



The Chilean Economy

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Outline

- Introduction
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1. Introduction

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- Thirty years ago, the Chilean economy was closed to international trade, suffered from a high degree of state intervention and had serious macroeconomic imbalances, such as:
 - Fiscal deficit of 30% of GDP;
 - Annual inflation rate above 500%;
 - Average import tariff of 105% (with great dispersion), multiple exchange rates and many other restrictions to trade (quotas, etc.).

1. Introduction

- In a major turnaround, Chile has become a stable and very dynamic and competitive open economy.
- This has been the result of deep reforms on policies and institutions introduced over the past three decades.

1. Introduction

- The initial reforms included:
 - In the 70s: fiscal stabilization (VAT and sharp spending reductions); liberalization of prices, the financial system and the capital account (partial); opening to foreign trade, privatization of SOEs, and pension reform;
 - However, banking regulatory and supervisory frameworks were not upgraded fast enough, leading to the debt crisis of the early 80s;
 - These errors were amended in the post-crisis years: new banking law; new bankruptcy law; updating of banks regulations; second wave of privatizations.

1. Introduction

- Moreover, in late 1989 the Central bank was granted full independence and was precluded (by law) from financing the government.
- Also in 1989 a successful transition to democracy was initiated while maintaining and strengthening the market economy model. The three administrations since have given more weight to social policies as a way to alleviate poverty.

1. Introduction

- During the 90s important reforms were introduced in many areas:
 - Competition in telecommunications (multicarrier system);
 - Private sector involvement in infrastructure development through (BOT) concessions;
 - Deepening integration with the world economy (unilateral tariff reductions and PTA with important countries);
 - Education reforms;
 - Anti-trust rules;
 - Adoption of Inflation Targeting.

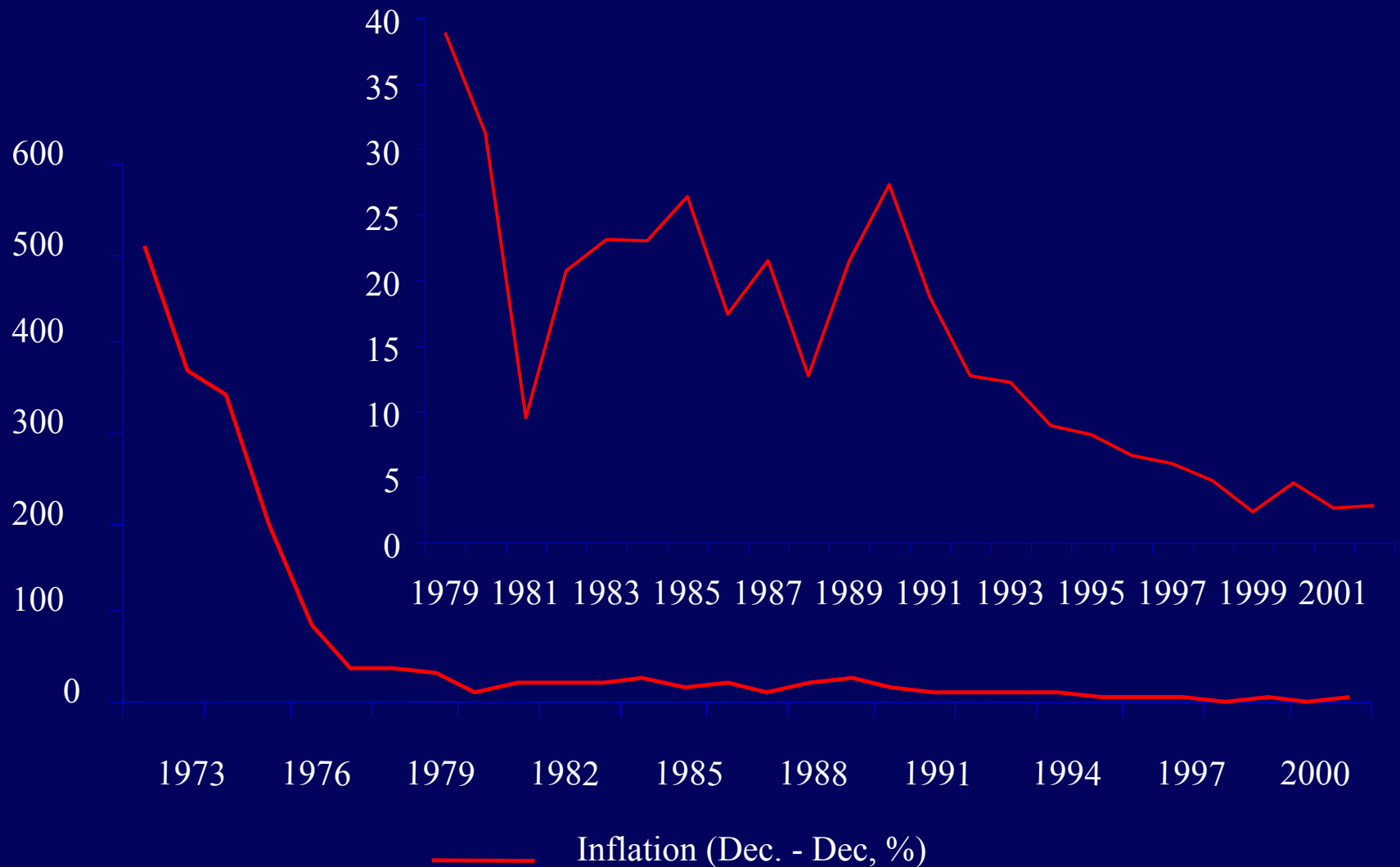
1. Introduction

- As a result, Chile acquired solid macro fundamentals and modern and robust institutions, all necessary elements for reaching high and sustainable growth rates.
- Chile's average annual growth rate in 1986-97 reached 7.3% (*the golden period*)

1. Introduction

- Growth was the result of both a quantum leap in Total Factor Productivity and an increase in the rate of capital accumulation.
- Chile's market-oriented economy made it more attractive to invest, hire labor and improve efficiency.
- Moreover, annual inflation was reduced to one-digit levels.

1. Introduction

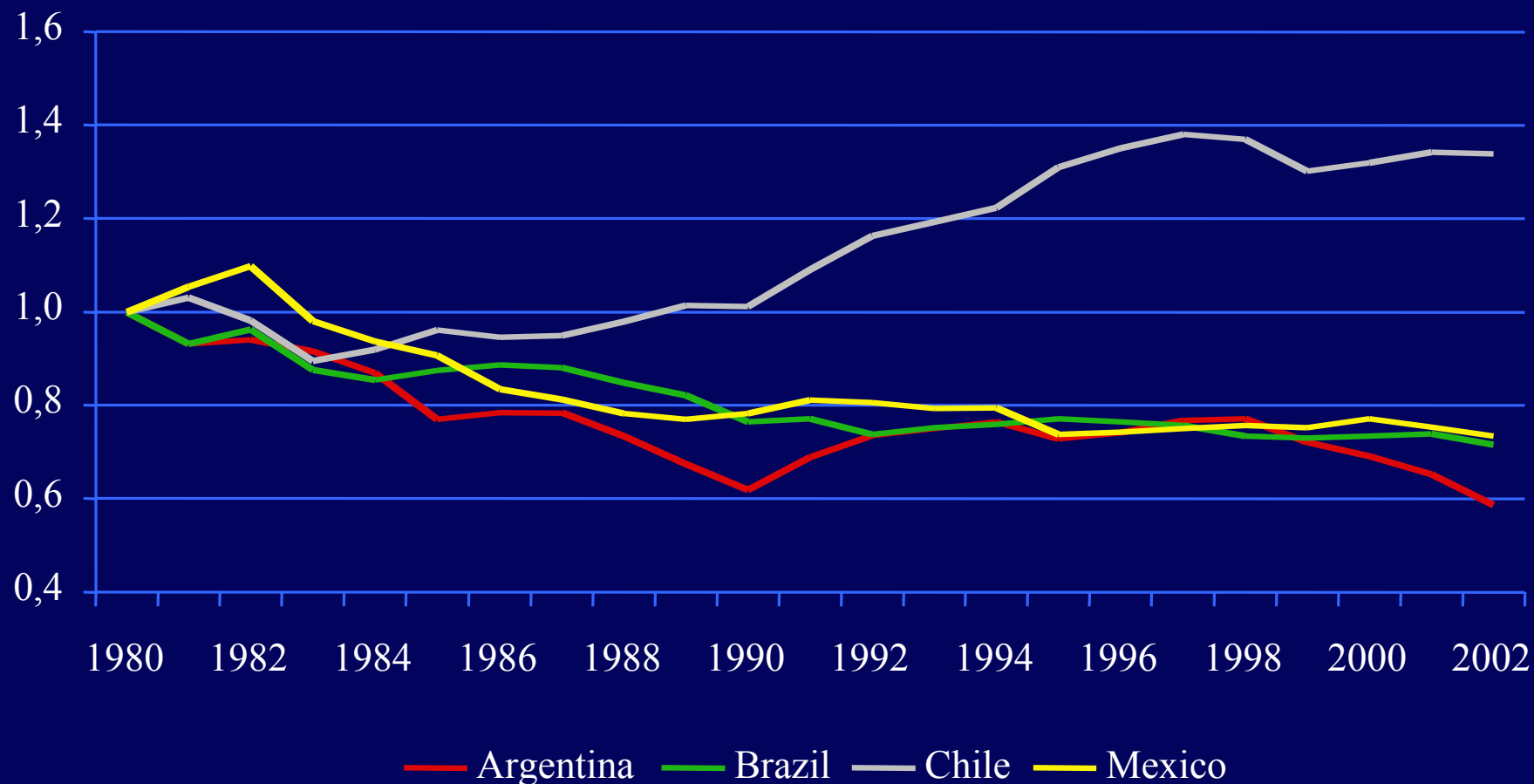


1. Introduction

- During this period:
 - The country progressed significantly in closing the per-capita GDP gap with medium to high income countries;
 - High economic growth and the targeting of social expenditures towards the poor resulted sharp improvement in Chile's social indicators.

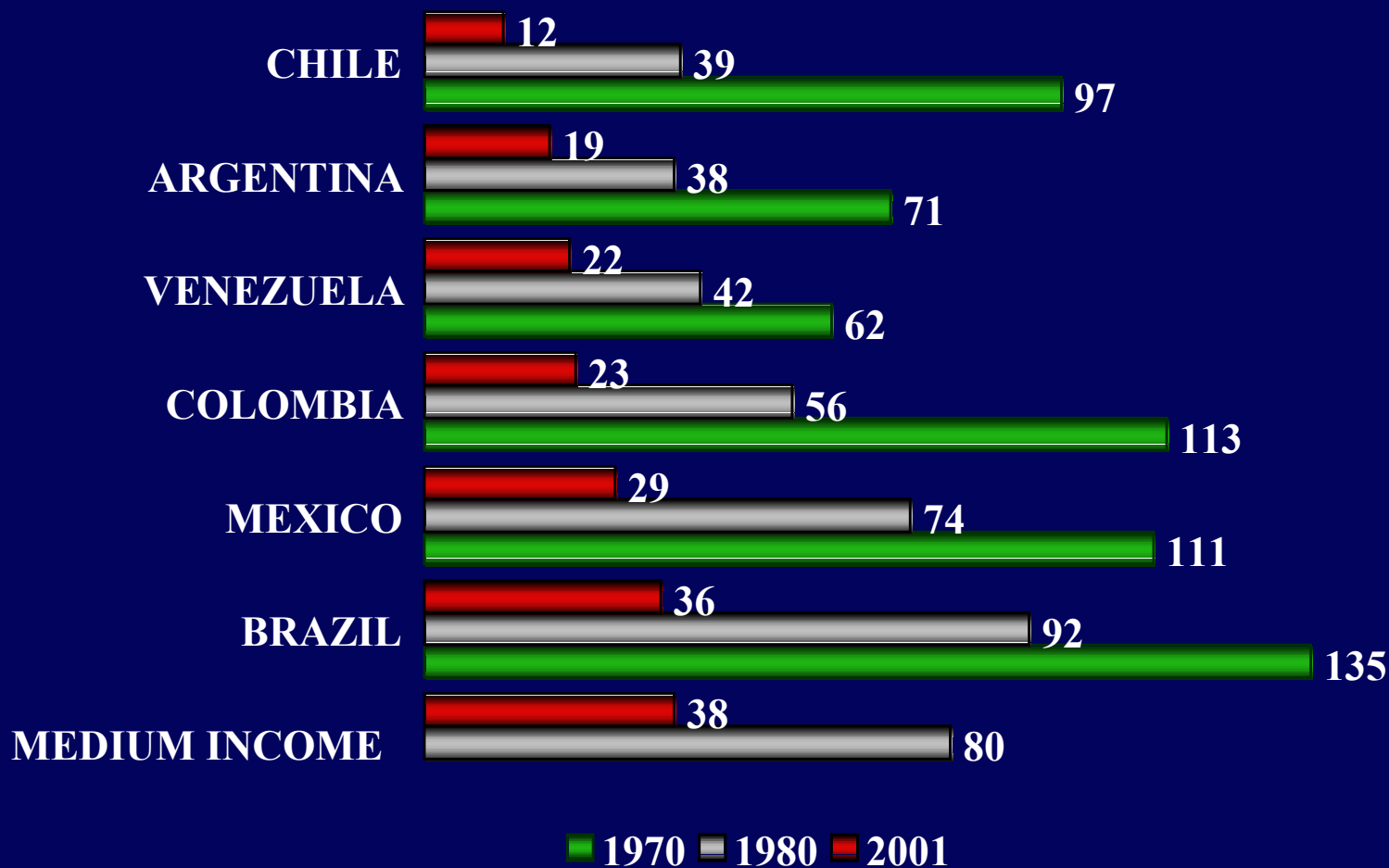
Relative Gross Domestic Output

(Country j per-capita GDP over USA per-capita GDP; 1980=1)



UNDER 5 MORTALITY RATE

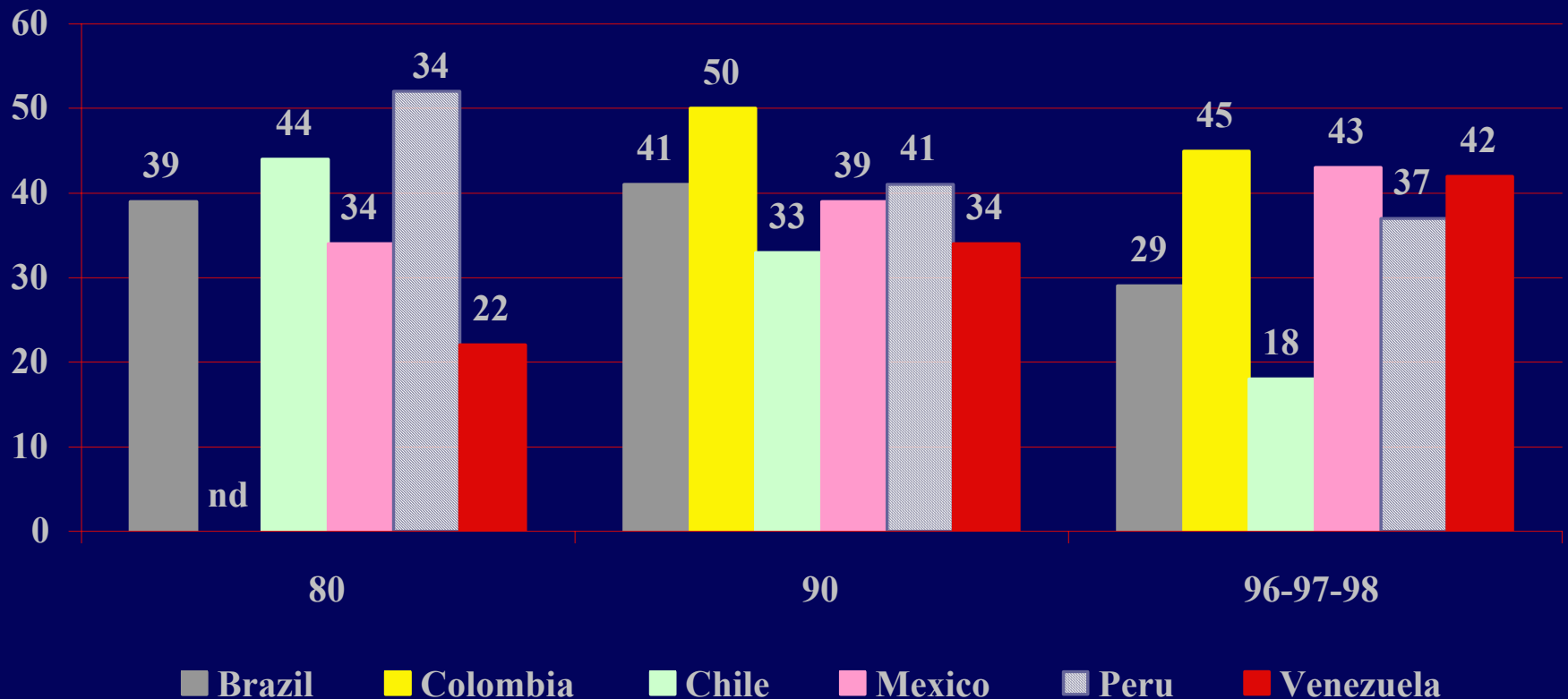
(Per 1000 born alive)



Source: World Bank, World Development Indicators 2003

POVERTY IN LATIN AMERICA

(% of households below the poverty line)



Source: CEPAL (2000), La Brecha de la Equidad.

2. The Current Situation

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- As Chile is a very open economy, its prospects are closely related to developments in the world economy.
- For this reason we have suffered the effects of the global slowdown of the past three years.

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- But in recent years Chile has strengthened its macroeconomic framework to make the country more resilient to shocks:
 - A fiscal rule of a 1% structural surplus was adopted in 2001;
 - The exchange rate band was abolished in 1999, thus consolidating the float and strengthening the Inflation Targeting Monetary Framework;
 - The opening of the capital account was completed in 2001 with the abolishment of all capital controls;
 - FTAs were signed with the EU in 2002, and with Korea and the US in 2003.

2. The Current Situation

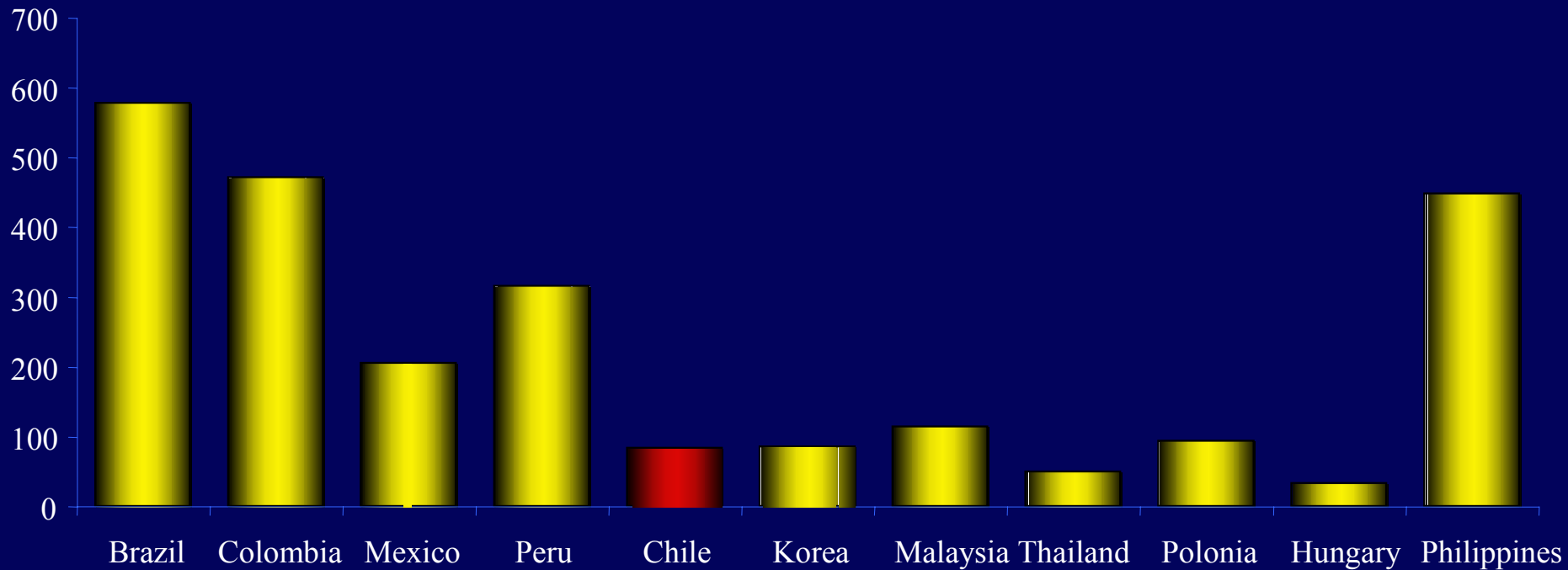
- Thanks to its good fundamentals and high credibility in its policies, Chile is today better prepared than in the past (and than other emerging economies) to accommodate shocks.
- Chile's important strengths include:
 - One of the lowest risk ratings (country-risk) in the emerging world;
 - Solid fiscal situation and very low public debt;
 - Solid financial system;
 - Small current account deficit;
 - Low and stable inflation;

2. The Current Situation

- Independent Central Bank that follows an inflation target;
- Constitution that authorizes only the executive branch to take initiatives on government spendings;
- Low corruption;
- Highly competitive (relative to other emerging market economies).

Country Risk

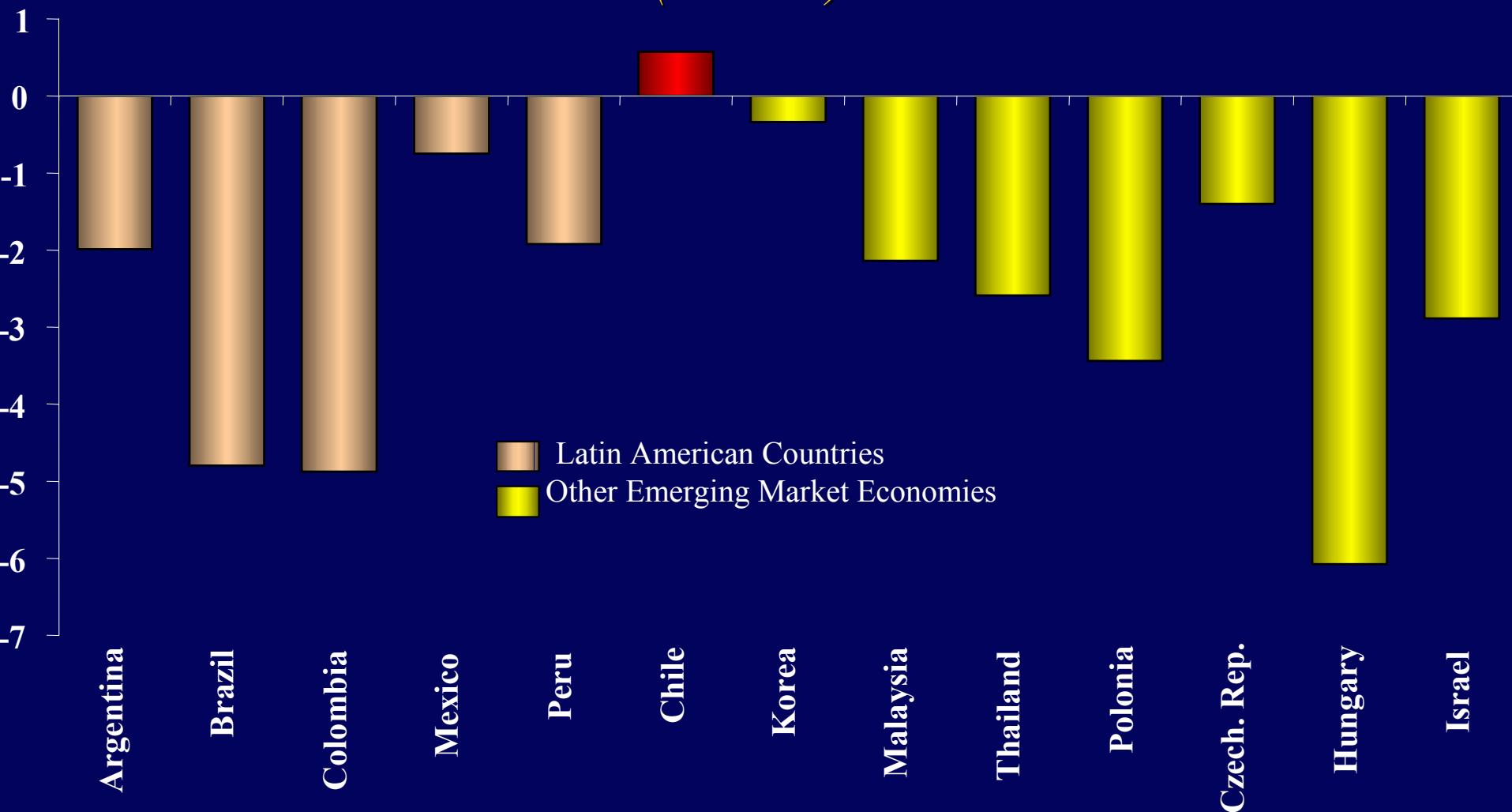
(basis points)



Source: JP Morgan, November 2003

Fiscal Balance: Average 1995-2002

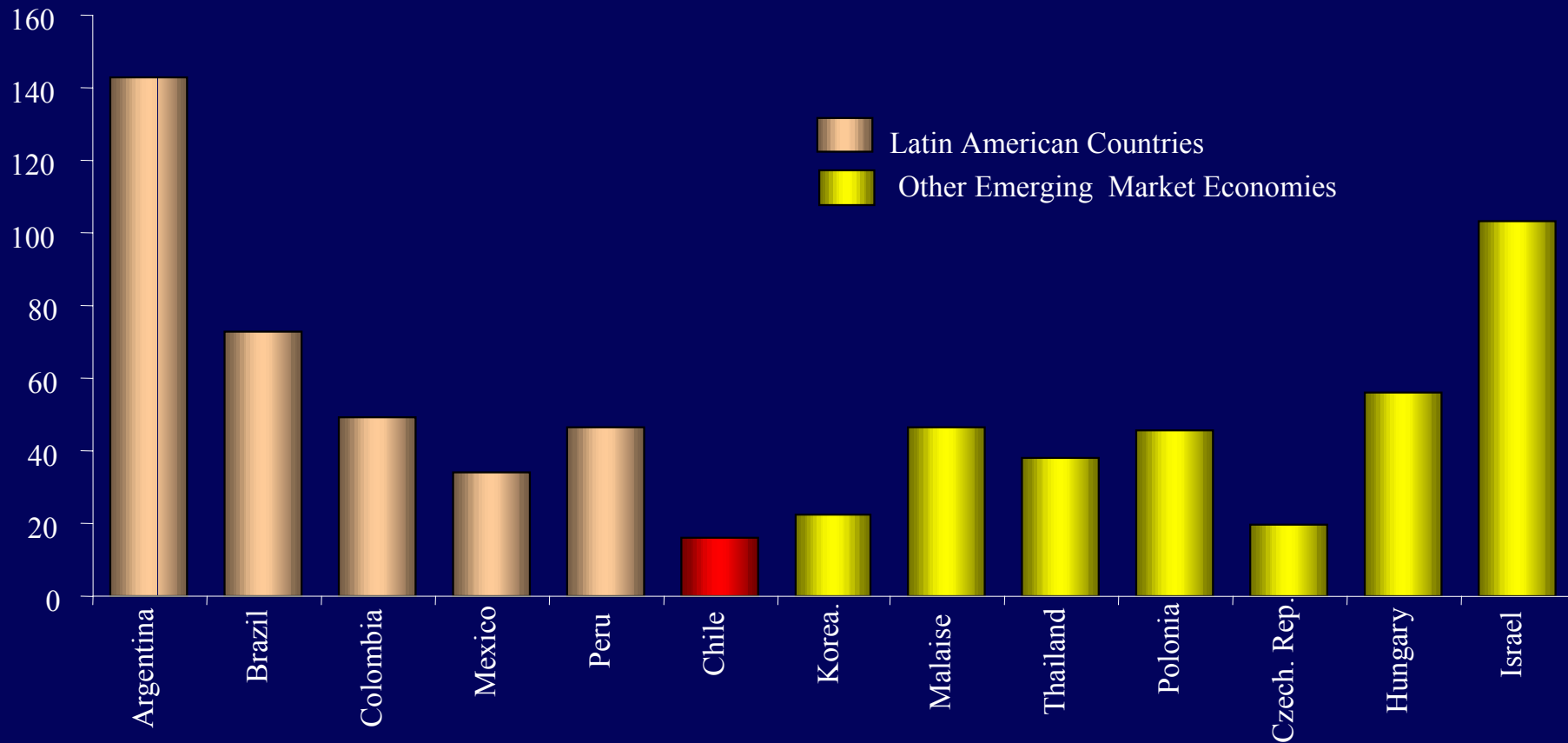
(% GDP)



Source: Moody's April 2003

Public Debt 2002 (1)

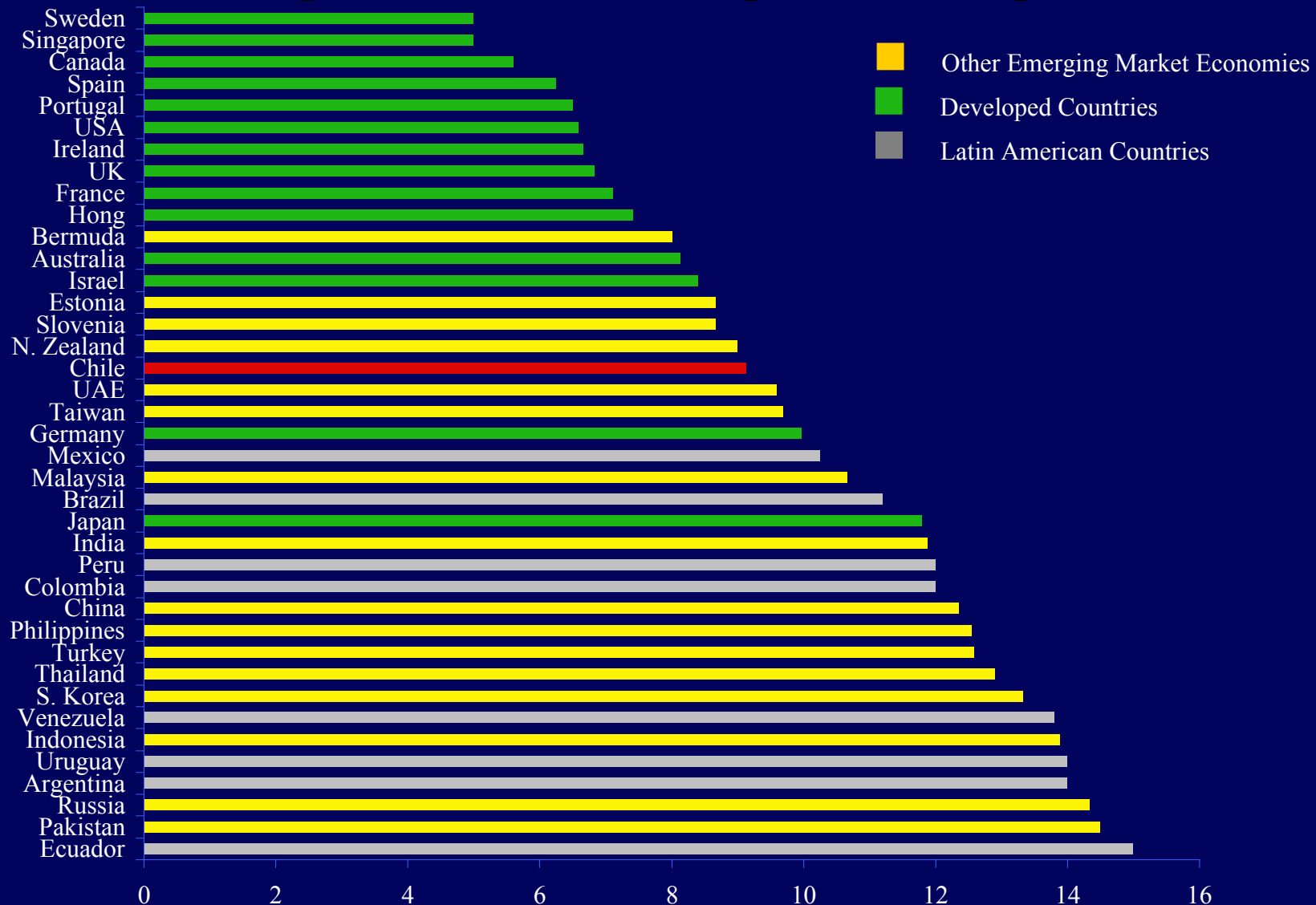
(% GDP)



(1) Gross central government debt (excludes debt from the central bank and social security trust funds)

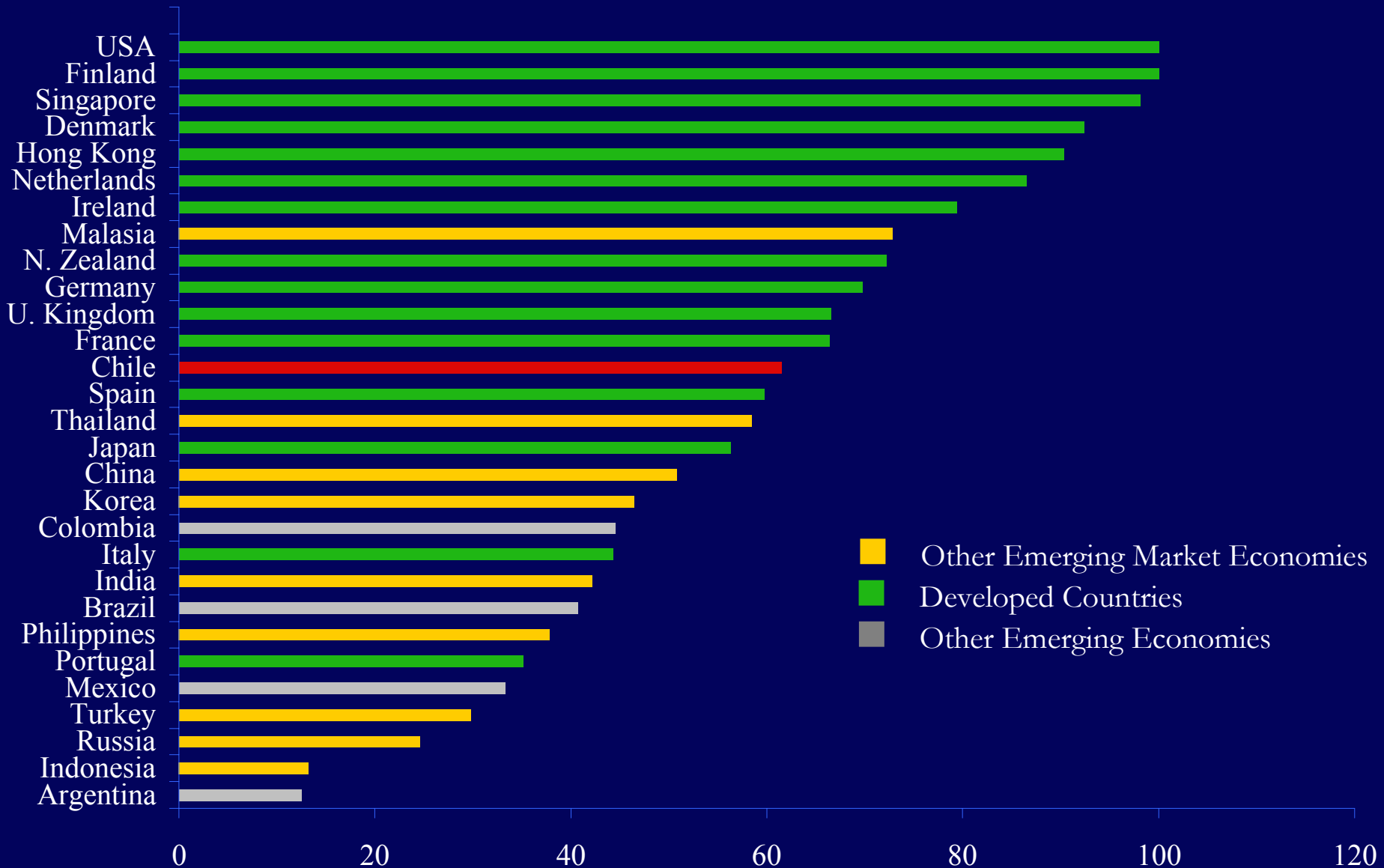
Source: Moody's April 2003, and Ministry of Finance

Ranking of Banking Strength



(Source: Moody's, March 2003.)

Competitiveness Ranking 2003



Source: IMD, May 2003.

3. Prospects

3. Prospects

- The solid macro fundamentals and robust institutions, together with better prospects for the world economy, allow us to look the future with optimism.
- Growth this year will be in the 3% to 3.5% range and inflation below 2%.
- Next year we expect a growth rate between 4% and 5%, inflation a bit below the 3% (medium-term) target and a small current account deficit.

3. Prospects

- However, to reach higher growth rates, like in the period 1985-97, it is necessary to continue looking for areas where efficiency gains can occur, producing a new jump in TFP.
- Main challenges are in education, health-care, technological innovation, labor flexibility and training.
- Recent initiatives show a clear intention to continue improving in these areas.

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