

Full Rating Report

Chile

Ratings

Foreign Currency	
Long-Term IDR	A+
Short-Term IDR	F1
Local Currency	
Long-Term IDR	AA-
Country Ceiling	AA+

Outlooks

Foreign-Currency Long-Term IDR	Stable
Local-Currency Long-Term IDR	Stable

Financial Data

Chile	
(USDbn)	2010
GDP	204.2
GDP per head (USD 000)	11.9
Population (m)	17.1
International reserves	27.9
Net external debt (% GDP)	-1.4
Central government total debt (% GDP)	8.6
CG foreign-currency debt	4.1
CG domestically issued debt (CLPbn)	7,087.8

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Related Research

- Applicable Criteria**
- [Sovereign Rating Methodology](#) (August 2010)
 - [Country Ceiling](#) (September 2008)
- Other Research**
- [Global Economic Outlook](#) (December 2010)
 - [Sovereign Data Comparator](#) (December 2010)
 - [Sovereign Review and Outlook](#) (December 2010)
 - [Latin America 2011 Government Financing Needs](#) (January 2011)

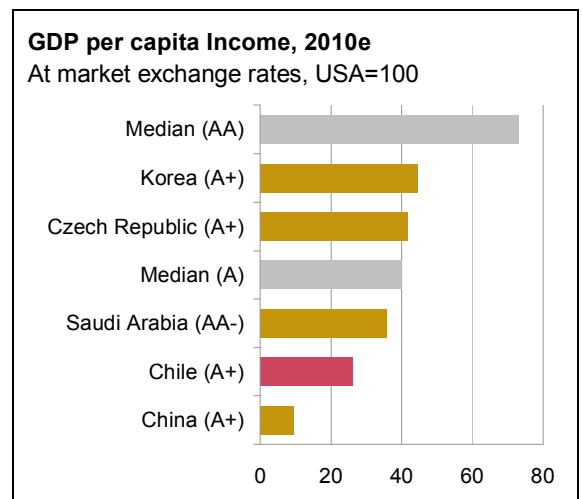
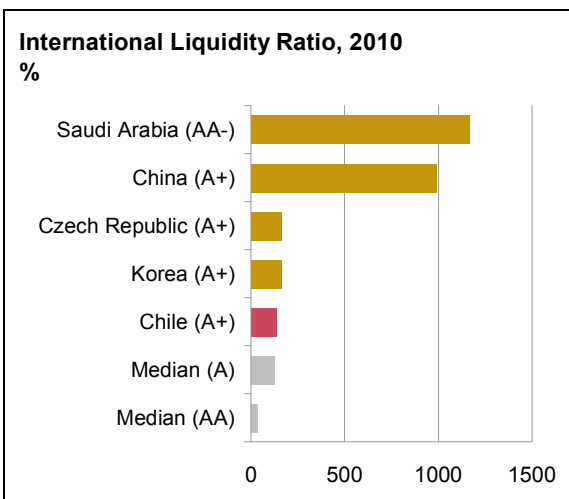
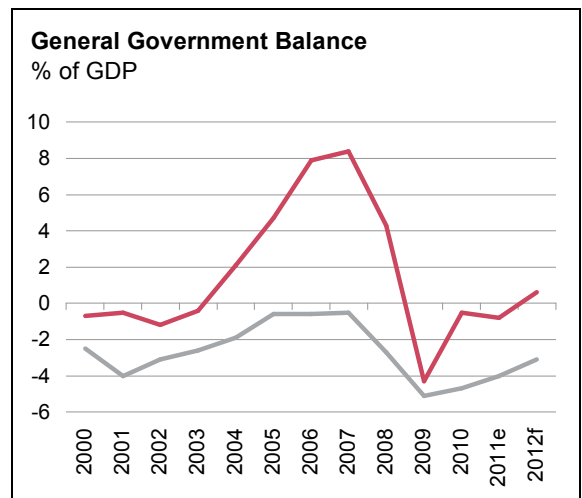
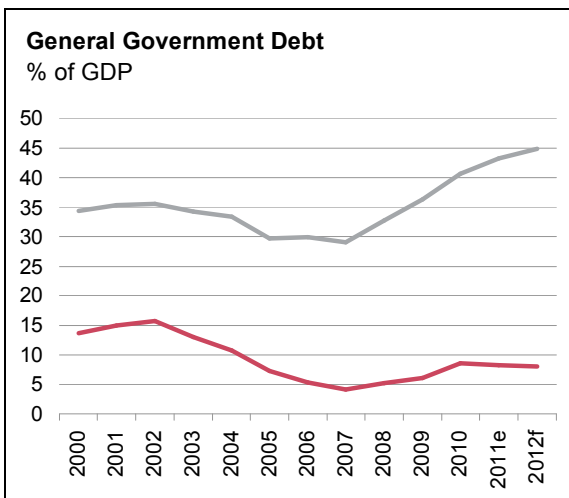
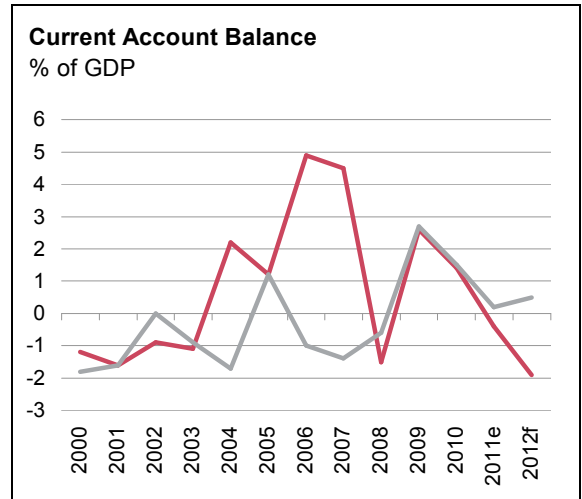
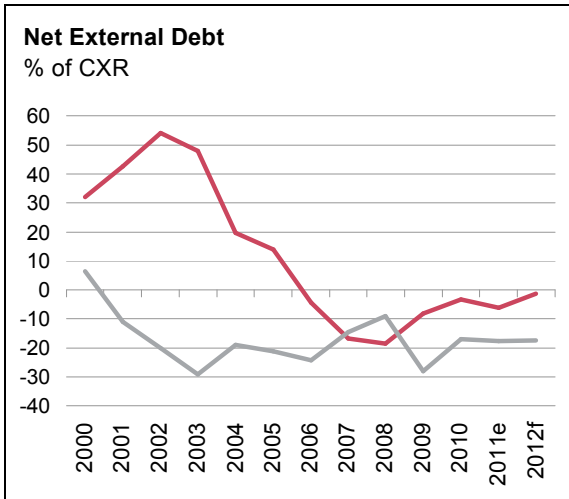
Rating Rationale

- Fitch Ratings upgraded Chile’s Foreign-Currency Issuer Default Rating (IDR) to ‘A+’ from ‘A’, and its Local-Currency Long-Term IDR to ‘AA-’ from ‘A+’ on 1 February 2011. The country’s ratings are underpinned by: years of prudent macroeconomic management that incorporates healthy public finances; an effective and credible monetary regime anchored by a freely floating currency; and an economic model based on competitive markets and trade deepening by way of multiple free trade agreements (FTAs). These strengths sufficiently counterbalance a high commodity dependence and the country’s low per capita income relative to ‘A’ category peers.
- Fitch estimates that 2010 GDP expanded by 5.3%, a better-than-expected result given the intensity of the February 2010 earthquake, and expects growth to accelerate to around 6.0% in 2011, returning to a more trend-like 4.8% thereafter owing to Chile’s robust domestic fundamentals and institutional stability.
- Fiscal performance continues to be in line with Fitch’s expectations and the agency expects the general government debt burden to remain below 10% of GDP, well below the peer median. Fiscal consolidation has been boosted by the economic recovery and rising copper prices, increasing the government’s fiscal flexibility and allowing it to face the enormous challenge of reconstruction from a stronger financial position.
- Fitch estimates the sovereign’s financing needs for 2011 at 1.7% of GDP, a highly manageable level in light of the government’s ample financing flexibility and large fiscal savings. These low funding needs reflect a favourable maturity structure and, combined with the sovereign’s ability to place local-currency debt in its developed domestic markets, further boost credit quality.
- The central bank’s recent announcement that it would accumulate USD12bn in the foreign-exchange market will provide a significant boost to foreign-exchange reserve levels, further enhancing the sovereign’s international liquidity and diminishing its susceptibility to external shocks. Moreover, it would mitigate the expected deterioration in Chile’s net external creditor position owing to the increases observed in private-sector external debt.

Key Rating Drivers

- Fitch would view steady improvement in the sovereign’s external and fiscal balance sheets positively. The agency would also regard positively sustained high economic growth and competitiveness-enhancing reforms that help in closing the per capita income gap relative to peers.
- Although not Fitch’s base case, a sustained deterioration in fiscal policy credibility and debt dynamics could undermine creditworthiness.

Peer Comparison



— Chile

— Medians

Peer Group

Rating	Country	
AA-	Republic of Cyprus,	
	Italy	
	Saudi Arabia	
A+	Chile	
	China	
	Czech Republic	
	Korea	
	Malta	
	Portugal	
	Slovakia	
	Taiwan	
	A	Bahrain
		Estonia
Israel		
San Marino		

Rating History

Date	Long-Term Foreign Currency	Long-Term Local Currency
01 Feb 11	A+	AA-
28 Mar 05	A	A+
24 Feb 03	A-	A+
03 Dec 97	A-	AA-
25 Nov 96	A	AA
30 Aug 95	A-	
10 Nov 94	BBB+	

Rating Factors

Summary: Strengths and Weaknesses

Rating factor	Macroeconomic	Public finances	External finances	Structural issues
Status	Neutral	Strength	Neutral	Neutral
Trend	Stable	Positive	Stable	Stable

Note: Relative to 'A' category (sovereigns rated 'A+', 'A' and 'A-')
Source: Fitch

Strengths

- A sound, rules-based macroeconomic policy framework, including a robust monetary and exchange rate regime, underpins Chile's economic stability through commodity cycles as well as domestic and external shocks.
- Chile's public finances are a key strength relative to peers. Years of elevated copper prices have yielded large fiscal surpluses and significant asset accumulation in the Economic and Social Stabilisation Fund (ESSF). These assets may be used to service debt, sustain public expenditure levels or finance fiscal stimulus when copper prices fall, as was the case in 2009. In addition, gross and net public debt ratios remain among the lowest in the 'A' category.
- Chile was a net external creditor with a low level of sovereign external debt and a sovereign net foreign asset position equivalent to 21% of GDP at end-September 2010.
- Financial stability is supported by a healthy, well-regulated and sufficiently capitalised banking system. In addition, relatively deep domestic capital markets offer ample liquidity for public- and private-sector funding, increasing financing flexibility and providing a buffer in the event of external shocks in international capital markets.

Weaknesses

- Chile's commodity dependence, at over 65% of current external receipts (CXR), remains a vulnerability that affects economic growth and fiscal and external accounts. Nevertheless, a countercyclical policy framework, bolstered by stabilisation fund assets held abroad, softens the real economic impact of copper and molybdenum price volatility and supports fiscal adjustment without endangering debt dynamics.
- A low per capita income relative to 'A' peers could constrain Chile's sovereign ratings to the 'A' category for some time. Reforms to reduce income inequality and enhance labour markets could support the longer-term convergence of GDP per head at market exchange rates with that of peers and higher-rated credits.

Local Currency Rating

Chile's Long-Term Local-Currency IDR of 'AA-' reflects lower general government debt compared with peers, at about 9% of GDP in 2010 compared with the category median of 34%, and 35% of revenue compared with 123%.

Country Ceiling

Chile's Country Ceiling of 'AA+' is the maximum three notches above its Long-Term Foreign Currency IDR. Macroeconomic stability, strong governance and rule of law, and high economic and financial integration with the global economy as indicated by WTO membership and an extensive network of FTAs minimise transfer and convertibility risk.

Outlook and Key Issues

Sound Economic Policies Underpin Credit Profile

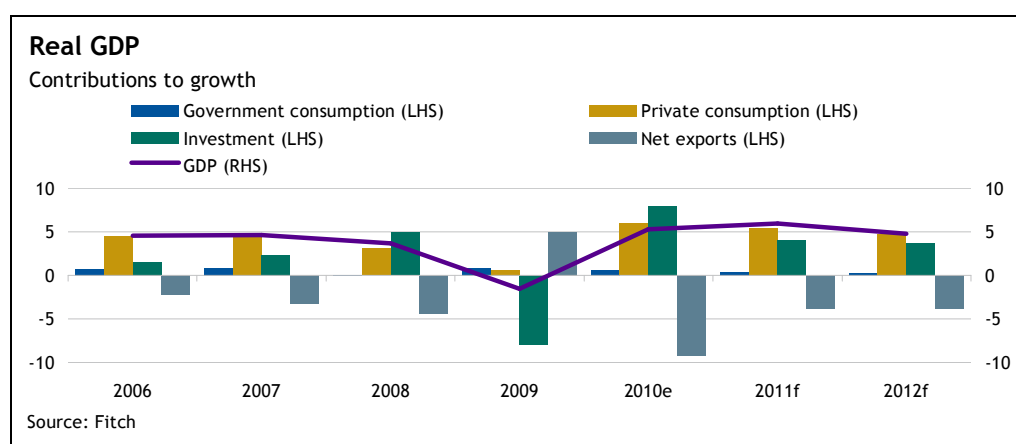
Chile's economy continues to be one of the most stable and resilient among its highly rated peers. It benefits from years of prudent macroeconomic management that incorporates healthy public finances, an effective and credible monetary regime anchored by a freely floating currency, and an economic model based on competitive markets and trade deepening by way of multiple FTAs.

These elements, along with broad political consensus on key economic policies, have ensured economic stability, steady growth and a heightened absorption capacity for internal and external shocks. Although the economy remains highly dependent on a largely commodity-based export sector, the structural strengths entrenched in Chile's economic model along with a very strong institutional framework and a sturdy government balance sheet serve to mitigate potential output and balance-of-payments volatility risks.

Strong Recovery and Medium-Term Prospects

The Chilean economy fell into recession for the first time in nearly a decade during the first quarter of 2009, as a consequence of the global financial crisis. Negative growth persisted until the last quarter of 2009, when output expanded by 2.1%, bringing the full-year growth rate to negative 1.5%. Expectations of a robust expansion were dashed in February 2010, when the seventh-strongest earthquake on record struck the central-southern region of the country, causing considerable destruction to local infrastructure and a substantial blow to economic activity. Nevertheless, despite the consecutive shocks, Chile's credit quality remained intact¹, and growth remained positive in the first quarter of 2010.

Following the earthquake, the country's economic performance has been boosted by a rebound in domestic demand, which has led to growth rates of 6.6% and 7.0% in the third and fourth quarters of 2010. Fitch estimates that 2010 GDP expanded by 5.3%, a better-than expected result given the intensity of the disaster. Driven by statistical carry-over effects from the first quarter and an intensification of reconstruction investment and expenditure, Fitch expects growth to accelerate to around 6.0% in 2011 and to return to a more trend-like 4.8% thereafter due to Chile's robust domestic fundamentals and institutional stability.



Domestic demand will be supported by a surge in public and private investment, and robust levels of private consumption benefiting from rising real wages and ample access to credit throughout the forecast horizon. As domestic activity intensifies, import demand will remain strong, especially during the reconstruction effort. Export growth will be supported by high copper prices, due to steady

¹ See Fitch's Special Report "Chile's Sovereign Creditworthiness Intact After Quake", published on 24 May 2010 and available at www.fitchratings.com.

demand from a rapidly urbanising China, and increased agricultural export volumes driven by solid global demand and Chile's multiple FTAs.

Enhancing Potential Output

Chile's GDP per capita at market exchange rates and on a purchasing power parity basis is lower than that of 'A' category peers and represents about 60% of the category median. Reducing this gap will entail higher sustained growth rates than those of the recent past and above-trend output expansion. The authorities are conscious of the need to rapidly raise income levels, especially since the country's accession as an OECD member in May 2010, and have devised a number of reforms aimed at enhancing productivity growth with the goal of raising potential output to 6.0% from the current 5.0%.

The government expects to achieve this through reforms that increase competition, facilitate the entry of new firms, make credit more accessible to small and medium-sized enterprises, and improve bankruptcy regulations. Education and labour market reforms, which are proving more contentious, are also in the works. Progress has been made on the education front, with the reform on its way to being discussed in the lower house of congress, while Fitch expects the labour reform to go through a protracted political process. These reforms would support the country's long-term creditworthiness, potentially boosting income levels through accelerated growth, further aiding in the convergence of GDP per capita with that of peers.

Ample Fiscal Space

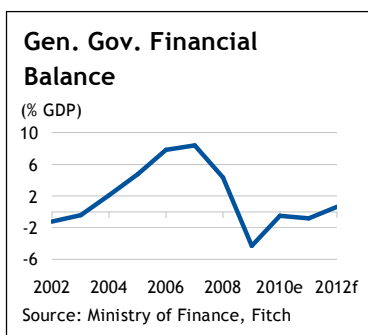
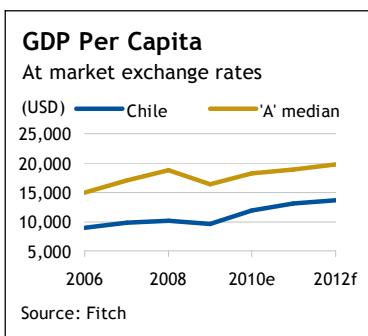
Chile's credit profile incorporates a high degree of transparency, large fiscal savings and a rules-based approach to policy making. Prudent fiscal management has been entrenched since before the commodity boom drove copper prices to record highs, with the fiscal accounts recording surpluses or very low deficits before 2004 and debt ratios falling under 15% of GDP. This implicit commitment to austerity and strengthening of the government's balance sheet became explicit through the creation of the Structural Surplus Rule (SSR), in place since 2001. This adjusts government expenditure to cyclically adjusted revenue², to result in a structural surplus of 1% of GDP, providing for an a-cyclical fiscal stance and the accumulation of fiscal savings given the copper revenue bonanza.

The Fiscal Responsibility Law complements the SSR framework. It establishes that after a portion of the government surplus is allocated to the Pension Reserve Fund (PRF) and to the recapitalisation of the central bank, excess resources are to be transferred to the ESSF.

With the SSR in place, government debt ratios fell below 10% of GDP. Fitch expects them to remain in single digits through the forecast period. Assets accumulated in the two sovereign wealth funds during 2008 made the government a net creditor, as these savings, along with treasury cash holdings, grew to about 18% of Chile's economic output. Foreign debt prepayments helped accelerate the decline in government debt ratios, while improving the currency composition of debt. The SSR was modified to aim for a structural balance of 0.5% of GDP in 2008 in order to help the government combat the persistence of relatively high income inequality and social imbalances through increased social spending.

As the global economic outlook deteriorated in 2009, the Chilean authorities acted decisively to support economic growth and employment with counter-cyclical policies. They adjusted the SSR to aim for a structural balance of 0.0% of GDP as a

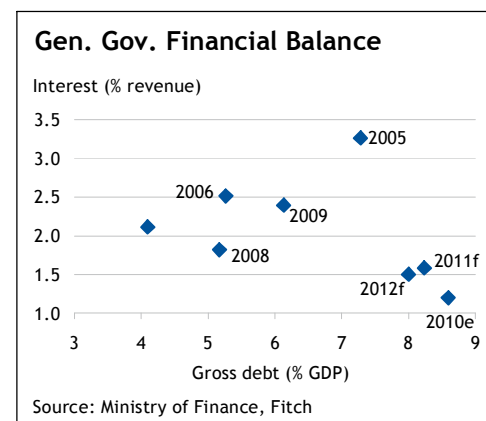
² Revenue is adjusted based on the long-term price of copper and long-term GDP growth trend taking into account gross fixed capital formation estimates, and labour force and total factor productivity rates, smoothing tax income based on the economic cycle. Further enhancements to the methodology in 2009 also control for interest income derived from government financial assets and income from molybdenum price changes.



temporary measure due to the magnitude of the global crisis. This fuelled expenditure growth and shifted the financial balance to a deficit of 4.3% of GDP in 2009, from a surplus of 4.3% in 2008. Having built ample fiscal space, the government financed stimulus spending and a large portion of the deficit by drawing down savings from the ESSF and effectively halving its worth from peak levels. Consequently, debt ratios remained fairly stable at 6.1% of GDP and 28% of revenue.

The temporary structural balance target of 0.0% of GDP was extended through to 2012 as an emergency measure due to the massive February 2010 earthquake. Even with the SSR relaxed, Fitch estimates that there was a substantial improvement in fiscal results for 2010 and expects a deficit of 0.5% at the general government level owing to higher copper prices, a recovery in tax revenue and expenditure restraint. This will allow the government to face the enormous challenge of reconstruction from a stronger financial position.

Consequently, government debt/GDP will peak at 8.6% in 2010 and will trend towards 8.0% of GDP through the forecast horizon based on a continuous recovery in revenue that will yield a deficit of 0.8% of GDP in 2011 and a 0.6% surplus as early as 2012. There is upside risk to these projections in light of significant rises in tax collections from the mining industry and escalating copper prices.



Public Finances: Sources and Uses (% GDP)^a

	2009	2010	2011e	2012f
Uses	6.0	1.6	1.6	0.7
Budget balance	4.4	0.4	0.8	-0.6
Amortisation (by place of issue)	1.6	1.2	0.8	1.3
Domestic	1.1	1.1	0.7	1.0
Foreign	0.5	0.1	0.1	0.3
Sources	6.0	1.6	1.6	0.7
Gross borrowing (by place of issue)	1.9	3.8	2.6	2.1
Domestic	1.8	3.0	2.5	2.0
Foreign	0.1	0.8	0.1	0.1
Privatisation	0.0	0.0	0.0	0.0
Other	4.1	-2.2	-1.0	-1.4

^a Central government
Source: Fitch

Asset Accumulation and Low Financing Needs Support Credit Quality

At 30 November 2010 assets in the ESSF totalled USD12.5bn (6.2% of GDP), while the PRF held USD3.8bn (1.9% of GDP) and other treasury financial assets came to USD5.4bn (2.6% of GDP). Total assets were therefore USD21.7bn (10.6% of GDP), preserving the sovereign’s net creditor position. Much of the windfall surplus from copper revenue will continue to be saved through the forecast period, which will further strengthen the sovereign’s balance sheet.

By almost any measure, Chile’s government finances will continue to be healthier than those of ‘A’-rated peers, highlighting the sovereign’s high level of resistance to multiple shocks. Fitch also estimates the sovereign’s financing needs for 2011 at 1.6% of GDP, among the lowest in Latin America³. This is a highly manageable level in light of the government’s multiple financing options and large fiscal savings.

³ See “Latin America 2011 Government Financing Needs” under Related Research on the first page.

These low funding needs reflect a favourable maturity structure and, combined with the sovereign's ability to place local-currency debt in its developed domestic markets, further boost credit quality.

Monetary Policy and External Finances

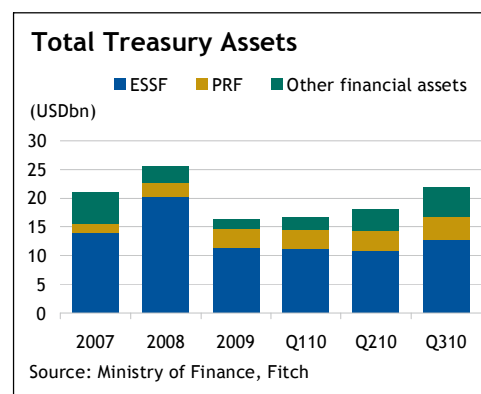
The autonomy of the central bank and its inflation-targeting focus represent another important institutional component of Chile's macroeconomic framework. Although the country remains vulnerable to global oil and food price shocks, the central bank's lengthy track record of preserving inflation rates within the target bands⁴ has created the conditions necessary to assure convergence of market expectations towards official targets. Consequently, the macroeconomic foundations for the sound development of a domestic capital market have been laid. Chile's large share of credit relative to GDP (about 80%) is evidence of a deep and liquid credit market.

In line with the central bank's commitment to price stability, the inflation rate for 2010 hit its target, ending the year at 3.0%⁵. The main driver of inflation dynamics will be domestic demand as spare capacity in the economy continues to diminish and the pace of monetary tightening decelerates. Fitch expects inflation to tend toward the higher end of the target band in 2011, and then gradually converge with the 3.0% target once again in 2012.

The central bank began a tightening cycle in mid-2010, raising the monetary policy rate from a low of 0.5% to 3.25% by December. The pace of tightening slowed in October with two rises of 25 basis points, rather than 50 basis points previously. This normalisation of policy is leading to widening interest rate spreads compared with advanced economies and has contributed to attracting capital flows that have led to an appreciating currency.

Although the central bank maintains a strong commitment to a fully flexible exchange rate regime, its recent announcement of plans to purchase USD12bn in the foreign

exchange market is aimed at stemming appreciation. This approach is based on the bank's assessment that the country's real exchange rate had risen to the strongest level compatible with fundamentals. The bank last intervened in 2008, when it announced a similar programme aimed at purchases of USD8.0bn. This was abandoned after the collapse of Lehman Brothers, by which time it had bought USD5.75bn. The measure will provide a significant boost to foreign exchange reserve levels, further enhancing the sovereign's international liquidity and diminishing its susceptibility to external shocks.



⁴ The annual inflation target is 3% +/-1%. Chile adopted an inflation-targeting framework in 1991, one of the first countries in the world to do so.

⁵ Period average inflation for the year came to 1.5%.

Forecast Summary

	2006	2007	2008	2009	2010	2011e	2012f
Macroeconomic indicators and policy							
Real GDP growth (%)	4.6	4.6	3.7	-1.5	5.3	6.0	4.8
Consumer prices (annual average % change)	3.4	4.4	8.7	1.5	1.4	3.2	3.3
Short-term interest rate (%) ^a	5.0	5.4	7.1	1.9	1.6	3.5	5.0
General government balance (% of GDP)	7.9	8.4	4.3	-4.3	-0.5	-0.8	0.6
General government debt (% of GDP)	5.3	4.1	5.2	6.1	8.6	8.2	8.0
CLP per USD (annual average)	530.3	522.5	522.5	560.9	493.2	490.0	505.0
Real effective exchange rate (2000 = 100)	93.6	90.8	91.8	90.5	92.3	91.4	90.5
External finance							
Current account balance (USDbn)	7.2	7.5	-2.5	4.2	2.8	-0.9	-4.5
Current account balance (% of GDP)	4.9	4.5	-1.5	2.6	1.4	-0.4	-1.9
Current account balance plus net FDI (% of GDP)	8.0	10.6	2.7	5.5	3.8	4.5	1.9
Net external debt (USDbn)	-3.2	-14.7	-16.2	-5.8	-2.9	-6.0	-1.5
Net external debt (% of GDP)	-2.2	-8.9	-9.5	-3.5	-1.4	-2.6	-0.6
Net external debt (% of CXR)	-4.4	-16.9	-18.5	-8.2	-3.3	-6.2	-1.4
Official international reserves including gold (USDbn)	19.4	16.8	23.1	25.3	27.9	39.5	39.0
Official international reserves (months of CXP cover)	3.5	2.5	3.1	4.6	4.0	4.9	4.3
External interest service (% of CXR)	2.2	1.9	1.7	1.5	1.8	1.6	1.2
Gross external financing requirement (% int. reserves)	38.2	17.5	102.8	50.6	24.9	24.7	29.5
Memo: Global forecast summary							
Real GDP growth (%)							
US	2.7	1.9	0.0	-2.6	2.8	3.2	3.3
Japan	2.0	2.4	-1.2	-6.3	3.2	1.5	1.7
Euro area	3.1	2.7	0.4	-4.1	0.9	1.5	2.0
World	3.8	3.7	1.4	-2.5	3.1	2.9	2.7
Commodities							
Oil (USD/barrel)	65.4	72.7	97.7	64.0	80.0	85.0	85.0

^a Monetary policy interest rate(annual average)

Source: Fitch

Comparative Analysis: Macroeconomic Performance and Policies

Chile

	2010						
	Saudi Arabia 'AA-'	Chile 'A+'	China 'A+'	Czech Republic 'A+'	Korea 'A+'	'A' median	'AA' median
Real GDP (5yr average % change)	2.7	3.3	11.1	2.7	3.7	3.9	1.7
Volatility of GDP (10yr rolling SD)	2.5	2.2	1.8	3.2	2.0	2.4	2.5
Consumer prices (5yr average)	5.4	3.9	2.9	2.9	3.0	2.8	2.7
Volatility of CPI (10yr rolling SD)	3.4	2.2	2.2	1.8	0.8	1.5	1.2
Years since double-digit inflation	33.0	16.0	15.0	12.0	29.0	n.a.	n.a.
Unemployment rate	10.5	8.7	4.2	7.2	3.8	7.2	6.5
Type of exchange rate regime	Conventional fixed peg	Free float	Crawling peg	Free float	Free float	n.a.	n.a.
Dollarisation ratio ^a	17.1	12.5	2.3	8.9	4.5	8.1	31.9
REER volatility (10yr rolling SD)	5.3	4.9	4.5	5.8	10.5	5.0	2.9

^a 2009 data
Source: Fitch

Strengths

- Chile's credible monetary and exchange rate regime is supported by sound fiscal policy and a well-managed domestic financial system. The sovereign's macroeconomic policy framework has underpinned economic stability through the recent copper price volatility and external and domestic shocks.
- GDP volatility is slightly below the 'A' median, owing to countercyclical budgeting and accumulation of fiscal assets overseas to reduce the risk of currency volatility and economic overheating.
- Medium-term inflation expectations are well anchored at the 3% target and volatility of CPI is in line with the peer median.
- Chile's real effective exchange rate volatility is very much in line with the 'A' median despite high commodity dependence.

Weaknesses

- Relatively rigid labour markets contribute to a slightly higher unemployment rate than the 'A' median. The participation of female and younger workers in the labour force has increased, but remains low relative to peers and to OECD members.
- Mining typically comprises 55%-60% of total exports and 5%-20% of fiscal revenue, depending on the point in the commodity price cycle. Nevertheless, the economic stabilisation mechanisms inherent in the macro-policy framework mitigate the primary risks associated with commodity dependence. In addition, according to local authorities, mining typically accounts for less than 10% of Chile's GDP and less than 2% of overall employment, which suggests some limit to the real impact of lower metals prices.

Commentary

The Chilean authorities are committed to preserving macroeconomic stability, further strengthening the policy framework, and creating incentives to boost productivity. Accelerating productivity growth is one of the government's top priorities and key initiatives in this area include increasing the efficiency of the public sector, along with comprehensive reforms aimed at making labour markets more flexible.

Comparative Analysis: Structural Features

Chile

	2010						
	Saudi Arabia 'AA-'	Chile 'A+'	China 'A+'	Czech Republic 'A+'	Korea 'A+'	'A' median	'AA' median
GNI per capita PPP (USD, latest) ^b	24,000	13,430	6,710	23,610	27,310	21,600	31,480
GDP per capita (USD, mkt exchange rates)	16,275	11,913	4,379	18,618	20,614	18,262	33,656
Human Development Index (percentile, latest) ^b	68.0	76.3	49.8	80.7	86.2	78.5	88.5
Ease of Doing Business (percentile, latest) ^b	94.6	77.0	57.2	66.0	91.8	80.3	86.9
Trade openness (CXR and CXP % GDP)	55.2	42.6	28.0	77.5	55.0	74.8	48.8
Gross domestic savings (% GDP)	39.6	24.8	51.1	28.8	31.0	29.3	23.7
Gross national savings (% GNP)	33.8	24.4	49.5	21.2	32.3	21.2	20.5
Gross domestic investment (% GDP)	25.8	21.6	45.5	21.3	29.2	21.5	20.5
Private credit (% GDP)	49.6	81.4	137.0	54.9	103.8	105.2	136.4
BSR Indicators	C1	B1	D3	C1	C2	n.a.	n.a.
Bank system CAR ^b	16.5	14.3	11.4	14.1	14.4	n.a.	n.a.
Foreign bank ownership (% assets)	13.0	60.0	7.8	97.0	14.3	n.a.	n.a.
Public bank ownership (% assets)	32.0	15.0	54.5	2.9	41.2	50.0	3.2
Default record (year cured) ^a	None	1990	None	None	None	n.a.	n.a.

^a Modern (ie, since 1980) rescheduling history: six times between 1983 and 1988.

^b 2009 data

Source: Fitch and World Bank

Strengths

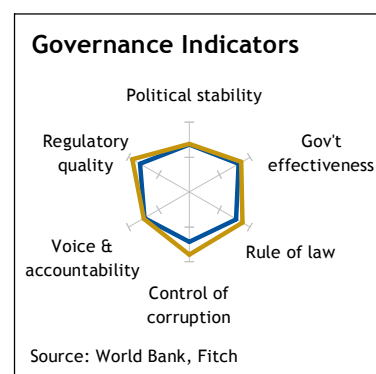
- The integrity of Chile's democratic institutions is well established. The country outperforms the 'A' and 'AA' medians on each of the World Bank's governance indicators. In addition, Chile's stable political system has a high degree of consensus regarding the macroeconomic framework.
- A healthy, well-regulated and sufficiently capitalised financial system supports monetary and exchange rate stability. The Chilean banking system had limited exposure to toxic assets and its soundness is underpinned by a conservative management approach and adequate supervision by the local regulator. Fitch's Banking System Indicator (BSI) and Macro-Prudential Indicator (MPI) for Chile are assessed at 'B1', the highest among rated sovereigns.
- Relatively deep domestic capital markets provide ample liquidity for both public- and private-sector financing. Fitch perceives little risk of the private sector being crowded out in Chile as banks, pension funds, mutual funds and insurance companies offer ample liquidity. The government can also meet its own financing needs with stabilisation fund assets.

Weaknesses

- Although Chile nears the 'A' median percentile on the United Nations Human Development Index, its lower per capita income is still an outlier among Fitch-rated 'A' sovereigns. Masked by other indicators, income inequality is also a persistent weakness relative to peers.

Commentary

The financial system weathered the crisis well, with only a moderate cyclical deterioration in credit quality despite two major adverse shocks. Non-performing loans remain relatively low at 3% of all loans. Banks are well capitalised and are primarily funded by deposits. Provisioning levels have strengthened, in part due to stricter provisioning requirements in place since January 2010.



Comparative Analysis: External Finances

Chile

	2010					Last 10 years	
	Saudi Arabia 'AA-'	Chile 'A+'	China 'A+'	Czech Republic 'A+'	Korea 'A+'	'A' median	'AA' median
GXD (% CXR)	45.5	93.4	30.7	59.7	76.4	86.7	276.1
GXD (% GDP)	27.9	39.5	9.5	45.8	43.2	47.9	130.0
NXD (% CXR)	-174.1	-3.3	-155.2	11.9	-5.7	-19.6	41.9
NXD (% GDP)	-106.5	-1.4	-48.1	9.1	-3.2	-14.9	23.7
GSXD (% GXD)	0.0	17.7	8.0	23.4	15.8	15.9	12.6
NSXD (% CXR)	-195.9	-34.8	-158.0	-15.2	-42.3	-25.2	-1.3
NSXD (% GDP)	-119.8	-14.7	-48.9	-11.7	-23.9	-16.0	-0.7
SNFA (USDbn)	542.8	30.0	2,969.1	22.7	253.2	5.9	0.6
SNFA (% GDP)	124.9	14.7	49.9	11.7	25.3	15.9	3.9
Ext. debt service ratio (% CXR)	3.3	12.3	3.7	8.7	7.2	11.5	31.0
Ext. interest service ratio (% CXR)	0.4	1.8	0.7	3.5	1.4	2.6	9.1
Liquidity ratio (latest)	1,169.1	136.5	992.3	166.3	161.9	132.1	40.6
Current account balance (% GDP)	15.9	1.4	5.2	-1.7	3.1	-0.6	0.2
CAB plus net FDI (% GDP)	18.7	3.8	5.6	-0.4	1.8	2.2	-0.7
Commodity dependence (% CXR, latest)	79.7	68.0	5.2	10.6	8.4	12.8	13.5
Sovereign net FX debt (% GDP)	-108.1	-11.6	-47.9	-15.5	-30.3	-	-

Source: Fitch

Strengths

- The majority of Chile's external debt and asset indicators compare favourably with corresponding 'A' medians, whether measured against CXR or GDP. Chile is an overall net external creditor, although its position is less robust than the 'A' median as the sovereign holds comparably lower reserves in light of its more flexible exchange rate regime.
- Chile's external debt and interest service burden is modest and bolstered by the sovereign's net external creditor status.

Weaknesses

- Commodities comprise over 65% of CXR, which is well above the peer median. Nevertheless, Chile's macro-policy framework cushions the impact of commodity price cycles on the overall economy and lessens the risks associated with negative terms-of-trade shocks.
- Chile's relatively high private-sector external debt contrasts with the public sector's strong net external creditor position. However, local capital markets are sufficiently deep and liquid to supplant external private-sector financing in the event of shocks that lead to diminished access to international capital markets.

Commentary

Chile's balance of payments is relatively stable considering that its export base is concentrated in primary products subject to sharp price volatility. A flexible exchange rate, open capital account and overseas fiscal stabilisation funds all help smooth external flows. As higher copper prices have boosted export receipts, corresponding outflows for import payments, mining company profit remittances abroad and increasing foreign assets of the corporate sector and the government's stabilisation fund have softened the impact on the overall balance of payments.

The liquidity ratio of 137% is in line with the category median. Chile's liquidity ratio will further strengthen over the forecast horizon as its central bank will bolster its foreign exchange position substantially in 2011.

Comparative Analysis: Public Finances

Chile

	2010					Last 10 years	
	Saudi Arabia 'AA-'	Chile 'A+'	China 'A+'	Czech Republic 'A+'	Korea 'A+'	'A' median	'AA' median
Budget balance (% GDP)	7.3	-0.5	-2.6	-5.5	-0.2	-2.5	-0.7
Primary balance (% GDP)	8.1	-0.1	-2.2	-3.9	1.5	-0.3	1.3
Revenue and grants (% GDP)	47.9	24.9	19.9	40.5	24.9	33.6	40.6
Volatility of revenue/GDP ratio	17.2	9.3	10.3	2.6	5.5	7.0	3.7
Interest payments (% revenue)	1.7	1.2	2.2	4.0	6.8	5.4	4.9
Debt (% revenue)	7.5	34.5	114.2	97.0	151.0	122.8	89.9
Debt (% GDP)	3.6	8.6	22.8	39.3	37.6	34.2	35.5
Net debt (% GDP)	-55.6	4.5	18.1	32.6	34.3	28.9	26.6
FC debt (% total debt)	0.0	23.3	3.3	16.1	1.1	24.1	4.3
CG debt maturities (% GDP)	0.6	1.2	1.5	4.6	3.6	5.6	9.6
Average duration of CG debt (years)	n.a.	n.a.	n.a.	4.2	3.8	3.7	4.1

Source: Fitch

Strengths

- Chile's rules-based fiscal policy prudently smoothes the impact of copper price volatility on fiscal accounts and enhances the resilience of public finances to commodity down-cycles. High copper prices supported large surpluses and strong accumulation of fiscal assets in recent years. The latter permit expenditure to remain stable or provide a source of stimulus during economic downturns.
- Chile has relatively little public debt. Gross and net public debt indicators, relative to GDP and revenue, are among the strongest in the 'A' category. Interest payments as a percentage of revenue are also a fraction of the peer median.

Weaknesses

- Volatility of revenue is higher than the 'A' median due to commodity dependence. However, Chile's countercyclical fiscal framework supports fiscal adjustment without endangering debt dynamics when copper prices fall.

Commentary

Values for all government debt ratios are extremely low. Therefore, even under adverse scenarios that may incorporate a relative deterioration in the government's credit indicators and reduced fiscal flexibility, the underlying credit quality of the Chilean government, as measured by key government credit metrics, is likely to remain stronger than observed in other 'A'-rated governments. This has been the case after recent, successive, shocks.

ESSF and PRF assets are managed by the central bank, with 70% of assets invested in sovereign bonds and 30% in liquid assets, and held abroad in order to minimise inflationary pressures, peso appreciation and economic overheating.

In light of the cushion afforded by the fiscal stabilisation funds, the main goals of public debt issuance are to maintain sovereign benchmarks and advance strategies for local capital-market development. Although the percentage of foreign-currency debt is low, about a third of new domestic debt issuance continues to be denominated in the CPI-indexed Unidad de Fomento (UF), as pension funds in particular maintain a strong preference for these instruments.

Fiscal Accounts Summary

% of GDP	2007	2008	2009	2010	2011e	2012f
General government						
Revenue	28.7	27.2	21.7	24.9	25.6	26.6
Expenditure	20.4	22.8	26.0	25.4	26.4	26.0
O/w interest payments	0.6	0.5	0.5	0.3	0.4	0.4
Primary balance	9.0	4.8	-3.8	-0.1	-0.4	1.0
Overall balance	8.4	4.3	-4.3	-0.5	-0.8	0.6
General government debt						
	4.1	5.2	6.1	8.6	8.2	8.0
% of general government revenue	14.3	19.0	28.3	34.5	32.1	29.9
General government deposits						
	3.1	4.3	5.4	4.3	3.9	3.7
Net general government debt	1.2	0.0	1.4	4.5	4.2	4.2
Central government						
Revenue	26.9	25.5	20.1	23.1	23.7	24.7
O/w grants	0.1	0.1	0.1	0.1	0.0	0.0
Expenditure and net lending	18.7	21.2	24.5	23.4	24.5	24.2
O/w current expenditure and transfers	15.5	17.4	19.8	19.1	20.1	20.1
- Interest	0.6	0.5	0.5	0.3	0.4	0.4
O/w capital expenditure	3.2	3.8	4.7	4.3	4.4	4.1
Current balance	11.4	8.1	0.2	4.0	3.7	4.7
Primary balance	8.8	4.8	-3.9	0.0	-0.4	0.9
Overall balance	8.2	4.3	-4.4	-0.3	-0.8	0.6
Central government debt						
	4.1	5.2	6.1	8.6	8.2	8.0
% of central government revenue	15.2	20.3	30.6	37.2	34.7	32.2
Central government debt (CLPbn)						
	3,517.4	4,614.5	5,619.2	8,657.8	9,142.1	9,624.7
By residency of holder						
Domestic	1,616.9	3,046.1	4,114.3	7,087.8	7,704.8	8,320.2
Foreign	1,900.5	1,568.4	1,504.9	1,570.0	1,437.3	1,304.5
By place of issue						
Domestic	1,616.9	3,046.1	4,114.3	7,087.8	7,704.8	8,320.2
Foreign	1,900.5	1,568.4	1,504.9	1,570.0	1,437.3	1,304.5
By currency denomination						
Local currency	1,704.6	2,768.1	4,337.9	6,693.5	7,186.7	7,676.7
Foreign currency	1,812.8	1,846.4	1,281.3	1,964.3	1,955.4	1,948.0
in USD equivalent (eop exchange rate)	3.7	2.9	2.5	4.1	3.9	3.8
By maturity						
Less than 12 months (residual maturity)	663.5	500.0	500.0	500.0	500.0	500.0
Average maturity (years)	-	-	-	-	-	-
Average duration (years)	-	-	-	-	-	-
Memo						
Non-financial public-sector balance (% GDP)	-	-	-	-	-	-
Net non-financial public-sector debt (% GDP)	-	-	-	-	-	-
Nominal GDP (CLPbn)	85,849.8	89,262.6	91,591.3	100,724.8	111,031.4	120,927.8

Source: Ministry of Finance and Fitch estimates and forecasts

External Debt and Assets

(USDbn)	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
Gross external debt	38.5	40.5	43.1	43.5	46.2	49.5	55.7	64.3	74.0	80.6
% of GDP	56.2	60.2	58.2	45.5	39.1	33.7	33.9	37.6	45.3	39.5
% of CXR	156.7	164.4	147.6	103.7	87.1	67.0	64.0	73.6	105.6	93.4
By maturity										
Medium- and long-term	33.4	35.4	36.4	36.4	39.2	40.2	44.4	48.8	57.8	62.4
Short-term	5.1	5.1	6.7	7.2	7.0	9.3	11.3	15.5	16.2	18.2
% of total debt	13.3	12.5	15.6	16.4	15.1	18.9	20.3	24.2	21.9	22.6
By debtor										
Monetary authorities	0.0	0.0	0.0	0.0	0.2	0.2	0.4	0.3	1.4	1.4
General government	6.1	7.2	9.3	9.8	9.8	11.4	12.8	12.3	13.8	14.3
O/w central government	2.8	3.6	5.7	5.4	4.7	4.2	3.8	2.5	3.0	3.3
Banks	2.5	3.7	5.1	6.0	7.1	7.1	10.0	12.6	14.9	16.4
Other sectors	29.9	29.6	28.7	27.7	29.2	30.9	33.0	39.4	45.4	50.0
Gross external assets (non-equity)	28.1	27.2	29.1	35.2	38.8	52.7	70.4	80.5	79.8	83.5
International reserves, incl. gold	14.4	15.3	15.8	16.0	16.9	19.4	16.8	23.1	25.3	27.9
Other sovereign assets net	0.6	0.3	0.1	0.2	1.1	2.7	14.9	22.7	14.7	16.4
Deposit money banks' foreign assets	4.1	2.4	1.8	2.5	3.4	4.9	9.7	7.6	11.3	12.3
Other sector foreign assets	8.9	9.2	11.3	16.6	17.4	25.7	28.9	27.2	28.5	26.9
Net external debt	10.5	13.3	14.0	8.3	7.4	-3.2	-14.7	-16.2	-5.8	-2.9
% of GDP	15.3	19.8	18.9	8.7	6.2	-2.2	-8.9	-9.5	-3.5	-1.4
% of CXR	42.6	54.1	47.9	19.7	13.9	-4.4	-16.9	-18.5	-8.2	-3.3
Net sovereign external debt	-8.9	-8.5	-6.6	-6.4	-8.2	-10.6	-19.0	-33.5	-26.2	-30.0
% of GDP	-13.0	-12.6	-9.0	-6.7	-6.9	-7.2	-11.6	-19.6	-16.1	-14.7
Net bank external debt	-1.6	1.3	3.3	3.5	3.8	2.2	0.2	5.1	3.5	4.0
Net other external debt	20.4	20.2	17.3	10.9	10.7	2.5	-10.8	-10.5	2.2	6.7
Net international investment position	34.0	31.1	37.5	30.2	32.7	15.2	-0.7	30.2	19.6	-
% of GDP	49.6	46.2	50.7	31.6	27.6	10.3	-0.4	17.7	12.0	-
Sovereign net foreign assets	8.9	8.5	6.6	6.4	8.2	10.6	19.0	33.5	26.2	30.0
% of GDP	13.0	12.6	9.0	6.7	6.9	7.2	11.6	19.6	16.1	14.7
Debt service (principal & interest)	6.2	8.0	7.5	10.1	9.6	15.3	12.6	16.3	16.9	10.6
Debt service (% of CXR)	25.2	32.3	25.8	24.0	18.1	20.7	14.4	18.7	24.1	12.3
Interest (% of CXR)	6.9	5.9	4.3	3.1	2.5	2.2	1.9	1.7	1.5	1.8
Liquidity ratio (%)	125.7	141.5	140.7	105.4	110.1	91.3	111.1	96.2	94.4	136.5
Net sovereign FX debt (% of GDP)	-7.6	-8.6	-7.8	-7.0	-8.6	-9.7	-8.0	-11.8	-13.9	-11.6
Memo										
Nominal GDP	68.6	67.3	74.0	95.7	118.3	146.8	164.3	170.9	163.3	204.2
Gross sovereign external debt										
Inter-company loans	4.9	4.8	4.2	4.2	4.3	2.4	2.8	3.6	4.7	-

Sources: NBP, IMF, World Bank and Fitch estimates and forecasts

Balance of Payments

(USDbn)	2007	2008	2009	2010	2011e	2012f
Current account balance	7.5	-2.5	4.2	2.8	-0.9	-4.5
% of GDP	4.5	-1.5	2.6	1.4	-0.4	-1.9
% of CXR	8.6	-2.9	6.0	3.2	-0.9	-4.3
Trade balance	23.9	8.8	14.0	13.1	11.2	7.3
Exports, fob	68.0	66.5	53.7	67.0	75.0	81.1
Imports, fob	44.0	57.6	39.8	53.9	63.8	73.7
Services, net	-1.0	-0.9	-1.1	-1.6	-1.7	-1.2
Services, credit	9.0	10.8	8.5	9.4	10.3	11.3
Services, debit	9.9	11.7	9.6	10.9	12.0	12.5
Income, net	-18.6	-13.4	-10.3	-12.0	-13.5	-14.0
Income, credit	6.3	6.3	5.4	6.0	7.0	7.5
Income, debit	24.9	19.7	15.7	18.0	20.5	21.5
O/w: Interest payments	1.7	1.5	1.0	1.5	1.5	1.3
Current transfers, net	3.1	2.9	1.6	3.2	3.2	3.4
Memo						
Non-debt-creating inflows (net)	1.1	2.7	-15.2	-1.5	7.5	3.5
O/w equity FDI	10.9	7.0	4.8	5.0	11.0	9.0
O/w portfolio equity	-9.8	-4.3	-20.0	-6.5	-3.5	-5.5
O/w other	0.0	0.0	0.0	0.0	0.0	0.0
Change in reserves (-=increase)	3.2	-6.5	-1.6	-3.7	-11.6	0.5
Gross external financing requirement	3.4	17.3	11.7	6.3	6.9	11.7
Stock of international reserves, incl. gold	16.8	23.1	25.3	27.9	39.5	39.0

Sources: IMF and Fitch estimates and forecasts

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