

Chile Business Forecast Report Q4 2014

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Abstracts

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Core Views

Deteriorating investor sentiment and an ongoing slowdown in private consumption will drive Chilean real GDP growth lower in 2014. Economic growth will accelerate moderately in 2015 on the back of stronger government consumption, an improved net exports position and a slight rebound in fixed investment, though our forecast is below consensus.

Near-term upside for copper prices will spur a rally in the Chilean peso over the coming weeks. However, we expect the rally will be short-lived, as weak economic growth, monetary easing by the central bank and monetary policy normalisation in the US are likely to keep the exchange rate under depreciatory pressure in H214. A narrowing current account deficit will prevent the currency from taking a major leg lower in 2015.

The Banco Central de Chile will continue its monetary easing cycle in the coming months, cutting the benchmark policy rate by 50 basis points to 3.50% by end-2014. Well-contained inflation expectations will provide the bank leeway to pursue additional rate cuts amid signs of a continued slowdown in economic activity.

A weaker Chilean peso in average terms will bolster Chile's export competitiveness while driving a contraction in goods imports in 2014, leading to a narrowing of the current account deficit. Chile's robust stock of foreign reserves and strong net international investment position will ensure that the balance of payments position remains stable despite a widening financial account deficit.

Major Forecast Changes

We have revised down our 2014 real GDP growth forecast from 3.1% to 2.8%. This implies a substantial drop-off from 4.1% real GDP growth in 2013 and average growth of 5.7% over 2010-2012. Our forecast for additional rate cuts this year by the Banco Central de Chile marks a shift from our prior view that the bank would hold rates at 4.00% through end-2015.

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Education Reform To Pass Despite Opposition
The Chilean legislature will pass a bill to reform the country's education system by the end of 2014, fulfilling one of President Michelle Bachelet's key campaign promises. That said, the process of passing the bill is likely to prove contentious, and we see scope for public protests and periods of policy gridlock in the coming months.

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. 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

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Deteriorating investor sentiment and an ongoing slowdown in private consumption will drive real GDP growth lower in Chile in 2014.
Economic growth will accelerate moderately in 2015 on the back of stronger government consumption, an improved net exports position

and a slight rebound in fixed investment, though our forecast is below consensus.

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Monetary Easing To Continue Amid Economic Slowdown

The Banco Central de Chile will continue its monetary easing cycle in the coming months, cutting the benchmark policy rate by 50 basis points to 3.50% by end-2014. Well-contained inflation expectations will provide the bank leeway to pursue additional rate cuts amid signs of a continued slowdown in economic activity.

Table: Monetary Policy

Fiscal Policy

Budget Surplus To Narrow Through 2015

Chile's primary budget surplus will shrink through 2015 as weaker real GDP growth suppresses revenue inflows and the government increases public spending to stimulate the economy. Beyond 2015, stronger economic growth and an increase in the corporate tax rate, which will bolster revenue growth, will see the budget surplus begin to widen again.

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Wider Trade Surplus To Drive Slimmer C/A Deficit

A weaker Chilean peso in average terms will bolster Chile's export competitiveness while driving a contraction in goods imports in 2014, leading to a narrowing of the current account deficit. Chile's robust stock of foreign reserves and strong net international investment position will ensure that the balance of payments position remains stable, despite a widening financial account deficit.

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CLP: Continued Weakness, But Largest Sell-Off Is Past

Near-term upside for copper prices will spur a rally in the Chilean peso over the coming weeks. However, we expect the rally will be short-lived as weak economic growth, monetary easing by the central bank and monetary policy normalisation in the US keep the exchange rate under depreciatory pressure in H214. A narrowing current account deficit will prevent the currency from taking a major leg lower in 2015.

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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 a 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 10-year period to 2023. Diversification away from exports to a more consumer-driven economy 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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