



Citi Global Wealth Investments

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Latin America Strategy Bulletin

Chileans Vote to Reject Constitution Draft

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Summary:

- On Sunday the Chilean people went to the polls to vote on a draft for a new constitution. Around 62% of the voters rejected the draft. A resounding 86% of the electorate showed up to vote. Polls had been forecasting a “reject” victory, but the 24% margin was a surprise. None of Chile’s 16 regions approved it.
- This result is noteworthy because only 2 years ago almost 80% of the population voted in favor of a new constitution and Gabriel Boric seized the presidency with the mandate to deliver it as part of his progressive reform agenda. These referendum results could then be seen as a defeat for the current administration and could incentivize it to moderate towards the center - with which the average voter identifies.
- The overwhelming rejection of the draft could be attributed to its excessive length – coming to 388 articles and 170 pages. The draft guaranteed over 100 fundamental rights,,and also included controversial definitions pertaining to property rights among many highly questionable issues.
- In response to the referendum results President Boric has met with political leaders to draw up a plan for next steps and has announced his intent to make cabinet changes. This result means that the uncertainty around basic principles and rules that will govern Chile will remain with the population, and investors, for quite some time.
- Like most countries, Chile is suffering from high inflation. But its macroeconomic position has been deteriorating for a while. The country has a sizeable current account and a fiscal deficit. Public debt has been steadily increasing since 2015, from 17% to around 40% of GDP. While at around 18% public external debt is not a concern, private external debt is 72% of GDP. International reserves are at around \$40bn, above pre-pandemic levels, but down 19% this year (July data). In response to the pandemic, government spending has increased and private savings have been used to fund consumption.
- The initial market response to the rejection of the draft was positive but fizzled out during the session. The Chilean Peso (CLP) opened the Monday session 3% stronger at 850, to weaken during the rest of the session and close at 881, 5 pesos weaker than Friday's close.
- The local stock exchange had rallied 4.5% on Friday in anticipation of the result. After opening another 6.4% higher on Monday, stocks retraced to close at 5779 or 2.23% higher than Friday.

- Citi Global Wealth Investments (CGWI) Global Investment Committee's portfolio holds a neutral allocation to Latin American equities, including Chile's which has rallied 33% in USD terms year-to-date. Valuations are attractive with PE multiples trading well below the -2 standard deviation bands (see Figure 4). We are, for the time being, comfortable with the fully allocated exposure to this name.
- More opportunistically, we see a CLP that should exhibit lower levels of volatility, as we see immediate policy and political risk reduced. We expect more range-bound, less extreme peaks and troughs price action for the currency. Meanwhile, inflation remains stubbornly high even though the Central Bank has raised rates to 9.75%. For equities, we take a cautious approach despite attractive multiples. We look for technical breakouts as triggers for bullish momentum exposure.

Figure 1: Copper represents roughly 48% of Chile's exports so it is a strong driver of CLP flows. High political uncertainty, however, has resulted in USD outflows, not allowing the CLP to take full advantage of rising copper prices

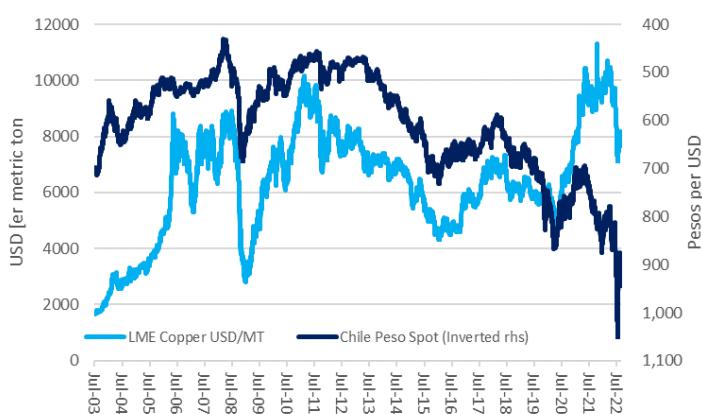


Figure 2: Since the social protests of 2019 and throughout the pandemic, Chile's external position has not improved in line with the favorable terms of trade presented by higher copper prices and easy financial conditions

Chile - Real Effective Exchange Rate and Terms of Trade

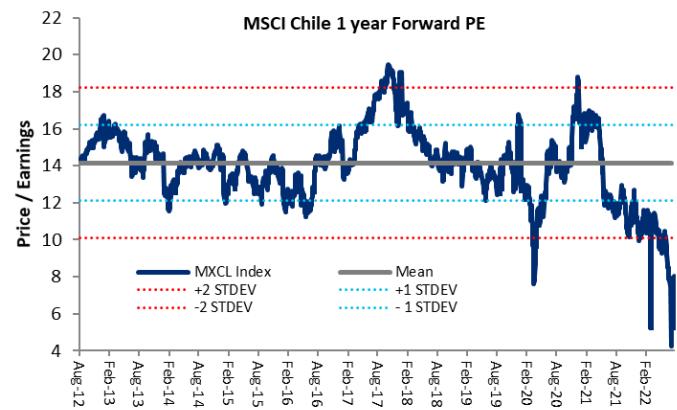


Source: Bloomberg as September 3, 2022. Indices are unmanaged. An investor cannot invest directly in an index. They are shown for illustrative purposes only and do not represent the performance of any specific investment. Past performance is no guarantee of future results. Real results may vary. All forecasts are expressions of opinion, are subject to change without notice, and are not intended to be a guarantee of future events.

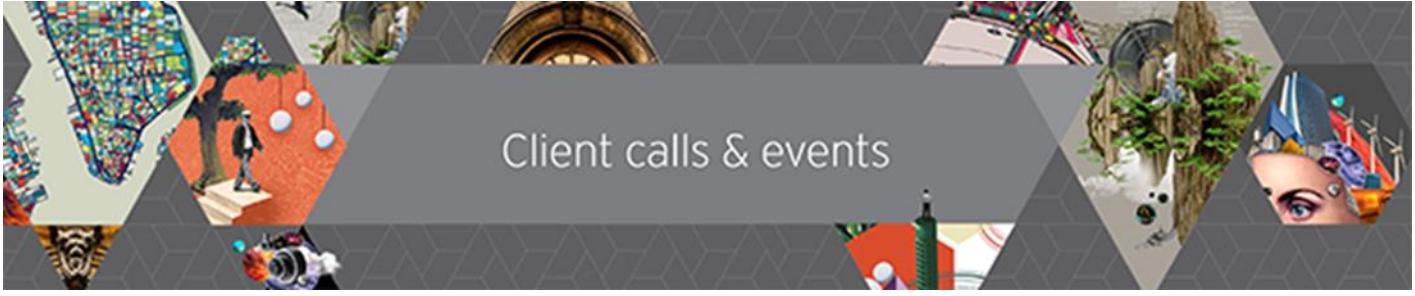
Figure 3: Now that it is clear the country is unwilling to validate the extreme agenda proposed by the president, risk premium should moderate. We look for the CLP to trade in less extreme ranges.



Figure 4: The equity market has had a strong run in 2022 and is trading at depressed multiples. MSCI earnings are comparable to the 2010 super cycle peak for commodities. But the MSCI is up 33% YTD and trading near the top of a trading range.



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