CHILE

A FULL PROGRAMME

Gabriel Boric won the second-round presidential election in December. He will take up his post in mid-March and will face many challenges during his term. The new government will have to deal with a fragmented legislative assembly and high levels of popular expectation. Economic growth is likely to slow as exceptional support measures are gradually withdrawn. Although vaccination levels are high, activity could be weakened by new waves of infection and the accompanying restrictions. Lastly, consolidating public finances whilst fulfilling promises to reform education, healthcare and pensions would seem to be the biggest difficulty.

A TENSE ELECTION

On 19 December 2021, Gabriel Boric, the candidate of a very broad coalition of leftist parties, won the second round of the presidential election from J. Kast, the extreme right wing candidate. He took 56% of votes cast, with a turnout of 55%, a record high since mandatory voting was ended in 2012. In last November's first round, the turnout was 46%. The new government will come to power on 11 March.

The task ahead looks particularly challenging for the president-elect, and his difficulties will be amplified by changes in the global health situation. Although the population is well-vaccinated (with 80% having had two jabs and 60% having had a booster shot), the country remains exposed to new potential waves of infection (which would hit domestic demand, the tourist industry and exports).

Moreover, Chile's political and social stability has deteriorated significantly since the violent demonstrations in the autumn of 2019. Surprising for both their scale and their duration, these demonstrations covered a broad range of claims including frustration with growing inequality and opposition to the Pinera government's proposed reforms on access to the healthcare system and pensions.

The economic and health crisis has also increased the fragility of the healthcare and social protection systems, which face great difficulties despite the massive support provided by the authorities over the past two years. People's expectations have nevertheless been raised.

At the same time, the process of writing a new constitution (which should be completed by the end of 2022) and the ensuing debates, focused on the same topics of education, healthcare and so forth, amplifies the pressure on the new government, even before it takes office. The independence of the central bank and its mandate (a growth and/or employment target could be added to the inflation target, in line with the Fed's mandate) are also being debated.

UNFAVOURABLE CONDITIONS

The implementation of the new government's economic and social policy is already looking like a challenge. The make-up of the new Congress (elected at the end of November at the same time as the first presidential round) is not clearly helpful for Mr Boric's government: there is no majority in the Senate, and the left has only a two-seat advantage in the 155-member Chamber of Deputies.

Such a situation may certainly prevent the radical change in economic policy feared by some analysts (the stock market dropped more than 6% on the day after the election). But it could also prevent any substantial structural reforms, and much negotiation and doubtless compromise will be needed if the government is to push them through.

FORECASTS

	2019	2020	2021e	2022e	2023e
Real GDP growth (%)	1.1	-5.8	10.8	2.5	2.0
Inflation (CPI, year average, %)	2.8	3.0	4.4	4.9	4.5
Central Gov. balance / GDP (%)	-2.8	-6.2	-7.6	-3.9	-3.5
Public debt / GDP (%)	28.1	32.7	35.1	38.7	40.7
Current account balance / GDP (%)	-3.6	1.3	-3.2	-3.5	-3.5
External debt / GDP (%)	70.0	82.6	74.3	72.6	71.0
Forex reserves (USD bn)	40.6	39.2	53.8	53.4	52.8
Forex reserves, in months of imports	4.8	5.5	5.3	4.8	4.5

e: ESTIMATE & FORECASTS

TABLE 1 SOURCE: BNP PARIBAS ECONOMIC RESEARCH

MONTHLY ACTIVITY INDICATORS

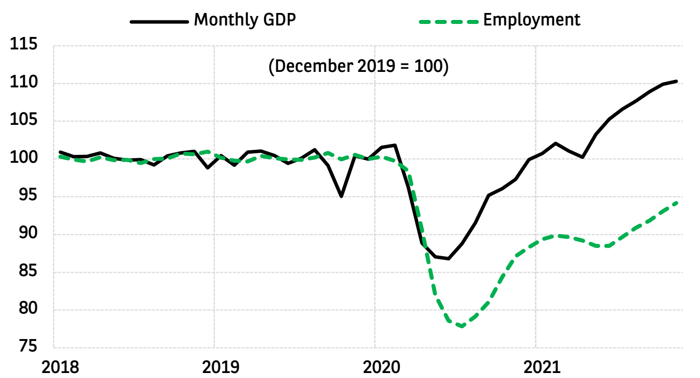

CHART 1 SOURCE: CENTRAL BANK

It is highly likely that the political and social climate will remain tense throughout the government's term, and that in the end changes will be much less radical than predicted.

Meanwhile, economic growth is likely to slow significantly. Real GDP probably grew by nearly 11% in 2021, thanks to the massive support from the authorities (as in 2020) and rising copper prices (in addition to comparison basis effects). However, the authorisation granted (on three occasions) to pension holders to draw against their retirement savings provided an artificial stimulus to consumption, and real GDP is likely to grow by 'only' 2.5% this year, with the gradual withdrawal of exceptional support measures and an uncertain international climate.

It is against this challenging background that the new government will begin its work in March. Details of its programme are not yet known, but the new president wants to find the 'right balance' between the need for reforms to improve social justice and the rebuilding of 'favourable conditions' for investment and growth, whilst remaining 'fiscally responsible'.

In other words, Mr Boric would appear to want to respond to the high levels of popular expectation and launch several large-scale reforms to achieve this. But he will also need to maintain the confidence of investors, the rating agencies and the IMF, something that has been undermined by the political crisis and the withdrawals of pensions savings with their medium and long-term economic and fiscal consequences.

It is worth remembering that Chile is one of the few countries to enjoy a flexible credit line with the IMF, providing a precious guarantee that helps boost market confidence in times of rising risk. Chile has had this credit line since May 2020.

PUBLIC FISCAL DEFICIT & DEBT

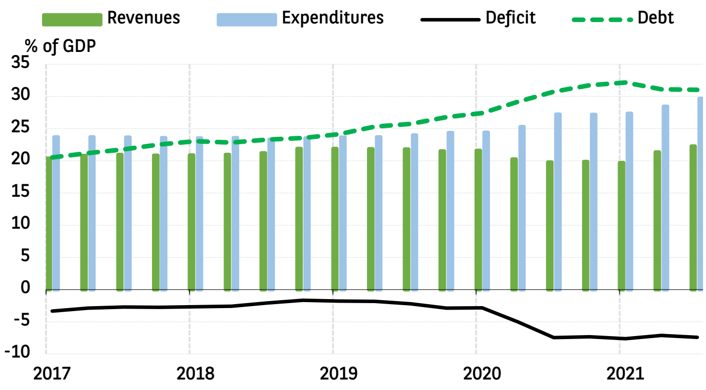

CHART 2 SOURCE: MINISTRY OF FINANCE

OVER-AMBITIOUS TARGETS?

The new government's many ambitions look hard to achieve and incompatible with fiscal constraints. As soon as the campaign had ended, Mr Boric announced that he wanted to increase public spending substantially, with the twin targets of improving the social safety net and beginning a deliberately 'aggressive' green transition, whilst also setting in motion a fiscal consolidation process.

But the president-elect has also committed to 'fiscally responsible' policies, with the initial aim of bringing the government deficit down from 7.6% of GDP in 2021 to less than 4% in 2022. He therefore plans to respect the target deficit of 3.9% of GDP which was set in the 2022 budget proposed by the outgoing government.

According to his announcements, fiscal deficit reduction should then continue throughout his term, returning it to levels similar to those before the crisis (between 2015 and 2019 the average government deficit was less than 2.5% of GDP). The aim is to stabilise the public debt ratio, which remains modest (35% of GDP at end-2021) but has been rising steadily for more than ten years, in order to keep it below 45% throughout his term.

Continuing fiscal consolidation whilst making significant (and lasting) increases in expenditure will thus require substantial and permanent increases in government revenue. The government's working hypothesis is that revenue can be increased by 5 points of GDP by the end of its term (revenue represented 21.5% of GDP on average between 2015 and 2019) through increases in business taxes, the introduction of a wealth tax and new 'green taxes', royalty charges for private mining companies and a significant reduction in tax evasion and exemptions. However, it seems fairly unlikely that the government will be able to pass the necessary measures and reforms to achieve the increases in either spending or revenue.

Mr Boric has also recently stressed that each lasting increase in spending must be preceded by an increase in revenue. In 2014, Michelle Bachelet proposed a fiscal reform which was projected to increase revenue by 3 points of GDP over her term. By 2018 revenue had risen by 1.4 points relative to 2014.

Concerning the pension system, one of the most keenly anticipated areas of reform, the new government could (on the basis of its campaign proposals) seek to reform the existing system totally but gradually. Three main phases are planned. First, improving and strengthening the 'solidarity pillar' by creating a universal minimum pension (with a value more than 30% above the current minimum pension, which is not universal at present). The resulting increase in spending (estimated at the equivalent of 2.5% of GDP) should be offset by additional revenue generated from fiscal reform.

Secondly, employer contributions will be gradually increased (from 10% of wages currently to 16% by the end of the government's term). Finally, a new public pension fund will be created that will gradually replace existing private pensions.

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