Chile

Crisis times

With violent protests rocking Chile since October, the government announced a series of measures to combat inequality and proposed a new version of its pension system reform. Above all, the government signed an agreement with the main opposition parties to draw up a new constitution. Yet persistently fierce political and social tensions are bound to curtail growth. Forecasts for the next two years have been revised largely downwards. The public debt and deficit are also expected to swell over the next five years.

Political model called into question

The violent protests that have swept Chile since October largely surpass simple opposition to the reform measures proposed by Sebastian Piñera's government, a coalition of centre-right parties in power since March 2018. Protest movements have sprung up spontaneously, bringing together a wide range of demands. According to several surveys, the protests are mainly motivated by frustration over rising inequality, the government's determination to drive through pension and healthcare system reforms and the lack of confidence in institutions. The government's initial response was very repressive, which only threw oil on the flames and reinforced the amplitude of protests. Sebastian Piñera then announced several vague economic and social measures.

The proposed "social programme" amounts to a total of USD 1 bn in 2019 and USD 1.4 bn in 2020. The main measures comprise a higher minimum wage and an increase in the minimum old-age pension, easier access to healthcare and greater public spending in several areas (support for the elderly and students; and infrastructure maintenance). Another USD 5.5 bn in measures were announced in December. To the best of its ability, the government is trying to limit the protest movement's impact on economic activity by stimulating private consumption (notably via transfers to low-income families) and investment (including measures to support small and mid-sized enterprises, and to restore infrastructure damaged during the protests, notably in the capital).

As fiscal measures failed to calm the protests, the opposition parties proposed to elaborate a new constitution together to replace the existing one dating back to the Pinochet dictatorship in 1980. In late November, the government signed an "agreement for peace and a new constitution" with the main opposition parties.

As a result, a referendum will be held next April to answer two questions. First, whether or not the constitution should be replaced, and if yes, what type of body should be in charge of elaborating the constitution: 1) a constituent assembly comprised exclusively of acting members of parliament, or 2) a mixed constitutional commission comprised of acting members of parliament and new, specially elected commission members. Next October, members will be elected to write the new constitution. Once the commission proposes a new text (within 12 months of their election), a final referendum will be held to decide whether or not to adopt the new constitution.

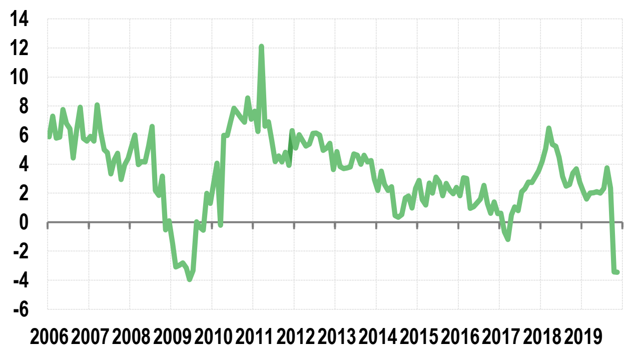
1-Forecasts

	2018	2019e	2020e	2021e
Real GDP growth (%)	4.0	1.0	1.3	2.0
Inflation (CPI, year average, %)	2.4	2.3	3.0	3.0
Central Gov. balance / GDP (%)	-1.7	-2.9	-4.7	-3.5
Public debt / GDP (%)	25.7	27.6	30.1	34.3
Current account balance / GDP (%)	-3.1	-3.4	-2.7	-2.1
External debt / GDP (%)	62.0	61.8	70.7	76.8
Forex reserves (USD bn)	39.9	36.9	32.3	34.1
Forex reserves, in months of imports	7.6	7.8	6.5	6.1
Exchange rate USDCLP (year end)	696	744	770	750

e: BNP Paribas Group Economic Research estimates and forecasts

2- Monthly GDP growth indicator has plummeted

Monthly GDP, % y/y, s.a.



Source: Central bank

Although a broad swath of the population seems to favour the proposal to draw up a new constitution, the political and social situation will remain extremely tense, especially with the approach of municipal and regional elections in March 2021, followed by presidential elections in November.

What about pension reform?

As the protest movement regained momentum in the beginning of the year, in mid-January the government proposed a new version of its pension system reform. According to the press release, the government proposes to raise payroll workers' pension contributions to 16% of monthly wages, from 15% in the initial version of the reform. The current rate of only 10% is much lower than the OECD average of 18%. The difference in contributions would be covered by the employer, with no change in net wages. Additional contributions would be distributed between individual savings accounts and a "solidarity fund". In both cases, the funds would be managed by a public administrator, which addresses criticisms of the current private management system, which is deemed to be too costly and inefficient. The reform would be implemented gradually, by increasing the contribution rate in steps of 0.5% a year, in order to ease the increase in the cost of labour.

The government affirms that the amount of pensions can no longer be less than the minimum wage, for all payroll workers having paid into the system for at least 30 years. Before it can be adopted, the new reform bill must first be presented to parliament.

Economic growth slows

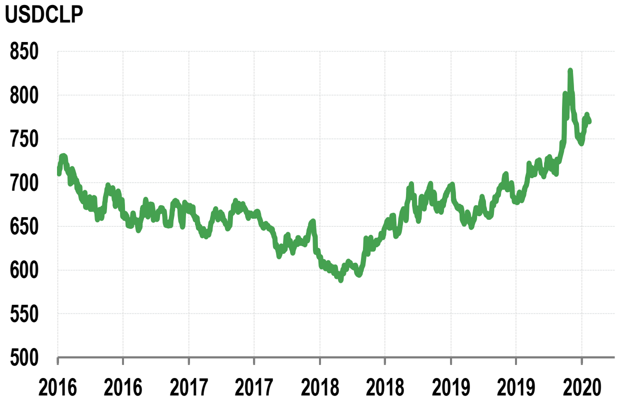
After rising 1.7% y/y in the first half of 2019 and then 3.3% in the third quarter, real GDP growth is expected to stall in the quarters ahead. The monthly growth index has already declined by 3.4% in October and November, after rising 2.3% in September. Government stimulus measures and low interest rates will not prevent household consumption and investment from declining. The consumer confidence index continues to erode and job market conditions have begun to deteriorate. At the same time, investor confidence continues to slump. According to the central bank's survey, several companies said they have postponed investment projects that were initially planned for 2020. In contrast, in the mining sector, which has been relatively sheltered so far, solid growth prospects should help reduce the decline in investment. All in all, real GDP growth is estimated at 1% in 2019 and 1.3% in 2020, down from 4% in 2018.

Economic policy support

The government's fiscal consolidation efforts are no longer on the agenda, at least not in the short term. According to Ministry of Finance projections released in December, public expenditure should increase by 1% in real terms between 2021 and 2024. The new version of the pension reform bill is unlikely to change this projection significantly. The fiscal deficit should exceed 4% of GDP in 2020 before narrowing gradually thereafter. The public debt would increase from 28% of GDP in 2019 to 38% in 2024.

At the same time, the central bank is expected to continue providing monetary policy support in 2020, after lowering its key rate by a total of 175 basis points, to 1.75%, in 2019. In its latest press release, the central bank indicated that monetary policy would remain accommodating "as long as inflation trends allow". Yet its latest forecasts call for inflation to rise to about 3.5% on average in 2020 (up from 2.3% in 2019), which is higher than its target rate of 3%. The central bank's scenario seems to be based on overly pessimistic assumptions. December's inflation was only 3% y/y, lower than the central bank's projection. The observed impact of currency depreciation was probably not as high as the central bank's figure, and was partially offset by the impact of the economic slowdown.

3- Mild depreciation of the peso



Source: Central bank

The economy's strong fundamentals have helped limit the peso's depreciation (8% since the outbreak of the crisis). Central bank communications have also helped reassure the markets, first via an early November press release in which the central bank stated that it had the necessary tools and adequate foreign reserves to contain any liquidity and volatility risks. Then in early December the central bank announced a currency sterilisation programme between early December 2019 and the end of May 2020. After hitting USDCLP 828 at the end of November, the exchange rate has returned closer to USDCLP 770 since early January (769 at 21 January). Under these conditions, we foresee at least one more key rate cut to stimulate economic growth in 2020.

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