

Chile Business Forecast Report Q1 2015

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Abstracts

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Core Views

The Chilean economy will expand at a sluggish pace in the coming quarters, as weaker growth in China and deteriorating business confidence weigh on fixed investment. In addition, falling consumer confidence indicates tepid household spending is ahead.

A weakening economy will hurt the ruling Nueva Mayoría (NM) coalition's popularity, prompting the Chilean government to shelve its social agenda in favour of pro-growth policies. With the NM likely to backtrack on education reform, there is a rising probability that Chile's student protest movement will reignite in the months ahead. Chile's external account rebalancing will continue in the coming years, with a weaker exchange rate bolstering the country's good trade dynamics. This will see the current account deficit shrink to 1.9% of GDP in 2014 and 1.2% in 2015, from 3.4% of GDP in 2013.

Major Forecast Changes

We have revised down our 2014 real GDP growth forecast from 2.5% to 2.0%, and our 2015 forecast from 3.2% to 2.6%, implying a more substantial drop-off from 4.1% growth in 2013. We revised down our 2014 average exchange rate forecast from CLP562.0/USD to CLP573.9/USD, expecting the peso to average CLP613.7/USD through the remainder of 2014, compared to the current spot price of CLP598.5/USD.

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SWOT Analysis

BMI Political Risk Index

Domestic Politics

Weak Economy To Put Brakes On Bachelet's Reform Agenda

A weakening economy will hurt the ruling Nueva Mayoría (NM) coalition's popularity, prompting the Chilean government to shelve its social agenda in favour of pro-growth policies.

Table: Political Overview

Long-Term Political Outlook

Broad Stability To Remain In Place

Market-friendly policies and strong institutions have been the hallmark of the Chilean government in recent years, and we believe that the country will continue to set the benchmark for political stability in the region going forward. That said, there is a risk that the political landscape could fracture over the longer term if the leading parties fail to address long-term concerns about an economy over reliant on copper export-and-investment-led growth.

CHAPTER 2: ECONOMIC OUTLOOK

SWOT Analysis

BMI Economic Risk Index

Economic Activity

No Major Rebound In Growth In 2015

The Chilean economy will expand at a sluggish pace in the coming quarters, as weaker growth in China and deteriorating business confidence weigh on fixed investment. In addition, falling consumer confidence indicates tepid household spending is ahead.

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Monetary Policy

Inflation To Keep Policy Rate On Hold

The Banco Central de Chile has concluded its monetary easing cycle and we forecast that the policy rate will remain on hold at 3.25% through to end-2015. Above-target inflation will forestall further cuts, despite weak economic growth.

Table: Monetary Policy

Fiscal Policy

Modest Fiscal Slippage On The Cards

Subdued revenue growth and higher levels of government expenditure will lead Chile's primary budget surplus to narrow through 2015.

Stronger revenues, stemming from recent Chile's tax reform legislation, will see the surplus widen again beginning in 2016.

Table: Fiscal Policy

Balance Of Payments

External Account Rebalancing Well Under Way

Chile's external account rebalancing will continue in the coming years, with a weaker exchange rate bolstering the country's good trade dynamics. This will see the current account deficit shrink to 1.9% of GDP in 2014 and 1.2% in 2015, from 3.4% of GDP in 2013.

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Exchange Rate Policy

CLP: Global Rebalancing To Maintain Downward Pressures

The Chilean peso will remain under broad downward pressure from US dollar strength and a secular downtrend in average copper prices in the coming years. That said, a narrowing current account deficit and more supportive monetary policy by the central bank mean that the largest sell-off in the currency is behind us.

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A stable political outlook and sound economic fundamentals position Chile for steady, albeit slower, economic progress, underpinning our view that the country will have achieved developed state status by 2023. While obstacles such as high reliance on copper exports

and oil imports continue to pose a risk to economic progress, especially in light of what we view as a long-term downturn in Chinese demand for Chilean copper, we remain optimistic about Chile's economic potential over the next 10 years. Diversification away from commodity exports and further development of regional and South-to-South trade will provide an important platform for growth over the next decade.

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