

## Chile

### 1. General trends

In 2009, Chile's economy contracted by 1.5% as a result of the global financial crisis that broke out in the last quarter of 2008. From then through the first few months of 2009, the worsening market outlook in developed countries and especially in the international financial system led to a precipitous drop in both the price and the volume of exports. Expectations for growth, employment and income worsened, and private spending on investment and consumer durables fell sharply. The GDP growth rate thus slowed considerably, resulting in a drop in production and inventories and higher unemployment.

In these adverse circumstances, the government drew on the countercyclical capacities it had built up during years of high export prices and implemented measures geared to stimulate spending and stave off further drops in employment and income for the poorest households. In a context of negative inflation, the central bank cut monetary policy interest rates drastically, in order to help maintain financial market liquidity and revive lending. Starting in the second quarter of 2009, exports began to climb again thanks to the buoyancy of emerging Asian economies, with prices showing an upturn and volumes growing at a faster pace. As a result, the Chilean economy began to recover in the second half of 2009, further bolstered by increased public spending, favourable domestic credit conditions and an improved external environment. Production rates rose and unemployment levels fell, making it possible to forecast 4.5% GDP growth for 2010.

At the end of February 2010, however, when the Chilean economy was in full recovery, the country was hit by an earthquake and tsunami—considered to be the fifth strongest and most extensive since measurements began. The worst effects of the earthquake were concentrated in three regions of south-central Chile that account for 16% of GDP and nearly 9% of exports, principally wood, pulp and pulp products, and fishmeal. The first output measurements after the earthquake and tsunami showed marked declines in March and April, with a slight upturn in the following months. Accordingly, GDP growth projections for 2010 have been revised down to 4%. The final outcome will depend, among other factors, on the reconstruction plan deployed by the new administration that took office in March, since the effect of this effort on production rates will start to become apparent during the second half of the year.

### 2 Economic policy

#### (a) Fiscal policy

Fiscal policy in 2009 continued to target a structural surplus equivalent to 0.5% of GDP. However, the

countercyclical policies implemented and the 23.2% drop in tax revenues resulting from the slowdown in economic activity and lower copper prices led to a deficit of 4.5% of GDP, equivalent to a structural deficit of 0.9%

of output. Total central government debt (domestic and external) went from 5.2% of GDP in 2008 to 6.3% in 2009 (US\$ 11.095 billion). Nevertheless, the reserves accumulated in previous high-surplus years enabled the government to maintain a net creditor position that reached 3% of GDP in 2009, despite making withdrawals of US\$ 9.277 billion (equivalent to 46%) from the Economic and Social Stabilization Fund (ESSF) to deal with fallout from the global financial crisis.

The fiscal policy target for 2010 is a structural balance of 0% of GDP. The budget act originally projected a 4.3% rise in public spending (consolidated central government total) over 2009, with an effective deficit of 1.1% of GDP. However, lower growth in the wake of the earthquake and tsunami are expected to push tax receipts below the amount originally budgeted while the reconstruction effort will drive spending over the original budget, especially from the second half of the year on. These trends in the direction of a larger effective deficit will be offset in part by greater public revenue from copper, whose international prices have risen significantly from the 2009 average.

The new administration has not spelled out a reconstruction spending programme, but has estimated that a total of total US\$ 8.431 billion will be needed in public spending between 2010 and 2013 and has proposed a three-part plan for financing this increased expenditure.

The first part calls for US\$ 700 million in budget reallocations. Second, a package of tax measures proposed to congress consists of temporarily increasing tax withholdings on the earnings of large corporations, permanently eliminating certain home purchase and voluntary retirement savings subsidies, raising tobacco and real estate taxes, amending the copper reserve law that earmarks 10% of the sales of the National Copper Corporation (CODELCO) for the armed forces, and offering mining companies the option of voluntarily paying a higher royalty in exchange for extending their tax invariability benefit. Incentives also were proposed in the form of a new, simplified tax regime for medium-sized companies and a permanent reduction in the tax on credits. Together, these tax measures would net US\$ 1.75 billion between 2010 and 2013. Third, the government will issue two bonds on the external markets, one in local currency for the equivalent of US\$ 500 million and another denominated in dollars for US\$ 1 billion. An additional withdrawal of some US\$ 4.45 billion from accumulated ESSF funds would also be necessary—and is entirely feasible since the balance in the fund as of first-quarter 2010 was approximately US\$ 11.130 billion and the expected rise in copper prices during the year should make replenishment possible.

## **(b) Monetary policy**

Monetary policy continued to target annual inflation of 3% per year on average for the medium term. As of January 2009, given the marked slowdown of inflation and in order to address the liquidity needs triggered by the crisis, the central bank implemented a series of deep cuts in the monetary policy rate, taking the annual rate to 0.5% by July 2009—down 775 basis points from the September 2008 high of 8.25%. These interest rate cuts were accompanied by a series of measures designed to boost liquidity.

The central bank held the monetary policy rate at 0.5% until June 2010. However, there is now a greater risk of higher inflation, both because of the damage wrought to production capacities by the earthquake and tsunami and because of the drop in inventories resulting from the 2008-2009 recessionary cycle and the pressures on spending expected for the second half of 2010. Accordingly, the central bank raised the monetary policy rate to 1% to keep the economy from overheating.

In early 2009 the central bank also began to withdraw quantitative monetary measures, in response to signs of incipient recovery and with a view to meeting the inflation target.

As a result of these measures, lending rates began to come down from mid-2009 on, and credit conditions improved. Loan placements, which had remained below 2008 levels throughout 2009, were thus showing signs of recovery at the end of the first half of 2010.

## **(c) Exchange-rate policy**

In the context of Chile's deep integration with international markets and its low country risk, the central bank has, for several years, maintained a floating exchange-rate policy and generally refrained from intervening significantly in the foreign-exchange market. Since early 2009, as access to international financial markets gradually returned to normal and the perception of risk eased, the currency regained a trend towards nominal appreciation. Nevertheless, although the central bank has not ruled out other measures in the future, it has not, in practice, attempted to counteract exchange market trends other than by explaining its position, on the basis that there is little evidence of real exchange rate misalignment from its equilibrium value.

### 3. The main variables

#### (a) Economic activity

The evolution of domestic demand during 2009 tracked the severe adjustment in expectations. Domestic demand contracted by between 9% and 10% in the second and third quarters, reflecting a sharp fall in consumption of durable goods (-8.4%) and investment (-15.3%), particularly in machinery and equipment (-24.2%). By contrast, government consumption expanded at an annual rate of 6.8%, in the framework of the countercyclical policies aimed at boosting demand. As a result, domestic demand, especially the private consumption component, began to show some recovery towards the end of the year.

Amid extreme uncertainty as to the depth of the crisis during much of 2009, current demand was met by drawing down inventories rather than increasing supply through domestic production or imports. The resulting steep falls in imports of durable and capital goods, associated with the heavy drop in those components of domestic spending, meant that net external demand made a positive contribution to growth despite the contraction in export volumes.

At the sectoral level, activity levels in the fishing industry contracted as a result of the crisis caused by infectious salmon anaemia. The sharpest downturn occurred in sectors associated mainly with durables consumption and investment in machinery and equipment (textiles, apparel, furniture, metal products, machinery and construction).

Domestic demand has seen a considerable upturn during 2010, despite the adverse effects of the earthquake early in the year. Private consumption and investment have started to trend up on the basis of improving expectations, favourable financial conditions and the reconstruction effort. This, along with low inventories following the preceding year's adjustments, has driven a rise in imports and boosted domestic production. Exports have grown at a similar rate to that of the second half of 2009, thanks to continuing demand from emerging countries, especially China. Nevertheless, turmoil in Europe has created some uncertainty as to the behaviour of exports during the second half of the year.

The damage to the salmon industry caused by infectious anaemia appears to have peaked, so no further declines in this sector's production are anticipated. Exports of fishmeal, production of wood and pulp, and the activities of the iron and steel and fuel refinery industries are all

centred in the regions hit hardest by the earthquake and slumped heavily. The upturn in consumption and investment (including the replenishment of inventories) should boost growth in the manufacturing, transport, commerce, construction, communications and basic service sectors, and demand did in fact rise in several of those sectors up to the fourth quarter of the year. Mining is likely to perform similarly to the second half of 2009, driven by continuing external demand.

So, bearing in mind that production contracted in the first quarter in the aftermath of the earthquake, GDP is projected to post moderate growth of 4% in 2010. The possibility of attaining higher growth will depend on the short-term effectiveness of efforts to rebuild production capacity in the hardest hit areas and on rising external demand. This remains a possibility, even after a disappointing first quarter, since some signs now point to faster-than-expected recovery.

#### (b) Prices, wages and employment

Twelve-month inflation to December 2009 was -1.4%, due to three different factors. First, the downturn in domestic demand helped contain and reduce domestic prices, as shown by the very low levels of the non-tradable component of the consumer price index (CPI) throughout the year. Some tradables whose prices are driven by domestic demand, like food, registered negative price variations because of increased supply. Second, the peso showed a certain tendency to appreciate, particularly in the final quarter of the year, as reflected in the real effective exchange rate index. Third, the world financial crisis pushed relevant 12-month external inflation into negative territory from mid-2009 until March 2010.

In January 2010 the National Statistical Institute changed the methodology for calculating the CPI, which now has national coverage. During the first quarter of the year the index was nearly flat and core 12-month inflation indicators remained in negative territory. But certain imported components, such as fuel, were significantly higher than a year earlier.

Inflation is projected to be higher in 2010 than in 2009 mainly because of the destruction of idle production capacity in the earthquake, the low level of inventories and rising domestic demand. Surveys show that private-sector expectations for inflation centre on the central bank's target range.

Table 1  
CHILE: MAIN ECONOMIC INDICATORS

	2001	2002	2003	2004	2005	2006	2007	2008	2009 <sup>a</sup>
<b>Annual growth rates<sup>b</sup></b>									
<b>Gross domestic product</b>	0.0	3.4	2.2	3.9	6.0	5.6	4.6	4.6	3.7
<b>Per capita gross domestic product</b>	2.2	1.0	2.8	4.9	4.5	3.5	3.5	2.6	-2.5
<b>Gross domestic product, by sector</b>									
Agriculture, livestock, hunting, forestry and fishing	7.5	6.8	2.6	11.0	7.0	4.0	0.9	4.1	0.5
Mining and quarrying	5.7	-4.2	5.5	6.1	-3.9	0.7	3.3	-5.6	-1.4
Manufacturing	0.6	1.9	3.3	7.0	6.0	3.9	3.0	1.4	-7.0
Electricity, gas and water	1.5	3.3	4.3	2.8	3.0	7.6	-28.8	-1.9	15.7
Construction	4.1	2.5	4.3	3.2	10.1	4.0	4.6	10.1	-5.2
Wholesale and retail commerce, restaurants and hotels	2.6	0.9	4.9	7.3	8.5	6.9	6.2	4.8	-2.7
Transport, storage and communications	7.4	5.3	5.8	5.5	6.9	6.9	8.7	6.7	-0.5
Financial institutions, insurance, real estate and business services	3.0	2.8	2.8	6.4	7.0	4.2	8.0	3.3	-0.3
Community, social and personal services	2.8	2.5	2.6	3.1	3.5	3.6	4.4	3.7	2.2
<b>Gross domestic product, by type of expenditure</b>									
Final consumption expenditure	2.9	2.5	4.0	7.0	7.1	7.0	7.0	4.0	1.8
Government consumption	2.9	3.1	2.4	6.1	5.9	6.4	7.1	0.5	6.8
Private consumption	2.9	2.4	4.2	7.2	7.4	7.1	7.0	4.6	0.9
Gross capital formation	0.8	2.2	7.8	9.0	21.7	6.2	9.2	18.7	-26.1
Exports (goods and services)	7.2	1.6	6.5	13.3	4.3	5.1	7.6	3.1	-5.6
Imports (goods and services)	4.1	2.3	9.7	18.4	17.2	10.6	14.5	12.2	-14.3
<b>Percentages of GDP</b>									
<b>Investment and saving<sup>c</sup></b>									
Gross capital formation	21.2	20.8	21.1	20.0	22.2	20.1	20.5	25.1	19.0
National saving	19.6	20.0	20.1	22.2	23.4	24.9	25.0	23.6	21.6
External saving	1.6	0.9	1.1	-2.2	-1.2	-4.9	-4.5	1.5	-2.6
<b>Millions of dollars</b>									
<b>Balance of payments</b>									
Current account balance	-1 100	-580	-779	2 074	1 449	7 154	7 458	-2 513	4 217
Goods balance	1 843	2 386	3 723	9 585	10 775	22 780	23 941	8 848	13 982
Exports, f.o.b.	18 272	18 180	21 664	32 520	41 267	58 680	67 972	66 464	53 735
Imports, f.o.b.	16 428	15 794	17 941	22 935	30 492	35 900	44 031	57 617	39 754
Services trade balance	-844	-701	-618	-746	-621	-631	-987	-871	-1 074
Income balance	-2 526	-2 847	-4 489	-7 837	-10 487	-18 401	-18 625	-13 423	-10 306
Net current transfers	427	583	605	1 072	1 783	3 406	3 129	2 934	1 616
Capital and financial balance <sup>d</sup>	504	779	413	-2 265	267	-5 157	-10 672	8 957	-2 569
Net foreign direct investment	2 590	2 207	2 701	5 610	4 801	4 556	9 961	7 194	4 719
Other capital movements	-2 086	-1 428	-2 288	-7 875	-4 534	-9 713	-20 633	1 764	-7 288
Overall balance	-596	199	-366	-191	1 716	1 997	-3 214	6 444	1 648
Variation in reserve assets <sup>e</sup>	596	-199	366	191	-1 716	-1 997	3 214	-6 444	-1 648
<b>Other external-sector indicators</b>									
Real effective exchange rate (index: 2000=100) <sup>f</sup>	111.8	109.4	114.5	108.5	103.1	100.9	102.8	102.4	106.1
Terms of trade for goods (index: 2000=100)	93.3	97.2	102.8	124.9	139.8	183.2	189.5	164.8	166.7
Net resource transfer (millions of dollars)	-2 022	-2 068	-4 076	-10 102	-10 220	-23 558	-29 297	-4 466	-12 876
Total gross external debt (millions of dollars)	38 527	40 504	43 067	43 515	46 211	49 497	55 733	64 318	74 041
<b>Average annual rates</b>									
<b>Employment</b>									
Labour force participation rate <sup>g</sup>	53.9	53.7	54.4	55.0	55.6	54.8	54.9	56.0	55.9
Open unemployment rate <sup>h</sup>	9.9	9.8	9.5	10.0	9.2	7.7	7.1	7.8	9.7
Visible underemployment rate <sup>i</sup>	7.1	6.2	6.5	8.4	8.5	8.5	8.0	9.0	10.8
<b>Annual percentages</b>									
<b>Prices</b>									
Variation in consumer prices (December-December)	2.6	2.8	1.1	2.4	3.7	2.6	7.8	7.1	-1.4
Variation in wholesale prices (December-December)	3.1	10.4	-1.0	7.8	3.2	7.9	14.0	22.7	-14.9
Variation in nominal exchange rate (annual average)	7.1	9.3	10.8	10.0	9.1	7.0	1.0	1.9	8.9
Variation in average real wage	1.7	2.0	0.9	1.8	1.9	1.9	2.8	-0.2	4.8
Nominal deposit rate <sup>j</sup>	6.5	4.1	3.2	2.4	4.5	5.5	5.9	7.8	2.4
Nominal lending rate <sup>j</sup>	16.7	14.4	13.0	11.0	13.5	14.4	13.6	15.2	12.9

Table 1 (concluded)

	2001	2002	2003	2004	2005	2006	2007	2008	2009 <sup>a</sup>
	<b>Percentages of GDP</b>								
<b>Total central government</b>									
Total revenue	21.7	21.0	20.7	22.0	23.8	25.8	27.4	26.2	20.0
Tax revenue	18.0	18.1	17.3	17.0	18.3	18.3	20.2	19.9	16.1
Total expenditure	22.2	22.3	21.2	19.9	19.3	18.1	18.6	21.0	24.4
Current expenditure	18.9	18.8	17.9	16.8	16.1	15.1	15.4	17.2	19.7
Interest	1.2	1.2	1.1	1.0	0.8	0.7	0.6	0.5	0.5
Capital expenditure	3.4	3.4	3.3	3.1	3.1	3.0	3.2	3.8	4.7
Primary balance	0.7	-0.1	0.7	3.1	5.4	8.4	9.4	5.7	-3.9
Overall balance	-0.5	-1.2	-0.5	2.1	4.6	7.7	8.8	5.2	-4.4
<b>Central government public debt<sup>k</sup></b>	14.9	15.7	13.0	10.7	7.3	5.3	4.1	5.2	6.1
Domestic	10.4	9.9	7.5	5.9	4.0	2.4	2.0	3.1	4.7
External	4.5	5.7	5.5	4.8	3.3	2.9	2.1	2.1	1.4
<b>Money and credit<sup>l</sup></b>									
Domestic credit	65.8	61.9	61.5	60.1	59.8	55.1	60.7	64.9	66.7
To the public sector	0.2	-3.9	-1.1	-2.2	-4.5	-8.5	-9.0	-14.4	-2.5
To the private sector	65.6	65.9	62.7	62.3	64.3	63.7	69.7	79.3	69.2
Liquidity (M3)	54.2	54.6	48.8	50.3	53.3	53.2	58.1	69.0	64.4
Currency outside banks and local-currency deposits (M2)	47.8	48.6	43.4	45.5	48.6	48.6	53.2	60.1	57.3
Foreign-currency deposits	6.3	5.9	5.4	4.9	4.7	4.7	4.8	9.0	7.1

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.

<sup>a</sup> Preliminary figures.

<sup>b</sup> Based on figures in local currency at constant 2003 prices. Up to 2003, based on figures in local currency at constant 1996 prices.

<sup>c</sup> Based on figures in local currency expressed in dollars at current prices.

<sup>d</sup> Includes errors and omissions.

<sup>e</sup> A minus sign (-) denotes an increase in reserves.

<sup>f</sup> Annual average, weighted by the value of goods exports and imports.

<sup>g</sup> Economically active population as a percentage of the working-age population; nationwide total.

<sup>h</sup> Percentage of the economically active population; nationwide total.

<sup>i</sup> Percentage of the working population; nationwide total.

<sup>j</sup> Non-adjustable 90-360 day operations.

<sup>k</sup> Does not include publicly guaranteed debt.

<sup>l</sup> The monetary figures are December averages.

The international financial crisis took its toll on growth and employment. Despite plans implemented to moderate the decline in employment and output, the unemployment rate averaged 9.6% in 2009 compared with a yearly average of 7.8% in 2008. In 2010 the National Statistical Institute began to publish a new, nationwide unemployment index with increased coverage. This new measurement showed that the national unemployment rate reached 11% in 2009 but fell during the second half of the year. There are no records for 2008.

So far in 2010, unemployment figures are trending down after peaking at 11.6% in July and August 2009. Employment levels dropped as a result of the earthquake's impact on production capacity, particularly in the regions where the worst damage to capacity and infrastructure occurred. Nevertheless, reconstruction efforts have helped to turn this situation around and a more rapid recovery could bring unemployment down from the previous year's levels.

In the context of a sluggish labour market, nominal wages grew only slowly, at a lower rate than in 2008. Real wage indices, however, rose considerably as a result of successive months of negative inflation. Wages are not expected to exert pressure on costs in 2010, because they tend to lag the prior-year inflation rate (which was negative in 2009) and because the labour market will continue to perform modestly during the year.

### (c) The external sector

The external prices of the commodities that Chile imports and exports fluctuated significantly in 2009. After raw materials prices plummeted in the final four months of 2008 owing to the international financial crisis, prices for Chile's principal exports recovered strongly in 2009. Even so, average unit export values for the year were down by 18%. Similarly, the average unit value for imports fell by 16%. Export volumes dropped by 5% while import volumes, particularly of durable goods, machinery and capital goods, declined 19%. This resulted in a current-account surplus of around 2.6% of GDP.

International reserves rose slightly in 2009, to US\$ 25.371 in December, thanks to the recent allocation of special drawing rights (SDRs) to Chile, continuing foreign direct investment flows, the resumption of corporate bond issues on the international markets and renewed lending to Chilean banks by external creditors.

The external prices of Chile's exports rose again in 2010, attaining record highs and nearing or exceeding pre-crisis levels in certain cases. Oil prices rose, too, albeit to levels that are still far from pre-crisis highs. Export prices have turned volatile again, however, owing to international market turmoil stoked by concerns surrounding the sovereign debt of some European countries.

Table 2  
CHILE: MAIN QUARTERLY INDICATORS

	2008				2009 <sup>a</sup>				2010 <sup>a</sup>	
	I	II	III	IV	I	II	III	IV	I	II
Gross domestic product (variation from same quarter of preceding year) <sup>b</sup>	3.7	5.1	5.2	0.7	-2.1	-4.5	-1.4	2.1	1.0	...
Goods exports, f.o.b. (millions of dollars)	19 277	18 423	16 419	12 336	11 482	12 914	14 050	15 290	16 240	16 323
Goods imports, c.i.f. (millions of dollars)	14 004	16 233	17 786	13 880	9 568	9 664	10 911	12 285	12 306	13 941
Gross international reserves (millions of dollars)	17 898	20 251	24 204	23 162	23 382	23 448	26 040	25 371	25 631	25 175
Real effective exchange rate (index: 2000=100) <sup>c</sup>	95	97	103	115	110	106	106	103	102	102 <sup>d</sup>
Unemployment rate	7.6	8.4	7.8	7.5	10.6	11.5	11.2	10.0	9.0	...
Consumer prices (12-month percentage variation)	8.5	9.5	9.2	7.1	5.0	1.9	-1.1	-1.4	0.2	1.5 <sup>d</sup>
Wholesale prices (12-month percentage variation)	10.4	13.7	19.4	22.7	15.5	2.5	-6.4	-14.9	-6.3	-1.4 <sup>d</sup>
Average nominal exchange rate (pesos per dollar)	463	472	517	642	607	566	546	518	519	531
Average real wage (variation from same quarter of preceding year)	0.6	-0.2	-1.1	-0.2	1.8	3.6	6.4	7.3	2.7	...
Nominal interest rates (annualized percentages)										
Deposit rate <sup>e</sup>	9.3	9.7	9.8	10.1	8.9	6.3	5.0	4.3	4.0	3.8 <sup>d</sup>
Lending rate <sup>e</sup>	16.7	17.3	17.3	17.5	16.6	13.4	11.7	10.4	9.9	9.6 <sup>d</sup>
Interbank rate <sup>f</sup>	9.5	9.7	9.9	9.8	8.6	6.0	4.3	3.7	3.3	3.3 <sup>d</sup>
Stock price index (national index to end of period, 31 December 2000=100)	268	277	254	219	229	285	311	330	347	380
Domestic credit (variation from same quarter of preceding year)	8.0	7.2	10.8	7.7	5.9	-1.5	-13.0	-15.6	-14.7	-14.4 <sup>g</sup>
Non-performing loans as a percentage of total credit	3.9	3.9	4.1	4.0	4.5	4.6	4.5	4.1	4.4	4.4 <sup>g</sup>

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.

<sup>a</sup> Preliminary figures.

<sup>b</sup> Based on figures in local currency at constant 2003 prices.

<sup>c</sup> Quarterly average, weighted by the value of goods exports and imports.

<sup>d</sup> Data to May.

<sup>e</sup> Non-readjustable 90-360 day operations.

<sup>f</sup> Overnight.

<sup>g</sup> Data to April.

Export volumes are projected to expand in 2010 thanks to steady growth in main destination markets, especially China. Imports are also expected to recover strongly—even more than exports—on the back of rising domestic demand in a context of low inventories, the partial destruction of domestic production capacity by the earthquake and tsunami, which has made it necessary to source externally to meet normal production and

consumption needs, and higher spending driven by the reconstruction effort.

International reserves remained stable through the first quarter of 2010, at levels similar to those posted in December 2009. Conditions for accessing the international financial markets also remained unchanged despite the turmoil arising from uncertainty as to sovereign debt sustainability in several European countries.