

CHILE

Growth is projected to remain strong over the next two years. With an uncertain external environment, solid domestic demand will underpin growth, aided by a stable inflation environment, public infrastructure projects and a tax reform. Inequality, though decreasing, remains high as informality and unemployment remain high and social transfers low.

The central bank has started to tighten monetary policy gradually and is projected to continue doing so as stronger wages and reduced labour market slack start putting pressure on prices. The planned gradual fiscal consolidation is appropriate and will stabilise the public debt-to-GDP ratio in the short-term. However, social spending and public investment needs may require higher revenues. Improving skills, integrating the recent flow of migrants, streamlining licencing and regulations, and increasing competition in network services are key for stronger and more inclusive growth.

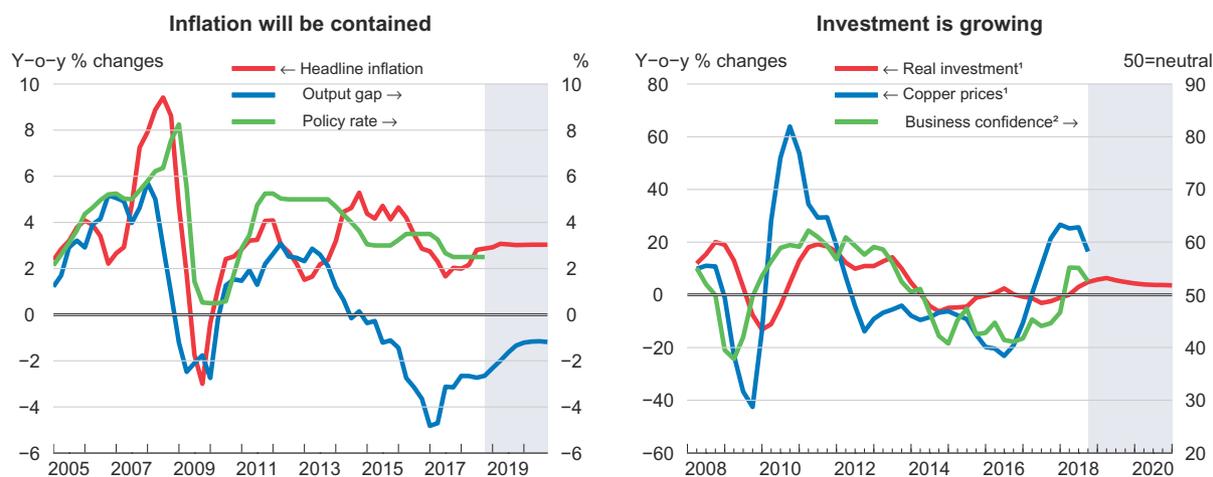
Economic growth is peaking but job creation remains low

Robust domestic demand drove growth in the first half of 2018 as household consumption accelerated amid subdued inflationary pressures and rising confidence. Investment also rose, reflecting buoyant non-mining sector spending. The labour market remains subdued, with a stable unemployment rate, as more migrants are coming into the labour force faster than employment grows. Excess capacity in the labour market has contained wages. Headline inflation has risen, and is around the 3% central bank's target, driven by higher oil prices and the peso depreciation against the dollar.

Measures to boost productivity are needed

The central bank has started increasing its policy rate and is projected to proceed gradually as slack in the labour market shrinks and wages start growing. Fiscal policy is

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1. Four-quarter moving average.

2. Data above (below) 50 indicates optimism (pessimism).

Source: OECD Economic Outlook 104 database; and Central Bank of Chile.

Chile: **Demand, output and prices**

| | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 |
|---|-------------------------------|---|------|------|------|------|
| | Current prices CLP billion | Percentage changes, volume (2013 prices) | | | | |
| GDP at market prices | 159 605.9 | 1.2 | 1.6 | 4.1 | 3.7 | 3.4 |
| Private consumption | 101 269.2 | 2.1 | 2.5 | 4.3 | 3.8 | 3.4 |
| Government consumption | 20 732.2 | 6.3 | 4.1 | 2.5 | 2.7 | 2.7 |
| Gross fixed capital formation | 37 934.3 | -0.7 | -1.1 | 5.8 | 4.3 | 3.6 |
| Final domestic demand | 159 935.7 | 2.0 | 1.9 | 4.4 | 3.8 | 3.4 |
| Stockbuilding ¹ | 20.6 | -0.7 | 1.2 | 0.8 | -0.4 | 0.0 |
| Total domestic demand | 159 956.3 | 1.5 | 3.3 | 5.2 | 3.3 | 3.3 |
| Exports of goods and services | 46 870.9 | -0.2 | -1.0 | 4.9 | 4.5 | 4.0 |
| Imports of goods and services | 47 221.3 | 0.2 | 4.7 | 9.6 | 4.9 | 3.6 |
| Net exports ¹ | - 350.3 | -0.1 | -1.6 | -1.2 | -0.1 | 0.1 |
| <i>Memorandum items</i> | | | | | | |
| GDP deflator | – | 4.8 | 4.5 | 2.6 | 3.1 | 3.0 |
| Consumer price index | – | 3.8 | 2.2 | 2.5 | 3.0 | 3.0 |
| Private consumption deflator | – | 3.4 | 2.1 | 2.1 | 2.9 | 3.0 |
| Unemployment rate (% of labour force) | – | 6.5 | 6.7 | 6.8 | 6.4 | 6.1 |
| Central government financial balance (% of GDP) | – | -2.7 | -2.8 | -1.8 | -1.7 | -1.8 |
| Current account balance (% of GDP) | – | -1.4 | -1.5 | -2.4 | -2.3 | -2.3 |

1. Contributions to changes in real GDP, actual amount in the first column.

Source: OECD Economic Outlook 104 database.

StatLink  <http://dx.doi.org/10.1787/888933877525>

broadly appropriate with a gradual consolidation in line with the fiscal rule. The government has set a target of containing spending to reduce the structural deficit of the public sector by around 0.2 percentage points of GDP per year. There is room to increase revenues and change the tax mix to make the tax system more equity and growth friendly by increasing green or property taxes or by broadening the personal income tax base. This would help spread the benefits of growth more broadly.

The structural reform agenda is ambitious. The law that requires banks' compliance with Basel III standards, approved in October 2018, will increase financial stability and resilience. A tax reform, in congress, that seeks to make the tax code simpler and includes accelerated depreciation and faster VAT reimbursement is expected to boost investment. The new office for productivity will seek to reduce procedures and ease the establishment of small businesses. Streamlining regulations and licensing procedures and increasing investment in research and development will be key to boosting medium-term growth. A reform to improve pensions, recently submitted to congress, increases the low contributions and the solidarity pillar while introducing more competition to the system. A public subsidy to encourage delayed retirement is also included. Aligning the retirement age of women and men and linking it to life expectancy would further improve old-age pension sustainability.

Growth will remain robust but external risks are looming

Growth is projected to ease somewhat but still remain robust. Solid macroeconomic fundamentals and improvements in business confidence support growth prospects. Strong

investment growth aided by public investment projects, solid copper prices and investment incentives will drive employment and wage growth. A stable inflationary environment and stronger job creation will bolster private consumption. However, the worsening of the external environment – mostly due to escalating global protectionism, regional instabilities and faster-than-expected normalisation of US monetary policy – remains an important downside risk to the outlook. On the upside, full implementation of the ambitious structural reform agenda could raise investment more than anticipated.