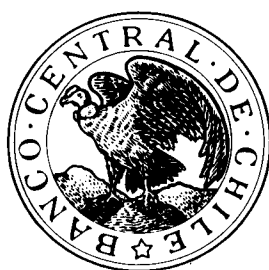


**GENERAL OVERVIEW ON THE
PERFORMANCE OF THE
CHILEAN ECONOMY : THE
1985 - 1988 PERIOD**



**BANCO CENTRAL DE CHILE
1989**

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GENERAL OVERVIEW ON THE PERFORMANCE OF THE CHILEAN ECONOMY: THE 1985 - 1988 PERIOD

ECONOMIC GROWTH

The Chilean economy has been growing very quickly in the last years. Real GDP grew at an increasing rate going from 2.4 percent in 1985 to 7.4 percent in 1988 (Table 1). In terms of per-capita GDP, it implied an average real growth rate of 3.4 percent per year reaching in 1988 a level of US\$ 1,743.5.

The most dynamic sectors of the economy have been those engaged in the production of tradable goods, specially industrial activities that grew at an average annual real rate of 5.4 percent in the last four years. Nevertheless, tradable sector's share in GDP has been kept around 38.5 percent since the nontradable sector's output has also grown fastly.

AGGREGATE DEMAND AND SUPPLY

After a slight decline in 1985, total real aggregate supply rose also at growing rates

between 1986-88 reflecting the strong growth in domestic output and a surge in imports, particularly in the last two years. Aggregate supply thus increased at rates of 7.7 percent in 1987 and 8.2 percent in 1988 determining an average annual growth of 5.5 percent for it in the four-years period (See Table 1).

Real domestic expenditure showed the same growth trend than aggregate supply. It expanded by almost 7.5 percent in 1987 and a further 8.9 percent in 1988 on the strength of a steady recovery in private consumption and an upsurge in investment. The recovery in private consumption is mainly attributed to the vigorous expansion in employment. Gross fixed capital formation has been growing at an accelerated pace. As a percent of real GDP, it increased from 12.9 percent in 1985 to 17.0 percent in 1988.

The rise in investment has been financed by a major expansion in national savings. The ratio of gross national savings to GDP was tripled in the 1985-88 period augmenting from 5.4 percent to 16.2 percent. This effort was equally shared by the government and private sector and it essentially resulted from: the implementation of conservative fiscal policies, the tax incentives to save granted by the 1984 Tax Reform and the high degree of capacity utilization which promoted investment and earnings. The growth of domestic investment since 1985 has been accompanied by a decline in Chile's net use of foreign savings from 8.3 percent of GDP in 1985 to 0.8 percent in 1988.

Foreign direct investment has increased significantly in Chile, especially in mining. This flow rose at an average annual nominal rate of 21 percent in the last four years reaching an average level of US\$ 180.0 millions in 1987-88. It is also worth noticing that, in the first half of 1988, the Foreign Investment Committee authorized an investment of US\$ 1.1 billion for a copper mine (La Escondida) that is expected to raise Chile's copper output by 20 percent when it begins production early next decade. In addition, significant foreign investment is also occurring in gold, fishing, and forestry and paper products.

EMPLOYMENT, WAGES, AND PRICES

Productive employment growth averaged 9.8 percent in the years 1985-88. This strong recovery in the level of employment contributed to reduce the unemployment rate from 12% in 1985 to 6.3% in 1988. The sustained increase in private employment made possible to cutback special programs of employment that were created in order to alleviate the effects of the recession that suffered the Chilean economy at the beginning of the present decade, employment in these special employment programs fell from a peak of over 13 percent of the labor force in 1983 to just 0.3 percent in 1988.

On the other hand, the reallocation of human resources, towards the tradable sector continued during the whole period. Employment growth in this sector almost doubled the percentual rise in total employment and increased its share in it from 32.6 percent in 1985 to 38 percent in 1988. In this process, the agricultural sector had a remarkable performance since its employment grew at an average annual rate of 10.2 percent.

Real wages, as measured by INE's index of wages and salaries deflated by the consumer price index, increased by 6.5 percent in 1988. On average, wages increased at a rate of 2.1 percent a year in the period of 1985-88. The growing trend shown by wages is mainly explained by both the noticeable expansion on labor demand and the continuing slowdown on inflation.

Since the elimination of wage indexation in 1982, wages have been determined through market forces or collective bargaining, except for wage increases of nonunionized public sector employees and legal adjustments in the minimum wage. In the case of nonunionized public sector employees, there is no automatic adjustment for inflation, but in recent years the authorities have tended to adjust wages in line with and, in some cases, beyond inflation.

The inflation rate, computed by using the December-to-December CPI, was cut by more than half in this period. It went down from 26.4 percent in 1985 to 12.7 percent in 1988. Even more impressive was the inflation cut measured through the December-to-December WPI. Accordingly, the annual rate was reduced from 30.3 percent to just 3.3 percent in the same years.

THE EXTERNAL SECTOR

The Balance of Payments

Chile's current account deficit has been reduced substantially in the last four years. After declining from US\$ 1.3 billion (8.3 percent of GDP) in 1985, to about US\$ 1.1 billion (6.5 percent of GDP) in 1986, the current account deficit narrowed further to US\$ 1.67 hundred million in 1988 (0.8 percent of GDP), reflecting a continued improvement in the balance of trade surplus (See Table 3)

Total export earnings (in U.S. dollar terms) have been lately growing at increasing rates. Following a 24.4 percent in 1987, these earnings rose by 35 percent in 1988 to US\$

7.1 billion, reflecting continued fast growth in noncopper exports and a price-related surge in copper exports. Exports accumulated real growth was 55.2 percent in the period 1985-88. This outstanding performance of exports was partially offset by an equivalent 36.9 percent imports expansion, mostly in capital goods, to US\$ 4.2 billion (see table 3). Interest payments, averaging about US\$ 1.9 billion or 11.8 percent of GDP in 1985-86, fell to US\$ 1.8 billion (8.1 percent of GDP) in 1988, reflecting both, lower international interest rates and the effects of the debt reduction. For 1988 these figures include accrued interest for US\$ 0.4 billion (retiming of interest payments).

Capital inflows as foreign investment have grown continuously and quickly during this period. This flow rose from US\$ 116 million in 1985 to almost US\$ 0.9 billion in 1988 (See Table 3) reflecting both the growing confidence of foreign investors in the steady recovery of the Chilean economy and the success of debt conversion programs. In addition, there has been a constant decline in the economy's dependence on other external capital flows.

All of these has allowed the country to transform its deficit in the balance of payments, prevalent in 1985-86, into a surplus. International reserves has also gone up at an average annual rate (in U.S. dollar terms) of 8.1 percent amounting to US\$ 2.5 billion in 1988 (See Table 3). In relation to imports, these reserves were on average equivalent to nearly 6.5 months in that year.

External Debt

Chile's total external debt in constant U.S. dollars declined 17.2 percent in the last four years. It decreased from US\$ 20.5 billion in 1985 to US\$ 17.0 billion in 1988 mainly reflecting the narrowing of the current account deficit and large debt conversions (See Table 4 and 5). As a result, the ratio of total external debt to GDP fell from 128.9 percent in 1985 to 89.0 percent in 1988. Likewise, the ratio of total external debt to exports went down from 4.4 times to just 2.3 times in the same period.

This significant reduction on foreign liabilities is mainly accountable by the contraction on medium-and long-term debt which has been partly offset by the nominal increase shown by short-term debt.

Debt conversion operations have increased rapidly since their introduction in June 1985. Such conversions amounted to about US\$ 6.2 billion during 1985-88 (See Table 5). Investment-related conversions amounted to US\$ 2.1 billion and Chapter XVIII conversions (by residents) reached a similar amount.

The debt conversion program is designed to take advantage of the market discounts,

which was steady at around 30 percent through August 1987 and subsequently increased beyond 40 percent.

Growing discounts overtime in the secondary market for external debt and confidence on the future performance of the Chilean economy have been the main factors that explain the relative success of the Chilean debt conversion program.

TABLE 1

AGGREGATE SUPPLY AND DEMAND
(At constant 1977 prices)

	1985	1986	1987	1988	Average 1985-88
I. Annual percentage change					
Aggregate supply	-0.1	6.3	7.7	8.2	5.5
Gross Domestic Product	2.4	5.7	5.7	7.4	4.6
Imports a)	-11.1	9.6	17.1	12.1	9.5
Domestic Expenditure	-1.9	5.4	7.4	8.9	5.3
Private sector consumption	-1.1	4.9	4.8	9.6	4.8
Public sector consumption	-0.2	-2.1	-2.1	4.8	0.1
Gross Fixed Capital Formation	14.6	7.2	16.1	10.7	8.4
Exports a)	6.9	9.8	8.8	6.1	6.1
II. Percent of real GDP					
Aggregate supply	120.1	120.8	123.1	124.1	122.0
Domestic Expenditure	93.6	93.4	94.8	96.2	94.5
Private sector consumption	67.6	67.1	66.5	67.9	67.3
Public sector consumption	12.1	11.2	10.4	10.1	11.0
Gross Fixed Capital Formation	12.9	15.0	16.4	17.0	15.3
Exports a)	26.5	27.5	28.3	28.0	27.6
Imports a)	20.1	20.8	23.1	24.1	22.0
Balance of Goods and Nonfactor services	6.4	6.7	5.2	3.9	5.6

a) Goods and nonfactor services.

Source: Banco Central de Chile

TABLE 2

LABOR MARKET INDICATORS

	1985	1986	1987	1988	Average 1985-88
I. National Employment Data a) (Annual percentage change)					
Population 15 years old and over	2.0	1.7	1.6	1.7	1.2
Labor force	5.8	6.3	2.0	4.5	3.2
Employment	8.2	10.1	3.0	6.4	4.8
Of which: special programs b)	-22.1	-32.0	-51.6	-82.5	-17.2
Employment tradable sector		22.8	7.7	6.3	8.9
(In percent)					
Unemployment rate	12.0	8.8	7.9	6.3	8.8
Layoff rate	9.3	7.1	6.5	5.1	7.0
Participation rate c)	33.6	35.1	35.3	36.4	35.1
II. Real Wages (Percentage change)					
General Index					
Annual Average	-4.3	2.1	0.2	6.5	2.1
December-December	1.9	2.1	0.5	4.3	1.7

a) Based on the October-December survey of each year.

b) Rates of change of persons employed by special public sector programs (PEM and POJH) designed to provide support to low income workers.

c) Labor force as percentage of total population.

Source: National Statistical Institute (INE).

TABLE 3

BALANCE OF PAYMENTS: 1985 - 1988

(In millions of US dollars of 1986)

	1985	1986	1987	1988	TOTAL GROWTH RATE (%) c)
Current Account	-1,379.9	-1,090.7	-765.5	-145.6	-89.4
Trade Balance	882.5	1,099.7	1,164.3	1,929.4	118.6
Exports	3,951.5	4,198.8	4,947.3	6,132.5	55.2
- Copper	1,858.0	1,757.1	2,116.4	2,970.8	59.9
- Other	2,093.5	2,441.7	2,830.8	3,161.8	51.0
Imports	-3,069.0	-3,099.1	-3,782.9	-4,203.1	36.9
Nonfinancial Services	-350.8	-387.6	-438.7	-559.3	59.4
Financial Services	-1,974.6	-1,887.3	-1,610.3	-1,669.3	-15.5
Transfers	63.1	84.5	119.1	153.7	143.6
 Capital Account	 1,280.7	 912.6	 894.6	 824.2	 -35.7
Direct Investment a)	116.0	319.3	874.6	886.9	664.6
Other Capital Flows	1,164.6	593.3	20.0	-62.7	-105.4
 Errors and Omissions	 -3.2	 -49.4	 -86.1	 -42.3	
 Overall Balance of Payments	 -102.4	 -227.5	 43.0	 636.4	
 Balance of International Reserves b)	 1,886.7	 1,778.3	 1,871.1	 2,549.9	

a) Includes debt conversion.

b) In millions of nominal U.S. dollars.

c) Computed considering the extreme years.

Source: Banco Central de Chile.

TABLE 4

OUTSTANDING EXTERNAL DEBT

(Stocks as of Dec. 31 st.)

	1985	1986	1987	1988	Total Variation (%)
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(In millions of U.S. dollars of 1986)

Total External Debt a)	20,533	20,278	19,652	17,001	-17.2
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(In millions of U.S. dollars)

Total External Debt a)	20,093	20,278	20,975	19,550	-2.7
Medium and long-term	17,654	17,768	17,955	16,096	-8.8
Short-term	2,439	2,510	3,020	3,454	41.6

Debt Ratios c)

Total External Debt/GDP	128.9 %	120.5 %	110.5 %	89.0 %
Total External Debt/Exports d)	4.42	4.03	3.29	2.36
Interest Payments/Exports d) (nom.)	43.5 %	38.6 %	26.4 %	21.7 %

a) Includes short-term debt of the Central Bank (BIS).

b) It considers Banco del Estado.

c) Ratios computed considering U.S. dollars of 1986.

d) It includes goods and services.

Source: Banco Central de Chile.

TABLE 5

FOREIGN DEBT CONVERSION ACCUMULATED TO DECEMBER 31 st, 1988

(In millions of U.S. dollars)

Debtor	Chapter XVIII	Chapter XIX	Other	Total
Public Sector	1,247.5	1,086.7	770.3	3,104.5
Private Sector	883.4	752.3	1,480.3	3,116.0
Total	2,130.9	1,839.0	2,250.6	6,220.5

Source: Banco Central de Chile (Depto. de Política de Financiamiento Externo).