

Chile Business Forecast Report Q2 2014

<https://marketpublishers.com/r/C1B5AB27C65EN.html>

Date: January 2014

Pages: 51

Price: US\$ 1,195.00 (Single User License)

ID: C1B5AB27C65EN

Abstracts

Core Views

We believe that weaker fixed investment amidst mounting external headwinds – namely, cooling external demand from China for copper – will negatively affect real GDP growth in Chile in 2014. That said, we expect that expansionary fiscal and monetary policies by the Chilean government will provide some support for the economy, underpinning our forecast for headline growth of 4.2% in 2014, only slightly down from estimated growth of 4.3% in 2013.

Slowing economic growth will prompt the Banco Central de Chile (BCC) to continue its ongoing monetary easing cycle in 2014, cutting the benchmark policy rate by 50 basis points to 4.00%. While we forecast higher average consumer price inflation in 2014, we do not expect inflation to accelerate significantly above the BCC's 3.0% year-on-year target, providing the central bank with ample leeway to maintain its dovish policy orientation. However, we note that the risks to our forecast lie primarily to the downside.

We expect the Chilean peso to depreciate in the coming months, as a weak economic growth outlook, the prospect of continued monetary easing by the Banco Central de Chile (BCC), and rising interest rates in developed markets place downside pressure on the exchange rate. Indeed, we forecast the peso to average CLP539.00/US\$ in 2014, implying further weakness from CLP532.32/US\$, where the unit is trading at the time of writing.

Michelle Bachelet's return to the Chilean presidency in 2014 will pave the way for a highly ambitious reform agenda, which seeks to raise taxes and introduce higher-quality free education in the country. However, due to an insufficient parliamentary majority, we believe that the centre-left coalition will need to compromise on reforms, ensuring that Chilean politics will not veer too far left over the coming years.

Major Forecast Changes

While Chile's external accounts will remain under pressure from weakening external demand from China for industrial metals exports, we believe that 2014 will see a narrowing of the country's current account deficit to 2.3% of GDP – a revision from our prior forecast of 3.1% – from 3.2% of GDP in 2013.

Key Risks To Outlook

We note that risks to our trade forecasts are weighted to the downside, as even with a below-consensus forecast for Chinese real GDP growth of 7.1% in 2014, persistent port strikes and delays in copper exports provide a high degree of uncertainty and could mean that our outlook for exports is overly optimistic.

The main risks to our 2014 real GDP growth forecast lie to the downside. For example, should we get more specification that Chilean projects figure prominently in Vale and Rio Tinto's cost reduction plans, we could be encouraged to revise down our 2014 GFCF forecast, which would have important knock-on effects for our 2014 real GDP growth forecast. Moreover, the Chilean government will be limited in the amount of fiscal stimulus it can employ by laws that require the structural fiscal account (which is tied to the price of copper and cyclical components of GDP) to be balanced.

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Michelle Bachelet's return to the Chilean presidency in 2014 will pave the way for a highly ambitious reform agenda, which seeks to raise taxes and introduce higher-quality free education in the country.

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