CHILE

NEW CHALLENGES

The economy should rebound strongly in 2021 thanks to a successful vaccination campaign, improved prospects for global growth and higher copper prices. According to the monthly economic index, in early Q2, real GDP returned to the pre-pandemic level of December 2019. Looking beyond 2021, economic growth prospects could be marred by persistent political tensions plaguing the country. Debates over the presidential election on the one hand and the process of drawing up a new constitution on the other will probably disrupt the implementation of economic policy as well as private sector investment decisions by both resident and non-resident investors.

ECONOMIC GROWTH REBOUNDS IN 2021

After plunging 5.8% in 2020, real GDP is expected to grow by 7% in 2021. The rebound in GDP observed in H2 2020 extended into H1 2021, driven mainly by improved global growth prospects (notably for Chile's main two trading partners, the US and China) and the upturn in copper prices, fuelled by strong demand from China.

Domestic demand also continued to rise in the first months of 2021, despite a spike in new Covid-19 cases since mid-January. The infection rate and the hospital bed occupancy rate continued to rise and have reached significantly higher levels than during the first wave of the pandemic in March 2020, despite the smooth rollout of the country's vaccination campaign. Consequently, the authorities had to reintroduce relatively tight health restrictions, which strained Q1 growth. By May, however, the central bank's monthly economic index (adjusted for seasonal variations) had virtually returned to the pre-pandemic level of December 2019, and the employment rate had bounced back to 51%, after plummeting to 45% in July 2020 (compared to a long-term average of about 58%).

Short-term prospects are rather favourable. From a health perspective, although the crisis is still going strong, the number of new Covid-19 cases, the infection rate and the hospital bed occupancy rate have declined continuously since mid-June. At the same time, the vaccination campaign continues to be a success. At the end of June, the government had beat its January targets: more than 85% of the over-50 age group and 53% of the 18-50 age group had received two doses of the vaccine. At the same date, 74% of the 18-50 age group had received at least one dose of the vaccine, and the vaccination campaign for 12-17 years old is slated to begin in July. Under this environment, and depending on the evolution of the pandemic in its neighbouring countries, the health restrictions should be gradually lifted over the course of the third quarter.

THE AUTHORITIES PROVIDE MASSIVE SUPPORT

The government and the central bank will continue to provide massive economic support, like they did in early 2020. The government's recovery plan, a multi-year programme launched in March 2020, was rounded out by new measures announced in March 2021 to offset the negative impact of reintroducing health restrictions on domestic demand. Amounting to a cumulative total of 13% of GDP, these measures aim to increase healthcare spending, subsidies for low-income households, and unemployment benefits, as well as to defer tax payments. Other measures include support for small and mid-sized enterprises (SME) via the state-owned bank Banco Estado, and a system of state-backed loans for companies and households via FOGAPE, the small business guarantee fund. A multi-year public investment plan was also launched.

FORECASTS

	2019	2020	2021e	2022e
Real GDP growth (%)	1.1	-5.8	7.5	3.0
Inflation (CPI, year average, %)	2.8	3.0	3.8	3.3
Central Gov. balance / GDP (%)	-2.8	-7.4	-4.7	-3.0
Public debt / GDP (%)	28.1	32.0	38.0	38.0
Current account balance / GDP (%)	-3.6	1.3	-1.0	-4.0
External debt / GDP (%)	70.0	81.1	72.0	72.6
Forex reserves (USD bn)	40.6	38.5	51.3	54.1
Forex reserves, in months of imports	4.8	5.5	5.3	4.8

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

GDP GROWTH AND MONTHLY EMPLOYMENT INDICATORS

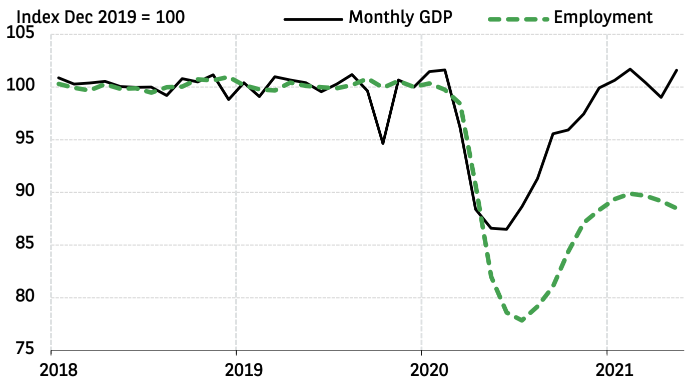

CHART 1
SOURCE: CENTRAL BANK

At the same time, the central bank cut its key policy rate by 125 basis points over a 3-month period, where it has held at the minimum rate of 0.5% since April 2020. The central bank also provided support for liquidity and lending to households and SME.

A large number of employees were also authorised to withdraw funds from their retirement savings on three occasions (in July and December 2020 and again in April 2021). According to IMF estimates, these withdrawals amounted to the equivalent of 15% of GDP in April 2021, and partially offset the loss of revenue caused by the pandemic.

Since May 2020, Chile has also benefitted from a 2-year arrangement with the IMF via a flexible credit line of USD 24 bn (roughly two thirds the amount of foreign reserves when the FCL was granted). Designed for crisis prevention and to reassure investors, the facility is reserved for countries that the IMF esteems to have "very solid" economic fundamentals. For the moment, only Chile, Colombia, Mexico, Peru and Poland have benefitted from FCLs. The IMF renewed its support in May 2021, esteeming that the country's economic fundamentals were still solid (moderate external vulnerability and a supportable, short-term deterioration in public finances triggered by its economic support plans).

In January 2021, the central bank also pledged to gradually increase the level of foreign reserves by USD 12 bn over 15 months. In May 2021, foreign reserves amounted to nearly USD 48 bn.

A PERSISTENTLY TENSE POLITICAL ENVIRONMENT

Unlike the economic situation, the political and social situation is deteriorating. The political crisis that broke out in October 2019 has not abated.

Faced with rising inequalities, unequal access to education and healthcare, and pension system reforms, rising popular discontent led to the outbreak of spontaneous protests in fall 2019. In response, the government has proposed a series of reforms and a new social pact, including the adoption of a new constitution.

After public consultations in October 2020, a large majority of Chileans confirmed that they wanted to abandon the current constitution (dating back to 1980, when Augusto Pinochet was in power). The new constitution must be drafted by a constitutional assembly comprised of newly elected members (and not current congressional members).

Elected in May 2021, the constitutional assembly is extremely divided: no one party has the number of votes necessary to pass amendments. As a result, the process of drafting a new constitution (which must be completed before year-end 2022) has been marked by the formation of numerous coalitions and endless discussions.

Moreover, independent, left and far-left parties won more seats than expected, to the detriment of the centre-right and right parties close to the government. Once again, this reflects popular aspirations for far-reaching social reforms, as well as the rejection of the government's party and the lack of confidence in the political establishment. These discussions have also mixed with debates about the elections, with presidential, congressional and regional elections scheduled for November (with the second round of the presidential election to be held in December).

This tense political climate, combined with haggling over the content of the new constitution (social rights, education, healthcare and retirement...), will have an impact on public finances, which could alarm national and foreign investors.

Moreover, investors did not really welcome the reform that enabled employees to dip into their retirement savings, in part because they run against the country's normal practices, and in part, because the withdrawals will have an impact on the medium to long-term equilibrium of the pension regimes. Although these withdrawals partially offset revenue losses in 2020, they also reduce the replacement rate for numerous employees (i.e. the percentage of earned income received by the employee when calculating pension rights). According to IMF estimates, about 25% of the contributors to pension funds withdrew all of their retirement savings during the first two rounds of withdrawals.

FOREIGN RESERVES AND THE EXCHANGE RATE

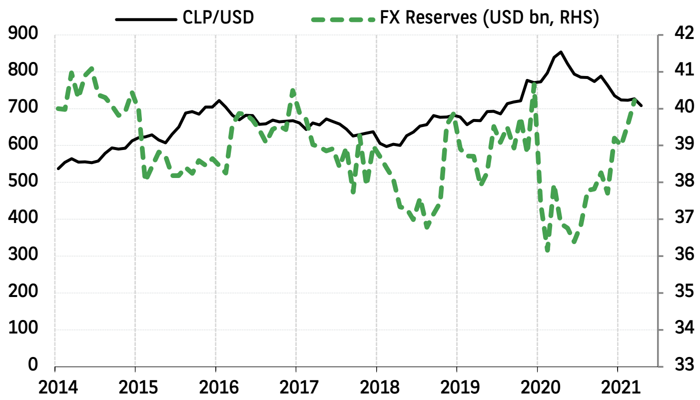

CHART 2 SOURCE: CENTRAL BANK

All in all, greater political instability and the prospects of deteriorating public finances could strain the country's investment prospects and medium-term growth outlook. Chile also suffers from structural weaknesses (dependence on commodities, decline in productivity in the mining sector). In April 2021, the IMF lowered its 5-year growth outlook to 2.5%, down from its previous forecast of 3.2% in October 2019.

Completed on 5 July 2021

Hélène DROUOT
helene.drouot@bnpparibas.com