Economic Outlook Chile

2nd QUARTER 2017 | UNIT: CHILE

Santiago, 17 April 2017

Contents

1. Editorial 3

2. Global environment: growth has consolidated but there are still risks 4

3. Growth in 2017: risks tilted to the downside 6

4. Long term interest rates on the upturn. 8

5. Inflationary convergence dependant on more depreciation of the peso 12

6. The monetary stimulus continues 14

7. Fiscal policy: Imminent downgrade in credit classification 16

8. External risks dissipate but some remain that are idiosyncratic 19

9. Tables 20

Closing date: 12 April 2017

BBVA | Research

1. Editorial

The forecasts for global growth in 2017-18 are revised slightly upward, but risks are still tilted to the downside. The better start of the year has boosted forecasts for the Eurozone and especially for China. In the United States, we maintain projections of 2.3% growth this year and 2.4% in 2018. As a result, we expect world GDP will growth 3.3% in 2017 and 3.4% in 2018, which, in both cases, is one tenth higher than we forecasted three months ago.

Domestically we are continuing to forecast growth of 1.6% this year, although risks are tilted to the downside too. We also maintain a growth forecast of 2.4% for 2018, a figure which takes into account that after the end of this year the economy should be growing in line with its potential.

Inflation will continue to fluctuate below 3% yoy for most of the year. Deflationary risks, associated with an economy which has remained sluggish for a longer period of time, a labour market which continues to struggle, the strength of the peso and a monetary policy rate which fails to incorporate on time all the stimuli expected by the market, will be more significant than the inflationary risks resulting from external price increases, such as food and fuel.

Our baseline scenario envisages a depreciation of the peso within the projected horizon thanks to cuts in the monetary policy rate that could place it at around 700 pesos to the dollar by the middle of this year. On the other hand, we anticipate the yield curve to rise sharply due as much to domestic as to external factors. We also predict that the monetary policy rate will be around 2.5% at the end of the first semester. However, if the inflation risk scenario materialises, then a greater monetary stimulus will be required.

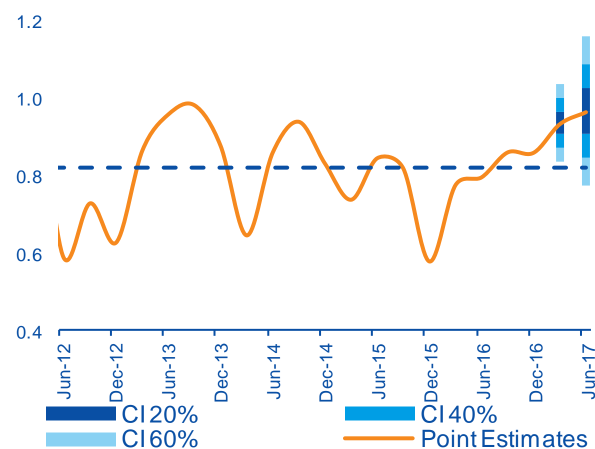
In terms of fiscal policy, we are keeping our estimate of 4% growth in public spending this year. Given the rise in spending in the first two months of the year, a slowdown in the rate of fiscal spending growth will be necessary for the remainder of 2017. The effective fiscal deficit will rise to 3.1% of gross domestic product (GDP) (US$8,000 million) and we do not see any room for a significantly lower debt issue during the year.

The balance of internal risks is negative in the short term. The risk of a late and inadequate monetary policy response has partly dissipated. There is a continued risk from the slow depreciation of the peso, something we consider essential to support the recovery of investment and competitiveness in the exports sectors. We also still consider the Presidential elections to be a risk, although a priori it is not possible to predict whether ultimately there will be positive or negative repercussions for the economy. Other internal risks include the non-recovery of businesses confidence and the effects of a downgrade in the sovereign risk clasification.

2. Global environment: growth has consolidated but there are still risks

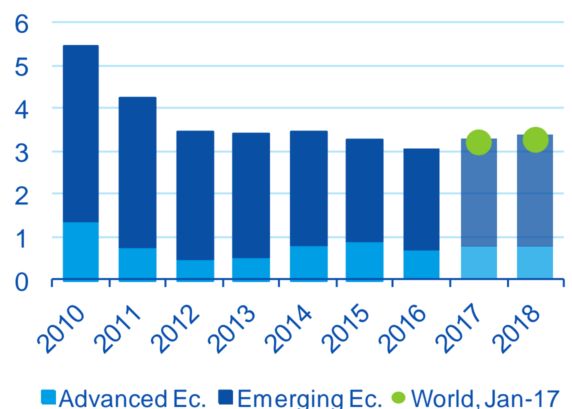
GDP growth has continued worldwide, at rates of around 1% per quarter, exceeding the 0.8% average since 2011 (Figure 2.1). This acceleration has been followed by general improved confidence, coupled with advances in global trade, stimulated largely by monetary and fiscal stimuli in China. The performance of countries in the developed world continues to be very strong. In the USA the recovery is strengthening and in Europe growth is occurring at rates that exceed potential. In contrast, Latin America will emerge from this year in recession, although there will be some moderate growth.

Figure 2.1 Global GDP Growth. Forecasts based on BBVA-GAIN (QoQ %)



Source: BBVA Research

Figure 2.2 Global Growth and Contributions by Region (YoY %)



Source: BBVA Research

We have revised the increase in global growth, which will rise from 3.1% in 2016 to 3.3% in 2017 and 3.4% in 2018.

Improved performance worldwide is accompanied by some clarification regarding the American economy, where expectations of rapid reflation supported by a fiscal boost and of a rapid drift towards protectionism have lessened, or at least been delayed. Nevertheless, the difficulty of carrying out a reform of the health care system has also revealed problems in getting other measures approved, such as those associated with tax cuts or the infrastructure spending plan. This eliminates the probability of a strong short term impetus.

The financial markets have remained calm over the last few months, registering low volatility in spite of the high uncertainty. In this context, the central banks are making gradual progress in the process of standardising monetary policy. The Fed, which is leading this process, maintains its message of gradual release, so we predict there will be two additional interest rate hikes this year and another two in 2018, up to 2%. At the same time, there are already plans to undertake the third phase of the exit strategy, in other words, the reduction of the balance sheet, something

which probably will not happen until next year and will be put in place passively. The ECB also appears more optimistic about growth, but is not yet confident about inflation and is lagging behind the Fed's exit rate. Given this process of monetary policy standardisation, it is worth waiting for a rise in the cost of finance at the global level going forward.

Overall, our forecasts for growth in 2017-18 have been revised only marginally. The best starts to the year have occurred in the Eurozone and especially China (where growth of 6.3% and 5.8% in 2017 and 2018 respectively is expected, around 0.5 percentage points more than three months ago), while the rates for the Latin American countries are more negative this year (with the notable exception of Mexico). In the US, we continue to predict growth of 2.3% this year and 2.4% in 2018, supported by a boost in investment. As a result, expected worldwide growth is 3.3% for 2017 and 3.4% for 2018, which, in both cases, is one tenth higher than our previous forecasts (Figure 2.2).

The risks of a downturn continue. Apart from the uncertainty that is still associated with the measures that are finally to be approved in the USA, above all in the business sector, there are doubts centred around the election results in France and Italy, due to the highly negative impact they could have on Eurozone stability in the (unlikely) event of a victory for the fiercely anti-European elements. There is also the risk associated with the Chinese economy, where recent strong investment may slow down the reduction in imbalances. Other significant risk factors are the Brexit negotiations (which have not got off to a good start), the multiple geopolitical risks and the risks associated with the standardisation of monetary policy, above all in the USA.

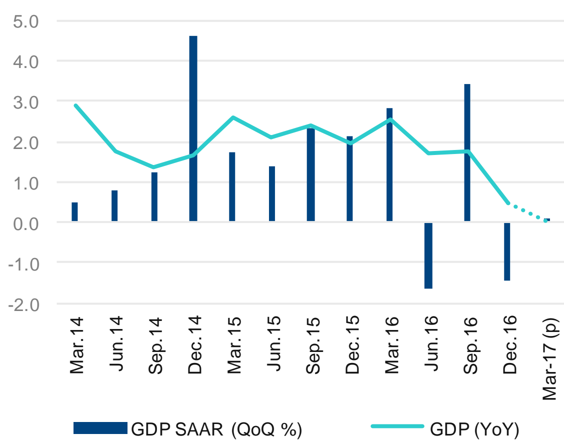
3. Growth in 2017: risks tilted to the downside

Only starting in Q4 2017 will the economy go back to growth rates in line with its potential

In the February report we projected 1.6% growth for this year, an almost identical figure to that for 2016. This was less than the 2% forecast made by the market and the Central Bank. Since then, information taken from a combination of reports has enabled us to confirm our viewpoint, that this quarter will see a sluggish economy, without any indications of recovery, at least until mid year. The economy has been affected by recent shocks such as the Escondida mining strike and the fires that affected the south of the country in the summer, as well as the lacklustre non-mining GDP, which was particularly affected by adjustments in the construction sector.

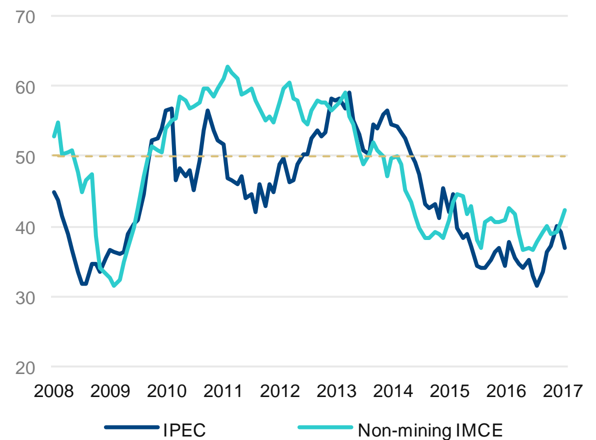
The non-mining GDP saw less growth in the 4th quarter of 2016 compared to previous quarters. Also, the rate of expansion was revised down in accordance with the new National Accounts. In January the IMACEC (Monthly Indicators for Economic Activity) showed an annual growth of 1.4%, in February, it shrunk by 1.3% and for March we forecast a figure of around 0%, affected once again by a double-digit drop in mining production. The first three months will therefore end with close to zero growth (Figure 3.1). However, this stagnation will not last beyond the first quarter and we forecast that growth will follow an upward trend throughout the year, ending 2017 at 1.6%.

Figure 3.1 Quarterly growth in GDP (% annual and quarterly variation)



(p): projected.
Source: BCCh, BBVA Research

Figure 3.2 Consumer and business confidence (indices)



Source: BCCh, BBVA Research

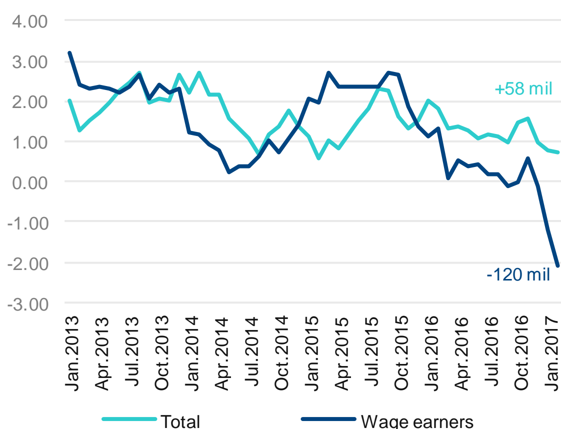
During the rest of the year, the biggest monetary impulse will contribute to creating improved financial conditions for households and companies, while the better scenario for global and trade growth will boost export sectors. Conversely, however, there are a number of factors that run contrary to improved domestic demand, including continuing low confidence (Figure 3.2); credit conditions that remain tight, uncertainty regarding regulations and

legislation in some sectors and the risk of a greater deterioration in the labour market. As well as this, there is the added source of uncertainty in the political sphere this year due to the Presidential and Parliamentary elections due in November.

In terms of the labour market, our baseline scenario considers the unemployment rate will average 6.9% this year (compared to 6.5% in 2016), implying that it will increase to 7% during the winter months. However, a new period of adjustment has begun in the past few months that may be more stark than predicted (Figure 3.3). We forecast that this year private consumption will grow in the range of 2.5% but if there is higher unemployment and the lack of confidence persists, this figure could be lower.

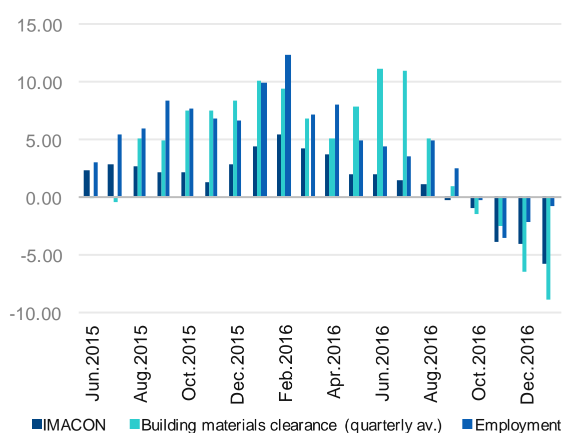
For fixed investment we predict a decrease of 1.3% this year, a figure which, if it materialises, would be the fourth consecutive annual reduction. In this context, the sharp fall in investment in the final quarter of last year, coupled with a poor start to the year for the construction sector and the stagnation of imports of capital goods, means a complicated year is anticipated for this area of spending, which is vital for increasing the economy's ability to grow (Figure 3.4). Government consumption is restricted by the fiscal rule, growing by around 3.4% in real terms this year and 4% next year. In regard to exports, the forecast envisages a recovery in volume this year and next, thanks to greater growth in trading companies and globally.

Figure 3.3 Job Creation (% annual variation)



Source: Banco Central de Chile, Spanish Statistical Office and BBVA Research

Figure 3.4 Construction Indices (% annual variation)



Source: Banco Central de Chile, Spanish Statistical Office and BBVA Research

Finally, we are keeping our GDP growth forecast at 2.4% for 2018, a figure which envisages that starting at the end of this year the economy will grow at rates in line with its potential, which is reasonably consistent with the consensus projection (2.5%), although below the average point of the range forecast by the Bentral Bank in its last Monetary Policy Report (2.75%).

4. Long term interest rates on the upturn.

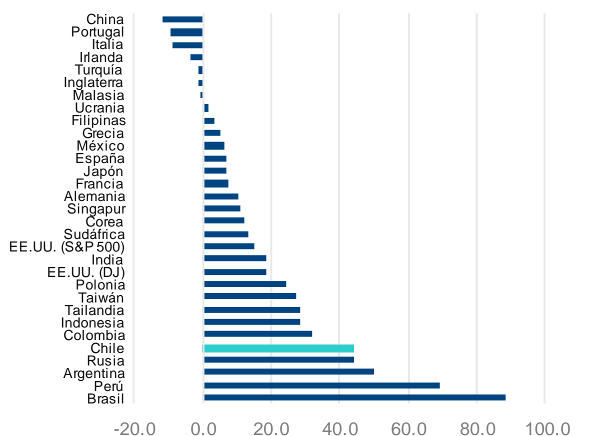
We anticipate a sharp upturn in the yield curve due to domestic and external factors

Uncertainty persists about how China's economy will evolve, although the recovery in the price of copper following the US Presidential elections has slightly improved the terms of trade. On the other hand, we believe that the continuing strength of the Chilean peso is preventing a faster adjustment process, since it discourages investment in tradable sectors, in an environment with low productivity. Anticipating economic recovery and/or allowing for a more benign business environment in the context of a change of government, the stock market has experienced significant recovery, which has placed it in the upper part of what we consider to be consistent with its fundamentals (Figure 4.1, Figure 4.2).

The real exchange rate remains close to historical averages, insufficient to support reallocation to non-mining sectors

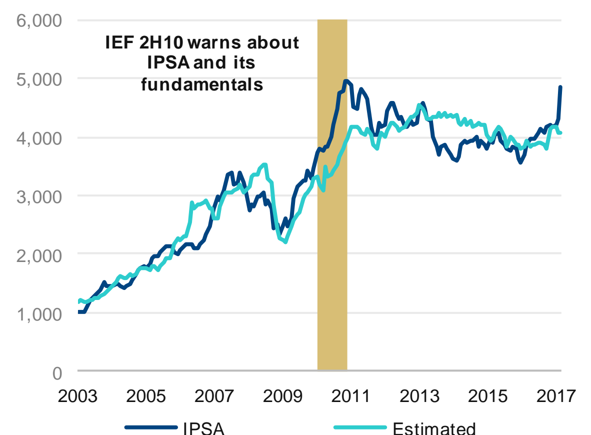
Despite the rise in the Fed rates and news of a significant fiscal stimulus in the US, the peso has remained at between $650 and $660, although there has been some multilateral depreciation (Figure 4.3). The lack of sufficient peso depreciation despite weak economic indicators and even a reversal in economic growth is explained by the appetite of foreign investors, although we note a certain differentiation for the Chilean peso which has led to the dismantling of the carry trade, as opposed to its brazilian counterpart, in line with the multilateral depreciation of the domestic currency (Figure 4.4).

Figure 4.1 Worldwide Stock Exchanges (US$, accumulated % variance since 2016).



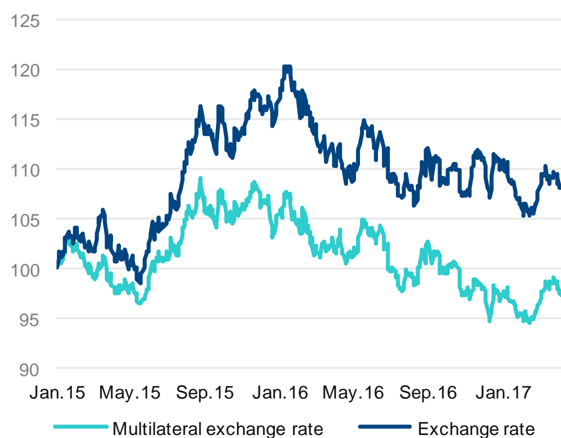
Source: Bloomberg and BBVA Research

Figure 4.2 Model of Fundamentals of the Public Sector Accounting Standards* (Index)



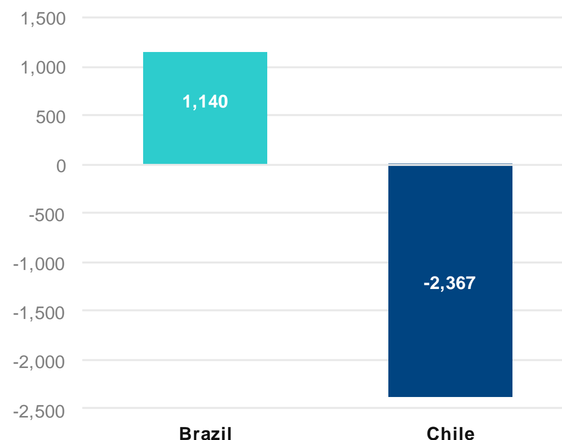
* Model of fundamentals, which includes as determining factors: Monthly Indicator of Economic Activity, copper price and real long-term interest rate.
Source: Bloomberg and BBVA Research

Figure 4.3 Multilateral and Peso/US$ Exchange Rate (Indices 2 Jan 2015 = 100)



Source: Banco Central de Chile and BBVA Research

Figure 4.4 Carry Trade Operations, Peso and Real* (Million US$)

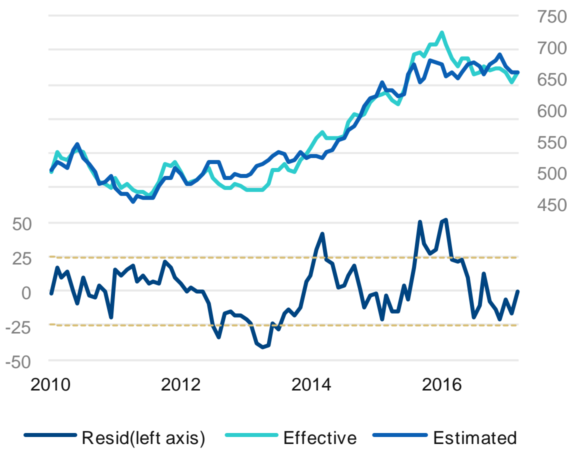


* Standardised contracts for Brazil for an amount of US$50,000. Increase observed between 31 March 2017 and 17 February 2017.
Source: Banco Central de Chile, BM&F Bovespa and BBVA Research

Risk of a rise in long term interest rates due to a possible change in contributors to high risk funds

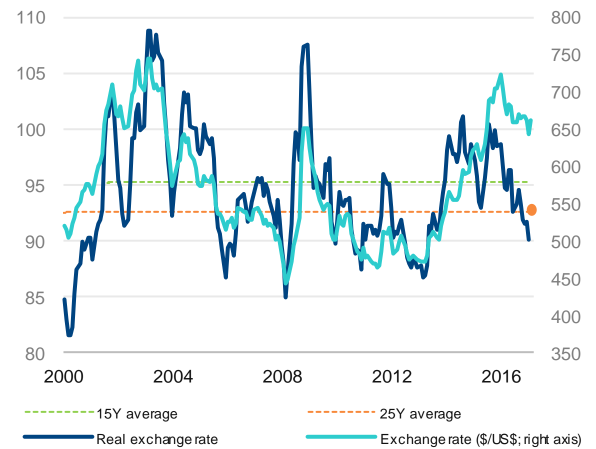
In our evaluation of nominal exchange rate misalignment, we see no clear evidence of the currency being at a different level from that suggested by the terms of trade and other short-term factors (Figure 4.5). However, the real exchange rate is below its historical average, which does not enable the reallocation of resources to export sectors (Figure 4.6). The monetary policy, justified by the medium-term deflationary effects that this strengthening of the peso, has started to introduce more stimulus. Our baseline scenario envisages a depreciation of the peso getting close to 700 per dollar mid-yeardue to, among others, cuts in the monetary policy rate.

Figure 4.5 Actual and estimated exchange rates (Peso/US$)*



* Model for determining the nominal exchange rate based on movements in copper prices, business confidence, Dollar index and the interest rate differential between Chile and the USA.
Source: Banco Central de Chile, BBVA Research

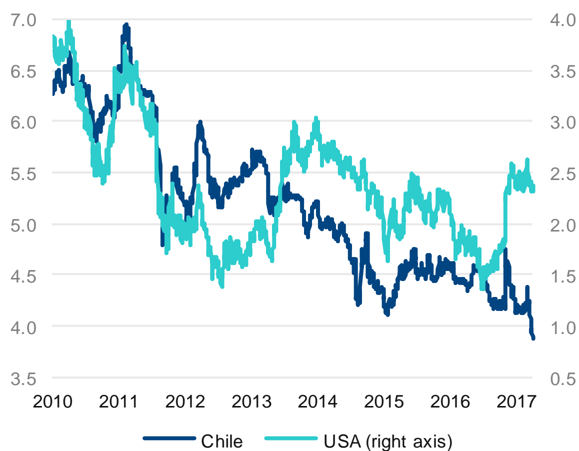
Figure 4.6 Real exchange rate (average 1986 = 100)



* Real exchange rate sampling point for March 2017 (92.7).
Source: Banco Central de Chile, BBVA Research

The benchmark interest rates experienced a sharp rise following the US Presidential elections, but they are now at historically low levels (Figure 4.7). Of specific concern for long term interest rates is a reversal in the cautious performance of the Pension Funds Administration contributors, and their movement to less risky funds for the major part of 2016 (Fund E). However, in light of recent improved yield (Fund A had an average real income of 6.5% in the 1st quarter of 2017) there may be a strengthening in the sale of fixed income instruments by Pension Fund Administrators (Figure 4.8).

Figure 4.7 10-Year Nominal Interest Rates (Percentage)



Source: Bloomberg and BBVA Research

Figure 4.8 Assets of Pension Funds Administrators in domestic sovereign bonds (percentage of system's total assets)

Source: Superintendencia de Pensiones (Chilean Pensions Supervisor) and BBVA Research

5. Inflationary convergence dependant on more depreciation of the peso

We maintain our forecast of 3.2% inflation for December 2017 but with a downward bias

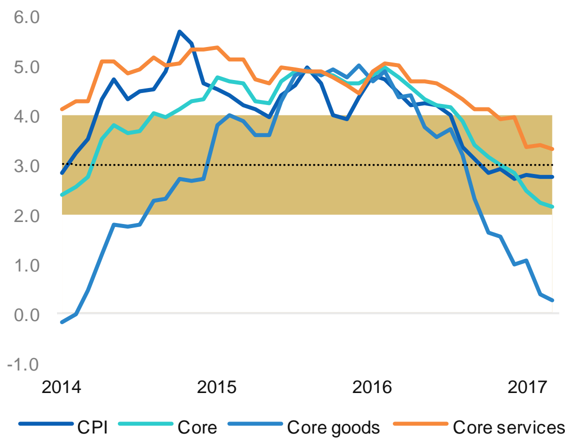
In the last few months, inflation has continued to fall, despite some unexpected movements in both directions during the first months of the year, confirming our view of generalised low inflationary pressures in a context of greater capacity gaps in the economy and contained depreciation of the peso. We expect that this inflationary trend will continue, at least until the middle of the year, and then begin to converge towards the target, reaching 3.2% annual in December, thanks to better figures of activity and more depreciation of the peso. However, we consider that the risk balance of this scenario is biased to the downside. The deflationary risks associated with an economy that has been sluggish for some time, a continuing stagnant labour market, less depreciation of the peso due to a copper price that is kept at current levels and a monetary policy rate that is failing to incorporate the expected market stimulus in a timely manner are seen as more significant than the inflationary risks that come from greater volatility of external prices, such as food and fuel. In fact, in a scenario in which the exchange rate does not depreciate as we projected and, moreover, continues to appreciate, we would see inflation levelling off markedly, at below 3%.

Core inflation, as measured by the Consumer Price Index, excluding food and energy (CPIEFE), has continued to fall in the past few months and is approaching the lower limit of the Banco Central's target range of tolerance. It has been driven not only by lower goods inflation linked to the exchange rate but also by a clear slowdown in services inflation (Figure 5.1). Core goods inflation practically disappeared in March, reaching an annual figure of 0.3%, thereby culminating the inflationary cycle that was linked to the depreciation of the peso in recent years. Services inflation, an item with a greater level of indexation within the CPI, has continued to slow down in the last few months, in line with the sluggishness that continues to widen the capacity gaps, the increased weakness in the employment market and the sustained slowing down of wage increases. In March, annual core services inflation was 3.3%, significantly below its previous 15 month average (4.2%).

Zero goods inflation and domestic stagnation would keep inflation contained in 2017

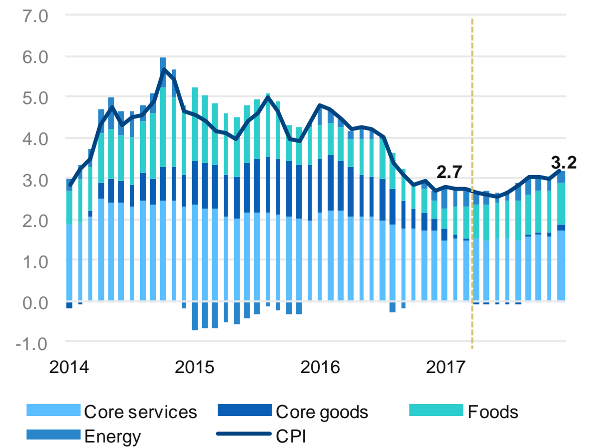
The most volatile components of the CPI basket, such as food and energy, have continued to inject some inflation in the past few months, in line with increases in international prices and the limited depreciation of the peso. In terms of food, inflation from non-perishables remains stable, despite rising international prices, due to the time lag before they are converted to domestic prices, along with their low incidence in the local CPI. Perishable goods have begun to recover, thanks mainly to the price of vegetables, in part due to historic seasonality, but also due to their expected recovery in the wake of low prices at the end of last year. In regard to energy prices, fuel has continued to stimulate inflation in the first quarter, in line with higher international fuel prices and the seasonal rise in refined fuel from the US Gulf Coast in the past few weeks.

Figure 5.1 Annual Inflation (Percentage)



Source: INE and BBVA Research
SAE: CPI excluding food and energy.

Figure 5.2 Annual Inflation Forecast (Percentage)



Source: INE and BBVA Research
SAE: CPI excluding food and energy.

Greater capacity and less depreciation would make it more difficult to converge on the target

In our baseline scenario for 2017, we forecast a year-end inflation figure of 3.2%, although it may fluctuate below 3% for much of the year. If our assumptions should materialise, regarding new reductions in the monetary policy rate of up to 2.5%, a convergence of copper prices to US$2.5 per pound and depreciation of the peso to $690, and economic slack that will begin to moderate, inflation will begin to recover towards the second half of the year (Figure 5.2). This forecast of inflation for 2017 is slightly higher than that reported in the Economic Forecasts Survey (2.9%) and the one implied in the inflation insurance contracts (2.9%), but it is consistent with our scenario of higher monetary stimulus and depreciation of the peso. At the Banco Central's policy horizon, expectations of inflation continue to be weakly anchored to the target, in particular in the Financial Traders Survey (2.9%) and breakeven inflation (2.6%-2.8%).

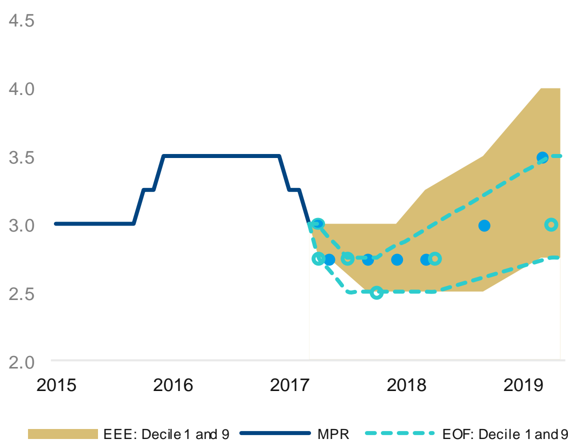
However, if these events do not materialise, inflation will remain stuck at the bottom of the Banco Central's range of tolerance for longer than estimated, with no significant pressures on core inflation.The more volatile products, such as energy and food, will continue to support inflation during the year, with inflation from food following an upward trend and recovering from last year's low levels. Energy will be very influenced by factors linked to fuel prices and adjustments due to the rise in electricity costs. The principal risks in these items come from sharp adjustments in international prices for non-perishable foods and in particular oil. However, the risk of an upward trend due to new OPEC agreements appears to be limited by the increased supply from non-OPEC countries, especially of shale oil.

6. The monetary stimulus continues

The Central Bank moves ahead with cuts and the market anticipates that the monetary policy rate will reach 2.5% in the next few months

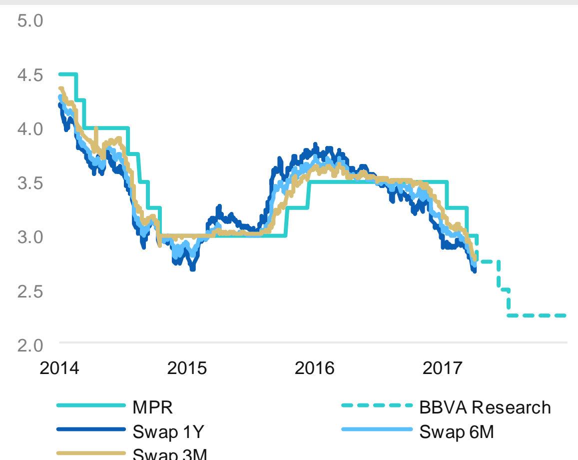
The recent macroeconomic situation, which has been characterised by a lower GDP growth, a further deterioration in the labour market and an absence of inflationary pressures, has enabled the Central Bank to cut the monetary policy rate on two occasions during the first quarter and there is scope for additional cuts. These decisions have come as a surprise to some parts of the market, as reflected by the consensus in the Economic Forecasts Survey, which in March saw the rate bottoming out at 3%. The Financial Operators Survey currently envisages a monetary policy rate of 2.5% in the next few months, while the Economic Forecasts Survey of the same month only forecasts an additional cut of up to 2.75% (Figure 6.1). For its part, the price of the assets, which was used by the Central Bank to outline the working hypothesis for the monetary policy, envisages a monetary policy rate of up to 2.5% (Figure 6.2).

Figure 6.1 Monetary Policy Rate Projections (%)



Source: Banco Central, BBVA Research

Figure 6.2 Monetary Policy Rate and Average Swap (Basis Points)



Source: Banco Central, Bloomberg and BBVA Research

Our baseline scenario continues to show that the monetary policy rate will reach 2.5% at the end of the first semester but we do not rule out the need for a greater stimulus. Our preliminary forecast considers that the monetary policy rate will remain at 2.5% until the middle of next year but that it will then begin a gradual return to normal and close 2018 at 3%. Certainly, the door should not be closed to a greater monetary stimulus if the economic conditions deteriorate further and/or inflation falls more than predicted.

In no way do we believe that increased monetary stimulus is the solution to the problem of low growth in the Chilean economy; rather we are calling for it to be allowed to work through the usual channels in order to keep inflationary expectations anchored. In fact, while it is true that the main reasons for the low rate of growth are related to the end of

the mining cycle and a critical lack of confidence at the domestic level, we also think that in a context in which exchange rate and demand pressures are well contained, greater monetary stimulus will help to reduce the cost of financing for households and businesses and, above all, will make it possible to sustain a higher exchange rate, at levels according to the cyclical position of the economy.

BBVA | Research

7. Fiscal policy: Imminent downgrade in sovereign debt rating

Not just a higher copper price, but also a lower exchange rate and growth are affecting fiscal income in 2017

The start of 2017 brought two pieces of fiscal news. Firstly, higher copper prices would have consequences: more income and less need for debt. On the other hand, public spending grew by more than 5% in January and February. On the first point, we predict an average copper price for the year of US$ 2.54 per pound, 34 US cents higher than the forecast used in the Budgetary Law. Based on our estimates, this increase would raise the Government's dollar income by something in the region of $600 million[1]. However, the Treasury has its expenditures in pesos. For the same reason, the lowest average estimated exchange rate of $681, $19 below the estimate in the Budgetary Law, would offset the effect of the rise in copper prices. The net effect is positive but only at 0.2% of GDP (US$ 500 million). Lower growth this year compared to what was considered in the Budget will mean that a reduction in revenue of around US$ 440 million[2].

We are maintaining a public spending growth 2017 of 4%, somewhat higher than the one given in the Budget Legislation due to the additional fiscal expenditure on construction following the fires in the south of the country. We still do not know how much the Government will earmark for this cause, but our preliminary estimates are around US$150 million. However, given the high increase in spending in the first two months of the year, there will be a necessary reduction in the completion rate during the rest of 2017. There will probably be a similar dynamic to that of last year, with spending highly concentrated in the first three quarters and a strong deceleration towards the end of the year.

The actual deficit will therefore rise to 3.1% of GDP (US$8,000 million). We do not see any scope for a significant reduction in debt issue during the year. On the other hand, the structural deficit will be placed initially at 1.8% of GDP. Although this figure is high, affected by increased spending and the effects on structural income of a reduced exchange rate, the revision of the GDP trend that will be made due to the change in the National Accounts could change things. It is still early to be making a reference to targeted convergence on the structural balance.

---

[1] The historic average of the impact on fiscal revenue of one cent more on the price of copper is higher than our calculation. However, the high industry costs, Codelco's low profits and adjustments to the provisional monthly payment rates, plus foreign remittances from the private mining sector, have led us to break with historical linearity and estimate a lower proportion.

[2] We estimate a higher income than in the Budget, a total of US$ 580 million, when the usual under-estimation of other income items is coupled with the effects mentioned in this paragraph.

The elements for downgrading are there: effects on the cost of external finance

In the last few months, both Fitch and S&P have changed Chile's debt classification from stable to negative. Among the reasons given by both agencies, the prospects of a reduced income and the rapid rise in gross debt over the last few years were highlighted.

No factors that could prevent a downgrade have been observed. There is no recovery in growth, no relief to the squeeze on expenditure, the accumulation of gross debt continues and there have been no improvements to institutionalism. So, we consider that a lowering of the risk classification is imminent.

The results of the downgrade will not only have a negative impact on the fiscal accounts. The blow to the country's risk and the cost of international debt will spread to fiscal and private issuance. In the case of government accounts, in the type of scenario that we are forecasting, with actual deficits sustained all the way to the projected horizon, the higher cost of foreign debt imposes a growing cost on medium term public spending, which is already under considerable pressure. If the cost of interest reached 0.76% of GDP in 2016 (almost US$ 1,900 million), it could rise to at least 1% of GDP in the medium term (US$ 2,500 million).

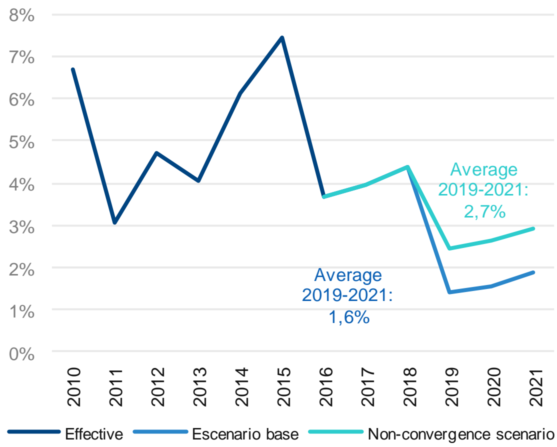
Presidential Definition 2018: Will the new Government continue to pursue the targeted convergence?

We have been issuing warnings for some time about the lack of scope for medium term increase in fiscal spending. The forecasts of the baseline scenario again show growth in spending as ring fenced at around 1.6% starting in 2019. However, this scenario takes into consideration that the structural deficit will be lowered to a rate of 0.25% of GDP, that is, in keeping with the target that was self-imposed by the current administration.

The alternatives for reaching an increased fiscal scope are 1) cutting spending 2) increasing taxation or 3) modifying the targeted convergence. Options 1) and 2) would be technically correct but difficult to implement. In regard to fiscal revenue, preliminary discussions indicate that there is a willingness to make tax adjustments, but there is no room for a rise in collections as was achieved in the 2014 Reform. In order to have a more efficient State, reduced expenditure would bring benefits, a point which has already been mentioned. However, there is still no mention of the regulations. With regard to option 3), there is a risk that it would have negative consequences macro-economically and for fiscal sustainability. As an exercise, Figures 7.1 and 7.2 show growth projections for expenditure and actual deficit under both the baseline scenario and a risk scenario, in which the structural deficit is maintained at 2018 levels (we estimate 1.5% of GDP). As can be appreciated, although higher growth in spending is achieved (average for 2019-2021 of 1.6% vs. 2.7%), it is noticeable that closure of the deficit has been abandoned, which would adversely affect the fiscal accounts in the long term.

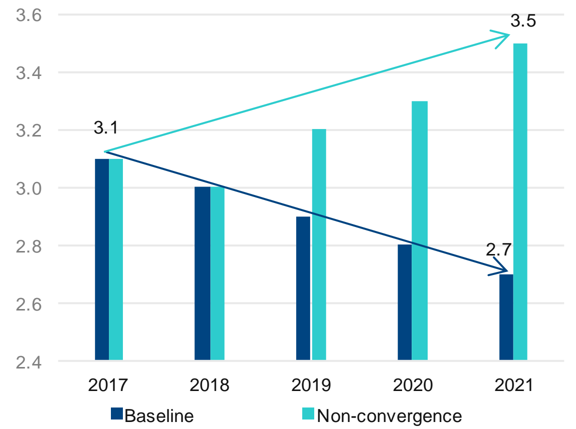
It will be essential to discover what the proposed structural target will be

Figure 7.1 Growth in Actual and Projected Public Spending (% variance)



Source: Government Budget Department, BBVA Research

Figure 7.2 Effective Fiscal Deficit Projections (% of GDP)



Source: BBVA Research

8. External risks dissipate but some remain that are idiosyncratic

A negative balance of risks is maintained in the short term

Monetary policy has taken a clear path toward delivering greater monetary stimulus than we believe is required to support the process of redirecting investment toward non- tradable sectors. Consequently, the risk of a late or inadequate response, which we raised in our previous report, has faded somewhat. There may still be a risk of slow depreciation of the currency, to a large extent because of the dollar's continued weakness worldwide, which we consider essential for supporting the recovery of investment and competition in the goods and services export sector.

Another additional risk factor this year is the presidential elections, which are already generating considerable political debate about reforms for various sectors and for the economy as a whole. There is no way of knowing whether the final effect of this debate will be positive or negative for the economy, but we do know that there will be uncertainty, at least until the candidates' specific proposals are known, and perhaps even until the result of the elections in December.

2016 ended with a third contraction in total investment, which deepened in the fourth quarter. For 2017, we predict that investment will fall again, but it would not be risk-free, given the possibility that business confidence might not recover and the fact that there is an inherent risk to the completion of projects under development, particularly in the energy sector. For now, our baseline scenario continues to envisage neutral levels of confidence in the latter part of this year or, at the latest, the beginning of 2018.

After Fitch and S&P's changed their outlook, the risk of a change of classification for sovereign risk has increased significantly and we do not rule out its happening this year, putting pressure on other agencies to move in the same direction. If these changes were to materialise, there would be adverse consequences for the cost of financing, making any recovery process even more difficult. We should also not ignore the damage to business confidence.

On the external front, the main risk to Chile in the medium term is still the performance of the Chinese economy, which could bring surprises, with a haphazard adjustment that would have significant effects on commodities, fiscal revenues, exports, investment and, ultimately, growth. A downturn in China's economy would also have a significant impact on other emerging markets, transmitted through financial channels as well as the real economy. This risk, although a factor in the last few reports, has lessened slightly.

We continue to view a tightening up of protectionist policies resulting from the new Donald Trump administration in the US as a global risk. It is difficult to estimate the effects, but there could be an impact on the dynamics of the external sector relevant to Chile. A more restrictive monetary policy on the part of the Fed, although risky from the viewpoint of external finance costs, would be positive for the currency, as we estimate that there is significant scope for peso depreciation without too much impact on inflation, given the easing on capacity and low inflation levels.

9. Tables

Table 9.1 Macroeconomic Forecasts

	2013	2014	2015	2016	2017	2018
GDP (% YoY)	4.0	1.9	2.3	1.6	1.6	2.4
Inflation (% Year on Year, eop)	3.0	4.6	4.4	2.7	3.2	2.9
Exchange rate (per US$, eop)	529	613	704	667	690	665
MPR (%, eop)	4.5	3.0	3.5	3.5	2.5	3.0
Price of copper (US$/lb)	3.32	3.11	2.50	2.21	2.54	2.46
Private Consumption (% YoY)	4.6	2.7	2.0	2.4	2.5	3.1
Public Consumption (% YoY)	2.8	4.4	4.5	5.1	3.4	4.0
Investment (% YoY)	3.3	-4.8	-0.8	-0.8	-1.3	2.7
Fiscal balance (% GDP)	-0.6	-1.6	-2.2	-2.7	-3.1	-3.0
Current Account (% GDP)	-3.7	-1.3	-2.0	-1.4	-1.4	-1.6

Source: Banco Central, BBVA Research

Table 9.2 Quarterly Macroeconomic Forecasts

	GDP (% YoY)	Inflation (% YoY, eop)	Exchange rate (per US$, eop)	Interest rates (%, eop)
Q1 14	2.9	3.5	563.8	4.0
Q2 14	1.8	4.3	553.1	4.0
Q3 14	1.3	4.9	593.5	3.3
Q4 14	1.7	4.6	612.9	3.0
Q1 15	2.6	4.2	628.5	3.0
Q2 15	2.1	4.4	630.0	3.0
Q3 15	2.4	4.6	691.7	3.0
Q4 15	1.9	4.4	704.2	3.5
Q1 16	2.5	4.5	682.1	3.5
Q2 16	1.7	4.1	681.1	3.5
Q3 16	1.8	3.1	668.6	3.5
Q4 16	0.5	2.7	667.2	3.5
Q1 17	0.0	2.9	670.0	3.0
Q2 17	1.3	2.7	690.0	2.5
Q3 17	2.0	3.1	698.0	2.5
Q4 17	3.2	3.2	690.0	2.5
Q1 18	3.7	3.4	687.0	2.5
Q2 18	2.6	3.2	683.0	2.5
Q3 18	1.2	3.0	674.0	2.8
Q4 18	1.9	2.9	665.0	3.0

Source: Banco Central, BBVA Research

BBVA | Research

LEGAL NOTICE

This document, prepared by BBVA Research Department, is informative in nature and contains data, opinions or estimates connected with the date of its publication. These derive from the department's own research or are based on sources believed to be reliable, and have not been independently verified by BBVA. BBVA therefore makes no guarantee, express or implied, as to the document's accuracy, completeness or correctness.

The estimates contained within this document have been formulated according to generally accepted methodologies and should be taken as such, i.e. as estimates or projections. The historical evolution of economic variables (positive or negative) is no guarantee that they will evolve in the same way in the future.

The contents of this document are subject to change without prior notice for reasons of, for example, economic context or market fluctuations. BBVA does not give any undertaking to update any of the content or communicate such changes.

BBVA assumes no responsibility for any loss, direct or indirect, that may result from the use of this document or its contents.

Neither this document nor its contents constitute an offer, invitation or solicitation to acquire, divest or acquire any interest in assets or financial instruments, nor can it form the basis of any contract, commitment or decision of any kind.

In particular as regards investment in financial assets that may be related to the economic variables referred to in this document, readers should note that in no case should investment decisions be made based on the contents of this document; and that any persons or entities which may potentially offer them investment products are legally obliged to provide all the information they need to take these decisions.

The contents of this document are protected by intellectual property law. It is expressly prohibited to reproduce, process, distribute, publicly disseminate, make available, take extracts, reuse, forward or use the document in any way and by any means or process, except where it is legally permitted or expressly authorised by BBVA.

BBVA | Research

This report has been produced by the Chile Division

Head Economist, Chile
Jorge Selaive
jselaive@bbva.com

Hermann González
hgonzalezb@bbva.com
+56 229391354.

Cristóbal Gamboni
cristobal.gamboni@bbva.com
+56 229391034.

Waldo Riveras
wriveras@bbva.com
+56 223931495.

BBVA Research

Chief Economist BBVA Group
Jorge Sicilia Serrano

MACROECONOMIC ANALYSIS
Rafael Doménech
r.domenech@bbva.com

Global Economic Situations
Miguel Jiménez
mjimenezg@bbva.com

GLOBAL FINANCIAL MARKETS
Sonsoles Castillo
s.castillo@bbva.com

Long term Global Modelling and Analysis
J. Julián Cubero
juan.cubero@bbva.com

Innovation and Processes
Oscar de lasPeñas
oscar.delaspenas@bbva.com

FINANCIAL SYSTEMS AND REGULATION
Santiago Fernández de Lis
sfernandezdelis@bbva.com

International Coordination
Olga Cerqueira
olga.gouveia@bbva.com

DIGITAL REGULATION
Álvaro Martín
alvaro.martin@bbva.com

Regulation
MaríaAbascal
maria.abascal@bbva.com

FINANCIAL SYSTEMS
Ana Rubio
arubiog@bbva.com

FinancialInclusion
David Tuesta
david.tuesta@bbva.com

Spain and Portugal
Miguel Cardoso
miguel.cardoso@bbva.com

United States
Nathaniel Karp
Nathaniel.Karp@bbva.com

Mexico
Carlos Serrano
carlos.serranoh@bbva.com

Middle East, Asia and Geopolitical
Álvaro Ortiz
Alvaro.ortiz@bbva.com

Turkey
Álvaro Ortiz
alvaro.ortiz@bbva.com

Asia
Le Xia
le.xia@bbva.com

South America
Juan Manuel Ruiz
juan.ruiz@bbva.com

Argentina
Gloria Sorensen
gsorensen@bbva.com

Chile
Jorge Selaive
jselaive@bbva.com

Colombia
Juana Téllez
juana.tellez@bbva.com

Peru
Hugo Perea
hperea@bbva.com

Venezuela
Julio Pineda
juliocesar.pineda@bbva.com

ENQUIRIES TO: BBVA Research: Calle Azul, 4. Edificio de la Vela - 4ª y 5ª plantas. 28050 Madrid (Spain). Tel.:+34 91 374 60 00 y +34 91 537 70 00 / Fax:+34 91 374 30 25 - bbvaresearch@bbva.comwww.bbvaresearch.com