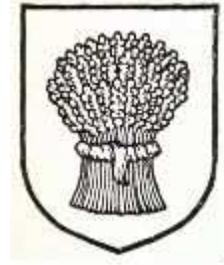


Saturday, September 12, 2009



# Hallgarten & Company

**Macro Review**

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## The Chilean Economy: The First Half of 2009

# The Chilean Economy

Going off a cliff, albeit a small one

## THE HALF YEAR THAT WAS

It has been a while since I took a thorough look at the Chilean economy from a macro perspective, and the publication this week of GDP and Balance of Payments figures for the first half of 2009 is a good incentive to update the situation. In certain cases, statistics are available beyond June, in which case the latest available numbers have been used in the text.

Overall, though some figures for the latest months show a point of inflection, in most cases it consists of a drop becoming softer, rather than going into reverse. Furthermore, as 2009 proceeds, we are comparing to increasingly depressed months of 2008, so the deterioration might not be as marked as for the earlier months.

An important point to keep in mind is that the only valid comparisons are with the same month or whatever period of last year, not the preceding month, a tendency often used by the ignorant Chilean media which in turned is taken advantage of by politicians to triumphantly claim progress, which does not really exist.

## ECONOMIC ACTIVITY IN JANUARY-JUNE 2009

According to the latest statistics, the Chilean economy shrunk by 4.5 % in the second quarter of 2009, after a 2.3 % drop in the first three months. Gross capital formation did particularly badly, with a 19 % drop in the quarter.

Inflation in the first 7 months of 2009 was a negative 1.2 %, and the cumulative 12-month total came down to just + 0.3 %. It is more than likely that the year will end with a negative inflation. This is good news, but with a proviso. Many Chilean businesses, either through the indexed UF unit of account or just by hiking prices, always put up their rates in line with inflation. Faced with a drop in income, one wonders how they will react.

The low inflation has helped improve real wages, which rose by 4.7% in the year to June. As of that date, the average gross wage was around U\$ 690 per month. Nevertheless, what also has risen has been unemployment. The rate reached 10.7 % (+2.3 points in a year) in the quarter to June. For the 15-24 year segment, nearly a quarter (24.8 %) are out of work, 4.1 points more than a year earlier. Even then, the statistics are underestimated by the existence of emergency municipal work programmes, without which it is estimated that the figure would be 3 to 4 points higher.

A new discussion front has arisen between big business and the finance minister. The former want, apart from “more flexible” labour legislation, lower taxes, whereas the minister says they should worry about better English. As true as that may be, it is not clear what the private sector is supposed to do about language proficiency (when Mr Paulmann of Jumbo cannot even spell “garbanzos” in Spanish). In any case, it is an old tradition of neglect. Among the first emissaries to London of independent Chile, were Mario Egaña and José Miguel de la Barra, who spoke no English. They had to hire a young Venezuelan as secretary, called Andrés Bello.

## SECTOR PERFORMANCE

Looking at a selection of sectors reflecting economic activity, the results, with a couple of exceptions, are generally pointing downwards. The exceptions include the sale of cinema tickets (up 20 %), and that of Cosmetics (up 6 %). These figures faithfully reflect the classical economic theory that in times of deep recession, people look for cheap entertainment, and women spend more on cosmetics to feel better. When the cost of “feeling better” goes up, then the figures change colour. Thus, restaurant turnover in the second quarter was 12.2 % lower, accumulating a 6-month fall of 10.1 %.

The more expensive the items get, the more pronounced is the drop. On retail, the accumulated statistics come from individual sectors because the national statistics office (INE) apparently does not believe in working them out. During the first semester, the sale of electronic goods was down by 6.5 %. If we take just the month of June, overall retail sales dropped by 4.7 %.

The rate of fall in passenger vehicle sales has slowed down a bit, but it was still 34.6 % in July, accumulating a 7-month drop of 46.6 %. This makes the industry’s recent triumphal declarations as to the year looking better than expected, sound very hollow. We have statistics for motorbike sales up to June (a drop of 27 % in the semester), and for trucks (- 52 %, with the June figure slightly better at -48.4 %, though the improvement is insignificant).

As for those who travel, be it business or pleasure, the number of air passengers in January-June decreased by 4.3 %, to 4.66 million. There was a small increase in domestic activity, which was up by 2.6 %, helped by heavy discounting, but international travel (where discounts are advertised but never seem to be available at the time of booking, or, with the exception of LAN, subject to “supplements” of 40 to 50 %), plunged by 10.3 %. The worst performance was in air cargo, where the volume transported dropped by 22.8 % (-13.9 % taking exports alone). Export tonnage shipped by sea dropped by 10 %, and by land 7.2%.

Total authorised new building surfaces in the semester dropped by 15 % to 7.18 million m<sup>2</sup>, though June marked an inflexion point with a 22.1% increase. This good monthly performance resulted from a 34.9 % in housing, and 35 % in public buildings, but private business premises were 34.5 % down. Increased subsidies for public housing and a rush to get the permits in before a change in the VAT treatment for the construction industry may have helped boost the last monthly figure. In the 7 months to July 2009, cement deliveries fell by 17.4 % to 52,775 bags, compared to the same period of 2008. The figure for July alone, a drop of 20.7 %, does not seem to announce a turnaround.

The combination of lower truck sales, less international air travel and a sharp fall in new construction permits for business premises show that investment pick-up is still lying behind in the private sector. Another sign of that is the 55 % drop in outward investment by Chilean firms, which totalled just US\$ 835 million in the semester.

In January-June, consumption of soft drinks and juices stagnated at + 0.9 %. Wine production rose 13.6 % (to 986 million litres), of which 302 million was exported (+ 9.7 %).

Electricity generation in the first half dropped by 1 % in the Central Integrated System (SIC), which supplies most of the country, whereas the autonomous northern network, which mainly supplies mining and similar industries increased its output by 6 %. It accounts for less than a quarter of the national total.

There are other signs of the economic squeeze that are rarely reported, but reflect how hard up the population, even the middle classes, are. No less than 107,000 subscribers to the private ISAPRE medical insurers are behind in their payments, whereas the unpaid toll debts of the private motorway concessionaires rose by 27 % during the semester.

## **THE EXTERNAL SECTOR**

Balance of Payments figures just published for the first semester show that the Current Account was in surplus to the tune of U\$ 1.4 bn, 12.4 % less than in 2008.

Trade statistics to July indicate a surplus of U\$ 6 bn, though 42 % down on last year. Imports dropped by 35.2 % (to U\$ 22 bn) and exports were 32.2 % down at U\$ 28 bn. Copper represented 45.2 % of total exports, and the amount exported dropped by 46.5 %. The fall was reduced to just 22 % in the month of July, reflecting the recovery in the metal price. The drop in imports was partly due to lower fuel purchases following the price drop. These were nearly 55 % lower. Due to futures contracts written up with China in 2006 at a fixed price of U\$ 1.6/lb. the state mining group had undersold the metal by nearly U\$ 1.5 bn as of June 30.

Though the number of incoming tourists for the first seven months was up by around 2 % to 1.74 million, they spent less than last year, and early indications for subsequent months point to a big drop in the Brazilian trade that usually comes to ski. More unrest in the Arauco region, now joined by protests on Easter Island, will not do much to help boost the number of foreign investors.

External reserves as of August 7 totalled U\$ 23.62 bn, little changed on the end-2008 level. Total external debt as of end June was U\$ 63.87 bn, of which the overwhelming proportion (82 %) was owed by the private sector. This sector has increased its foreign liabilities by 44 % in the past two and a half years alone, and I have been convinced for some time that the government is keeping the exchange rate low, in order to help big business service its external debt, irrespective of the damage caused to other people. Of total external debt, just 21.5 % was due within a year.

## **FISCAL RESULTS**

A sharper than expected drop in revenue (down nearly 35% in real terms during January-June), and an election-driven increase in spending (which went up by 15.1 % for current expenses and 24.9 % for capital expenses), changed the colour of public finances during the period, which produced a deficit of 2.6 %. All types of revenue were down, led by copper (-90 %), but also income tax (- 40 %) and VAT (-19%).

The deficit in money terms was the equivalent of around U\$ 4.22 bn, of which the lower price of copper contributed U\$ 2.86 bn. With the metal price having recovered strongly so far in the third quarter, there should be subsequent moderation in the deterioration, which in any case is nothing much to worry about. The country can take it, without seriously feeling it. If you want to worry about fiscal accounts, worry about Brazil, or further away about the USA, Britain, France or Spain, whose public finances are a disaster, the effect of which will hit us sooner rather than later.

## **FINANCIAL AND CURRENCY MARKETS**

In the first 7 months of 2009, the Santiago stock exchange's blue chip IPSA index jumped by 61.2 % as measured in U\$ terms, with daily turnover averaging U\$ 134 million (a 2.7% real terms increase on 2008). Total market value as of end July was U\$ 199 bn.

The country's leading corporations (included both listed and unlisted companies), did less well as far as the bottom line was concerned during the first half of 2009. The over 500 companies in the sample saw earnings fall by 46 % to U\$ 3.78 bn, on sales 17 % lower at U\$ 41.62 bn. The performance was unequal, with 53 % of reporting companies increasing their earnings, 19 % seeing a drop and 27 % making a loss. The EBITDA of those companies reporting under new accounting standards dropped by 47%.

Despite the stupendous performance of the Bolsa, private pension fund returns are still marking time. Those invested in the more speculative A funds saw their assets shrink by over 13 % in the year to July, and even the most prudent ones who invested in the safest E funds showed a return of only 5 % over the

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same period. The AFPs total assets as of end July amounted to U\$ 102.22 bn. Only 51 % of the 8.5 million pension accounts were current in their contributions.

I have already dedicated a special paper to the banking and credit sectors not so long ago. The accounting muddle and the arrogant refusal to publish comparative pro-forma historical figures mean that we cannot notice any meaningful trend. Let us be contented with the fact that the system is healthy.

The exchange rate has been see-sawing in recent weeks, but by mid-August, the peso had risen by over 13 % in real terms against the U\$, since the close of 2008, despite the protests of the exporting sector, particularly in agriculture. The situation of wine growers is a good illustration of this. The 9.7 % volume increase in exports during the first semester was not matched by the U\$ value of the bottles sold, which dropped by 2.4%. Combined with a stronger peso, their real domestic returns are some 15% lower than a year ago.

## Important disclosures

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