

Chile Economic Outlook

1ST QUARTER 2016 | UNIT CHILE



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The downward adjustment to Chile growth projections for 2016-17 is due to the materialisation of external and internal risks

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Reduced pressure from exchange rates and food prices will allow inflation to converge with the target

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Monetary Policy Rate should see only one more hike this year, to 3.75%

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Closing date: 5 February 2016

1 Editorial

The intensification during the last quarter of 2015 of some of the risk clusters with a global impact led to a further downward revision of world economic growth forecasts for this year. The transition to a lower growth pattern in China, with economic reforms and changes to key objectives such as the exchange rate, is being accompanied by bouts of intense financial volatility and falling commodity prices. All this leads to a much less favourable global outlook for commodity-exporting economies, as well as for those perceived as more financially vulnerable.

The recent behaviour of the financial markets is largely explained by doubts concerning the strength of the world economic cycle, particularly as regards to emerging economies. The world economy faces a 2016 of limited growth, with a balance of risks that is tilted to the downside and concentrated in the emerging block. How China's economy evolves, both as regards the degree of slowdown in activity and how the authorities manage the financial imbalances that exist, will continue to have a significant influence on financial flows and commodity prices in general, not just oil. The level of corporate indebtedness in those emerging countries most vulnerable to external circumstances constitutes an additional source of instability, in a context of lower earnings and higher financing costs (bigger risk premiums). Allied to this, geopolitical tensions in certain parts of the world and the risk of a scenario of low growth and low inflation in the major developed economies complete the outlook for the world economy in 2016.

In Chile, we are adjusting our growth projection for this year down to 1.8%, but we continue to see that the balance of risks for this projection has a negative bias. Convergence towards the potential growth rate, which we estimate at around 3%, is being put off by the persistent weakness of both capital expenditure and private consumption and by deteriorating external conditions. For next year we are projecting that the economy will grow by 2.5%. A risk scenario in which the economy grows markedly less this year has a low probability of occurrence, but cannot be ruled out.

The current account deficit does not pose a threat to our economy, unlike in other emerging countries where it poses a risk of the first order within a context of growing risk aversion and increased sovereign risk premiums. Lower oil prices and the adjustment that has already taken place in domestic demand allow us to retain a favourable outlook for the current account at the forecast horizon, despite the fall in the price of copper. However, the foregoing also alerts us to the challenges associated with improving potential growth by means of greater productivity in a scenario of reduced capital expenditure on mining.

Inflation for 2015 ended the year at 4.4%, having moderated during the last quarter. Inflationary pressures will probably reappear during the first part of 2016, albeit fleetingly. The slowdown in the inflation affecting goods prices – associated with reduced currency pressures – and food prices will probably lead to inflation for the whole year coming in at 3.7%. Although in line with the outlook for activity, the risks are tilted towards a faster decrease in inflationary pressures. For the following year we foresee inflation holding at around 3%.

The baseline scenario of this report is compatible with a hike in the Monetary Policy Rate (TPM) to 3.75%, which we see taking place in March or April of this year. As we point out in the risks section, if negative scenarios for economic activity were to materialise, this could lead to the hike being postponed or even not taking place at all. If the economy grows at below the floor of the central bank's projected range, there will be a powerful argument for moderating the interest rate hikes announced in December 2015, but it would also take currency depreciation to ease and, more importantly, inflation to start falling more quickly than foreseen by the central bank to make it no longer necessary to raise the Monetary Policy Rate (TPM) to 4% (the level we consider neutral) during this year.

In the fiscal area, we believe that even with the change in the macroeconomic scenario, the actual deficit for 2016 will not deteriorate substantially relative to the Budget. However, 2017 and the coming years present risks of greater tightness, the extent of which is subject to the uncertainty of the adjustment in the reference parameters used to calculate the structural revenues under the fiscal rule. Assuming a scenario in which adjustment of these parameters is feasible, we do not rule out the possibility of the government's opting to cut spending this year, as the Minister of Finance has started to hint at in his recent public statements.

We are projecting a moderate appreciation of the peso in the second part of this year and during 2017, consistent with a slow recovery in the price of copper and an expected slight multilateral weakening of the dollar. Long-term interest rates in pesos have held steady, while neutral rate expectations implicit in asset prices have diminished, which leads us to see benchmark interest rates remaining low. However, risk premiums have increased and the scenario of an increase in reference rates associated with a decompression of term premiums remains valid.

As for the risks faced by the economy, on the domestic front we would highlight the fact that in the absence of signals favouring investment initiatives, and with the continuous advance of the process of reform, economic agents' confidence remains low, impeding recovery of both private consumption and capital expenditure and endangering future job creation. Added to this is the risk of a further fall in the price of copper, which would affect not only mining activity but also the fiscal situation, external accounts and activity of industries that provide direct or indirect services to the mining industry. A fall in the price of copper by more than that assumed in the baseline scenario of this report would result in reduced GDP growth this year.

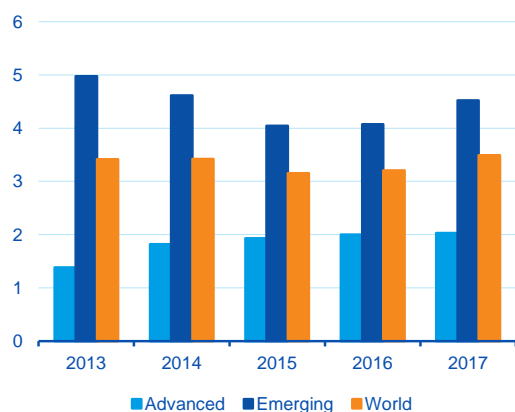
In the external dimension, emerging markets including Chile are under strong pressure following the adjustment to commodity prices and the increase in risk premiums. Not only China but the USA too is showing signs of increased weakness, which may lead to global growth below that envisaged in the baseline scenario, with negative implications for the expected growth of the Chilean economy. For the time being we consider that external scenarios putting the Chilean economy into recession this year have a low probability of occurring, and would come about only in the event of an abrupt adjustment of China's economy.

2 Global environment: anaemic and more fragile growth

The intensification during the last quarter of 2015 of some of the risk clusters with a global impact led to a further downward revision of world economic growth forecasts for this year. The transition to a lower growth pattern in China, with economic reforms and changes to key objectives such as the exchange rate, is being accompanied by bouts of intense financial volatility and falling commodity prices. All this leads to a much less favourable global panorama for large commodity-exporting economies, but also for those perceived as more vulnerable financially.

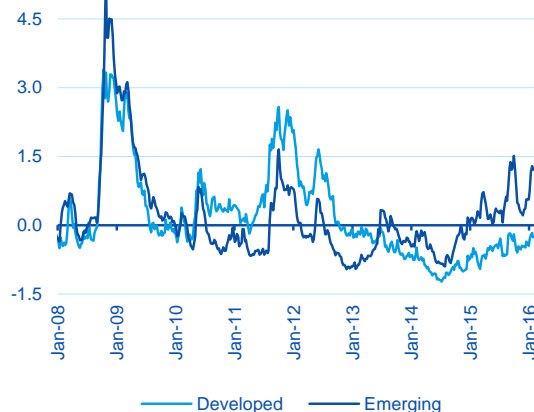
In fact, the leading indicators (confidence indices) and the increase in financial stresses point to more moderate growth in early 2016 than as foreseen three months ago. Therefore, world GDP will grow by just 3.2% in 2016, repeating the advance of 2015 and postponing recovery to 2017 when it should reach rates of around 3.5% (figure 2.1). This lower growth rate reflects slackening demand in emerging economies. Recovery in developed economies is still fragile and highly dependent on the possible impact of the slowdown in world trade and the increase in financial instability on industrial output, capital investment and consumer spending. With the US growing at 2.5% and the Eurozone by less than 2%, the tenuous improvement in activity in developed economies as a whole will not be enough to offset emerging markets' deceleration.

Figure 2.1
World GDP, % YoY



Source: BBVA Research and IMF

Figure 2.2
BBVA index of financial tensions (normalized values)



Source: BBVA Research and Bloomberg

The recent behaviour of the financial markets is largely explained by doubts about the strength of the world economic cycle. Activity indicators continue to show the greatest degrees of deterioration concentrated in manufacturing and trade. Activity in services, which until now had benefited from the recovery of private consumption in major developed economies, is also starting to show signs of less dynamism. Then, the BBVA Research's Financial Stress Index for emerging countries has climbed back up to the levels seen in July and August of 2015 (first wave of the Chinese stock exchange crisis), reaching the stress levels of 2011 (Figure 2.1). Volatility remains contained in developed economies, in a context in which capital seeks refuge in financial assets with a lower risk profile such as sovereign bonds of countries like Japan, the US and Germany.

All the same, the world economy faces a 2016 of limited growth and with a balance of risks showing a negative bias and concentrated in the emerging bloc. How China's economy evolves, both as regards the degree of slowdown in activity and how the authorities manage the financial imbalances that exist, will continue to have a significant influence on capital flows and commodity prices in general, not just oil. The level of corporate indebtedness in emerging countries most vulnerable to the external environment constitutes an additional source of instability, in a context of lower profits and higher funding costs (risk premia). Allied to this, geopolitical tensions in certain parts of the world and the risk of a scenario of low growth and low inflation in major developed economies complete the outlook for the world economy in 2016.

USA: moderate growth and dependent on consumer spending

In the second half of 2015, US economic growth steadied at around 2.5%, the level we estimate it to grow this year and next. However, activity deceleration in the fourth quarter, as well as the leading signals from business confidence signals, increase the chances of a lower-than-expected growth this year. Meanwhile, the Federal Reserve has repeatedly stressed that the path of interest rate increases will be gradual and subject to the continuation of the dynamic of domestic demand and inflation. In a context of relatively low inflation and considering the recent fall in oil prices, we expect at most two interest rate hikes in 2016.

China: the challenge of eliminating financial instability

Doubts about China's ability to successfully manage the transition to a more moderate and balanced economic growth model resurfaced in the last quarter of 2015 following a new bout of financial instability deriving, as last August, from the stock and currency markets.

While maintaining financial stability is crucial in order to avoid any repetition of episodes of risk aversion such as the recent one, the growth dynamic shown by China in the short and medium term continues to be of decisive importance for the world economic cycle. For the time being, growth continues to gradually moderate and to recompose itself, as has been occurring since 2011. Our base scenario holds GDP growth for 2016 at 6.2% and at 5.8% for 2017. Additional monetary stimulus measures during 2016 in the form of key interest rate cuts cannot be discounted, although they will be constrained by the impact they might have on capital flows. Finally, it is quite likely that this scenario will lead to a situation of greater risk given the doubts about the pace of rebalancing of the economy and the authorities' room for manoeuvre for managing it smoothly.

Eurozone: no changes to expected growth

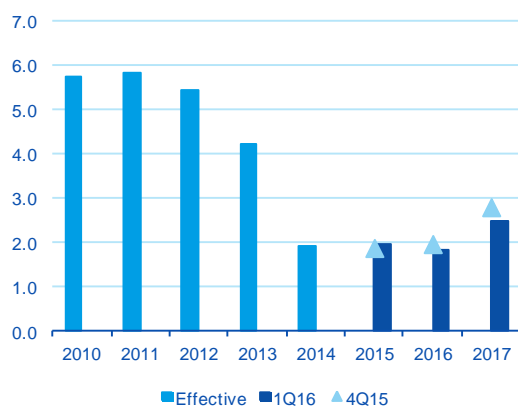
If the recent recovery dynamic is maintained, the Eurozone could grow this year by 1.8% and 2.0% in 2017, the same figures as forecast last quarter. The positive effect of the fall in energy prices, a more expansionary fiscal policy and the continuation of loose monetary conditions would be partly offset by the negative impact of the slowdown in international trade on the export of goods and of increased financial and political instability on investment decisions.

3 Downward adjustment to growth projections for 2016-17, and downside risks persist

We have adjusted our growth projections for this year and next downwards to 1.8% and 2.5% respectively. We continue to see that the balance of risks for this projection has a negative bias, while at the same time convergence towards potential growth rates, which we estimate at around 3%, is being delayed by the weakness of investment and deteriorating external conditions.

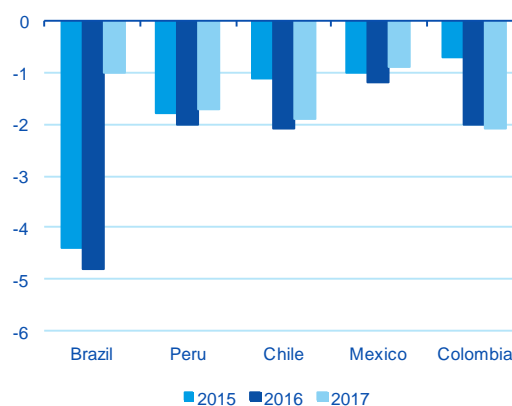
Economic activity performed less well than expected in the last few months of 2015, which ended with growth of 2.0%, similar to 2014 (1.9%). For this year, we consider that the risks that we raised in our growth projection of 2.0% last November have materialised in part. Consequently, we are projecting GDP expansion of 1.8%, although the balance of risks, both internal and external, continues to show a negative bias (Figure 3.1). The recent significant fall in the price of copper and the reduced prospects for world growth are factors adding to the already impaired domestic outlook and counteracted only by the positive effects of the fall in fuel prices on the price of petrol and companies' production costs. For 2017 too, we have revised our growth projection downwards, from 2.8% to 2.5%. It is worth pointing out that the adjustments made to Chile's growth projections are part of a regional trend, with several countries facing even greater reductions in their projections (Figure 3.2). The projection of greater growth next year is conditional on a gradual improvement in the confidence of local economic agents, together with the realisation of expectations of greater world growth and stabilisation of commodity prices above the levels seen at the beginning of this year.

Figure 3.1
Real and projected GDP growth (change % YoY)



Source: Central Bank of Chile, BBVA Research

Figure 3.2
Corrections to GDP growth projections between 2015 and 2017* (%)



*Correction to Q1 2016 relative to the projection made in Q1 2015 by BBVA Research.
Source: BBVA Research

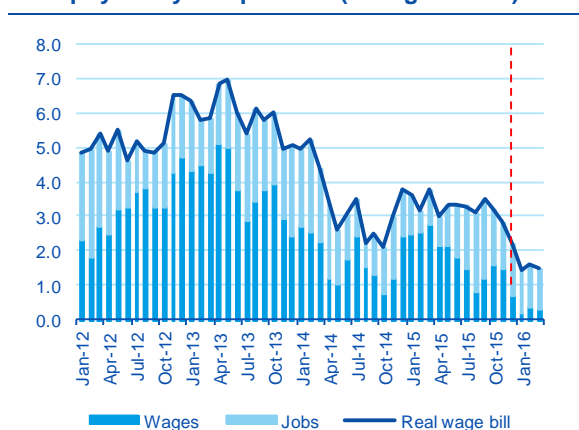
Domestically, economic agents' confidence remains low, with no clear signs of recovery. Inflation has remained high for longer than foreseen, eroding families' disposable income, while; financial conditions have tightened and the tax stimulus will start to fall off from this year. To this we should add the increase in the unemployment rate, which would deliver a fatal blow to household consumption, which is already depressed. From the point of view of domestic demand, the growth projection for this year assumes that private consumption will maintain low growth, total investment will grow moderately following two years of adjustments and the public sector will continue to contribute to growth, albeit less than in 2015. Externally, it supposes a partial, limited recovery of both exports and imports.

Although the market consensus calls for GDP growth of just over 2%, some projections consider that it could be closer to 1%, a scenario which for the time being we see as a risk in the event of a further deterioration in external conditions, with a low probability of occurrence, but which can certainly not be ruled out.

The tax stimulus, which was key for growth in 2015, started to moderate in the last part of the year, and will continue to do so during 2016, since the Ministry of Finance has clearly signalled that it puts fiscal responsibility before any further counter-cyclical policies (see chapter 7). According to the figures contained in the Budget, if all the public investment is carried out, it will increase by nearly 1.2% this year, after growing by 14% in 2015. The reduced incidence of fiscal spending should be offset by the contributions of private domestic demand and external demand to sustain growth at around 2%; however there is so far no evidence of increased growth in these GDP components.

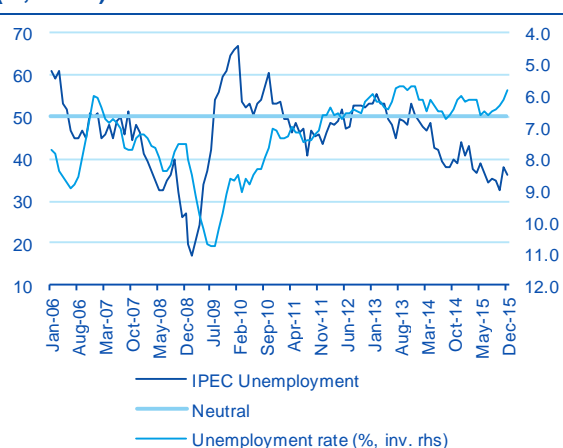
Private consumption will remain weak, in a context of continuing pessimism on the part of economic agents, less growth in wages and less expansionary financial conditions (Figure 3.3). Although unemployment has not increased as expected, it will probably increase this year in line with reduced contribution from jobs in the public sector and in construction. In fact, consumers are expecting more joblessness in the future, according to available surveys, this being one of the factors negatively influencing consumption decisions (Figure 3.4).

Figure 3.3
Total payroll by components (change % YoY)*



*Information from dotted line on corresponds to projection.
Source: Central Bank of Chile, BBVA Research

Figure 3.4
Unemployment rate and confidence indicators* (% index)

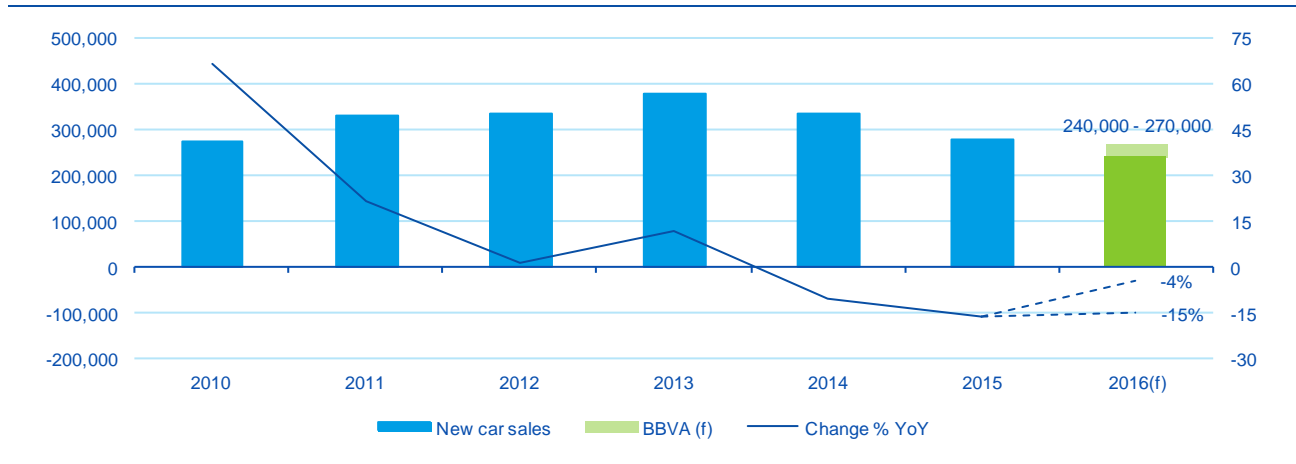


*IPEC (Index of Perception of the Economy) unemployment corresponds to expectations of the level of unemployment in response to the question: Do you think there will be more unemployment, about the same, or less than now? Zero indicates maximum pessimism and 100 maximum optimism.
Source: INE (National Statistics Institute), Adimark and BBVA Research

The persistence of inflation at high levels has also eroded the real value of household incomes and has been a decisive factor in the continuing high degree of pessimism among households. This being so, household consumption will continue to be concentrated in basic goods and services, with purchases of durable goods being postponed and precautionary savings increased whenever possible. By way of example, we project a new and significant fall in new vehicle sales, which in the opinion of sector representatives would lead to the showroom closures and job losses in the industry¹ (Figure 3.5).

1: See report *Situation of Chile's Automotive Sector 2015-16*.

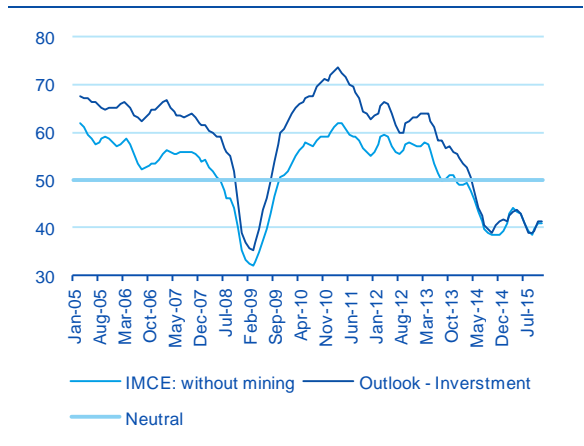
Figure 3.5
New car sales (units, change % YoY)



Source: ANAC (National Automotive Association), BBVA Research

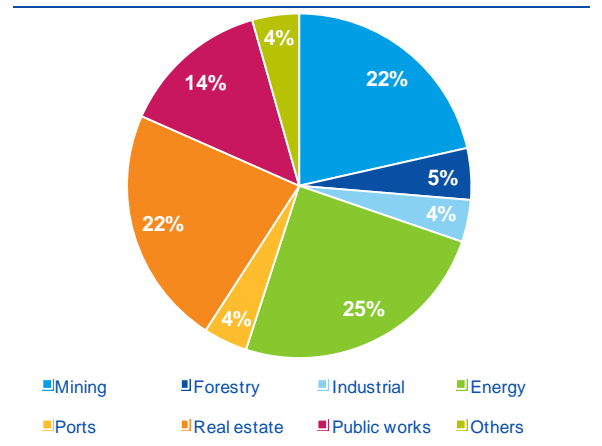
As for investment, the worsening growth outlook, business people's pessimism, tighter credit terms and the fall in the price of copper all combine to prevent any significant recovery in the private component, following two years of sharp adjustments. Anecdotal evidence points to there being no significant investment plans, largely attributed to a high degree of regulatory uncertainty and to the unfinished process of reforms (Figure 3.6). At sector level, for the period 2016-2019, 25% of projected investment is concentrated in energy, 22% in real estate and 22% in mining. Investment in mining is of course heavily dependent on how the price of copper evolves (Figure 3.7).

Figure 3.6
IMCE (Monthly Business Confidence Indicator):
Business confidence and expected investment
(index, quarterly moving average)



*Index created from the simple average of expected investment in the manufacturing and trading sectors. Values in excess of [less than] 50 points indicate more [less] investment in three months' time.
Source: Central Bank of Chile, ICARE, BBVA Research

Figure 3.7
Private investment to be carried out by sectors,
period 2016-2019 (US\$38 billion)

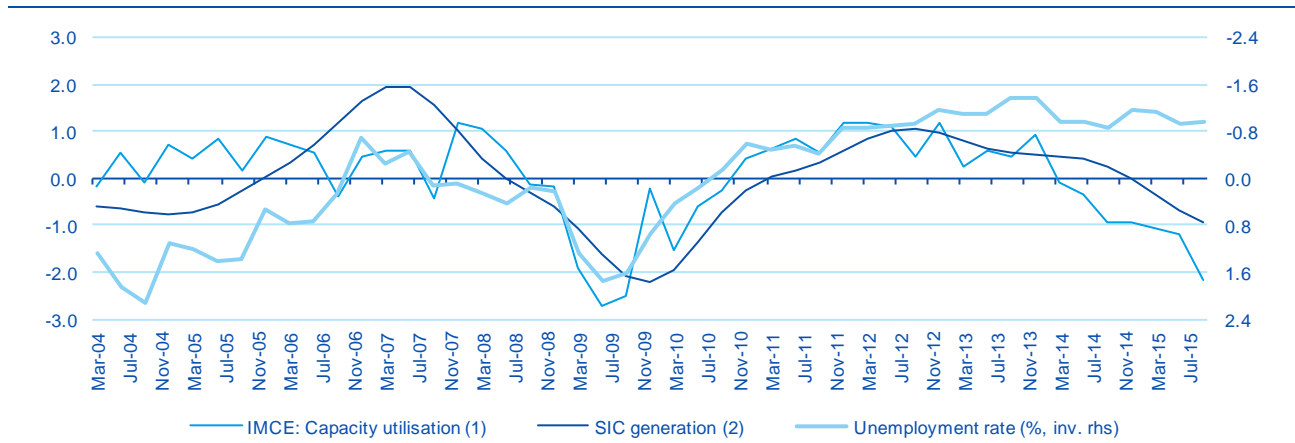


Source: CBC (Corporation of Technological Development on Capital Goods), BBVA Research

Lastly, a recovery driven by non-mining tradeable goods sectors seems remote, since Chile's trading partners are also experiencing lower growth, which together with the lower export prices and particular problems in certain industries has reduced the effectiveness of the exchange rate as a driver of export recovery.

The low growth in the three-year period 2014-2016 is fuelling debate about the economy's real capacity for expansion. At BBVA Research, we estimate potential growth at somewhat below 3.0%, meaning that the performance of the past few years is in fact increasing spare capacity in the economy, contrary to what is indicated by the unemployment rate for example. Indicators such as manufacturing capacity utilisation and electricity generation show that the economy is operating below its potential (Figure 3.8).

Figure 3.8
Capacity Utilisation and Electricity Generation (standardised series)



(1) Only the manufacturing sector is taken into account. (2) Central Interconnected System (SIC) generation. Cyclical component obtained from a Christiano and Fitzgerald (2003) band-pass filter. Standardisation based on normalisation using the mean and standard deviation of each series. Source: CNE, Central Bank of Chile, BBVA Research

4 Despite lower copper prices, the current account deficit remains within bounds following the adjustment of the past few years

We are postponing our projected external equilibrium in view of the further weakening in external demand from emerging economies and the gloomier outlook for the price of copper. The fall in oil prices will not be enough to offset these effects, but it does allow us to maintain a positive outlook for the current account at the forecast horizon.

The balance of trade ended 2015 at US\$4.4 billion, less than the nearly US\$5.7 billion expected three months earlier, as a result of statistical revisions of nearly US\$1.2 billion in the value of exports and negative surprises from mining and manufacturing exports of close to US\$350 million during Q4 2015. The balance of services will also show a greater than expected deficit of close to US\$1.45 billion, associated with both statistical corrections and a fall in services exported. Lastly, to all this is added a greater deficit in the balance of income of some US\$900 million. All the same, our projected surplus of 0.3% of GDP in 2015 is adjusted to a deficit of around 1.4% of GDP, equivalent to US\$3.37 billion (Figure 4.1).

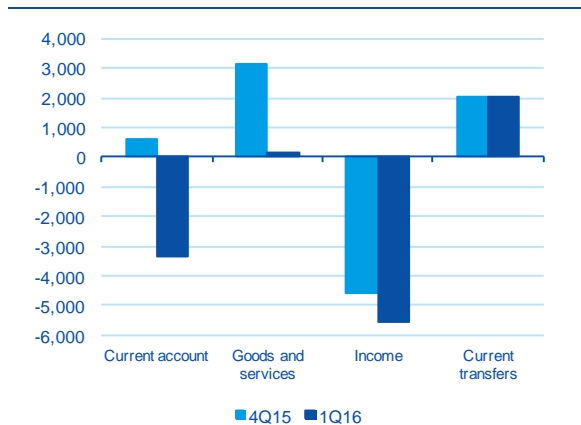
In this context, we have made marginal adjustments to our estimates of the external balance over the next few years. In particular, although we retain our view of a declining trend in the current account deficit at the projected horizon, the recent fall in commodity prices together with the poor outlook for global demand lead us to delay convergence with external equilibrium.

The first aspect to consider is that we again adjust the average price of copper downwards, this time to US\$2.02/lb and US\$2.29/lb for 2016 and 2017 respectively. This represents US\$0.35/lb and US\$0.17/lb less in each case relative to our projection of three months ago (further details in the following section). To this is added a slower recovery in total physical exports, particularly those of mining and manufacturing, which leads us once again to adjust expected balance of trade figures downwards. Again, the fall in both spot prices and prospects for oil will not be enough to offset the reduced export revenues, although they do allow us to retain our favourable estimate of the external balance. The current account is thus attaining sustainable levels that do not represent a risk for external debt servicing capacity..

Lastly, the balance of income will continue trending towards a reduced deficit, driven by the reduction in remittances in view of low returns on financial and corporate assets, in the context of increasing currency depreciation. Added to this is the reduced inflow of FDI, in particular from utilities' re-investment.

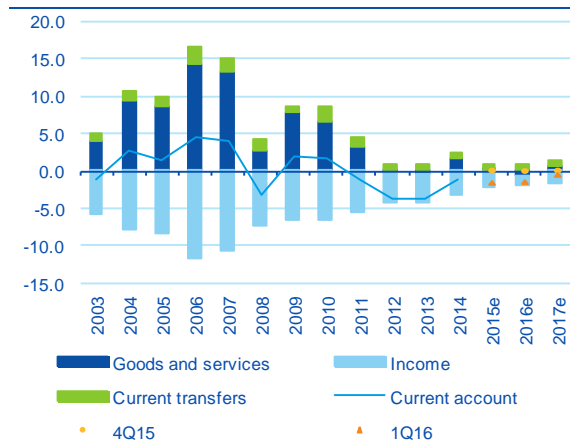
We have consequently corrected the expected surplus of 0.2% of GDP to a deficit of 1.3% of GDP for this year (equivalent to nearly US\$3 billion), while for 2017 we see a negative external balance of around 0.3% of GDP, postponing and slowing convergence into an external equilibrium (Figure 4.2).

Figure 4.1
Change in projection by components
(US\$ millions)



Source: Central Bank of Chile, BBVA Research

Figure 4.2
Current account balance (% of GDP)



Source: Central Bank of Chile, BBVA Research

Factors behind the fall in the price of copper are by no means all transitory

Commodity prices suffered a sharp fall at the beginning of 2016. Although the fall is generalised, in some cases, such as oil, there are underlying supply factors. The price of copper, which is of the greatest importance for mining and economic activity in Chile, has fallen to levels even below average production costs, i.e. below US\$2.0 a pound. Admittedly world growth estimates have been cut, China's financial markets have experienced high volatility, and the dollar has appreciated against practically all currencies, although the recent fall in the price of copper cannot be completely explained by fundamental variables. Only by incorporating the activity of non-trading economic agents (largely speculators) in the derivatives markets can we explain the current levels. We therefore forecast copper at an average price of US\$2.02/lb for 2016, although with a first half-year below this level and a recovery in the second half, since those economic agents' bets against the price of copper will start to unwind and the price will start to better reflect fundamentals.

As regards our long-term estimates of copper prices, we believe lower oil prices have a permanent component and that since oil is essential for mining we are correcting the price of copper from levels of approximately US\$2.70/lb to US\$2,60/lb. However, for as long as the dollar continues to appreciate and the composition of growth in China continues to adjust, the price of copper will remain below this level, gradually rising and not finally reaching it until 2018.

5 Inflationary pressures will moderate over the course of the year

The slowdown in the inflation affecting goods prices – associated with reduced currency pressures – and food prices will probably lead to inflation for the whole year coming in at 3.7%. Although in line with the outlook for activity, the risks are tilted towards a faster decrease in inflationary pressures.

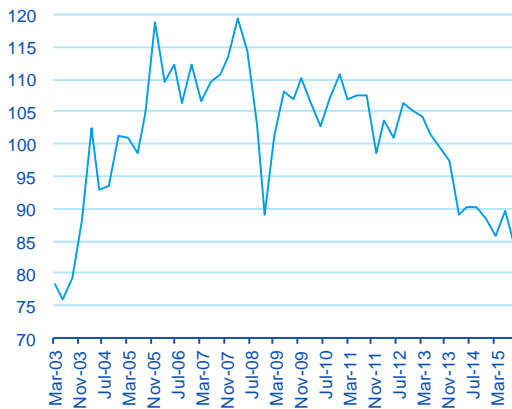
During the last part of 2015 inflation moderated, with two monthly showings of zero in November and December. A large part of the downward surprise in both months was due to food prices, particularly of perishable foodstuffs, slowing by more than the seasonal norm, significantly reducing their contribution to annual inflation. The sharp fall in oil prices also contributed to reducing inflation, mainly through lower petrol prices at the pump. On the other hand the depreciation of the Chilean peso over the past three months has partly offset this effect, through core inflation (excluding food and energy), which has remained at around 5% YoY. CPI inflation therefore ended 2015 at 4.4% for the year, marginally below the 4.5% estimated in our last Chile Outlook for Q4 2015.

The central bank has emphasised core inflation (excluding food and energy) as an indicator of inflationary demand pressures and as such as a foretaste of future inflationary pressures. Nevertheless, our estimates do not support this argument. In fact, as shown in Box 1, empirical evidence shows that the ability of core inflation excluding food and energy to improve out-of-sample total inflation projections is limited at international level and insignificant in the case of Chile.

2016 has started with an turbulent financial climate characterised by sharp falls in the price of certain commodities and a generalised appreciation of the dollar, driving down currencies of commodity-exporting countries such as Chile, making imports more expensive. Considering that corporate margins have been squeezed in the past few years, the risk of intensified knock-on effects of any further significant depreciation of the peso is substantial (Figure 5.1).

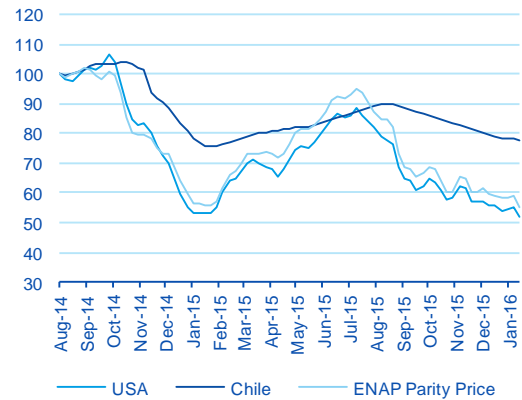
Apart from this, the sharp fall in oil prices afforded some relief to consumers in the last quarter of 2015 and the early part of 2016, by way of sustained cuts in the price of petrol and other petroleum derivatives at local level, albeit less than those seen internationally, due to other costs associated with the import of fuel and the specific tax which exists (Figure 5.2). However, we think that this relief would occur only during the first part of the year, since according to our estimates the price of WTI would be at levels of around US\$37 a barrel towards the end of 2016.

Figure 5.1
Margins (average index 2003-2015=100)*



*The margins were calculated on the basis of the ratio of core inflation without food and energy to the value in Chilean pesos of imported consumer goods.
Source: Central Bank of Chile, BBVA Research

Figure 5.2
Gasoline prices in CLP (index Aug. 2014=100)

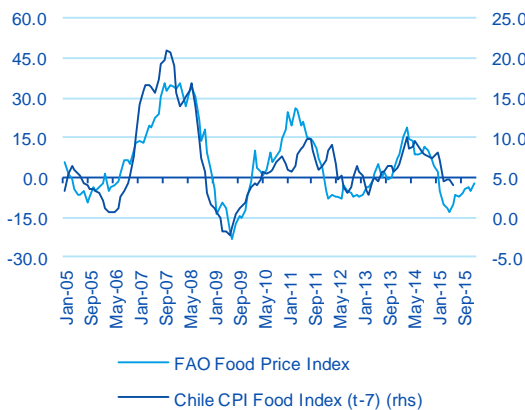


Source: Bloomberg, ENAP (Chile's National Petroleum Company) and BBVA Research

As for food prices, we consider that they still have room for additional declines given the falls in international prices and their transfer to local level, which has so far been partly diluted by currency depreciation (Figure 5.3). In this way, and assuming normal water and weather conditions during the year, food prices will continue to have less and less impact on annual inflation.

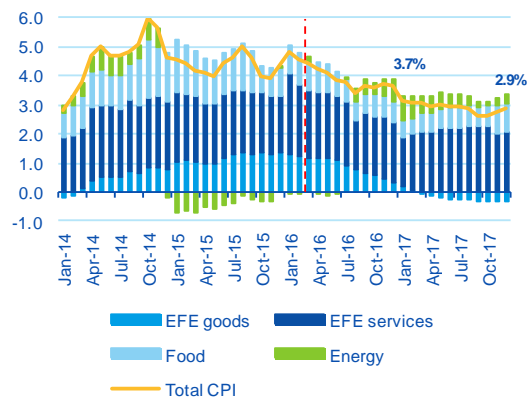
Accordingly, for 2016 we are projecting CPI inflation at 3.7% for the year, with two main drivers associated with lower inflation: (1) a slowdown in core inflation excluding food and energy closely linked to projected nominal currency appreciation (2) slackening pace of growth in food prices (Figure 5.4).

Figure 5.3
Food prices (change % YoY in pesos)



Source: FAO, OECD, BBVA Research

Figure 5.4
CPI inflation projection by components (change % YoY)*



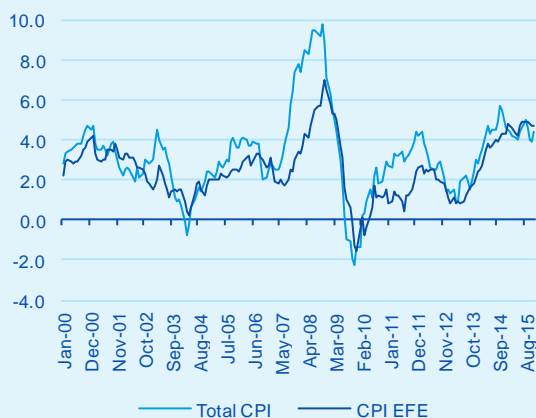
*Information from dotted line on corresponds to projection.
Source: INE, BBVA Research

Lastly, we expect inflation of services associated with the underlying basket component to slow slightly in line with a flagging labour market and real wages growing at a moderated pace. All the same, considering the risk scenarios for activity, we see the bias as being inclined towards a faster decrease in inflationary pressures over the course of the year. Similarly, we think that inflation will slowly converge towards the central bank's target of 3% in the course of 2017.

Box 1. The elusive predictability of core inflation

Monetary policy makers normally use core inflation as an indicator of inflationary demand pressures and consequently a harbinger of increased future inflationary pressures. The commonest measure of core inflation is the CPI excluding food and energy, since these items are assumed to be more volatile and less tied to supply pressures. Figure R1.1 shows CPI inflation and core inflation without food and energy and the correlation between them.

Figure R.1.1
Headline and core inflation (change % YoY)



Source: Central Bank of Chile, BBVA Research

In view of the high level reached by core inflation without food and energy during the past few quarters and the central bank's repeated warnings of its future inflationary implications, we examined the predictive ability of core inflation without food and energy for CPI inflation for an extensive group of OECD countries including Peru and Colombia.² It should be highlighted that in *Box V.1 of its Monetary Policy Report of March 2015* the central bank reports predictive ability of core inflation without food and energy for CPI at medium- and long-term horizons.

The methodology used compares a benchmark model with the projections of the same model but increased by core inflation without food and energy:

$$\pi_{t+1} = \alpha + \beta(L)\pi_t^{core} + \varepsilon_t \tag{1}$$

$$\varepsilon_t = \rho\varepsilon_{t-1} + u_t - \theta u_{t-1} - \tau u_{t-12} + \tau\theta u_{t-13} \tag{2}$$

$$\Delta\pi_{t+1} = \alpha + \vartheta(L)\Delta\pi_t^{core} + \omega_t \tag{3}$$

$$\omega_t = \gamma\omega_{t-1} + v_t - \phi v_{t-1} - \delta v_{t-12} + \delta\phi v_{t-13} \tag{4}$$

where $\beta(L) = \sum_{j=0}^q \beta_j L^j$ and $\vartheta(L) = \sum_{j=0}^p \vartheta_j L^j$ represent the polynomial lag. L represents the lagged operator.

Although the detailed results can be found in Pincheira et al (2015), the main results are summarised in Table R1.1. First, core inflation without food and energy contributes in the best scenario for no more than 55% of the countries to a reduction in RMSPE³. If we require the reduction to be "economically" significant and at least 5%, the ability of core inflation without food and energy to improve out-of-sample projections of total inflation falls to just 25% of the countries. Chile is not among them.

The conclusions point to core inflation without food and energy having to be treated cautiously by central banks when determining the appropriate monetary stimulus, avoiding excessive weighting of high or low levels of core inflation without food and energy as a predictor of high or low total inflation in the future. These results support the views of Bullard (2011) regarding (de)-emphasis on core inflation in setting monetary policy.⁴

2: This box is based on Pincheira, Selaive and Nolasco (2015) "The Evasive Predictive Ability of Core Inflation", Working Paper No. 15/34, BBVA Research.

3: Corresponds to the root-mean-square prediction error (RMSPE).

4: President's Message: "Headline vs. Core Inflation: A Look at Some Issues". Federal Reserve Bank of St. Louis.

Table R1.1

Percentage of countries for which core inflation is statistically significant for predicting total inflation for different out-of-sample exercises.

Specification of level	h=1	h=3	h=6	h=9	h=12	h=18	h=24
<i>Automatic selection of lags for core inflation in accordance with BIC criterion</i>							
Recursive window = 80	46.88%	31.25%	31.25%	34.38%	34.38%	40.63%	31.25%
Recursive window = 100	48.48%	24.24%	36.36%	30.30%	27.27%	30.30%	18.18%
Moving window = 80	31.25%	25.00%	25.00%	25.00%	21.88%	18.75%	18.75%
Moving window = 100	45.45%	21.21%	33.33%	27.27%	27.27%	30.30%	21.21%
<i>12 lags for core inflation</i>							
Recursive window = 80	65.63%	43.75%	40.63%	40.63%	40.63%	34.38%	28.13%
Recursive window = 100	60.61%	39.39%	39.39%	45.45%	48.48%	39.39%	27.27%
Moving window = 80	31.25%	31.25%	28.13%	28.13%	31.25%	25.00%	28.13%
Moving window = 100	39.39%	21.21%	21.21%	24.24%	30.30%	15.15%	15.15%

Source: BBVA Research

6 Scope for further withdrawals of monetary stimulus is running out

The baseline scenario of this report is compatible with only one additional increase in the Monetary Policy Rate (TPM) this year, to 3.75% during the first half-year. If negative scenarios for economic activity were to materialise, this could lead to the hike being postponed or even not taking place at all.

In its meetings of October and December 2015, the central bank raised the reference rate by 25 bps to 3.5%, while at the same time using the word “unhurried” to refer to future additional hikes. As later became clear in the December Monetary Policy Report, these would be two more of 25 bps each if the baseline scenario for activity and inflation outlined in the report came true. Then, in the January meeting, the rate was held, as was the restrictive bias. In this context, we project an additional hike of 25 bps for March or April, the main argument for this being the high level and persistence of inflation. We consider that another additional hike is less likely given the development of international financial markets and domestic activity at the end of 2015 and the beginning of 2016.

The increased concerns over global growth which led to volatility, greater risk aversion and falls in financial markets and commodity prices at the beginning of the year took central banks around the world by surprise. Some of them, such as the Central Bank of Brazil, the ECB and the Bank of Japan, have announced changes in their monetary policy strategy to support their economies in a context that is starting to look less deflationary than foreseen, and Chile's Banco Central might also follow this path. The financial markets have also significantly reduced the probability assigned to an additional rate hike in the US.

The central scenario we present in this report envisages only one further increase in the Monetary Policy Rate (TPM), to 3.75%, during the first half-year, a level we consider close to neutral and at which the rate will be held at least until year-end. However, taking into account the negative bias of the risks to activity, a scenario in which there are no further rate increases cannot be ruled out.

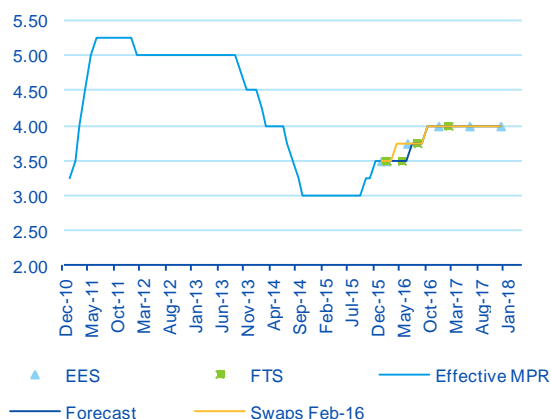
Surveys of analysts and financial operators carried out when finalising this report show expectations in line with the baseline scenario of the Monetary Policy Report, i.e. with two additional hikes of 25 bps each at a one-year horizon (Figure 6.1). Analysts expect the Monetary Policy Rate (TPM) to be at 4% at year-end and are not projecting additional changes, while financial operators in the January survey expected the rate to be at 4% in twelve month's time and to remain at that level for a further 24 months. Swap rates also incorporate two additional increases of 25 bps, in April and September and do not anticipate additional changes in the following two years, reflecting expectations of a lower neutral interest rate.

Although the current level of the Monetary Policy Rate (TPM) can be considered expansionary given the level of inflation, this argument does not hold up if we consider the real rate of interest at year-end, which means that monetary policy will cease to contribute to growth in domestic demand if the two scheduled hikes take place. Indeed, for a sample of countries with similar political frameworks to ours, if we consider the inflation projected by central banks and the Monetary Policy Rate (TPM) estimated by the market for December, Chile's real rate would be one of the least expansionary (Figure 6.2).

The monetary policy response we have seen so far may be understandable in view of the high level and persistence of inflation, but to continue raising rates in a context in which the source of inflation is a supply shock associated with a change in relative prices does not strike us as the most appropriate path to take. The slow pace of economic growth is clearly not a consequence of the level of key rates, but an expansionary policy is needed in order to avoid a worse outcome for this slowdown phase, which could lead,

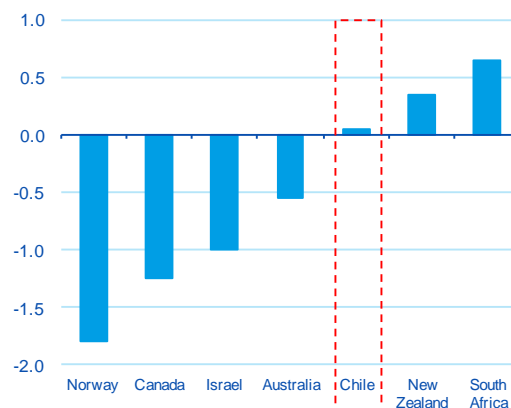
once the currency adjustment is completed, to inflation markedly and persistently below the 3% target. If the economy grows at below the floor of the central bank's projected range this year, there will be a powerful argument for moderating interest rate hikes, but it would also take currency depreciation to ease and, more important, inflation to start falling more quickly than foreseen by the central bank to make it unnecessary to raise the Monetary Policy Rate to 4%.

Figure 6.1
Effective and estimated Monetary Policy Rate and trajectories implicit in swaps and surveys (percentage)*



*EES: The Chilean central bank's Survey of Economic Expectations, with data as at January 2016.
FTS: The Chilean central bank's Survey of Financial Operators, with data for the second week of January 2016.
Source: Central Bank of Chile, Tradition, BBVA Research

Figure 6.2
Real Monetary Policy Rate* (%)



*Calculated as the expected Monetary Policy Rate at the end of 2016 minus expected inflation at the same date, Inflation of central banks, as Monetary Policy Rate from Bloomberg survey.
Source: Central banks of Chile and the respective countries, Bloomberg, BBVA Research.

7 Fiscal policy: everything depends on what happens with the reference parameters

Even with the change in the macroeconomic scenario, the effective deficit for 2016 will not deteriorate substantially relative to the Budget. However, 2017 presents risks of greater tightness in reaction to a new adjustment in the structural parameters. We do not rule out a slowdown in spending this year aimed at preserving greater expansion for 2017.

Final figures for 2015 were better than had been officially projected in September. An effective deficit of 2.2% of GDP, growth of 7.4% in spending and a 14% increase in public investment are certainly more contained than was estimated by the government at the time of the Budget Act. This result was largely anticipated by BBVA Research, for the reasons that we advanced at the time: reduced execution of capital expenditure and increased income not related to the economic cycle. Added to this was a better-than-expected result of repatriation of capital at a reduced rate of tax, a window allowed by the Tax Reform during the past year.

Although 2015 ended in good shape, all the signs point to 2016 being tighter for the fiscal accounts. However, we should differentiate between how the effective deficit on the one hand and the structural deficit on the other will be affected. The change in the macroeconomic scenario, while adversely affecting both measures, affects them in different degrees in the longer term.

Table 7.1 shows the differences between the level of revenues expected by the treasury at the time the Budget was drawn up and BBVA Research's projection, broken down by type of revenue. As can be seen, the source of greatest revenue is "Other", explained by the higher closing level of fiscal revenues not related to the cycle (see Box 2). Apart from this, revenues related to mining are close to their floor, i.e. it is assumed that neither CODELCO nor the private sector mines will have taxable profits and that their contributions will come only from taxes applied to their sales: the *Ley Reservada del Cobre* ("Restricted Law on Copper") in the case of the state mines and the PPMs (provisional monthly payments) for private sector mines (which will revert via greater refunds in the 2017 tax year.) Tax revenues are affected by lower GDP, but the fact that we are working with an assumed domestic demand greater than that which the Ministry of Finance had (2.2% vs. 2.0%) enables us to offset the fall in the total via a marginally better yield from indirect taxes.

Table 7.1

Breakdown of differences in projected tax revenues 2016 (\$US millions)*

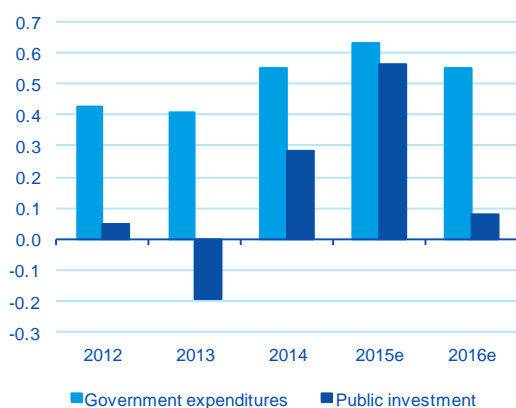
	2016
(1) MoF Revenue September	48,961
(2) Revenue projected by BBVA Research	48,795
(2) - (1)	-165
Revenue from mining (CODELCO + private sector)	-537
Non-mining tax revenue	-238
Other revenue	610

*Figures converted at 712 pesos to the dollar

Source: Government Budget Department, BBVA Research

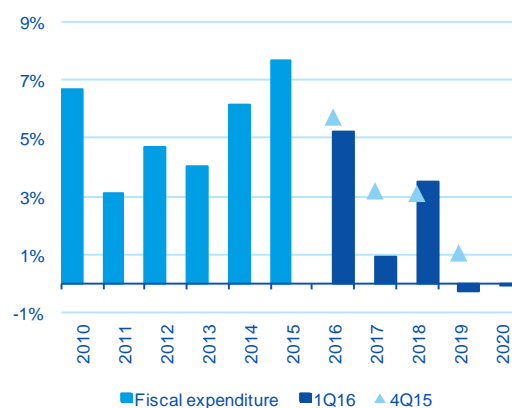
Given that there are factors offsetting the fall in fiscal revenues due to the change in macroeconomic scenario, we estimate the effective deficit for 2016 at 3.3% of GDP, only slightly higher than that projected by the Ministry of Finance. This implies growth of 5.2% in real spending. In contrast to what was said when the Budget was announced, public investment shows a positive rate of change, albeit only of 1.2%, due to a less demanding basis of comparison given the under-execution of capital expenditure in 2015. With these figure, even though growth in spending this year would be slightly greater than estimated in the Budget, **the incidence of public spending on growth in 2016 via public consumption and private sector investment would be practically half that of 2015** (see Figure 7.1).

Figure 7.1
Effects of government consumption and public investment on GDP growth (% pts.)



Source: Central Bank of Chile, BBVA Research

Figure 7.2
Projected growth in actual spending



Source: Government Budget Department, BBVA Research

Fiscal tightness is approaching in the medium term, but subject to the uncertainty of the adjustment in the reference parameters used to calculate the structural revenues in the fiscal rule. The fall in the price of copper has been accompanied by an adjustment to estimates of its long-term level, in accordance with various analysts. If this is shared by the members of the Committee of Experts on copper, together with an almost inevitable change in estimates of trend GDP, we could be facing the biggest downward adjustment to the reference parameters since the fiscal rule has been in existence.

In our baseline scenario, we work on the assumption that the reference price of copper will adjust from US\$2.98/lb to US\$2.70/lb and that growth in trend GDP will fall from 3.6% to 2.9%. this would involve adjusting the calculation of the structural deficits for every year, given the change in methodology introduced in September by the Ministry of Finance. According to our estimates, taking the possible new parameters and considering the convergence path and discounting revenues from capital repatriation (approximately 0.3% of GDP), the structural deficit for 2015, on which the convergence is calculated, would be around 1.25% of GDP. Table 7.2 shows how the scenario would look based on these structural assumptions and assuming the government's convergence target of reducing the structural deficit to 0.25% of annual GDP is met. Figure 7.2 contains the growth path of spending for the coming years in accordance with our baseline scenario. As can be seen, after a tight 2017, the increased marginal contribution of revenues from the Tax Reform (associated with the end of the FUT (Taxable Profit Fund)) allows greater growth to be maintained in 2018. However, once the marginal contributions of the Tax Reform come to an end, 2019 and 2020 tighten once more, even showing negative growth according to our estimates.

Table 7.2

BBVA Research projection of main fiscal variables

	2016	2017	2018	2019	2020
Trend GDP (change YoY)	2.9	2.9	2.9	2.9	2.9
Reference price of copper (US\$/lb)	270	270	270	270	270
Target Structural Balance (% of GDP)	-1.0	-0.8	-0.5	-0.3	0.0
Effective balance (% of GDP)	-3.3	-3.0	-2.4	-2.0	-1.2
Growth in spending (change YoY)	5.2	0.9	3.5	-0.3	-0.1

Source: BBVA Research

We consider it of fundamental importance for the government to maintain its commitment to converge gradually towards the structural balance, which may require starting as soon as this year to make adjustments to spending, as the authorities have recently signalled. The advantages of maintaining a responsible fiscal conduct are many and varied, but they include the possibility of maintaining a contained level of public debt and with it Chile's credit rating and access to low international interest rates. It is also beneficial internally, in that moderate growth in public spending relieves the pressure on monetary policy at times when it is necessary to maintain the monetary impetus so as not to hamper already weak economic growth.

Box 2. The treasury's "other revenues". What are they and how important are they?

Analyses of fiscal revenues usually focus on tax revenue (mining and non-mining) and transfers from CODELCO, the state-owned copper mining company. This is fair enough as far as it goes, since they are items that react to the precise point in the GDP and copper price cycles and have represented close to 86% of the total in the past ten years.

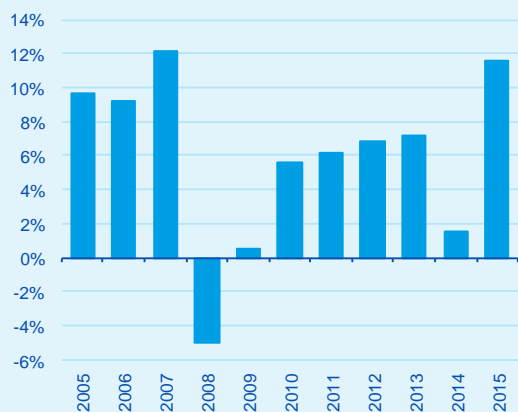
However, in our recent analyses of fiscal results we predicted that the effective deficit for 2015 would be less than the government's forecast due to the fact that "other revenues" were being underestimated. These "other revenues", which represented the remaining 14% of total revenues, consist of pension contributions (FONASA (National Health Fund) and provisions for the armed forces), donations received by the government, income from property (interest on financial assets and transfer of profits from state-owned companies), operating revenue (hospitals and other services provided by the state) and other (fines, claims, etc.) In the September projection, the treasury estimated that these revenues would total about US\$6.79 billion in 2015. In the end they came to about US\$7.68 billion, explaining to the extent of 0.4% of GDP the better result of the effective deficit for the past year. Since this revenue is not adjusted for the economic cycle, they have the same positive impact on the structural deficit.

What happened in 2015 with this revenue is nothing new. Figure R2.1 shows the bias of the error in the September projection of this revenue relative to the actual figures. We wish to stress that this is a projection made just four months before year-end. Nevertheless, the Figure shows us that the tendency has been systematically to underestimate this type of revenues.

Some of these revenues have a direct correlation with expenditure items. For example, higher forecast revenues imply, to some extent, that the expenditure of FONASA (Chile's national health service) could also be higher. So is this underestimate of revenues offset by an equivalent underestimate of expenditure? Figure R2.2 shows us that such an assertion cannot be sustained. Moreover, in the case of expenditure, the component that tends to be underestimated in the September projection is capital expenditure. Therefore we do not see the underestimate of other revenues as being offset in the estimates of expenditure.

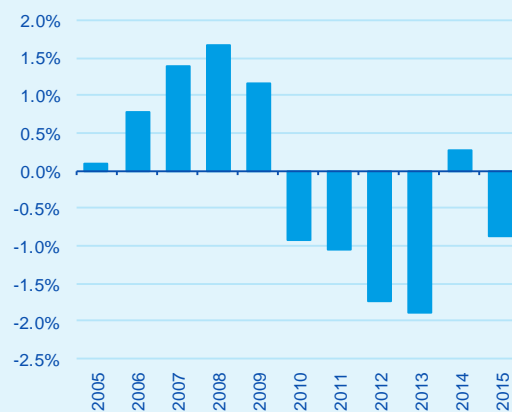
What are the implications of the above for our fiscal projections? This other revenue, except in the case of 2008, has shown sustained year-on-year growth. However, the level projected in September for the 2016 Budget is even less than that seen at the end of 2015. **Therefore this year there will probably be another underestimate of these items, which we calculate at around 0.3% of GDP.** In a year such as this one, in which there may be a fiscal adjustment due to the correction of the macroeconomic scenario, this other revenue has a significant positive bearing on the adjustment of projections of the effective and structural deficits. If they were again to be underestimated, this could lead to an over-adjustment of spending, with undesirable social and political effects.

Figure R2.1
Differences between "Other revenue" projected in September and actual (%)*



*The information announced in January of the subsequent year is used as effective information.
Source: Government Budget Department, BBVA Research

Figure R2.2
Differences between "Total Expenses" projected in September and actual (%)*



*The information announced in January of the subsequent year is used as effective information.
Source: Government Budget Department, BBVA Research

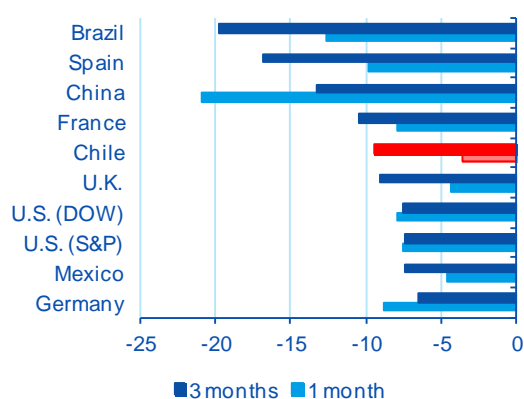
8 The peso's weakness will persist, while long-term interest rates will see limited increases in the baseline scenario

We are projecting a moderate nominal appreciation of the peso at the projected horizon (2016-2017), consistent with a recovery in the price of copper and a multilateral weakening of the dollar. Although long-term peso interest rates have held steady or eased depending on the term, risk premiums have increased and the risk of an increase in base rates associated with widening term premiums continues to exist.

The uncertainty about the developments in China's economy and the fall in oil prices have led to an increase in risk aversion in global markets and a sharp adjustment to prices of the riskier asset classes, including share prices. Chile's stock exchange has lost 13% so far this year in dollar terms, wiping out all last year's gains (Figure 8.1).

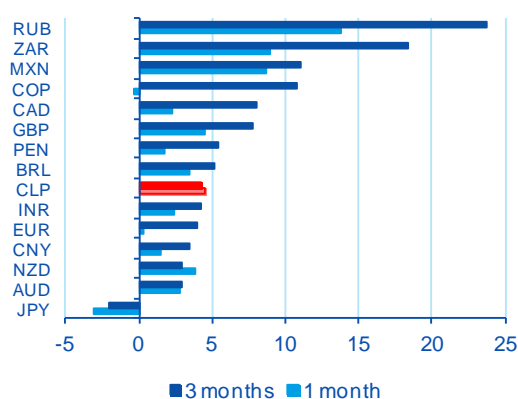
The Chilean peso has depreciated since our last report, peaking at 730 to the dollar towards the middle of January, 4% more than the level seen three months before. This development was accompanied by the unwinding of more than US\$3 billion of carry trade and a sharp fall of 14% in the price of copper. Falling oil prices have been a fundamentally decisive factor in the depreciation of various oil-exporting countries' currencies, as is the case of the Russian rouble, the Mexican peso, the Colombian peso and the Brazilian real (Figure 8.2). It is for this reason that in this economic situation the Chilean peso has been relatively less penalised than in other episodes of depreciation of emerging market currencies.

Figure 8.1
Main stock exchanges in the world (USD, % variation)



Source: Bloomberg, BBVA Research

Figure 8.2
Exchange rates (units of local currency per dollar, %)



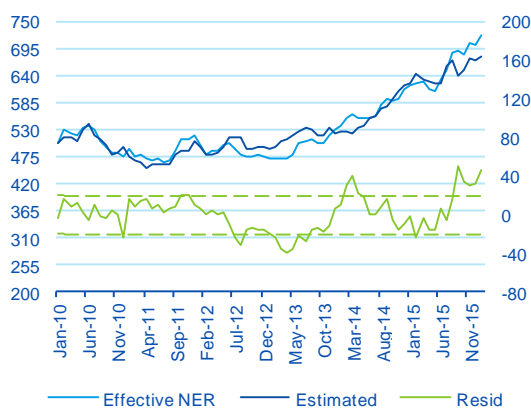
Source: Bloomberg, BBVA Research

Judging by the evolution of the fundamentals determining the value of the Chilean peso, we feel that there is a slight disconnect between them and the current exchange rate, which we believe is somewhat above the level explained by its determinants (Figure 8.3). We believe that even copper prices marginally below US\$2/lb are not consistent with an exchange rate of 730 as was reached. On the contrary, we consider that these values were posted as a result of the increase in volatility in these markets, which is a notoriously transitory phenomenon. If the dollar appreciates marginally and the price of copper rises slightly during the

year as we posit in the baseline scenario, the peso would therefore stand at just under 700 to the dollar in December this year and around 650 at the end of 2017.

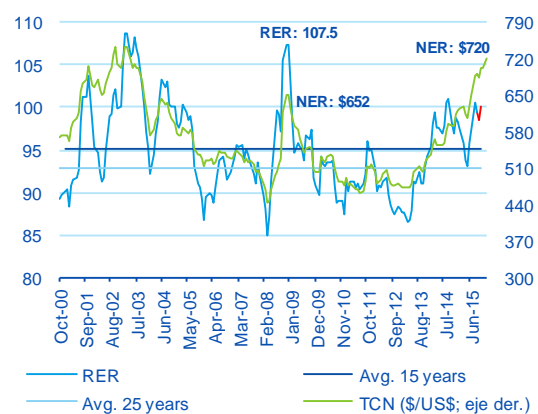
In the short term, due to the high degree of volatility in global financial markets, we do not rule out further depreciation of the peso, which could take the rate back to levels above 730. In this context, we consider that the Chilean central bank will continue to express its concerns regarding the nominal exchange rate and its inflationary implications, but without intervening in the foreign exchange market given the limited effect that such a measure would have, the high costs involved and, above all, because the peso's multilateral depreciation has been relatively limited (Figure 8.4)

Figure 8.3
Actual and estimated exchange rates (CLP/USD)*



*Model for determining the nominal exchange rate based on movements in the price of copper, business confidence, the dollar index and the interest rate differential between Chile and the USA. Source: Central Bank of Chile, BBVA Research

Figure 8.4
Index of the average real exchange rate (1986 = 100)

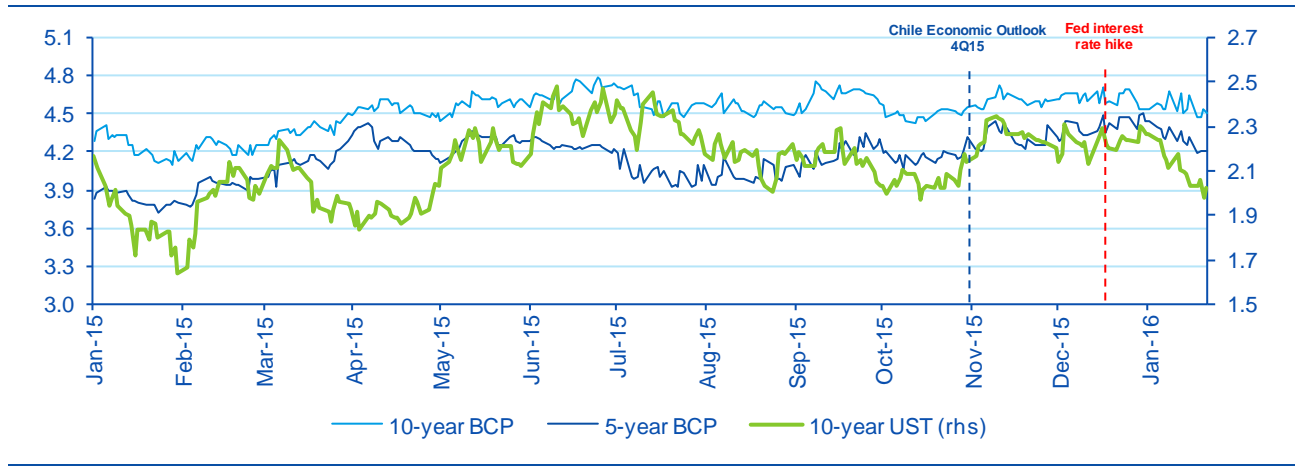


Source: Central Bank of Chile, BBVA Research

Ten-year benchmark peso interest rates have held steady, while five-year rates have closely tracked changes in US dollar interest rates (Figure 8.5). In the baseline scenario, interest rates on long-term instruments in both pesos and dollars are adjusted upwards at the projected horizon, albeit to only a limited extent, based on the process of monetary normalisation in Chile and the US. However, in a risk scenario in which the increase in key rates is postponed, long-term references could recede and continue at all-time lows.

Figure 8.5

Local and external interest rates (%)



Source: Bloomberg, BBVA Research

9 External risk scenario partly materialises, while domestic confidence continues depressed

The internal risks for the Chilean economy continue to be linked to how economic agents' confidence evolves, and to the price of copper. On the external front, the evolution of China's economy is the main threat to growth, although for the time being we consider that the scenarios that could put the Chilean economy into recession this year have a low probability of occurrence.

The first significant external risk for Chile is the performance of China's economy, and here the news has not been at all encouraging. Although we continue to expect a soft slowdown of the economy, it is not possible to rule out a scenario of abrupt adjustment which, as we have pointed out, would have a significant impact on the price of copper, fiscal revenues, exports, investment and, bottom line, growth. This risk has been referred to in recent editions of this report, and most recently it has partly materialised, with significant impacts on financial markets and commodity prices.

Looking ahead, concerns remain about a more marked slowdown in China amid doubts surrounding the fragility of its financial system. There has also been a generalised increase in the perception of risk on the emerging markets in general. A downturn in China's economy would have a significant impact on emerging markets, transmitted through both financial channels and the real economy. Of particular concern are the implications for the price of copper, as well as for the growth of Chile's significant trading partners.

Another external risk factor mentioned in previous reports was the effect that the start of the process of monetary normalisation in the USA would have. The first rate hike has taken place, and the financial impact was limited. The market had thoroughly factored in the decision, and the announcement that the process of raising rates would be gradual and depending on data was interpreted as a positive sign which would not jeopardise global growth. The figures in the margin for the US economy show that, apart from the labour market, activity has lost dynamism, in part due to the effect that the strengthening dollar is having on the manufacturing sector. This, plus the risk posed for inflation by the sharp fall in the price of oil, leads us to expect a more gradual process of monetary normalisation than was foreseen a few months ago.

Internally, the risks are concentrated on the possibility of even less dynamism in private sector domestic demand than envisaged in the baseline scenario. This would occur, for example, in the event that no recovery in economic agents' confidence were to be seen and that this were to lead to a bigger adjustment in investment, with negative implications for employment. Sentiment has remained pessimistic for longer than expected, which can partly be attributed to the way in which the incessant process of reforms has been carried out over the past few years. The central scenario of this report assumes a moderate recovery in business confidence, but there is a risk that this will not come about. If this should prove to be the case, then we could see greater adjustments to private sector investment and, without the tax support of the past few years, an increase in unemployment that would damage households' weak consumption even more.

The evolution of the mining sector is also a risk for the growth outlook of the coming years, in that a scenario of further falls in the price of copper cannot be ruled out. This would involve further adjustments to mining output, with negative effects not just on this sector but on all the sectors providing services to mining and those that benefited in the past from the copper price boom such as trade, construction and financial services. A scenario such as this would, of course, also have a negative impact on employment.

Risk scenario, Chile

We assign a 10% probability to a risk scenario for Chile's economy, in which case it would grow by 1.6 and 2.0 percentage points less than in the baseline scenario in 2016 and 2017 respectively. In such case, which we may consider as an abrupt adjustment, as opposed to the gentle adjustment assumed in the baseline scenario, we estimate that the impact on the price of copper, the growth of Chile's economy and the relevant financial variables would be significant. Indeed, we estimate that instead of growing by 1.8% and 2.5%, GDP would grow by 0% and 0.5% respectively in 2016 and 2017.

The channels through which this reduced growth would come about are increased cost of external finance, reduced external demand and the price of copper. The price of copper falls by 30% relative to the baseline scenario (US\$1.60/lb in 2016-17), reducing exports but also generating more acute negative wealth effects that further worsen the already bleak prospects for private consumption. The rise in risk premiums and the downgraded outlook for copper and economic activity lead to depreciation of the peso to average rates of 785 and 750 to the dollar for 2016 and 2017 respectively. This is equivalent to a path located on average 10% and 12% above the baseline scenario.

Although in this scenario there would be greater pressure on inflation in the short term, it would not be enough to offset the reduced inflationary pressures generated by the increase in spare capacity and the effect of lower oil prices on domestic prices that would occur in this case. We estimate that inflation would end this year at 2.5% and that in 2017 it would fall once more to 1.5%.

In this case the central bank would not only postpone monetary normalisation, but would cut the rate by at least 100 bps both this year and next to avoid its becoming an obstacle to growth in economic activity, in a context of extremely low inflationary pressure, both domestic and imported. We might also expect more action in the form of fiscal policy, which would imply an increase in spending and a postponement in the target of convergence with structural balance.

Additionally, we consider an alternative baseline scenario for China, with a 30% probability of occurrence, in which growth is 0.4 percentage points less than in the baseline scenario in 2016-2017, in which expected growth for Chile falls to 1.5% and 2.2% in 2016 and 2017 respectively. In this case, the price of copper is on average 10% less per year relative to the baseline scenario and the peso depreciates to averages of 735 and 690 to the dollar in 2016 and 2017 respectively. This is equivalent to a path located on average 3% above the baseline scenario. In this scenario, the Central Bank would postpone monetary normalisation, maintaining the Monetary Policy Rate (TPM) at 3.50% throughout 2016 and 2017. We do not expect a different reaction from that of the baseline scenario on the part of the fiscal policy makers.

Table 9.1

Risk scenario for Chile in different Chinese growth scenarios

	2016	Base (60%)	Alternative base (30%)	Risk (10%)
China's GDP (%)		6.2	5.8	4.6
Chile's GDP (%)		1.8	1.5	0.0
Exchange rate (per US\$, ave.)		712	735	785
Inflation (% YoY, eop)		3.7	3.0	2.5
Monetary Policy Rate (TPM) (% eop)		3.75	3.50	2.50

Source: BBVA Research

10 Tables

Table 10.1

Macroeconomic forecast

	2013	2014	2015	2016	2017
GDP (% YoY)	4.2	1.9	2.0	1.8	2.5
Inflation (% YoY, eop)	3.0	4.6	4.4	3.7	2.9
Exchange Rate (vs. USD, eop)	529	613	704	695	651
Interest Rate (% eop)	4.50	3.00	3.50	3.75	4.00
Private Consumption (% YoY)	5.9	2.2	1.7	1.5	2.3
Government Consumption (% YoY)	3.4	4.4	5.4	4.5	1.7
Investment (% YoY)	2.1	-6.1	0.0	1.0	2.7
Fiscal Balance (% GDP)	-0.6	-1.6	-2.2	-3.3	-3.0
Current Account (% GDP)	-3.7	-1.2	-1.4	-1.3	-0.3

Source: BBVA Research

Table 10.2

Macroeconomic Forecast

	GDP (% YoY)	Inflation (% YoY, eop)	Exchange Rate (USDCLP, eop)	Interest Rate (% eop)
1Q14	2.7	3.5	563.8	4.00
2Q14	2.1	4.3	553.1	4.00
3Q14	1.0	4.9	593.5	3.25
4Q14	1.8	4.6	612.9	3.00
1Q15	2.5	4.2	628.5	3.00
2Q15	1.9	4.4	630.0	3.00
3Q15	2.2	4.6	691.7	3.00
4Q15	1.6	4.4	704.2	3.50
1Q16	1.2	4.5	721.7	3.75
2Q16	1.6	3.9	722.1	3.75
3Q16	2.0	3.7	700.0	3.75
4Q16	2.5	3.7	694.8	3.75
1Q17	2.6	3.1	680.7	4.00
2Q17	2.7	3.0	670.6	4.00
3Q17	2.5	2.6	660.5	4.00
4Q17	2.2	2.9	650.7	4.00

Source: BBVA Research

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