

Summary

Chile's economy continued to grow vigorously in 2011, although growth slowed somewhat in the course of the year. The latter is welcome, as the economy was close to overheating. For example, unemployment is now very low by Chilean standards, while the current account has fallen into deficit. Faced with a decline of the external environment, the central bank has recently cut its policy rate. After large scale protests and strikes, most students have returned to their classrooms. However, the protests illustrate that after a long period of economic growth and moderate social policies, Chile's social model continues to face challenges. Although Chile has the best educational system of Latin America, social mobility remains low, while poverty and inequality remain relatively high. Meanwhile, partially due to the protests, the Piñera government has become even more unpopular.

Things to watch:

- Copper prices
- New student protests

Author:

Herwin Loman
Country Risk Research
Economic Research Department
Rabobank Nederland

Contact details:

P.O.Box 17100, 3500 HG Utrecht, The Netherlands
+31-(0)30-21-31105
H.Loman@rn.rabobank.nl

Chile			
National facts		Social and governance indicators	
Type of government	Republic	Human Development Index (rank)	rank / total 44 / 187
Capital	Santiago	Ease of doing business (rank)	39 / 183
Surface area (thousand sq km)	756	Economic freedom index (rank)	11 / 179
Population (millions)	17.1	Corruption perceptions index (rank)	22 / 183
Main ethnic groups	White, white-Amerindian(95%) Mapuche (4%)	Press freedom index (rank)	33 / 178
Main religions	Roman catholic (70%) Evangelical (15%) Jehovah's Witnesses (1%)	Gini index (income distribution)	52.3
Head of State (president)	Sebastián Piñera Echenique	Population below \$1.25 per day (PPP)	2.00%
Head of Government	Sebastián Piñera Echenique	Foreign trade	
Monetary unit	peso (CLP)	2010	
Economy		2010	
Economic size		Main export partners (%)	
	<i>bn USD</i>	<i>% world total</i>	Main import partners (%)
Nominal GDP	236	0.34	China 22
Nominal GDP at PPP	280	0.35	US 17
Export value of goods and services	100	0.46	Japan 10
IMF quatum (in mln SDR, 2010)	856	0.39	US 9
Economic structure		Main export products (%)	
	2011	5-year av.	
Real GDP growth	6.1	3.3	Copper 57
Agriculture (% of GDP)	5	5	Fresh fruit 5
Industry (% of GDP)	34	35	Cellulose 4
Services (% of GDP)	53	51	Salmon & Trout 3
Standards of living		Main import products (%)	
	<i>USD</i>	<i>% world av.</i>	
Nominal GDP per head	13693	127	Intermediate goods 52
Nominal GDP per head at PPP	16226	131	Consumer goods 23
Real GDP per head	8551	105	Capital goods 16
		Openness of the economy	
		2011	
		Export value of G&S (% of GDP) 42	
		Import value of G&S (% of GDP) 37	
		Inward FDI (% of GDP) 7.7	

Source: EIU, CIA World Factbook, UN, Heritage Foundation, Transparency International, Reporters Without Borders, World Bank.

Introduction and update

Chile's economy has continued its quick recovery from the 2008 crisis. The economy is estimated to have grown by 6.1% in 2011, with growth being driven by consumption, easy credit conditions and reconstruction after the 2010 earthquake. However, in the course of the year, the speed at which the economy grew slowed down, with growth falling from 9.9% year-on-year in the first quarter, to 6.6% in the second quarter and 4.8% in the third quarter. Due to the less favourable external environment growth will be lower still in 2012. Therefore, we expect it to be in the 3.5-4.5% range. This is not unwelcome, as Chile's economy was close to overheating. Unemployment has reached record low levels, with the average annual unemployment rate falling to 7.2% in 2011, the lowest level in 13 years. In 2011, Chile's current account fell into deficit, due to strong domestic demand resulting from a booming economy, falling prices of copper and strikes at several copper mines. However, the country still manages to attract large inflows of FDI. As a result, its balance of payment position remains rather strong. Copper exports are likely to increase in the coming years, as copper production is set to increase from approximately 5.4mln tonnes in 2011 to 6mln tonnes in 2012 and 7.5mln tonnes in 2016. In December, inflation was 4.4% year-on-year, which implies a breach of the 2-4% inflation target range. High inflation was partially the result of the tight labor market and strong domestic demand. However, base year effects also contributed. Meanwhile, the external environment has deteriorated sharply since August 2011. The central bank has reacted by cutting its policy rate by 25 basis point to 5% in January 2012. It was the first rate cut since June 2009. The current rate gives the central bank substantial room to further ease monetary policy, if a further worsening of the external environment should make this necessary.

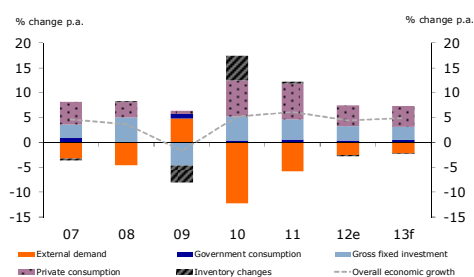
Student protests reveals strains within Chile’s social model

In 2011, Chile was hit by a massive 7-month during student protest. Students protested for free higher education and the elimination of for-profit education. The government opposed their demands by stating that Chile only has the financial means to realize free education for the poorest part of the population. The protests started peacefully, but became violent in August, with several confrontations between the students and the police taking place and many people being arrested. Nonetheless, the government was able to push through its education budget in November. The budget foresees a 10% increase of the education budget to USD 12bn, which makes the education ministry the ministry with the highest budget allocation. The budget will extend the coverage of pre-school education to a much bigger part of poor households. The government will also increase the number of scholarships. However, it fails to address the underlying moral objections of the protesters against the free market nature of the existing higher education system. Nevertheless, the strikes ended in November 2011, when most students went back to their classrooms to avoid losing the entire school year and scholarships and grants (which the government threatened to cancel). However, new protest may erupt in the coming months.

Although Chileans have become better educated in the past decade, it seems that access to education could indeed be improved. Compared with other countries tuition fees are indeed high in Chile, while the government contribution to higher education is relatively small. According to the OECD the Chilean government only pays 16% of the total costs of higher education, while the average for all OECD countries is 70%. More than in most other countries, educational achievement is strongly correlated with the socioeconomic background of people, and the intergenerational social mobility remains low. This is one of the reasons why, as the OECD recently noted, both poverty and inequality in Chile are still relatively high. Indeed, while Chile has already more than two decades been implementing moderate social policies after the end of military dictatorship in 1989, the Gini-index has only fallen from a very high 56 in 1990 to a still relatively high 52 in 2009. More fundamental reforms are required if Chile wants to become a more equal society. In this respect, the OECD also noted that tax system hardly redistributes income and that there is scope for higher taxation of mining incomes.

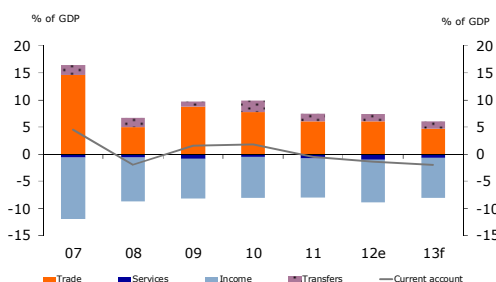
Meanwhile, the education crisis has been damaging for president Sebastián Piñera. Despite the strong growth of the economy in 2011 and the low unemployment rate, he has become even more unpopular, with his approval rate falling from 26% in the middle of 2011 to 23% in the last months of the year, while his disapproval rate increased from 53% to 62% over the same period. However, the center-left Concertación opposition is also very unpopular, partially due to a corruption scandal concerning pension payments between 1993 and 2010 that has been revealed recently. At the same time, former Concertación president Michelle Bachelet, who is now United Nation's under-secretary-general for Gender Equality and the Empowerment of Women, remains very popular. She stand a good chance of winning the 2013 presidential elections, should she decide to run.

Figure 1: Growth performance



Source: EIU

Figure 2: Current account



Source: EIU

Chile							
Selection of economic indicators	2007	2008	2009	2010	2011	2012e	2013f
<i>Key country risk indicators</i>							
GDP (% real change pa)	4.6	3.7	-1.7	5.2	6.1	4.4	4.9
Consumer prices (average % change pa)	4.4	8.7	1.5	1.4	3.2	3.4	3.4
Current account balance (% of GDP)	4.5	-1.9	1.6	1.9	-0.5	-1.4	-1.9
Total foreign exchange reserves (mln USD)	16837	23072	25284	27816	41514	43740	45440
<i>Economic growth</i>							
GDP (% real change pa)	4.6	3.7	-1.7	5.2	6.1	4.4	4.9
Gross fixed investment (% real change pa)	11.2	19.4	-15.9	18.8	14.1	9.5	8.1
Private consumption (real % change pa)	7.0	4.5	0.9	10.4	9.8	5.4	5.5
Government consumption (% real change pa)	7.1	0.5	7.5	3.3	4.6	3.5	3.6
Exports of G&S (% real change pa)	7.6	3.2	-6.4	1.9	9.2	4.8	5.7
Imports of G&S (% real change pa)	14.5	12.6	-14.6	29.5	17.0	7.3	7.2
<i>Economic policy</i>							
Budget balance (% of GDP)	8.8	5.2	-4.5	-0.3	0.2	0.8	1.5
Public debt (% of GDP)	4	5	6	9	9	9	8
Money market interest rate (%)	6.0	8.3	0.5	3.1	5.3	5.0	5.5
M2 growth (% change pa)	21	19	-5	9	12	12	11
Consumer prices (average % change pa)	4.4	8.7	1.5	1.4	3.2	3.4	3.4
Exchange rate LCU to USD (average)	522.5	522.5	560.9	510.2	484.9	509.7	507.4
Recorded unemployment (%)	7.0	7.8	9.6	7.1	7.4	7.3	7.1
<i>Balance of payments (mln USD)</i>							
Current account balance	7458	-3307	2570	3802	-1155	-3520	-5270
Trade balance	23941	8529	14117	15855	14404	14900	12740
Export value of goods	67972	66259	54004	71028	87130	94980	103740
Import value of goods	44031	57730	39888	55174	72726	80080	91000
Services balance	-987	-964	-1444	-1019	-1836	-2460	-1830
Income balance	-18625	-13802	-11666	-15424	-17048	-19430	-20000
Transfer balance	3123	2924	1616	4390	3325	3470	3820
Net direct investment flows	9961	7194	4719	7221	10375	13880	11750
Net portfolio investment flows	-15599	-5931	-13669	-8539	-8218	-9610	-10300
Net debt flows	5717	7304	7072	12382	14766	3760	3610
Other capital flows (negative is flight)	-10091	976	1522	-12331	-2070	-2290	1910
Change in international reserves	-2554	6236	2214	2535	13698	2230	1700
<i>External position (mln USD)</i>							
Total foreign debt	56443	64297	71646	84028	98794	102560	106170
Short-term debt	11056	14910	17476	21388	29373	31590	36380
Total debt service due, incl. short-term debt	20816	26943	30193	33839	39992	47540	50180
Total foreign exchange reserves	16837	23072	25284	27816	41514	43740	45440
International investment position	727	-29835	-18953	-10026	n.a.	n.a.	n.a.
Total assets	164585	142711	188707	235916	n.a.	n.a.	n.a.
Total liabilities	163858	172546	207660	245942	n.a.	n.a.	n.a.
<i>Key ratios for balance of payments, external solvency and external liquidity</i>							
Trade balance (% of GDP)	14.6	5.0	8.8	7.8	6.1	6.0	4.7
Current account balance (% of GDP)	4.5	-1.9	1.6	1.9	-0.5	-1.4	-1.9
Inward FDI (% of GDP)	7.6	8.9	7.9	7.7	7.7	8.2	6.7
Foreign debt (% of GDP)	34	38	45	41	42	42	39
Foreign debt (% of XGSIT)	65	74	102	90	87	83	79
International investment position (% of GDP)	0.4	-17.5	-11.8	-4.9	n.a.	n.a.	n.a.
Debt service ratio (% of XGSIT)	24	31	43	36	35	39	37
Interest service ratio incl. arrears (% of XGSIT)	3	2	2	2	2	2	2
FX-reserves import cover (months)	3.7	4.0	6.1	5.0	5.7	5.5	5.0
FX-reserves debt service cover (%)	81	86	84	82	104	92	91
Liquidity ratio	116	102	111	110	110	105	103

Source: EIU

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