

FUNDAMENTALS OF THE CHILEAN ECONOMY

BBVA CHILE – JANUARY 2017



FUNDAMENTALS CHILE

1. Brief Description



Highlights

1

Chile: *where the land ends*

2

GDP per-capita (PPP,USD): \$ 23.803

3

Population: 18.191.884 (2016)

4

Area: 756.096 Km²

5

Presidential Republic



The Chilean Economy in 2016

• GDP :	US\$ 240.1 billion
• GDP growth (%):	1.5
• Trade (X+M), % of GDP :	57
• Poverty rate (%):	11.7
• Gini coefficient:	0.47
• Inflation (annual average of y-o-y, %) :	3.8
• Unemployment rate (%):	6.4
• Ratings:	Moody's Aa3 (stable) / S&P AA- (stable) / Fitch A+ (negative)

Institutional history

Since 1989 the Central Bank Constitutional Organic Law established the Central Bank of Chile (CB) as an autonomous organism with two explicit goals: to provide stability of the currency and to warrant a well functioning payment channel, at both internal and external.

Since 1990 the CB has implemented an inflation target regime, and until 1999 this objective was shared with the existence of an exchange-rate band. After eliminating the exchange-rate band, the CB started with a full fledged inflation target system.

Since 2001 the government implemented a fiscal rule based on annual cyclically adjusted balance –as % of GDP- with the aim of avoiding the pro-cyclical nature of fiscal policy and stabilizing public expenditures over the business cycle. Additionally, the rule considers a smoothing mechanism to cope with swings in copper prices.



Central Bank of Chile



Finance Ministry of Chile

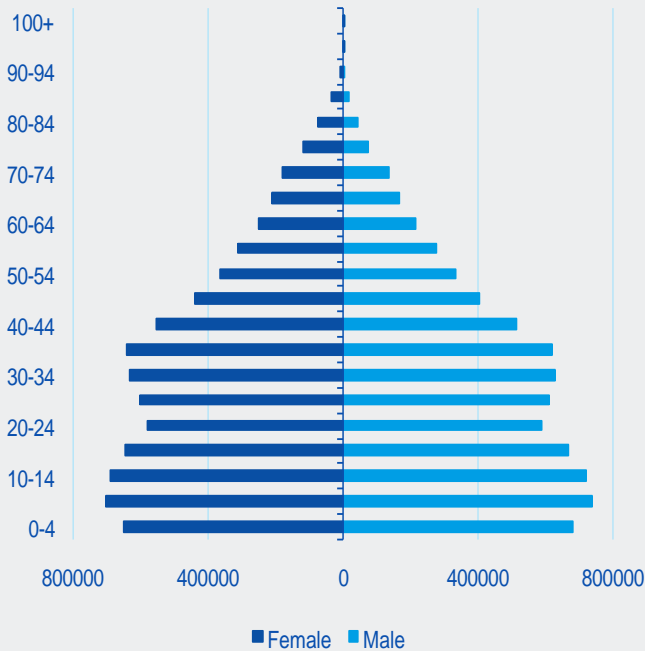
FUNDAMENTALS CHILE

2. *Social Indicators and Labor Market*

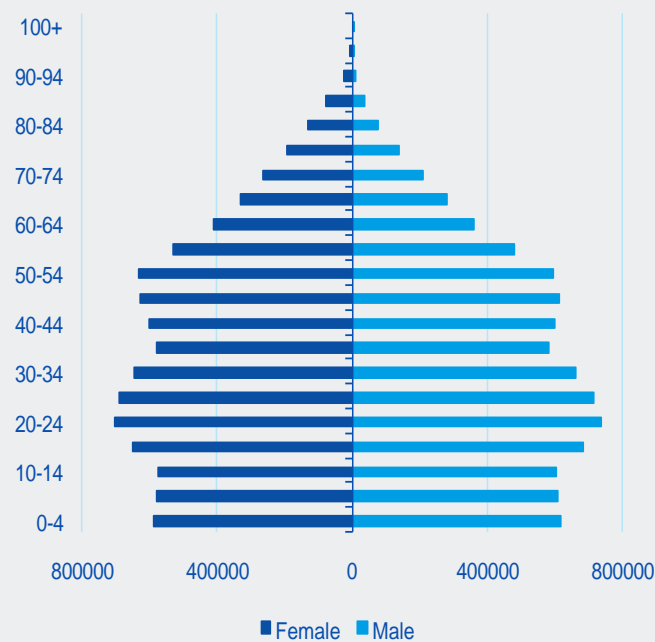


The population is aging at a fast pace...

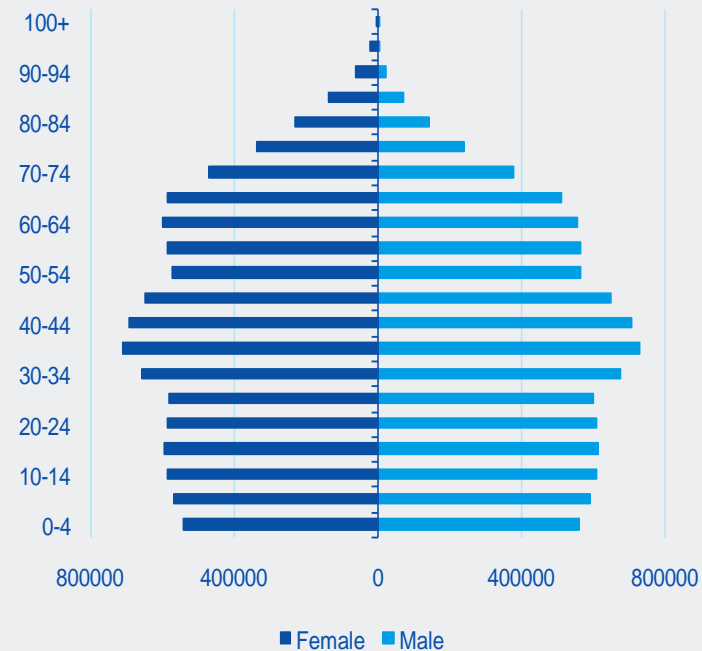
Chile population pyramid, 2000
(individuals)



Chile population pyramid, 2015
(individuals)

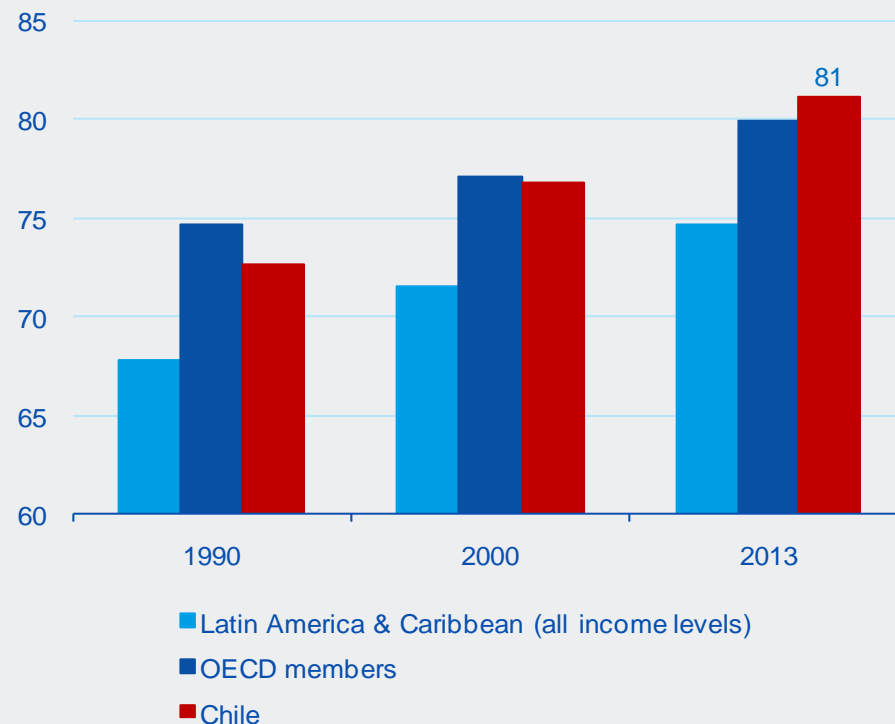
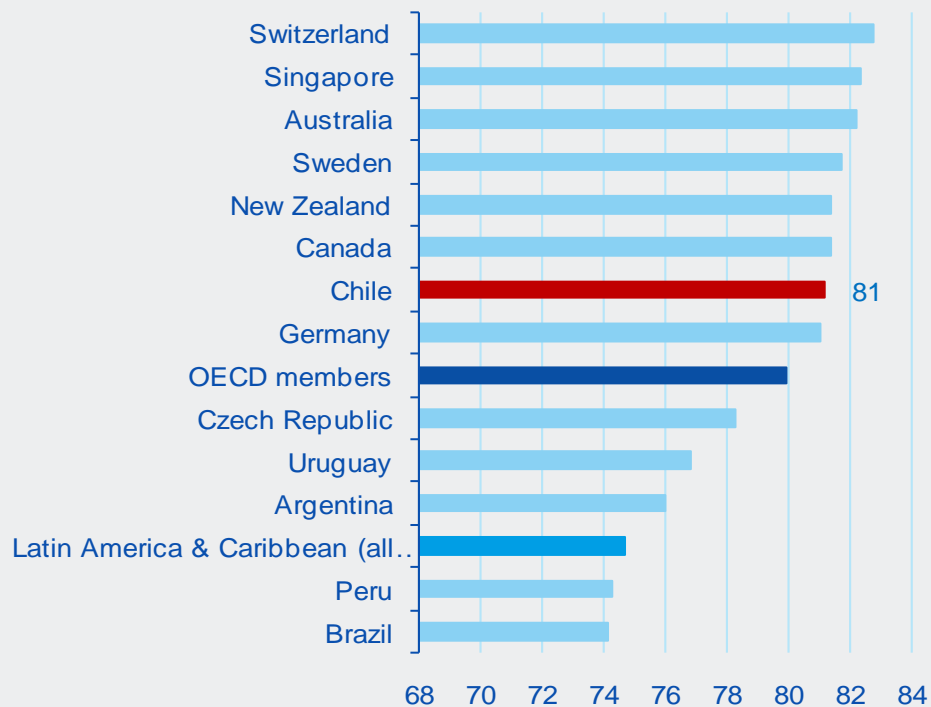


Chile population pyramid, 2030
(individuals)



... while life expectancy is improving

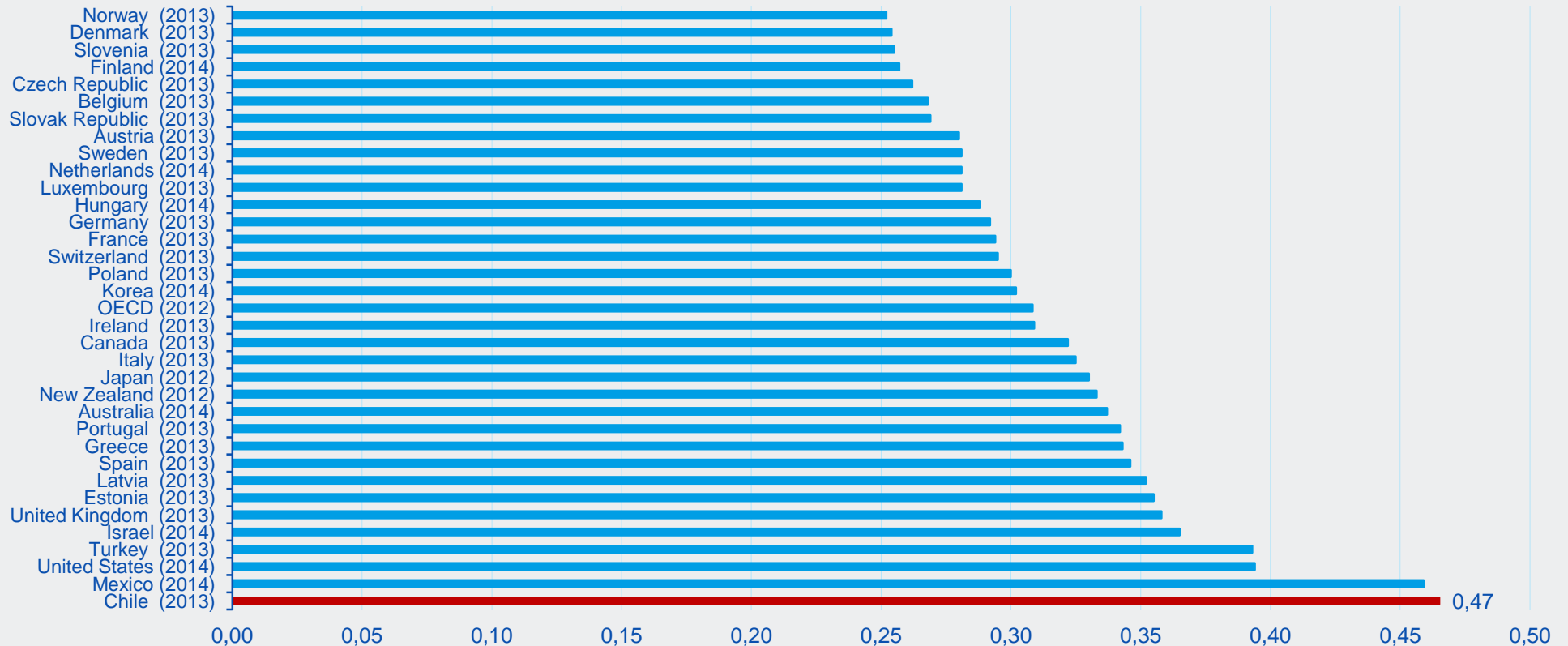
LIFE EXPECTANCY (years)



Source: World Bank

High inequality: a potential source of instability

GINI COEFFICIENT*



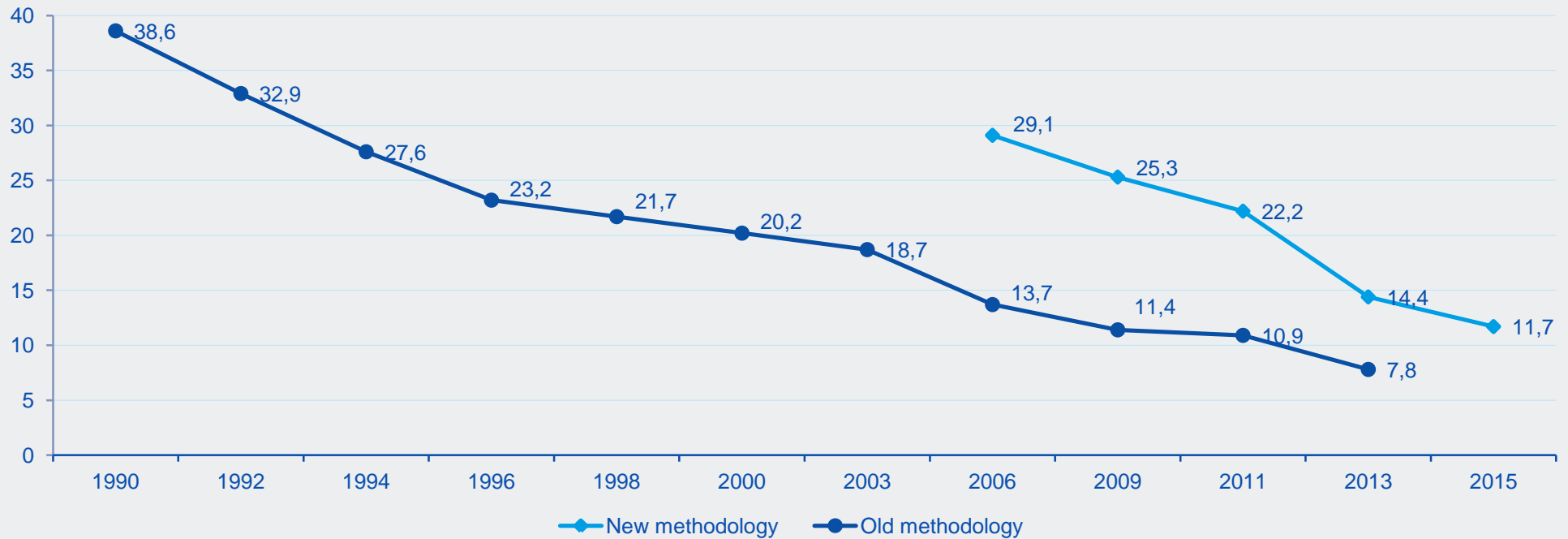
Source: OECD Social Indicators

*A Gini coefficient of 0 represents perfect equality, while an index of 1 implies perfect inequality

Nonetheless, poverty rate has declined systematically

POVERTY RATE

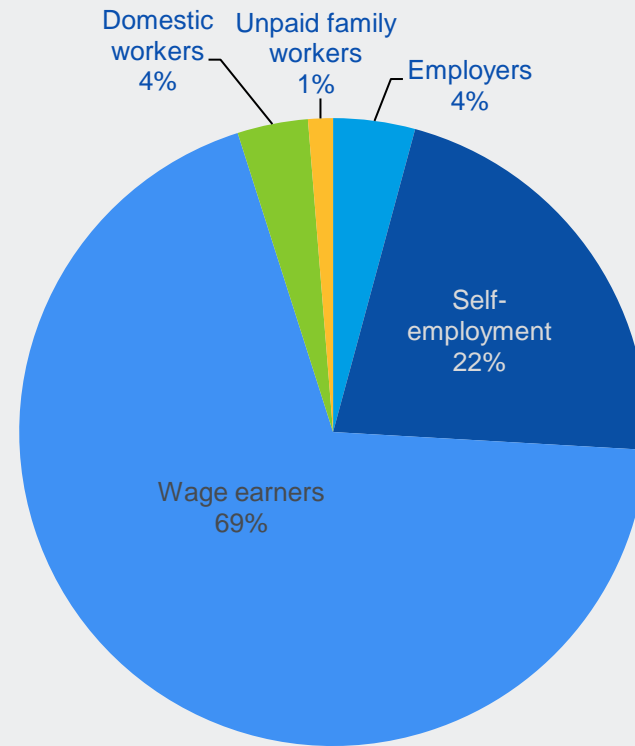
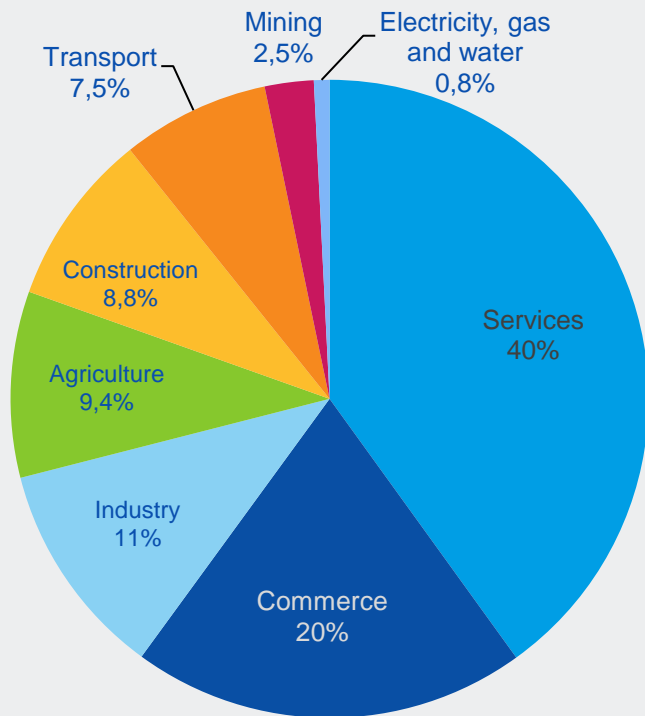
(%, Population Below Poverty Line)



Source: Ministry of Social Development (CASEN)

Workers mostly placed at service and commerce sectors

EMPLOYMENT
(% Total, 2016)

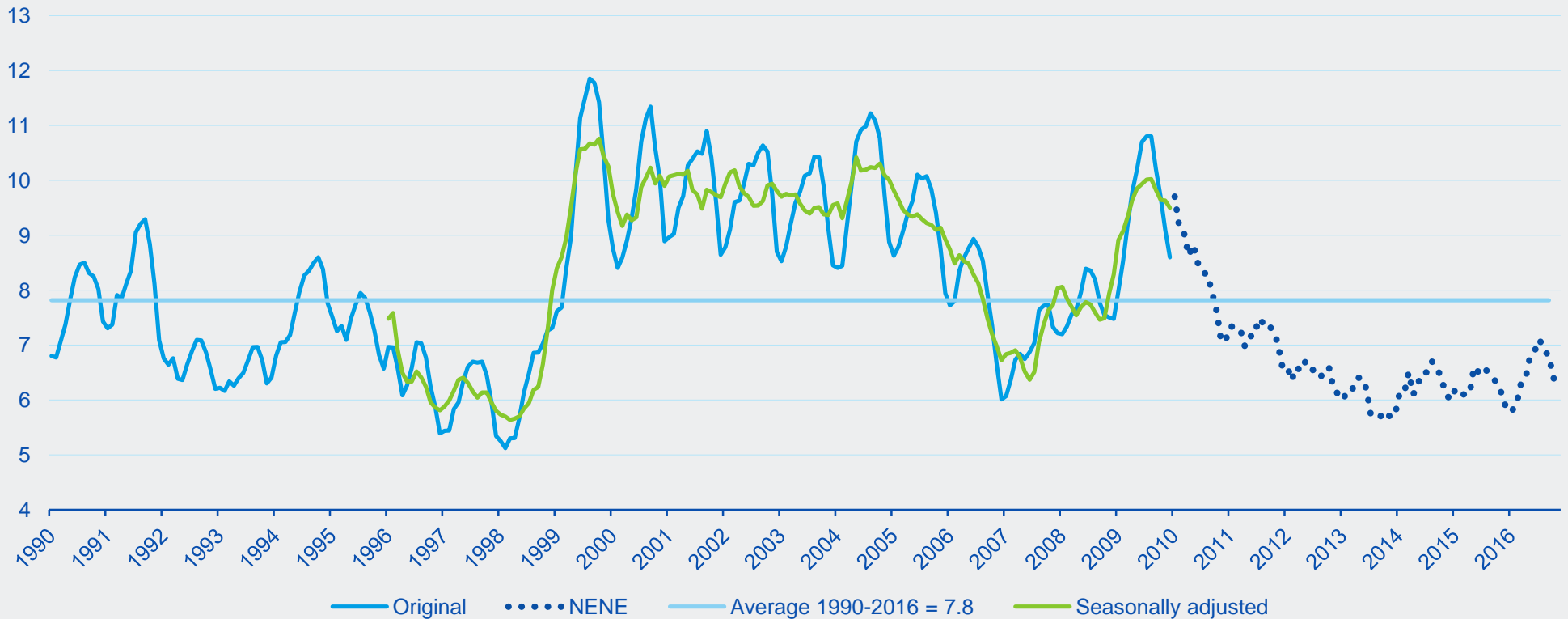


Source: National Institute of Statistics

Unemployment rate has been quite resilient to the slowdown in output

NATIONAL UNEMPLOYMENT RATE

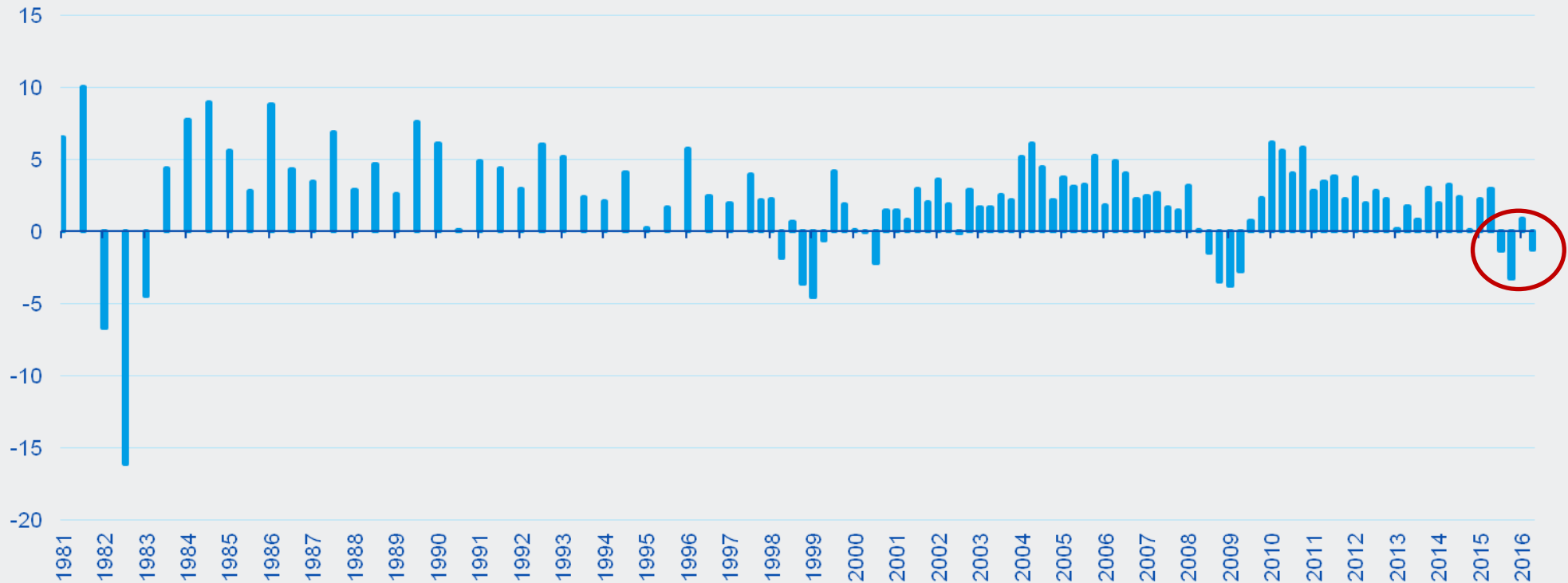
(% labor force)



Source: National Statistic Institute

Nonetheless, job destruction arises for first time since 2009

EMPLOYMENT METROPOLITAN AREA
(annual %, thousand of people)

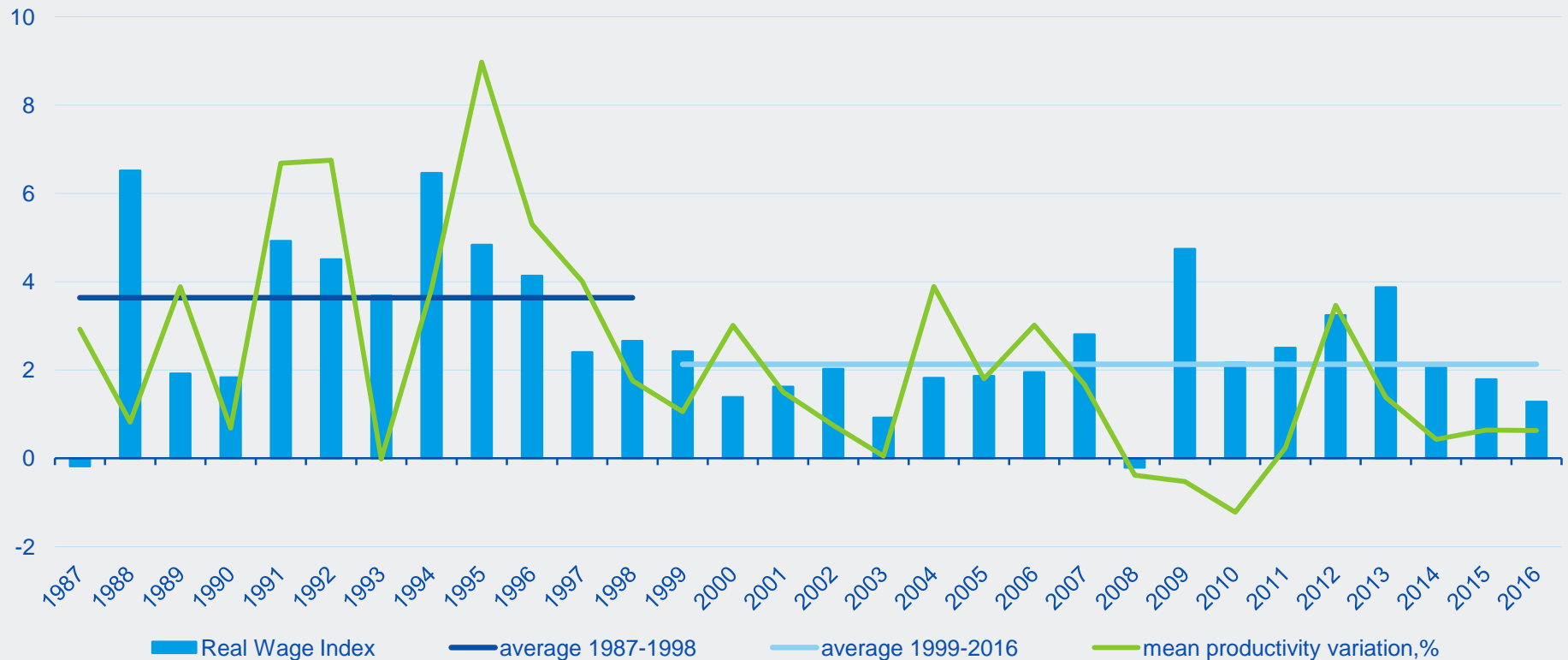


Source: University of Chile

Wages are increasing at a lower pace

REAL WAGES*

(mean annual change, %)



Source: National Statistic Institute

*Based on annual averages

Participation rate is not so lagged from developed economies - room for increase in women and young people participation

PARTICIPATION RATE

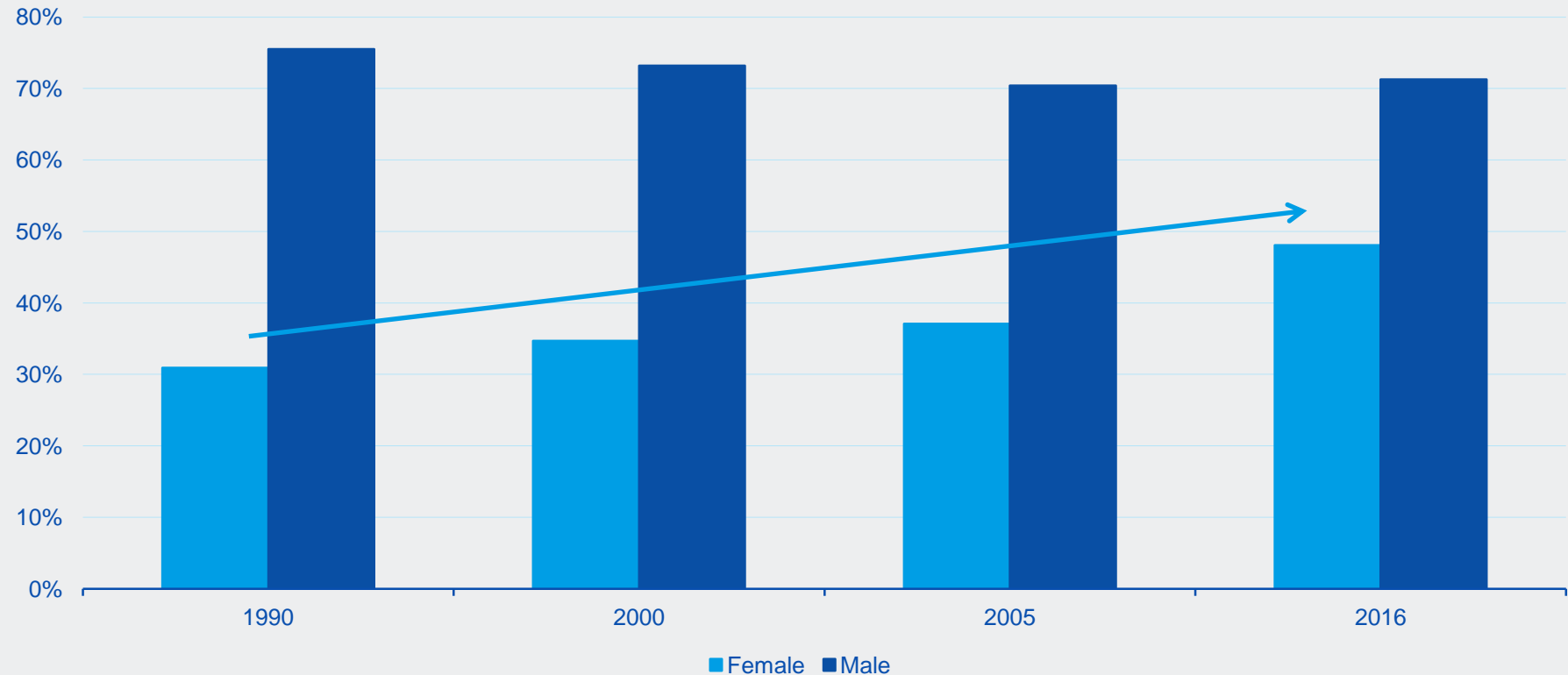
(labor participation %, 2015)

Country	Participation (total)	Female (total)	15-19 years	20-24 years
Chile	59.7	48.2	15.9	55.2
Australia	65.0	59.0	53.9	79.3
New Zealand	69.0	63.7	46.9	76.6
Canada	65.8	61.2	49.9	76.4
Denmark	62.2	57.8	51.4	71.8
Germany	60.2	54.7	27.7	68.4
USA	62.7	56.7	34.3	70.7
France	56.1	51.6	13.4	62.3
Spain	59.5	53.7	14.9	56.7
United Kingdom	63.1	57.6	44.8	74.3
Italy	49.5	40.2	8.7	44.1
Netherlands	64.4	58.8	60.4	76.1
Mean (exc. Chile)	61.6	55.9	36.9	68.8

Further improvements in female participation requires sound labor market policies

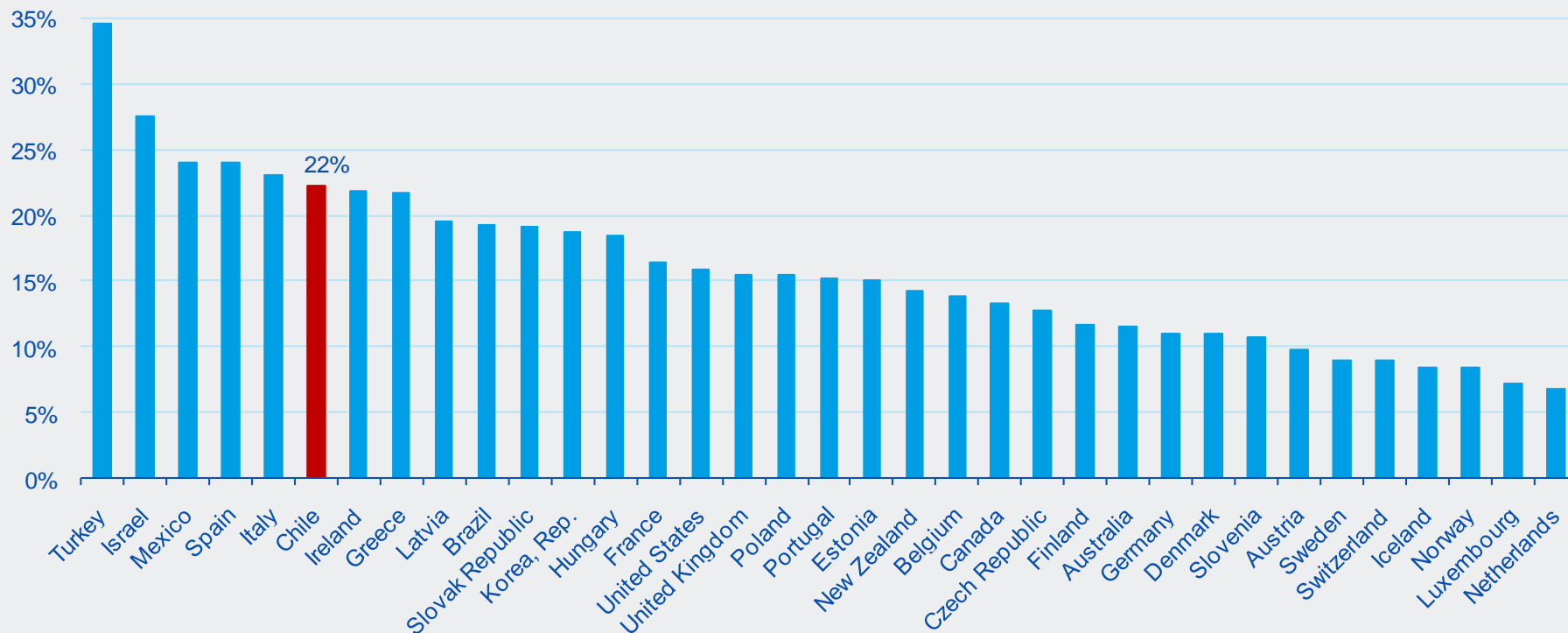
PARTICIPATION RATE

(%)



NEET: a new phenomenon that can drag participation rate prospects

YOUTH NOT IN EMPLOYMENT, EDUCATION OR TRAINING (NEET)*



Source: OECD indicators

*As % of people between 15-29 years old

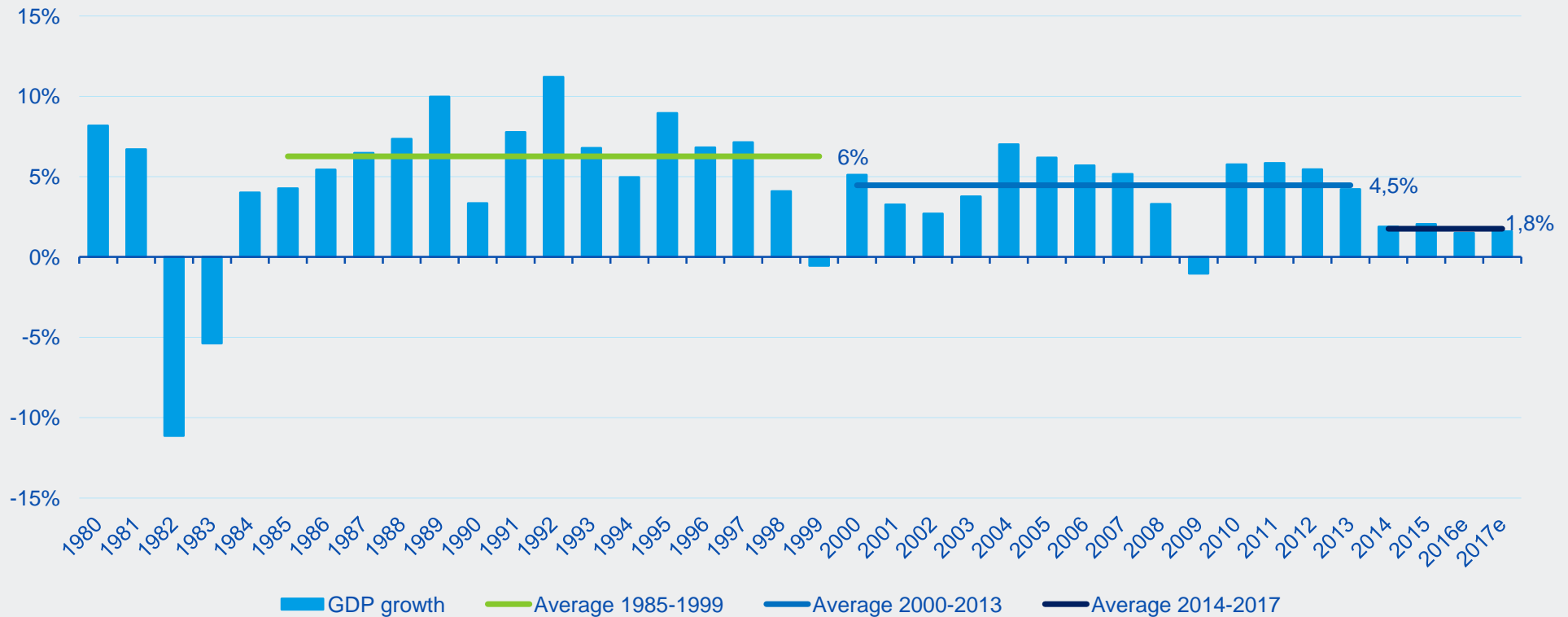
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3. *National Accounts*



GDP is growing below its nearest average

REAL GDP GROWTH
(annual change, %)



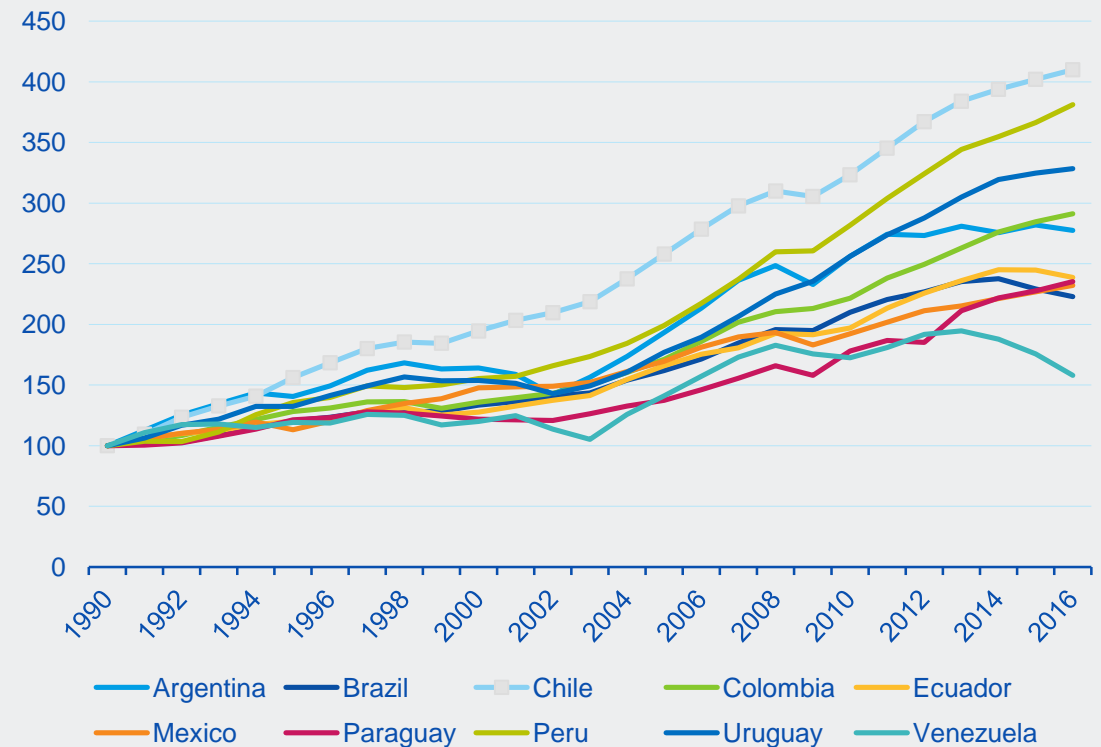
Source: Central Bank of Chile

...but still showing the highest GDP per capita in Latam

PER CAPITA GDP
(PPP, 2016)

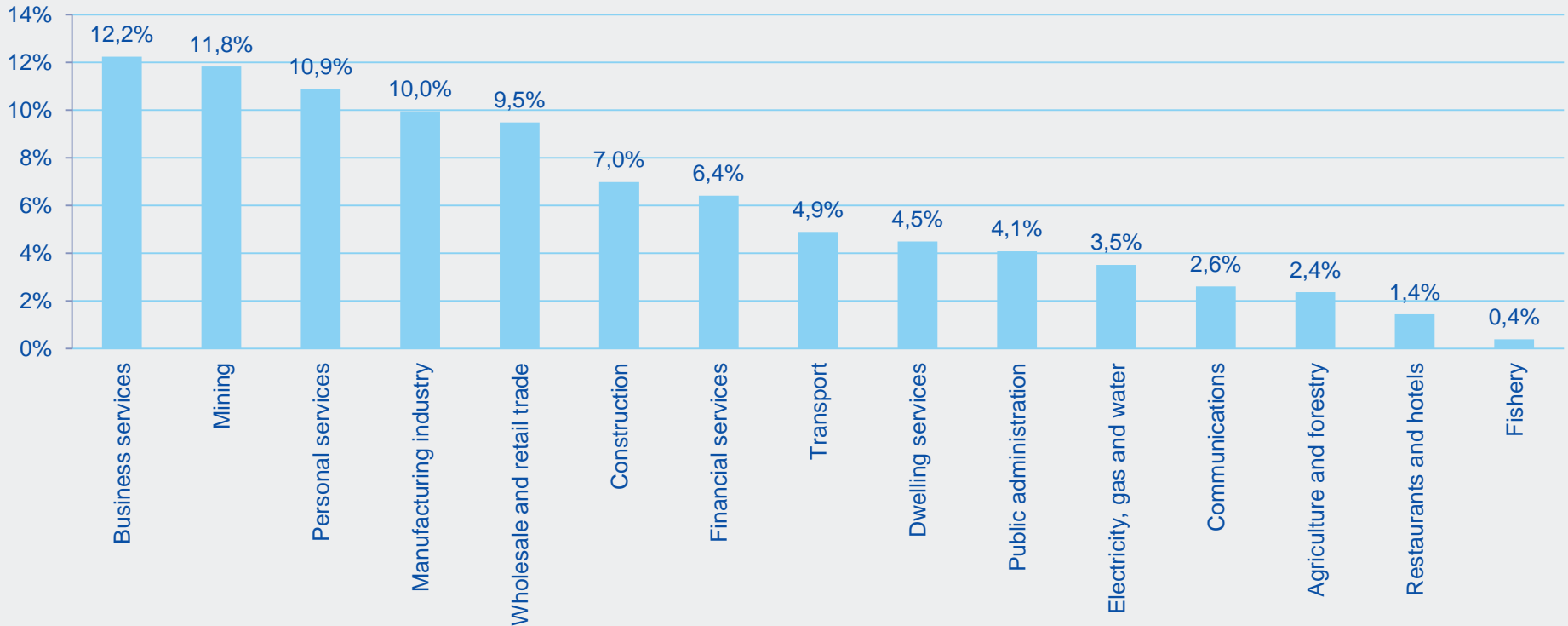
Chile	23.969
Uruguay	21.570
Argentina	20.171
Mexico	18.865
Brazil	15.211
Venezuela	15.103
Colombia	14.162
Peru	13.019
Ecuador	11.037
Paraguay	9.354

PER CAPITA GDP
(PPP, index 1990=100)



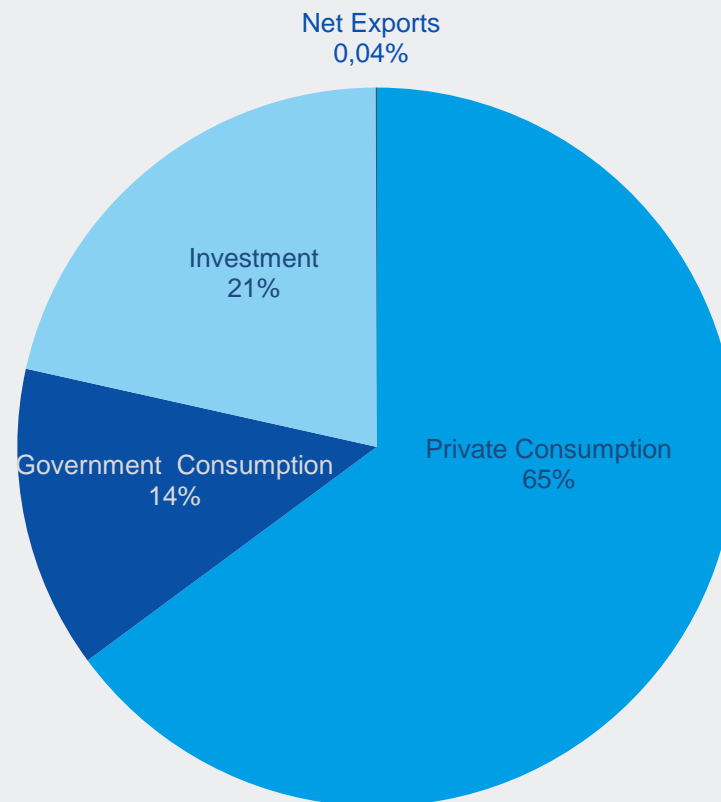
Mining and services are the most relevant sectors of the economy

GDP 2015 BY ECONOMIC ACTIVITY
(% total)



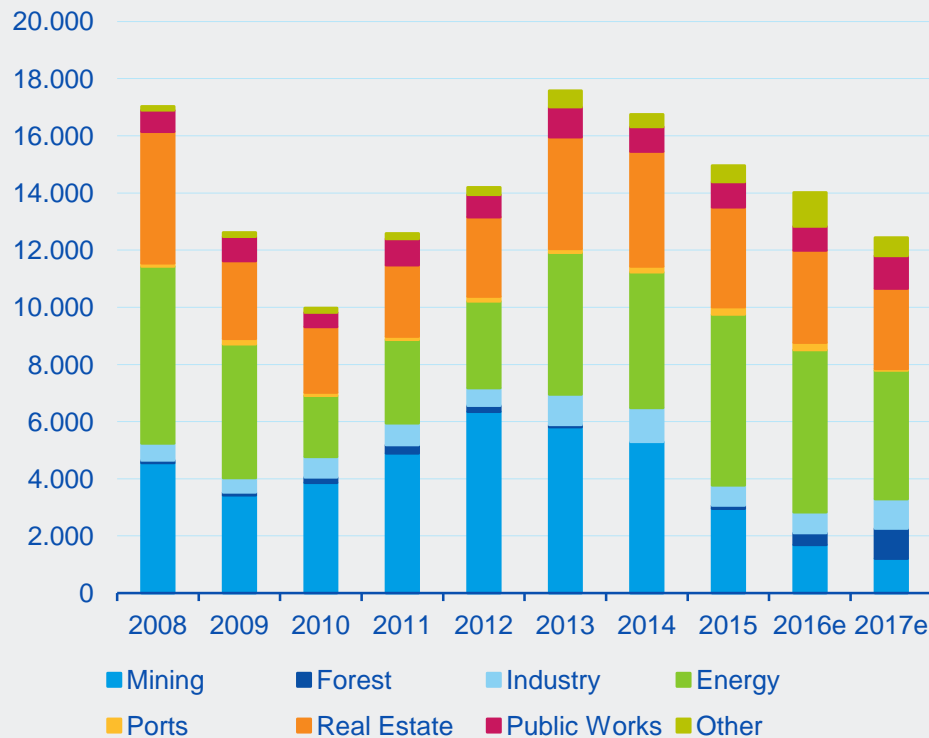
While private consumption accounts for almost two thirds of total GDP

GDP EXPENDITURE
(% of total, 2016)

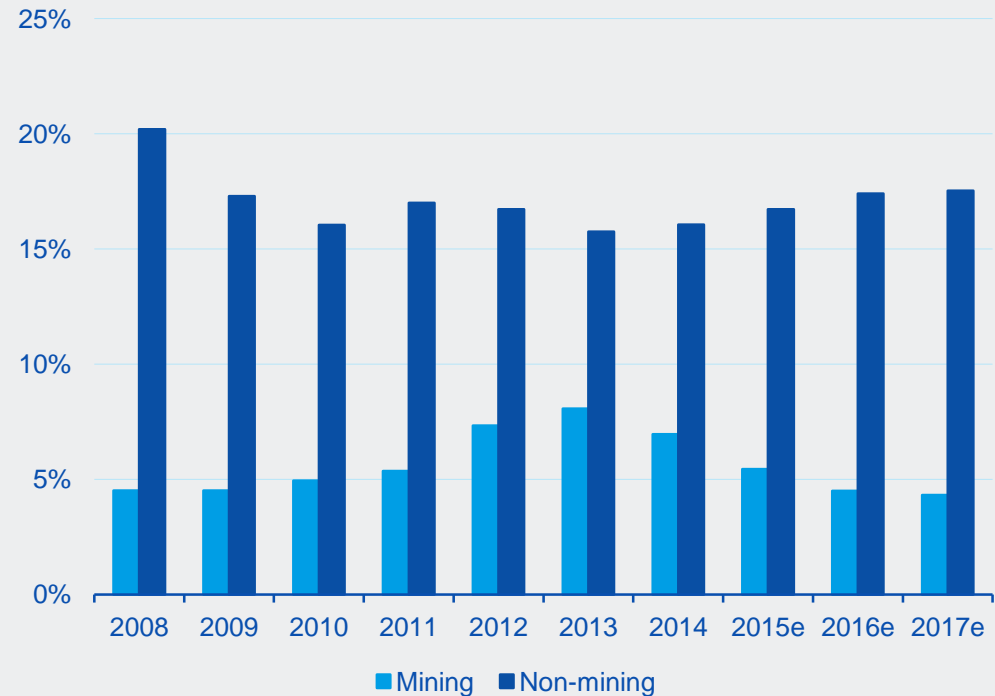


Strong adjustment of investment in the mining sector, but recovery of projects in the energy sector

PRIVATE INVESTMENT TO MATERIALIZE BY SECTORS
(USD MM)



MINING AND NON-MINING INVESTMENT
(% GDP)

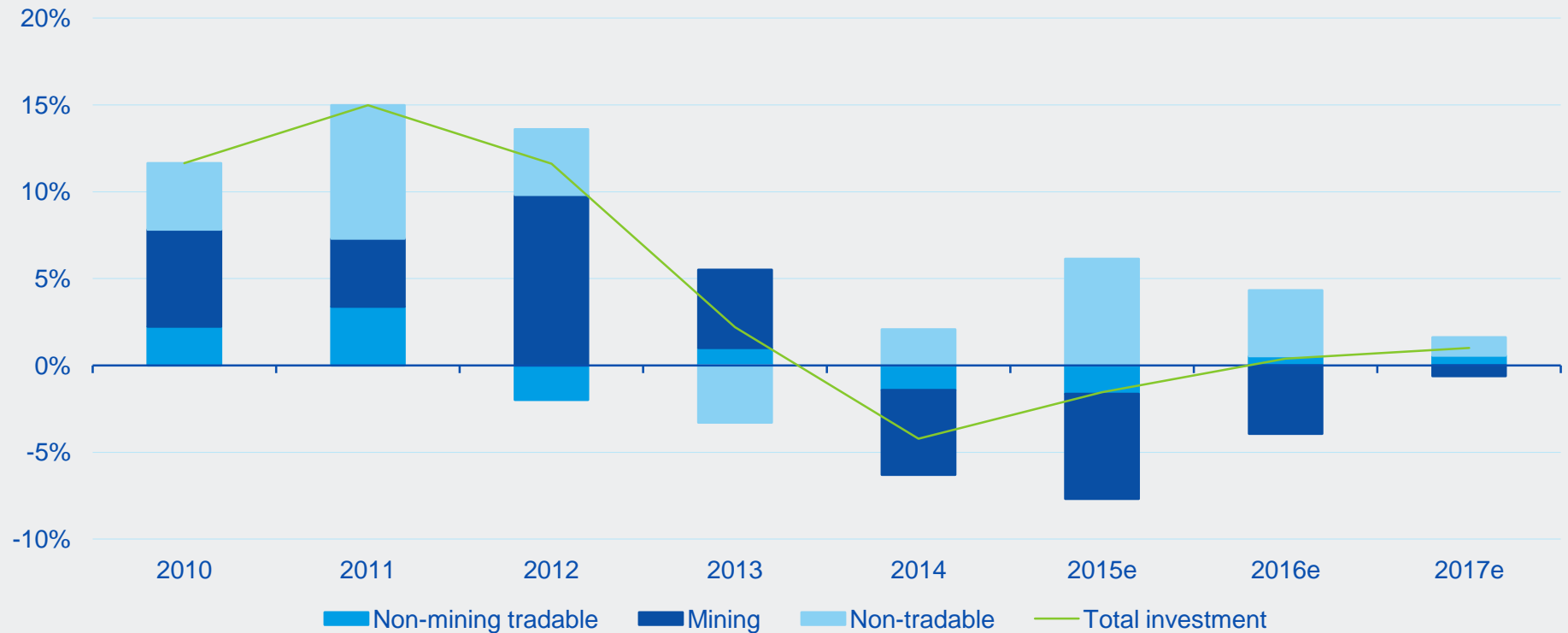


Source: CBC, BBVA Research, Central Bank of Chile

Mining is the main source for investment fluctuations...

INVESTMENT COMPOSITION

(% variation)



...with negative contributions during last years

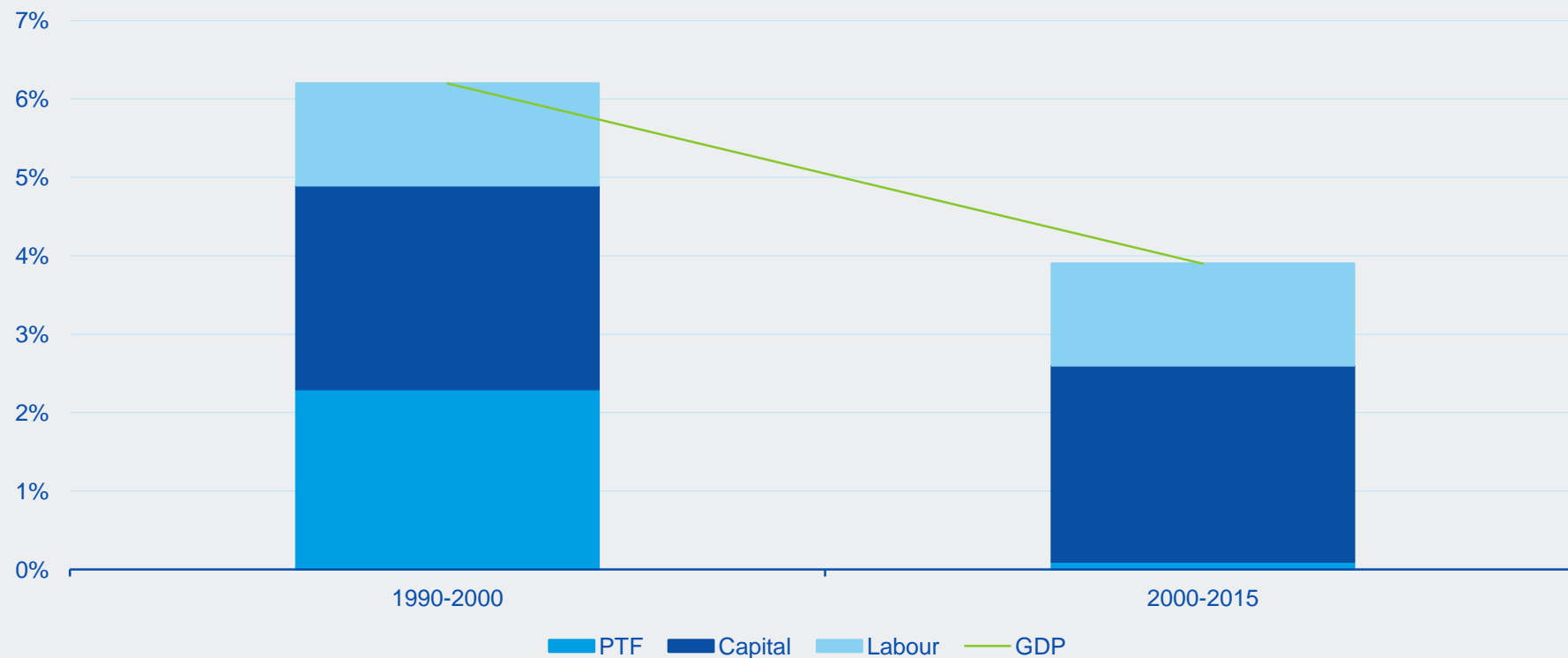
GDP BY SECTORS

(% growth)

Activity	2014	2015	2016*
Agriculture, forestry and fishery	-3.0%	4.3%	3.0%
Mining	2.5%	-0.2%	-2.8%
Manufacturing industry	-0.6%	2.1%	-0.8%
Construction	2.6%	2.3%	-0.1%
Wholesale and retail	-0.3%	1.8%	4.1%
Financial services	3.7%	4.3%	3.5%
Business services	0.9%	2.0%	0.9%
Personal services	4.3%	2.9%	6.0%
Others	3.4%	3.2%	2.8%

TFP has reduced its contribution to GDP growth ...

TFP CONTRIBUTION TO GDP GROWTH



Source: National Productivity Commission

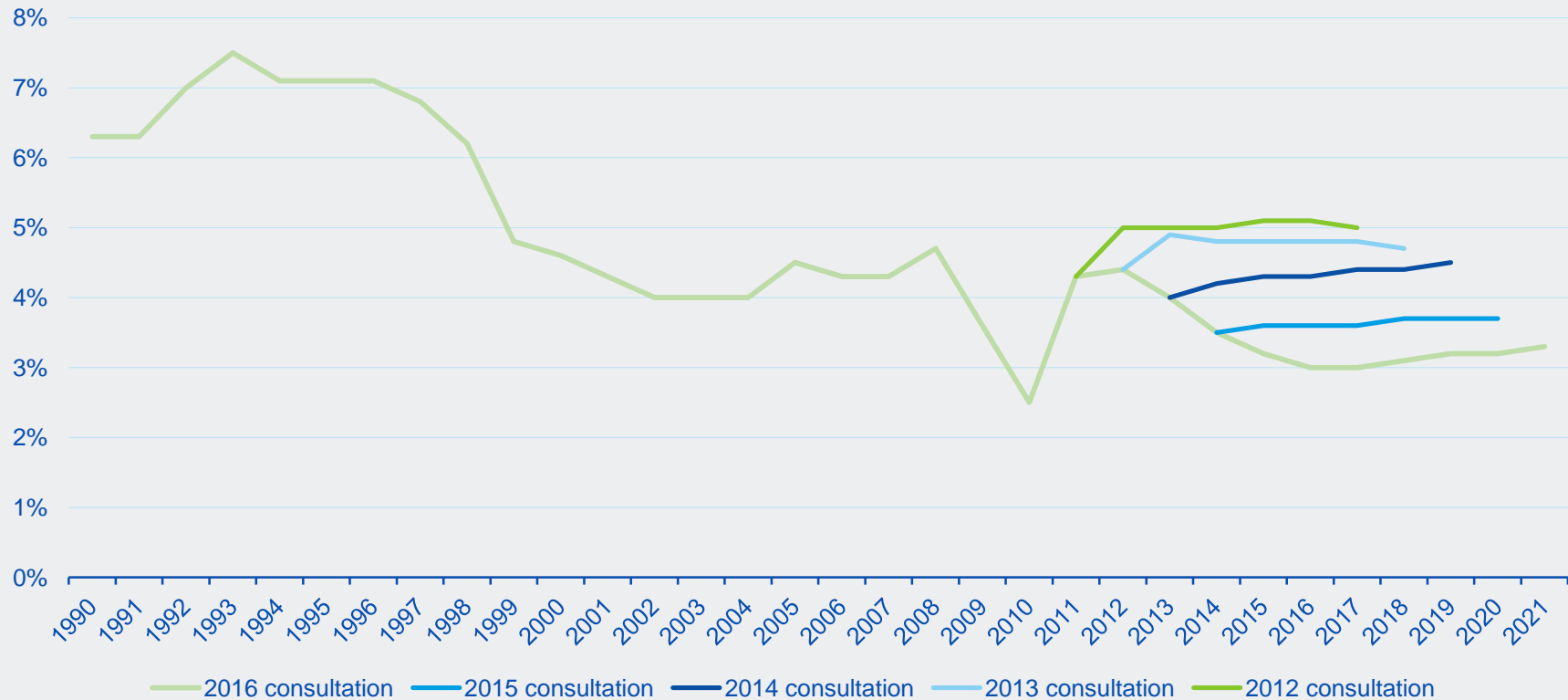
...driven mainly by the mining sector

AVERAGE GROWTH RATE OF TFP BY SECTORS

	1990-2000	2000-2015
Agriculture and fishing	4.5%	3.5%
Mining	2.1%	-8.9%
Industry	2.1%	-0.4%
Electricity, gas and water	3.8%	-1.4%
Construction	0.9%	-0.9%
Commerce, Hotels and Restaurants	2.7%	3.4%
Transportation and communications	3.4%	0.9%
Services	1.4%	1.7%

Downward adjustments in trend GDP growth to near 3%

TREND GDP*
(% growth)



Source: Ministry of Finance

* Estimation by a panel of experts.

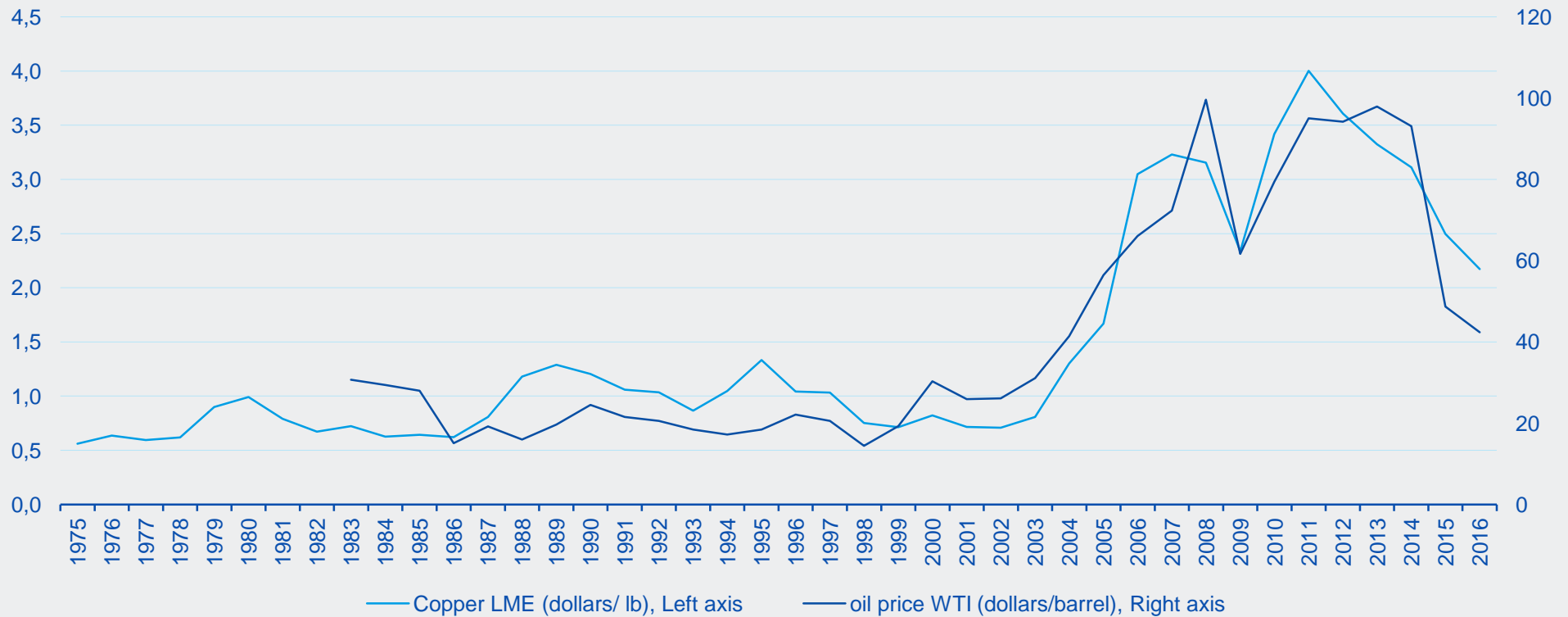
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4. *External Sector*



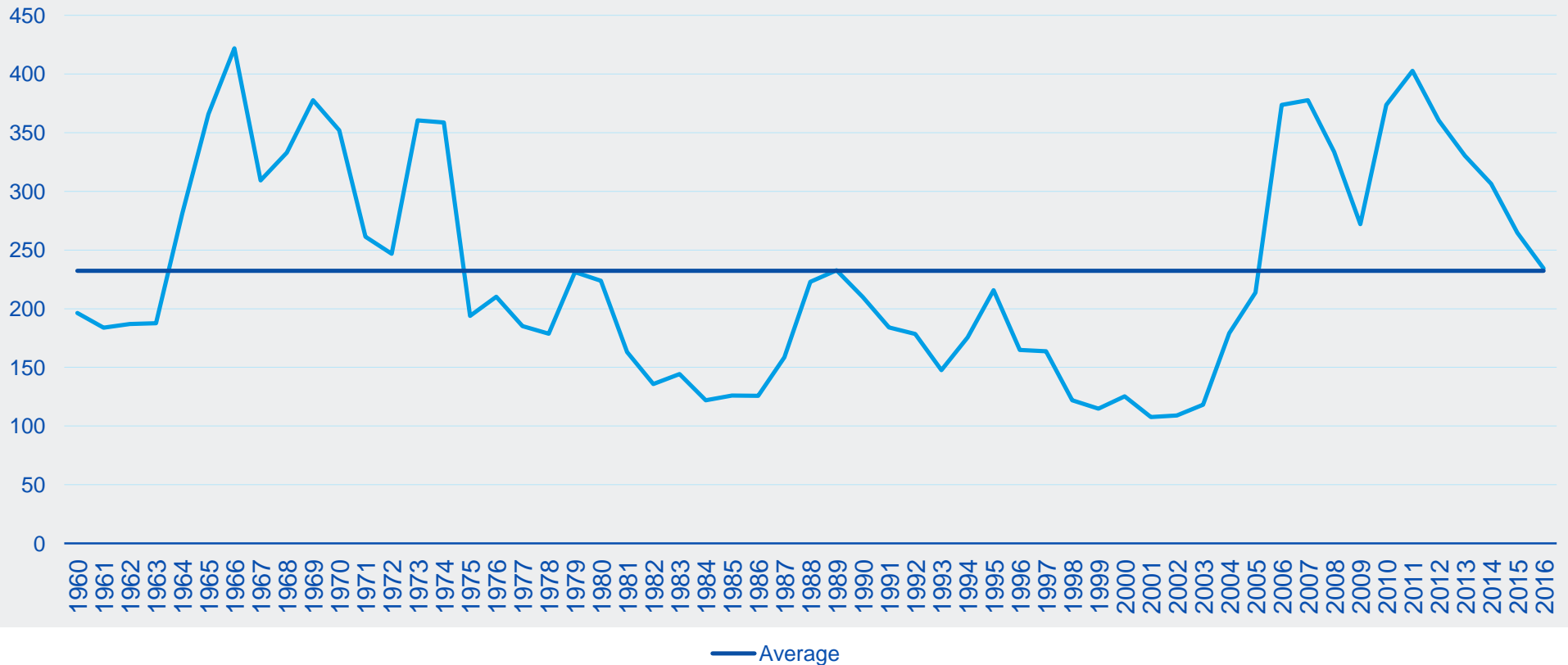
We are at the end of a commodities super-cycle...

COPPER AND OIL PRICES



...with copper price receding to historical average in real terms

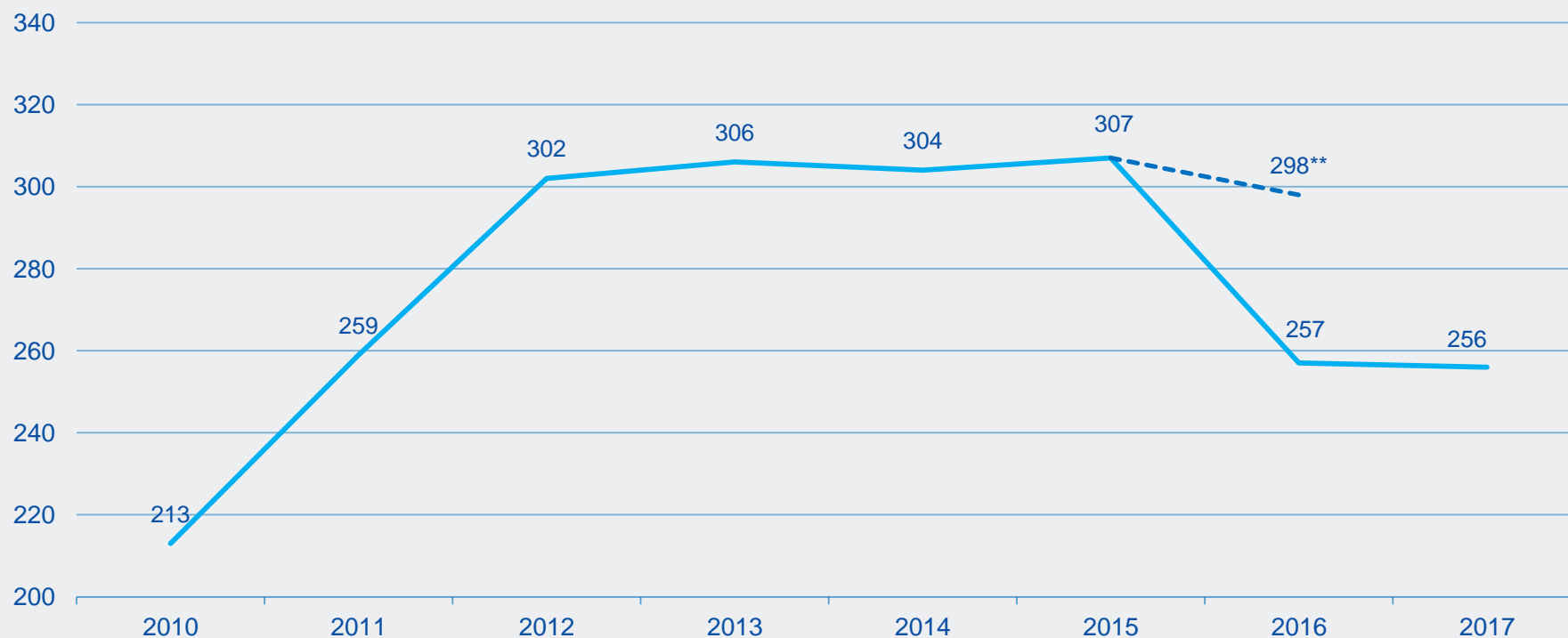
REAL COPPER PRICE
(USD cents/pound)



Source: Chilean Copper Commission, Ministry of mining

Downward adjustments in long-term copper price

LONG-TERM PRICE OF COPPER*
(US\$ Cents/Pound)



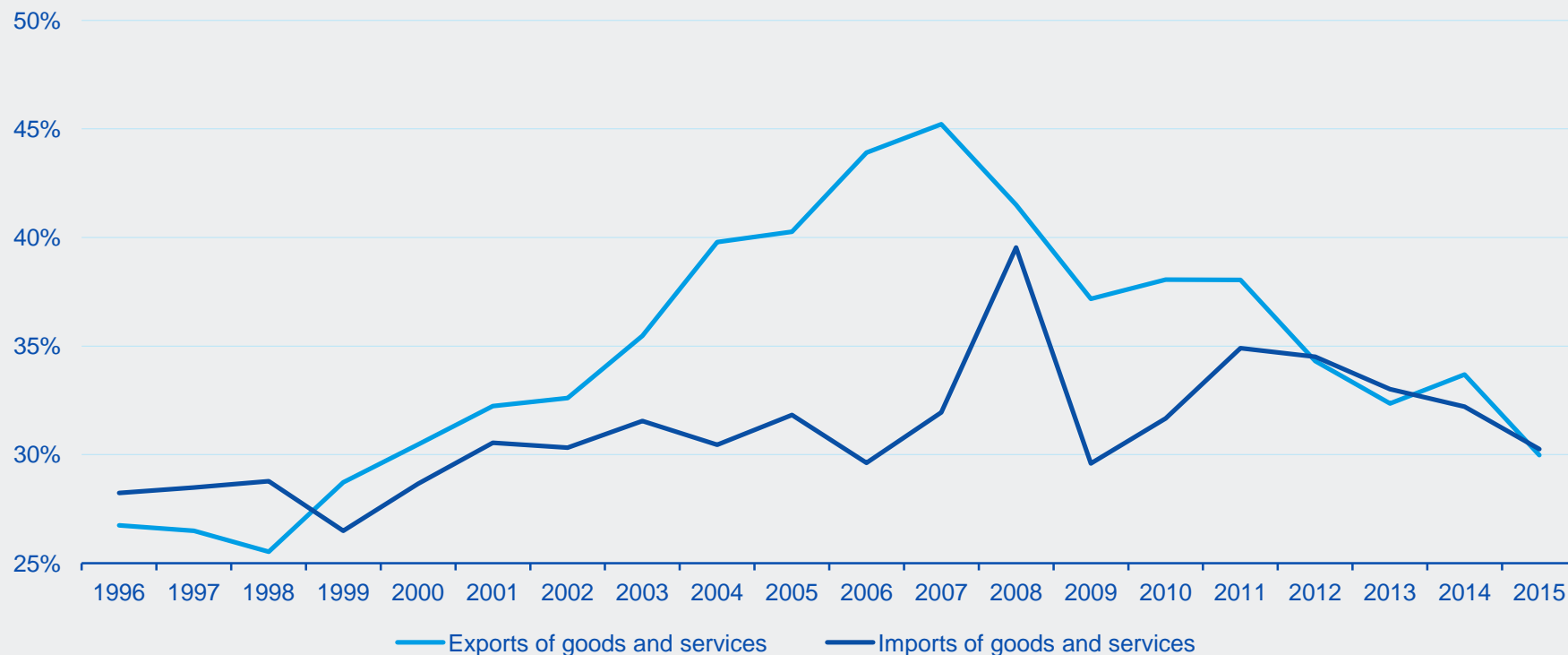
Source: Ministry of Finance

*Average copper price for the next ten years (estimation by committee of experts)

**Revised in extraordinary consultation

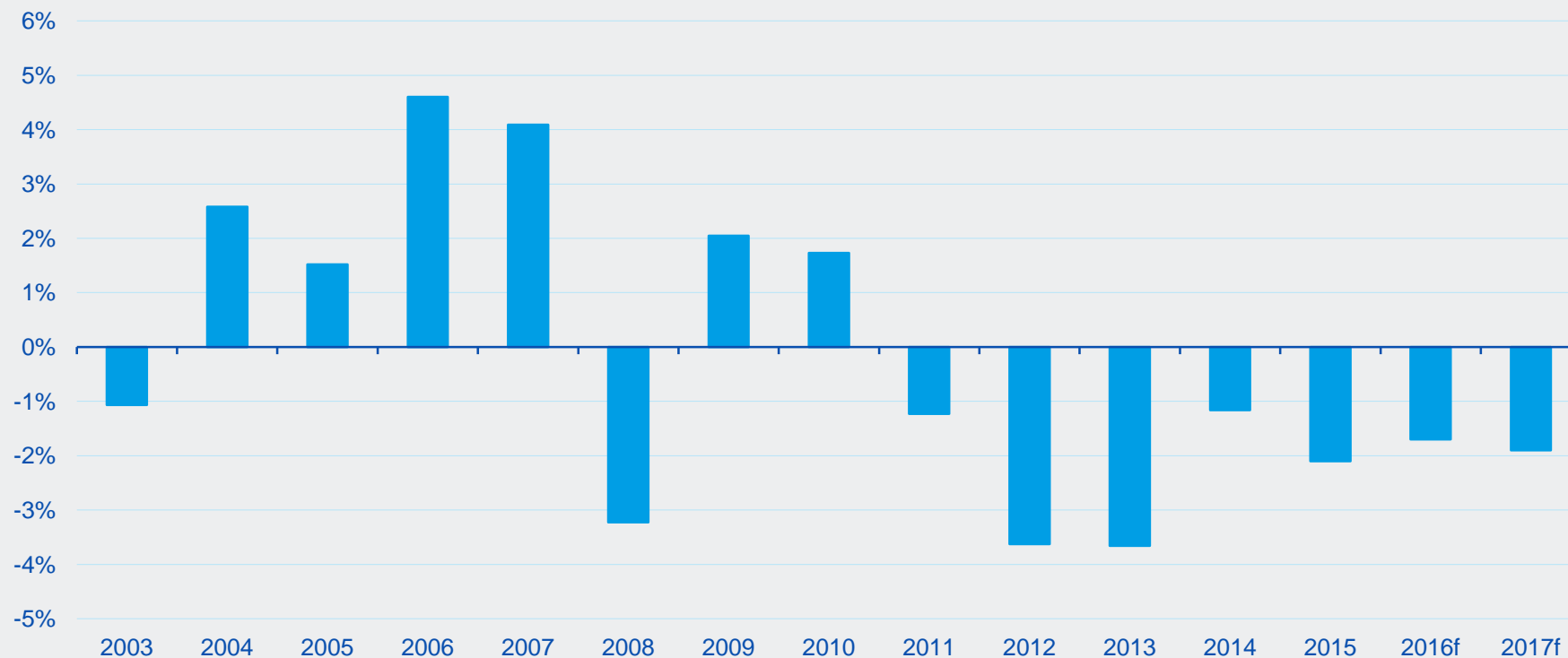
Less trade openness driven by lower commodity prices

EXTERNAL TRADE
(as % of GDP)



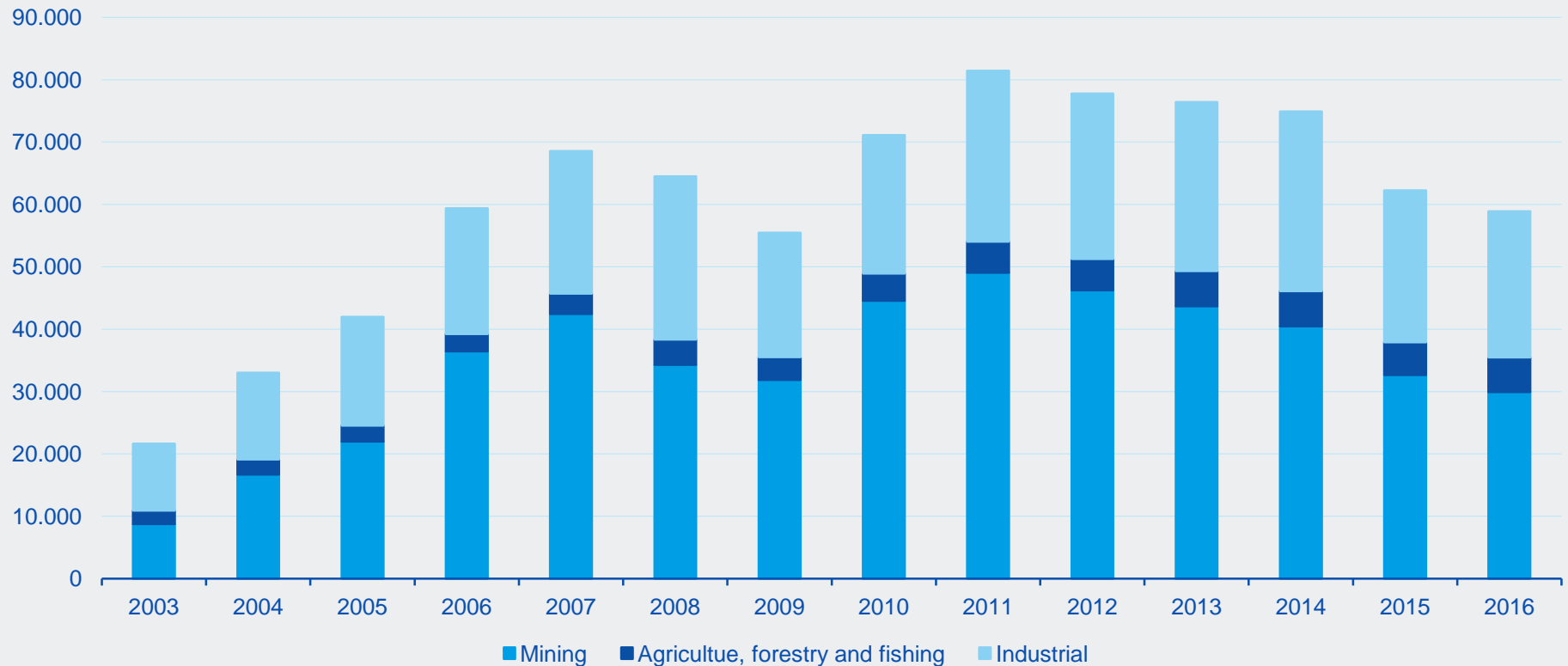
Current account deficit close to sustainable levels

CURRENT ACCOUNT
(% GDP)



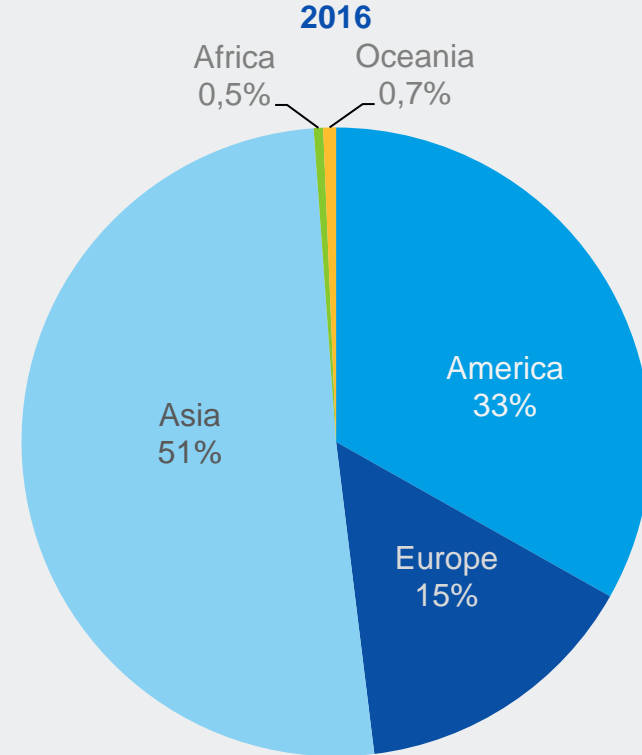
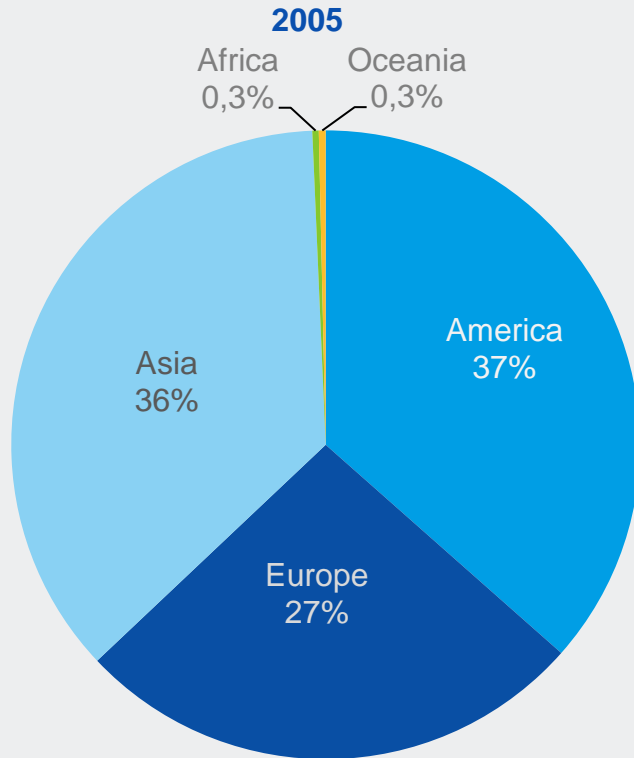
Mining is reducing contribution to exports ...

EXPORTS OF GOODS
(millions USD)



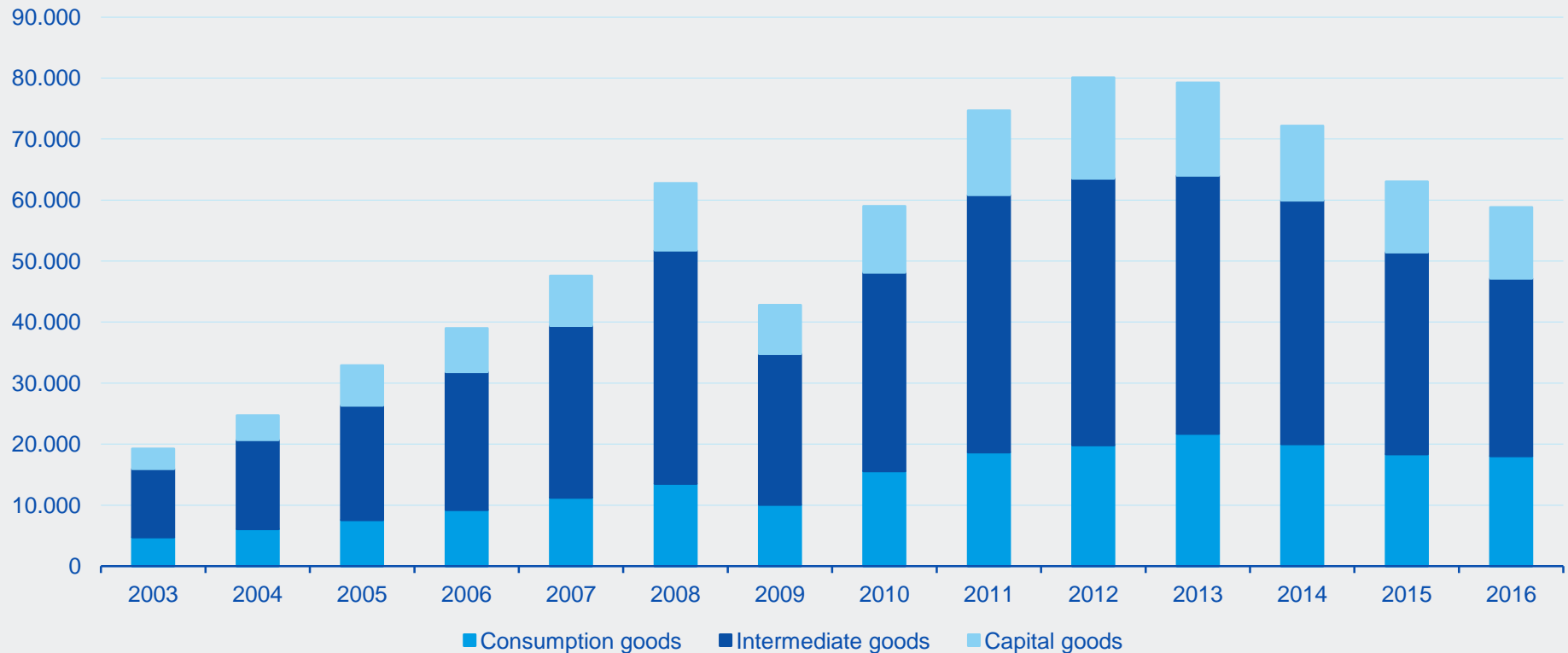
... in a context where Asia remains as the most relevant market

EXPORTS OF GOODS BY CONTINENT
(% of Total)



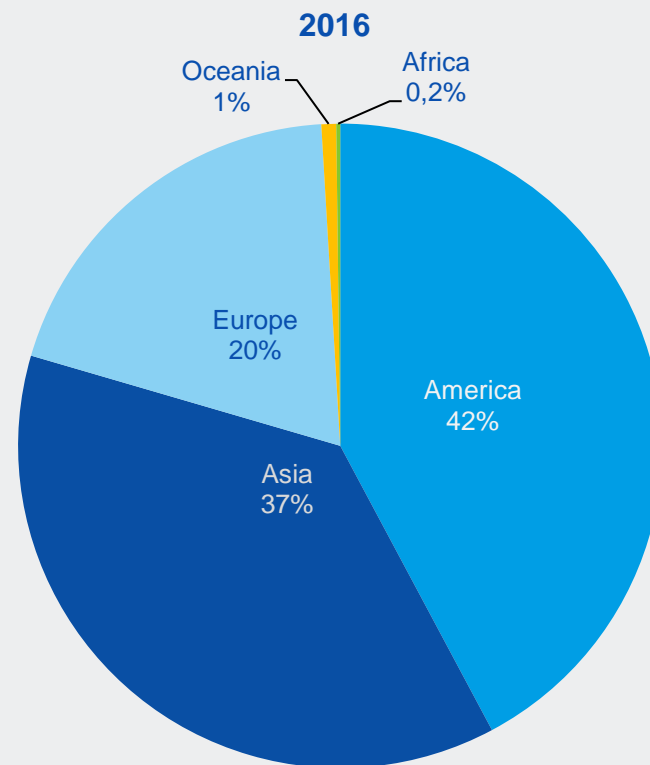
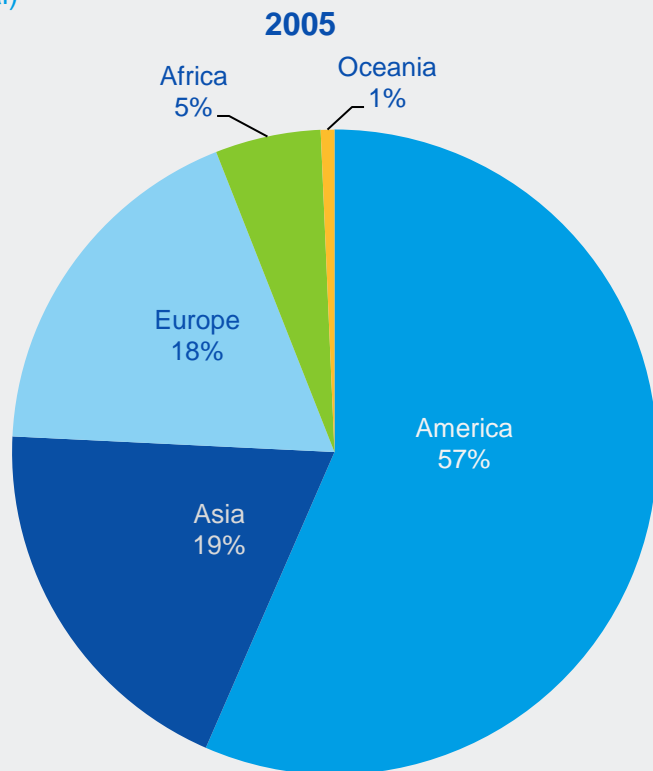
Imports also receded, especially intermediate goods

IMPORTS OF GOODS
(millions USD)



Once again, with Asia increasing its importance as supplier...

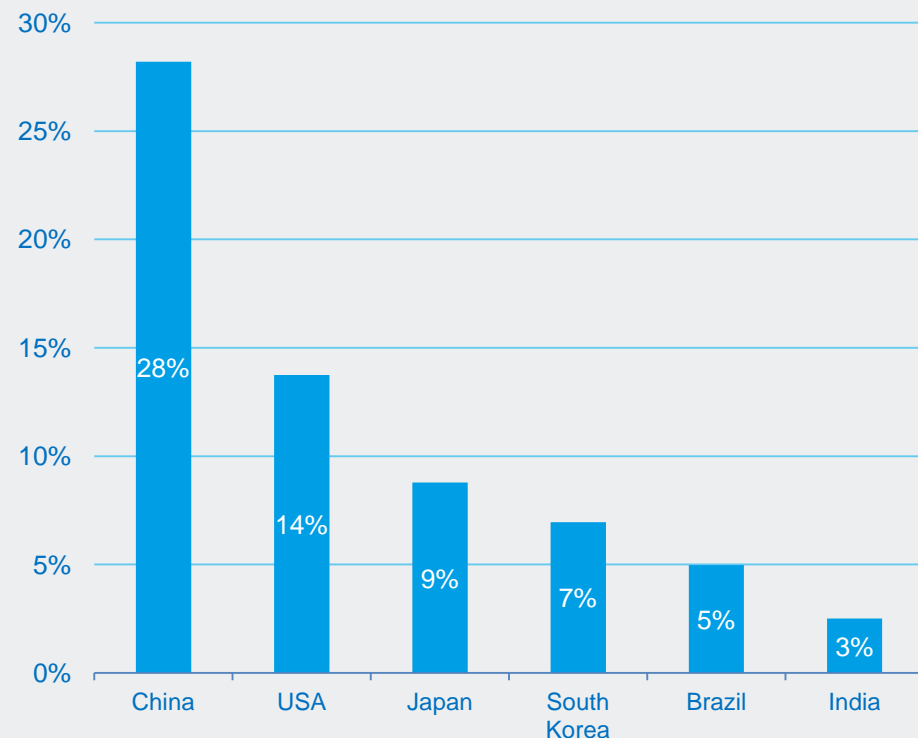
IMPORTS OF GOODS BY COUNTRY
(% of Total)



...and China consolidating as the major trade partner

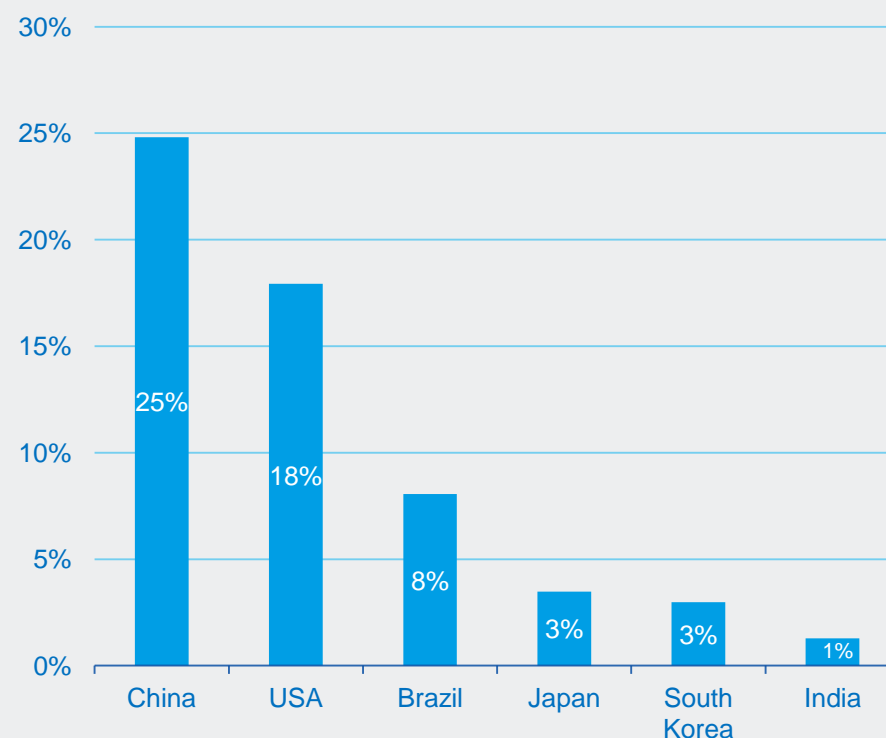
EXPORTS OF GOODS BY COUNTRY

(% of Total, 2016)



IMPORTS OF GOODS BY COUNTRY

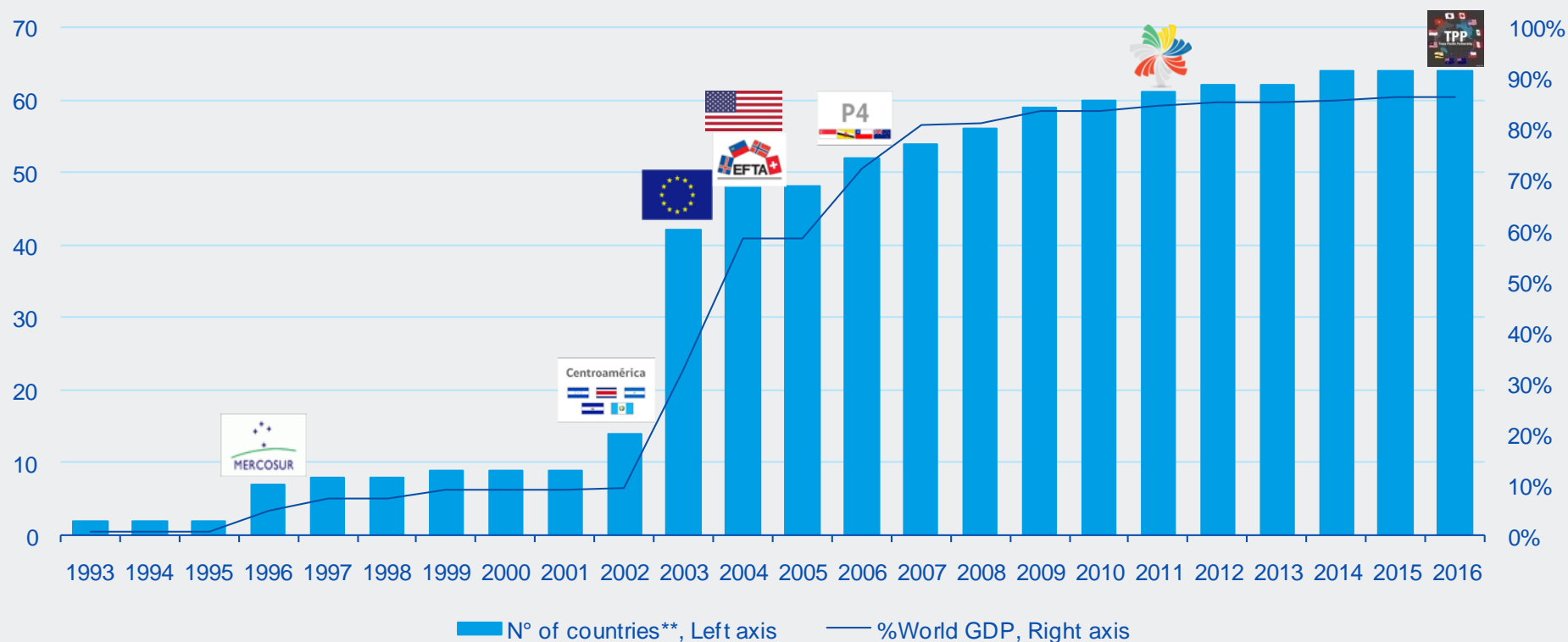
(% of Total, 2016)



Source: Central Bank of Chile

Chile has free trade agreements with 86% of global GDP

FREE TRADE AGREEMENTS*



Source: General Directorate of International Economic Relations

*Includes: Economical complementation agreements, free trade agreements, association agreements, partial agreements and economical cooperation

** Countries are counted only once

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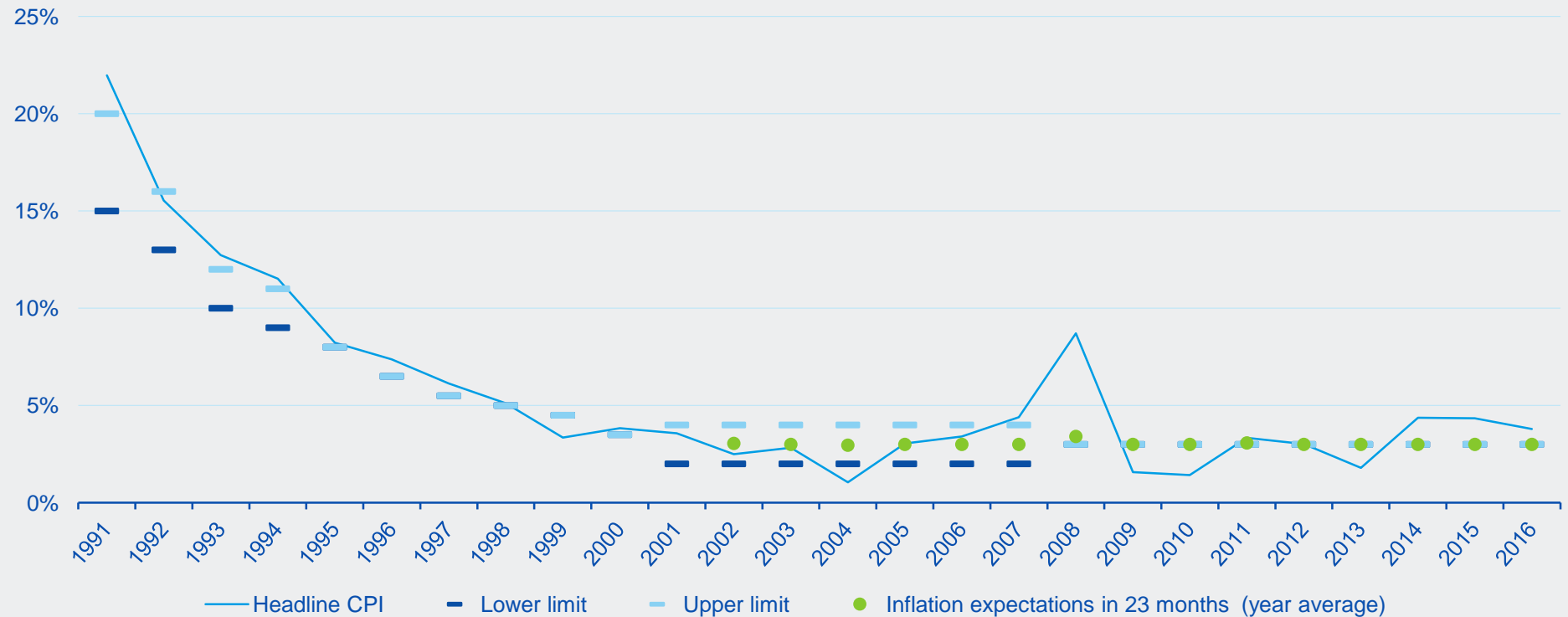
5. Inflation and Exchange Rate



The Central bank has adopted a successful inflation target regime, allowing the anchor of long-term inflation expectations

INFLATION

(annual change, %)



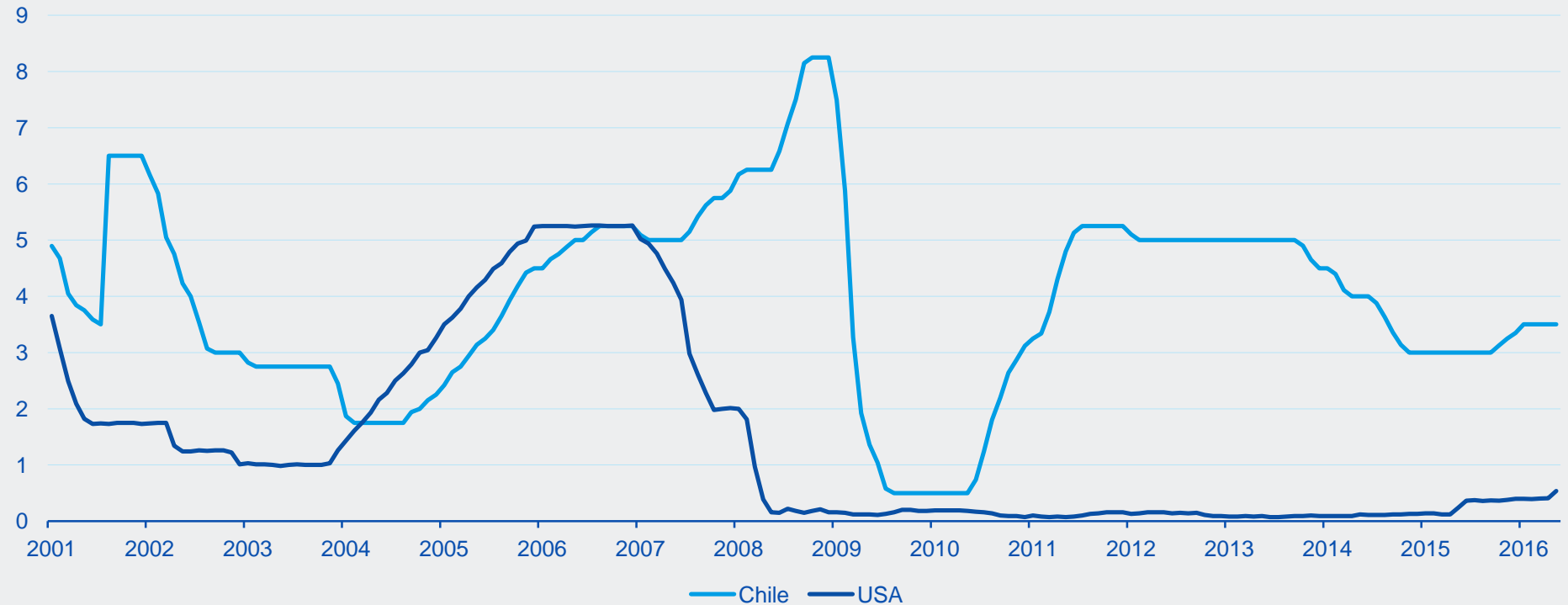
With a floating exchange-rate regime...

REAL EXCHANGE RATE
(index average 1986=100)



... that has allowed to manage an independent monetary policy

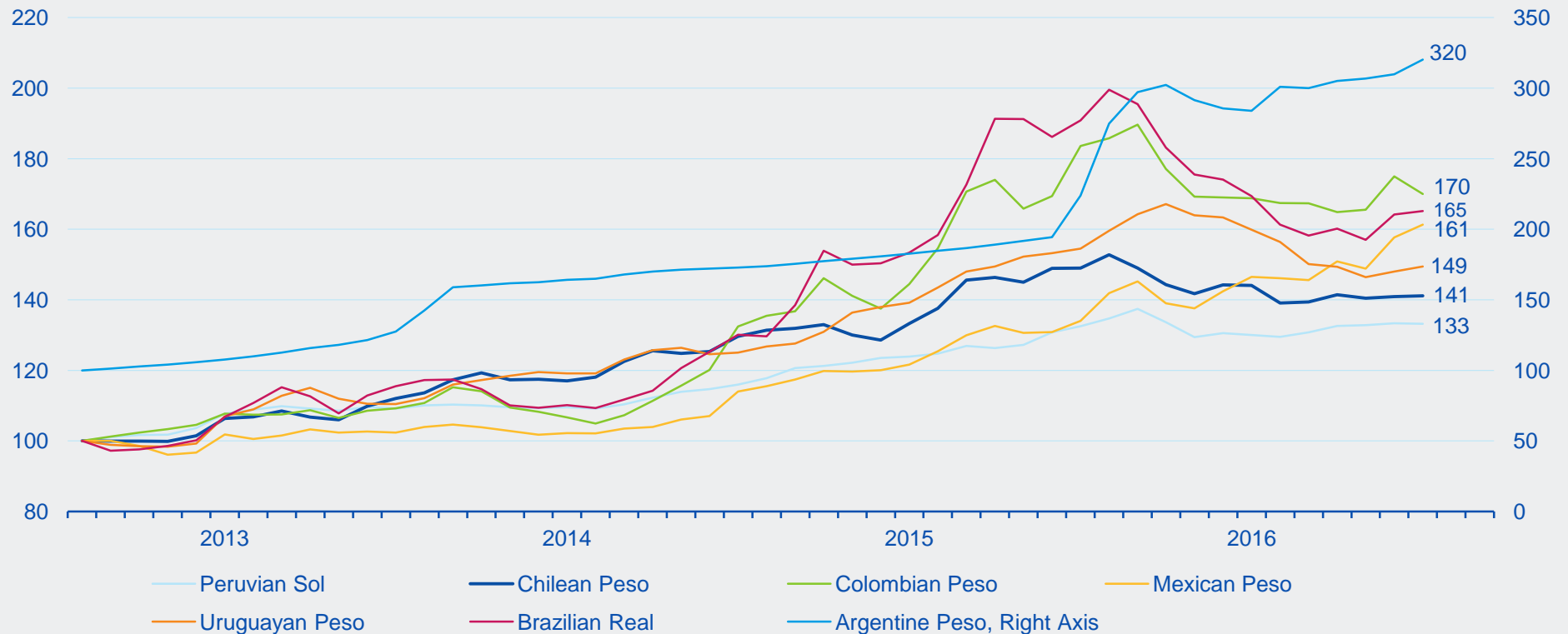
MONETARY POLICY RATE
(%)



CLP has depreciated in recent years, but less than other LatAm currencies

FOREIGN EXCHANGE PARITIES

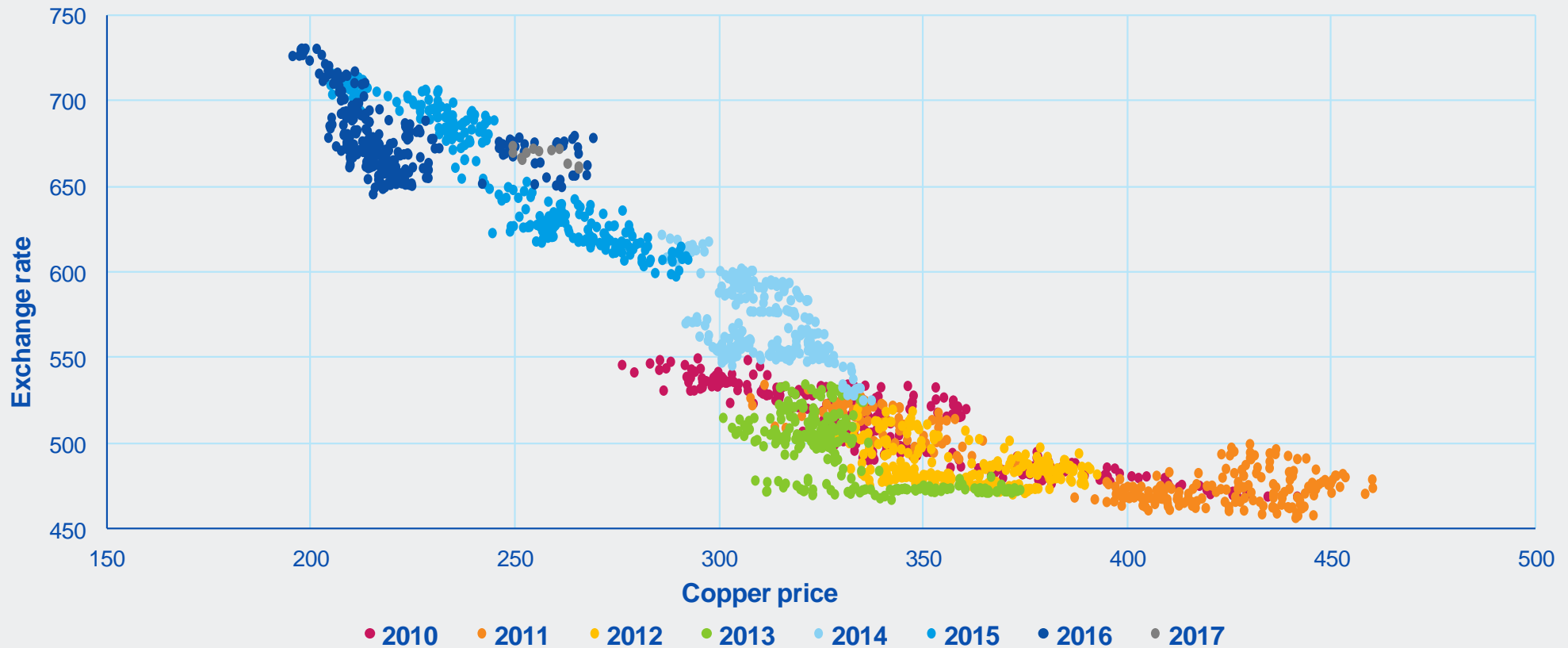
(currency/US dollar, index 2013=100)



Historical relationship between copper price and exchange rate

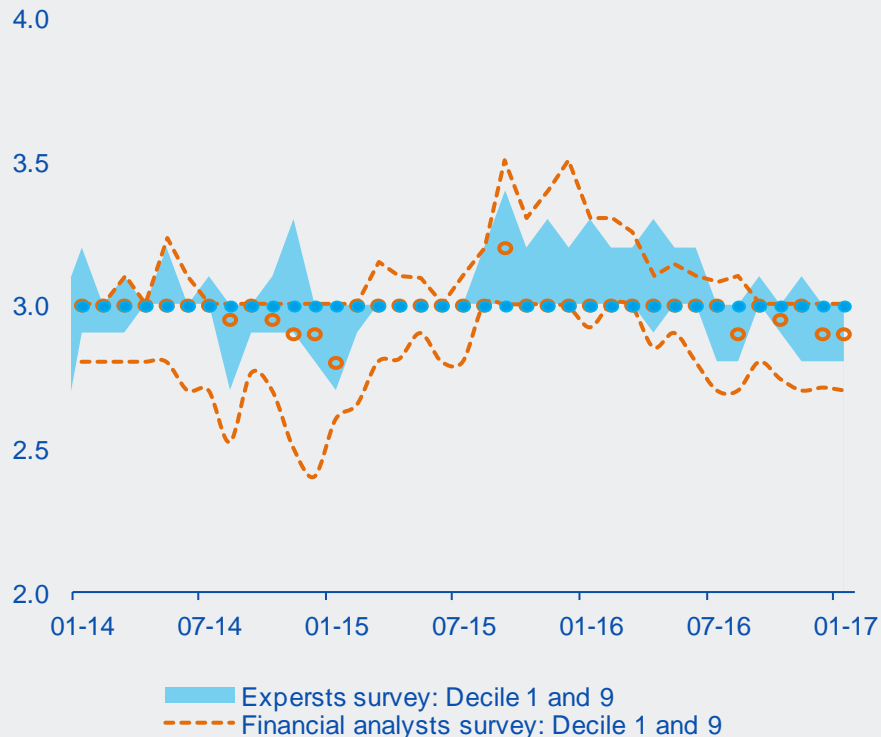
COPPER PRICE AND NOMINAL EXCHANGE RATE

(\$/US\$, US\$/Pound, period 2010-2017)

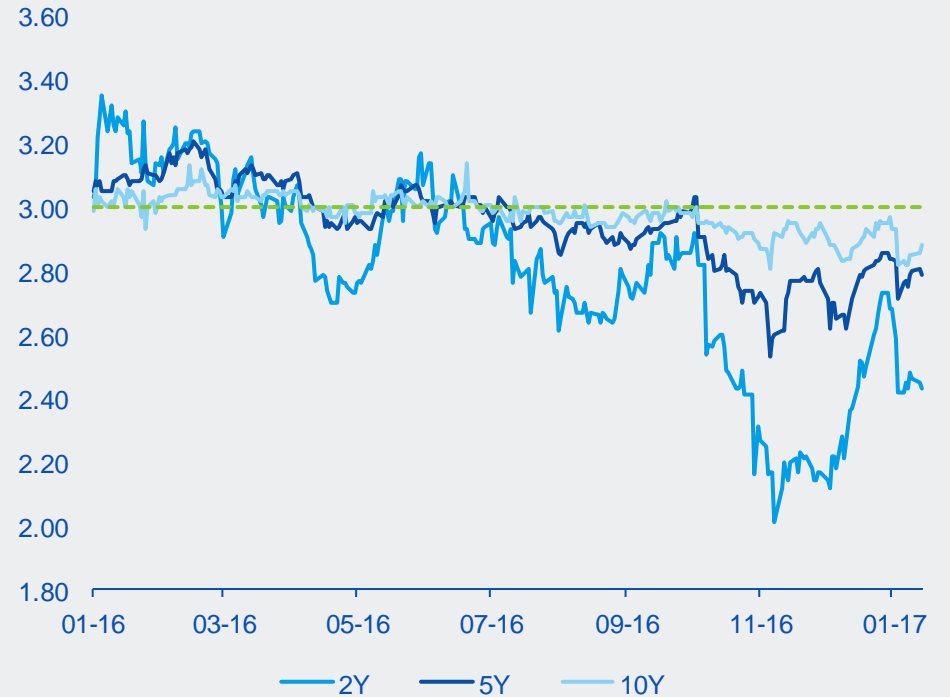


Inflation expectations are below the 3% target

INFLATION EXPECTATIONS: SURVEYS
(YOY, %)



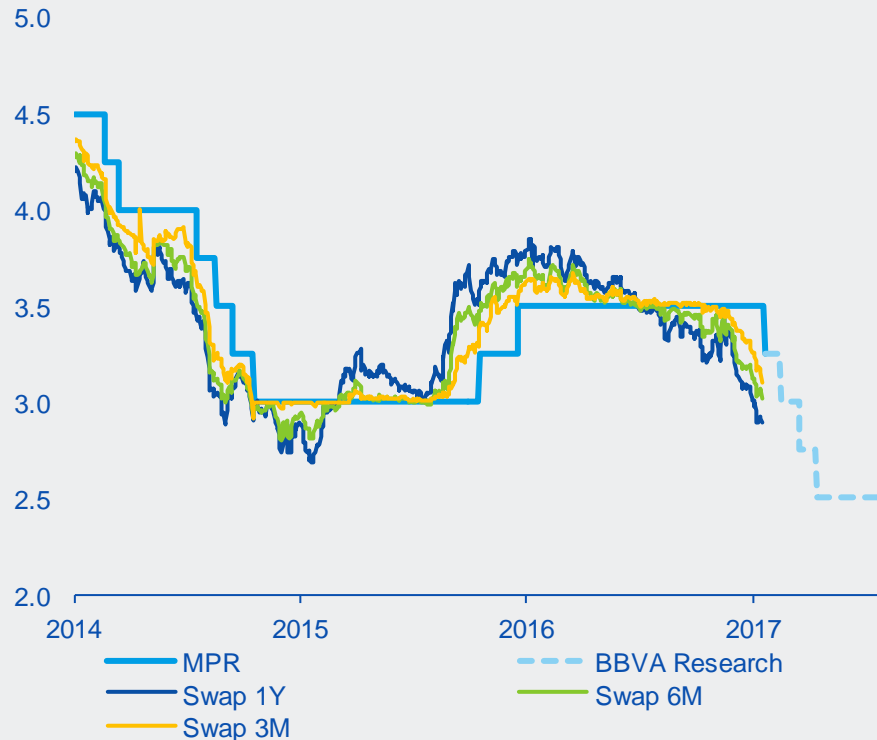
BREAKEVEN INFLATION RATE
(YOY, %)



Markets expect up to four 25 basis points cuts of the Monetary Policy Rate (MPR) during 2017

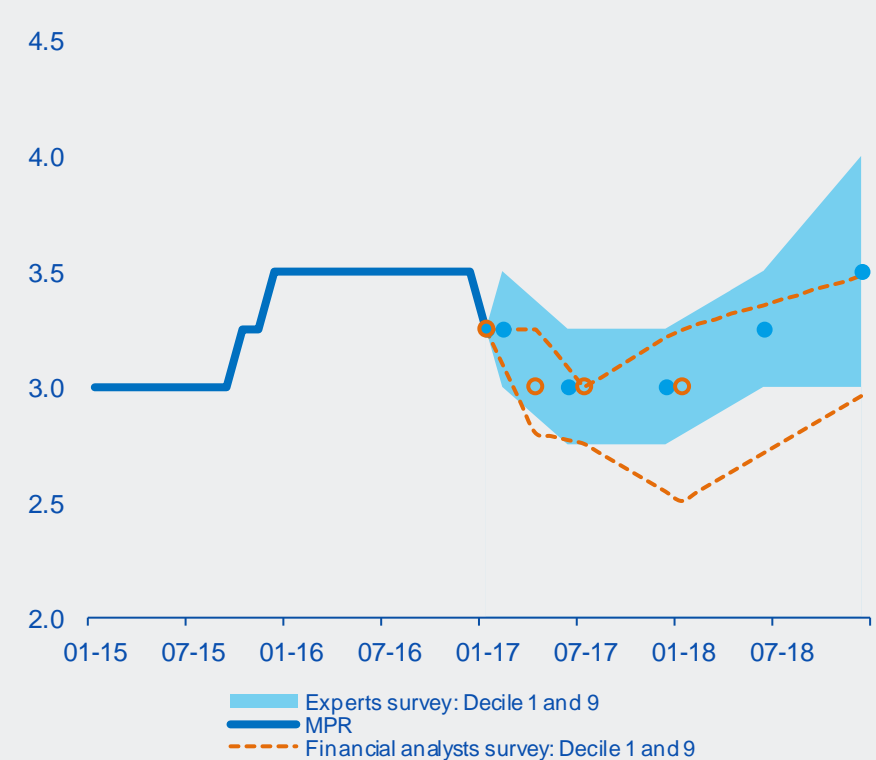
MPR AND SWAP RATES

(Percentage)



MPR EXPECTATIONS

(Porcentaje)



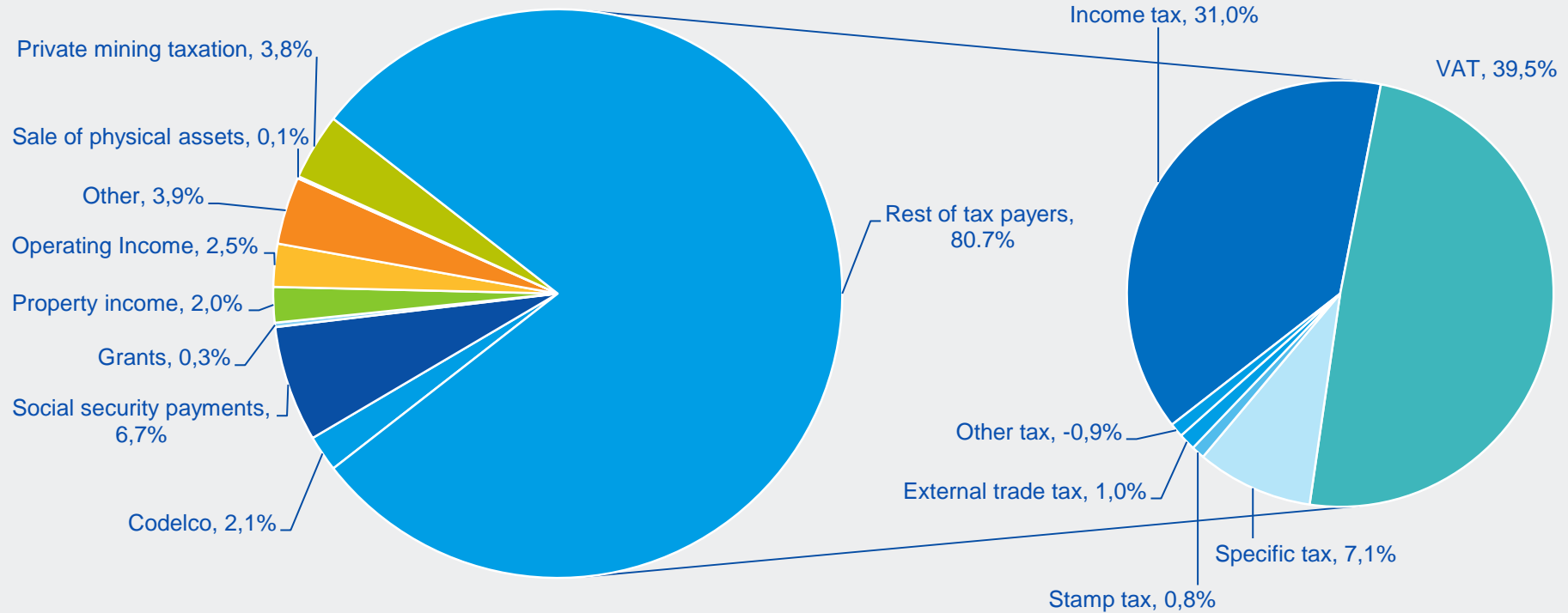
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6. *Fiscal Sector*



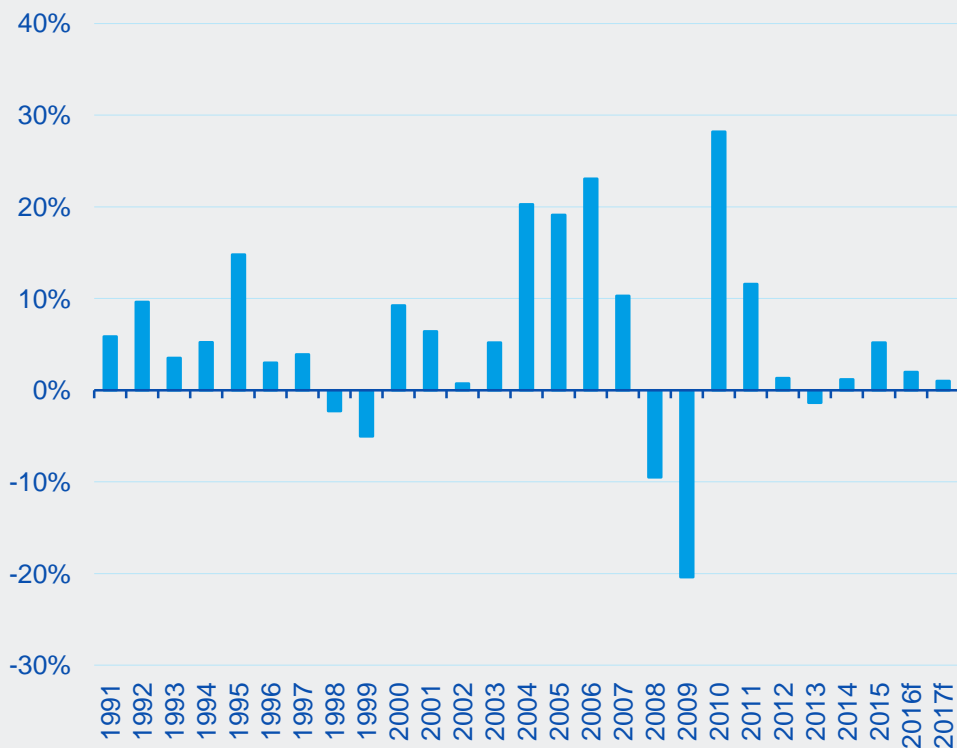
Income tax and VAT account for most of fiscal revenues

GOVERNMENT REVENUES (% of total, 2015)

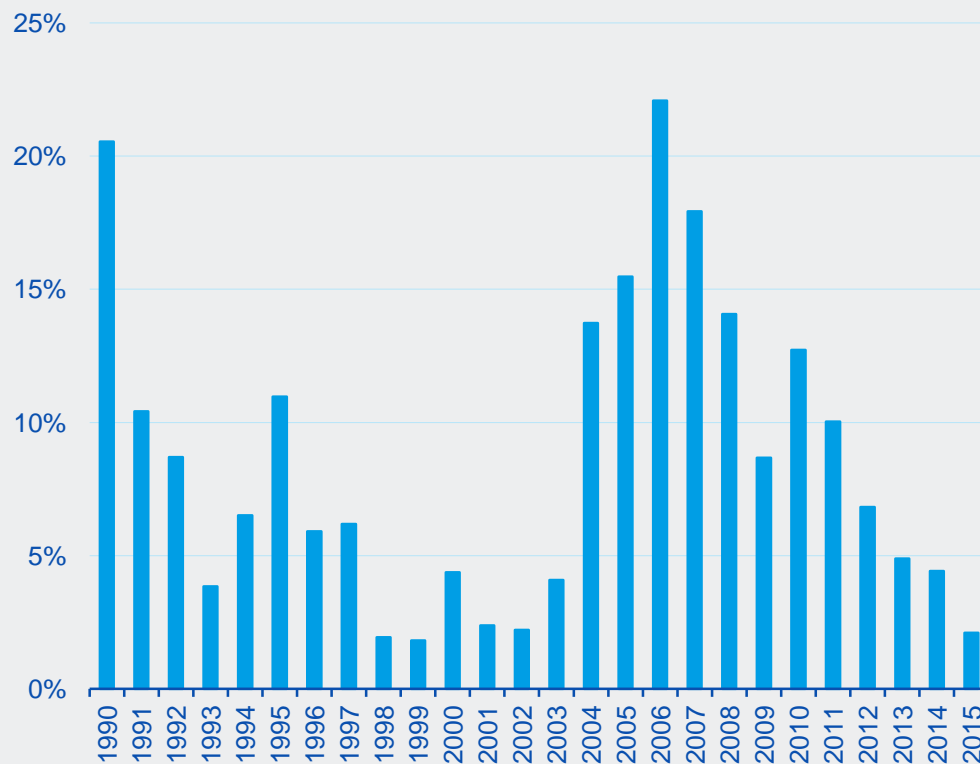


Government revenues affected by copper-related industries and companies

GOVERNMENT REVENUES
(%, change, constant currency 2015)

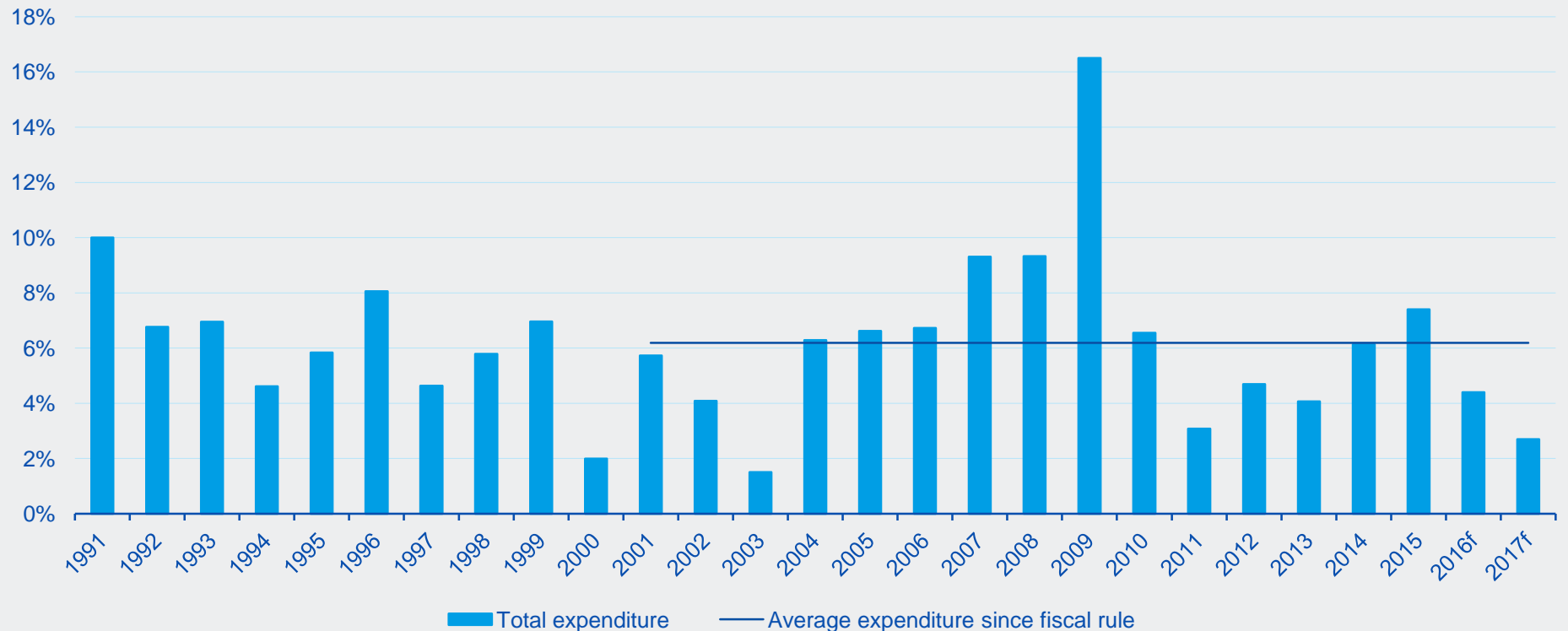


CODELCO
(% of total, constant currency 2015)



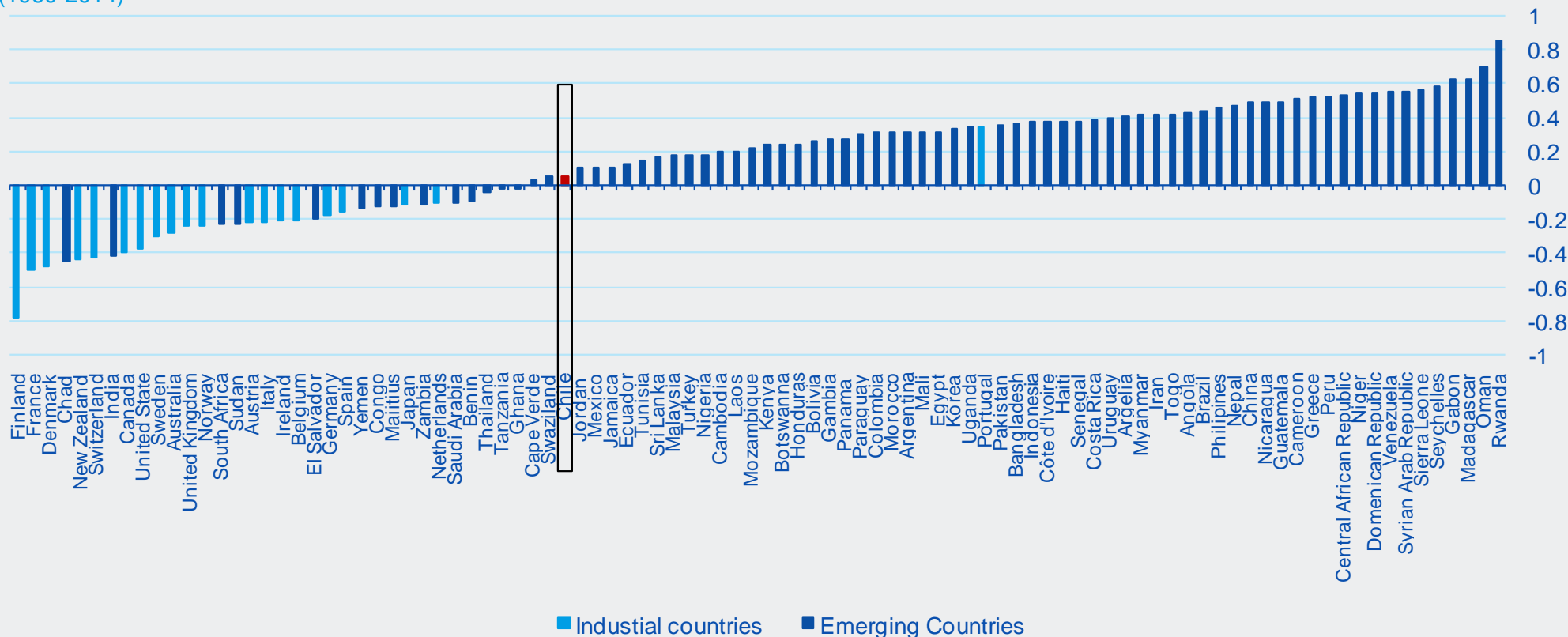
Avoiding pro-cyclicality: fiscal expenditure has increased 6% on average since the inception of the fiscal rule

GOVERNMENT EXPENDITURE
(%, change, constant currency 2015)



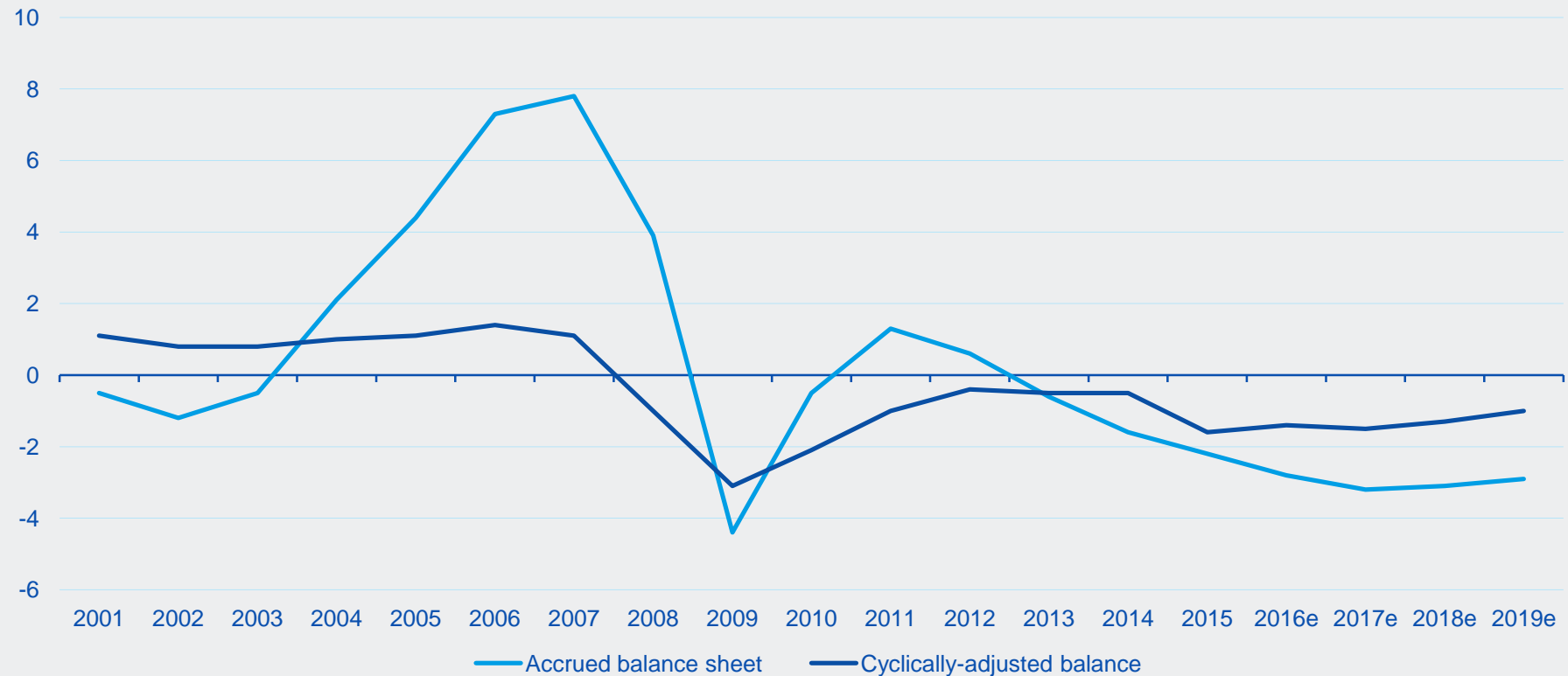
Showing a relatively low pro-cyclicality of fiscal expenditures

COUNTRY CORRELATIONS BETWEEN CYCLICAL COMPONENTS OF REAL FISCAL SPENDING AND GDP GROWTH (1960-2014)



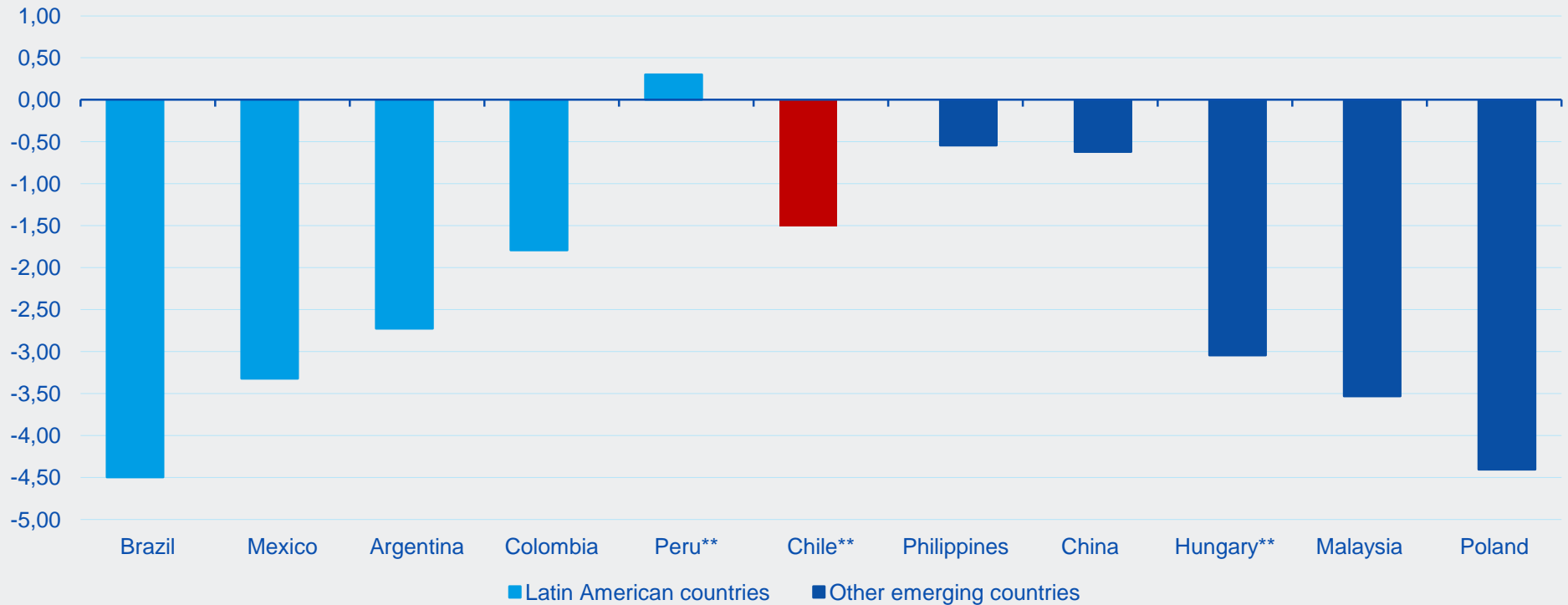
Fiscal stance remains supportive, while the convergence to a structural balance has been quite slow

FISCAL BALANCE
(% of GDP)



Although fiscal structural deficit averaged 1.5% of GDP since 2007 ...

CYCLICALLY ADJUSTED BALANCE
(% of potential GDP, average 2007-2015)

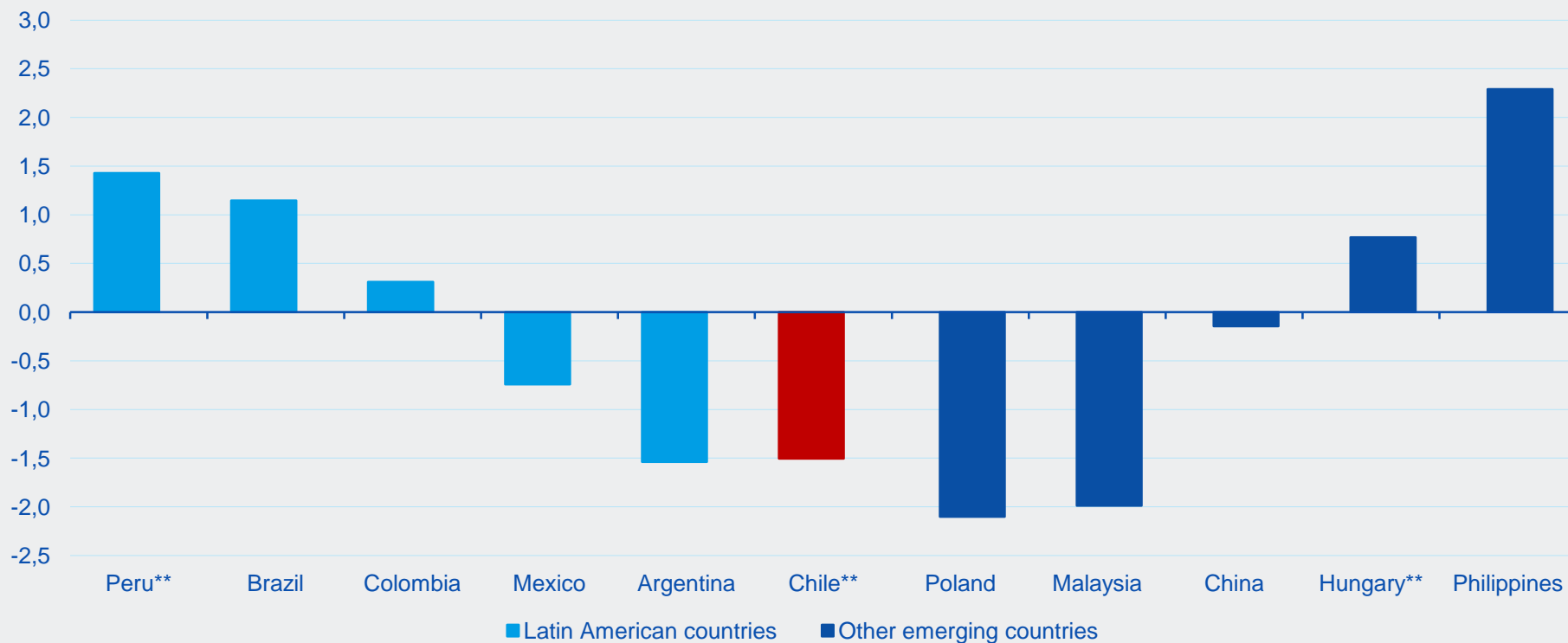


Source: International Monetary Fund, Fiscal Monitor

** The data for these countries include adjustments beyond the output cycle

... the primary balance figure does not show sustainability risks

CYCLICALLY ADJUSTED PRIMARY BALANCE
(% of potential GDP, average 2007-2015)

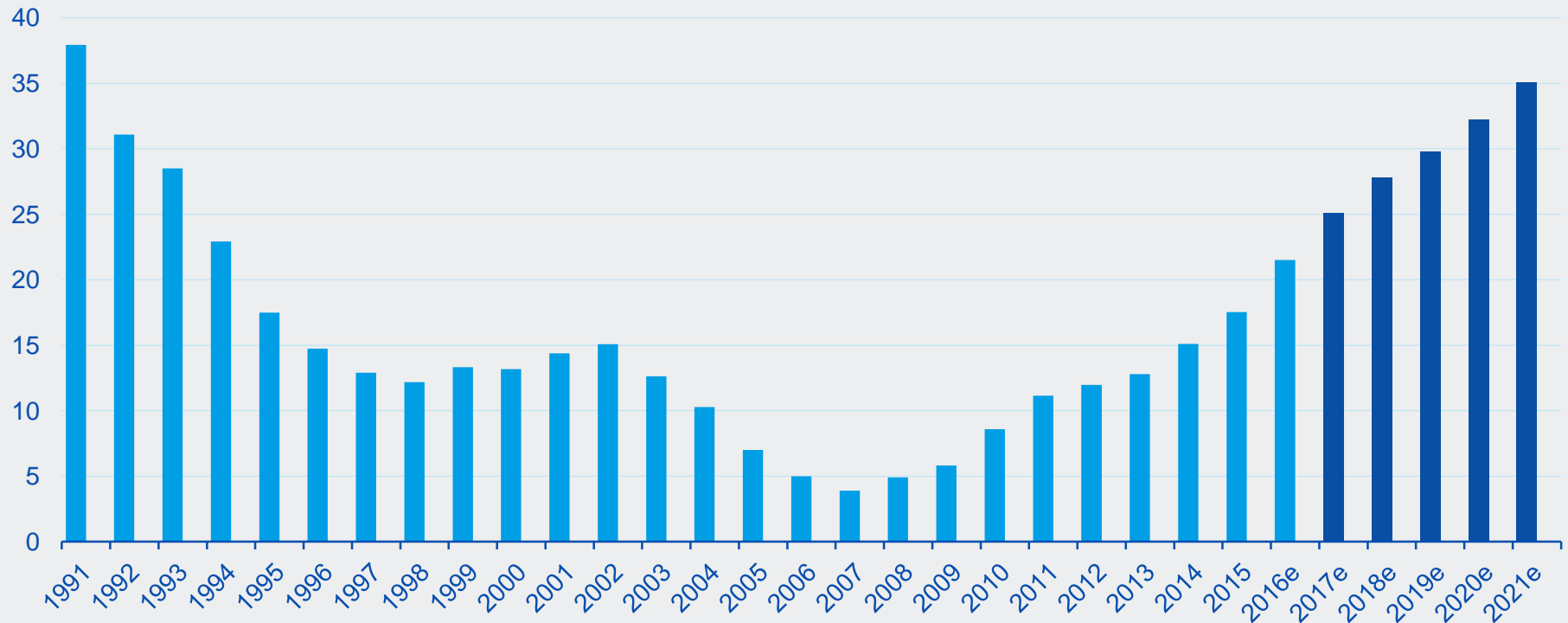


Source: International Monetary Fund, Fiscal Monitor

** The data for these countries include adjustments beyond the output cycle

Gross debt has increased and it will continue growing in next years

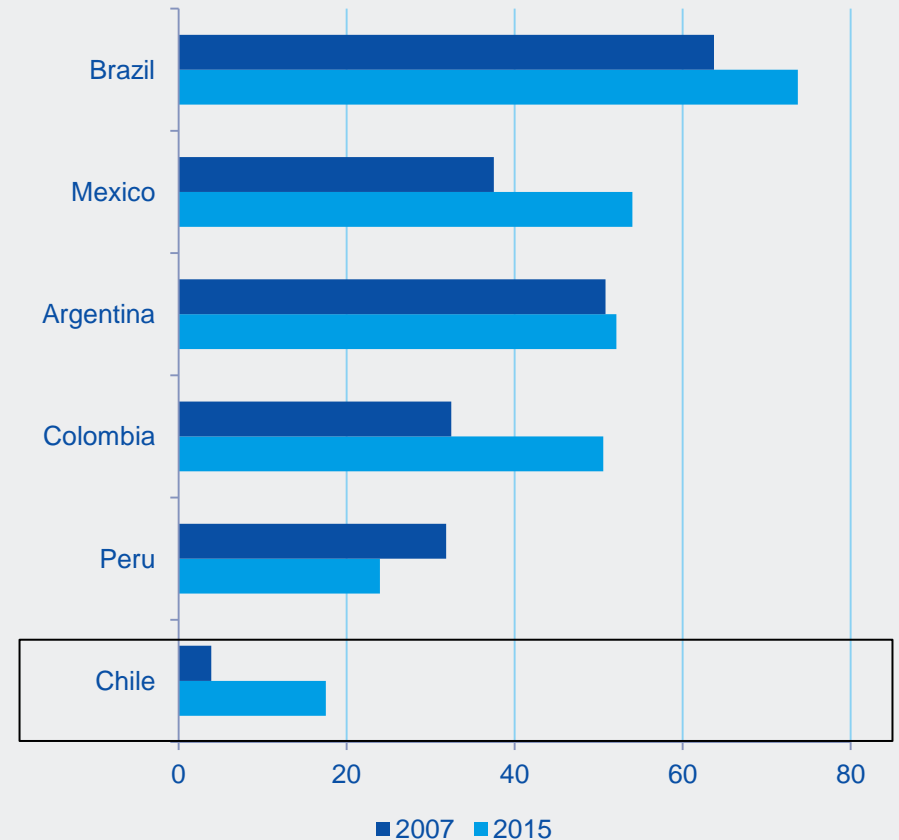
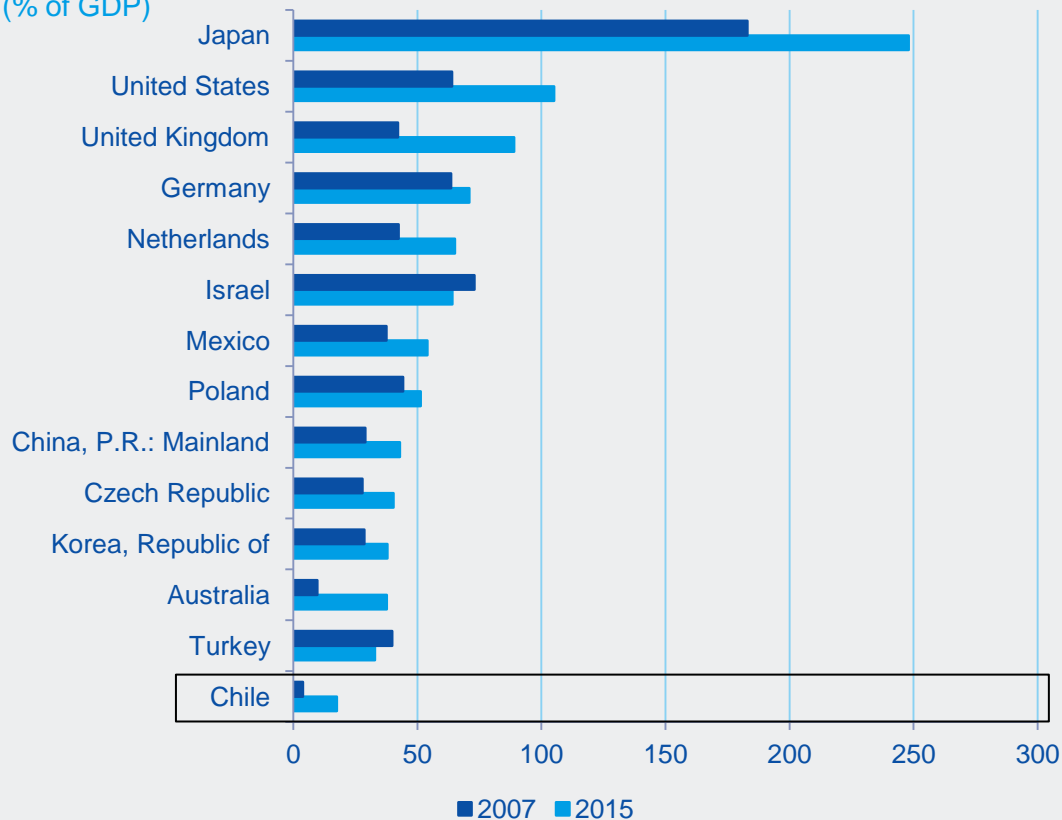
GROSS PUBLIC DEBT
(% of GDP)



Source: Ministry of Finance, BBVA Research

...but remains relatively low

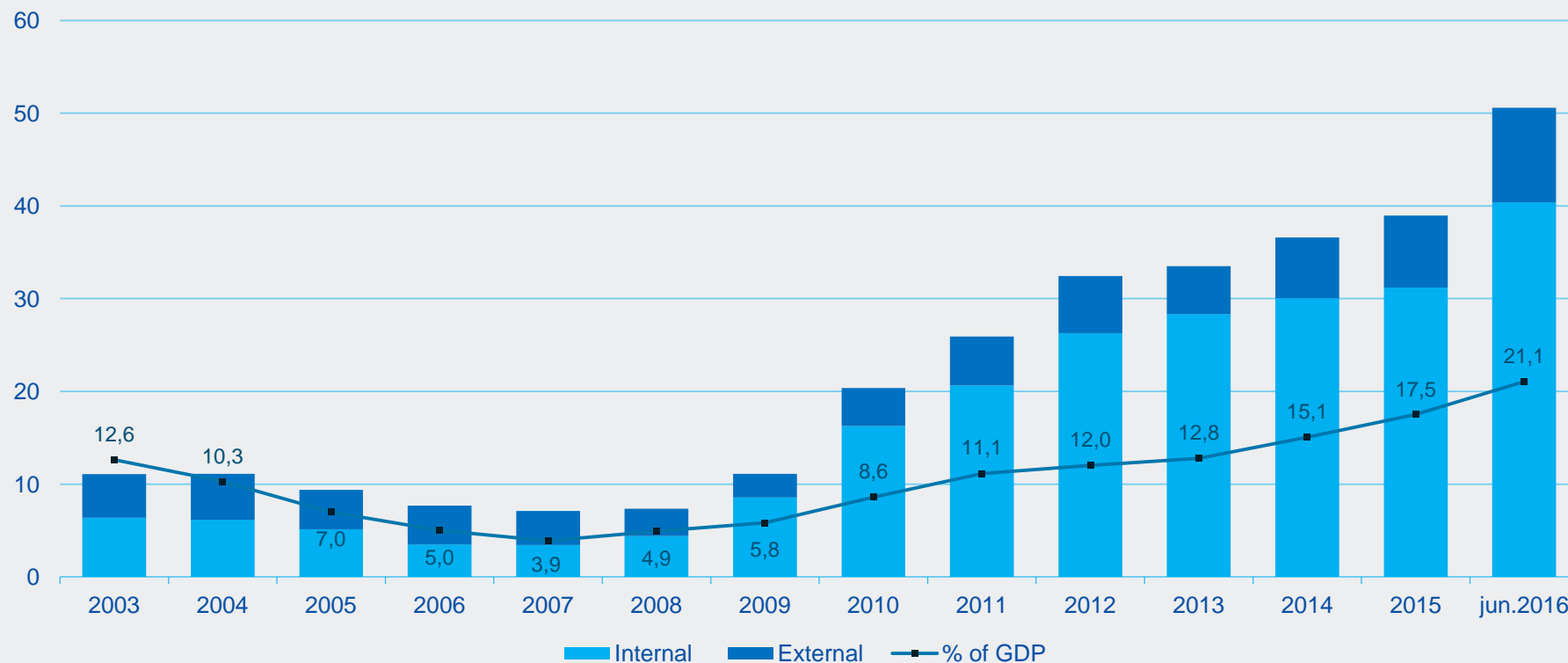
GROSS PUBLIC DEBT (% of GDP)



And it is mostly owned by local agents

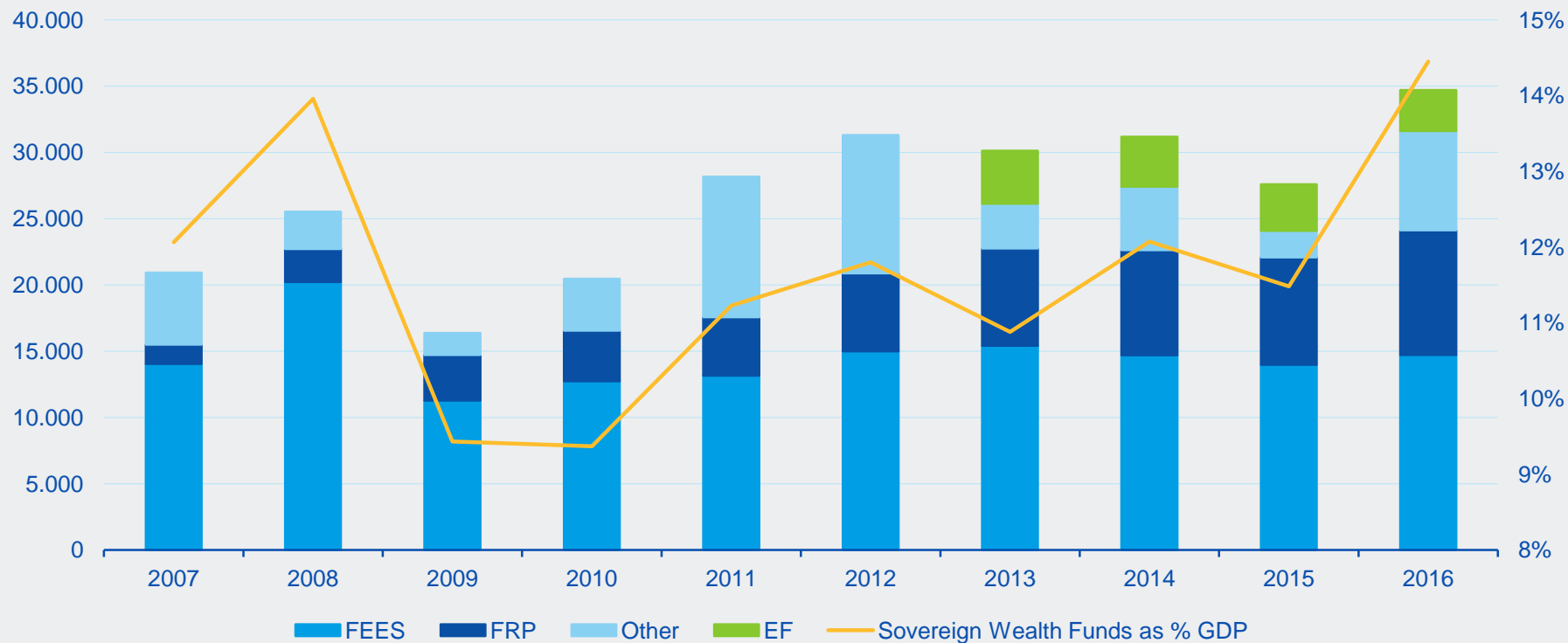
CENTRAL GOVERNMENT DEBT

(US\$ bn)



Additionally, Sovereign Wealth Funds account for almost 15% of GDP

SOVEREIGN WEALTH FUNDS*
(MM USD and % GDP)

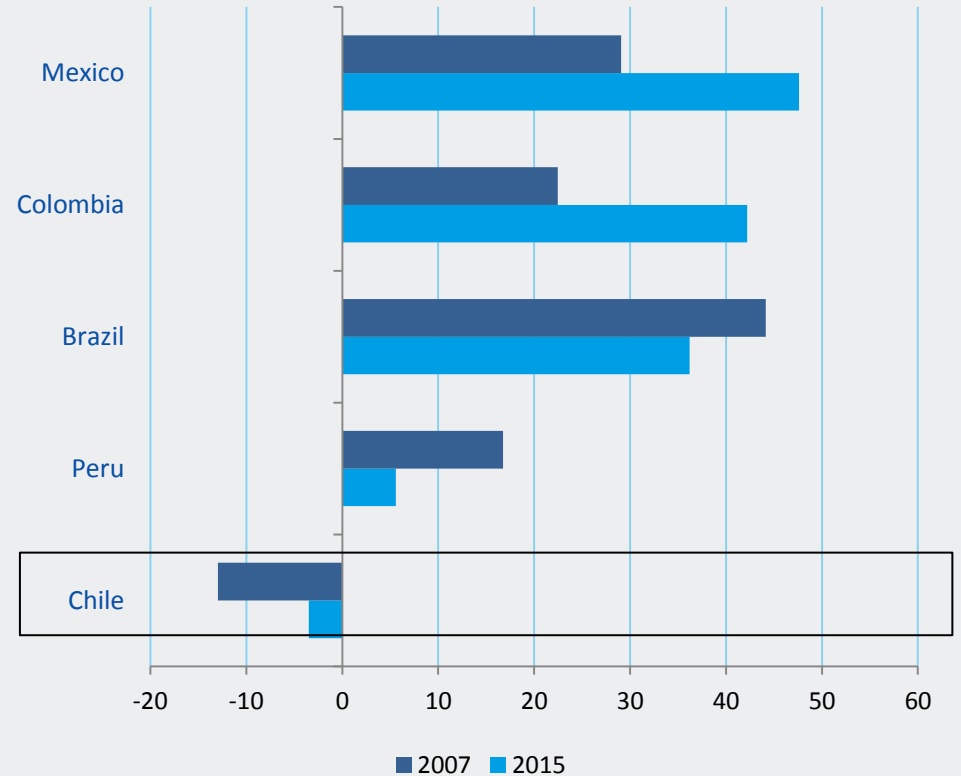
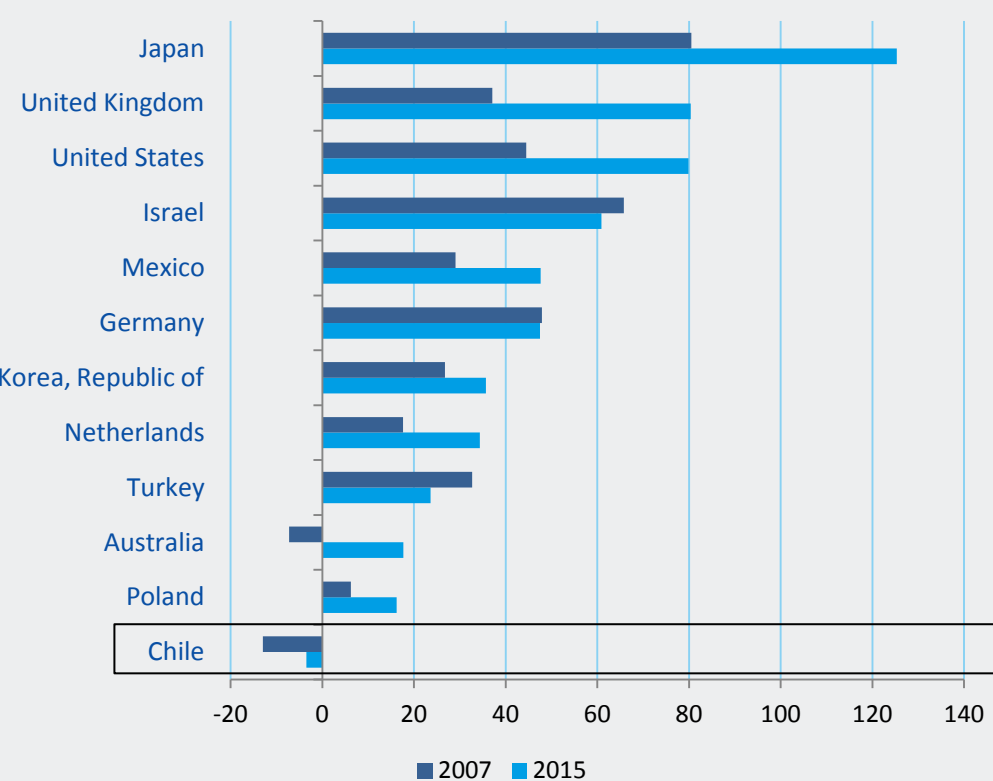


Source: Budget Office, BBVA Research

*FEES: Social and Economic Stabilization Fund; FRP: Pension Reserve Fund; EF: Educational Fund

Therefore, net debt remains negative...

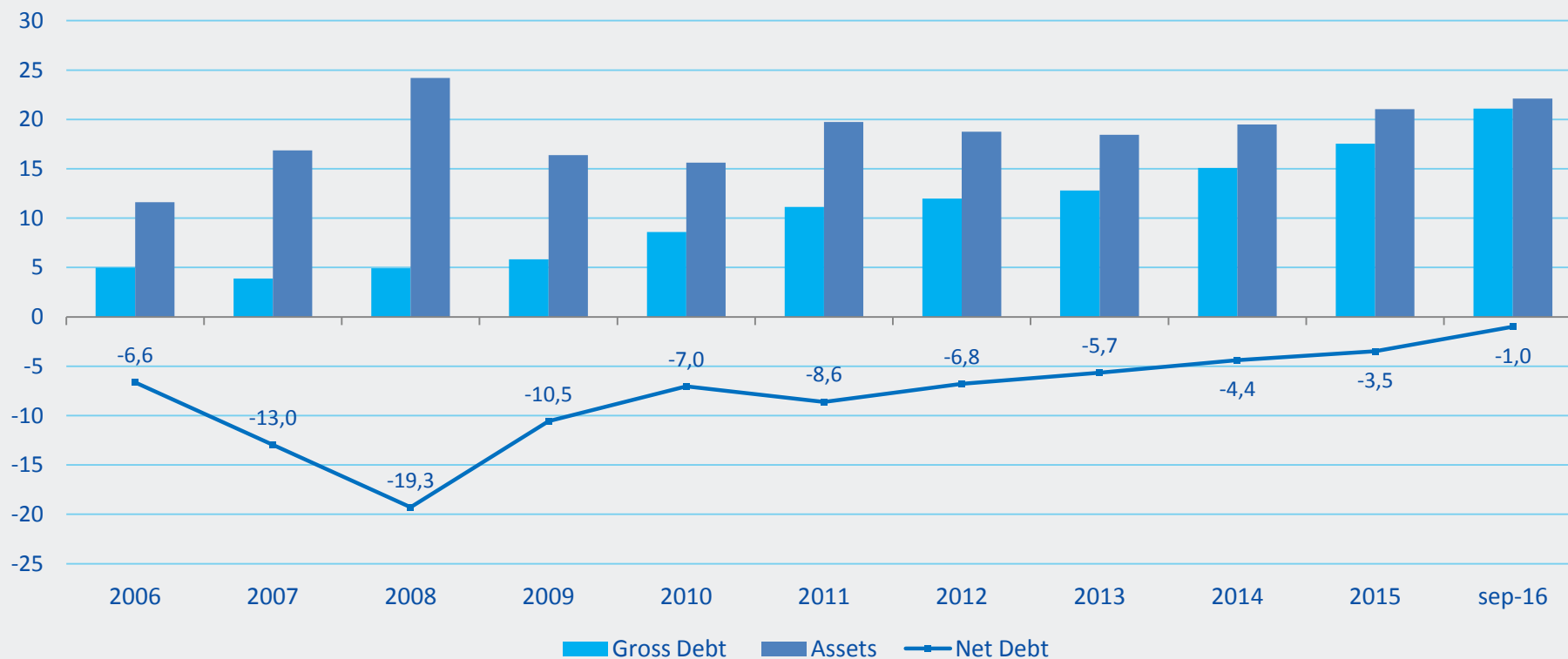
PUBLIC NET DEBT
(% GDP)



Source: International Monetary Fund

... and as a net creditor for the last decade

CENTRAL GOVERNMENT DEBT AND ASSETS*
(% of GDP)

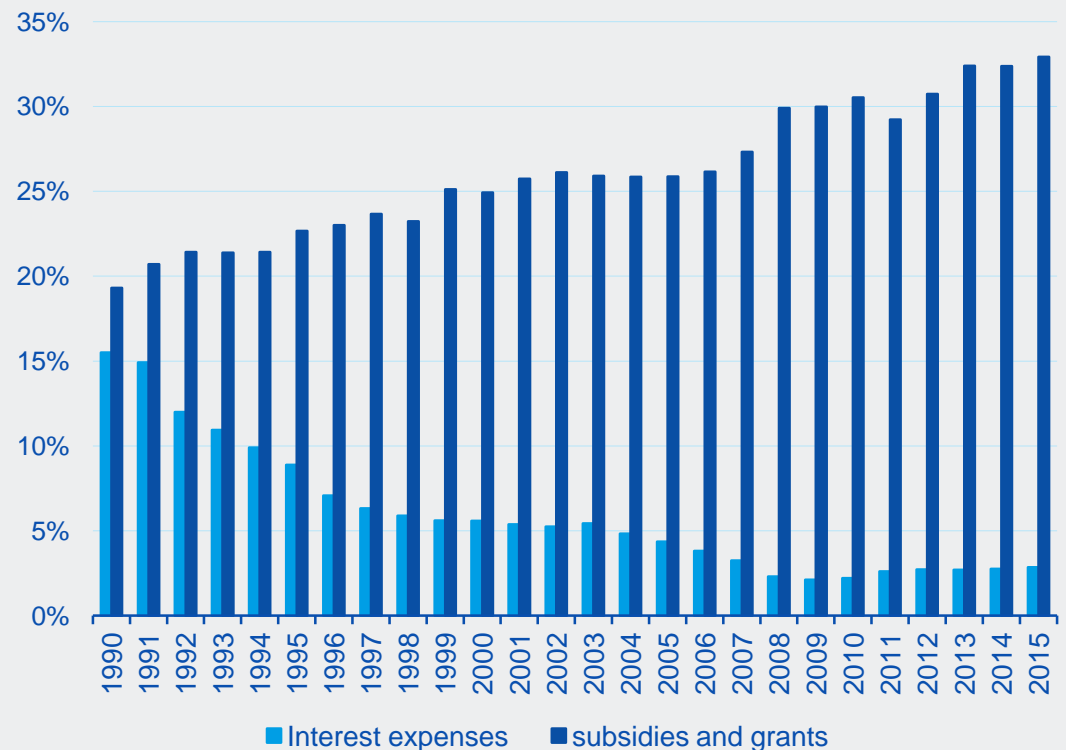
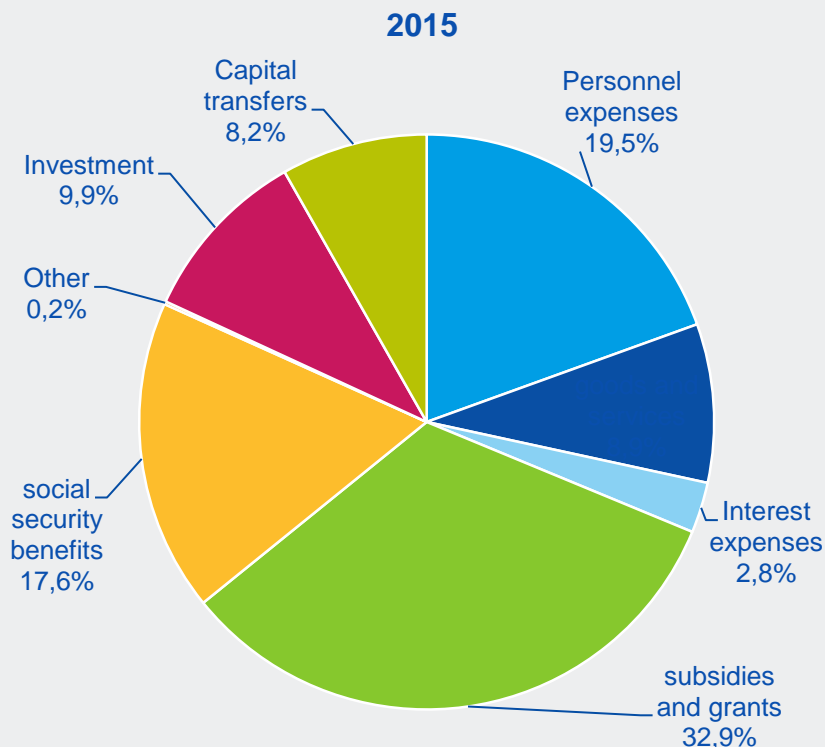


*Source: Ministry of Finance

*Assets include Sovereign Wealth Funds, Other Public Assets, Cash of Central Government Institutions, State Participation in Public and Private Companies

Debt services have declined significantly, mainly due to lower borrowing costs

GOVERNMENT EXPENDITURES
(% of total, constant currency 2015)



Source: Budget Office

FUNDAMENTALS CHILE

7. *Financial System*



Assets under management (AUM) by institutions

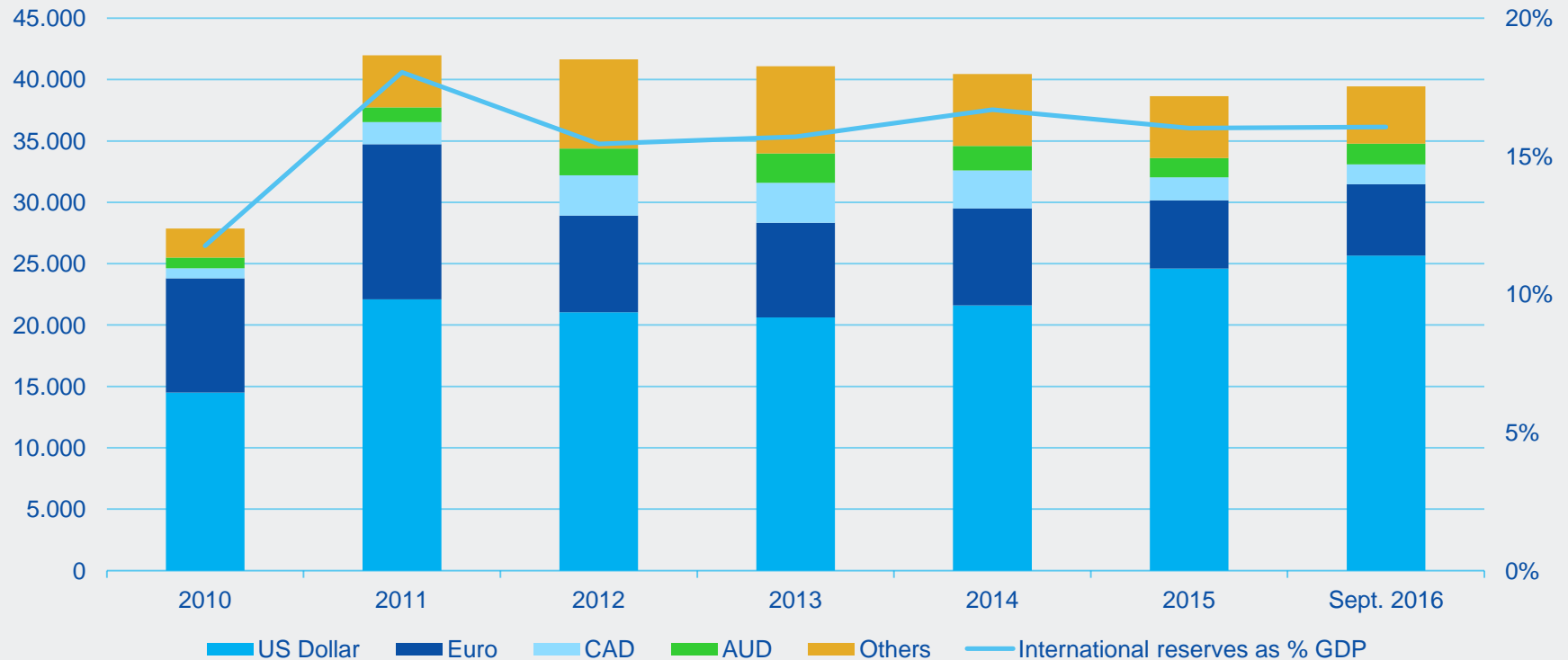
2016	Assets (million USD)	Assets as % of GDP
Institutional Investors	268.069,1	109%
Mutual Funds	46.649	19,0%
Insurance Companies*	46.328	19,2%
Pension Funds (AFP)	175.092	71,3%
Sovereign Wealth Fund	34.701,7	14%
FEES	14.721	6,0%
FRP	9.403	3,8%
Other	7.479	3,0%
EF	3.098	1,3%
Central Bank International Reserves	39.436,6	16%
US dollar	25.663	10,5%
EURO	5.812	2,4%
CAD	1.619	0,7%
AUD	1.687	0,7%
Other	4.656	1,9%

Sources: Mutual Funds association, Central Bank of Chile, Budget Office, Pension Supervisor, Values and Insurance Supervisor

*2015

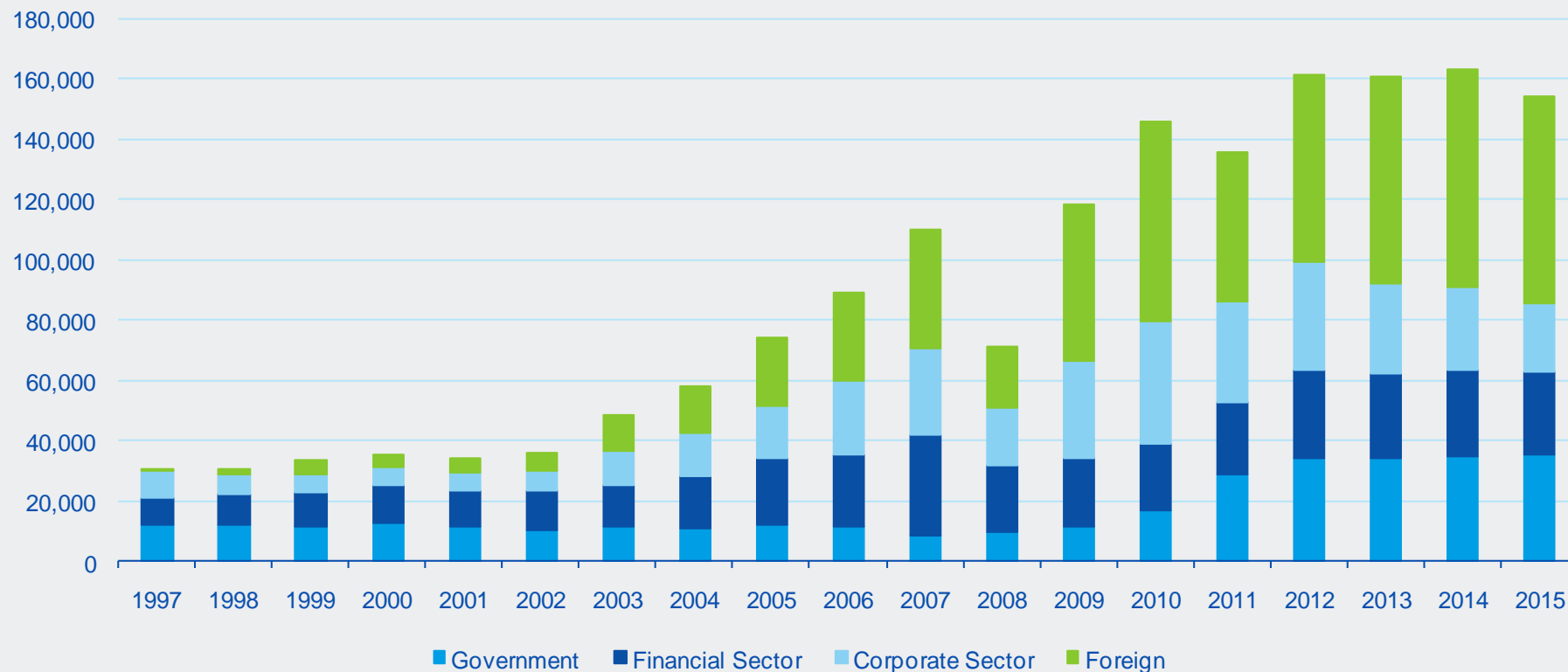
International Reserves without relevant changes in recent years

CENTRAL BANK INTERNATIONAL RESERVES
(million USD and %)



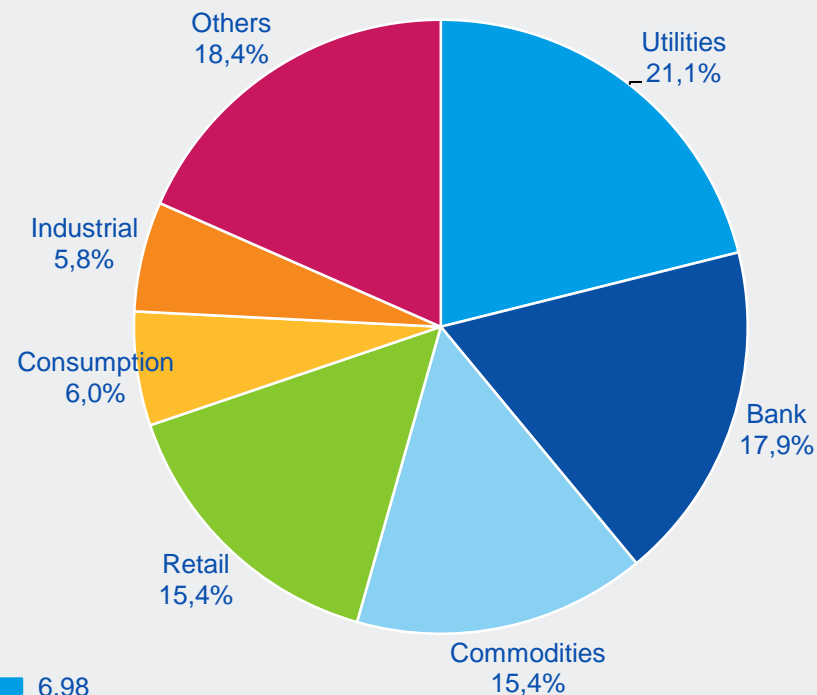
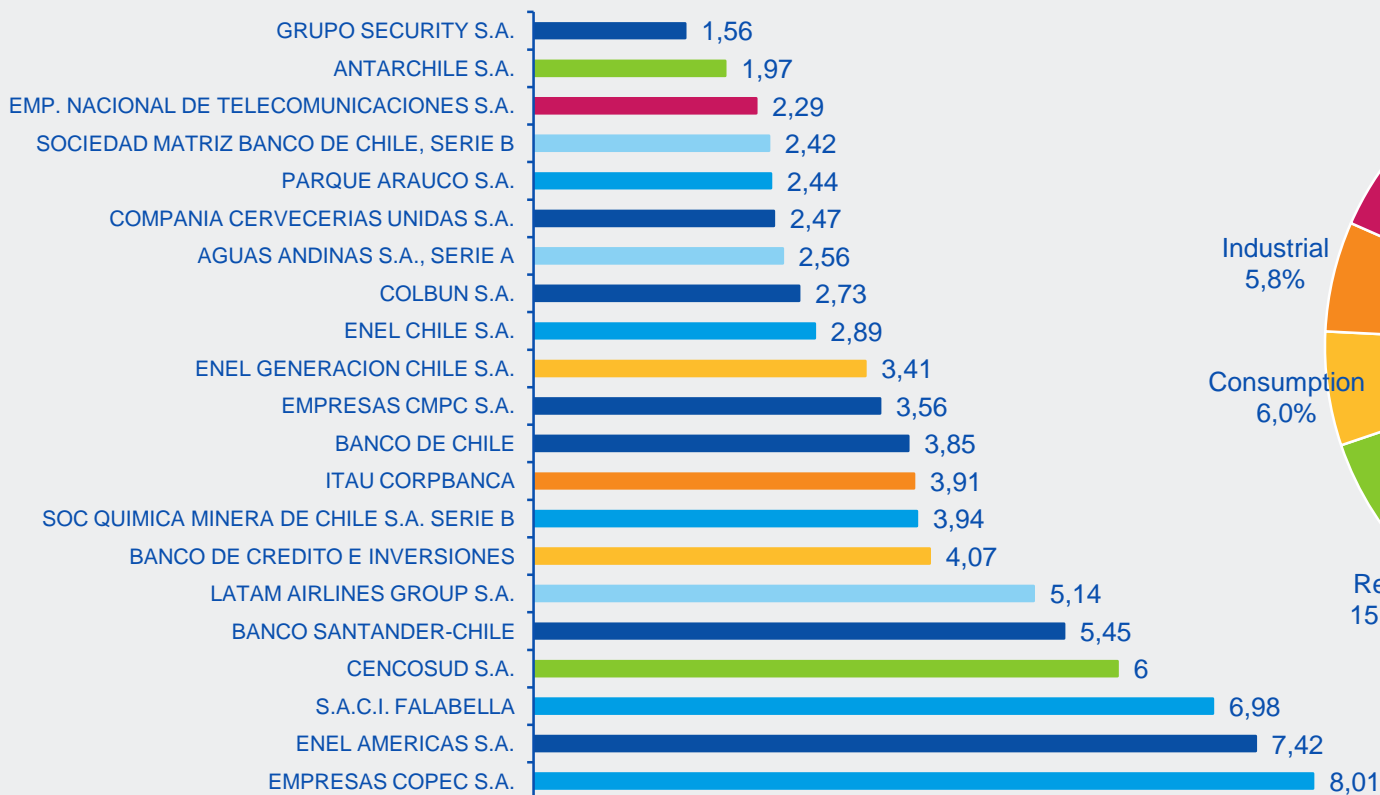
Domestic investment of pension funds has declined during recent years

PENSION FUNDS
(million USD)



Copper industry is under-represented in Chilean equity market (IPSA)

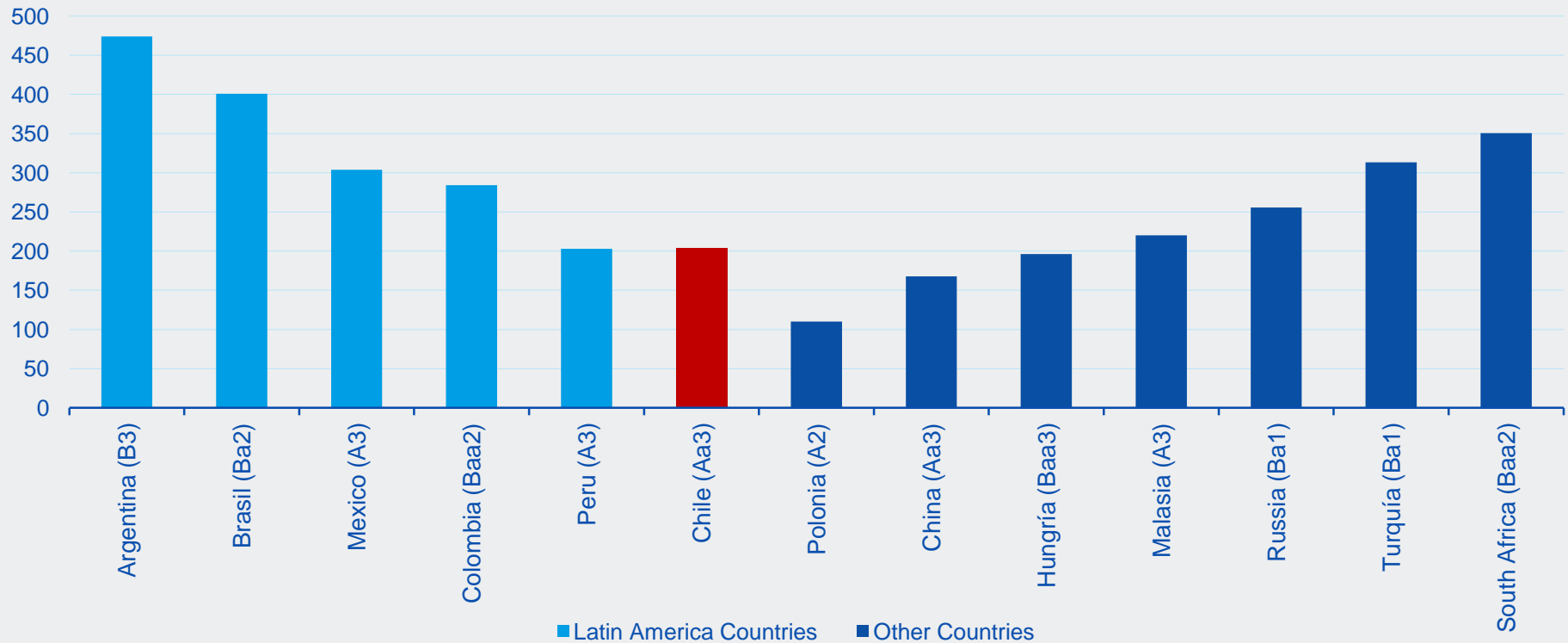
IPSA 2016 PARTICIPATION RATE



Low country risk relative to other emerging economies

COUNTRY RISK*

(Basis points EMBI, average 2016)



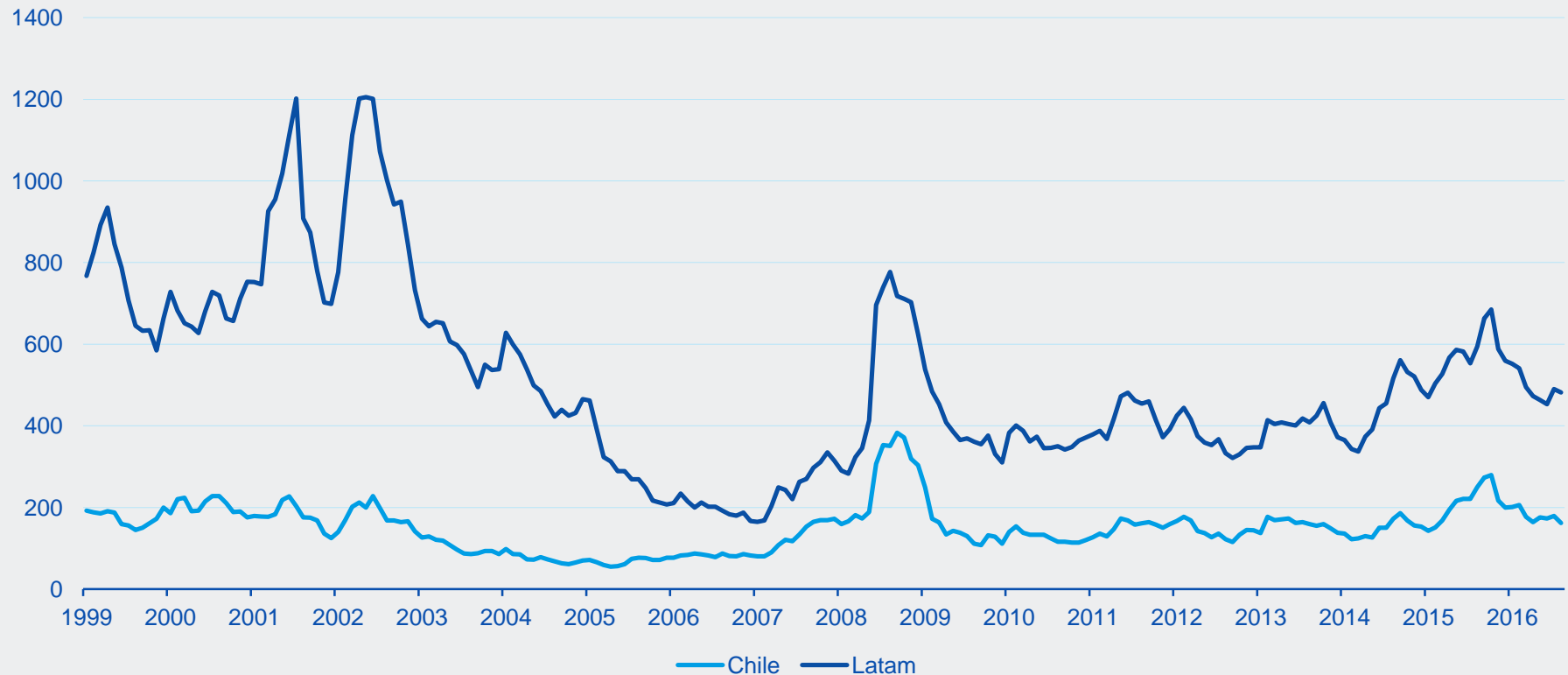
Source: JP Morgan Chase

*Risk classification by MOODY'S

...and also lower borrowing costs

SOVEREIGN SPREADS: GLOBAL EMBI SPREAD

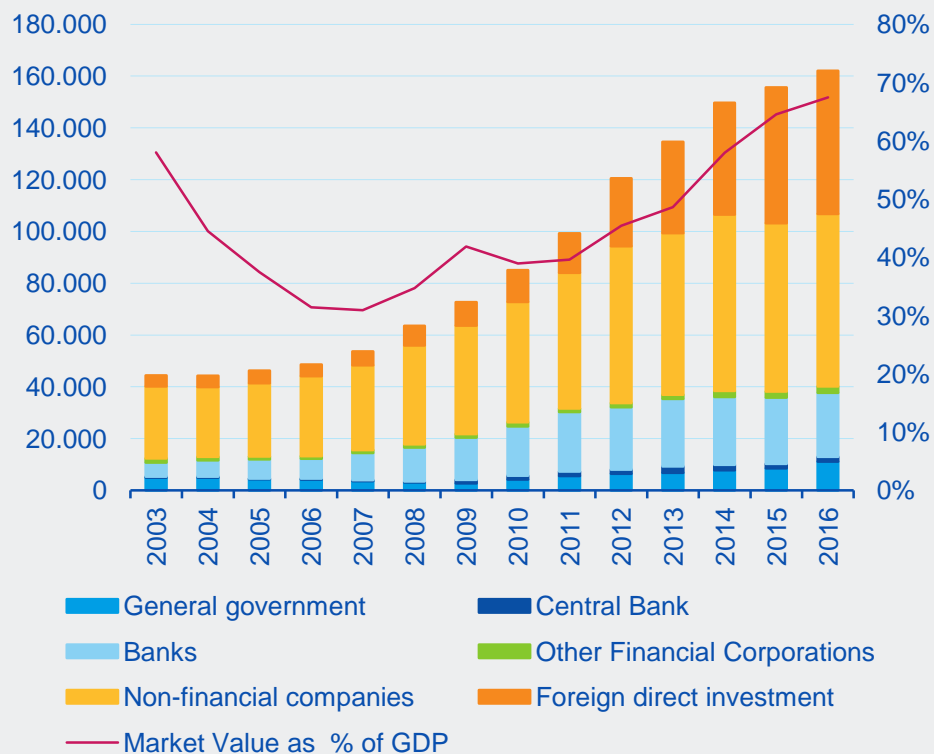
(averages, basis points)



Although, external debt has raised sharply

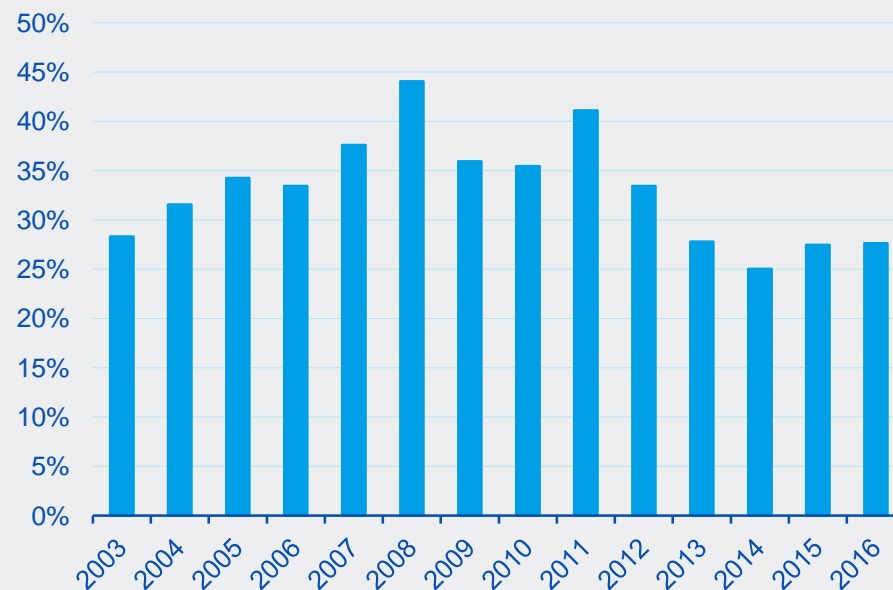
EXTERNAL DEBT AT MARKET VALUE

(millions of dollars and %)



GROSS EXTERNAL DEBT, SHORT TERM

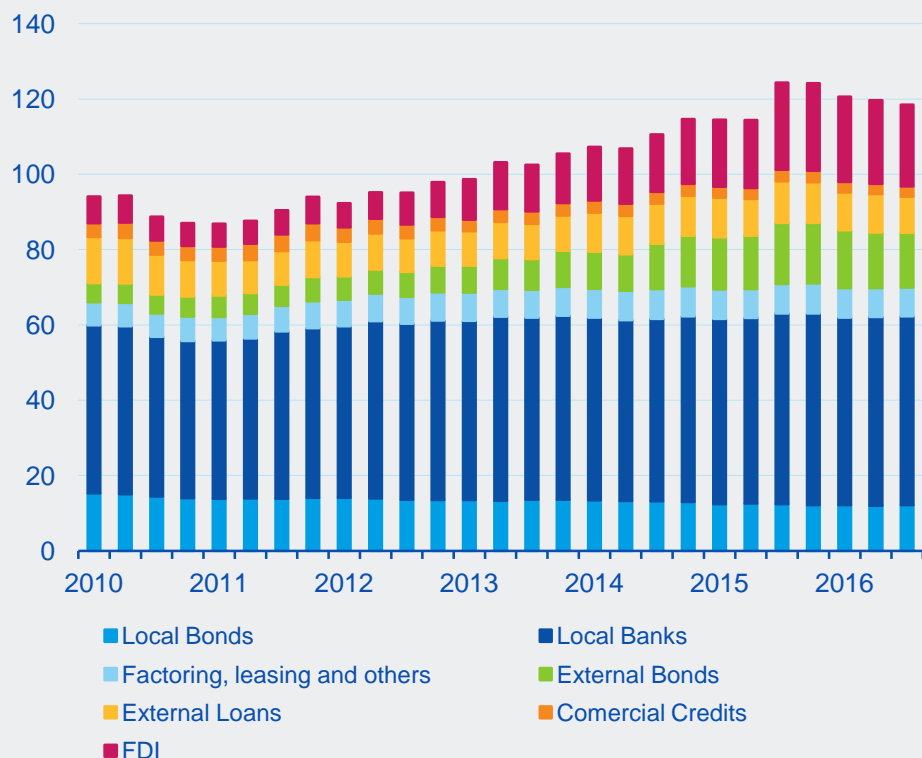
(% of External Debt)



And private sector debt has also increased

TOTAL DEBT OF NON-BANKING COMPANIES

(% of GDP)



HOUSEHOLD DEBT

(% of disposable income)



Source: Central Bank of Chile, Financial Stability Report, second half 2016.

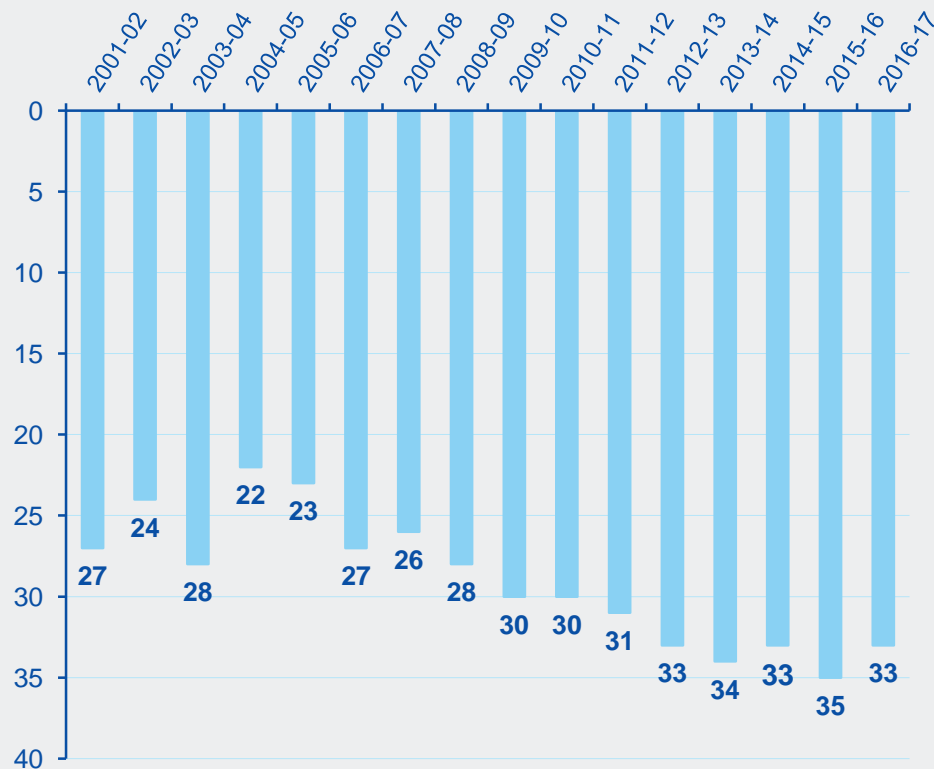
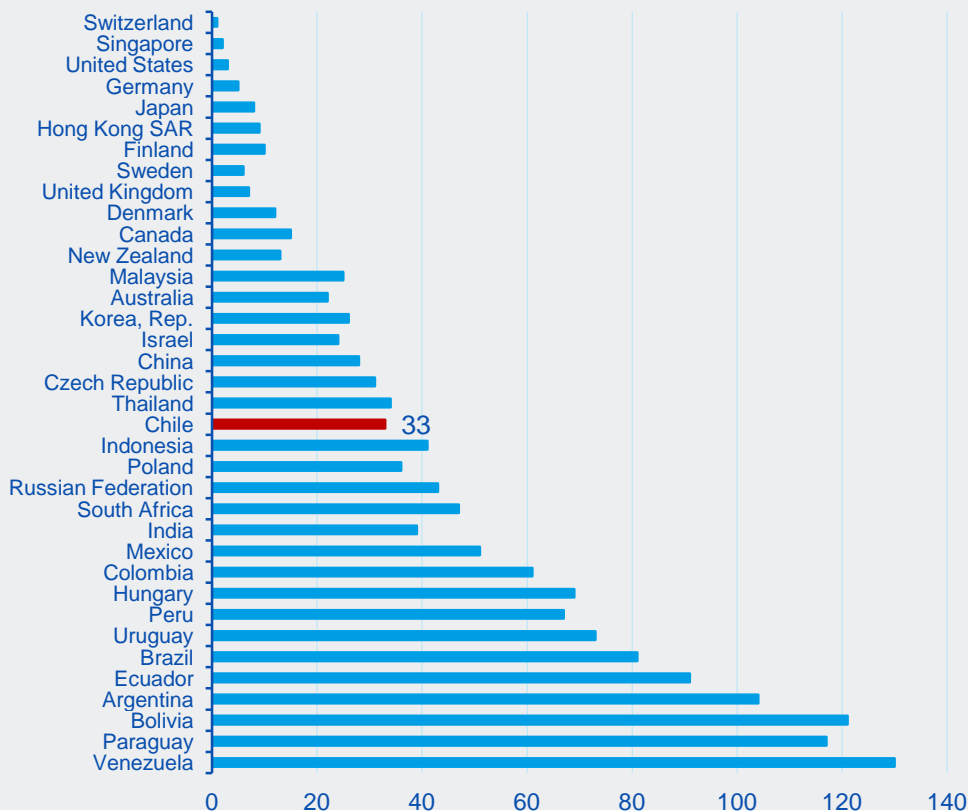
FUNDAMENTALS CHILE

8. Competitiveness, Politics and Other Indicators



High competitiveness but stagnant since 2007...

COMPETITIVENESS* (2016-17)

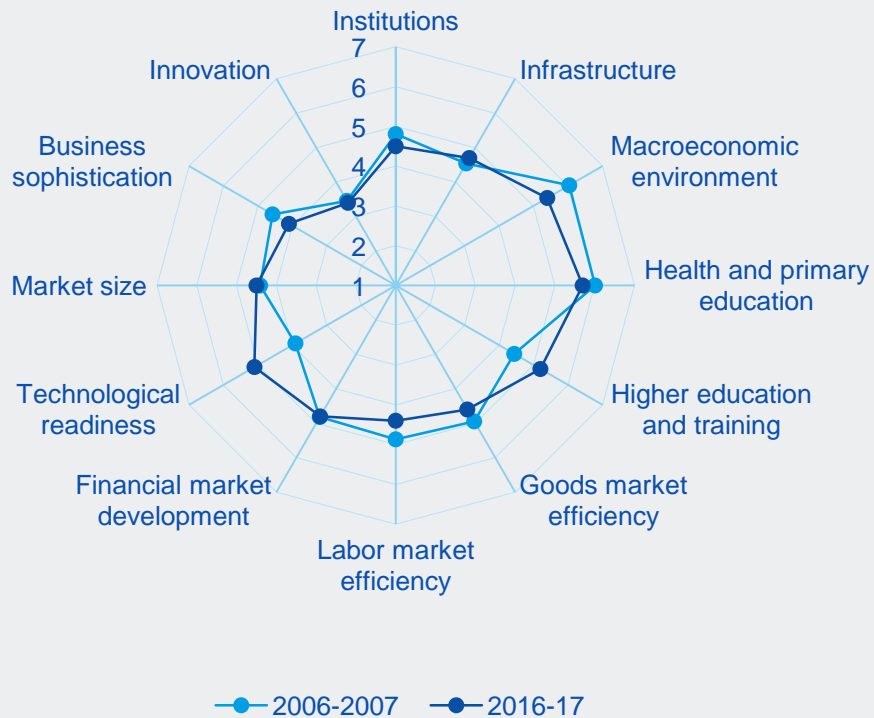


Source: World Economic Forum

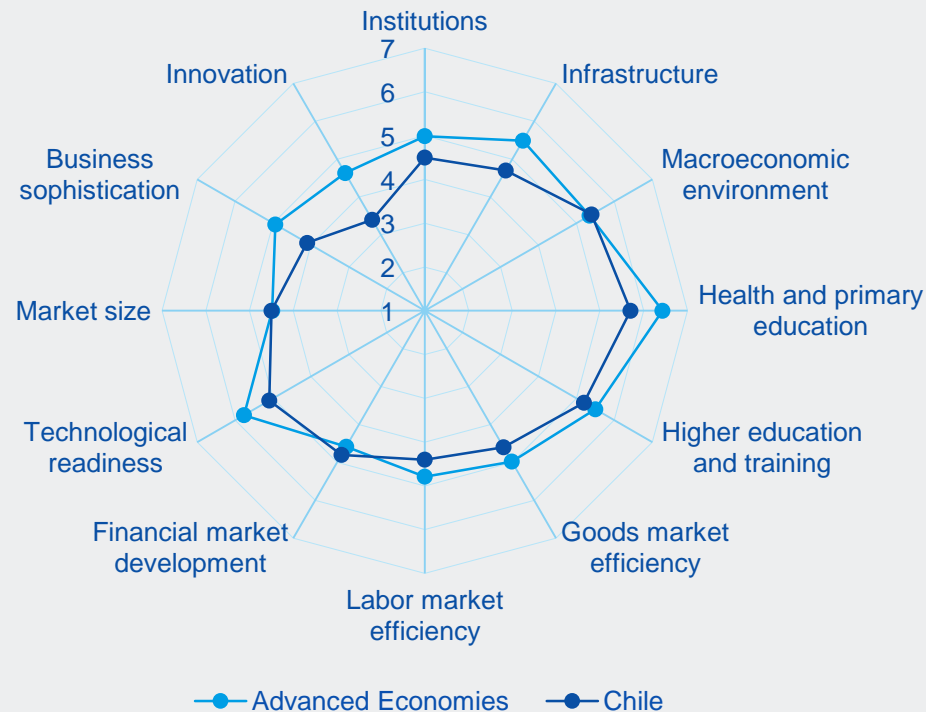
*The competitiveness index measures country's ability to achieve high and sustainable per capita GDP growth. The number beside each bar represents the place in the ranking.

...because of lack in innovation

COMPETITIVENESS INDEX, CHILE



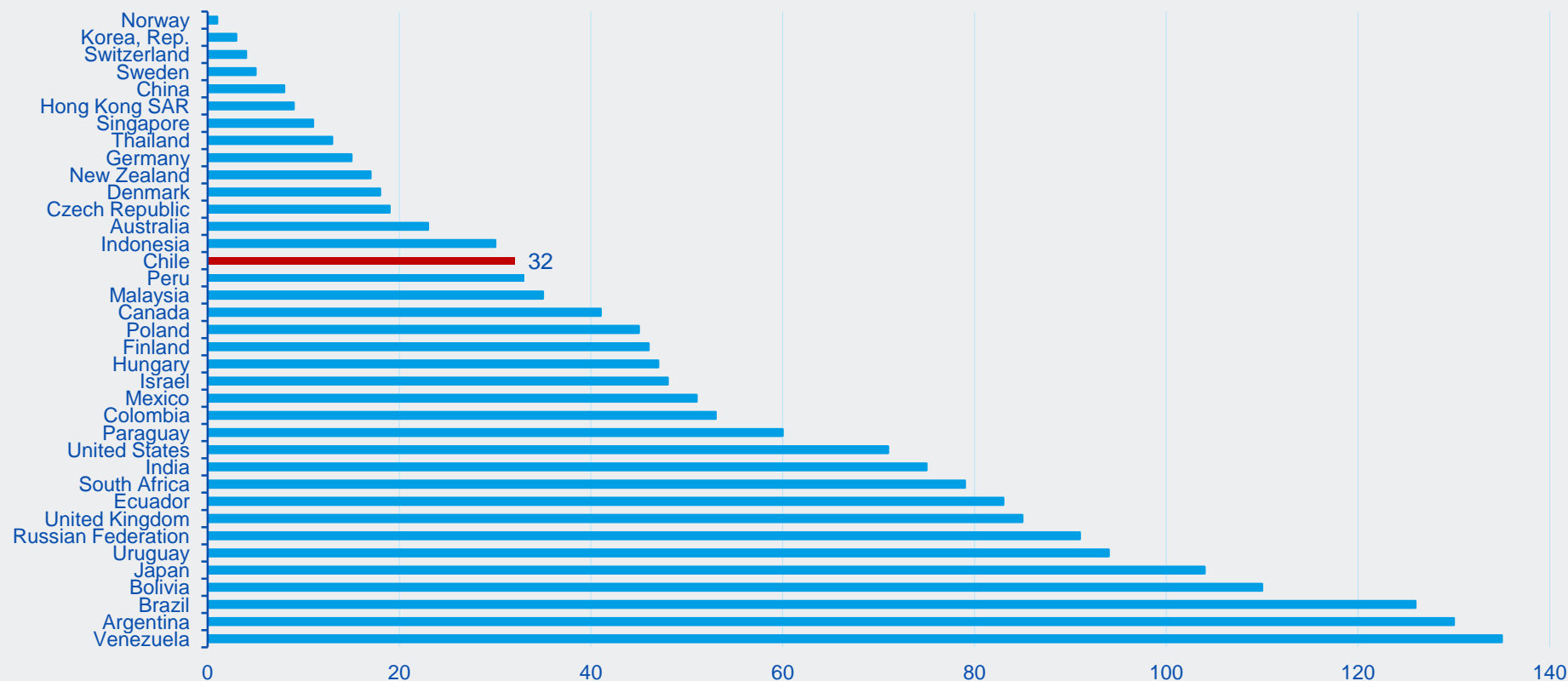
COMPETITIVENESS INDEX (2016-17)



Chile shows the best macroeconomic environment in LatAm ...

MACROECONOMIC ENVIRONMENT*

(Ranking 2016-17)

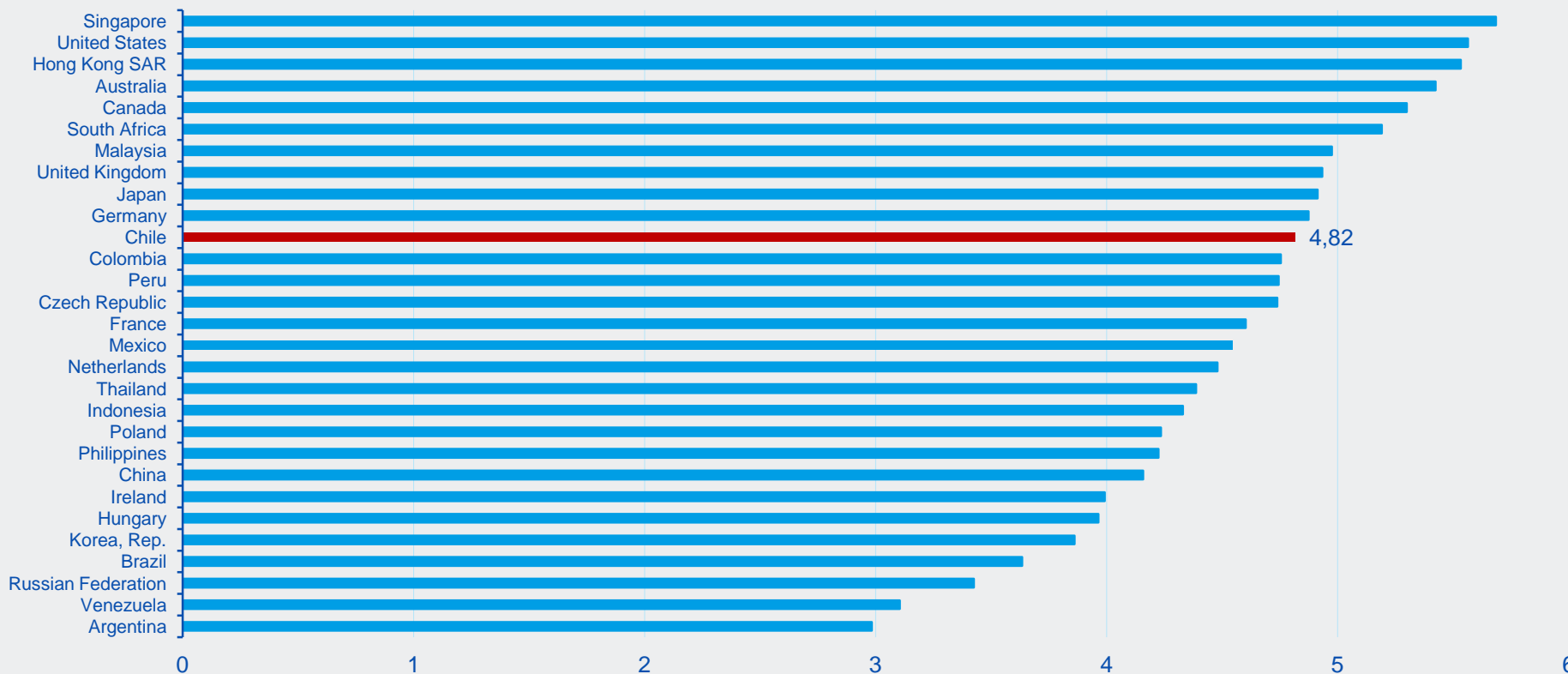


Source: World Economic Forum

*Based on: Government budget balance(% GDP), Gross National Savings (% GDP), Inflation (annual % change), General Government debt (% GDP), Country credit rating

... and a deep financial system

FINANCIAL MARKET DEVELOPMENT* (2016-17)

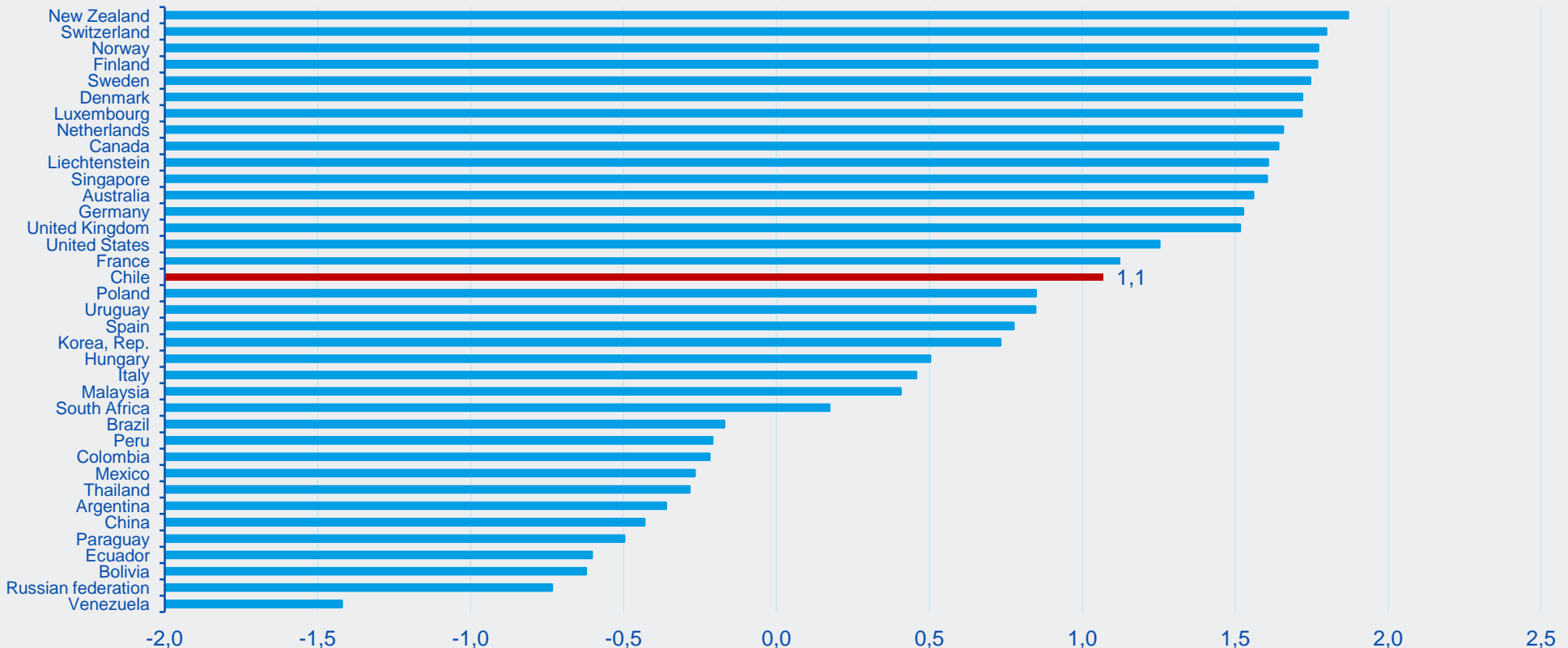


Source: World Economic Forum

*It is quantified in a scale from 1 (low) to 7 (high)

And also, high institutional quality ...

QUALITY OF INSTITUTIONS INDEX* (2015)



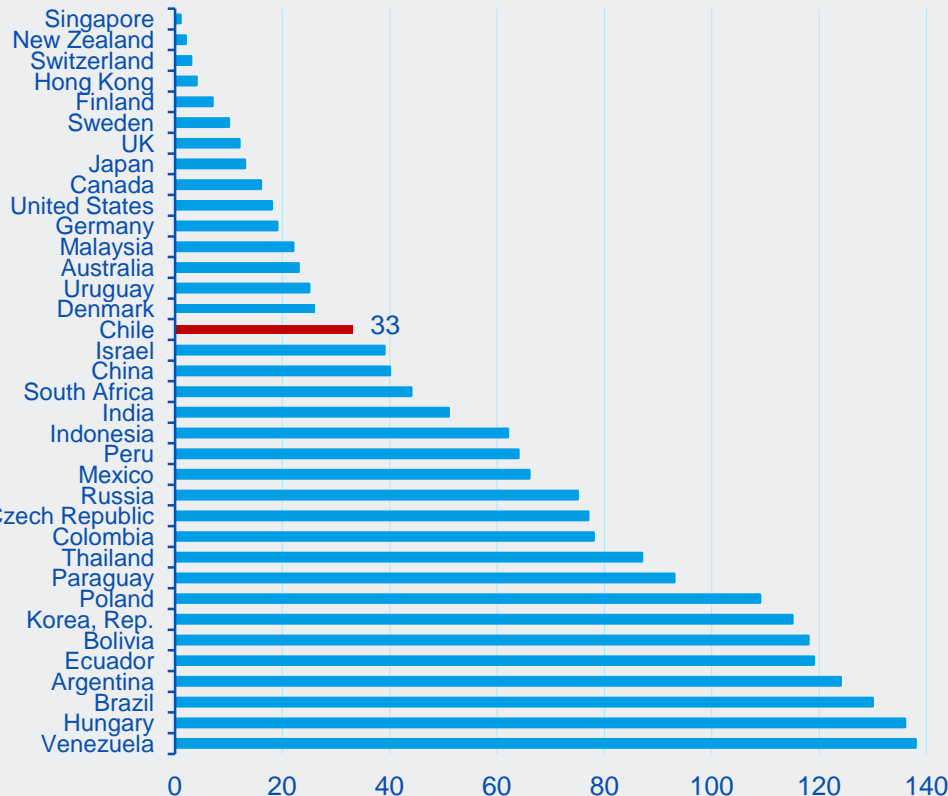
Source: World Bank

*Average of six indexes: rule of law, corruption control, political stability, quality of regulations, government effectiveness and accountability

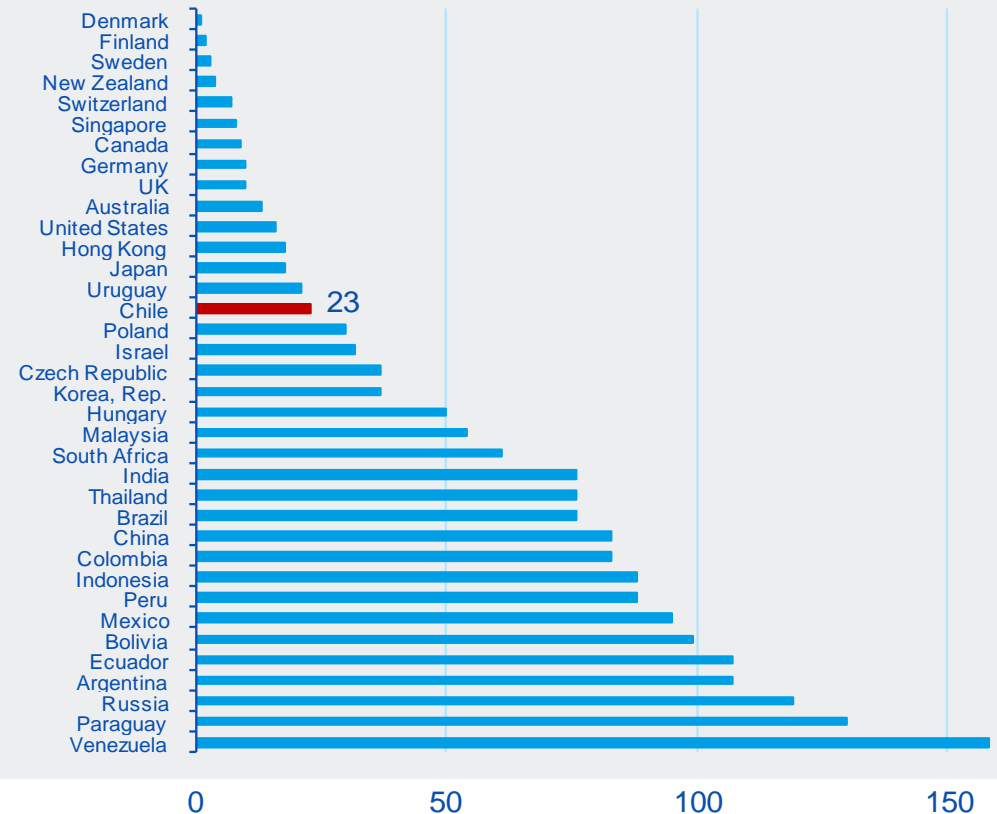
** Ranges from approximately -2.5 (weak) to 2.5 (strong) governance performance

... with relatively low levels of corruption

TRANSPARENCY OF GOVERNMENT*
(Ranking 2016-17)



CORRUPTION PERCEPTION **
(Ranking 2015)



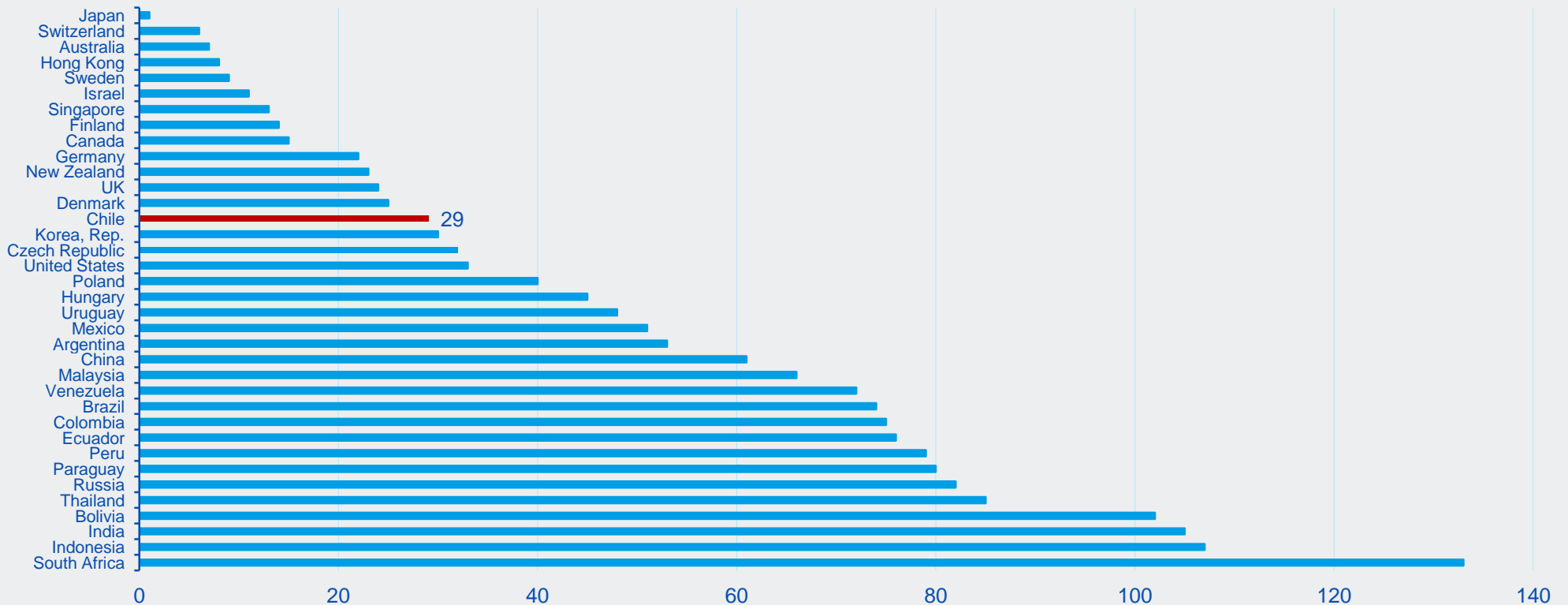
Sources: World Economic Forum, Global competitiveness Index and Transparency international

*index based on calcification about how easy is it for companies to obtain info. about changes in government policies and regulations affecting their activities

** The Corruption Perception Index 2015 is calculated using 12 different data sources from 11 different institutions that capture perceptions of corruption within the past two years.

Health index seems reasonable comparable to developed countries

HEALTH INDEX*
(Ranking 2016-17)



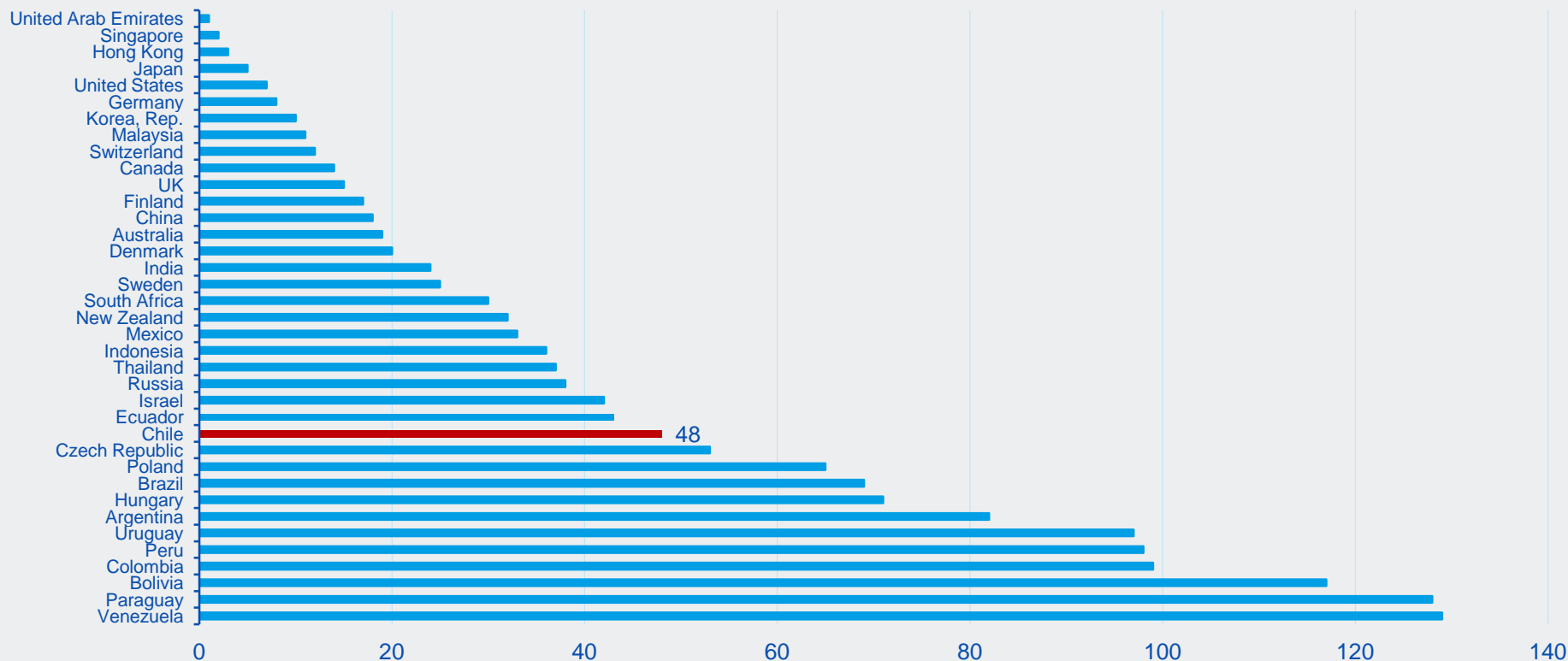
Source: World Economic Forum, Global competitiveness Index

*includes: Malaria cases/100,000 pop., Business impact of malaria, Tuberculosis cases/100,000 pop., Business impact of tuberculosis, HIV prevalence % adult pop., Business impact of HIV/AIDS, Infant mortality deaths/1,000 live births, Life expectancy years.

Challenge arises in transportation infrastructure ...

TRANSPORT INFRASTRUCTURE*

(Ranking 2016-17)

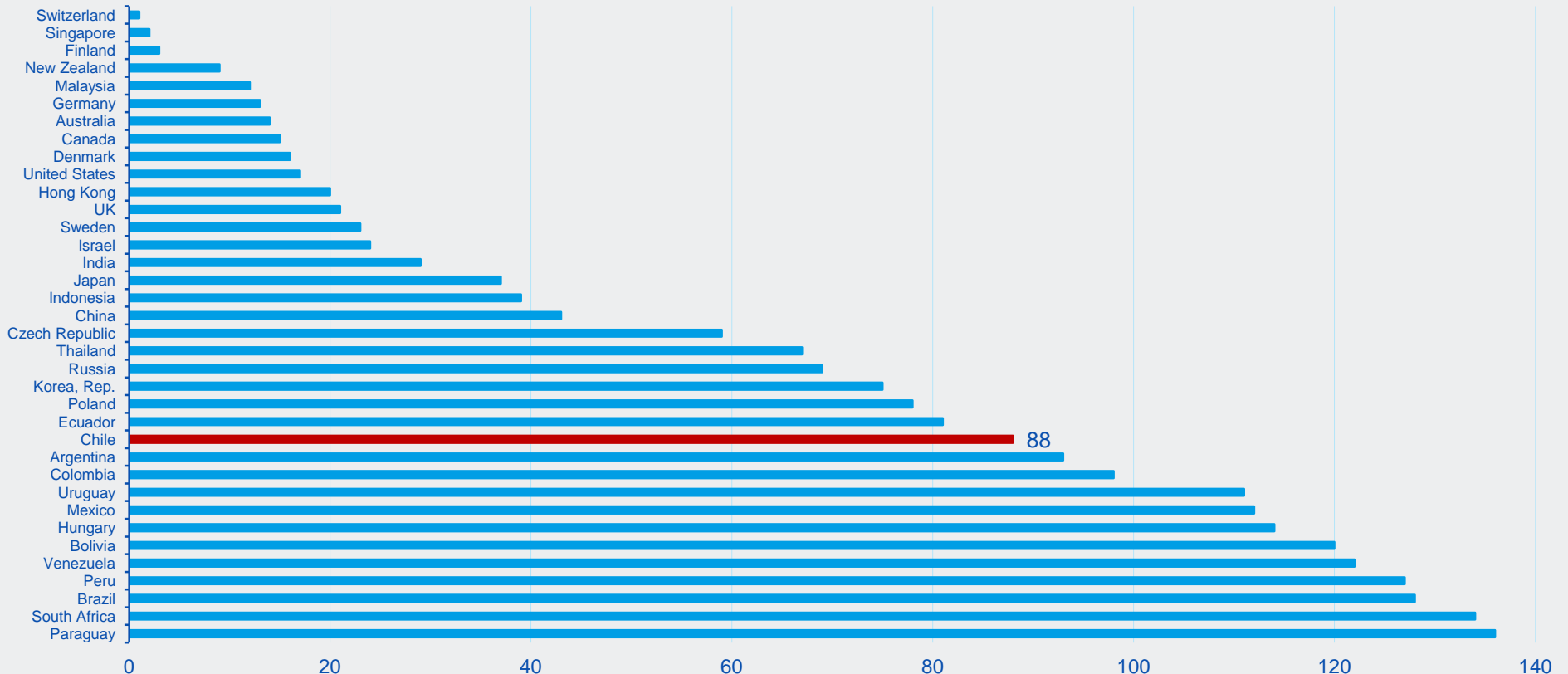


Source: World Economic Forum, Global competitiveness Index

*Quality of overall infrastructure, Quality of roads, Quality of railroad infrastructure, Quality of air transport infrastructure, Available airline seat km/week, millions.

...as well as in education quality

QUALITY OF THE EDUCATION SYSTEM* (Ranking 2016-17)

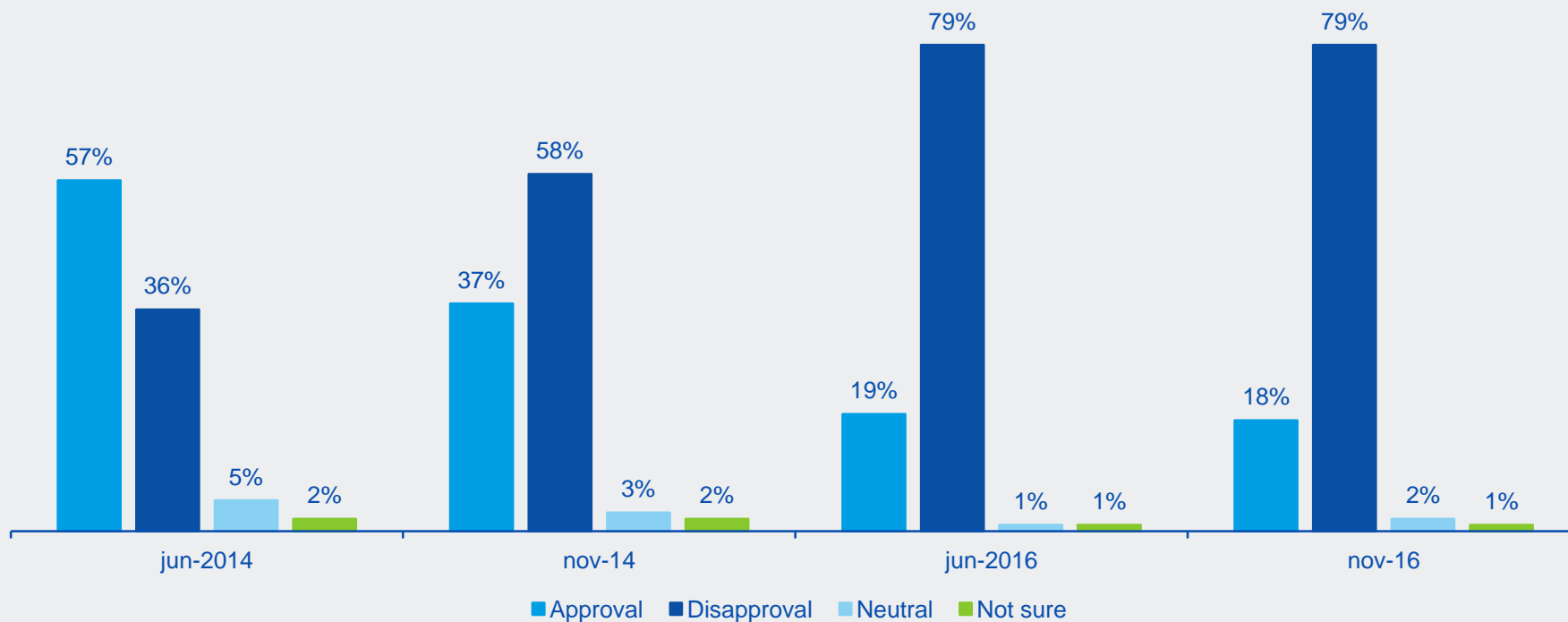


Source: World Economic Forum, Global competitiveness Index

*index based on calcification (1=not well at all to 7=extremely well) about how well does the education system meets the need of a competitive economy.

Government's approval has dropped during last years

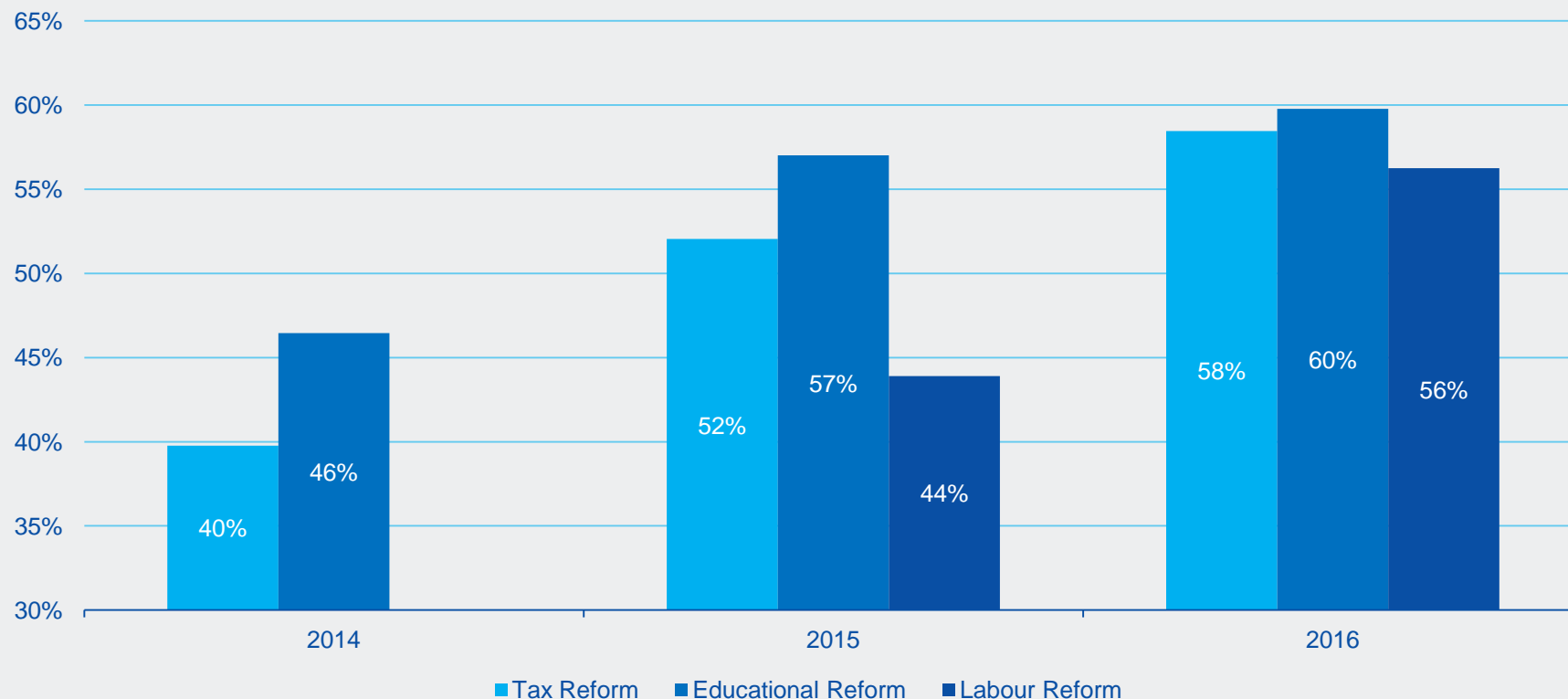
GOVERNMENT APPROVAL
(%)



With increasing rejection of its most iconic reforms

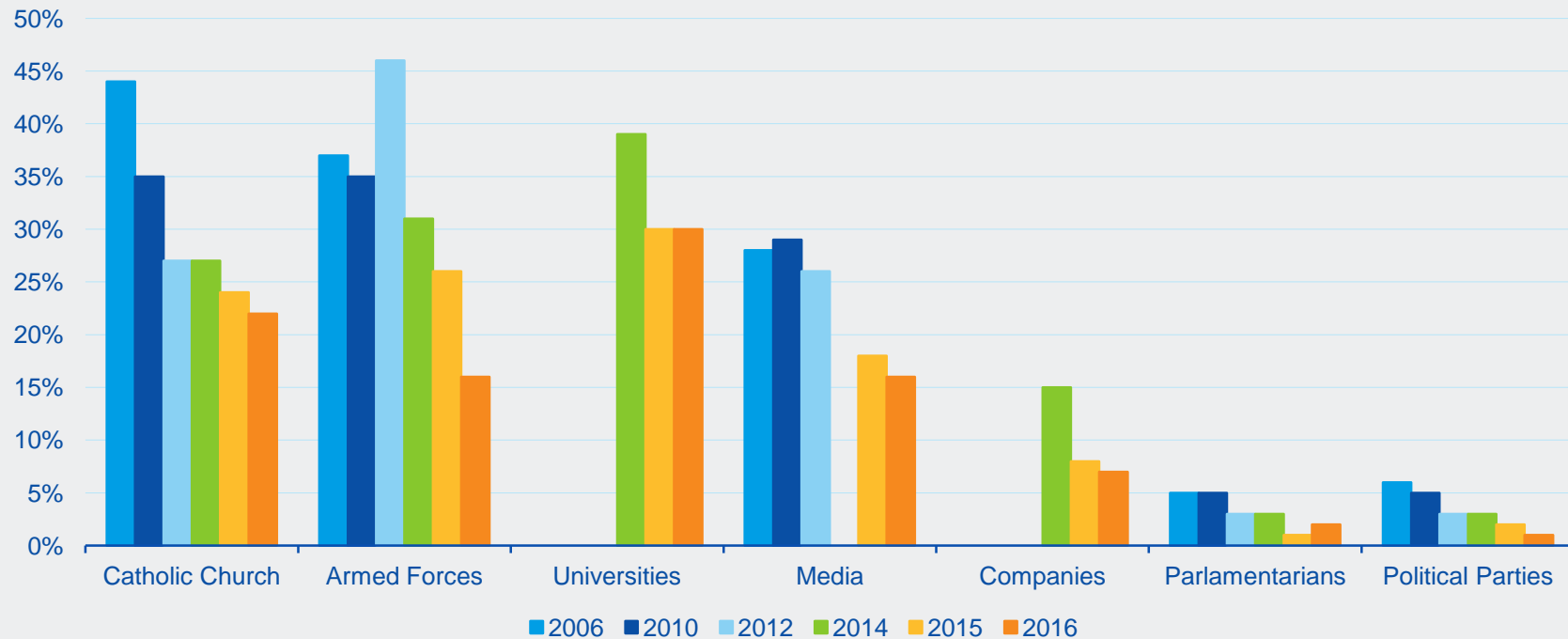
REJECTION TO GOVERNMENT REFORMS

(%)



And a significant decline in confidence in institutions

CONFIDENCE IN INSTITUTIONS*
(%)

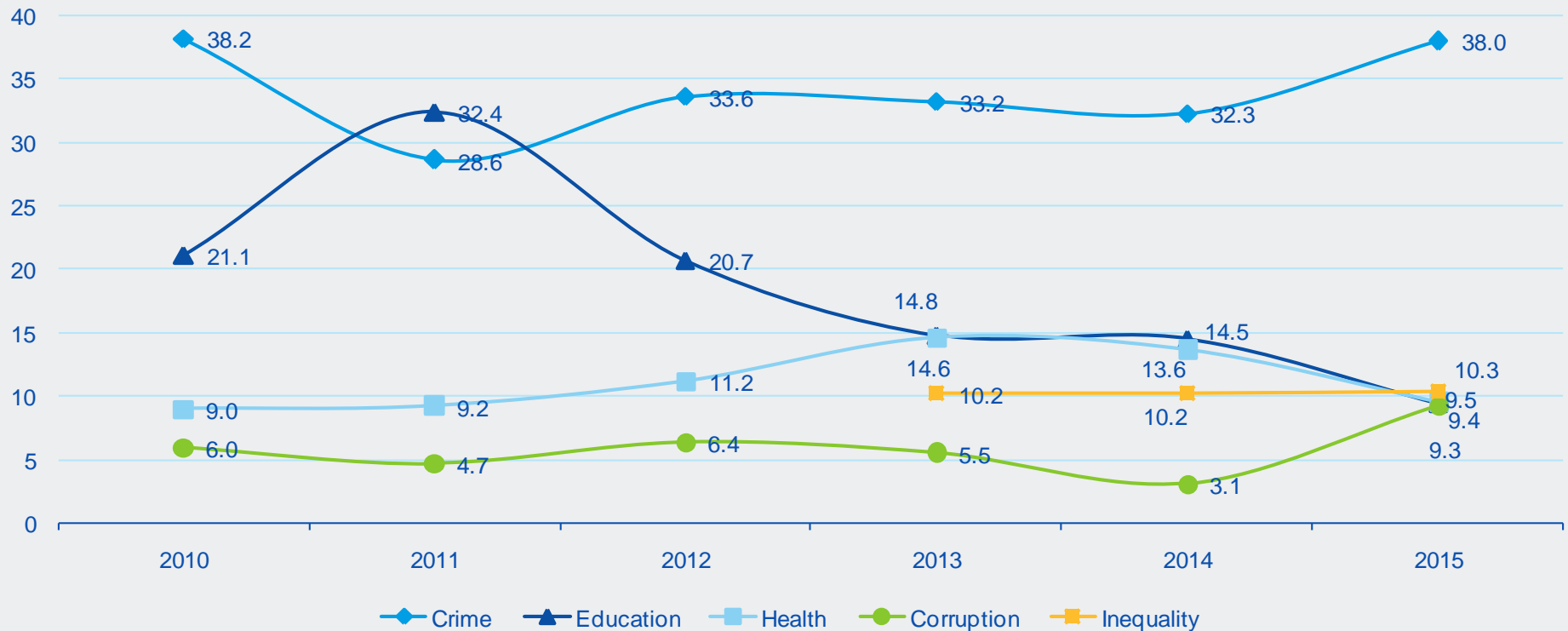


Source: Catholic University of Chile - GFK Adimark National Survey (2016)

*Percentage of people who declares to trust a lot or enough in the institution

Crime as the main concern among citizens since 2012

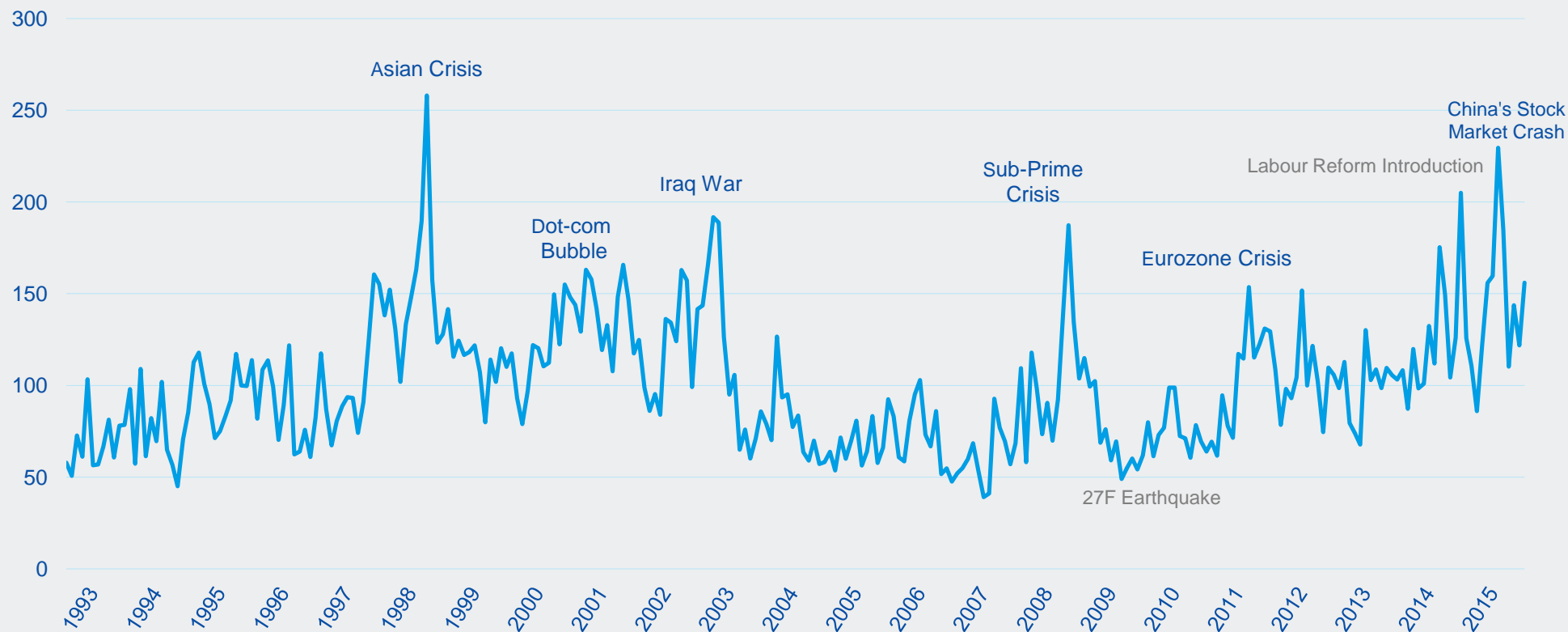
MAIN PROBLEMS PERCEPTION



Source: National UDP survey

Economic Policy Uncertainty at high levels in recent years...

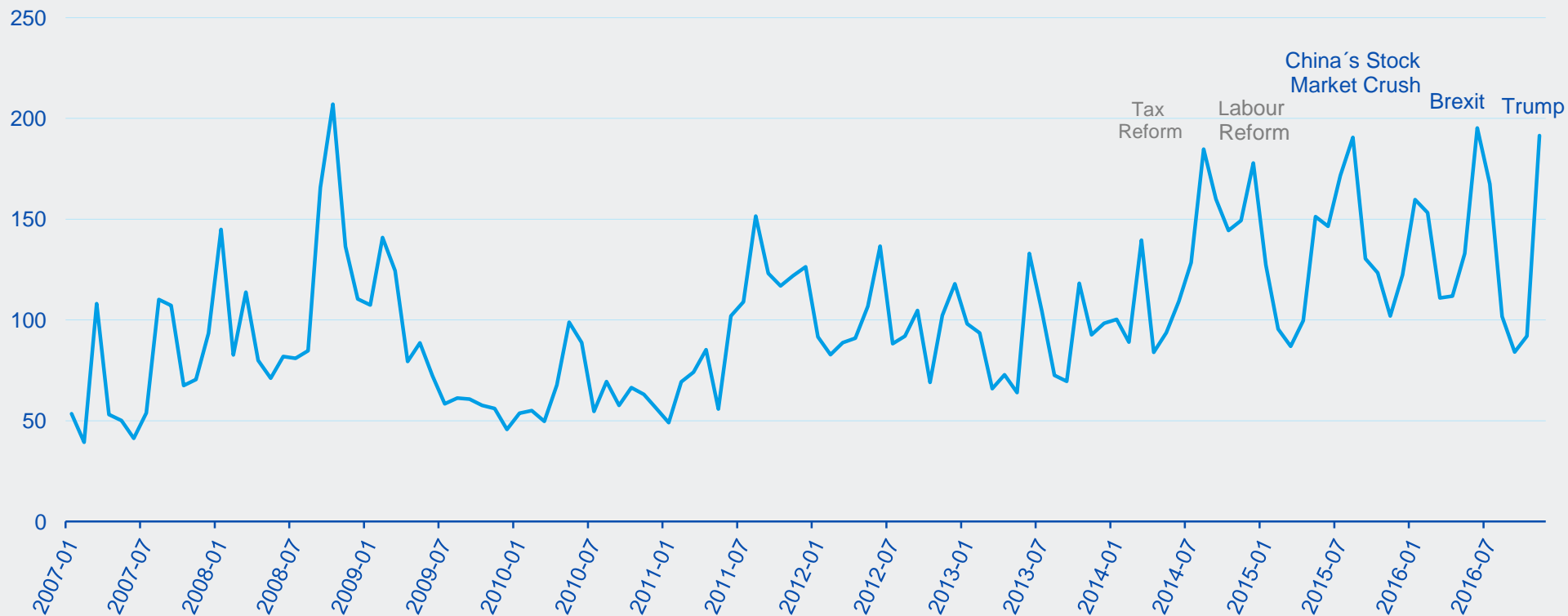
HISTORICAL ECONOMIC UNCERTAINTY INDEX



Source: Clapes UC

... and rising in the last decade

CONJUNCTURAL ECONOMIC UNCERTAINTY INDEX



FUNDAMENTALS OF THE CHILEAN ECONOMY

BBVA CHILE – JANUARY 2017



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