



The Chilean Economy in the Current External Environment

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Outline

- Current Developments
- Macroeconomic Resilience
- Financial Resilience
- Prospects



Current Developments



The overall Chilean economic outlook shifted drastically during the last quarter of 2008.

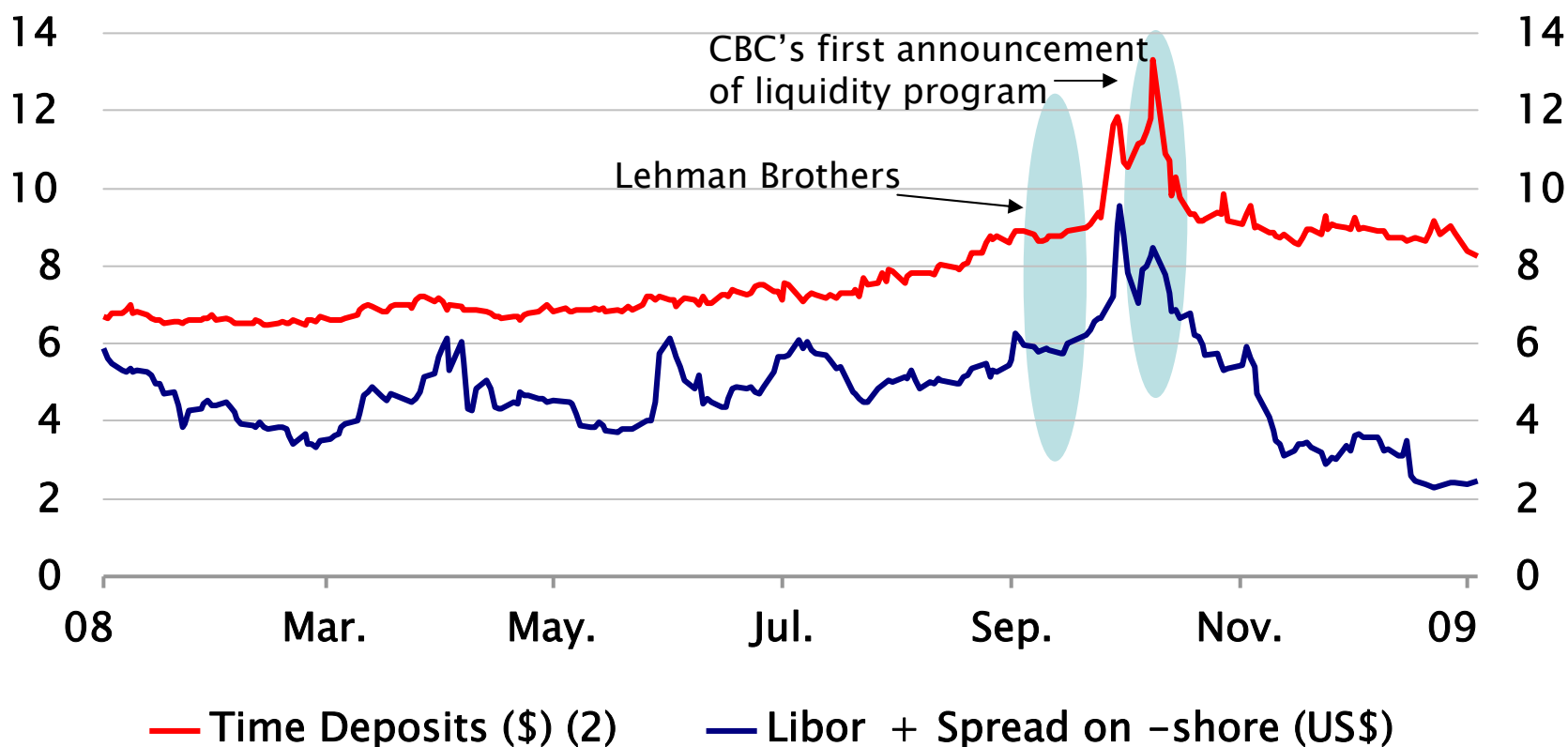
- Global growth prospects for 2009 showed a severe downshift, to figures not seen in decades.
- What began as a localized crisis in the US housing/mortgage sector, transmuted into a threat to global financial stability, with few precedents in contemporary history.



Locally, external tensions were reflected in transitory money market and USD liquidity stress.

Domestic Market Rates in US\$ and CLP (1)

(percentage)



(1) 90 days. (2) Traded on the Chilean Stock Market.
Sources: Central Bank of Chile and Bloomberg.

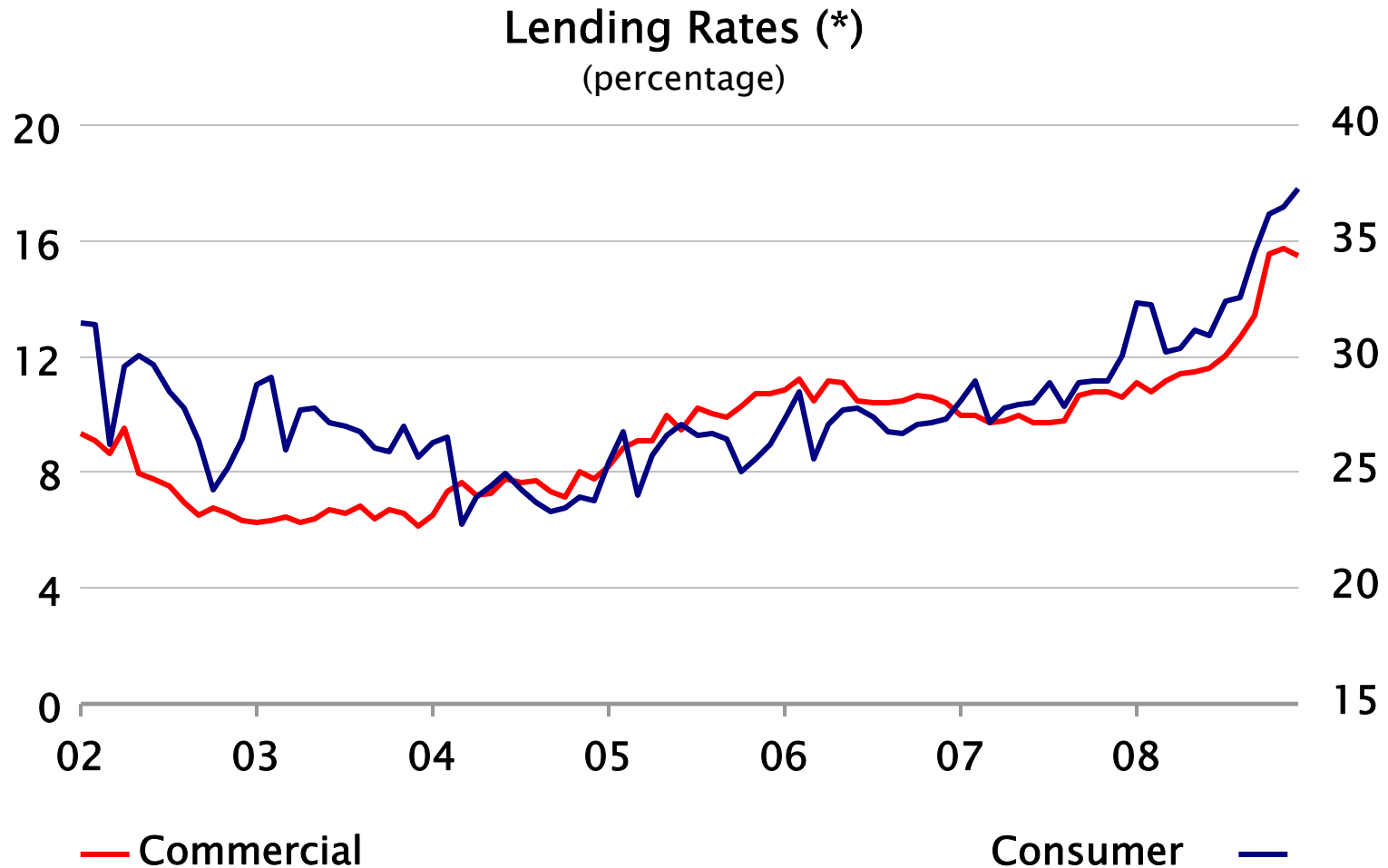


The Central Bank took a number of measures to ease domestic liquidity tensions

- Sept. 29th: Reserve accumulation program was terminated, USD repo 1 month operations announced (sales of USD spot + 1 month forward USD purchases, through competitive auctions)
- Oct. 10th: Broadening of eligible collaterals for money market operations (now encompassing CDs), USD repo program extended to six months.
- Dec. 10th: Extension of liquidity measures for all of 2009. Enhancement of liquidity facility through credit lines accepting a broader range of collateral for longer tenors.



Credit conditions have tightened.

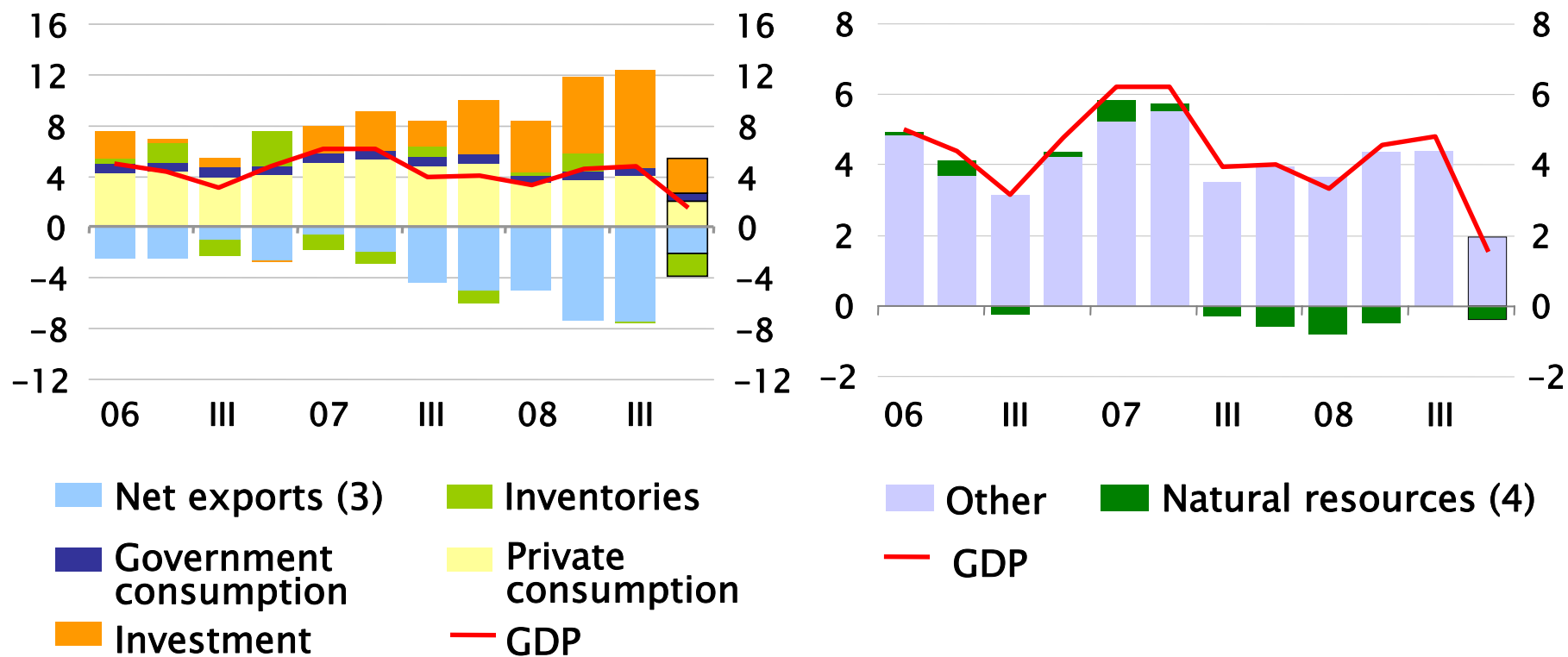


(*) Weighted average interest rate.
Source: Central Bank of Chile.



Growth and domestic demand decelerated significantly, particularly those components most sensitive to credit conditions (durables, machinery, inventories).

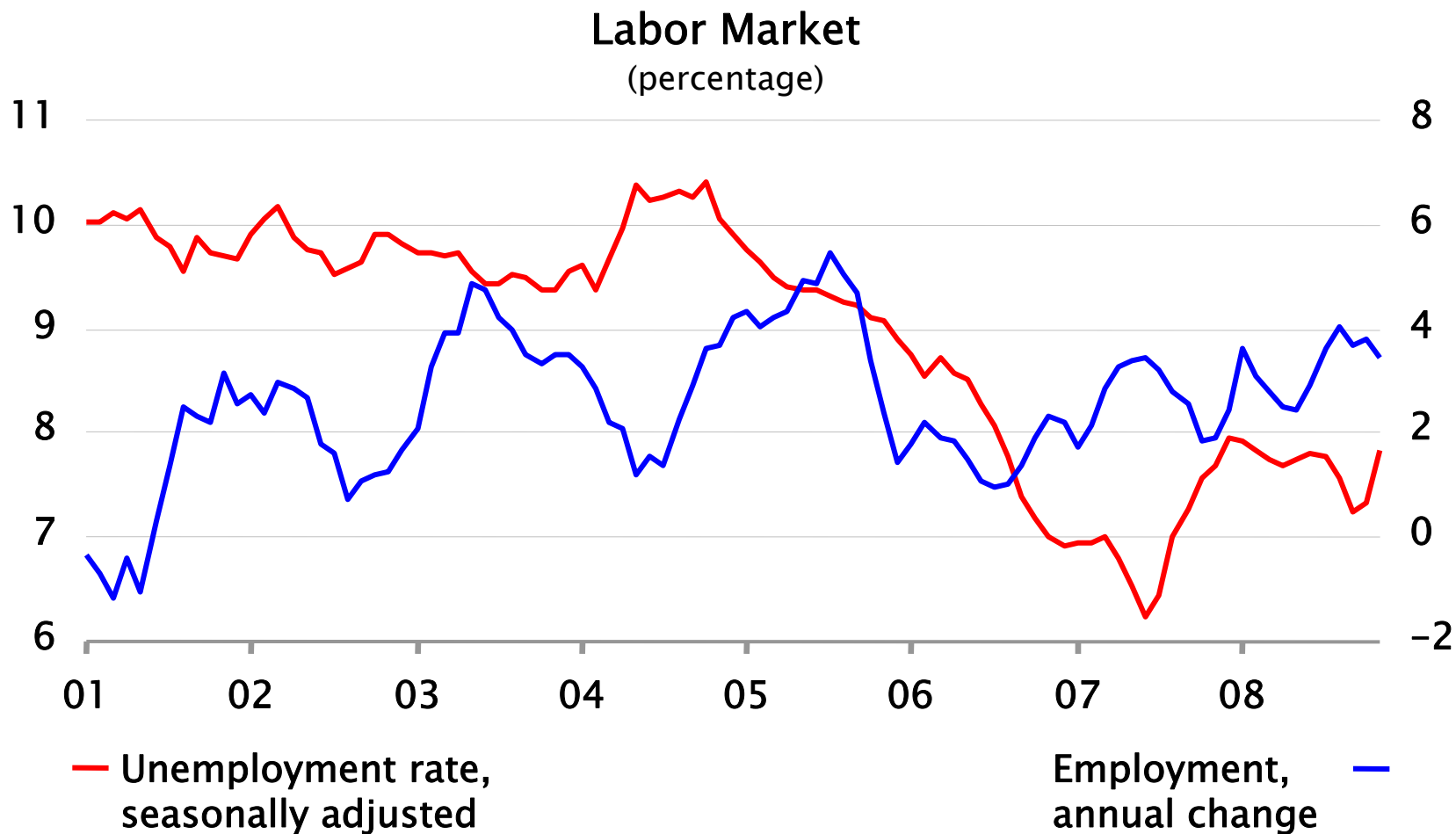
Contribution to GDP Growth (1) (2)
(real annual change; percentage points)



(1) Data published on November 24th, 2008. Data for 4Q08 projected, Monetary Policy Report, January 2009.(2) Contribution by sector corresponds to GDP at factor cost and bank charges. (3) Goods and services exports minus goods and services imports. (4) Corresponds to the sectors: mining, fishery and electricity, gas and water. Source: Central Bank of Chile.



Employment has continued to grow and the unemployment rate has remained stable.



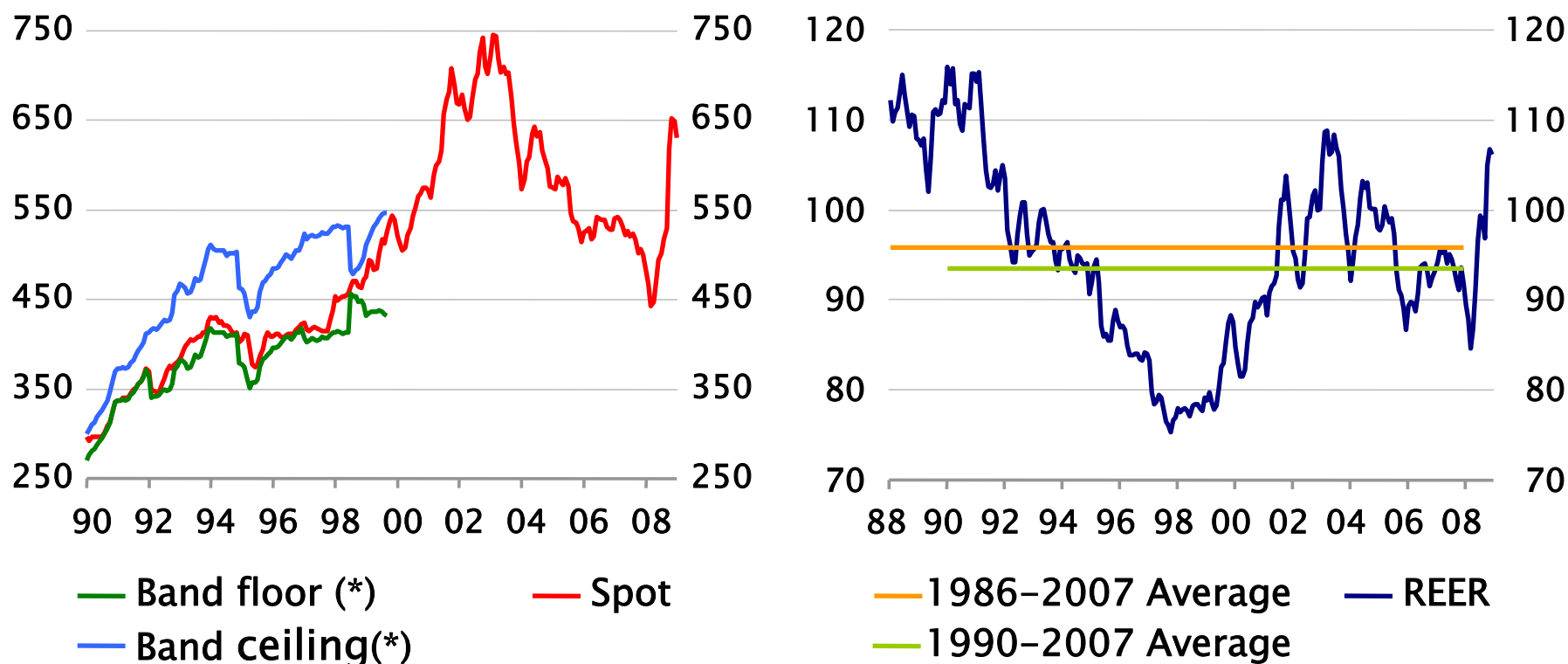
Sources: Central Bank of Chile and National Bureau of Statistics.



The exchange rate has depreciated significantly in nominal terms. The real exchange rate is weaker than historic averages.

Nominal and Real Exchange Rate

(CLP/USD; index, 1986=100)

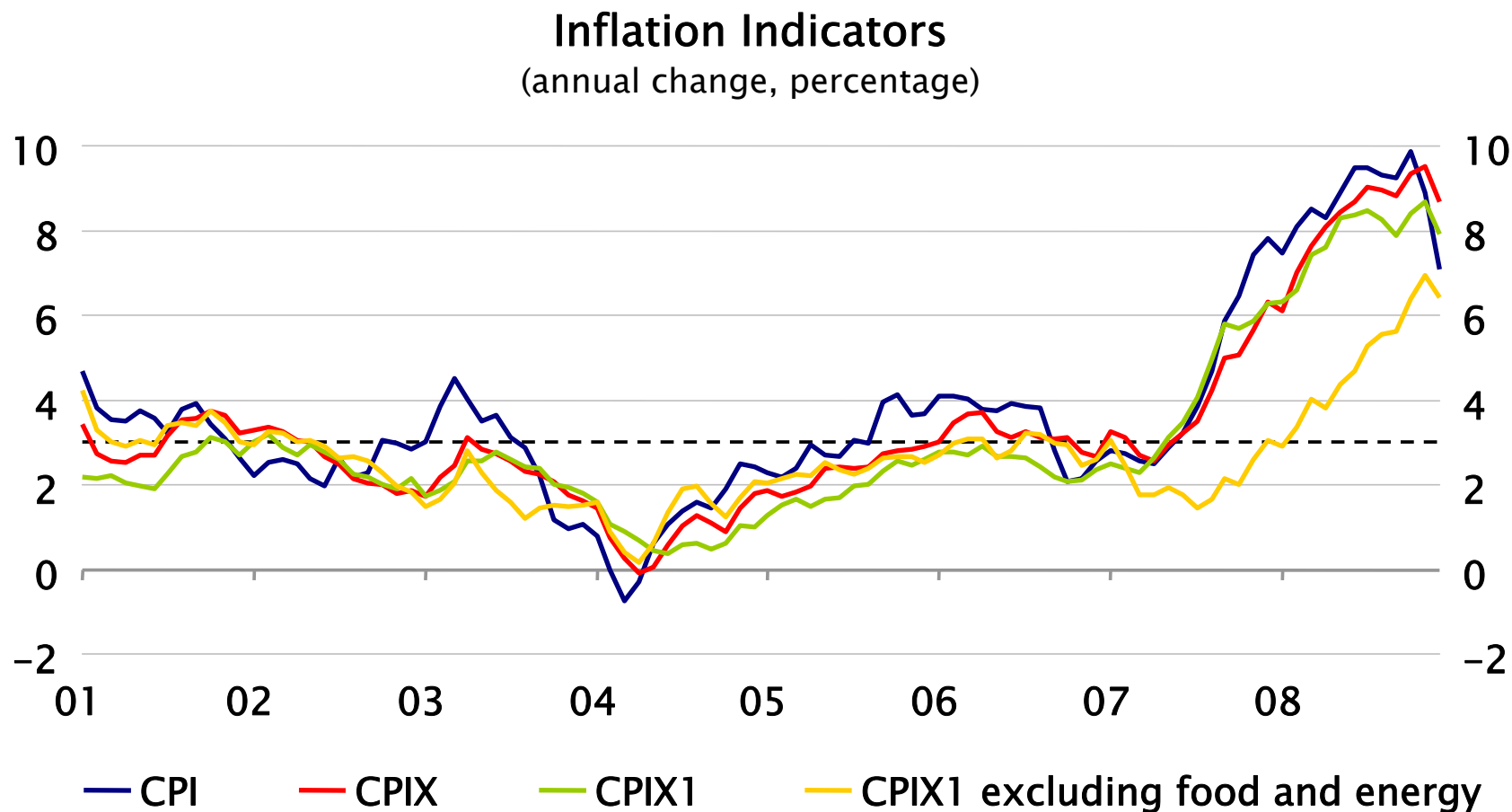


(*) The exchange rate bands are the upper or lower limit of a range inside which the exchange rate is allowed to float. This system operated until September 1999.

Source: Central Bank of Chile.



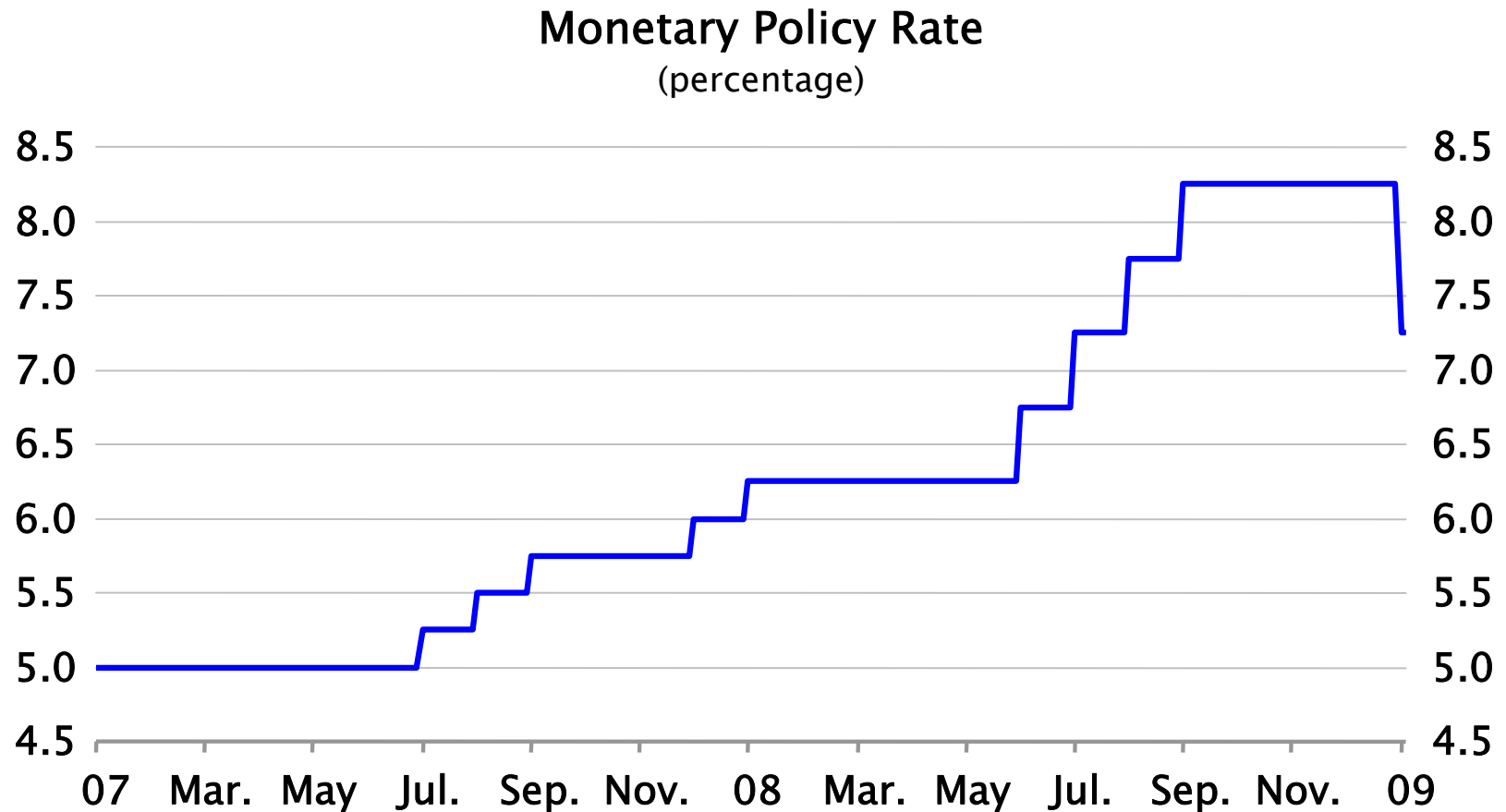
Monthly annual inflation has come down fast, particularly because of the significant drop in energy prices. Core inflation measures have stopped increasing.



Sources: Central Bank of Chile and National Statistics Bureau.



In this context, the Board has started a monetary policy easing cycle.



Source: Central Bank of Chile.



Macroeconomic Resilience

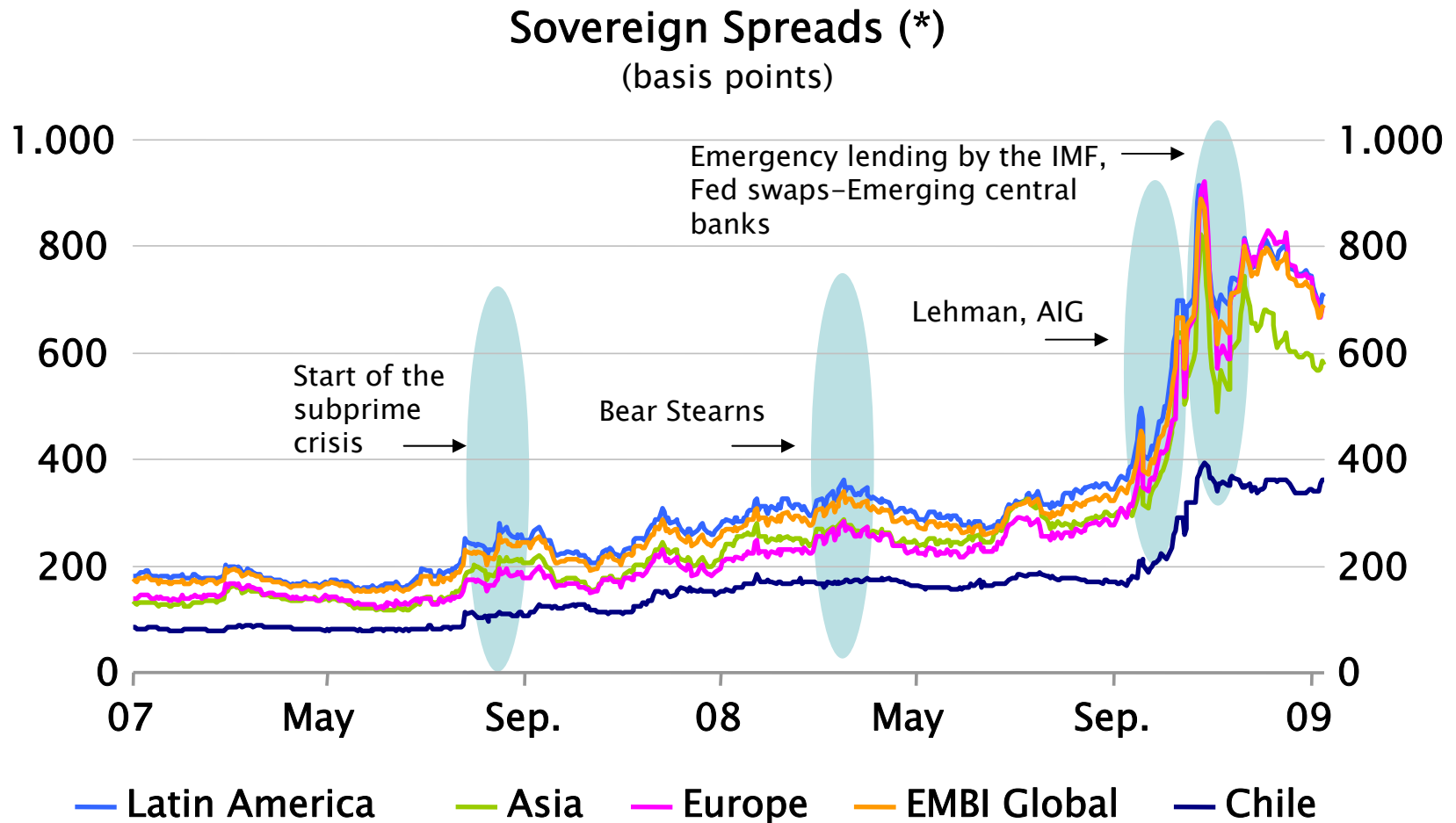


Chile's macroeconomic framework rests on four main pillars.

1. A responsible and predictable fiscal policy which guarantees public sector solvency and smoothes the spending out of copper income. A policy that was sometimes questioned for being too strict is revealing its merits;
2. Monetary policy is conducted by an independent central bank which uses an inflation targeting regime supported by a floating exchange rate;
3. Increasing trade openness allowing for the diversification of import and export markets;
4. A solid financial system, with competitive and well-capitalized banks, appropriately regulated and supervised.



September turbulences were felt across emerging economies.



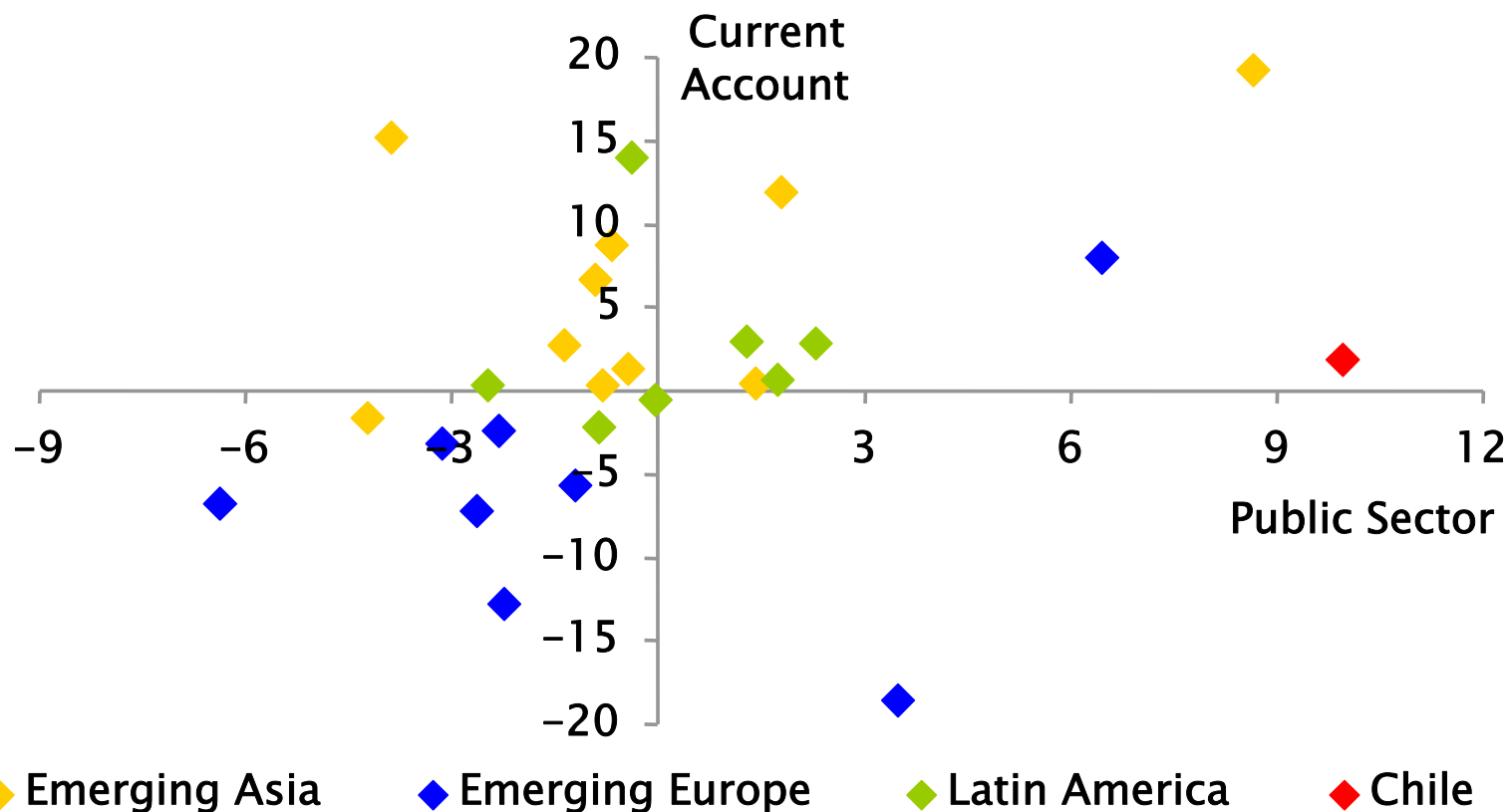
(*) Considers JPMorgan's Emerging Market Bond Index.
Sources: Bloomberg and JPMorgan.



The current account and the fiscal balance posted significant surpluses in 2005–2008.

Current Account and Public Sector Balance (*)

(average 2005–2008, percentage of GDP)



(*) Forecast for 2008.
Source: JP Morgan Chase.

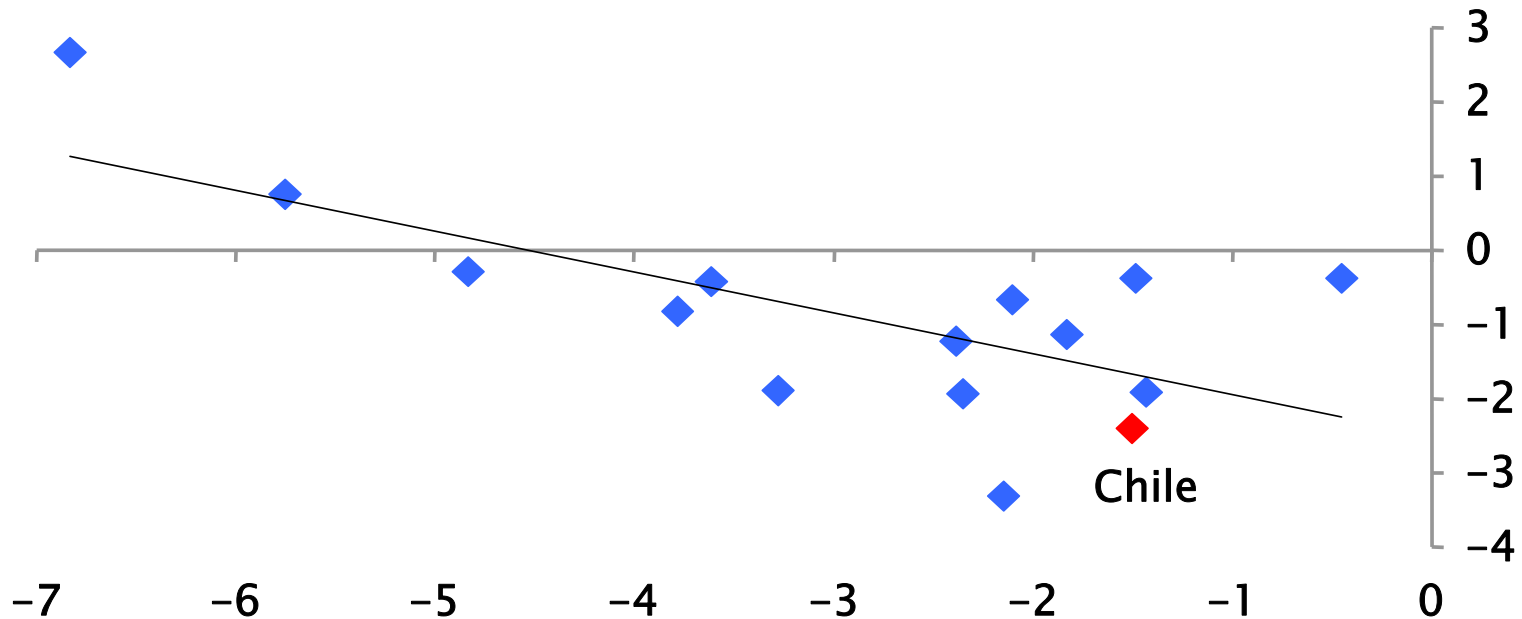


Markets have shown a sharp differentiation across emerging economies in their responses to the global crisis.

Adjustments in GDP Growth Forecasts and Long-Term Interest Rates since September 2008

(percentage points)

Long-Term Interest Rate (*) changes
Dec.08–Sep.08



Change in GDP Growth Forecast MPR Jan.09–Sep.08

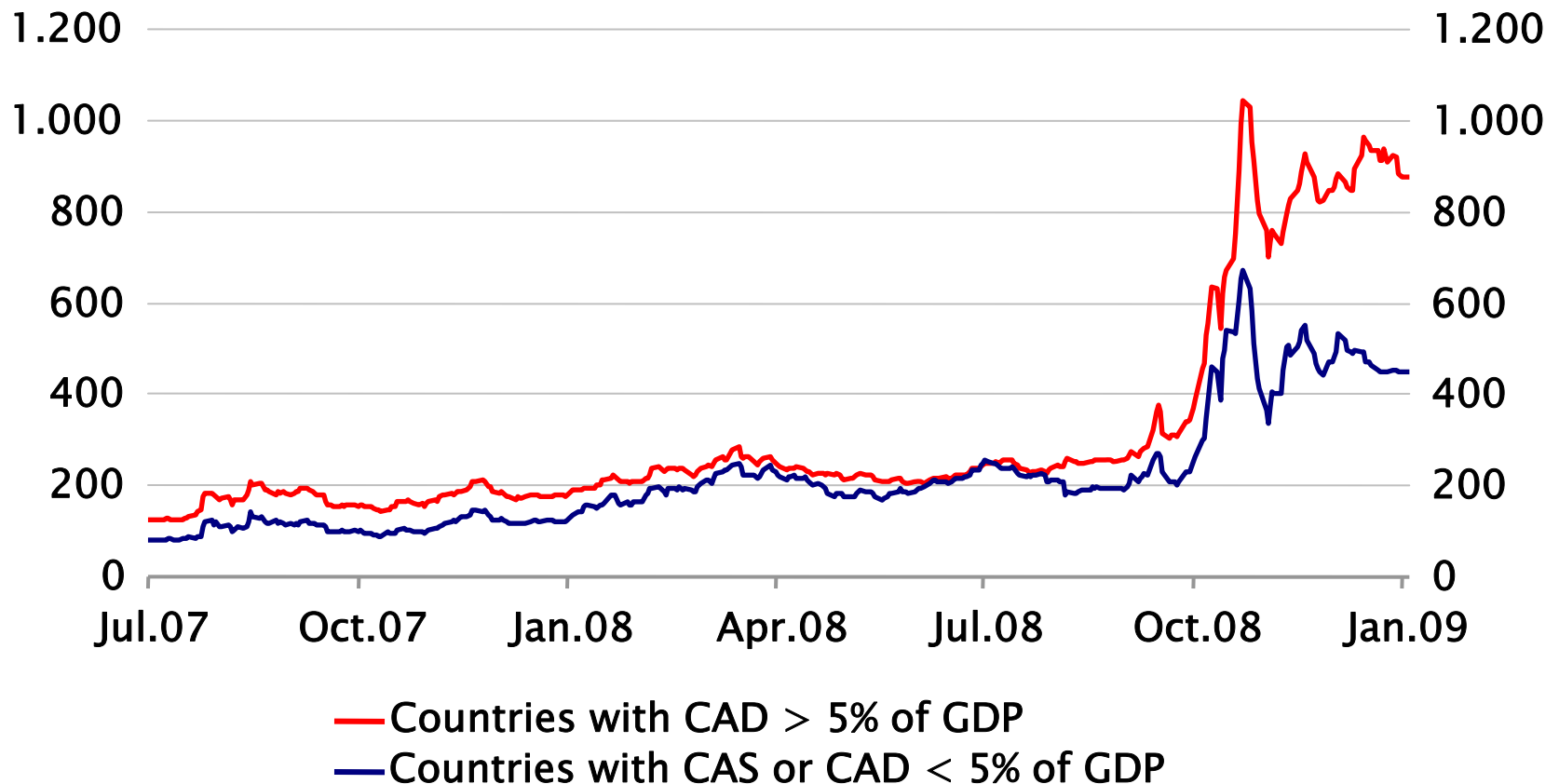
(*) Considers JP Morgan's Government Bond Index (GBI) for 14 emerging economies. For Chile, it considers the BCP-5 rate.

Sources: Central Bank of Chile and JP Morgan Chase.



But more strongly in those economies with weaker fundamentals.

Sovereign Risk Premium According to the Current Account Size (*) (basis points)



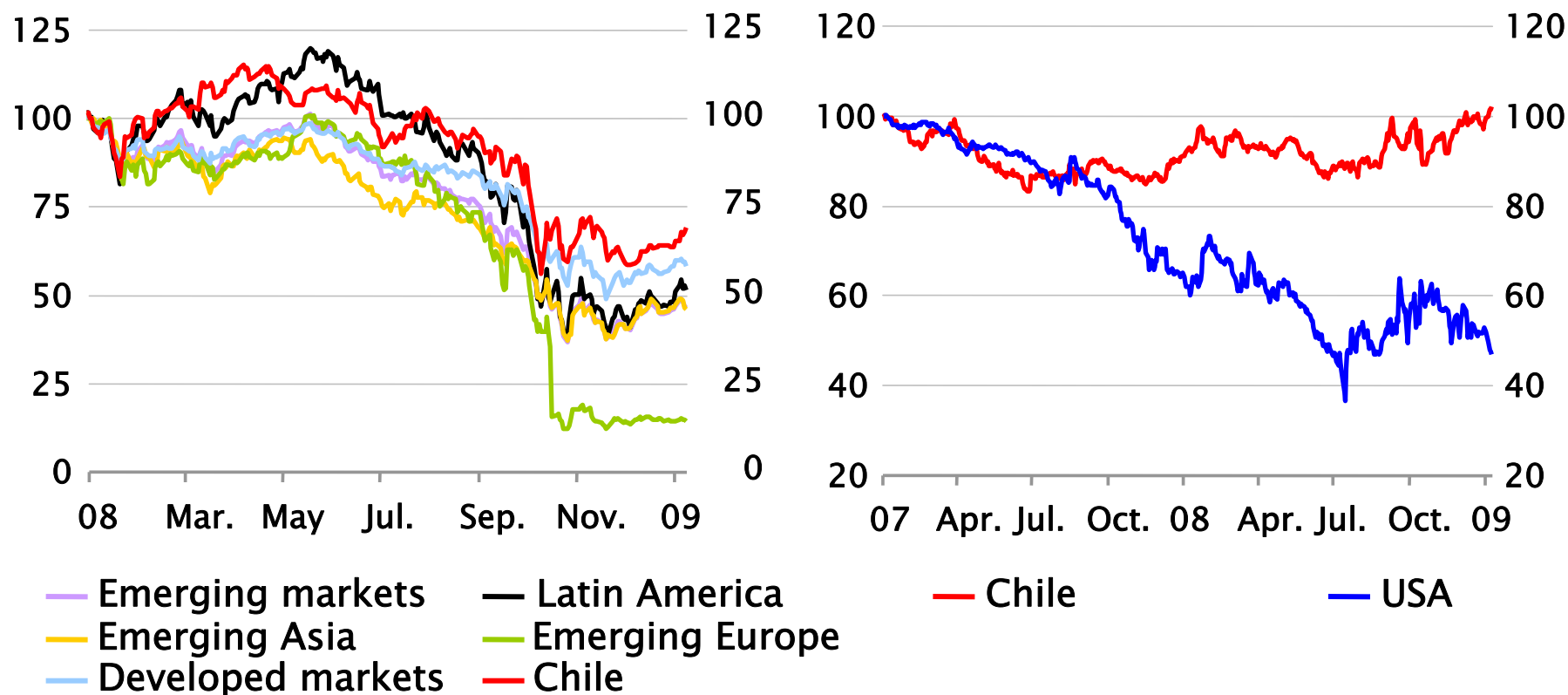
(*) Sovereign risk premium measured by CDS spread.
Sources: Bloomberg and International Monetary Fund.



Stock market valuations have been resilient to the shock. Banking stocks have performed similarly to the broader market.

Stock Market Index and Ratio of Bank Index to Aggregate Stock Index (1) (2)

(index, January 2, 08=100; index, January 1, 2007=100)

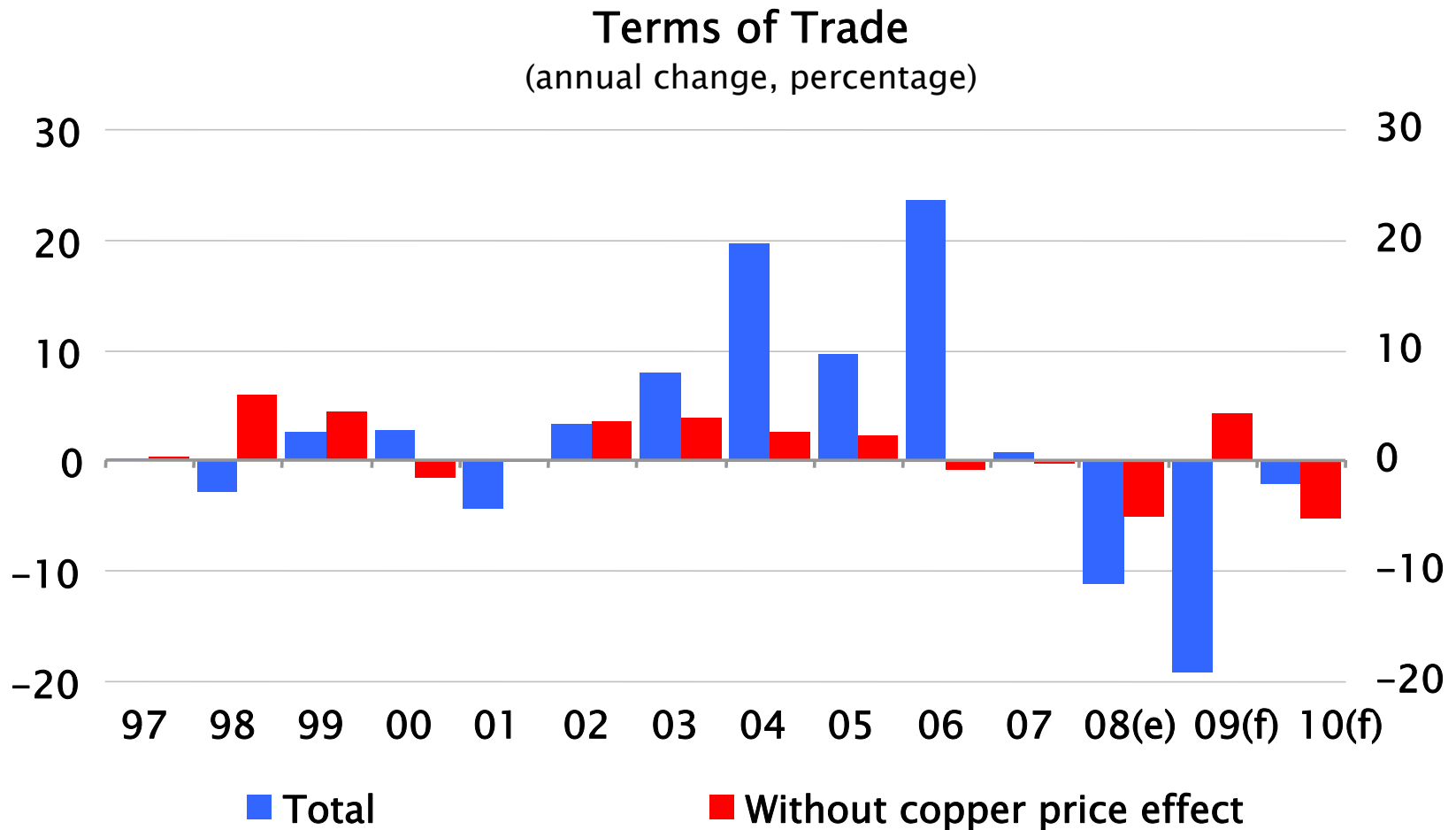


(1) First figure shows the Stock Market Index considering the MSCI index. (2) Second figure shows the ratio of banking stock index/ total stock index: S&P 500 for the USA and IPSA for Chile.

Sources: Bloomberg and Central Bank of Chile.



Terms of trade have been significantly affected by the price of copper. Noncopper ToT will actually increase in 2009 thanks to lower oil prices.

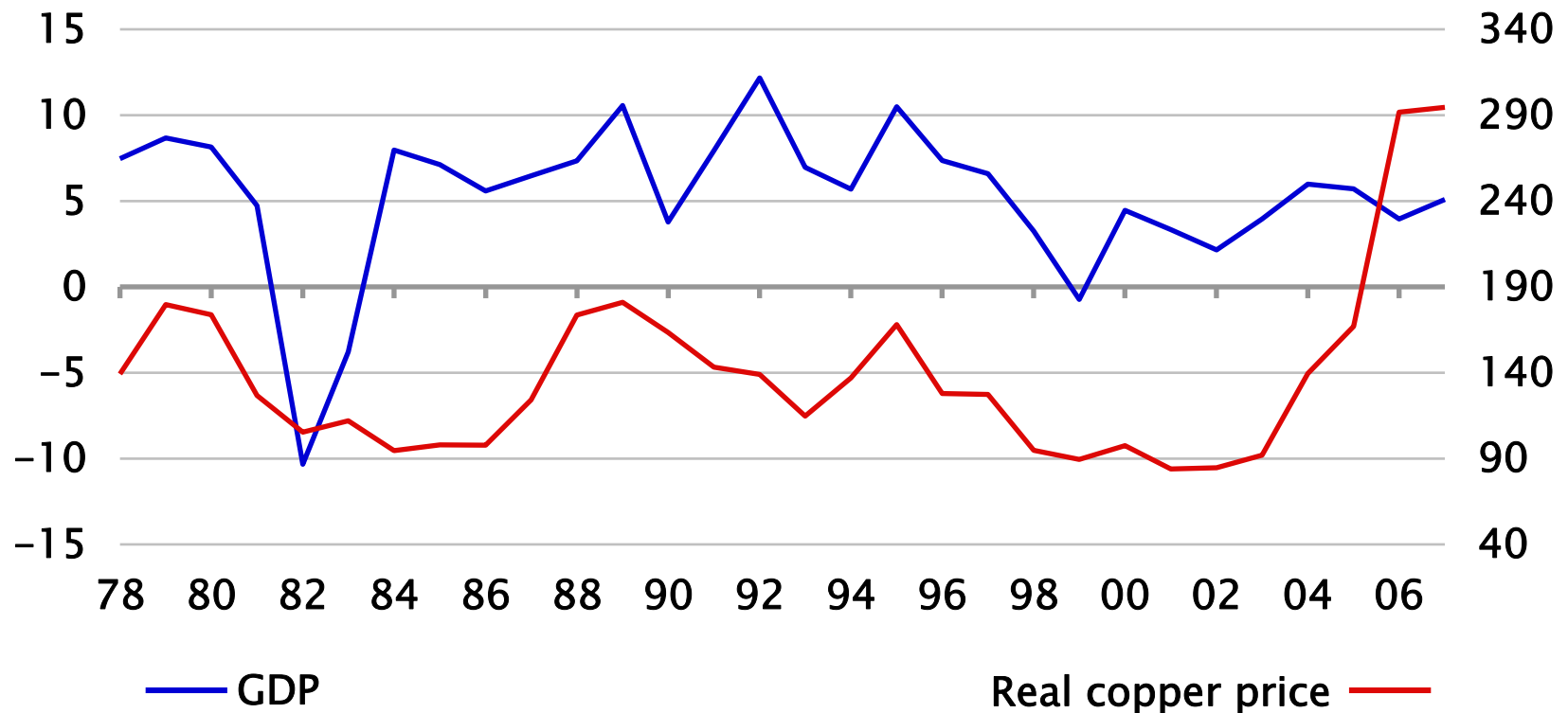


(e) Estimate; (f) Forecast. Monetary Policy Report, January 2009.
Source: Central Bank of Chile.



Chile's GDP growth has become increasingly insensitive to copper price booms and busts.

GDP Growth and Real Copper Price (*)
(annual change, percentage; US\$ cents per pound)



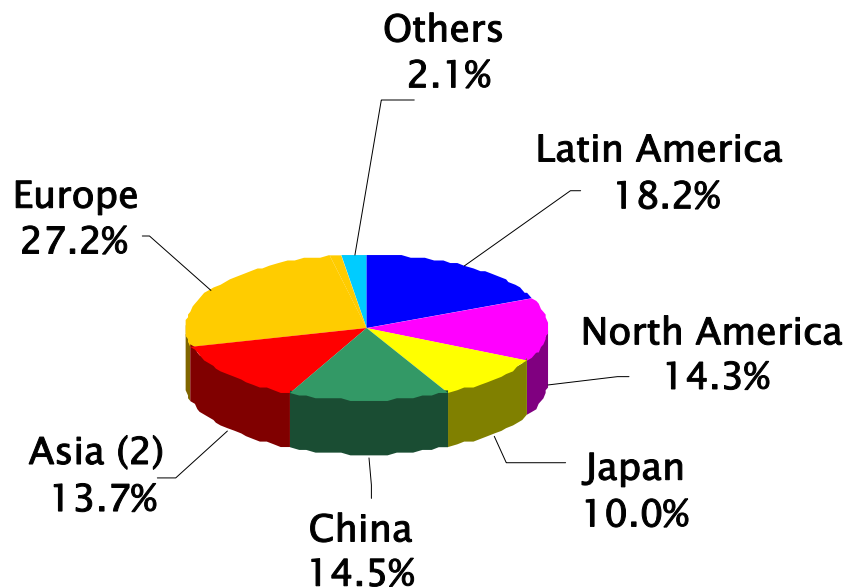
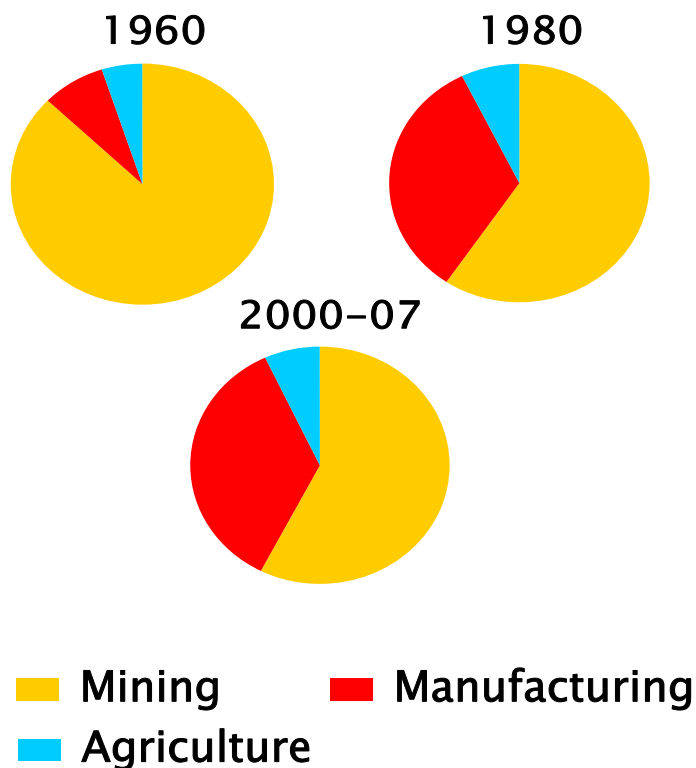
(*) Copper price deflated by U.S. Commodity PPI (2005=100).
Sources: Central Bank of Chile and Cochilco.



Increased diversification thanks to adherence to free trade.

Chilean Exports by Economic Sector and Destination (1)

(share of total exports, percentage)



(1) Export destination data as of 3Q08.

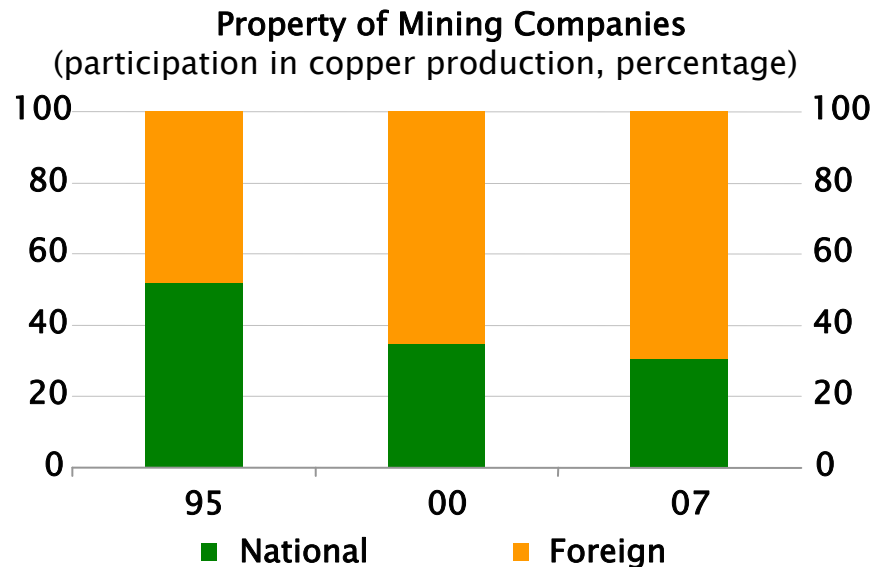
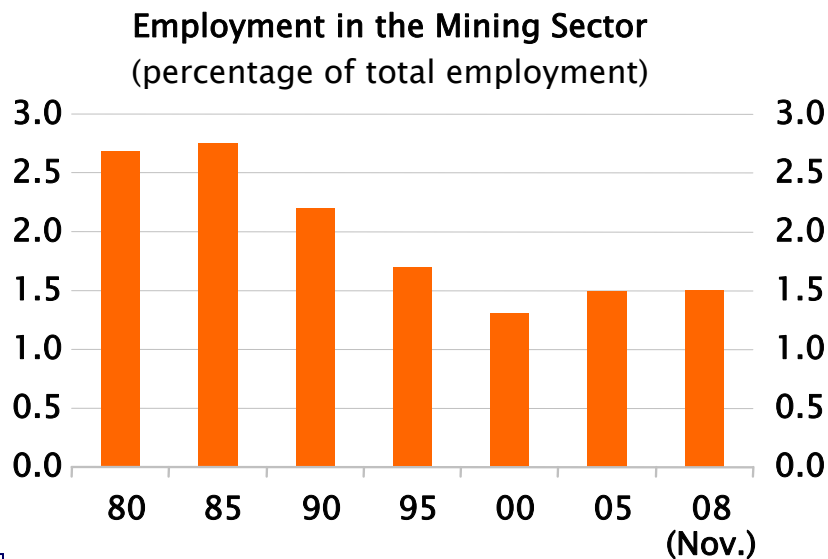
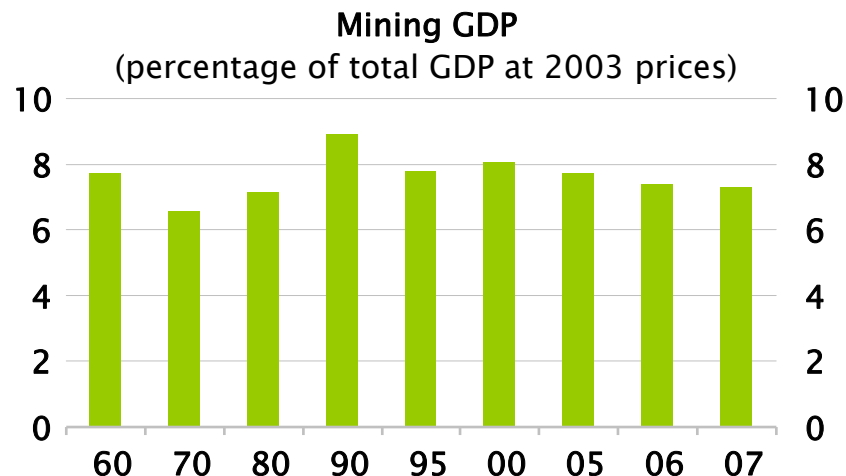
(2) Asia excluding China and Japan.

Source: Central Bank of Chile.



Even though copper is still important in the Chilean exports structure, the copper price decline should pose no serious problem as mining accounts for a small part of the economy.

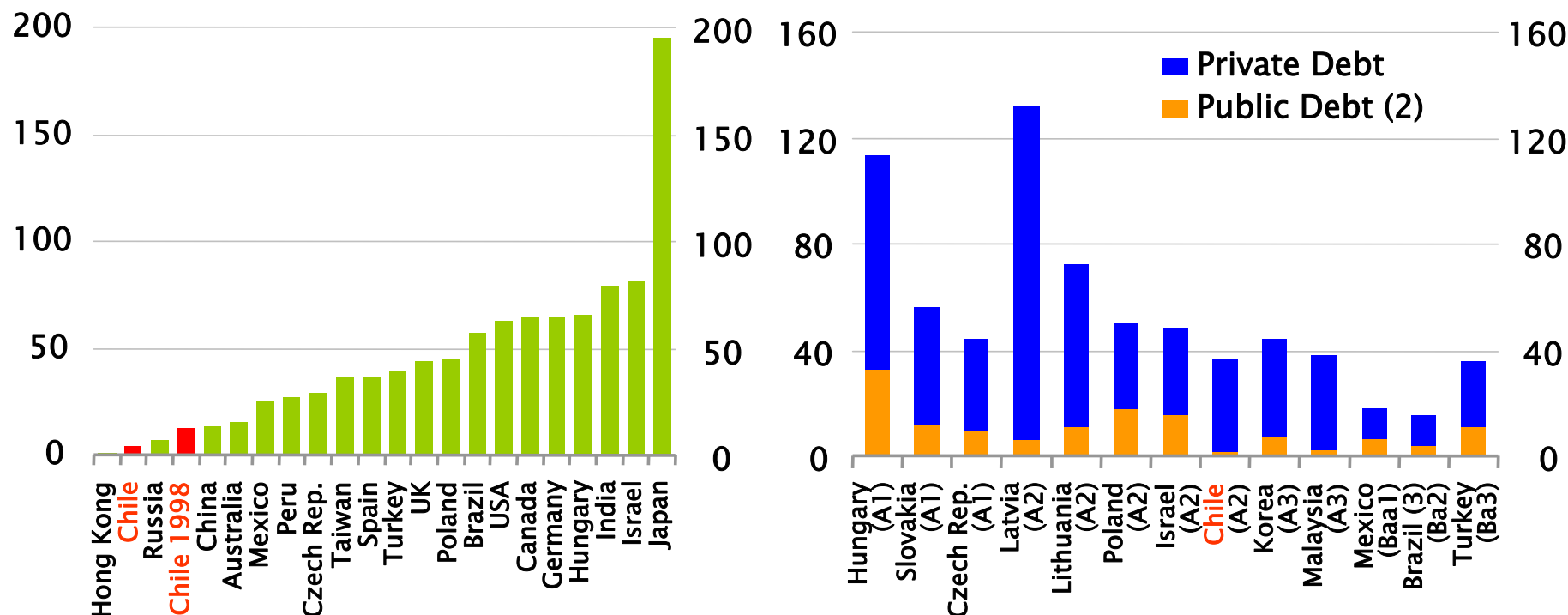
Mining accounts for less than 10% of Chile's GDP and less than 2% of total employment. A large fraction of mining is foreign-owned and the copper price mostly affects fiscal revenues, through state-owned copper enterprise and taxes.





Indebtedness is low, particularly public debt.

International Comparison: General Government Debt 2007 and Total External Debt (1) (percentage of GDP)

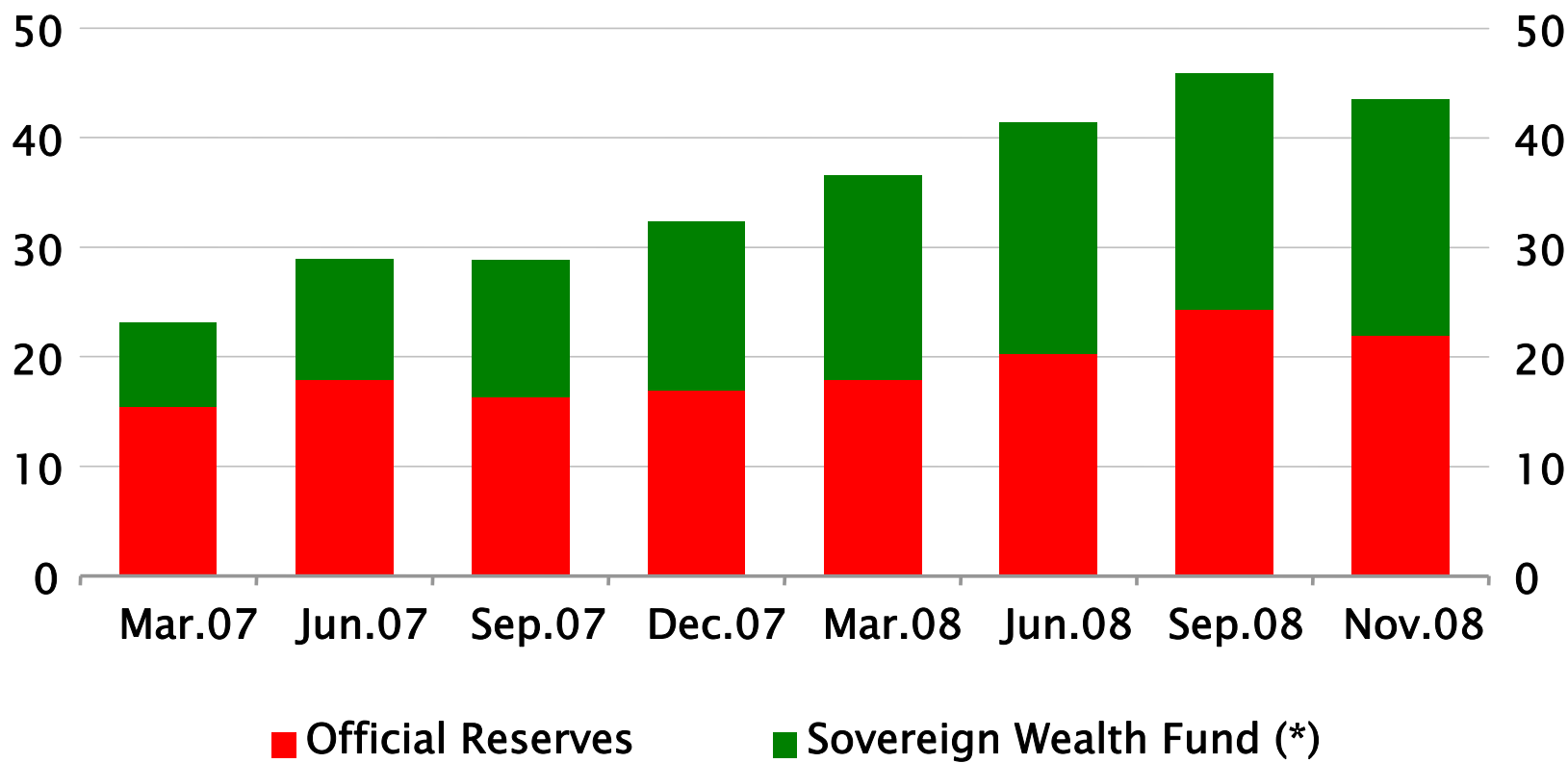


(1) First figure shows general government debt 2007 considering gross debt. Second figure shows the total external debt at June 2008, excluding Chile (November 2008). Estimated GDP 2008, Moody's risk rating.
(2) Considers Consolidated Government Debt. (3) Brazil began a program of announced prepayments of its debt starting 2005. Sources: Central Bank of Chile, World Bank, IMF and Moody's.



Foreign assets of the CBC and the Treasury have increased 59% yoy, totalizing US\$46 billion.

Net International Reserves and Sovereign Wealth Fund (USD billions)



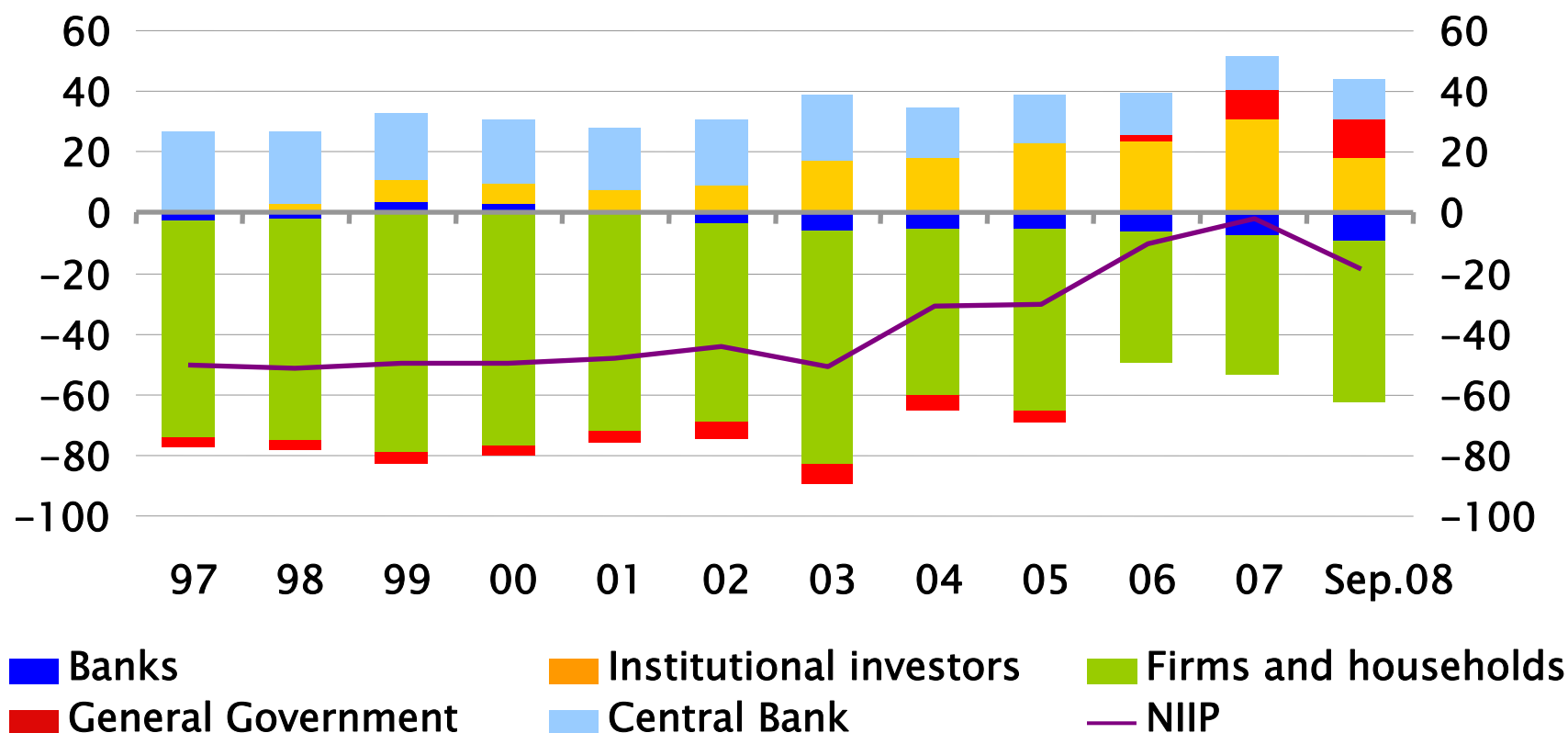
(*) Includes the Pension Reserve Fund (PRF) and the Economic and Social Stabilization Fund (ESSF).
Sources: Central Bank of Chile and Ministry of Finance.



From an international and historical standpoint, the International Investment Position of the economy is visibly strong, thanks to reserve accumulation, public savings and increased diversification of pension funds abroad.

Net International Investment Position (*)

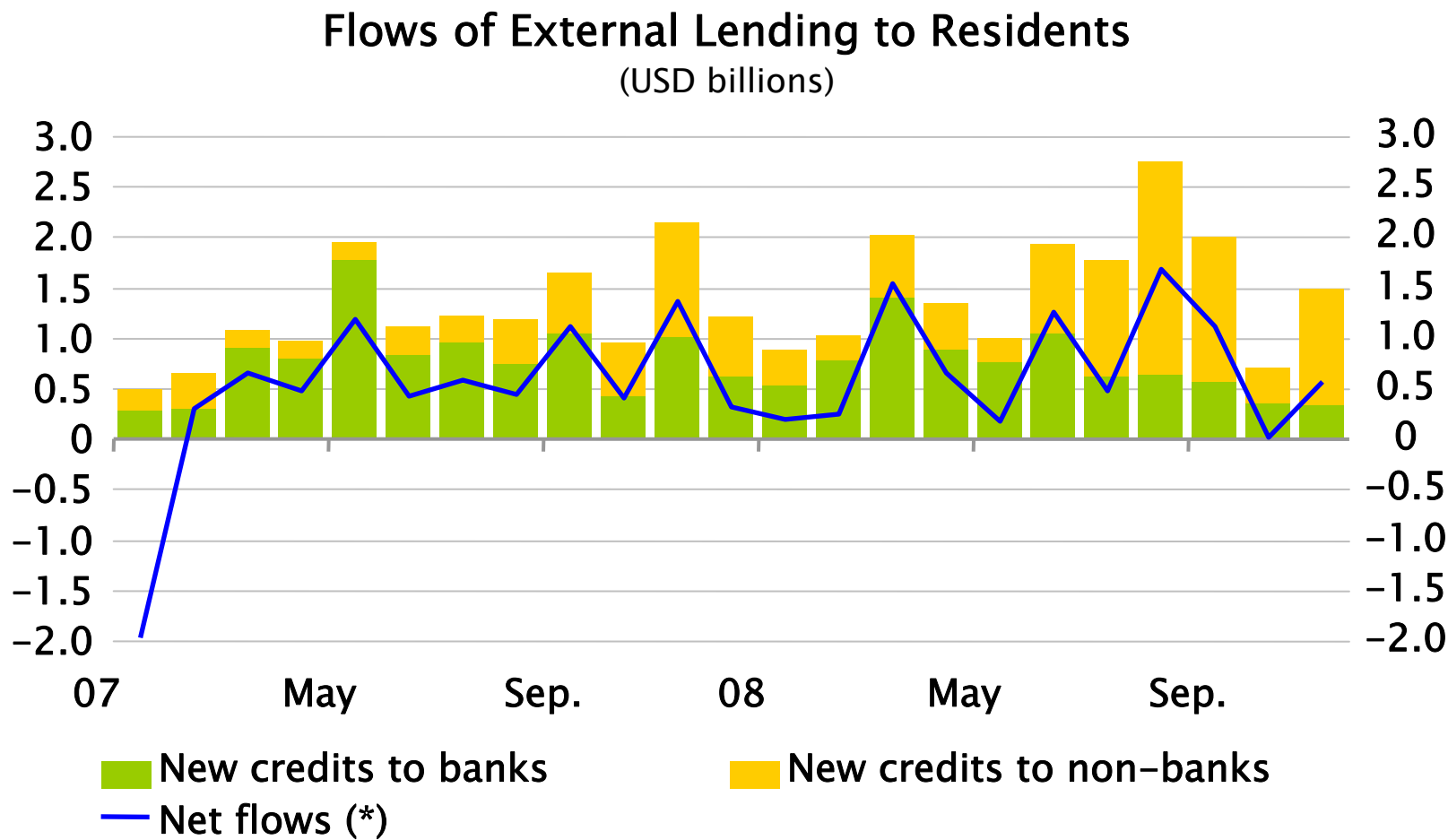
(percentage of GDP)



(*) GDP at constant real exchange rate (base rate September 2008=100).
Source: Central Bank of Chile.



Access to external funding by banks and corporations has remained open.



(*) Total new lending amount discounted by amortization made by banks and non-banks.
Source: Central Bank of Chile.



Financial Resilience

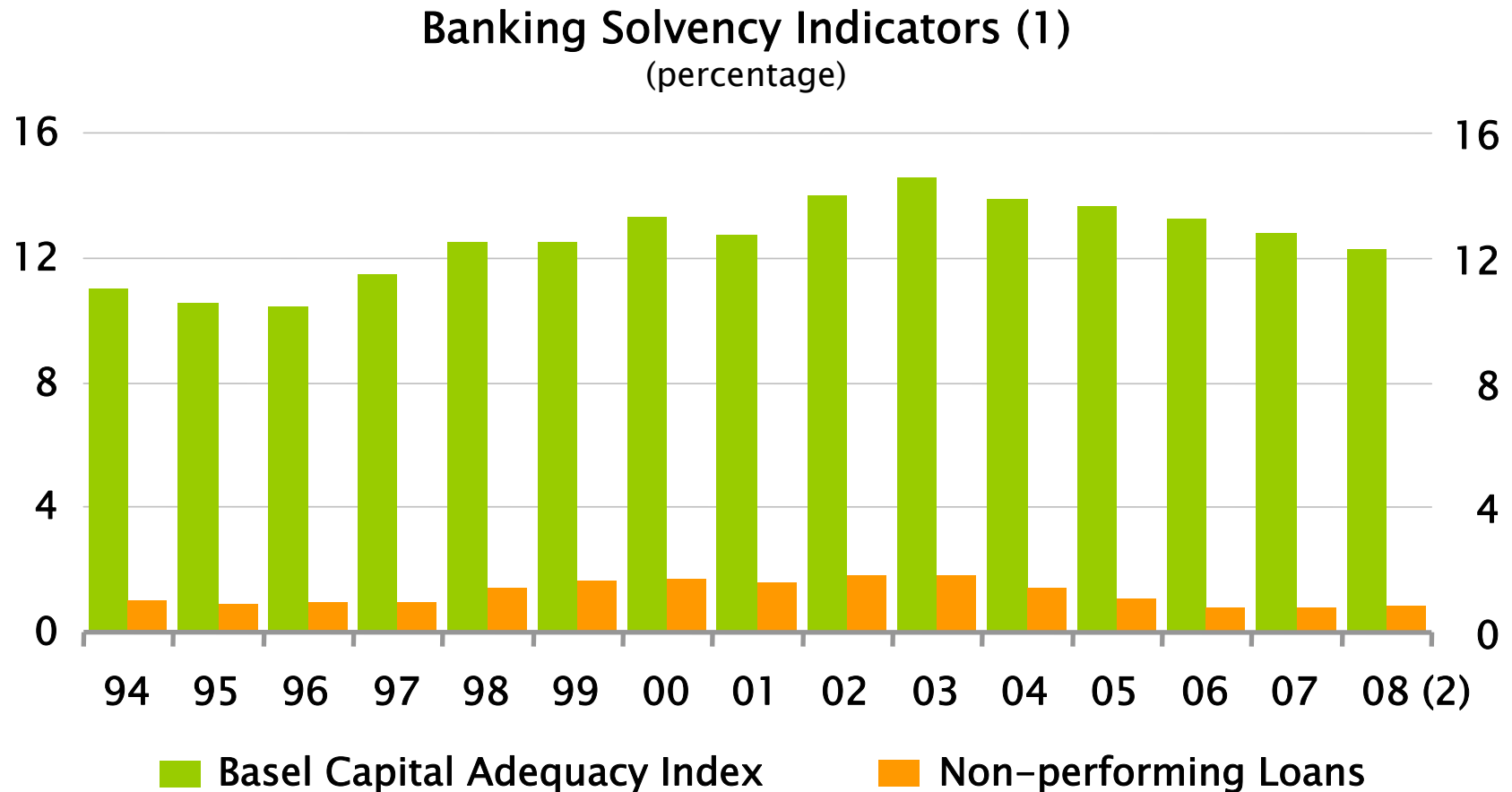


Main characteristics of the banking sector.

- Traditional orientation, based on retail funding. No vulnerabilities similar to the one observed in developed economies have been observed (off-balance-sheet liquidity exposures, structured instruments).
- Banking system maintains low exposure to forex risk.
- Several indicators show the relative strength of the banking system: Capital adequacy ratio around 12%.
- Mild increase in the non-performing loan indicator. Moreover, banks have increased provisioning expenses.



Strong capital base and low NPL.

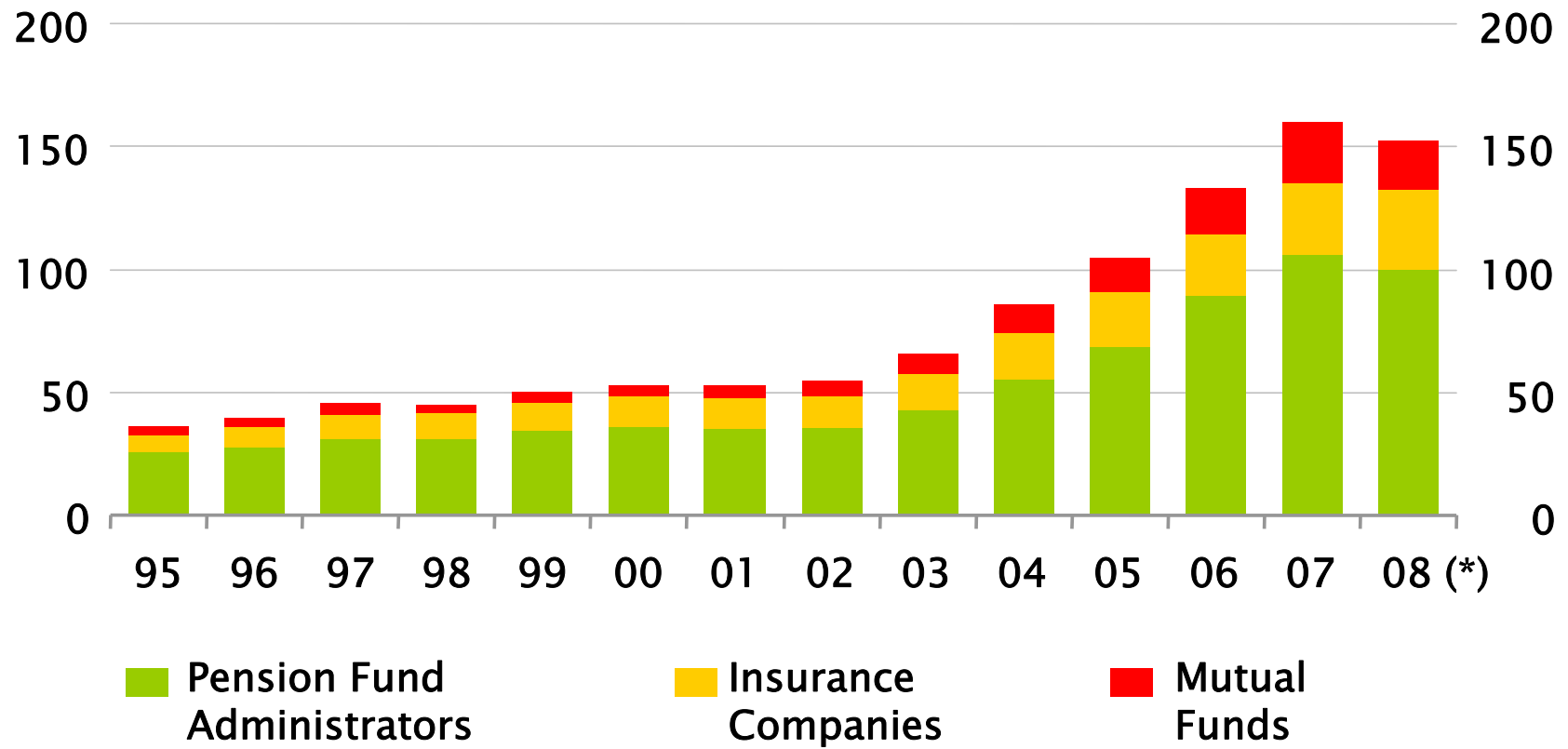


(1) As of January 2008, data of past-due loans is not strictly comparable with earlier data, since as part of the convergence plan to International Financial Reporting Standards (IFRS), banks changed the format of their financial statements. (2) November figures for past-due loans and October ones for the Basel indicator. Sources: Central Bank of Chile and Superintendence of Banks and Financial Institutions.



A large capital market, supported by regulated institutional investors.

Financial Savings by Institutional Investors
(USD billions)

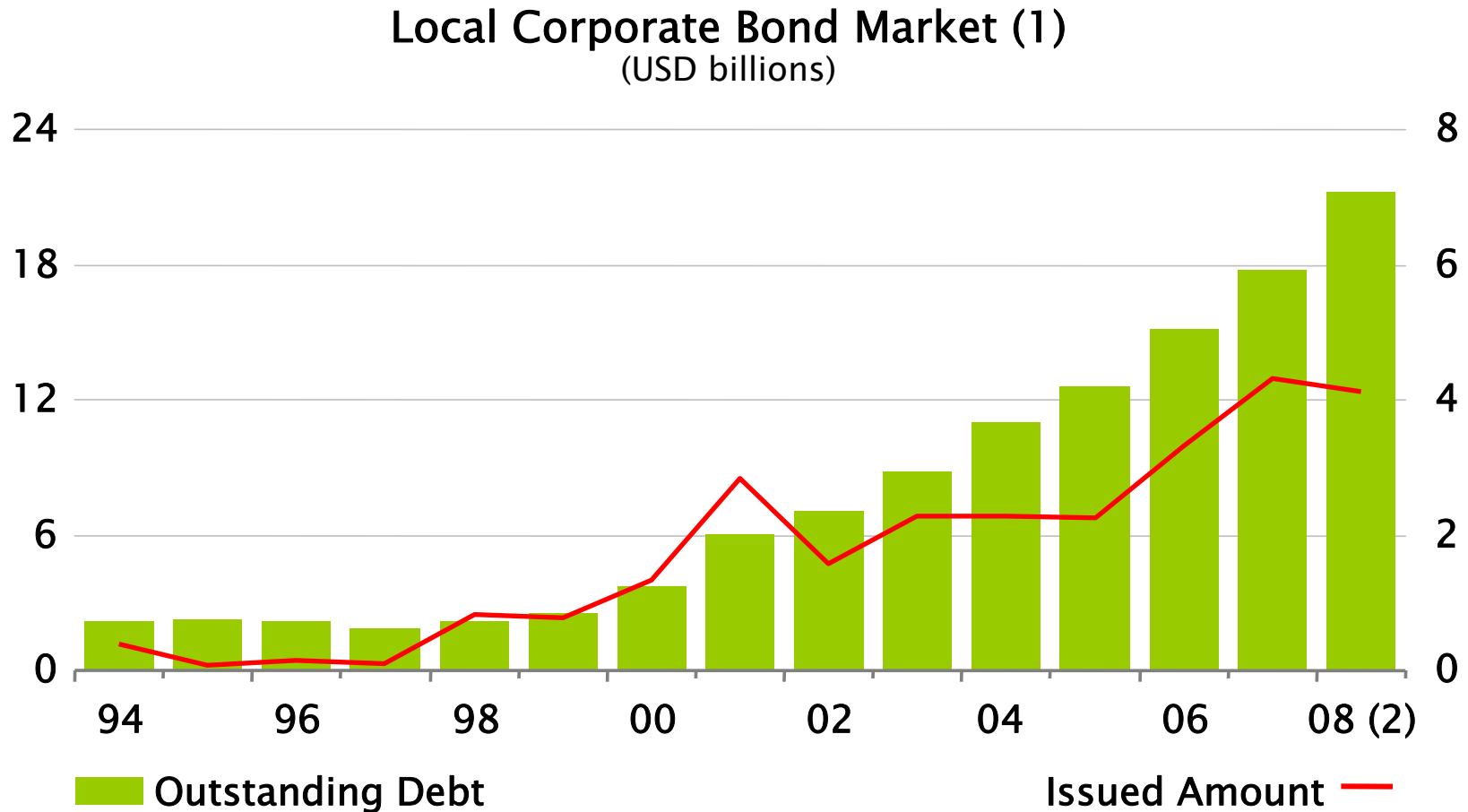


(*) September 2008 data.

Sources: Superintendencia de Securities and Insurance and Superintendencia de AFP.



Financing through the capital markets has increased over time and has remained resilient in the face of recent turmoils.



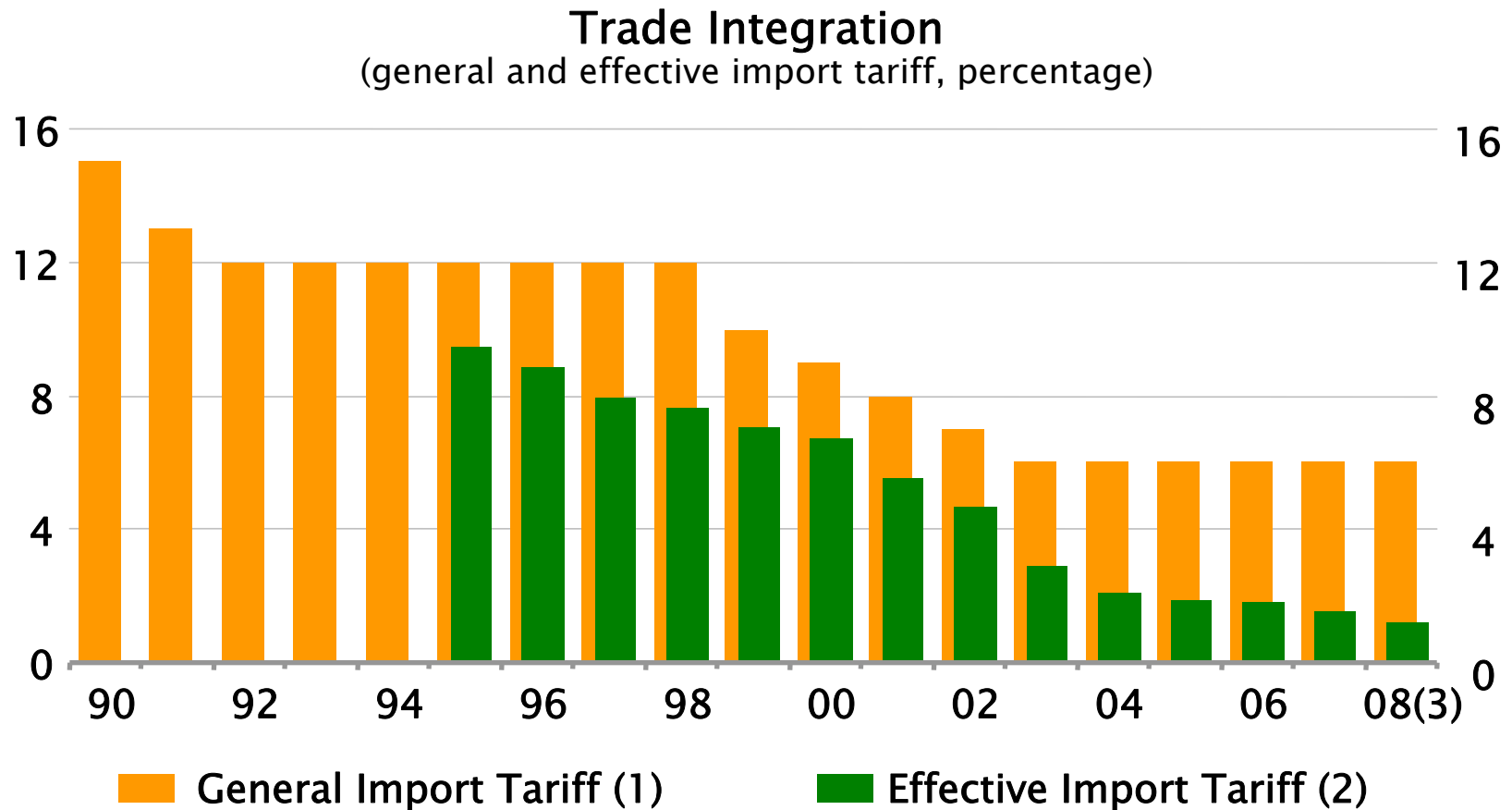
(1) Excludes banking sector.

(2) Outstanding debt and amounts issued until November 2008.

Source: Superintendence of Securities and Insurance.



An open an increasingly integrated economy.



(1) Includes every product of General Agreement and excludes those of Free Trade Agreements. (2) Becerra, G. (2005), Statistical Economic Studies 50. Posterior data is estimated as the ratio of Foreign Trade Tariffs to imports. 2008 estimate until 3Q08. (3) As of September 2008.

Source: Central Bank of Chile.



Prospects



Growth prospects have been dramatically cut worldwide.

World Growth (*) (annual change, percentage)

	Aver. 90-99	Aver. 00-05	2007 (e)	2008 (f)		2009 (f)			2010 (f)	
				MPR Sep.08	MPR Jan.09	MPR Sep.08	MPR Jan.09		MPR Sep.08	MPR Jan.09
World	2.9	3.8	5.0	4.0	▼ 3.6	3.7	▼ 1.2		4.4	▼ 3.3
World at market parity	2.4	2.9	3.8	2.8	▼ 2.4	2.5	▼ -0.3		3.4	▼ 2.3
United States	3.1	2.5	2.0	1.6	▼ 1.2	1.0	▼ -1.8		2.8	▼ 2.0
Euro area	2.2	1.9	2.6	1.2	▼ 0.9	0.4	▼ -1.9		1.9	▼ 1.0
Japan	1.5	1.6	2.4	0.8	▼ -0.1	0.8	▼ -2.4		2.0	▼ 1.2
China	10.0	9.4	11.9	9.9	▼ 9.2	9.0	▼ 7.5		8.9	▼ 8.0
Rest of Asia	5.5	4.8	5.8	4.6	▼ 4.0	5.0	▼ 1.2		5.2	▼ 3.2
Latin America	2.7	3.0	5.6	4.3	▲ 4.7	3.8	▼ 1.2		4.2	▼ 2.7
Commodity exporters	2.7	3.1	3.3	1.6	▼ 1.2	2.2	▼ 0.2		2.9	▼ 1.8
Trading partners	3.1	3.1	4.8	3.5	▼ 3.2	3.1	▼ 0.4		3.8	▼ 2.7

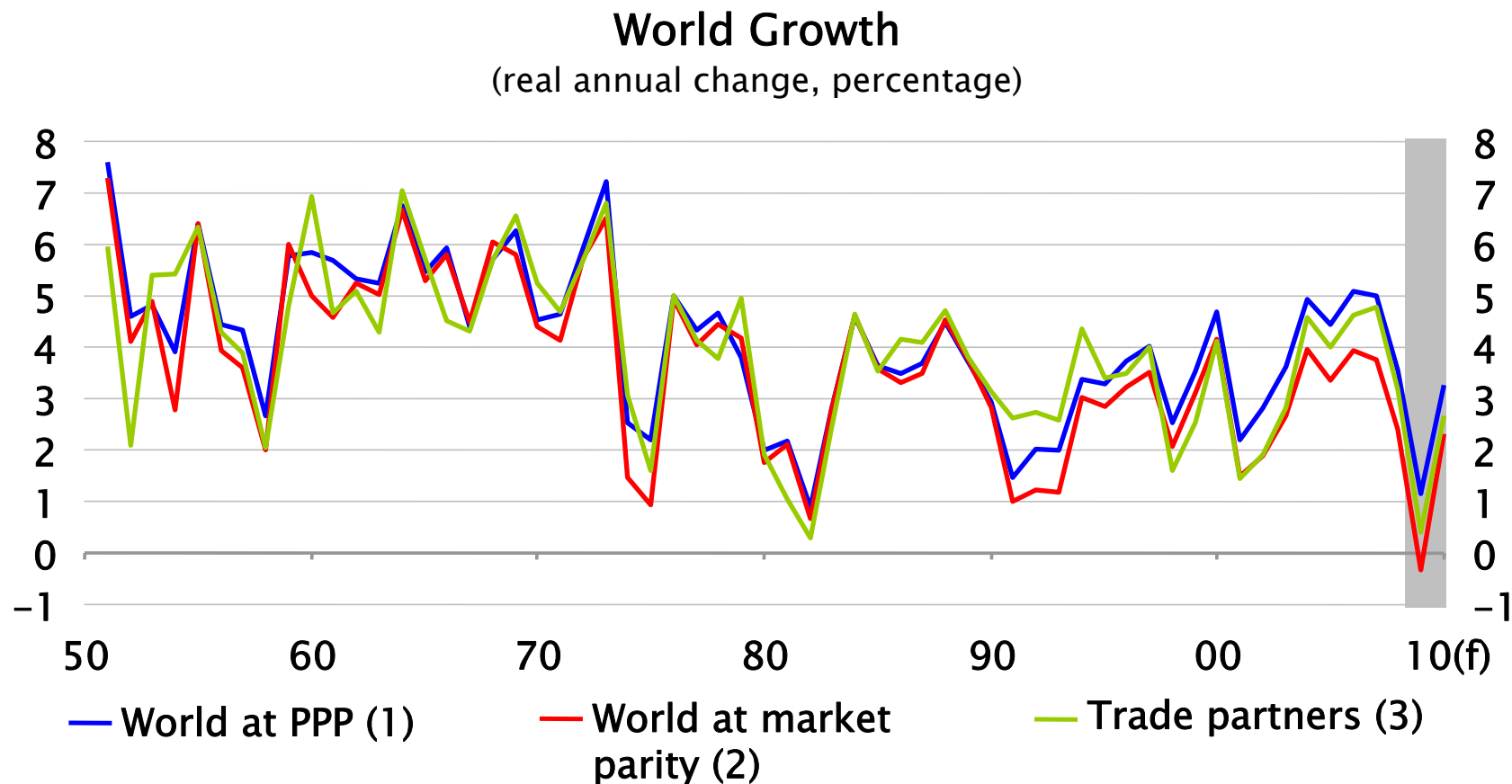
(*) Regional growth according to PPP weights published by the IMF in World Economic Outlook, October 2008.

(e) Estimate; (f) Forecast.

Source: Central Bank of Chile based on information from investment banks, Consensus Forecasts and IMF.



World growth in 2009 is expected to be the lowest in decades.



(f) Forecast. (1) Considers PPP weights of 1980 between 1950 and 1980. From 1980 on considers PPP weights of 2008. (2) Considers weights at market exchange rates of 1970 between 1950 and 1970. From 1970 on considers weights of 2008. (3) Considers weights of trade partners based of 1970 between 1950 and 1970. From 1970 on considers weights of 2008.

Source: Central Bank of Chile based on World Bank, Eurostat, IMF and Penn World Tables.



The sharp fall in commodity prices persists over the forecast horizon.

International Baseline Scenario Assumptions

(annual average)

	2008 (e)			2009 (f)			2010 (f)		
	Sep.08	Nov.08	Jan.09	Sep.08	Nov.08	Jan.09	Sep.08	Nov.08	Jan.09
WTI oil price (US\$ /barrel)	115	105	100	116	70	50	115	80	60
LME copper price (US\$ cents/lb)	350	320	317	310	165	150	300	190	160
Terms of trade (annual change, %)	-5.9	-10.5	-11.1	-7.2	-18.2	-19.1	-4.3	-2.5	-2.0
External prices (US\$) annual change, %)	14.1	12.2	12.0	3.3	0.5	-0.8	2.8	4.8	5.5

(e) Estimate; (f) Forecast.

Source: Central Bank of Chile.



GDP growth in Chile is expected to reach 2–3%.

Economic Growth and Current Account

(annual change, percentage)

	2006	2007	2008 (e)	2009 (f)
GDP	4.3	5.1	3.5	2.0 – 3.0
National income	6.7	7.8	3.9	0.0
Domestic demand	6.4	7.8	8.5	0.7
Gross fixed capital formation	2.9	11.9	19.9	–4.5
Total consumption	6.4	7.4	5.0	2.5
Exports of goods and services	5.5	7.8	1.8	2.1
Imports of goods and services	10.5	14.3	13.4	–1.7
Current account (% of GDP)	4.7	4.4	–2.6	–4.6

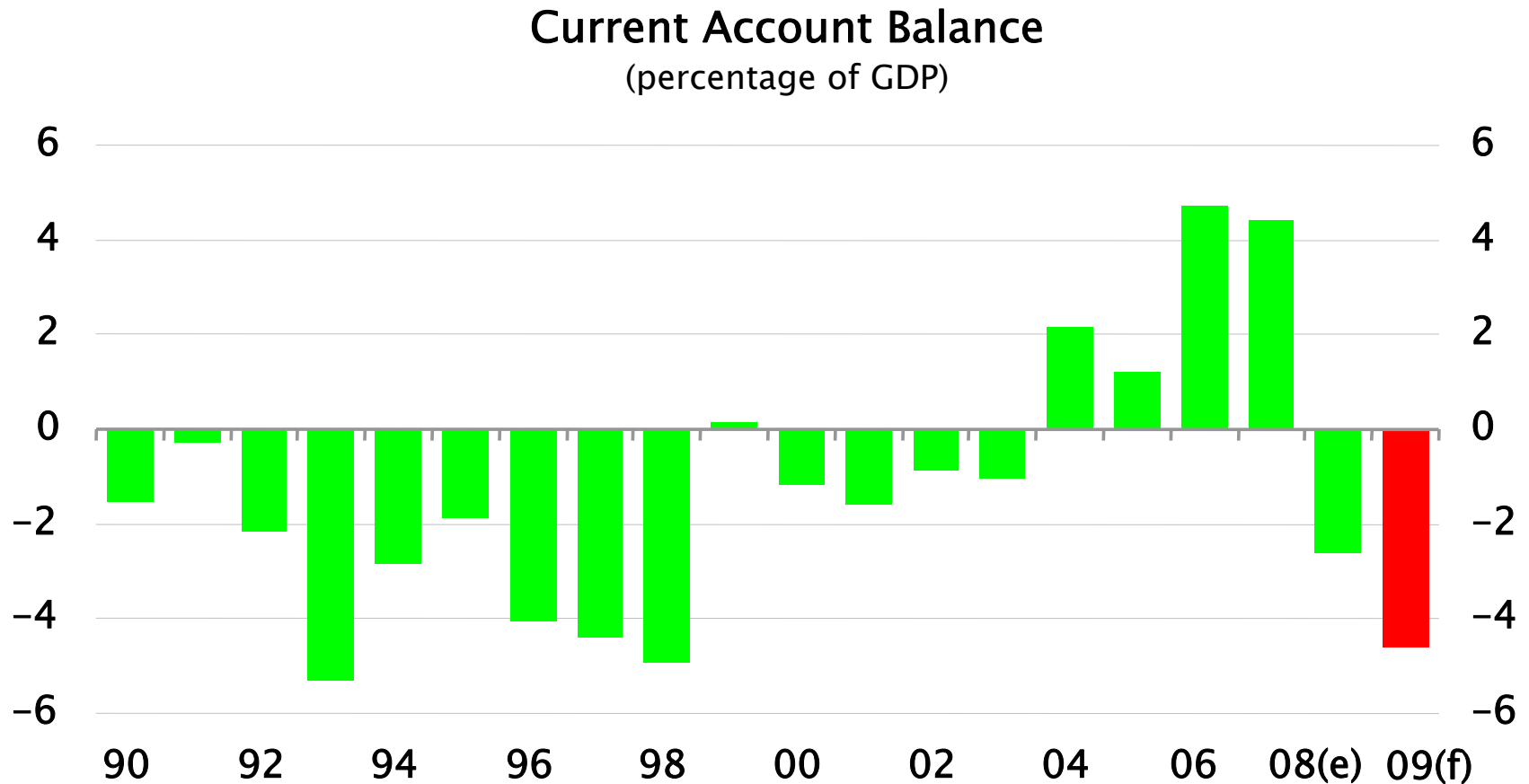
(e) Estimate.

(f) Forecast.

Source: Central Bank of Chile.



After several years of surplus, the current account should move into deficit.



(e) Estimate.

(f) Forecast, Monetary Policy Report, January 2009.

Source: Central Bank of Chile.



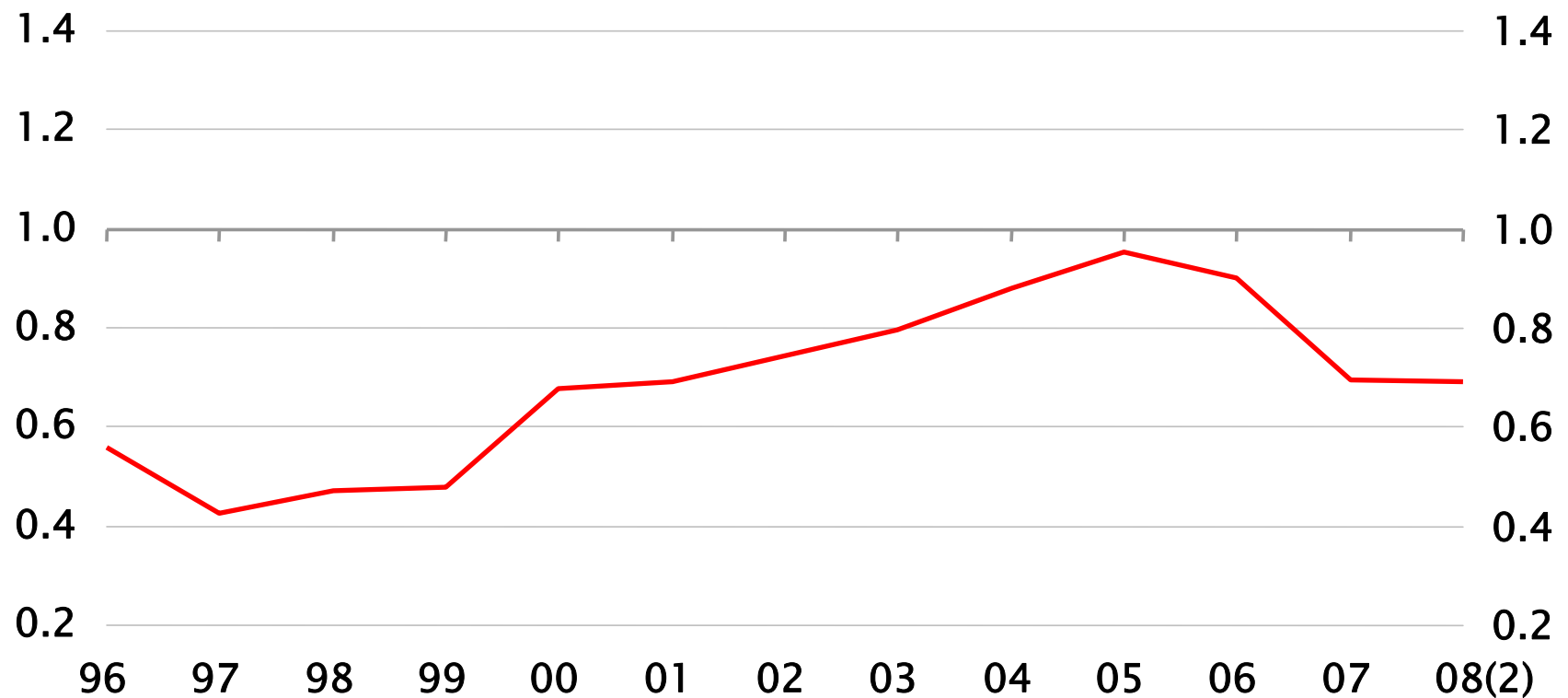
Domestic demand should experience a significant deceleration.

- Private consumption should expand at a moderate pace while investment is forecast to contract. The investment rate should remain high by historical standards.
- The forecast considers that the fiscal stimulus package has an incidence of around 1% in higher growth.
- The financing of the current account deficit comes hand in hand with the use of the Stabilization Fund for the financing of the expected fiscal deficit (government forecast: 3%) and the cash deficit in pesos. The baseline scenario considers that the remaining financial needs can be satisfied without mayor tensions. If the need arises, external liquidity is available to ensure a smooth adjustment.



External liquidity in the SWF and IR are 50% higher than short-term residual external debt.

Short-Term Residual External Gross Debt/Assets in Foreign Currency (1)
(ratio)



(1) Considers Net International Reserves and the Economic and Social Stabilization Fund (ESSF).

(2) November 2008.

Source: Central Bank of Chile.



Inflation should converge quickly to target, hovering around 3% over 2010.

Inflation Forecast (annual change, percentage)

	2006	2007	2008	2009 (f)	2010 (f)
Average CPI inflation	3.4	4.4	8.8	4.5	2.9
December CPI inflation	2.6	7.8	7.1	3.1	
CPI inflation around 2 years (*)					3.0
Average CPIX inflation	3.2	4.0	8.4	6.3	2.6
December CPIX inflation	2.7	6.3	8.7	3.0	
CPIX inflation around 2 years (*)					2.8
Average CPIX1 inflation	2.5	4.1	7.8	5.4	2.7
December CPIX1 inflation	2.4	6.3	7.9	3.3	
CPIX1 inflation around 2 years (*)					2.5

(f) Forecast.

(*) Corresponds to the projected average inflation between the fourth quarter of 2010 and the first quarter of 2011.

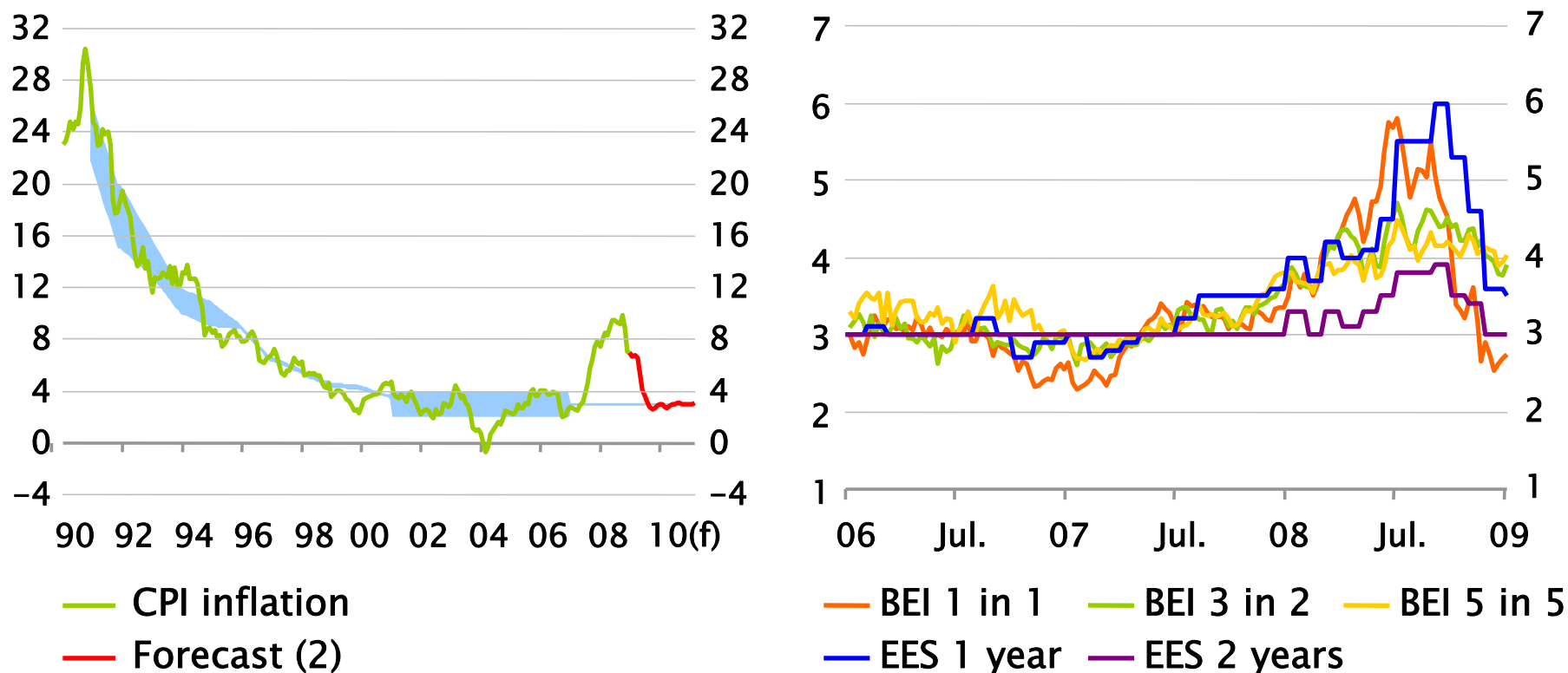
Source: Central Bank of Chile



Prospects for inflation and measures of expected inflation indicate a quick convergence to the target.

Inflation, Target Inflation and Inflation Expectations (1)

(annual change, percentage)



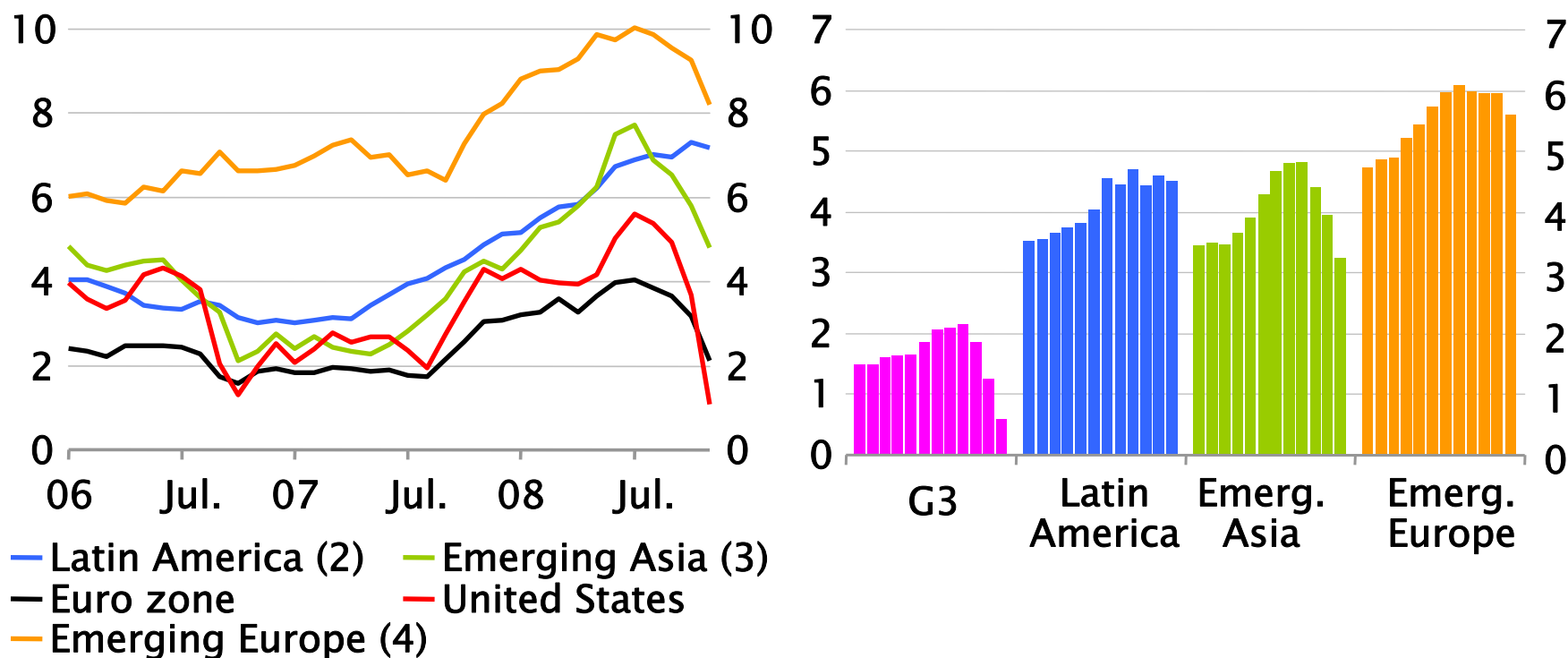
(f) Forecast, Monetary Policy Report, January 2009. (1) Considering breakeven inflation (BEI) based on forward instruments and the Economic Expectations Survey (EES). (2) The forecast considers a monthly frequency based on a quarterly forecast. Sources: Central Bank of Chile and National Bureau of Statistics.



The turnaround in expected inflation is a global phenomenon, with some exceptions.

Inflation Data and Inflation Expectation by Economic Area (1)

(annual change, percentage)



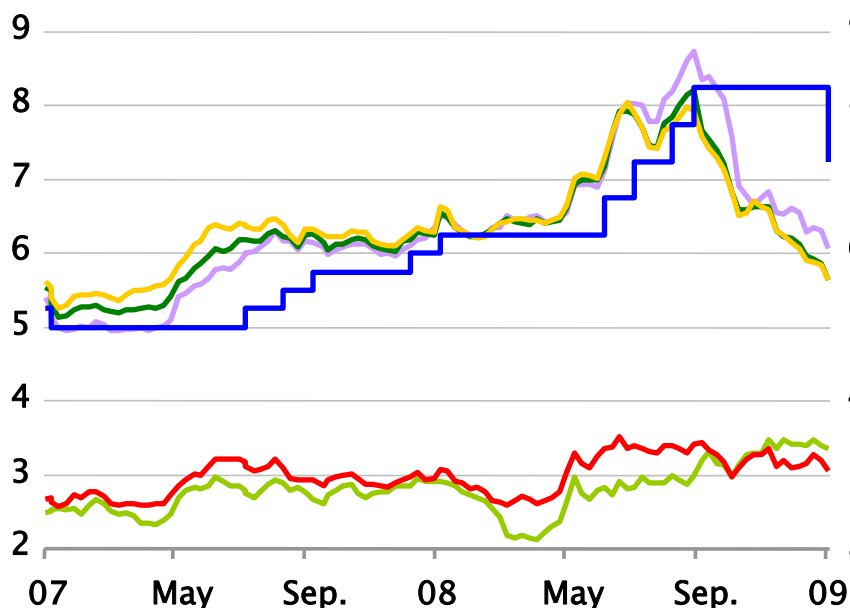
(1) Geometric average of the considered countries of each region. In the case of the inflation expectation figure, each bar corresponds to the average annual inflation projection for 2009, of each month since January 2008. (2) Brazil, Chile, Colombia, Mexico and Peru. (3) China, Indonesia, Korea, Malaysia, Singapore, Taiwan and Thailand. (4) Czech Republic, Hungary, Russia and Turkey.

Sources: Central Bank of Chile based on CEIC data and Consensus Forecasts.

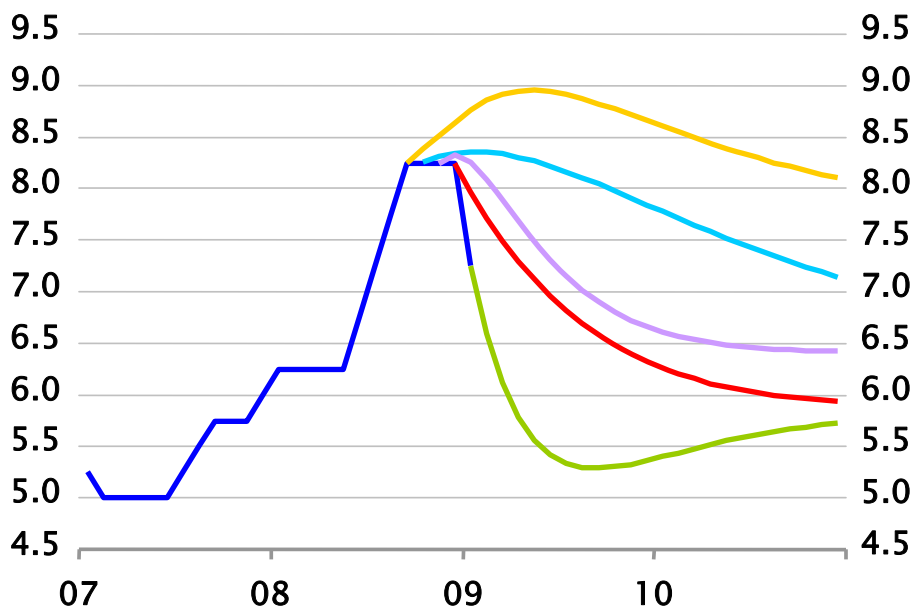


The baseline scenario considers further easing of the monetary policy, in the short term somewhat below what is implicit in financial asset prices.

MPR, Interest Rates on CBC instruments and Forward Curve (*)
(percentage)



— MPR
— BCP-2
— BCP-5
— BCP-10/BTP-10
— BCU-5
— BCU-10



— MPR
— Forward Sep. 08
— Forward Oct. 08
— Forward Nov. 08
— Forward Dec. 08
— Forward Jan. 09

(*) First figure based on weekly averages.
Source: Central Bank of Chile.



Snapshot

	2005	2006	2007	2008
Gross Domestic Product (billions of USD)	118.6	146.4	163.9	183.2 (*)
Real GDP growth (%)	5.6	4.3	5.1	3.5 (e)
Consumer prices (annual % change Dec/Dec)	3.7	2.6	7.8	7.1
Population (millions of inhabitants)	16.3	16.4	16.6	16.8
Exports of goods FOB (millions of USD)	41,267	58,485	67,644	67,800 (e)
Imports of goods FOB (millions of USD)	30,492	35,899	43,991	57,600 (e)
Current account balance (% of GDP)	1.2	4.7	4.4	-2.6 (e)
Foreign exchange reserves excl. gold (millions of USD, as of 31 Dec. of each year)	16,960.1	19,424.6	16,904.7	23,156.6
Foreign debt (% of GDP)	39.1	33.6	34.1	37.4 (*)
Average exchange rate (Chilean pesos per dollar)	559.9	530.3	522.7	521.8

(*) Considers the last twelve months up to 3Q08.

(e) Estimate.

Sources: Central Bank of Chile and National Bureau of Statistics.

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