



Rabobank

Country Report Chile

Country Report
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A new government took office in March 2014 and has been pushing through a bold reform agenda. In the meantime, the economy took a downturn, but economic activity is likely to improve in 2015.

Strengths (+) and weaknesses (-)

(+) Strong institutions

Especially by Latin American standards, Chile has strong institutions. The quality of governance is high and corruption is low.

(+) Good fiscal position

The government has committed itself to a structural fiscal surplus rule since 2001. Fiscal prudence has led to small public deficits and has kept public debt low, at 15% of GDP in 2014. A high level of FX reserves and USD 23bn in sovereign wealth funds allow the government to be a net creditor.

(-) Dependence on commodity (copper) exports

Chile is the world's largest copper producer and the metal accounted for 52% of total exports in 2013, while other commodities accounted for another 24% of exports.

(-) Relatively high level of inequality

Although inequality has fallen in the past two decades, it remains relatively high. In recent years, there have been rising social demands, particularly in the field of education.

Key developments

1. New government, bold structural reforms, unfortunate timing?

In March 2014, a new cabinet of President Bachelet took office (Bachelet was already president between 2006 and 2010). The new government has an ambitious structural reform agenda, as it seeks to address Chile's high level of inequality and raise the long-term trend growth. As the ruling Nueva Mayoría holds majorities in both the Chamber of Deputies and the Senate, it can easily implement reforms and deliver on its electoral agenda. In 2014, the government commenced reforms of the tax system, education, labour and energy.

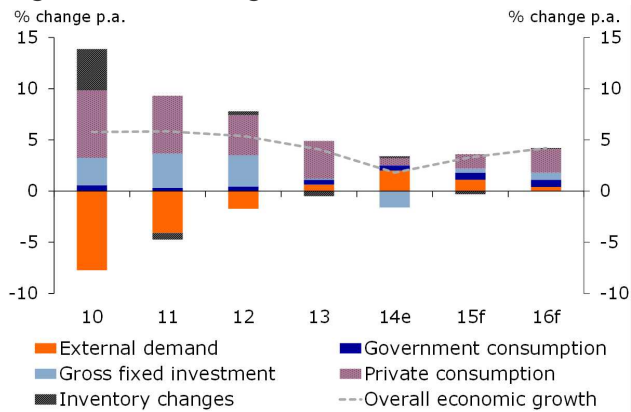
The purpose of the already approved tax system reform is to increase tax revenues by 3% of GDP by 2018, in order to increase spending on education and social programs and to reduce the structural public deficit. This is achieved by gradually increasing taxes and by closing loopholes that facilitate tax avoidance, such as the tax deferral on undistributed earnings that is currently in place. The tax hikes are tilted towards the upper income brackets and business sector and thus increase the (currently low) progressivity of the Chilean tax system. However, the reform increases the corporate tax burden at a time of economic downturn, so the timing is rather unfavourable.

A labour reform proposed in December 2014, which reinforces collective bargaining and empowers labour unions, is also set to increase the burden on the business sector. That could further hurt business confidence, especially as the debate related to its content could last until the end of 2015 and thus result in a prolonged period of uncertainty. On the positive side, the labour bill could contribute to a more even distribution of income and, thus, higher private consumption. However, the law could be harmful for the business climate. Namely, by stipulating a preferential treatment for unionised workers, the law is poised to increase labour costs, make labour relations more contentious and increase labour market rigidity. The government's education reform, on the other hand, should boost potential economic growth, because it improves access to education at all levels in a country where education access and attainment are strongly related to socio-economic background and where intergenerational social mobility is low. However, Chile's education system also has a quality problem that needs to be tackled. The energy plan, which includes the construction of a new LNG terminal and aims to reduce energy costs and increase supply from renewable sources, is also a positive development, since deficient energy supply is a major impediment to growth. However, its implementation could be delayed by environmental regulation and local protests. All in all, the reforms could help Chile to deal with important structural issues the country is grappling with. However, the timing and the simultaneous approach seem less fortunate, as some reforms increase the cost of doing business for the private sector burden at a time of economic slowdown. Besides, policy uncertainty will persist as only the tax reform and some education bills have been approved.

2. Economic growth took a downturn, but next year should see some recovery

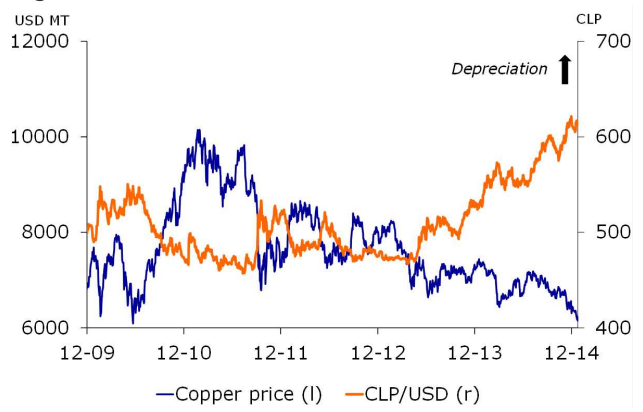
Economic activity took a downturn in 2014, as the economy adjusted to external shocks, while policy uncertainty hurt confidence. The outlook for 2015 is more favourable, but there are serious downside risks. Economic growth more than halved to 1.8% in 2014. Contracting gross fixed investments and decelerating private consumption growth were the main drivers, though a deterioration was visible across all components. The marked contraction in fixed investments is mainly a result of the fall in copper prices in recent years, which did not only affect mining output and exports, but also confidence across the board. The lower private spending in general also seems to be related to a deterioration of confidence due to policy uncertainty (there were fears of increasing interventionism) as well as the 16% depreciation of the currency in 2014. Chile's free floating exchange rate serves as a shock absorber of detrimental external developments. In 2014, currency depreciation contributed to a smaller trade deficit, though weaker investments also played a role. The current account deficit halved to 1.7% of GDP in 2014.

Figure 1: Economic growth slows down



Source: EIU

Figure 2: CLP serves as external shock absorber



Source: Macrobond, London Metal Exchange

In 2015, the economy is expected to perform better and grow by around 3%, on the back of the economic recovery in the US, some improvement on copper markets and fiscal stimulus. Lower oil prices, improved competitiveness due to currency depreciation and an accommodative monetary stance will also support recovery. There are already some signs of a recovery. The leading economic activity index (IMACEC) of the Central Bank of Chile has improved since August, when it reached its lowest level since March 2010, and yoy growth of capital imports returned to positive territory for the first time since July 2013 in December 2014. However, both business and consumer confidence hit the lowest levels since 2009 in December 2014. Furthermore, risks are tilted to the downside, as a sharper than expected slowdown in China could hurt copper prices, while policy uncertainty could hurt private sector confidence and expenditure. The current account deficit is expected to stabilize at 1.5% of GDP in 2015, as both exports and imports are expected to pick up, and to remain comfortably covered by net FDI flows that are forecast at 3.7% of GDP.

Factsheet of Chile

Chile				
National facts			Social and governance indicators rank / total	
Type of government	Republic		Human Development Index (rank)	40 / 187
Capital	Santiago		Ease of Doing Business Index (rank)	34 / 185
Surface area (thousand sq km)	756		WEF Global Competitiveness Index (rank)	34 / 148
Population (millions)	17.7		Corruption Perceptions Index (rank)	22 / 177
Main ethnic groups	White and non-indigenous (89%) Mapuche (9%)		Press Freedom Index (rank)	60 / 179
Main religions	Roman catholic (67%) Evangelical (16%) Jehovah's Witnesses (1%)		Gini index (income distribution)	52.1
Head of State (president)	Michelle Bachelet		Population below \$1.25 per day (PPP)	0.83%
Head of Government (president)	Michelle Bachelet		Foreign trade 2013	
Monetary unit	Peso (CLP)		<i>Main export partners (%)</i>	<i>Main import partners (%)</i>
Economy 2014			China	25
<i>Economic size</i> bn USD % world total			US	13
Nominal GDP	249	0.33	Japan	10
Nominal GDP at PPP	399	0.37	Brazil	6
Export value of goods and services	88	0.38	<i>Main export products (%)</i>	
IMF quatum (in m SDR, 2013)	856	0.39	Copper	52
<i>Economic structure</i> 2014 5-year av.			Fresh fruit	6
Real GDP growth	1.8	4.0	Cellulose	5
Agriculture (% of GDP)	4	3	Salmon & trout	5
Industry (% of GDP)	34	38	<i>Main import products (%)</i>	
Services (% of GDP)	63	59	Intermediate goods	54
<i>Standards of living</i> USD % world av.			Consumer goods	27
Nominal GDP per head	14,082	121	Capital goods	19
Nominal GDP per head at PPP	22,541	140	<i>Openness of the economy</i> 2014	
Real GDP per head	9,870	113	Export value of G&S (% of GDP)	35
			Import value of G&S (% of GDP)	33
			Inward FDI (% of GDP)	7.6

Source: EIU, Central Bank of Chile, CIA World Factbook, UN, World Economic Forum, Transparency International, Reporters Without Borders, World Bank.

Background information

With a per capita income of USD 14,139 (or USD 22,564 at PPP) in 2014, almost twice its level a decade earlier, Chile is one of Latin America's richest countries. By regional standards, Chile has strong institutions, sound macroeconomic policies and a good business environment. Actually, Chile scores better than the OECD average on both the Ease of Doing Business and the WEF Global Competitiveness Index. Since the end of 1999, a full-fledged inflation targeting regime has been in place and the country is fiscally prudent. Chile's economy is very open and diversified. Chile's financial system is large, its assets being estimated at 205% of GDP in 2012. It is also strongly interrelated with both the domestic real economy and global markets, rendering Chile vulnerable to developments in international financial markets. Chile has concluded free trade agreements with many other countries. Furthermore, Chilean companies have strongly increased their investments in neighbouring countries in recent years.

In the late 1960s and 1970s, political polarization culminated in the 1973 coup d'état by the military that overthrew the Allende government. A military dictatorship led by general Pinochet ruled Chile until 1990. The political landscape has been dominated by centre-left governments ever since, bar the 2010-2014 period, when a centre-right coalition ruled. Since 1990, Chile has managed to reduce its traditionally high inequality, but the level remains high. In recent years, opposition to the economic and political elite has grown and support for the two voting blocks that have ruled Chile since 1990 has weakened. The large-scale 2011 student protest were a reflection of this trend. Nevertheless, politics has remained relatively consensual by Latin American standards.

Economic indicators of Chile

Chile							
Selection of economic indicators	2010	2011	2012	2013	2014e	2015f	2016f
<i>Key country risk indicators</i>							
GDP (% real change pa)	5.8	5.8	5.4	4.1	1.8	3.3	4.2
Consumer prices (average % change pa)	1.4	3.3	3.0	1.9	4.4	4.1	3.1
Current account balance (% of GDP)	1.6	-1.2	-3.4	-3.4	-1.7	-1.5	-1.4
Total foreign exchange reserves (mln USD)	27,816	41,932	41,636	41,084	40,366	39,530	39,600
<i>Economic growth</i>							
GDP (% real change pa)	5.8	5.8	5.4	4.1	1.8	3.3	4.2
Gross fixed investment (% real change pa)	12.2	14.4	12.2	0.4	-6.3	1.8	3.2
Private consumption (real % change pa)	10.8	8.9	6.0	5.6	1.0	2.0	3.4
Government consumption (% real change pa)	4.6	2.5	3.7	4.2	4.0	5.5	5.5
Exports of G&S (% real change pa)	2.3	5.5	1.1	4.3	2.0	5.7	5.4
Imports of G&S (% real change pa)	25.9	15.6	5.0	2.2	-3.0	2.5	4.1
<i>Economic policy</i>							
Budget balance (% of GDP)	-0.3	1.5	0.6	-0.6	-2.3	-1.9	-1.0
Public debt (% of GDP)	9	11	12	13	15	17	17
Money market interest rate (%)	3.1	5.3	5.0	4.5	3.6	3.5	3.8
M2 growth (% change pa)	9	18	8	15	9	13	12
Consumer prices (average % change pa)	1.4	3.3	3.0	1.9	4.4	4.1	3.1
Exchange rate LCU to USD (average)	510.2	483.7	486.5	495.3	570.4	617.2	626.3
Recorded unemployment (%)	8.4	7.2	6.4	6.0	6.4	6.4	6.4
<i>Balance of payments (mln USD)</i>							
Current account balance	3,584	-3,072	-9,081	-9,485	-4,149	-3,700	-3,670
Trade balance	15,737	11,039	2,507	2,117	7,418	7,980	8,680
Export value of goods	71,109	81,438	77,965	76,684	75,504	75,630	81,090
Import value of goods	55,372	70,399	75,458	74,567	68,086	67,660	72,420
Services balance	-1,881	-3,054	-2,276	-2,908	-2,613	-1,350	-900
Income balance	-14,683	-13,922	-11,503	-11,102	-11,123	-12,490	-13,750
Transfer balance	4,411	2,865	2,191	2,408	2,168	2,160	2,310
Net direct investment flows	6,264	3,193	6,212	9,335	7,859	9,310	10,750
Net portfolio investment flows	-13,680	3,621	-8,082	-65	-2,462	-3,620	-3,980
Net debt flows	11,168	15,428	21,596	13,202	8,657	9,570	9,660
Other capital flows (negative is flight)	-4,801	-5,053	-10,940	-13,543	-10,623	-12,400	-12,690
Change in international reserves	2,535	14,117	-295	-556	-717	-840	80
<i>External position (mln USD)</i>							
Total foreign debt	81,435	96,245	117,478	130,858	139,454	148,430	157,800
Short-term debt	14,869	17,164	22,770	20,317	18,681	18,210	18,110
Total debt service due, incl. short-term debt	29,074	30,315	35,733	42,881	42,788	41,960	44,030
Total foreign exchange reserves	27,816	41,932	41,636	41,084	40,366	39,530	39,600
International investment position	-29,632	-31,709	-43,860	-39,232	n.a.	n.a.	n.a.
Total assets	235,084	254,513	291,509	306,954	n.a.	n.a.	n.a.
Total liabilities	264,716	286,222	335,369	346,186	n.a.	n.a.	n.a.
<i>Key ratios for balance of payments, external solvency and external liquidity</i>							
Trade balance (% of GDP)	7.2	4.4	0.9	0.8	3.0	3.2	3.3
Current account balance (% of GDP)	1.6	-1.2	-3.4	-3.4	-1.7	-1.5	-1.4
Inward FDI (% of GDP)	7.2	9.3	10.7	7.3	7.6	8.4	8.6
Foreign debt (% of GDP)	37	38	44	47	56	60	60
Foreign debt (% of XGSIT)	87	92	117	131	142	150	148
International investment position (% of GDP)	-13.6	-12.6	-16.5	-14.2	n.a.	n.a.	n.a.
Debt service ratio (% of XGSIT)	31	29	36	43	44	42	41
Interest service ratio incl. arrears (% of XGSIT)	2	2	3	3	4	4	5
FX-reserves import cover (months)	4.9	5.8	5.5	5.5	5.8	5.8	5.4
FX-reserves debt service cover (%)	96	138	117	96	94	94	90
Liquidity ratio	110	115	106	101	105	106	106

Source: EIU

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