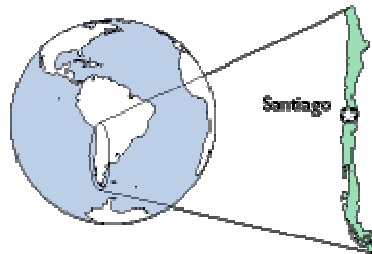


# COUNTRY REVIEW

## Chile

### Update



June 2010

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**EULER HERMES COUNTRY RISK GRADE: A**

**Country Risk Grades are on a scale of AA, A, BB, B, C, D  
where AA is the lowest and D the highest risk.**

## CHILE

SELECTED ECONOMIC INDICATORS	2006	2007	2008	2009f	2010f
Nominal GDP (USD mn)	146,773	164,318	170,851	163,305	186,639
Population (mn)	16.47	16.64	16.80	16.96	17.12
GDP per capita (USD)	8,912	9,875	10,170	9,629	10,902
Real GDP growth (% yr/yr)	4.6	4.7	3.2	-1.5	4.5
Inflation (% eop)	2.6	7.8	7.1	-1.4	3.5
Fiscal balance (% of GDP)	7.7	8.8	5.2	-4.4	-2.5
Current account balance (% of GDP)	4.9	4.5	-1.5	2.6	0.1
External debt/Exports of goods & services (%)	33.7	33.9	37.9	45.3	43.0
Interest payments/Exports of goods and services	1.5	1.3	1.7	2.3	2.0
Import cover (months)	4.5	4.3	2.9	5.5	4.6
Exchange rate assumption, CHP:USD (av)	530.3	522.5	522.5	560.9	530.0
f: CRU central forecast					

Sources: National, IMF, World Bank, Euler Hermes

### Political Stability

Stable democracy is well established with peaceful transfers of power through widely accepted constitutional elections, notwithstanding an unstable period during the late 1960s and early 1970s followed by a period of dictatorship until 1989 under President (formerly general) Pinochet. The dictatorship ended peacefully, however, as the Pinochet regime respected the outcome of a plebiscite that went against the president.

A Concertacion government—a centre-left coalition—ruled continuously from 1989 to 2009, but elections in December brought a right-of-centre government under President Sebastian Pinera. The liberal economic policy framework established during the Pinochet years was broadly maintained by successive Concertacion governments. Systemic stability risk is low.

### Economic Stability

Copper accounted for 14% of GDP and 53% of merchandise exports in 2009 (high vulnerability to commodity price changes) though growth volatility has been moderate, partly as a result of built-in policy safeguards. Data transparency is very good. Annual average growth of GDP per capita in past ten years was 2.4% (moderate).

Real GDP contracted by 1.5% in 2009 but began to recover in H2 and growth in 2010 of 4.5% likely, despite serious earthquake in Q1 2010, as reconstruction will compensate for initial disruption to output. Much depends on copper prices, but on central assumptions growth of 5% is forecast in 2011.

Fiscal policy is based on a structural target that allows fiscal policy to operate counter-cyclically. Spending is adjusted to trend revenues (based on GDP growth and copper price assumption). Actual fiscal surpluses go partly to a fund to cover minimum pension liabilities, partly to gradual re-capitalisation of the central bank and the rest to a Fund for Economic and Social Stabilisation (FEES), which is mainly held as financial assets abroad.

In 2009 the actual deficit was 4.3% of GDP, the result of countercyclical spending. In 2010, despite costs associated with the earthquake (5.2% financing requirement over 2010-2013) the deficit should be around 2.5% (higher than budgeted copper price and the spreading of reconstruction costs over four years. The FEES stood at USD11.1bn at end-2009 (6% of GDP). Public debt is low at less than 30% of GDP, even including public enterprises.

Monetary policy is based on inflation targeting (3% +/-1%). Inflation has returned in 2010, after prices fell in 2009, but is unlikely to exceed 3.5% at end-2010 before easing back in 2011. Interest rates were lowered sharply in 2009 and have remained on hold in 2010, though the central bank has shifted to a tightening bias and interest rates are likely to be raised in H2. The REER is not overvalued.

The current account balance returned to surplus in 2009 (2.6% of GDP) as imports collapsed y more than exports. As imports recover in line with stronger domestic demand, the current account will be

close to balance in 2010. Net foreign direct investment flows are likely to be around 3% of GDP in 2009-2010. Foreign exchange (FX) reserves provide 4.6 months import cover at 2009-2010 and 95% of external debt falling due in 2009 (ST and M/LT principal repayments on M/LT). However, the net external financing requirement is less than the FX reserves plus FEES. The M2/FX reserves ratio is just under 400%. The external debt-GDP has risen but is still a moderate 45% of GDP and 114% of exports of goods and services.

### **Structural Business Environment**

The Structural Business Environment is generally strong, though Closing a Business was below average (based on data and definitions from the World Bank's 2010 Doing Business Survey). The World Bank Institute's Governance Research Indicator puts regulatory quality, the rule of law and control of corruption well above average for the Latin American region and for the upper middle-income group of economies. Transparency International's Corruption Perception Index, 2009, assigns Chile a score of 6.7—on a scale of 1 (bad) to 10 (good)—and a ranking of 25= out of 180. As a broad measure of the pro-business environment The Heritage Foundation 2010 Index of Economic Freedom ranks Chile 10 out of 179

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