CHILE

A BUSY POLITICAL AGENDA

Chile's economic growth stabilised during the second half of 2023, inflation eased and the current account deficit fell. The expected upturn in activity in 2024 should ensure that growth comes close to its potential, driven by household consumption, private investment and mining exports. Political pressures have eased after the decision to suspend the process of adopting a new Constitution (which is expected to be left alone for a number of years). Nevertheless, Gabriel Boric's government and the opposition parties are still clashing on a number of areas, most notably, fiscal reform, pension system reform and the energy sector framework law.

A RETURN TO GROWTH

Investment and private consumption were adjusted downwards in the final quarter of 2022 and in the first half of 2023, after the emergency measures introduced in 2020-2021 were brought to an end and real GDP fell for three consecutive quarters. Activity stabilised starting from the second quarter of 2023, with real GDP growing by 0.6% and 0.4% y/y during Q3 and Q4, respectively. In the end, economic growth stood at 0.2% for 2023.

The short-term outlook is brighter. Expected real GDP growth for 2024 is nearly 2%, thanks, in particular, to the upturn in private consumption and mining exports. The rapid disinflation process (inflation slowed to 7.6% y/y in 2023, after 11.6% in 2022, and continued to ease during the first few months of 2024, taking it to 3.2% y/y in March 2024) is expected to lead to higher real incomes. At the same time, the (aggressive) monetary easing cycle is continuing (since July 2023, the Central Bank of Chile has already cut its key rate by 480 bp to 6.5% as at the start of April, and further cuts are expected in the short term). This should improve access to credit for both consumers and investors. At the same time, investment and exports will benefit from increasing demand for Chilean mining products (mainly copper and lithium), as well as green hydrogen. However, the risks are still on the downside. In particular, political tensions could result in continued stalemates over reforms and could hurt consumer and investor sentiment.

FORECASTS

	2021	2022	2023e	2024e	2025e
Real GDP growth (%)	11.7	2.4	0.2	1.9	2.0
Inflation (CPI, year average, %)	4.5	11.6	7.6	3.3	3.0
Central Gov. balance / GDP (%)	-7.5	1.1	-2.5	-2.1	-1.6
Public debt / GDP (%)	36.3	38.0	39.2	40.5	40.7
Current account balance / GDP (%)	-6.6	-8.7	-3.7	-3.4	-3.3
External debt / GDP (%)	75.0	76.4	74.3	74.1	74.2
Forex reserves (USD bn)	51.3	39.1	46.3	46.3	46.3
Forex reserves, in months of imports	5.3	4.9	7.0	7.5	7.6

TABLE 1

e: ESTIMATES & FORECASTS
SOURCE: BNP PARIBAS ECONOMIC RESEARCH

CHILE: INFLATION AND POLICY RATE

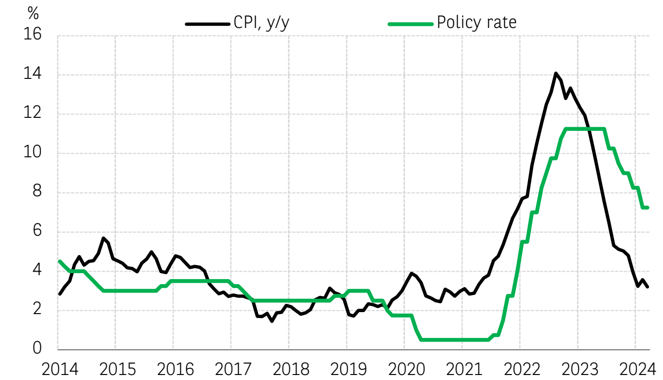

CHART 1

SOURCE: CENTRAL BANK, BNP PARIBAS

A PERIOD OF REFORMS

Since coming into office in March 2022, President Boric and his government have been vocal about their desire to introduce a large number of reforms. A number of bills have been introduced (most notably on pension-system reform and accelerating the energy transition), but the various Constitutional bills have been the main focus of political debates.

The rejection of two proposed new Constitutions (the first, which was supported by the government but viewed as too progressive, was rejected by 62% of the votes in the referendum on 4 September 2022, and the second, which, conversely, was viewed as too conservative and was denounced by the government, was rejected by 55.8% of the votes in the referendum on 17 December 2023) is emblematic of the polarised political climate in the country and the difficulties faced by both the government and the opposition parties. By mutual agreement, the draft constitution is being put on hold for a number of years (as a result, the current Constitution shall continue to apply for the time being), so that political debates can focus on other areas.

Political pressures are expected to remain high over the coming months and further difficulties could arise for the government: there are high expectations from the public, but the President and the government are unpopular, while the opposition parties have a majority in the Senate, which has already restricted the government's efforts to introduce reforms since coming into office.

What's more, the government does not have long to push ahead with its key reforms, before political discussions are monopolised by the local and regional elections (October 2024), followed by the general elections (presidential and parliamentary elections, in November 2025). First of all, a second version of the fiscal reform (the first was rejected in March 2023) was tabled in Congress in January 2024. This new version proposes an increase in tax revenue of nearly 1.5% of GDP by 2026 (compared to 4% of GDP in the first bill), achieved almost exclusively through reinforced measures to enforce tax payment compliance (whereas the initial bill planned to increase income and wealth taxes). The additional revenue is expected to be used to finance further social spending, meaning that this spending will only have a marginal effect on public finances. The bill is currently being debated in the Senate and these debates are turning out to be heated.

At the same time, the draft reform of the pension system (which mainly sets out to improve the replacement rate and coverage), initially tabled in mid-2022, was approved by the Chamber of Deputies (the lower house of the National Congress of Chile) in January 2024, after many amendments were made to the original bill. This bill is now being discussed in the Senate and its scope could be further reduced. The increase to the minimum old-age pension, approved by elected representatives, is unlikely to be under threat. Conversely, the creation of a public administrative agency, resulting in the role of AFPs (Administradoras de Fondos de Pensiones, the administrations responsible for managing pension funds) being scaled back to simply financial management over pensions, approved by elected members of the lower chamber, could be reconsidered during senators' discussions. In addition, while the government has already had to accept that the revenue linked to the new employer contribution (of 6% of an employee's salary) cannot be fully used to strengthen the solidarity pillar, the Senate could decide that the revenue can only go into individual accounts.

Finally, discussions about the energy transition framework law are continuing. In April 2023, the government tabled a particularly ambitious National Lithium Strategy in Congress, aimed at improving national lithium production efficiency (including bringing Chilean companies into the lithium value chain) and increasing tax revenue, while establishing a "socially and ecologically" sustainable framework. At the end of March 2024, the government stated that lithium mining at the "strategic" salt flats of Atacama (the only one in operation for the time being) and Maricunga would be undertaken via public-private partnerships majority-owned by the State. Five other salt flats may be mined under public-private partnerships and, finally, 26 other salt flats (accounting for less than 20% of the country's total production) will be opened to private companies.

SLOWER THAN EXPECTED FISCAL CONSOLIDATION

Against this backdrop, the fiscal consolidation targets set by the government (to reach a balanced budget in 2028) seem optimistic. After a surplus in 2022 (of 1.1% of GDP), the fiscal balance was once again in the red in 2023, with a deficit of 2.5% of GDP, as the increase in revenue from lithium mining was not enough to offset the effects of lower activity and falling copper prices. Revenue was down almost

CHILE: BUDGET DEFICIT AND PUBLIC DEBT

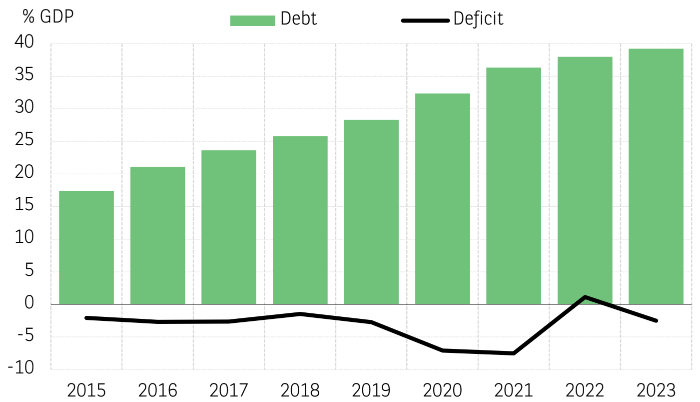

CHART 2

SOURCE: MINISTRY OF FINANCE, BNP PARIBAS

8% y/y in total. At the same time, spending increased by almost 10% y/y. Over the next two years, we expect a slight decline in the fiscal deficit: despite activity recovering, public pressure on increasing social spending is unlikely to dissipate.

Nevertheless, even if fiscal consolidation is slower than the authorities are expecting, sovereign risk is still limited. Public debt has increased significantly in recent years, but is still moderate (standing at 39.2% of GDP, compared to 28% of GDP in 2019). Debt is expected to continue rising gradually over the next few years, but its profile is still good. Debt maturity is still higher than 10 years, and contingent debt remains low, which is evidence of the low public-sector debt and the careful and effective regulation of the financial system.

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