CHILE

1. General trends

In 2017, the Chilean economy grew by 1.5%, a rate similar to the previous year's 1.3%. The trend of GDP reflected the weakness of both investment and exports, which was not offset by consumption growth fuelled partly by heavier private-sector borrowing. The counterpart of this pattern was contractions in mining, agriculture and construction. The sectors that grew most strongly (communications; commerce; electricity, gas and water; and services) are precisely those most closely linked to consumption.

Economic growth was too lacklustre to support an improvement in the fiscal accounts, which deteriorated slightly relative to the previous year (a deficit of 2.7% of GDP in 2016 widening to 2.8% in 2017), despite the higher copper price and the positive effects of the 2014 tax reform on income tax revenue. The wider central government deficit added to the external debt, which nonetheless remains low by international standards.

In this context, current output was below potential, which, combined with the appreciation of the exchange rate and the slackening pace of wage growth, held inflation down, despite higher energy prices. The monetary authorities reacted countercyclically by implementing an expansionary 100-basis-point cut in the monetary policy rate.

Externally, the current account deficit widened as the income balance became more negative, while the trade balance improved on the back of stronger copper prices, offsetting a reduction in export volumes. The income account balance reflects the repatriation of earnings from foreign direct and portfolio investment. Financial outflows responding to monetary policy normalization by the United States Federal Reserve also contributed to this result. The deficit was mostly financed by portfolio financial flows. Overall, the country's net international investment position worsened.

In 2018, the economy is expected to grow by about 3.3%, over twice the 2017 rate, thanks to the revitalization of investment —especially in the mining sector— which has been visible since the second half of 2016, and, to a lesser extent, buoyant consumption. This stronger growth will boost tax revenues, which, in conjunction with public spending restraint, will help to reduce the public deficit (forecast at 1.9% of GDP for 2018). Stronger growth will also attract additional imports, but this should be offset by export growth resulting from the higher international copper price. The current account is forecast to deteriorate owing to heavy profit repatriation. The economy's two weakest flanks are the rising levels of private sector debt and reliance on portfolio flows to finance the current account deficit.

2. Economic policy

(a) Fiscal policy

In 2017, the central government deficit widened slightly to 2.8% of GDP (compared to 2.7% in 2016) implying a larger structural deficit than the previous year's 2.0% of GDP. This is explained by a slight reduction in the tax burden (to 17.3% in 2017 compared to the year-earlier 17.5%)[1], since the authorities managed to contain the increase in expenditure (23.7% of GDP in 2017 compared to the previous year's 23.5%).

The easing of tax pressure mainly reflected the trend of non-mining tax revenues (which dropped to 16.7% of GDP in 2017 from 16.8% in the previous year) and, in particular, revenue from income tax on non-mining activities (6.5% of GDP in 2017 compared to 6.6% in 2016), which represents 38% of the central government's tax revenues. The behaviour of non-mining income taxes is explained by a reduction in the tax base that was not offset by the rate hike included in the 2014 tax reform. Tax revenues from private sector mining (2.7% of the total) tracked the rise in the copper price (from US$ 2.21 per pound in 2016 to US$ 2.55 per pound in 2017).

The contribution of other taxes to overall tax pressure was unchanged from the previous year. Value added tax (8.3% of GDP in 2016 and 8.4% in 2017) expanded in line with economic activity and private consumption growth. The revenue obtained from excise taxes (1.5% of GDP in 2016 and 2017) reflects declining cigarette sales, higher fuel prices and a 15% hike in the tax on extraction rights provided for in the fishing law.

On the spending side, the behaviour of central government expenditures is explained by the current spending component (19.9% of GDP) and, in particular, by expenditure executed by the ministries of education, health and labour, since capital spending retreated (-3.1% in real terms for 2017).

The widening of the central government's deficit added to its debt stock, which represented 23.6% of GDP in 2017 compared to 21.3% in 2016.

For 2018, the authorities are projecting a reduction in the fiscal deficit by about one percentage point of GDP (to 1.9%, down from 2.8% in 2017), based on expenditure cuts (from 23.8% of GDP in 2017 to 23.3% in 2018), together with revenue growth (from 20.8% to 21.6% of GDP in 2018) supported, in part, by stronger economic growth and the higher international copper price. Expenditure will be targeted on education and health.[2]

(b) Monetary policy

Against a backdrop of weak inflationary pressures owing to slack domestic demand and the appreciation of the exchange rate, the central bank adopted a countercyclical policy, involving a 100-basis-point reduction in the monetary policy rate from 3.5% in December 2016 to 2.5% in May 2017. As from the second half of the year, the Board of the Central Bank of Chile held the rate at 2.5%, in view of the economic recovery, reflected partly by the stronger performance of the mining sector, which accounts for roughly 20% of GDP and 25% of gross capital formation.

The expansionary economic policy stance did not have a major effect on the interest rate structure in the banking system. In 2017, nominal interest rates for consumer, trade and housing loans averaged 22.1%, 7.3% and 3.4%, respectively, only slightly lower than in 2016 (23.1%, 7.4% and 3.7%, respectively). This did not affect domestic currency lending, which grew more slowly (7.5% in 2017

[1] Does not include social security contributions.
[2] These estimates are based on a GDP growth projection of 3.8% in real terms and a copper price of US$ 3.10 per pound.

compared to the previous year's 10%), reflecting slacker demand for credit in consonance with weak economic growth.

Monetary policy is expected to remain expansionary in 2018, which will help consolidate more vigorous economic growth. This will depend partly on the buoyancy of domestic demand and the trend of the output gap. The determinants of nominal exchange-rate variation and the speed with which it is passed through to domestic prices will also affect this behaviour. Changes in the nominal exchange rate associated with interest rate spreads tend to have a greater impact than those deriving from international prices.[3]

(c) Exchange-rate policy

The fall in interest rates did not noticeably affect the exchange rate, which appreciated in nominal terms (from 670.68 pesos per dollar in January 2017 to 615.44 pesos in December) and remained stable in real terms (103.1 and 103 pesos per dollar over the same period). This is explained in part by a benign external environment with less financial volatility and a greater appetite for risk among foreign investors, supported by rising international metal prices.

In the first five months of 2018, the nominal exchange rate has behaved more erratically, first appreciating between January and February (from 615.4 pesos per dollar at the start of January to 595.2 pesos per dollar by late February), before reversing course in early March and especially from the third week of April, coinciding with a rise in the yield on United States Treasury Bills and the steep devaluation of the Argentine peso, which heightened the perceived risk of the region's economies.

The emerging market bonds index (the difference between the interest rates paid by dollar-denominated bonds issued by emerging countries and United States Treasury Bills, which are considered risk-free), which had been trending down in 2017 and early 2018 (157, 116 and 109 points in January 2017, December 2017 and February 2018, respectively), shows a rise in response to the hike in federal funds rates on 22 March and later in the third week of April, before peaking at 177 points at the end of May. By end-June, however, the index had come back down to 131 points.

Nonetheless, this behaviour is not expected to affect competitiveness, since the real exchange rate is expected to remain stable throughout the year.

(d) Other policies

The measures to be introduced by the new government that took office in March this year include pension reform, with a view to encouraging greater competition in the pension fund administration (AFP) market and increasing pensions. Other reforms include the creation of specialist training for primary health care physicians and measures to reduce shortages in certain medical specialties; and a national education quality plan and a new solidarity-based system of access to higher education.

3. The main variables

(a) The external sector

[3] Central Bank of Chile, *Monetary Policy Report, March 2018*, p. 38.

The balance-of-payments current account ended 2017 with a deficit of US$ 4.146 billion, or US$ 647 million larger than in the previous year. This is explained by a sharp increase in the repatriation of earnings abroad (US$ 10.802 billion in 2017 compared to the previous year's US$ 7.045 billion), which more than absorbed the surplus on goods and services trade (US$ 4.863 billion in 2017 up from US$ 2.160 billion in 2016).

Exports of goods and services expanded by 13% relative to their 2016 level (from US$ 70.185 billion to US$ 79.328 billion), fuelled by the rise in export prices generally (16.3%) and in copper prices particularly (28.4%), which more than compensated for the 1.9% contraction in the volume exported. Mining exports were down by 23% (following a 6.4% contraction in 2016). On the other hand, external sales of agricultural products fell by 4.8% (following 13.3% growth in 2016), owing to a smaller volume of fruit exported, while exports of manufactured products increased by 7.1%. The behaviour of imports (rising from US$ 68.025 billion in 2016 to US$ 74.464 billion in 2017) is also partly explained by higher prices for raw materials, particularly energy (24.8% higher than in 2016), together with an expansion of imports of consumer goods (3.5% growth in 2017 compared to -0.5% in the previous year).

The current account deficit was financed mainly by a rise in external net borrowing (US$ 193 million in 2016 and US$ 3.039 billion in 2017), partly as a result of external loans to local banks, and to a lesser extent by foreign direct investment (FDI), which retreated from the previous year's level (US$ 1.595 billion in 2017 compared to US$ 4.909 billion a year earlier). Portfolio investment largely reflects government bond flotations on the local market and, to a lesser extent, corporate bond issuance. Foreign direct investment corresponds to the reinvestment of profits.

All in all, the economy's negative net international investment position worsened (US$ 44.409 billion in 2016 to US$ 58.216 billion in 2017); and the external debt grew to 62% of GDP. By institutional sector, the non-financial corporate sector holds the largest external debt stock, followed by the financial sector.

(b) Economic activity

In 2017, the economy grew at a measured pace similar to that of the previous year. The expansion was largely driven by consumption (up by 2.7%), since investment and exports, the two most dynamic components of demand, contracted by 1.1% and 0.9%, respectively. The robustness of consumption was party fuelled by additional household debt. Government consumption also contributed to the overall growth performance (4.0%). The decrease in investment reflects slacker activity in construction and other works, while the drop in exports in real terms is explained by the smaller volume of mining and agricultural exports.

At the sector level, growth was driven by the communications, commerce, electricity, gas and water sectors, services and, to a lesser extent, the manufacturing industry. The expansion of communications (3.9% in 2017 compared with 2.6% in 2016) may be attributed to the robust performance of mobile telephony. The improvement in commerce —where growth accelerated from 2.1% in 2016 to 3.2% in 2017— was reflected in its wholesale, retail and automotive components, and was driven by buoyant private and public consumption, and by increased imports. The better performance of the electricity, gas and water sector (growth rising from 2.0% in 2016 to 3.2% in 2017) reflects an increase in electric power generation due to greater use of renewable energies. The overall trend in services was determined by personal, housing and real estate services. Manufacturing (which grew by 1.6% in 2017 having shrunk by 2.4% in the previous year) was helped by more benign economic conditions in the second half of the year, which fostered an increase in the demand for metal products, machinery and equipment.

Agriculture, mining and construction all contracted. The performance of the crop and livestock sector (a 2.5% contraction in 2017 compared to 3.7% growth the year earlier) is explained by a smaller volume of livestock products and agricultural crops, which outweighed the increase in fishery output (up by 20.7% in 2017 following a 12.3% reduction in the previous year). The trend in mining (-2.8% in 2016 and -2.0% in 2017) is explained by performance in the first half of the year that was hampered by the strike (from 9 February to 23 March 2017) at the Escondida copper mine, which produces roughly 20% of Chile's copper. Thereafter, in the second half of the year the sector rebounded on the back of stronger copper prices and better investment prospects.

Growth in 2018 is forecast to be 3.3%, twice the 2017 rate, thanks to a general recovery in the economy that encompasses both the mining sector (with higher copper prices and greater investment in the sector) and the non-mining sectors, reflecting favourable conditions of external demand and an expansionary monetary policy, despite the maintenance of fiscal austerity.

(c) Prices, wages and employment

In 2017, the inflation rate was lower than in the previous year (2.3% December-December) and again at the lower bound of the central bank's target range of 3% with a one-percentage-point margin on either side.

The inflation trend reflected slack domestic demand and the exchange-rate appreciation, which helped to restrain goods inflation (0.1% in 2017 compared to 1% in 2016, December-December) and made it possible to control the rise in energy prices. Energy was the component that recorded the highest price increase, up by 5.3% in 2017 following a 2.9% rise a year earlier. The easing of nominal wage growth —particularly sharp in the first quarter of 2018— also helped to curb inflation overall.

Inflation is expected to be around 2.3% by end-2018; and in 2019 the 3% target will be attained thanks to a smaller output gap as economic activity picks up.

The national open unemployment rate rose slightly as an annual average relative to 2016 —from 6.8% to 6.9%. However, in the January–March 2018 quarter, at 7.0%, this rate showed no further rise in year-on-year terms. Unemployment is more prevalent among women than men (8.1% as against 6.2% for March–May, respectively). The trend in unemployment reflects the correlative rise in the labour supply and demand (both 2.1%). In keeping with the sectoral performance of the economy, the services sector was the largest job creator.

Table 1
CHILE: MAIN ECONOMIC INDICATORS

	2009	2010	2011	2012	2013	2014	2015	2016	2017 a/
	Annual growth rates b/								
Gross domestic product	-1.0	5.8	5.8	5.5	4.0	1.8	2.3	1.3	1.5
Per capita gross domestic product	-2.0	4.7	4.8	4.5	3.0	0.9	1.4	0.4	0.7
Gross domestic product, by sector									
Agriculture, livestock, hunting, forestry and fishing	-5.6	0.3	11.8	-2.2	0.1	0.2	6.4	1.4	0.3
Mining and quarrying	-1.0	1.5	-5.0	3.8	5.6	2.3	-0.9	-2.8	-2.0
Manufacturing	-4.2	2.6	7.6	3.6	1.3	-0.7	0.3	-2.4	1.6
Electricity, gas and water	13.8	8.4	11.7	8.4	6.0	3.8	3.4	2.0	3.2
Construction	-5.3	1.8	6.8	7.2	3.8	-1.9	4.3	2.8	-2.5
Wholesale and retail commerce, restaurants and hotels	-5.8	15.0	12.2	6.7	6.8	2.8	2.2	2.1	3.2
Transport, storage and communications	-5.2	8.8	7.0	9.8	6.5	2.9	5.5	3.0	3.0
Financial institutions, insurance, real estate and business services	2.0	5.4	7.5	6.0	2.8	2.3	2.0	0.7	1.0
Community, social and personal services	4.0	4.4	5.1	4.8	4.1	2.8	3.1	4.4	2.9
Gross domestic product, by type of expenditure									
Final consumption expenditure	0.8	9.8	7.8	5.7	5.2	2.9	2.6	2.9	2.7
Government consumption	9.2	4.6	2.5	3.5	3.5	3.8	4.8	6.3	4.0
Private consumption	-0.8	10.8	8.9	6.1	5.5	2.7	2.1	2.2	2.4
Gross capital formation	-23.5	30.8	16.5	11.3	-1.2	-4.8	-0.3	-0.7	-1.1
Exports (goods and services)	-4.5	2.3	5.5	0.1	3.3	0.3	-1.7	-0.1	-0.9
Imports (goods and services)	-16.2	25.5	16.0	4.8	2.1	-6.5	-1.1	0.2	4.7
Investment and saving c/	**Percentajes of GDP**								
Gross capital formation	21.3	23.4	24.9	26.8	25.6	23.2	23.8	22.2	22.1
National saving	23.1	24.8	23.3	22.8	21.6	21.6	21.5	20.8	20.6
External saving	-1.9	-1.4	1.6	3.9	4.0	1.6	2.3	1.4	1.5
Balance of payments	**Millions of dollars**								
Current account balance	3 220	3 069	-4 084	-10 471	-11 237	-4 288	-5 511	-3 499	-4 146
Goods balance	15 321	15 893	10 772	2 608	2 015	6 466	3 426	5 440	7 922
Exports, f.o.b.	55 463	71 109	81 438	78 063	76 770	75 065	62 035	60 733	69 230
Imports, f.o.b.	40 142	55 216	70 666	75 455	74 755	68 599	58 609	55 293	61 308
Services trade balance	-1 638	-1 757	-2 453	-2 542	-3 425	-3 730	-3 575	-3 280	-3 059
Income balance	-12 026	-15 477	-15 268	-12 597	-12 035	-9 140	-7 219	-7 045	-10 802
Net current transfers	1 563	4 410	2 865	2 060	2 207	2 117	1 858	1 385	1 793
Capital and financial balance d/	-1 572	-45	18 274	10 104	11 548	5 345	5 722	5 305	1 397
Net foreign direct investment	6 622	6 559	3 898	9 736	10 937	10 936	5 026	4 909	1 595
Other capital movements	-8 195	-6 604	14 376	367	612	-5 591	696	395	-198
Overall balance	1 648	3 024	14 190	-367	311	1 057	211	1 805	-2 750
Variation in reserve assets e/	-1 648	-3 024	-14 190	367	-311	-1 057	-211	-1 805	2 750
Other external-sector indicators									
Real effective exchange rate (index: 2005=100) f/	101.6	96.3	95.3	94.0	95.2	105.4	109.4	108.4	105.2
Terms of trade for goods (index: 2010=100)	82.3	100.0	101.8	94.6	91.7	89.9	87.2	91.2	100.9
Net resource transfer (millions of dollars)	-13 599	-15 522	3 006	-2 493	-486	-3 796	-1 498	-1 740	-9 406
Total gross external debt (millions of dollars)	72 617	86 570	100 973	122 668	136 351	152 135	160 904	166 974	181 513
Employment	**Average annual rates**								
Labour force participation rate g/	59.9	58.5	59.8	59.5	59.6	59.8	59.7	59.5	59.7
Open unemployment rate g/	11.3	8.5	7.4	6.7	6.2	6.7	6.4	6.8	6.9
Visible underemployment rate h/	10.8	11.5	11.9	11.5	11.6	11.3	10.3	10.9	11.1

Table 1 (concluded)

	2009	2010	2011	2012	2013	2014	2015	2016	2017
Prices	**Annual percentages**								
Variation in consumer prices (December-December)	-1.4	3.0	4.4	1.5	3.0	4.6	4.4	2.7	2.3
Variation in industrial producer prices (December-December)	-14.9	3.5	10.0	0.7	-2.8	-3.3	-10.7	10.2	8.4
Variation in nominal exchange rate (annual average)	6.8	-8.8	-5.2	0.5	1.9	15.2	14.7	3.3	-4.0
Variation in average real wage	4.8	2.2	2.5	3.2	3.9	1.8	1.8	1.4	3.1
Nominal deposit rate i/	2.3	2.7	5.6	5.9	5.2	3.9	3.8	4.0	3.0
Nominal lending rate i/	12.9	11.8	12.4	13.5	13.2	10.8	9.3	10.4	11.5
Central government	**Percentajes of GDP**								
Total revenue	19.0	21.4	22.6	22.2	20.9	20.6	21.0	20.8	21.0
Tax revenue j/	15.2	17.1	18.6	19.0	18.1	17.9	19.1	18.6	18.6
Total expenditure	23.3	21.9	21.3	21.6	21.5	22.2	23.2	23.5	23.7
Current expenditure	18.9	18.0	17.3	17.7	17.9	18.4	19.0	19.6	20.1
Interest	0.5	0.5	0.6	0.6	0.6	0.6	0.7	0.7	0.8
Capital expenditure	4.4	3.9	4.1	4.0	3.6	3.8	4.2	3.9	3.6
Primary balance	-3.8	0.0	1.8	1.2	0.0	-1.0	-1.5	-2.0	-1.9
Overall balance	-4.3	-0.5	1.3	0.6	-0.6	-1.6	-2.1	-2.7	-2.8
Central government public debt k/	5.7	8.6	11.0	11.9	12.8	14.9	17.4	21.3	23.6
Domestic	4.4	7.2	9.1	10.0	10.8	12.3	13.9	17.3	19.2
External	1.3	1.5	1.9	1.9	2.0	2.7	3.5	4.0	4.4
Money and credit l/	**Percentages of GDP, end-of-year stocks**								
Domestic credit	63.3	55.2	59.8	61.6	62.9	62.6	71.2	71.4	71.9
To the public sector	-1.7	-1.5	-1.3	-0.3	0.9	-0.1	-0.4	-0.4	1.6
To the private sector	72.0	66.9	71.4	75.1	77.7	79.5	82.0	81.3	80.2
Others	-6.9	-10.2	-10.4	-13.3	-15.7	-16.7	-10.4	-9.5	-10.0
Monetary base	4.7	5.0	5.6	6.1	6.3	5.5	5.7	6.1	6.2
Money (M1)	14.7	15.1	15.5	15.9	16.5	17.4	18.4	17.9	18.7
M2	56.4	53.8	60.4	63.2	65.8	66.5	69.5	70.1	68.9
Foreign-currency deposits	5.5	6.3	5.8	6.3	7.0	8.6	9.0	8.8	8.1

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 2013 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/ Includes social security contributions.
k/ Does not include publicly guaranteed debt.
l/ The monetary figures are December averages.

Table 2

CHILE: MAIN QUARTERLY INDICATORS

	2016				2017				2018	
	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/	2.7	0.9	1.2	0.3	-0.4	0.5	2.5	3.3	4.2	...
Gross international reserves (millions of dollars)	38 756	39 803	39 313	39 814	39 538	38 909	38 364	38 721	38 401	37 203
Real effective exchange rate (index: 2005=100) c/	111.1	109.7	107.0	105.9	104.0	106.8	105.6	104.6	100.1	100.9
Open unemployment rate	6.3	6.9	6.8	6.1	6.6	7.0	6.7	6.4	6.9	...
Employment rate	55.7	55.3	55.4	55.9	55.5	55.4	55.7	56.2	55.8	...
Consumer prices (12-month percentage variation)	4.5	4.2	3.1	2.7	2.7	1.7	1.4	2.3	1.8	2.5
Wholesale prices (12-month percentage variation)	-5.5	-8.2	-4.2	10.23	8.6	9.6	13.0	8.37	4.8	10.1
Average nominal exchange rate (pesos per dollar)	701.6	677.3	661.6	663.5	655.5	663.9	642.3	633.3	601.9	621.8
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 d/	4.3	4.0	3.9	4.0	3.4	2.9	2.8	3.0	2.8	2.8
Lending rate d/	9.9	10.0	10.6	11.0	13.2	11.0	10.9	10.7	11.1	10.1
Interbank rate	3.5	3.5	3.5	3.5	3.2	2.7	2.5	2.5	2.5	2.5
Monetary policy rates	3.5	3.5	3.5	3.5	3.2	2.6	2.5	2.5	2.5	2.5
Sovereign bond spread, Embi Global (basis points to end of period) e/	213	202	180	158	133	132	128	117	128	144
Risk premiia on five-year credit default swap (basis points to end of period)	95	95	86	83	72	66	59	49	51	61
International bond issues (millions of dollars)	2 650	94	1 197	1 395	2 610	3 844	5 004	2 990	3 737	1 845
Stock price index (national index to end of period, 31 December 2005 = 100)	200	203	204	211	243	242	272	283	282	270
Domestic credit (variation from same quarter of preceding year)	11.5	9.6	8.1	6.4	3.6	4.4	7.0	6.8	10.5	11.1 f/
Non-performing loans as a percentage of total credit	0.9	0.8	0.8	0.8	0.8	0.8	0.8	0.9	0.9	0.9

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 2013 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.