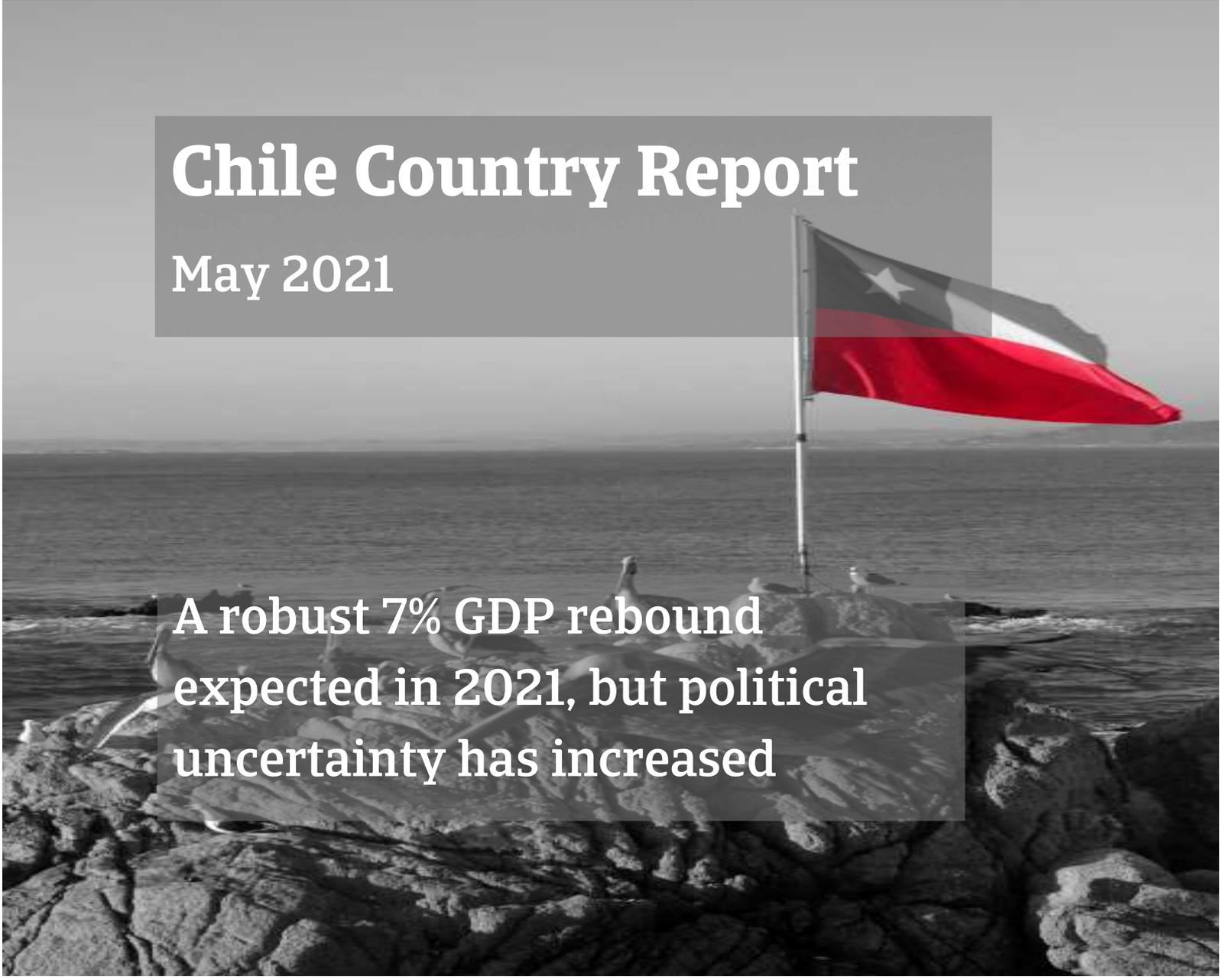


# Chile Country Report

May 2021



A robust 7% GDP rebound expected in 2021, but political uncertainty has increased

# Chile industries performance forecast

May 2021

 <b>Excellent:</b> The credit risk situation in the sector is strong / business performance in the sector is strong compared to its long-term trend.	Agriculture	Automotive/ Transport	Chemicals/ Pharma	Construction	Consumer Durables	
						
	 <b>Good:</b> The credit risk situation in the sector is benign / business performance in the sector is above its long-term trend.	Electronics/ICT	Financial Services	Food	Machines/ engineering	Mining
						
	 <b>Fair:</b> The credit risk credit situation in the sector is average / business performance in the sector is stable.	Metals	Paper	Services	Steel	Textiles
 <b>Poor:</b> The credit risk situation in the sector is relatively high / business performance in the sector is below long-term trend.						
 <b>Bleak:</b> The credit risk situation in the sector is weak compared to its long-term trend.						

## Political Situation

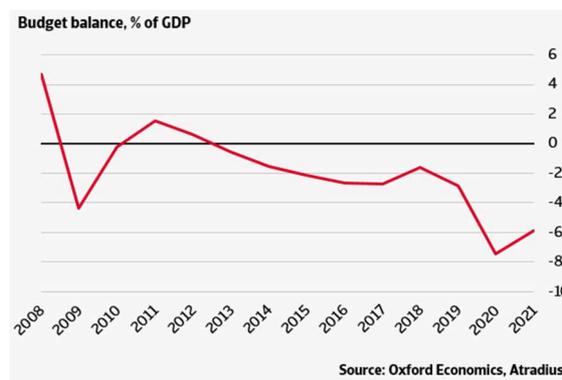
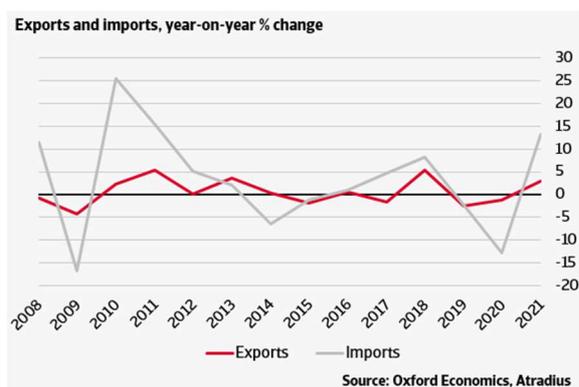
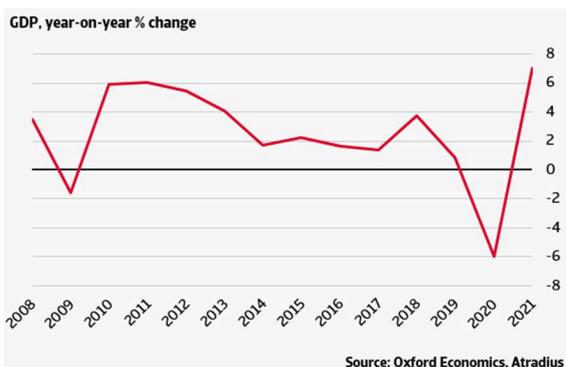
### Political uncertainty has increased

In October 2019, massive social riots broke out, due to a deep frustration among large parts of the population with growing inequality, rising costs of living and unequal access to public services. One of the protesters' key demands was to reform the old Pinochet-era constitution, which they argued entrenched inequalities by putting the private sector in control of health, education, housing and pensions. Finally, the government gave in and announced a referendum to change the constitution. The referendum was held in October 2020, with a turnout of 51%, and 78% voting in favour. As a result, another vote is scheduled for 15-16 May 2021 to select 155 people who will make up a convention that will draw up the new constitution.

The process of rewriting and passing a new constitution will last until 2022 and poses many challenges. This will add to policy uncertainty, which could weigh on the economic outlook and financial markets' sentiment.

The incumbent government under President Sebastián Piñera and his centre-right "Chile Vamos" have no majority in Congress. Approval ratings for the President have dropped as he repeatedly has tried to block popular pension withdrawal bills in 2020 and early 2021 (the bills allow workers to tap into a share of their retirement cash amid risen poverty and unemployment due to the pandemic). Presidential and parliamentary elections are due to take place in November 2021 (President Piñera will not run again).

## Economic Situation



### Robust economic growth of 7% expected in 2021

In 2020 GDP contracted 6%, due to the negative impact of adverse weather conditions on mining, the US-China trade war, ongoing social unrest and the coronavirus pandemic. However, a rebound has started since Q3 of 2020, and in 2021, the economy is forecast to grow strongly by 7%, helped by a fast vaccination rollout. Copper exports and prices have surged again, and private consumption is expected to grow by more than 8%, supported by the pension withdrawal bills. Meanwhile, real fixed investments will increase by about 8.5%. Inflation remains within the Central Bank's 2%-4% target range.

Chile's economy is still highly dependent on copper exports (accounting for more than 40% of export earnings and 10% of GDP) and subsequent demand from China, which accounts for more than 30% of Chilean exports. However, due to tax reforms, dependence of government revenues on copper earnings has decreased, from more than 25% to 10% over the past decade. Additionally, diversified export destinations via a large network of foreign trade agreements somewhat mitigate the trading risk.

Meanwhile, the service sector accounts for more than 60% of GDP. While Chile is highly integrated in the global financial markets, the high stock of inward portfolio investments by non-residents (more than 250% of official reserves) makes it vulnerable to shifts in market sentiment.

### A resilient and well-regulated banking sector

The Chilean banking sector is predominantly owned by foreign banks (about 60%). Following the adoption of a banking law in 2019, the regulatory framework was aligned with Basel III in March 2021. Capital buffers are adequate and the credit quality is good, reflecting conservative lending practices. Non-performing loans have remained low in recent years (about 2% on average) and are fully provisioned.

The main vulnerability is exposure to shifts in market sentiment, as the sector is a net-external debtor, and deposits do not fully cover loans. However, dependence on external wholesale interbank funding is low, as banks rely on domestic financing (mainly private pension funds).

### **High public spending is affordable due to a solid fiscal position**

In order to mitigate the economic impact of the pandemic, the Central Bank cut the benchmark interest rate by 125 basis points to a historical low of 0.5% and took measures to support credit lines for consumers and business alike in early 2020.

Fiscal measures to support the economy amounted to about 8.5% of GDP. Therefore, the fiscal deficit increased to 7.4% of GDP in 2020 and will remain high in 2021 and in 2022 (at about 6% of GDP and 4.5% of GDP respectively), as extended public spending will continue. The government has set up a so-called “Paso a Paso: Chile se Recupera” (Chile recovers step-by-step) investment plan worth USD 12 billion, mainly for social spending, job creation and infrastructure investment.

Chile has a solid medium-term fiscal position, which allows it to implement the sizeable fiscal stimulus. While public debt will increase to 40% of GDP in 2021, this is still low compared to Chile’s South American peers. Public debt structure remains low risk, as most of it is peso-denominated (77%) and domestically held (72%; i.e. pension funds) with long maturities, mitigating currency and refinancing risks. Additionally, two sovereign wealth funds (SWF) amounting to almost 8% of GDP, along with Chile’s net-external creditor position, mitigate the sovereign risk.

The economy’s shock resistance remains strong, given prudent macroeconomic policies, a credible inflation-targeting regime by the Central Bank, a solid banking sector, the use of natural and financial hedges and abundant reserves (including fiscal savings in the two SWF). A flexible exchange rate serves as an effective shock absorber, mitigating the impact of copper prices and external demand volatility. In the early stages of the coronavirus pandemic, copper prices deteriorated and capital was withdrawn from the country, leading to a 15% depreciation of the peso against the USD. However, access to capital for both the sovereign and private companies was quickly restored, and due to the recovery in copper prices and capital inflows, the peso has fully recovered. However, the currency is expected to remain volatile in the coming months, as policy

uncertainty related to the drafting and passing of a new constitution could affect market sentiment.

### **Solid external position and sustainable external debt**

Despite increases since 2019, external debt remains sustainable. Most external debt relates to the private sector (68% corporates, 15% banks, 17% sovereign). Access to international capital markets of both the sovereign and the private sectors remains solid.

While official reserves have declined on the back of capital outflows due to the pandemic, they still cover more than 6 months of imports and almost the entire external financing requirement, and they are underpinned by the two SWFs. In order to weather the pandemic-related volatility and to boost market sentiment, Chile has received an unconditional two-year Flexible Credit Line (FCL) of USD 24 billion from the IMF, which it intends to treat as precautionary. Such a facility is only provided to countries with sound macroeconomic policy frameworks.

### **Chile remains open to international trade, maintaining a sound business environment**

The Chilean business environment remains one of the best in the region, underpinned by sound institutions, low corruption and effective macroeconomic policies, while regulatory burdens remain an issue. Good access to foreign and domestic capital by local companies reduces refinancing risks.

Chile has 30 bilateral and multilateral free trade agreements with more than 60 countries. Bilateral trade agreements cover most of the world’s largest economies, including the US, the EU, China, Japan, Canada and Australia. Chile recently ratified bilateral agreements with Brazil (its largest trade partner in Latin America) and Ecuador, which will be beneficial for regional integration and economic growth in the longer run.

Currently, the best performing sectors in Chile are agriculture, packaging and pharmaceuticals. In agriculture and packaging, demand for machinery and industry-related technology is increasing, providing exporters in those segments with opportunities. The same accounts for pharmaceuticals exporters, as Chile imports most of the related items.

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