



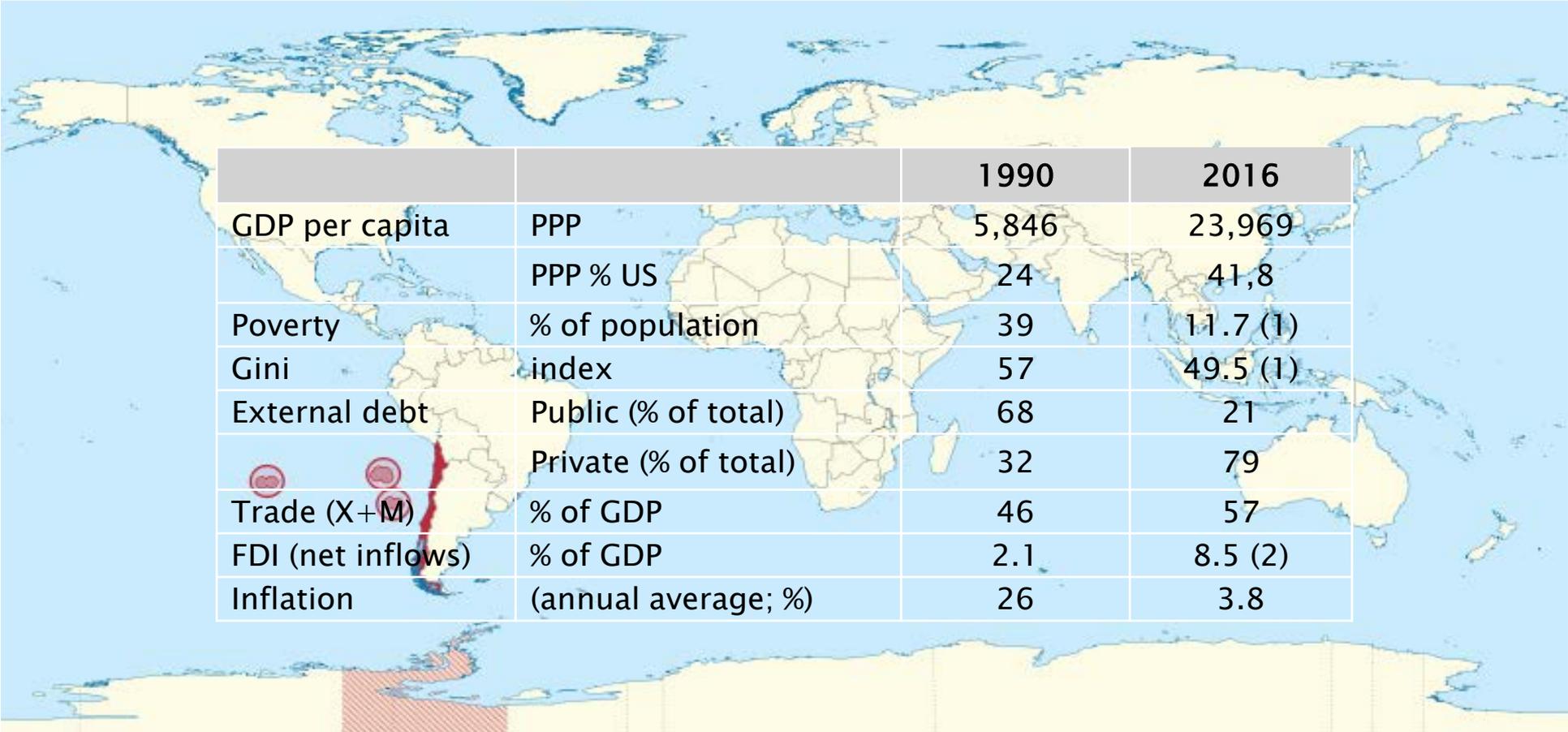
# The Chilean Economy: Recent Developments and Coming Challenges

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Governor



Central Bank of Chile, March 2017

# The Chilean economy: past and present



|                   |                      | 1990  | 2016     |
|-------------------|----------------------|-------|----------|
| GDP per capita    | PPP                  | 5,846 | 23,969   |
|                   | PPP % US             | 24    | 41,8     |
| Poverty           | % of population      | 39    | 11.7 (1) |
| Gini              | index                | 57    | 49.5 (1) |
| External debt     | Public (% of total)  | 68    | 21       |
|                   | Private (% of total) | 32    | 79       |
| Trade (X+M)       | % of GDP             | 46    | 57       |
| FDI (net inflows) | % of GDP             | 2.1   | 8.5 (2)  |
| Inflation         | (annual average; %)  | 26    | 3.8      |

(1) 2015, Casen survey. (2) 2015 figure.

Sources: World Bank, Central Bank of Chile, IMF, Social Development Ministry of Chile.

# Overview

**Emerging economies have seen growth and investment negatively affected by the end of the commodity super-cycle. Domestic factors have also played a role in some cases.**

**The global outlook is currently improving and commodity prices have risen, but downside risks remain relevant.**

**Economic growth has been slow in Chile since 2014. Potential GDP growth has declined for over a decade. Still, macroeconomic balances have held on, and the ability of the economy to accommodate changes has improved.**

**Economic expectations remain on negative ground. Some blame controversial policy reforms while others point to a deterioration of trust due to political and business scandals. Yet business opportunities remain and may rely on ongoing developments in cost containment and financial deepening.**

# Overview

**Monetary policy has remained expansionary for a number of years in order to help the economy to adjust to the end of the commodity price cycle; a floating exchange rate has allowed relative prices to adjust.**

**After a couple of years of higher inflation, prices are converging to the 3% policy target. The financial sector remains healthy, with a well-developed long-run capital market and a strong presence of institutional investors.**

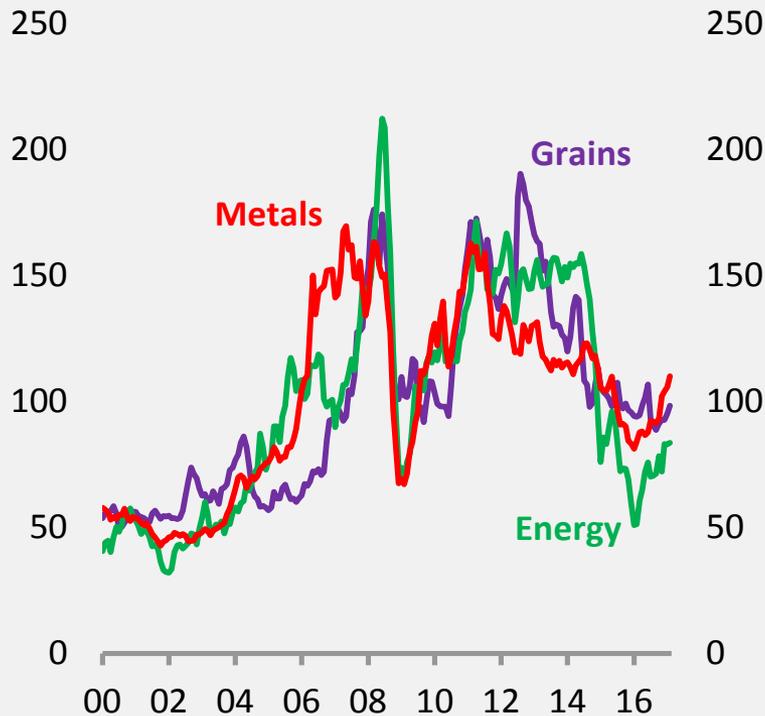
**The necessary conditions to accelerate growth are already there. The Central Bank of Chile is providing monetary support and financial surveillance to facilitate the adjustment.**

# **Economic Environment in the LAC Region**

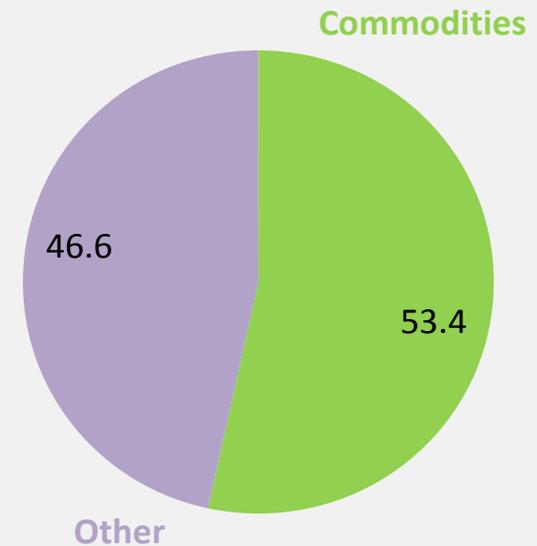


# The commodity price boom resulted in fast economic growth in Latin America, explained by the weight of these products in the region's exports

**Commodity prices (\*)**  
(index, 2000-2013=100)



**Latin America: Exports structure**  
(percent of total)



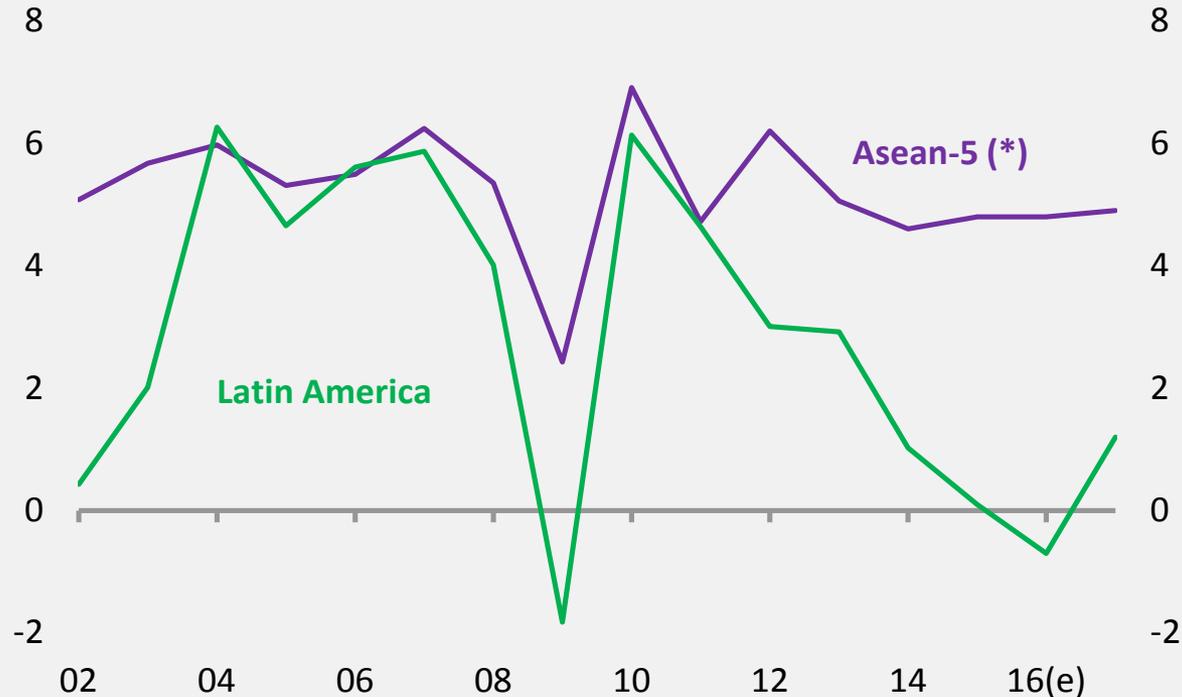
(\*) Goldman Sachs aggregate index.

Sources: Bloomberg and United Nations Conference on Trade and Development.



**In recent years growth in Latin America has been disappointing, drifting away from the more sustained dynamism of South Asian countries**

**Growth in Latin America and Asia**  
(annual change, percent)

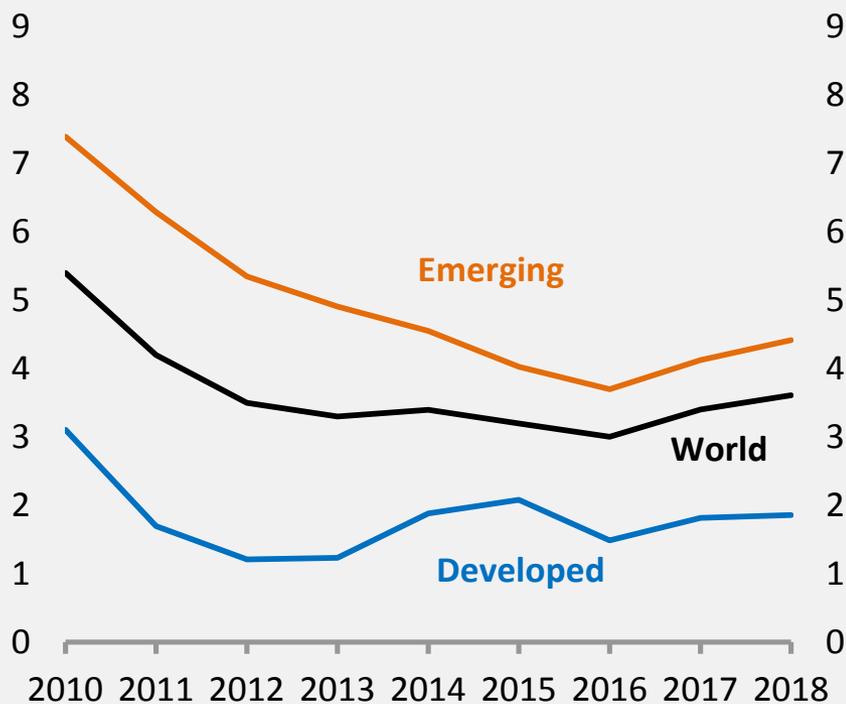


(\*) Asean-5: Indonesia, Malaysia, Philippines, Thailand and Vietnam. (e) Estimation included in World Economic Outlook, Update January 2017. Source: IMF.

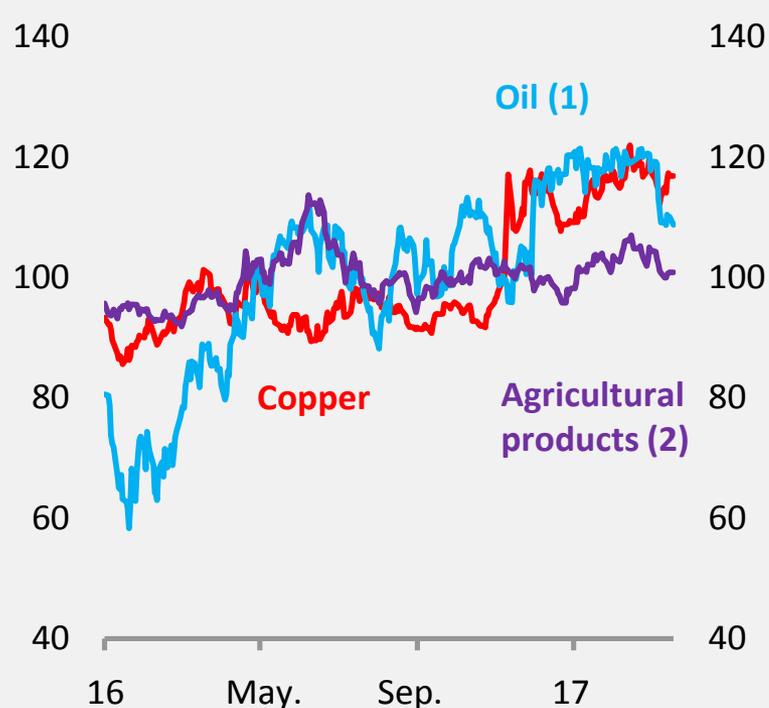


# However, the tone of the global economic scenario is improving. Growth prospects have strengthened and commodity prices are rising

## World growth (annual change, percent)



## Commodity prices (index, average 2016-2017=100)

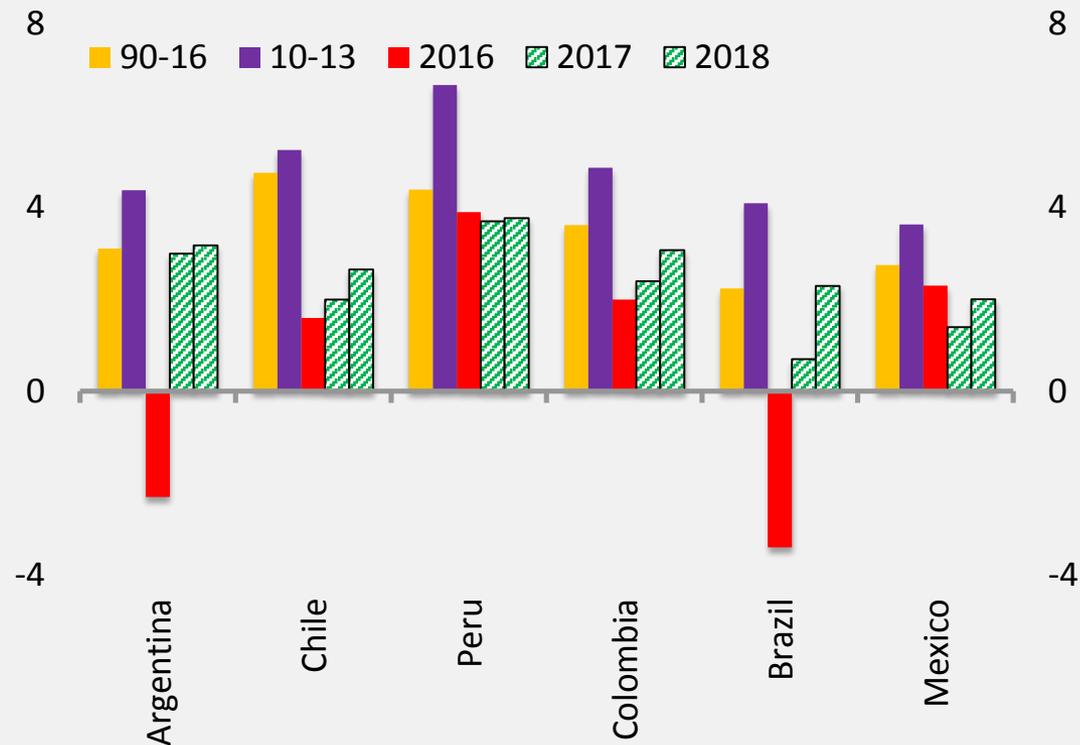


(1) WTI and Brent average. (2) Goldman Sachs index.  
Sources: Bloomberg, Consensus Forecasts and IMF.



# Thus, economic growth is expected to recover in the LAC region

## GDP: Latin American countries' growth and outlook (annual change, percent)

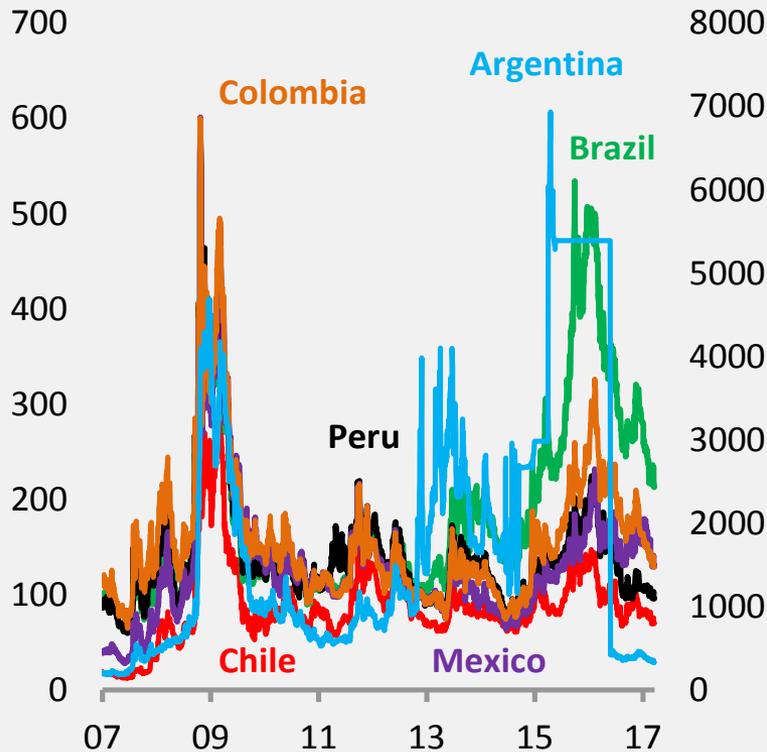


Source: Central Bank of Chile, Consensus Forecasts and IMF.

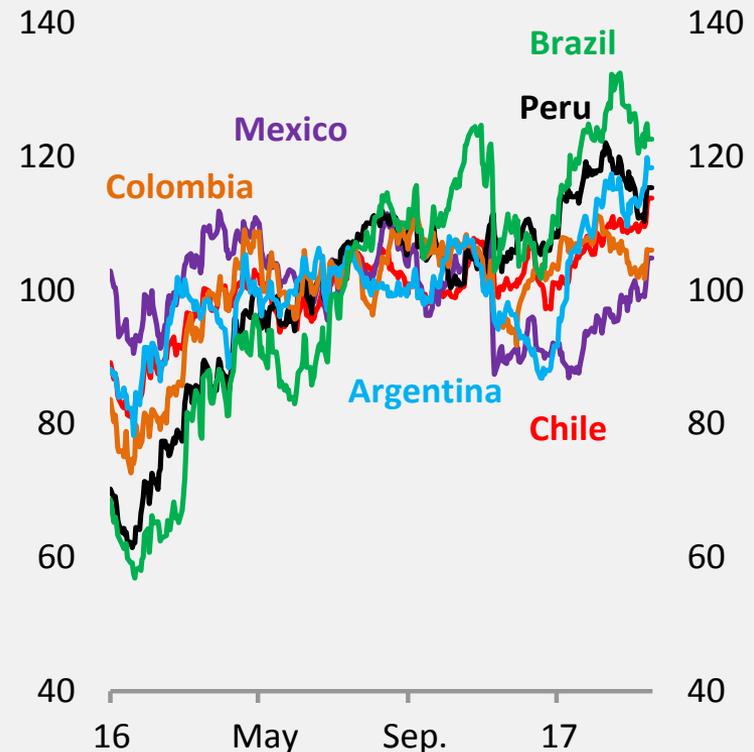


# Moreover, international financial conditions have improved, and risk appetite is growing

## 5-year CDS (basis points)



## Stock market (index, 2016-2017=100)

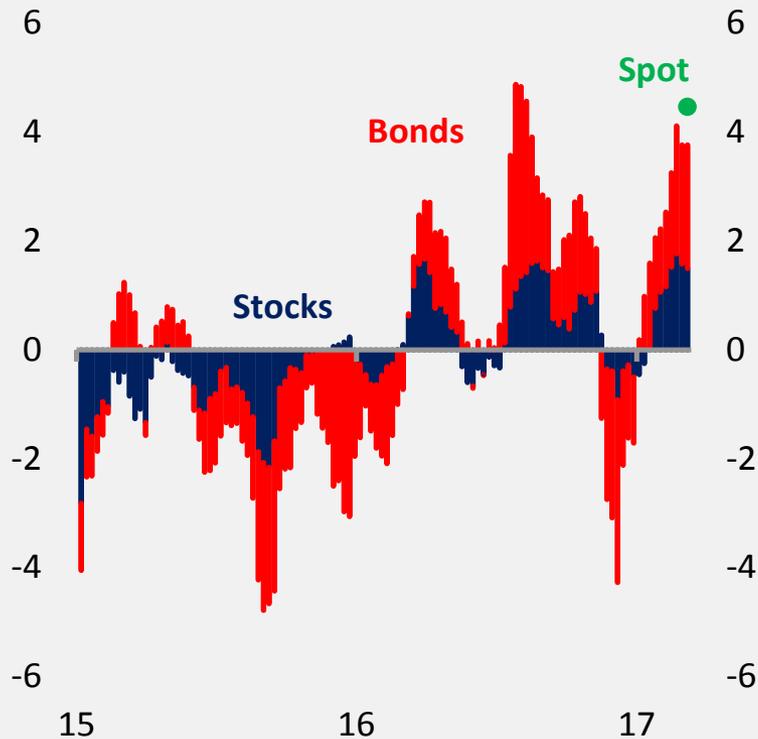


Source: Bloomberg.

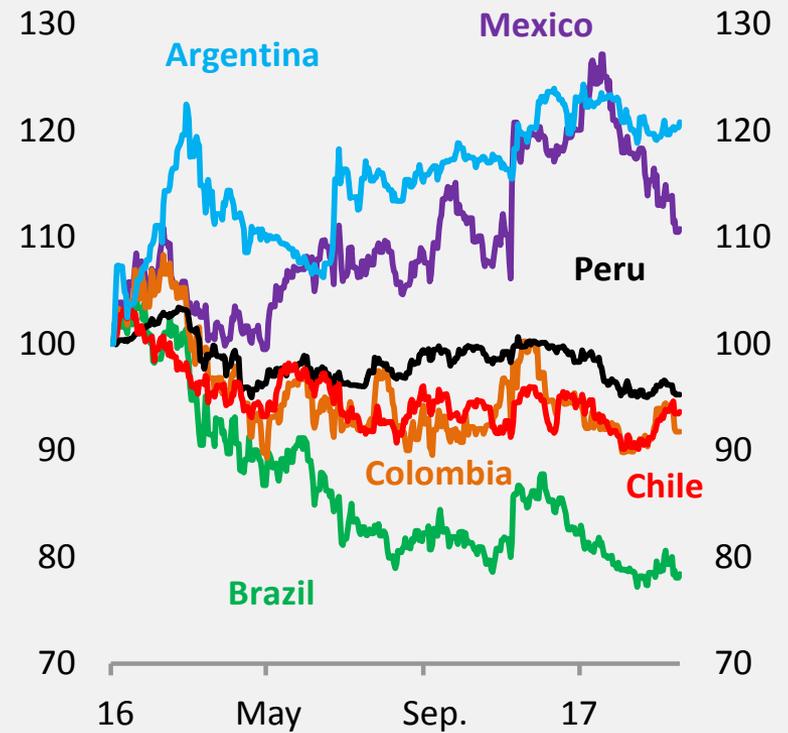


# This has prompted capital inflows and currency appreciation

## Net capital flows to Latin America (billions of dollars, moving month)



## Nominal exchange rates (against USD, index, 2 January 2016 = 100)

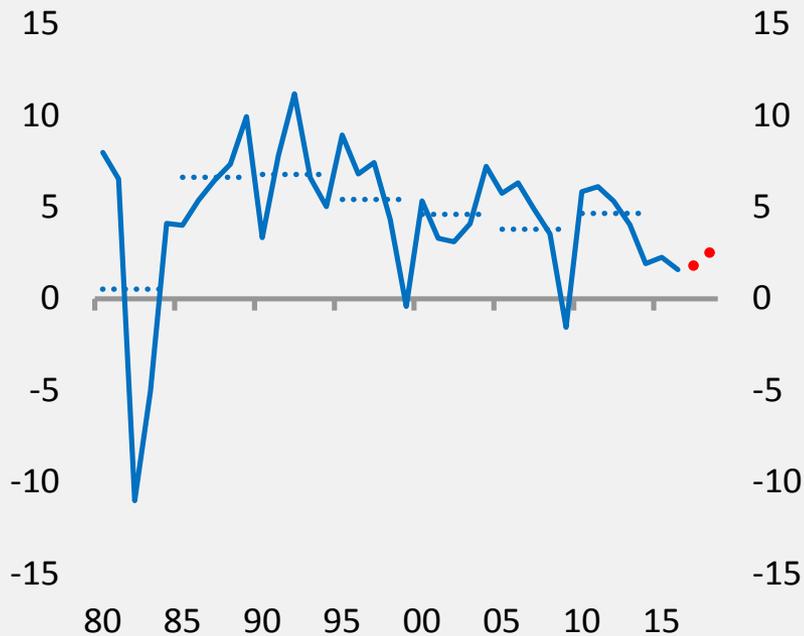


# The Chilean Economy

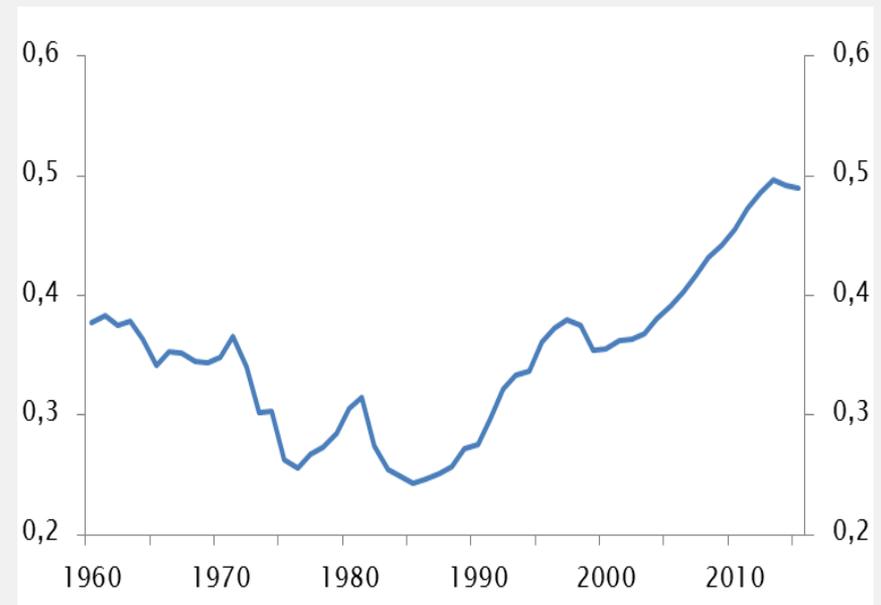


# Chile has been a solid economic performer since the mid-1980s, reducing significantly its gap with advanced countries

## Chile's economic growth (1)(2) (annual change, percent)



## Per capita GDP as a share of US's(3)



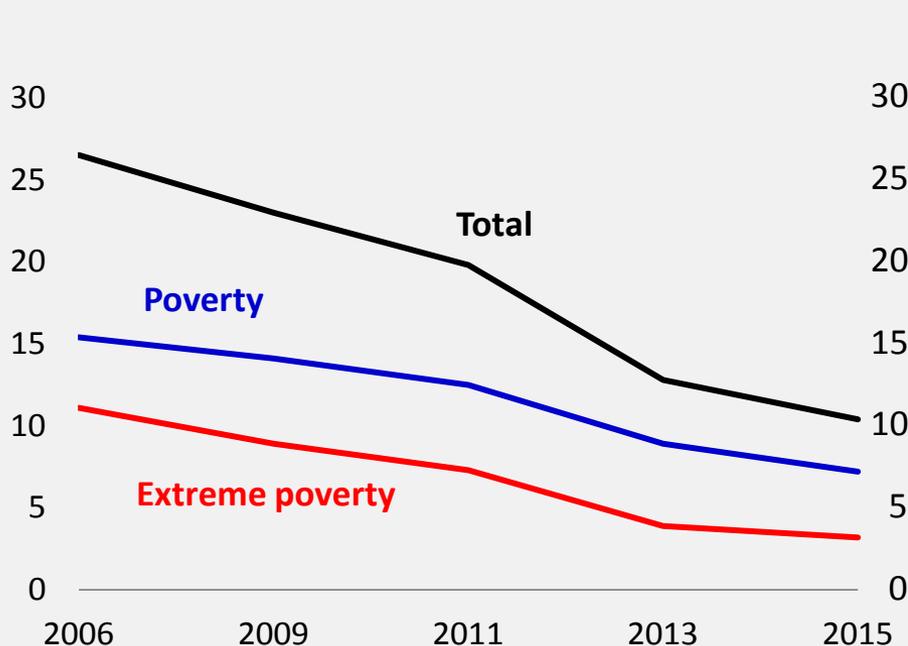
(1) Dotted lines show averages every 5 years. (2) 2017 and 2018 forecasts (read dots) use the median in March 2017's Economic Expectations Survey. (3) At 1990 PPP.

Sources: Central Bank of Chile and The Maddison Project (2013), World Bank

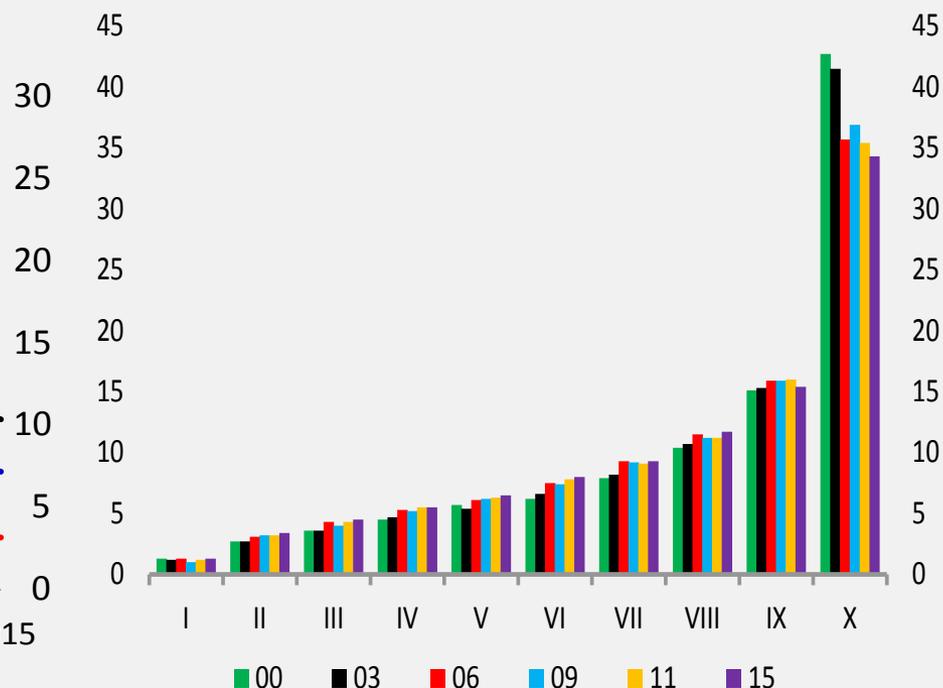


# Poverty has fallen dramatically and inequality has receded

**Population in poverty and extreme poverty**  
(people in poverty by household income, %)



**Autonomous income distribution by decile of per capita autonomous income**

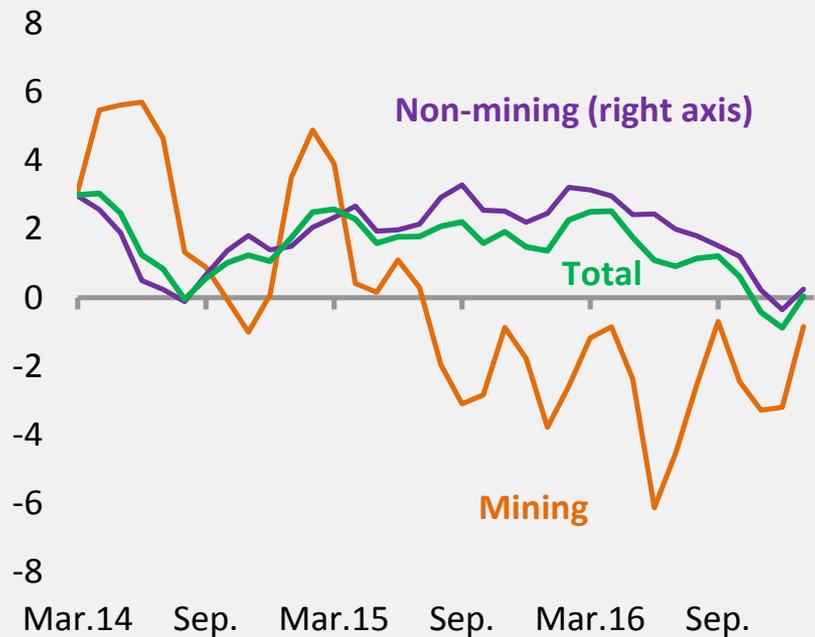


Source: CASEN surveys.

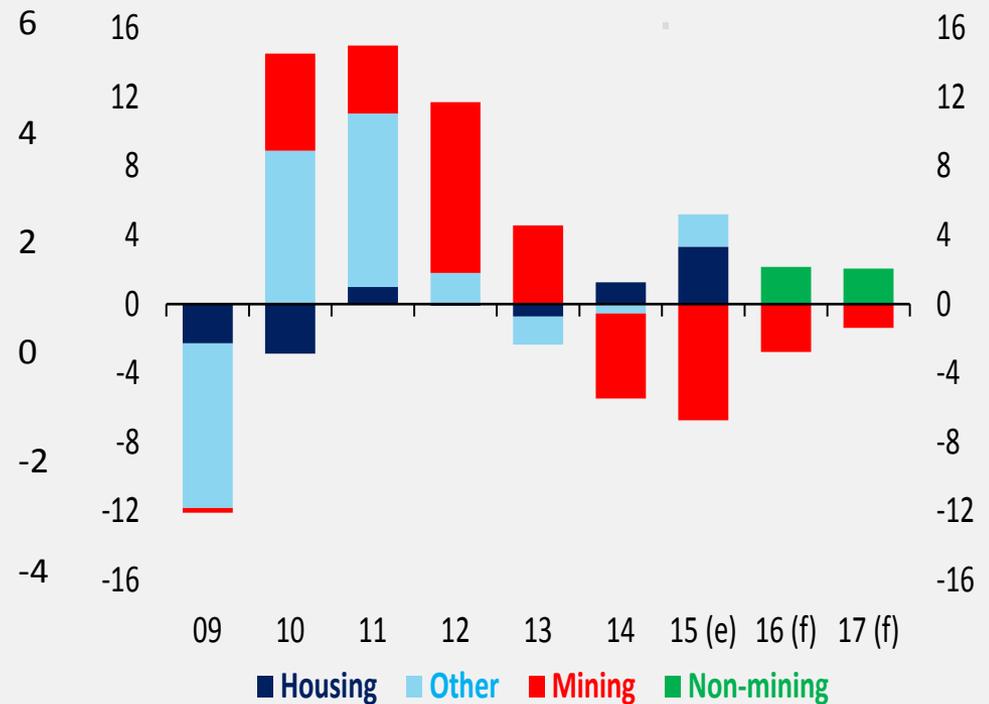


**However, activity has slowed substantially in recent years. Weakness in the mining sector has played an important role, but non-mining activity has slowed down too**

**Imacec (1)**  
(annual change, percent)



**Real annual contributions to GFCF (2)**  
(percentage points)

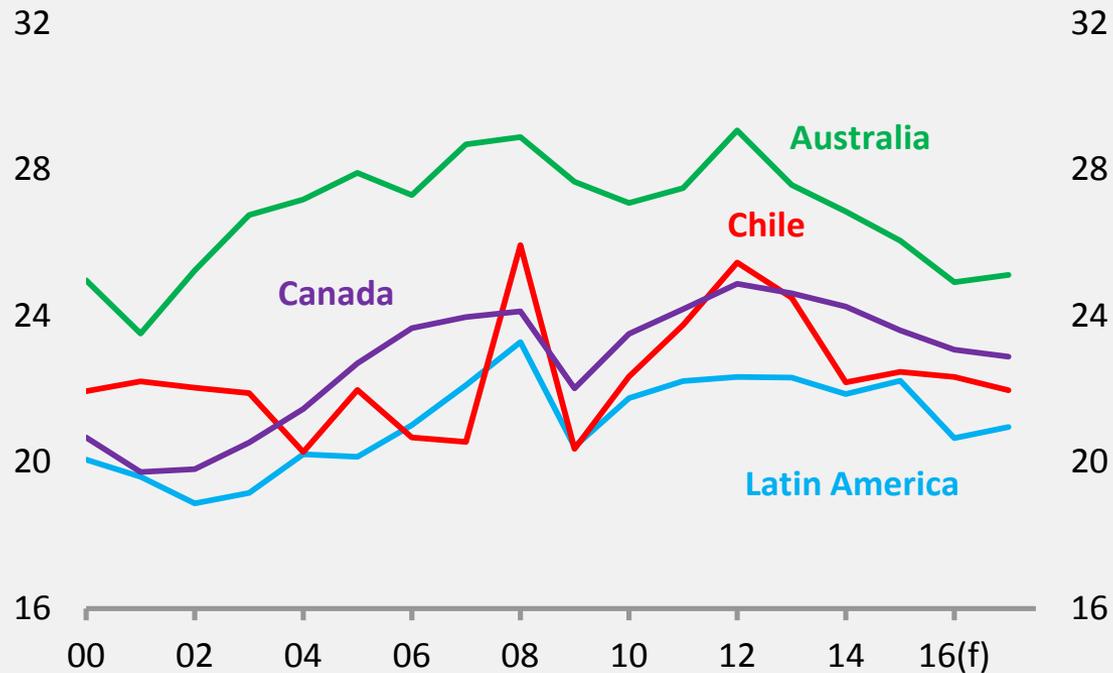


(1) Monthly index of economic activity. Three months moving average. (2) Estimations details for 2015, 2016 and 2017 in MPR December 2016. (e) Estimate. (f) Forecast. Source: Central Bank of Chile.



# The decline in investment has not only affected Chile; it has been a drag on growth in many economies, including in Latin America and commodity producers

## Investment/GDP ratios



(f) Forecast.

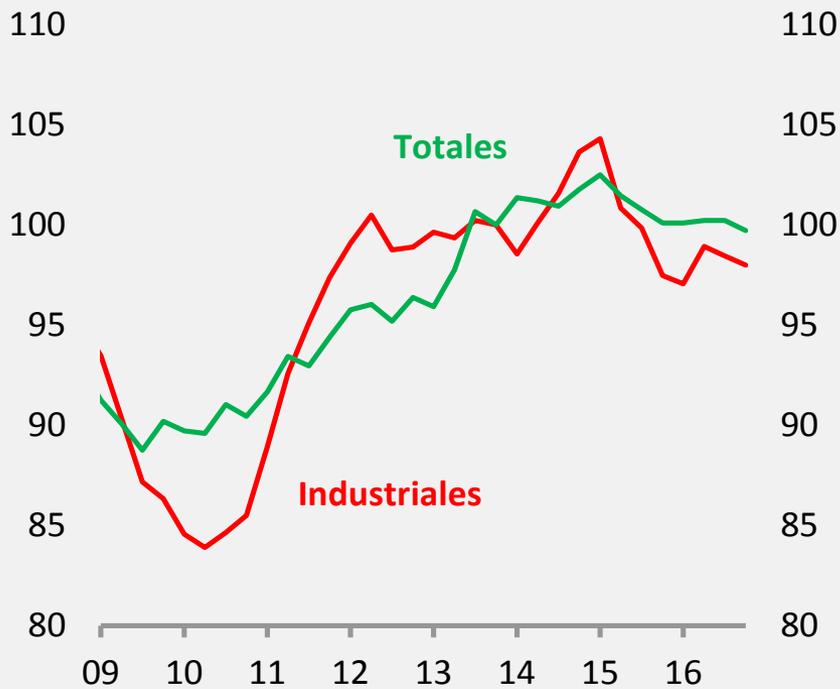
Source: World Economic Outlook, IMF.



**Despite the nominal depreciation of the peso, export volumes have not increased significantly, since the higher exchange rate has been linked to a global appreciation of the dollar**

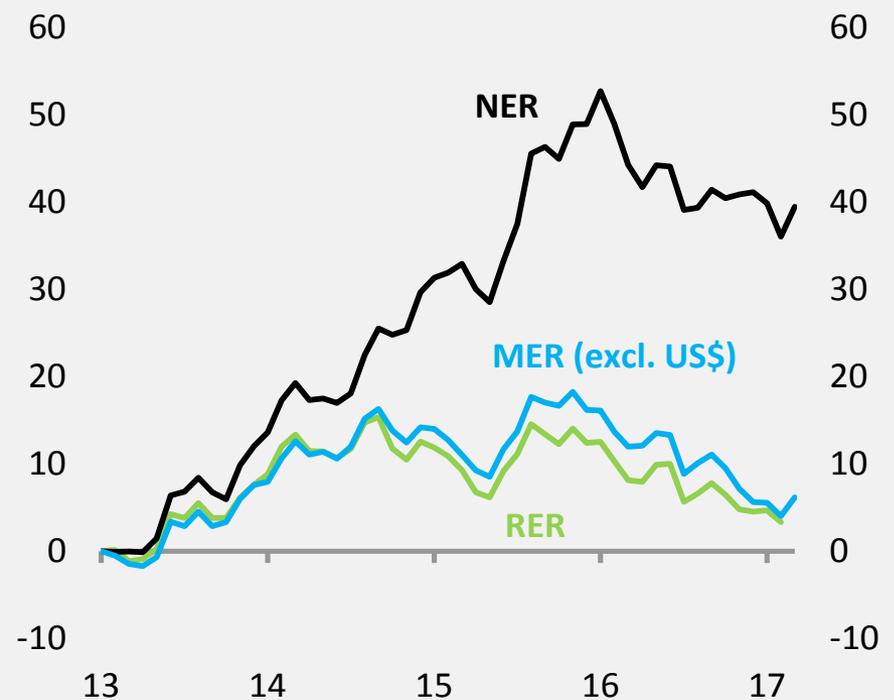
### Export volumes

(index, 2008=100, four quarters moving average)



### Exchange rate

(accumulated change since Jan. 2013, percent)



Source: Central Bank of Chile.

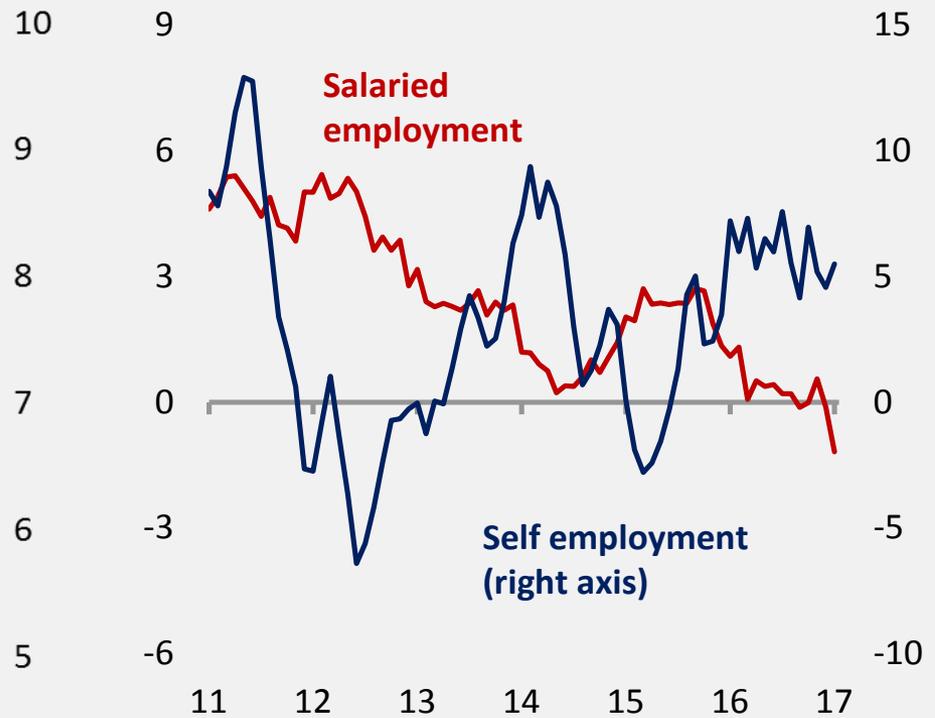


# However, slower growth has not translated into an increase in open unemployment due to flexibility in the labour market

### Unemployment rate (annual change, percent)

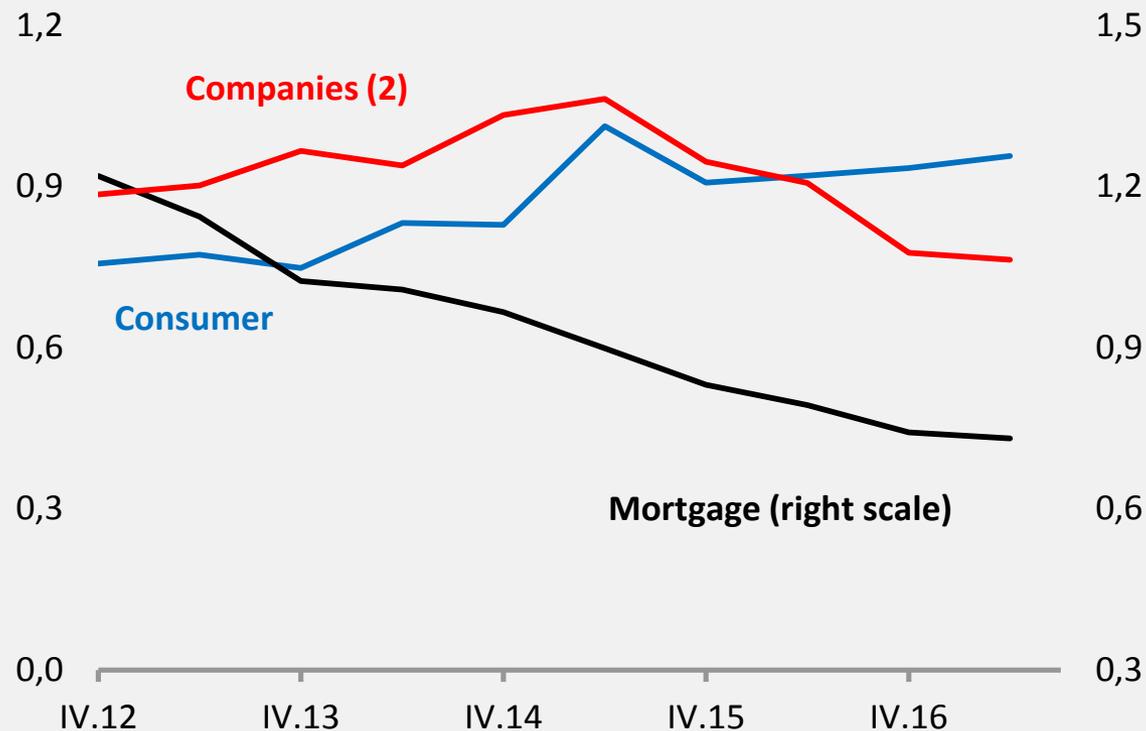


### Job creation by occupational category (annual change, percent)



# The financial health of companies and households has not been largely affected. Non-payment indicators have remained low despite the economic slowdown

## Arrears ratio (1) (percentage of loans)

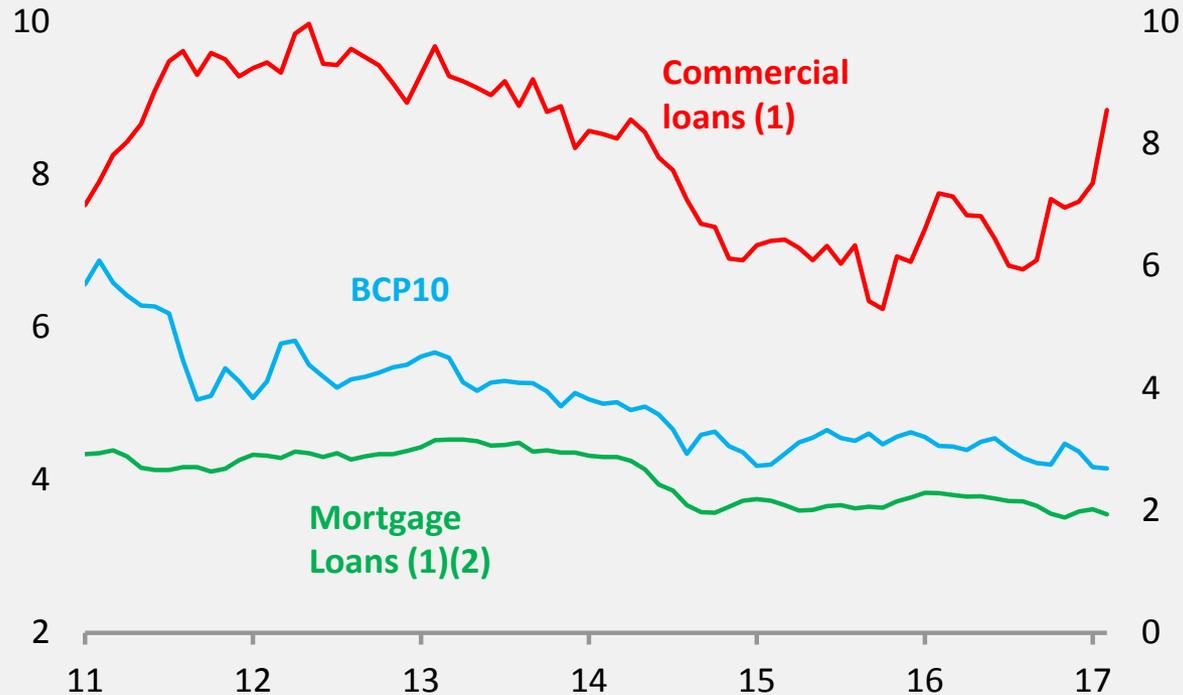


(1) Latest figure corresponds to January 2017. (2) Includes credits not classified by industries, and individuals.  
Source: Central Bank of Chile using data from INE, SII and SBIF.



# The resilience of the economy has been partly due continuing favorable financial conditions

## Interest rates (percentage)



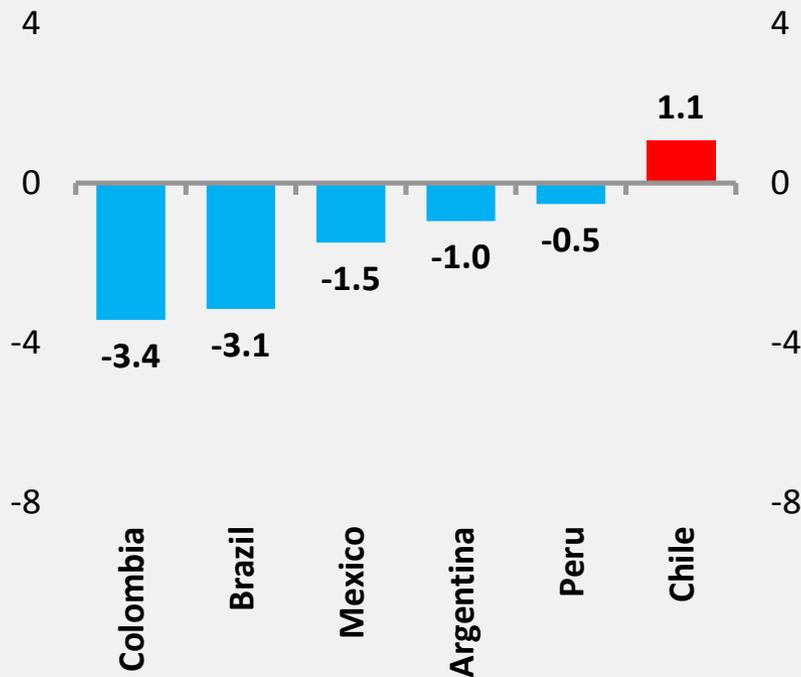
(1) Weighted averaged rates of all the operations performed in each month. (2) UF-indexed loans.

Source: Central Bank of Chile.

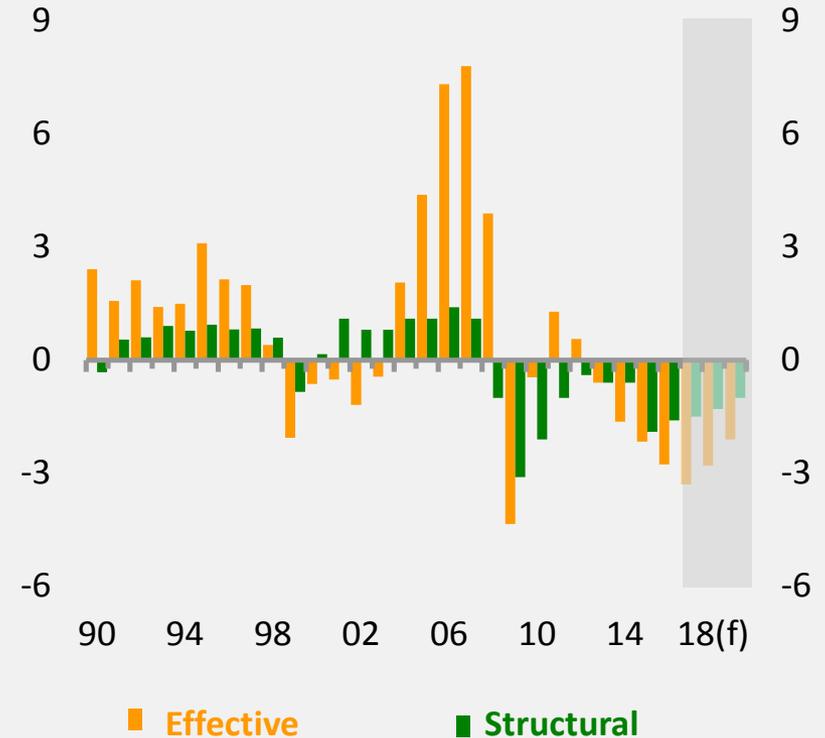


# Chile was one of the first few countries to introduce a structural fiscal policy. It has been applied consistently over 16 years allowing the government to save during good times

**Public sector balance: 1995-2015 average (\*)**  
(percent of GDP)



**Public sector balance: Chile**  
(percent of GDP)



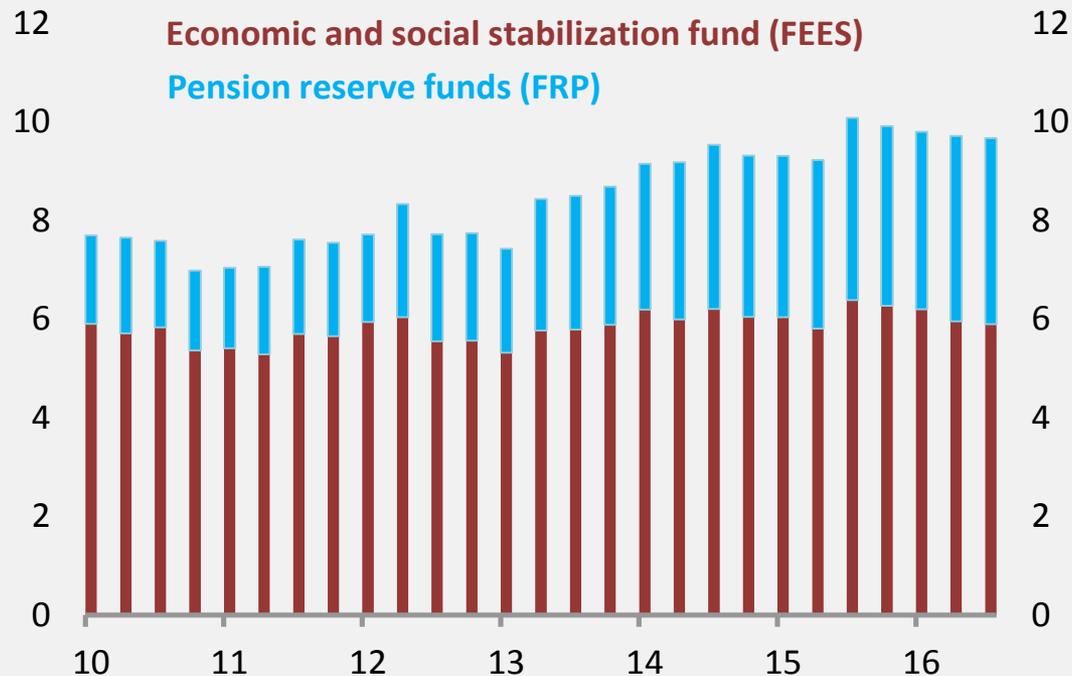
(\*) General Government Financial Balance. (f) For 2017 to 2019, forecasts obtained from the “Public Finance Report. Public Sector Budget for 2017”, October 2016.

Sources: Moody’s and National Budget Department, Ministry of Finance of Chile.



**Which reflects on a considerable accumulation of fairly liquid financial assets in two SWFs. These balance gross debt to a government net debt ratio of less than 10% of GDP**

### **Sovereign wealth funds (percent of GDP)**

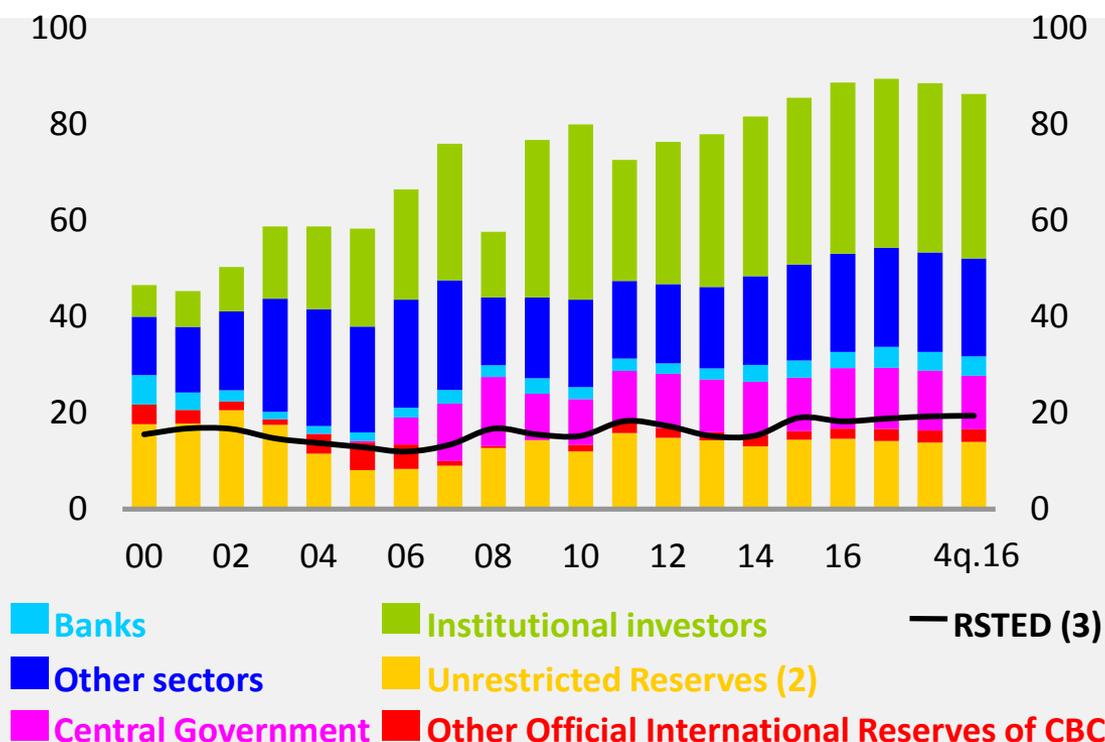


Sources: Ministry of Finance of Chile and Central Bank of Chile.



**In general, Chile has more liquid external funds available than in earlier low-growth periods, which couples with international financial conditions that have remained favorable**

**Availability of net foreign financial liquidity (1)  
(percent of GDP)**



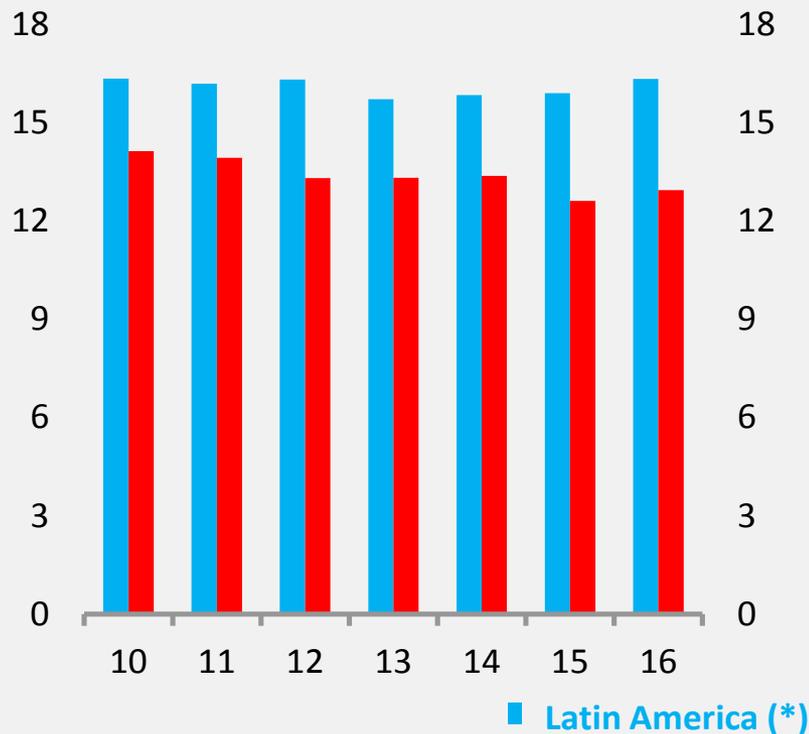
(1) GDP at constant real exchange rate (index Dec. 2016 = 100). External liquidity includes short-term loans, currency and time deposits, and portfolio investment. Excludes derivative positions. (2) Official reserves minus short-term commitments in foreign currency (BCX maturities, BCD, swaps). (3) Residual short-term external debt. Source: Central Bank of Chile.



**Banks' capital adequacy ratios are good, while non-performing loans have diminished, which compares very favorably to regional averages, especially considering the higher depth of Chile's financial sector**

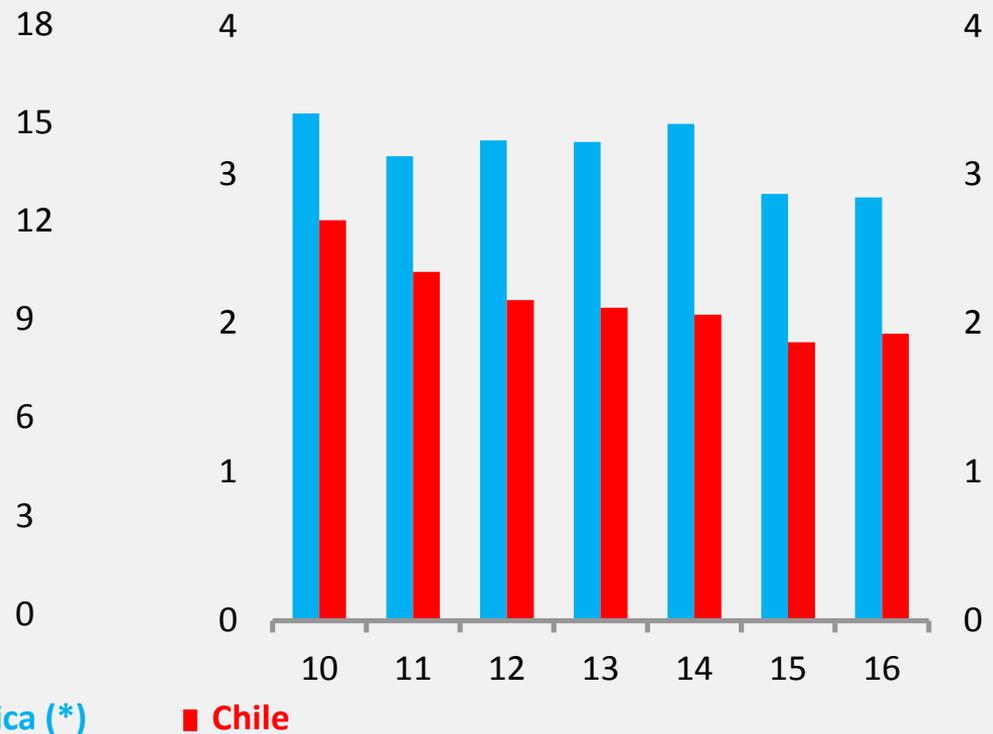
### Regulatory Capital

(percent of risk-weighted assets)



### NPL

(percent of total loans)



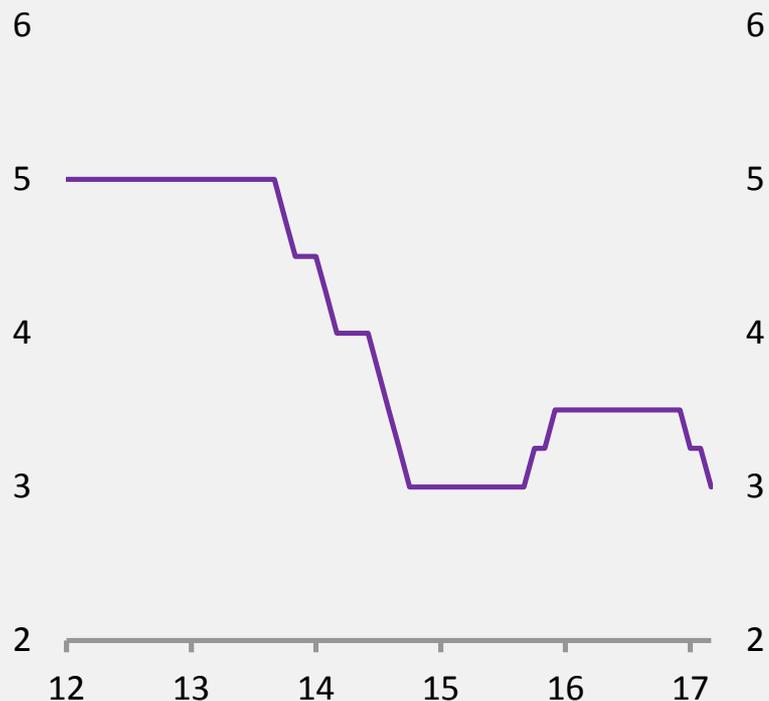
(\*) Shows the region's simple average.

Source: Global Financial Stability Report, IMF.

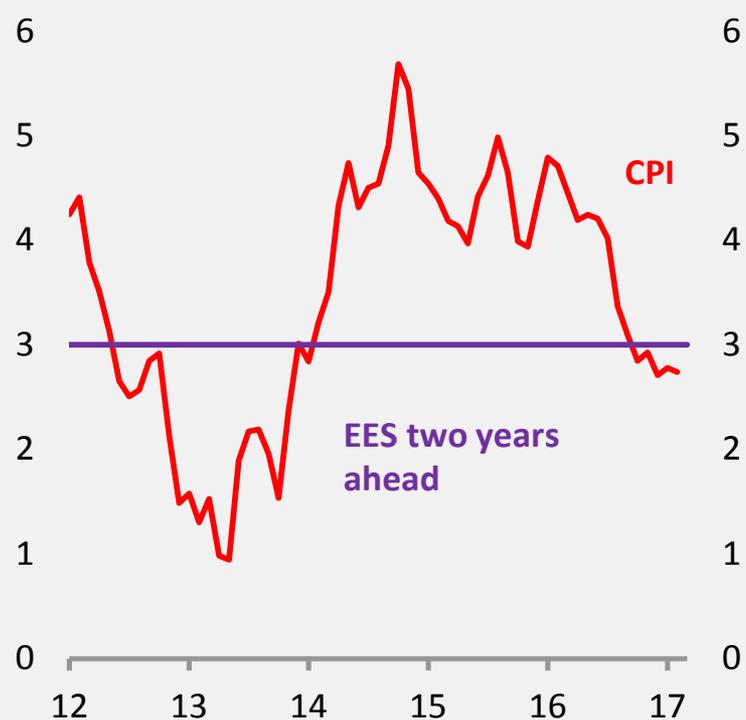


**Favorable domestic financial conditions have been supported throughout by an expansionary monetary policy. The credibility of the Central Bank has been essential**

**Monetary Policy Rate  
(percent)**

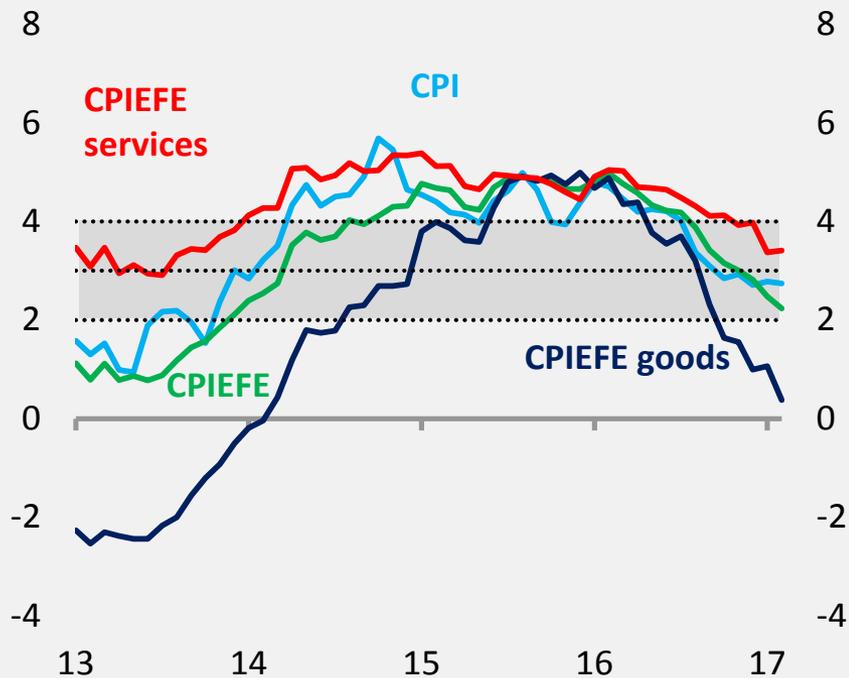


**CPI and expectations  
(annual change, percent)**

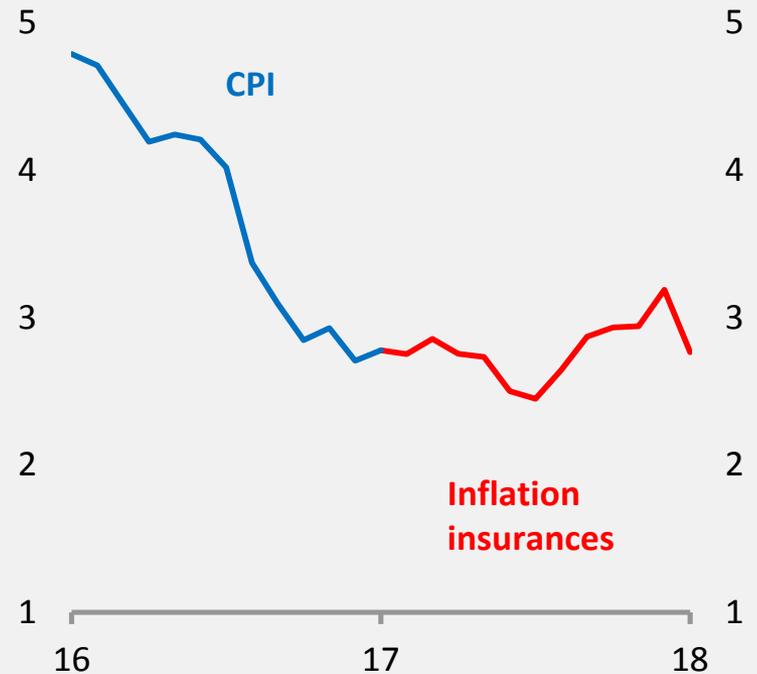


**Inflation is currently below 3% and it is expected to remain so in the coming months. Monetary policy will ensure convergence to the policy target over the medium term**

**Inflation indicators**  
(annual change, percent)



**Inflation expectations: insurances**  
(percent)

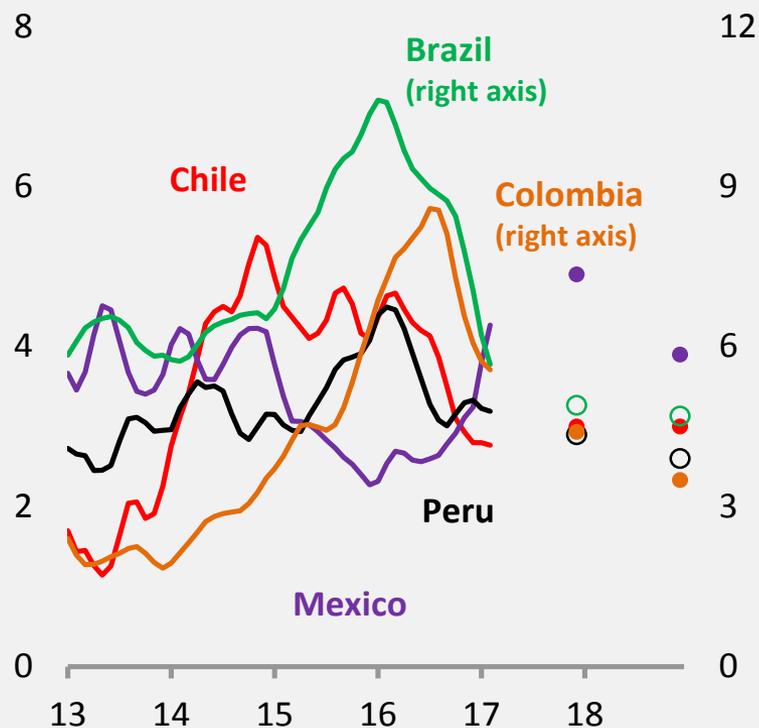


Sources: Central Bank of Chile and National Statistics Institute (INE).

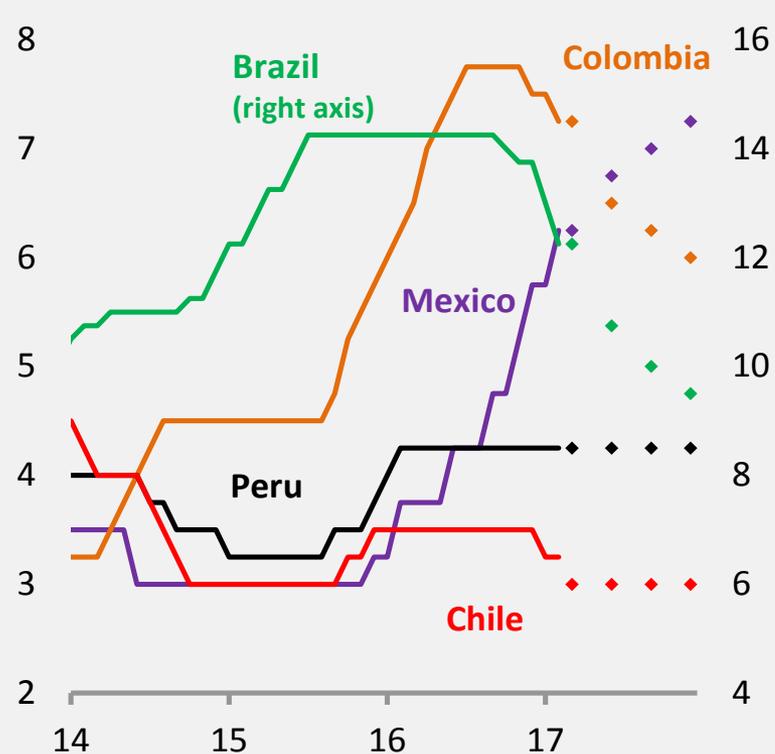


**Exchange rate dynamics have been relevant in the recent decline in inflation in Chile and Latin America in general. This has made room for looser monetary policy in most Latin American economies.**

**Inflation (1)**  
(annual change, percent)



**MPR (2)**  
(percent)

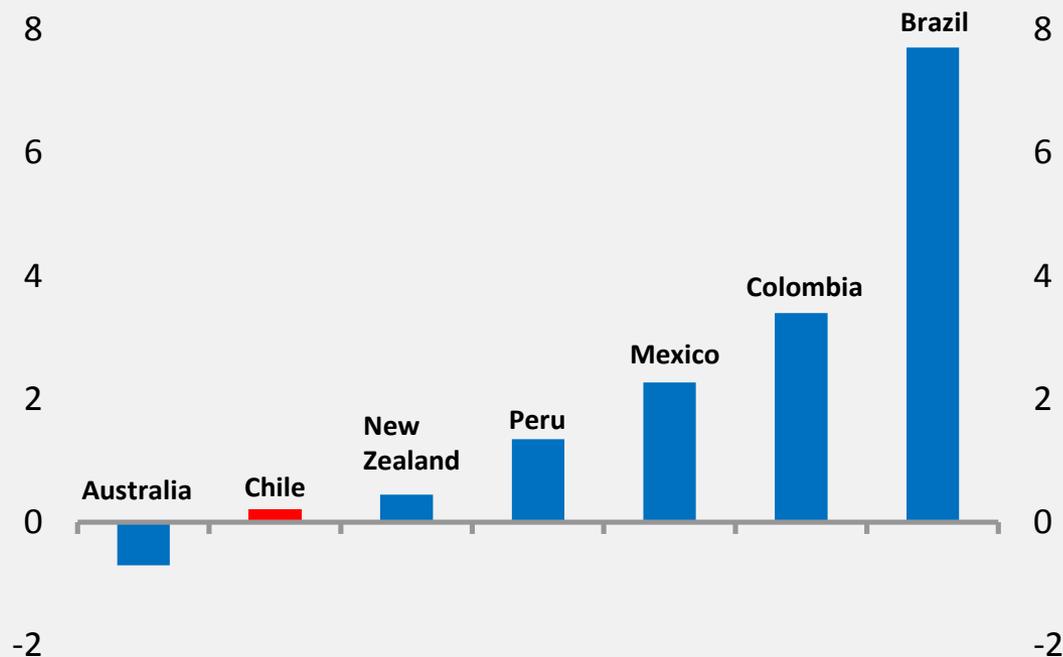


(1) Dots or circles denote forecasts included in February 2017's Consensus Forecasts. (2) Forecasts correspond to the median of Bloomberg surveys of 3 March 2017. For Chile, the Economic Expectations Survey of February 2017 is used. Sources: Central Bank of Chile, Bloomberg and Consensus Forecasts.



# Chile's monetary policy will continue to be one of the most expansionary comparable economies.

Real MPR (\*)  
(percent)



(\*) Calculated as the current MPR minus expected inflation one year out.  
Sources: Central Bank of Chile and the central banks of the respective countries.

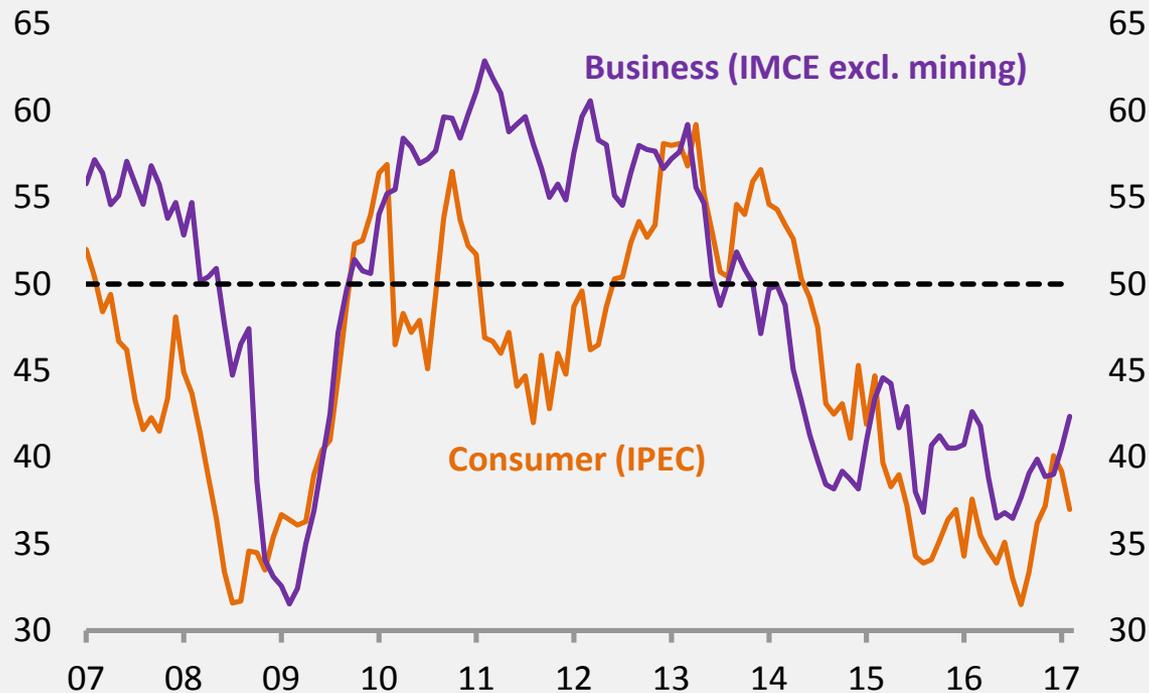


# Challenges Ahead



# The business environment has been less conducive to growth; consumer and business confidence have remained low since 2014

## Business and consumer expectations (\*) (index)



(\*) Value above (below) 50 denotes optimism (pessimism).  
Sources: Adimark and Icare/Universidad Adolfo Ibáñez.



**While there is a valid dispute on the economic impact of recent tax and labor market reforms on business investment, a number of other developments under way may help improve productivity and efficiency in the near future**

**New Energy Policy, prompting record investment in unconventional renewable energy projects, a more diversified energy matrix and lower energy costs**

**Legal amendments broadening the portfolios of institutional investors, deepening long-term capital markets**

**Reform of the governance structure of financial regulation, including the creation of a Financial Stability Council under the Ministry of Finance**

**Reforms on payments systems to increase financial inclusion and foster competition in supportive transaction infrastructures**

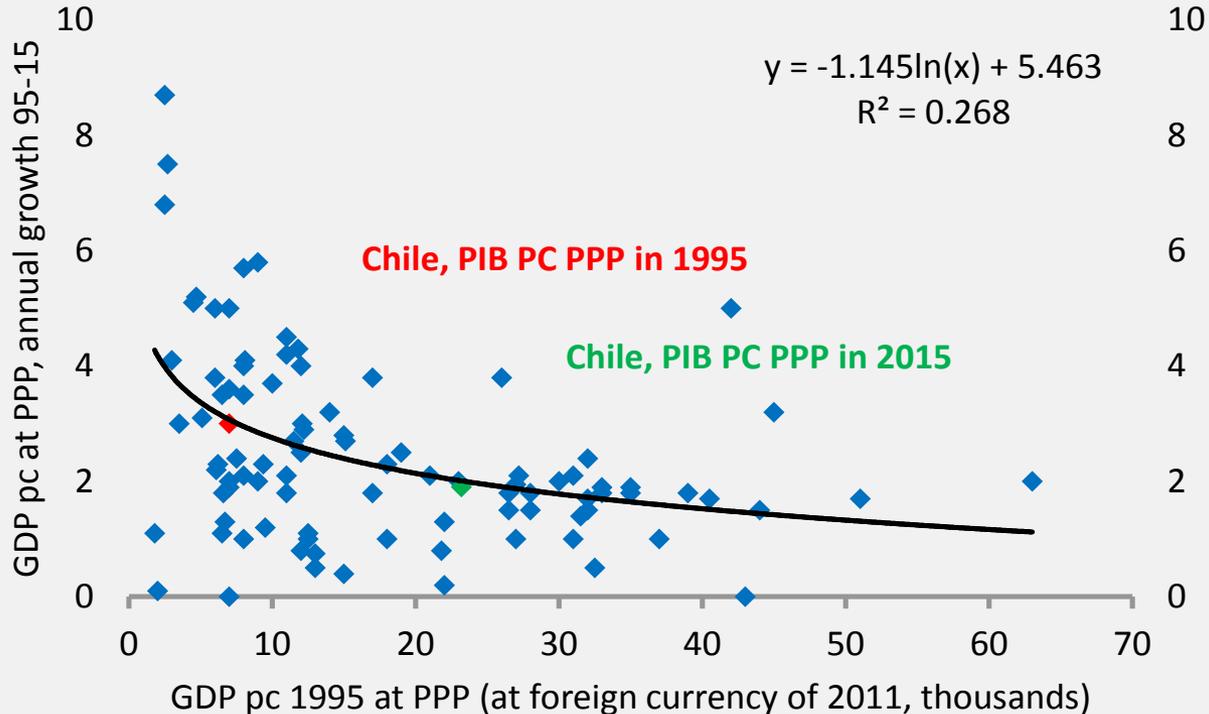
**Forthcoming banking bill to adopt Basle III capital regulations**

**Creation of an Infrastructure Fund and overhaul of governance arrangements to foster PPPs**



# Potential growth estimates do not differ significantly from what is statistically associated to Chile's current level of development

## GDP growth and per capita income (\*)



Source: Central Bank of Chile on the basis of a sample of 100 middle income countries.



# So there is a range of possibilities for Chile's economic growth in the coming years

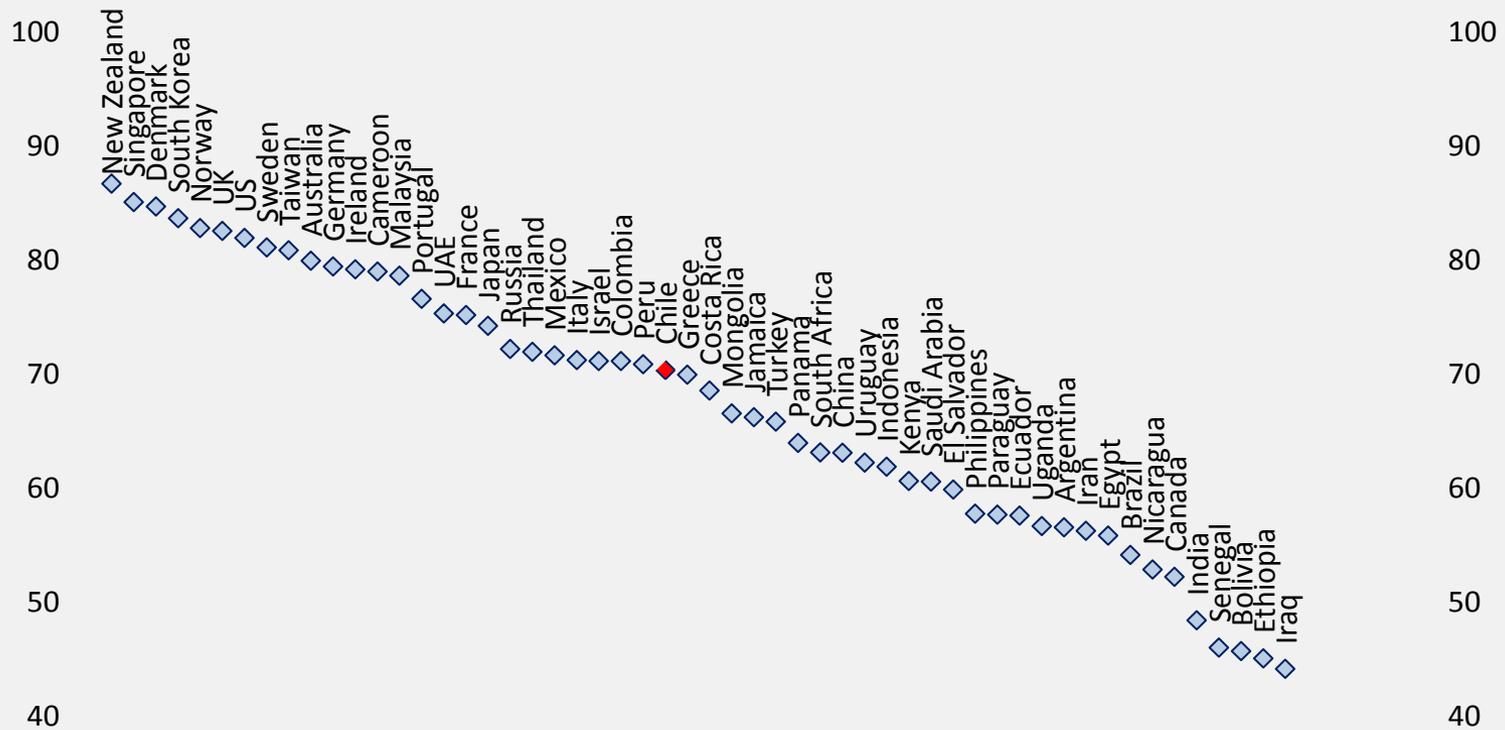
## Alternative growth scenarios

| Benchmark                                                              | Average annual growth |                                                                                                                                 |
|------------------------------------------------------------------------|-----------------------|---------------------------------------------------------------------------------------------------------------------------------|
| Actual GDP 2014-2016                                                   | 1.5-2%                | Declining inventories; improving external conditions; countercyclical macro policies                                            |
| Potential GDP                                                          | 2.5%-3%               | Resource reallocation; working capital; efficiency gains; improving expectations                                                |
| Trend GDP                                                              | 3.2%                  | Private and public investment returning to historical ratios; long-term capital available                                       |
| Trend GDP with "normal" investment ratios                              | 3.5%                  | Growing human capital; R&D investment; reduced transaction and compliance costs; economic diversification; enhanced competition |
| Trend GDP with feasible improvements in productivity and human capital | 3.5%-4%               |                                                                                                                                 |



# Areas for improvement: regulation and transaction costs

## Regulatory frontier



Source: Doing Business, World Bank 2015.



# Final Remarks

**Chile does not face any acute constraints to grow. Macroeconomic policy has been accommodative and can remain so on the basis of the financial, institutional and social capital accumulated over the years**

**However, one should not forget that Chile has become more of a mature economy, with a potential for growth that is lower than 20 years ago and tougher political and social challenges**

**These challenges create policy dilemmas whose response from authorities may impact growth in one direction or another. Chile is also exposed to the demands that enhanced transparency and higher social standards impose on institutions**

**Committed leadership and solid institutions remain key in moving forward in the development path**



# The Chilean Economy: Recent Developments and Coming Challenges

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