




# Emerging Markets Spotlight

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## Chile – too much of a market economy?

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


### Economic situation

Real growth	
Public consum. (y-o-y)	
Private consum. (y-o-y)	

### Economy seems to be through the worst

Early indicators suggest the turning point may have been reached. Private consumption remains weak but net exports and public demand are expanding at a healthy pace. With signs of robustness in the labour market and real wages rising at the start of the year, private domestic demand can be expected to follow suit.




### Growth financing

Current account balance / GDP	
Real effective exchange rate	
Budget balance / GDP	

### Deficits under control

Both the current account and the domestic budget are in deficit. This appears unproblematic given that the current account position has improved enormously and sectors producing tradables have seen their competitiveness improve as a result of the substantial currency depreciation in 2013/2014. National debt is low, meaning that any short-term budget deficit can be rectified without difficulty.




### Growth resources

Investment ratio	
Unit labour costs (y-o-y)	
Labour market participation	

### Copper investment cycle appears to have passed its peak

Private investment is weak at present. However, this has been compensated for to some extent by government investment, resulting in a relatively constant investment ratio over the last three years. Unit labour costs fell significantly last year and this should boost labour demand. Given also the reforms now underway in the labour market and in education, this should benefit both labour market participation and the formal labour market in the longer term.






### Economic relations with Germany

German share in goods exports	
German share in goods imports	
FDI inflows from Germany	

### Focused trade with Germany

Trade with Germany is not particularly extensive and reflects the areas in which each of the two countries enjoys a competitive advantage. Ores and metals make up the bulk of Chilean exports to Germany, while machines and vehicles account for most of the flow in the opposite direction. Direct investment flows – both from Germany and in general – have been a great deal more volatile since 2011.

Legend (for detailed explanation of methodology see p. 5)

 very good     good     neutral     weak     very weak

### Investment climate: assessment by our local experts

Chile is able to boast stable institutions, a responsible macro-economic policy and an effective legal system – not just when compared to other Latin American countries but on an international level as well. However, its small internal market and its unfavourable geographical position limit its potential as an investment and export location. Consumer and business confidence is also weakened at present by a dip in the economy and by the weakened government's rather vague reform agenda in certain areas.

Continued on p. 2

### Focus: Better education and more skilled labour force needed

The economic system is very liberal and provides favourable conditions for doing business, as evidenced by Chile's 41st place in the global Ease of Doing Business rankings and 33rd place in the Global Competitive Index. Reforms are now underway, aimed at tackling the country's segmented labour market and education system, thus reducing inequality. The reforms are designed to give the state greater responsibility in respect of unemployment protection, pensions and the education sector; social elements are to be added to the market economy system.

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### Investment climate: assessment by our local experts

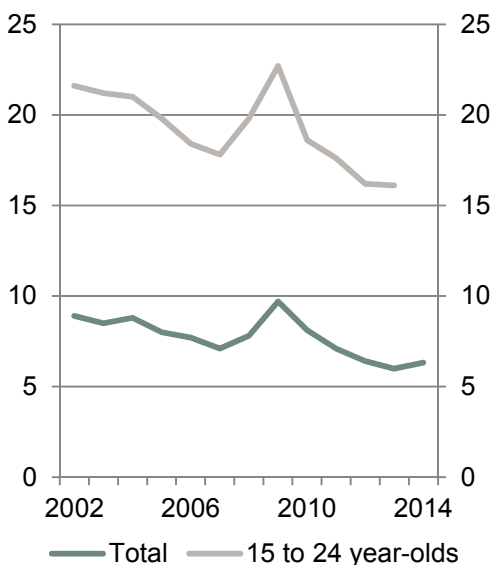
**Chile provides good institutional framework conditions and strong property rights.** The country's stable fiscal and monetary policy environment deserve special mention. It has a prudent fiscal policy which operates in accordance with a rule that sets a target for the structural budget balance in relation to gross domestic product. The central bank pursues a policy of inflation targeting which includes a specific inflation target of 3% ±1 percentage point. The capital markets view this policy in a positive light, as demonstrated by the relatively low risk premiums associated with the purchase of government bonds. The effective legal system, including properly functioning courts of arbitration, is worthy of special praise.

**Small country with a limited internal market.** Although per capita income levels are relatively high, the fact that the population numbers no more than 18 million means that sales potential is somewhat limited. This is not helped by the country's unfavourable geographical position which means that imports and exports have to travel great distances. Other barriers to business include high real estate prices and labour costs, not to mention high levels of bureaucracy. The country's main export is copper, Chile being the world's leading producer. As a result, mining remains a significant branch of the economy, despite the fact that the price of copper has fallen. The reform agenda of President Bachelet's government also affects the energy sector. The renewable energy industry is expected to be a beneficiary of the reforms, with renewables targeted to account for 20% of energy production by 2025 (excl. major hydroelectricity projects).

**Education's entrenched status as a commodity perpetuates existing high levels of inequality.** International organisations have been making the case for greater quality and equity in the education system if Chile is to achieve the transition from an efficiency-based economy to an innovation-based one. Although education standards at university level are often very good, the quality of education for the population as a whole leaves much to be desired. Education reform is to be funded by raising corporation tax from 20% to between 25 and 27% (depending on the tax status chosen by the taxpayer) up until 2018. Some uncertainty remains as to the extent of any additional government measures beyond this. One of the consequences of this uncertainty has been to delay private investment. The euphoria with which society – including consumers – initially greeted the announced reforms has fallen away, as the political crisis, including the cabinet reshuffle carried out in May 2015 and the weekend government that emerged, make it likely that even those measures that had already received approval will take longer to implement than was originally planned.

Based on interviews conducted with Dr Joerg Seyfart (DEG Andean Countries Office Director) on 16<sup>th</sup> June 2015 and Sebastian Blum (KfW IPEX-Bank, São Paulo, Office Director) on 18<sup>th</sup> June 2015. ■

Figure 1: Unemployment rate  
[percentages]



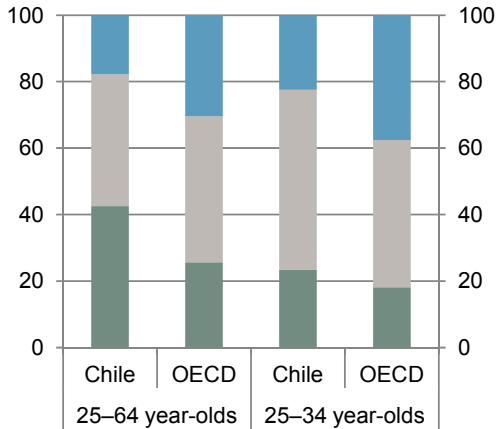
Source: WDI, INE.

### Focus: Better education needed to create more skilled labour force

The current weakness in the economy has affected the labour market much less than expected. Unemployment is at a historically low level, despite the fact that the long-term downward trend in unemployment – interrupted by the economic crisis in 2009 – has come to a temporary halt. The weighting of young generations with high rates of unemployment is decreasing – to the advantage of the labour market statistics. At the same time, both the labour market and the education system are plagued by structural problems. They therefore represent an exception to what is otherwise a positive overall assessment of competitiveness and business environment.

**Labour market regulation favours members of the formal sector.** In contrast, informally employed people do not benefit from the protection offered by labour market regulation (as defined by the International Labour Organisation (ILO)), i.e. they do not have employment contracts and / or do not make any social security contributions. Compared to other Latin American countries, the proportion of people in informal employment is relatively low (approx. 20%). However, in absolute terms, it is still quite a substantial number. According to the OECD, one of the reasons why informal sector employment levels are so high is that re-

**Figure 2: Educational attainment**  
[Share of population in each age group in percentages, 2011]

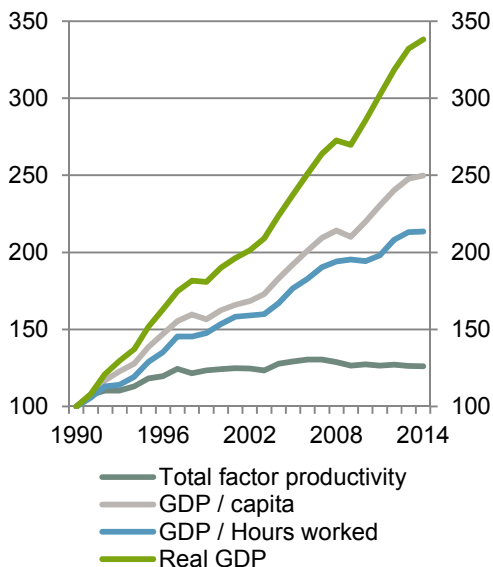


- Tertiary education degree
- Upper secondary education\*
- Max. lower secondary education

Remark: \*including post-secondary non-tertiary

Source: OECD

**Figure 3: Productivity growth**  
[Index 1990=100]



Source: Chilean Ministry of Finance, OECD, own calculations.

dundancy payments in the formal sector are relatively high. In fact, the redundancy costs in salary weeks are almost twice that paid in Germany. This makes it less attractive for employers to offer formal employment contracts and the incentive to not make severance payments more increases.

The minimum wage is regarded as binding and was 43% of that of the average full-time employee in 2013 according to the OECD. International analysis show that this reduces employment prospects for young people and those with low skills. Therefore, a lower minimum wage is being recommended for young adults. However, when it comes to encouraging more women to participate in the labour market, child care opportunities are regarded as more relevant. Despite growing by 20 percentage points since 1990, today's female labor force participation rate of around 55% is still too low.

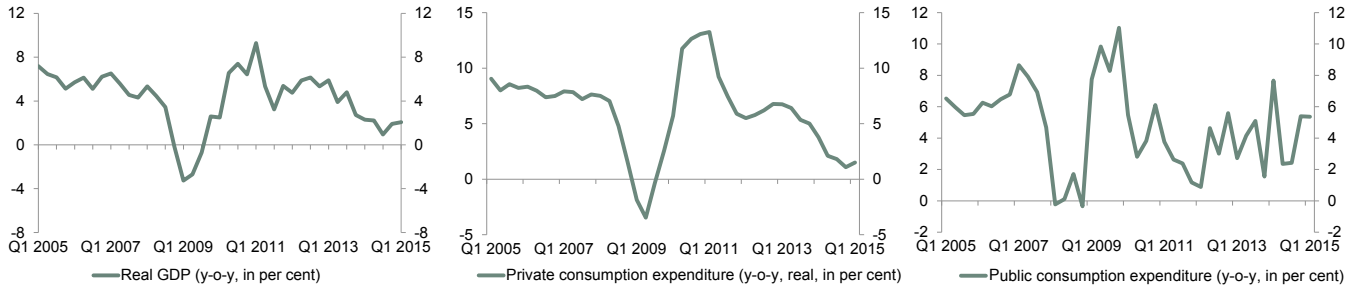
**High levels of youth unemployment illustrate how difficult it is to make the transition from education and training into the labour market.** The proportion of 15 to 29 year-olds neither in employment nor in training is relatively high (approx. 22%); unemployment levels amongst 15 to 25 year-olds are currently around 16%. At the same time, around 41% of employers complain that their business activities are held back because of a lack of adequately trained staff. Enormous progress has been made in improving education quantity, with nearly 54% of 25 to 35 year-olds having attained upper secondary education by now (OECD average 44%). However, education quality has failed to keep up. Despite the significant progress it has made, as measured by the PISA Survey, and notwithstanding the fact that it tops the Survey's list of Latin American countries, Chile still comes out well below the OECD average. There is a marked difference in performance between public schools and private schools, significantly fed by a selection procedure that is based on children's socio-economic background and by the resources available to different types of school.

**Per capita income levels have grown dynamically over the past 25 years.** However, productivity reflecting technical progress has essentially remained static since 1998. It is true that investment-specific factor productivity has grown significantly during this period: the economy has benefited from technological progress incorporated in the quality of capital goods. However, much remains to be done when it comes to organising production activity and realising the potential efficiency gains associated with it. One of the reasons for this is that the labour force lacks necessary skills and abilities.

**Certain aspects of education reform are targeted directly at improving training and matching it with the labour market demand.** By way of example, a law was passed in December 2014 to set up 15 state technical training centres. If Chile succeeds in reducing the segmentation of its labour market and education system – helping, along the way, to dismantle inequality and to improve productivity over the longer term – it should be able to build on its position as the leading Latin American economy. ■

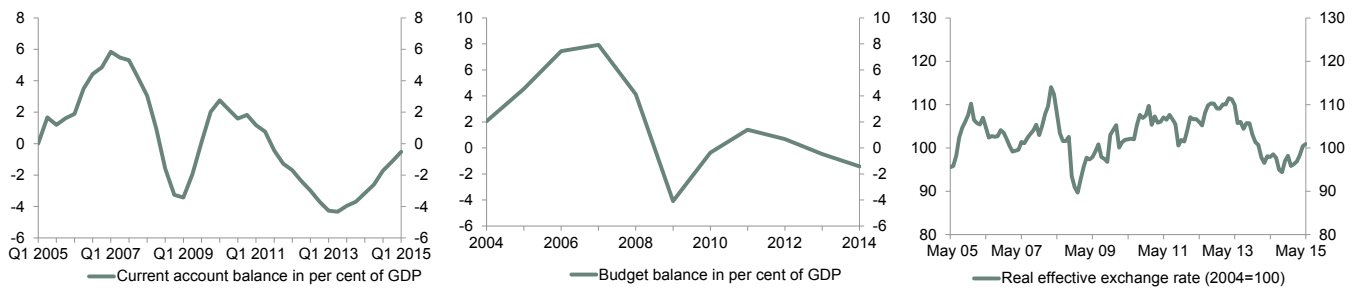
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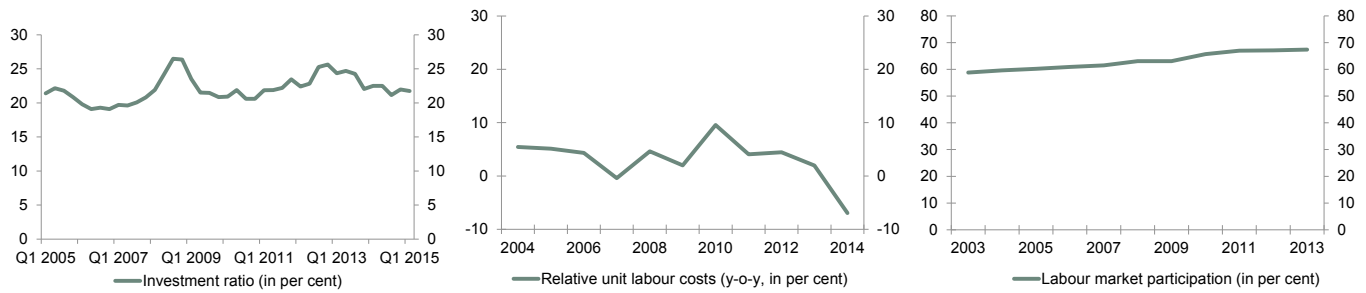
Source: Datastream, OECD, National Institute of Statistics, own calculations.

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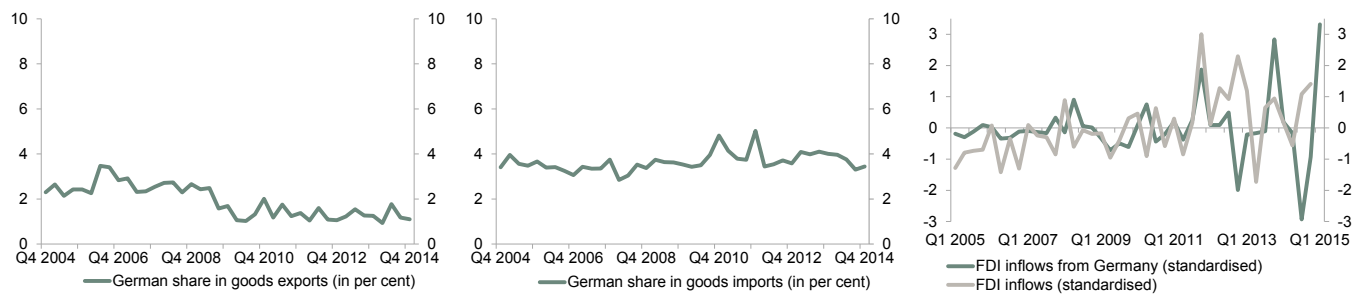
Source: Datastream, IMF, BIS, own calculations.

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Source: Datastream, OECD, Worldbank, own calculations.

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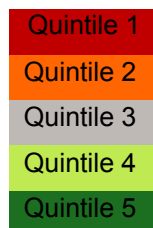


Source: Deutsche Bundesbank, Datastream, IMF, Central Bank of Chile, own calculations.

### Methodology

In the Emerging Markets Spotlight, a selected country is analysed based on various macroeconomic indicators. These indicators are grouped into four categories: economic situation, growth financing, growth resources and economic relations with Germany.

The indicators are used to compare the country's situation with its peers. The group comprises Brazil, China, India, Indonesia, Mexico, Russia, South Africa and Turkey. The comparison is based on a quintile ranking in five categories, which are labelled in different colours:



The country is assigned to a quintile of the country group for each indicator analysed. The best quintile may be different for each indicator. For example, higher growth rates are better, so here the upper quintile is coloured dark green, but higher debt rates are a negative factor, so here the upper quintile is coloured dark red.

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