CHILE

GROWTH CLOSE TO ITS POTENTIAL

In Chile, the recovery in economic activity seen in 2024 is expected to continue in 2025. Commodity exports will remain strong, while private consumption will benefit from slowing inflation and a gradually improving labour market. Against a political backdrop marked by ongoing tensions, and an opposition coalition strengthened by the results of recent local elections, the government is trying to press ahead with its flagship reforms, relating to the energy sector in particular, before the end of its term, which will be in late 2025. Against this backdrop, public finances are still being gradually consolidated, at a slower pace than initially anticipated.

RECOVERING ACTIVITY

GDP growth is expected to be close to its potential level in 2024 and 2025, after a year of almost zero growth in 2023 (+0.2%). The recovery in activity in 2024 has been driven by exports (principally copper, lithium and cellulose), up 5% on average and year-on-year over the first 9 months of the year, with this growth expected to continue over the coming months. Copper exports, in particular, are expected to remain strong, partly thanks to technical issues being resolved. Private consumption is the second driver of growth, buoyed by rapidly easing inflation (from 14% in August 2022 to 3.7% in March 2024), the gradually improving labour market (the unemployment rate was 8.7% in September and is expected to continue falling, hitting 8% by the end of 2025, according to IMF estimates) and incrementally better access to credit. Investment is expected to gradually improve over the coming quarters.

The inflation rate has recovered slightly in recent months (hitting 4.1% in September 2024), due to transitory shocks, in particular, the end of the electricity price freeze (in place since 2019). The price of electricity is expected to rise by around 50% by 2026. The Central Bank of Chile has lowered its key interest rate by 600 basis points since June 2023 (to 5.25% in October) and has signalled that this decrease will continue over the coming months, in line with macroeconomic forecasts.

FORECASTS

	2021	2022	2023	2024e	2025e
Real GDP growth (%)	11.7	2.4	0.2	2.5	2.2
Inflation (CPI, year average, %)	4.5	11.6	7.6	4.0	4.4
Central Gov. balance / GDP (%)	-7.5	1.1	-2.5	-2.4	-2.1
Public debt / GDP (%)	36.3	38.0	39.2	40.5	40.7
Current account balance / GDP (%)	-6.6	-8.7	-3.5	-2.8	-2.6
External debt / GDP (%)	75.0	76.4	71.1	74.1	70.4
Forex reserves (USD bn)	51.3	39.1	46.3	47.8	49.3
Forex reserves, in months of imports	5.3	4.9	7.0	7.3	7.5

TABLE 1 e: ESTIMATES & FORECASTS
SOURCE: BNP PARIBAS ECONOMIC RESEARCH

CHILE : TOTAL AND COPPER EXPORTS

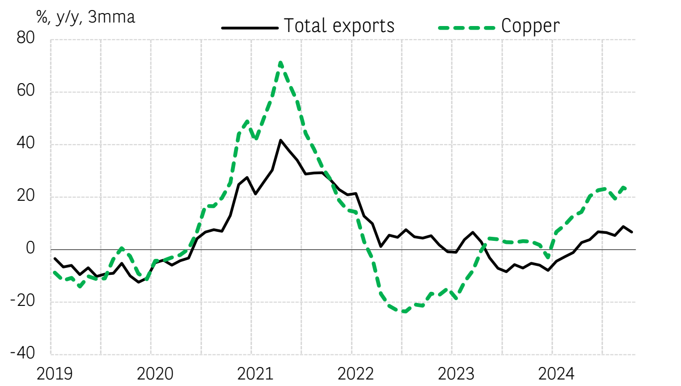

CHART 1 SOURCE: CENTRAL BANK, BNPP

BALANCE OF RISKS

In the very short term, risks to growth are still on the downside, mainly due to external factors. The potential escalation of conflicts in the Middle East could lead to higher oil prices (with Chile being a net importer of oil), while the very likely hardening of the United States' trade policy will adversely affect the Chilean export sector.

It is harder to assess the effect of the slowdown in Chinese growth on the Chilean economy. Although Chinese copper demand currently accounts for nearly half of the global demand and China is Chile's leading trading partner (the destination for more than 40% of the country's total exports, and 70% of copper exports), the copper demand from sectors more or less directly linked to the low-carbon transition is buoyant and could partially offset the falling copper demand from the construction sector (estimated at around 30% of Chinese copper demand). Overall, Chinese copper imports have slowed, but are still increasing nevertheless (+4.5% y/y over the first 9 months of 2024) and the outlook remains relatively optimistic. In its most recent report, the International Energy Agency also notes that the (moderate) fall in copper prices seen in recent months is predominantly due to excess supply (as a result of new mining operations starting up and maintenance work in various countries ending) and that the forecasts for the next two years are on the upside. Therefore, the effect of the Chinese slowdown could remain marginal on copper exports.

That being said, the relationship between the Chinese and Chilean economies covers so much more than just copper exports. Chile is China's main partner in the region, with diplomatic relations between the two countries dating back over 70 years and many trade agreements signed between them over the past fifteen years.

Most notably, the Chinese government's energy sector investment strategy (broadly covering lithium, wind energy, solar energy and green hydrogen) has understandably focussed on Chile. Foreign direct investments and position-taking in Chilean energy companies have increased exponentially over the past three decades. In the case of lithium, for example, China holds a stake of approximately 30% in Chile's largest producer, Sociedad Química y Minera (which currently accounts for about half of Chile's total lithium production). Therefore, beyond the short-term challenges, the challenge faced by Chile's economy is successfully reducing its dual dependence, on commodities on the one hand (the economy is currently being diversified, but commodity exports still account for more than 50% of the total), and on China on the other hand (the main player in the entire critical material value chain and, in particular, in the lithium value chain). The policies required to move up the value chains are gradually being put in place, but the effects are still weak. According to the TiVA database (which is produced by the OECD and quantifies the value added by each country in international trade), the value added of Chilean exports to China has increased steadily over the last two decades (including outside the mining sector), but the value added remains relatively low. In addition, the upgrading in value chains, as is the case in the lithium-ion battery industry, for example, is inextricably linked to the anticipated development of a large-scale electric-mobility industry in a neighbouring geographical area, which is not currently the case in Latin America.

THE START OF AN ELECTION YEAR

The end of wrangling over a potential new constitution (for "several years", according to the government) has significantly reduced the political noise and the many uncertainties among investors about Chile's institutional framework. The government has been able to focus on a number of major reforms, including the new budget law, which was adopted in July 2024 and formally set the public debt ceiling at 45% of GDP. A tax compliance law was then passed in September, which aims to "make taxation fairer", while also combating tax evasion. Its main objective is to increase revenue by an amount equivalent to 1.5% of GDP, in order to finance the future increase in retirement pensions and other social welfare spending.

That being said, Chile's political landscape is still polarised and fragmented. There is widespread consensus that structural reforms are needed, but the approach to the reforms to be adopted are being debated long and hard. The government has to contend with falling popularity, high public expectations and a strong opposition (opposition parties have a majority in the Senate). The government's room for manoeuvre to implement its reforms before the end of its term (the next general election is scheduled for autumn 2025) has been further reduced by the opposition coalition strengthening in the municipal and regional elections held at the end of October. The government's two flagship reforms for its term, relating to the pension system and the energy sector (including highly anticipated details among domestic and foreign investors about the National Lithium Strategy and mining in "strategic" salt flats) are still being debated in the National Congress of Chile.

SHARE OF CLEAN ENERGY TECHNOLOGY SUPPLY CHAIN, 2023

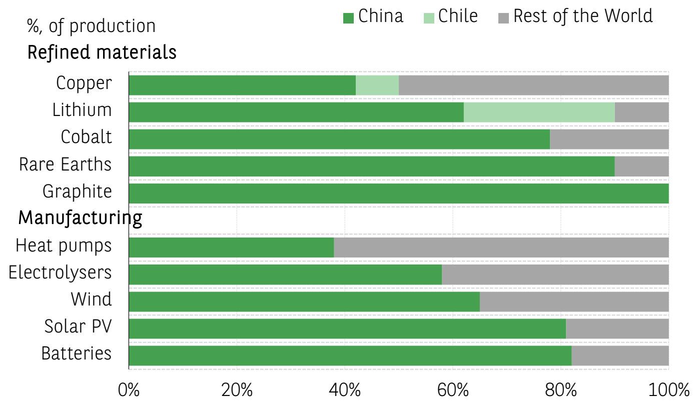

CHART 2 SOURCE: IEA, BNPP

It is against this backdrop that President Boric presented the government's budget for 2025. Fiscal consolidation is expected to continue at a slower pace than initially anticipated (the public deficit will be gradually reduced, with the books balanced by 2029, compared to 2028 in the previous budget). This scenario still seems optimistic to us. For 2025, for example, the government is relying on a small increase in spending (4% in real terms, i.e. an equivalent growth rate to the rate seen over the last two years) and an (unlikely) increase in revenue of more than 9% in real terms (over the past ten years, revenue has increased by just over 3.5% per year on average). Recovering activity, rising revenue from the (lithium and copper) mining sector and the effects of the new law will most probably not be enough to achieve this objective.

However, the public finance risk is still moderate in Chile. Public debt has risen steadily in recent years, but is still moderate, standing at close to 40% of GDP, and has a favourable profile (it is mainly denominated in local currency and has an average maturity of over 10 years).

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