

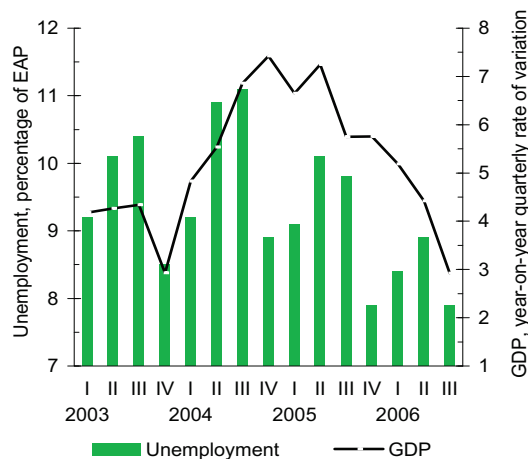
Chile

The growth rate posted for the Chilean economy in 2006 was lower than both the previous year's figure and initial projections. Nevertheless, thanks to policy continuity and a favourable external environment, the macroeconomic situation was stable, unemployment gradually diminished and the government's fiscal position remained sound.

Fiscal policy's continued focus on achieving a structural surplus of 1% of GDP translated into measures for saving the windfall revenues generated by rising international copper and molybdenum prices. In the first half of 2006 central government accounts showed a surplus of 6.2% of GDP, which, combined with the previous years' positive balances, yielded a cumulative surplus of 9.3% of GDP. Public spending rose by 6% in 2006. The budget law for 2007 calls for an increase of 8.9% next year together with a surplus equivalent to 4.4% of GDP.

The central bank continued to curb monetary growth during the first part of the year, but in August decided to suspend any further increases in the monetary policy rate, since domestic activity had expanded more slowly than expected; this trend then carried through to the end of the year. Core inflation was expected to fall within the lower part of the target range (between 2% and 4% annually), as indicators dropped sharply in the closing months of the year, in part because of lower fuel prices in the second semester. Accordingly, after rising from the low of 1.75% recorded in August 2004, the monetary policy rate stabilized at 5.25% in July 2006. Initially, the monetary authorities indicated that the break in the rate's upward trend would be temporary and that further hikes could not be ruled out if the rate of inflation made them necessary. At the end of the year the authorities altered their stance, however, implicitly admitting the possibility of a reduction in the monetary policy rate. This was because lower-than-expected growth meant that production-demand gaps would not be closed until 2007; in addition, inflation expectations were aligned with the target range and, since labour cost trends and the secondary effects from fuel price hikes have been moderate, inflation is under control. In November 2006 the 12-month inflation rate, calculated on the basis of the consumer price index, was 2.1%, while core inflation for the same period stood at 3.1%. Both indicators were trending rapidly downward from the levels observed up to June.

Figure 1
CHILE: GROSS DOMESTIC PRODUCT AND UNEMPLOYMENT



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

In 2006 the growth rate has been lower than in 2005 (6.3%), and GDP is expected to have expanded by about 4.4%, since growth in domestic demand has slowed sharply, with the 3.9% annual rate in the third quarter of 2006 falling well below the 11.5% recorded a year earlier. In terms of individual components, the drop in demand is due mainly to the slowdown in investment, especially in machinery and equipment, which in the third quarter of 2006 posted an annual expansion of 3%, compared to 48.6% for the same period of 2005. The growth rate for investment in construction and other works slowed from 9.5% in the third quarter of 2005 to an annual 3.3% a year later, while the annual rate of increase in consumption fell from 7.5% in the third quarter of 2005 to 6.4% in the same quarter of 2006. Durable goods consumption recorded a particularly sharp decrease, as it fell from 32.9% to 17.6% during this same period.

These results are due to a number of factors. First, the significant increase in investment during 2005 resulted in a build-up of stocks which was then rapidly reversed in the first part of 2006. Second, investment in construction slowed as a result of late starts on new projects and slower growth in demand for new housing. This last factor, together with slower increase in durables consumption, is attributable to the trend in bank credit, whose rate of expansion decreased in response to gradually rising interest rates and the toughening of conditions attached to corporate and personal loans, including, in the latter case, consumer and mortgage loans. The rise in international fuel prices reduced disposable private income by an estimated 1.5%, thus reinforcing the effect of the factors associated with slackening demand.

In contrast, the external environment remained favourable, and export growth is therefore expected to come in at a similar rate to that of 2005, while import volumes will show a smaller expansion than in that year. This is consistent with the reversal of the 2005 uptrends in investment in machinery and equipment and consumption of durable goods.

On the supply side, increased interruptions in the flow of natural gas from Argentina dampened production in some industries and, in the mining sector, technical difficulties and labour negotiations delayed production and constrained growth.

Employment continued to expand, although the annual growth rate as a moving average for the three months ending in September was 1.4%, which was below the peak annual rate of 5.5% observed in July 2005. This overall trend masks an important change in the structure of employment, however, since waged employment continued to expand steadily at a rate of close to 5%, while own-account employment contracted from mid-2005 onward. As the participation rate also fell, the unemployment rate continued to decline, reaching an average of 8.4% for January-September 2006—an improvement over the 9.7% recorded for the same period of 2005. Economic forecasts for 2007 and recently reported growth statistics for total employment indicate that unemployment levels should continue to fall, albeit a little more slowly.

The external environment remained positive, partly because of an estimated 34% terms-of-trade gain relative to 2005. The high prices for copper, wood pulp and fishmeal boosted export values to record levels, and export volumes

Table 1
CHILE: MAIN ECONOMIC INDICATORS

	2004	2005	2006 ^a
Annual growth rates			
Gross domestic product	6.2	6.3	4.4
Consumer prices	2.4	3.7	2.1 ^b
Average real wage ^c	1.8	1.9	1.9 ^d
Money (M1)	20.9	14.7	11.7 ^e
Real effective exchange rate ^f	-6.6	-5.0	-6.1 ^g
Terms of trade	21.5	11.9	33.7
Annual average percentages			
Urban unemployment rate	10.0	9.2	7.9 ^h
Central government overall balance/GDP	2.1	4.7	7.6
Nominal deposit rate	2.4	4.5	5.5 ⁱ
Nominal lending rate	11.0	13.5	14.7 ⁱ
Millions of dollars			
Exports of goods and services	38 278	47 746	67 723
Imports of goods and services	29 771	38 154	44 249
Current account	1 586	703	5 888
Capital and financial account	-1 772	1 013	-5 188
Overall balance	-186	1 716	700

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

^a Preliminary estimates.

^b Twelve-month variation to November 2006.

^c General hourly wage index.

^d Estimate based on data from January to September.

^e Year-on-year average variation, January to November.

^f A negative rate indicates an appreciation of the currency in real terms.

^g Year-on-year average variation, January to October.

^h Estimate based on data from January to October.

ⁱ Average from January to November, annualized.

are expected to rise at much the same rate as they did in 2005, in which case the current account is likely to show a surplus of 4.2% of GDP.

Investment levels are also expected to bounce back somewhat, in line with recent indicators showing a rise in project start-ups. With public spending budgeted to expand significantly, GDP growth is forecast at over 5% for 2007. Activity levels are expected to rise in the mining sector, since the technical problems and labour negotiations that hurt production in 2006 are in the process of being resolved.

The external environment will continue to be propitious, although doubts as to the direction to be taken by monetary policy in the United States have yet to be fully dispelled. Meanwhile, the supply of natural gas from Argentina will probably continue to fall short of demand, but, since oil prices are expected to come down from the highs seen in 2006, this may have a smaller impact on industry and households during the year ahead.