

# Chile

	<b>COUNTRY RISK CATEGORY</b> <h2>2/7</h2> <p>The country risk categories range from 0 to 7. The lower the number the better the credit rating the country has.</p> 	<b>EKN'S OUTSTANDING GUARANTEES TO THE COUNTRY</b> <b>SHORT-TERM TRANSACTIONS:</b> SEK <197> MILLION <b>MEDIUM AND LONG-TERM TRANSACTIONS:</b> SEK <1,140> MILLION
	<b>DATE</b> <h2>12/02/2015</h2>	

## Politically stable, but slowing growth

The political situation in Chile is stable. The democratic agenda has been followed exemplarily since the military handed over power in 1990. The country also has a long tradition of responsible economic policies, which is appreciated by the international financial markets. Falling commodity prices and lower demand have however led to substantially lower growth for the time being. The major income disparities in the country serve as a factor of uncertainty. The centre-left coalition's return to power, led by President Michelle Bachelet, will lead to reforms geared toward income equalisation. The country's more recent tradition of consensus solutions will most likely persist, but the changed majority situation in the parliament will increase the government's propensity toward unilateral solutions. However, it is highly likely that the situation will remain under control within the bounds of the country's parliamentary system.

### THE COUNTRY'S STRENGTHS AND WEAKNESSES

#### Strengths

- Political consensus on economic policies
- Basic political stability
- Strong institutions and a robust banking system

#### Weaknesses

- Large income disparities could create political problems
- Lack of economic diversification and innovation
- Lack of domestic energy

## EKN'S POLICY

### **No special restrictions**

EKN has Chile in country risk category 1 for short-term guarantees and country risk category 2 for long-term guarantees. Chile is no longer categorised within the OECD, as Chile is now a high-income country. Regardless of the buyer category or the duration of the credit period, EKN has no specific, general restrictions, but each transaction is assessed on its own merits.

## WHAT MIGHT CAUSE A CHANGE IN THE COUNTRY POLICY?

### **The policy may be made less restrictive in the event of**

- Increased export diversification and reduced dependence on copper
- Increased public savings to reduce the effects of commodity price fluctuations

### **The policy may be made more restrictive in the event of**

- The lack of income equalisation reforms potentially leading to increased social conflict
- Continuing low international copper prices

## EKN'S EXPOSURE AND EXPERIENCE

### **Chile keen to maintain its good reputation**

EKN's payment experiences from Chile are on the whole very good. It is clear that the government is very keen to maintain its good relations with lenders. EKN's outstanding guarantees for transactions in Chile totalled just over SEK 1.3 billion, and the vast majority were guarantees for exports of buses for the public transport system in Santiago.

## COUNTRY ANALYST



<Image>

EKN's country analyst for Chile:  
Claes Nordström

## DISCLAIMER

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### **Domestic policy consensus**

Political developments in Chile have been calm since democracy was restored in 1990. The country has been ruled by centre-left governments ever since, with the exception of the period from 2010 to 2013 when a right-wing alliance under Sebastian Piñera took power. His term of office was characterised by economic successes, but also social protests. However, the 2013 elections restored the old order and the centre-left coalition under former President Michelle Bachelet is back in power.

As regards economic policy, consensus between the various parties is relatively high – both the current and former governments have adopted orthodox economic policies with a clear market economy orientation. Piñera's government stood for continuity rather than change, but despite its right-wing profile, it has made welfare-oriented reforms. One key objective of Michelle Bachelet is to overhaul the tax system, and, in particular, reform the educational sector. Constitutional reform is also high on the agenda. The constitution drafted during the time the military government ruled significantly complicates the ability to create voting majorities in the parliament for any of the political blocks.

The government's challenge is to manage the large and increasing income disparities in the country. These disparities should also be seen in the context of the fact that there are a small number of groups that in practice control a large portion of economic activity in Chile. One manifestation of this problem can be seen in the large-scale student demonstrations that have been held in recent years. The students are demanding a fairer educational system where poorer Chileans have the same opportunities as richer Chileans. This also served as a foundation for the policies Bachelet formulated. In spite of the fact that this government, as opposed to its predecessors, has a parliamentary majority on many issues, it has proven problematic for Bachelet to push through her reforms. One reason is disagreement within the governing coalition. Nevertheless, it seems likely that some kind of solution in an orderly parliamentary form can eventually be achieved, given Chile's recent tradition of consensus.

Chile's relations with neighbouring countries have often been problematic. As a result of Chile's centuries-long conflict with Bolivia on its claims for access to the sea, Chile does not have access to Bolivia's coveted natural gas. In addition, Chile cannot rely on uninterrupted supplies of natural gas from Argentina, whose export potential is limited because of the energy crisis there. Argentine import restrictions have further complicated relations between the two countries. Chile's energy situation will continue to be an Achilles heel in light of its lack of energy resources and the difficulty of developing nuclear power due to the risk of earthquakes. Chile is therefore dependent on the supply of energy in neighbouring countries.

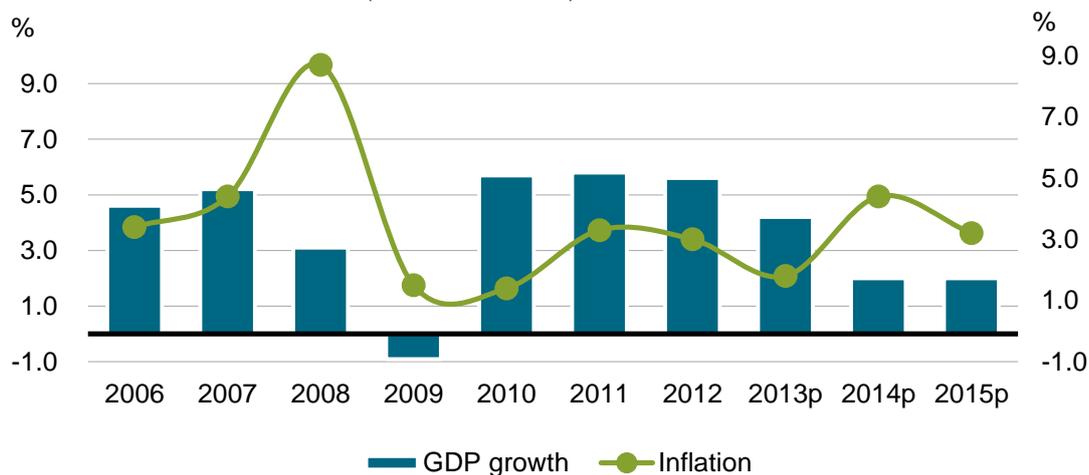
There is a genuine desire throughout Chilean society for unity and peaceful development following years of political turmoil in the 1970s and the 1980s. Sebastian Piñera tried to emphasise this tendency with consensus-based policies and Michelle Bachelet will also continue working in this direction. It is therefore highly likely that domestic political conflicts will be manageable within the bounds of the parliamentary system.

## Copper dominant

Copper dominates the Chilean economy and has traditionally accounted for nearly 40% of export revenue. The high copper prices of recent years have enabled the creation of a stabilisation fund, which can now be utilised given today's significantly lower copper prices. Other important export products consist primarily of fruit, fish and fish meal, wine, and wood and paper products. In terms of Chile's markets, its exports are relatively evenly distributed between the US, EU, Asia and Latin America. Chile signed a trade agreement with the EU a few years ago and has subsequently joined as a member of the North American free trade zone, NAFTA. In recent years, China has become an increasingly important trade partner and its high demand played a part in the high international copper prices. This has contributed to the very good economic growth in Chile in the 2000s.

However, reduced demand from China over the past year, and the resulting drop in copper prices, has left its mark on the Chilean economy. Growth came in at only 2% last year and is expected to remain on that level this year. The level of investment has fallen a couple of percentage points over a couple years to just below 24%. This is partially related to a decrease in investments in the mining sector due to the lower copper prices, but is also due to greater uncertainty within the Chilean business community as a result of the government's proposed tax reforms – which include higher corporate tax rates. The ongoing economic slowdown is partially being counterbalanced by the fact that the Chilean export industry is benefiting from the North American recovery, but also the fiscal and monetary easing which has in particular led to a more competitive exchange rate. The country's good public finance situation thus gives the country room for manoeuvre in a rougher economic environment. The combination of steady growth and price stability are likely to continue to be features of the Chilean economy in the future.

GDP – GROWTH AND INFLATION (SOURCE: IMF, EKN)



*Economic growth is well balanced in Chile but also sensitive to global fluctuations.*

However, Chile's long-term growth potential is increasingly being called into question. The low level of education in Chile in particular is restricting the potential to increase productivity in existing industries – this is something that the proposed education reform aims to change.

Arguably, the most important problem to tackle is however the lack of economic diversification. The question is therefore ultimately about the future potential of the country's commodity-based export model, in the absence of any new export products. Raw materials, particularly copper, continue to dominate and make Chile sensitive to fluctuations in international commodity prices.

The Chilean business community is known more for its administrative efficiency (especially in a Latin American context) than its creativity. Chile's well-managed administration is a glowing testament to the country. The same can be said of the country's public administration, even though the corruption cases of recent years have tarnished this image a little. However, the country must still be considered relatively spared from the much more prevalent and widespread corruption that is common in other Latin American countries.

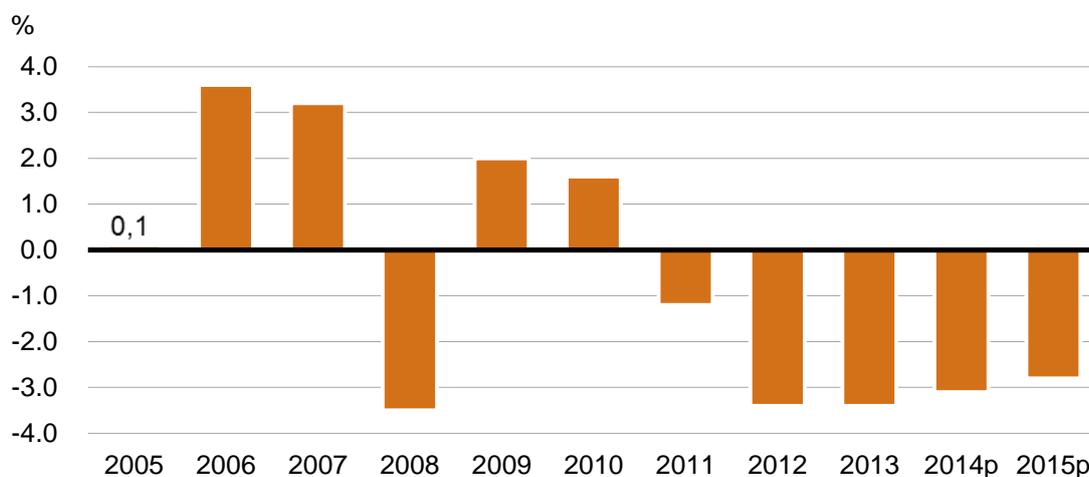
The problems in many other Latin American countries with respect to weak finances on the state level are not at all as common in Chile, as the country is much more centrally controlled than other countries. The country's traditionally austere fiscal policies have consequently paved the way for balanced development in the public sector and created scope for countermeasures when the country was exposed to external shocks. Overall, it is highly likely that the Chilean economy will move forward steadily in the long-term, but at a lower rate, given the weak trend in the country's outlet markets.

#### BALANCE OF PAYMENTS AND DEBT ISSUES

##### Good relations with the financial market

As a result of the positive economic growth in Chile, the country has had no need of IMF financing or debt renegotiations for some time. The country's relations with the IMF are very good and its debt is moderate. Different Chilean governments over the years have also demonstrated a very strong will to meet their obligations. The extensive structural reforms implemented in the 1980s and 1990s (including deregulation, privatisation and liberalisation) have enabled the country to fend off both external and internal pressures.

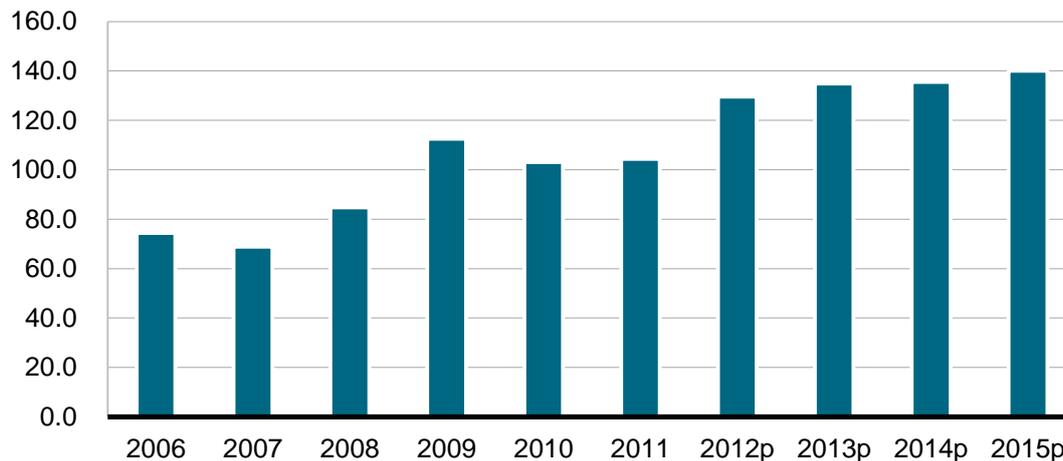
CURRENT ACCOUNT BALANCE (% OF GDP) (SOURCE: IMF)



*The amount of direct investments is more than enough to cover the increasing current account deficit.*

The country's well-managed economy has also made it popular to invest in for the international capital market, which however has created problems in the form of an appreciating exchange rate. This is one reason why the current account balance has run a deficit over the past years, although it has been fully counterbalanced by the inflow of direct investments. The deficit will likely decline in the future, given that the Chilean peso is currently dropping in value.

EXTERNAL DEBT (% OF EXPORTS) (SOURCE: IMF)



*Chile's debt is relatively moderate, but private debt in particular is on the rise.*

#### CURRENCY POLICY

##### **Independent central bank**

Chile's central bank has independent status. The bank uses a floating exchange rate with an inflation target set over a two-year period. The central bank may also intervene in the currency market, which it previously did during periods of substantial exchange rate fluctuations. The central bank's floating exchange rate, inflation target policy and policy of fiscal austerity are minimising the risk of economic collapse. The Chilean currency has a high degree of convertibility and can be assessed by EKN in transactions financed in local currency. Chile also uses an inflation-proof variant of the Chilean peso called the Unidad de Fomento (UF), which is a unit chiefly used for international transactions, but also for pricing capital goods and for long-term contracts. The central bank adjusts its value on a daily basis.

#### FINANCIAL SECTOR

##### **Strong banking sector**

Institutionally, Chile is a relatively highly developed country where leading institutions such as the ministry of finance, central bank and the banking regulatory authority all have a very good reputation. In particular, the banking regulatory authority's strict regulation of the financial sector has led to Chile currently having Latin America's strongest and most developed banking system. The banking system's assets are equal to over 90% of the country's GDP, far above the Latin American average. Lending in relation to GDP is high, while the proportion of credit losses is limited to just over 2%. The banking system also has a high rate of capitalisation. The lending rate in proportion to assets is high on a regional level, but the high confidence of depositors and the very limited amount of short-term financing provided significantly reduce the refinancing risk.

Foreign influence is considerable (over 60%) and market concentration is high. The four largest banks (one foreign-owned, two domestic private and one government owned) have about two-thirds of the loan market. Spanish banks (Santander, BBVA) play considerable roles on the Chilean market. However, the European financial crisis has had very little impact in Chile due to the Chilean banking system's limited exposure to European banks in terms of borrowing.

**BUSINESS ENVIRONMENT**

**Concentrated ownership**

Chile's stable macroeconomic climate has facilitated the growth of a healthy and relatively well-managed business sector. However, ownership is highly concentrated to a few groups of owners who also largely dominate the media sector and public opinion. The availability of financial information on private buyers is good, and imports on open credit are common. Letters of credit are rare. Demand for financing solutions via EKN is also limited on a relatively mature market such as Chile.

The World Bank's Doing Business Indicators rank Chile 41st (out of 189). Chile is just behind Colombia, Peru and Mexico in Latin America. The lack of a higher ranking reflects a general Latin American problem: the slow legal system (albeit less pronounced in Chile). In other business environment aspects, such as rule of law, control of corruption and transparency, the country is at par with the other OECD countries

**EKN'S EXPOSURE**

**Transport sector dominant**

EKN's outstanding guarantees for transactions in Chile totalled just under SEK 1.5 billion, and the vast majority are guarantees for exports of buses for the public transport system in Santiago. The value of the offers is over SEK 300 million, relating to guarantees in several different industries.

OFFERS & GUARANTEES, SEK MILLION

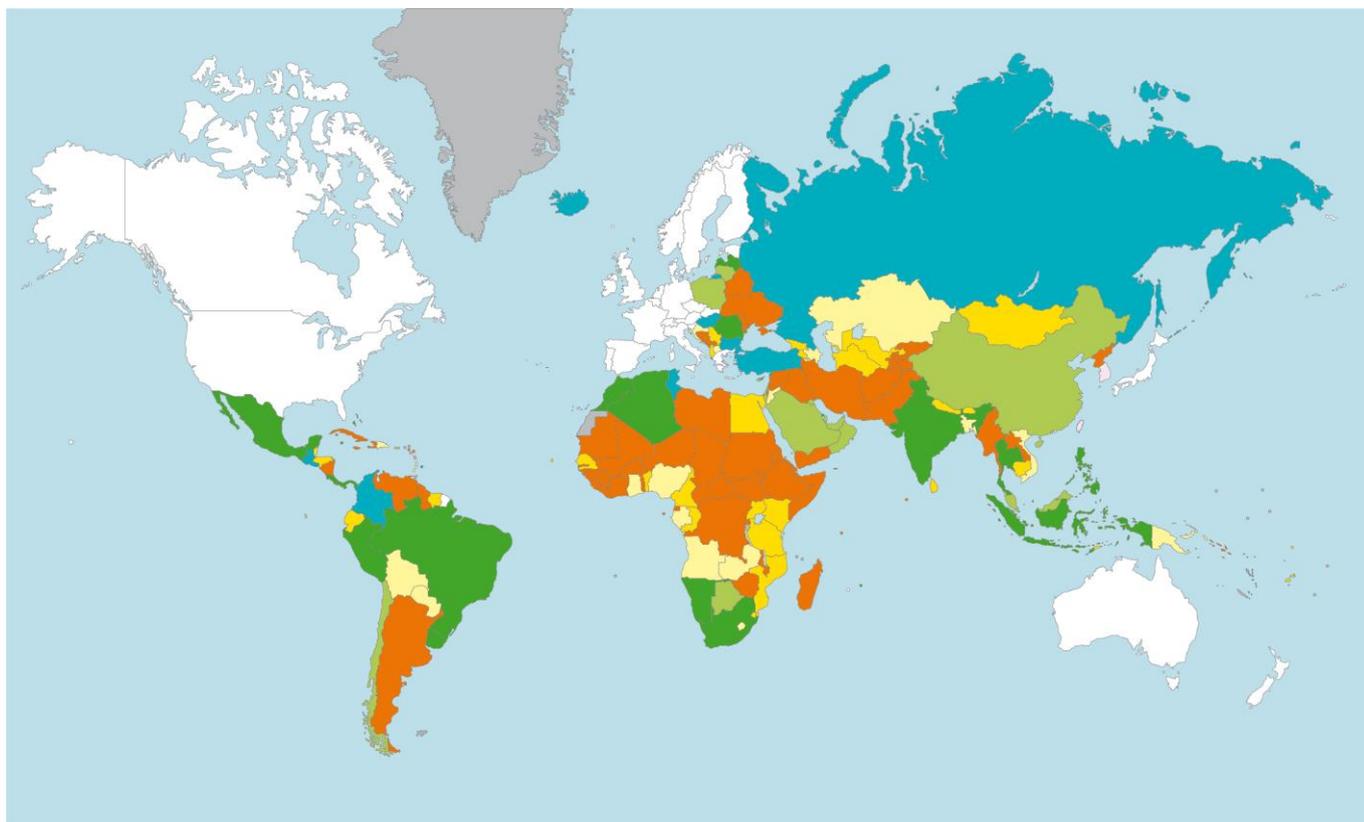


*The volume of guarantees has been relatively constant over the past years, although there has been an increase in the number of guarantees.*

### Chile keen to maintain its good reputation

EKN's payment experiences from Chile are on the whole very good. The same is true of the experiences of the other private and public export credit insurers that are members of the Berne Union (an industry association which includes EKN). However, payment delays in the private sector do occur, but mostly for administrative reasons. Transactions involving the public sector are working well. It is clear that the government is very keen to maintain its good relations with lenders.

COUNTRY DATA	CREDIT RATINGS
<b>Area:</b> 756,945 km <sup>2</sup> (1.7 times Sweden) <b>Population:</b> 17.4 million (YYYY) <b>GDP:</b> USD 281.7 billion (Sweden USD 552 billion) <b>GDP/capita:</b> USD 19,100 (Sweden USD 40,900)	<b>Moody's:</b> Aa3/Aa1 <b>S&amp;P:</b> AA-/AA+ <b>Fitch:</b> A+/AA+



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 The lower the number the better the credit rating the country has.



**EKN – CREATING CONFIDENCE IN YOUR EXPORTS**

EKN is a government agency that supports Swedish exports and the internationalisation of Swedish industry. This we do by offering exporting companies and banks guarantees for payment and financing, together with advice on business structure and risk management.

Our services provide an extra level of confidence, increased competitiveness and more opportunities for successful export transactions.

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