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CHILENO BRITÁNICA
DE COMERCIO

# Chilean Economic Report
# Fourth Quarter 2022

4th Edition 2022 — Produced since 1922

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# Dear reader

As we near the end of 2022, Chile continues to battle with the aftermath of the pandemic and all of its ramifications. Reduced economic activity, high inflation, high interest rates, and increasing unemployment signal tough times ahead. Wages continue to decline in real terms, and the Chilean peso has had a rough ride for most of the year.

All these factors, coupled with a high level of political uncertainty, explain low levels of business and consumer confidence. Certainly the "feel good" factor produced by last year's cash handouts and the subsequent spending boom has passed, and the hard road to recovery has started. Chileans are naturally conservative, and there seems to be a prevailing negative sentiment.

But from an external perspective Chile is not doing so badly. Comparatively speaking, most of its neighbors and global trading partners have equal or worse economic and political situations. Inward investment has grown in areas such as renewable energy, transport, and mining. The demand for lithium has rocketed and driven record prices. The service sector remains strong. So not all bad news.

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

Here in the Chamber, we have finished the year strongly, with a successful golf tournament in October, our fourth Female Leadership Summit in November, and the final round of our Innovation in Sustainability concourse in December. Thankyou to our investors and members for their continuing support and participation, and we wish you all a healthy and successful 2023.

Economic Report Committee: Peter Lynch, President, British Chilean Chamber of Commerce. Leslie Hemery, Director, 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, External Journalist. 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

• The Chilean economy is set to contract by more than 1.0% during 2023, after growing by almost 2.5% in 2022, as consumption and investment decline and global growth slows.

• After rising to its highest level since 1994, driven by high energy and food prices, inflation has begun to ease. The Consumer Price Index is expected to remain significantly above the Central Bank's target range for most of the next year.

• In October, the Central Bank lifted interest rates to 11.25%, their highest level in three decades, but could begin to relax monetary policy from early next year as inflation falls.

• Unemployment is expected to climb over the coming quarters as investment falls. Discounted for inflation, real wages have continued to decline.

• Chile's current account deficit grew to a record 9.9% of GDP in the third quarter, reflecting the fall in national savings (following the pandemic stimulus efforts) and a deficit in the trade balance.

• After slumping to record lows against the US dollar, the Chilean peso has begun to recover, reaching CLP 860/dollar by mid-December. Share prices have fallen in the face of the weaker outlook for the global economy.

• Exports have declined on lower copper prices and production. Copper is expected to average US$3.55/lb next year in line with weaker global growth.

• In November, President Gabriel Boric unveiled the government's flagship pensions reform which it says will bolster current and future pensions through a new employer contribution and eliminate the AFPs.

• Congress approved Chile's membership of the Trans-Pacific Partnership four years after it was signed. The government signed a new enhanced trade agreement with the European Union.

• In December, lawmakers agreed the process to draft Chile's new constitution. The new text will be drafted by a new Constitutional Council of 50 elected members, advised by a commission of experts appointed by lawmakers, and put to a referendum in November 2023.

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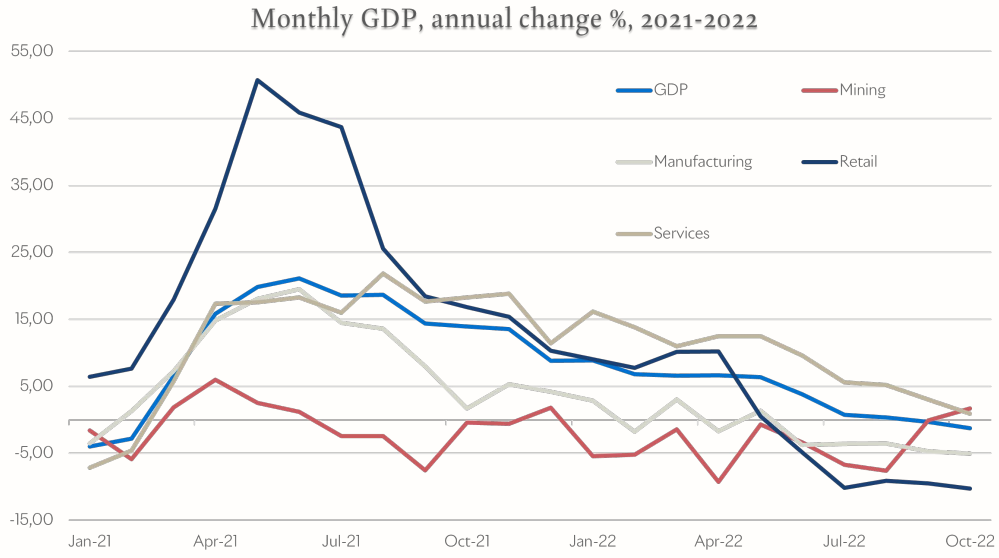
# Domestic Economic Performance

1



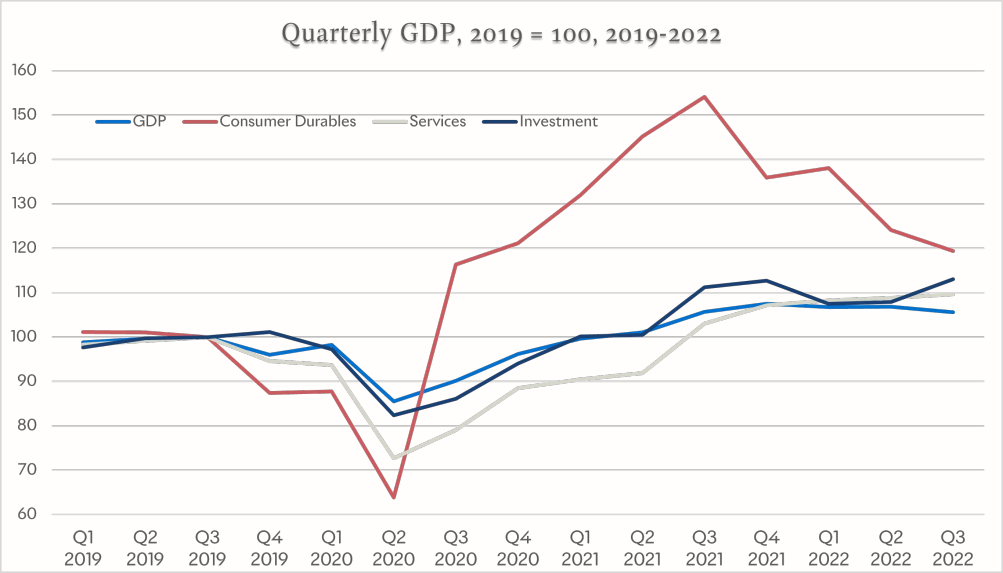

Source: Central Bank of Chile

The Chilean economy has begun to contract in the aftermath of the post-pandemic boom. According to preliminary figures, activity shrank by 1.2% in the year to October, marking its worst performance since February 2021. On a seasonally adjusted basis, the economy grew by 0.5% from the previous s month of September.

The contraction has been driven by retail which declined by more than 10.0% from last year's spending boom, while manufacturing shrank by 5.0%. However, services (which accounts for half of GDP) grew by 0.9%, thanks to increased travel and business services, while mining grew 1.7% as copper production recovered (See 2.2 Mineral Exports).

So far, the decline in activity has been less than expected. Analysts had predicted a fall of up to 2.5% in October.

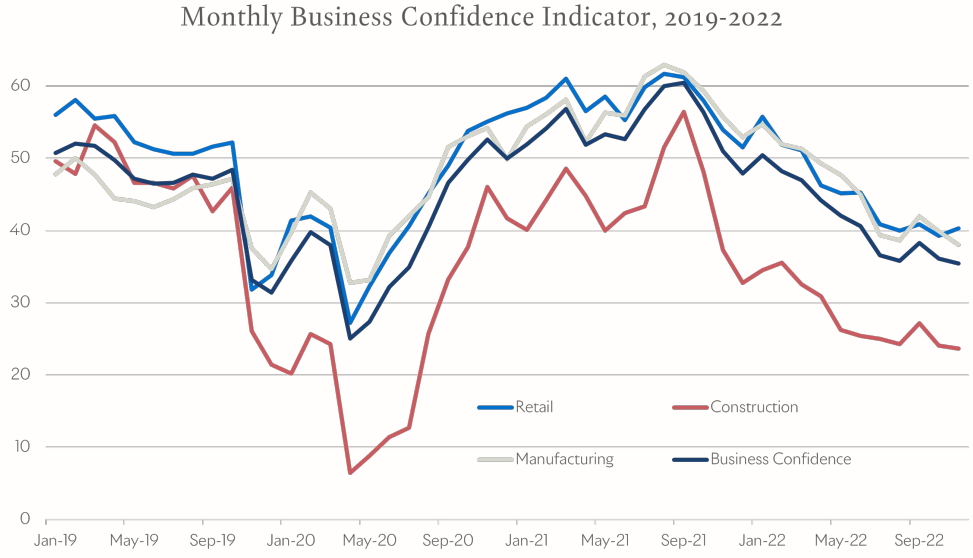
The resilience shown by the economy reflects the divergence between different sectors. While consumption has fallen dramatically, particularly sales of consumer durables, (although sales of services have continued to grow), investment has not faltered with Gross Fixed Capital Formation rising by 4.7% in the third quarter compared with twelve months earlier. The Central Bank attributed the rise to investments in renewable energy (with more than 5GW of wind and solar projects under construction), transport (electric buses for Santiago) and mining (especially Teck's QB2 mine).




Source: Central Bank of Chile

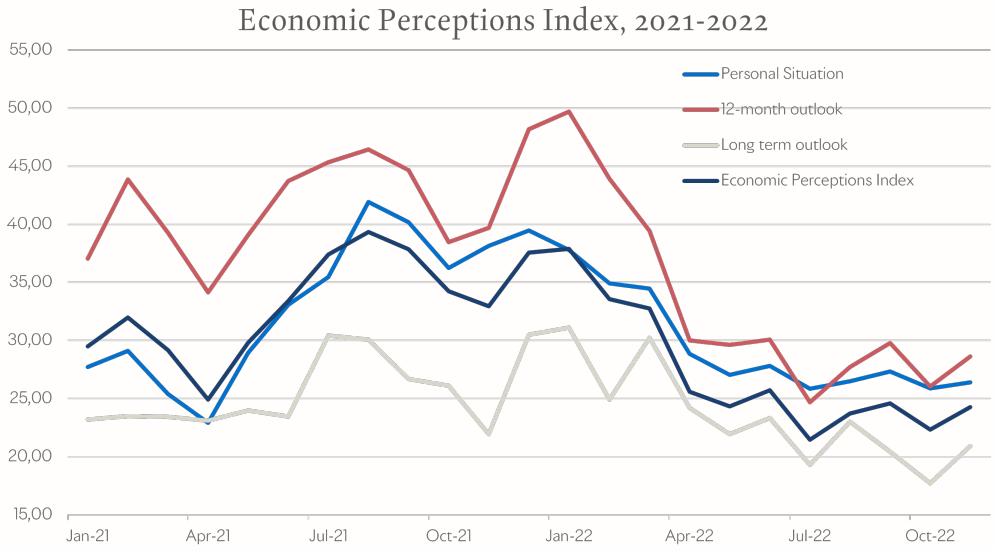
But the economy is expected to shrink over the coming quarters as businesses and households rein in spending in the face of higher prices, tighter financial conditions, and political uncertainty.

In December, the Central Bank predicted that the economy would shrink by between 0.75% and 1.75% in 2023 (against a previous prediction of 0.5%-1.5%), driven by a 5.9% decline in private consumption and a 5.0% fall in investment.




Source: Adolfo Ibáñez University, ICARE

Business confidence has continued to decline amid slowing economic activity, high inflation, and political uncertainty. In November, the Monthly Business Confidence Indicator, produced by the Adolfo Ibáñez University and ICARE business organization, fell to 35.45 points (not including the mining sector), its lowest level since the height of the first lockdown in July 2020. Gloom is heaviest in the construction industry, reflecting the drop in investment and house sales, although manufacturing and retail are firmly in negative territory.



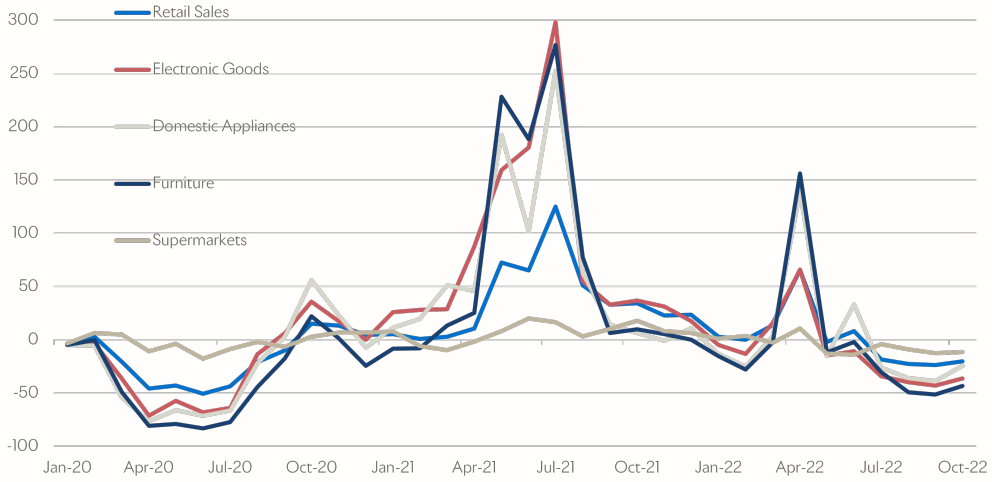

Source: GFK

After declining through the first half of 2022, consumer confidence appears to have stabilized although at historically low levels. GfK's Economic Perceptions Index reached 24.28 points in November, down eight points from a year earlier, reflecting consumer concern about their personal economic situation and long-term outlook for Chile.

## Retail

The decline in economic activity has been led by the retail sector as it corrects following the spending boom triggered by last year's Emergency Family Income and pensions withdrawals. Retail activity declined by 9.6% in the third quarter, compared to 12 months earlier.

### Retail sales in Santiago, annual change %, 2020-2022




Source National Retail Chamber

As last year's liquidity measures are exhausted, consumer confidence falls and incomes are squeezed by inflation and lower job prospects, households have slashed spending. According to the National Retail Chamber, retail sales in the greater Santiago area declined by 21.6% in the third quarter of the year (after growing by 62.6% in the same period of 2021). In October, sales of furniture fell 43.2% compared to a year earlier, followed by domestic appliances (down 36.3%) and footwear (down 34.1%). Supermarket sales are down almost 12% from a year ago.

New car sales have also declined. Sales during the three months to November totalled 97,068, down 19.2% from a year earlier.


El **Ranking Most Innovative Companies Chile** nos ubicó en lo más alto de este estudio, donde además fuimos destacados como una de las **5 empresas más innovadoras del país** según los propios líderes empresariales que participaron de la investigación, elaborada por la ESE Business School de la Universidad de Los Andes.

Porque cuando decides cambiarlo todo, lo haces a través de la innovación, la ciencia y la tecnología.

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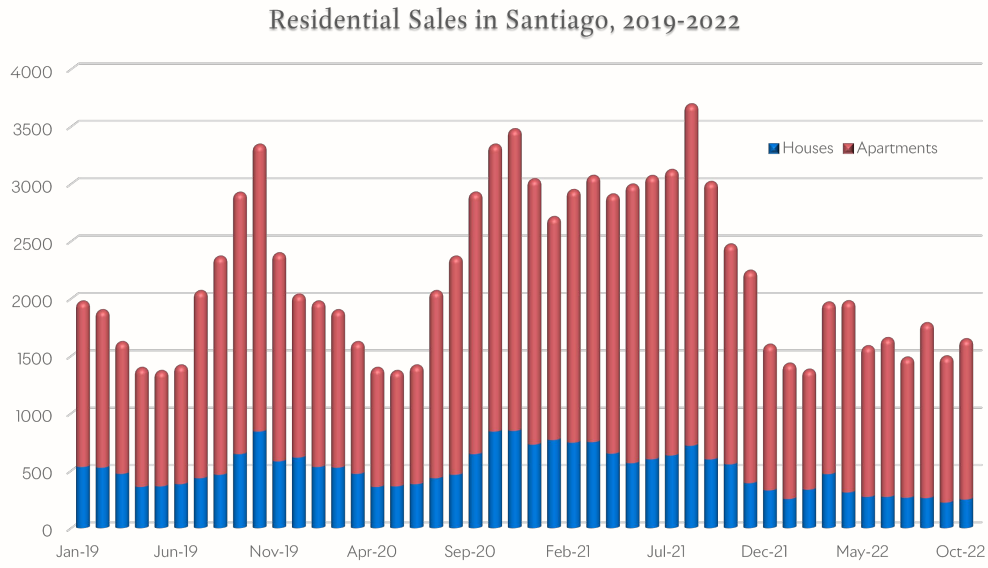
## Construction

The building industry is facing a major crisis as the rise in interest rates slows the housing market and private investment declines (See 3.0 Insight). The Chilean Chamber of Construction's Construction Activity Index fell in August to its lowest level since the height of the pandemic lockdown in 2020, reflecting a drop in confidence, lower sales of building materials and fewer residential construction permits.




Source: InfoInmobiliaria

After declining sharply from late 2021, home sales in Santiago area have stabilized but remain at roughly half the level seen during the first half of 2021.

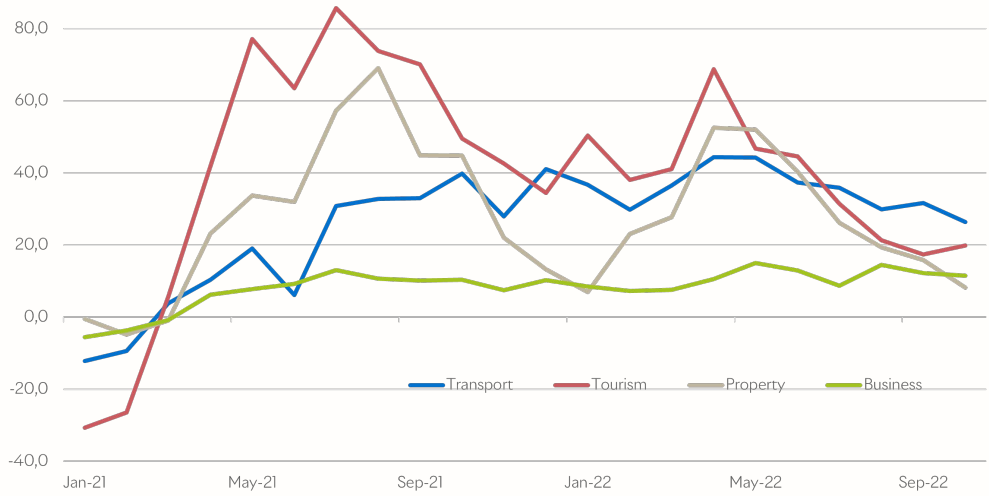
## Manufacturing

Manufacturing activity declined 9.2% in the year to October, reflecting a drop in wine production (due to a fall in orders), maintenance stoppages at a paper mill and an oil refinery and a fall in methanol output due to restricted supplies of natural gas during the southern hemisphere winter.

## Services

In contrast to most other sectors, services has continued to grow as it continues to recover from the impact of the Covid-19 pandemic, rising by 1.1% in the third quarter, compared to one year earlier.

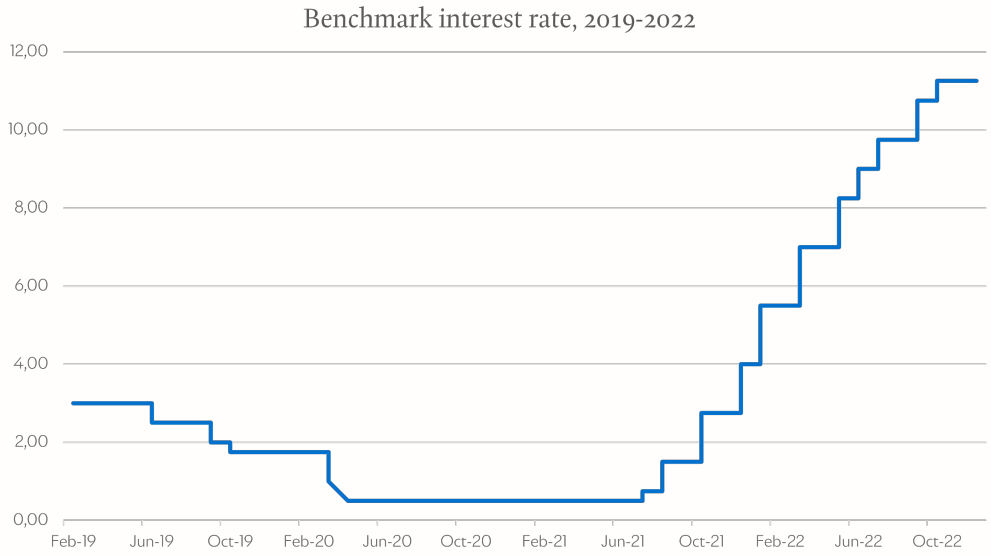
Service Sales, annual change %, 2021-2022




Source: National Statistics Institute

Business services has been particularly dynamic which the Central Bank attributed to corporate restructuring as companies invested in automation and outsourcing to reduce costs.

With the lifting of travel restrictions earlier this year, the transport sector has recovered significantly. The number of people travelling on the Santiago metro reached 48.3 million in October, up 23.8% from a year earlier, while the number of cars travelling on toll motorways rose 6.3% to 49.7 million.




Source: Central Bank of Chile

After lifting its benchmark interest rate to its highest level in three decades in October, the Central Bank has paused its rapid tightening of monetary policy (the most intense in the world over the last year) amid signs that inflation has finally begun to slow and economic activity is contracting. On December 6th, the board voted unanimously to hold the rate at 11.25%, marking the first time it has not increased the rate in almost 18 months. The Bank said that it will keep the rate at its current level until it becomes clear that inflation is converging with its 3% medium-term target rate.

Analysts surveyed by the Central Bank in December predicted that the board would begin cutting the interest rate from April next year to reach 7.0% by the end of 2023 and 5.0% by the end of 2024.

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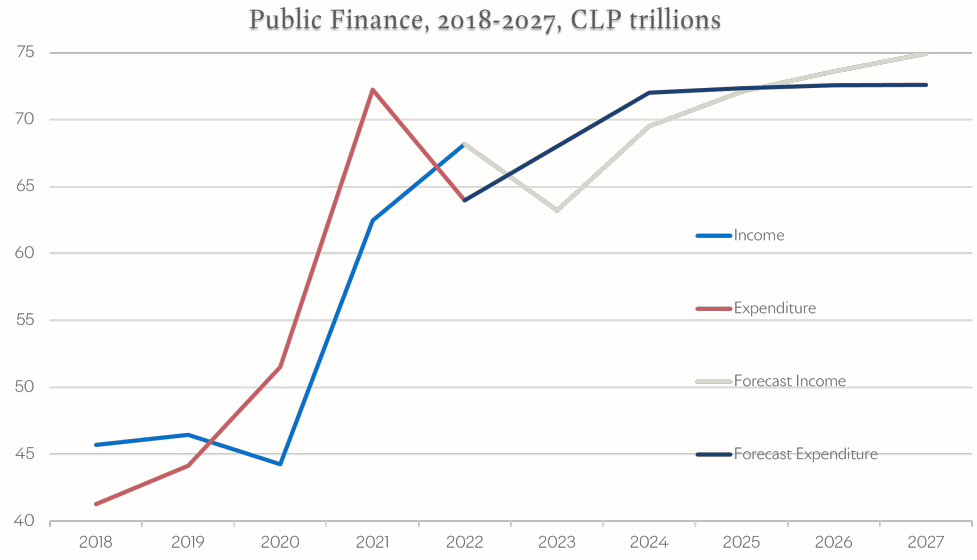
In November, Congress completed approval of the government's budget for 2023 which foresees a 4.2% real increase in public expenditure next year to CLP81.6 trillion (US$96.3 billion).

This includes a 5.5% increase in public investment, designed to create jobs and bolster activities as the economy slows, and an 8.0% increase in welfare spending, particularly pensions, healthcare, and education. Spending on law and order will rise 4.4% as the government increases efforts to fight organised crime and drugs trafficking.

Government revenues are expected to fall sharply in 2023 as the economy slows, with tax revenues dropping 11.3% to CLP 53.9 trillion (US$62.5 billion). As a result, public finances are expected to move into a deficit of CLP 7.6 trillion (US$8.8 billion) or 2.7% GDP, compared to a forecast surplus of 1.6% in 2022.

The government still aims to largely eliminate the public deficit by the time it steps down in 2026. This is dependent on the strength of economic growth (which the government says will average almost 2.9% between 2024 and 2027) and approval of the government's tax reform, currently in Congress. Under its first version, these would boost government revenues by the equivalent of 4.1% of GDP once fully in force from 2026. However, amendments admitted before discussions had begun reduced this increase to just 2.7%




Source: Ministry of Finance

In line with this year's budget, government spending during the first ten months of the year fell to CLP 45.2 trillion (US$52.4 billion), down 29.9% from the same period of last year. In contrast, revenues rose 14.8% to CLP 58.0 trillion (US$67.3 billion), reflecting a 15.6% increase in revenues from income tax and higher royalty payments on lithium production on the Salar de Atacama . These are expected to reach CLP 2.1 trillion (US$2.4 billion) this year.

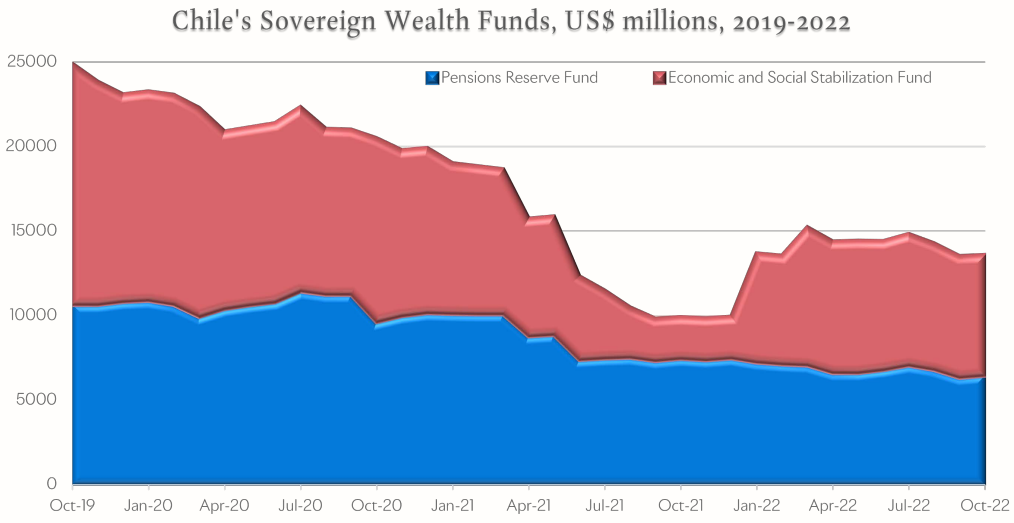
## Credit Ratings

Fitch Ratings.....A- (stable)
S&P Global Ratings.....A (stable)
Moody's .....A2 (stable)
JCR .....AA- (stable)

In September, Moody's Investors Services downgraded its credit rating for Chile's local and foreign currency debts from A1 to A2. The agency said the move reflected the sustained increase in government debt, which accelerated during the pandemic, and expectations that the new constitution will increase social spending. However, the agency upgraded its outlook for Chile to stable from negative (where it has been since 2020).

In October, S&P Global Ratings left its rating for Chile unchanged at A with a stable outlook.

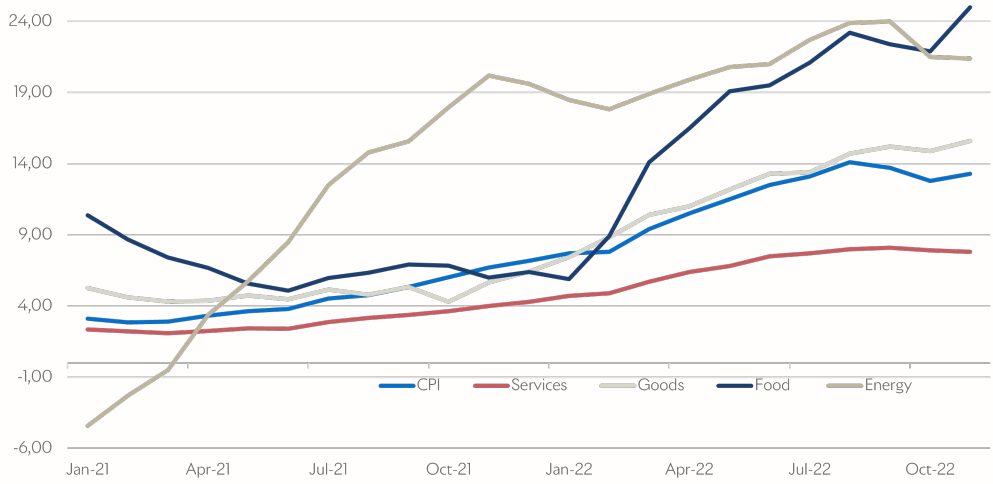
## Sovereign Wealth Funds




Source: Ministry of Finance

By the end of October, Chile's two sovereign wealth funds controlled assets worth US$13.6 billion, up from 40% from a year ago, reflecting contributions worth around US$6.0 billion made by the previous administration at the start of 2022. However, the funds have suffered more than US$3.0 billion of capital losses so far this year as the value of financial assets have tumbled of the face of record inflation.

Consumer Price Index, annual change %, 2021-2022




Source: National Statistics Institute

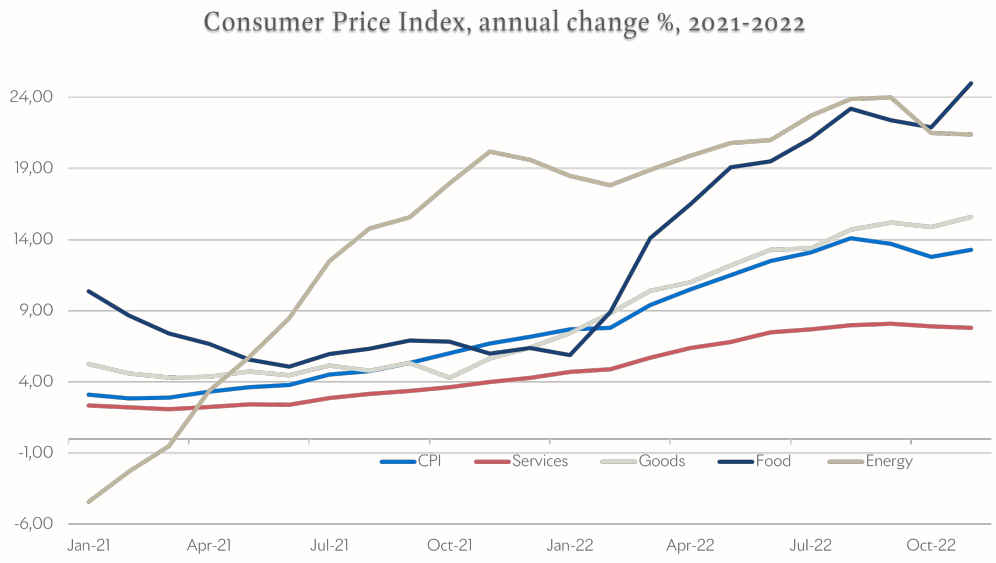
Inflation appears to have peaked. In October, the government's Consumer Price Index rose by 0.5%, its smallest increase in eight months. However, in November, the index rose 1.0%, double market expectations, bringing annual inflation to 13.2%.

The surge was driven principally by volatile food and energy prices, which rose by 2.0% and 1.4% respectively. However, the inflation was widespread, with ten out of twelve categories recording increases, and non-volatile goods prices rising by a record 1.8%. Ahead of the first summer holidays in three years without travel restrictions, air fares rose by almost 10% in a month.

The November figure has not had a significant impact on inflation expectations. Analysts surveyed by the Central Bank after the data had been published predicted the index to end 2023 at 5.0%, and to reach 3.3% by December 2024, barely changed from a month earlier.

In December, the Central Bank was more optimistic about inflation, predicting a decline to 3.6% by December 2023 and to 3.0% by late 2024.

After nationwide protests by lorry drivers in November, the government agreed to cap diesel prices at current levels for the next 120 days and inject more funds into its fuel price stabilization mechanism.




Source: National Statistics Institute

The proportion of the workforce which is looking for work has crept higher amid a dearth of new jobs. The unemployment rate averaged 8.0% in the three months to October, up from 7.2% at the end of last year. After growing by around 800,000 in the year to May 2022, the number of people in work has plateaued at around 8.8 million while the number of people classed as inactive has stabilized at 6.4 million, up from 5.7 million before the pandemic.

With the exception of construction (which has shed 30,000 jobs since January 2022), employment has been stable in most sectors although this could change over the coming quarters. The low level of business confidence and a sharp decline in the number of vacancies posted online suggest the labour market will weaken significantly during 2023, bringing with it a rise in unemployment.

Wages have continued to rise rapidly, growing by 10.9% in the year to October, according to the government's remunerations index, although down from 11.1% in August. Adjusted for inflation, however, real wages declined by 1.7% in the year to October, marking twelve months of falling incomes.

After a period of significant volatility, financial markets have stabilized slightly. Long term interest rates have declined, with yields on 10-year bonds falling around 125 basis points and yields on one- and two-year bonds by around 250 bp. Spreads against international rates have also declined as investor focus turns from local uncertainty to external risks.

## Banking

Bank lending remains slow amid a lack of demand among consumers and businesses and more restrictive conditions from banks.

By the end of October, outstanding loans stood at CLP 247.6 trillion (US$289.7 billion), barely changed from a year ago. Corporate lending shrank by 1.3% to CLP 140.0 trillion (US$163.8 billion) as increased lending to large businesses was offset by a decline in lending to small and medium-sized businesses, reflecting the impact of the government's state-guaranteed loan scheme during the pandemic.

Consumer lending was unchanged at CLP 27.9 trillion (US$32.6 billion) while mortgage lending grew by 2.3% to CLP 77.4 trillion (US$90.6 billion), down from growth of 7% in 2021, reflecting the slump in the housing market.

Despite the slowdown in lending, bank profits during the first ten months of the year reached CLP 4.7 trillion (US$5.5 billion), up 40.4% from a year earlier, boosted by higher interest rates.

# Chile's Fintech Law

New legislation approved by Congress in October will give official recognition to a new class of companies shaking up the banking industry by providing financial services online.

The term financial technology or fintech covers a range of services, from digital wallets and online payments systems to crowdlending and exchanges for cryptocurrencies and other assets.

Although Chile can boast high levels of financial inclusion, thanks to no-frills products such as BancoEstado's Cuenta RUT, many clients are not happy with the service they receive which often includes charges for transfers and cash withdrawals.

New digital banks offer such services at a much lower cost (often for free) and without the need to visit a physical branch. Others are competing with banks to provide credit to small businesses.

Industry association FinteChile estimates that there are already around 260 digital companies based in Chile that provide financial services online, making it an important centre for fintech in Latin America, second only to Brazil.

In the past, fintechs have sometimes fallen foul of regulators and the banks themselves because they operate just outside existing financial regulation.

The new law should avoid such problems by bringing the sector under the regulation of Chile's Financial Markets Commission with different levels of scrutiny depending on the services they provide. It also facilitates the sharing of data between banks, fintechs and other financial institutions, making it easier for them to assess potential clients.

This should reduce the risk of fraud and give greater confidence to customers and investors to put their trust in the new companies.

The increased competition has already prompted banks to reduce fees and expand the range of services they offer online, from paying for the metro and opening an account, to buying insurance or applying for a mortgage.

## Stock Markets


Source: Santiago Stock Exchange

Share prices in Chile fell sharply in September as investors reacted to the weaker outlook for the global economy. However, after falling briefly below 5,000 points, the IPSA index of the largest companies listed on the Santiago Stock Exchange reached 5,250 points in early December, up 21.5% from the start of the year.

## Pension Funds

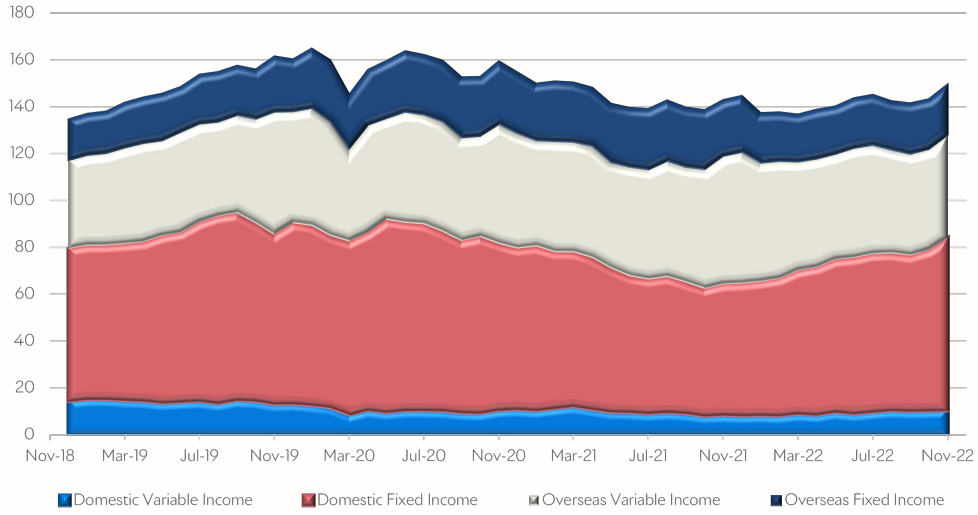
AFP Assets under Management
(November 2022)

| Type of fund | Amount | Change | Return | Limits on equity investments | |
|---|---|---|---|---|---|
| | (billions of pesos) | December 2021 – November 2022 (%, real in pesos) | December 2021 – November 2022 (%, adjusted for inflation) | Limits on equity investments (% of fund assets) | |
| | | | | Maximum | Minimum |
| A Funds | 22,700 | -14.4 | -16.05 | 80 | 40 |
| B Funds | 25,791 | -3.9 | -12.27 | 60 | 25 |
| C Funds | 53,505 | 0.9 | -7.16 | 40 | 15 |
| D Funds | 27,075 | 22.8 | 1.73 | 20 | 5 |
| E Funds | 23,290 | 62.8 | 8.49 | 5 | 0 |
| Total | 152,664 | 6.7 | | | |

Source: Superintendence of Pensions

The value of assets managed by Chile's pension fund administrators has grown steadily, reaching CLP 152.7 trillion (US$178.3 billion) in November, up 6.7% from twelve months earlier. The growth has been driven by a rise in the value of Chilean bonds over the last year while the value of foreign shares has fallen.

AFPs by asset class, US$ billions, 2018-2022




Source: Superintendence of Pensions

# Reforming Chile's pensions

In November, President Boric unveiled the government's plan to overhaul the pensions system, promising not only better pensions for current and future retirees, but also to eliminate the private pension fund administrators which have dominated pensions provision since 1981.

Under the legislation sent to Congress, the government will maintain the existing individual workers accounts, bolster the universal pension, and create a new social security funded by employers that would reduce inequality amongst the elderly.

• The tax-funded Universal Guaranteed Pension (PGU from its initials in Spanish) would be lifted to CLP 250,000 (US$290) a month, up from CLP 194,000 currently. This will benefit more than two million pensioners once the law is approved, rising to an estimated 3.4 million by 2030.

• Employers will be required to contribute the equivalent to 6% of a workers' wages to a new pension system. Of this, 70% will go nominally to the worker's personal pension, while the rest will be distributed equally between all savers, boosting the pensions of low-income workers. While the contribution will be introduced gradually over five years, payments will be made in full immediately financed through drawdowns from Chile's Pension Reserve Fund (which contains assets worth US$6.5 billion).

• The existing private accounts pension system will continue but will be overhauled with the creation of a new public entity Autonomous Pensions Administrator that will replace the AFPs in managing workers' accounts. Savers will be able to choose whether to invest their savings through a new state-owned Autonomous Public Pensions Investor (the default option) or a Private Pensions Investor (IPP), which could be owned by a range of financial institutions. The AFPs will be able to choose whether to become an IPP within two years of the law's approval or be closed down.

Given its lack of a majority in either house of Congress, the government will likely have to negotiate with the centre-right opposition to win approval of the reform. While polls showed the public initially welcomed the announcement of the reform, there is also evidence that in the wake of the pension withdrawals, savers have become more appreciative of having their own pensions savings.

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# External Sector

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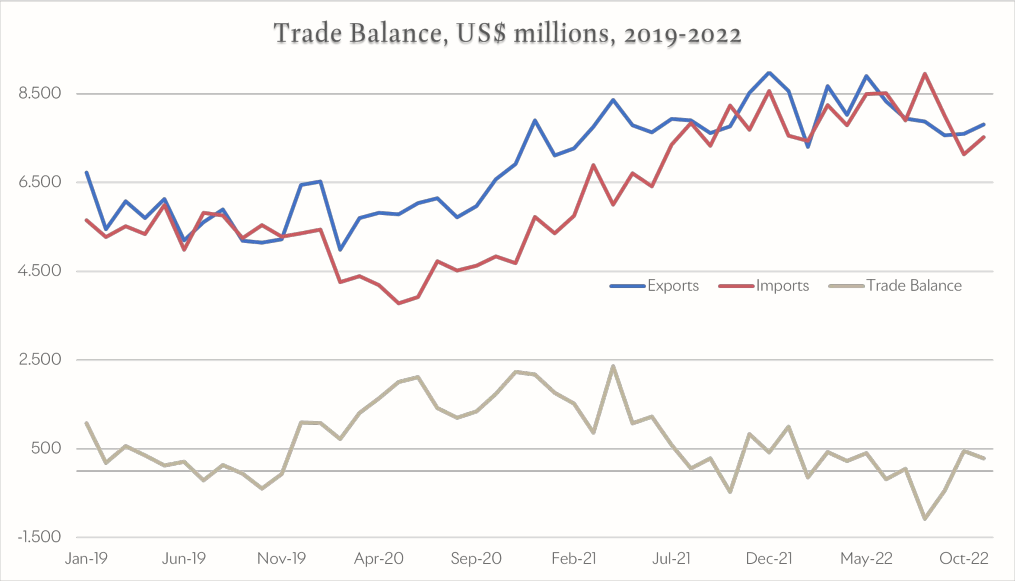
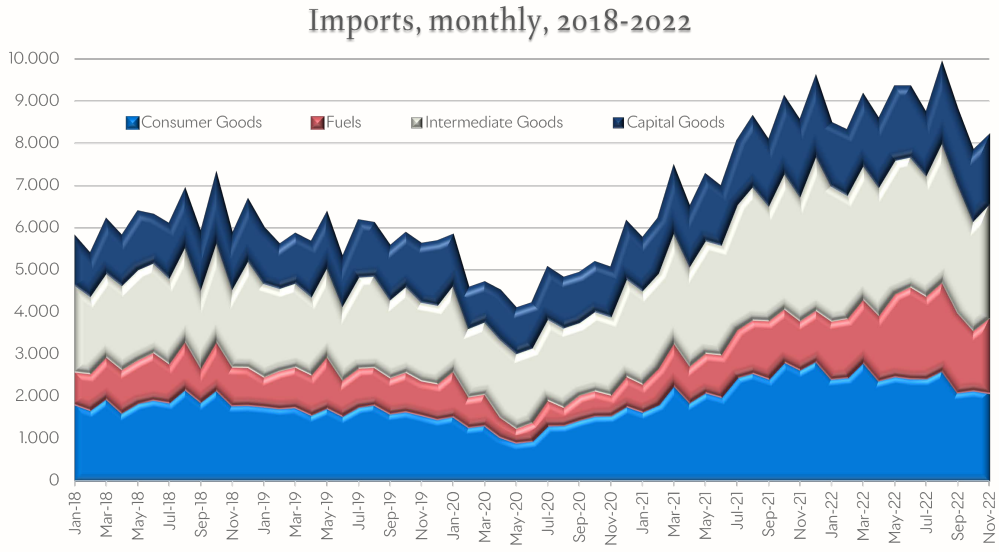



Source: Central Bank of Chile

Chile's foreign trade has slowed in recent months as a drop in copper prices and production hit mineral exports and imports of consumer goods and fuels decline. Exports during the three months to November 2022 reached US$23.0 billion, down from US$25.3 billion in the second quarter, while imports fell to US$22.7 billion, down from US$24.8 billion. The decline in imports has reduced Chile's trade deficit which reached US$2.0 billion in the November quarter, compared with US$5.2 billion in the three months to June.

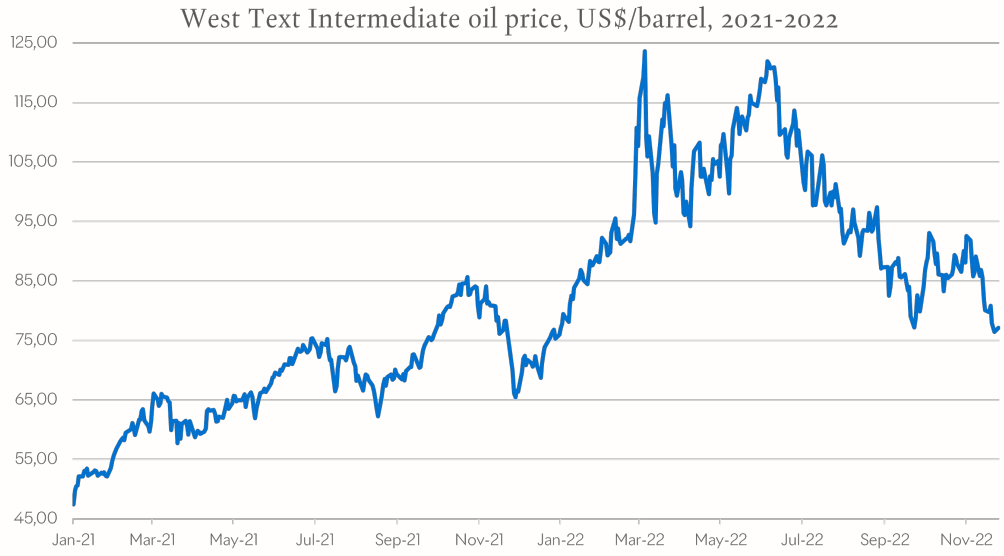
## Imports




Source: Central Bank of Chile

Imports of consumer goods during the three months to November fell to US$6.4 billion, down from US$8.0 billion in the same period of 2021, largely due to falls in imports of consumer durables, especially electronic goods, and fuels.

Fuel imports fell to US$5.0 billion in the quarter to November, down from US$5.6 billion in the second quarter of the year, reflecting lower imports of coal, liquefied natural gas and diesel. After reaching record levels in the wake of Russian invasion of Ukraine, oil prices have declined this year to below US$80/barrel in recent weeks as global demand slows.

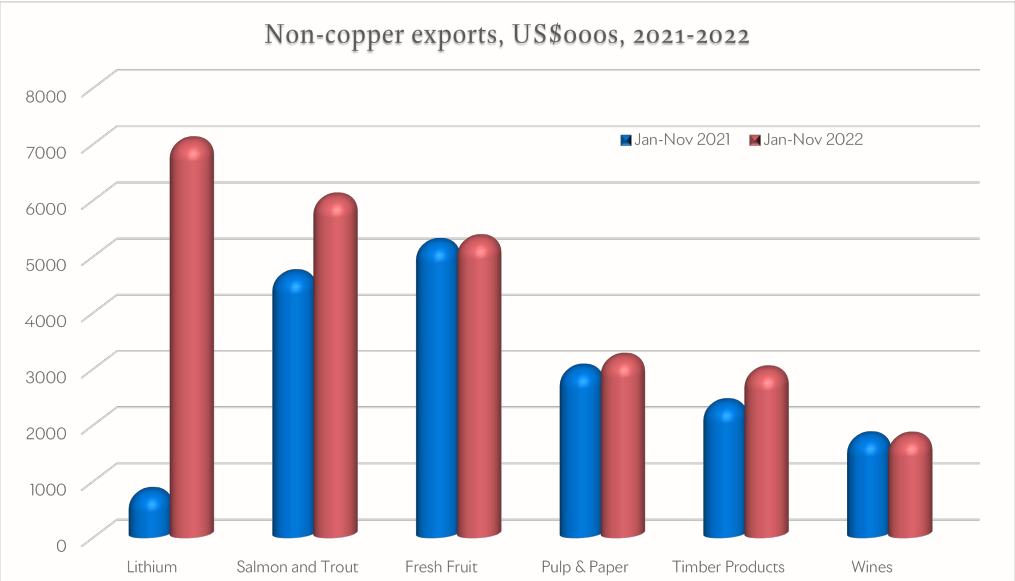



Source: St Louis Federal Reserve

Reflecting sustained investment in the energy and transport sectors, imports of capital goods have continued to exceed pre-pandemic levels. They reached US$5.0 billion in the November quarter, unchanged from the same quarter of last year, as increased imports of buses and electrical equipment offset a decline in imports of construction and mining equipment.

Imports of intermediate goods fell to US$8.4 billion, down from US$9.3 billion in the second quarter, on lower imports of chemical and metallic products and spare parts.

Exports




Source: Central Bank of Chile

Chile's non-mineral exports have risen this year, partly offsetting the decline in mineral exports. While farm exports reached US$6.0 billion between January and November, up 2.2% from a year ago, industrial exports rose 22.1% to US$32.4 billion.

The rise in farm exports reflects a 1.3% increase in shipments of fresh fruit to US$5.3 billion, especially grapes and cherries, and a 61.7% increase in seafood exports to US$170 million.

Industrial exports were driven by higher exports of chemical products which rose 51.8% to US$8.1 billion, reflecting increased commodity prices. Iodine exports rose 85.5% to US$1.0 billion, fertilizer

shipments more than doubled to US$972 million and methanol exports rose 51.8% to US$370 million. SQM said in November that rising prices have bolstered sales of iodine and fertilizers this year, while Methanex, which operates the Cabo Negro methanol facility in Magallanes, said a 40% jump in production and higher prices have driven up exports.

Timber exports reached US$3.0 billion, up 24.5% from a year ago, while exports of pulp and paper rose 6.5% to US$3.2 billion as higher prices offset a fall in production.

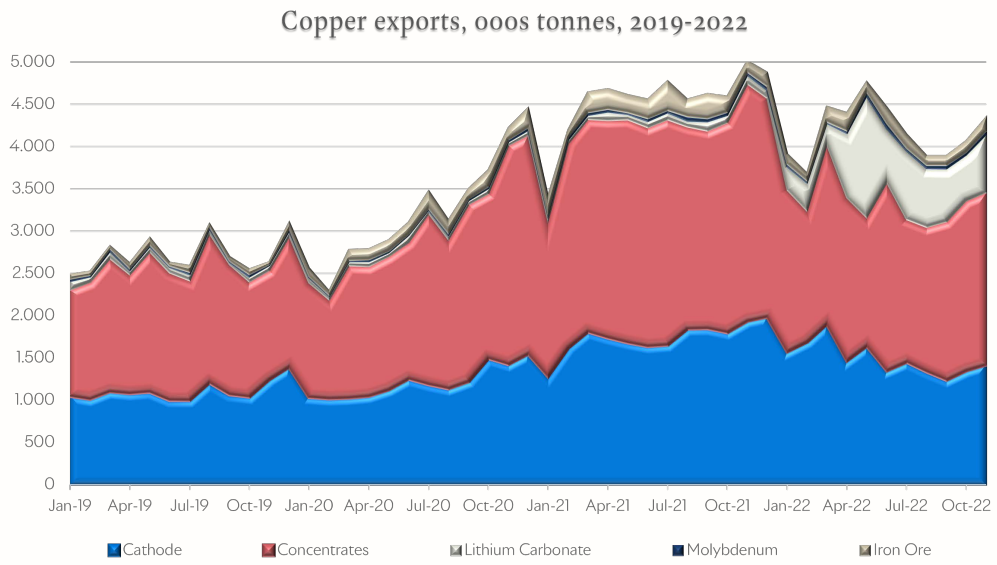
Pulp prices have risen this year, with Bleached Eucalyptus Kraft Pulp (BEKP) averaging US$871 a tonne in the third quarter, up 23.9% from a year earlier, but production was hit by maintenance stoppages. The start of operations at Arauco's new Mapa pulp mill, delayed from late 2022, will lift Chile's pulp production capacity by 1.56 million tonnes annually from next year.

Chile exported US$6.0 billion worth of salmon during the first eleven months of the year, up 29.2% from 2021. According to Chile's Salmon Council, the increase largely reflects higher prices, which averaged US$9.00 per kilogram during the first nine months of the year, up 24% from last year, while volumes rose 2% to 531,551 tonnes.

Shipments of wine reached US$1.8 billion in the year to November, down 0.3% from twelve months earlier. According to industry body Vinos de Chile, exports of bottled wine reached US$1.3 billion to October, up 2% from 2021, as a 4% increase in volumes (to 45.3 million cases) offset a 2.1% fall in prices (US$29.20/case). Lower exports to China and the UK have been offset by increased exports to Brazil, the US and Japan.

## Exports by region

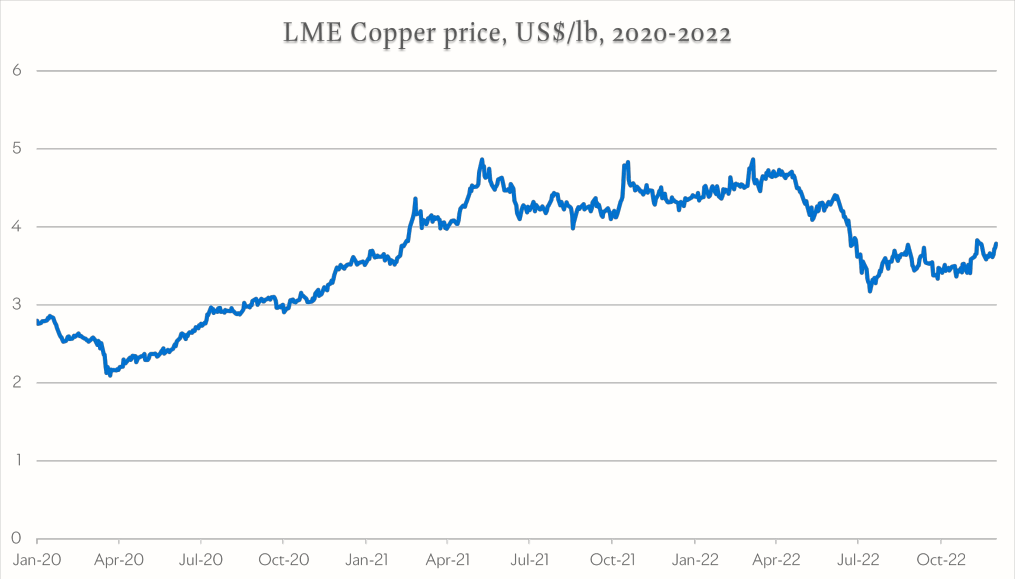
As the global economy slows, China has continued to draw in more exports from Chile. Exports to China reached US$31.5 billion in the first ten months of the year (or 39% of Chile's total exports), up 6.5% from a year earlier. In comparison, exports to the US declined 5.7% to US$11.5 billion




Source: Chilean Copper Commission

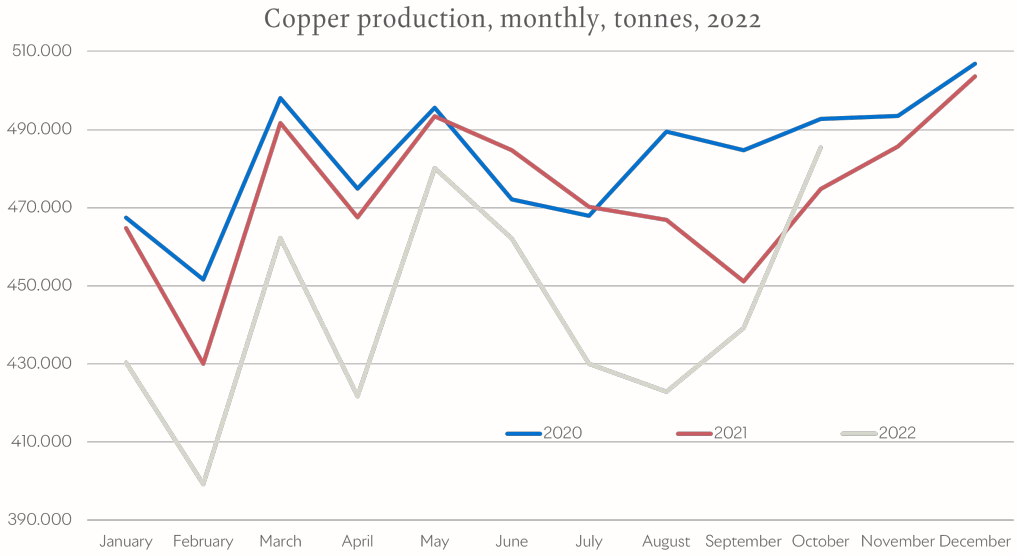
(representing 14.2% of the total) while exports to Europe fell 11.8% to US$8.1 billion (10.0% of Chile's total exports).

Chile's mineral exports declined to US$50.2 billion during the first eleven months of the year, down 5.8% from twelve months earlier, in line with lower copper production and prices. Copper exports during the first eleven months of 2022 fell to US$39.6 billion, down 18.1% from the same period of 2021.




Source: Chilean Copper Commission

After a sharp drop during the second quarter, copper prices have stabilized around US$3.60/lb, supported by low copper inventories and the improved outlook for the Chinese economy. Copper prices are forecast to continue around current levels over the next two years with the Central Bank predicting prices to average US$3.55/lb in 2023 and US$3.45/lb in 2024.



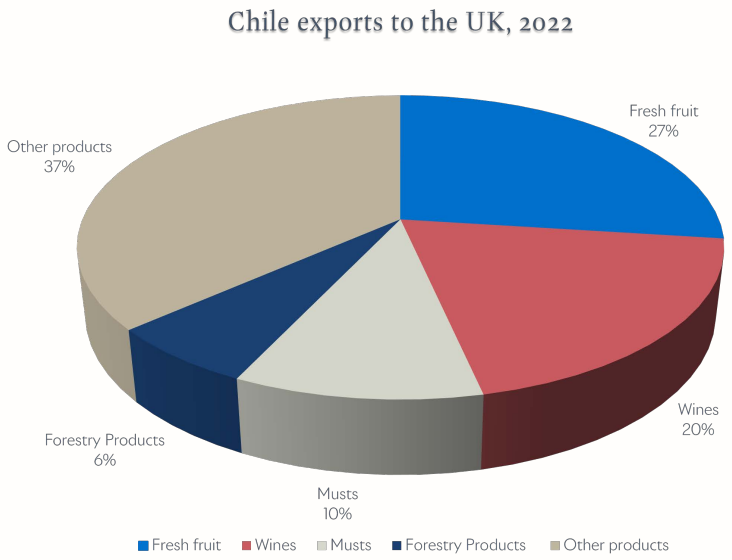

Source: National Statistics Institute

Copper production has begun to recover from the weak start to 2022 with production reaching 485,447 tonnes in October, up 2.2% from the same month of last year. However, production during the first ten months of the year totalled just 4.43 million tonnes, down 5.6% from the same period of 2021, as mining companies struggled with lower ore grades, water shortages and technical problems.

After falling to an estimated 5.4 million tonnes in 2022, a ten-year low, production is expected to rise to 5.7 million tonnes in 2023, thanks to higher production at the Collahuasi and Escondida mines and the start of production at the new QB2 mine, according to national mining association SONAMI. However, in November, Teck said that the start of production at QB2 could be delayed until early next year, reducing output during its first year of operations.

Exports of lithium carbonate have soared on higher production and record prices. Shipments during the first eleven months of the year reached US$7.0 billion, up almost ninefold from the same period of 2021, as export volumes rose 44.6% to 200,543 tonnes.

In November, SQM, Chile's largest producer of lithium, said prices traded at an average price of more than US$50,000 a tonne in the third quarter and are expected to remain high due to a tightly balanced global market. The company has approved plans to expand its production capacity for lithium hydroxide to 100,000 tonnes, up from around 10,000 tonnes currently.




Source: Central Bank of Chile

Exports of molybdenum reached US$2.2 billion in the first eleven months of the year, up 7.7% from twelve months earlier, reflecting higher prices. While production so far this year has declined 10.2% to 37,732 tonnes, prices of molybdenum oxide have averaged US$17.86 a kilogram, up 12.7% from 2021.

Trade in goods between Chile and the UK reached US$1.2 billion during the first eleven months of 2022, up 5.5% from the same period of 2021.

Chilean exports to the UK rose 13.3% to US$637 million in the period as increased exports of forestry products offset declines in shipments of wines and fresh fruit. Exports of forestry products rose 8.7% to US$41 million while exports of fresh fruit fell 16.5% to US$172 million. Wine shipments fell 16.6% to US$124.5 million.

UK exports to Chile fell to US$558 million, down 2.0% from a year earlier, reflecting a decline in shipments of cars, foodstuffs, and clothing. Shipments of cars fell 46.9% to US$32.3 million. In contrast, exports of machinery to Chile reached US$139.6 million, up 10.3% from a year ago.

Chile's current account deficit widened to US$9.4 billion in the third quarter, the equivalent to 9.9% of GDP, up from approximately 8.5% in the previous quarter. The record figure contributed to the Chilean peso's temporary depreciation against the US dollar.

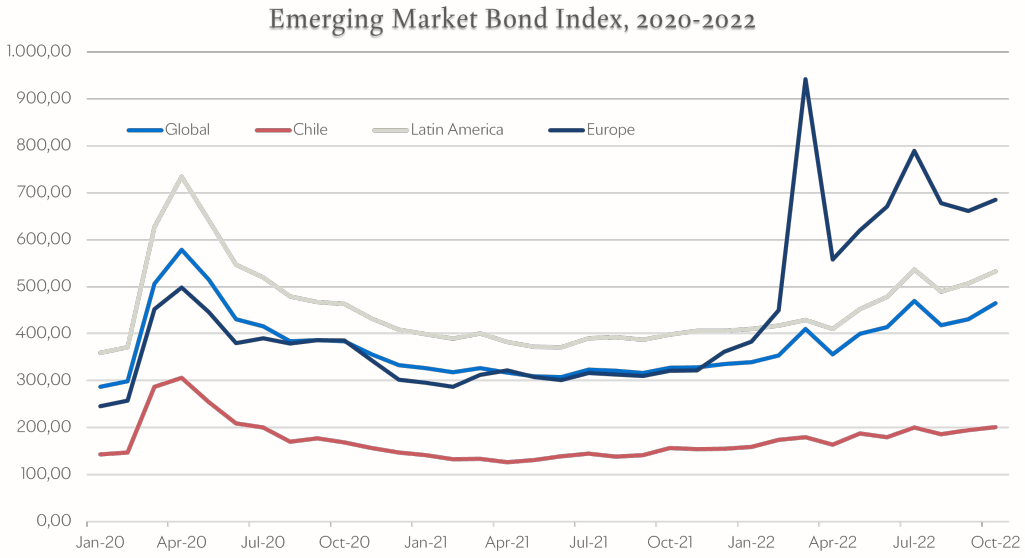
In its latest Monetary Policy Report, the Central Bank attributed the expansion of Chile's current account deficit to the fall in national savings – following the government transfers to households and pensions withdrawals implemented during the pandemic – as well as the fall in the terms of trade, higher transport costs and the rise in energy prices.

As consumption and investment fall over the coming quarters, the Central Bank predicts that the deficit will rapidly narrow to approximately 4.9% of GDP in 2023 (and 4.1% in 2024).

Similarly, Chile's financial account recorded a deficit of US$11.2 billion (up from US$7.4 billion in the previous quarter), as the Central Bank sold US dollar-denominated financial assets during the third quarter to stabilize the exchange rate.

Chile's International Investment Position reached a net debt of US$44.6 billion by the end of September, up from US$29.1 billion three months earlier. The sharp increase reflected the impact of the Central Bank's intervention in currency markets and the fall in the value of foreign assets owned by pension funds.

Chile's foreign debt declined to US$226.2 billion at the end of the third quarter, equivalent to 84% of GDP, down from US$233.9 billion in June. The fall reflected the decline in government debt as its bonds fell in value in response to the rise in international interest rates, the sale of local bonds by foreign investors and the depreciation of the euro and Chilean pesos against the US dollar.




Source: JP Morgan

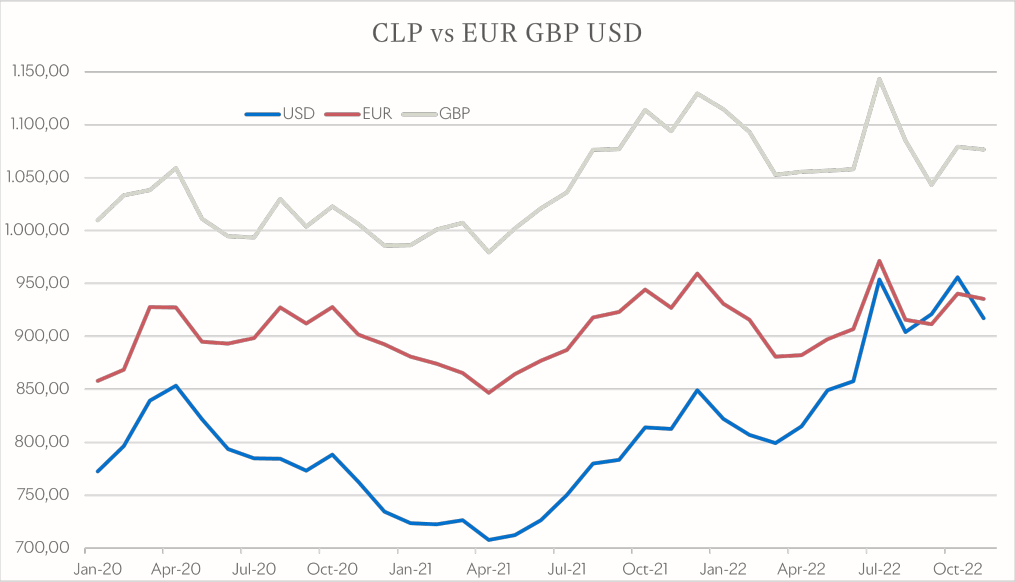
## Country Risk

Risk premiums for Chile have continued to rise. JP Morgan's Emerging Market Bond Index (EMBI)


Source:Central Bank of Chile

reached 201 points in October, up 45 points from a year earlier and its highest level since June 2020, the height of global lockdown for Covid-19. However, the increase is less than that seen in other countries with the index for Latin America gaining more than 130 points over the last twelve months.

Foreign exchange markets have remained volatile with the Chilean peso oscillating in a wide range against the US dollar. After slumping to a record low of CLP 1,030/dollar in July, the peso has traded between CLP 860/dollar and CLP 980/dollar through the final months of the year, driven by changes in global inflation and monetary policy, the copper price, and other macroeconomic data. Most recently, the peso fell sharply after data revealed a record current account deficit in the third quarter, before recovering below CLP 900/dollar on a recovery in copper prices. The peso averaged CLP 926/dollar during the third quarter, compared to CLP 759/dollar during the whole of 2021.




Source:Central Bank of Chil

To stabilise the exchange rate, the Central Bank sold US$6.2 billion worth of US dollars and US$9.1 billion in hedging instruments between July 28th and September 30th.

The peso's depreciation partly reflects the US dollar's rise against almost all major currencies over the last year as the US Federal Reserve launched its fastest tightening of monetary policy in forty years.

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# Quarterly Insight

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As the Chilean economy prepares for its second contraction in four years, it is hitting some sectors worse than others.

## Construction

The impact of the pandemic lockdown, slowing investment and a decline in the housing market have triggered a wave of failures in Chile's construction industry. A study by the University of Talca found that almost 250 building firms have filed for bankruptcy since January 2021, including 110 in the first six months of 2022. They include well-known names, such as property developer Sencorp, which built Chile's second tallest skyscraper (it sought restructuring after office rents plummeted during the pandemic) and construction major Claro, Vicuña, Valenzuela which sought bankruptcy protection in October (with the loss of 2,500 jobs and the suspension of 50 projects).

As well as difficult economic conditions, another factor may be the way the state pays for infrastructure projects. According to the study, many firms got into deep water after switching to public sector contracts which have slower payment times and less flexibility on costs (which have soared over the last year).

The trend is worrying given the importance of construction to the Chilean economy, accounting for 9% of GDP and around 800,000 jobs, and a weakened building industry could slow an investment-led recovery.

In response, the government announced measures to support the sector, including a new state loan guarantee for low-cost homes, additional insurance coverage to reduce mortgage rates and an extension of the VAT break for housebuilders until 2027. But that is probably not enough to prevent more companies going under.

## Healthcare

The future of Chile's private health insurance providers is in jeopardy following a series of interventions by the courts and lawmakers into how they price their policies. ISAPREs (as they are known from their initials in Spanish) provide health insurance to around 3.3 million people in Chile, mostly higher income earners who pay extra for shorter waiting times and better service than the public health system can offer, contributing 7% or more of their monthly income. Since their creation in the 1980s, they have financed a significant expansion of Chile's healthcare infrastructure, which is amongst the best in Latin America.

However, how ISAPREs assess and charge clients has come in for criticism. Since 2010, policyholders have filed more than 1.3 million injunctions to prevent their ISAPREs from raising contributions on constitutional grounds. When the pandemic struck in 2020, Congress passed legislation freezing the contributions for two years. Then this year the Supreme Court has ordered ISAPREs to return unjustified contribution increases to clients.

In the meantime, ISAPREs have seen their operating costs soar by more than a quarter, including a 60% increase in sick leave in the wake of the pandemic.

As a result, the five largest ISAPREs suffered losses totalling CLP 137 billion (US$159 million) last year. Strapped for cash, they owe around CLP 450 billion (US$532 million) to private clinics, many of which have begun requiring policyholders to pay for operations and exams upfront and in full. The fear is that one or more ISAPREs could go bust, leaving hundreds of thousands of clients without coverage.

The government is unwilling to step in. President Boric wants to replace the ISAPREs with a universal health insurance scheme, although this reform appears to have been delayed for now.

However, the parlous state of the ISAPREs may force the government to act.


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# Political Context

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Following its defeat in the constitutional referendum and given its lack of majority in either house of Congress, the government has struggled to control the political agenda.

The Finance Ministry has already scaled back its planned tax reform, reducing the expected increase in government revenues from 4.1% to 2.7%, even before the debate in Congress had begun.

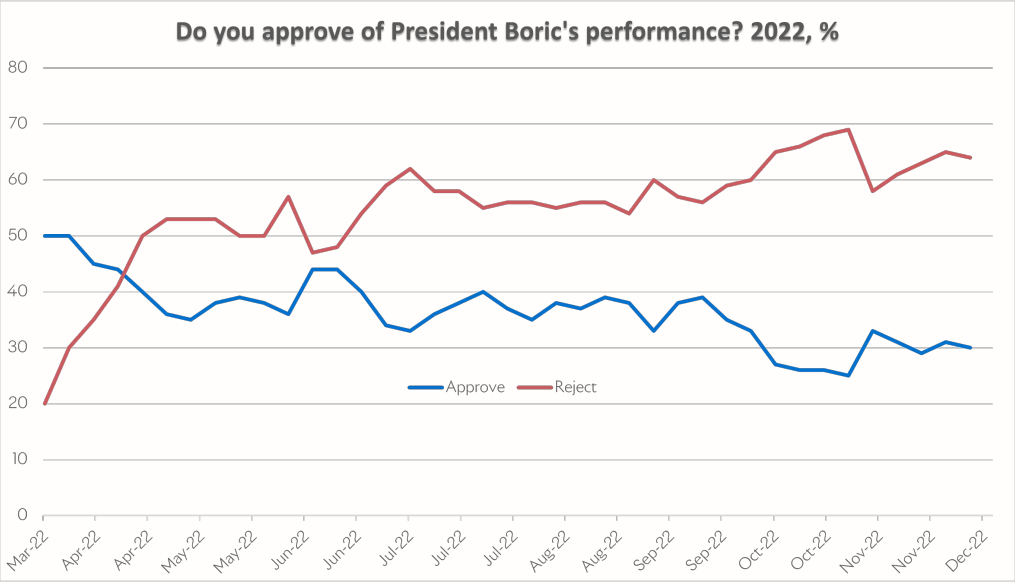
In November, the government presented a major reform of the pensions system, including the elimination of the private pensions funds administrators to Congress (See Box: Pensions Reform). It will likely have to concede parts of the reform in order to win the necessary votes.

Government supporters in Congress were forced to drop their attempt to have Communist Deputy Karol Cariola elected president of the lower Chamber of Deputies after the centrist Christian Democrat and People's Party withdrew their support. In November, the Senate rejected the government's candidate for the post of national prosecutor.

In October, lawmakers approved the Comprehensive and Progressive Agreement for Trans-Pacific Partnership despite the opposition of President Boric and many of his allies. The government is seeking some safeguards from other CPTPP members before ratification.

In December, the government signed a new framework trade deal with the European Union which had been delayed since the start of the year.

Government supporters in Congress have begun to debate new legislation allowing workers to withdraw part of their pension savings despite warnings from ministers about its impact on inflation and financial markets.




Source: CADEM

Support for the government has declined significantly since its defeat in the referendum on the new constitution. By early November, approval of President Gabriel Boric's performance had fallen to a record low of just 25%. The launch of the government's flagship pensions reform bolstered support, but these gains have since been reversed.

On December 12th, lawmakers reached agreement on a new process to draft Chile's new constitution, after the previous proposal was rejected by voters in September. The new constitution will be drafted by a Constitutional Council consisting of 50 elected members advised by a 24-person Expert Commission chosen by lawmakers (in contrast to the wholly elected 150-member Constitutional Convention).

To avoid the radical changes included in the rejected text, lawmakers have agreed that the new constitution will preserve Chile as a democratic republic with a unitary, decentralized state and three arms of government including an executive with exclusive powers to propose tax and spend measures, a two-chamber legislature, and an autonomous judiciary. It will also maintain the autonomy of the Central Bank and national prosecutors' office, protect human rights, and recognize its international treaties.

Mandatory elections to the Constitutional Council will take place next April. It will then have five months to draft the text which will then be put a referendum in November 2023.

In December, the International Court of Justice in The Hague confirmed Chile's assertion that the Silala River in western Bolivia is an international river, rejecting Bolivia's claim to sovereignty over the water course.

Amid growing concern over violent crime, support for Chile's uniformed police (Carabineros) has sharply increased, reaching 73% in November, up from an average of just 45% last year.

From October 1st, following a sharp fall in the number of Covid-19 cases, the government significantly relaxed social-distancing measures imposed during pandemic, lifting the requirement to wear masks in public places (except in healthcare establishments) and to show a vaccine pass and reducing the required isolation period from 7 to 5 days. Authorities have also begun to administer the new bivalent vaccine, starting with vulnerable groups.

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# Economic Outlook

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The Chilean economy is set to contract over the next few quarters as it continues to adjust to the huge expansion in consumption in 2021, caused by increased government spending and the pensions withdrawals.

With consumption and investment expected to decline more than 5% each during 2023, the Central Bank has forecast a decline in economic activity of between 0.75% and 1.75%, a slight deterioration from its previous outlook.

As predicted, the contraction began during the second half of 2022, but the economy has performed better than expected thanks to robust services activity and continued investment in renewable energy and transport projects.

The fall in economic activity is likely to cause a rise in unemployment which has been creeping upwards since early 2022 amid a dearth of new jobs. Weak business confidence and a fall in the number of job vacancies suggest this process will accelerate during 2023.

Falling economic activity should allow inflation return to more sustainable levels. After ending 2022 at close to 13.0%, the Central Bank has predicted that the inflation will average 6.6% during 2023, end the year at 3.6% and return to its target rate of 3.0% by late 2024. However, November's surprisingly high inflation figure suggests that this process could take longer than expected which would delay the easing of monetary policy forecast to begin early next year.

As economic conditions deteriorate, there will be increased pressure on the government to provide additional social help to vulnerable families. This could threaten efforts to put public finances on a more stable path after the sharp rise in spending during the pandemic. However, the administration's hands could be forced if lawmakers continue to advance another pensions withdrawal, a move which would further rattle financial markets and delay the fall in inflation.

The government's plans also depend on approval of its flagship pensions and tax reforms, which will require negotiations with the opposition. The latter is key to providing the necessary legal certainty to ensure a recovery in investment.

2023 will see Chile make a second attempt at drafting a new constitution although the limits agreed by lawmakers on the scope of the debate should reduce the level of uncertainty that this process will cause.

An additional risk is the state of the global economy which is expected to slow significantly next year as the US and the European Union both enter recession, and the Chinese economy seeks to recover from the impact of its extended Covid-19 lockdown. Europe is especially vulnerable to the extension of the war in Ukraine and its devastating impact on energy markets but a deeper slowdown in China would have an even bigger impact on Chile, given its importance as a trade partner.

Economic Forecasts, 2022

| | Central Bank 1/ | Finance Ministry 2/ | Private analysts 3/ |
|---|---|---|---|
| GDP (% annual variation) | -0.75 - 1.75 | -0.5 | -1.5 |
| Inflation (% annual variation) | 3.6 | 6.3 | 5.0 |
| Monetary-policy interest rate (% annual, nominal, end-year) | ??? | NA | 7.0 |
| Exchange rate (pesos/US$) | NA | 868 | 860 4/ |
| Copper price (US$/lb) | 4.00 | 3.62 | NA |

1/ Monetary Policy Report, December 2022.
2/ Public Finances Report, September 2022
3/ Average of selected private analysts surveyed by Central Bank, December 2022.
4/ November 2022

# Latin America Regional News

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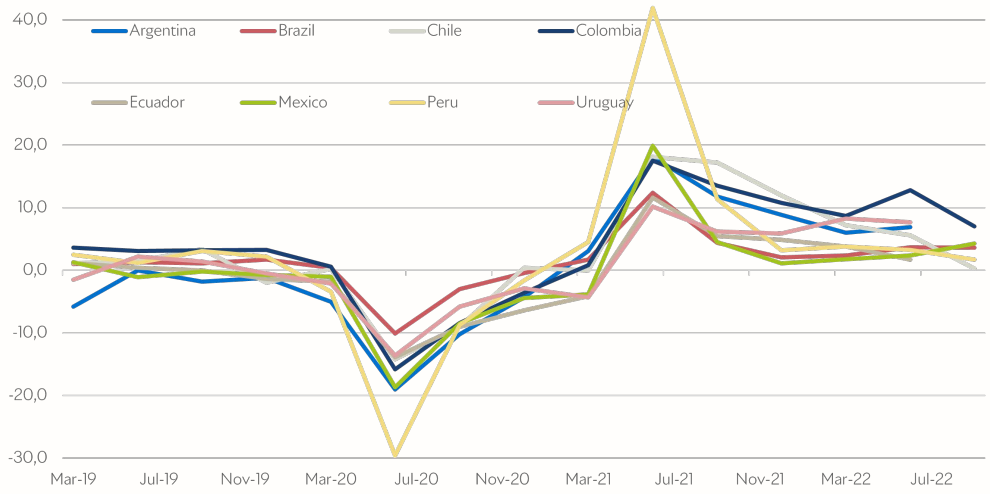
Quarterly GDP, annual change %, 2019-2022




Source: Trading Economics

Argentina: With the government still divided on how to stabilize public finances, inflation soared to 88% in October while the economy is set grow by just 0.5% next year (down from 4.4% in 2022). Next year's presidential elections have been thrown wide open after Vice-President Cristina Fernández was barred from running following her conviction for corruption.

Brazil: Luiz Inácio Lula da Silva was elected president in the second round of voting on October 30th, narrowly beating right-wing incumbent Jair Bolsonaro. The government cut its growth forecast for 2023 from 2.5% to 2.1%, citing a deterioration in the global economy and tighter financial conditions.

Colombia: Lawmakers approved President Gustavo Petro's tax hike that will increase public revenue by around 1.3% of GDP from next year but its impact could be wiped out by a new fuel subsidy. Growth is expected to fall to just 0.5% in 2023, from 7.9% in 2022, according to the Central Bank, as the world economy slows.

Ecuador: President Guillermo Lasso has called a referendum in February 2023 seeking voter support for plans to extradite drug traffickers who control parts of the country. The economy is set to grow by 2.7% in 2023, above the average for the region.

Mexico: President Andrés López Obrador has threatened to ban genetically modified imports after 2024, risking a trade dispute with the US, and sought to overhaul Mexico's electoral authority. The Bank of Mexico has forecast that the economy will grow 1.8% next year as the global slowdown hits exports.

Peru: Former vice-president Dina Boluarte was sworn in as Peru's sixth head of state in five years on December 7th after Congress impeached Pedro Castillo who had tried unsuccessfully to dissolve the legislature and form an emergency government. Despite the political turmoil, economic activity remains stable, with activity set to rise 3.0% in 2023, similar to growth in 2022.

Uruguay: President Luis Lacalle has said that his government will apply for membership of the Trans-Pacific Partnership. The World Bank expects the Uruguayan economy to grow around 2.0% next year, down from 5.0% in 2022.

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