

Axesor assigns Chile a rating of A- with a stable outlook that highlights its position of strength to face the impact of the economic crisis caused by COVID-19

Axesor's first rating report for the country points out its low debt levels and the good starting position from which to meet its financial obligations. Furthermore, it underlines the credibility of the economic policy, with a stable exchange rate, controlled inflation and a sound financial system.

Sovereign rating of the Republic of Chile

The first unsolicited credit rating of A- with a stable outlook to is based on Chile's good starting position to meet its financial obligations. The country has a low level of net debt to GDP, which is expected to reach 14.7% by year-end, which facilitates its access to financial markets under favorable conditions. In addition, the fiscal margin that allows a more ambitious spending program than its peers, a commercial activity more exposed to Asia (a market that will experience less economic decline) and a productive activity dependent on branches less sensitive to the health crisis, result in Chile suffering less from the impact of the economic and health crisis caused by COVID-19 and position it for a more favorable recovery in the coming years.

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Axesor Rating has assigned an unsolicited rating of A- with a stable outlook to the Republic of Chile in the initial rating report of the country. The rating report highlights Chile's good starting point marked by the performance of the last decades which has resulted in its economy growing above that of the region, and has thus been able to better withstand the impact of the health crisis and be better positioned towards the expected recovery over the next few years.

According to the report, the low level of debt is one of the strengths of the Chilean economy. Last year, the level of gross debt to GDP was 27.9% and 7.9% in net terms. Despite the impact of the COVID-19 pandemic which, logically, will result in an increase in the aforementioned figures, Chile will close the year with levels of debt to GDP of 32.8% and 14.7% in gross and net terms, respectively. A circumstance that will continue to facilitate access to financial markets and allowing the country to fund itself under better conditions than other emerging countries.

Axesor Rating highlights the "coherent" fiscal policies implemented by the Chilean government, as well as stability of prices, with inflation sustained at levels between 2% and 4%, and solidity of the exchange rate. Moreover, Chile has a financial system that is characterized by being highly concentrated, with average returns of 15.8% and a low non-performing loan ratio of 1.9%.

Chile is expected to end the year with an unemployment rate of 11.4%, with more than four points above what was recorded in the previous year (7.2%). However, the rating takes into account the high rate of temporary employment and self-employment in the country, with rates of 27% and 27.2% respectively, well above the average of the OECD (Organisation for Economic Cooperation and Development) of 11.8% and 15%. Levels that, together with the youth unemployment figures, negatively affect labor productivity with a higher turnover rate amongst workers and low spending on training that affects the structural growth of the country.

Additionally, the impact of the pandemic on the Chilean economy will be severe, with growth decreasing from the 1.1% achieved in 2019 to the contraction of -6.0% that is forecasted by the IMF (International Monetary Fund) for 2020. In the second quarter of this year 2020, the drop was 14.1%. However, the rating also considers that the Chilean economy was the second best performer of the region out of the six largest South American economies, which ranged from -11.4% in Brazil to -30.2% in Peru.

Looking ahead to 2021, Chile is estimated to grow at a rate of 4.5% and its GDP is expected to recover its pre-pandemic levels during the first months of 2022. These figures are better than those forecasted for the whole region, whose economy will contract by -8.1% this year 2020 and will rebound by 3.6% in 2021. Although Chile is the second country with the most COVID cases per inhabitant and the fourth in deaths in South America, if we look at the number of tests per inhabitant carried out by Chile -which is more than double the average for the region- and the most adjusted difference between deaths reported by COVID and excess deaths for the period, the real impact of the pandemic would not be as intense compared to the main countries in the area.

Debt, fiscal balance, and liquidity

Although Chile is one of the South American countries that has been the most affected by the pandemic - it ranks second in cases per inhabitant and fourth in deaths. Due to the reduced weight of tourism along with the importance of sectors like manufacturing industry business and financial services, as well as the orientation of its exports to the Asian market (54.1% went to Asia), the country will have a better starting point to tackle the economic impact caused by the health crisis.

Regarding this, the rating assesses the moderate levels of gross debt to GDP of Chile, which ended 2019 with a ratio of 27.9%, markedly lower figures compared to other developed and emerging countries. This favorable position is further strengthened considering the net debt to GDP which closed the last financial year at 7.9% benefiting from financial assets held by the Economic and Social Stabilization Fund (FEES) and the Pension Reserve Fund (FRP), which serve as buffers against unforeseen events. However, the rating takes into consideration the significant increase in debt that has occurred in recent years and which is expected to continue over the next five years. In fact, the IMF forecasts that the public debt will reach 41.9% of GDP in 2024, inter alia, due to the cost of the measures implemented in 2019 under the reform program called 'New Social Agenda' (increased pensions, minimum income...), as well as due to the increase in public expenditure resulting from the health crisis.

Furthermore, the Chilean government includes an increase in public expenditure of 9.5% and a growth in public investment growth of 14.9% in the draft budget law for 2021. All the mentioned expenditures will raise the structural deficit to 4.7%. However, it is worth noting that Chile's higher fiscal margin compared to neighboring countries allows for the implementation of major stimulus plans that will be crucial to address both the current crisis and the subsequent recovery of the Chilean economy.

On the downside, Axesor Rating warns of the high levels of private debt which reached 205.5% in 2019 and grew at an average rate of 3.5% during the last decade, "being an additional source of risk".

Another threat is the possible drop in the demand and/or in the price of copper - a mineral representing 50% of Chilean exports - due to the decline in global demand growth. This fact

would be compensated by lower energy costs or by the drop in imports resulting from lower domestic demand.

At the same time, Chile's international reserves are at appropriate levels, totaling in approximately 37,000 million dollars in April 2020, which represents about 15% of Chilean GDP. The Assessing Reserve Adequacy (ARA), defined by the IMF to assess the level of reserves of a country compared to its appropriate level, is at 90% - somewhat below the 100% recommended by the organization for emerging countries. This deficit is tempered by the liquid assets in foreign currency that are maintained by the Central Bank of Chile and the Economic and Social Stabilization Fund, which would raise the ARA to 110%, in addition to economic stability and by the fact that the short-term external debt is bank debt largely covered by liquid assets in foreign currency by financial institutions under constant supervision.

To conclude, the rating positively assesses the strength of the Chilean institutional framework, which has been at the forefront of the region for many decades and which is highly valued in the Worldwide Governance Indicators of the World Bank. Even so, the weakening of economic growth, high inequality, and social challenges result in Chile having to deal with a demanding period of many challenges within a complex context. In addition, a constitutional reform is being carried out and Axesor hopes it will strengthen the quality of its democracy without weakening the institutional strengths and consensus that have enabled the country to obtain good results over the past decades.

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