Euler Hermes Economic Research

Country Risk Analysis

Chile

Copper bottomed

General Information

GDP	USD248,6bn (World ranking 38, World Bank 2011)
Population	17.27 million (World ranking 59, World Bank 2011)
Form of state	Republic
Head of government	Sebastian PINERA Echenique (independent)
Next elections	2013, presidential and legislative

Strengths

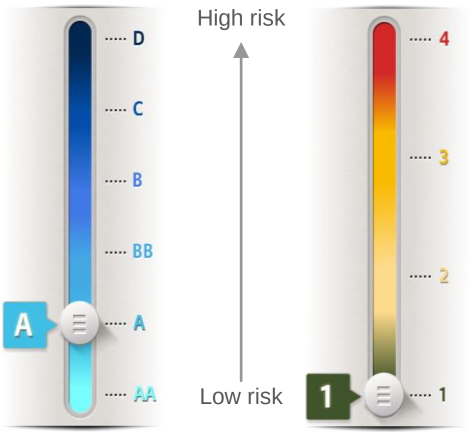
- Natural resource base (largest copper producer in world, but also other minerals, forestry and agriculture)
- Strong medium-term growth
- Pro-business, sound macro-policy framework. Support from IFIs very likely if needed
- Sound external balance
- Very strong Structural Business Environment.
- Widely accepted, democratic political system with suuccessive peaceful transfers of power.

Weaknesses

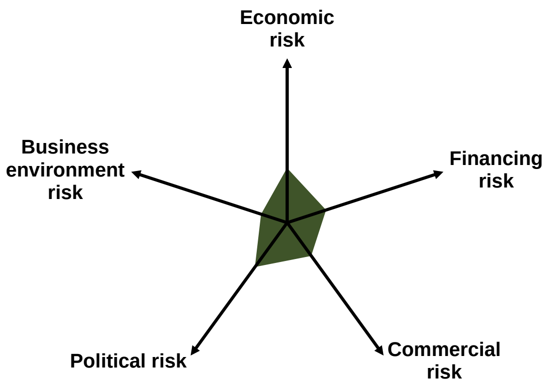
- Sensitive to commodity prices, particularly copper (more than 50% of exports).
- Skewed income distribution.

Country Rating A1

Country Grade **Country Risk Level**

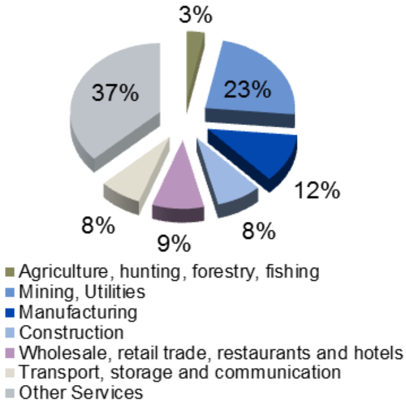


Risk Dimensions



Economic Structure

GDP breakdown (% of total, 2010)



Trade structure (% of total, 2010)

By destination/origin

Exports		Rank		Imports
China	26%	1	19%	United States
Japan	11%	2	16%	China
United States	10%	3	9%	Argentina
Brazil	7%	4	8%	Brazil
South Korea	6%	5	6%	South Korea

By product

Exports		Rank		Imports
Non Ferrous Metals	38%	1	8%	Refined Petroleum Products
Non Ferrous Ores	24%	2	8%	Crude Oil
Other Edible Agricultural Prod	7%	3	6%	Cars And Cycles
Meat	5%	4	5%	Commercial Vehicles
Paper	4%	5	4%	Construction Equipment

Sources: Chelem, UnctadStat, IHS Global Insight, Euler Hermes

Economic Forecast

	2009	2010	2011	2012	2013f	2014f
GDP growth (% change)	-1.0	5.8	5.9	5.5	4.5	4.7
Inflation (%, end-year)	-1.5	3.0	4.4	1.5	2.5	3.0
Fiscal balance (% of GDP)	-4.1	-0.3	1.4	0.6	-0.5	-0.5
Public debt (% of GDP)	28.8	27.7	34.7	34.7	35.0	35.0
Current account (% of GDP)	2.0	1.5	-1.3	-3.5	-3.7	-3.1
External debt (% of GDP)	41.7	39.0	39.3	44.1	45.1	46.1

Sources: IHS Global Insight, National sources, Euler Hermes

Economic Growth

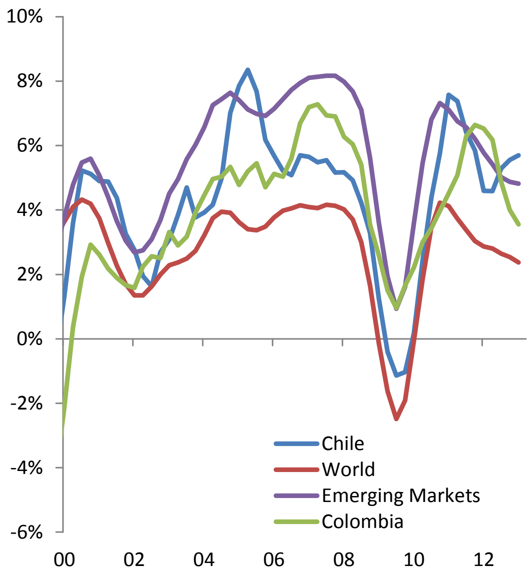
Strong medium-term growth, but sensitive to commodity prices

Medium-term growth has been strong with annual average growth of per capita GDP of 3.6% in the past decade. The small, open economy is very sensitive to commodity prices, particularly copper, which accounts for more than 50% of exports. Despite the vulnerability to external shocks, growth volatility has been moderate, reflecting in good part sound macroeconomic policies in place over an extended period under successive governments.

Slower pace in 2013 and 2014

After an annual average increase of 5.8% in 2010-12, weaker demand for commodities (notably from China, Chile's largest export market) is likely to lead to a slower pace of growth in 2013. In Q1 GDP increased by +4.1% y/y. Domestic demand remains robust, however, led by private consumption and the highly negative net export contribution in Q1 should improve, leading to full year 2013 growth of +4.5%, though the risks are to the downside. Growth should remain solid in 2014 at 4.7%.

GDP growth (y/y, 4 qtrs cumulated %)



Sources: IHS Global Insight, Euler Hermes

Economic Policies

The policy environment is generally sound framed at the macro level by inflation targeting and a fiscal responsibility law that manages public finances effectively through commodity price cycles. Presidential and legislative elections are to be held in November 2013, but broad policy continuity is likely to be maintained.

Inflation targeting

Monetary policy is framed against inflation targeting, currently 3% with a +/-1% range. Inflation eased steadily through 2012, helped by strong exchange rate appreciation, falling below 3% y/y in June 2012 and continuing to fall to just 1% y/y in April 2013. While inflation is likely to pick up, it should end in 2013 still below the mid-point target. The policy interest rate was last cut in January 2012 since when it has been unchanged. As inflation is below target there is some scope to lower rates if growth slows more than expected. Credit expansion is still strong, however, and the real effective exchange rate has appreciated, though it does not appear seriously overvalued.

Bank lending to the private sector is moderate and banking system indicators are adequate. Tier 1 capital ratios are 10%, non-performing loans are 2.2% and fully covered by provisions. Foreign currency loans, however, remain relatively high and as the banking system has a high level of foreign ownership it is potentially vulnerable to external shocks.

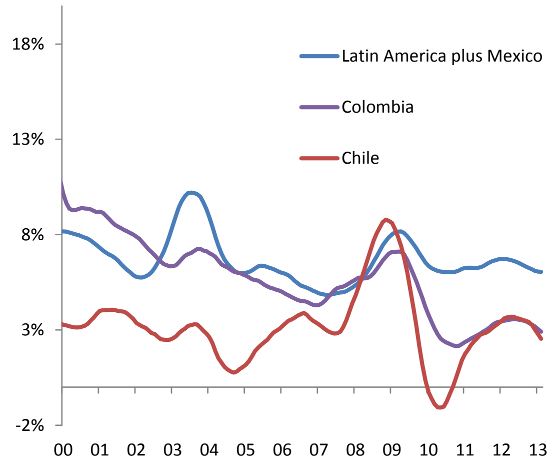
Sound fiscal managent based on structural surplus rule

Fiscal management is built around a structural surplus rule, the aim of which is to ensure that policy is counter-cyclical and effectively manage the fiscal accounts against copper price shocks. Spending is adjusted to trend revenues (based on GDP growth and the copper price assumption) and any surplus revenues (when copper prices are high for example) go mainly into two funds, one to cover minimum pension liabilities and the other, the Fund for Economic and Social Stabilisation (FEES), which is mainly held as financial assets abroad to provide financing at appropriate times. The FEES was just under USD15bn at end-2012. The aim of the current government is to reduce the structural deficit to -1% of GDP by 2014 (withdrawing the large fiscal stimulus applied in the 2009 downturn).

The actual fiscal balance (general government, IMF data) was in surplus of 0.6% in 2012, as was the central government balance. Planned expenditure increases are expected to take the actual balance of the central government into small deficit in 2013, though the general government balance may remain in surplus.

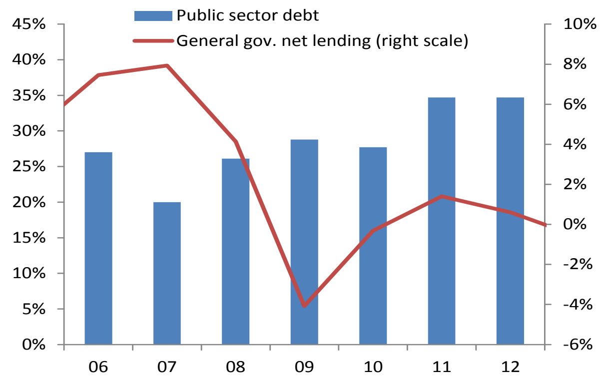
The public debt-GDP ratio (including central bank debt) is low at 34.7% in 2012. Moreover, the public sector is a net creditor.

Inflation rate (%)



Sources: IHS Global Insight, Euler Hermes

Fiscal balance and debt (% of GDP)



Sources: IHS Global Insight, Euler Hermes

Current account deficit but strong FDI flows

The current account deficit widened in 2012 to -3.1% of GDP from -1.3% in 2011 and surpluses in preceding years, as exports earnings declined, mainly on lower copper receipts. With the boom years of copper prices receding, the current account is likely to remain in deficit in 2013 of -3.7% narrowing to -3.1% in 2014, as export prospects improve on strengthening global demand.

FDI flows are strong in both directions but net flows in 2012 covered almost 100% of the current account deficit and should remain at this level in 2013-14, reducing the need for debt financing.

External debt moderate

External debt ratios are moderate. External debt is 44% of GDP, 124% of exports of goods and services and interest payments are 2.8% of exports of goods and services.

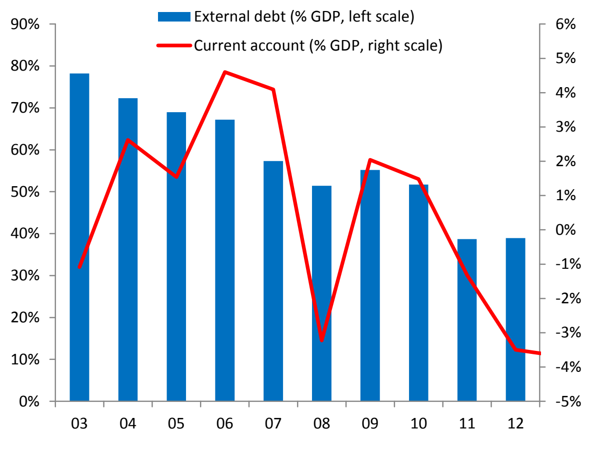
The bulk of the debt outstanding is owed by the private sector.

Foreign exchange reserves increase

FX reserves have risen strongly in recent years and cover 5.2 months of imports of goods and services and just over 100% of % of external debt falling due in 2012 (ST and M/LT principal repayments). Moreover, if assets held in the FEES are included this ratio rises to 130%. M2/FX reserves are also moderate if the FFEs assets are included.

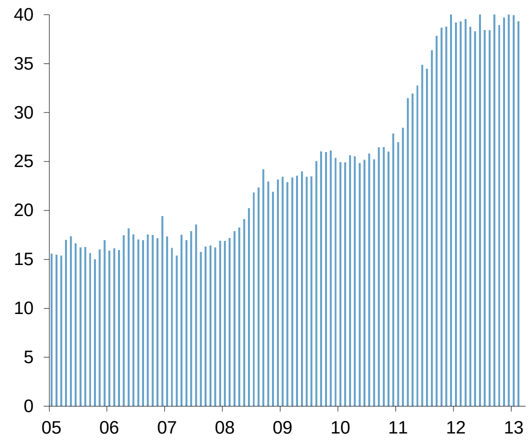
Overall the external balance is sound.

Current account and external debt (% of GDP)



Sources: IHS Global Insight, Euler Hermes

FX reserves (USDbn)



Sources: IHS Global Insight, Euler Hermes

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