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Saturday June 11, 1977 [redacted]

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CHILE: Economic Situation for 1977

[redacted] *Gradually recovering world copper prices and rising noncopper exports should permit Chile some relief from the harsh fiscal and monetary measures of recent years. The ruling military junta plans a 24-percent increase in imports this year. The gain will spur a recovery in real gross national product from the severely depressed 1975-76 levels and should further aid in reducing Chile's triple-digit inflation.*

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[redacted] Unlike most countries of comparable development and sophistication, Chile had to slash imports--and thus domestic income and employment--to cope with the payments problems stemming from rising oil prices and world recession. Until recently, its extremely weak international credit rating practically ruled out access to commercial funds. World criticism of Chilean human rights practices severely limited new official economic assistance and made foreign debt renegotiation difficult at best.

[redacted] The Chilean populace has complained little about the austerity because of the threat of government repression and, more importantly, because many citizens--if not most--still feel they are better off than under the Allende regime.

[redacted] The balance of payments had improved considerably by mid-1976 because of rising earnings from noncopper exports, booming copper production, moderate recovery in world copper prices, and short-term capital inflows attracted by soaring interest rates. The junta took advantage of the improvement to terminate its foreign debt renegotiation efforts and to rebuild foreign reserves. Although peso devaluation was slowed and tariffs were further cut, other fiscal and monetary measures caused imports for the year as a whole to drop an additional 8 percent.

[redacted] This year the military government intends to use its improved foreign reserve position and the small additional gain expected in export earnings to permit an increase in imports sufficient to restore real gross national product to the 1974 level. Although this will require some easing of austerity, the government hopes that increased supply will permit continued progress against inflation. It also intends to avoid debt renegotiations and to assert its independence of the US and other critics of its human rights practices by sharply reducing borrowing from governments and international agencies.

[redacted] Exports are likely to rise about 7 percent in 1977, to $2.1 billion. Copper shipments will remain roughly at last year's level of 980,000 tons, but an expected rise in average copper prices will boost earnings moderately. Stronger demand for noncopper exports in markets developed since 1973 should allow sales of such goods to rise to $820 million, despite an expected weakening in Chile's competitive position because of slower peso devaluation.

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[redacted] The government's reduction of US and International Monetary Fund aid this year will lead to a cut in official capital inflows to around $180 million, compared with $460 million in 1976. Chilean missions to the US and Western Europe are seeking commercial bank loans to help fill the gap.

[redacted] Direct investment will remain low, mainly because of past bureaucratic delays in approving new projects. Full debt amortization payments for 1977 will require $555 million, slightly more than in 1976. Total net capital inflows will consequently shrink to about $170 million, compared with $680 million in 1976.

[redacted] Chile is expected to increase imports to about $2 billion. Higher domestic wheat yields and low wheat import prices will permit a reduction in spending for food imports. Most of the increase in imports will come in fuels, raw materials, and goods for industry. Bringing total imports to the target level will require about $175 million more than Chile now expects to receive from trade and capital flows. Given the recent improvement in the Chilean credit rating, we believe that Chile can raise this additional amount from private sources.

[redacted] Although the junta is still pursuing a strong anti-inflation policy, it intends to ease austerity. Real wages are to be increased about 5 percent. The junta began a slight relaxation of its restrictive monetary policy in the first quarter. It announced a moderate program of tax reductions, increased social spending, and wage increases for government workers on May 1. These steps are expected to result in a government deficit of around 12 percent of expenditures this year--well below the 17-percent deficit of 1976.

[redacted] Growth in the money supply is expected to decline from last year. The attack on inflation was also aided by a two-month voluntary price freeze by private industry that ended in May. On balance, we estimate that inflation will decline in 1977.

[redacted] With somewhat stronger demand, real gross domestic product should grow 6.5 to 7 percent this year. Finished goods inventories in some industries are likely to hold industrial growth to 10 percent, compared with 12.2 percent last year. Good weather should permit agricultural production to rise as much as 7 percent above last year. Construction activity, which began picking up late last year, should grow this year for the first time since 1974. Employment will rise some 4.5 percent this year. The unemployment rate will decline only slightly, to 12.2 percent. [redacted]

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