

CHILE

1. General trends

In 2016 the Chilean economy grew at a slower rate (1.6%) than in 2015 (2.3%), as the drop in investment and exports outweighed the rise in private and public consumption. This was reflected in the slowdown of most economic sectors, with a few exceptions (commerce), and in the contraction of key industries, such as mining. This subdued context was partly a reflection of weak external aggregate demand and international copper prices falling below 2015 levels.

The economic slowdown translated into sharp declines in tax revenues, despite the positive impact of taxes collected on account of the fiscal reform implemented the year before. Efforts to curtail public spending were insufficient to counter the downward trend in tax revenues, and the public deficit climbed from 2.2% of GDP in 2015, to 2.7% in 2016.

Inflationary pressures were dampened by the combined effect of weak aggregate demand, falling international prices and labour costs, and the appreciation of the Chilean peso. Thus, the rate of variation of the price index was lower than the year before (4.4% in 2015 versus 2.7% in 2016). Against this backdrop, monetary policy remained expansionary. However, this had no impact on the interest rate structure which, together with sluggish domestic aggregate demand, resulted in lower demand for credit, and for commercial and housing lending.

The slowdown translated into a sharp reduction in imports, which led to a narrowing of the current account deficit (from -2.1% to -1.4% of GDP) and more than offset the contraction in exports and the increase in the deficit on the income account. The deficit was financed by foreign direct investment flows that were, nevertheless, well below levels recorded the year before. All things considered, the economy's net debt position improved; external debt stood at 65.4% of GDP in 2016 compared to 70.1% in 2015.

In spite of the economic slowdown, unemployment remained at record lows in 2016, although it increased in the first quarter of 2017. Wages recorded their slowest growth rate of the decade in 2016 owing to the drop in aggregate demand and to cost control efforts by companies.

The economic downturn is expected to continue in 2017, albeit more gently than in 2016, with expectations for GDP growth of around 1.4%. These projections are based on lacklustre domestic demand, a more restrictive fiscal policy and an expansionary monetary policy that nonetheless has had a limited impact on economic activity. More favourable external conditions, in the form of stronger external aggregate demand and rising international copper prices, could boost exports and mitigate, to a certain extent, the negative impact that domestic conditions have had on growth and employment.

2. Economic policy

(a) Fiscal policy

In 2016, the central government fiscal deficit continued its upward trend, rising to 2.7% of GDP (2.2% in 2015) as a result of the sharp slowdown in fiscal revenues —especially tax revenues— whose

growth fell from 8.3% in 2015 to 0.9% in 2016, in real terms, and despite efforts to control public spending, which slowed from 7.4% in 2015 to 3.7% in 2016, in real terms.

The decelerating growth rate of fiscal revenues was particularly evident in income taxes (from 20.8% in 2015 to -5.8% in 2016, in real terms), which represent close to 40% of total tax collection, and to a lesser extent in value added tax (VAT) collection (which slowed from 4.8% in 2015 to 2.1% in 2016, in real terms). Lower income tax collection was attributable to the lacklustre performance of the economy in general, the contraction of mining output and the drop in copper prices.

These factors clearly outweighed the positive impact of the tax reform, which had been reflected in the higher category one tax rate, in revenues from the temporary tax on the historical taxable profits fund (FUT) and in non-recurrent revenues from the registration of overseas capital holdings (543 billion pesos in 2015 and 520 billion pesos in 2016, equivalent to 0.3% of GDP in both years).

The overall drop in public spending reflected the combined effect of the slight deceleration in current expenditure (which slowed from 7.3% in 2015 to 5.7% in 2016, in real terms) and the contraction in capital expenditure (which rose 14% in 2015 and fell 4.8% in 2016, in real terms). Current public spending was mostly directed towards health and education, while capital spending—which recorded its lowest annual growth of the last seven years—underwent large downward adjustments in health, education and public works, with significant growth only in the housing sector.

The central government's deficit widened, with debt expanding from 17.4% of GDP in 2015 to 21.3% in 2016. Accordingly, between 2015 and 2016 the gross debt of the public sector rose from 40.6% to 44.4% of GDP, and it is expected to reach 50% of GDP in 2017.

Public spending is expected to drop 2.7% in real terms in 2017, with fiscal revenues mainly earmarked for public safety, health and education. This target is intended to align public spending with the cyclical downturn of the Chilean economy, in order to ensure fiscal sustainability. These objectives will be supported by higher fiscal income thanks to the rise in international copper prices (from US\$ 2.50 to US\$ 2.56 per pound).

(b) Monetary policy

In 2016 the monetary policy rate was kept at 3.5%. It was cut by 50 basis points in the first quarter of 2017 to 3.0%, clearly below neutral policy levels and thus signalling the new expansionary bias of monetary policy in response to Chile's falling inflation rates and sluggish economic growth.

However, this expansionary stance has barely had an impact on nominal and real interest rates across the different lending categories. Between January and December 2016, nominal interest rates for the consumer, commercial and housing sectors went from 23.39% to 22.38%, 7.28% to 7.64% and 3.83% to 3.59%, respectively. For the same period and sectors, real interest rates went from 22.78% to 22.56%, 6.75% to 7.86% and 3.32% to 3.80%, respectively. No major changes are expected for interest rates in the first quarter of 2017, with real rates for the aforementioned sectors expected to stand at 22.58%, 7.27% and 3.21%, in real terms.

Similarly, the evolution of interest rates has had little or no impact on the demand for credit, which has generally tracked the overall deceleration of the Chilean economy. Available data for January-December 2016 indicate that commercial and housing lending fell in real terms from 4.0% to 2.1% and

from 9.9% to 6.8%, respectively, while consumer lending rose from 2.5% to 5.4% for the same period, which was reflected in higher growth rates in private consumption.

Interest rate levels have not produced any change in the financial burden of households, either, which remains at around 15% of income; household debt continues to rise, going from 66.5% of disposable income in 2015 to 68.2% in 2016. The non-financial corporate sector brought its indebtedness slightly down from 109.9% to 106.5% of GDP, although it remains at historically high levels.

Monetary policy should maintain its expansionary bias in 2017, with the market expecting policy rates to remain within the 2.5%-3.0% range. However, the potential impact of monetary policy on short-term growth will depend in part on the pass-through of monetary policy decisions to the financial sector, as well as on external economic and political risks and on future aggregate demand expectations.

(c) Exchange-rate policy

In the framework of Chile's full-fledged inflation-targeting scheme, its free-floating nominal exchange rate acts as an absorber of external shocks.

For January-December 2016, the Chilean peso appreciated 7%, from 721 to 667 pesos per dollar, in nominal terms. In the first four months of 2017 the exchange rate has remained stable in both nominal (665 pesos per dollar) and real terms.

The fact the peso remains competitive in international markets paves the way for production and export diversification efforts that would help to transfer resources from traditional sectors (such as mining) to others that have benefited from recent exchange-rate movements.

(d) Other policies

The new labour reform, which mainly seeks to improve relations between workers and employers, came into force in the second quarter of 2017. Among other things, the reform provides a broader spectrum of tools to improve collective bargaining conditions for workers, and forbids the use of replacement workers during strikes. The government has also continued with its education reform plans, especially with regard to the bill on higher education, which in its current version calls for eliminating State-sponsored student loans by 2018, increasing tuition-free coverage, prohibiting control of education institutions by profit-making concerns and establishing new public bodies to strengthen education institutions throughout the country, among other things.

3. The main variables

(a) The external sector

Chile's current account deficit narrowed from US\$ 4.670 billion (2.1% of GDP) in 2015 to US\$ 3.574 billion (1.4% of GDP) in 2016, owing mainly to the large rise in the trade surplus (from US\$ 3.465 billion in 2015 to US\$ 5.256 billion in 2016), attributable in turn to a drop in imports of goods and services —resulting from the economic slowdown and falling fuel prices— that partially offset the deterioration in the income balance (from -US\$ 6.576 billion in 2015 to -US\$ 7.117 billion in 2016).

Total exports contracted as a result of falling mining exports (from US\$ 32.470 billion in 2015 to US\$ 30.871 billion in 2016) due to drops in both volumes (3.0%) and in prices (2.0%). Copper exports,

which represent close to 46% of the total, declined in value terms from US\$ 30.097 billion to US\$ 28.091 billion.

The income balance reflected a drop in the income of Chilean companies domiciled abroad (from US\$ 3.960 billion in 2015 to US\$ 2.836 billion in 2016), while the repatriation of earnings from foreign direct investment (FDI) in Chile fell from US\$ 10.311 billion to US\$ 9.649 billion in the same period.

The current account deficit was financed mostly through FDI flows (US\$ 12.225 billion), which despite benefiting sectors such as mining, transport and electricity, gas and water, was nonetheless much lower than the year before (US\$ 20.469 billion).

These developments, combined with the favourable evolution of the exchange rate and of local financial markets, reduced the economy's net debt position from 20.3% of GDP in 2015 to 16.3% in 2016. Overall, Chile's external debt fell from 70.1% of GDP in 2015 to 65.4% in 2016, with institutional debt mostly concentrated in the non-financial corporate sector, and to a lesser degree in the financial sector and in the government.

(b) Economic activity

In 2016 the Chilean economy grew at a slower rate (1.6%) than in 2015 (2.3%) as the contraction in investment levels and the slowdown in exports (down 1.8% in 2015 and 0.1% in 2016) outweighed the acceleration in private consumption (from 4.5% in 2015 to 5.1% in 2016). Declining investment levels were explained by the slowdown in gross fixed capital formation (down 0.8% in both 2015 and 2016) and in inventory rundown (down 0.3% in 2015 and 1.1% in 2015).¹

The output of agriculture (up 3.7% in 2016 versus 6.7% in 2015) was a reflection of the sector's uneven performance over the year, in which nature-related events were compounded by falling exports and the contraction of fishery activity.

Mining performance (0% in 2015 and -2.9% in 2016) was a result of sluggish external demand for metals and the drop in copper prices, which remain below commodity supercycle levels.

The performance of manufacturing (0.2% in 2015 and -0.9% in 2016) was attributable to falling exports, lower domestic demand, expectations of lower growth and the contraction of the fishing industry.

The construction sector grew at a slower pace than the year before (3.9% in 2015 versus 2.5% in 2016) as a result of declining investment in construction and works (2.7% in 2015 versus -1.1% in 2016), especially in mining and road works.

Commerce was the best performing sector (3.4% in 2016 compared with 2.3% in 2015), across both the retail and wholesale components. Growth in private consumption and improving liquidity conditions for private consumption were the main drivers.

In keeping with the general performance of the economy and the composition of aggregate demand, business services contracted in 2016 (-1.8%, compared with a gain of 1.2% in 2015), while personal services grew at a faster rate (up 5.2%, compared with 1.8% in 2015).

¹ Inventory rundown corresponds to the quotient between changes in inventories and GDP, at average prices of the year before.

Chile is expected to grow 1.4% in 2017, as several sectors of its economy —mining, manufacturing, construction, electricity, gas and water, and business services (close to 40% of GDP)— have been contracting for the past three quarters, with the exception of construction, which has contracted in the last two.

Overall economic performance will also be affected by the strike at the Escondida mine (from 9 February to 23 March), which represents approximately 20% of Chile's copper production.

Lastly, forest fires that affected three regions —which represent 14% of GDP— in early 2017 will also weigh on growth, albeit in smaller measure than the aforementioned factors.

(c) Prices, wages and employment

Headline inflation (as well as core inflation) fell significantly from 4.4% in 2015 to 2.7% in 2016 (year-on-year in December), as a result of lower cost pressures and a wider demand gap owing to the slowdown in domestic demand.

Costs fell as a result of price drops in the basic food basket and of cost containment measures by companies in response to sluggish economic conditions. The nominal appreciation of the Chilean peso together with price drops in certain imported inputs and final goods with a high exchange-rate pass-through translated into an overall decline in the unit price of imports. Expectations for 2017 are that inflation will hover around the central bank's 3% target rate, owing to nominal exchange-rate fluctuations and the evolution of the output gap.

Despite the overall economic slowdown, the unemployment rate stood at historically low levels (6.3% and 6.4% for the rolling quarters of January-March 2016 and December 2016-February 2017, respectively). However, available data for the last rolling quarter (January-March 2017) indicates that national unemployment edged up slightly to 6.6% as a result of falls in labour demand.

This backdrop has had an impact on the evolution of nominal wages and labour costs; in the first quarter of 2017 growth rates for wages and labour costs continued to slow (from 4.9% year-on-year in March 2016, to 4.3% year-on-year in March 2017).

Table 1
CHILE: MAIN ECONOMIC INDICATORS

	2008	2009	2010	2011	2012	2013	2014	2015	2016 a/
Annual growth rates b/									
Gross domestic product	3.7	-1.0	5.8	5.8	5.5	4.0	1.9	2.3	1.6
Per capita gross domestic product	2.5	-2.1	4.6	4.7	4.3	2.9	0.8	1.2	0.5
Gross domestic product, by sector									
Agriculture, livestock, hunting, forestry and fishing	4.0	-5.6	0.3	11.8	-2.2	0.1	0.1	6.7	3.7
Mining and quarrying	-5.6	-1.0	1.5	-5.0	3.8	5.6	2.3	0.0	-2.9
Manufacturing	1.4	-4.2	2.6	7.6	3.6	1.3	-0.3	0.2	-0.9
Electricity, gas and water	-1.8	13.8	8.4	11.7	8.4	6.0	3.8	3.5	1.6
Construction	10.1	-5.3	1.8	6.8	7.2	3.8	-1.9	3.9	2.5
Wholesale and retail commerce, restaurants and hotels	4.9	-5.8	15.0	12.2	6.7	6.8	2.8	2.4	2.8
Transport, storage and communications	6.4	-5.2	8.8	7.0	9.8	6.5	2.8	4.6	3.2
Financial institutions, insurance, real estate and business services	3.2	2.0	5.4	7.5	6.0	2.8	2.3	2.5	0.9
Community, social and personal services	3.8	4.0	4.4	5.1	4.8	4.1	3.2	2.4	4.5
Gross domestic product, by type of expenditure									
Final consumption expenditure	3.9	0.8	9.8	7.8	5.7	5.2	3.0	2.4	2.8
Government consumption	0.5	9.2	4.6	2.5	3.5	3.5	4.4	4.5	5.1
Private consumption	4.5	-0.8	10.8	8.9	6.1	5.5	2.7	2.0	2.4
Gross capital formation	19.3	-23.5	30.8	16.5	11.3	-1.2	-4.8	-0.8	-0.8
Exports (goods and services)	3.2	-4.5	2.3	5.5	0.1	3.3	0.3	-1.8	-0.1
Imports (goods and services)	12.6	-16.2	25.5	16.0	4.8	2.1	-6.6	-2.7	-1.6
Investment and saving c/									
Percentajes of GDP									
Gross capital formation	27.2	21.3	23.4	24.9	26.8	25.6	23.2	23.3	21.6
National saving	23.5	23.1	24.7	23.2	22.8	21.5	21.5	21.4	20.1
External saving	3.7	-1.8	-1.4	1.7	4.0	4.1	1.7	1.9	1.4
Balance of payments									
Millions of dollars									
Current account balance	-6 658	3 112	2 969	-4 258	-10 706	-11 524	-4 501	-4 670	-3 574
Goods balance	6 055	15 321	15 893	10 772	2 608	2 015	6 523	3 465	5 256
Exports, f.o.b.	64 510	55 463	71 109	81 438	78 063	76 770	75 122	62 183	60 597
Imports, f.o.b.	58 455	40 142	55 216	70 666	75 455	74 755	68 599	58 718	55 341
Services trade balance	-1 017	-1 638	-1 757	-2 453	-2 542	-3 425	-3 754	-3 418	-3 137
Income balance	-14 625	-12 134	-15 577	-15 442	-12 832	-12 322	-9 387	-6 576	-7 117
Net current transfers	2 930	1 563	4 410	2 865	2 060	2 207	2 117	1 858	1 424
Capital and financial balance d/	13 102	-1 465	55	18 448	10 339	11 836	5 558	4 881	5 379
Net foreign direct investment	9 476	6 733	6 693	4 122	10 006	11 204	11 211	3 726	5 101
Other capital movements	3 626	-8 198	-6 638	14 327	333	632	-5 653	1 155	279
Overall balance	6 444	1 648	3 024	14 190	-367	311	1 057	211	1 805
Variation in reserve assets e/	-6 444	-1 648	-3 024	-14 190	367	-311	-1 057	-211	-1 805
Other external-sector indicators									
Real effective exchange rate (index: 2005=100) f/	97.3	101.6	96.3	95.3	94.0	95.2	105.4	109.5	108.4
Terms of trade for goods (index: 2010=100)	78.4	82.0	100.0	101.3	94.8	91.9	89.9	86.0	87.9
Net resource transfer (millions of dollars)	-1 523	-13 599	-15 522	3 006	-2 493	-486	-3 829	-1 695	-1 738
Total gross external debt (millions of dollars)	63 534	72 617	86 570	100 973	122 668	136 351	152 135	157 764	163 789
Employment									
Average annual rates									
Labour force participation rate g/	56.0	55.9	58.5	59.8	59.5	59.6	59.8	59.7	59.5
Open unemployment rate g/	7.8	11.3	8.5	7.4	6.7	6.2	6.7	6.4	6.8
Visible underemployment rate h/	9.0	10.8	11.5	11.9	11.5	11.6	11.3	10.3	10.9

Table 1 (concluded)

	2008	2009	2010	2011	2012	2013	2014	2015	2016 a/
Prices	Annual percentages								
Variation in consumer prices (December-December)	7.1	-1.4	3.0	4.4	1.5	3.0	4.7	4.4	2.7
Variation in industrial producer prices (December-December)	22.7	-14.9	3.5	10.0	0.7	-2.8	-3.3	-10.7	10.2
Variation in nominal exchange rate (annual average)	0.2	6.8	-8.8	-5.2	0.5	1.9	15.2	14.7	3.3
Variation in average real wage	-0.2	4.8	2.2	2.5	3.2	3.9	1.8	1.8	1.4
Nominal deposit rate i/	7.8	2.3	2.7	5.6	5.9	5.2	3.9	3.8	4.0
Nominal lending rate i/	15.2	12.9	11.8	12.4	13.5	13.2	10.8	9.3	10.4
Central government	Percentajes of GDP								
Total revenue	24.1	19.0	21.4	22.6	22.2	20.9	20.5	21.1	21.1
Tax revenue	18.8	15.2	17.1	18.6	19.0	18.1	17.9	19.1	18.8
Total expenditure	20.2	23.3	21.9	21.3	21.6	21.5	22.1	23.2	23.8
Current expenditure	16.6	18.9	18.0	17.3	17.7	17.9	18.3	19.0	19.9
Interest	0.5	0.5	0.5	0.6	0.6	0.6	0.6	0.7	0.8
Capital expenditure	3.6	4.4	3.9	4.1	4.0	3.6	3.8	4.2	4.0
Primary balance	4.3	-3.8	0.0	1.8	1.2	0.0	-1.0	-1.5	-2.0
Overall balance	3.9	-4.3	-0.5	1.3	0.6	-0.6	-1.6	-2.2	-2.7
Central government public debt j/	5.1	5.8	8.7	11.1	11.3	12.8	15.0	17.4	21.3
Domestic	3.0	4.5	7.2	9.2	9.9	10.8	12.3	13.9	17.3
External	2.0	1.3	1.5	1.9	1.4	2.0	2.7	3.5	4.0
Money and credit k/	Percentages of GDP, end-of-year stocks								
Domestic credit	61.4	63.3	55.2	59.8	61.6	62.9	62.5	64.9	64.8
To the public sector	-3.4	-1.7	-1.5	-1.3	-0.3	0.9	-0.1	-0.4	-0.4
To the private sector	75.1	72.0	66.9	71.4	75.1	77.7	79.4	82.5	82.3
Others	-10.3	-6.9	-10.2	-10.4	-13.3	-15.7	-16.7	-17.2	-17.1
Monetary base	4.5	4.7	5.0	5.6	6.1	6.3	5.5	5.8	6.2
Money (M1)	11.8	14.7	15.1	15.5	15.9	16.5	17.3	18.5	18.1
M2	55.9	53.1	50.0	55.7	56.4	59.2	60.0	63.2	63.4
Foreign-currency deposits	6.9	5.5	6.3	5.8	6.3	7.0	8.6	9.0	8.9

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/ The series 2009 and 2010-2016 are not comparable, owing to the changes in methodology that took place in 2010.

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

	2015				2016				2017	
	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/	2.6	2.1	2.4	1.9	2.5	1.7	1.8	0.5	0.1	...
Gross international reserves (millions of dollars)	38 806	38 574	38 277	38 565	38 756	39 803	39 313	39 814	39 538	38 906 c/
Real effective exchange rate (index: 2005=100) d/	107.6	105.4	111.8	113.1	111.2	109.7	107.0	105.8	103.9	106.2 c/
Open unemployment rate	6.1	6.5	6.4	5.8	6.3	6.9	6.8	6.1	6.6	...
Employment rate	55.9	55.7	55.8	56.4	55.7	55.3	55.4	55.9	55.5	...
Consumer prices (12-month percentage variation)	4.2	4.4	4.6	4.4	4.5	4.2	3.1	2.7	2.7	2.6 c/
Wholesale prices (12-month percentage variation)	-3.6	-3.1	-8.5	-10.67	-5.5	-8.2	-4.2	10.23	8.6	8.5 c/
Average nominal exchange rate (pesos per dollar)	624.5	618.0	677.2	698.0	701.6	677.3	661.6	663.5	655.5	663.9
Average real wage (variation from same quarter of preceding year)	2.6	2.0	1.2	1.3	0.9	1.1	1.6	2.0	1.5	...
Nominal interest rates (average annualized percentages)										
Deposit rate e/	3.3	3.7	3.8	4.3	4.3	4.0	3.9	4.0	3.4	2.9 c/
Lending rate e/	9.7	10.0	8.8	8.6	9.9	10.0	10.6	11.0	13.2	12.2 c/
Interbank rate	3.0	3.0	3.0	3.2	3.5	3.5	3.5	3.5	3.2	2.8 c/
Monetary policy rates	3.0	3.0	3.0	3.3	3.5	3.5	3.5	3.5	3.2	2.6
Sovereign bond spread, Embi Global (basis points to end of period) f/	158	158	244	253	213	202	180	158	133	134 c/
Risk premia on five-year credit default swap (basis points to end of period)	83	87	146	129	95	95	86	83	72	66
International bond issues (millions of dollars)	1 263	3 884	2 425	79	2 650	94	1 197	1 395	2 610	1 517 c/
Stock price index (national index to end of period, 31 December 2005 = 100)	199	198	188	187	200	203	204	211	243	242
Domestic credit (variation from same quarter of preceding year)	6.3	8.6	8.8	10.0	11.5	9.2	8.1	5.6	3.8 g/	...
Non-performing loans as a percentage of total credit	1.0	0.9	0.9	0.9	0.9	0.8	0.8	0.8	0.8	0.8 h/

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/ Measured by J.P.Morgan.

g/ Figures as of February.

h/ Figures as of April.