

Latin America Strategy Bulletin

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Chile: President Gabriel Boric and What Comes Next

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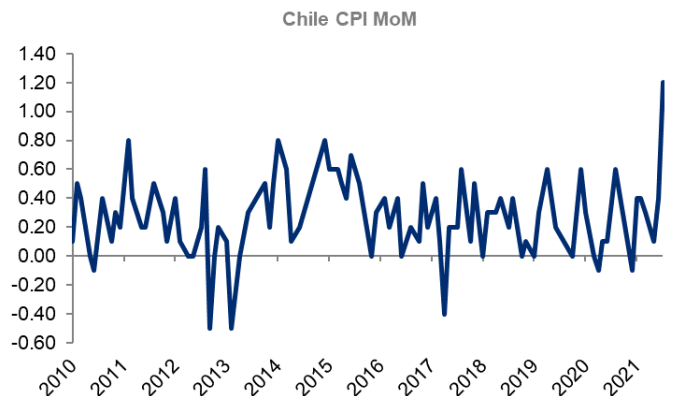
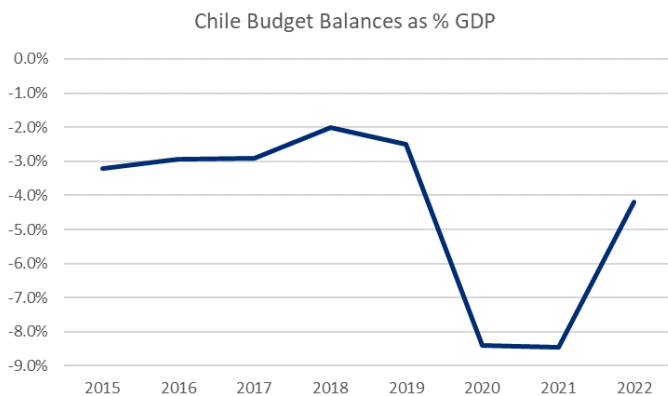
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- Chileans went to the polls yesterday, 19 December, for the second round of presidential elections. Gabriel Boric won the runoff to be the next president of Chile with 55.9% of the votes. In the end, voter turnout, specifically young voters, decided the outcome. This race had the highest level of voter turnout since voting became voluntary in Chile, reaffirming the high level of public discontent with growing income and wealth inequality as we saw during the social protests that erupted in 2019.
- Since the return of Democracy in 1990, Chile has avoided the extremes of the political spectrum with two coalitions, a center-left and a center-right governing the country. This forced past Presidents to govern from the center. Following the first round elections on November 21, both Boric and his conservative opponent Jose Antonio Kast moderated their rhetoric and platforms to attract moderate and disenfranchised voters.
- Gabriel Boric is 35 years old from Punta Arenas and is affiliated with the Autonomist Movement and Social Convergence political party. About a decade ago he led thousands of students through Chile protesting for change, specifically calling for free education for all. He is currently a member of Chamber of Deputies sitting on the Commissions of Human Rights and Indigenous Peoples, Extreme Zones and the Chilean Antarctic, and Labor and Social Security.
- Boric's platform focuses on raising taxes, 8-8.5% of GDP along with a "super rich" and ad valorem tax for mining/fuel, to create a stronger social safety net and address voter demands. Along with a tax increase, Boric would like to strengthen unions and encourage employee rights to protest. Lastly, Boric proposed an elimination to the current private pension fund system and have the savings managed by a public sector organization, which would cost around 3.5% of GDP (2% higher than the cost of pensions that currently exist). Boric's government will represent a significant change in policy, however, facing a divided Congress, a polarized electorate and limited fiscal space, he will need to compromise with the opposition which could lead to more moderate policy outcomes. On election night, Boric acknowledged he would need to work with the opposition to push his reform agenda. As the saying goes, personnel is policy so a key indicator of how Boric plans to govern will be who he selects for his cabinet, particularly for finance minister.

- With the Presidential election behind us, there remain other major political uncertainties going forward:
 - Constitutional Re-write – The constituent assembly was elected in May 2021, and they are only now starting to discuss the content of the “new” constitution. The process brings another added level of political uncertainty, especially with the approval rate of the assembly falling and a new president involved. The shape of the new constitution will be a key variable for the country’s future as it could potentially delineate a change in the governmental power structure.
 - Pensions Withdrawals – Chile’s Congress recently rejected the fourth pension withdrawal (for now) as the Central Bank and President Pinera opposed it. We will likely see this political debate continuing throughout the presidency of Boric.
 - Downgrades in Rating Agencies – Fitch downgraded Chile’s credit rating to an “A-“ in 2020 due to political and social unrest along with slowing economic growth. S&P followed suit in March 2021, signaling that Moody’s may soon trail, especially with Omicron concerns.
- Since the Constituent Assembly elections in May, there has been an underperformance in CLP in comparison to other EM currencies and a decoupling from copper, a historically strong driver of CLP performance. Additionally, this weakening may also be passing through to inflation expectations which is resulting in a more hawkish Banco Central de Chile, who increased interest rates to a seven-year high last week to 4% from 2.75%. Locals have, in turn, began to dollarize more aggressively and shift their holdings from funds with predominantly local fixed income assets to funds with predominantly foreign equities. Correlated, we see the gap between terms of trade and CLP continue to widen as political factors dominate

Figure 1: The pandemic has had a large impact on fiscal accounts. Even after the 2021 recovery, budget balance is expected to remain in a worst position than in 2019.

Figure 2: Inflation spikes, resulting from a combination of global supply gluts with CLP depreciation pass-through, mean the central bank will likely have a hawkish bias, putting pressure on growth and consumption.

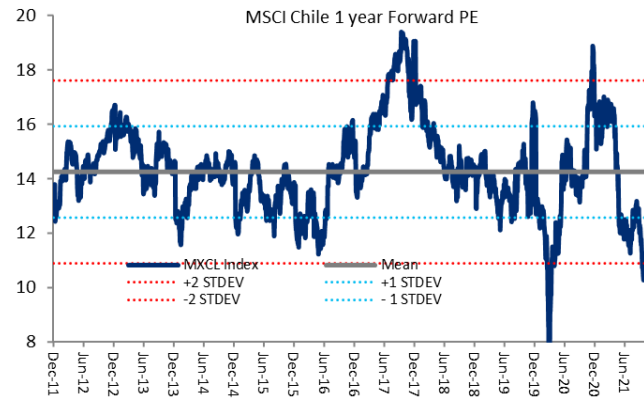


Source: Bloomberg as of 15 December, 2021

All forecasts are expressions of opinion and are subject to change without notice and are not intended to be a guarantee of future events.

Figure 3: The CLP is closing 2021 down nearly 17% despite strong support from copper prices.

Figure 4: Equities are trading near the cheapest multiples of the last decade. But investors will want to wait and see and growth is likely to suffer in the interim.



Source: Bloomberg as of 15 December, 2021

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- **Summary:**

- **Boric's victory will likely be unwelcomed by investors. The fact that the uncertainty over the presidency is over could bring some respite to markets in the coming weeks. However, he will have to prove himself by consistently sending the right signals if he wants to avoid the consequences of a potential market driven negative spiral in the economy.**
- **The re-write of the Constitution will be a key driver of uncertainty in 2022. A draft is expected around mid-year. A mandatory referendum will follow for final approval-rejection. The importance of the shape of this new document cannot be understated as it lays the basic rules of governance, rights and principles of the country.**
- **Congress remains highly divided. Boric's more extreme proposals are unlikely to become reality. Attempts to major changes in legislation could get stuck in congress, especially until after the new constitution is approved.**
- **The country's higher fiscal spending and debt burden, the drawdown in pension fund saving accounts combined with political uncertainty provide a highly uncertain and challenging backdrop for the economy. A sharp economic slowdown is expected in 2022 to around 3-4% relative to the strong 12% rebound of 2021. Inflation should also retrace to around 3.5% from close to 7% in 2021.**
- **Markets have been pricing in risks. The currency, unable to benefit from favorable terms of trade, is trading above 850 CLP/USD and is the worst performing in the region, down around 17% YTD. The equity market is down nearly 25% YTD in USD terms and trades at around 11x 2022 forward price-earnings, a 2x standard deviation move below its long-term average.**
- **We expect Chilean markets, despite their historical attractiveness, to trade with a high degree of volatility and sensitivity to political uncertainty and economic data in 2022. It is a market that has the potential to be at either extreme of the performance range, depending on their response and policy choices, somewhat of a digital outcome proposition and not the most palatable for asset allocators.**

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Bond Credit Quality Ratings	Rating Agencies		
Credit Risk	Moody's¹	Standard & Poor's²	Fitch²
Investment Grade			
Highest Quality	Aaa	AAA	AAA
High Quality (Very Strong)	Aa	AA	AA
Upper Medium Grade (Strong)	A	A	A
Medium Grade	Baa	BBB	BBB
Non-Investment Grade			
Low Medium Grade (Somewhat Speculative)	Ba	BB	BB
Low Grade (Speculative)	B	B	B
Poor Quality (May Default)	Caa	CCC	CCC
Most Speculative	Ca	CC	CC
No Interest Being Paid or Bankruptcy Petition Filed	C	D	C
In Default	C	D	D

Source: Citi Investment Management

¹ The ratings from Aa to Ca by Moody's may be modified by the addition of a 1, 2 or 3 to show relative standing within the category.

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