

CHILE

1. General trends

Chile's gross domestic product (GDP) grew by 1.9% in 2014, slowing markedly from 4.2% in 2013. An expansion of 2.5% is forecast in 2015, driven by increased public spending and positive developments in the external sector. The Chilean economy is benefiting from higher growth in the United States and lower international oil prices, which have been a boon for both companies and households. Although the flooding that hit the north of the country in March 2015 will have a negative impact on economic activity in general, particularly in the mining sector, the reconstruction efforts are expected to have a positive effect. Government spending has been the primary engine of growth, as private spending has shown little sign of improvement.

Economic growth in 2014 was driven by higher external demand, which boosted exports, particularly in the mining and industrial sectors. Domestic demand, which fell by 0.6%, weakened the growth momentum as higher private consumption and public spending failed to offset the decline in investment, which continued through until the fourth quarter, when it began to rise again, thanks to an uptick in public investment. Unemployment averaged 6.4% in 2014, a low level considering the subdued domestic economic environment.

In addition to the aforementioned factors, 2014 was a year of major changes. The new government that took office in March immediately launched discussions on an active reform agenda to address a number of areas, particularly tax, education and the political system.

On the external front, the balance-of-payments current account deficit narrowed, owing to the fall in imports (as growth slowed) and investment income.

Year-on-year inflation averaged 4.6% in December 2014, much higher than the rate of 3.0% recorded in 2013. However, prices rose more slowly in the first half of 2015 and are expected to continue thus in the second half, to close the year within the central bank's target range of 3% with a 1 percentage-point margin on either side. The peso depreciated by 15.7% year-on-year in nominal terms against the dollar in December 2014 and by 13.6% at the end of the first quarter in 2015, owing chiefly to the stronger United States economy and lower copper prices.

2. Economic policy

(a) Fiscal policy

Total central government revenue rose by 1.5% in real terms in 2014, as net tax revenues grew by 2.2% (after shrinking in 2013). Receipts from private mining companies and the State-owned copper mining company, CODELCO, contracted sharply, by between 7% and 8%, owing to the fall in international copper prices. Total spending rose by 6.5% in real terms in 2014, reflecting the strong expansionary stance of fiscal policy in a year of low growth. Spending on goods and services for

consumption and production, which was up by 11.6%, accounted for most of the rise. As a result, the central government deficit was equivalent to 1.6% of GDP, 1 percentage point wider than in 2013.

Fiscal policy is guided by a medium-term structural balance target. In view of the economic slowdown, the budget passed for 2015 contains countercyclical measures to boost activity, especially investment. Public spending is projected to increase by 9.8%, including public investment growth of close to 28%. In line with the budget, cumulative spending expanded by 8.4% year-on-year in May 2015.

The government is maintaining a countercyclical policy and is expected to continue providing a fiscal stimulus if growth remains low. The aims of the tax reform passed in 2014 are fourfold: to fund improvements in education and health; to reduce inequality through a more progressive tax system; to incentivize investment by both large firms and small and medium-sized enterprises (SMEs), as well as personal savings; and lastly, to reduce tax evasion and avoidance. This reform will be completely operational in 2018 and will provide an extra US\$ 8.3 billion in revenue (3.02% of GDP) per year. The rise in sales tax on alcoholic and sugary drinks and a change to the tax on tobacco (a higher specific tax and a lower ad valorem tax) were among the first measures implemented. In 2015, incentives to boost individual savings, anti-tax evasion and avoidance measures, taxes on vehicle emissions and several measures in favour of micro-, small and medium-sized enterprises (MSMEs) will be introduced. The measures to be implemented in the final stages of the reform include VAT on housing, new measures to support SMEs, taxes on fixed sources of pollution and reinvestment incentives.

(b) Monetary policy

As economic activity slowed, the central bank gradually lowered the interest rate in a bid to adjust the economic cycle, from a year-on-year rate of 5% in October 2013 to 3% in October 2014. The central bank has since left the interest rate unchanged as it raised its inflation forecast for December 2015 from 2.8% in December 2014 to 3.4% in June 2015, suggesting that there will be no further interest rate cuts and that the central bank could tighten up its monetary policy.

The growth of monetary aggregates was similar to that recorded in recent years: the M1 aggregate expanded by 12.1% on average in 2014 and broader aggregates performed similarly. This trend continued into the first half of 2015. Credit growth, which had been slowing since 2012, closed 2014 at an average annual rate of 9.6%. As a result of the economic slowdown, commercial and consumer credit growth rates fell from 15% in 2012 to 9% in 2014. In May 2015, total credit expanded by an average year-on-year rate of 9% and consumer and commercial credit expanded by a little over 7%.

(c) Exchange-rate policy

In keeping with Chile's free-floating exchange-rate policy, the peso depreciated by 15.7% year-on-year in nominal terms against the dollar at the end of 2014, as the value of the dollar strengthened on the whole against the currencies of other countries in the region and emerging economies. This extended episode of depreciation—the longest of the last decade—afforded greater competitiveness to the external sector, which helped offset the recent weakness of domestic demand. In the first half of 2015, the peso continued to downtrend, reaching prices not seen since the peak of the international financial crisis at the end of 2008.

The main factors behind the peso's loss of value against the dollar included the fall in copper prices, which curbed foreign-exchange flows into Chile, and the improvement of the United States economy over the year, which bolstered the dollar in the world economy. Furthermore, the lowering of

the monetary policy rate, which narrowed the gap with international rates, also played a part in the depreciation of the peso.

The real effective exchange rate depreciated by 6.7% year-on-year in 2014, slowing to 1.3% year-on-year in May 2015. According to the central bank, the real exchange rate is expected to hold steady at the current rate, which is slightly above the average for the last two decades, but is consistent with the economic cycle and long-term fundamentals.

(d) Other policies

With respect to the energy agenda, in April 2015 the government signed a decree to connect the country's two main electricity systems, the Central Interconnected System (SIC) and the Interconnected System of the North (SING), in a bid to create a more efficient and sustainable electricity market, with a more secure supply and lower costs. The use of non-conventional renewable energies (NCRE) is being promoted through investment in thermal and hydroelectric energy up to a capacity of 20 MW (which the government considers NCRE), among other measures. Furthermore, the National Petroleum Corporation (ENAP) will receive US\$ 650 million between 2015 and 2018 for new investments.

The National Congress adopted a new framework for foreign direct investment, replacing Legislative Decree 600, which had rarely been used in the last decade and was in fact eliminated in the tax reform process. The new legislation establishes that a committee of ministers shall decide on the strategy to attract foreign investment in Chile, which is to be implemented subsequently by a promotion agency.

Lastly, in response to several cases of irregular funding of political activities, the government has put forward a set of far-reaching initiatives to increase transparency between politics and business.

3. The main variables

(a) The external sector

In 2014, the balance-of-payments current account posted a deficit for the fourth year in a row, this time equivalent to 1.2% of GDP (US\$ 2.995 billion), which was less than in the previous two years when it had exceeded 3.5% of GDP. This was attributable to the deficit on the income account, owing to foreign direct investment (FDI) income and, to a lesser extent, the deficit in the trade in services. In contrast, the drop in imports widened the goods surplus with respect to 2013, to 3.2% of GDP.

The value of exports fell by 0.9% year-on-year, as volumes rose by 1.9% (thanks to industrial and mining goods) and prices dropped by 2.8%. Copper prices were hit most severely, falling by 6.9% on average in 2014. One contributing factor in the overall performance of exports was the slower growth recorded by Chile's largest trade partners, including China, its principal export market, and regional partners, such as Argentina and Brazil. In early 2015, prices in all the major categories decreased further, while food export volumes experienced an upturn. Demand from China continued to fall, but demand from regional trade partners picked up. The value of goods imports was down by 9% year-on-year in 2014, owing to lower prices (1.6%) and volumes (7.4%), as falling oil prices and lower volumes of capital and consumer goods imports took their toll. During the first quarter of 2015, a similar decline was seen in the prices of oil and other intermediate, consumer and capital goods. Import volumes continued to fall, on

the whole, although much more slowly than in 2014. The income account deficit, which stood at US\$ 8.857 billion in 2014, was mainly due to the decline in direct investment earnings, which plummeted by over US\$ 2 billion as profits fell in the mining sector.

The capital and financial account posted a surplus of US\$ 4.052 billion in 2014, down from US\$ 10.436 billion in 2013, but which nevertheless made it possible to finance the current account deficit and accumulate US\$ 1.057 billion in reserves. Foreign direct investment grew by 14% to US\$ 22.002 billion, which contrasted with declining FDI levels in the rest of the region and globally. The main sectors of investment were the electricity sector, particularly renewable energies, mining and commerce. Portfolio investment posted a deficit as outward flows of investment assets fell. Portfolio investment liabilities increased, with corporate bond issues abroad rising by 35%, as better interest rate conditions allowed for debt refinancing. The stock of international reserves totalled US\$ 40.447 billion, equivalent to 16.8% of GDP, 27.8% of total external debt or 6.2 months of imports.

In view of the trends observed in the first half of the year, the balance-of-payments current account deficit is expected to narrow in 2015, and could become a surplus if imports continue to contract.

(b) Economic activity

GDP expanded by 1.9% in 2014, owing to growth in all sectors apart from manufacturing, which contracted slightly. Business and personal services accounted for the largest share of growth (0.4 percentage points), driven by public and private health services and legal and accounting activities. Mining expanded by 1.2% as operations began on a new iron ore deposit. Growth in copper mining was marginal, as certain negative factors, such as declining ore grade in some deposits and maintenance work at certain sites, were counterbalanced by the opening of new operations. The manufacturing industry contracted by 0.3% year-on-year, with lower production in beverages, tobacco, wine, textiles, clothing and footwear. The fishing sector contributed to the upturn in the food industry. Construction was boosted by engineering works, especially in the electricity sector, although a decline in building construction slowed the momentum somewhat.

With regard to expenditure, domestic demand contracted by 0.6% year-on-year in 2014, after growing by 3.7% in 2013. Reduced investment was a key factor: after declining in the first three quarters of the year, it edged up slightly in the fourth and closed the year down by 6.1%. This fall was attributable to lower investment in machinery and equipment, a trend that began in 2013, when investment growth started to slow, and is expected to continue into 2015. Household consumption grew by 2.2% year-on-year—down from 6% in the two previous years—and was linked to higher consumption of services and, to a lesser extent, non-durable goods, and to lower consumption of durable goods. As budgeted, government consumption rose by 4.4% year-on-year. Exports grew by 0.7% year-on-year in 2014, as goods exports (industrial goods and copper) increased and services exports fell, owing to the reduced use of transport services. Imports contracted by 7% year-on-year, as fewer goods and services were purchased abroad. Imports of durable goods and capital goods declined, which also pushed down transport services imports. Performance in the first quarter of 2015 was similar to the previous year, with a slightly faster expansion of the tradable sector, driven by agriculture and mining, and a continued fall in manufacturing. The non-tradable sector sustained its growth rate, thanks to personal and business services, among other factors. Zero year-on-year growth was reported for exports, as services exports declined further. Imports also continued to fall, although at a slower pace than in 2014. Ultimately, against the backdrop of weak private consumption and investment, government spending is expected to propel growth in 2015, as was the case in the first few months of the year.

(c) Prices, wages and employment

Year-on-year inflation stood at 4.6% at year-end 2014, in a context of price rises that peaked at 5.7% in October. From that point until halfway through 2015, domestic prices reflected the lower oil prices, bringing down inflation, which, at 4%, nevertheless remained above the ceiling of the target range set by the central bank. A significant factor in the rising prices was the depreciation of the peso, which affected core inflation (4.3% at the end of 2014) through its impact on production costs. Higher prices for cigarettes, under the new tax reform, and for services also had an impact on inflation, which is projected to retreat towards the target range, as the exchange rate settles and indexed prices continue to be applied. Furthermore, the tax reform has already had an impact on inflation and its effects are expected to be more marked in 2015.

Unemployment averaged 6.4% in 2014, which was low considering the sluggish economic environment, but did reflect an increase over the 2013 rate (5.9%) as the participation rate rose by 0.25 percentage points while employment remained flat. In the first quarter of 2015, labour participation decreased as both employment and unemployment rates fell (the latter to 6.1%).

In 2014, wages rose by 6.6% year-on-year on average in nominal terms and by 1.8% in real terms. Over the first four months of 2015, nominal wages rose at a constant rate, slightly above the previous year's average, and real wages grew by 2.5% on average.

Table 1
CHILE: MAIN ECONOMIC INDICATORS

	2006	2007	2008	2009	2010	2011	2012	2013	2014 a/
	Annual growth rates b/								
Gross domestic product	4.6	4.6	3.7	-1.0	5.8	5.8	5.5	4.2	1.9
Per capita gross domestic product	3.5	3.6	2.7	-2.0	4.8	4.9	4.5	3.3	1.1
Gross domestic product, by sector									
Agriculture, livestock, hunting, forestry and fishing	4.0	0.9	4.0	-5.6	0.3	11.8	-2.2	-0.3	2.8
Mining and quarrying	0.7	3.3	-5.6	-1.0	1.5	-5.0	3.8	5.9	1.2
Manufacturing	3.9	3.0	1.4	-4.2	2.6	7.6	3.6	1.1	-0.3
Electricity, gas and water	7.6	-28.8	-1.8	13.8	8.4	11.7	8.4	9.8	4.9
Construction	4.0	4.6	10.1	-5.3	1.8	6.8	7.2	3.9	1.5
Wholesale and retail commerce, restaurants and hotels	6.9	6.2	4.9	-5.8	15.0	12.2	6.7	6.3	0.6
Transport, storage and communications	6.9	8.7	6.4	-5.2	8.8	7.0	9.8	5.3	3.8
Financial institutions, insurance, real estate and business services	4.2	8.0	3.2	2.0	5.4	7.5	6.0	3.4	2.2
Community, social and personal services	3.6	4.4	3.8	4.0	4.4	5.1	4.8	4.6	3.8
Gross domestic product, by type of expenditure									
Final consumption expenditure	7.0	7.0	3.9	0.8	9.8	7.8	5.7	5.5	2.5
Government consumption	6.4	7.1	0.5	9.2	4.6	2.5	3.5	3.4	4.4
Private consumption	7.1	7.0	4.5	-0.8	10.8	8.9	6.1	5.9	2.2
Gross capital formation	6.2	9.2	19.3	-23.5	30.8	16.5	11.3	-1.8	-12.1
Exports (goods and services)	5.1	7.6	3.2	-4.5	2.3	5.5	0.1	3.4	0.7
Imports (goods and services)	10.6	14.5	12.6	-16.2	25.5	16.0	4.8	1.7	-7.0
Investment and saving c/	Percentajes of GDP								
Gross capital formation	20.6	21.1	26.0	20.3	22.3	23.7	25.5	24.3	21.4
National saving	25.2	25.2	22.7	22.3	24.0	22.5	21.9	20.6	20.3
External saving	-4.6	-4.1	3.2	-2.0	-1.7	1.2	3.6	3.7	1.2
Balance of payments	Millions of dollars								
Current account balance	7,116	7,079	-5,800	3,518	3,769	-3,088	-9,624	-10,125	-2,995
Goods balance	22,947	24,132	6,074	15,360	15,941	11,040	2,333	1,820	7,767
Exports, f.o.b.	59,380	68,561	64,510	55,463	71,109	81,438	77,791	76,477	75,675
Imports, f.o.b.	36,433	44,430	58,436	40,103	55,167	70,398	75,458	74,657	67,908
Services trade balance	-875	-1,323	-1,208	-2,010	-1,897	-3,073	-2,744	-3,402	-3,757
Income balance	-18,363	-18,860	-13,596	-11,395	-14,686	-13,920	-11,274	-10,730	-8,857
Net current transfers	3,406	3,129	2,930	1,563	4,410	2,865	2,060	2,187	1,851
Capital and financial balance d/	-5,118	-10,293	12,244	-1,870	-746	17,278	9,258	10,436	4,052
Net foreign direct investment	6,586	8,326	7,453	6,159	6,049	3,057	7,902	8,956	9,950
Other capital movements	-11,704	-18,619	4,791	-8,029	-6,795	14,221	1,356	1,481	-5,898
Overall balance	1,997	-3,214	6,444	1,648	3,023	14,190	-367	311	1,057
Variation in reserve assets e/	-1,997	3,214	-6,444	-1,648	-3,023	-14,190	367	-311	-1,057
Other external-sector indicators									
Real effective exchange rate (index: 2005=100) f/	95.5	97.1	97.3	101.6	96.2	95.2	94.0	95.2	105.3
Terms of trade for goods (index: 2010=100)	89.8	92.9	80.8	81.7	100.0	100.6	94.9	92.2	91.0
Net resource transfer (millions of dollars)	-23,481	-29,153	-1,352	-13,265	-15,432	3,358	-2,016	-294	-4,805
Total gross external debt (millions of dollars)	48,601	53,627	63,534	72,617	84,986	99,306	120,546	132,632	145,666
Employment	Average annual rates								
Labour force participation rate g/	54.8	54.9	56.0	55.9	58.5	59.8	59.5	59.6	59.8
Open unemployment rate g/	7.7	7.1	7.8	9.7	8.2	7.1	6.4	5.9	6.4
Visible underemployment rate h/	8.5	8.0	9.0	10.8	11.5	11.9	11.5	11.6	11.3

Table 1 (concluded)

	2006	2007	2008	2009	2010	2011	2012	2013	2014 a/
Prices	Annual percentages								
Variation in consumer prices (December-December)	2.6	7.8	7.1	-1.4	3.0	4.4	1.5	3.0	4.7
Variation in industrial producer prices (December-December)	7.9	14.0	22.7	-14.9	3.5	10.0	0.7	-2.8	-3.3
Variation in nominal exchange rate (annual average)	-5.2	-1.6	0.2	6.8	-8.8	-5.2	0.5	1.9	15.2
Variation in average real wage	1.9	2.8	-0.2	4.8	2.2	2.5	3.2	3.9	1.8
Nominal deposit rate i/	5.5	5.9	7.8	2.3	2.7	5.6	5.9	5.2	3.9
Nominal lending rate i/	14.4	13.6	15.2	12.9	11.8	12.4	13.5	13.2	10.8
Central government	Porcentajes of GDP								
Total revenue	24.5	25.6	24.2	19.0	21.5	22.7	22.3	21.1	20.7
Tax revenue	17.4	19.2	18.9	15.3	17.2	18.7	19.0	18.2	18.1
Total expenditure	17.2	17.8	20.3	23.4	22.0	21.4	21.7	21.7	22.3
Current expenditure	14.3	14.7	16.7	19.0	18.0	17.3	17.7	18.0	18.5
Interest	0.7	0.6	0.5	0.5	0.5	0.6	0.6	0.6	0.6
Capital expenditure	2.9	3.1	3.6	4.4	3.9	4.1	4.0	3.7	3.8
Primary balance	8.0	8.4	4.4	-3.9	0.0	1.8	1.2	0.0	-1.0
Overall balance	7.3	7.8	3.9	-4.4	-0.5	1.3	0.6	-0.6	-1.6
Central government public debt j/	4.9	3.9	5.1	5.8	8.7	11.1	11.3	12.8	15.1
Domestic	2.3	1.9	3.0	4.5	7.2	9.2	9.9	10.9	12.4
External	2.7	2.0	2.0	1.3	1.5	1.9	1.4	2.0	2.7
Money and credit k/	Percentages of GDP, end-of-year stocks								
Domestic credit	52.4	57.7	61.7	63.6	55.5	60.1	61.8	63.3	63.2
To the public sector	-3.4	-3.3	-3.4	-1.8	-1.5	-1.3	-0.3	0.9	-0.1
To the private sector	60.5	66.2	75.5	72.4	67.3	71.8	75.5	78.2	80.3
Others	-4.8	-5.2	-10.3	-7.0	-10.3	-10.4	-13.4	-15.8	-16.9
Monetary base	4.2	4.1	4.5	4.8	5.0	5.6	6.1	6.4	5.6
Money (M1)	11.3	12.0	11.8	14.7	15.2	15.5	15.9	16.6	17.5
M2	46.4	51.4	56.1	53.4	50.2	55.9	56.7	59.6	60.7
Foreign-currency deposits	4.4	4.6	6.9	5.5	6.3	5.8	6.4	7.0	8.7

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

a/ Preliminary figures.

b/ Based on figures in local currency at constant 2008 prices. Up to 2008, local currency at constant 2003 prices.

c/ Based on values calculated in national currency and expressed in current dollars.

d/ Includes errors and omissions.

e/ A minus sign (-) indicates an increase in reserve assets.

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

g/ Nationwide total. New measurements have been used since 2010; the data are not comparable with the previous series.

h/ Nationwide total. The 2004-2005, 2006-2009 and 2010-2012 series

are not comparable. In the first series a different sample was used and in the later series different measurements were used.

i/ Non-adjustable 90-360 day operations.

j/ Does not include publicly guaranteed debt.

k/ The monetary figures are December averages.

Table 2
CHILE: MAIN QUARTERLY INDICATORS

	2013				2014				2015	
	Q.1	Q.2	Q.3	Q.4	Q.1	Q.2	Q.3	Q.4	Q.1	Q.2 a/
Gross domestic product (variation from same quarter of preceding year) b/	5.4	4.0	4.8	2.8	2.7	2.1	1.0	1.8	2.4	...
Gross international reserves (millions of dollars)	39,705	40,793	41,022	40,605	40,316	40,758	40,251	40,067	38,806	38,771 c/
Real effective exchange rate (index: 2005=100) d/	91.6	93.8	96.7	98.9	103.6	104.1	107.3	106.4	106.8	103.6 c/
Open unemployment rate	6.2	6.2	5.7	5.7	6.5	6.5	6.6	6.0	6.1	...
Employment rate	55.9	55.9	55.7	56.5	56.2	55.7	55.5	56.4	55.9	...
Consumer prices (12-month percentage variation)	0.8	0.6	1.5	1.8	3.2	4.9	4.9	5.6	4.4	4.1 c/
Wholesale prices (12-month percentage variation)	-3.3	-5.8	-3.4	-3.3	-3.1	1.5	3.3	-1.0	-6.6	-1.9 c/
Average nominal exchange rate (pesos per dollar)	472.4	485.4	507.0	517.1	552.0	554.7	577.9	598.2	624.5	617.9
Average real wage (variation from same quarter of preceding year)	4.4	4.6	3.4	3.1	2.5	1.3	1.8	1.5	2.6	...
Nominal interest rates (average annualized percentages)										
Deposit rate e/	5.4	5.1	5.3	5.0	4.4	4.1	3.6	3.6	3.3	3.6 f/
Lending rate e/	13.7	13.4	12.8	13.0	12.1	11.7	10.4	9.0	9.7	10.2
Interbank rate	5.0	5.0	5.0	4.7	4.3	4.0	3.6	3.1	3.0	3.0 f/
Monetary policy rates	5.0	5.0	5.0	4.7	4.3	4.0	3.5	3.1	3.0	3.0 c/
Sovereign bond spread, Embi Global (basis points to end of period) g/	153	180	171	148	143	123	137	169	158	158
Risk premia on five-year credit default swap (basis points to end of period)	66	99	89	80	78	64	78	94	83	87
International bond issues (millions of dollars)	3,109	2,822	1,999	3,610	1,274	1,432	5,341	5,721	1,263	3,884
Stock price index (national index to end of period, 31 December 2005 = 100)	226	205	195	188	192	197	201	196	199	198
Domestic credit (variation from same quarter of preceding year)	8.0	7.8	11.7	9.6	9.7	7.1	6.8	7.2	5.4	...
Non-performing loans as a percentage of total credit	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0 c/

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

a/ Preliminary figures.

b/ Based on figures in local currency at constant 2008 prices.

c/ Figures as of May.

d/ Quarterly average, weighted by the value of goods exports and imports.

e/ Non-adjustable 90-360 day operations.

f/ Figures as of April.

g/ Measured by J.P.Morgan.