
CHILE

1. General trends

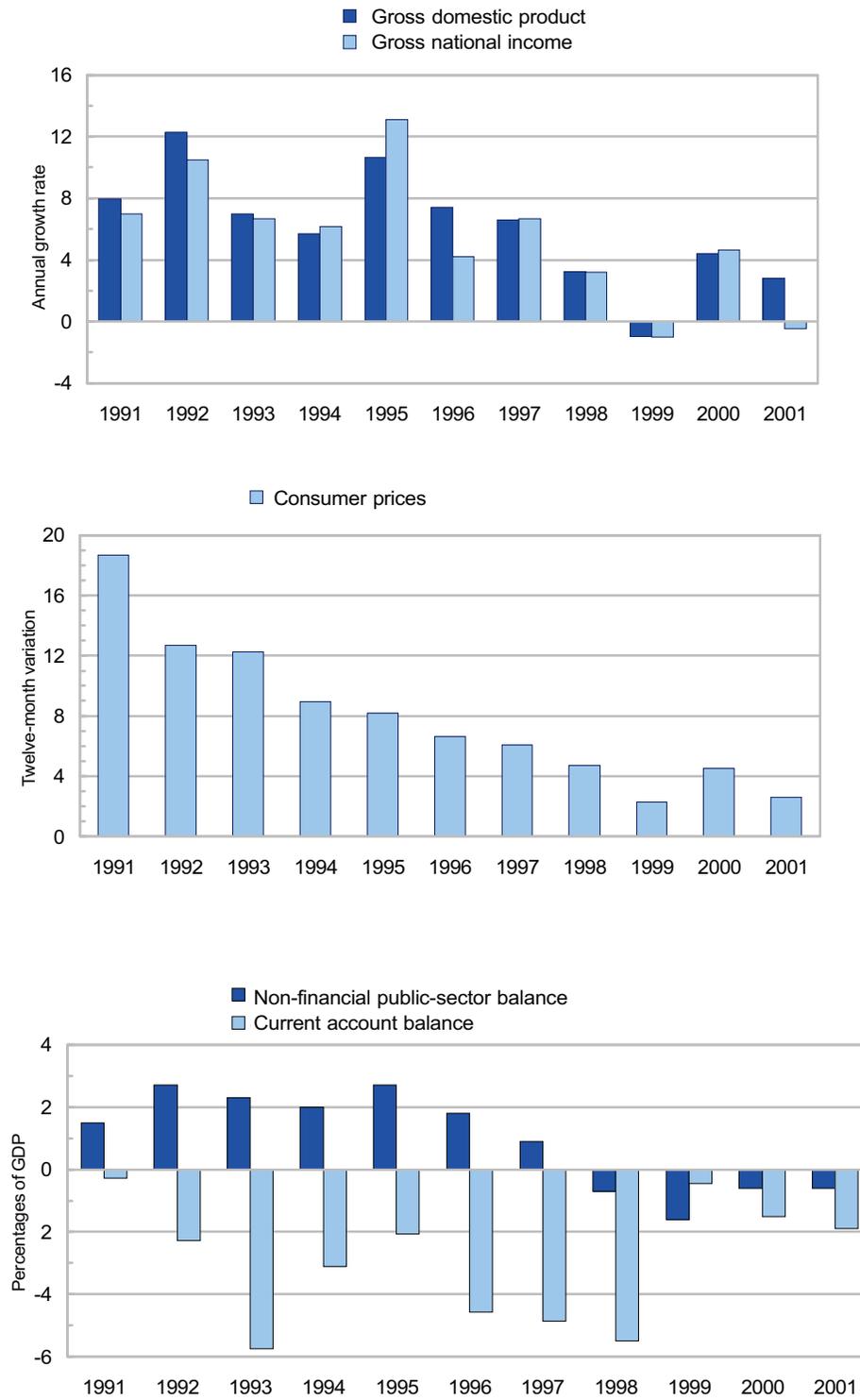
The Chilean economy's growth rate slackened from 4.4% in 2000 to 2.8% in 2001. The worldwide economic slowdown dealt a severe blow to the terms of trade, which fell by 8.7%, with the result that national income decreased by 0.5%. Indeed, the external environment in 2001 was one of the worst the country had faced since the mid-1980s: according to official estimates, copper and petroleum prices and dwindling inflows of external capital resulted in a loss of income on the order of seven percentage points of GDP in comparison to what would have been expected in a "normal" year. Average growth for 1998-2001 was 3%, which contrasts with the average of nearly 7% recorded between 1986 and 1997, while the 12-month inflation rate was 2.6%. The external deficit amounted to 1.2% of GDP and the public deficit to 0.3% of GDP. Despite harsh international conditions and the stagnation of domestic spending, an exchange-rate hike and the reduction of the interest rate set by monetary policy-makers created monetary conditions that will undoubtedly have a reactivating effect in the medium term. Nonetheless, the real interest rate applicable to most firms remained very high, thus reflecting the difficulties involved in passing on rate cuts to the credit market.

THOUGH ACTIVITY remained virtually stagnant in the first half of 2002, recent Central Bank projections point to a 3% increase in GDP. This presupposes a robust and rapid recovery in the GDP of Chile's main trading partners (the United States, Europe and Japan), which would also improve the terms of trade. The volume of exports would be the most dynamic component of aggregate demand, since it is likely to grow at an annual rate of 7%.

Domestically, it is quite possible that spending will pick up in the second half of the year owing to the expected replenishment of inventories, a reduction in the monetary-policy interest rate (to historically low

levels of around 4% a year in nominal terms) and the projected 5% increase in public expenditure, which can be expected to generate macroeconomic effects. Public investment will rise by about 11%, while the central government's deficit is projected to amount to about 0.3% of GDP. The outlook for the current account points to a possible deficit of 2.3% of GDP, assuming average prices of US\$ 0.73 per pound for copper and US\$ 24 per barrel for petroleum. This deficit can easily be financed, even if global capital flows to emerging economies continue to dry up at their current rapid pace. Owing to the absence of inflationary pressures, prices are expected to increase by 2.7% up to December 2002.

Figure 1
CHILE: MAIN ECONOMIC INDICATORS



Source: ECLAC, on the basis of official figures.

2. Macroeconomic policy

Since stubbornly high unemployment and its effects on private investment and consumption dampened the expectations of domestic economic agents considerably in 2001, the authorities tried to stop the contraction of demand through moderately counter-cyclical fiscal, monetary and foreign exchange policies.

(a) Fiscal policy

The central government recorded a deficit equivalent to 0.3% of GDP, which was slightly higher than the budgeted level but lower than the figure projected by private analysts. Revenues, in contrast, showed a real increase of 3.8%. Local-currency tax receipts were much higher than analysts had been led to expect by the behaviour of their determinants (i.e., domestic demand and imports). This development was attributable to the decline in tax evasion brought about by the implementation of a series of measures during the year and to more careful oversight. Because the average price of copper (US\$ 0.716) was far below the price used in preparing the national budget (US\$ 0.88), the government had to withdraw a total of US\$ 420 million from the Copper Stabilization Fund. However, the price slump was offset by the increased output of CODELCO and the effects of a higher-than-expected exchange rate (the central government ran a surplus in dollar terms).

Expenditures having macroeconomic effects were fully executed and rose by 5.2% with respect to the preceding year. The 2.5% increase in operating expenses (personnel and consumer goods and services) in 2001 was moderate in comparison to the 9% upswing in real investment and capital transfers. The latter included the bulk of the resources in the Employment Contingency Fund, which were used to finance over 150,000 subsidized jobs, especially in the third quarter. Programmes to provide direct public employment or subsidies for private employers helped to mitigate the deterioration of the situation in the labour market over the winter.

The authorities met their previously announced structural surplus target of 1% of GDP, which required a sizeable adjustment (on the order of 0.8% of GDP). As mentioned earlier, this discretionary contraction, or negative fiscal impulse, was primarily a reflection of the expansion of tax receipts. Thanks to the authorities' policy of allowing automatic fiscal stabilizers to operate freely, the unforeseen cyclical variations in income did not affect budget performance. This relative autonomy of expenditure, which cushions it from volatility in

revenues, is a hallmark of current fiscal policy and has a powerful stabilizing effect on the level of activity. The over 5% rise in public expenditure in 2001 contrasted with the 1.8% decline in private expenditure.

An important development in 2001 was the country's placement of a US\$ 650 million sovereign bond issue, with a rate of 7.2% and a spread of only 256 points. The funds raised by this means were paid into the Copper Stabilization Fund so that any public deficit could be financed even if the price of copper remained low. In April 2002 the authorities launched a US\$ 600-million sovereign bond issue with a spread of just 134 basis points. All these resources will be used to make prepayments on debts previously incurred by the State at higher rates. This operation is expected to result in savings of US\$ 30 million a year, which will be allocated to employment programmes. The Government also floated a bond issue in the amount of 300 million euros, with a spread of 83 basis points with respect to German treasury bonds. These resources are to be used to finance part of the fiscal deficit budgeted for 2002, which is expected to amount to 0.3% of GDP.

(b) Monetary policy

In line with the aim of keeping inflation in the 2%-4% range and with the operational target of 3%, in August 2001 the Central Bank took steps to "nominalize" the policy rate of interest by setting the rate in nominal terms. Previously, the rate had been set in real terms on the basis of operations carried out in *unidades de fomento* (UF), which are inflation-indexed units of account.

As the combined effect of domestic and external factors helped to alleviate inflationary pressures, the Central Bank successively reduced the policy interest rate and altered the tranches for the line of liquidity credit. These measures have been reflected in a decrease of 150 basis points since the beginning of January, with the policy rate dropping from 8% to 6.5% in nominal terms as a result of the five adjustments that were made in the course of the year. In 2002 the Central Bank Council decided to reduce the monetary-policy rate four more times up to May; the rate finally reached 4% a year, while the line of liquidity credit's tranches were adjusted by a total of 250 basis points. However, the reduction was considerably less drastic in real terms, since inflation was lower than expected. In fact, while the monetary-policy rate fell by 400 basis points in nominal terms, the reduction did not exceed 100 basis points in real terms.

Table 1
CHILE: MAIN ECONOMIC INDICATORS

| | 1993 | 1994 | 1995 | 1996 | 1997 | 1998 | 1999 | 2000 | 2001 ^a |
|--|--------|--------|--------|--------|--------|--------|--------|--------|-------------------|
| Annual growth rates^b | | | | | | | | | |
| Growth and investment | | | | | | | | | |
| Gross domestic product | 7.0 | 5.7 | 10.6 | 7.4 | 6.6 | 3.2 | -1.0 | 4.4 | 2.8 |
| Per capita gross domestic product | 5.2 | 4.0 | 8.9 | 5.9 | 5.1 | 1.8 | -2.3 | 3.1 | 1.5 |
| Gross domestic product, by sector | | | | | | | | | |
| Goods | 6.8 | 5.0 | 8.1 | 6.5 | 6.0 | 1.2 | -0.8 | 3.8 | 2.4 |
| Agriculture | 3.1 | 7.5 | 6.9 | 2.8 | 3.4 | 2.3 | 0.0 | 6.7 | 6.5 |
| Mining | -0.2 | 8.9 | 9.3 | 15.8 | 11.3 | 8.3 | 11.1 | 5.2 | 3.6 |
| Manufacturing | 7.3 | 4.1 | 7.5 | 3.2 | 4.7 | -2.3 | -1.3 | 4.0 | -0.3 |
| Construction | 23.5 | -1.1 | 9.9 | 8.6 | 6.3 | 1.9 | -10.0 | 0.2 | 3.8 |
| Basic services | 5.6 | 5.6 | 12.9 | 6.8 | 10.1 | 6.0 | -0.1 | 9.9 | 6.3 |
| Electricity, gas and water | 4.8 | 6.2 | 7.6 | -3.8 | 8.3 | 4.4 | -1.7 | 14.5 | 7.3 |
| Transport, storage and communications | 5.8 | 5.4 | 14.7 | 10.2 | 10.9 | 6.6 | 0.6 | 8.0 | 5.9 |
| Other services | 5.8 | 5.1 | 9.3 | 7.1 | 5.9 | 3.9 | -0.4 | 3.2 | 2.6 |
| Commerce, restaurants and hotels | 7.3 | 5.1 | 14.2 | 9.5 | 7.6 | 3.5 | -5.0 | 3.0 | 3.0 |
| Financial establishments, insurance, real estate and business services | 6.0 | 6.2 | 8.3 | 6.1 | 5.9 | 5.0 | 0.7 | 3.4 | 2.4 |
| Consumption ^c | 7.0 | 7.4 | 9.2 | 8.8 | 6.5 | 4.3 | -0.5 | 3.4 | 1.6 |
| General government | 4.3 | 1.9 | 4.2 | 4.0 | 5.8 | 2.2 | 2.5 | 2.8 | 2.7 |
| Private | 7.4 | 8.2 | 9.8 | 9.4 | 6.6 | 4.7 | -1.0 | 3.5 | 1.4 |
| Gross domestic investment | 21.1 | 0.8 | 34.2 | 5.9 | 9.4 | 2.2 | -19.6 | 14.0 | -7.6 |
| Exports of goods and services | 3.5 | 11.6 | 11.0 | 11.8 | 11.2 | 5.2 | 6.6 | 7.5 | 9.7 |
| Imports of goods and services | 14.2 | 10.1 | 25.0 | 11.8 | 13.2 | 6.7 | -9.3 | 12.6 | -1.3 |
| Percentages of GDP^c | | | | | | | | | |
| Gross national income | | | | | | | | | |
| Gross domestic investment | 92.1 | 93.1 | 96.7 | 94.2 | 94.1 | 94.0 | 93.7 | 93.9 | 90.8 |
| National saving | 22.6 | 22.5 | 26.2 | 26.4 | 27.1 | 26.8 | 21.6 | 23.7 | 21.2 |
| External saving | 18.6 | 20.1 | 24.5 | 22.3 | 22.5 | 21.7 | 21.0 | 22.1 | 20.0 |
| | 3.9 | 2.4 | 1.7 | 4.1 | 4.6 | 5.1 | 0.6 | 1.6 | 1.2 |
| Percentages | | | | | | | | | |
| Employment and wages | | | | | | | | | |
| Labour force participation rate ^d | 55.2 | 55.4 | 54.8 | 54.2 | 54.2 | 54.4 | 54.4 | 53.7 | 52.8 |
| Open unemployment rate ^e | 5.8 | 3.1 | 3.6 | 3.8 | 4.4 | 6.1 | 8.0 | 7.5 | 8.5 |
| Real average wage (index: 1995=100) | 91.8 | 96.1 | 100.0 | 104.1 | 106.6 | 109.5 | 112.1 | 113.7 | 115.5 |
| Growth rates | | | | | | | | | |
| Prices (December-December) | | | | | | | | | |
| Consumer prices | 12.2 | 8.9 | 8.2 | 6.6 | 6.0 | 4.7 | 2.3 | 4.5 | 2.6 |
| Wholesale prices | 6.7 | 7.8 | 8.2 | 3.1 | 1.9 | 0.3 | 13.5 | 7.9 | 3.1 |
| External sector | | | | | | | | | |
| Terms of trade (index: 1995=100) ^c | 74.2 | 84.1 | 100.0 | 80.7 | 83.0 | 73.3 | 73.5 | 73.6 | 68.5 |
| Nominal exchange rate (pesos per dollar) | 404 | 420 | 397 | 412 | 419 | 460 | 509 | 535 | 635 |
| Real effective exchange rate for imports (index: 1995=100) | 110.9 | 107.1 | 100.0 | 97.0 | 91.0 | 93.7 | 98.5 | 99.8 | 112.0 |
| Millions of dollars | | | | | | | | | |
| Balance of payments | | | | | | | | | |
| Current account | -2,554 | -1,585 | -1,345 | -3,144 | -3,671 | -4,014 | -302 | -1,073 | -1,241 |
| Trade balance (goods and services) | -1,217 | 583 | 1,060 | -1,134 | -1,575 | -2,588 | 1,501 | 1,269 | 1,094 |
| Exports | 11,709 | 14,444 | 19,359 | 20,185 | 21,751 | 20,161 | 20,789 | 22,971 | 22,315 |
| Imports | 12,926 | 13,861 | 18,299 | 21,319 | 23,326 | 22,749 | 19,289 | 21,702 | 21,221 |
| Capital and financial accounts ^f | 2,984 | 4,736 | 2,403 | 5,663 | 6,991 | 1,849 | -342 | 1,410 | 645 |
| Overall balance | 430 | 3,151 | 1,058 | 2,519 | 3,320 | -2,165 | -644 | 337 | -596 |
| Variation in reserve assets (- indicates an increase) | -173 | -2,919 | -741 | -1,122 | -3,320 | 2,165 | 644 | -337 | 596 |

Table 1 (concluded)

| | 1993 | 1994 | 1995 | 1996 | 1997 | 1998 | 1999 | 2000 | 2001 ^a |
|--|------|-------|-------|-------|-------|------|------|------|-------------------|
| Percentages | | | | | | | | | |
| External debt | | | | | | | | | |
| Gross debt (as a percentage of GDP) | 44.2 | 42.8 | 33.3 | 33.5 | 35.7 | 39.8 | 47.6 | 52.4 | 57.7 |
| Net interest (as a percentage of exports) ^g | 6.1 | 4.3 | 3.1 | 3.7 | 3.0 | 3.7 | 3.9 | 3.9 | 4.3 |
| Percentages of GDP | | | | | | | | | |
| Central government | | | | | | | | | |
| Current income | 23.2 | 22.5 | 22.2 | 23.4 | 23.3 | 22.9 | 22.5 | 23.7 | 22.8 |
| Current expenditure | 18.2 | 17.6 | 16.7 | 17.6 | 17.7 | 18.8 | 20.0 | 20.0 | 19.6 |
| Capital expenditure (net) | 2.9 | 3.2 | 2.9 | 3.5 | 3.6 | 3.7 | 3.9 | 3.6 | 3.5 |
| Financial balance | 2.0 | 1.7 | 2.6 | 2.3 | 2.0 | 0.4 | -1.5 | 0.1 | -0.3 |
| Non-financial public sector balance | 2.3 | 2.0 | 2.7 | 1.8 | 0.9 | -0.7 | -1.6 | -0.6 | -0.6 |
| Growth rates^h | | | | | | | | | |
| Money and credit | | | | | | | | | |
| Net international reserves | 41.0 | 62.5 | 26.6 | 31.6 | 40.9 | 1.2 | 28.3 | 7.4 | -0.7 |
| Net domestic credit ⁱ | 22.5 | 11.9 | 20.8 | 17.1 | 14.7 | 10.8 | 4.2 | 12.4 | 9.6 |
| To public sector | 15.1 | -18.1 | -11.2 | -14.6 | -24.2 | 10.0 | 49.3 | 46.2 | 17.8 |
| To private sector | 26.9 | 14.6 | 23.1 | 16.6 | 11.6 | 8.6 | 6.1 | 10.9 | 6.8 |
| Money (M1) | 20.6 | 20.6 | 23.5 | 10.5 | 16.6 | -5.5 | 20.4 | 9.3 | 6.6 |
| Local currency savings and time deposits | -6.9 | 18.9 | 31.4 | 26.5 | 23.4 | 19.1 | 9.0 | 8.7 | ... |
| M2 | -0.1 | 19.4 | 29.0 | 21.8 | 21.6 | 12.9 | 11.4 | 8.9 | 3.2 |
| Annual rates | | | | | | | | | |
| Real interest rate (annualized, %) | | | | | | | | | |
| Deposit rate | 3.5 | 2.4 | 4.3 | 5.0 | 5.0 | 13.9 | 4.7 | 4.7 | 2.2 |
| Lending rate | 8.1 | 6.4 | 7.9 | 8.1 | 8.0 | 18.4 | 8.3 | 9.6 | 7.5 |
| Equivalent interest rate in foreign currency ^j | 16.5 | 14.2 | 12.0 | 12.6 | 12.4 | 13.8 | 8.0 | 8.6 | 5.5 |

Source: ECLAC, on the basis of official figures.

^a Preliminary figures. ^b Based on constant 1986 pesos. ^c Based on constant 1995 dollars. ^d Percentages of the working-age population. ^e Percentages of the economically active population. ^f Includes errors and omissions. ^g Refers to net interest as shown in the balance of payments, divided by exports of goods and services. ^h Owing to changes in the methodology used, the figures given from 1998 on are not strictly comparable with those of previous years. ⁱ Includes entries under the heading "other" which could not be divided between the public and private categories. ^j Interest rate on deposits, deflated by the variation in the exchange rate.

This rate reduction was only noticeable in the banking system in large-scale operations, which represent 85% of total lending but only 5% of borrowers. Its effects were not evident in the interest collected from individuals and small and medium-sized enterprises (SMEs), owing to the increased risk inherent in these borrowers' activities in a recessionary environment. Between January and April 2002, the financial system's short-term lending rates shrank by only 0.36 points, while medium-term rates rose by 1.32 points.

(c) Foreign-exchange policy

The Central Bank currently allows the exchange rate to float as part of the gradual liberalization process begun in the early 1990s. This process was completed on 19 April 2001 with the elimination of all remaining foreign-

exchange restrictions, which particularly affected short-term portfolio operations.

Increased volatility and a sharp depreciation of the peso were seen in 2001. The observed exchange rate went from a monthly average of 571.12 pesos to the dollar in January to 669.14 in December and, in October, it reached daily peaks of 716 pesos to the dollar. This pattern primarily reflected contagion from Argentina's financial problems. The Central Bank intervened on several occasions, thus ending what had until then been a clean float of the exchange rate.

In mid-November the exchange rate began to break free from Argentina's country risk rating. This alleviated fears of an upsurge in inflation as a result of the exchange rate's patent misalignment with forecasts made early in the year. The sale of nearly US\$ 800 million to commercial banks under the intervention programme

Table 2
CHILE: MAIN QUARTERLY INDICATORS

| | 1999 | | | | 2000 | | | | 2001 ^a | | | | 2002 ^a |
|--|--------|--------|--------|--------|--------|--------|--------|--------|-------------------|--------|--------|--------|-------------------|
| | I | II | III | IV | I | II | III | IV | I | II | III | IV | I |
| Gross domestic product (change from same quarter of preceding year) ^b | -1.4 | -4.4 | -1.5 | 3.7 | 3.6 | 5.0 | 4.5 | 4.4 | 3.0 | 3.8 | 2.7 | 1.7 | 1.5 |
| Consumer prices (12-month variation, %) | 4.0 | 3.8 | 2.9 | 2.3 | 3.4 | 3.7 | 4.3 | 4.5 | 3.5 | 3.6 | 3.9 | 2.6 | 2.8 |
| Exports (millions of dollars) | 4,360 | 4,270 | 4,070 | 4,494 | 5,122 | 4,661 | 4,738 | 4,725 | 5,153 | 4,945 | 4,197 | 4,210 | 4,601 |
| Imports (millions of dollars) | 3,543 | 3,567 | 3,823 | 3,803 | 4,074 | 4,348 | 4,448 | 4,222 | 4,382 | 4,163 | 4,195 | 3,672 | 3,666 |
| International reserves (millions of dollars) | 14,898 | 15,014 | 14,615 | 14,710 | 14,497 | 14,597 | 14,157 | 14,741 | 14,869 | 14,543 | 14,595 | 14,400 | 14,150 |
| Real effective exchange rate ^c (index: 1995=100) | 95.6 | 94.6 | 99.8 | 104.1 | 98.1 | 97.4 | 102.9 | 100.9 | 103.8 | 107.3 | 117.4 | 119.7 | 102.3 |
| Money (M1) ^d (change from same quarter of preceding year) | -5.4 | -4.0 | 9.6 | 17.5 | 6.9 | 1.7 | 0.7 | -1.7 | 11.4 | 17.9 | 13.7 | 11.1 | 8.4 |
| Real interest rates (annualized, %) | | | | | | | | | | | | | |
| Deposit rate | 4.4 | 5.7 | 3.2 | 5.7 | 5.8 | 5.5 | 3.0 | 4.5 | 1.0 | 3.8 | 1.7 | 3.0 | -1.2 |
| Lending rate | 8.4 | 9.3 | 6.4 | 9.2 | 9.6 | 10.1 | 8.5 | 10.2 | 7.5 | 8.9 | 6.5 | 6.9 | 2.0 |

Source: ECLAC, on the basis of official figures.

^a Preliminary figures. ^b On the basis of official figures denominated in constant pesos. ^c Refers to exchange rate for imports. ^d Private-sector money.

announced in August was offset by an increase in Treasury deposits in the Central Bank. This increase, which was derived from the proceeds from a government bond issue, held the variations in international reserves to a minimum. The exchange rate then dropped back to levels under 660 pesos to the dollar, despite Argentina's complicated economic situation. The real exchange rate for the currencies of Chile's main trading partners rose considerably, resulting in a 10.1% depreciation over the course of the year.

(d) Structural reforms

In 2001 the Government obtained congressional approval of a number of laws to which it attached great importance. The unemployment insurance law provides for the establishment of individual funds for newly hired workers, so that a worker who becomes unemployed after having contributed to such a fund for a full year is eligible for a gradually decreasing unemployment benefit for a five-month period. Workers whose contributions are insufficient can make up the required amount with resources from the Solidarity Fund, to which the Treasury

contributes US\$ 10 million annually. In December a labour reform bill went into effect which tightens controls and may moderately raise the cost of laying off workers. The promulgation of this law put an end to a prolonged debate between the Government and business leaders.

The tax reform includes a law that tightens controls and is expected to reduce tax evasion by just over one percentage point of GDP in the medium term. A subsequent reform in August 2001 changed the income tax structure for both individuals and corporations. For individuals, it reduces the marginal rate for the middle- and high-income tax brackets, widens the tax-exempt bracket and gradually reduces the maximum marginal rate from 45% to 40%. For corporations, it raises the corporate profits tax from 15% to 17% over a three-year period. These changes may not suffice to reduce incentives for evasion by high-income individuals who submit their tax returns as corporations, which continues to be one of the main loopholes in the Chilean tax system. Moreover, depending on their income levels, taxpayers may be able to deduct up to 100% of the mortgage interest they have paid.

The reform of the capital market eliminated the capital gains tax, lowered taxes on interest from fixed-

income instruments for foreign investors and created tax incentives for voluntary saving on the part of workers. This law complements the legislation on public share offers and corporate governance as well as helping to round out the process involved in liberalizing the capital account. Moreover, this legislation established the legal definition of a qualified investor, reducing the information requirements which such investors must meet in order to operate in the private placement market.

In January 2002, Decree-Law No. 3500 on pension funds was amended to allow administrators to offer their clients a choice among five different funds with risk levels that vary according to the proportion of the portfolio invested in variable-income instruments. This new arrangement will make the system more flexible by ensuring that factors such as the client's age and the number of years left before retirement are taken into account. In the second half of 2002

the Government will submit a bill to Congress known as the "Capital Market Reform Act II", which, if enacted, would make the financial system even more flexible with a view to developing the venture capital industry in Chile through pension fund administrators (AFPs).

In late 2001 the Government opened a debate with business associations on a microeconomic programme aimed at jump-starting the country's economy, known as the "Agenda for Growth". To that end, 28 technical committees were established, with the participation of representatives of governmental and business sectors; in January 2002 these committees unveiled a set of proposals grouped into eight thematic areas: regulation, technology, tax structure, capital market, efficiency in public spending, labour market, streamlining of procedures and export development. It is expected that these proposals will be reflected in the Government's work plan and that the Cabinet will collaborate in their implementation.

3. The main variables

(a) Economic activity

In addition to replacing the 1986 input-output matrix with the 1996 version, the Central Bank took the structural and price changes that had occurred in those 10 years into account in calculating GDP. Changes were also made in the weightings assigned to individual sectors in determining the total value of production, with a reduction in the relative importance of agriculture, forestry, mining and commerce and an increase in that of construction, manufacturing, public administration and home ownership. Since these changes reduced the weight of activities linked to international trade, the result primarily reflects trends in domestic demand. Owing to these changes, GDP growth rates in recent years appear lower when compared to previous estimates.

Domestic demand shrank by 0.7% in 2001, owing particularly to the reduction of inventories, which fell from 1.5% of GDP to -0.8%. This gave rise to a negative annual gap of 3.5 percentage points between the growth of domestic spending and that of output. Gross fixed capital formation rose by 2%, while household consumption increased by 1.4%. Exports, which grew by 9.7%, were the most dynamic component of expenditure; imports, on the other hand, dipped considerably (-1.3%).

The performance of the various economic sectors was uneven. The fisheries sector was the most dynamic of all, since it expanded by 12.2%. Next came some non-

tradable goods sectors, such as energy (7.3%), whose growth reflected the performance of hydroelectric generating plants in the first half of the year, followed by the transport and communications sector (5.9%). The agricultural sector expanded by 4.7% thanks to good weather conditions in the first half of the year. The remaining sectors showed more modest growth, in line with the general trend of the economy. Mining expanded by 3.6%, basically on the strength of copper production, while construction was up by 3.9% owing to the performance of the building subsector. Manufacturing, however, showed disappointing results, contracting by 0.3% in response to a downshift in domestic and external demand.

(b) Prices, wages and employment

Inflation was relatively stable throughout the year, with the consumer price index (CPI) rising by just 2.6%, which was considerably less than the 4.5% increase recorded in the previous period. Early in the year, the high exchange rate's effect on import prices stirred fears that this impact might be passed along to the CPI, but this did not materialize, as the wholesale price index took a considerable downturn late in the year, ending at 3.1% thanks to the decline in petroleum prices. In any event, recent studies reveal a fairly low pass-through rate of about 18% over a two-year period.

High risk premiums and the restrictive lending policies of commercial banks raised the hurdles faced by SMEs. This, in turn, was one of the reasons behind the manufacturing industry's poor performance and the persistently high unemployment rate, which remains the authorities' primary area of concern, since it hovered around 10% in the winter months for the third year in a row. The seasonally adjusted average unemployment rate in 2001 was 9.2%. The situation has worsened slightly in 2002, owing to cutbacks in emergency employment plans over the summer. Wages appear to have held steady, when calculated on the basis of the real hourly wage index and the real labour cost index, whose annual average levels varied by 1.6% and 1.4%, respectively.

(c) The external sector

The trade balance in goods and services ended the year with a surplus of nearly US\$ 1.1 billion, which represented a slight deterioration in comparison to the 2000 figure, while the current account showed a deficit of US\$ 1.241 billion, equivalent to 1.2% of GDP. The value of merchandise exports dropped to about US\$ 17.4 billion, mainly because of reductions in the prices of copper (-11.2%) and cellulose, which were partly offset by an increase in export volumes (8.6%). The standouts among non-traditional exports were salmon and trout, which experienced a 14.7% increase in export volume and reached a value of US\$ 1.2 billion, and wine, with external sales of this product increasing by 12% to nearly US\$ 600 million. The value of imports fell by 3.8% to US\$ 15.9 billion; this slide became steeper in the last quarter of the year. Specifically, declines were recorded in the value of imports of consumer goods (-5.7%), intermediate goods (-4.4%) and capital goods (-0.4%).

Import prices exhibited a marked reduction, owing primarily to the 13.4% drop in the price of petroleum.

The country's trade strategy has combined multilateral negotiations and unilateral liberalization measures with the gradual reduction of general tariff levels, which will reach 6% in 2003, and the conclusion of trade agreements with Chile's main trading partners. The entry into force of the Political and Economic Association Agreement between Chile and the European Union—which will give Chile access to a potential market of more than 500 million consumers and should spark a resurgence in foreign investment—will reduce the average tariff to just 3%. It is expected that the agreement, signed in May, will enter into force in 2003 once it has been ratified by the respective legislative bodies. Negotiations with the United States on a free trade agreement should also be concluded by the end of 2002, as should the agreements aimed at avoiding double taxation of exports that are being negotiated with Brazil, Peru, Norway and the Republic of Korea.

Foreign investment inflows amounted to US\$ 4.6 billion in 2001 and were concentrated primarily in the first quarter of the year, owing to the purchase of local firms and the large-scale mining projects initiated in late 2000. Investment abroad totalled US\$ 3.8 billion as of October, compared to US\$ 4.8 billion in 2000. With outflows standing at US\$ 1.5 billion and inflows reaching just US\$ 1.34 billion, net portfolio investment was approximately -US\$ 175 million. The factors involved included a negative net balance of American Depositary Receipts (ADRs) and the investments made abroad by pension funds, which amounted to US\$ 1.2 billion but were offset in part by the sovereign bond issue. International reserves amounted to US\$ 14.2 billion, which represents a drop of nearly US\$ 500 million from the preceding year.