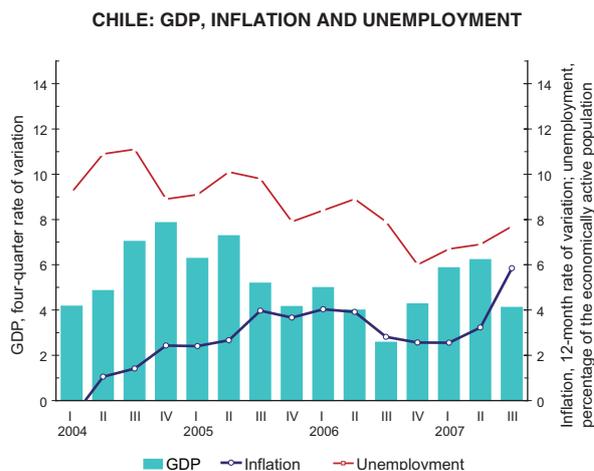


## Chile

In 2007, the rate of expansion of the Chilean economy increased in relation to the 4% recorded in 2006, and GDP growth for the year is estimated at close to 5.3%. This improvement was helped along by strong upward trends in most components of internal demand, led by a rise in investment of about 12%, a boom in comparison with the low levels of 2006. This was complemented by strong export growth which was due to high worldwide demand for the country's main exports (copper, molybdenum, wood pulp, methanol and salmon). Private consumption continued to expand, sustained by an active labour market, and public consumption was up almost 8.5%, in accordance with the terms of the budget law.

Macroeconomic management was made more difficult by risks which arose in the external and internal environments. First, soaring world commodity prices, while favourable for several of the country's exports, were reflected in increasing costs for a number of goods which affected prices on the domestic market: fuels, wheat, maize and milk. This was accentuated by a hard winter, the worst in many years, which had a strong negative impact on the supply of fruits and vegetables and caused sharp, albeit temporary, price rises. Furthermore, rising fuel prices and the energy shortage led to increases in regulated prices. This caused unexpected and sharp rises in both short- and long-term inflation indices from April onwards, and the inflation figure for the 12 months to October stood at 6.5%, exceeding the central bank's target range.

Second, the crisis in the United States mortgage market initially led to higher country-risk premiums for the emerging economies. This had a limited impact on Chile because the country is well equipped to deal with such fluctuations. The measures taken by the monetary authorities in the United States to deal with the crisis, including interest rate cuts, widened the positive margin between the rate in Chile and the United States rate. This led to faster appreciation of



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

the Chilean peso against the dollar, making it harder for some Chilean products to compete with imports and eroding the competitiveness of some exports.

Third, the outbreak of labour disputes cut the output of the state-owned and private mining industry and of some agro-industrial and forestry enterprises.

In the case of the Corporación Nacional del Cobre de Chile (CODELCO), it is estimated that the labour conflicts will result in higher costs and make it more difficult to generate surpluses.

Lastly, in July severe restrictions were placed on the supply of natural gas from Argentina, but this did not have a significant impact on electric power generation, thanks to the fact that many power stations which had been using gas are also able to run on diesel fuel. In any case, the cost of thermoelectric power generation increased and its value added fell. The production and export of methanol, the main input of which is natural gas, was affected, and this situation is expected to continue.

Despite these negative events, the foundations of the Chilean economy remain strong, characterized by great fiscal solvency, careful macroeconomic management and continuing buoyancy in the markets for its principal exports, which are well diversified. Thus, the economy is in a good position to cope with external fluctuations. The main exogenous risk factors are rising oil prices and the danger that an economic slowdown in the United States may spread to other developed economies. On the domestic scene, a possible source of risk might be a worsening of political and labour disputes in an election year such as 2008. However, the upturn in investment will strengthen supply and the continuing improvements in the labour market will boost consumption, so most analysts expect yearly GDP growth in 2008 to be around 5.0%.

There was continuity in the general orientation of the government's main policies, although some changes were seen in the parameters which govern them. Fiscal policy continued to aim for a structural surplus, the target for which was set at 1% of GDP up to 2007 but was lowered to 0.5% for 2008. Together with a relative increase in structural revenue from copper, this will continue to boost the economy. Real spending growth for 2007 is estimated at 8.5%, and the effective surplus should be about 7% of GDP.

In the monetary policy area, the authorities continued attempting to hold inflation within a target range of 2% to 4% annually, a goal which, according to the central bank, aims at the medium-term, or a period of 18 to 24 months. Unexpected surges in inflation from April onwards led to a series of increases of 25 basis points each in the monetary policy rate, in July, August and September, bringing it up to 5.75%. The rate has remained unchanged since October because of a relative slackening in economic activity, evidence that ripple price effects have had little impact on other products or on domestic wages, and that medium-term inflationary expectations had remained steady at an

#### CHILE: MAIN ECONOMIC INDICATORS

	2005	2006	2007 <sup>a</sup>
<b>Annual growth rates</b>			
Gross domestic product	5.7	4.0	5.3
Per capita gross domestic product	4.6	2.9	4.2
Consumer prices	3.7	2.6	7.4 <sup>b</sup>
Average real wage <sup>c</sup>	1.9	1.9	2.9 <sup>d</sup>
Money (M1)	14.7	11.9	16.5 <sup>e</sup>
Real effective exchange rate <sup>f</sup>	3.1	-4.3	2.2 <sup>g</sup>
Terms of trade	11.9	31.4	5.8
<b>Annual average percentages</b>			
Urban unemployment rate	9.2	7.7	7.0 <sup>h</sup>
Central government overall balance / GDP	4.5	7.7	8.0
Nominal deposit rate	4.5	5.5	5.8 <sup>i</sup>
Nominal lending rate	13.5	14.4	13.8 <sup>i</sup>
<b>Millions of dollars</b>			
Exports of goods and services	48 317	65 620	77 263
Imports of goods and services	38 148	44 329	53 133
Current account	1 315	5 256	7 985
Capital and financial account	442	-3 245	-10 985
Overall balance	1 757	1 997	-3 000

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

<sup>a</sup> Preliminary estimates.

<sup>b</sup> Twelve-month variation to November 2007.

<sup>c</sup> General hourly wage index.

<sup>d</sup> Estimate based on data from January to September.

<sup>e</sup> Twelve-month variation to October 2007.

<sup>f</sup> A negative rate indicates an appreciation of the currency in real terms.

<sup>g</sup> Year-on-year average variation, January to October 2007.

<sup>h</sup> Estimate based on data from January to October.

<sup>i</sup> Average from January to November, annualized.

annual rate of 3%. The authorities have not ruled out further rate rises if hikes in the prices of certain goods (foodstuffs, fuels) were to spread to other prices or to wages, thereby altering expectations. The central bank argues that the monetary policy rate is still below the neutral level and therefore has stimulated demand in practical terms; future rate rises cannot therefore be implicitly ruled out.

With a floating exchange-rate policy, a high level of integration into world markets and a low country risk, the depreciation of the United States dollar against other reserve currencies, improving terms of trade and the need for the state to sell a greater proportion of its dollar revenues to cover increased spending, should lead to further appreciation of the peso. The trend intensified in September owing to the widening gap between the central bank's internal and external interest rates, following its decision to increase them while the Federal Reserve of the United States was cutting its rates. Currency market trends in November 2007 do not point to any significant changes in that area, and the central bank denies that the real exchange rate is clearly out of alignment with its equilibrium level.

In sum, given the pickup in economic activity and the inflationary shocks, together with the downward trend in the value of the United States dollar against the world's currencies, monetary and exchange-rate policies will continue to face the challenge of striking a delicate balance between inflation targets and the need to maintain the competitiveness of the economy.

The labour market has reflected the recent economic buoyancy, recording the decade's lowest unemployment rates during the third quarter, and showing a marked increase in formal wage employment. The unemployment rate will average 7.0% for 2007, comparing favourably with the annual rate of 7.8% recorded in 2006.

In the first semester of 2007, the country's total exports posted a 12-month increase of 13.6%, led by mining (18.9%) and agriculture (6.5%). Over the same period, the volume of imports expanded by 17.5%, mostly owing to purchases of capital goods (20.5%) and intermediate goods (19.6%). The prices of the country's exports were up by 4.2% and those of its imports by 2%, indicating an improvement in the terms of trade. As a result, the balance-of-payments current account continued to show a surplus, which is expected to stand at 5.4% of GDP for the year as a whole. In October 2007, the central bank's international reserves totalled US\$ 16.2 billion.