

General Political Environment:

The ruling centre-left coalition, commonly known as the "Concertación", won its fourth consecutive term in elections held in December 2005. Concertación has been in power since Chile's transformation from a dictatorship to a democracy in 1990. An alliance of the two principal right-leaning parties, called the Alliance for Chile, constitutes the main opposition. While Concertación includes extreme leftist groupings, and the Alliance includes parties of the far right, both compete vigorously for the crucial centrist vote.

When elected, Chilean President Michelle Bachelet promised continuity on various fronts and has maintained the country's orthodox economic policies. Despite her leftist stance, she has proven to be as moderate and pragmatic as her predecessor, Ricardo Lagos. Her key social objectives include pension reform, job creation, labour reform, increasing opportunities for women and the indigenous and an education system upgrade.

Bachelet's popularity dropped as a result of various protests against her educational reform proposals and in reaction to the shortcomings of the transit system in Santiago. Her attempts to increase her support include cabinet changes in late October 2008 and early 2009, as well as the possibility of reforming Chile's two-party electoral system through a national referendum. Although the latter is popular, the opposition has repeatedly voiced its disagreement with the proposal because it would expand the number of parties competing, not to mention the fact that the plebiscite would by-pass Congress. Despite the initial support from the Congress for the Bachelet administration, the impeachment of Education Minister Yasna Provoste in April 2008 over financial irregularities has proven that the Legislature has the potential to constrain over the government.

Chile experienced deep national trauma stemming from the extensive human rights abuses committed under right-wing dictator Augusto Pinochet (1973-1990). The Concertación has made great strides in reconciling with the country's violent past and the Bachelet government is expected to continue these efforts. Pinochet died in late 2006, but the government intends to prosecute those members of his regime and family accused of human rights abuses and fraud.

A series of constitutional amendments adopted in 2005 made a clear break with the country's authoritarian past. The new constitutional framework increases civilian control over the military, eliminates senatorial appointments and reduces the presidential term from six to four years.

Investment Environment:

Chile has successfully negotiated free trade agreements with several partners including Canada, Japan and the US. These agreements underscore Chile's status as a free-trading nation.

Chile officially encourages foreign investment and investment legislation has been incrementally liberalized since 1974. The country also benefits from a transparent regulatory system and well-functioning bureaucracy.

There is no waiting period before profits can be repatriated, and investors are guaranteed access to foreign exchange in the inter-bank currency market.

Systemic problems in Argentina's energy sector have serious implications for Chile. Argentina's government has repeatedly restricted gas shipments to Chile to ensure adequate domestic supply.

In September 2009, ILO Convention 169 became law in Chile. The convention requires that the government consult with indigenous communities whenever it is considering legislative or administrative measures which may directly affect them. This also means that private investors should consult with indigenous communities on planned investment projects.

Political Violence:

Since Chile's return to democracy in 1990, there has been very little political violence, but occasionally small bombs have planted by anti-globalization activists or those with political grievances.

Strikes and demonstrations are commonly used as a means to express grievances, including labour unions and environmental activists. The mining sector is especially vulnerable.

Political

Political Structure

Presidential Republic

President

Michelle Bachelet

Legislative Bodies

- Congress (120 seats)
- Senate (38 seats)

Major Parties (seats in Congress)

- Concertación of Parties for Democracy (Concertación) (62)
- Alliance for Chile (Alianza) (53)
- Communist Party of Chile (PCC)
- Humanist Party (PH)

Last Elections

- Presidential: December 2005-January 2006
- Legislative: December 2005

Next Elections

- Presidential: 13 December 2009
- Legislative: December 2009

Press Freedom Survey:

- 2008 Score: 30 Free (0: Free; 100: Not Free)
- freedomhouse.org

Control of Corruption Index:

- 2008 Score: +1.31 (-2.5: Worst; +2.5: Best)
- worldbank.org

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Political Outlook

Chile's now-solid foundations in economic management and democratic rule point towards policy stability for the foreseeable future. Despite the fact that Bachelet figures amongst South America's growing pool of leftist leaders, she is considered moderate and pragmatic. Although her administration's approval ratings substantially fell for most 2008, they have again risen as it has shown a remarkable management of the economy during the current global economic uncertainty. Therefore, although Presidential elections are shaping up for the opposition conservative coalition *Alianza* to wrest power away from the ruling *Concertación*, the latter now seems to have a better chance of remaining in power for a fifth consecutive Presidential term.

Economic

Credit Rating:

Moody's: A1
S&P: A
Fitch: A+

Nominal GDP (2008):

USD 169.5bn

Population (2008):

16.8mn

Total Trade / GDP:

74.9%

Currency:

Chilean Peso

Exchange Regime:

Independently floating

Merchandise Imports from Canada (2008):

CAD 675.5mn

Main Sources of Foreign Exchange (excl. FDI):

Copper

Largest Trading Partners:

United States
Japan
Argentina
Brazil

Main Imports:

Intermediate goods
Capital Goods

Risks to the Outlook:

↑ Fiscal Stimulus
Spending
Loose Monetary
Policy

↓ Sustained low
copper prices

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Market Spotlight: Lower copper prices will drive GDP growth down sharply this year. ■ Inflation became negative in August (-1%), as a consequence, the Central Bank is expected to maintain interest rates at very low levels until mid 2010 ■ The government's use of counter-cyclical fiscal policy coupled with the monetary stimulus are expected to start reversing the sharp economic slowdown starting early next year.

Real Sector: Chile was one of the first countries in the region to hit the recession mark last year and given some of the characteristics of this economy (small, very open, commodity dependence, trade ties with the US, etc), we expect it will recover in tandem with most developed economies. Most economic indicators released so far this year are still at record lows. We expect GDP to fall by 1.9% in 2009 and rebound by 2.3% in 2010.

Monetary Policy: As a result of weak domestic demand, inflation has decrease dramatically since the beginning of the year and it is now in negative territory (-1.1% y/y in September). We expect that economic deceleration - owing to both weaker exports and household consumption - will maintain inflation at very lower levels over the next two years. Amid a rapidly slowing economy, the Central Bank has slashed rates by 775 basis points so far this year and we expect it will keep rates at very low levels in 2009 and 2010. Despite the historic low rate (0.5%), the peso has appreciated considerably over the last couple of months driven by higher copper prices. We expect the currency to stabilize around P\$/USD 565 by the end of the year.

External Sector: Notwithstanding negative shifts in Chile's terms of trade, the country benefits from an upbeat balance of payments medium-term outlook. That said, as a small open economy (trade accounts for 75% of GDP), Chile has suffered directly from the impact of the global slowdown and lower commodity prices. As a result, we expect the current account deficit to be around 2.5% of GDP this year. On a positive note, the CA deficit will be fully financed by FDI and Chile will continue benefitting from its investment grade status. Foreign exchange reserves are expected to remain adequate at 3.5 months of current account debits.

Fiscal Policy: The implementation of counter-cyclical fiscal policy has allowed the country to save the windfall from above-historical-average copper prices and economic growth. Past budget surpluses are meant to be drawn upon in the event of adverse economic conditions, so the government is taking advantage of these savings to accelerate fiscal spending as the economy weakens. The government is trying to stimulate the economy by implementing a spending package worth USD 4.5 bn (2.8% of GDP), reducing the structural surplus requirement to 0% of GDP and increasing the required lending by public banks.

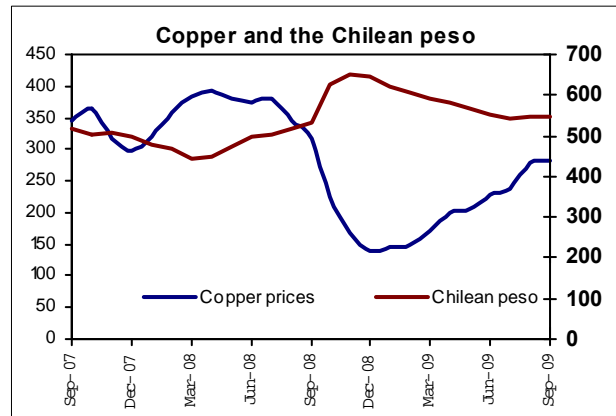
Debt: In addition to increasing fiscal flexibility, the public sector revenue windfall of the last few years has enabled the government to repay International financial institutions' debt, and boost Chile's net creditor position. This will continue to be an advantage for the country when trying to raise funds under the tight global financial conditions.

Outlook: Short-term downside risks are related to a further deterioration in copper prices and tighter global credit conditions. Due to strong macroeconomic fundamentals and good economic (fiscal and monetary) management, the medium-long term outlook for the Chilean economy is positive. Medium-long term risks are associated with energy infrastructure investment needs, which if left unattended may dampen growth prospects over the horizon.

Economic Indicators

	02-07 avg.	2008	2009	2010
GDP (% growth, real)	5.0	3.2	-1.9	2.3
Inflation (%chg, pa avg.)	2.9	8.7	2.0	2.0
Fiscal Balance (% of GDP)	4.6	5.7	-3.3	-1.3
Exports (% comp. annual growth)	30.1	-1.8	-27.0	6.2
Imports (% comp. annual growth)	22.8	30.8	-25.0	4.0
Current Account (% of GDP)	2.3	-2.0	-2.5	-1.5
Reserves (months of curr. debits)	4.2	3.0	3.2	2.7
External Debt (% of GDP)	41.8	38.8	40.6	40.8
Debt Service Ratio (due)	18.4	8.4	10.7	10.5
Exchange Rate (to USD; eoy)	540.7	629.1	565	535

Source: EIU, EDC Economics



Source: HAVER.