7th Annual Conference of the Bilateral Assistance and Capacity Building for Central Banks Programme

Policy Panel 2

Impact on financial stability: should fiscal and monetary policy be coordinated, and if so how?

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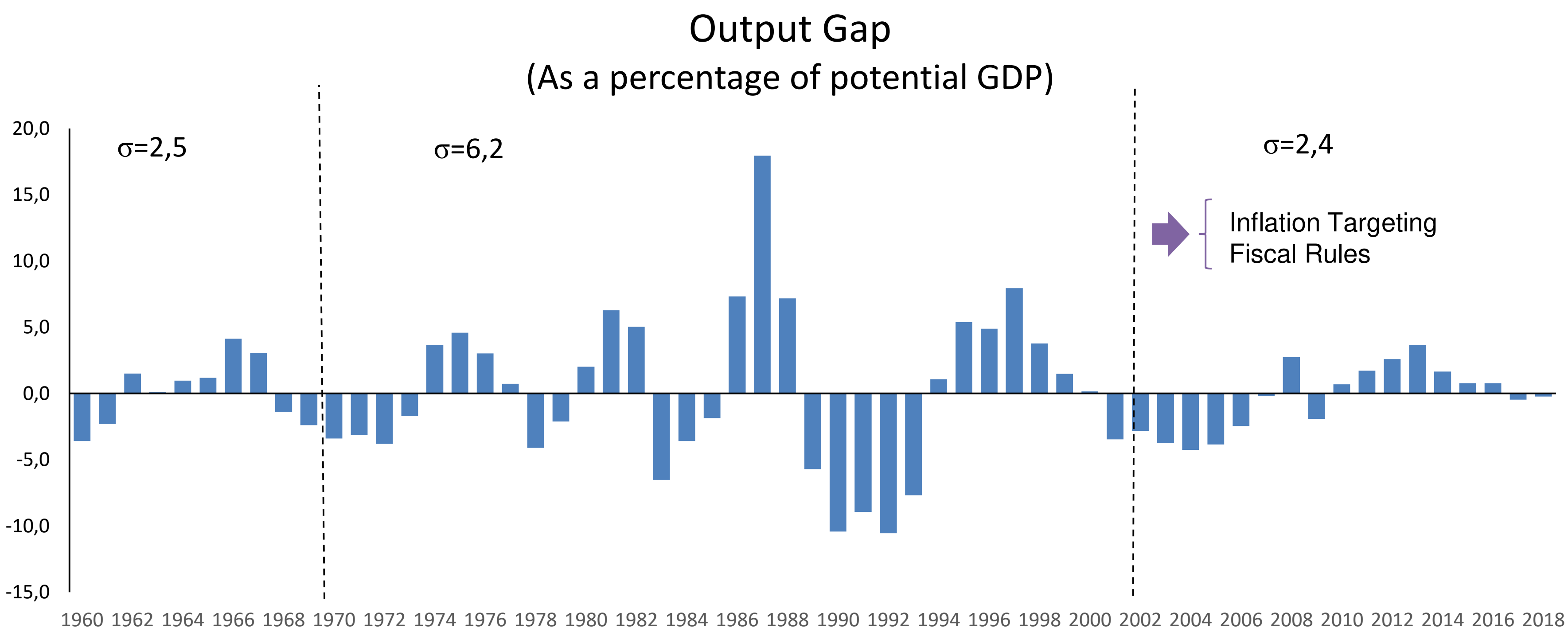
During 70's through 90's cycles were volatile, after the introduction of IT (2002) and Fiscal Rules (2000) volatility was reduced more than a half



Implicit Coordination between an independent Central Bank and the Ministry of Finance through the forecast of both institutions

Fiscal Policy:

Multiannual Macroeconomic Framework:

- August and revised in April next year
- Forecast for 4 years ahead

Monetary Policy:

Inflation Report

- March, June, September, December
- Forecast for 2 years ahead

Institutional Framework: Policy Objectives and implementation

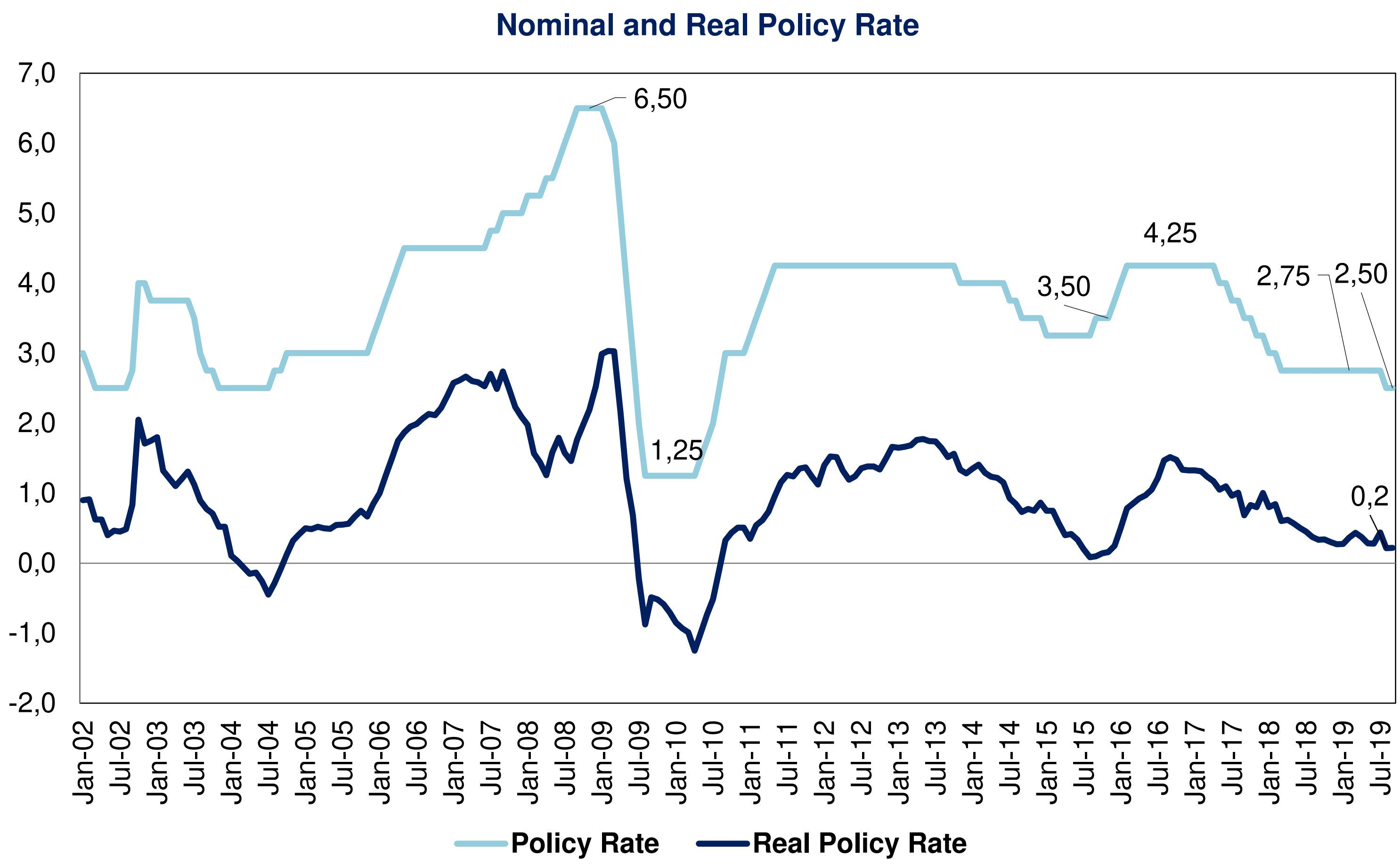
Monetary Policy:

- Autonomous Central Bank with a single objective: price stability
- Public Sector Financing is forbidden
- Inflation Targeting: 2% +/- 1%
- Operational Target: Overnight interbank interest rate
- Monthly monetary policy decision
- Risk management related to credit dollarization: NIR accumulation and reserve liquidity management to sterilize unsustained capital inflows
- Quarterly forecasts

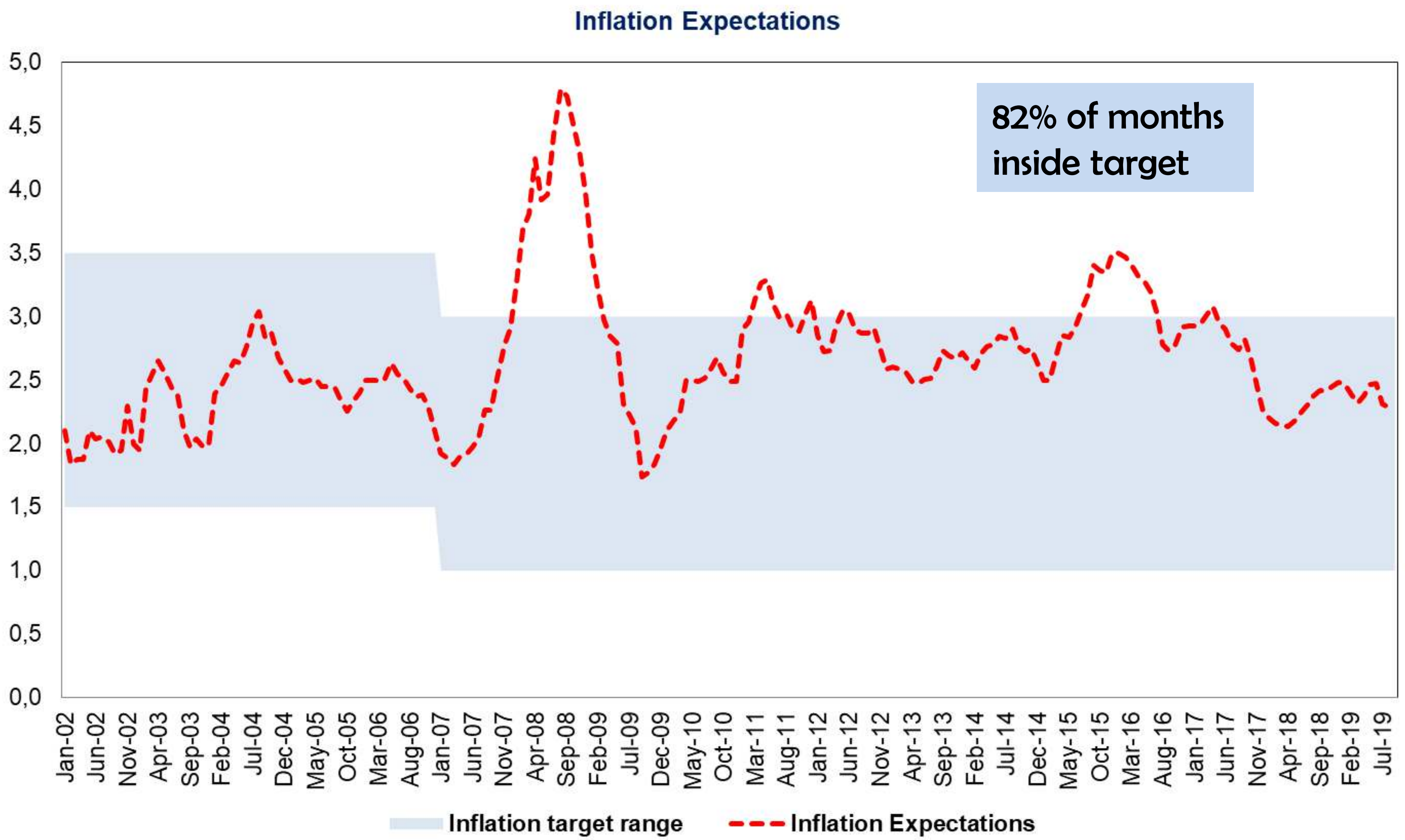
Fiscal Policy:

- Fiscal Rules:
  - Nominal Deficit: ≤ 1% of GDP
  - Non financial expenditure growth: ≤ average GDP growth (20 years) +/- 1%
  - Debt ceiling: ≤ 30% of GDP
- Annual Macroeconomic Framework with a 4 year horizon
- Stabilization Fund for external shocks or natural disaster
- Cash Management Comitee with Central Bank participation

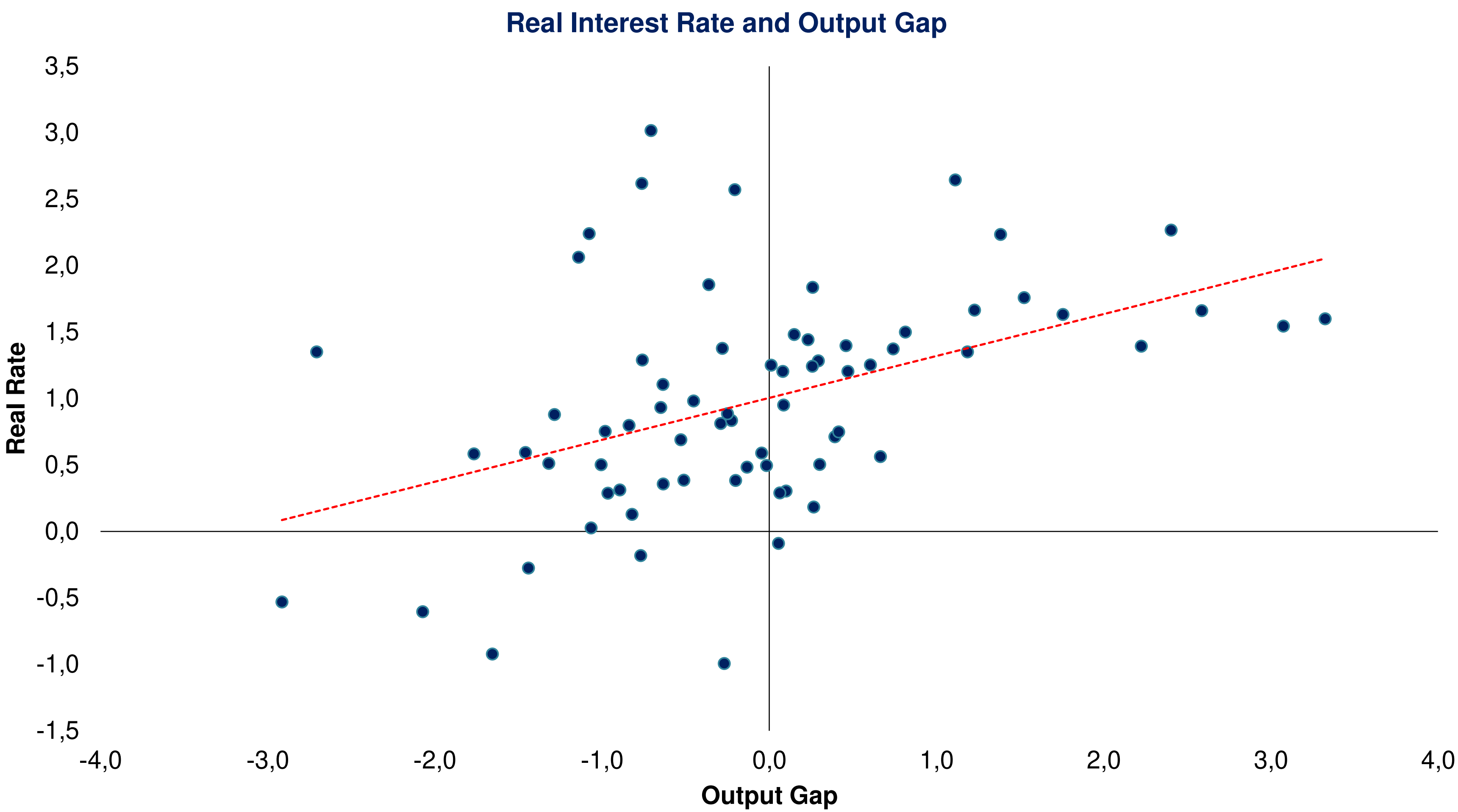
Monthly Monetary Policy Decisions



Inflation expectations have remained within the limits of the inflation target range.

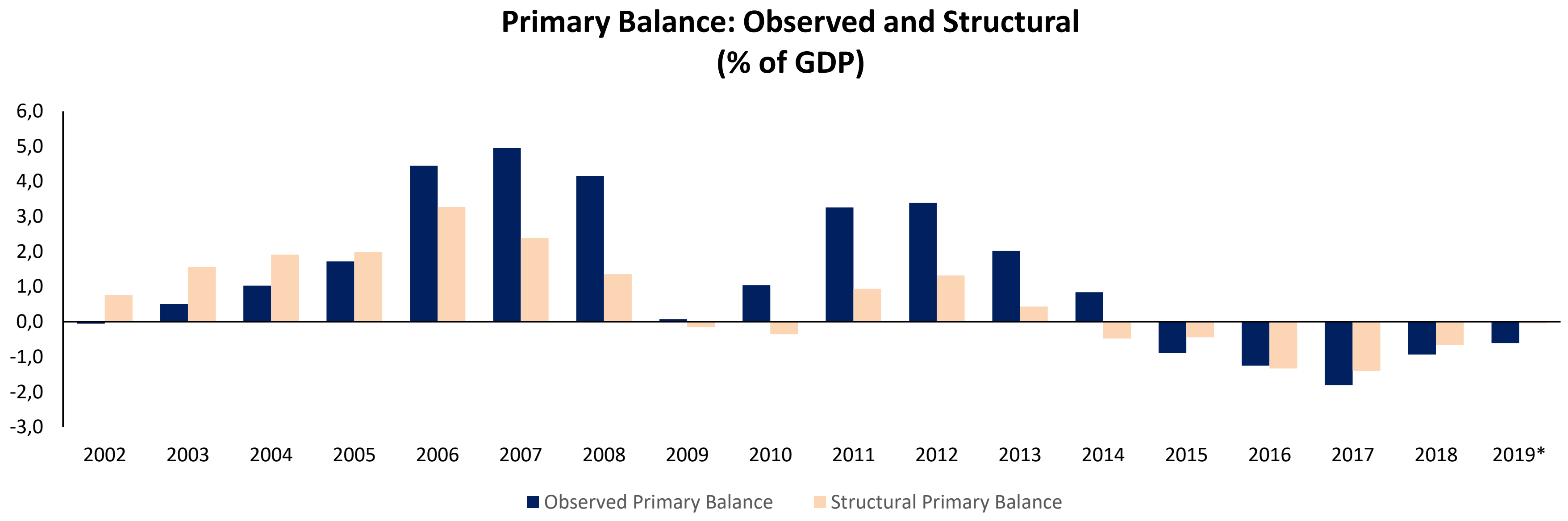


Countercyclical Monetary Policy Stance: increases in real rates as economy overheates



Impact of macroeconomic variables in Fiscal Balance: Structural Balance

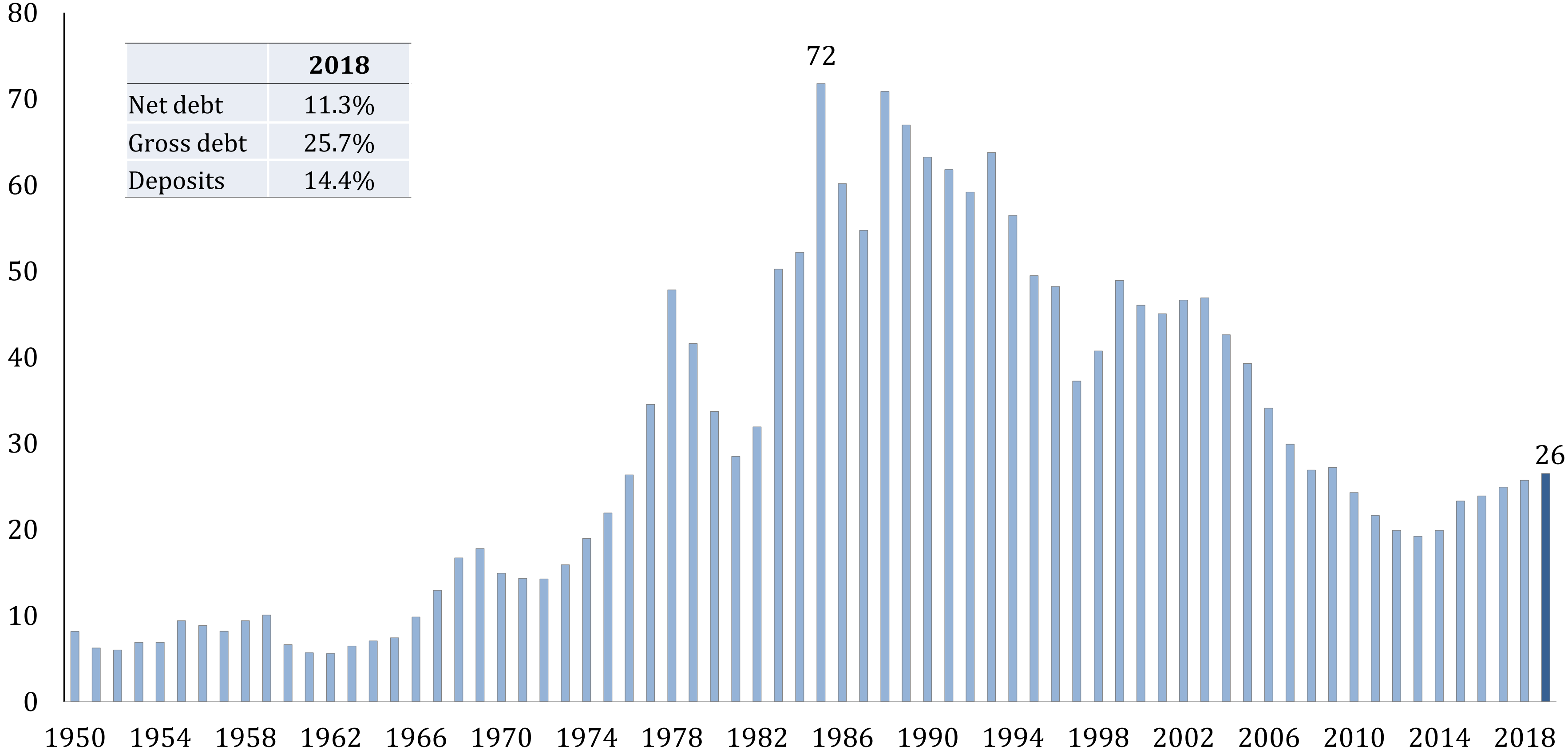
Structural balance discount the Output Gap and Commodity Price effects on revenues



Public debt: From 72% of GDP to a sustainable public sector financing

Public debt
(% GDP)

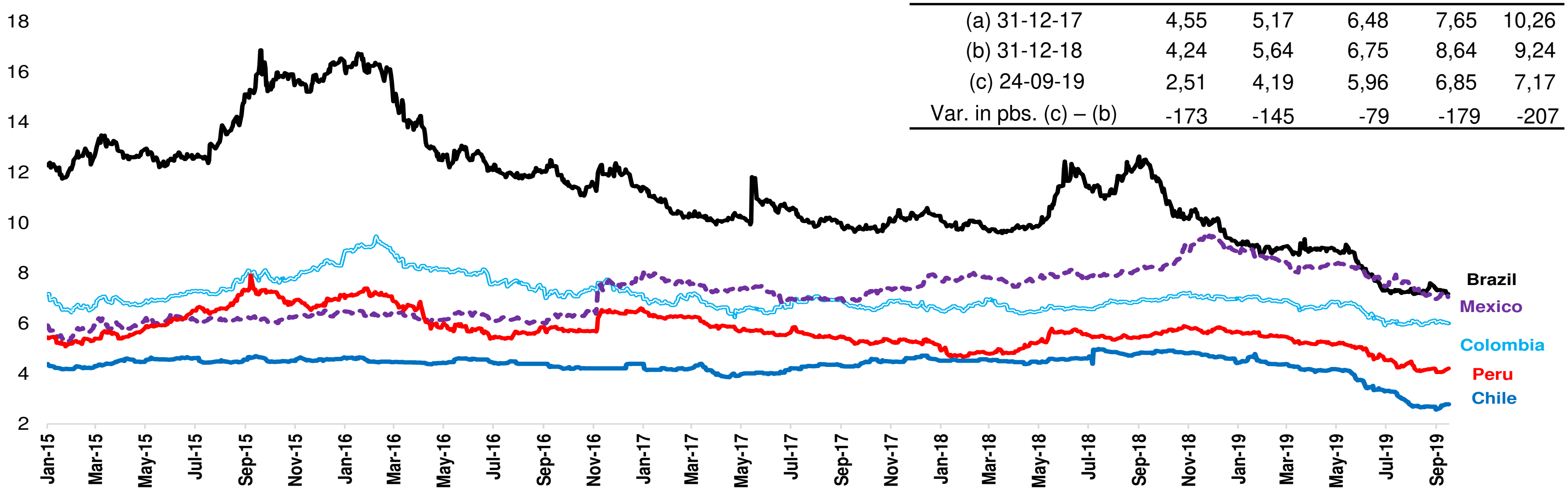
	2018
Net debt	11.3%
Gross debt	25.7%
Deposits	14.4%



Sovereign interest rates are low due to sound macroeconomic policy (low inflation and low debt)

10 Year Treasury Yield in Domestic Currency
(%)

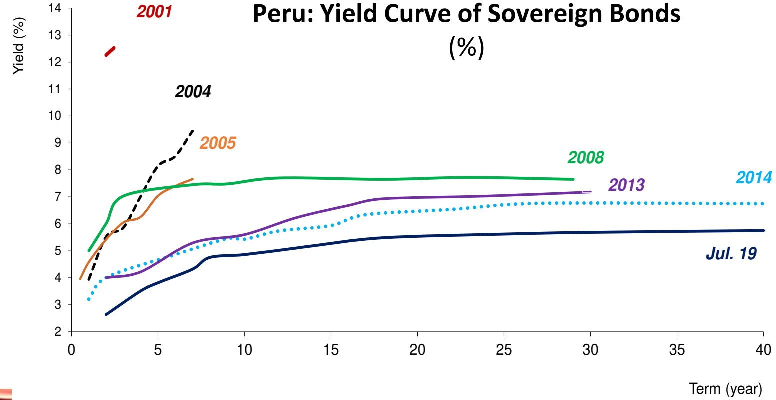
	Chile	Perú	Colombia	México	Brasil
(a) 31-12-17	4,55	5,17	6,48	7,65	10,26
(b) 31-12-18	4,24	5,64	6,75	8,64	9,24
(c) 24-09-19	2,51	4,19	5,96	6,85	7,17
Var. in pbs. (c) – (b)	-173	-145	-79	-179	-207



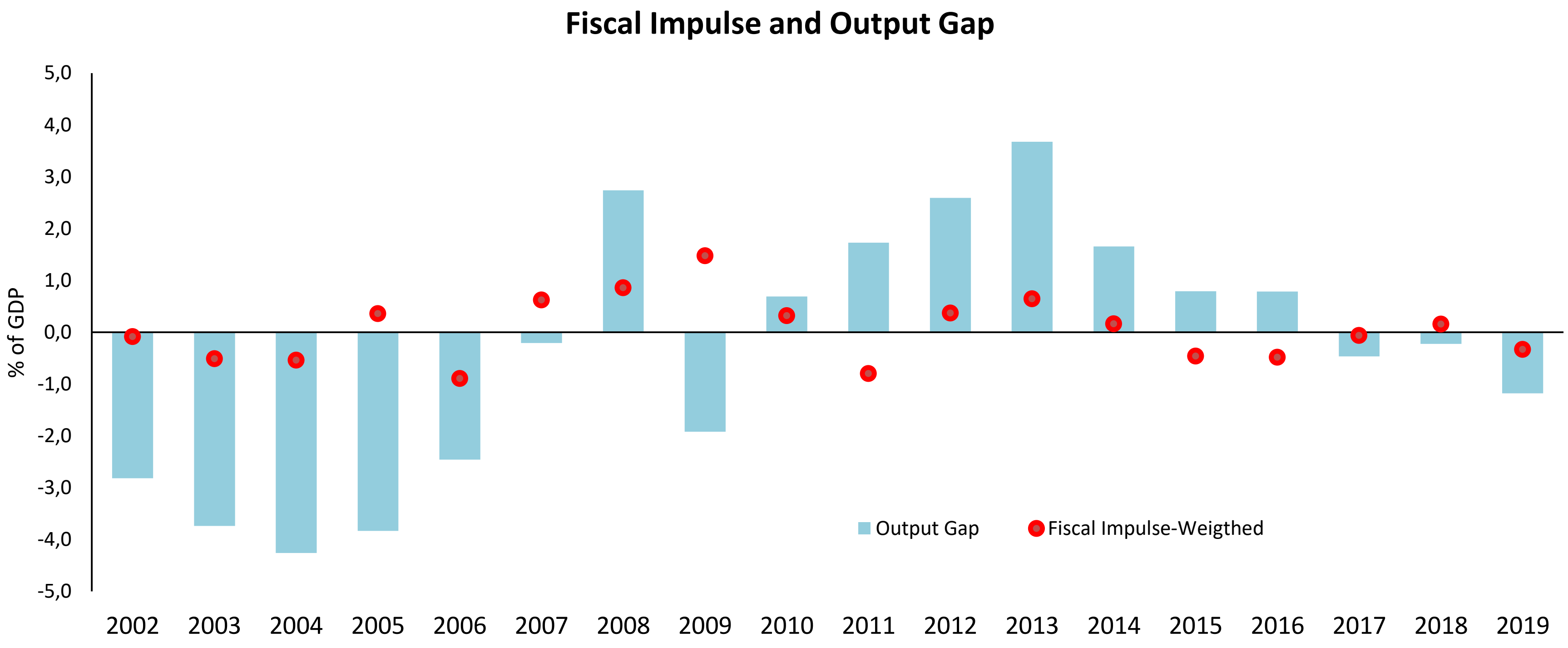
Source: MEF and Bloomberg

Development of the yield curve in domestic currency

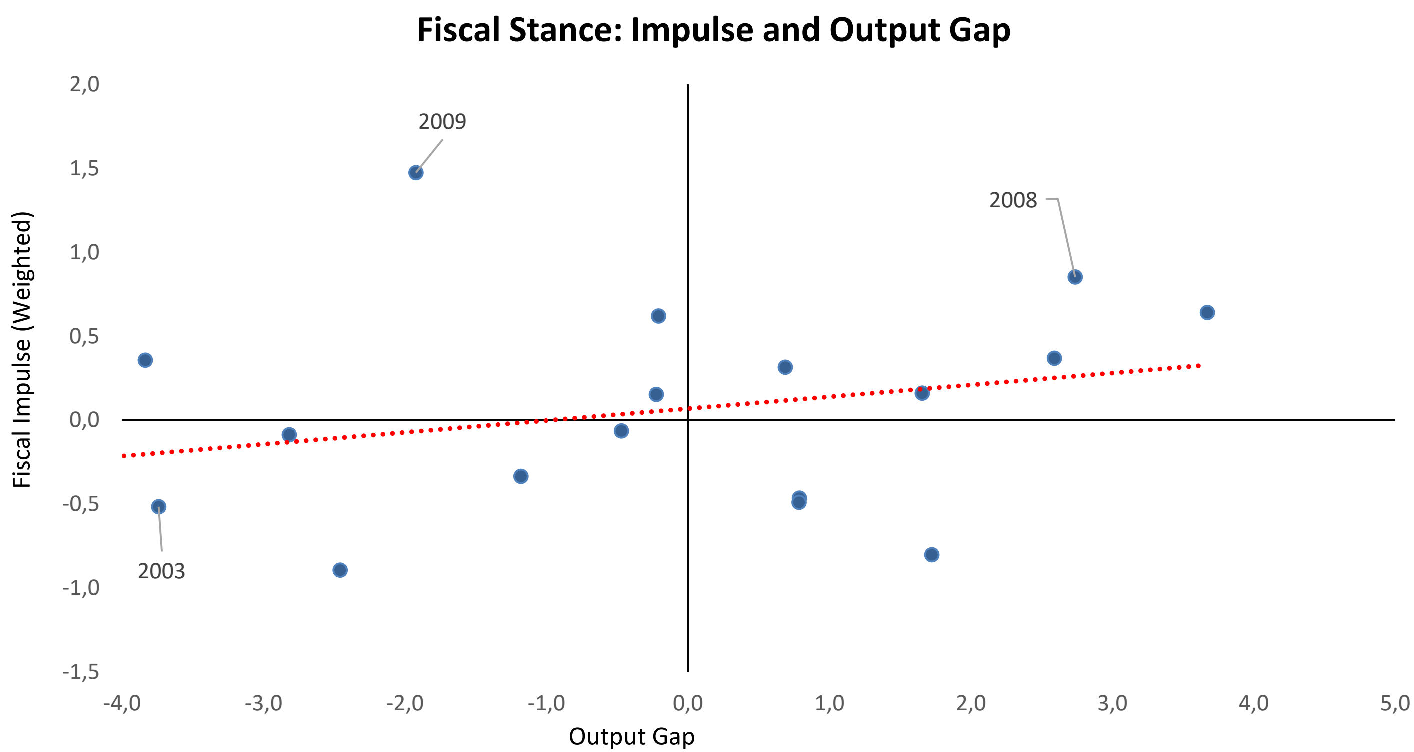
Peru: Yield Curve of Sovereign Bonds
(%)



Fiscal Stance: Change in the Structural Primary Balance weighted by multiplier impact of the fiscal instruments



Fiscal Stance: Episodes of prociclical policy during expansions and recessions



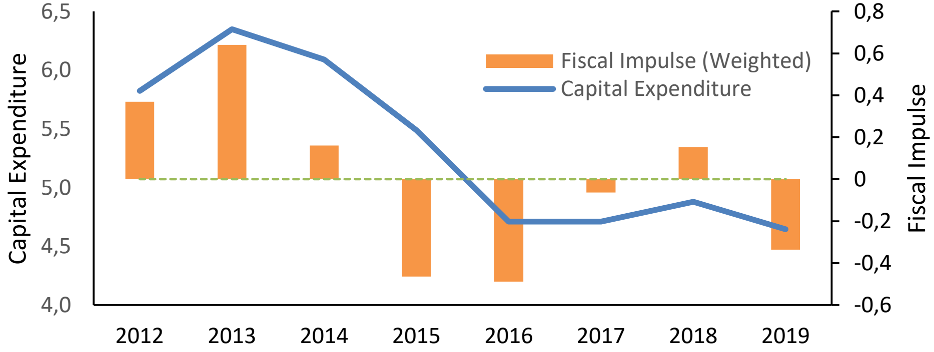
On average some degree of prociclicity in fiscal policy

Determinants of Fiscal Prociclicality: Problems in procurement and Management (mainly Subnational governments)

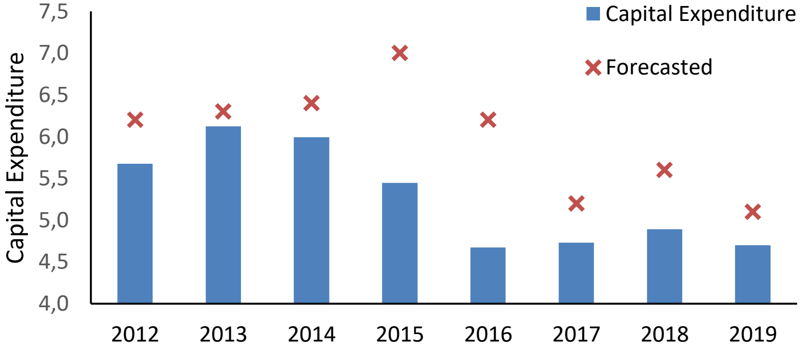
Recent episodes of fiscal contractions in a context of reduction in public investment.

Lower investment than planned due to management problems

Capital Expenditure and Fiscal Impulse
(% Potential GDP)



Capital Expenditure
(% GDP)



Looking Ahead: Reducing Fiscal Prociclicity

- Adopt a countercyclical fiscal rule in which the fiscal impulse compensate the output gap:

$$FI=-a*b$$

where a is the parameter of policy response and b is the output gap.

Therefore the Structural Primary Balance (SR) of the period would be:

$$SR(t)=SR(t-1)-FI$$

- Establish blocks of public investment to be implemented when a fiscal expansion is needed, or postponed when a restrictive stance is appropiated