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CHILENO BRITÁNICA
DE COMERCIO

Chilean Economic Report
First Quarter 2022

1st Edition 2022 — Produced since 1922

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Dear reader

We continue to live in uncertain times. Just as we are coming out of the pandemic, war has broken out in the Ukraine. Every day the news if filled with horrific images of the Russian invasion.

Greg Holland
General Manager
British Chilean Chamber of Commerce
Santiago, Chile

Globally we are preparing for shortages of energy and commodities such as grain, and there is bound to be some knock-on effect in Chile. Oil prices are at their highest level in ten years. The copper price has risen to record levels in March amid fears of shortages and higher demand related to the war.

Drought has become the biggest environmental challenge Chile has ever faced. As we enter the 13th year of below average rainfall, 2021 was the driest year on record. If the situation continues, Santiago may face restrictions in the second half of 2022. Water shortages are affecting many parts of the economy such as mining and agriculture.

Here in Chile the jury is still out as we await the outcome from the constitutional convention, and more details of the changes proposed by the new government. Business confidence has recovered slightly since the elections in December, but the construction industry is suffering as lack of investment and expensive mortgages are freezing sales.

The economy this year faces significant challenges following the consumer boom during 2021. Inflation could reach 10% during the year, which will be its highest level in over 20 years. Interest rates have already reached 7%, with further rises likely during the year, and growth is forecast to be below 2% through 2022 and 2023.

Here in the Chamber, we will continue to do our best to bring you information and analysis relevant to the many important issues that are under discussion.

We are delivering this report with a new design, which is part of a full rebranding we have been working on for the Chamber. Our new website will be on line soon www.britcham.com. For the first time we include a Doing Business in Chile Guide, which we have developed in partnership with the UK Department of International Trade. We would love to hear your feedback.

Economic Report Committee: Peter Lynch, Audit Manager, BHP. Leslie Hemery, Vice-President, British Chilean Chamber of Commerce. Guillermo Tagle, President, Credicorp Capital. Andrew de la Mare, External Consultant, Jorge Selaive, Chief Economist, Scotiabank Chile. Gareth Taylor, Head of Economic Affairs & Sustainable Development, British Embassy in Chile. Tom Azzopardi, Editor in Chief, Chile Explore Group. Greg Holland, General Manager, British Chilean Chamber of Commerce.

• Production coordinator: María Isabel Juppet C. • Electronic version of the report: www.britcham.cl • Design and layout: Forma • Printer: A Impresores S.A.

Key points

- After growing by almost 12% last year, economic activity is expected to expand by less than 2% in 2022 and by just 0.5% in 2023 amid political uncertainty, curtailed public and private spending and tighter financial conditions.

- Driven by last year's consumer boom and soaring commodity prices, inflation is set to rise as high as 10% by the middle of the year, its highest level in more than two decades, reducing disposable incomes.

- To contain prices, the Central Bank has rapidly raised interest rates to 7.00% and plans further hikes in the coming months. Higher interest rates have already slowed bank lending and sales in the housing market.

- The radical proposals being debated for inclusion in the new Constitution are continuing to worry investors and moderate voters. Polls in early April suggested more people would vote to reject than approve the document in the referendum set for September.

- Incoming President Gabriel Boric reassured markets by appointing respected economist Mario Marcel as Finance Minister. The former Central Bank head plans to send legislation to Congress by mid-2022 that would raise taxes by 4.0% of GDP.

- The new administration has promised to honour a 20% cut in public spending approved in this year's budget legislation but is under pressure from its supporters to help families in the weakening economy.

- The unemployment rate has begun to rise as investment slows and people start looking for work again after the pandemic while high inflation has eliminated the impact of rising wages.

- Copper prices have surged to record levels following the Russian invasion of Ukraine. But a slump in mine production because of water shortages has reduced exports.

- Share prices and the Chilean peso have rallied strongly since December, reflecting high commodity prices and increased confidence in the new government.

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Domestic Economic Performance

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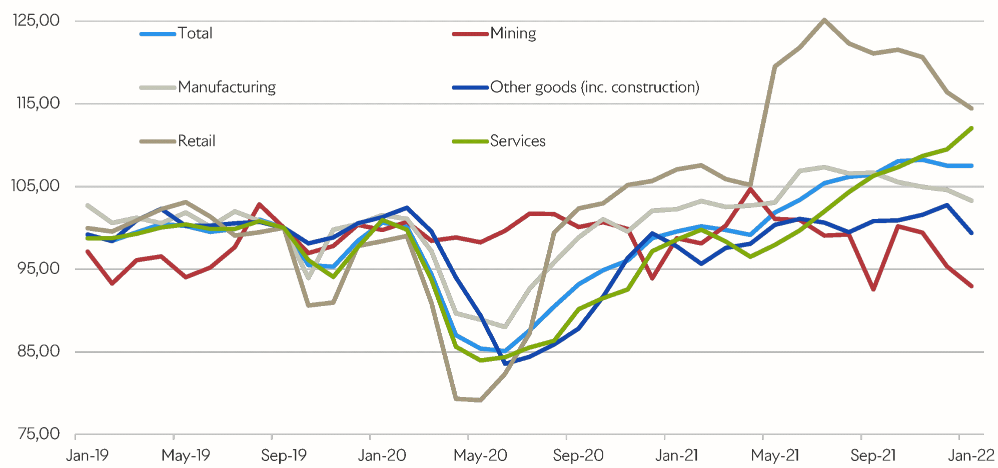
Economic Activity, Monthly (Sep 2019 = 100), 2019 - 2022



Source: Central Bank of Chile

After growing by 11.7% in 2021, its fastest rate in several decades, the Chilean economy has begun to slow as consumers and businesses react to increased borrowing costs, a fall in household liquidity, and political uncertainty, especially over the development of the new constitution (See 3.0 Insight).

Preliminary data from the Central Bank showed that the economy grew by 6.8% in February on an annualized basis but contracted on a seasonally-adjusted basis by 0.5% from the previous month of January, marking the fourth consecutive month of negative or negligible growth. While services activity has continued to grow as social-distancing rules are relaxed, construction, retail and mining have all fallen, reflecting falling investment, a drop in sales of consumer durables and a slide in copper production.

The figures for January and February reflect a trend that began in the final three months of 2021 when both private consumption and investment began to slow.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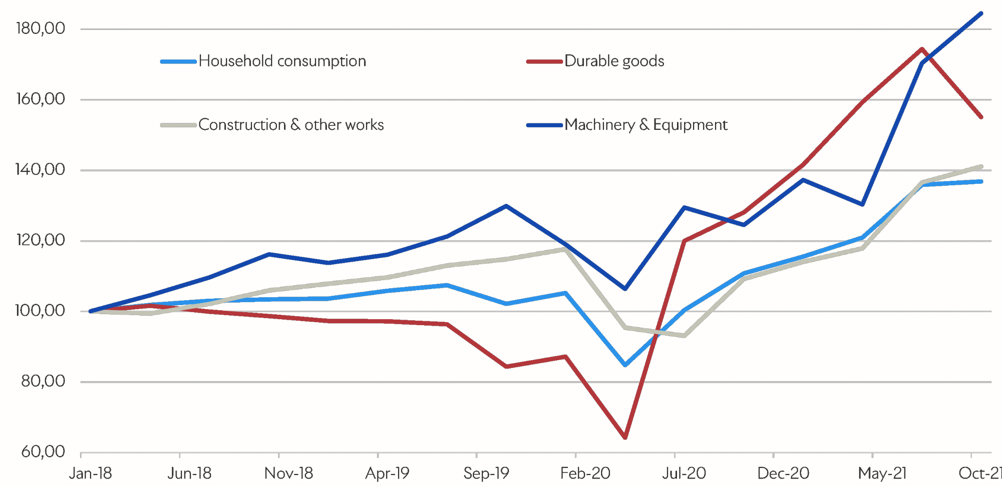
Investment & Consumption, Quarterly (2018=100), 2018-2022



Source: Central Bank of Chile

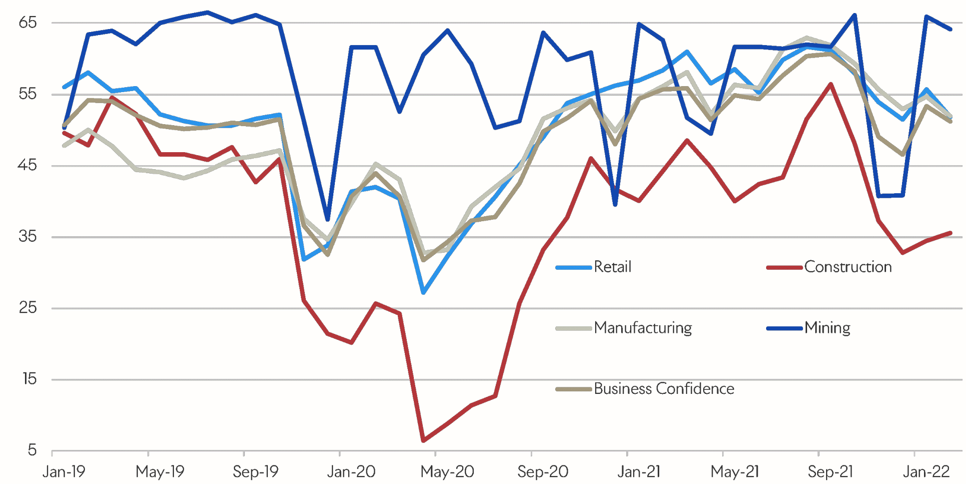
Private consumption grew by just 0.7% in the fourth quarter, down from 12.4% in the third, reflecting a decline in sales of consumer durables. Meanwhile, investment (as measured by Gross Fixed Capital Formation) grew by 5.3%, down from 21.3% in the previous quarter as spending on both machinery and construction slowed sharply.

Looking ahead, the Central Bank predicted that the economy would grow by just 1.0-2.0% this year, down from its previous forecast of 1.5-2.5% made in December 2021. The drop reflects expectations that both private consumption and investment will decline this year (by 0.3% and 3.8% respectively) rather than the marginal growth predicted previously. Next year, the Central Bank forecast that the economy would barely grow (0.25-0.75%) and many analysts have warned that the economy could contract later this year due to 2021's high base of comparison.

Confidence

Business and consumer confidence have declined in recent months reflecting concern over rising inflation, the weaker economic outlook, and uncertainty about the political situation (See 3.0 Insight).

Monthly Business Confidence Indicator, 2019-2022

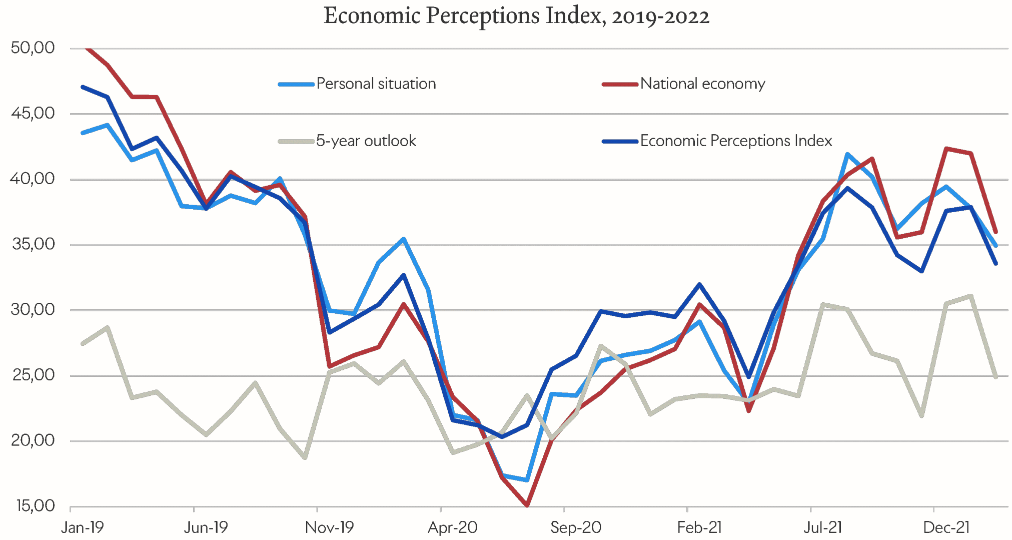


Source: Adolfo Ibáñez University, ICARE

In February, the Monthly Business Confidence Indicator, produced by the Adolfo Ibáñez University and the ICARE business association, reached 51.19 points. Although it marked a 5-point increase from a brief foray into negative territory after last December's presidential elections, it marks a fall of almost ten points from six months earlier. Confidence has fallen furthest among executives in the construction industry who have seen a steep fall in demand as businesses halt investment and high mortgage rates chill the housing market.

The majority of executives surveyed by the Central Bank in February said that sales had slowed or fallen in recent weeks (especially in the property market) while rising costs were eating into margins.

Economic Perceptions Index, 2019-2022



Source: GfK

After recovering from rock-bottom levels through the pandemic, consumer confidence has fallen back as consumers react to the weaker state of the economy. GfK's Economic Perceptions Index slipped to 33.6 points in February down four points from December. Concern about the labour market and inflation have started to rise again.

After last year's consumer boom, sales have slowed with the government's retail activity index declining by 1.4% in February, its fourth consecutive monthly fall and down 8.6% from six months earlier. In part, the reopening of the economy is allowing consumers to spend more on services rather than goods, but high inflation, the end of fiscal assistance for households and the exhaustion of the pension withdrawals are also squeezing disposable incomes.

The decline is most visible in sales of consumer durables which declined by 11.0% in the final three months of last year, compared to the previous quarter. New car sales totalled 69,000 in January and February, down 13.4% from the previous two-month period.

Source: National Automobile Association

Services

While other sectors have begun to slow, services (which accounts for half of Chilean GDP) are still expanding, benefitting from the almost total relaxation of social-distancing rules. Tourism sales grew by 39.3% in February, compared with twelve months earlier, driven by restaurant sales and hotel stays, while entertainment activities more than doubled, driven by the reopening of the casinos, sports events, and cultural activities.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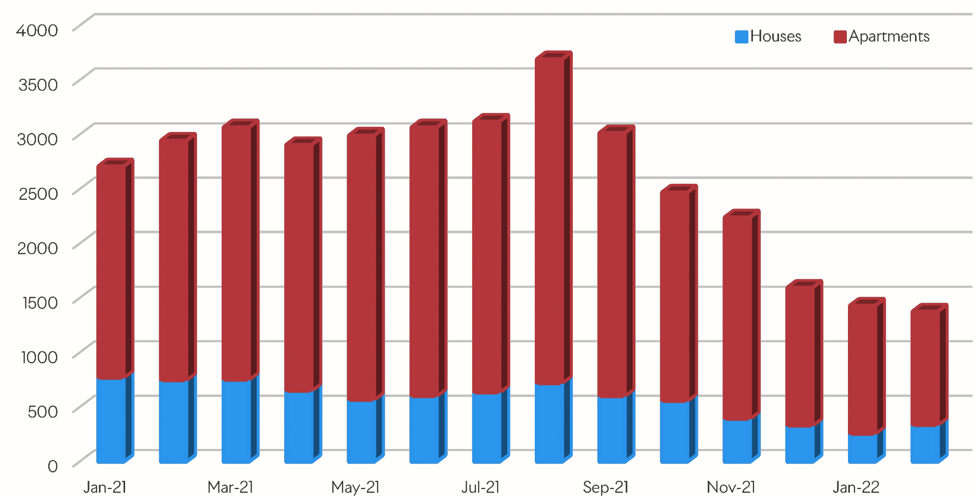
Construction

Construction activity has begun to decline as companies halt investment and higher interest rates slow sales in the housing market. The Chilean Chamber of Construction's construction activity index fell by 3.1% in the year to January, compared to a rise of 26% to July last year. The decline reflects falls in residential sales, deliveries of cement and requests for new building permits.

Home sales in Santiago have fallen from a monthly average of over 2,800 in 2021 to just 1,400 so far this year.

Residential Sales in Santiago, 2021-22

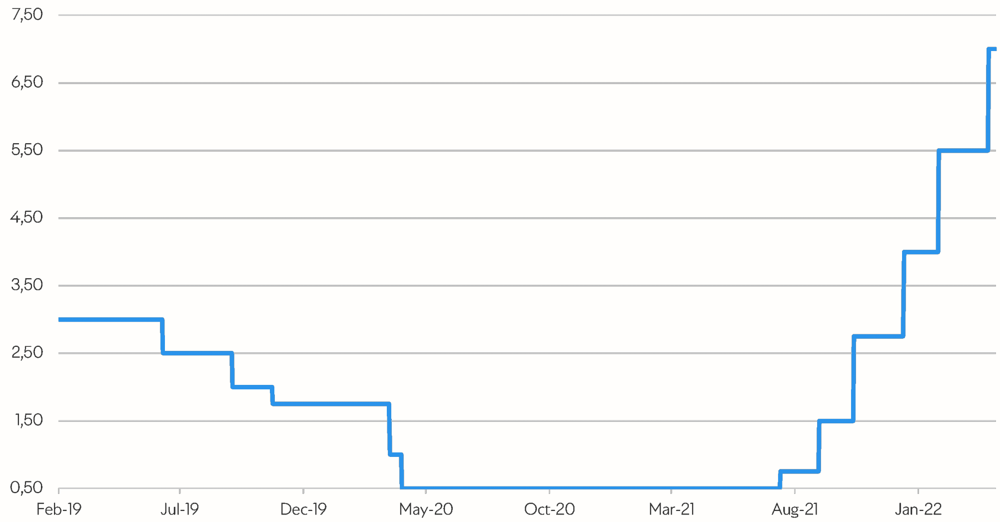


Source: InfoInmobiliaria

Manufacturing

Manufacturing activity fell 2.2% in the year to February, including a seasonally-adjusted fall of 1.1% from the previous month of January, following a drop in production of fertilizers and metallic products. In February, steel producer CAP warned that it lost around 50,000 tonnes of production, equivalent to 6% of its annual output, following technical problems at its Huachipato plant.

Monetary Policy Rate, %, 2019-2022



Source: Central Bank of Chile

The Central Bank has accelerated the withdrawal of its monetary stimulus as it strives to contain growing inflation. On March 29th, the board voted unanimously to raise its benchmark rate by 150 basis points to 7.00%, its highest level since 2009. It is the third consecutive 150 bp increase since October last year. Although the jump in oil prices following the Russian invasion of Ukraine is expected to drive inflation higher in the coming months, the Bank said future rate hikes would be smaller.

As inflation and oil prices have risen, expectations for future increases in interest rates have also grown. Surveyed by the Bank in early March, analysts forecast that the rate would rise to 7.75% later this year before declining to 5.00% by early 2024. However, traders surveyed just two weeks later predicted the rate could hit 8.50% during 2022 and would decline to just 6.50% over the next 24 months.

Following the resignation of Mario Marcel to become Finance Minister, President Piñera appointed Rosanna Costa as president of the Central Bank, the first woman to hold the post in its 97-year history. In February, the Senate ratified economist Stephany Griffith-Jones, an advisor to Gabriel Boric during last year's election campaign, as the board's newest member.

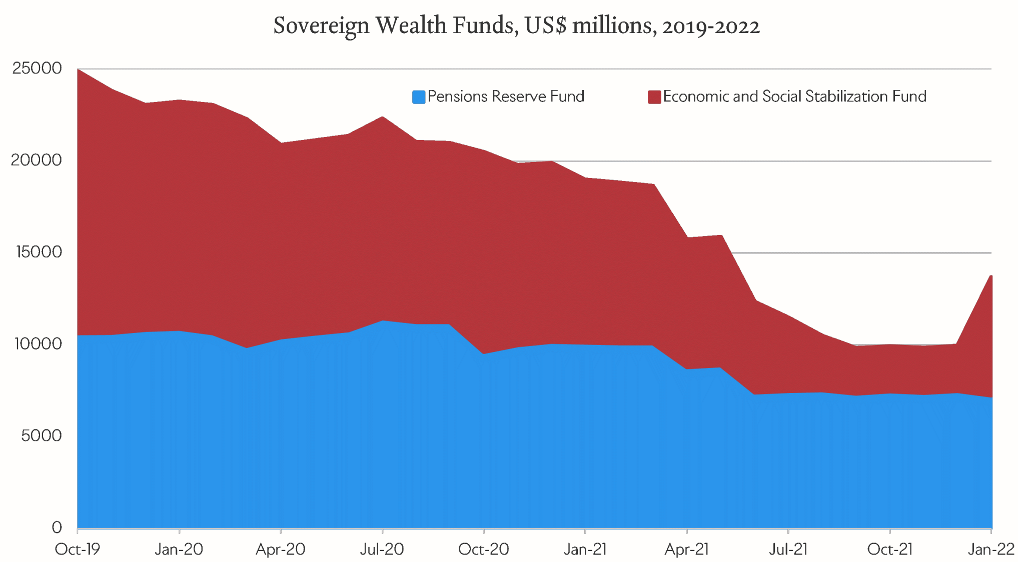
Chile's new government has committed to a sharp reduction in public spending this year, similar to the 20% cut included in the previous government's budget legislation. The unprecedented cut (following last year's 37% spending increase, largely on fiscal assistance to households) is necessary not only to contain government debt, but also to bring down soaring inflation. Finance Minister Mario Marcel is expected to set out the administration's fiscal strategy by the end of April.

Beyond 2022, spending will depend on the success of the government's legislative agenda which includes plans to increase taxes and reform the pensions system. Marcel has said that he aims to send the tax legislation, which would increase government revenues by approximately 4.0% of GDP, to Congress by the middle of the year.

In its final report released in February, the outgoing administration claimed that the rapid expansion of the economy last year had left public finances in a much better state than previously expected. As a result, the government deficit would shrink from a record 7.6% in 2021 to just 1.0% in 2022 (down from 8.3% and 2.8%, respectively predicted in October). The tax revenues generated by this growth would provide an additional US$30.0 billion over the life of the incoming government.

However, the Autonomous Fiscal Council, the public spending watchdog, warned the incoming authorities to take the figures with a pinch of salt, especially the expectation that the economy would grow by 3.5% this year (up one percentage point from the government's previous forecast). With the Central Bank now predicting growth of less than 2.0% this year, public finances are going to be in a much tighter state than previously thought.

Sovereign Wealth Funds



Source: Ministry of Finance

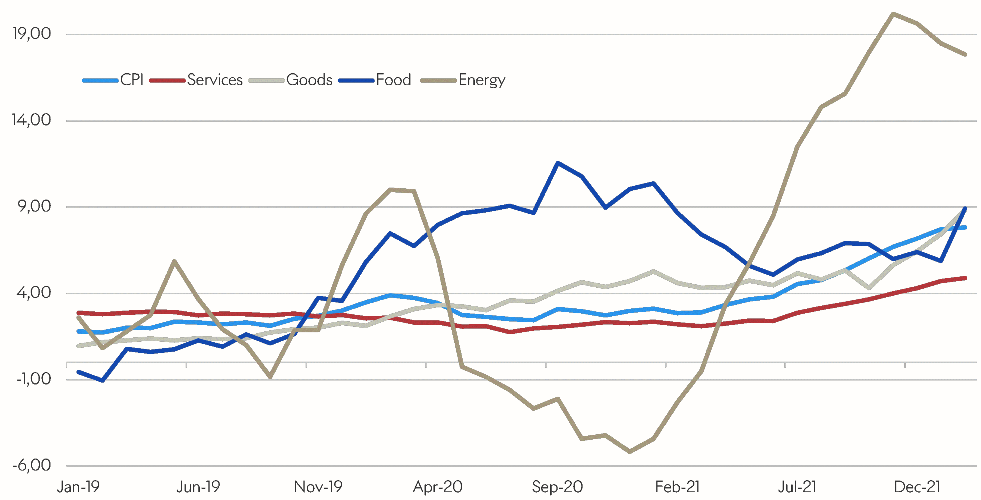
After withdrawing US$6.0 billion from the Social and Economic Stabilization Fund during 2021, the outgoing administration injected US$4.0 billion into the fund, citing better-than expected tax revenues following last year's spurt. As a result, Chile's two sovereign wealth funds now hold assets worth US$13.6 billion, down from US$18.9 billion twelve months earlier.

Credit Ratings

The world's leading credit ratings have left Chile's sovereign debt credit ratings unchanged as the new government takes office.

Fitch Ratings	A- (stable)
S&P Global Ratings	A (stable)
Moody's	A1 (negative)
JCR	AA- (stable)

Consumer Price Index, annual change %, 2019 -2022



Source: Central Bank of Chile

Inflation has surged to its highest level in a decade and is expected to continue rising driven by soaring energy prices. In February, the government's Consumer Price Index rose by 7.8%, its highest level in almost fourteen years, pushed up by strengthening goods prices.

On a monthly basis, the index rose by just 0.3% in February, compared to market expectations of a 0.7% rise. Analysts attributed the slight deceleration to the impact of the wave of Omicron infections which swept the country at the start of the year, forcing thousands to self-isolate.

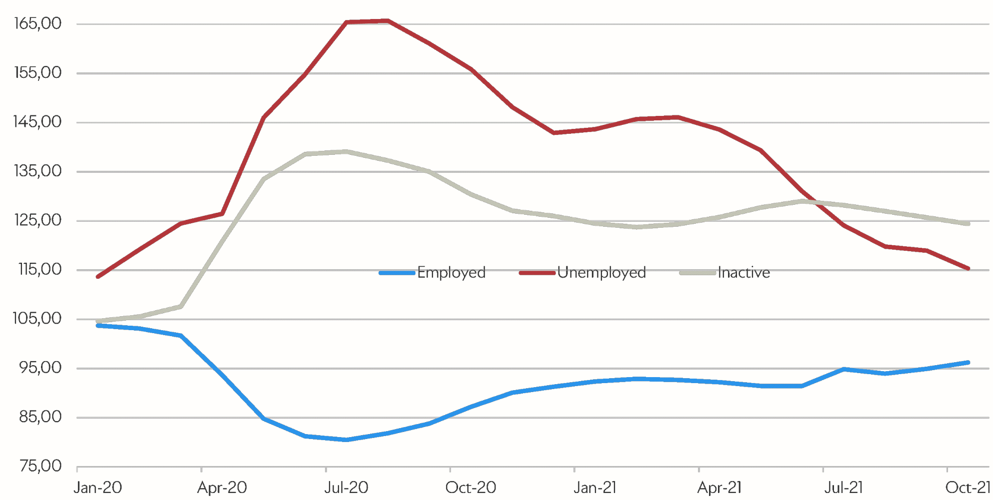
However, the increase in food and energy prices triggered by Russia's invasion of Ukraine in February is expected to keep up the pressure on prices over the coming months even as economic activity slows in Chile. Analysts surveyed by the Central Bank in early March predicted that monthly inflation could reach 0.8% in March and 0.5% in April.

Worryingly, despite the Central Bank's unprecedented raising of interest rates, inflation expectations have continued to rise with analysts surveyed in March predicting that inflation will reach 4.0% by the end of 2023, up from 3.5% predicted at the end of 2021.

The rise in inflation comes despite government efforts to hold down rising energy prices. In March, the outgoing administration approved changes to its Fuel Price Stabilization Mechanism which would hold diesel and petrol prices around CLP 200 a litre below where they would otherwise be. Nevertheless, petrol prices have risen by almost a third over the last year.

The unemployment rate has begun to climb as thousands of people left idle by the pandemic start to look for work again and the number of new jobs created slows as investment slows.

Labour market, January 2018 = 100, 2020 - 2022



Source: National Statistics Institute

According to the government's monthly job survey, the workforce reached almost 9.5 million in the three months to February, its highest level in almost two years and up around 120,000 since the start of the year, mirroring a fall in the number of people classed as inactive.

Meanwhile, the number of new jobs created by the economy has slowed, rising by just 90,000 since the start of the year compared to an average of around 100,000 a month during the second half of 2021. This mirrors a drop in demand among employers since the end of last year, with fewer companies surveyed by the Central Bank declaring they are looking to expand their workforce, while the number of vacancies posted online has fallen.

As a result, after falling from over 10% to 7.2% last year, the jobless rate climbed to 7.5% in the February quarter.

To boost employment, outgoing President Sebastián Piñera extended the IFE Laboral jobs subsidy programme (which pays new workers up to CLP250,000 (US$318) on top of their monthly wage) by another three months until June 30th. It has benefited more than 740,000 workers so far.

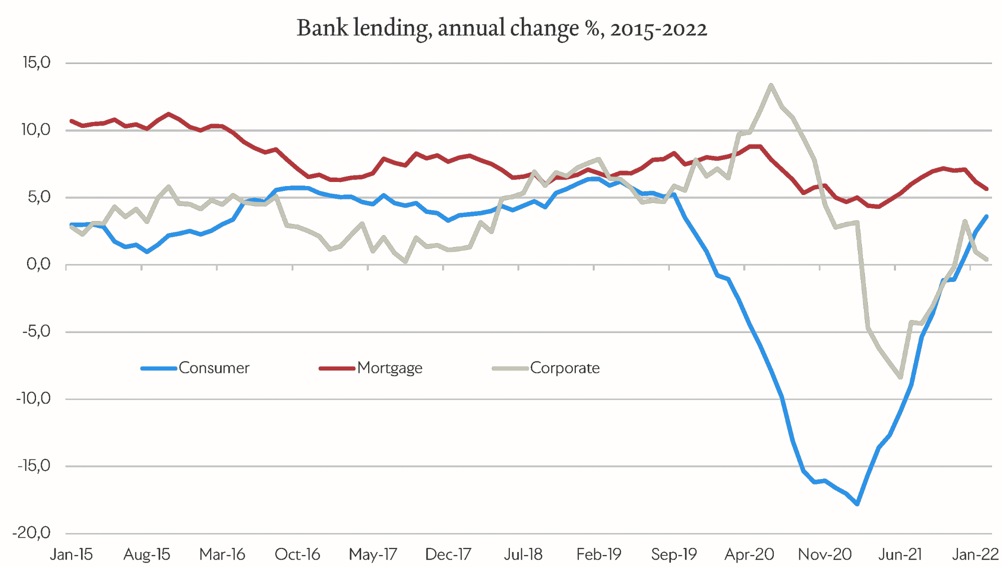
Despite the relatively high levels of unemployment, around 90% of companies surveyed by the Central Bank in February reported difficulties filling vacancies. Many have responded by raising wages to attract staff. As a result, the government's remunerations index rising by 7.5% in the year to February, its fastest rate since 2008. However, most of these gains have been consumed by inflation with wages falling by 0.2% in real terms over the same period.

Financial markets have largely stabilized since the final quarter of last year, as investors reacted to the rejection of the fourth pensions withdrawal bill and the moderate tone struck by president-elect Gabriel Boric since his election.

Long term interest rates have fallen but remain at historically high levels reflecting the withdrawal of the Central Bank's monetary stimulus as well as the impact of last year's pensions withdrawals on capital markets. Ten-year peso-denominated bonds were trading at around 6.0% by mid-March, down from almost 7.0% in October when the fourth withdrawal bill was being debated.

However, capital markets remain subdued with few non-financial companies issuing bonds in Chile while foreign issues have declined following the interest rate rises in the US, the UK and elsewhere.

Bank lending



Source: Financial Market Commission

Bank lending grew by 2.6% in the twelve months to February to CLP222.8 trillion (US$283 billion), an increase from growth of 1.5% in 2021.

While corporate lending was little moved at CLP125.9 trillion (US$160.1 billion), lending to individuals grew by 5.1% to CLP95.2 trillion (US$121 billion). Consumer lending has recovered, growing by 3.6% to CLP25.8 trillion (US$32.8 billion), after rising by 0.6% in 2021. However, mortgage lending has begun to slow, growing by 5.7% to CLP69.4 trillion (US$88.2 billion), compared to growth of 7.1% last year.

Driven by the increase in interest payments, bank profits reached CLP842 billion (US$1.1 billion) in the first two months of the year, up 29.6% from twelve months earlier. This rise comes despite a sharp rise in bank provisions as they prepare for an increase in the number of non-performing loans over the next year.

Stock Market

IPSA, 2021-2022

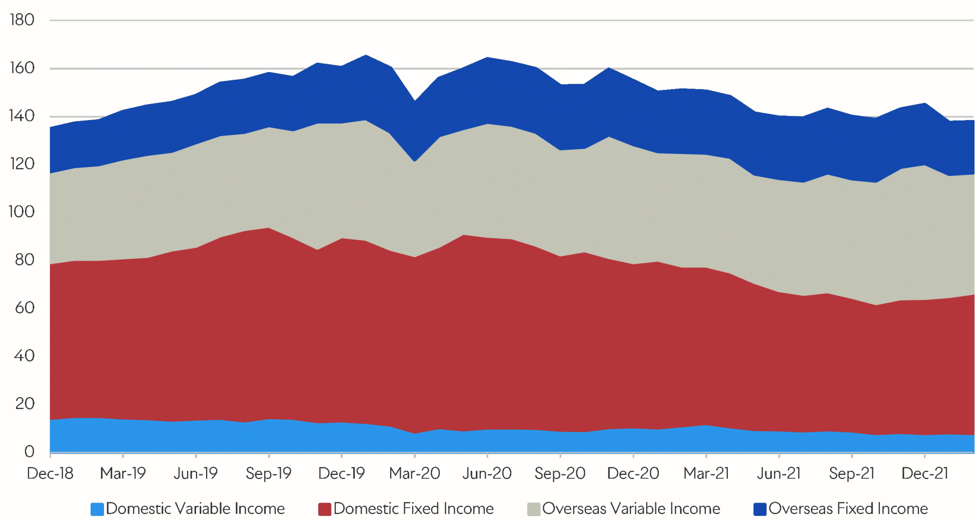
Source: Santiago Stock Exchange

Share prices in Chile have rallied sharply so far this year as investors reacted to the moderate stance adopted by President Gabriel Boric and the rally in commodity prices triggered by the Russian invasion of Ukraine. By late March, the IPSA index of the largest stocks was close to breaching 5,000 points for the first time since the start of the pandemic two years ago and up almost 20% since last December. Major gains have been made by natural resource companies with iron ore miner CAP rising 46% and lithium producer SQM gaining 49%.

As a result, the Chilean shares have outperformed most stock exchanges around the world.

Pensions Funds

AFPs by asset, trillions of CLP, 2018-2022



Source: Superintendence of Pensions

The value of Chile's pension funds has begun to stabilize after last year's pension withdrawals, reaching CLP139.2 trillion (US$176.9 billion) by the end of February, down by 8.7% from twelve months earlier and from a peak of over CLP165 trillion (US$209.7 billion) in January 2020. Chileans have withdrawn almost US$52.0 billion from their savings since August 2020 under legislation designed to supplement incomes during the pandemic.

In March, lawmakers voted to debate another bill allowing savers to make a further withdrawal of up to CLP 4.5 million (US$5,700) from their savings despite the new government's criticism of the measure.

Amid the rise in inflation and the war in Ukraine, pension funds have largely suffered losses this year. After gaining 12.98% in 2021, the riskiest A funds lost 10.9% in January and February, reflecting their exposure to foreign share prices and bonds. In comparison, the conservative E funds gained 1.4%, compared to a 13.1% loss in 2021.

Type of fund	Amount (billions of pesos)	Change March 2021 – February 2022 (%, real in pesos)	Return December 2021 – February 2022 (%, adjusted for inflation)	Limits on equity investments Limits on equity investments (% of fund assets)	
				Maximum	Minimum
A Funds	23,999	7.4	-10.85	80	40
B Funds	25,296	12.4	-8.45	60	25
C Funds	51,494	0.9	-5.91	40	15
D Funds	22,531	-15.6	-1.91	20	5
E Funds	15,853	-46.9	1.36	5	0
Total	139,172	-8.7			

Source: Superintendence of Pensions

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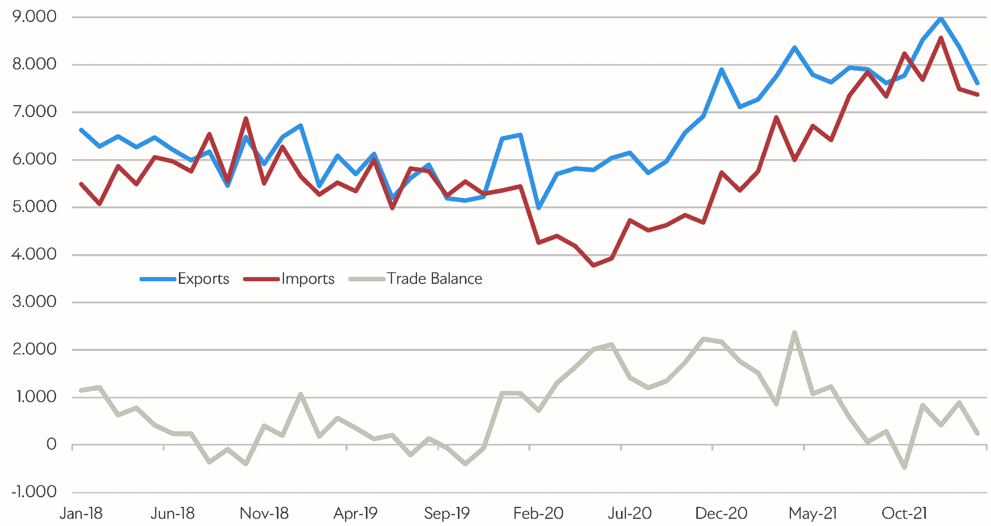
External Sector

2

Trade balance, monthly, US$ billions, 2018-2022

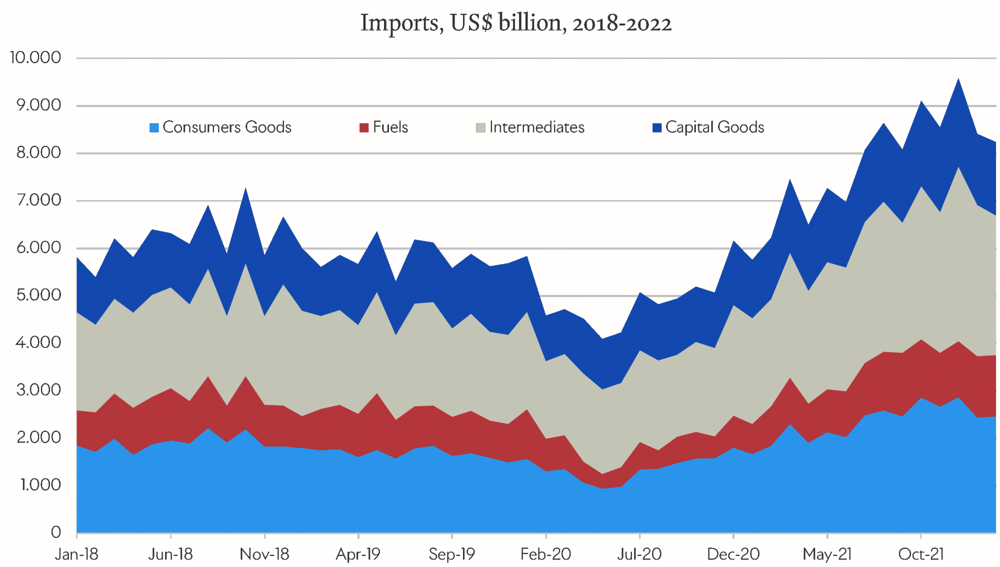


Source: Central Bank of Chile

After expanding to record levels in late 2021, Chile's foreign trade has slowed significantly in the first two months of 2022, reflecting a drop in copper production and lower demand for consumer and capital goods. Imports have continued to catch up with exports, largely eliminating the large trade surpluses recorded at the start of the pandemic.

Imports

Imports during the first two months reached US$14.9 billion, up more than a third from the same period of 2021, but down 8.6% from the previous two months as imports of consumer and capital goods slowed.



Source: Central Bank of Chile

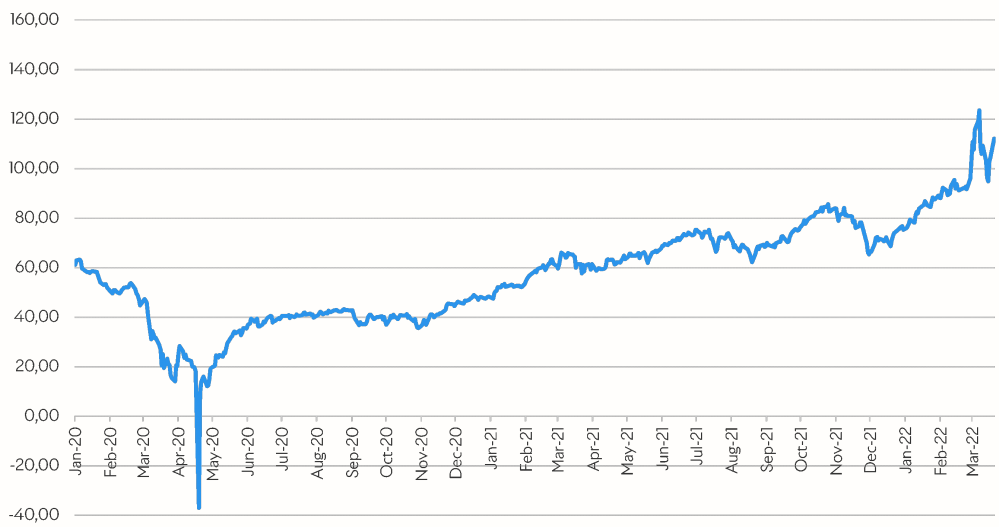
After expanding by more than 70% in 2021, imports of consumer goods totalled US$4.9 billion during January and February, down 11.5% from the final two months of 2021. The fall largely reflected lower imports of consumer durables, with car imports falling 15.7% to US$526 million. However, imports of clothing and footwear have continued to grow, rising 18.7% to US$946 million so far this year.

Reflecting the forecast decline in investment this year, imports of capital goods have also declined. After growing 36.5% in 2021, imports in January and February fell 16.7% to US$3.0 billion, compared to November and December, with sharp declines recorded for lorries, other transport vehicles, mining equipment, and electric motors and generators.

Imports of intermediate goods fell 7.7% to US$6.1 billion, on lower imports of metallic products, fertilizers, and spare parts for machinery.

Only fuel imports have bucked the trend, reflecting the sharp rise in energy prices. Imports rose 11.8% to US$2.6 billion, driven by a 53.2% jump in imports of crude oil.

WTI oil price, US$/barrel, 2020-2022

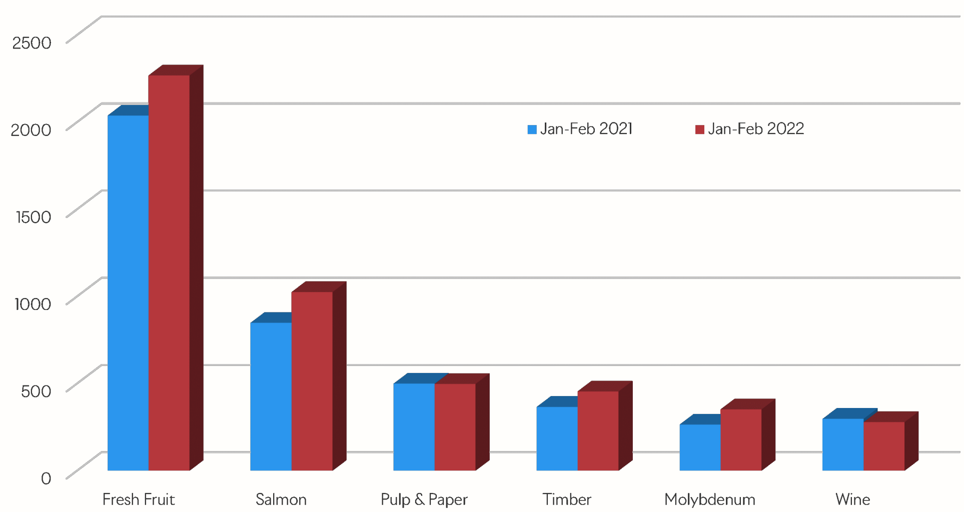


Source: St Louis Federal Reserve

Following Russia's invasion of Ukraine, oil prices have rallied to their highest level in almost a decade although they have pulled back from highs of over US$120/barrel in recent days. Prices were already rising before the conflict, with the West Texas Intermediate benchmark, upon which state oil firm ENAP bases its import parity prices, averaging US$87.43/barrel in January and February, up 64% from a year earlier.

Exports

Non-copper exports, US$ millions, 2021-2022



Source: Central Bank of Chile

Exports during the first two months of the year reached US$20.1 billion, up 11.2% from twelve months earlier, driven by higher mineral, agricultural and industrial exports.

Agricultural exports reached US$2.4 billion in the first two months of the year, up 11.1% from the same period of 2021, driven by fresh fruit exports. Cherry shipments, now Chile's principal fruit export, jumped 22.9% to US$1.4 billion, offsetting declines in exports of most other fruits. However, fruit exporters have warned that high shipping costs and congestion in ports could leave many facing losses this year.

Industrial exports during January and February totalled US$5.0 billion, up 22.2% from a year earlier, reflecting the higher value of timber, chemical and food shipments. However, compared to the final months of 2021, industrial exports fell 12.7% with particularly sharp declines recorded in exports of forestry and metallic products and wines.

Chemicals exports rose 60.9% to US$1.3 billion, as exports of fertilizers, potash, and methanol all roughly doubled. Exports of timber rose 24.3% to US$454 million. However, exports of pulp and paper were little changed at US$497 million. Although pulp prices have rallied in recent months, these were offset by a fall in volumes, as a plant shutdown reduced shipments of short fibre (eucalyptus) pulp.

Pulp export volumes will be boosted this year by the expansion of the Arauco pulp mill which is due to be brought online in late April.

Salmon and trout exports continue to recover from the impact of the Covid-19 pandemic on demand, reaching US$1.0 billion in January and February, up 20.8% from a year ago. Following the start of the war in Ukraine, exporters have diverted shipments once bound for Russia, which was the fourth largest market for Chilean salmon last year, to other markets.

Exports of wine have fallen 6.2% so far this year to US$278 million, reflecting a drop in bulk wine exports. Farm statistics office ODEPA attributed the decline to lower prices. Exports of bottled wine have been driven by higher shipments to China and the UK.

LME Copper Price, US$/lb, 2020 - 2022

Source: Chilean Copper Commission

Despite soaring commodity prices, the value of Chile's mineral exports has fallen in recent months following a significant slowdown in mine activity this year. Mineral exports in January and February totalled US$8.6 billion, up 5.6% from a year ago but down more than a fifth from the final months of 2021, largely due to a similar decline in shipments of copper.

International copper prices have risen again to record levels this year with contracts on the London Metal Exchange trading as high as US$4.87 a pound on March 7th amid fears that the conflict could affect supplies from Russia, the world's eighth largest producer of the metal. They have since fallen back but remain significantly above levels seen at the start of the year.

The sharp rise in copper prices have forced analysts to lift forecasts for the coming two years. In March, the Central Bank predicted that prices would average US$4.35/lb this year, up from US$4.25/lb in 2021 and compared to a previous forecast of US$4.05/lb made last December. Prices will decline to average US$3.90/lb in 2023, up from US$3.60/lb forecast previously.

Copper exports have been undermined by a sharp fall in mine production as mining companies contend with water shortages, falling ore grades, and technical problems. Production during the first two months of the year totalled 830,205 metric tonnes, down from 7.2% from twelve months earlier.

Anglo American and Antofagasta Minerals have both warned that water shortages will continue to reduce production at their operations during 2022 (the latter will commission a desalination plant to supply its Los Pelambres mine later this year). In January, BHP reduced production at its Cerro Colorado mine after a court ordered the company to stop pumping water from high-altitude wetlands because of environment damage.

Despite the poor start to the year, the Chilean Copper Commission has predicted that Chilean copper production will rise 2.6% to 5.788 million metric tons. Output is expected be boosted in the second half of the year by the commissioning of Teck's US$5.3 billion Quebrada Blanca 2 project. The largest private copper mine to be built in Chile in eight years, it will produce up to 300,000 metric tons annually during its first three years of operations.

Despite a rally in iron ore prices this year, exports of iron ore fell to US$173 million, down 40.8% from the previous two months.

The value of Chile's exports of precious metals fell to US$167 million in January and February down a fifth from twelve months earlier, reflecting lower production levels. In February, Kinross Gold began commissioning its La Coipa mine. The mine is expected to produce one million ounces of gold equivalent over the next four years.

Molybdenum prices, US$/lb, 2019 - 2022

Source: Chilean Copper Commission

Exports of molybdenum rose by almost a third to US$351 million in January and February, reflecting higher prices for the metal. Molybdenum prices averaged almost US$19/lb in January and February, up more than 70% from a year earlier, offsetting an 18.7% decline in molybdenum production.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Chile's white gold turns white hot

Demand for lithium is booming, creating opportunities for Chile.

As consumers around the world increasingly opt for electric vehicles, carmakers and battery manufacturers are scrambling to secure supplies of the mineral. According to Chile's SQM, the world's largest lithium producer, global demand grew almost 50% to around 500,000 tonnes last year and will rise another 30% in 2022.

As producers struggle to keep up, prices have soared to record levels. Spot prices for lithium carbonate in China have risen sevenfold over the last year to almost US$80,000 a tonne. Chile is already reaping the benefits. Exports of lithium carbonate reached US$440 million in January and February this year, up fourfold from a year ago, reflecting the higher prices and increased production. SQM's profits rose almost fivefold in the final quarter of 2021 to US$322 million.

However, once the world's leading producer, Chile has lost ground over the last decade to new producers in Australia and Argentina where the industry is less tightly regulated. Almost half of Chilean export revenues flow to the state under royalty payments.

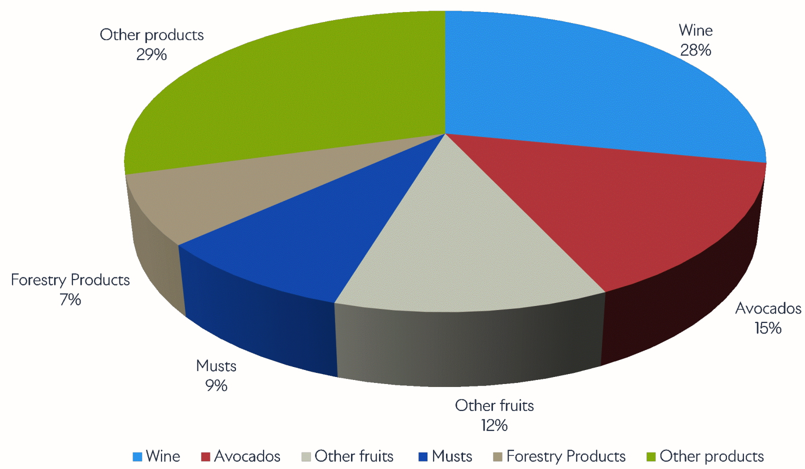
To recover market share, local producers Albemarle and SQM are investing to increase production from the Salar de Atacama, the giant salt-flat which contains about a quarter of global lithium reserves. New facilities due to be commissioned this year and next promise to lift Chilean production capacity to around 300,000 tonnes annually, a fivefold increase from 2017.

But even with these investments Chile will struggle to keep up with global demand which is forecast to exceed one million tonnes by 2025. To attract new investment, outgoing President Piñera awarded permits earlier this year to electric vehicle maker BYD and mining firm Servicios y Operaciones Mineras del Norte allowing them to produce up to 424,000 tonnes of lithium carbonate equivalent each over a 30-year period.

Initially critical, the new administration has agreed to respect the tender although the results have been challenged in the courts for not taking the interests of local communities into account. But President Boric wants to follow a very different strategy to exploit the lithium windfall, creating a partly state-owned national lithium company that could develop downstream industries to convert Chile's lithium into battery components and other products.

However, developing a whole new high-tech industry from scratch will not be easy and previous attempts to attract lithium manufacturing to Chile have failed.

Chilean exports to UK, Oct-Dec 2021



Source: National Customs Service

Trade between Chile and the United Kingdom reached US$336 million in the final three months of last year, up 23.6% from the same period of 2020.

Chilean exports to the UK rose 39.8% to US$177 million. While fruit exports slipped slightly to US$47 million, wine exports rose almost two-thirds to US$50 million.

Over the same period, UK exports to Chile rose 9.4% to US$158 million. Exports of machinery rose 36.9% to US$45 million offsetting a 64.2% drop in vehicles exports to US$10.2 million.

Chile's current account deficit soared to a record US$20.3 billion in 2021 (the equivalent to 6.6% of GDP), up from US$4.3 billion in 2020. The expansion reflected an increase in profits remitted abroad to foreign investors and the shrinking of the trade surplus.

In March, the Central Bank forecast that the current account deficit would shrink to US$14.8 billion, equivalent to 4.6% of GDP in 2022, reflecting the slowdown in consumption and weaker investment as well as increased exports.

Financial Account

Chile recorded a financial account deficit of US$22.4 billion, reflecting government bonds issued to fund the response to the pandemic and the liquidation of assets by pension funds to finance withdrawals.

Foreign Direct Investment reached US$15.3 billion, thanks to investment principally in the energy sector, up from US$9.2 billion in 2020. Chilean investment abroad reached US$14.5 billion, up from US$6.7 billion.

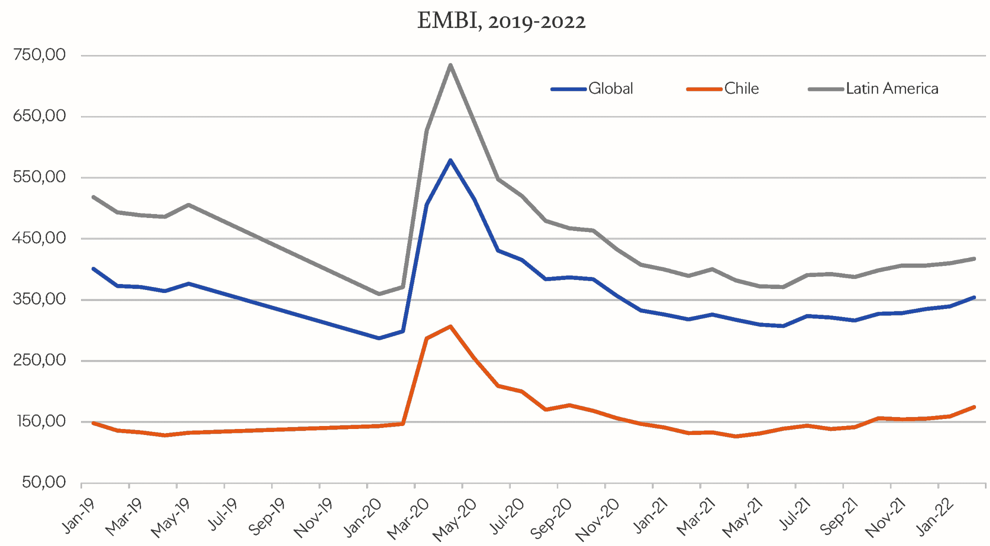
Portfolio investment into Chile rose by US$32.2 billion, driven by purchases of long-term government and corporate debt, while Chileans bought a net US$1.6 billion of foreign financial assets as share purchases were offset by sales of debt instruments, largely by the AFPs.

External Debt

Chile's external debt rose 12.3% to US$239 billion by the end of 2021, equivalent to 84.4% of GDP. The rise was led by the expansion of government debt, which rose by a third to US$45.6 billion, and non-financial corporate debt, which grew 12.4% to US$100.5 billion.

Chile's International Investment Net Position grew to a net debt of US$15.5 billion, equivalent to 5.5% of GDP, up from US$14.9 billion twelve months earlier, reflecting increased corporate and government debt and the decline in bond and share prices following the rise in interest rates.

Country Risk



Source: JP Morgan

Chile's risk premium has climbed in recent weeks with JP Morgan's Emerging Market Bond Index reaching 174 points in February, up 19 points from the end of last year and its highest level since September 2020. The rise matches the increases in risk premiums around the world as investors react to the start of the conflict in Ukraine. The spread on 5-year Credit Default Swaps ended March at 74.5 points, little changed from December.

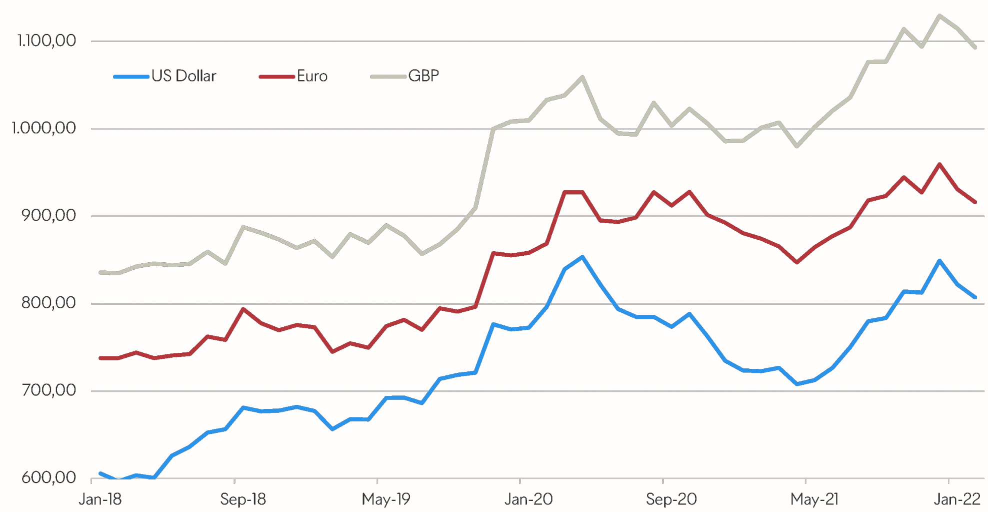
CLP vs USD, 2020-2022

Source: Central Bank of Chile

The Chilean peso has appreciated more than 10% against the US dollar this year as investors reacted to the more moderate stance adopted by President Gabriel Boric and higher copper prices. After trading at a record CLP870/dollar immediately after the vote, the currency has averaged CLP810/dollar so far this year and by late March had fallen below CLP780/dollar for the first time in almost six months. However, despite recent gains, the currency continues to trade at historically low levels given the high copper price, last year's strong economic recovery and the rapid hike in interest rates. Analysts attribute the implicit discount to investor concern over the political situation, including the new constitution.

Analysts surveyed by the Central Bank in early March predicted that the exchange rate will average CLP 810/dollar over the next two years, close to current levels.

CLP vs EUR, GDP, USD, 2018-2022



Source: Central Bank of Chile

The Chilean peso also recovered against most other currencies, including the Euro and British sterling. But the real exchange rate (measured against a basket of trade-weighted currencies) remains close to lows not seen since the 2008-2009 global finance crisis.

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Quarterly Insight

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Drafting Chile's new constitution

Nine months on from its creation, Chile's Constitutional Convention is advancing at great speed to draft the country's new constitution in time to meet its July 4th deadline. If they succeed, the document will be put to a national referendum later this year.

Beginning in February, the Convention began on voting in full on the thousands of proposals that have been presented by its 155 members or by public petition (requiring at least 15,000 signatures) and then approved by one of nine thematic committees.

If approved by two-thirds of members, the proposal then passes to form part of the final draft. Otherwise, it returns to the committee where it can be amended before a second and final plenary vote.

Although by late March, the Convention has only voted on a small proportion on the proposals approved at the committee stage, it is becoming clear that the new proposed constitution would bring radical changes to almost every aspect of the country's legal and political system.

The report from the Political Committee proposes to replace the current Senate with a new Chamber of the Regions with much reduced powers to revise the work of the lower Chamber of Deputies. It would also grant much greater autonomy to Chile's sixteen regional governments, including powers to raise taxes, issues bonds and run their own finances.

The report from the Environment Committee would replace the current constitution's right to live in a pollution-free environment with one that recognizes of the rights of Nature itself and that all animals are sentient beings.

It would also replace Chile's system of private water rights (only recently amended by Congress after a decade of debate) and nationalize large mining operations.

While the Justice Commission has agreed to maintain the autonomy of the Central Bank, it would augment the current five-person board to allow for greater diversity and expand its mandate to include keeping employment high, protecting the environment, and ensuring regional development.

Once the plenary has voted on all these proposals, work will then begin on combining them into a single document. This is likely to be fraught and complex given that some of the proposals are contradictory and there are likely to be gaps which needed to be filled.

SOMOS GENERACIÓN DE CAMBIO

ANTOFAGASTA MINERALS

The scope and ambition of the proposals on the table have worried many experts. While some politicians warn that eliminating the Senate would reduce democratic oversight of government, lawyers say modifications to the judicial system would reduce the rule of law. Mining executives have warned that the threat of nationalization will freeze investment in the sector for several years.

While President Boric has sought to reassure investors about the government's plans, especially its commitment to consolidating public finances, uncertainty over the Convention, which has only increased as its work has progressed, continues to hang over financial markets, including the Chilean peso-US dollar exchange rate.

This uncertainty may grow as the date of the referendum, currently planned for early September, approaches. Compulsory voting will make predicting its outcome harder than recent votes. If too many voters see the document as very radical, there is a risk that it will be rejected or approved by only a narrow margin which could trigger a new constitutional impasse for the country. A series of polls published in early April found that more voters would vote to reject the new constitution than vote in favour of it for the first time since the Convention was established.

If approved, implementing its contents will dominate politics in Chile for the rest of the current government's term and the foreseeable future.

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Political Context

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Gabriel Boric took office as Chile's youngest-ever president on March 11th, promising significant social reforms but warning supporters that tough economic conditions meant that these would have to be implemented gradually. His appointment of former Central Bank president Mario Marcel as Finance Minister has helped to reassure voters and financial markets that he is serious about consolidating Chile's deteriorated public finances in the wake of the pandemic.

However, other key posts have gone to former lawmakers who, like the president, were advocates of pension withdrawals and universal welfare payments which helped to overheat the Chilean economy and weaken capital markets last year.

The government's first two legislative priorities will be a major new tax reform (Chile's fifth in a decade), which Minister Marcel has said will increase government finances by around 4.0% of GDP, and an overhaul of the pensions system. The tax bill, which is expected to target the wealthy, the mining industry, and greenhouse gas emissions, will be sent to Congress by June.

Like previous administrations, the new government wants to bolster future pensions through an additional contribution to workers' individual accounts although these would be managed by a new state pensions entity rather than the private pension fund administrators (AFPs).

The government's lack of a majority in the Senate means that it will have to offer concessions to the centre-right opposition to gain the necessary votes to approve any legislative proposals. The government's own coalition is deeply divided. In March, supporters in Congress agreed to debate legislation that would allow savers to make another withdrawal from their pension funds, something the administration opposes.

Another pressing challenge will be the violence in southern Chile, linked to indigenous land claims. Four people have been killed in the zone so far this year despite the presence of armed forces. President Boric has ended the state of emergency in place since October last year and is instead pursuing dialogue to end the violence. However, when Interior Minister Izkia Siches tried to meet with indigenous community leaders in one of the Araucanía region's crime hotspots, she was greeted with protests and gunshots.

In January, Congress approved the creation of the tax-funded Universal Guaranteed Pension, which aims to reduce old age poverty by paying around 2.4 million over 65s a monthly stipend of CLP 185,000 (US$236). Unlike the Solidarity Pension which it replaces, the benefit will be paid on top of an individual's private pension (as long as they receive less than CLP 630,000 (US$804) a month), meaning beneficiaries will see their income rise by at least 30%.

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Economic Outlook

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With the government's Consumer Price Index set to rise to almost 10% in the coming months, inflation has emerged as the principal problem facing the Chilean economy in 2022.

Driven by last year's jump in government spending and a consumer boom as well as external factors such as snags in global supply chains and the oil market rally, prices will rise at their fastest rate in over a decade, causing hardship for households.

To bring inflation under control, the government and the Central Bank are rapidly withdrawing the unprecedented stimulus provided to the economy during the pandemic. Interest rates have already risen six times since last June and will continue to rise over the next quarter while public expenditure will fall by almost a fifth if the new government sticks to its predecessor's spending plans.

Combined with a freeze on private investment, higher energy prices and the exhaustion of pension withdrawals, this will have a chilling effect on economic activity this year and next. Growth will fall from almost 12.0% in 2021 to less than 2.0% in 2022 and less than 1.0% in 2023, according to the Central Bank's latest forecast, with the risk of the economy entering recession at some point.

This will slow the recovery in the labour market which has yet to return to pre-pandemic levels while the unemployment rate may rise as the withdrawal of government benefits forces thousands back into the workforce. Meanwhile, inflation is set to wipe out any wage gains.

The economic outlook is further dampened by the complicated global scene with the threat of a prolonged conflict in eastern Europe, tighter financial conditions, energy shortages and new surges in Covid-19 infections.

Under these conditions and lacking a united coalition in Congress, President Boric is likely to come under strong pressure to do more to help struggling households, especially as high copper prices bolster government coffers.

Advancing the legislative agenda, including a major tax reform needed to stabilize public finances and support increased welfare spending, is also likely to be extremely difficult, given the president's lack of a majority in the Senate.

The political situation will be further complicated by the new constitution which is set to include many provisions which are an anathema to many moderate voters, the business sector, and foreign investors. If voters fail to approve the new document in the referendum scheduled for later this year, it could trigger a new constitutional standoff with the risk of a return of the protests of three years ago.

Economic Forecasts, 2022

	Central Bank 1/	Finance Ministry 2/	Private analysts 3/
GDP (% annual variation)	1.0-2.0	3.5	2.0
Inflation (% annual variation)	8.2	6.5	5.8
Monetary-policy interest rate (% annual, nominal, end-year)	NA	NA	7.50
Exchange rate (pesos/US$)	4.05	825	810 4/
Copper price (US$/lb)	4.35	4.10	NA

1/ Monetary Policy Report, March 2022

2/ Public Finances Report, February 2022

3/ Average of selected private analysts surveyed by Central Bank, March 2022.

4/ February 2023

Latin America Regional News

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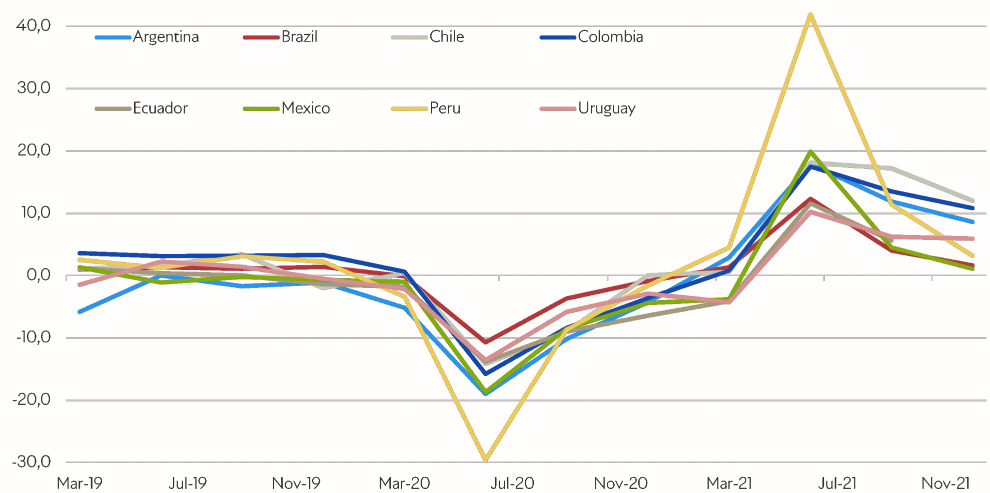
Quarterly GDP, annual change %, 2019 - 2022



Source: Trading Economics

Argentina: In March, lawmakers approved a new US$45 billion loan from the International Monetary Fund avoiding a possible default later this year, but there is little agreement on how to balance public finances. The government has tightened price controls after annual inflation exceeded 50%.

Brazil: Former head of state Luiz Inácio Lula da Silva is leading President Jair Bolsonaro in polls to win next October's president elections. The Central Bank has said it is not planning any further rate hikes after lifting interest rates by nine percentage points to 12.75% to combat rising inflation.

Colombia: Leftist Senator Gustavo Petro is the frontrunner to win the presidential elections in May after attracting more than twice as many votes as his nearest rival in a primary. Investors are worried by his promise to halt oil exploration.

Ecuador: President Guillermo Lasso suffered a major defeat in March when the opposition-led Assembly rejected legislation to allow private investment in infrastructure. However, the rally in oil prices has bolstered government finances.

Mexico: Bank of Mexico expects the economy to grow by just 2.4% this year, slowed by growing inflation and supply chain problems. Despite the weak economy and the poor handling of the pandemic, almost two-thirds of voters continued to support Andrés López Obrador as he began the second half of his presidency.

Peru: President Pedro Castillo narrowly survived the opposition's third attempt to impeach him, but his nine-month-old government remains paralyzed and unable to advance his legislative agenda, including a major tax reform. Growth is expected to slow to 3.0% this year, down from 13.3% in 2021, as the economy faces more difficult trading conditions.

Uruguay: In a March referendum, voters narrowly approved President Luis Lacalle Pou's package of pro-business measures, limiting union rights, protecting landlords and increasing competition in telecoms markets. The economy is set to grow 3.8% in 2022, after expanding by 4.4% in 2021.

UK Economy, Quarter 4 – 2021

In 2021, the UK saw faster-than-previously-expected economic recovery, with the highest growth rate in the G7 in 2021. The IMF forecasts the UK to have the highest growth in the G7 again in 2022. This reflects public policy efforts towards the labour market. However, there are challenges ahead. Global supply chain disruption and higher energy prices are adding to inflation worldwide – including in the UK. An additional energy shock will come from the Russian invasion of Ukraine.

1. Economic growth

In quarterly terms, GDP grew by 1.0% in Q4 2021, following a downward revised 1.0% increase in Q3 2021, UK GDP grew by 7.5% in 2021, following a 9.4% contraction in 2020. The biggest driver of GDP growth was the services sector, which expanded by 1.2% in Q4 2021. The services sector is now estimated to be 0.5% above pre-pandemic levels in Q4 2019. The production sector contracted by 0.4% in Q4 2021, falling to 3.6% below pre-pandemic levels. The construction sector on the other hand expanded by 1.0% in Q4 2021, following a fall of 1.4% in the previous quarter. In monthly terms, GDP contracted by 0.2% in December following a 0.7% expansion in November. The service sector contracted by 0.5% in December, while construction and production sectors expanded by 2.0% and 0.3% respectively. In quarterly terms, GDP is now 0.4% below pre-pandemic levels (Q4 2019), however in monthly terms GDP is now equal to pre-pandemic levels (February 2020) following December's contraction.

2. Inflation and Wages

The annual Consumer Price Index (CPI) and CPIH (which includes housing costs) inflation rates registered at 5.5% and 4.9% year-on-year respectively in January 2022, up from December 2021 levels of 5.4% (CPI) and 4.8% (CPIH). This is the highest CPI 12-month inflation rate in the national statistics data series, which began in January 1997. It was last higher in the historical modelled data series in March 1992, when it stood at 7.1%. The largest contribution to inflation was still transport (1.54%), despite motor prices falling by 0.5% in the month to January. Household services (housing, water gas, electricity and other fuels) were also large contributors to inflation (1.0%), because of price rises for gas and electricity following the increase in the cap on energy prices which changed on the 1st October. This, combined with the lowered energy price cap in April 2020, saw 12 month inflation rates of 19.2% for electricity and 28.3% for gas in January. Growth in average total pay (including bonuses) was 4.3% and regular pay (excluding bonuses) was 3.7% for the three months from October to December 2021. In real terms, total and regular pay in October to December fell by 0.1% and 0.8% respectively.

3. Monetary policy

In the most recent meeting in February, the Bank of England's Monetary Policy Committee voted to increase interest rates to 0.5% from 0.25%, the first back-to-back interest rate rise since 2004. This was in response to inflation accelerating more than expected, with December figures being almost 1 percentage point higher than expected at the time of the November Report. The Bank of England will also begin to reduce the assets held under the asset Purchase Facility (quantitative easing). The Bank will not reinvest any of the £875bn of government bonds it has bought under quantitative easing programmes when they mature (worth £70bn over 2022 and 2023, and £130bn over 2024 and 2025). The Bank will also sell off its £20bn corporate bond portfolio by the end of 2023.

4. Labour market

The UK employment rate in the three months to December 2021 was estimated at 75.5%. This is 1.1% lower than before the pandemic (three months to February 2020), but 0.1% higher than the previous quarter. The unemployment rate in the three months to December 2021 was estimated to be 4.1%, 0.1% higher than before the pandemic, but 0.2% lower than the previous quarter. The redundancy rate in the three months to November decreased by 1.2 per thousand employees to 2.6 per thousand, falling below pre-pandemic levels to record lows. Tight labour markets continue as the number of job vacancies in the three months to January 2022 was a record high of 1,298,000, an increase of 513,700 from pre-pandemic levels.

5. Trade

The UK's total trade balance, excluding precious metals, fell by £0.2bn to a deficit of £12.8bn in Q4 2021. Total imports increased by £5.9 billion to £170.2 billion while total exports increased by £6.1 billion to £157.4 billion. This was mainly driven by the fall in trade in goods balance, which narrowed by £0.2 billion to £43.0 billion in Q4 2021. Total annual imports of goods increased by £36.0 billion to £465.6 billion in 2021, when compared with 2020 but was £23.4 billion lower than 2018. Similarly, annual total exports of goods increased £14.5 billion (4.9%) to £312.4 billion in 2021 when compared with 2020 but were £36.8 billion (10.5%) lower than 2018. Early estimates suggest the trade in services surplus reduced slightly in Q4 2021 to £30.2 billion.

6. Government finances

Public Sector New Borrowing excluding public sector banks (PSNB ex) was estimated to have a surplus of £2.9bn in January 2022. This was equivalent to £5.4bn less borrowing than in January 2021 but still a £7.0bn smaller surplus than in January 2020. PSNB for the financial year-to-January was estimated to have been £138.5bn, the second-highest level for the equivalent period since records began in 1993, but around half of the equivalent figure for the same period last year. Public Sector Net Debt (excluding public sector banks, PSND ex) was £2,317.6bn at the end of January 2022, equivalent to 94.9% of GDP, maintaining a ratio not seen since the early 1960s. Central government receipts in January 2022 were estimated at £91.6bn, up £8.6bn compared to January 2021, while central government current expenditure was £76.3bn, £0.5bn more than January 2021.

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