Overview

After the weak start the Chilean economy reported in Q1 2017 (0.2% YoY growth), GDP recovered somewhat and grew by 1.3% YoY in Q2 2017. The expansion in GDP growth during Q2 was mainly the result of an improvement in the mining sector from Q1 to Q2. While the mining sector negatively affected GDP growth in both Q1 and Q2, the contraction in the sector diminished from 12.8% YoY in Q1 to just 3.0% YoY in Q2 2017.

Inflation continues to decrease and the YoY inflation rate in July 2017 was just 1.7%, the lowest rate since January 2014. Because of the low inflation and lackluster economic growth, the Central Bank reduced the interest rate 1.0 percentage point so far this year, and in its last meeting in August, decided to maintain the interest rate at 2.5%.

The Chilean economy is expected to see a continuation of the lackluster growth in 2017 (1.5% YoY). The expected slow growth in 2017 is mainly due to the particularly poor performance of the mining sector in the first quarter. For 2018, Chile is expected to see a modest acceleration in its GDP growth as a result of a slight increase in copper prices and low interest rates.
1. GDP

After the weak start the Chilean economy reported in Q1 2017 (0.2% YoY growth), GDP recovered somewhat and grew by 1.3% YoY in Q2 2017 (Figure 1).

Consumption

Consumption increased by 2.7% YoY in Q2 of 2017. While both household and government consumption grew at similar YoY rates in Q2 2017 (2.7% YoY and 2.5% YoY, respectively), household consumption accelerated in Q2 compared to Q1, counteracting the reduced growth in government consumption (Figure 2). A principal factor for the growth in household consumption was an increase in the consumption of durable goods, principally vehicles and technological products. This improvement coincides with an improvement of household confidence in the economy during the first half of 2017.

Investment, Exports and Imports

Gross Fixed Capital Formation (GFCF) declined for the fourth consecutive quarter (4.0% YoY) in Q2 2017 (Figure 3). GFCF has been affected by a weak construction sector that has led to a dearth of investment projects, especially in the housing sector.

Exports also registered a contraction during Q2 2017 (2.6% YoY), although this contraction was smaller in comparison to the previous quarter (4.9% YoY). This contraction is explained by the mining sector, especially copper, which is still recovering from a strike in Q1 2017 (mining exports contacted 4.1% YoY in Q2 2017 in comparison to 16.1% in Q1 2017). Imports, on the other hand, experienced an increase of 6.9% YoY in Q2 2017, mainly due to an increase in imports of clothing, food and chemical products.
GDP by Sector

On the production side, the expansion in GDP growth during Q2 was mainly the result of an improvement in the mining sector from Q1 to Q2 (Figure 4). While the mining sector negatively affected GDP growth in both Q1 and Q2, the contraction in the sector diminished from 12.8% YoY in Q1 to just 3.0% YoY in Q2 2017. Other sectors such as commerce, personal services and financial services, which also have large shares of overall GDP, continued to report steady growth in Q2.

Mining Sector

Copper mining is one of the most important parts of the Chilean economy. Although copper mining sector’s share of GDP has decreased slightly over time (Figure 5), it is still very important to GDP growth. During the last 2 years, the sector has been impacted by low copper prices that led to a contraction in the sector and corresponding sluggish growth in the Chilean economy more generally. As the mining sector is poised to continue its recovery in the second half of the year (due to higher copper prices and the return to normal production activities after a strike in Q1 2017), GDP growth may also accelerate somewhat in the second half of 2017.
2. Fiscal Policy

The fiscal balance in Chile had been deteriorating constantly since 2011 (Figure 6). It is expected that the year-end fiscal deficit for 2017 will be higher than in 2016.

In 2017, copper prices are beginning to recover, which will likely lead to increased government revenues coming from the mining sector. However, expenditures are likely to surpass the budgeted amount due to emergency responses as a result of fires in the south of the country. Also, presidential elections in Chile will take place later this year and an increase in spending could occur in the run up to it.

3. Inflation and Monetary Policy

Inflation continues to decrease and the YoY inflation rate in July 2017 was 1.7%, the lowest rate since January 2014, and just below the lower band of the inflation target of 2.0% (Figure 7). This decrease was driven by modest growth in the prices of food (1.0% YoY) and transportation (0.3% YoY) and by a decrease in clothing and footwear\(^1\) prices (-5.1% YoY), the latter mainly affected by exchange rate appreciation.

Because of the low inflation and lackluster economic growth, the Central Bank reduced the interest rate 1.0 percentage point so far this year, and in its last meeting in August, decided to maintain the interest rate at 2.5%.

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\(^1\) Clothing and footwear have a weight on overall inflation of 4.5%
4. Exchange rate

After reaching its lowest level in January 2016 (721.9 CLP per US Dollar), the Chilean Peso has appreciated, gaining almost 10% in value by July 2017 (658.2 CLP per US Dollar) (Figure 8).

The strengthening of the Chilean Peso is mainly due to the increase in copper prices.

5. Outlook

The Chilean economy is expected to see a continuation of the lackluster growth in 2017 (1.5% YoY). The expected slow growth in 2017 is mainly due to the particularly poor performance of the mining sector in the first quarter.

Inflation is expected to close 2017 under the inflation target of 3.0% and for 2018 it is expected to increase slightly to right around the target rate. The low inflation rate and the continued weak economic activity are some of the factors that could lead the Central Bank to pursue more rate cuts during the second half of 2017. Such actions by the Central Bank could lead to some depreciation of the exchange rate, making Chilean exports more competitive on the international market.

For 2018, Chile is expected to see a modest acceleration in its GDP growth as a result of a slight increase in copper prices and low interest rates.
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