Monthly Economic Update

July 27, 2020

Cámara ChilenoBritánica

100 años 1917-2017

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EVENTS IN CHILE

On July 22nd, Congress approved legislation allowing millions of pensions savers to make a one-off withdrawal from their individual capital accounts to mitigate the economic impact of the Covid-19 pandemic. The constitutional reform achieved the necessary two-thirds majority after large numbers of government-supporting lawmakers joined the opposition to vote in favour of the move, defying warnings from minsters and experts about its detrimental impact on future pensions. In the face of overwhelming popular support for the measure, President Sebastián Piñera enacted the law, dropping plans to veto or challenge the legislation before the Constitutional Court.

Under the reform, most savers will be able to withdraw up to CLP 1,000,000 (around US$1,300) while those with savings worth more than CLP 10,000,000 will be able to withdraw up to 10% up to a maximum of CLP 4,300,000. A July 20th poll by Cadem found that 82% of savers plan to make a withdrawal from their pension fund, suggesting that up to US$20 billion could be withdrawn over the coming weeks. According to economists, the move could boost economic activity (as savers spend withdrawn funds) while disrupting financial markets (especially the currency markets as AFPs sell overseas assets to finance the withdrawals). The Central Bank said it would step up monitoring of financial markets and take measures to mitigate any instability the sell-off could cause.

Instead of pensions withdrawals, the government has proposed additional tax-funded benefits for members of Chile's middle class. Approved by Congress in late July, these include a CLP500,000 bonus and a soft loan worth up to CLP 650,000 for individuals with monthly incomes of between CLP 400,000 and CLP 1.5 million who have seen their income fall by at least 30% as a result of the pandemic.

The government's popularity tumbled during the debate over the pensions withdrawal. The latest Cadem poll showed approval of President Piñera fell to 12% in late July, down from 27% one month earlier and its lowest level since the start of the Covid-19 outbreak, while disapproval has climbed 16 percentage points over the same period to 78%.

Following the defeat over the pensions withdrawal, President Piñera undertook a major cabinet reshuffle on July 28th, his second in less than two months, bringing in veteran conservative lawmakers to bolster the government.

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The rate of new reported Covid-19 infections has declined in recent weeks to less than 3,000 a day by late July, down from a peak of almost 7,000 a day in early June. In response, the government has gradually begun lifting quarantine measures in some areas. Shops and restaurants have been allowed to open in the southern regions of Araucanía, Aysén and Los Rios while restrictions on movement were relaxed in northeast Santiago from July 28th. However, the number of cases has continued to rise in some cities, especially in the north of the country.

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ECONOMIC DATA

Economic activity contracted by an unprecedented 15.3% in May, according to the Central Bank's monthly indicator IMACEC, following a 14.1% fall in April. Forecasts now suggest an annual contraction of at least 5.0% this year. Private forecasts surveyed by the Central Bank in July averaged 6.2%, within the Bank's own 4.75-6.25% range while the United Nations' Economic Commission for Latin America and the Caribbean suggested a fall of 7.1%.

The pandemic has ravaged Chile's labour market, with more than 1.6 million jobs disappearing between February and May, according to the government's latest employment survey. The unemployment rate averaged 11.3% in the latest rolling quarter, up from four points from a year ago, but the figure does not reflect the huge number of dismissed workers who have effectively withdrawn from the workforce due to the lack of opportunities and the almost 700,000 employees have been furloughed without pay.

Amid record job losses and falling activity, consumer confidence has continued to fall. GfK's Economic Perceptions Index fell to 20.3 points in June, down more than ten points from start of the pandemic and its lowest level in more than two decades. While confidence in the economy has stabilized among most classes, the latest survey showed a five-point drop among interviewees from the C2 social class (skilled manual workers). Assessment of the current state of the economy and their personal situation has continued to worsen although optimism for the short-term outlook and jobs prospects has improved.

In contrast, business confidence has begun to improve, by some measures. The Monthly Business Confidence Indicator produced by the Adolfo Ibánez University and business organization ICARE, reached 37.3 points in June, up from 31.74 points in April and above levels seen in the wake of last year's social unrest. Confidence has improved in all sectors but remains extremely low (11.4 points) in the construction industry.

Inflation has continued to slow mirroring the collapse in economic activity, the depreciation of the Chilean peso and the fall in energy prices since April. The government's Consumer Price Index fell by 0.1% in June for an annual increase of 2.6%, down from 3.8% reached last February. Private analysts have followed the Central Bank in predicting that the indicator will fall to 2.0% by the end of the year at the bottom of the bank's medium-term target range.

On July 15th the board of the Central Bank voted unanimously to maintain its benchmark interest rate at 0.5% for a fourth consecutive month. The Bank expects to maintain the monetary stimulus at this level for the next two years and will continue with its existing asset-buying program.

Share prices in Chile have slipped on expectations of large withdrawals from the private-run pensions funds. After reaching its highest level since the outbreak began in early July, the IPSA index of the largest companies listed on the Santiago Stock Exchange had fallen by more than 6.0% by July 27th.

Concern that the outbreak could hit production at mines in Chile and Peru has caused international copper prices to soar to almost US$3.00/lb, their highest level since early 2019 and up more than 40% from early March. Rising numbers of infections among mineworkers have led mining companies to deploy stricter measures to protect staff which are expected to slow copper production in Chile during the second half of the year.

Reflecting rising copper prices as well as an expected sell-off of overseas financial instruments by the pension funds, the US dollar has depreciated against the Chilean peso. By July 27th, it was trading at CLP 768/dollar, down 11.5% from its post-pandemic peak reached in April.

Lower energy prices and a fall in consumer demand caused imports to fall to US$12.0 billion in the second quarter, down 26.5% from a year ago, while exports fell 6.9% to US$16.0 billion. The quarterly trade surplus rose fourfold to US$4.0 billion.

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