

Chile Macro Update

HOPE OF RECOVERING CRUISE VELOCITY

- The economy is expected to accelerate in coming quarters as two main hurdles (terms of trade and political environment) are set to improve. Economic conditions are basically balanced in Chile (low inflation, modest current account deficit, deteriorating but still acceptable fiscal accounts) and signal a gradually improving macro outlook.
- Two main risks for the recovery are linked to the same factors that improved considerably in the last weeks: sustainability of both better terms of trade and political ability to make easier investment.

MACRO SITUATION

Current year economic growth is expected at +1.4%, which would represent a marginal slowdown relative to 2016 (+1.6%). A stronger recovery is expected to be gradually evident in H2, especially in Q4, and at this point, reverting to the sluggishness we witnessed in H1 2017 seems unlikely. For 2018, growth should accelerate to 2.8%, with an upward bias, boosted by better terms of trade and a likely better domestic environment for business. Both factors improved considerably in the last weeks, but not soon enough to have a dramatic impact in current year. On the spending side, investment contracted more than originally expected this year, to a weak +0.8%, but a rebound to 2.8% is forecasted for 2018, with a sustained rebound in machinery and a progressive improvement in construction. As for private consumption, it should accelerate from 2.4% in the current year to 3.3% the next, shored up by lower inflation though a still shaky labor market will remain a drag. Durable goods sales should stay strong, while a mild recovery in non-durable goods is expected. Though in economics and investment, we see patterns that rhyme, but don't repeat themselves, current macro conditions for the Chilean economy remind us of those we saw at the beginning of the previous decade that was followed by a sustained growth of six or seven years.

Inflation remains subdued because the exchange rate has remained within a relatively narrow trading range, and on the other hand, below-trend growth has led to increasing spare capacity (of both capital and labor). Inflation in the current year could close near 2.6%, and converge to 3% for 2018. In August the Chilean peso (CLP) appreciated frenetically, propelled by copper prices and a broadly weak USD. Our forecast for year-end points to an exchange rate of 641 USD/CLP, and next year the appreciation should continue to 631 USD/CLP. As for capacity utilization, we expect it to move towards 80%, while average unemployment rate should gradually move towards 6.9% for the current year. Though both seem aligned with the rhythm of the economy, we expect the former will become restrictive before the second in coming quarters. Amidst this panorama, part of the market is expecting more monetary stimulus, and as the peso rallies, the probability is increasing. However, our base case is still no change in the MPR (currently at 2.5%) for the rest of the year. There is not yet room, nor political support for fiscal actions (more expansive), meaning spending will be likely be kept in check.

CONTACTS

Benjamin Sierra
56.2.2619.4974 (Chile)
Scotiabank Chile
benjamin.sierra@scotiabank.cl

Chart 1

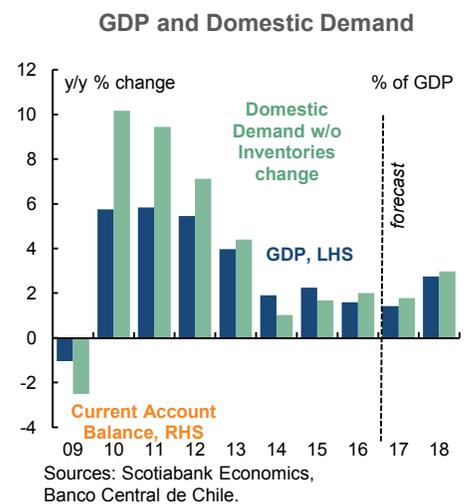
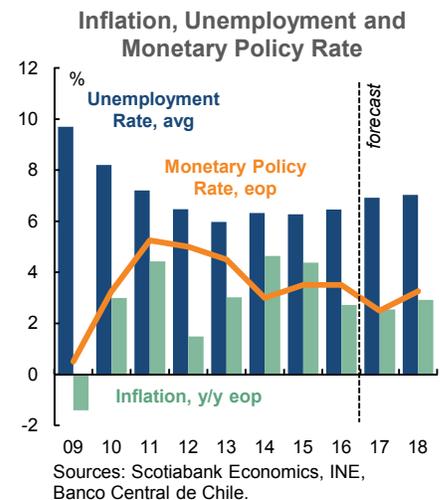


Chart 2



POLITICAL PANORAMA

General election will take place on November 19th (President, half the Senate, and the whole House): surveys show Mr. Piñera (opposition, pro market and growth) with support around 43%, followed by Mr. Guillier (center left, including the communists) with 18%, Mrs. Sánchez (left) polls around 18% and Mrs. Goic (center, Christian Democratic) with 5%. There are 3 more candidates (all of them rather left-leaning) with less than 2% each. To the right of Mr. Piñera, we have J.A. Kast with 5% support in recent polls. Markets seem to be converging to the view that a Piñera victory is highly likely. Regarding Congressional elections, there are no surveys yet (candidates only became known two weeks ago), but expectations are that the opposition (Chile Vamos) will recover a stronger position, relative to center left groups (including the currently ruling Nueva Mayoría). However, even though the center right's position is expected to strengthen, it is not expected to have a strong enough showing to get a majority.

Even in a country that has recently leaned to the left in the political spectrum, weak growth and episodes of disappointing leadership and lack of reform have pushed the pendulum to swing towards Piñera. However, center-left groups will likely keep strong support from some unions and in the street (as in other countries of the region or Southern Europe). The main challenge for Mr. Piñera will be to disentangle/fix some of Bachelet's reforms: mainly on tax and labor markets (the second would be even harder than the first) and to speed up process for infrastructure investment execution (environmentalists and political interests raised hurdles that are affecting execution). A potential Piñera government is expected to act as quickly as possible to benefit from tailwinds. However, it's worth noting that despite the presidential and legislative period being only 4 years long, Mr. Piñera's agenda includes several items with an 8-year horizon, which suggests a stronger interest to get a second period for the coalition than they showed in the previous period 2010–2014.

MAIN RISKS

As in any forecast, there are positive and negative factors (in this case, with a balance positively biased). The main major risks we see are: a political stalemate, and a Chinese slowdown which is deeper than expected. Our sense is that the probability of them is lower than 25% each, and a probability of less than 6% for them taking place together. The latter would be even more serious and hard to manage than the first, because the country is already in a weaker position than 4 years ago.

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