

COPING WITH SPILLOVERS FROM POLICY NORMALIZATION IN ADVANCED ECONOMIES

Renzo Rossini

Central Reserve Bank of Peru

Geneva, September 27-28, 2018

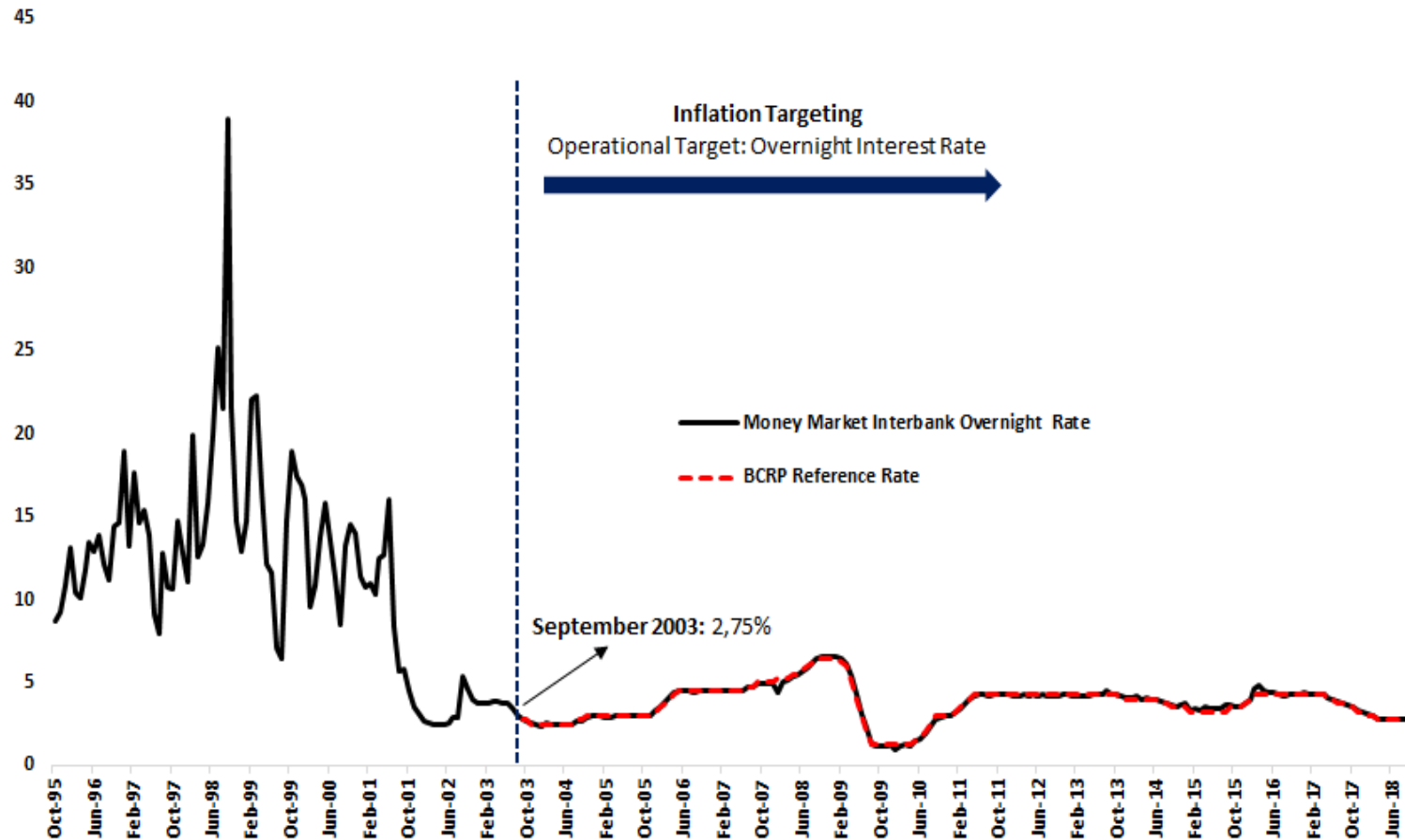
6th Annual Conference of the
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- Inflation targeting and independent monetary policy
- Inflation targeting + : takes into account financial macro stability
- Building buffers to contain capital flows and to retain the policy rate as an effective tool

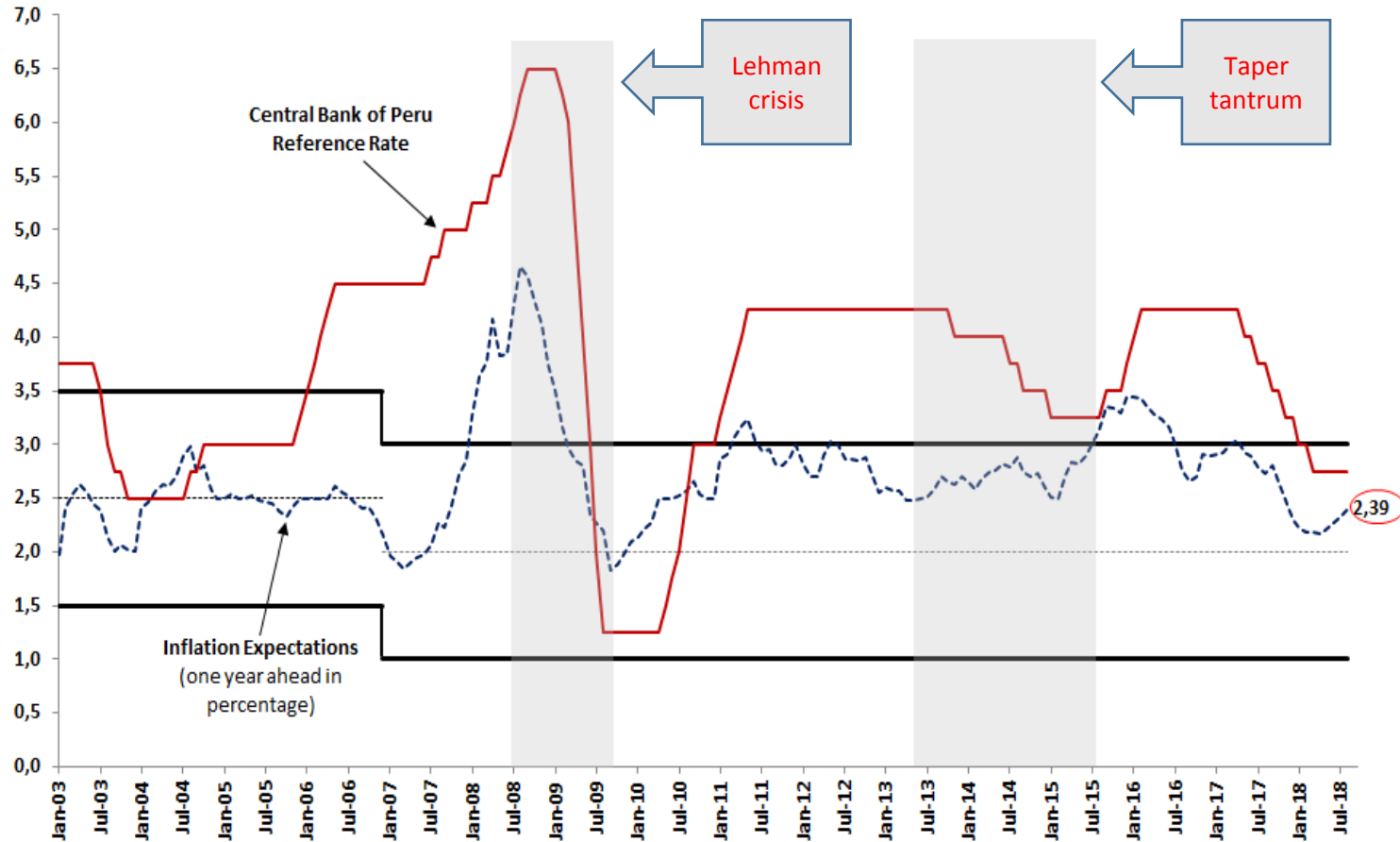
Since its inception in 2002, inflation targeting in Peru reduced the volatility of the interbank interest rate and recover the policy rate as an effective instrument to anchor inflation expectations and to regain the monetary policy as a countercyclical tool.
Prior to 2002, and since 1990, the Central Bank used money base targets.

Peru: Interbank Overnight Rate and Central Bank Reference Rate



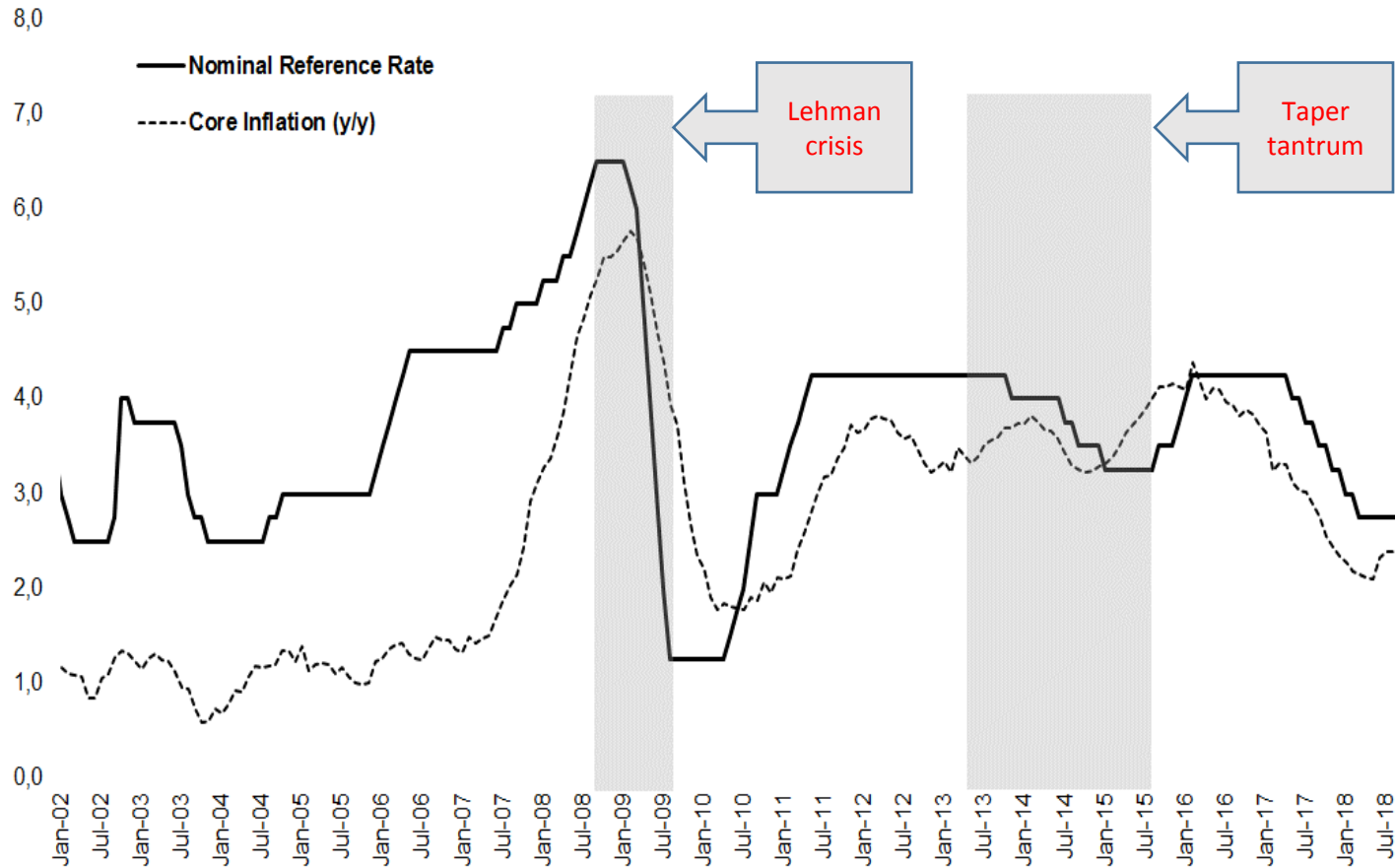
Inflation targeting has been effective in maintaining inflation expectations anchored within the target range (1 to 3 percent) in 82% of the months since 2002.

Policy Rate and Inflation Expectations: 2002-2018



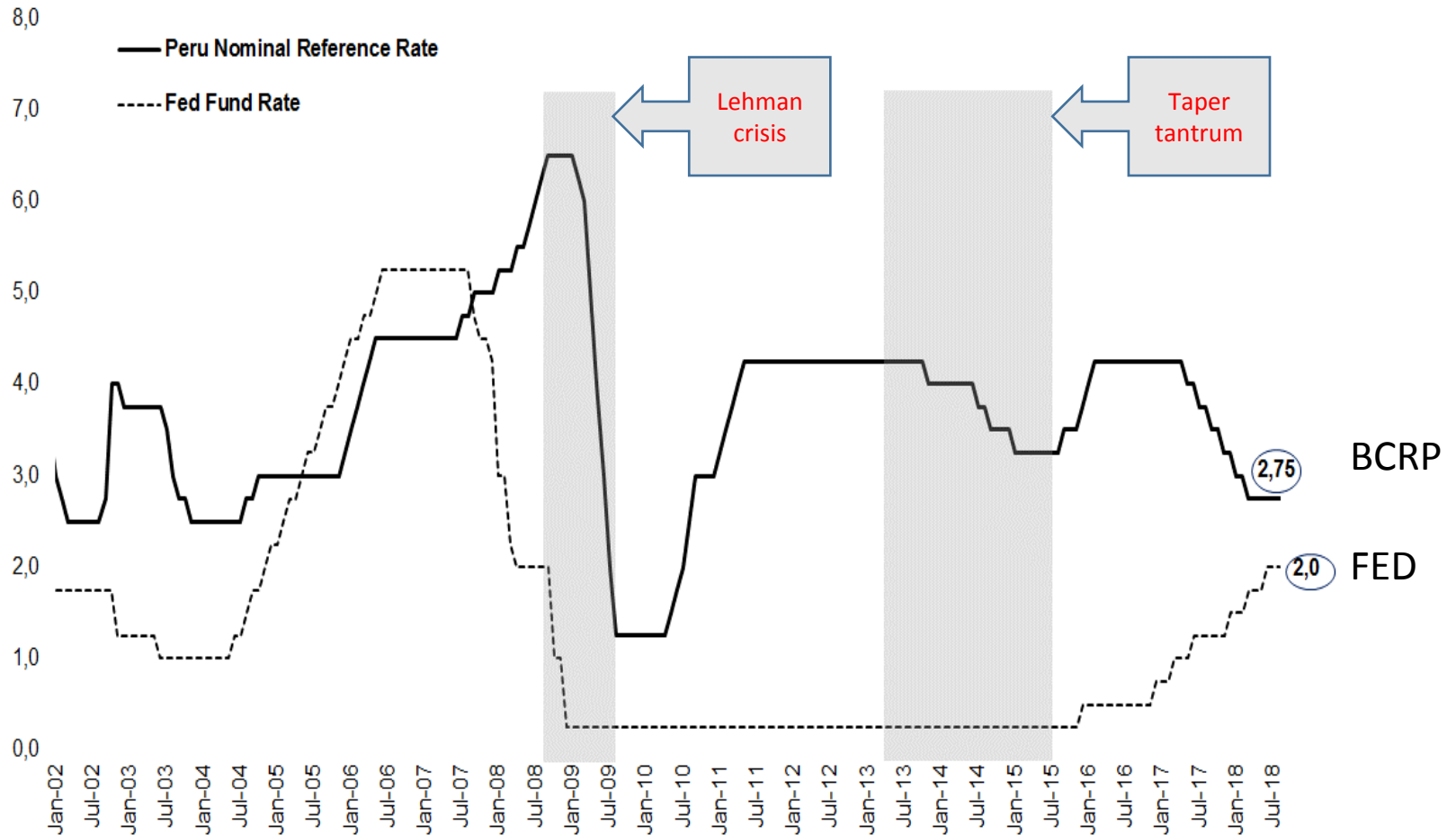
BCRP policy rates changes are highly correlated with core inflation.

Central Bank of Peru Reference Rate and Core Inflation: 2002-2018

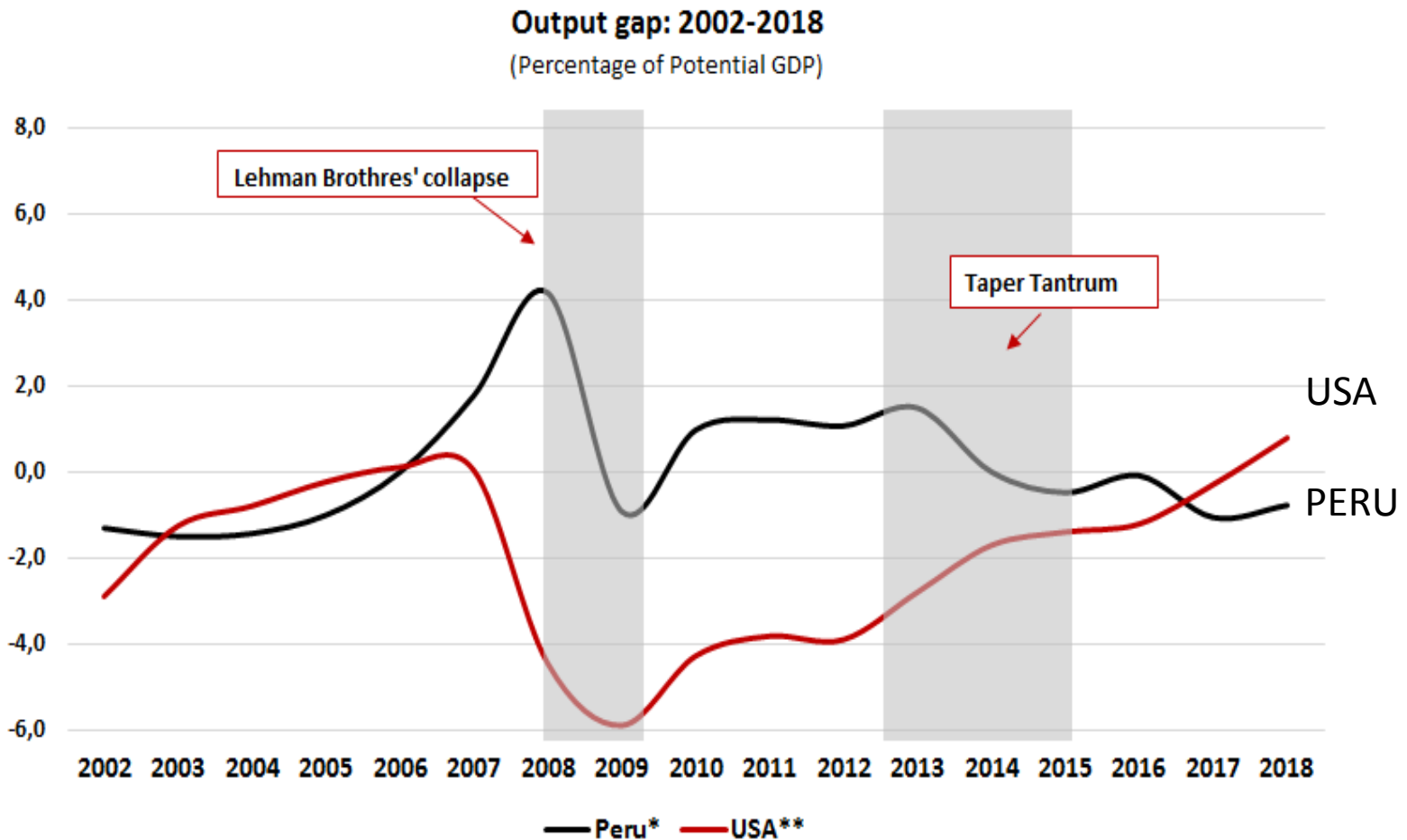


**Independent monetary policy.
BCRP policy rate move in line with Fed Fund rate only when domestic macroeconomic conditions are in line with the business cycle of the US.**

Central Bank of Peru Reference Rate and Fed Fund Rate: 2002-2018



Peru and US output gap moved together during the global financial cycle, but in the opposite direction since 2010.



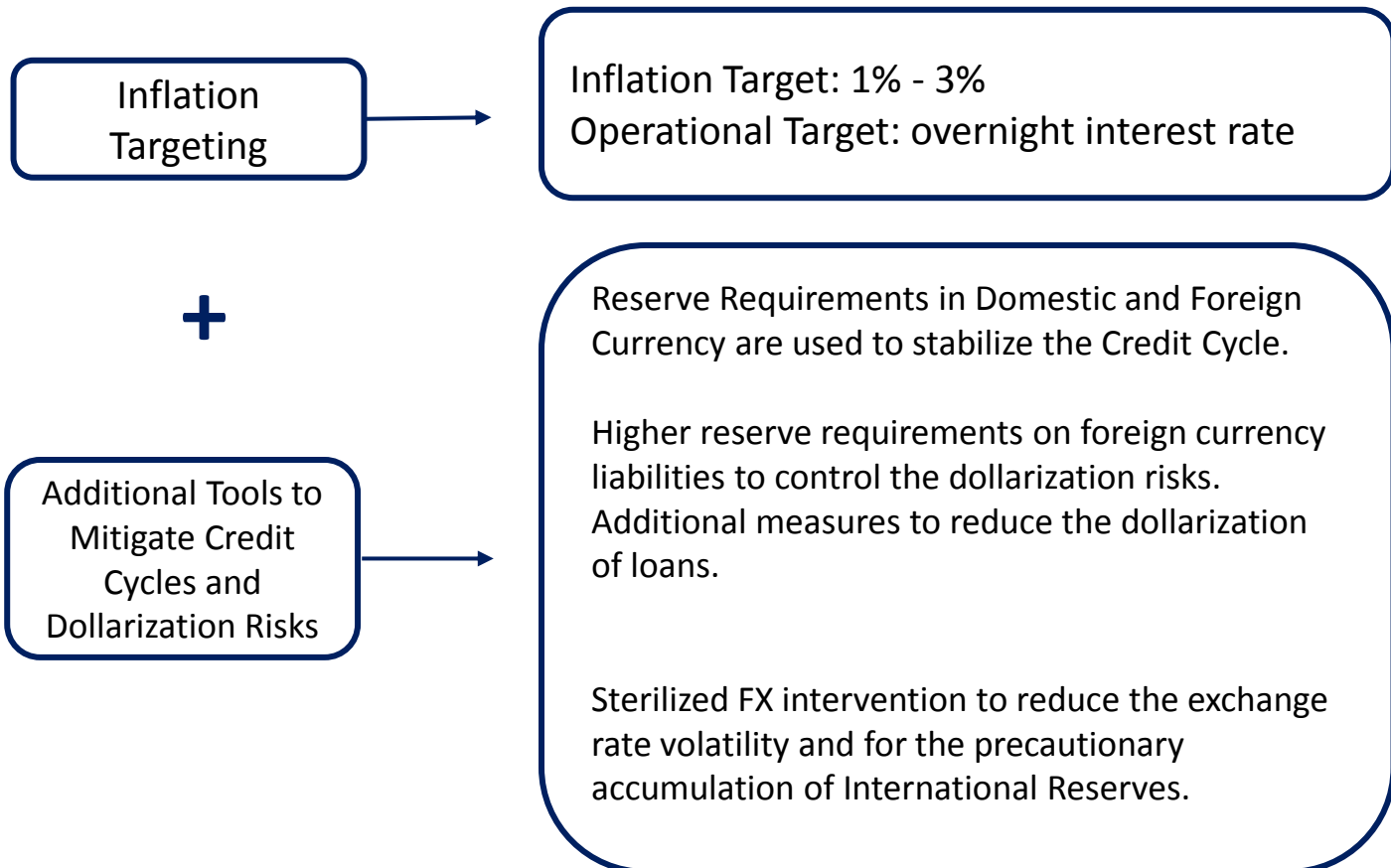
*BCRP

**Congressional Budget Office.

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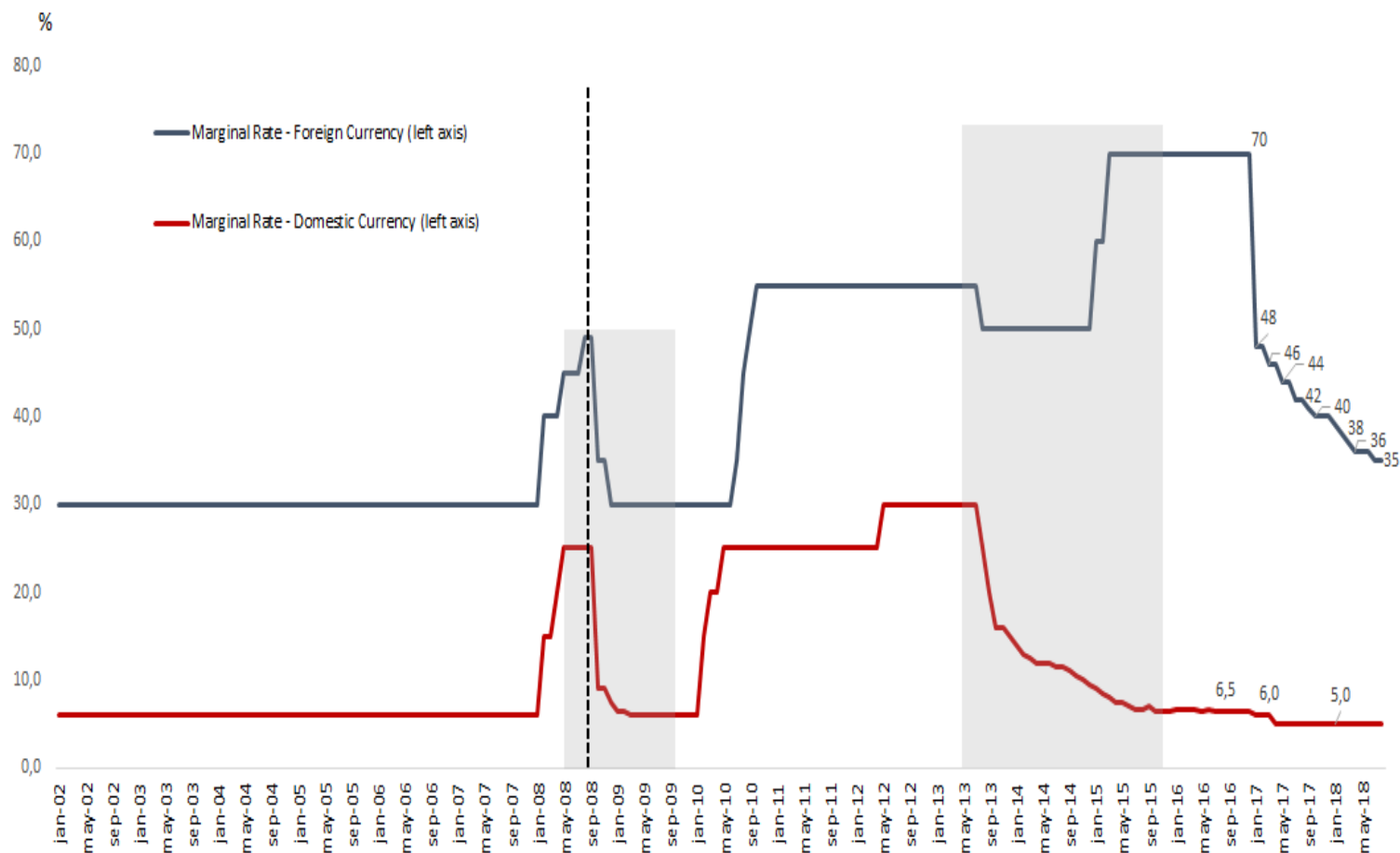
Monetary policy in Peru is conducted considering also macroprudential objectives.

Monetary Policy Framework in Peru



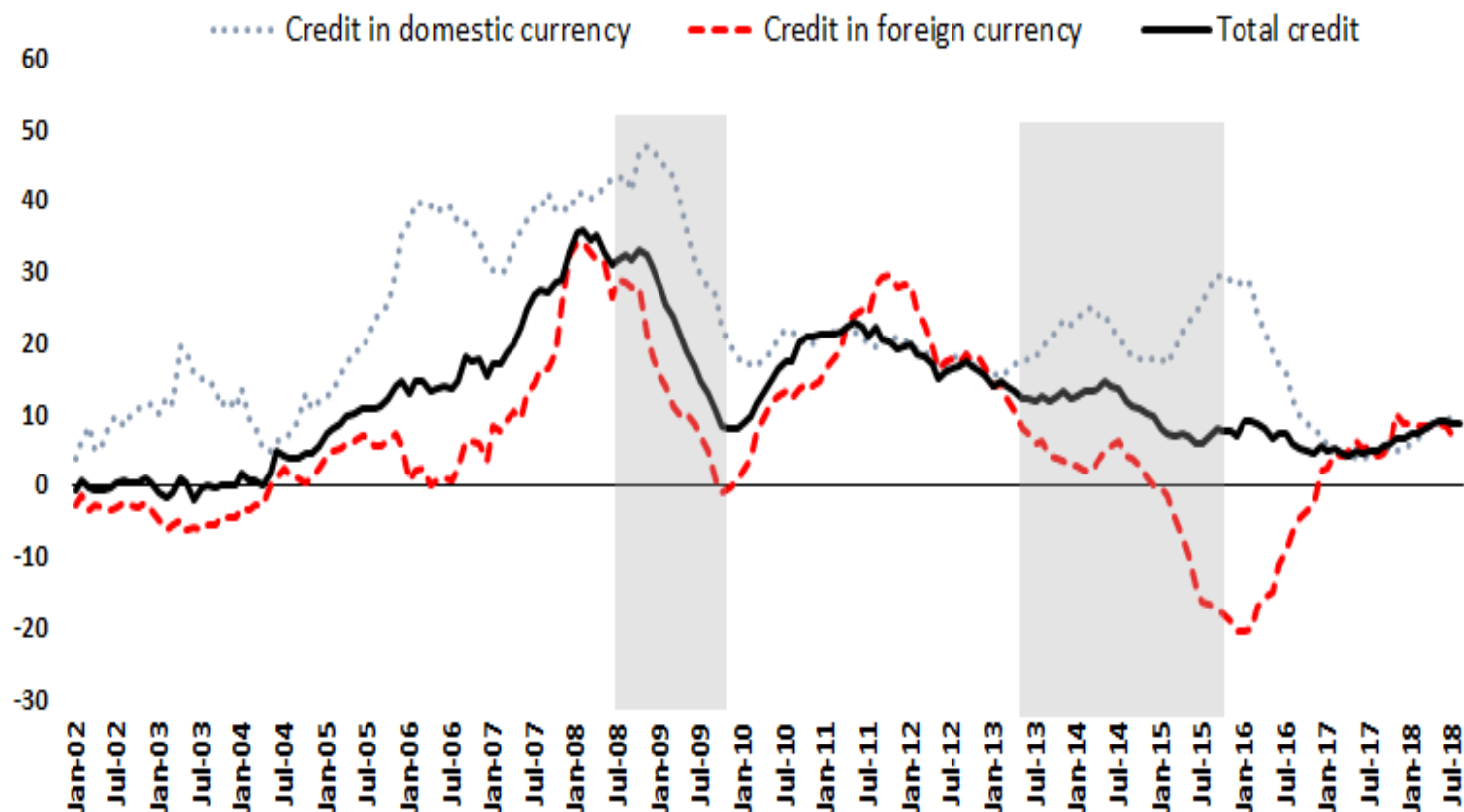
An active use of reserve requirements can limit the impact of the global credit cycle on domestic credit and increase the capability of BCRP to implement counter-cyclical monetary policy even during periods of high financial markets volatility.

Reserve Requirements Rate in Domestic and Foreign Currency: 2002-2018
(as % of total deposits)

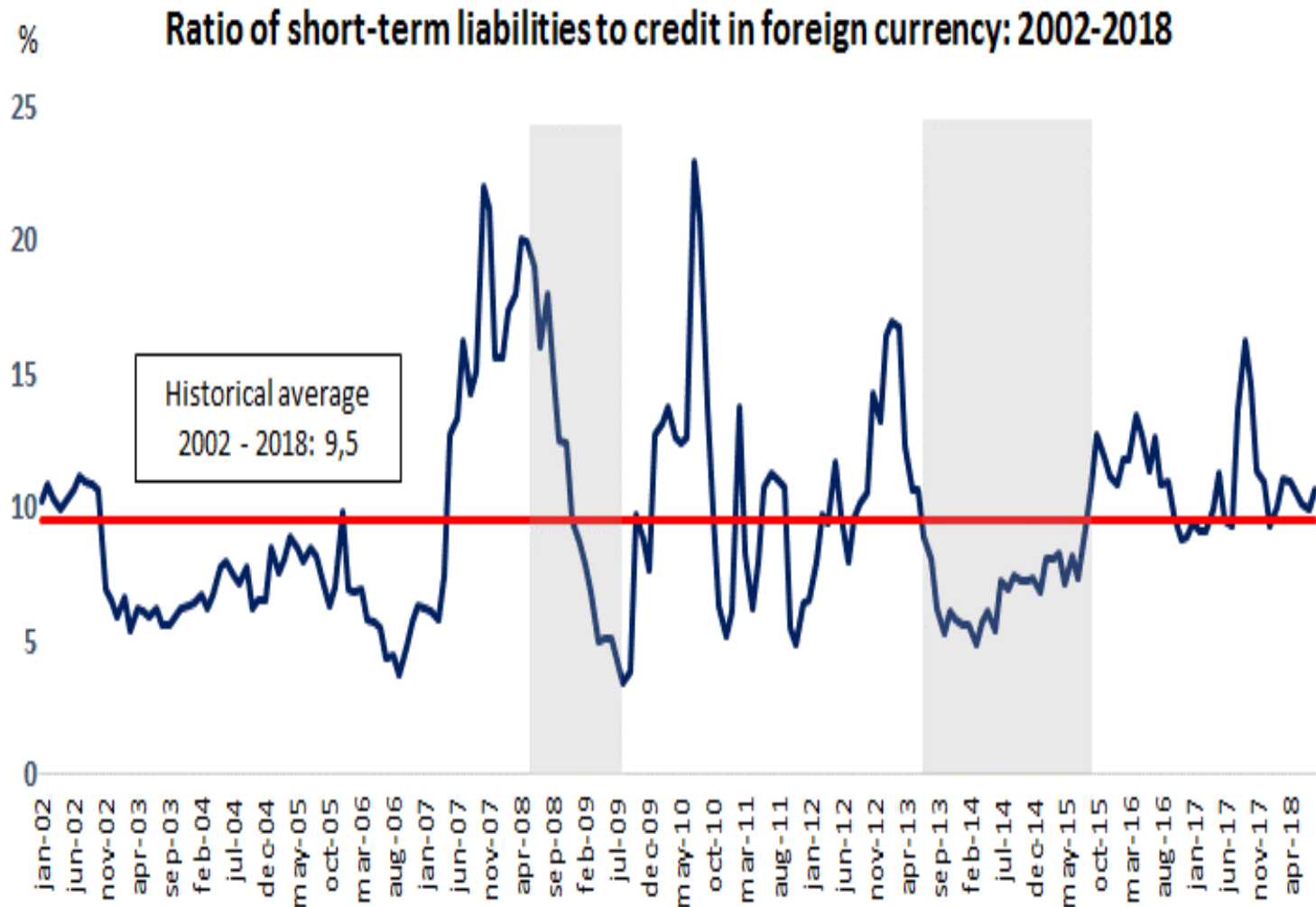


The use of reserve requirements have contributed to reduce financial risks associated with credit cycles.

Credit Growth (yoy change)



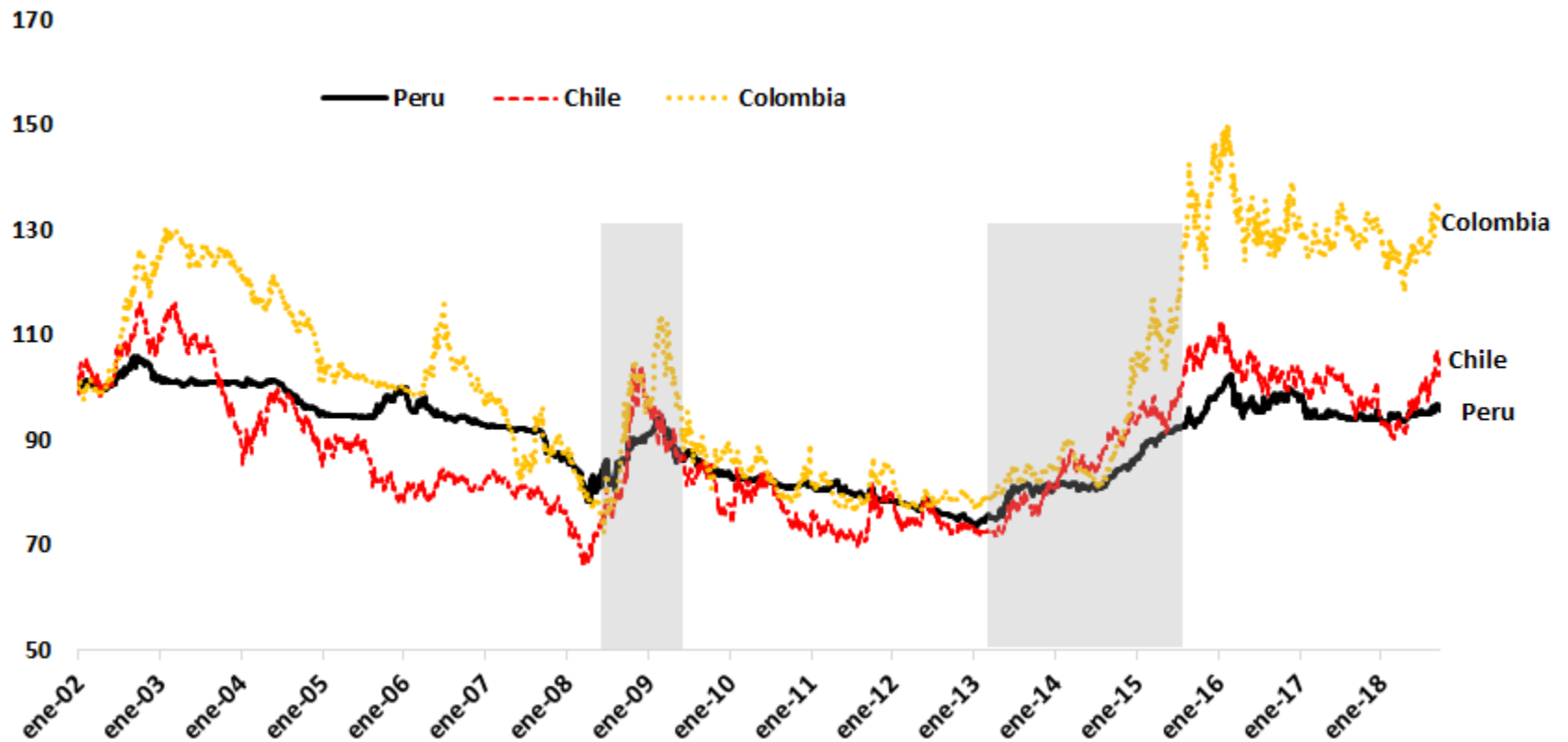
Prudent reserve requirement policies have contributed to reduce the use of short-term bank's foreign liabilities to finance domestic credit expansion.



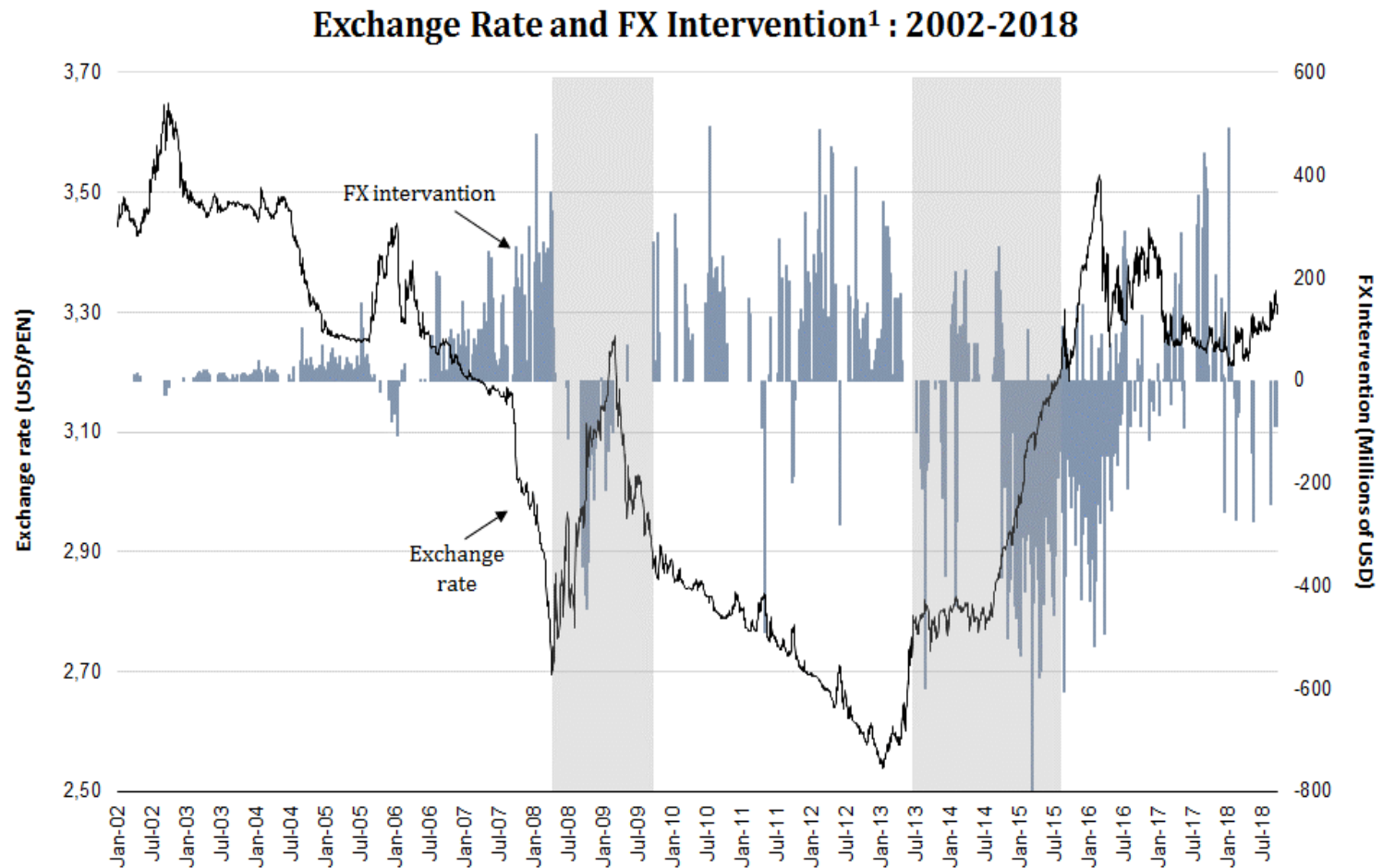
In 1990 adopted a floating exchange rate regime with the possibility of FX interventions oriented to reduce extreme volatility without affecting the trend. The exchange rate flexibility allowed the use of the interest rate as an effective policy tool.

Nominal Exchange Rates: 2002-2018

(02 Jan. 2002 = 100)



Sterilized FX intervention of leaning against the wind has been effective in reducing the balance-sheet risks of balance without affecting the FX trend.

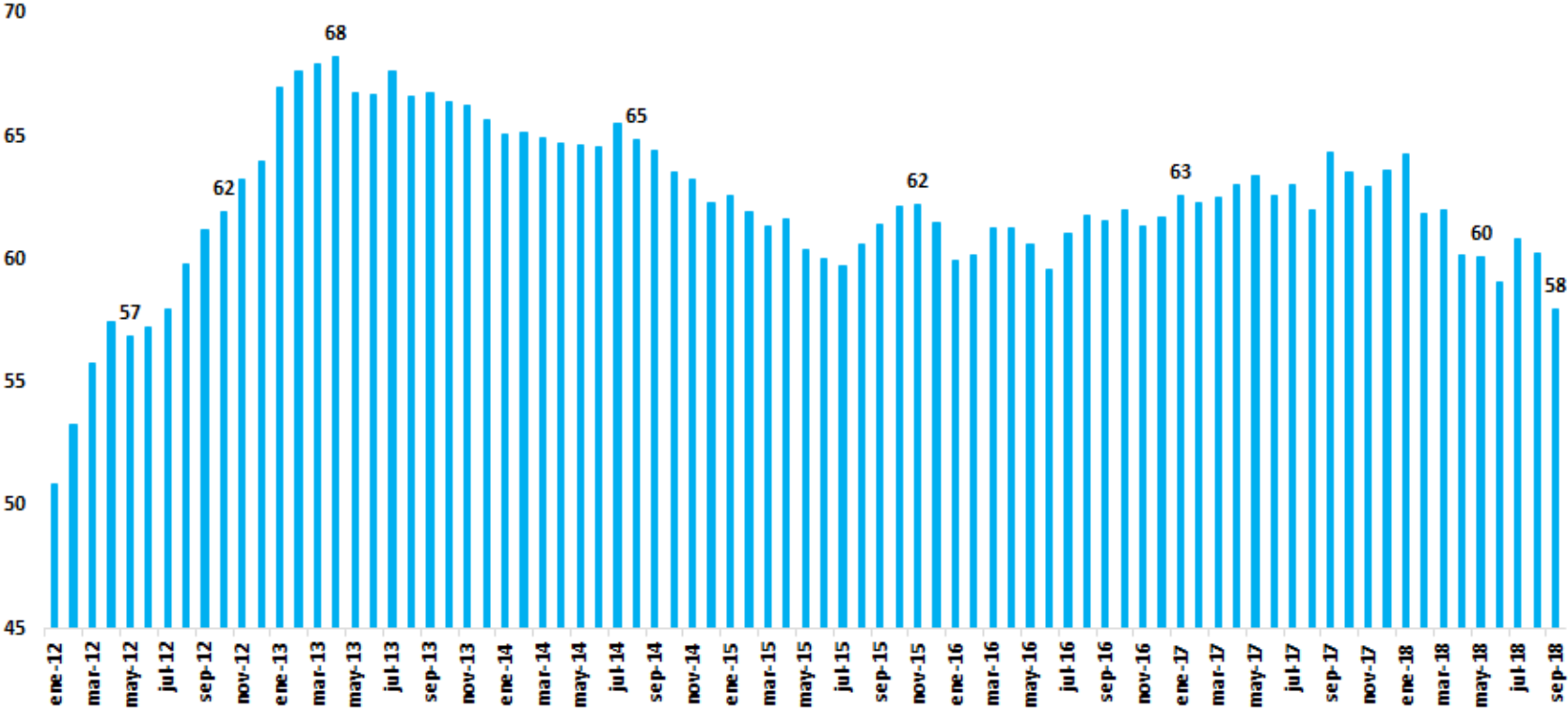


1/ Includes: Net purchases of dollars in the spot market and issuance of CDLD BCRP, CDR BCRP and FX Swaps.

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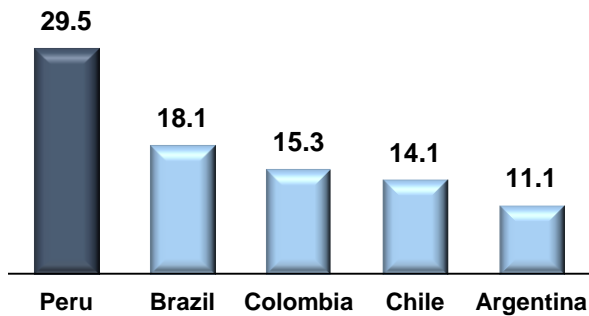
FX reserves as a buffer stock has helped to reduce dollarization risks and the risk perception by market participants about the Peruvian economy

Peru: FX Reserves
(billions of US Dollars)

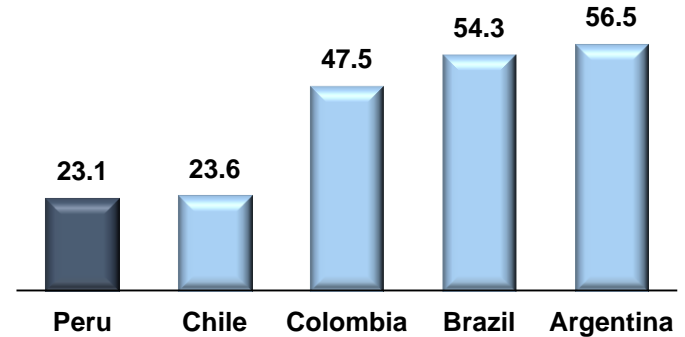


Peru has solid fundamentals that allows the country to soften the effects of financial shocks.

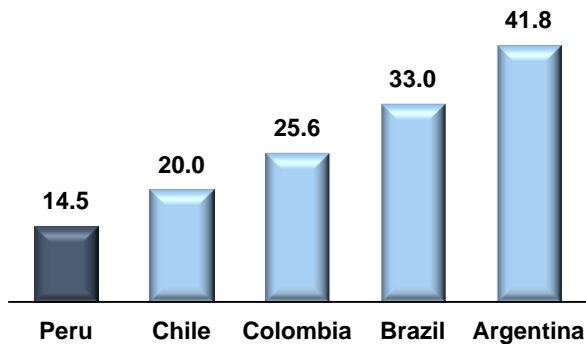
2017: International Reserves (% GDP)



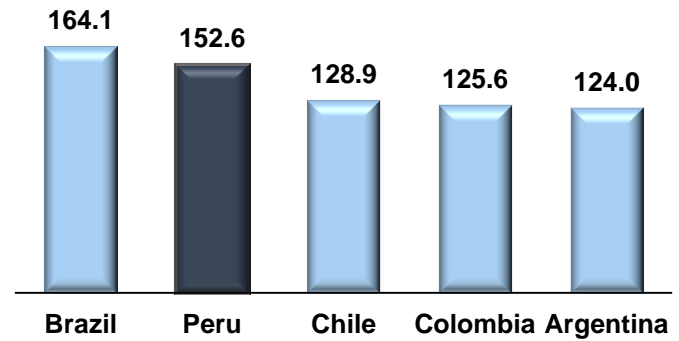
2017: Gross Debt – Central Government (% GDP)



2017: Total Debt Service (% Exports of goods and services)



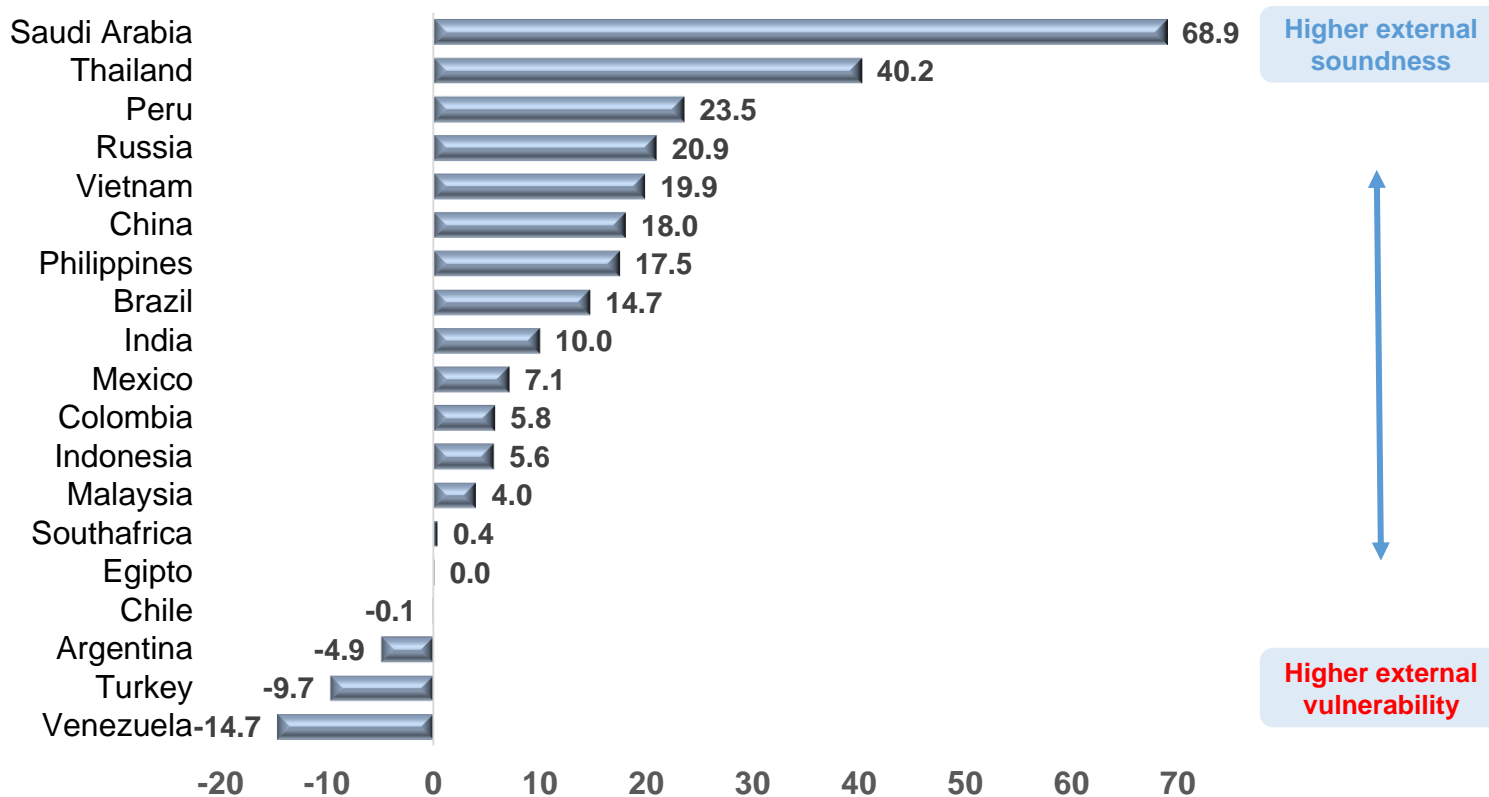
2017: Bank's Provisions (% non-performing loans)



Source: Moody's.

Also Peru has low external vulnerability, as it has high international reserves, and low short-term external debt and current account deficit.

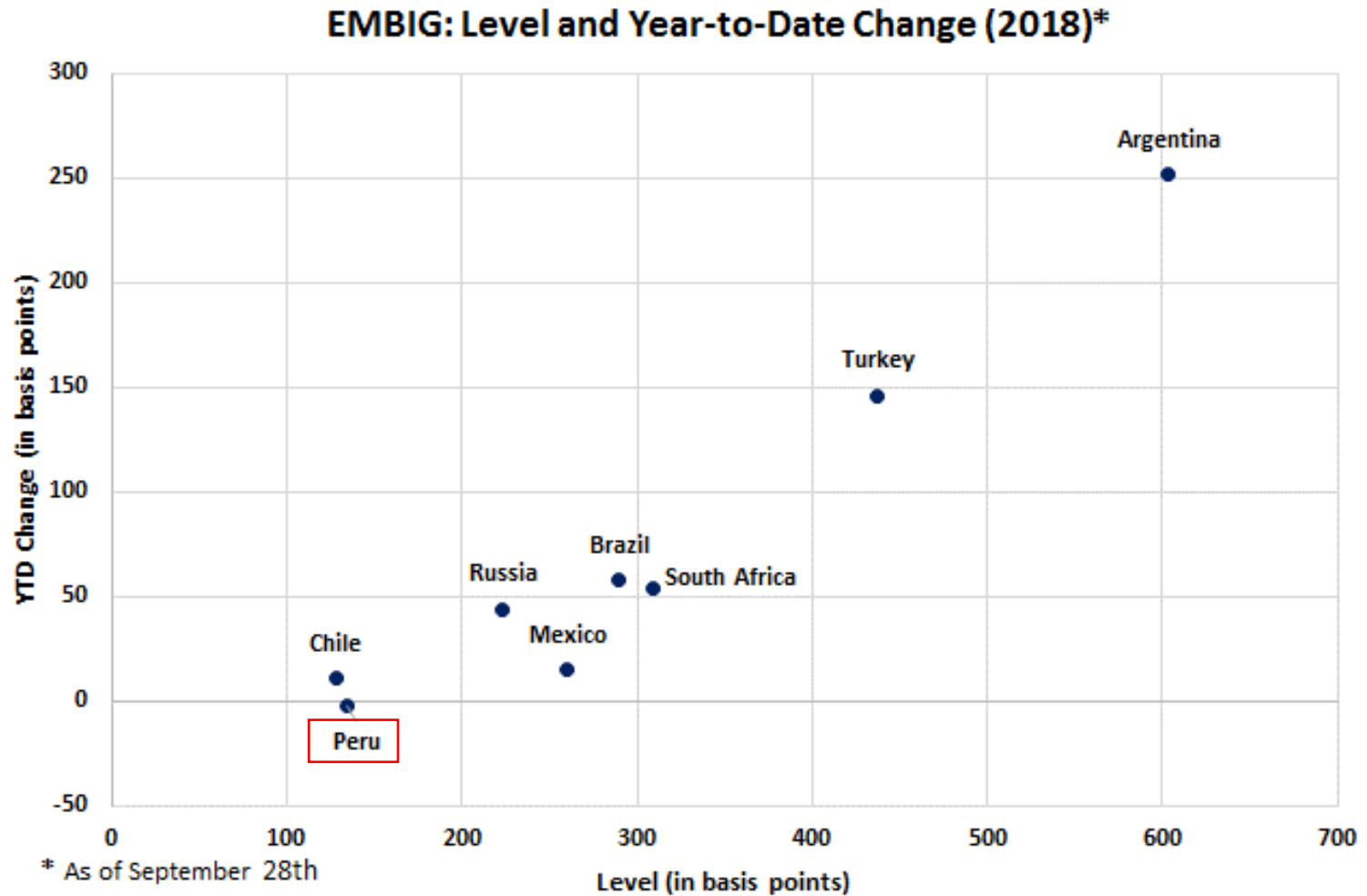
External Vulnerability Indicator: 2017
(% GDP)



Note: Indicator = [Official Foreign Exchange Reserves - Short-term External Debt + Current Account Balance] / GDP.

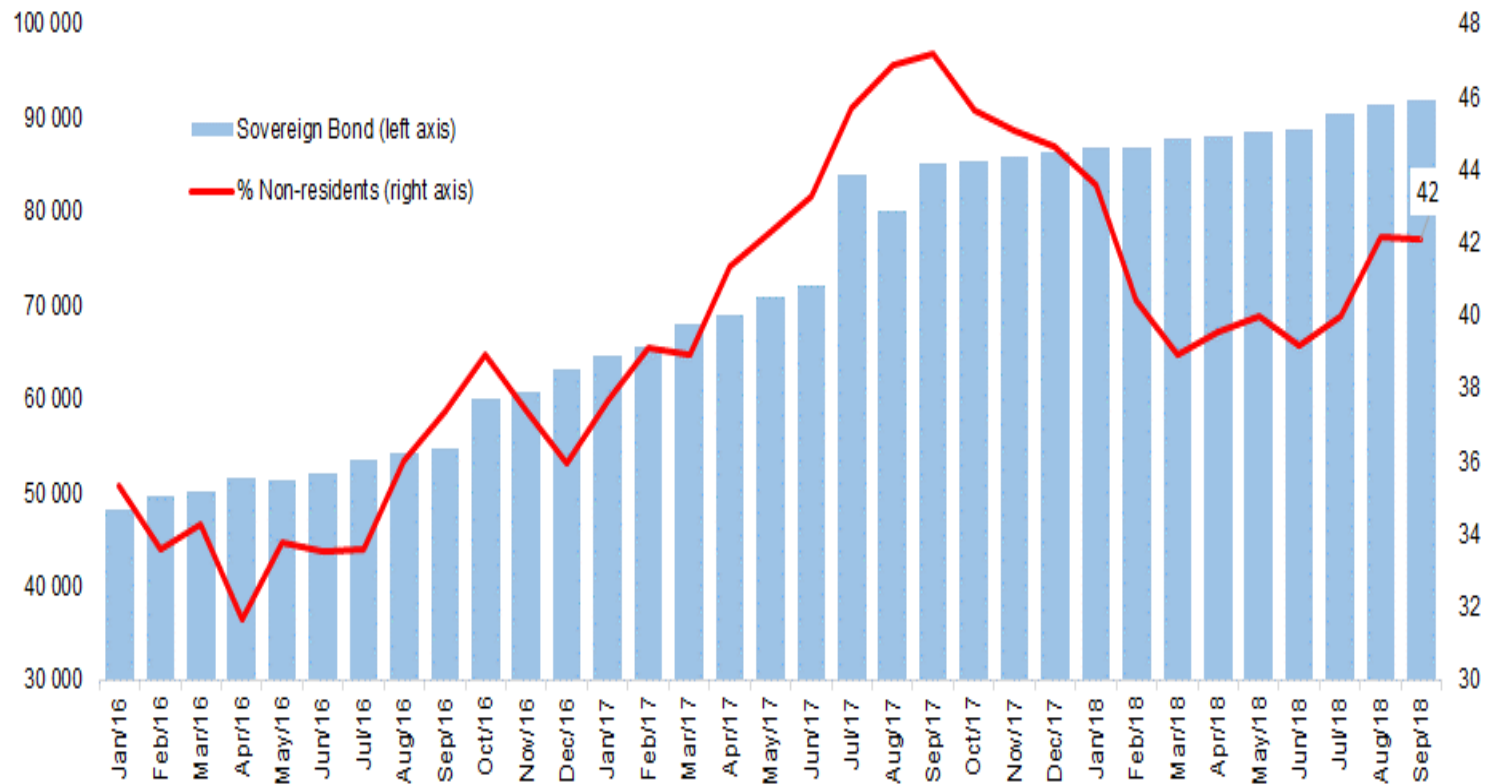
Source: Moody's

Peru is among the few emerging market economies that has seen its risk perception (EMBIG) reduced during this year, and also has one of the lowest levels across the region.



Despite the international financial markets volatility that has affected emerging markets, Peru has not experienced a significant sell-off in its local assets because of the solid macroeconomic fundamentals.

Balance of Sovereign Bonds and Shares of Non-Resident Investors
(Amounts in Million PEN and shares in %)



Source: MEF

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