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Chile Business Forecast Report Q3 2014

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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 3.4% in 2014, down from growth of 4.1% in 2013.

We believe that the Banco Central de Chile's monetary easing cycle has now concluded following 100 basis points (bps) of cuts to the benchmark interest rate since October 2013, bringing it to 4.00%. That said, given our below consensus outlook on economic growth, we acknowledge downside risks to our end-2014 policy rate forecast of 4.00%, and we cannot completely rule out another 25 or 50bps of rate cuts.

We expect a slight narrowing of Chile's current account deficit in 2014, due to more moderate income account and services balance shortfalls, combined with slight upside for non-mining exports. While weaker investment inflows could still leave the current account underfunded, leading to a drawdown in foreign reserves, we expect Chile's balance of payments position to remain broadly stable in the coming years as the economy rebalances.

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 do not veer too far left over the coming years.

We forecast that Chile's primary budget surplus will shrink to 1.6% of GDP by 2015,

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from 2.9% in 2013, due to decelerating growth in revenues as economic growth weakens, and an uptick in public expenditures. That said, we believe that the government's tax reform bill, which will be gradually phased in over the coming years, will bolster revenues over the long term, prompting the primary budget surplus to widen again beginning in 2016.

Major Forecast Changes

We are revising down our 2014 real GDP growth forecast for Chile from 3.7% to 3.4%, as a sharp drop in fixed investment in Q413 points to weaker economic activity in the months ahead, particularly given the fall in the price of copper, Chile's key export, seen during the first quarter of 2014. While expansionary fiscal and monetary policies by the Chilean government will provide some support for the economy, we believe that the risks to our growth forecast remain weighted to the downside, particularly should copper price take another substantial leg lower.

We have revised down our 2014 average exchange rate forecast to CLP562.00/USD from CLP545.00/USD, as our core scenario is for the peso trade between its current spot of CLP554.43/USD and CLP580.00/USD through the remainder of 2014.

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Contents

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Primary Surplus To Shrink Through 2015

We forecast that Chile's primary budget surplus will shrink to 1.6% of GDP by 2015, from 2.9% in 2013, due to decelerating growth in revenues as economic growth weakens, and an uptick in public expenditures. That said, we believe that the government's tax reform bill, which will be gradually phased in over the coming years, will bolster revenues over the long term, prompting the primary budget surplus to widen again beginning in 2016.

Table: FISCAL POLICY

Monetary Policy

BCC To Hold Rates Through Year-End

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Table: MONETARY POLICY

Balance Of Payments

BoP Position To Remain Stable Amidst Rebalancing Pressures

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Table: CURENT ACOUNT

Exchange Rate Forecast

CLP: Depreciation Has Further To Run

Despite a recent relief rally that has seen the Chilean peso strengthen by 4.0% since hitting a multi-year low of CLP576.90/USD on March 12, we expect renewed depreciatory pressures to act on the unit in the coming weeks and months. Indeed, our Commodities team's view that global copper prices are in a secular downtrend, combined with the ongoing monetary policy normalisation in the US, suggests that the peso will remain in its multi-month downtrend over the next three to six months. While we believe that the Banco Central de Chile (BCC)'s monetary easing cycle has now concluded following 100bps of cuts to the benchmark interest rate since October 2013, additional support for the peso is unlikely to be forthcoming from Chile's monetary authorities, given relatively wellcontained inflation and the beneficial effect of a weak exchange rate on the non-mining economy.

Table: Currency Forecast

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Table: EXCHANGE RATE

CHAPTER 3: 10-YEAR FORECAST

The Chile Economy to 2023
Slower Growth, But Strong Fundamentals
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.
Table: Long -Term Macro economic For ecasts

CHAPTER 4: BUSINESS ENVIRONMENT

SWOT Analysis
BMI Business Environment Risk Ratings
Business Environment Outlook
Institutions
Table: BMI Busin ess And Operation Ris k Ratings
Table: BMI Legal Framewor k Rating
Infrastructure
TABLE: LA BOUR FORCE QUAL ITY
TABLE: TRADE AND INVESTMENT RATINGS
Operational Risk
TABLE: LA TIN AMERICA - ANNUAL FDI INFLOWS

CHAPTER 5: KEY SECTORS

Defence
Table: Manpow er available for Milit ary Servic e, 2012-2017
Table: Defence Expenditure, 2012-2017
Freight Transport
Table: Rail Freight, 2011-2018
Table: Air Freight, 2011-2018
Table: Maritim e Freig ht, 2011-2018
Other Key Sectors
Table: Oil and Gas Sector Key Indic ators

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