Chile INVESTMENT REVIEW

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GOVERNMENT FORECASTS BUDGET SURPLUS OF 1.6%

Chile's Ministry of Finance raised slightly its 2004 Gross Domestic Product growth forecast to 5.0% from 4.9% and said inflation would also be higher than originally expected. In a presentation to a joint congressional budget committee, Budget Director Mario Marcel said 12-month accumulated inflation at the end of 2004 would come in at 2.5 % instead of 1.8% as previously forecast.

Chile's economic expansion has picked up speed on rising export revenues due to strong prices for copper, Marcel said. "To the extent that internal demand grows -including investment- and that copper prices improve, the world economy gets better, our exports grow at double digit rates, obviously that generates the possibility of growing more quickly", he added.

Marcel also announced that Chile will post a budget surplus this year of 1.6% of GDP after three years of deficits. Internal demand, which had lagged behind overall economic growth, will grow 5.8% in 2004 compared with the government's previous forecast of 6.4%, he added.

Reuters, June 23

CHILE: WHY BUST DOESN'T HAVE TO FOLLOW BOOM

Chile's economy has always been vulnerable to big swings in global commodity prices. Not surprisingly, with demand and prices red-hot, the world's largest copper producer is rapidly emerging from a long malaise that dates back to the 1997 Asian crisis and has continued through the global slowdown of recent years. And Chile may be better equipped to deal with the boom-bust commodity cycle that has threatened its stability in the past.

Fueled in part by the recent doubling of copper prices, the economy expanded in March at a 6.3% clip from the year before, the fastest pace in nearly six years. Overall exports in April surged 49% from the previous year, and domestic demand is being encouraged by low interest rates and stable prices. The Central Bank has slashed interest rates to 1.75%, including back-to-back half-point cuts in late 2003 and early 2004. The economy is expected to grow 5% to 5.5% this year, far faster than the 3.5% growth rate anticipated for the entire Latin American region.

Better yet, bust may not inevitably follow boom this time around. Analysts Gray Newman and Claudia Castro at Morgan Stanley argue that the economy is more open than in the mid-1990s and that key reforms have made Chile less susceptible to global shocks, including a rule requiring a structural budget surplus, which has made fiscal policy more effective. Most important, they say, is that investment financing is less dependent on copper prices, which tended to create a feast-or-famine situation. Now, Chilean finances are aided by the country's investment-grade credit rating, more favorable debt ratios, lower country risk, and its many Free Trade Agreements.

The real test of Chile's stability may lie in how fast the economy accelerates in the coming year. The country is unlikely to return to the scorching growth rates it posted in the mid-1990s. But the same economic reforms that are aiding growth should help to cushion the next downswing in commodity prices. Plus, because Chile's exports are evenly divided between Asia, Europe, and the Americas, it'll be less vulnerable to a cooling of Chinese demand.

BusinessWeek, May 31

VESPUCIO NORTE HIGHWAY PLACES US$ 424 MILLION IN BONDS

Concessionaire Vespucio Norte Express, which is building an expressway in Chilean capital Santiago, placed US$ 424 million in bonds on June 25, the Santiago stock market reported. The proceeds from the bonds (series A1), issued in the country's inflation-indexed currency the UF, will go to paying off a bridge loan and project construction, maintenance and operation costs, among other items.

Vespucio picked up a US$ 250 million, 30-year concession in 2002 to build the northern portion of Santiago's Américo Vespucio beltway. Construction began last year, with the expressway slated to open in 2006. Some 40,000 vehicles a day are expected to use the stretch, which will run between El Salto in the capital's northeast and the junction with highway Ruta 78 in the city's southwest. Dragados, Hochtief, Brotec, Belfi and Taurus make up Vespucio Norte Express.

Business News Americas, June 25

CHILE'S FISCAL POLICY PRAISED BY THE OECD

The Organization for Economic Co-operation and Development (OECD), praised Chile's solid public finances in a report released in Madrid early in June. The document examines not only the framework for Chile's fiscal policy, but also the way in which the budget is formulated, debated and approved and the mechanisms in place for managing public spending and evaluating its results.

As regards to the framework for fiscal policy, the report highlights, among other factors, the strength of Chile's fiscal finances, and the credibility and consistency achieved through the introduction of a rule that ensures a structural budget surplus equivalent to 1% of GDP. The document also draws attention to the fact that, in formulating and discussing the budget proposal, intensive use is made of the information yielded by different mechanisms for evaluating the performance of existing programs. In this field, it highlights the existence of a Bidding Fund, through which new initiatives must compete for resources, which it describes as an extremely innovative and effective way of countering the incremental nature of traditional budgeting methods.

The report also praises Chile's highly transparent management of its public finances as well as the timeliness with which information is made available, both about budget implementation and the performance of government programs.

Looking at areas in which improvements can still be made, the report identifies the lack of Congressional control over the resources that are transferred directly from the State copper company, CODELCO, to the armed forces as an ongoing weakness. In addition, it suggests that Congress should be encouraged to play a more active role in debating the budget. However, it recognizes the progress that has been achieved in this area through specific "protocols" embodying undertakings entered into by the Ministry of Finance and Congress. It also commends the recent decision to transform the Joint Congressional Budget Commission, which was previously assembled on an annual basis, into a permanent committee.

The report praises Chile's efforts to achieve greater administrative and financial flexibility in the management of fiscal spending, and to increase professional standards in the public administration. It points out that a reform of the public administration, setting up a new personnel agency and establishing new selection procedures, means significant progress in terms of merit-based appointments. Finally, the report draws particular attention to Chile's development of a system of performance indicators, which it describes as comparing favorably with those of OECD countries.

Ministry of Finance (Press Release), June 10

BBVA LOCATES REGIONAL CENTER FOR PENSIONS SOFTWARE DEVELOPMENT IN CHILE

In mid-June, Spain's BBVA financial services group launched a Software Maintenance and Development Center in Santiago. The Center, to which BBVA plans to commit around US$ 70 million over the next five years, will provide services to all the group's pension fund administrators in Latin America. The launch of this Center forms part of BBVA's strategy of technological regionalization and will mean a significant improvement in the quality of its customer services, as well as in the efficiency of its Latin American pensions activities.

BBVA President Francisco González said that the choice of Chile as the location for this new center of technological development for the group's Latin American pension fund administrators reflects the fact that it is "a stable country and has an investment-grade rating, as well as the commitment of its government and institutions, its solid economic fundamentals, strong growth potential, high-quality communications infrastructure, and highly-trained human resources".

"This Center will be responsible for developing a shared and integrated technological platform for all our pension fund administrators in Latin America (ten in total), for maintaining the software and for the future development of associated applications, as well as providing technical training for the other countries of the region", he explained.

Service improvements: With a 100-strong staff that is highly specialized in technology, the Center will focus on software development. In addition, hardware and data processing services will be located in BBVA's Regional Corporate Center in Monterrey, Mexico, which is integrating the operations of the group's Latin American banks, pension fund administrators, and insurance companies.

Francisco González underlined that "for us, the significance of this new Center goes beyond merely technological considerations since it will deliver tangible and material benefits for our clients and for the industry". BBVA's pension fund administrators in Latin America serve 12 million clients, of which 2.9 million correspond to BBVA Provida in Chile.

Among the services that this new "software factory" will provide, some of the most important are the production and distribution of new products and services; the development of sophisticated marketing tools that will allow the group to offer its clients a more personalized advisory service; and the provision of more detailed and complete information. The new Center is already working to develop a single technological platform for all the group's Latin American pension fund administrators. In addition, it is already providing support to AFP BBVA Provida in Chile y and Afore BBVA Bancomer in Mexico.

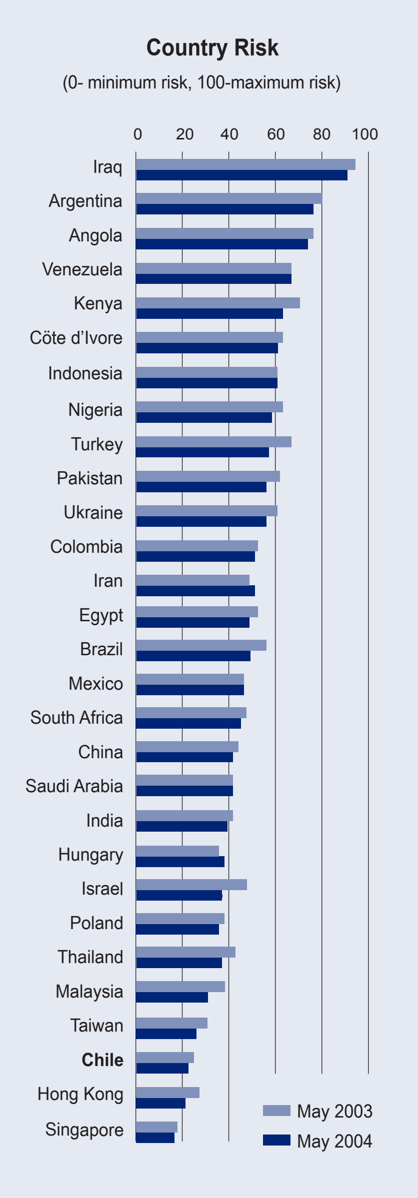
The group's other pension fund administrators in Argentina, Bolivia, Ecuador, El Salvador, Colombia, Panama, Peru and the Dominican Republic will gradually be incorporated into the project.

BBVA also envisages that, in the near future, the Center will take responsibility for the computing operations of the group's Latin American insurance companies.

BBVA (Press Release), June 15

COUNTRY RISK

Most emerging markets have become less risky during the past year, according to the latest country-risk analysis by the Economist Intelligence Unit, a sister organization of *The Economist*. The rankings combine measures of political risk (such as the threat of war) and economic risk (such as the size of fiscal deficits). They also include measures that affect a country's liquidity and solvency (eg, its debt structure and foreign-exchange reserves).



The Economist, May 27

CHILE IN THE 2004 IMD COMPETITIVENESS REPORT

Chile ranked 26th in the *2004 World Competitiveness Yearbook*, published by the Institute for Management Development (IMD). The study, which includes 60 countries, placed Chile ahead of Spain (31st), South Korea (35th), Czech Republic (43th), Brazil (53rd), Mexico (56th) and Argentina (59th).

The Yearbook analyzes over 300 criteria that determine a country's ability to provide an environment that sustains the competitiveness of enterprises.

According to the IMD, Chile's strengths include its non-discriminatory treatment of local and foreign investors, its reasonable level of business costs, its lack of restrictions on the employment of foreign labor, the effective supervision provided by corporate boards, and the country's high level of international integration. Due to these and other factors, the IMD identified Chile as the second most competitive country in terms of its image abroad and of the positive impact this has on business development.

Chile also performed well on a number of the specific indicators used to construct the IMD's overall ranking. On Business Legislation it reached 2nd place, while on Government Efficiency, it advanced from 16th place in 2003 to 8th place in 2004. However, some of its highest scores related to the high quality of its human capital, including the Competency of Senior Management (1st), Attitudes and Values Toward Globalization (3rd) and the Availability of Qualified Engineers (11th).

The IMD report also highlights the challenges that Chile faces in its bid to become increasingly competitive. They are reflected in the low ratings that the country obtained for Access to Medical Assistance, measured as the number of inhabitants per physician (60th); Pupil-Teacher Ratio (55th); Female to Male Income Ratio (43rd); and Total Expenditure on R&D (51st), all issues currently being addressed through government programs and public policies.

International Institute for Management Development (Press Release), May 2004

ORGANON PHARMACEUTICAL HOLDING LOCATES HEADQUARTERS IN CHILE

In the context of the program "Chile, A Springboard Country", Netherlands-based multinational AKZO NOBEL has chosen Chile as the location of the Headquarters for Latin America, the Middle East and Africa of Organon, its human healthcare business unit.

Tony van Bijleveld, Vice-President of Organon ALAMA, which covers these regions, said that the company's activities in Latin America, the Middle East, and Africa will be supervised from Chile. He explained that, until 2003, all the company's subsidiaries were managed out of the headquarters of Organon NV in the Netherlands and the United States. However, in view of the difficulties of supervising markets in Latin America, the Middle East, and Africa from these locations, the company opted to establish a new headquarters in Latin America, which accounts for 80% of ALAMA's income.

Van Bijleveld reported that, after studying a number of other alternatives, the company selected Chile because it has Latin America's most stable environment, both politically and economically. "Chile offers a competitive business environment in terms of its price/quality relationship, and provides a very high quality of life for expatriate staff", he said.

Organon ALAMA is already in operation in Chile, with a team of 18 executives, drawn from different countries. The new offices were officially inaugurated on June 23 in the presence of AKZO NOBEL President, H. Wijers. AKZO NOBEL, which is considered one of the world's largest chemical-pharmaceutical multinationals, operates in 80 countries around the world.

Organon (Press Release), June 23

CHILEAN EXECUTIVES ON MISSION TO MIAMI

Hernán Reitze already does business with the United States, hiring translators and selling the services of his Chilean company, Corporate Translation Services. But Reitze, a former Chilean diplomat and World Bank official, still felt the need to join a delegation of companies from Chile hosted by the Greater Miami Chamber of Commerce. Their two-day visit to Miami began on June 21. "I am looking to consolidate various relationships and look for possible new contacts”, Reitze said. “We are doing nontraditional exports; we are exporting intelligence”.

Reitze, who is from Santiago, said his company handles corporate, legal, banking, arbitration and other translations, working in numerous languages, often finding the translator through the Internet or a network of language providers. The delegation also included a cosmetic maker, law firm, several consulting firms and a variety of other small companies.

Executives heard from Governor Jeb Bush and a panel of experts at a breakfast meeting. Also on the agenda are visits to the Port of Miami-Dade and the American Airlines terminal at Miami International Airport, along with face-to-face meetings with potential partners or other new contacts.

Bright Future: In his breakfast speech at the JW Marriott Hotel, Bush hailed Chile's "bright future”. Bush said, breaking into Spanish, Chileans “are an inspiration for everyone”. Bush said that Florida had to seek new alliances in the hemisphere, particularly in textiles.

Later a panel of experts offered a checklist of do's and don'ts for business dealings in the United States and also discussed Miami's advantages as a location for the secretariat of the proposed Free Trade Area of the Americas.

Crucial Time: The delegation is visiting at a time when Chile is entering into a growing number of trade agreements, including a pact with the United States that went into effect in January. Other recent trade agreements were signed with the European Union and Korea.

US exports to Chile have grown by 21% in the first four months of 2004 since the new trade agreement took effect, according to statistics from the US Commerce Department. US exports from January to April were US$ 1.0 billion in 2004, compared to US$ 853 million in 2003.

Meanwhile, Chilean exports to the United States grew by a scant 2.7% in the first four months of this year, growing from US$ 1.511 billion in the first four months of 2003 to US$ 1.552 billion in the same period this year, according to the US statistics.

Miami Herald, June 22

CHILE SIGNS DOUBLE TAXATION AGREEMENTS WITH SWEDEN AND FRANCE

During a visit to Stockholm, Chile’s Minister of Finance Nicolás Eyzaguirre joined his Swedish counterpart, Bosse Ringholm, in signing a Double Taxation Avoidance Agreement between the two countries. Minister Eyzaguirre subsequently traveled to France, where he also signed a similar agreement. As a result, two important powers have been added to the already long list of countries with which Chile has signed double taxation agreements.

Chile-Sweden Double Taxation Agreement: The signing of this agreement marked the culmination of a process that began in 1998. Chile has an active policy of negotiating double taxation agreements and, over the past six years, has built a network of such agreements with countries in Europe, Asia, and the Americas. To date, ten agreements are in force, while a further six have been signed and are awaiting ratification, and two are awaiting signature. By January 2005, it is anticipated that a total of 16 agreements will be in force.

Under the Chile-Sweden agreement, the royalty tax on the transfer of technology, currently charged at 30% by both countries, will generally drop to 10%. Similarly, technical services and other services supplied in Chile or Sweden by a resident of the other country will no longer be liable to taxation providing they have a duration of less than six months (in Chile, these services are currently liable to tax rates of 20% and 35%, respectively).

In addition, the agreement ensures that investors will be able to use taxes paid in either signatory country as a credit in the other country. Moreover, the dividends distributed by a Chilean subsidiary, in which a Swedish company holds at least a 25% stake, will be exempt from taxation in Sweden, while for Chilean investors in Sweden, the credit for taxes paid there will rise from 17% to 30%.

As a result, double taxation between the two countries will be avoided, fulfilling the core objective of this type of agreement. In addition, the agreement is expected to mean an increase in the transfer to Chile of technology and technical services, which are crucial for the country’s present stage of development. It is also expected to provide an important boost to Swedish investors’ growing interest in Chile. The agreement will come into effect once the two countries notify its ratification, according to each country’s internal procedures.

Sweden and France are respectively the fifth and sixth European Union member States with which Chile has reached Double Taxation Agreements (after Spain, the United Kingdom, Denmark and Poland). In the context of Chile’s Association Agreement with the EU, these new agreements further strengthen the country’s ties with this increasingly important common market and are expected to mean greater capital flows and trade in goods and services between Chile and both countries. They also reaffirm the Chilean government’s commitment to its policy of international integration.

Chile has Double Taxation Agreements in force with Spain, Canada, Mexico, Brazil, Peru, Argentina, Norway, South Korea, Poland, and Ecuador. Agreements have been signed, but have yet to come into effect, with the United Kingdom, Denmark, Croatia, New Zealand, Sweden, and France, while agreements have been negotiated, pending signature, with Malaysia and Russia.

Minister of Finance (Press Release), June 4.

CHILE IN THE EYES OF WALL STREET

The following are excerpts from Wall Street Rating Agencies' and Investment Banks' reports on Chile:

From Credit Suisse First Boston's "Global Emerging Markets Outlook", June 11

FIRING ON ALL CYLINDERS,
NOT SPARKING INFLATION

• **Chile's economic performance has continued to surprise on the upside, despite already high expectations:** On the growth front, we now expect the economy to grow 5.0% in 2004 in real terms, compared to our previous forecast of 4.5%. Our new forecast coincides with the mid-point of the Central Bank's forecast range of 4.5% to 5.5% and is slightly above consensus estimates. This revision reflects the stronger growth in the first half of the year, relative to our expectations three months ago, as well as the run-up in copper prices. This forecast revision factors in the negative impact associated with the decision of the Argentine government to restrict natural gas exports to Chile since March 2004. Assuming that these restrictions last through September, this problem is only expected to reduce GDP growth by about 0.1 percentage points.

• **Copper prices are boosting local sentiment, public finances and the external accounts:** In the case of the fiscal accounts, we expect the copper-related revenue windfall to reach close to US$ 1.4 billion, or 1.6% of GDP. This windfall is based on an average copper price of US$ 1.20 per pound in 2004, compared to the budget estimate of an average price of US$ 0.83 per pound. On the external front, we estimate the current account surplus will reach 1.6% of GDP, largely thanks to higher exports. Finally, notwithstanding Chile's diversified export platform (by region and by product), the government is still pursuing the signing of Free Trade Agreements with China and India, with negotiations expected to start in late 2004. This, in our view, would be yet another positive factor underpinning the country's strong fundamentals.

• Finally, excessively low inflation is still one of the main sources of macro concern, as the latest (May) annual headline and core inflation readings were 0.6% and 0.1%, respectively, with high energy prices boosting the headline figure. Given the gradual reduction in idle capacity and the weakness of the peso, we expect inflation to creep gradually to the low end of the Central Bank's target range of 2.0% to 4.0%. Although the Central Bank appears to have recently given more weight to the possibility of resuming a tightening cycle, we still believe it can wait until later in 2004 to tighten. If the Bank were to choose to do it earlier, we would expect the pace of tightening to be very measured. Based on this, we expect local interest rates to remain near current record low levels for several quarters, which should further support the expansion of the domestic economy.

From Citigroup's "Latin America Economic Outlook and Strategy", June 10

• **The improving global outlook (better economic data coming out of Japan and the US) coupled with higher copper prices are supportive of the Chilean peso, but the recent strength of the US dollar relative to the euro and the yen, coupled with regional concerns over financial stability in Brazil have depressed the value of the currency. The recent correction in commodity prices and the dollar may prove temporary. From a long-run perspective the currency is undervalued.** Chilean corporates have been able to tap international credit markets and the sovereign spread remains low, increasing the supply of dollars into the economy.

• **The Central Bank eased aggressively as inflation expectations were low and the country suffered from deflation. But there are signs inflation may be heading up as energy costs increase and the economy accelerates.** We expect the Central Bank to begin raising interest rates at the end of the third quarter.

• While Chile's unemployment rate is still a bit high at 8%, signs of quickening growth are apparent. **The economy is responding to slowly improving global conditions. Employment is increasing at a 2.0% annual rate. The industrial and mining sectors in particular are performing strongly.** Bank lending is picking up and we expect strong growth in domestic demand this year. **We expect growth of 5.4% in 2004, above the regional average.**

• Fiscal policy remains very prudent and higher copper prices improve the fiscal outlook for 2004 significantly. **The country should run a fiscal surplus in 2004, consistent with abnormally high copper prices and the structural fiscal surplus target of 1% of GDP. Monetary policy should become less expansionary toward the end of this year.**

• Export grew a healthy +16% in 2003 and is now growing at a rate of more than 30%. **Much higher copper and commodity prices explain this jump in exports. Dependence on Asian markets is relatively high. The Free Trade Agreement with the US increases the prospects for export growth. The country may run a current account surplus this year.**

• There are municipal elections later this year that may test the strength of the opposition and the different factions within the ruling coalition. **Furthermore, the government has responded to some political pressures and is proposing to Congress a royalty tax on copper revenues. We believe the proposal will not have a large impact on the mining companies but it will be negative nonetheless. The country is also suffering the spillover effects of the Argentine energy crisis. The corporate sector should see energy costs increase significantly.**

CHILE IN THE EYES OF WALL STREET

From Standard & Poor's, June 17

HIGHLY RATED BUT LONELY

• **Chile is rare example of a Latin American country that has prospered through open markets.** It is the highest rated sovereign in Latin America, with a long-term foreign currency sovereign credit rating of 'A'. **Mexico ('BBB-') is the only other investment-grade country in the region.**

Chile's high rating reflects its successful use of monetary, exchange-rate, and fiscal policies to reduce external vulnerability, increase economic flexibility and sustain GDP growth. Rising standards of governance, a low public-debt burden, and a strong policy framework place Chile in the 'A' category of sovereigns. **However, Chile's sovereign rating is constrained by a comparatively narrow economic base that leaves it vulnerable to sharp changes in the terms of trade and by the continued dependence of the private sector on external capital inflows.**

• The Chilean economy is expected to grow more than 5% in 2004, with domestic demand growing even faster at perhaps 7%. **This growth will outpace that of Latin America, which is projected to realize 4% growth in 2004 after growing at an average of only 2% over the past five years. While the gap between Chile's economic performance in 2004 and that of its neighbors is small, its long-term economic performance compared with the region's is a better reflection of the growing divergence between their credit ratings.**

• Chile's growing economic divergence from the rest of Latin America is due to both good economic policies (that are endorsed by all major political parties) and strong public institutions. **Good economic institutions provide security for property rights and relatively fair access to economic resources for a broad section of society. Strong institutions allow Chileans to take greater advantage of market-based economic policies than would be possible in other countries that have a poorer institutional environment but similar economic policies.**

• Chile's average annual increase in per capita GDP was 4.8% in the 1990s, compared with an average growth rate for Latin America as a whole of only 1.6%. **More tellingly, the only Latin American countries that matched Chile's rapid pace were Argentina (4.2%) and the Dominican Republic (5.1%), both of which subsequently suffered severe economic setbacks (Argentina defaulted on its debt in 2001). Interestingly, Chile's 4.8% per capita GDP growth rate in the 1990s exceeded the 3.9% average rate of nine East Asian countries.** Chile's average GDP growth rate (not per capita) reached 6.3% during 1990-2000, the thirteenth-fastest growth rate by any nation globally for that period.

• **The quality of economic growth, meaning its volatility and impact on poverty, has also been good in Chile. Between 1991 and 2001, the poverty rate rose in Argentina, Bolivia, and Venezuela while falling marginally in Mexico, Brazil and Colombia.** Chile had the sharpest drop in the poverty rate, to 21% in 2000 from 39% in 1990, and it continues to fall. **However, in common with most of the continent, Chile did not become a more egalitarian society even as it became more prosperous. Income inequality, as measured by the GINI coefficient, increased in most Latin American countries from 1990 to 2000 (including Chile).**

• Beneath the cyclical factors, Chile's structural strengths augur well for long-term growth and creditworthiness. **These strengths are based upon prudent fiscal and monetary policies, strong public institutions, and on being open to world trade. Fiscal policy is now subject to the discipline of a transparent budget rule introduced in 2000. The government calculates fiscal balances based upon "permanent" revenue, estimating an output gap and a reference copper price based upon input from independent experts. The method allows the government to run limited countercyclical fiscal policy, with the budget deficit during years of below-average growth constrained to a level consistent with a 1% of GDP budget surplus adjusted for the business cycle. The approach allows for a limited and transparent level of fiscal stimulus during periods of slow growth, as was the case in recent years.**

• Chile's financial system is one of the strongest in Latin America. **The average rating assigned to Chilean banks by Standard & Poor's is 'A-', compared with 'BBB-' for Mexican banks and 'B+' for Brazilian banks. Problem loans are less than 2% of total loans in Chile. Foreign-owned banks account for about 40% of the assets in the Chilean banking system, compared with only 25% in Brazil and over 80% in Mexico. The healthy banking system and strong supervision standards allow Chile to enjoy the flexibility of its exchange rate without running serious risk in the financial sector.**

• Chile's credit ratings will be constrained in the medium term by several factors, including the continued dependence of its private sector on external capital inflows. **As a small country, Chile has a narrow economic base that leaves it vulnerable to sharp changes in the terms of trade.**

The industrial sector accounts for about 38% of Chile's GDP, about the same as in Brazil and much higher than the 25% share in Argentina. However, according to OECD estimates, the level of intra-industry trade in Chile is less than that in Argentina and about half that in Brazil. Brazil benefits from a much larger economy with a bigger and more sophisticated industrial sector, where firms can provide each other with a wider range of inputs and outputs. Greater intra-industry trade is usually associated with more specialization and higher productivity. Moreover, a high level of intra-industry trade across borders usually results in a greater correlation between imports and exports, reducing the volatility of the country's current account balance. Hence, the nature of Chile's economy exposes it to bigger changes in its terms of trade and in its current account. The volatility is only partially alleviated by Chile's flexible exchange rate.

• Chile's technological base is also weaker than that of many countries with a similar sovereign rating. **For example, spending on research and development is only 0.6% of GDP, compared with 2.7% in Korea and 4.4% in Israel. Chile's profile in that regard is closer to that of its Latin American neighbors.**

• Government spending on education at all levels has been rising in recent years, but the benefits in terms of economic performance will appear with a lag. **Moreover, Chile will remain poorer than most similarly rated sovereigns for many years, with per capita GDP now less than US$ 6,000, or just over half that of the 'A' median. Such factors are likely to constrain Chile's credit rating at its current level for some years, even as it remains the highest-rated sovereign in Latin America.**

From Merrill Lynch's "Emerging Markets Debt Monthly", June 25

• As 12-month inflation expectations continue below the lower end of the Central Bank's inflation band of 2%, monetary policy remains loose, and will likely stay that way for a long time. Economic activity is showing signs of acceleration but still the recovery is coming slightly slower than anticipated. Retail sales increased 4.4% year to May and are expected to grow in 2004 faster than the 5% estimated GDP expansion. The government announced that the fiscal balance would end up at a positive 1.6% of GDP this year, the first surplus in 6 years, backed by copper prices and increased copper demand from abroad. In fact, the Ministry of Finance said that it expects copper related tax revenues of US$ 463 million, more than double the budgeted-US$ 207 million.

From JP Morgan's "Data Watch:Chile", June 18

• **Economic activity is picking up as expected in the second quarter after a 4.8% increase in the first.** This reflects persistent improvement in both domestic and external demand. **The full-year 2004 real GDP growth forecast of 5.0% is on track.** However, the expected acceleration to 5.5% in 2005 still depends on a pickup in investment. Such a pickup has been elusive during this current cycle despite the positive demand signals. The lack of investment also has taken a toll on jobs, which in turn has depressed consumer confidence over the last three months. This shortcoming warrants monitoring, although it appears a yellow, not a red, light given its lack of impact on retail sales so far.

• **Growth is supported by solid foreign trade performance (a surplus of US$ 5.7 billion on a 12-month basis, up from US$ 2.9 billion for all of 2003)**. Record-high copper prices are part of the headline export story, but the impact of rising external demand is also visible -note the acceleration in noncopper exports. Despite unabated trade improvement, the lack of investment means that the tradable, and in particular the copper, sector's increased profit margins are largely being channeled abroad. Consequently, the balance of payments has done little to counter the drag on the peso from increased global risk aversion. With the Central Bank's monetary policy adjustment expected to lag that of the Fed, widening interest rate differentials may delay the peso's convergence toward the stronger level supported by fundamentals. But the forecast still envisions a reversal of the peso from the current CLP/USD 645 to 625 by year end and -if investment proves forthcoming- to 610 in early 2005.

• **For the most part price pressures remain tame and inflation of little concern.** CPI inflation did accelerate to 0.5%m/m in May but due to increased oil prices and passthrough from peso depreciation, not demand pressures. The "core" measure of consumer prices (excluding volatile items) advanced just 0.1%m/m. CPI inflation is still running well below the lower bound of the Central Bank's 2-4% target range, and the forecast envisions a return to the bottom of that range by end-2004. The policy interest rate therefore will remain unchanged for the rest of this year.

CENCOSUD BAGS RETAIL INVESTORS

The Chilean grocery store chain storms into the stock market with an IPO aimed at domestic and international investors and feeds an appetite for Latin shares.

Chile's number two retailer conducted the largest-ever initial public offering in the country in May, with a strong base of support from individual investors. Cencosud's US$ 333.5 million offering drew orders of US$ 1 billion. The company raised US$ 228.19 million in Santiago from mainly retail investors, and US$ 105.38 million in a level one-listing of American Depositary Shares on the New York Stock Exchange.

Oscar Molina, co-head of corporate finance at Chilean investment bank Celfin Capital, which was joint bookrunner on the deal, says that "Initially we thought local demand for a large deal like this would not be sufficient. The local market proved to be much deeper than we thought six months ago". Laurence Golborne, chief executive officer of Cencosud, says the company's controlling shareholder, Horst Paulmann, wanted to sell the 20% stake in his family-owned company, to as broad base of investors as possible. Golborne explains the level of interest in the offering surpassed all expectations. "We thought we would assign investors a pro rata share of between 40% and 50%, but in the end it was 19% to each of the shareholders".

Cencosud's offering follows two successful, if more modest, equity offerings in Chile in recent months. Last September, private equity fund Southern Cross sold 20% of its wholly owned Chilean retailer, La Polar, in an initial public offering for US$ 30 million. In March, private equity investors Hicks, Muse, Tate & Furst, JP Morgan Partners and The Blackstone Group sold their 23% stake in Chile's Corpbanca in a US$ 231.2 million global secondary offering.

Cencosud's IPO is only the third to go to market in Chile since 1997. But unlike previous equity placements, retail investors played a much greater role, buying more than 70% of the local shares. Pablo Echeverría, Managing Partner and Equity Portfolio Manager at Moneda Asset Management in Chile, says low interest rates in Chile are encouraging yield-hungry retail investors to return to Chile's equity market. "There are a lot of voluntary savings in Chile that need to be invested". Echeverría thinks that equity market could double in size in the next several years.

Cencosud's listing on Santiago's Mercado de Acciones de Empresas Emergentes, or exchange for emerging companies, founded four years ago, helped stimulate interest. Investors don't have to pay capital gains tax on their dividends in the first year.

Local tranche bookrunners BBVA Corredores de Bolsa and Celfin Capital sold 214.9 million shares at 665 pesos a share for US$ 228.19 million. The international tranche bookrunners, BBVA Securities and Santander Investment Securities, sold 6.67 million shares at US$ 15.80 a share and raised US$ 105.38 million. Cencosud's shares traded up 8.6% on May 7, the day after launch, from 665 pesos to 722 pesos.

Cencosud was able to garner strong support by capitalizing on its brand awareness in Chile, where it owns the popular supermarket chain, Jumbo. It also launched a national publicity campaign in the run up to the offering. "Cencosud is very well managed with a very interesting business on the supermarket side in Chile", says Moneda's Echeverría: "Jumbo is one of the strongest companies in Latin America". Golborne adds that Cencosud also wants to be known outside Latin America: "It is a good thing to broaden the number of participants who will know and follow the company and will report on our company. It helps for the long-term continuity of things we are doing and to have a broad base of financial support if we go back to the market again at a later date".

Cencosud plans to use the capital to help pay down short-term debt for its acquisition of supermarket chain, Las Brisas, in Chile, and to help fund its acquisition of Argentine supermarket chain Disco from troubled Dutch company, Royal Ahold, for US$ 315 million with co-investors Capital International, AIG Capital Partner and the International Finance Corporation, the private sector arm of the World Bank.

Latin Finance, June 2004

CHILE BANKER CORBO SAYS INFLATION TOO LOW TO MERIT RATE RISE

Chilean Central Bank President Vittorio Corbo said that the nation's inflation rate is too low to merit an increase in the Bank's benchmark lending rate.

Corbo said in an interview with *Bloomberg News* in London that the Bank will only raise interest rates when there's a risk that the annual inflation rate rises above 3%. “That's not a problem today”, said the 61-year-old central banker. Inflation in the 12 months through May was 0.6%, less than the Bank's annual target rate of about 3%. Slowing inflation led the Bank to cut its benchmark lending this year to a record low of 1.75%.

“We don't know when the moment will be that we'll begin to reduce the excessive monetary stimulus we've put on our economy to help to bring inflation toward 3%”, Corbo said. Chile's economy this year will expand as much as 5.5%, the Central Bank said, outpacing average growth in Latin America that the United Nations forecasts at about 4%. Higher exports have boosted growth.

Copper: Corbo said that prices for copper, Chile's top export, probably will slip next year following efforts by China's government to slow its economy. Demand from China, the largest user of copper, have led futures prices in New York to rise 49% in the past 12 months. “Everything makes it foreseeable that this good price won't be able to be maintained for much time, especially now that China is decelerating in an orderly way”, Corbo said.

Bloomberg, June 22

PUTTING CHILE'S NEST EGG TO WORK

Drivers in Chile don't have to wait until they're 65 to enjoy their pension benefits. Every day thousands do so when they speed from Santiago to Viña del Mar along the Rutas del Pacífico toll road, which opened on April 13 with funding from the country's deep-pocketed pension funds. A billboard reminds passing motorists: "Your savings are financing this highway, and this highway is financing your retirement".

Indeed, this year alone, the government's privately managed Pension Fund Administrators, or AFPs, expect to buy nearly US$ 1 billion in locally issued bonds to fund projects such as the new highway. And the AFPs expect to earn a healthy return on that investment: Annual real returns have averaged 10% for the last two decades. "It's a perfect circle for everyone involved", says Alvaro González, local manager for Sacyr, a Spanish construction company that operates the highway.

The new expressway is the latest perquisite of a 23-year-old government-mandated but privately managed pension system that oversees some US$ 50 billion in assets. That's the largest such pool of funds in Latin America, even though Chile is only the region's sixth-largest economy. The pension system's kitty has grown so fast, in fact, that the government relaxed its pension laws in 1996 to allow money to be invested outside Chile and to fund public works.

Among the big-ticket projects funded recently: the extension of Santiago's highly efficient subway system, hundreds of miles of highways, and construction of nearly 500,000 homes for low-income families. "Without the AFPs, it's unlikely Chile would have the modern infrastructure it does", says Axel Christensen, an executive with Santiago-based Moneda Asset Management.

Back in 1981, Chile replaced its pay-as-you-go retirement system with the 401(k)-like savings and investment program, which is fully portable -meaning workers' portfolios move with their jobs. The reform was an attempt to defuse a fiscal time bomb brought on by an aging population. Under the pension scheme, each month the 95% of Chilean workers opting into the system have 10% of their salaries automatically routed to the pension fund of their choice. Although overseen by the Ministry of Labor, the money is managed by one of six private AFPs, which were initially set up by local investors as highly regulated mutual funds that invested mostly in domestic equities and government bonds.

Imitation Equals Flattery: The Chilean government estimates that 10% of the country's growth since 1981 is directly or indirectly attributable to the new pension system, thanks to investments bankrolled by AFP funds. In the same period, the money under management at the AFPs has grown to the equivalent of 70% of Gross Domestic Product. And since early retirement options were introduced in 1988, the average monthly pension benefit for workers retiring early has increased from US$ 258 to US$ 318. The average retired worker in the US, by comparison, gets US$ 925 under Social Security, even though the US has eight times Chile's per-capita income. No wonder the "Chilean model" of pension reform is being emulated in a wide range of countries, from Poland to South Korea.

Chile's pension system has generated a critical mass of capital that has made the country's financial markets the most sophisticated in Latin America. Hundreds of Chilean companies -from retail chain Falabella to airline Lan Chile- today depend not on the whims of foreign investors but on the AFPs, which control 70% of the local equity and bond market. The only downside appears to be the local markets' dependence on the AFP funds -and the possibility of an asset bubble at some point.

But the bottom line for most Chileans is that they're and living better than ever in their golden years. And their economy is all the better for it.

BusinessWeek, May 31

CHILE SCORES A HAT TRICK AT DRINKS BUSINESS AWARDS

The inaugural Drinks Business Awards, announced at London International Wine and Spirits Fair, confirmed a hat trick of titles for Chile's wine industry in what has been an outstanding year of change and development.

Wines of Chile UK scooped the first award of the day, "Best Trade Campaign", for its activities during its launch year 2003/4. Beating off tough competition from other generics (Germany and Argentina), as well as big brand launches, Wines of Chile UK met the stringent requirements of the judges who required evidence of "planning, resourcefulness, originality, execution and where possible, results".

More awards followed with Chile taking the top spot for Woman of the Year. Alexandra Marnier Lapostolle from Casa Lapostolle was the deserved winner of this award for her "truly inspirational" character and sheer determination. Realizing Chile's great potential as a wine producing country, Alexandra set up Casa Lapostolle ten years ago. Since then she has worked tirelessly and successfully to prove Chile's place in the premium producers of the world.

Drinks Business Man of the Year went to another true champion of Chile, Patrick McGrath MW, Managing Director of Hatch Mansfield. Not only has he been instrumental in the establishment of some of the UK's leading Chilean brands, Errázuriz and Caliterra, he also played a pivotal role in the campaign to get the generic Wines of Chile office up and running again.

These three awards were supported by more Chilean names on the short lists giving Chile overall, a dominant presence in these prestigious awards. María Luz Marin, Casa Marin, was short listed for Woman of the Year and both PLB Wines for the launch of Chileno, and Buckingham Vintners for the San Pedro 35 South campaign, were nominated for Best Consumer Campaign.

Wines of Chile (Press Release), May 25

Between January and April of 2004, materialized Foreign Direct Investment totaled US$ 3 billion. The Foreign Investment Statute (D.L. 600) channeled 90.3% of the inflows. The main recipient sectors of D.L. 600 FDI were Electricity, Gas & Water (80.8%); Transport & Communications (9.6%); Industry (3.8%); Mining (2.8%) and Construction (2.1%). During those months, materialized D.L. 600 FDI came mainly from Spain (94.1%); Australia (2.3%); and United States and Canada (0.8% each).

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FOREIGN DIRECT INVESTMENT REPORT / January - April 2004
(in nominal US$ million)

Instrument/Period	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	Jan-Apr 2003	Jan-Apr 2004	Growth rate
FOREIGN INVESTMENT STATUTE (DL 600)													
- Equity Contributions	1,549.0	1,802.6	3,967.5	3,803.1	4,368.7	8,591.0	2,536.6	4,320.2	2,260,1	1,091.9	267.7	2,663.2	894.8%
- Other Capital	976.0	1,235.1	868.7	1,414.7	1,665.7	607.4	484.9	461.6	1,116,4	184.5	0.6	40.8	6700.0%
MATERIALIZED INVESTMENT (DL 600) (1)	**2,525.0**	**3,037.7**	**4,836.2**	**5,217.8**	**6,034.4**	**9,198.4**	**3,021.5**	**4,781.8**	**3,376,5**	**1,276.4**	**268.3**	**2,704.0**	**907.8%**
CHAPTER XIV (2)													
- Equity Contributions	410.2	409.5	441.6	920.6	539.3	688.8	735.6	775.2	442,3	1,187.9	128.4	290.4	126.2%
TOTAL F,D,I, MATERIALIZED *(DL 600 + Chapter XIV)*	**2,935.2**	**3,447.2**	**5,277.8**	**6,138.4**	**6,573.7**	**9,887.2**	**3,757.1**	**5,557.0**	**3,818,8**	**2,464.3**	**396.7**	**2,994.4**	**654.8%**
REMITTANCES													
- DL 600 (1)	-208.9	-656.2	-553.2	-746.2	-569.4	-1,226.1	-1,181.1	-1,336.3	-3,240.1	-885.3	-48.4	-2,789.8	5664.0%
Equity	-49.4	-392.6	-303.4	-354.9	-119.9	-234.0	-462.7	-665.8	-1,712.1	-248.2	-27.1	-2,468.3	9008.1%
Other capital	-159.5	-263.6	-249.8	-391.3	-449.5	-992.1	-718.4	-670.5	-1,528.0	-637.1	-21.3	-321.5	1409.4%
- CHAPTER XIV (Equity) (2)	-10.1	-3.5	-30.2	-20.6	-323.9	-47.8	-78.7	-289.4	-32.4	-18.8	-11.8	-150.9	1178.8%
TOTAL REMITTANCES	**-219.0**	**-659.7**	**-583.4**	**-766.8**	**-893.3**	**-1,273.9**	**-1,259.8**	**-1,625.7**	**-3,272.5**	**-904.1**	**-60.2**	**-2,940.7**	**4784.9%**

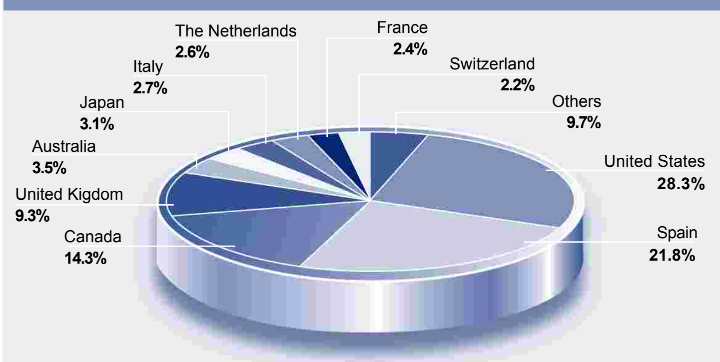
(1) Source: Foreign Investment Committee,
(2) Source: Central Bank of Chile, figures for Other capital are not available,
* Provisional figures as of April 30, 2004

MATERIALIZED FOREIGN INVESTMENT UNDER THE FOREIGN INVESTMENT STATUTE (DL 600) BY SECTOR 1974-2004*
(in nominal US$ million)

SECTOR/PERIOD	74-96	1997	1998	1999	2000	2001	2002*	2003*	2004*	TOTAL
Agriculture and Livestock	178	14	13	21	23	10	2	0	0	261
Construction	329	114	279	211	29	164	138	27	55	1,346
Electricity,Gas & Water	479	1,395	495	4,540	860	908	473	150	2,184	11,484
Fishing and Aquaculture	169	12	8	0	92	5	0	10	0	296
Forestry	153	29	38	17	4	1	1	1	0	244
Industry	3,661	627	530	828	240	754	209	234	103	7,186
Mining	9,564	1,703	2,465	1,350	243	958	1,999	383	76	18,741
Transport and Communications	1,370	177	224	374	870	1,281	336	340	260	5,232
Insurance	373	250	702	208	90	265	20	4	0	1,912
Wholesale and retail trade	385	272	190	86	117	110	82	43	13	1,298
Financial services	2,631	459	813	950	261	108	56	41	1	5,320
Other Services	1,247	167	279	614	192	217	60	43	12	2,831
TOTAL	20,539	5,219	6,036	9,199	3,021	4,781	3,376	1,276	2,704	56,151

Note: Materialized investments include amounts authorized each year and in all forms accepted under the Foreign Investment Statute
Source: Foreign Investment Committee

MATERIALIZED FOREIGN INVESTMENT UNDER THE FOREIGN INVESTMENT STATUTE (DL 600) BY COUNTRY OF ORIGIN 1974-2004*
(in nominal US$ million)



REGION	VALUE (in US$ million)	SHARE
United States	15,913	28.3 %
Spain	12,224	21.8 %
Canada	8,050	14.3 %
United Kingdom	5,227	9.3 %
Australia	1,979	3.5 %
Japan	1,733	3.1 %
Italy	1,506	2.7 %
The Netherlands	1,467	2.6 %
France	1,342	2.4 %
Switzerland	1,249	2.2 %
Others	5,461	9.7 %
TOTAL	**56,151**	**100.0 %**

Source: Foreign Investment Committee - Chile
*provisional figures as of April 30, 2004