



# Prospects and fundamentals of the Chilean economy

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# Topics

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- The Macroeconomic scenario
- Prospects and fundamentals of the Chilean economy (financial resilience)
- Final thoughts



# Introduction

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- The Chilean economy recovered quickly from the global crisis of and from the damages of the earthquake/tsunami of February 2010. Last year growth was 5.2%, this year expected growth is in the range of 6.25% to 6.75%.
- The recovery of output has coincided with high job creation and a decline in unemployment.
- Inflation has returned to figures close to the 3% target.
- For 2012, the current forecast for growth lies between 4.25% and 5.25%, with inflation close to 3%.
- This, in a context of significant risks to the global economy that are not expected to disappear any time soon.
- Policy tools are available to mitigate the adverse effects of the external scenario. Furthermore, the financial system is sound, and therefore should not amplify the shocks.



# Macroeconomic scenario



# The global macro scenario

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- The current international macroeconomic scenario depends critically on the evolution of the sovereign debt crisis in the Euro-zone and its repercussions on the European financial system.
- Moreover, economic activity in the developed world has lagged forecasts, in a context of fears about the possibility of a double-dip recession, or of growth remaining slow for a long time.



# In the last MPR, trading partners growth was revised downward.

## World growth (annual change, percent)

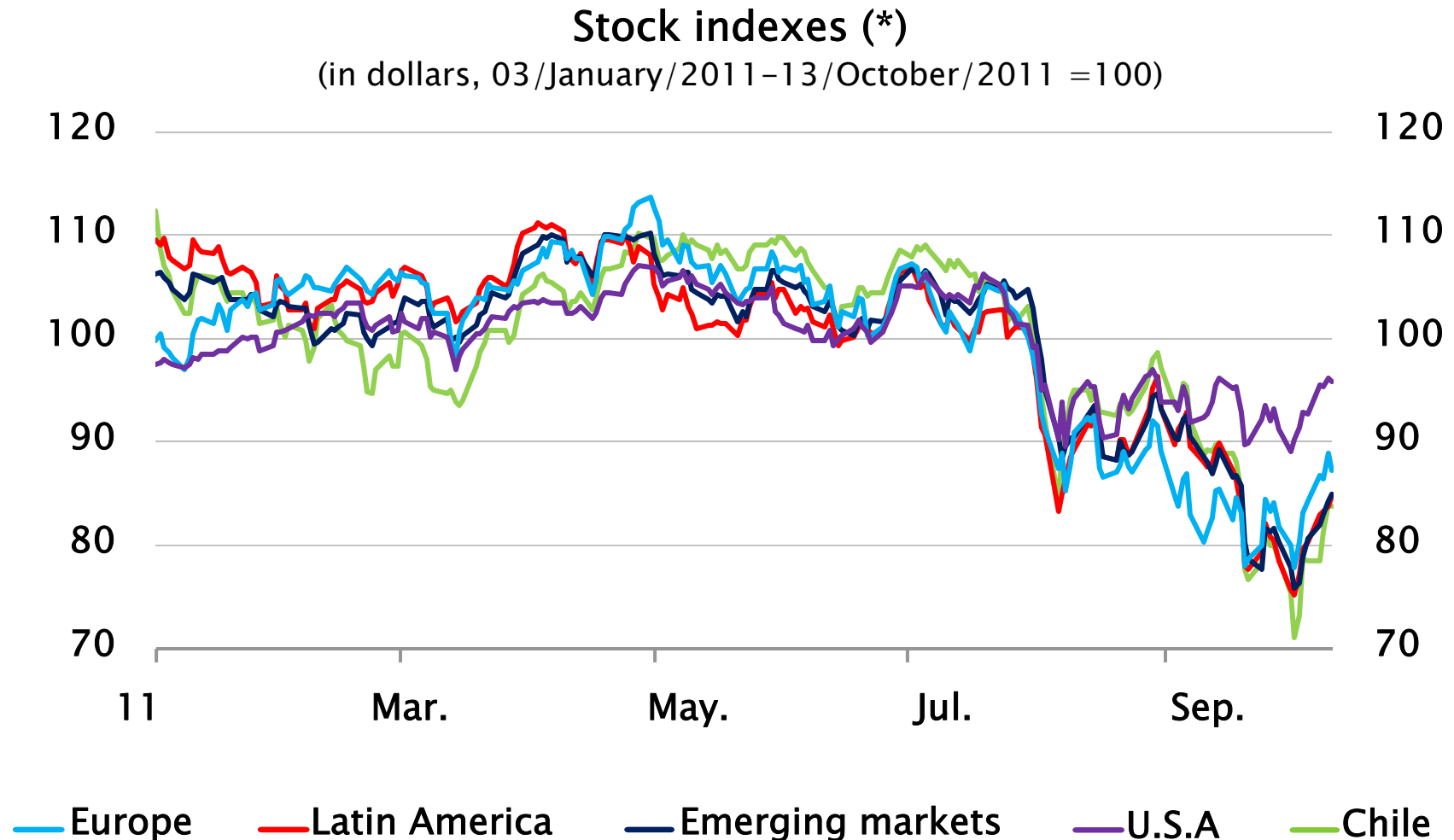
	Average 00-07	2009	2010	2011 (f)			2012 (f)			2013 (f)
				MPR Jun. 11	MPR Sep. 11	WEO Sep. 11	MPR Jun. 11	MPR Sep. 11	WEO Sep. 11	MPR Sep. 11
World at PPT	4.2	-0.6	5.0	4.1 ▼	3.9	4.0	4.5 ▼	4.0	4.0	4.5
World at MER	3.2	-2.1	3.8	3.2 ▼	3.0	3.0	3.8 ▼	3.3	3.2	3.7
United States	2.6	-3.5	3.0	2.7 ▼	1.6	1.5	3.2 ▼	2.0	1.8	2.8
Eurozone	2.2	-4.1	1.7	1.7 =	1.7	1.6	1.5 ▼	1.2	1.1	2.1
Japan	1.7	-6.3	4.0	-0.6 ▲	-0.5	-0.5	3.1 ▼	2.8	2.3	1.8
China	10.5	9.2	10.3	8.9 ▲	9.0	9.5	8.6 ▼	8.3	9.0	8.7
Rest of Asia	5.1	0.1	7.8	4.8 ▲	4.9	4.9	4.9 ▼	4.5	5.0	5.0
Latin America (excl. Chile)	3.5	-2.0	6.3	4.2 =	4.2	4.5	4.3 ▼	3.9	3.9	4.2
Commodity exporters	3.1	-1.2	2.9	2.7 ▼	2.2	2.0	3.0 ▼	2.5	2.5	3.2
Trading partners	3.6	-0.4	5.9	4.3 ▼	4.2	4.4	4.7 ▼	4.3	4.5	4.6

(f) Forecast.

Source: Central Bank of Chile.



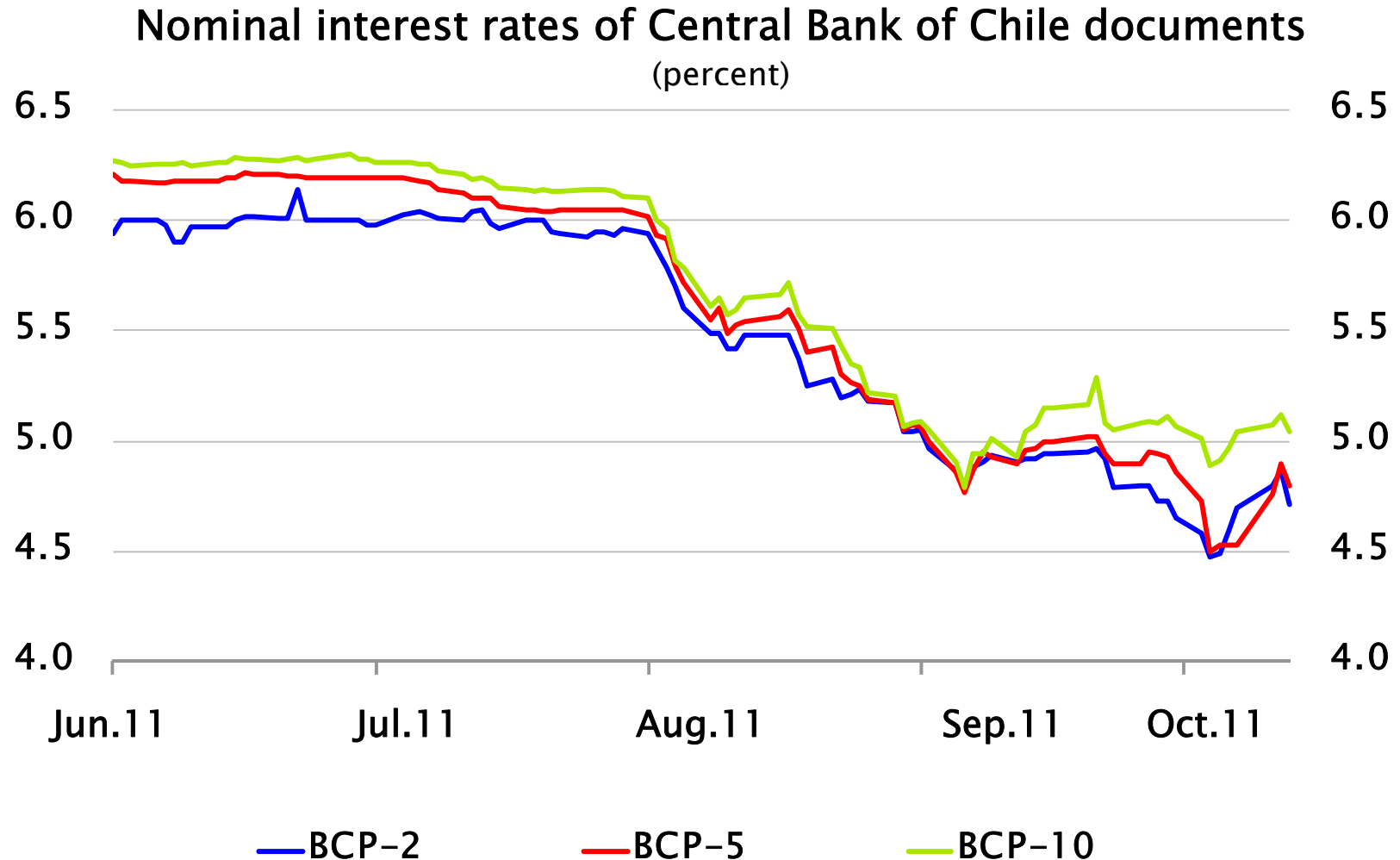
## Recent financial stress has had a significant impact on the Chilean stock market, in line with other emerging economies



(\*) For Europe, Latin America and Emerging markets corresponds to MSCI index. For United States and Chile corresponds to the Dow Jones index and the IPSA index, respectively . Source: Bloomberg.



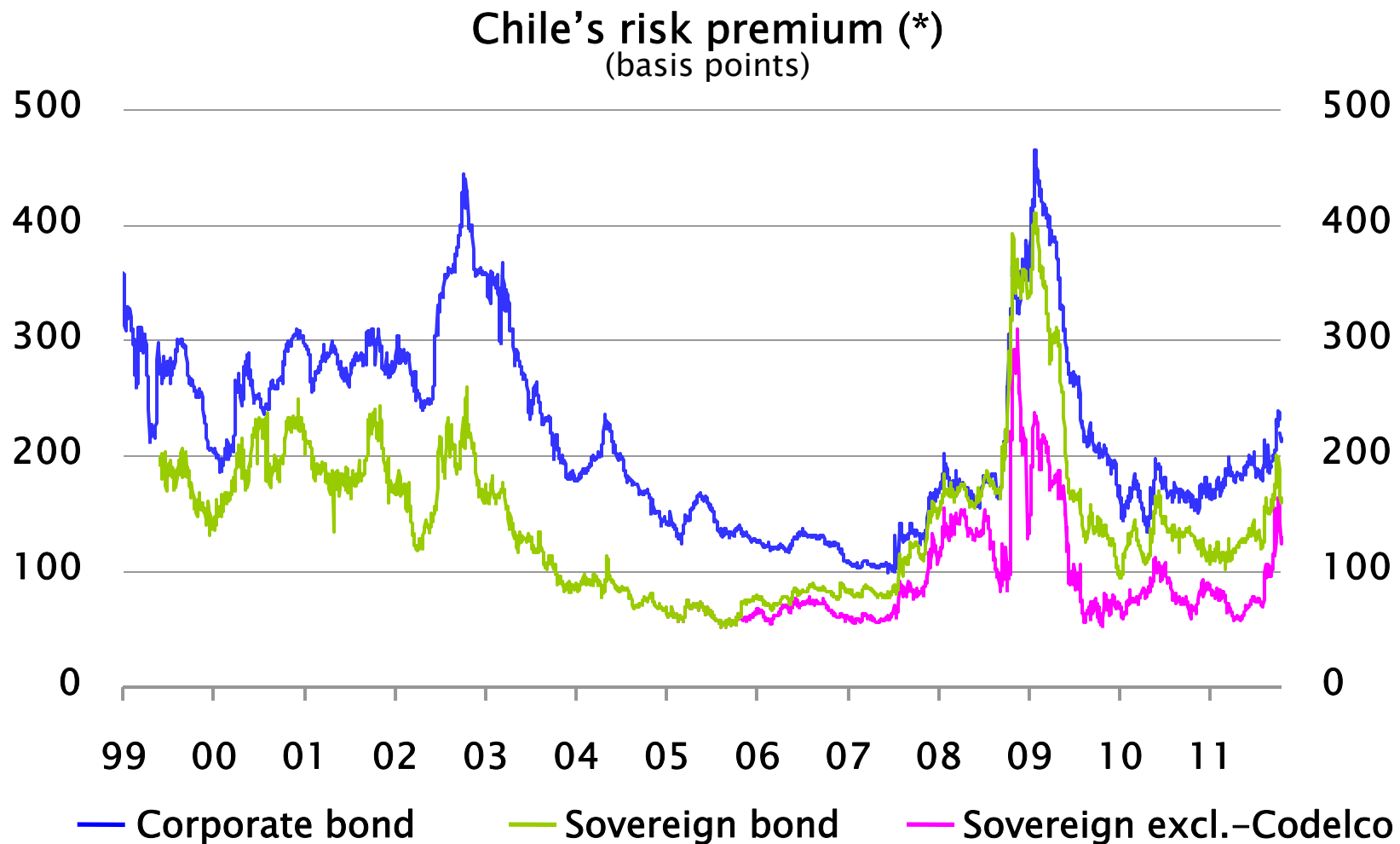
Debt markets have operated normally. Long term interest rates have fallen since the last episode of external turmoil, and the withdrawal of the monetary policy bias.







## The foreign risk premium has risen in recent weeks, although it remains low by historical standards...

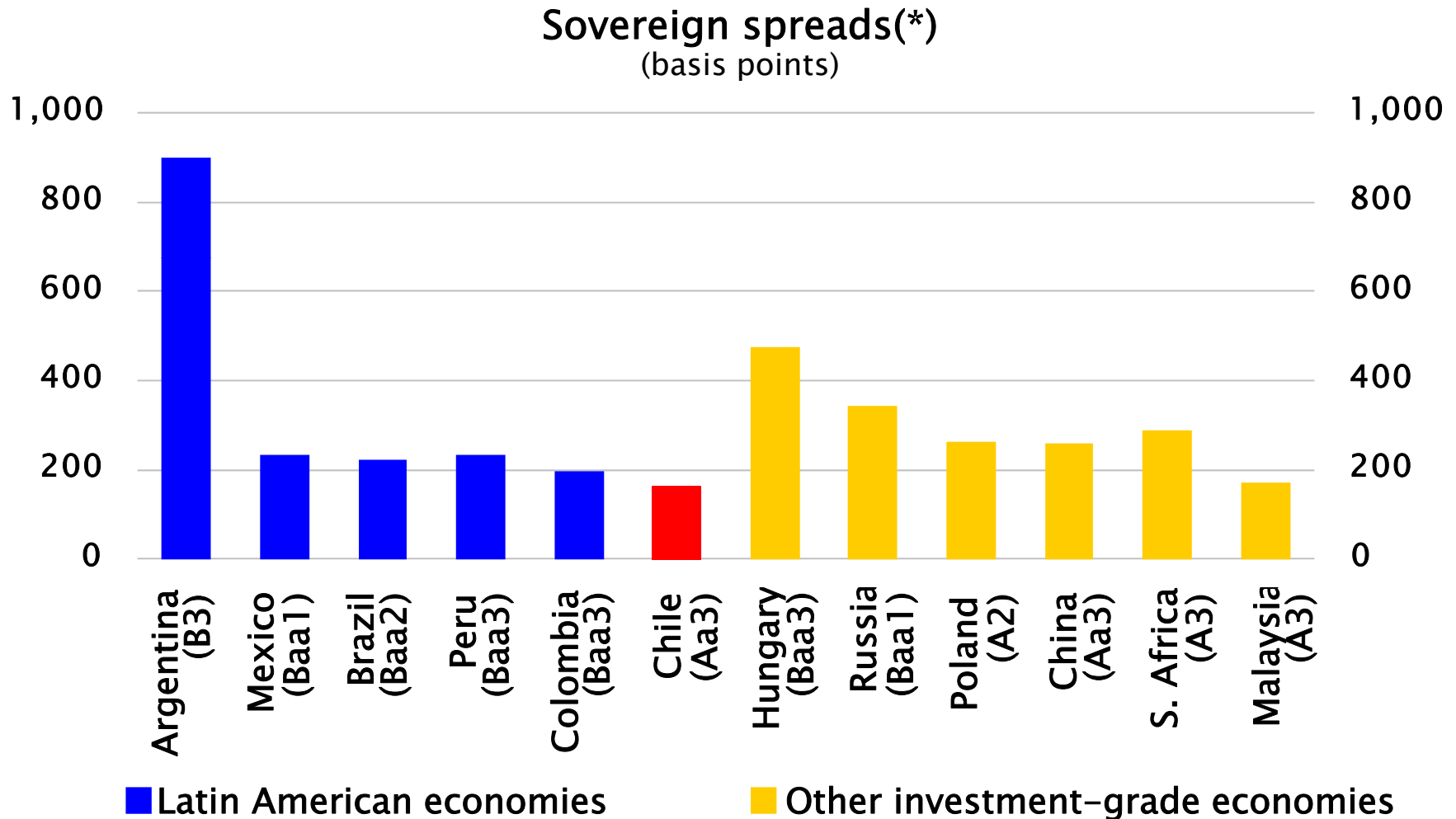


(\*) As from September 2009, Chile's sovereign spread (excluding the copper corporation Codelco) is proxied by Chile's 5-year CDS hedge contracts' spread.

Sources: Central Bank of Chile and JP Morgan Chase.



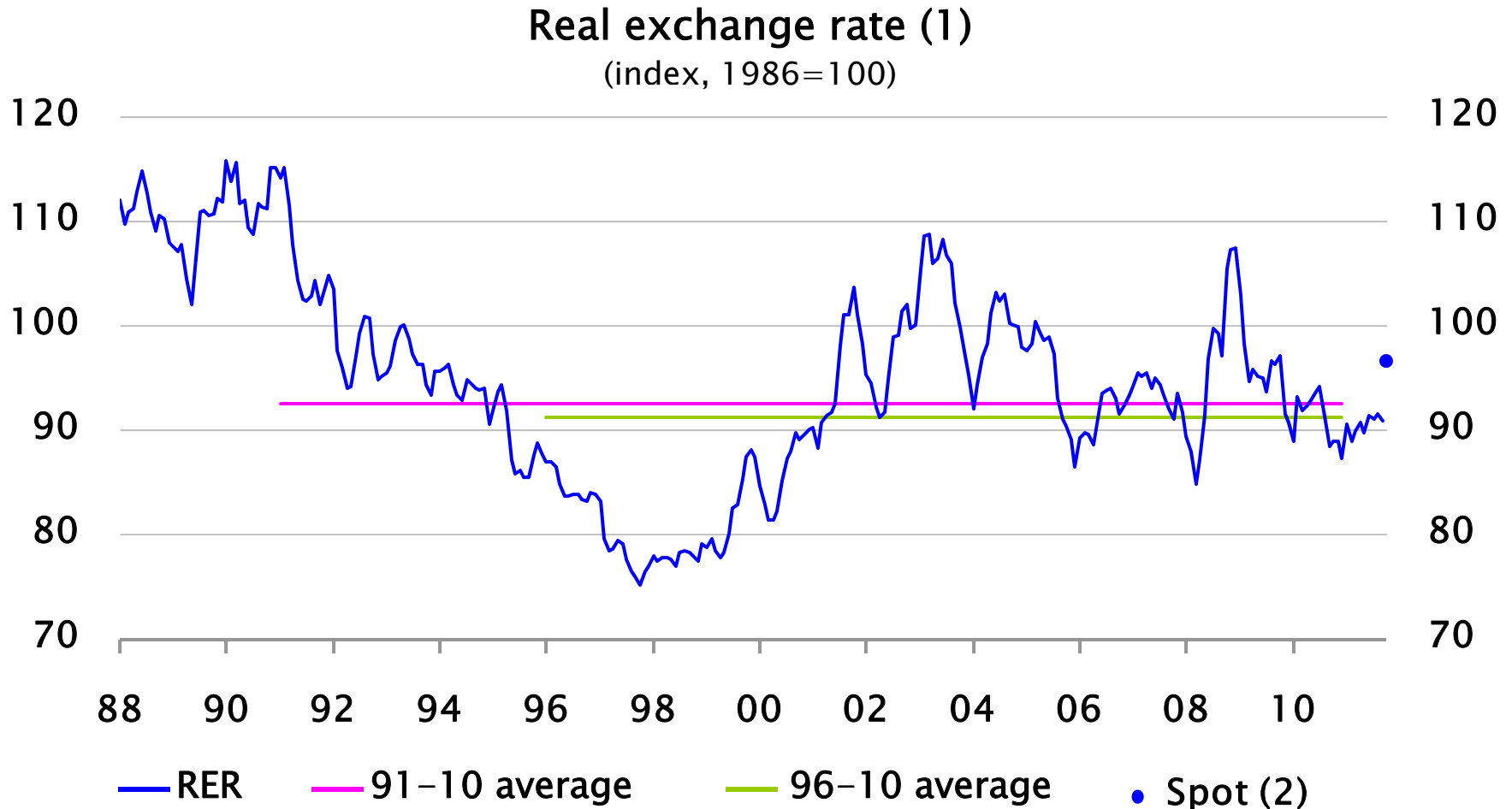
... and compared to other economies in the region or with similar credit rating.



(\*) JP Morgan Chase's EMBI Global. In parentheses, Moody's rating.  
Sources: JP Morgan Chase and Moody's.



Exchange rate volatility has been high. The current levels of the real exchange rate are close to historical averages.

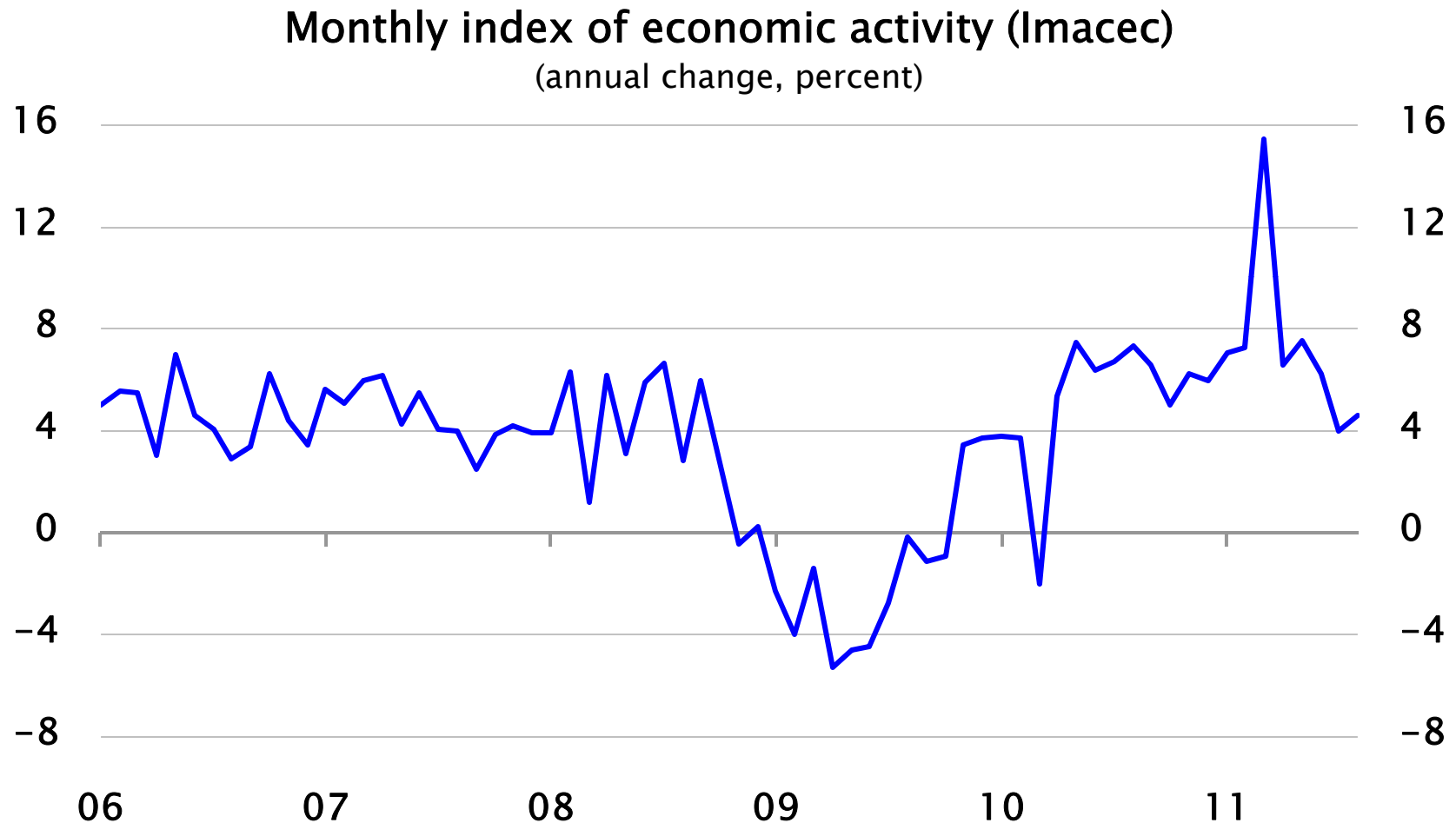


(1) Preliminary for October 2011. (2) Calculated using the observed exchange rate of 11/October/2011.

Source: Central Bank of Chile.



The economy is still growing strongly, and is showing signs of converging toward trend growth rates.





Also, the labor market recovered quickly from the recession of 2009. Employment is posting significant growth rates and unemployment is lower than its historic average.

Employment and unemployment (\*)  
(index, centered on 1990–2011 average)

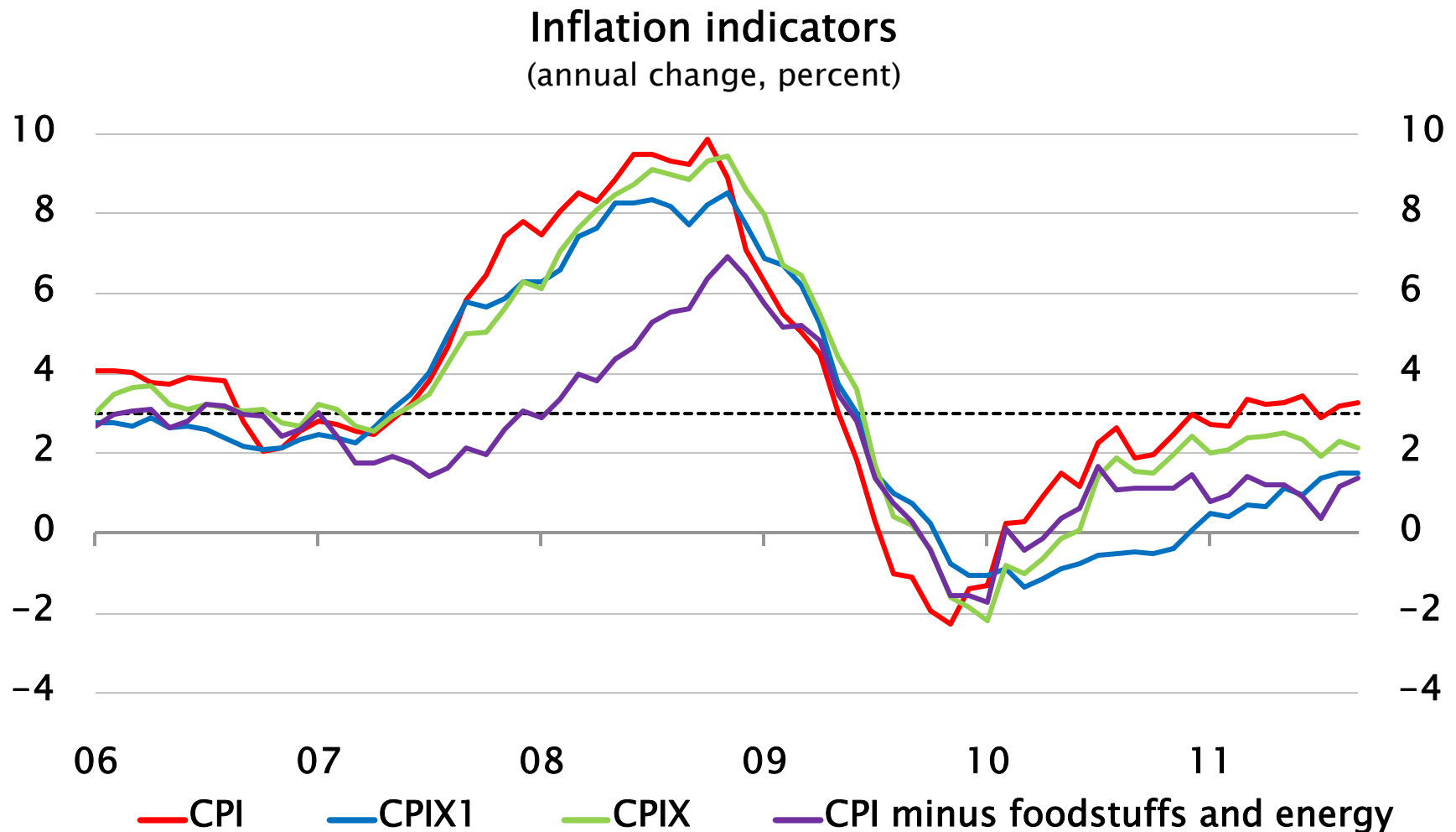


(\*) Seasonally-adjusted quarterly series.

Source: Ricaurte, M. 2011. "Indicadores de Mercado Laboral para la Comparación de las Crisis Asiática y Financiera Internacional." Preliminary document, Central Bank of Chile (June).

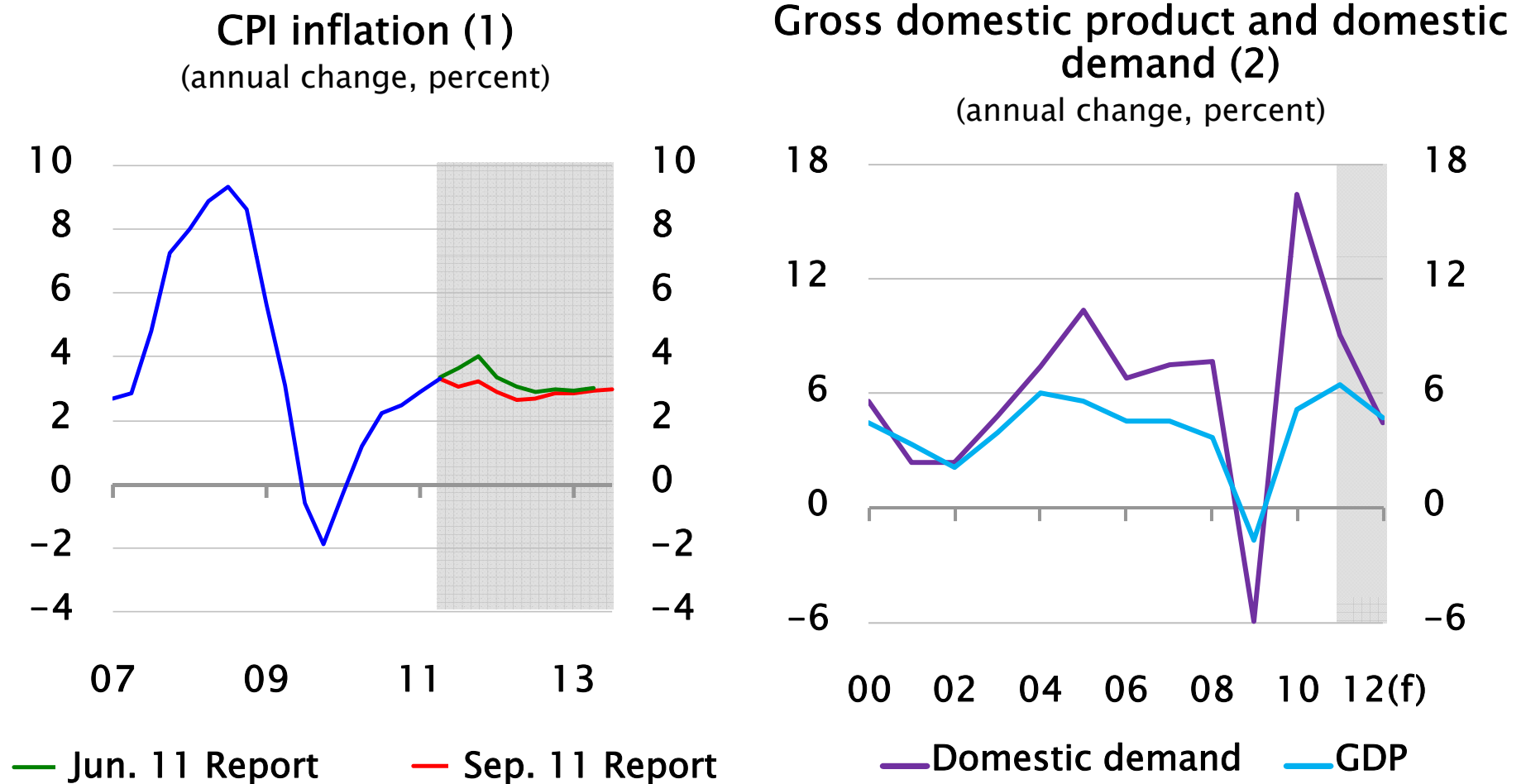


Headline inflation has hovered around 3% (y-o-y), while core measures remain contained. The propagation of external shocks has been in line with projections.





September's Monetary Policy Report assumes that inflation will hover around 3% over the next two years, and that economic growth will approach trend-consistent levels in 2012.



(f) Forecast. (1) Gray area, as from third quarter of 2011, shows forecast. (2) Gray area, as from 2011, shows mid-point of growth forecast in the baseline scenario of September 2011's Report for this and next year. Sources: Central Bank of Chile and National Statistics Institute (INE).



# Prospects and fundamentals of the Chilean economy





**Chile is not immune to external developments, but it has tools with which to cushion their potential impact.**

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- The global scenario is highly uncertain, with non trivial possibilities of outcomes that are significantly worse than our current base scenario.
- However, the Chilean macroeconomic framework has been increasingly effective for ensuring macroeconomic stability when dealing with external shocks.
- Its main elements are:
  - Predictable fiscal policy that safeguards solvency and smoothes expenditure,
  - Monetary policy conducted by an autonomous central bank under an inflation–targeting regime,
  - A flexible exchange rate,
  - Sound financial system with appropriate regulation and supervision.



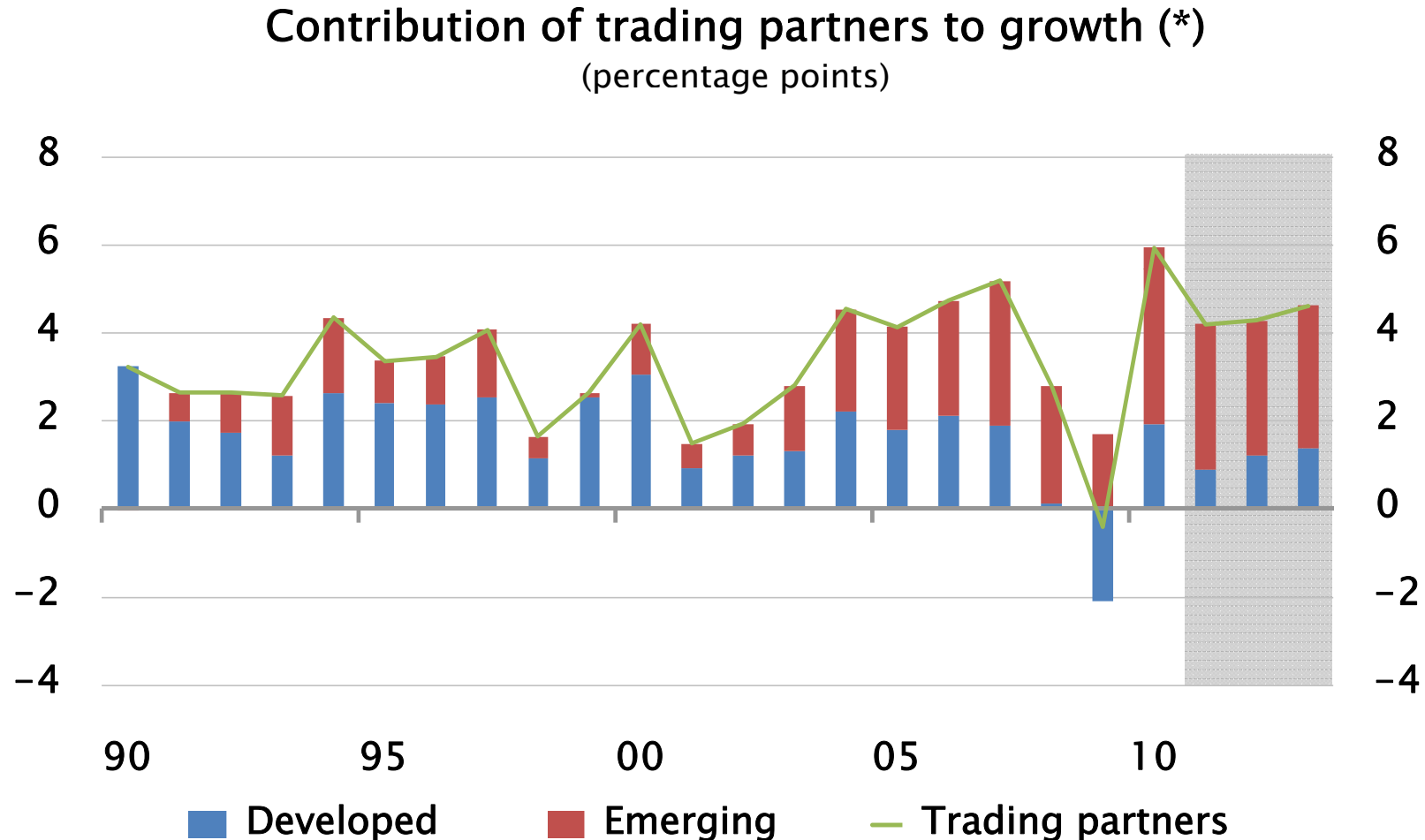
## In terms of financial resilience several factors contribute to mitigating potential shocks...

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- Current public sector debt levels are very low.
- Aggregate foreign liquidity levels have been rising relative to rollover needs.
- Currency mismatches in the bank and corporate sectors are low.
- Bank dependence on foreign financing is limited.
- Recent years have not seen an expansion of corporate leverage or household debt (relative to income).



## Despite downward corrections Chile's trading partners are expected to show high growth in the coming years



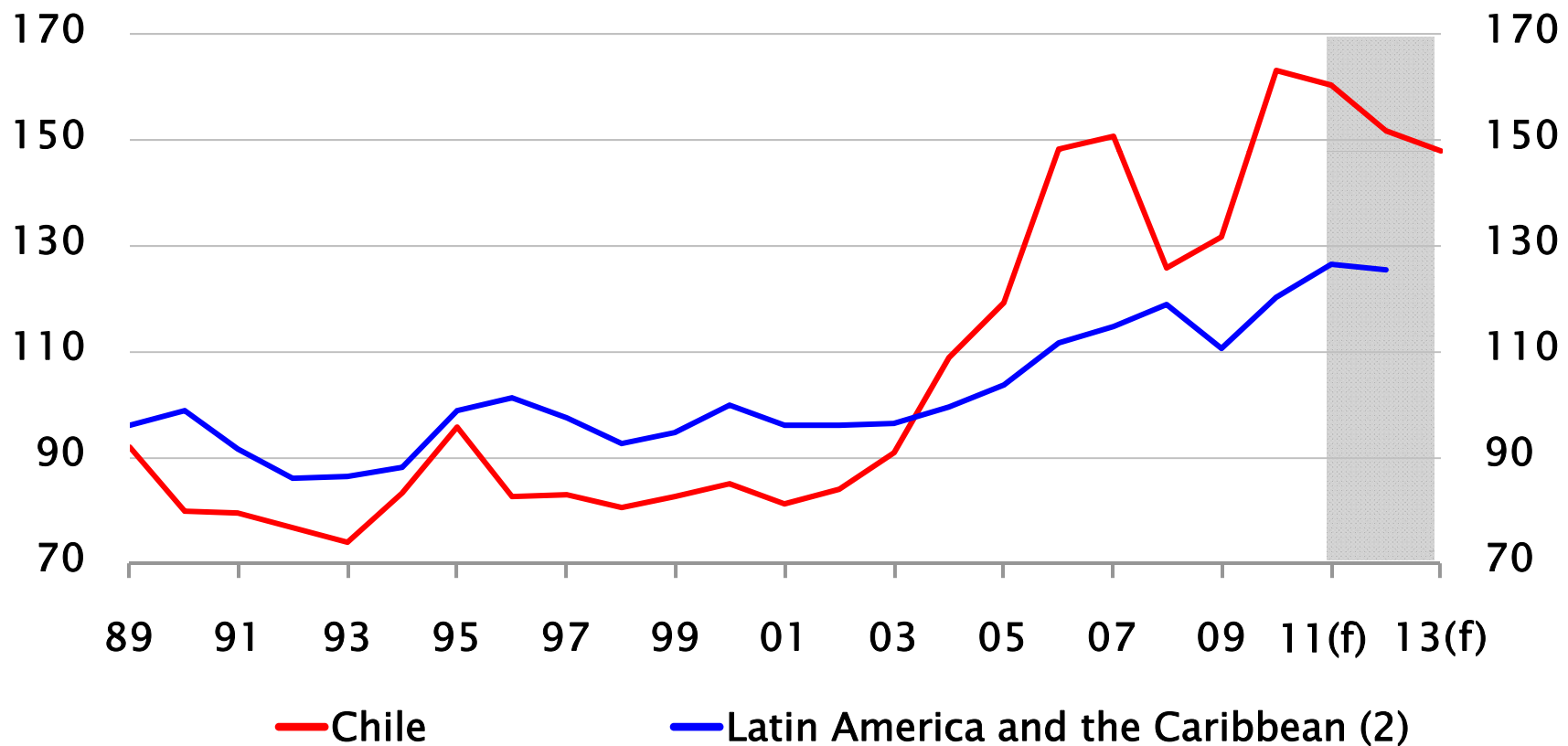
(\*) Gray area, as from 2011, shows forecast.

Sources: Central Bank of Chile based on a sample of investment banks, Consensus Forecasts, IMF and respective countries' statistics bureaus.



Moreover, the terms of trade are still high from a historical perspective and are expected to remain high despite drops in commodity prices.

**Terms of trade (1)**  
(index, 1989–2010 average = 100)

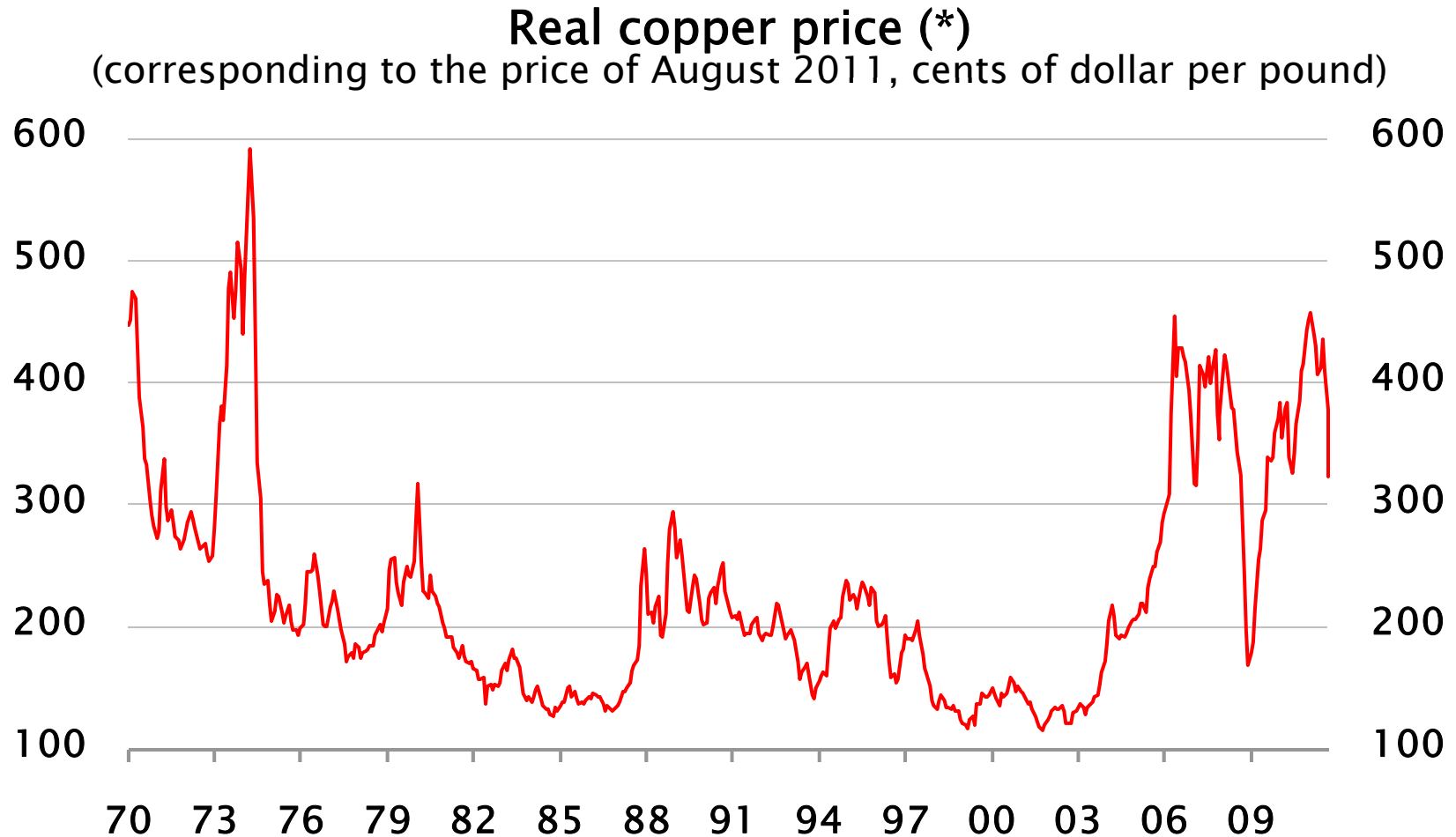


(f) Forecast.

(1) Gray area, as from 2011, shows forecast. (2) Shows terms of trade for the exchange of goods and services. Sources: Central Bank of Chile (Report of September 2011) and IMF.



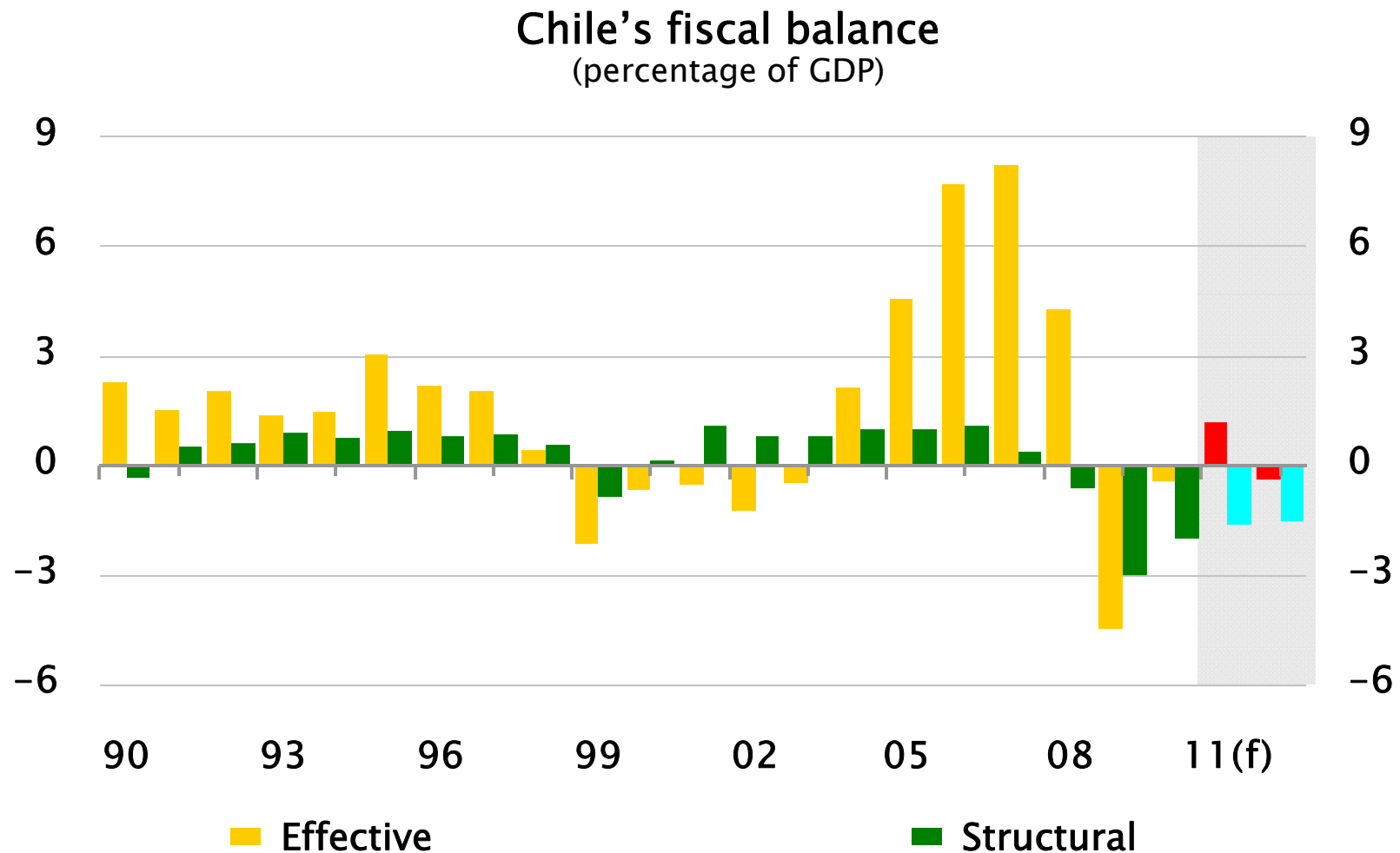
In fact, copper price is still high in real terms from a historical perspective.



(\*) Price at the London Metal Exchange deflated by the US metal PPI. Includes data up to 12/October/2011.  
Sources: Bloomberg and Cochilco.



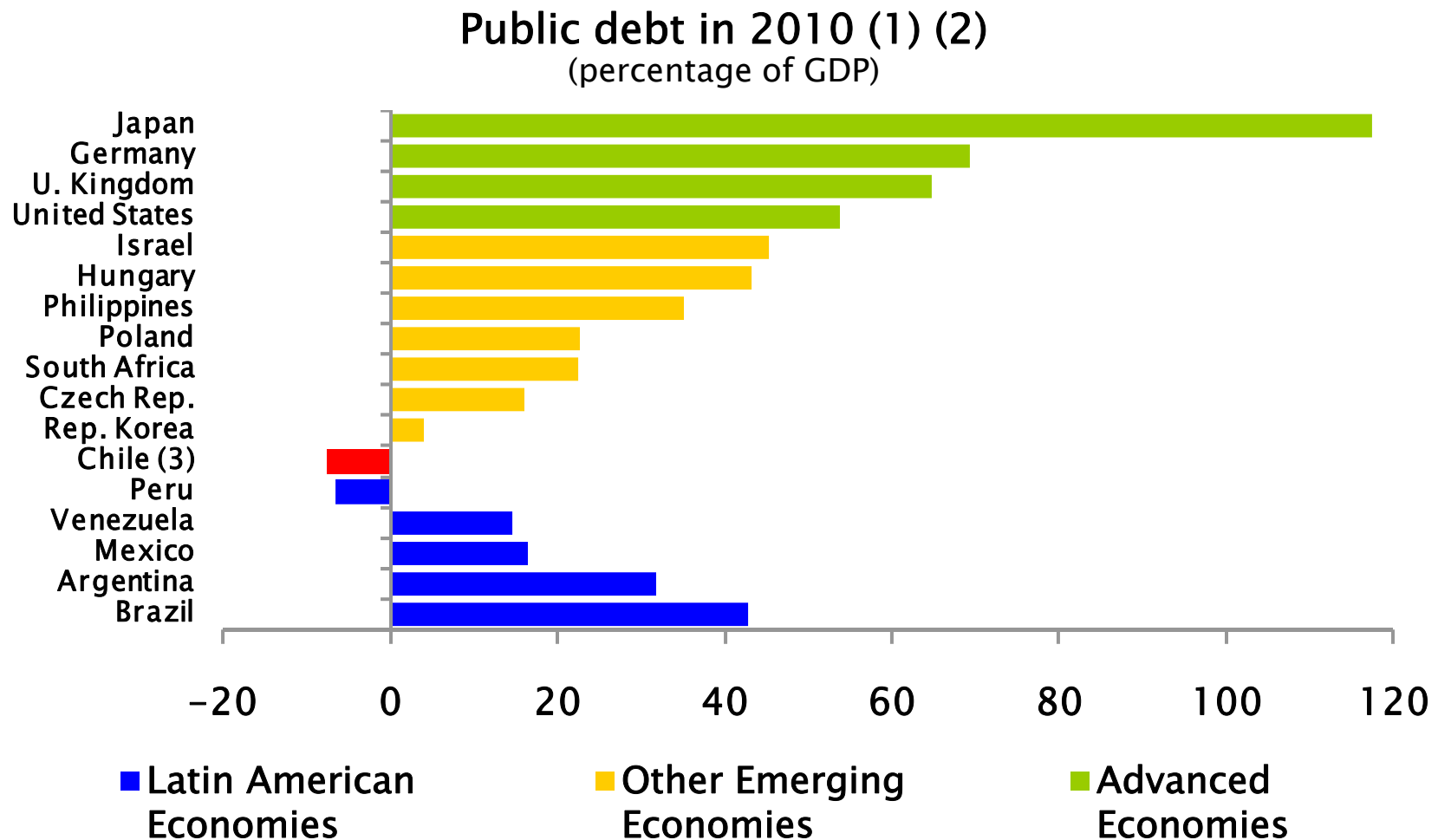
Chile's fiscal situation is favorable, with a structural balance rule that allows saving in good times and spending in bad.



(f) Forecast. Report published by the Finance Ministry in October 2011.  
Source: Budget Office, Finance Ministry of Chile.



Additionally, the Chilean state is a net creditor, which gives it room for action if more complex scenarios arise.



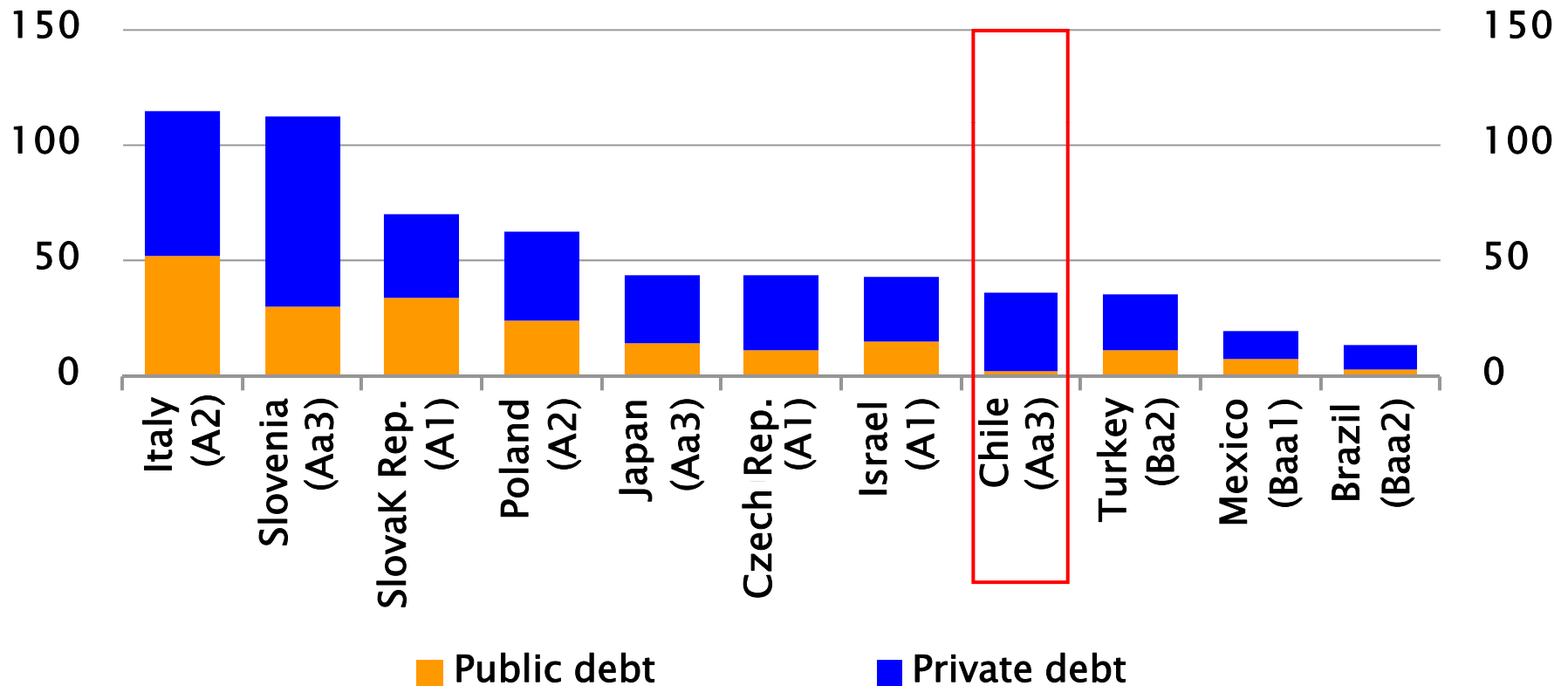
(1) Net debt of central government (excludes reserves, Central Bank debt and social security). (2) Data from emerging economies, except Chile, are Moody's estimates. (3) As of December 2010, the net debt of the central government amounts to -7.5% of GDP.

Sources: Central Bank of Chile, IMF, JP Morgan Chase, Finance Ministry of Chile and Moody's.



The level of the Chilean external debt is also low by international standards.

External Debt: International comparison (1) (2)  
(percent of GDP)



(1) For comparison effects, public debt is defined as the debt of the consolidated government.

(2) External debt as of the first quarter of 2011; GDP of 2011 as forecast by the IMF and Moody's risk rating.

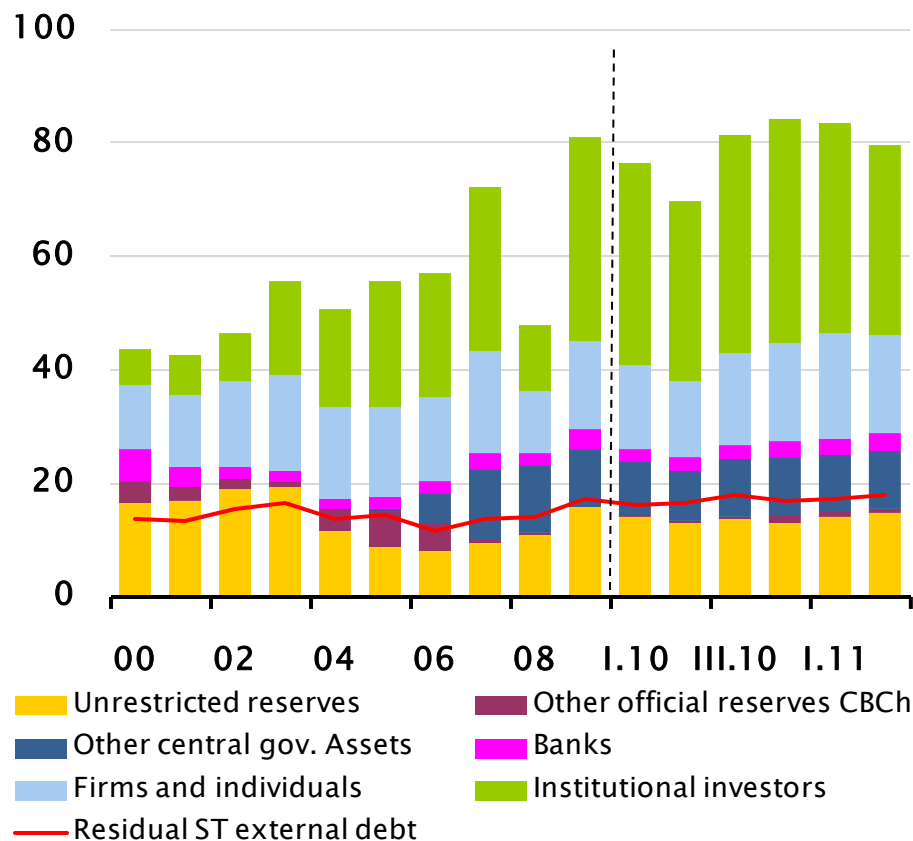
Sources: Central Bank of Chile, World Bank, IMF and Moody's.



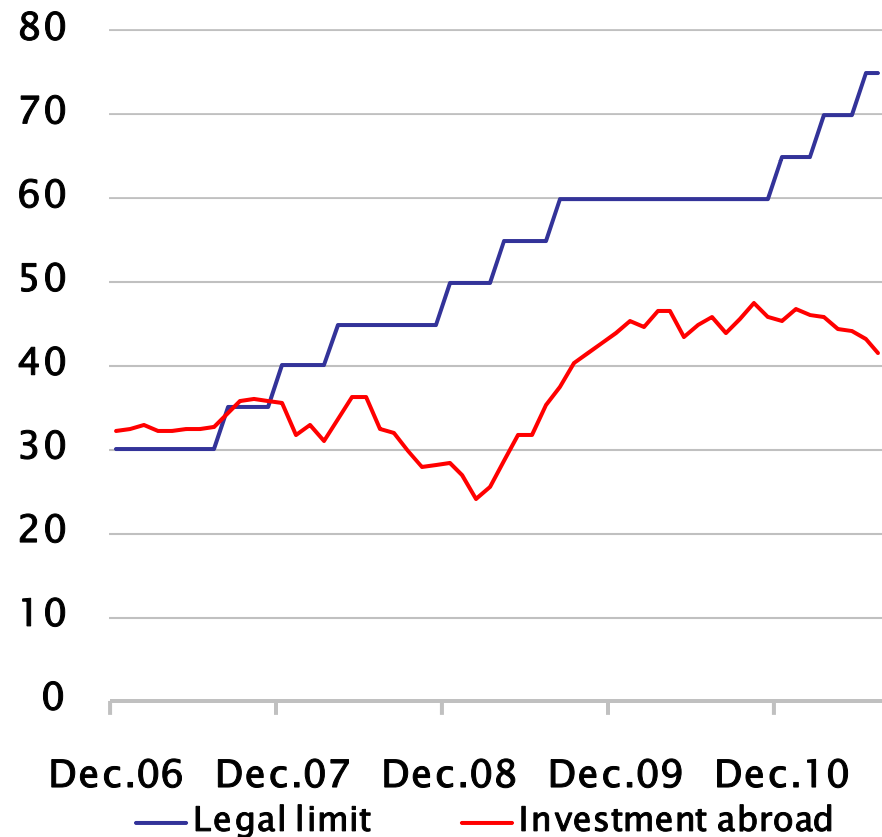


## Public and private sector foreign liquid assets exceed rollover needs. Local investors “retrench” for specific shocks.

Availability of Foreign Liquidity (1)  
(percent of GDP)



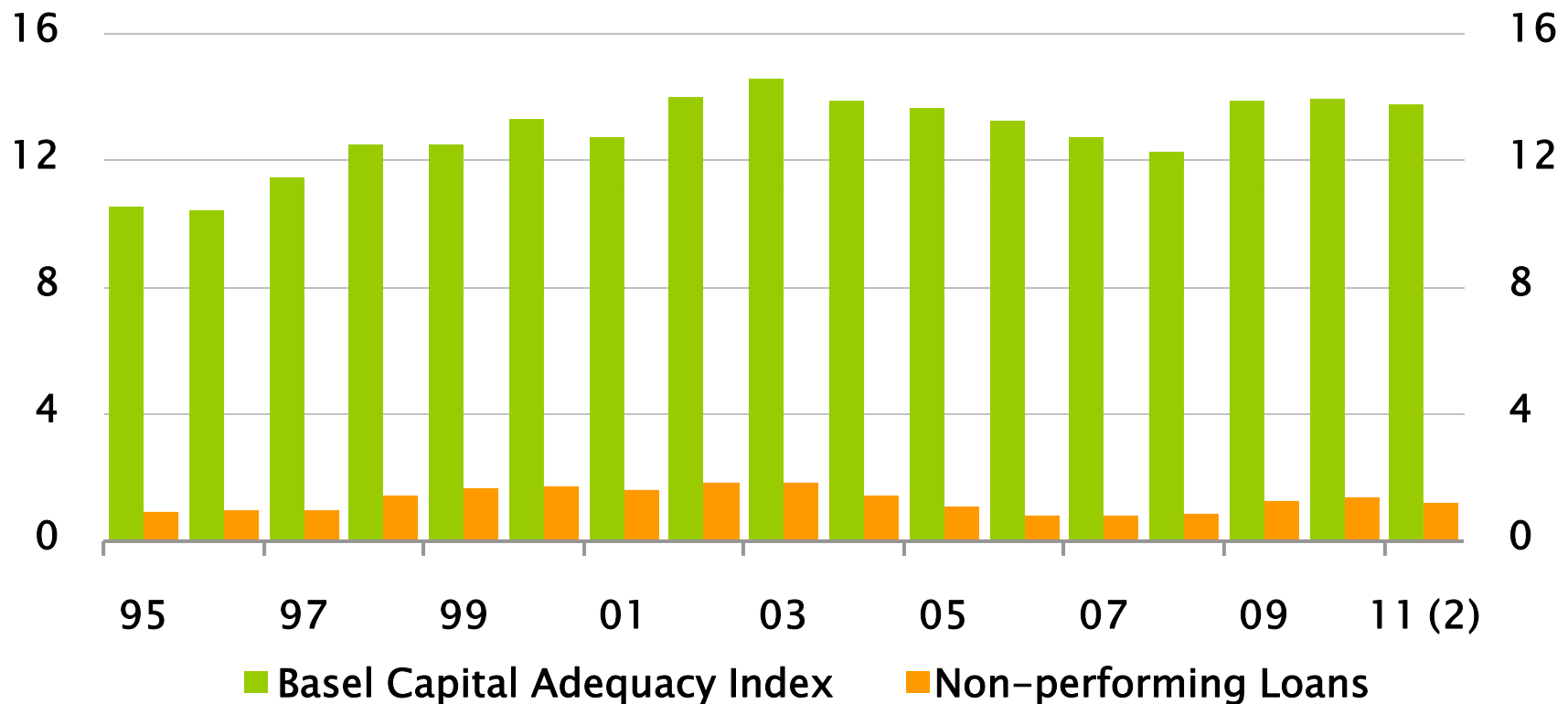
Limits and Investment Abroad by  
Pension Funds  
(percent of assets)





Bank leverage has fallen due to significant capitalization. NPLs remain low.

Banking solvency indicators (1)  
(annual average, percent)

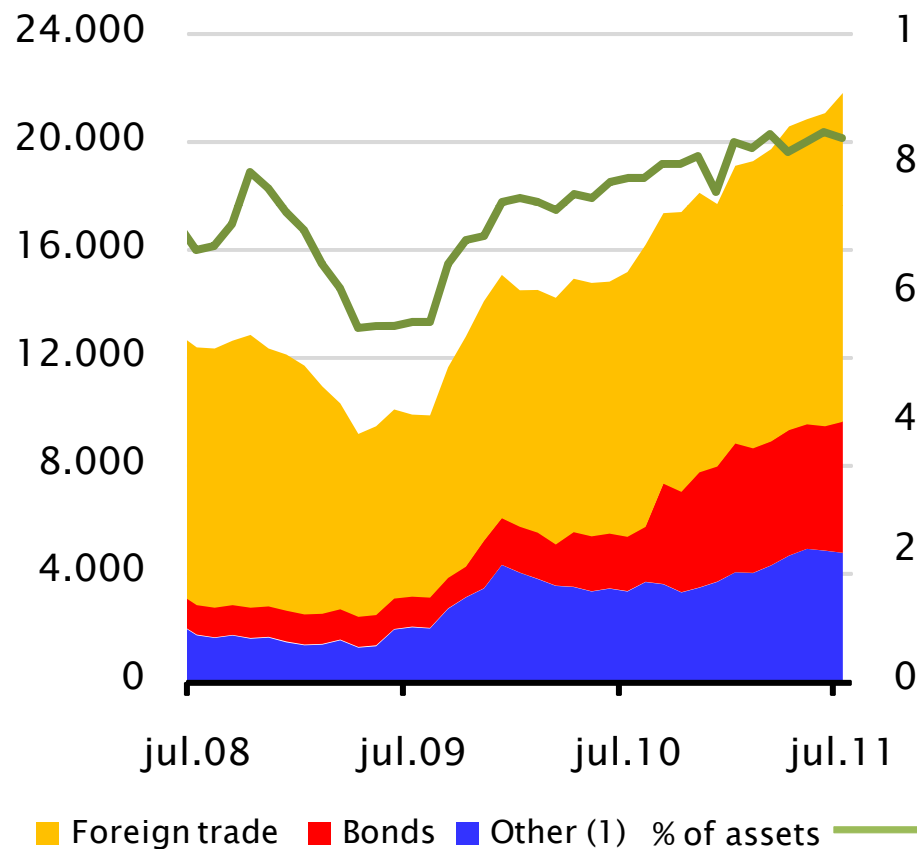


(1) As from January 2008, past-due portfolio data are not strictly comparable with previous figures, because, as part of the plan to converge to international financial reporting standards (IFRS), the banks modified the format of their financial statements. (2) Figures up to June 2011 for the Basel index, and up to August 2011 for past-due portfolio. Sources: Central Bank of Chile and Superintendence of Banks & Financial Institutions (SBIF).

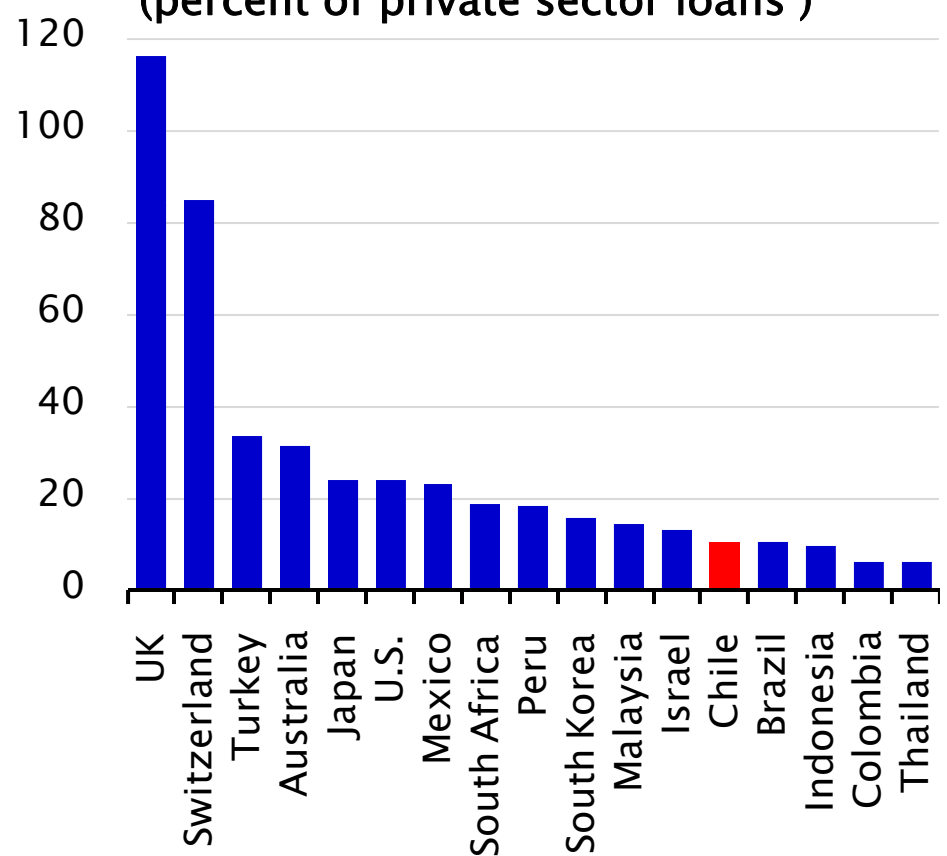


External funding of banks has increased, but is still relatively low.

External funding of the banking system  
(millions of dollars, percent)



Foreign liabilities of the banking  
system (2)  
(percent of private sector loans)



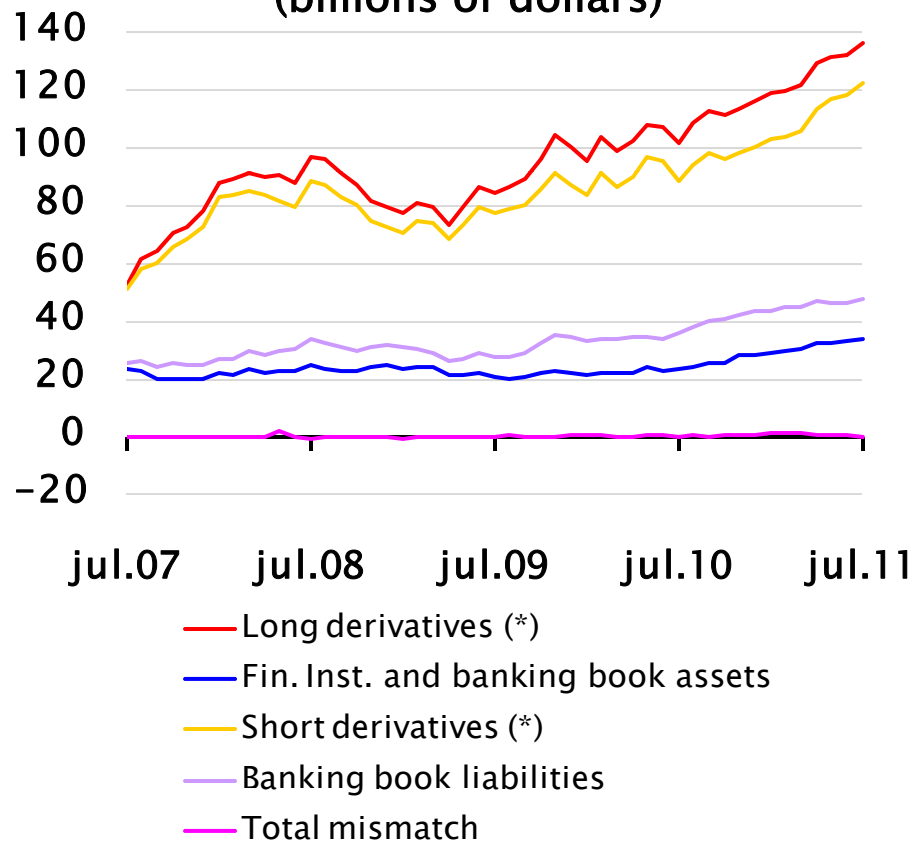
(1) Includes bank credit lines and syndicated loans.

(2) Average from the first quarter of 2008 to the third quarter 2010.

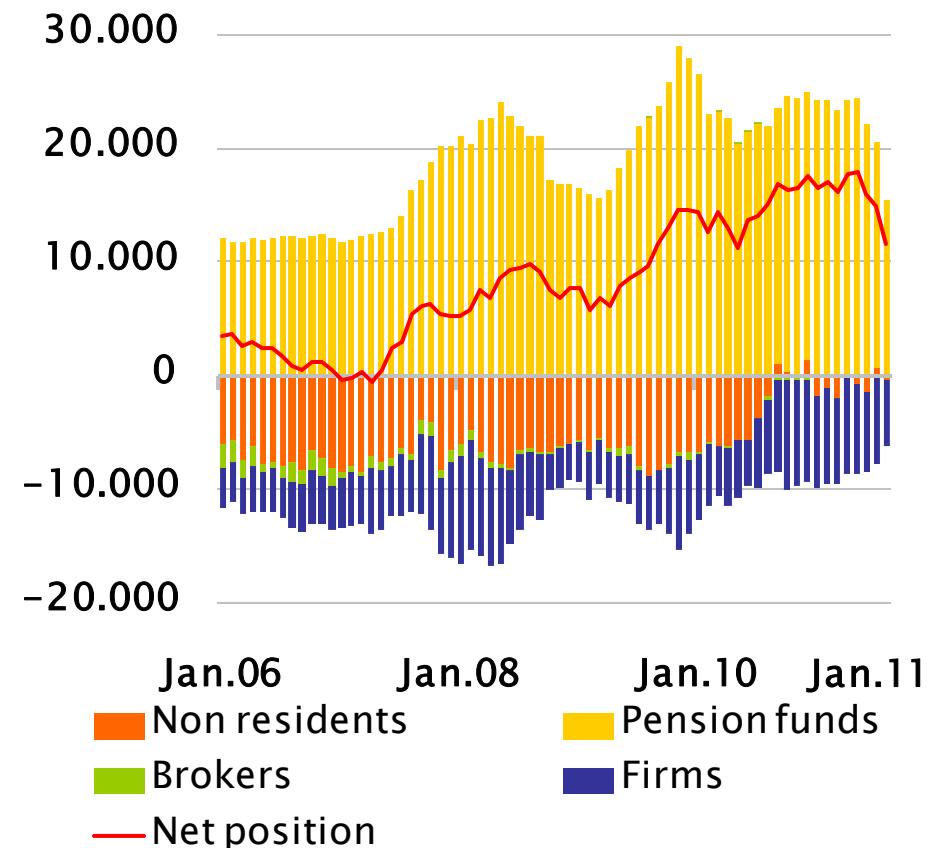


Despite significant fluctuations in currency derivatives, currency mismatches in banks are low.

Foreign currency balance of the banking system  
(billions of dollars)



Net position on foreign exchange derivatives  
(millions of dollars)



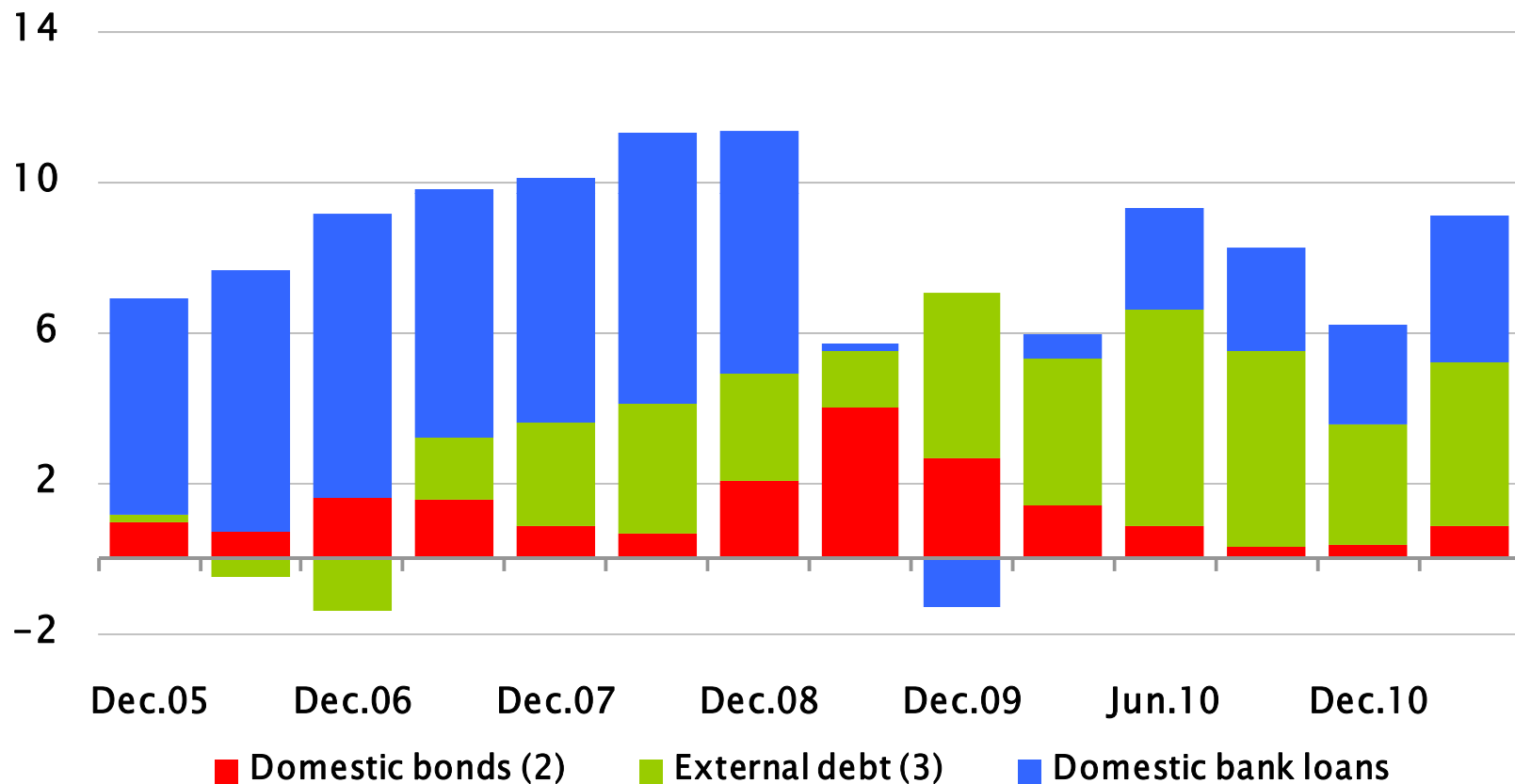
(\*) Includes notional value of foreign currency forwards and swaps.

Source: Central Bank of Chile and SBIF.



## External debt has been a relevant source of firm financing...

Sources of financing of firms  
(contribution to annual growth) (1)



(1) Percentage points. (2) Corporate bonds (except Codelco), securitized with commercial papers and nonbank assets.

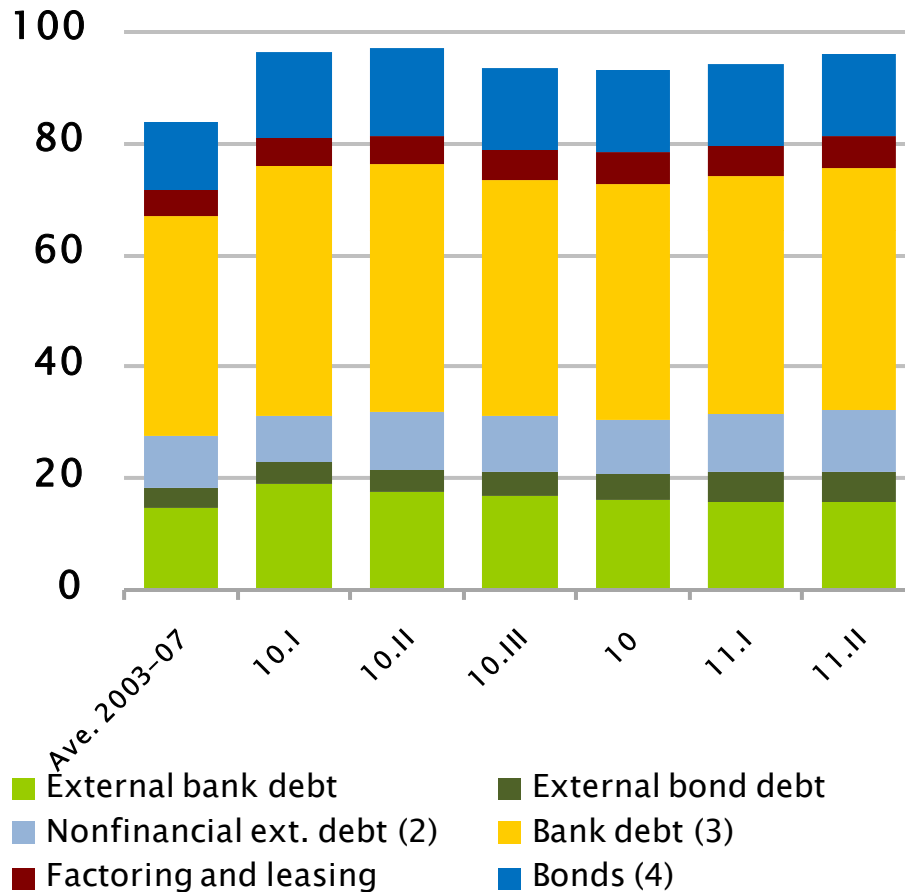
(3) Includes foreign direct investment loans. Converted to pesos using the average exchange rate in the period from 2002 to March 2011.

Source: Central Bank of Chile, based on data from Achef, SBIF, and SVS.



# In the corporate sector most leverage and liquidity indicators have remained stable

**Total debt of corporate sector (1)  
(percent of GDP)**



**Financial indicators of corporate sector (5)**

	Average 2003-07	2009 IV	2010 IV	2011 I
	(times)			
(-) Indebtedness (6)	0.88	0.95	0.89	0.84
(+) Interest coverage ratio (7)	11.70	12.29	10.95	8.62
(+) Acid test (8)	2.03	2.21	2.24	2.39
	(percentage)			
(+) ROA (9)	9.05	9.37	9.63	9.12

(5) Data from percentile 75 of registered firms in SVS, excluding mining sector. Consolidated financial statements.

(6) Financial debt to equity.

(7) Operating flow to financial expenses.

(8) Current assets net of inventory to current liabilities.

(9) Return on Assets.

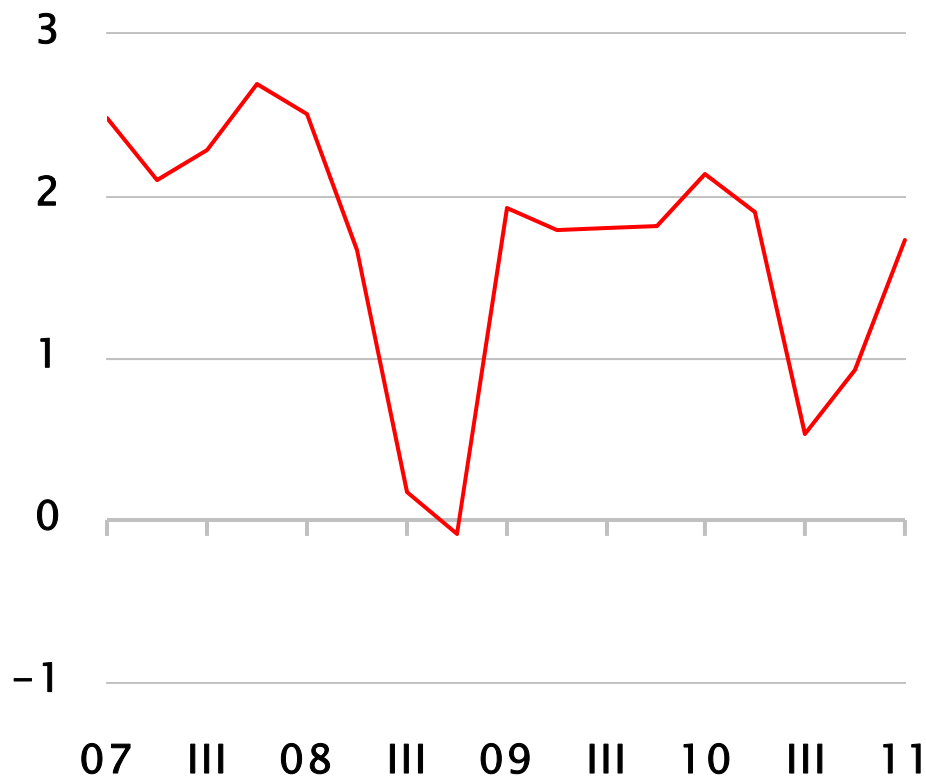
(1) Total debt of nonfinancial firms. (2) FDI-related loans and commercial loans. (3) Commercial and foreign trade. (4) Corporate bonds (excluding Codelco), securitized bonds with nonbank underlying assets, and commercial papers.

Sources: Central Bank of Chile, Achef, SBIF and SVS.

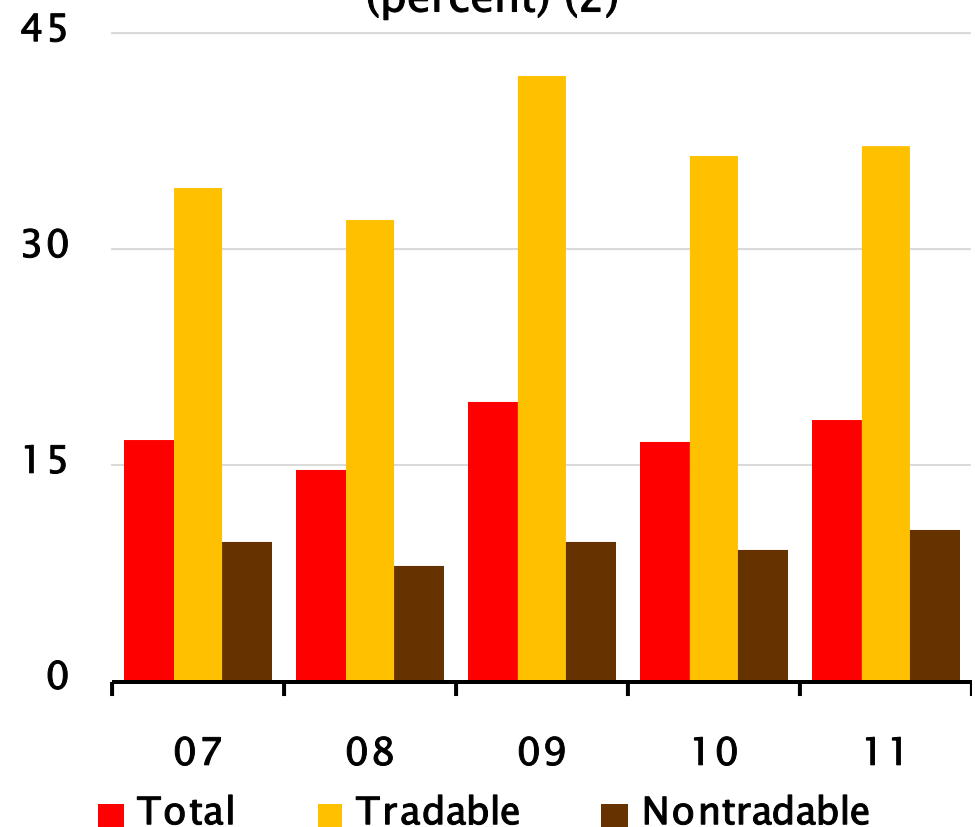


Currency mismatches remain stable and resident bank foreign currency debt largely to tradable sector. Foreign debt data for non listed firms suggest similar pattern.

**Currency mismatches**  
(percent of total assets) (1)



**Banking domestic debt in foreign currency / Total banking debt**  
(percent) (2)

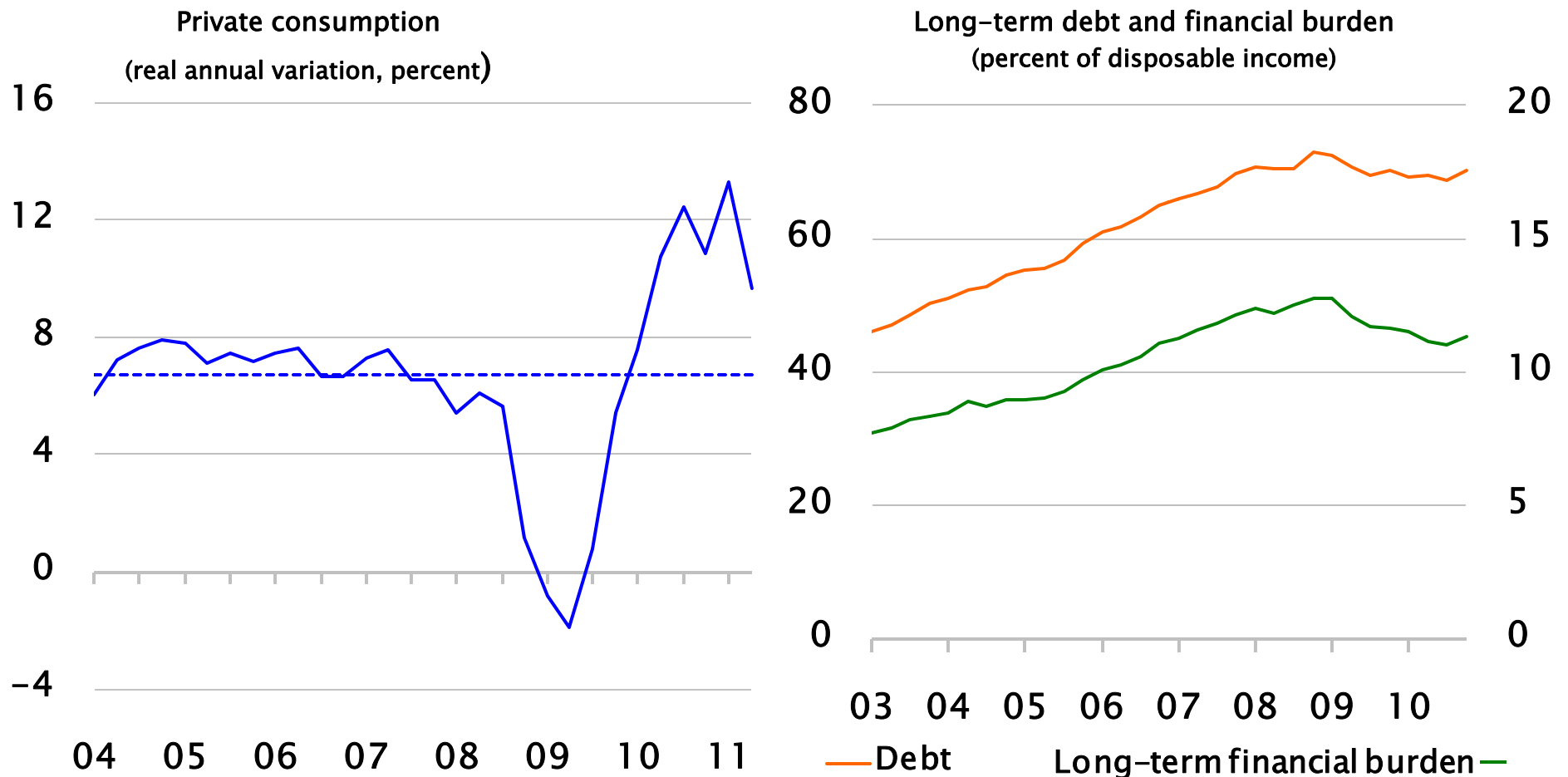


(1) Dollar liabilities less dollar assets, less the net derivatives position over total assets. Asset-weighted average of an average sample of 190 firms.

(2) Data updated to February of each year.



## Consumption recovery reduces growth rates. Households financial burden is stable







## Final thoughts



## A complex global scenario...

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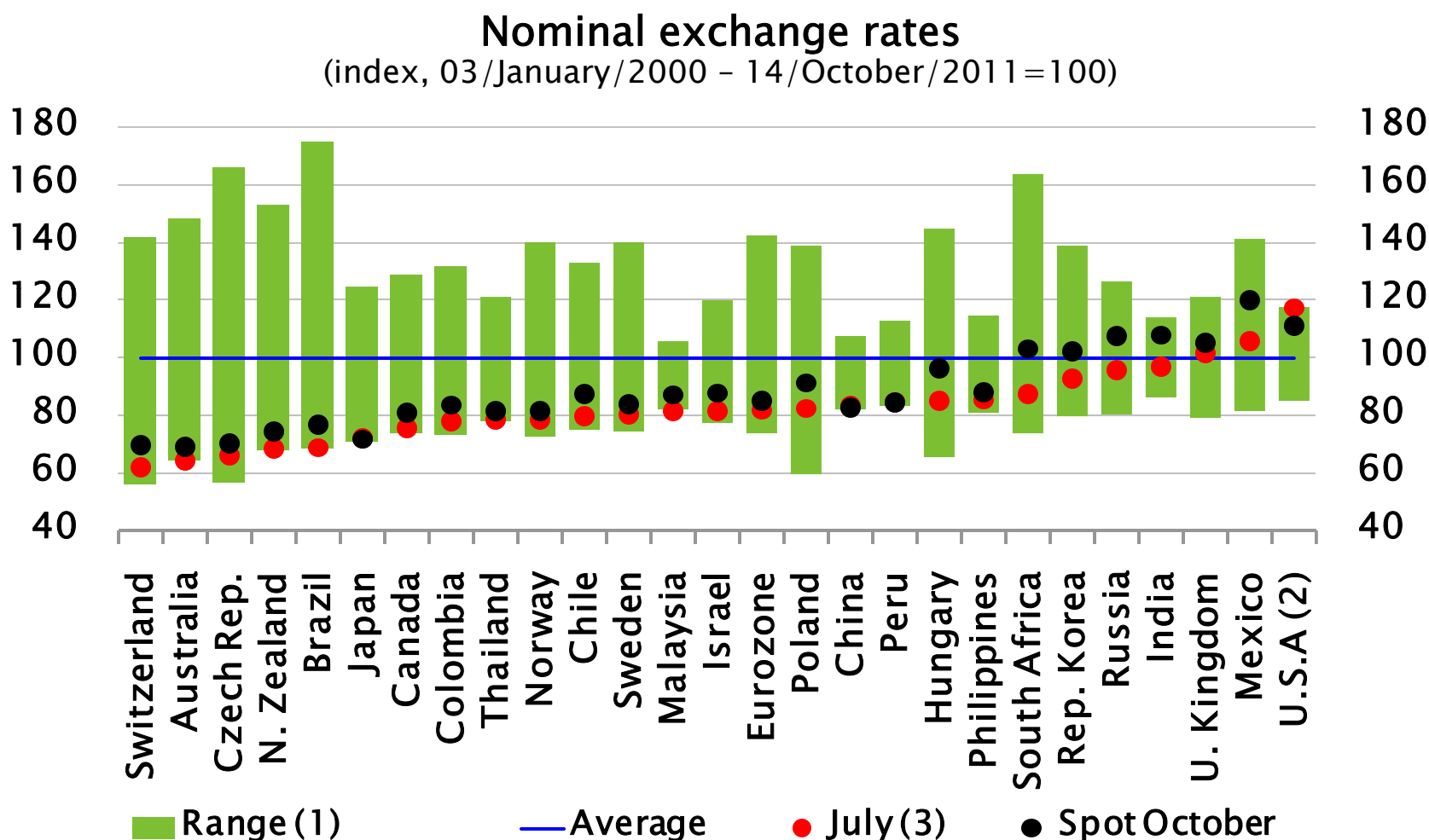
- Risks to the external scenario are significant. Today they are primarily in Europe, but there could be important repercussions on emerging economies.
- Several “technical” solutions exist. The implementation of these solutions is extremely challenging.
- In Chile there is space to act both on the fiscal and monetary front.
- Overall the financial sector is robust. Recent steps have been taken to strengthen the detection of risks and coordinate responses (CEF).



# Prospects and fundamentals of the Chilean economy



Emerging and commodity-exporting countries have been subject to pressures to appreciate their currencies, although somewhat less recently.



(1) The range indicates the highest and lowest values of the local currencies during the indicated period. (2) Uses the *Broad* index. (3) Data for 27 July 2011.  
Sources: Central Bank of Chile and Bloomberg.