

Argentina and Chile:

Recent performance and main
challenges

Economic Research Department

March 2010

Recent Performance: similar outcomes, different processes

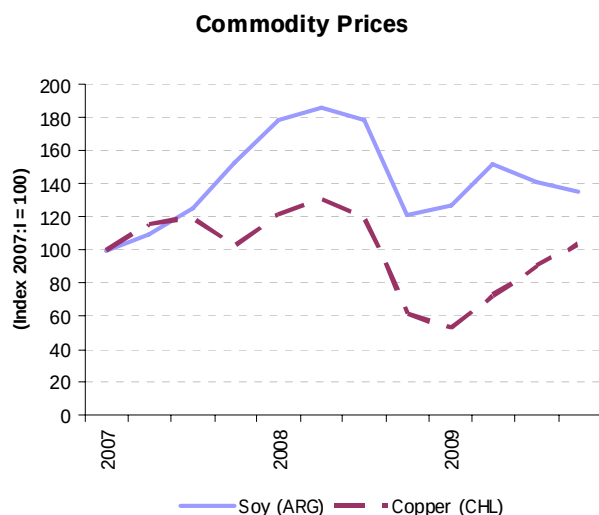
- **Transmission channels**
- **Policy reactions**

The Outlook: diverging paths

- **Argentina: financially constrained**
- **Chile: the challenges of reconstruction**

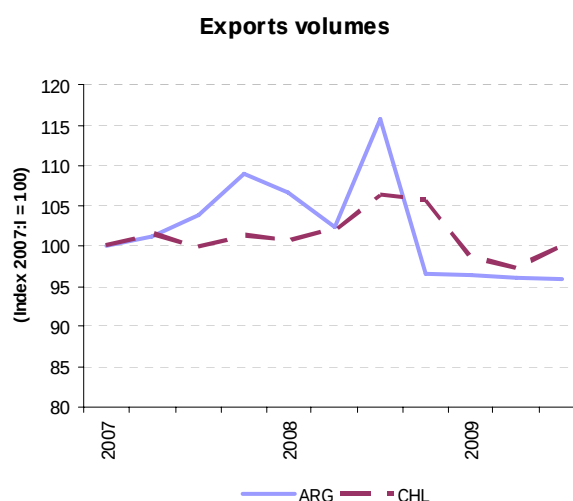
Three main sources:

Commodity price shock



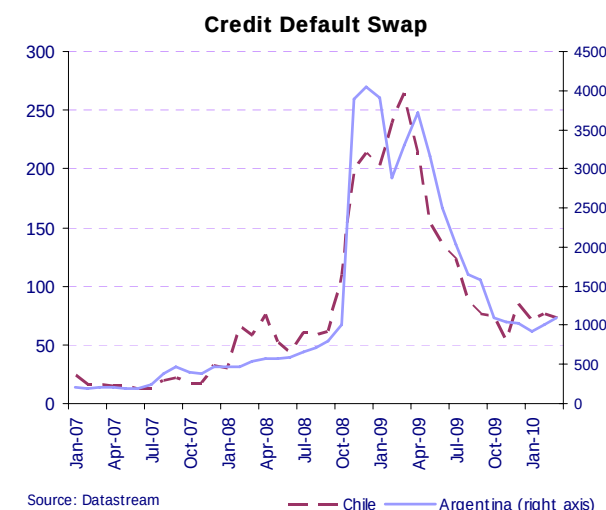
- Both suffered major drops in main commodity exports prices, after a boom
- Boom in copper prices began earlier. Compared to trend prices the shock was similar
- In both cases there was a significant fiscal impact

Exports volumes



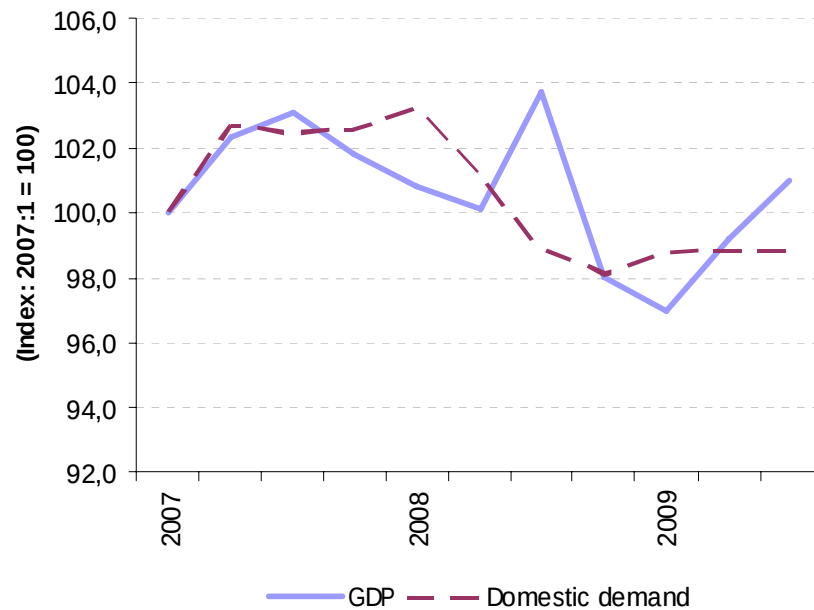
- Exports suffered a major blow after the LB collapse
- Argentina: the “brazilian connection” and a drought amplified the shock
- Chile also suffered a supply shock (salmon disease crisis) but benefited from “Asian connection”

Financial shock

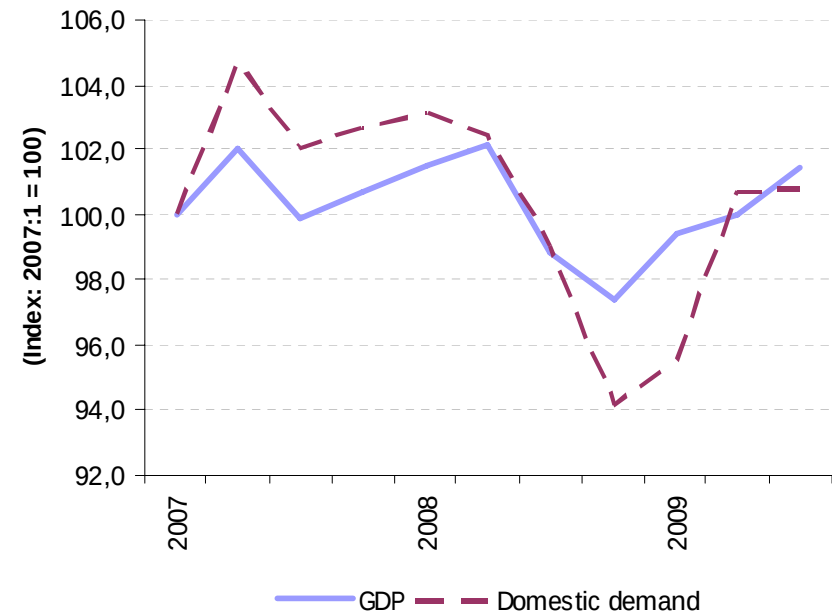


- Argentina did not suffer a “sudden stop”
- Strong indirect effect: flight from peso to dollars cut bank lending
- Chile: strong but short lived negative shock, without financial casualties

Argentina: Real Activity Levels



Chile: Real Activity Levels



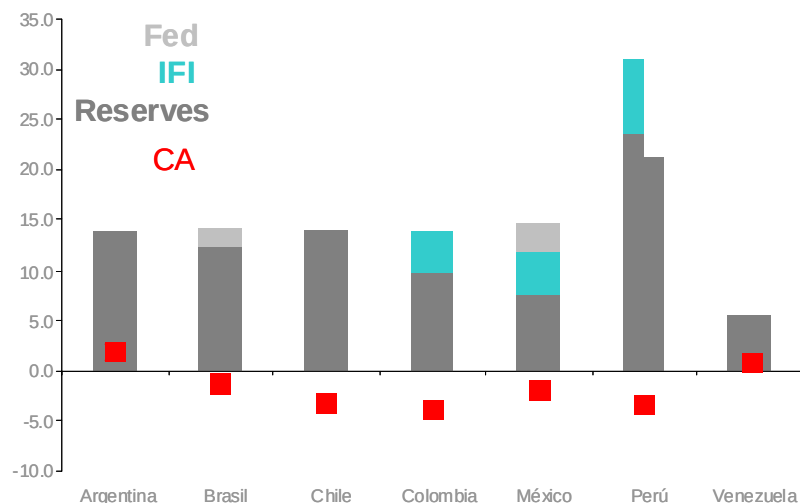
Some similarities:

- Sluggish expansion previous to the crisis
- Domestic demand was slowing down previous to the crisis
- Recession of similar length and both began recovering in H209

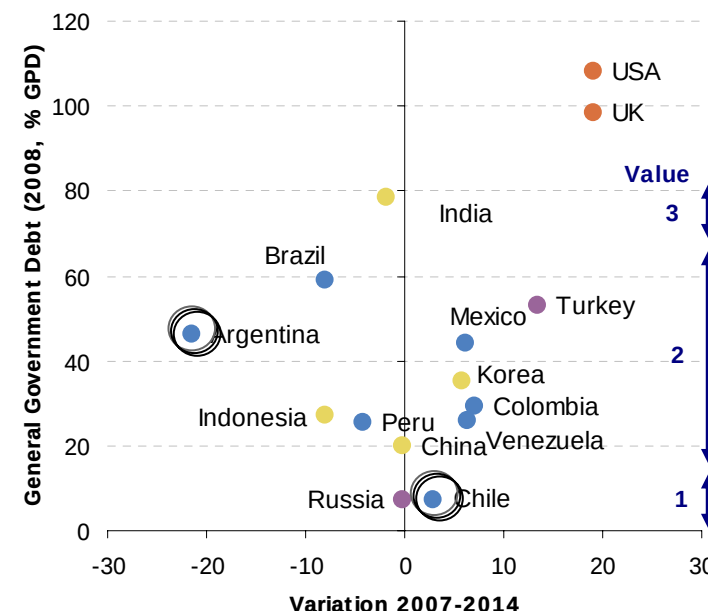
Differences:

- Domestic demand drove recession and recovery in Chile. Not so in Argentina

Reserves and Credit lines (% GDP)

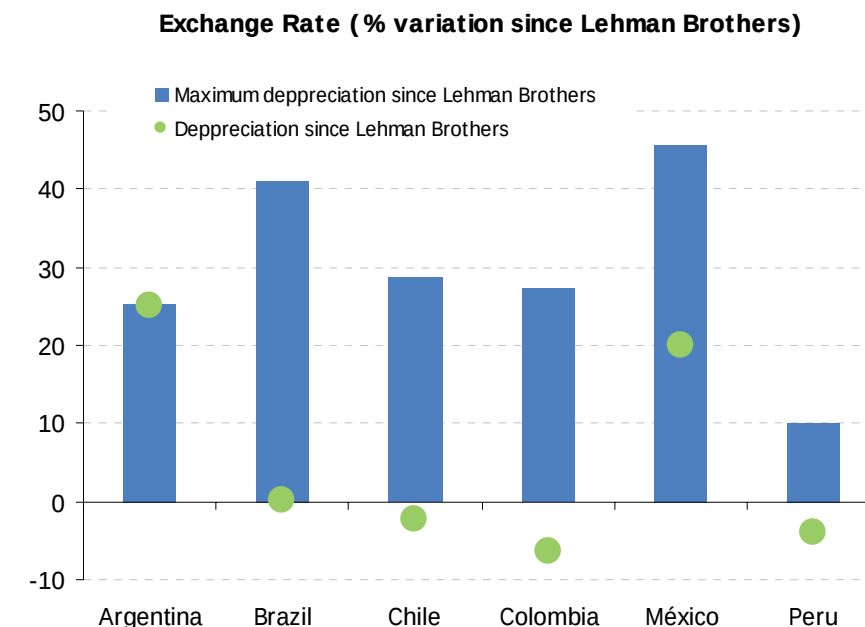


General Government Debt (% GDP)



Source: IMF

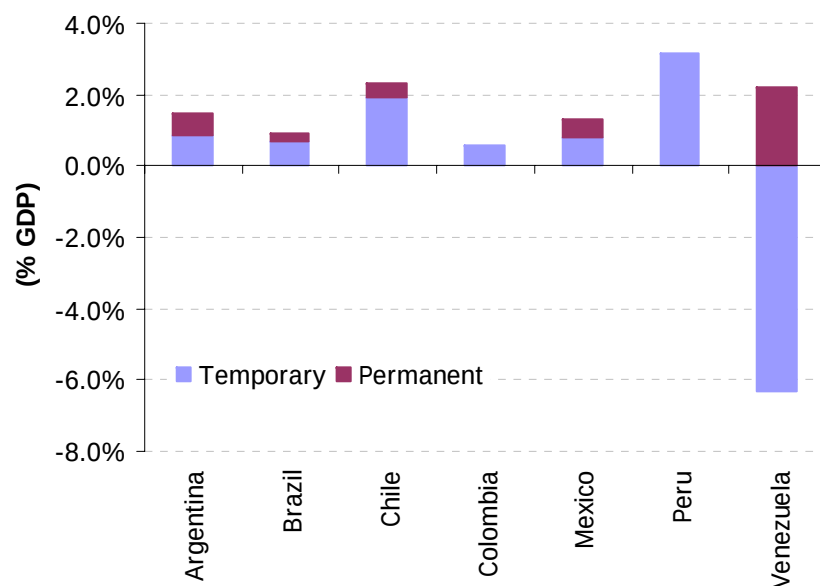
- Both countries had large reserves, but Argentina did not have access to financial markets and little access to multilaterals. Chile had the lowest country risk in LATAM and was in good standing with multilaterals
- Argentina had a Public Debt that was not very high for international standards, but had to rely mostly in domestic sources to finance the gap. Chile had a very small debt, very large sovereign funds and ample access to domestic and foreign sources of funding



Source: Bloomberg and BBVA.

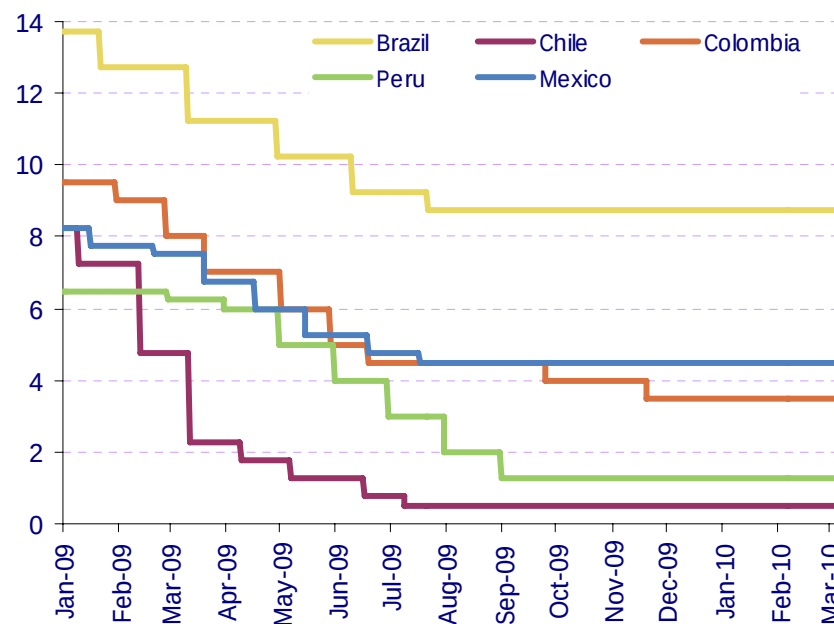
- Both countries had EXR flexibility, but ARG was far more constrained by “fear of floating” due to vulnerability to capital flights. Chile already had a decade of experience with a largely free EXR.
- There is also a large difference in inflation rates, meaning that ARG needs large depreciations just to keep up with PPP.
- Monetary policy in Argentina is largely quantitative, while Chile is an inflation targeter with a very good record and high credibility.

Latin America: Composition of the 2009 fiscal stimulus



Source: BBVA

Latin America: Interest Rate (%)



Source: Bloomberg

Similarities are deceptive:

- Fiscal policy: Besides differences in sizes and design the main difference was in funding: Chile relied on previous savings. Argentina nationalized private pension funds.
- Monetary expansion in Chile was by policy design (active). In Argentina was passive subordinated to achieve EXR stability: rather contractive at the beginning of the year (capital outflows) and expansionary at the end, when confidence returned.

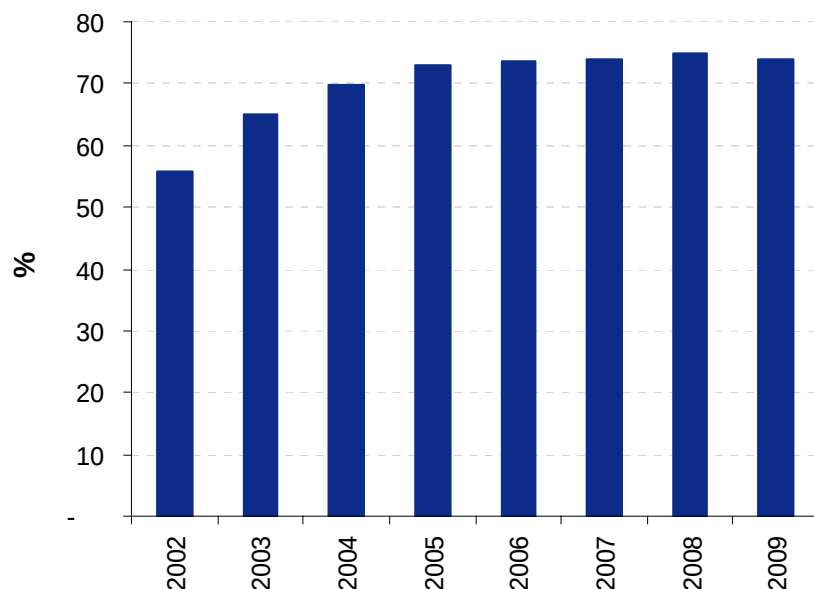
Recent Performance: similar outcomes, different processes

- Transmission channels
- Policy reactions

The Outlook: diverging paths

- Argentina: financially constrained
- Chile: the challenges of reconstruction

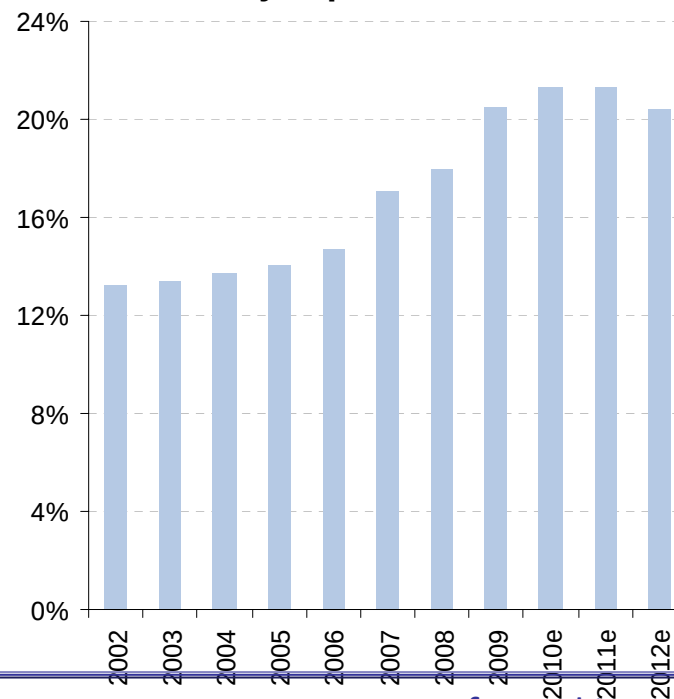
Industrial Capacity Utilization



Source: SEE BBVA Banco Francés

- After a fast recovery, capacity has increasingly become a binding constraint.
- Investment in key sectors (energy) have remained relatively low.

Primary expenditures / GDP



- Government expenses rose fast taking advantage lower financial limitations thanks to the recovery, high soy prices and the reduction in debt service.
- Fast expansion of government expenditure exhausted those resources in 2008.
- Soy prices are coming down, growth stalled after the crisis. Public finances are constrained now.

Fiscal financial constraints

Fiscal Result and Public Debt maturities

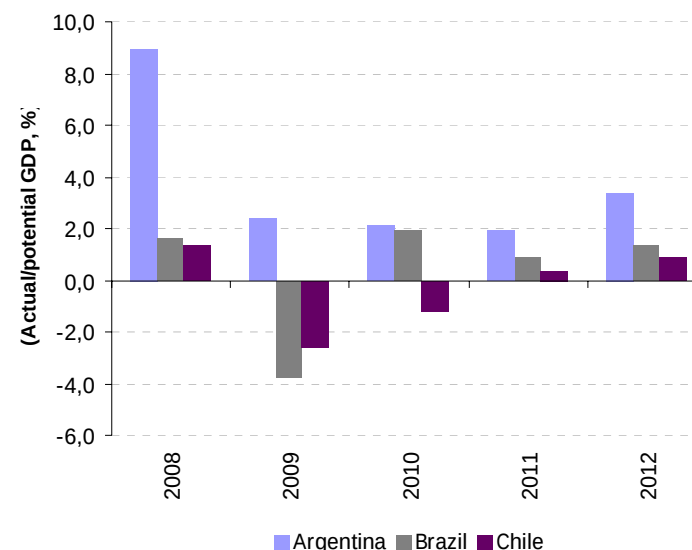
<i>(estimated figures)</i>	USD million 2010
(1) Primary Fiscal Balance	
USD million	2,2
% GDP	0,6%
(2) Public Debt Maturities **	12,8
Principal	7,5
Interest	5,3
(1)-(2) Financial needs	10,6

**** Maturities intra public sector excluded.**

- The use of reserves, funds in the ANSES and good exports revenues will help the Argentine government through 2010
- 2011 looks harder, unless there is a return to international markets. Monetization of the deficit is a real possibility.

Supply-side constraints

Estimated Output Gaps



- Supply constraints were relaxed by the recession, but they will become more pressing as the recovery proceeds.
- Large investments requirements to support growth are not being met fast enough.
- Inflation pressures are rising.

Inflation and the creation of a favorable climate for private investment are the main challenges for Argentina. Default seems unlikely in 2010-11

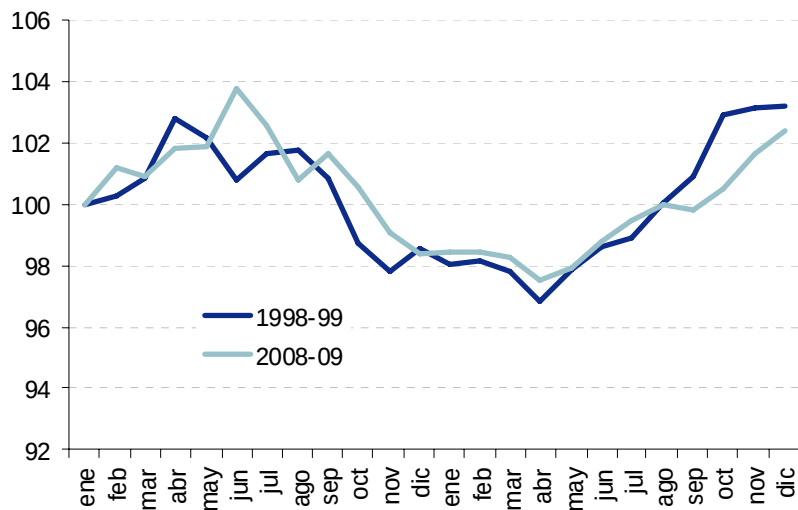
The crisis: similar outcomes for different reasons

- Transmission channels
- Policy reactions

The Outlook: diverging paths

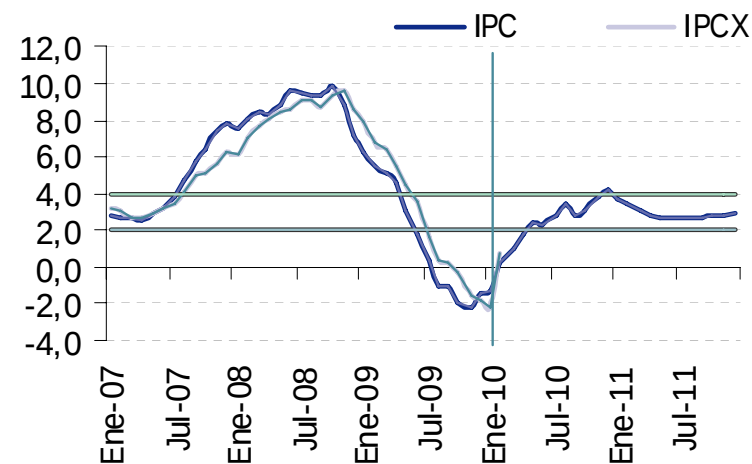
- Argentina: Multiple constraints
- Chile: the challenges of reconstruction

CHILE: Seasonally adjusted IMACEC in two recessions



source: CBCh and BBVA

**Inflation Behavior
(var. % y/y)**

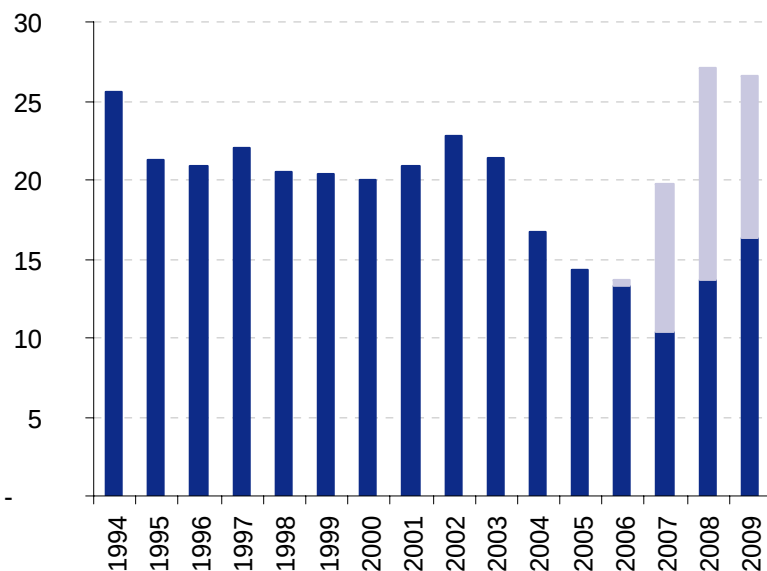


Source: CBCh and BBVA

- A strong recovery was well underway
- Inflation pressures were under control
- Large reserves and government savings in sovereign funds gave ample room for maneuver for the new authorities.
- Copper prices remained quite high in spite of poor growth in Developed Countries.

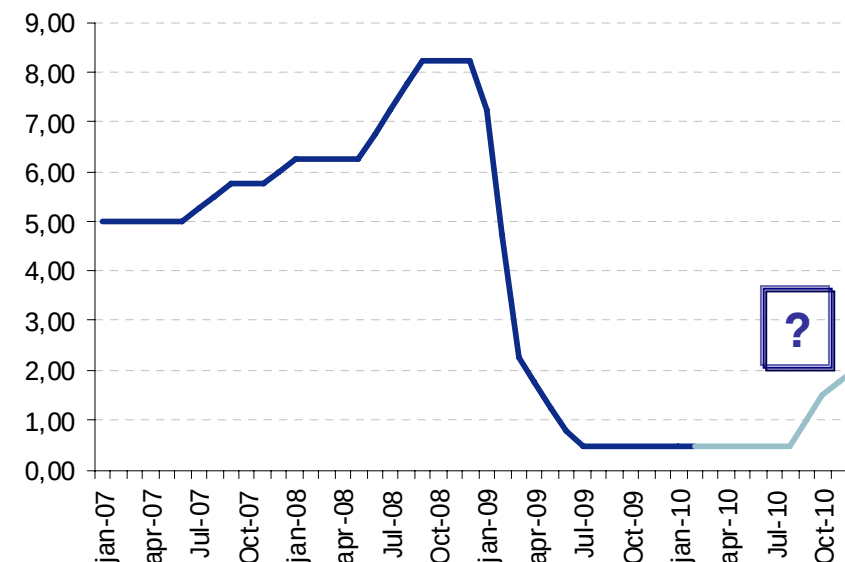
- The most affected regions are the Bio-Bio (VIII) and Maule (VII), with shares at around 9% and 4% of GDP, respectively, and whose main economic activities are manufacturing (Wood and pulp, steel, flour fish and wine), agriculture, forestry and power generation.
- Even though partial information is available, the estimated **capital loss** of around U.S. \$ 20 billion. Most of the losses in infrastructure are covered by **insurance**.
- This represent a massive supply shock in the short – term (2nd quarter), with temporary losses of industrial production (oil refineries, steel, cellulose plant, fish meal) as well as wine. Most of it is temporary and will take weeks or a couple of months to recover.
- Massive losses in housing (mostly in rural areas, old adobe houses)
- Temporary disruptions in land and air transportation, and major investments to fully repair them will be needed, but they are operational to some degree already.
- Services infrastructure: hospitals, schools, jails, and other public buildings: slow and expensive reconstruction and repairs.
- This will mean that GDP growth in 2Q10 will be close to 0 (or even negative)
- But as the reconstruction effort builds up, there will be a massive surge in public and private investment that will carry well into 2011.
- All in all, GDP will grow about 4% in 2010 and above 5% in 2011.

**International Reserves and Sovereign Funds
(Percentage of GDP)**



source: BCCh and Dipres

Chile: Monetary Policy Rate



source: BCCh and BBVA forecast

- Financing the reconstruction effort will not be an issue
- The main concern is macroeconomic: will excess demand cause inflationary pressures and earlier rise in interest rates and excessive appreciation?
- Recent discussion about rising taxes has more to do with this concern than with funding

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