MUFG Focus Latin America

Chile: macroeconomic performance

(2015 GDP and Current Monthly Indicators)

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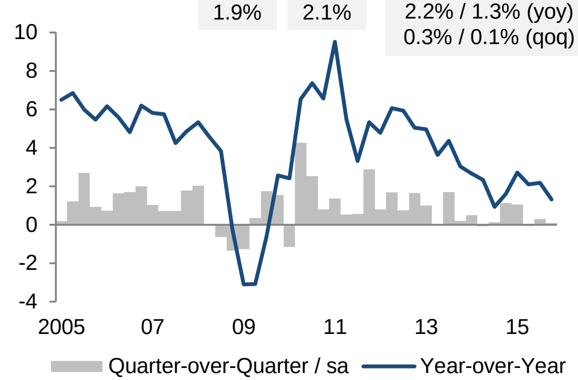
I) Chile: Growth Momentum (1)

▪ Another lackluster performance: the Chilean economy posted a 2.1% growth rate in 2015.

- By all accounts, 2015 was another lackluster year for the Chilean economy: GDP expanded 2.1%, a pace that is a bit higher than in 2014, but far below the 5.3% average during 2010-13. Similarly, private consumption growth slowed to 1.5% amid anemic real wage growth and weak consumer confidence. Neither gross fixed capital formation, a proxy for investment, nor exports gathered better momentum in 2015. Investment sagged for 2 years in a row as mining firms continued to slash capital expenditure to deal with low copper prices; and export volumes shrank for the first time since the global recession in 2009, pulled down by weaker demand from its main trading partners. Even more troubling is that GDP growth slowed visibly to 1.3% yoy in 4Q15, after showing signs of stabilizing around 2% in the first three quarters. This probably hints the ongoing adjustments to low copper prices are yet affecting the economy's growth path. The revised GDP data points to that direction: investment shrank again in 4Q after picking up in the prior quarter, and private consumption growth continued to slow during 2015.

Figure 1: GDP Growth

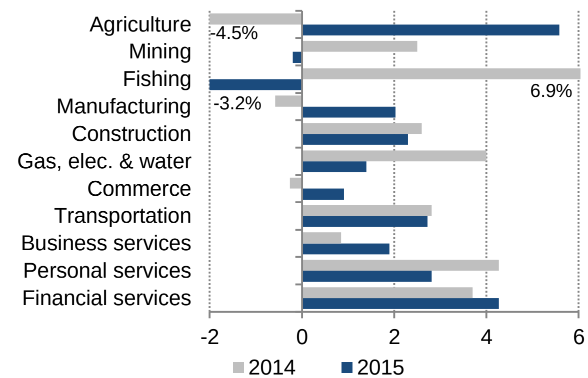
% real change	2014	2015	3Q / 4Q 2015
	1.9%	2.1%	2.2% / 1.3% (yoy) 0.3% / 0.1% (qoq)



Source: Central Bank of Chile

Figure 2: GDP by Sector

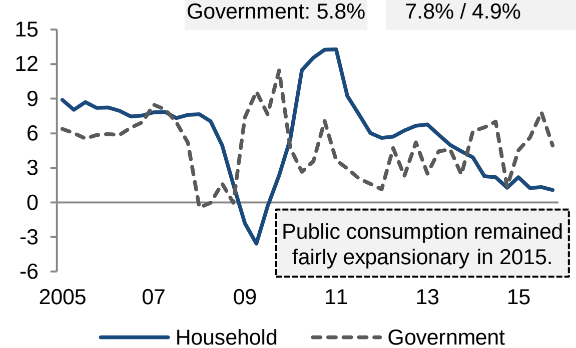
% real change yoy



Source: Central Bank of Chile

Figure 3: Consumption

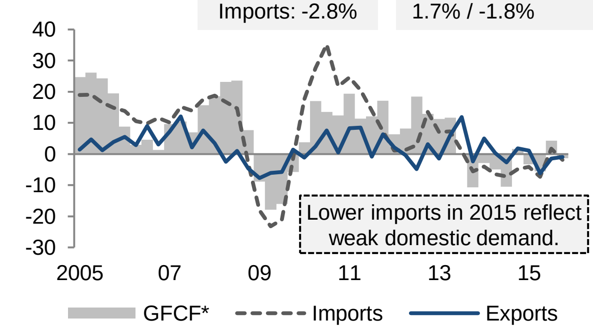
% real change yoy	2015	3Q / 4Q 2015
	Household: 1.5% Government: 5.8%	1.3% / 1.1% (yoy) 7.8% / 4.9%



Source: Central Bank of Chile

Figure 4: Investment, Exports and Imports

% real change yoy	2015	3Q / 4Q 2015
	Investment: -1.5% Exports: -1.9% Imports: -2.8%	4.3% / -1.3% (yoy) -1.4% / -0.9% 1.7% / -1.8%



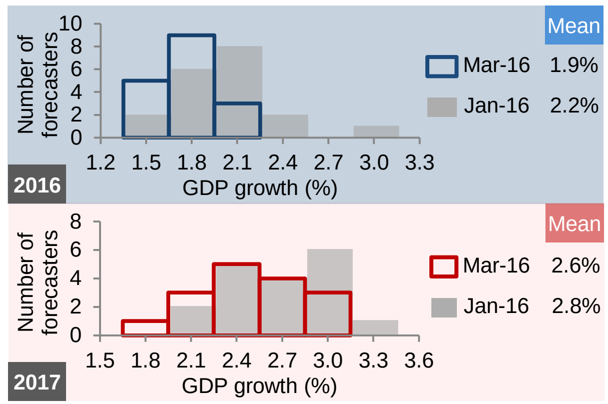
*Gross fixed capital formation
Source: Central Bank of Chile

I) Chile: Growth Momentum (2)

- **In the absence of strong engines of growth, the economy will probably grow at a similar pace as in 2015.**

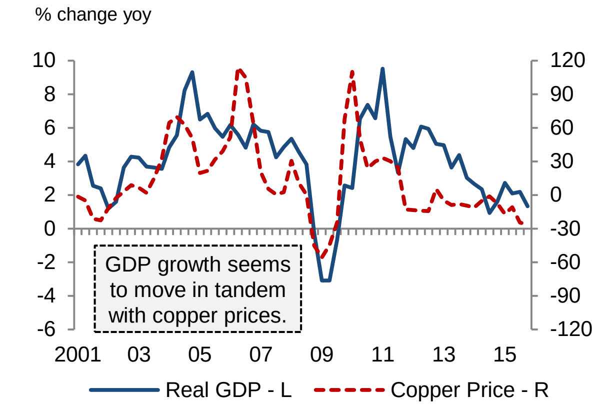
- One thing is clear for the Chilean economy: the old days of growing by around 5%, when international prices of copper were skyrocketing, are unlikely to return anytime soon. A recent study from the IMF (*End of the Supercycle and Growth of Commodity Producers: The Case of Chile*) argues that a drop in copper prices has durable effect on GDP growth, and its intensity is the highest during the first three years. Not surprisingly, the Imace index, a measure of economic activity released by the central bank, increased by just 1.6% yoy in the first two months of 2016, suggesting that, in the absence of engines of growth (e.g., low copper prices, anemic external demand, and weak investment growth), this year's GDP growth will probably be in the neighborhood of 2% again, a view that is widely shared by market forecasters. True, private consumption growth may have bottomed out last year and could gain speed in the next months. Yet, public consumption, which has remained fairly expansionary since early 2014, will likely weaken as the government cuts spending in the face of lower fiscal revenues from copper.

Figure 5: GDP Growth (private forecasts)



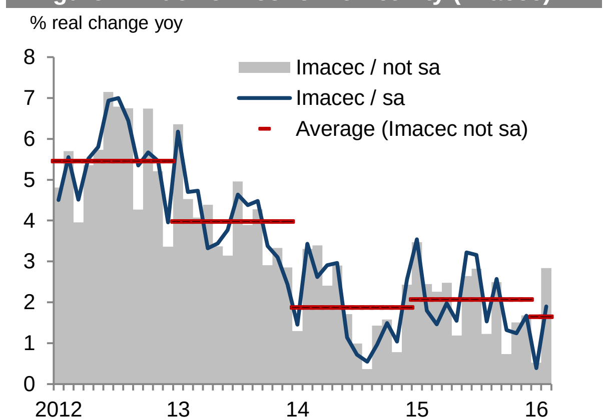
Source: Consensus Economics

Figure 6: Copper Price and Real GDP



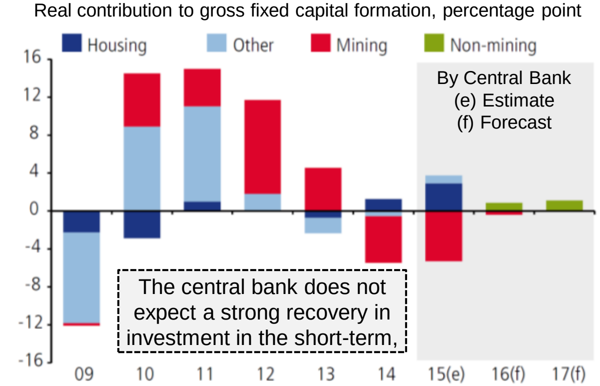
Source: Central Bank of Chile; LME

Figure 7: Index of Economic Activity (Imacec)



Source: Central Bank of Chile

Figure 8: Investment Growth



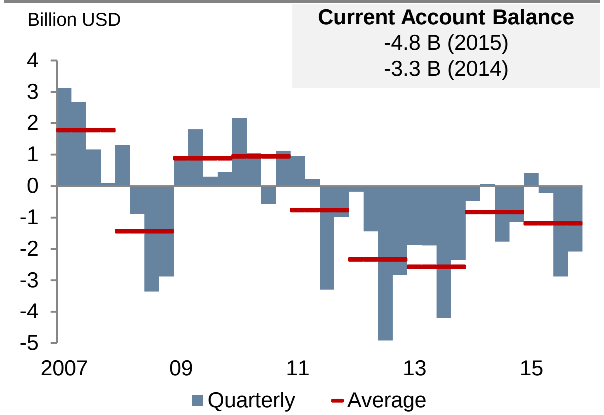
*Non-mining includes housing and other investments, for 2016-17 only.
This graph is taken from Monetary Policy Report, March 2016, page 36
Source: Central Bank of Chile, Monetary Policy Report March 2016

II) Chile: External Sector

▪ Low copper prices and weak external demand put a heavy dent in Chile's exports in 2015.

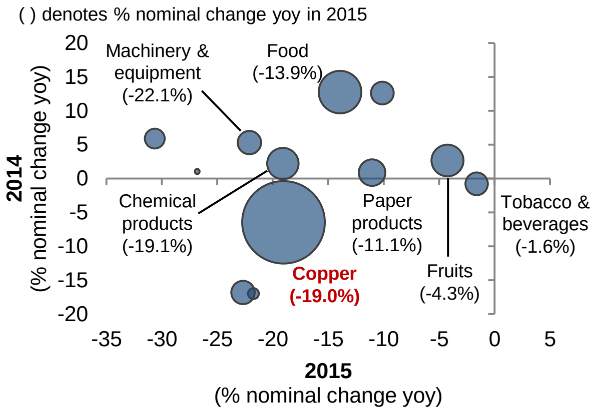
- Chile's current account deficit (CAD) widened by 43.6% in 2015 compared with the previous year, to $4.8bn, even as its income deficit narrowed by 19.5% due to lower corporate remittances. Much of the increase, evidently, was fueled by a sharp 45% plummet in its trade surplus. Yes, Chile, a country whose exports hinge heavily on refined copper and copper ores (see our *Chile: Export Profile* report), recorded a trade surplus of $3.5bn last year, when international copper prices slumped by about 20%. However, its curious trade surplus stemmed from a continued fall in imports (fueled not only by low oil and gas prices, but also weak domestic demand for consumer and capital goods), rather than an upturn in exports. Actually, export earnings fell by 17% in 2015, dragged down by low copper prices, anemic growth in copper production, and a weak external demand that put a big dent in most Chilean exports. Yet, from a regional perspective, the country's CAD was small (about 2% of GDP) compared with other commodity-reliant economies such as Venezuela (7.5%), Colombia (6.5%) or Peru (4.4%).

Figure 9: Current Account Balance



Source: Central Bank of Chile

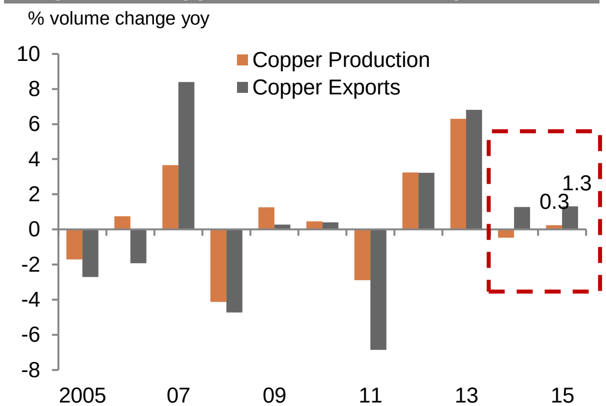
Figure 10: Exports by Types of Product*



*Size of bubbles indicates share in total Chile's exports

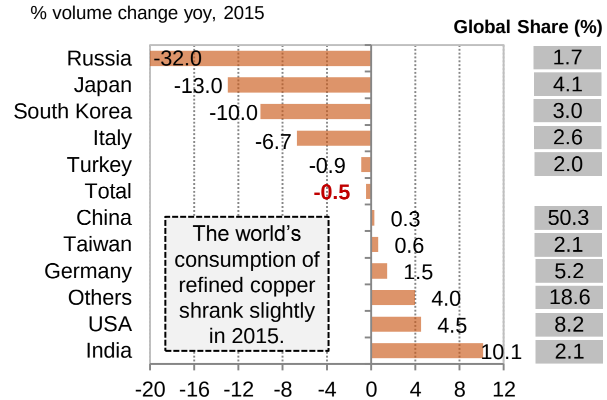
Source: Central Bank of Chile

Figure 11: Copper Production and Exports



Source: Chilean Copper Commission (Cochilco)

Figure 12: Consumption of Refined Copper*



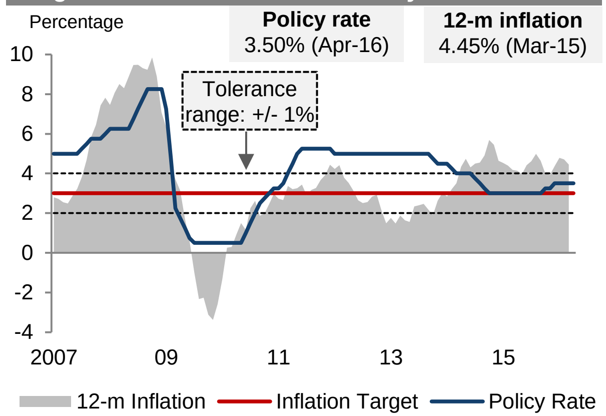
*Estimated by Cochilco, quarterly report Jan 2016

Source: Chilean Copper Commission (Cochilco)

Inflation is still high, but expected to cool off gradually towards the end of 2016

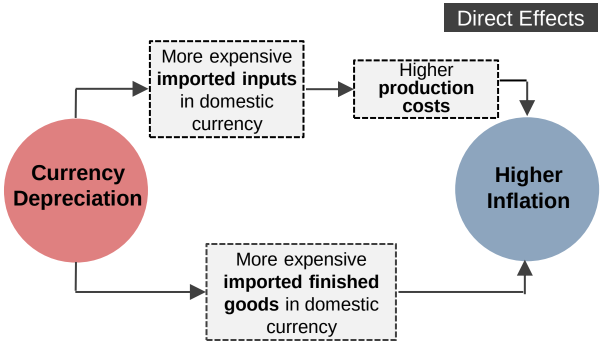
- In our previous report, we argued that the so-called exchange rate pass-through (ERPT), a process in which a weaker peso causes inflationary pressures by raising production costs and making imported goods more expensive, was one reason why CPI inflation has been entrenched above the official target range of 2%-4% over the last two years. The initial evidence supported that explanation: tradable (imported) inflation increased to 4.3% in December 2015 from 1.9% in January 2014. Now a study from the Central Bank of Chile sheds even more light on the topic, as it found that the estimated ERPT (i.e., the extent in which the peso's depreciation fuels inflation) for Chile is high even from an international perspective. Given that the peso depreciated about 15% on average in 2015, it is hardly surprising that inflation has stayed stubbornly above 4% in the first three months of the year. Looking forward, we see inflation easing during 2H16 and probably ending the year marginally below 4%. One reason is the expected appreciation of the peso in 2016. The other: inflation expectations have started to fall.

Figure 13: CPI Inflation and Policy Rate



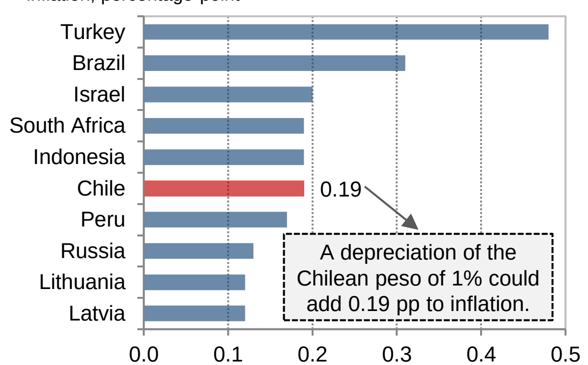
Source: INE; Central Bank of Chile

Figure 14: FX Pass-through to Prices



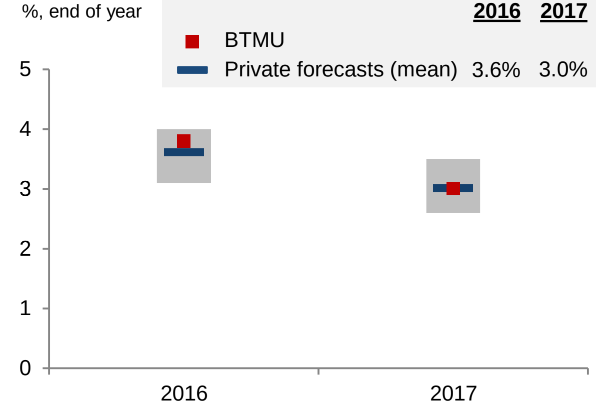
Source: BTMU

Figure 15: Estimate of FX Pass-through to Prices*



*Top 10 ERPT coefficients of a total of 48
Source: Central Bank of Chile, Economic Policy Paper #58

Figure 16: CPI Inflation (Forecasts)



Source: Consensus Economics

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