CHILE: GROWTH WITH STABILITY (*)

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Good Morning. I think that this Conference is an excellent opportunity to share with you a review of the major developments in the Chilean economy during the last years, looking particularly at the developments in the capital market. Additionally, it provides a useful occasion to discuss the major challenges Chile faces in this area for the future.

I plan to tell you briefly about the performance of the Chilean economy during the last years and to provide you with an outlook for the medium term. I have organized my presentation in three sections. In the first one, I will comment on the main macroeconomic indicators during the last years. The conclusion of this section will be that Chile has experienced high economic growth and overall macroeconomic stability during this period. The second section will focus on external sector indicators and the increasing integration of Chile to the world economy. Finally, I will present some concluding remarks.

Before starting with this plan, I wish to emphasize that within the last decade, the major issues facing the Chilean economy have changed dramatically. A decade ago, just after the external debt crisis, the major challenge was to overcome the huge recession of the early eighties. At that time the country was facing a major balance of payments restriction and it was crucial to generate foreign exchange, in order to resume growth and reduce unemployment. Today, the Chilean economy is entering its twelfth year of continuous and high growth, unemployment is at low levels and the external constraint problem has disappeared. To make this latter point clear, one of the major challenges of these last four years has been to avoid a major appreciation of our national currency in face of very good export performance and large capital inflows. Savings and investment are at historical high levels and the current account of the balance of payments has improved significantly. On the other hand, at the time of the recession of the early eighties, inflation was not perceived as a major issue and we were used to live with an inflation rate of about 20% a year. During the 90s -the central bank became independent from the government at the end of 1989- the reduction of inflation has been a top priority and each year it has been gradually reduced from 27% in

1990 to less than 9% in 1994. Of course we still have a lot to do in this area -our target is to reach in the medium term an inflation rate below 4%- but we are sure things are going in the right direction. In general, it can be said that ten years ago the challenge was to get off the recession as soon as possible. Today the challenge is to approach the level of economic development of industrial countries.

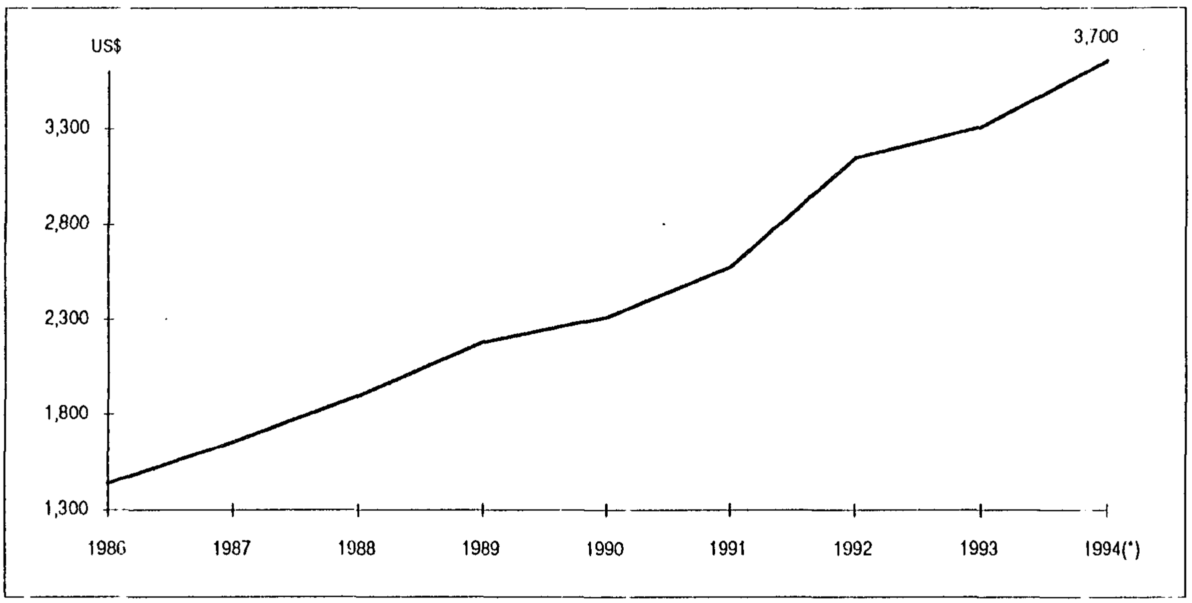
I. Main macroeconomic indicators

	Average 1986-94	1994
1. GDP Real Growth Rate	6.8	4.3 (*)
2. Unemployment Rate	6.6	5.9 (1)
3. Annual Inflation Rate (%)	17.0	8.9
4. Gross Fixed Capital Formation (% GDP)	22.4	26.3 (*)
5. Gross Domestic Savings (% GDP)	21.9	25.5 (*)
6. Real Interest Rate (2)	5.7	6.4

(*) Estimated
(1) Until Novenber
(2) On Central Bank 90 days bills

As it can be seen in this table, the average annual GDP growth in the period 1986-94 has been 6.8%. The unemployment rate, which reached 30% in the worst moments of the recession in the early eighties, has been 6.6% during 1986-94 and 5.6% on average in the period 1990-94. Real wages have grown at an average rate of 3.3% and inflation has been systematically decreasing over the last years. Gross fixed investment has been 22.4% of GDP on average during the whole period, though with an increasing trend. In the 1990-94 period investment has been 24.2% of GDP and in 1994 it reached 26.3% of GDP. The savings rate was 26% in 1994, the highest figure since statistics are available. These rates of savings and investment are similar to some of the successful East Asian countries, although they are still not as high as in most of them. However, if the growing trend continues -as it has been the case in the past, and as we expect it to be in the future- our savings and investment rates will reach about 30% of GDP in the coming years. Furthermore, during all these years the external accounts have improved significantly as it will be clear during the second part of this presentation.

Per Capita GDP 1986 - 1994



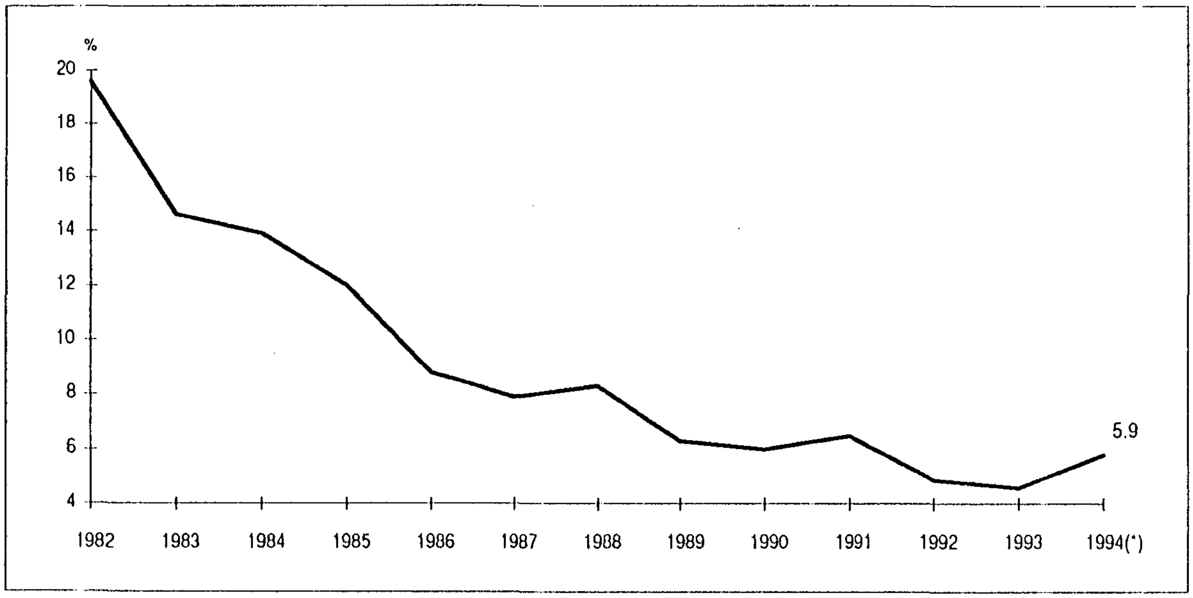
(*) Estimated

Figures are not adjusted by the purchasing power of domestic currency.

This figure shows the evolution of per capita GDP in current USD since 1986. It shows an impressive increase from US$1,438 in 1986 to an estimated US$3,700 in 1994. It is important to point out that sometimes it can be misleading to make international comparisons of per capita GDP in current dollars, because that measure depends in large degree on how appreciated or depreciated a currency may be in a given period of time. For example, if a country has temporarily appreciated its domestic currency, its GDP in current dollars will overestimate its true GDP. Additionally, the cost of living differs in different countries. With the purpose of making this type of information comparable, the World Bank publishes statistics of per capita GDP at purchasing power parity. According to the last publication, Chile had in 1992 a per capita GDP, in purchasing power parity, which is the second largest in Latin America -after Venezuela- and which is about 35%

of the US per capita GDP. Since 1992 Chile has had a high rate of growth, so it is very likely that our position in that ranking has kept rising.

Average Annual Unemployment Rate

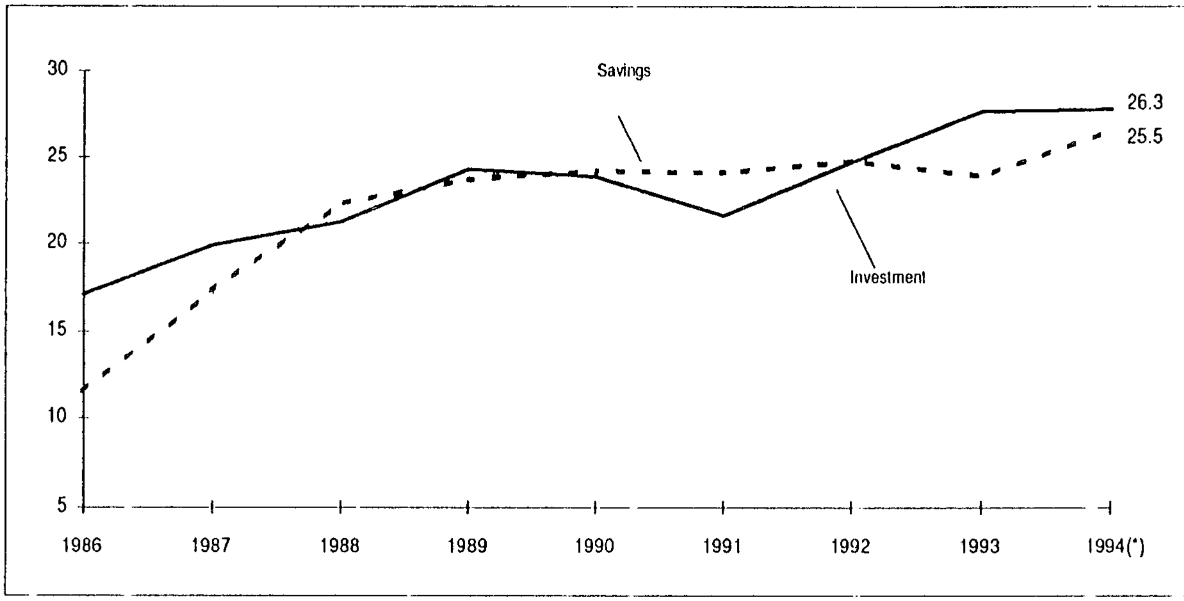


(*) Until November

Here we can see the evolution of the unemployment rate since 1982. It is remarkable how much Chile has achieved in this matter during the last years. Today´s unemployment rate is low, not only in historical terms, but also by international standards. In 1994 there has been a slight increase in the unemployment rate, which has its origins in a tight monetary policy aimed at keeping inflationary pressures under control. This tight monetary policy reduced the GDP growth rate for 1994 to an estimated 4.3%, which is lower than 6%, which is our estimated potential output growth. This lower growth has had some moderate negative effects on the unemployment rate. From next year on, however, we expect output growth to gradually resume its long term trend, which should also have a positive impact on employment.

Savings and Investment

as percentage of GDP

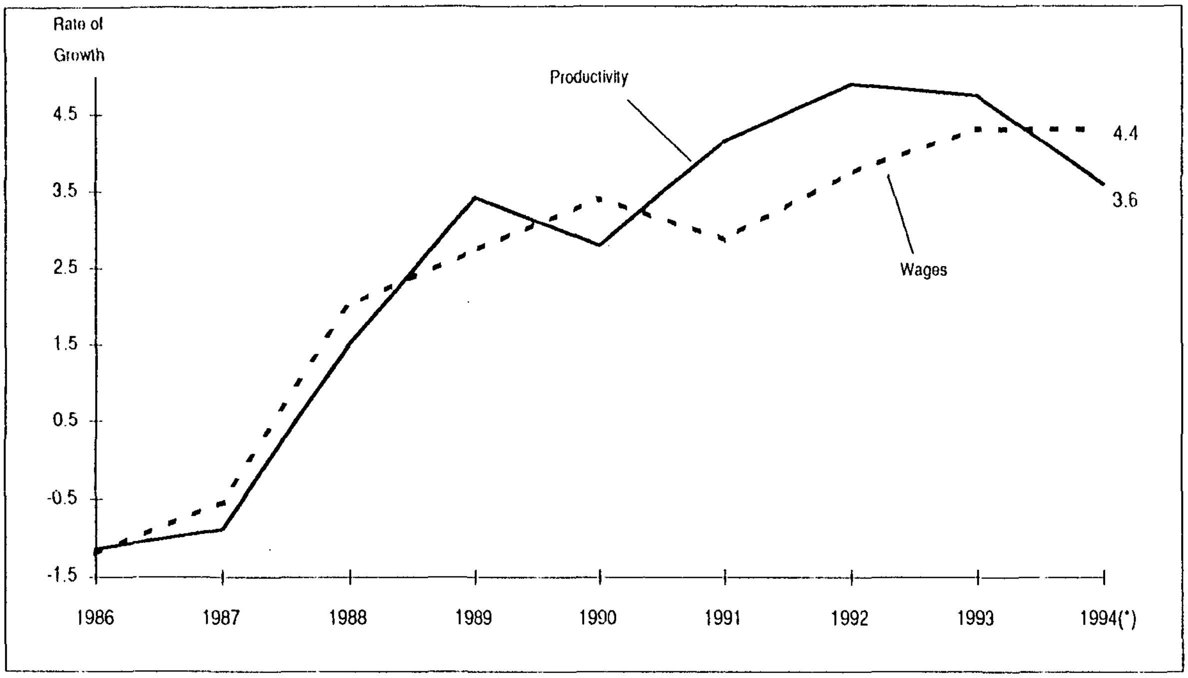


(*) Estimated

- Savings in nominal terms
- Investment represents the Gross Fixed Capital Formation in 1986 prices

The evolution of savings and investment has also been significantly positive. In 1986 domestic savings accounted for about 11% of GDP and today it accounts for more than 25% of GDP. Gross fixed capital formation, on the other hand, has increased from 17% in 1986 to more than 26% of GDP for 1994.

Productivity and Real Wages



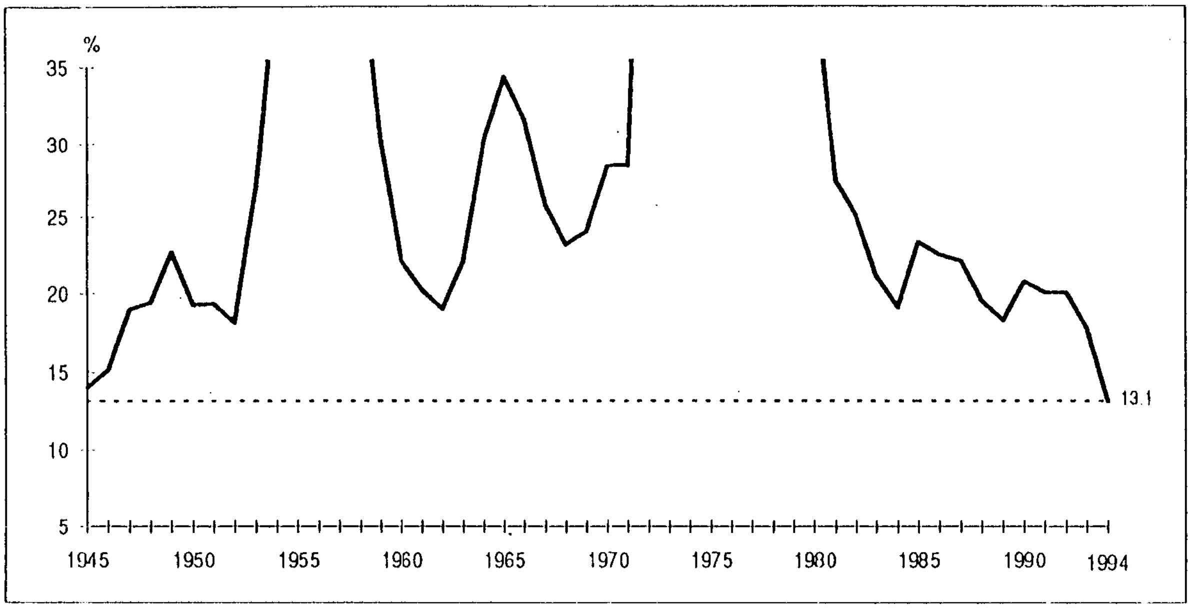
(*) Estimated
Three years moving average

This figure shows the evolution of real wages and productivity. As it can be seen, both have gone hand in hand. This reflects a sound macroeconomic policy, which implies the adoption of the necessary measures in order to avoid an excessive increase in wages and to keep inflation under control. As it is well known, the only medium term effect of wages growing faster than productivity is higher inflation. Indeed, the only medium term real gain in wages can be made out of higher labour productivity. This figure shows that there has been no disequilibrium for the Chilean economy in this matter in the last decade. We are absolutely convinced that the same should happen in the future, if we want to replicate in the next decade the successful macroeconomic performance of the previous one.

Annual Inflation Rate

As seen in this figure, inflation has decreased markedly since the Central Bank became independent. By the end of 1994 we reached an inflation rate slightly lower than 9%. I know that for those who are not Chileans, this inflation rate is still high. For us, at the Central Bank, it is also too high, and that is why we need to go on gradually but systematically reducing inflation in the coming years. However, in order to correctly understand what the current levels of inflation mean for the Chilean economy, it is important to go a little back in history.

Annual Inflation Rate: 1945 - 1994



Four years moving average

As this figure shows, the moving average for the four year period ending in 1994 is the one with lowest inflation in half a century in Chile. In other words, although our current inflation rate is still high for international standards, and we are decided to design and implement monetary policy so as to gradually move in the next years towards inflation rates below 4%, it is also true that having brought down the annual rate of growth of prices to around 9%, within a context of a decreasing inflationary time-path, cannot be considered a minor achievement for the Chilean economy.

I would like to stress that the current reduction in the rate of inflation has been achieved without having created any disequilibrium in other areas of the economy. In fact, the exchange rate and the external accounts, as well as the labour market, are in line with their fundamentals. In this sense, there is no risk of a major rebound in prices. This means that we are in good shape to continue our successful fight against inflation, within a growing economy characterized by increasing savings and investment as well as solid external accounts.

As a summary to this first section, let me say that Chile has had a high output growth rate during the last years and that it has been achieved in an environment of overall macroeconomic stability with no major or significant disequilibria. The return to democracy has provided an environment of political stability which is needed to create a favourable business climate. The medium and long term outlook looks very encouraging, with output maintaining its high growth rates which are being leaded, as in the past, by exports and investment.

II. External sector indicators and Chile's integration to the world economy

In this second section I will focus my comments on some external sector indicators, in order to show the evolution of the Chilean economy in this front, and also to see how our economy has been integrating itself to the world economy.

Main External Sector Indicators

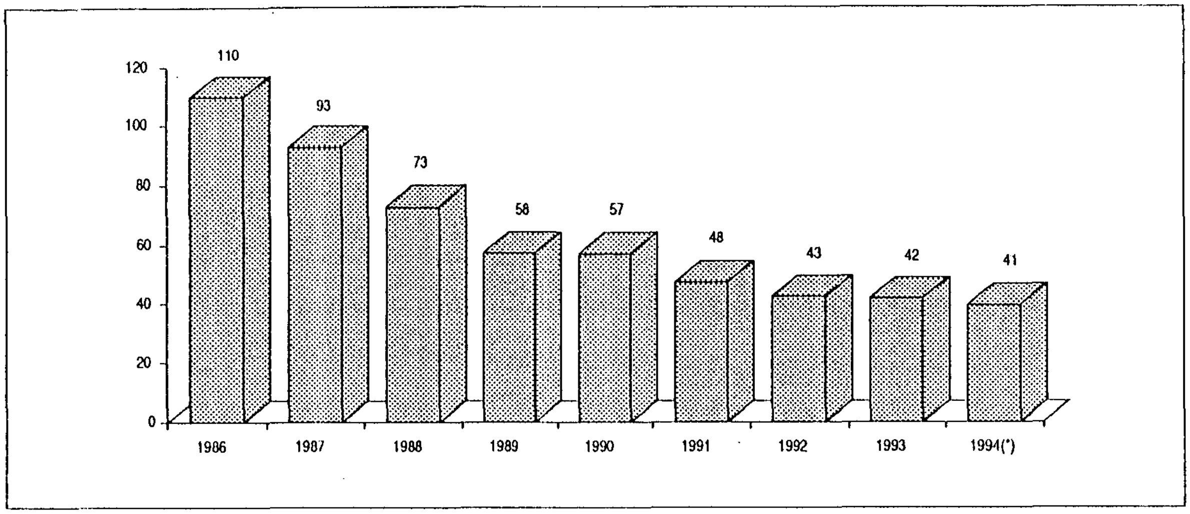
	1986-94	1994 (*)
1. External Debt / GDP (%)	63	41
2. External Debt / Export of Goods and Ss. (%)	202	143
3. Net. Int. Res. / External Debt	32	64
4. Real Exchange Rate (index, 1986=100)	104	95 (1)
5. Average tariff (%)	15	11
6. Growth Rate of Non-Copper Exp. of Goods (%)	16	21
7. Current Account Deficit / GDP (%)	2.6	0.9
(number of months)		
Net Int. Res. / Imports of Goods (Fob)	9	15
(% of par value)		
Price of External Debt	76	94

(*) Estimated
(1) Until November

As it can be seen, all the indicators show a positive evolution.

External Debt as Percentage of GDP

percentage

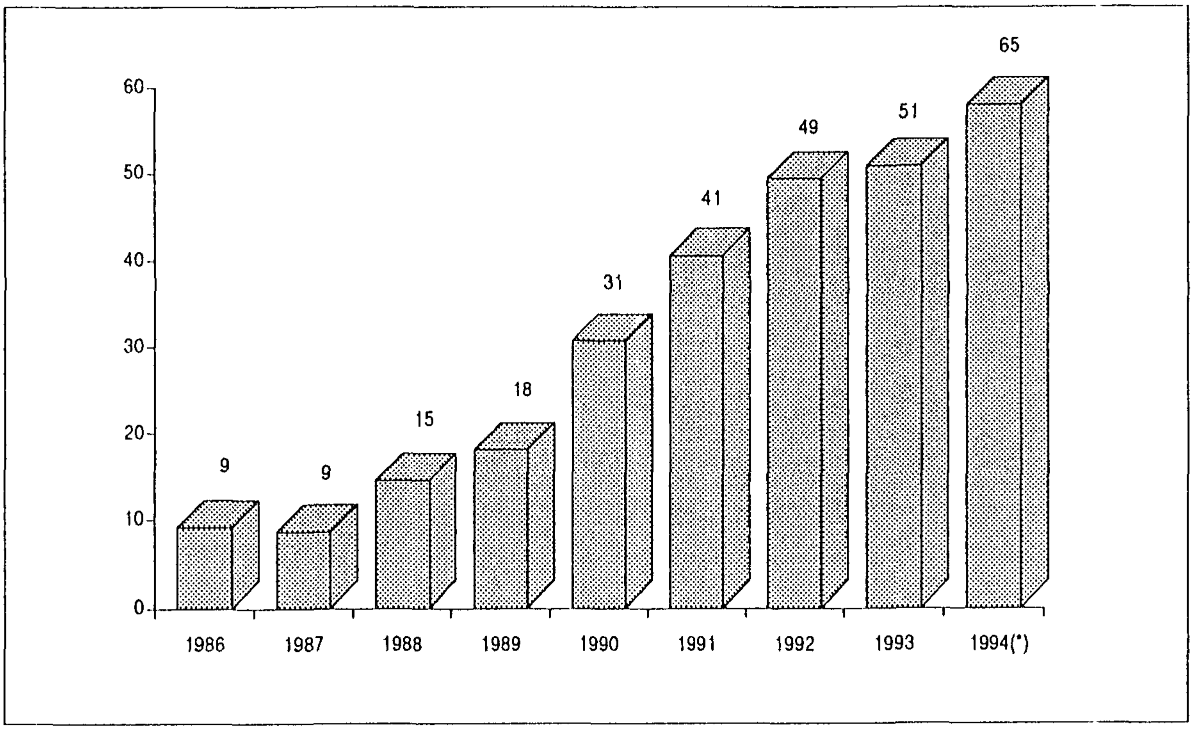


(*) Estimated

For example, the external debt, which in 1986 represented 110% of GDP, in 1994 accounts for about 41% of GDP. Related to exports of goods and services, debt has decreased from about 400% in 1986 to around 140% in 1994.

Net International Reserves / External Debt

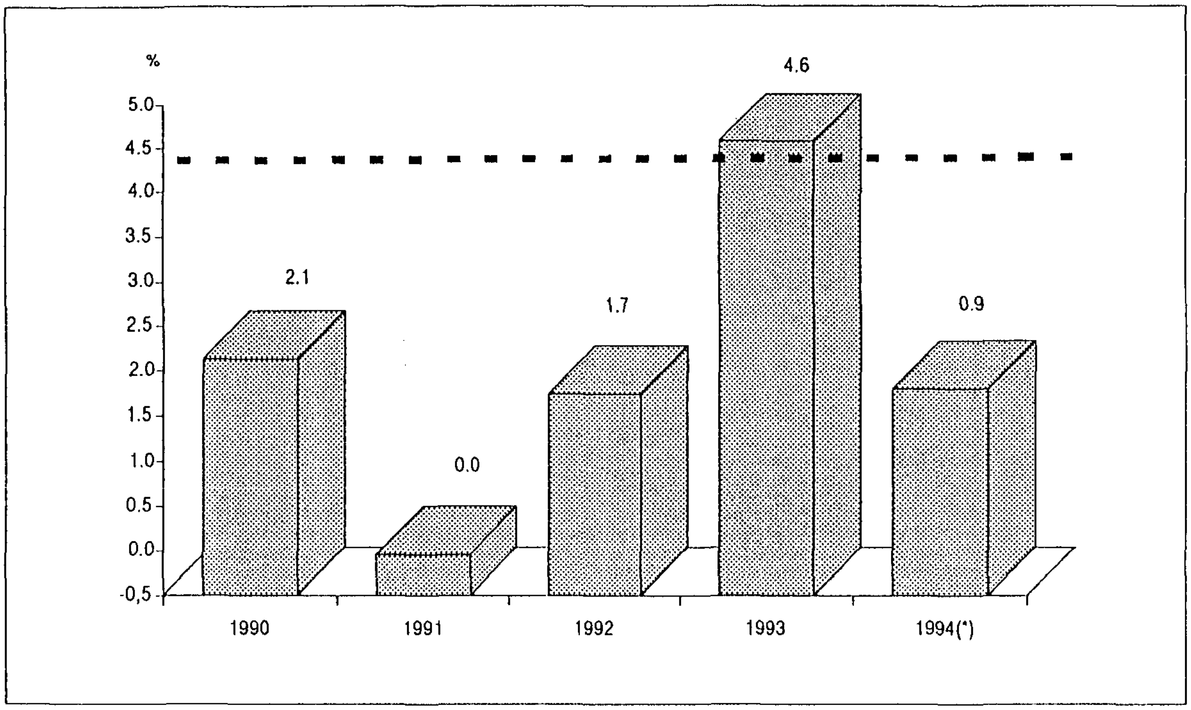
percentage



(*) Estimated

Net international reserves, on the other hand, have expanded from less than 9% of total external debt in 1986 to about 65% in 1994. This figure and the previous one mean that the net external debt, i.e., net of international reserves, has decreased from 100% of GDP in 1986 to less than 15% in 1994.

Current Account Deficit as Percentage of GDP



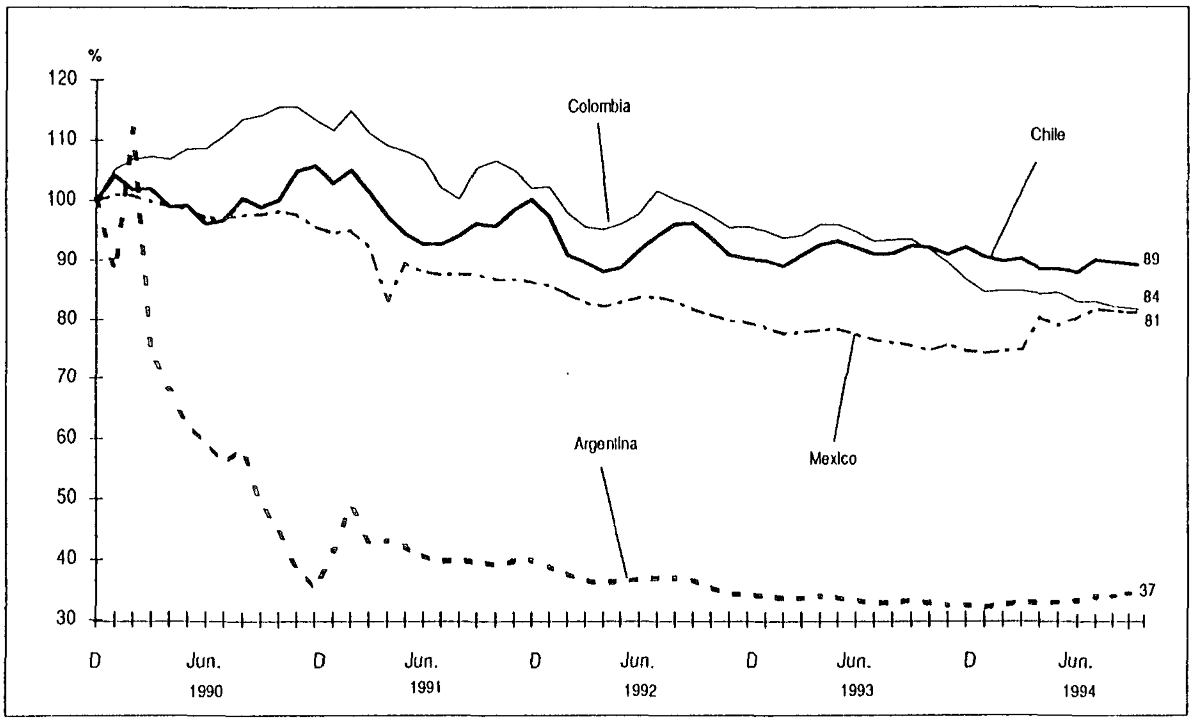
(*) Estimated

This figure shows the current account deficit as percentage of GDP. Our policy target is to have current account deficits, on average, lower than 4% of GDP. Having larger current account deficits could, in the long run, endanger our external strength and creditworthiness and make the country more vulnerable to external shocks. With a current account deficit in the target range, the external debt will keep gradually falling as percentage of GDP. As this table shows, the current account deficit has largely been within the target range during the last years. Of course, if in one particular year it is somewhat higher than 4%, it is no matter of concern if it is deemed to be transitory. For example, an adverse terms of trade shock produced a current account deficit of 4.6% of GDP in 1993. However, it was clear that the depressed international prices of our main exports was a transitory situation, and therefore, no policy measures were necessary. As you may see, in 1994 things came back to the target track in such a way that the current account deficit was slightly lower than 1% of GDP. The point we wish to stress here is that, in the long run, we estimate it desirable to have reasonable current accounts deficits; and by reasonable we currently mean somewhat lower than 4% of GDP.

It is also important to point out that international comparisons with this indicator can be misleading. Indeed, a country that has an appreciated domestic currency shows a higher GDP (measured in current dollars) and thus a lower current account deficit as a percentage of GDP.

Real Exchange Rate: December 1989 - October 1994

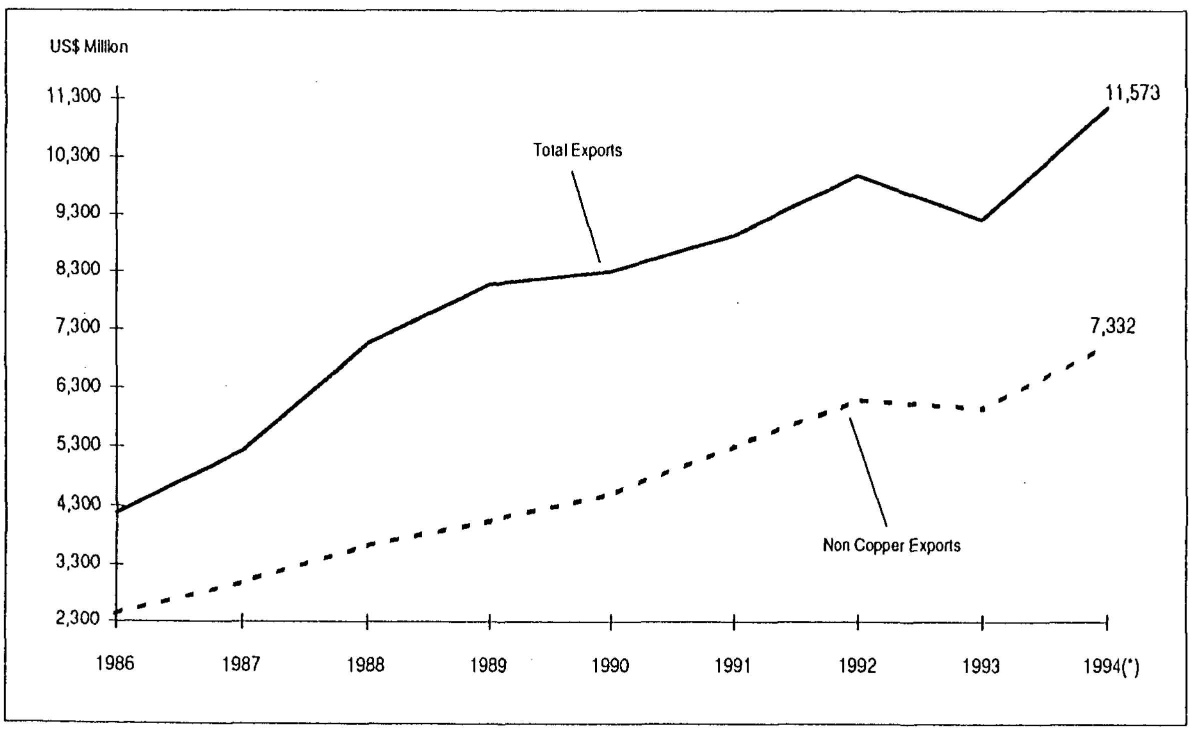
index, December 1989 = 100



Central Bank Estimates

This figure shows the evolution of the real exchange rate for several Latin American countries. A decreasing path means an appreciation of the local currency. As it can be seen, Chile is the country, within this sample, which has exhibited the smallest appreciation since the end of 1989. Although market forces have pressed towards an appreciation in most of Latin America, we are aware that in certain cases some financial and asset bubbles can appear and key macro-prices can be temporarily out of line with fundamentals. This can have particular damaging effects on the level and rate of change of the exchange rate. For example, in periods of large capital inflows, the exchange rate can fall below its fundamentals. This is especially damaging for the exportable sector and, lastly, for the economy as a whole. So, although we think that there has been an equilibrium appreciation of local currency, a significantly larger appreciation is not desirable, because it is not a sustainable medium term equilibrium situation. This is one of the reasons why we have imposed reserve requirements on short term foreign financing and other restrictions on capital inflows. In the last years, and until recently, the relevant international interest rate for Chile has been historically low, and has created some problems for the management of our monetary policy, in the context of an exchange rate policy which is based in a central parity plus a band of ±10%. The difference between the domestic and the international interest rate induced large short term capital inflows to Chile. The purpose of the reserve requirement is to make the short term foreign indebtedness more expensive, in order to decrease these type of capital inflows. So far we have been successful and the rather moderate appreciation that this figure shows is an evidence of that.

Total and Non - Copper Exports

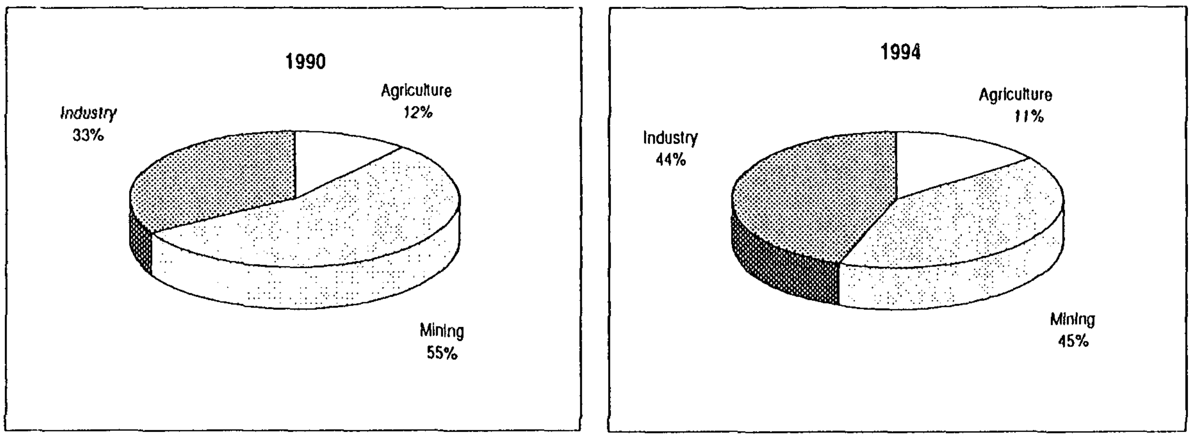


(*) Estimated

The growth of exports has been quite impressive during the last years. Indeed, while in 1986 total exports of goods amounted to US$4.2 billion, they reached US$11.6 billion in 1994. The growth rate of non-copper exports has been even higher: they have increased almost threefold between 1986 and 1994 (from US$2.4 billion to more than US$7 billion).

Export Structure

percentage of participation



Exports have not only increased in dollar terms but they have also diversified substantially. Industrial exports, for example, have increased from 33% of total exports of goods in 1990 to 44% in 1994, while the share of mining exports has declined in the same years from 55% to 45%.

Flows of Gross Foreign Investment

(Excluding Chapter XIX)

US$ Million

	1986	1987	1988	1989	1990	1991	1992	1993	1994 (*)
1. D.L. 600 (1)	186	373	702	727	1,376	1,017	1,014	1,754	2,533
2. ADR	0	0	0	0	105	9	292	822	1,727
3. Other Sources	7	15	18	17	36	98	158	204	410
Total	**193**	**388**	**719**	**744**	**1,516**	**1,124**	**1,463**	**2,780**	**4,670**
% GDP	1.1%	1.9%	3.0%	2.6%	5.0%	3.3%	3.4%	6.1%	9.1%

(*) Estimated

(1) Includes disbursement of associated loans

Source: Balance of Payments

Regarding foreign investment, it has grown from about 1% of GDP in 1986 to more than 9% estimated for 1994. Most of the increase has come from foreign direct investment (DL600), which has increased more than tenfold since 1986. It is interesting to note that since 1990 ADRs are also present and with an increasing importance within foreign financing. Shares of eighteen of our major enterprises are currently traded in the international financial markets and this number is increasing rapidly. The total inflow to Chile by issuing ADRs is almost US$3 billion. The requirements to issue ADRs -in terms of minimum amounts, required risk rating, etc. have been gradually relaxed in a process of increasing integration with international financial markets.

Gross Capital Outflow - Chapter XII

US$ Million

1990	15
1991	100
1992	353
1993	411
1994 (*)	865
Accumulated during the period	1,744 (1)

(*) Estimated

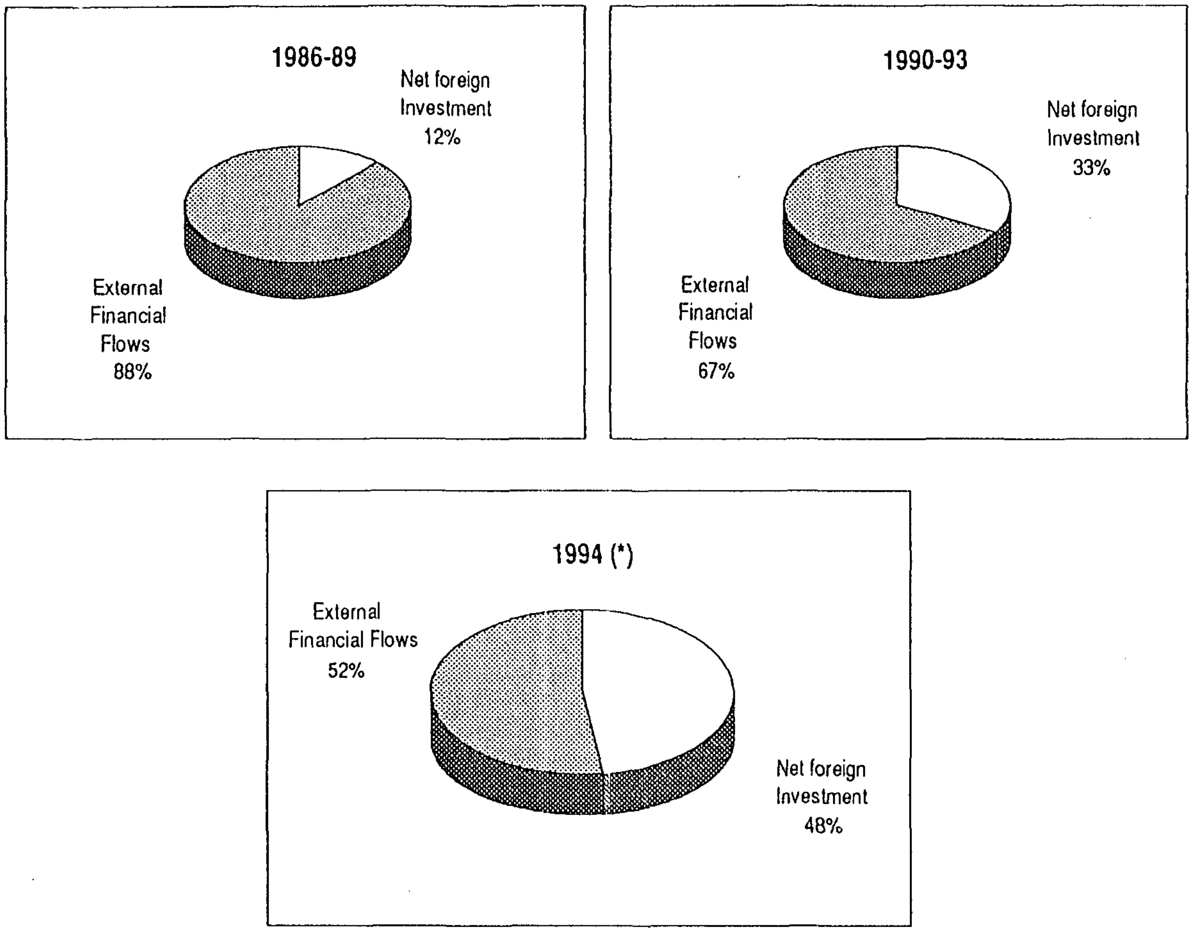
(1) Total Accumulated since 1975 is US$ 1,895 Millions

Source: Balance of Payments

In 1990, rules governing Chilean investment abroad were simplified, producing a major increase in these investments. Indeed, between 1975 -the year in which the previous rules were set- and 1989, the total Chilean investment abroad amounted to only US$166 millions. Between 1990 and 1994 this figure increased to more than US$1.7 billion. This means that during fifteen years the total investment by Chileans abroad was only ten percent of what it has been during the last five years. Again, this shows that the integration with the world economy is not anymore only in terms of flows of trade, but also in terms of flows of real and financial investment.

Net Foreign Investment and External Financial Flows

percentage of capital account



(*) Estimated
- Net Foreign Investment excluding associated credits and Chapter XIX
- External Financial Flows including associated credits

Source: Balance of Payments

This figures show what I would call a rather healthy evolution of the composition of the inflow of capital during the last years. The first figure shows that net foreign investment has increased its share in total net inflows to Chile, from 12% in 1986-89 to 33% during 1990-93 and to almost 50% in 1994.

External debt flows

US$ Million

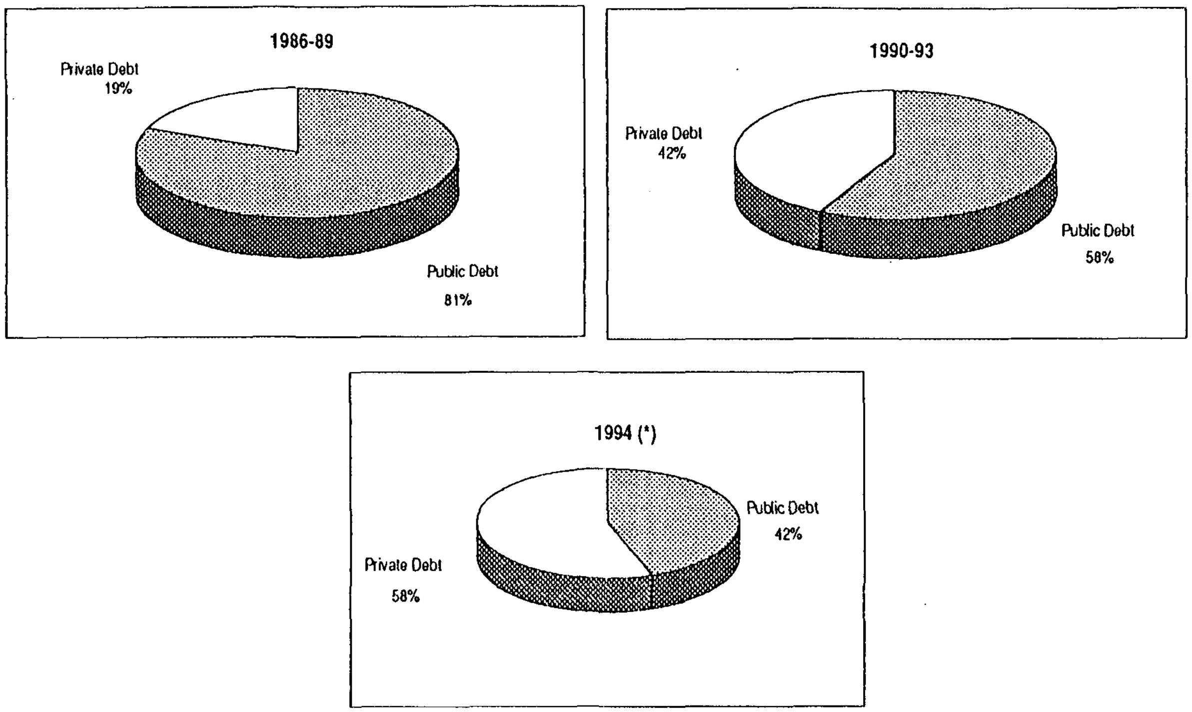
	1992	1993	1994 (*)
Debt	1,878	944	2,017
1. Medium and Long Term Debt	602	932	1,929
2. Short Term Debt	1,276	12	88

(*) Estimated

The second figure shows how debt flows have concentrated increasingly in the long run. Indeed, out of the total flows of debt during 1993 and 1994, more than 90% are medium and long term credits, and therefore the rest, less than 10%, are more volatile, short term ones. Of course, the reserve requirement on short term credits, which I refered to earlier, has something to do with this.

Public and Private External Debt

percentage of total debt



(*) Until August

This last figure shows that public external debt has declined significantly its share in total foreign debt. While in 1986-89 it represented more than 80% of total external debt, by 1990-93 it had reduced its share to less than 60%, and to 42% in 1994.

As a summary to the second section of my presentation, it is necessary to stress, in the first place, that Chile presents sound trade and current account balances. Special mention deserves the very dynamic behaviour of exports and particularly of non-traditional exports. Chile´s sovereign risk has been classified by international rating agencies in BBB+, which is the highest classification in Latin America. For several years now, we do not have an IMF program, and the bonds that our enterprises have floated in the international capital market have been priced with a risk premium among the lowest of similar Latin American enterprises. Foreign investment has increased significantly and represents today about 9% of GDP. Most of this foreign investment corresponds to direct investment, although lately ADRs have become increasingly important. The capital account structure has shown a positive evolution, in the sense that financial inflows into the country are of a more sustainable and anticiclycal nature, thus reducing the vulnerability of the Chilean economy to changes in world interest rates and/or to eventual and abrupt changes in foreign creditors assessment of the country risk evaluation and creditworthiness. There has been an increasing share of capital inflows corresponding to foreign investment rather than debt. Within the debt component, an increasingly larger share consists of medium and long term rather than short term debt and also an increasingly larger component corresponds to private rather than public debt. Finally, Chile's economy presents a consistently growing integration to the international financial markets.

III. Concluding remarks

I will finish my presentation with some concluding remarks. As it has been shown, Chile has had high growth rates during the last years. Between 1986 and 1994 its average growth rate has been 6.8% a year. This has been accompanied by increasing investment and savings rates, which are currently around 26% of GDP. Unemployment is at low levels. The perspectives are really promising. We estimate that the growth rate will be 6% on average during the following years and that investment and savings will keep rising. This performance has been achieved in an environment of internal and external equilibria. On the one hand, inflation and unemployment trends have been falling. In 1994 the inflation rate was 8.9%, which is a major achievement for my country, so used to chronic and high inflation, and we are decided that in the medium run the annual inflation rate will be below 4%. On the other hand, the external accounts have improved markedly and the current account deficit has been kept within reasonable magnitudes. This shows that the external situation is also in equilibrium. Regarding this issue, it is important to stress that in the last decade, in Chile the exchange rate has not been used for antiinflationary purposes. We had a bad experience in the early eighties with that type of policy and so we avoid it, especially if it means a large appreciation of our currency. The main instruments used for stabilization purposes have been and will continue to be tight monetary and sound fiscal policies.

I would like to highlight the responsibility with which the financial opening up strategy has been designed and implemented. The opening of our capital account has been based on a gradual and prudent approach which privileges overall macroeconomic equilibria. Steps taken so far imply that the capital account today is almost completely open. Individuals and enterprises can invest with no restrictions abroad. There still remain some restrictions to investment abroad for institutional investors and banks. The new capital market law -which is about to be definitely approved- and the new banking law -being discussed in Parliament- contain significant advances in this matter. Once these two laws are approved, the remaining restrictions for capital outflows will be the traditional prudential restrictions used in almost all countries. With respect to capital inflows, the major restriction is the reserve requirement, which, as it was said, is motivated by the management of the exchange rate and the monetary policy. It is recognized that this reserve requirement has some costs in terms of resource allocation, but we are convinced that the macroeconomic benefits largely exceed those costs.

Finally, the major macroeconomic challenges that the Chilean economy faces today are: (i) to increase productivity, (ii) to increase even further the savings rate, (iii) maintaining, as has been done rigourously in the past, the macroeconomic equilibria, (iv) to achieve in the medium term, inflation rates below 4% a year and (v) to continue our so far successful process of commercial and financial integration to the world economy.

We are convinced that by maintaining and deepening the macroeconomic stability framework is the best way in which the Central Bank may contribute to foster sustainable growth and to reduce inflation, while at the same time achieving sound external accounts and increasing integration of Chile to the international economy.

Thank you very much.