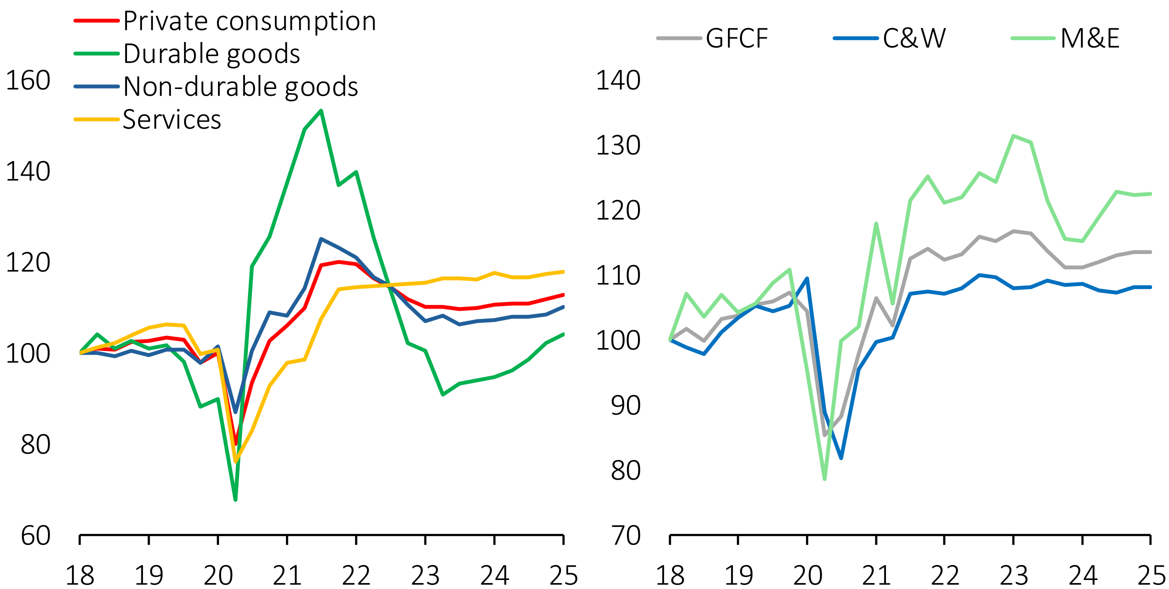
(*) "Other goods" includes agriculture and forestry, fishery, EGW & waste management, and construction.
Source: Central Bank of Chile.

Figure 4

Domestic demand by components

(index, 2018.Q1 = 100, real seasonally adjusted series)

a) Private consumption **b) Gross fixed capital formation (GFCF)**

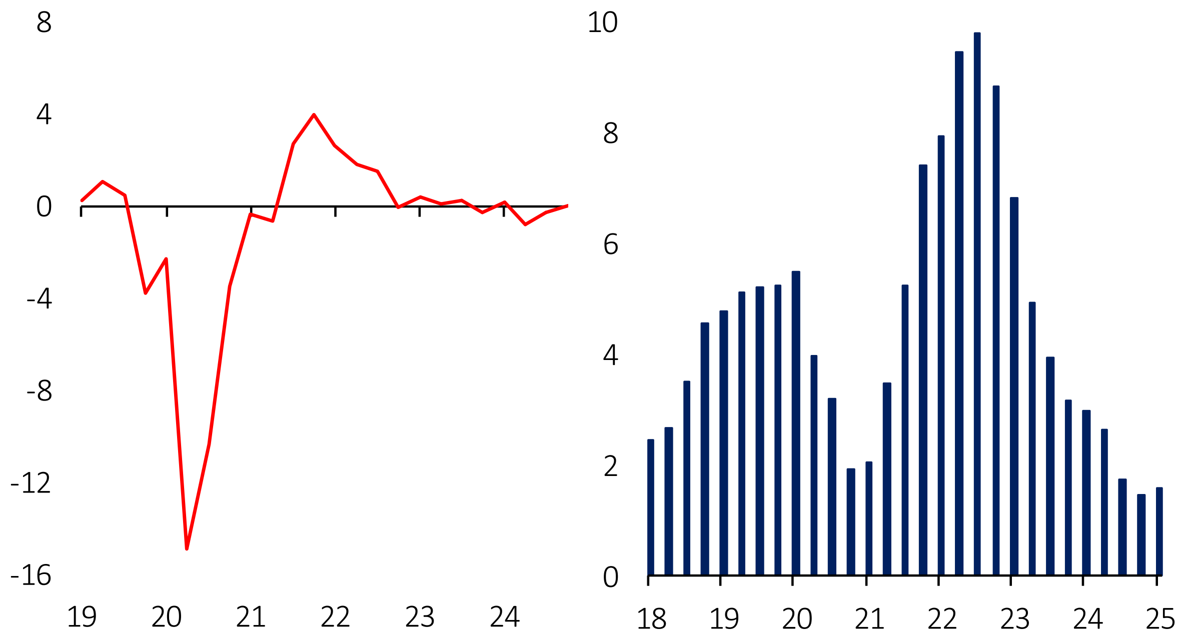


Source: Central Bank of Chile.

Figure 5

Activity gap (*) **Current account deficit**

(level, percentage points) (percentage of GDP, accumulated in a rolling year)



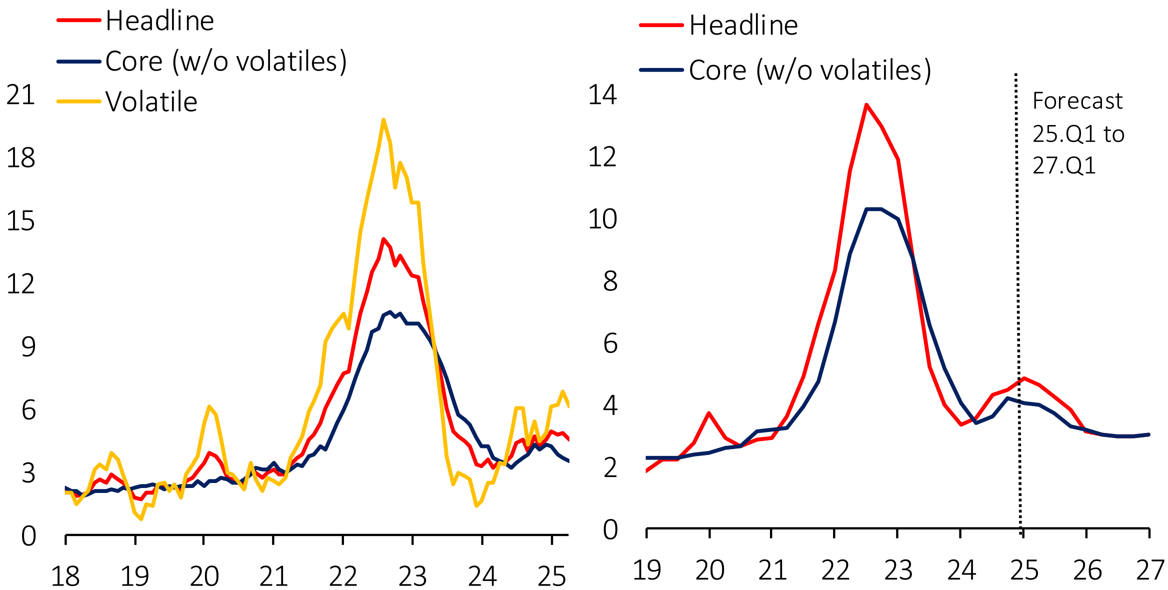
(*) Estimated in the March 2025 IPoM. Source: Central Bank of Chile.

Figure 6

Consumer price index (CPI) (*)

(annual change, percent)

Effective **Forecast**



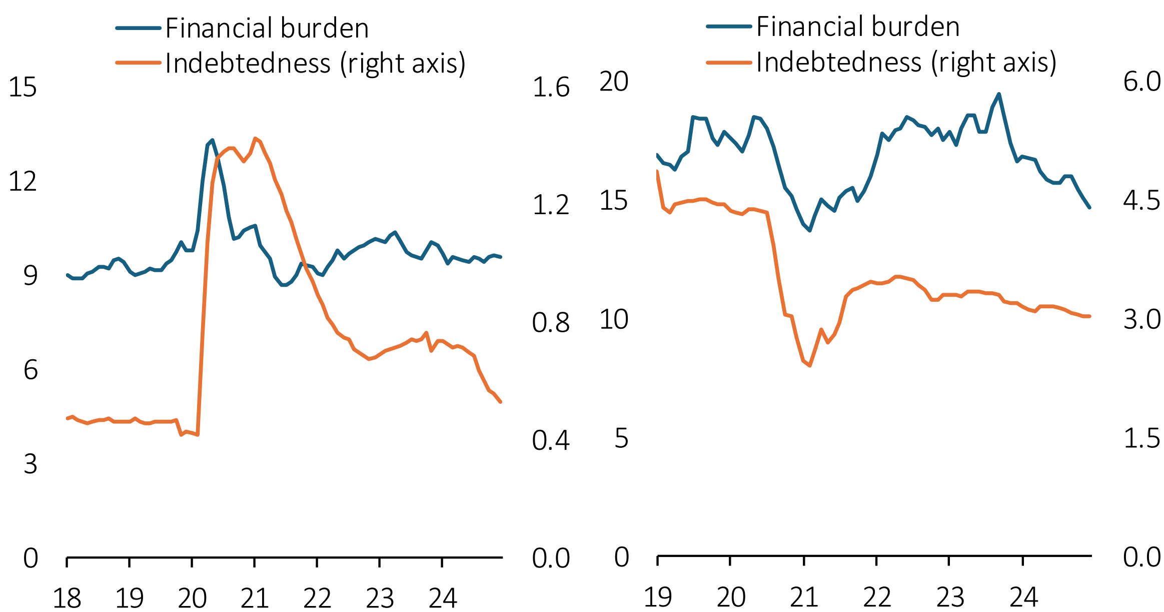
(*) The series consider the CPI’s 2023 benchmark basket and the splicing made by the Central Bank of Chile. Sources: Central Bank of Chile and National Statistics Institute.

Figure 7

Financial burden and bank debt

Firms (1)
(percentage of monthly sales, times monthly sales)

Households (2)
(percentage of income, times income)

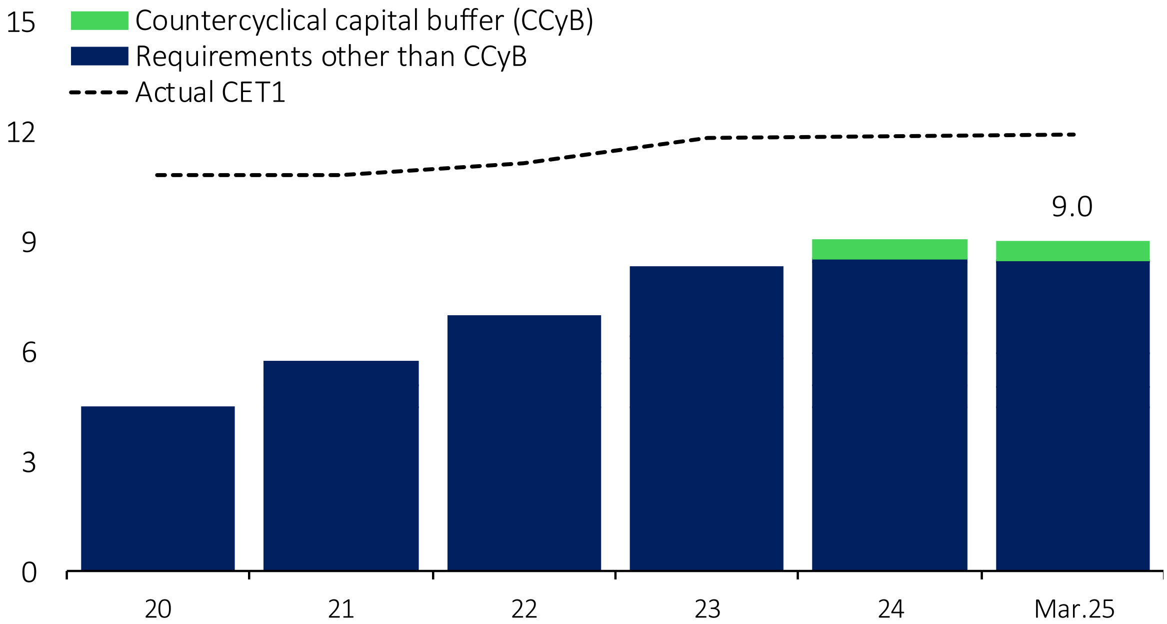


(1) Group median used. Firms with local bank financing, does not consider individuals. Data up to February 2025. (2) Median, quarterly moving average. Data up to December 2024. Sources: Central Bank of Chile based on information from the AFC, CMF, SII and SUSESO.

Figure 8

Basic capital (CET1) and system capital requirements (*)

(percentage of risk-weighted assets)

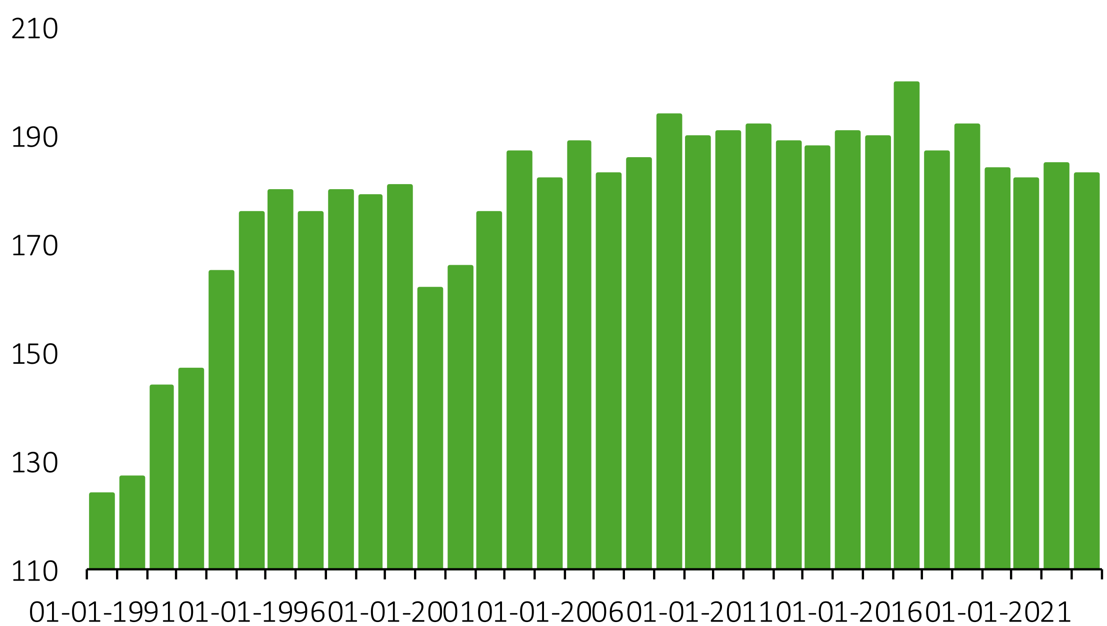


(*) Blue bars correspond to minimum capital requirements and other charges to be completed with CET1 defined by the law. Source: Central Bank of Chile based on information from the Financial Market Commission.

Figure 9

Destination countries for Chilean exports (*)

(number of countries)



(*) Include exports to territories not recognized as countries. Source: Central Bank of Chile.