LATAM Market Update

- **Chile: President Piñera announces several social measures to appease protests**

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Context

On October 6th, Metro de Santiago, the capital's subway operator, raised the price of its tickets to as much as $830 pesos (about US$1.15) during peak hours—just weeks after the government announced a 10% hike in electricity bills. On October 18th, a student-led protest against the fare hike spiraled into arson and looting in public and private infrastructure. Further protests and damages caused widespread disruption in cities across the country. What began as protests against subway-fare increases quickly morphed into outpourings of discontent over income inequality, pensions, health and education. President Sebastian Piñera declared a state of emergency last Friday and called on the army to restore order. On Saturday, Piñera back-pedaled on the Metro fare increase, but violence had already unleashed.

The government initially tackled the violence as a law-and-order matter, an approach that only made things worse. However, in a televised address on October 22nd, President Piñera apologized for having failed to recognize the genuine grievances behind the protests and set out a new social agenda.

What's in this new social agenda?

- **Pensions**

1. Immediate increase of 20% of the Basic Solidarity Pension, which will benefit 590 thousand pensioners.
2. Immediate increase, as soon as the law is approved, of 20% in the Solidarity Pension, which will benefit 945 thousand pensioners (which do not receive the Basic Solidarity Pension).
3. Additional increase in basic pensions and solidarity pensions, during the years 2021 and 2022, for pensioners over 75 years.
4. Contributions from fiscal resources to complement the pension savings of the middle class and the women who work and contribute, to increase their pensions at the time of retirement, which will favor 500 thousand workers.
5. Contributions from fiscal resources to improve pensions for non-senior citizens.

- **Health and medications**

1. Immediate discussion for the proposed Bill that creates the Catastrophic Diseases Insurance, in order to ensure a ceiling for family health spending. The expense that exceeds that ceiling will be covered by the Insurance.
2. Creation of Insurance that covers part of the expenditure on medicines of Chilean families, not covered by other insurance programs.

3. Extension of the National Health System Fund agreement with pharmacies to reduce the price of medicines, which will benefit more than 12 million people.

- **Guaranteed Minimum Income**

  Creation of a Guaranteed Minimum Income of $350 thousand pesos per month (about US$490), to complement the salary of full-time workers when it is less than $350 thousand pesos. The difference between the Minimum-Wage (paid by firms) and the Guaranteed Minimum Income will be funded by fiscal revenues. This benefit will be applied proportionally to those under 18 and over 65.

- **Electricity rates**

  Creation of a mechanism to stabilize electricity rates, which will allow the recent 9.2% increase in electricity to be canceled, returning the value of electricity rates to the level of the first half of this year. This stabilization mechanism will work similarly to the mechanism already implemented to stabilize fuel prices.

- **Income tax rate**

  Higher taxes for the highest income sectors: Creation of a new tranche in the Income Tax, applying a 40% rate for incomes exceeding $8 million pesos per month (about US$11,000), which will increase tax collection by US$160 millions.

- **Others**

  1. Greater equity between high and low income municipalities: Strengthening of the Municipal Common Fund, establishing greater contributions from the higher income municipalities, for the benefit of lower income ones. This will allow greater equity in the provision of municipal services such as security, lighting, infrastructure, parks, sports, recreation and others.

  2. Congress and Public Administration: Reduction on the wages of parliamentarians and high-salaried public workers, reduction in the number of parliamentarians and limitation of re-elections.

  3. Reconstruction plan for damages and destruction caused by violence occurred in recent days, causing serious damage to public infrastructure, especially in subway (Metro) and other public facilities. This Reconstruction Plan will commit resources for more than US$350 millions.

Fiscal cost of the agenda

According to the Ministry of Finance, the social package has an estimated cost of US$1,200 MM (around 0.4% of GDP) in 2020. This fiscal stimulus will be partially funded by reallocation of fiscal expenses and increases in income taxes, generating a higher fiscal deficit for the part not covered by tax revenues. Probably, this fiscal deficit will require a mix between the emission of debt and the use of treasury assets. In sum, the convergence of both the structural and effective fiscal deficits will be postponed.

Changes in our macroeconomic outlook

Social disruptions have generated capital losses in public and private sectors. Preliminary estimates account for about US$500 million in damages. These circumstances have led us to adjust our short-term economic activity forecast, and also our macroeconomic outlook for next year. Short-term impact on economic activity is negative due to a reduction in working hours, generated by a curfew decreed by the Government and massive disruptions in transport services. Economic activity has slowed down significantly, especially in manufacturing, commerce and services. We estimate a negative impact between 1.5-2.5pp on economic growth for October, leaving an activity expansion of 0.5-1.5% y/y.

Additionally, due to higher uncertainty on both current events and future developments, we expect consumer and business confidence to remain pessimistic for a longer period, postponing the recovery in domestic demand. All in all, we reduce our growth forecast for 2019 and 2020 to 2.2% and 2.7%, respectively (from a previous 2.7% and 3.2%).

The agenda recently announced by President Piñera is a first step to overcome social unrest. It includes an important fiscal package that we believe would have a positive impact on economic activity next year, since it will boost domestic demand and improve confidence measures.

In terms of prices, we have adjusted downward our inflation forecast for December 2019 to 2.8% y/y, from a previous 3.0%, due to the freezing in electricity bills and subway rates. Due to methodological factors, the hikes announced in October in electricity and transport services will have an impact on this month's CPI (+0.3pp) but would be reversed in November (-0.3pp). On the other hand, we incorporate an upward bias in the CPI for next year due to a higher CLP, which will have a significant effect on imported goods and some services. In addition, we estimate higher inflationary pressures coming from higher public and private expenditures.

The Central Bank will continue stimulating the economy, with a cut of 25 bp in yesterday's meeting, and maintaining a dovish bias linked to external and domestic headwinds. We expect the monetary policy rate to reach 1.5% by mid-year 2020.

—Jorge Selaive, Carlos Muñoz & Waldo Riveras