

Discurso del Presidente de la República en Visita a Bolsa de Nueva York NYSE
PROSPECTS OF THE CHILEAN ECONOMY
New York Stock Exchange, September 7, 2000

Performance during the nineties

The Chilean economy exhibited a very strong performance over most of the 90s, with real GDP growth averaging 7.8 percent between 1990 and 1997, and inflation declining gradually from 27 percent to 6 percent during the same period.

In this excellent environment social indicators improved substantially, with the poverty indexes being the chief example. Indeed, population behind the poverty line dropped from 45% in 1987 to less than 22% in 1998. The speed of decline in this indicator is considered record high and comparable to what has happened in China. There are two main explanations for this achievement: a strong macroeconomic performance and an effective and well focused social policy.

The macroeconomic performance has several important roots. During the last decades structural reforms were made in Chile, including an increasingly open trade regime, a strong banking supervision mechanism, and prudent macroeconomic policies. In particular, on the fiscal side, the strong position of the public finances has helped to achieve stability within a rapid growth path. On the monetary side, a modern and independent central bank has certainly contributed to the substantial reduction of inflation and the adequate macroeconomic maneuvering.

The impact of the recent crisis

By the end of 1997, and as a consequence of the crisis first experienced by the Asian countries, a substantial change occurred in the international markets conditions. This new environment resulted in a reduction in the availability of capital flows for emerging countries and a sharp decrease in their terms of trade. In the case of Chile, terms of trade dropped by 12.5% in 1998, one of the largest declines in Latin America.

The plunge of terms of trade, together with an expansive economic cycle in Chile during 1997 led by overheated domestic demand, explain the significant widening of the current account deficit observed towards 1998. This situation, combined with declining capital inflows, increased pressures against our currency.

In response to these pressures, and in order to prevent a large and disorderly depreciation, monetary policy was tightened significantly in 1998, while public expenditure was reduced below budgeted levels. As a result, demand experienced a sharp contraction, while the current account deficit was increased. It would be fair to say that the economic contraction observed between the end of 1998 and during the first three quarters of 1999 was stronger than expected. The unemployment rate reached a peak of 11.5% in mid-1999. Despite these facts, it is also important to say that Chile maintained a better performance than the region average.

During the first half of 1999, once pressures eased and the current account deficit was under control, economic policy became more expansionary. This change, together with an improvement of the international situation, produced a rapid recovery of GDP and employment levels during the last quarter of 1999. Meanwhile, inflation continued declining and exports started to grow strongly following world recovery and the real exchange depreciation that accumulated during 1998-1999.

Forecast for 2000

The recovery of economic activity began decidedly in the fourth quarter of 1999 with a rate of growth of 3.9%. During the first semester of the year GDP growth reached 5.8%, mainly due to a dynamic external demand. The key issue in this regard is that the economy has optimal conditions to initiate a new phase of growth based on healthy fundamentals.

Indeed, many indicators show the strength of the Chilean economic situation and perspectives, among them a solid external position. In this matter, robust activity growth of our trading partners and the world as a whole has increased commodities prices and our export sector continues to grow rapidly. Despite imports had shown an important recovery, the current account deficit for the moving year that ends in June 2000 reached only 1.0% of GDP. It is expected that this figure will be less than 2.0% for the year 2000, a sound figure in tune with the fundamentals of the Chilean economy.

On the fiscal side, budget figures show a clear improvement during the first semester. The budget deficit moved from a deficit of 1.5% of GDP to a surplus of 0.2% of GDP in the year that ends in June 2000. These figures show that my government commitment with sound and solid fiscal accounts is strong and clear. It is quite clear for us that in order to maintain a stable growth path it is very important to maintain a strong fiscal position. Let me remind you how solid this position is: Public debt is below 10% of GDP.

The indicators I have already mentioned, together with others such as growth perspectives, lack of misalignment of the real exchange rate, availability of foreign exchange reserves, among others have made Chile to appear as the most stable economy—having the lowest risk level—among emerging countries.

We are convinced that the Chilean economy has all the conditions to start a new phase of high growth. However, consumption and investment have reacted somehow slower than expected during the last few months. Lack of liquidity in international markets, a composition of growth less labor intensive than predicted, as well as stronger a long lasting effects of the recession in terms of debt overhang, have contributed to a less dynamic domestic demand. The monetary and fiscal authorities have agreed on the idea that the economy needed a further impulse and announced last week a decline of interest rates and several measures to foster both consumption and investment growth.

It should be noticed, however, that GDP growth in our country is still strong. We expect GDP to grow between 5.5 and 6.0% during this year and above 6.0% during 2001. This performance is salient when compared to other Latin American countries. Market forecasts show that Chile and Mexico will have the higher growth rates in the region

Perspectives 2001-2006

After the economic troubles we faced during the last two years -problems by the way that we have certainly overcome- I can affirm that our country has remarkably solid basis to start a new virtuous-circle that will render growth and welfare.

My Government is committed to play a crucial role in sustaining and boosting economic growth. During the last decades we have learned that macroeconomic stability is a key precondition for stability and growth. Investment and individual initiative develops faster when agents are able to foresee opportunities and risks are under control. By achieving serious and responsible macroeconomic management we hope to reach this goal. And in Chile we have excellent institutions to execute economic policy.

Fiscal policy

One extremely relevant instrument to achieve a stable economy is a balanced and trustworthy fiscal policy. There are too many experiences in which what appears to be an output gain led by an irresponsible fiscal impulse, is at the end short lived and ends up in long run losses. The Chilean Government has committed itself to achieve a structural fiscal surplus of 1% of GDP, starting on 2001.

There are good reasons for countries like Chile to maintain a small fiscal surplus. First, a solid public finance position decreases vulnerability to international liquidity shocks. Second, countries like Chile, with a non-renewable resource as the main export product, should save part of the revenues for future generations. This is a matter of inter-temporal justice and equity. And last, but not least, an economy that needs to promote and encourage exports as the main growth source, needs a competitive real exchange rate, and a fiscal surplus is key ingredient to support it.

Economic policy in general, and fiscal policy in particular, are taking decisive steps towards a more transparent policy scheme. For example, in August 2000 the Minister of Finance, together with the Governor of the Central Bank, allowed the International Monetary Fund (IMF) to publish their annual report on the Chilean economy. This assessment, classified until now, let the public obtain an external, independent and expert opinion about the economic outcome and the policy applied in our country. Chile is one of the first emerging countries to publish this report.

Monetary policy

Our sound macroeconomic performance is due, to a great extent, to the independence of our Central Bank—a legal arrangement that has proven to be efficient in many countries. This institution has been autonomous for more than 10 years and has conducted monetary policy in a responsible manner. In a coordinated way with the fiscal authority, inflation has declined to industrialized country levels.

In line with this inflation achievement, the Central Bank has announced a 2-4% inflation target for 2001 onwards. Moreover, it has completed its inflation targeting framework with the publication of a monetary policy report very much in line with the

reports published by the Central Banks of OECD countries such as Australia, Sweden, and the UK. This report is a thorough analysis of the current macroeconomic situation that allows the private sector to take better informed decisions, lower risks and, more generally, improve the allocation of resources in the economy.

Financial development

Financial development has proved to cause growth. An improved resource allocation, as well as better risk-sharing arrangements, are important by-products of a deep financial sector. Of course, if it is ill-regulated, financial development could cause more problems than benefits.

Chile's financial sector is increasingly developed. Moreover, regulation and supervision is efficient and up to date. In fact, despite the recession, commercial banks continue to be among the strongest within developing countries. Both stock market capitalization and credit over GDP figures demonstrate that our capital market is one of the most developed among emerging economies. Of course, our economy is not large, but there are several domestic markets in which financial transactions are highly sophisticated. A simple example should suffice: A family can get a 30-year mortgage in Chile to buy a house.

Financial integration is also important for our economy as means to absorb terms of trade shocks. A small export-oriented economy such as Chile is highly dependent on the international environment. External shocks are transmitted mainly through sharp fluctuations of commodity prices (although, sometimes, through violent changes in external financing conditions). A well functioning and integrated financial system is an extremely useful vehicle through which a country is able to limit the effect of these shocks.

But, in order to obtain these benefits, the sole liberalization of capital account restrictions is not enough. A country also needs adequate safeguards such as transparent accounting codes, professional risks management, a solid banking regulation, and, obviously, a consistent macroeconomic policy. Chile has been recognized for having these characteristics.

Our economy is increasingly open both financially and in trade. At the same time, however, we are modernizing further our financial sector to take full advantage of this integration.

Perhaps a good example of what I am saying is the government effort of modernizing minority share-holder protection in Chile. We will soon have congress approval for a new tender offer law that includes state-of-the-art corporate governance. This new law will put Chile at the front among emerging markets and will deepen further our market.

World's evidence clearly suggests that there is a direct relationship between adequate rules and capital market development. In fact, it has been clearly proved that countries with a higher degree of minority shareholder protection succeed in having a profound capital market that enhances economic development. On the other hand, weak corporate governance is related to vulnerability in the economy. Our legislation is geared towards

high protection of foreign investors because we are certain that external financing is a fundamental component of our development.

Conclusion

To conclude, let me remark that the Chilean economy has had an impressive performance during the last 15 years. In fact, its has been used as an example extensively around the world.

But that is past. What I have told you is future. My government is committed to continue this successful path. Macroeconomic policy in Chile has even a better design than in the past, institutions are modern and economic policy decisions will continue to be taken in a responsible manner. We are sure Chile will continue to be an example for emerging economies.

Thank you very much.