



The Chilean Economy: Recent Developments and Prospects

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2. Recent Developments

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1. Overview

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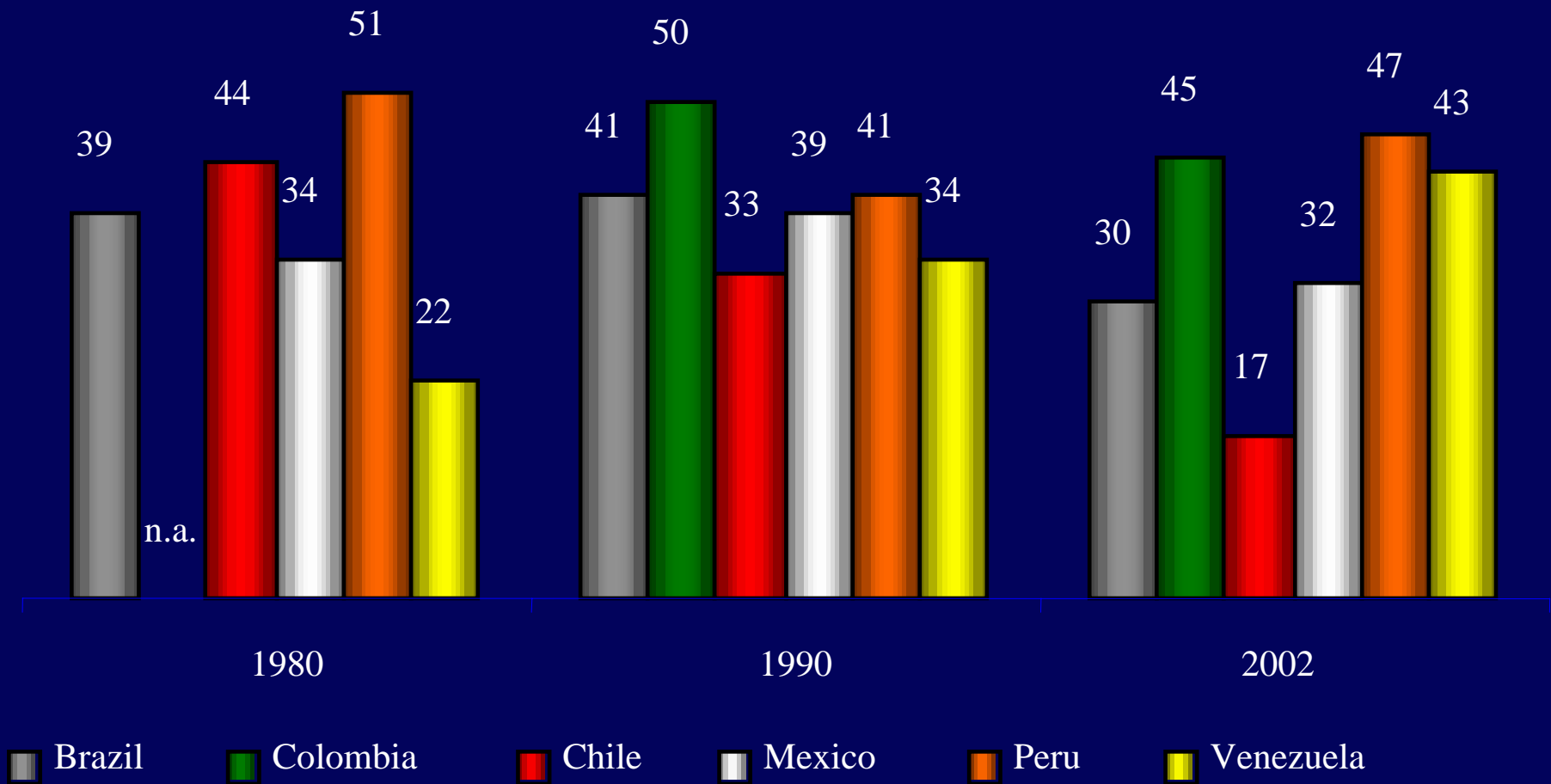
- In the past thirty years Chile implemented a reform process that completely changed its economy.
- As a result of these reforms Chile has built solid macro and institutional foundations:
 - Fiscal policies and institutions that have led to a low public debt and healthy public accounts;
 - An independent Central Bank with a proven track record in the use of IT with a flexible exchange rate;
 - A banking regulation and supervision system that has given origin to a solid banking system.

1. Overview

- As a result of these changes, the Chilean economy has become very stable, open, dynamic and competitive.
 - The country's average annual growth rate in 1986-97, the *golden period*, reached 7.3%.
 - And the 1998-99 turmoil in the world economy had a relatively mild effect on the economy.
- Meanwhile, social indicators have improved markedly, and are now among the best in the region.

Poverty in Latin America

(% of households below the poverty line)



Source: ECLAC (2004).

1. Overview

- The reform process has continued until today.
- Critical components of the strong institutions and sound policies in the macroeconomic realm are:
 - Bank regulation and supervision (1986 and beyond);
 - Central Bank independence (1989);
 - Full fledged inflation targeting (2000);
 - Flexible exchange-rate system (1999);
 - 1%-of-GDP structural fiscal surplus rule (2001);
 - Full liberalisation of capital account (2001).

1. Overview

- As a result, today Chile has solid macro fundamentals, together with modern and robust institutions:
 - Solid financial system;
 - Solid fiscal situation with a low level of public debt;
 - A current account surplus;
 - Low inflation;
 - An adequate and consistent macro framework (fiscal, monetary and exchange rate policy mix).

Public Debt

(% of GDP)

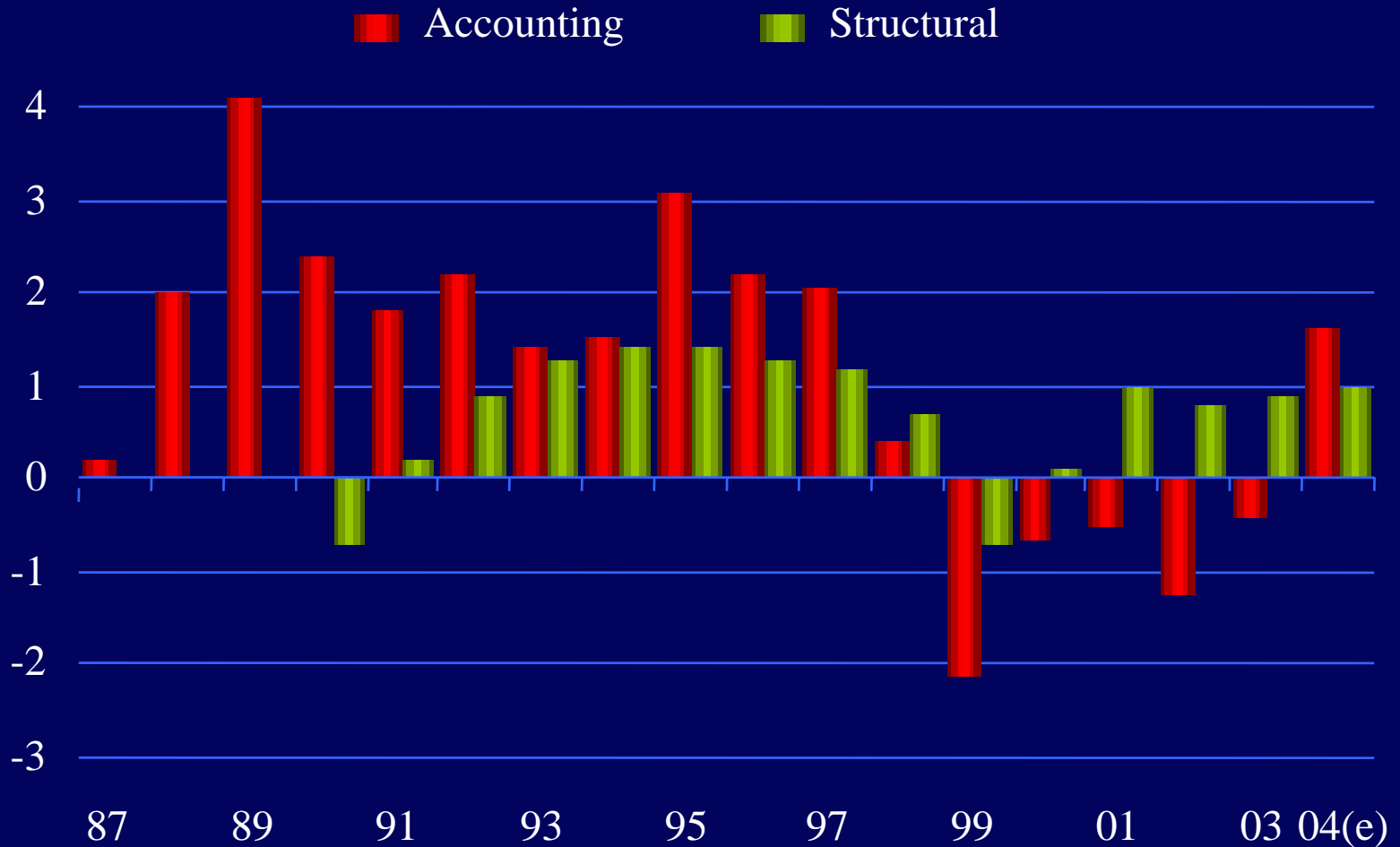


Consolidated of Central Government and Central Bank

(p) Preliminary figures

Fiscal Balance

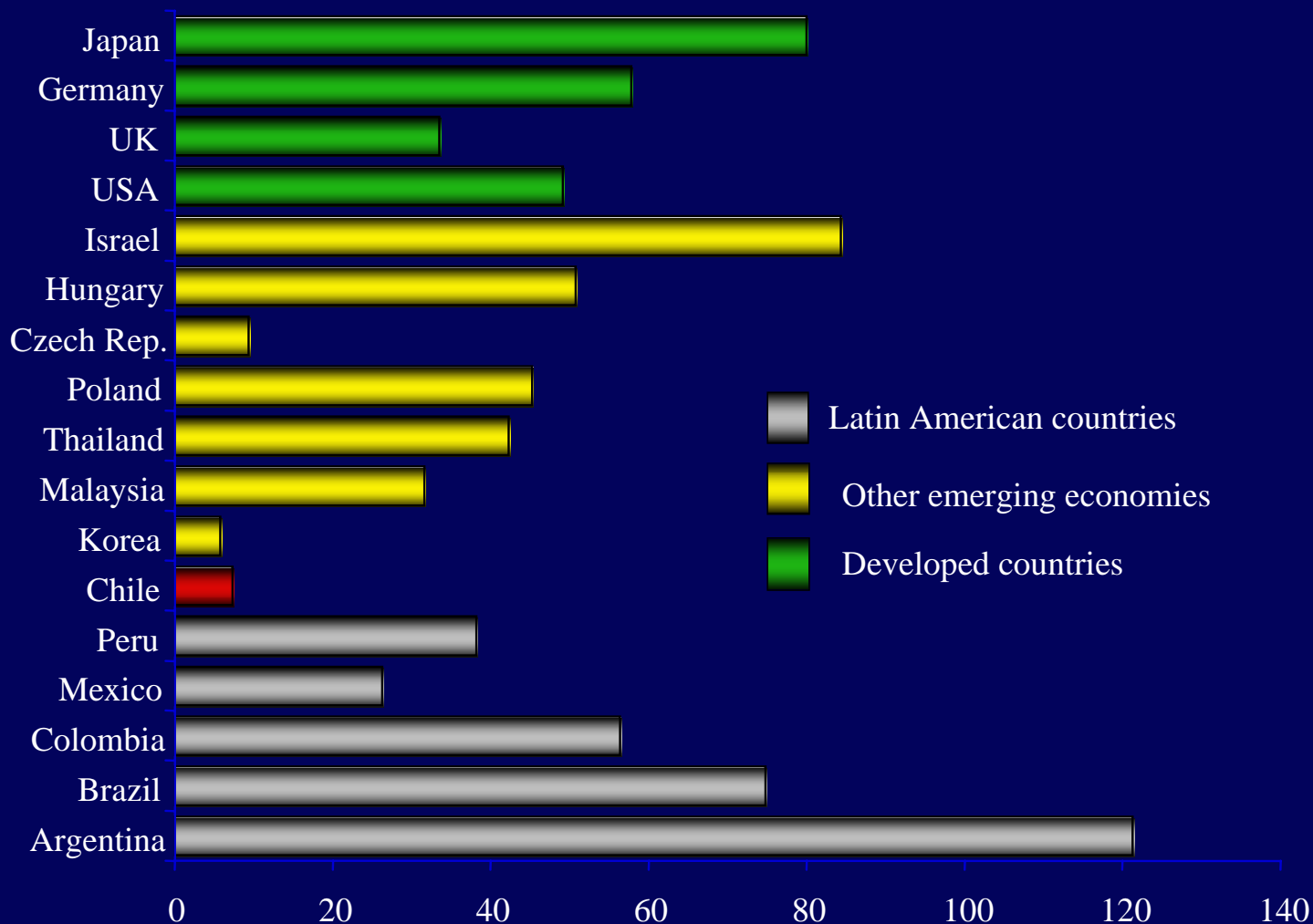
(% of GDP)



(e) estimated

Net Public Debt in 2003 ⁽¹⁾

(% GDP)

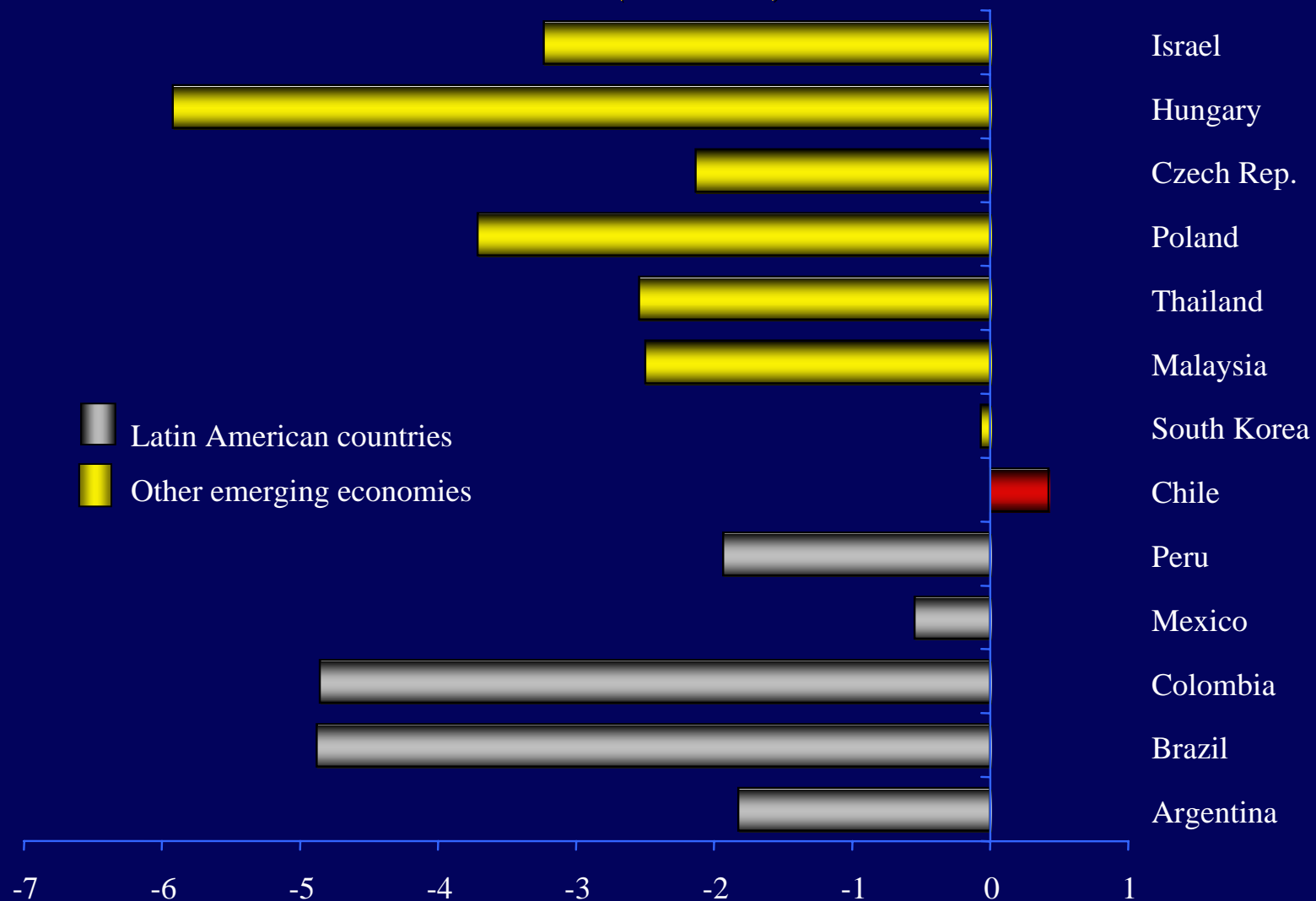


(1) Chile considers Consolidated Public Sector. The rest of countries, only the Central Government debt.

Source: Deutsche Bank, IMF Sept 2003, Ministry of Finance.

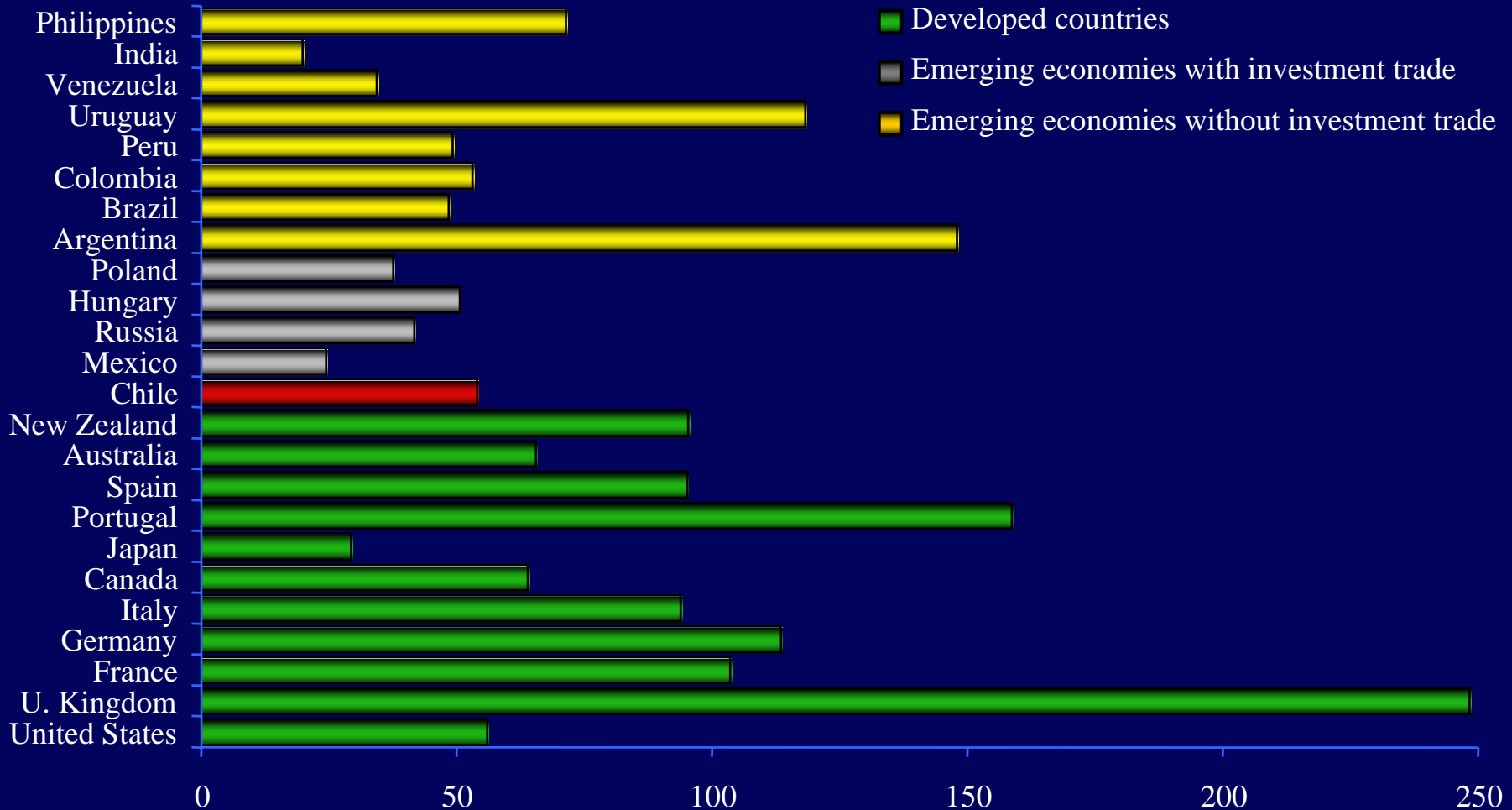
Fiscal Balance: 1995-2003 Average

(% GDP)



Source: Moody's Sept 2003, Ministry of Finance.

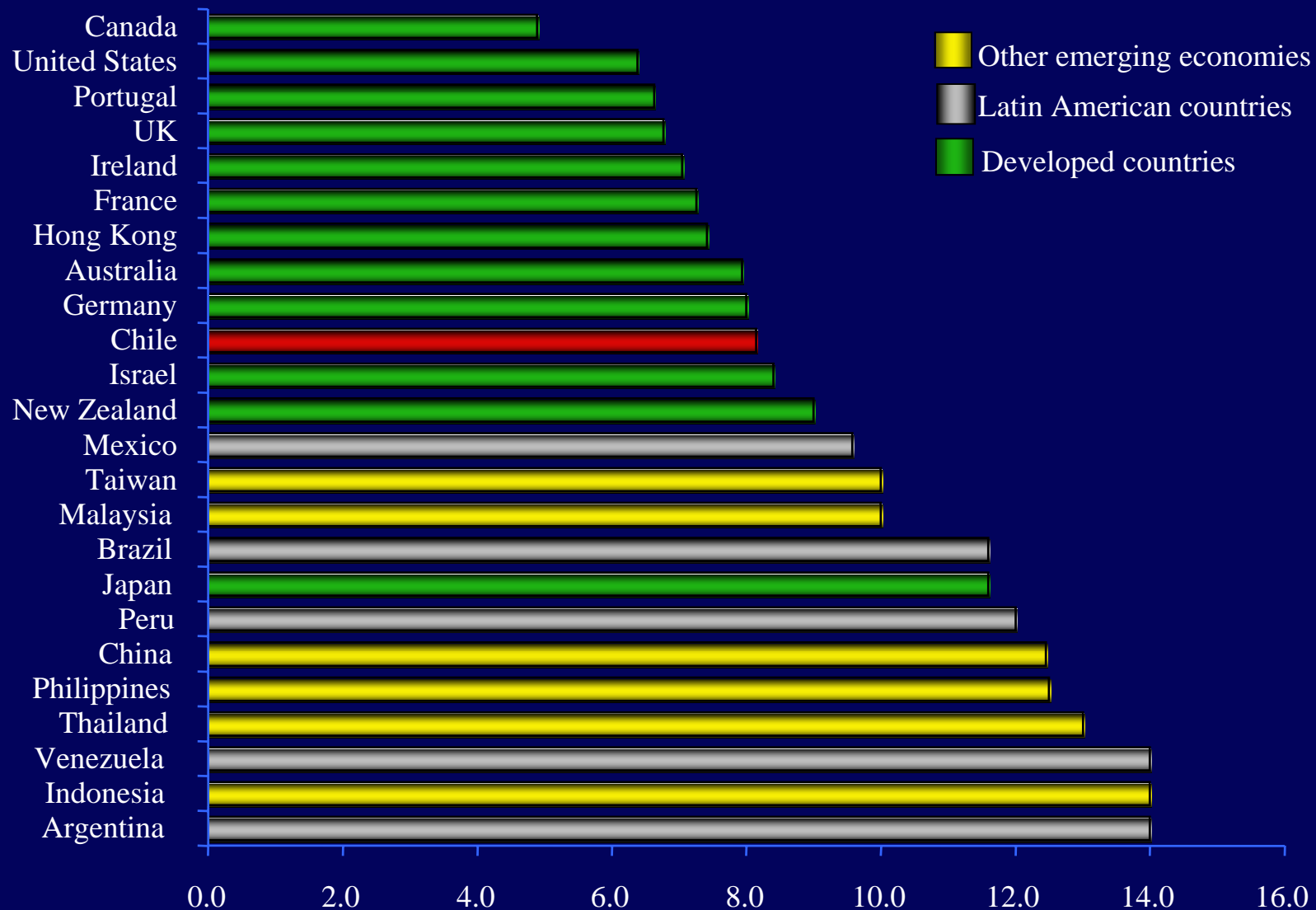
External Debt / GDP



Source: IMF.

* December 2002. External debt = Debt securities liabilities + other investment liabilities from IIP

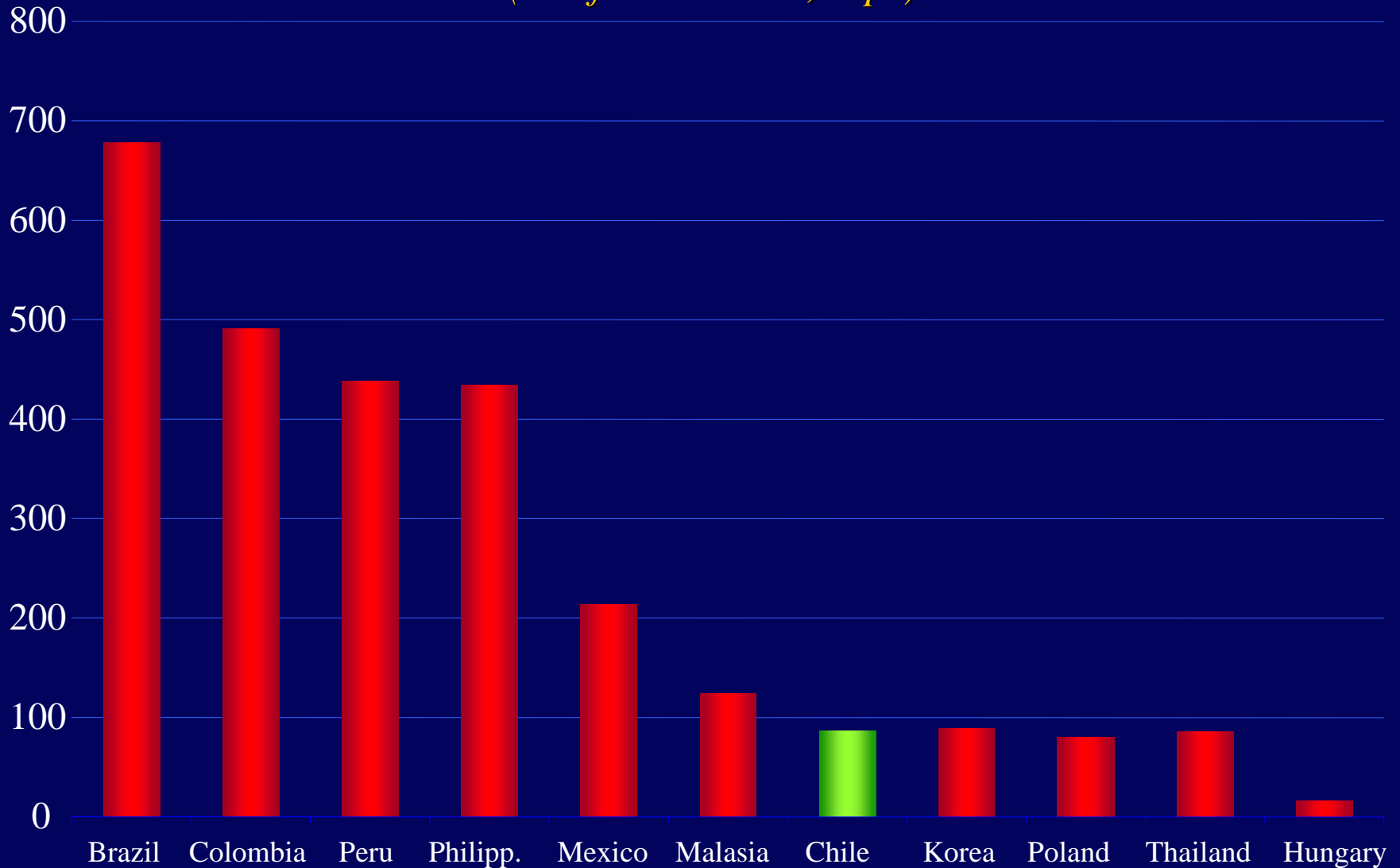
Ranking of Banking Strength



Source: Moody's, Feb. 2004.

Emerging Countries Spreads

(as of 06/11/2004, Pips)

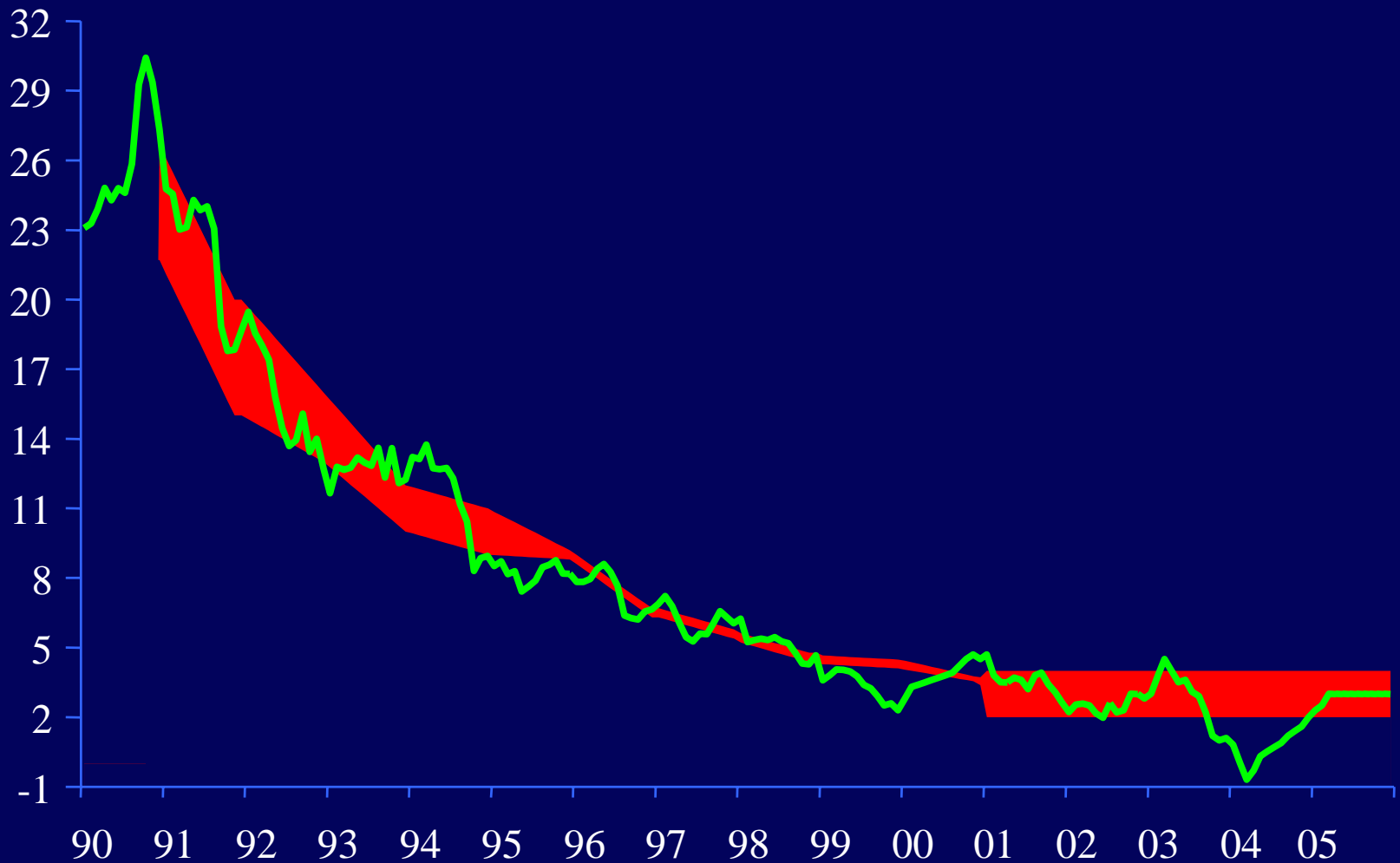


1. Overview

- On the back of its fundamentals, the autonomous Central Bank has achieved a drastic reduction in inflation.

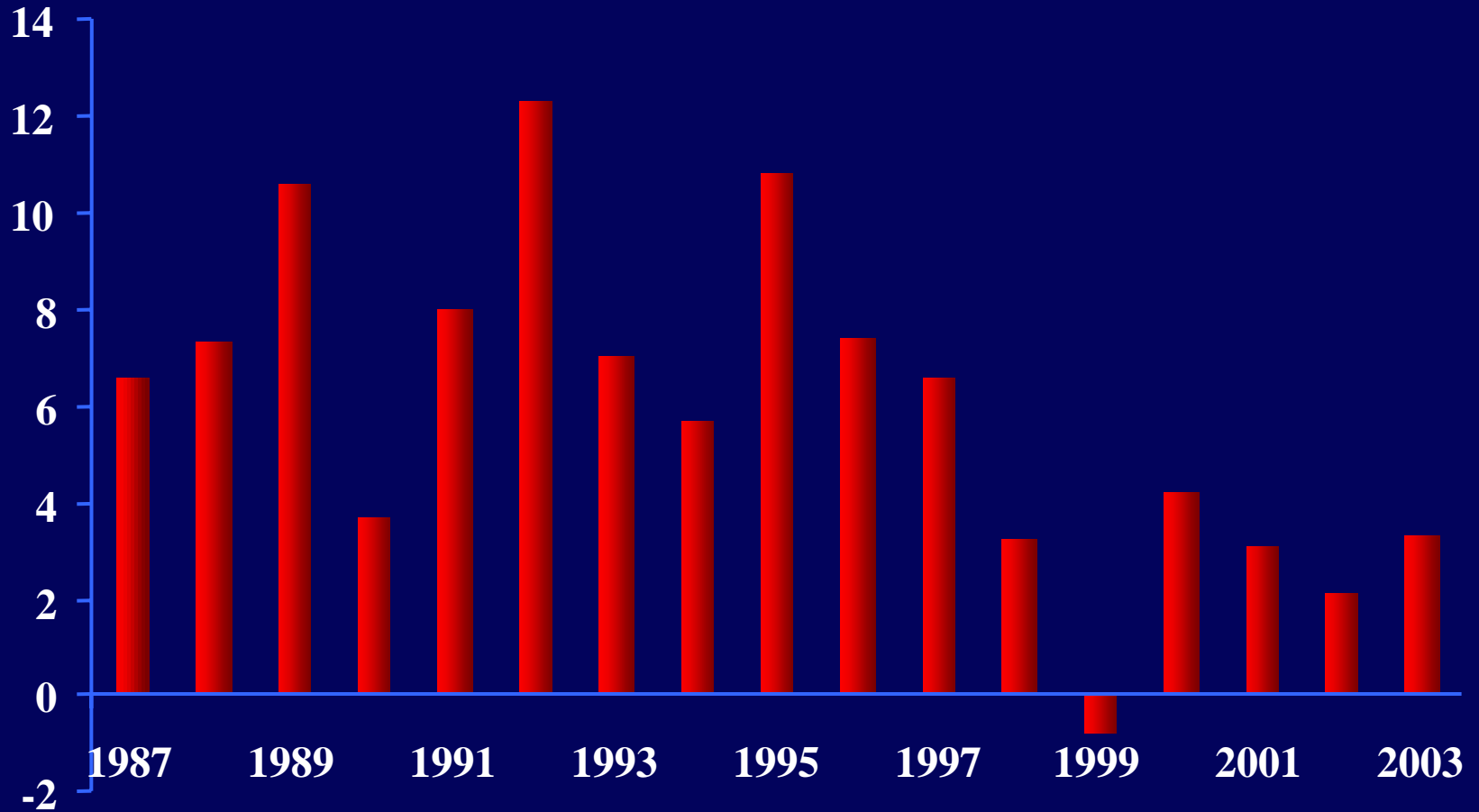
Inflation Targets and Inflation Rate

(y-o-y % change)



GDP Growth: 1987-2003

(%)



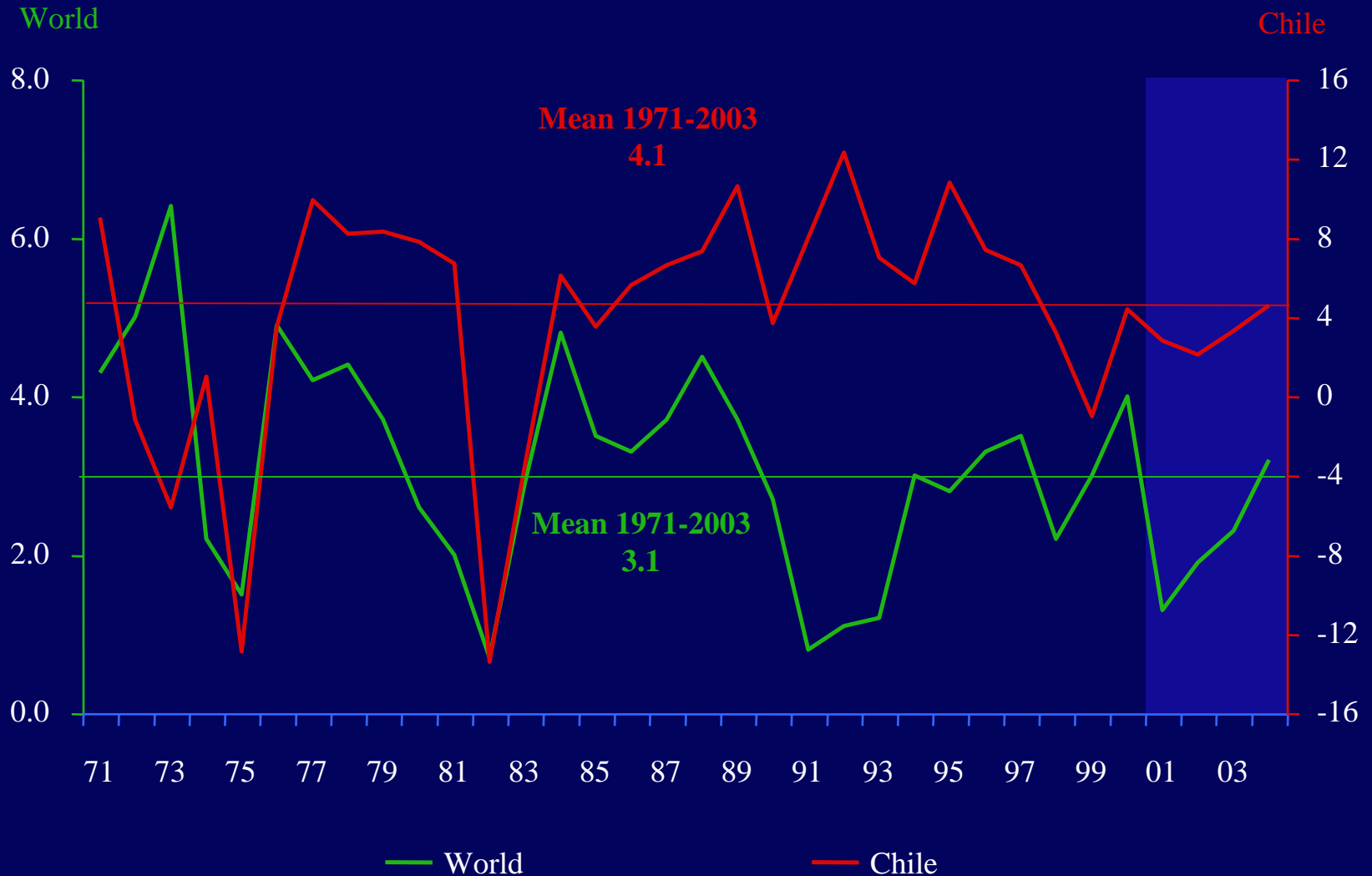
2. Recent Developments

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- The very open Chilean economy is closely linked to global developments.
- Thus, it is not surprising that the series of crises in emerging markets and the global slowdown of 2000-2002 negatively affected its recent growth record.

World and Chile's Growth 1971-2004

(%)



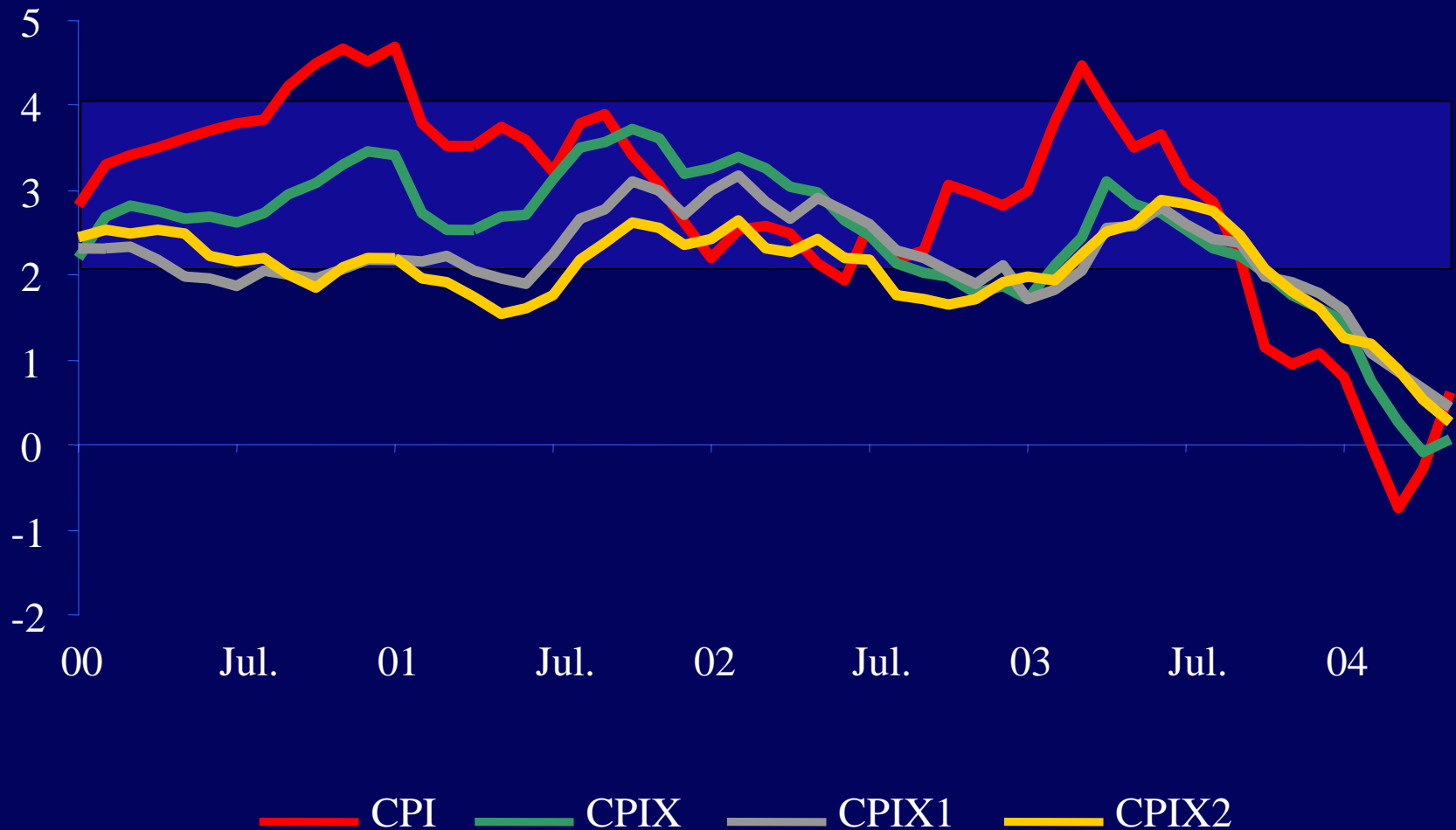
Source: IMF

2. Recent Developments

- On the inflation front, after several years of keeping inflation in line with the target, a sudden peso appreciation in the second half of 2003 and competition in retail brought inflation below the target range.
- Two prompt reductions in the policy interest rate have helped to start raising inflation toward the target range.

Inflation 2000-2004

(12 months variation, %)



3. Future Prospects

3. Future Prospects

- The recovery in the global economy initiated last year has improved the external environment relevant to Chile:
 - Terms of trade have improved, especially driven by copper;
 - Regional uncertainty has receded;
 - International financial conditions have improved.
- At the moment, Chile's economic growth is picking up.

External Baseline Scenario: Summary

	2002	2003	2004(f)	2005(f)
<i>(annual percent variation)</i>				
Terms of trade	3.3	2.9	12.8	-1.5
Trade partners' GDP	2.0	2.7	4.3	3.6
External prices (in US\$)	-4.1	10.5	5.6	1.8
<i>(levels)</i>				
Copper price BML	70.8	80.6	118.0	110.0
<i>(US\$cent/lb)</i>				
Brent oil price	24.9	28.9	33	29
<i>(US\$/barrel)</i>				
Libor US\$	2.0	1.2	1.4	3.2
<i>(Nominal, 90 days)</i>				

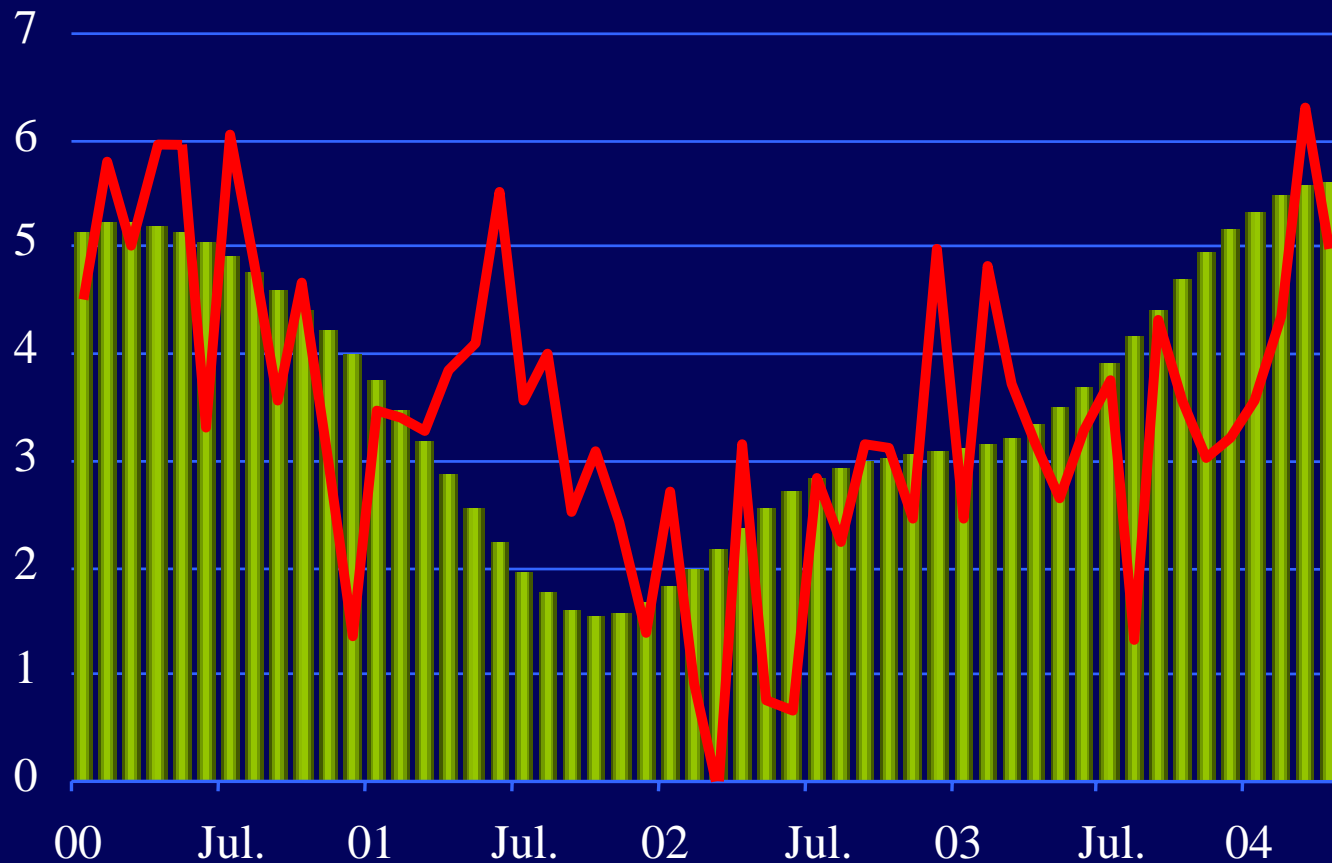
(f) forecast

Monthly Activity (Imacec)

(%)

■ Annualised monthly var.ct.

— y-o-y rate of change



3. Future Prospects

- The improved external environment - enhanced by the solid macro and micro foundations- have assisted the acceleration of growth.
- In addition, the current monetary policy stance –aimed at pushing inflation toward the 3% central target– supports a faster recovery.
- As a result, the prospects for the Chilean economy have improved markedly.

3. Future Prospects

- As Chile has a flexible exchange rate, the nominal parity of the peso with respect to the US\$ has changed with the changes in the US\$ and in its fundamentals.
- The real exchange rate is today lower than the average for the 1990s.

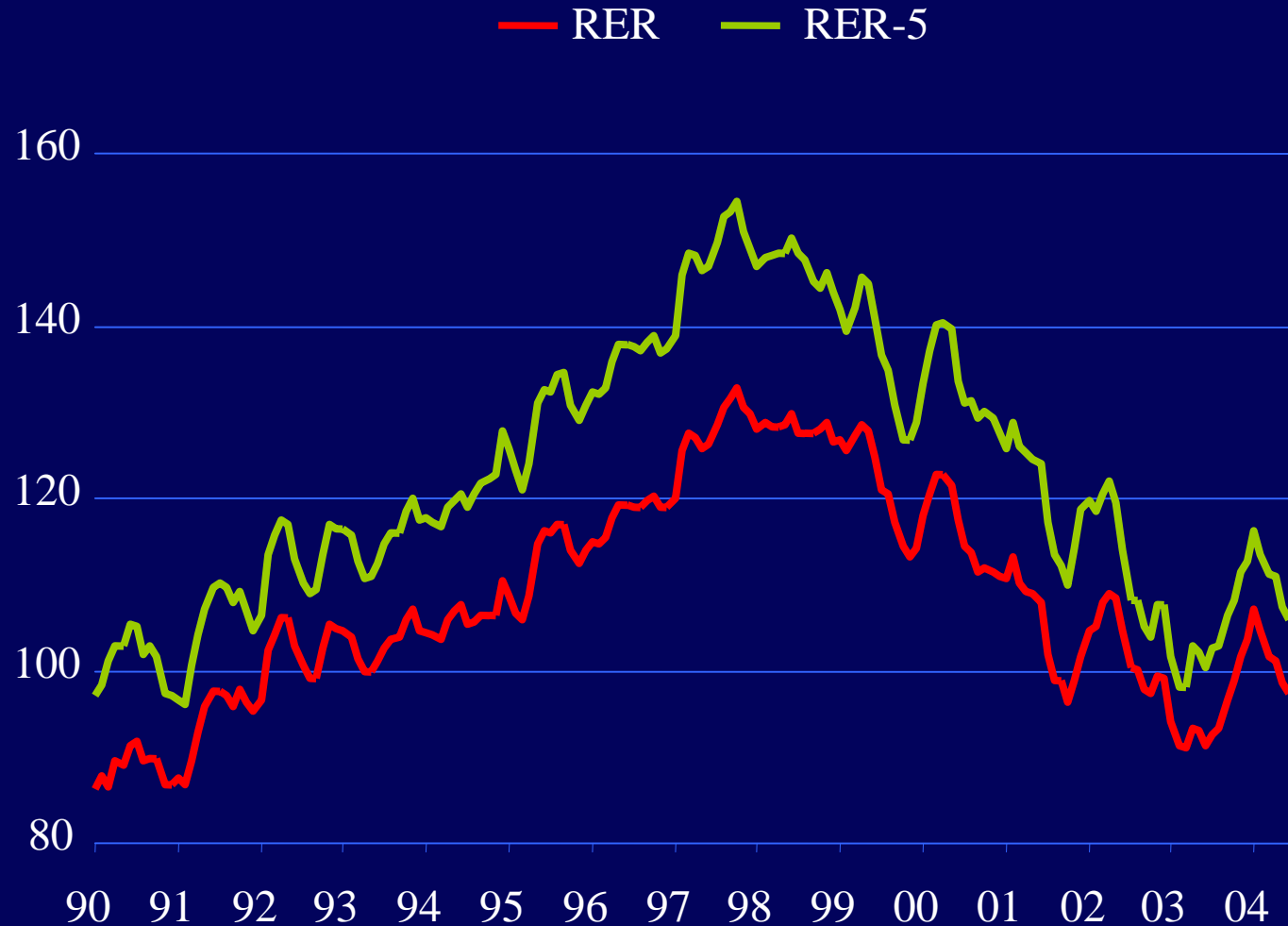
Exchange Rates: Accumulated Change

(in % with respect to the US\$ at the closing of 06/10/2004)

	Dec.00	Dec.01	Dec.02	Dec.03
Argentina	196.5	196.0	-11.9	0.8
Brazil	59.5	34.6	-12.2	7.5
Mexico	18.0	24.0	9.5	1.1
Chile	13.3	-1.7	-9.7	9.7
Japan	-4.4	-17.0	-8.0	2.2
Australia	-19.9	-26.9	-19.5	7.7
N. Zealand	-30.0	-34.3	-17.2	3.8
South Africa	-14.9	-46.1	-24.8	-3.9
Canada	-9.2	-14.6	-13.4	5.2
Sweden	-19.7	-27.9	-13.0	5.1
Euro Zone	-22.1	-26.5	-13.3	4.1

Real Exchange Rate

(index, average 1986=100)



3. Future Prospects

- The Central Bank of Chile's forecasts for 2004 presented in its Monetary Policy Report of last May are:
 - Economic growth between 4.5% and 5.5% (up from 3.3% in 2003);
 - Annual inflation rate below the central value of the target range;
 - Current account surplus of more than 1% of GDP.
- Inflation should return to the target center toward the end of 2005.

Macroeconomic Forecast

(annual real variation, %)

	2002	2003	2004(f)
GDP	2.2	3.3	4.5 - 5.5
National income	3.2	3.4	6.3
Domestic demand	2.5	3.5	5.7
Investment	1.4	4.8	7.1
Other components	2.8	3.1	5.2
Exports	1.5	7.8	11.8
Imports	2.4	8.8	13.8
Current account <i>(% GDP)</i>	-1.2	-0.8	1.1

(f) Forecast

3. Future Prospects

- To resume the higher and sustainable growth rates of 1985-97, it is necessary to continue looking for areas where efficiency gains can occur, producing a new jump in TFP.
- Main opportunities are in education, health-care, regulation in public utilities, technological innovation, labor flexibility and training.



Exchange Rate Volatility

(Standard deviation of the daily changes)

		Peso	Euro	Yen	AUS\$	CAN\$	NZ\$
I Quarter	2001	8.3	11.7	10.1	13.3	5.3	13.0
	2002	9.6	9.1	9.7	8.7	5.9	9.9
	2003	8.2	10.3	8.2	10.0	8.6	10.4
	2004	13.3	12.2	9.8	14.2	9.6	15.3
	2004	14.4	12.3	7.8	12.6	10.1	13.3
	Abril	11.5	12.8	11.5	15.6	9.1	17.6
	May	12.4	11.9	12.7	16.3	9.2	17.9
	June	11.5	10.8	12.6	16.6	8.4	17.9