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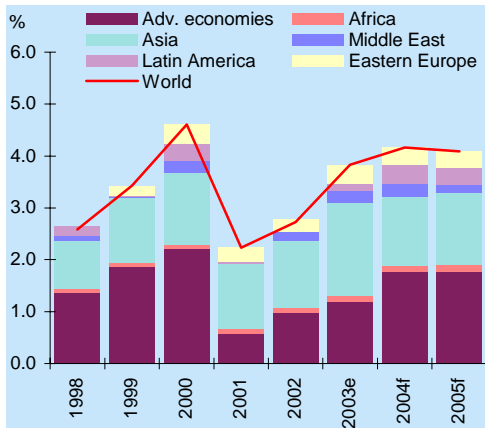
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This *D&B Country Report* was prepared in August 2004.

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Global Economic Outlook

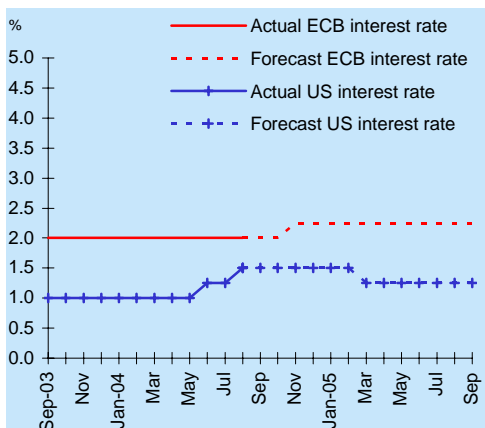
Real GDP growth forecast	2004	Interest rates and oil price	Aug. 2004
World, %	4.2	US interest rate, %	1.50
US, %	4.1	ECB interest rate, %	2.00
Euroland, %	1.8	Japan interest rate, %	0.10
Japan, %	3.2	Oil price (Brent crude), US\$ p/b	45.2



Sources: International Monetary Fund; D&B

World Growth

The global economy continues to recover from the low experienced at the beginning of the decade. The US economy is strengthening, albeit at a slower pace than earlier reported. The Japanese economy continues to expand, as does the EU, albeit to a lesser extent. This supports emerging countries, many of which are benefiting from higher prices for their commodity exports. Nonetheless, some risks in key economies remain, and the recovery is uneven. Most importantly, the recent oil price hike will subdue growth prospects in many countries. Furthermore, although the US dollar appears to have stabilised, large imbalances leave a lingering prospect of further large currency movements.

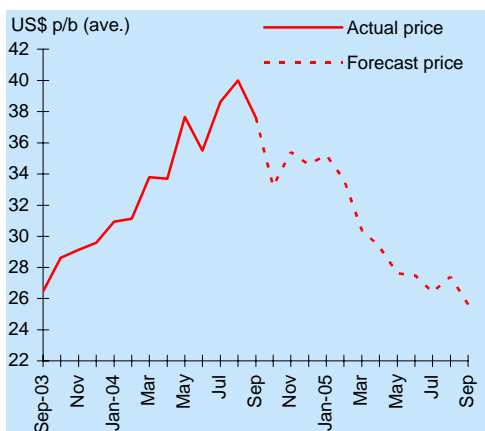


Sources: US Federal Reserve; European Central Bank; D&B

US and Euroland Interest Rates

US: The Federal Reserve increased interest rates by a further 25 basis points on 10 August, although the current tightening in policy takes place against a background of weaker data releases (e.g. employment) and high oil prices. Further increases remain possible, although policy may need to remain loose if macro imbalances unwind in 2005.

Euroland: Euro-area interest rates remained on hold at 2% in early August. Short-term inflationary pressures are viewed by the ECB to be transitory, remaining stable over the medium term. While economic weakness remains a feature of the German economic picture, demand growth is rising across Euroland. Only modest tightening is expected in the second half of 2004.



Source: D&B

Oil Price (Brent Crude)

We have increased our oil price forecast for 2004 to US\$35.3 per barrel (p/b). The price of Brent has reached new peaks, hitting an all-time high of US\$45.2p/b on 20 August. Security concerns, strong global demand and the difficulties faced by Yukos have increased fears of inadequate supply following a disruption. The security situation in Iraq has also deteriorated: in August, the oil fields in the south of the country were closed after threats of sabotage. The International Energy Agency has increased its global demand forecast to 82.2 million barrels per day; with higher OPEC production in July, this has reduced global spare capacity to its lowest point in three decades.

Country Risk Indicator

DB2b

For Country Risk Indicator Definition see page 44

Regional Risk Indicators	
Canada	DB1c
US	DB1c
Chile	DB2b
Trin. & Tob.	DB2d
Mexico	DB3a
Costa Rica	DB3c
Brazil	DB3d
Panama	DB4a
Colombia	DB4b
El Salvador	DB4b
Peru	DB4c
Jamaica	DB4d
Uruguay	DB4d
Guatemala	DB5a
Dom. Rep.	DB5b
Argentina	DB5c
Bolivia	DB5c
Ecuador	DB6a
Honduras	DB6a
Venezuela	DB6a
Paraguay	DB6b
Nicaragua	DB6c
Cuba	DB6d
Chile's Risk Indicator History	
End-2001	DB2b
End-2002	DB2b
End-2003	DB2b
Comparative Risk Indicators	
Greece	DB2b
Japan	DB2b
Mauritius	DB2b

Low Risk

Low degree of uncertainty associated with expected returns. However, country-wide factors may result in higher volatility of returns at a future date.

The DB indicator is a comparative, cross-border assessment of the risk of doing business in a country. The indicator seeks to encapsulate the risk that country-wide factors pose to the predictability of export payments and investment returns over a time horizon of two years.

Overall Outlook

- D&B's risk rating of DB2b for Chile reflects the country's sound macroeconomic fundamentals, buoyant external sector, strong regulatory environment and entrenched democratic politics. With robust economic growth, and despite a presidential election in December 2005, which may unsettle investor sentiment towards the sovereign, we do not foresee any significant rating change, either negative or positive, over the next year.

Positive Risk Factors

- + President Ricardo Lagos Escobar's government remains relatively popular despite corruption scandals that threatened to derail the administration. The government faces an important year, attempting to enact labour market change, healthcare reform and anti-corruption legislation prior to presidential and congressional elections in December 2005.
- + As international copper prices and global consumer demand increased through late 2003 and into 2004, Chilean export receipts rose dramatically. We expect a substantial trade surplus in 2004 to return a current account surplus.
- + Successive Chilean governments have signed numerous free-trade agreements with major markets and real import tariffs are at all-time lows.
- + Growing private consumption and export growth will fuel production and boost corporate profits. In turn, fixed investment will recover after recent weak growth. We expect that the commercial risk environment will improve and help to boost payments performance.
- + The financial sector is healthy, well regulated and transparent. The authorities will continue to implement reforms to keep Chile in line with international norms.

Negative Risk Factors

- The Lagos government has an ambitious policy agenda but without a majority in the lower house it must seek opposition support. With a presidential election in December 2005, policy initiatives may stagnate as legislators seek to avoid losing popular support or, with such things as sensitive labour market reform, may take on a worryingly populist stance.
- Following strong GDP growth, inflation has picked up from previous lows. To counter the rise in inflation the monetary authorities are likely to raise interest rates in the final quarter of 2004 and into 2005. Interest rate increases must be well timed to allow a gradual normalisation without stifling demand or seeing prices climb beyond the central bank target rate of between 2-4%.
- Chile remains exposed to changes in the international copper price. Low prices for copper place pressure on the current account and, to a lesser extent, the fiscal account. Investment flows to the copper industry may also stumble owing to a proposed tax on mining royalties.

Key Information

Economic and Development Information

	2001	2002	2003	2004f	2005f
GDP					
CLP billion	43.4	46.4	49.8	52.3	54.5
US\$ billion	68.4	67.4	72.1	83.0	82.6
Breakdown of GDP					
Agriculture (%)	14.0	14.0	14.9	14.7	14.4
Industry (%)	23.8	23.9	24.0	23.9	24.0
Services (%)	62.2	62.1	61.1	61.4	61.6
Economic indicators					
Real GDP growth (% change)	3.4	2.2	3.3	4.9	4.2
Inflation, annual average (%)	3.6	2.5	2.8	2.5	3.2
Government balance (% GDP)	-0.9	-1.4	-0.5	0.0	0.6
Unemployment, annual average (%)	9.1	9.0	8.0	8.5	7.6
Current account balance (% GDP)	-1.6	-1.3	-0.8	0.9	0.2

Long-term real GDP growth potential, annual average, 2004-13: 4.0-5.0%

Development indicators	Argentina	Brazil	Chile	Mexico	US
Population, 2000 (m)	37.0	170.1	15.2	97.4	281.6
Population, 2010 (m)	41.0	190.3	16.9	111.6	305.1
Population, 2050 (m)	52.6	244.7	21.5	155.7	351.4
Adult literacy (%)	96.5	84.0	95.2	90.1	99.0
GDP per capita (US\$)	7,460	3,580	4,590	5,070	34,100
GDP per capita (US\$ PPP)	12,050	7,300	9,100	8,790	34,100
Life expectancy (years)	73.6	67.5	75.0	72.4	78.1
Internet hosts (per 10,000 people)	47.3	39.0	82.3	50.6	2420.0
Dependency ratio, 2000	0.59	0.51	0.50	0.61	0.51
Dependency ratio, 2010	0.53	0.46	0.55	0.52	0.49
Dependency ratio, 2050	0.59	0.58	0.61	0.56	0.69

Political Information

Head of state & government	President Ricardo Lagos Escobar
Political system	Multiparty democracy
<i>Present constitution adopted</i>	1980
Ruling coalition	Concertacion Coalition
Last elections	Presidential: December 1999; Congressional: December 2001
Next elections	Presidential: December 2005; Congressional: December 2005

Miscellaneous Information

Religion	Roman Catholic
Capital (population)	Santiago (4.8 million)
Timezone	GMT -4 hours

Sources: World Bank, *World Development Report*; D&B

Executive Summary

Political Risk

With presidential and congressional elections in December 2005, and a 57% approval rating for President Ricardo Lagos Escobar and the Concertacion coalition, the government must focus on strengthening domestic consumption by reducing unemployment and convincing a sceptical business community that the leftist Concertacion can effectively manage the economy.

We believe that the presidential election will be close run. At present, the leading contender to represent the Concertacion is Defence Minister Michelle Bachelet (Socialist Party, PS). She has yet to declare her intentions to stand, although public opinion (as of mid-2004) suggests that she would narrowly beat present opposition leader, and likely 2005 candidate, Joaquin Lavín (Alianza por Chile coalition, APC). Foreign Minister Soledad Alvear of the Christian Democratic Party (PDC) holds significantly less public support than Bachelet but will be supported by the powerful PDC faction of the Concertacion alliance. We believe that a Bachelet candidacy would test the PDC's commitment to the Concertacion, especially if she lost the election or her presidency lost public support early in its tenure. Meanwhile, Lavín should win support for his proposals to boost investment opportunities by cutting individual and corporate taxes and easing restrictions on hiring and firing labour. There are many factors that could alter the shape of the 2005 election. However, while there are a number of policy differences between the two major coalitions, we do not believe that Chile's risk rating will suffer (or improve) significantly from the election of any of the current major presidential contenders.

Macroeconomic Risk

We expect real GDP to grow by 4.9% in 2004, followed by an expansion of 4.2% in 2005. In both years, growth will be led by resurgent private consumption, domestic investment and the propitious external environment, namely high international copper prices and improved demand for Chilean goods from major markets in the US, the EU and Asia. The 2004 trade surplus will easily exceed the US\$7 billion targeted by the central bank, ensuring that net exports contribute significantly to overall growth.

Despite bullish economic growth and high international energy prices, we believe that upward pressure on inflation and interest rates will be manageable. However, we foresee an interest rate rise during the final quarter of 2004. Interest rate increases must be well timed to allow a gradual normalisation of monetary policy (from historic low rates) without stifling demand, exacerbating the high level of unemployment or pushing prices beyond the central bank target rate of between 2-4%. Meanwhile, government revenues remain sound. The rise in copper prices will see significant contributions to the Copper Stabilisation Fund, helping to smooth out long-term commodity earnings and funding the retirement of some US dollar-denominated public debt.

Government spending on poverty reduction has so far been well targeted and social spending programmes should continue to reduce the level of poverty. However, 20% of the population still live in poverty and income distribution is highly skewed (both of which prevent the steady development of consumer markets over the long term). High levels of unemployment are also a concern. Despite economic growth, joblessness has not fallen significantly and will average around 8.5% in 2004. We believe that structural defects remain in the Chilean labour market that must be addressed over the short to medium term to improve economic efficiency and long-term growth prospects.

External Economic Risk

D&B is holding a cautiously positive stance on the short- to medium-term outlook for Chile's external accounts. On the positive side, Chilean exports have boomed through 2004 owing to robust international copper prices. We expect sustained high prices over the two-year forecast period. Moreover, Chile has benefited from buoyant demand from major markets; the signing of bilateral and multilateral free-trade agreements over the last decade has given Chile room to exploit the global recovery. We expect Chile to continue signing free-trade agreements with major markets around the world over the two-year forecast period, with particular emphasis on negotiations with China. Finally, the growth in import demand has been dwarfed by the surge in exports. As such, the trade surplus will exceed the central bank's initial trade surplus target of US\$7 billion in 2004, underpinning a current account surplus of 0.9% of GDP. We forecast another good year in 2005 and a current account surplus of 0.2%.

D&B expects that public sector external debt accumulation will be minimal over the two-year forecast period. Furthermore, healthy foreign exchange reserve holdings will allow the central bank to reduce the sovereign's short-term and US dollar-denominated debt. Over the medium term, the deepening of domestic (peso-denominated) financial markets will boost the availability of domestic credit for Chilean companies and reduce risks from adverse exchange rate movements. Finally, the floating exchange rate regime has worked well over the last few years, allowing the economy to adjust smoothly to external shocks. We believe that the floating exchange rate will remain in operation over the foreseeable future. D&B forecasts an average exchange rate of CLP630:US\$ in 2004 and CLP660:US\$ in 2005.

On the negative side, the economy is heavily dependent on copper exports. The price of copper is highly vulnerable to swings in the international market price and so forms a moderate risk element. Elsewhere, with a presidential election in 2005 and the possibility of a royalty tax being imposed, foreign direct investment inflows may be stymied. The boost in trade (and thus trade credits) will also weigh heavily on the financial account. A growing imbalance on the financial and capital account will damage Chile's ability to secure a sustainable balance of payments over the medium to long term.

Commercial Risk

Credit conditions will improve over the two-year forecast period as firms reap higher profits from buoyant export and internal demand. Healthy corporate returns will boost counter-party prompt payments and reduce the level of late payments, which have been beyond acceptable levels in recent years. Despite a forecast rise in interest rates and inflation, credit conditions will remain positive and overall trading risks when dealing with Chile are minimal.

Meanwhile, conditions in the financial sector are good, with regulation and transparency in line with international norms. Reform over the short to medium term will strengthen competition within the financial sector to benefit small and medium sized enterprises and increase regulatory sophistication so that Chilean legislation remains on par with global standards. Reform of copyright law should be a priority before 2008 (as part of Chile's free-trade deal with the US) as Chile could face legal action for widespread copyright breaches due to presently inadequate legislation.

Finally, corruption is not as widespread as in the rest of the region, but recent events show that all countries are vulnerable to corrupt activity. A widespread political consensus against corruption and new laws designed to minimise the chance of corruption re-occurring should safeguard Chile's 'clean' reputation.

Political Risk

Key Point: President Ricardo Lagos Escobar and his ruling Concertacion coalition have recovered well from the scandals that threatened to destroy the government. With healthy popular support, Lagos must maintain high levels of public support for the Concertacion alliance ahead of elections in 2005.

Recent Developments

Chile's centre-left Concertacion alliance has held uninterrupted power since the country returned to democratic government in 1989. Ricardo Lagos Escobar was elected president in January 2000. He beat right-wing opponent Joaquin Lavín of the Alianza por Chile (APC) coalition by a narrow majority, ensuring another six years in power for the Concertacion.

Table 1

Results of 2000 Presidential Election

Candidate	First round	Second round
Ricardo Lagos Escobar (PPD)	48.0	51.3
Joaquin Lavín (UDI)	47.5	48.7
Gladys Marín Millie (PCC)	3.2	-
Tomas Hirsch Goldschmidt (PH)	0.5	-
Sara Larrain Ruiz-Tagle (Ind.)	0.4	-
Arturo Frei Bolívar (UCCP)	0.4	-

Source: Ministry of the Interior, <http://www.elecciones.gov.cl>

Congressional elections were held in December 2001. The run-up to the elections saw fierce inter-party competition, within both the APC and Concertacion coalitions, and between the government and opposition. Legislative elections mirrored the close presidential poll and returned the Concertacion with a vulnerable majority.

Table 2

Party Standings Following December 2001 Congressional Elections

Party	Chamber of Deputies (seats)	Senate (seats)
Concertacion Coalicion	62	20
<i>Of which:</i> Christian Democratic Party (PDC)	24	12
Party for Democracy (PPD)	21	3
Socialist Party (PS)	11	5
Radical Social Democrats (PRSD)	6	-
Alianza por Chile Coalicion	57	18
<i>Of which:</i> Independent Democratic Union (UDI)	35	11
National Renovation (RN)	22	7
UPC Independents (UPC-Ind)	-	-
Other	1	-
Total	120	38

Source: Ministry of the Interior, <http://www.elecciones.gov.cl>

Political Environment

Since its election, Lagos' government has been dogged by scandals that have threatened to destroy the cohesion of the governing alliance. In December 2002, Carlos Cruz (Christian Democratic Party, PDC), the minister for public works, was allegedly bribed to wrongly award lucrative public sector contracts. In March 2003, Gonzalo Rivas and Javier Moya, executives in Chile's main public sector development agency Corfo, resigned after allegations that they illegally endorsed US\$100 million worth of Corfo certificates-of-deposit to Inverlink, a private financial holdings group. Shortly after the Rivas and Moya resignations, Carlos Massad, president of the central bank, also resigned after his secretary was found selling market-sensitive information to Inverlink's brokerage business.

Lagos' response to the allegations was swift and investigations saw the removal of six legislators from Congress. Importantly, their departure eliminated the government's majority in the Chamber of Deputies. This development forced the government to seek opposition support in Congress in order to get its reform programme through the legislature. The scandals also revived divisions within the governing alliance, especially criticism of the president from the PDC (Lagos is the first Concertacion president from outside the PDC, the majority party within the Concertacion). Lagos allied himself with loyal PDC members who then convinced the party to remain within the Concertacion.

Lagos' approval rating suffered during the months immediately after news of the scandals broke. However, since August 2003, the president had regained much of his lost popularity with the Chilean public owing to his strong handling of the corruption crises and the country's strong economic performance. Moreover, Lavin's ability to damage Lagos has been restricted by more recent sex scandals involving members of his own party. By July 2004, the president's approval rating had reached 57% (compared with 47% at the beginning of 2004) with a correspondingly high rating for potential Concertacion presidential election candidates.

Municipal elections in October 2004 will be a significant test of public opinion and voting intentions for the presidential election in 2005. With support for Lagos and his alliance high, we believe that the alliance will do well in October. However, Lagos will hope that the Concertacion's popularity has not peaked too soon and that his party's presidential election candidate will enjoy a similar level of support. Currently, the leading contender to represent the Concertacion in 2005 is incumbent Defence Minister Michelle Bachelet (Socialist Party, PS). She has yet to declare her intentions to stand, although public opinion (as of mid-2004) suggests she would narrowly beat present opposition leader and likely APC candidate Joaquin Lavin. Foreign Minister Soledad Alvear (PDC) is also in the running to take the Concertacion candidacy and will be supported by the powerful PDC faction of the alliance, but holds significantly less public support than Bachelet.

We believe that a Bachelet candidacy would test the PDC's commitment to the Concertacion, especially if she lost the election or her presidency lost public support early in its tenure. The PDC may play a part in reducing Bachelet's effectiveness if it obstructs the left-wing policy orientation of her government. Furthermore, many voters remain sceptical of the Concertacion's ability to manage the economy effectively. In July 2004, Lagos' popularity had risen to 57%, but the same poll suggested only 50% were happy with his handling of an economy growing at around 4.5% per annum in 2004 and 2005. Any significantly negative economic data posted in the run up to the elections or populist rhetoric from the Concertacion candidate could alienate many voters. Should the PDC win the Concertacion nomination, it will position itself to the right of its coalition allies in a bid to stem the flow of PDC voters heading for the opposition Independent Democratic Union (UDI).

Meanwhile, Lavin, the most likely opposition candidate, should win support for his proposals to boost investment opportunities by cutting individual and corporate taxes and easing restrictions on hiring and firing labour. Lavin's business-friendly proposals, combined with promises to raise healthcare standards, will win him centrist support at the expense of the Concertacion (especially if Bachelet takes the party to the political left). We believe that the 2005 presidential election result is wide open and that the political situation should be monitored closely.

Political System

The Executive: Chile's president is directly elected for a non-renewable term of six years. The length of the presidential term reduces the president's incentives to legislate for short-term gain over long-term stability. The president appoints the cabinet and does not require congressional support to stay in office: in these respects Chile's system is 'presidentialist'.

The Legislature: Legislative power lies in a bicameral Congress comprising a lower house (Chamber of Deputies) of 120 members elected nationally for a four-year term and an upper house (Senate) of 38 elected and nine appointed members and one senator for life (currently former President Eduardo Frei). Senators are elected for a maximum term of eight years; half the Senate is re-elected every four years. Despite the existence of a number of political parties, the institutionalisation of two major (and relatively stable) coalitions has effectively created a two-party system. The coalition system tends to moderate parties' sectoral political demands.

Some of the vestiges of authoritarian rule have yet to be removed, including provisions within the 1980 constitution that limit the power of Congress. The president can call a plebiscite on constitutional amendments rejected by Congress. Budgets proposed by the presidency must be voted on within 60 days or they automatically go into effect. In addition, the constitutional tribunal has the final say on important legislation.

The Judiciary: The judiciary was once subservient to the military junta, so judicial reform was an important policy priority for the Frei administration as part of overall efforts to democratise the country's political institutions. The power of the Supreme Court was strengthened and its role expanded to ensure that the executive and legislature were accountable. The alliance between the judiciary, the military and the executive has now been successfully broken.

Policy Agenda

Mining Royalty Tax: One of the most contentious pieces of legislation currently under discussion is the government's proposal to introduce a mining royalty tax of 3% on some large mines' net sales as of 2007, raising some US\$100 million a year to finance technological research in Chile. Polls show that most Chileans strongly agree with a royalty tax on mining companies. However, having been defeated by the APC in the Senate in August 2004, the proposal cannot be resubmitted to the Senate for one year. Should the government wish to pursue its proposal (and a compromise scheme is not adopted in the interim), the royalty tax would prove a highly volatile pre-election policy. We believe that significant popular and left-wing support for the tax, and a widespread belief that mining companies evade or underpay tax, will result in some levy on mining profits over the medium term.

Trade: The Lagos government has been a strong advocate of free-trade reforms, both domestically and within the region, especially through Mercosur. General import tariffs in effect in Chile are 6%, but are discounted according to bilateral free-trade agreements with many countries or by special discount, making real tariffs on products imported into Chile around 1.5% (see **Trade Environment**). We expect Lagos to continue to push for trade deals (especially with China) and will welcome a Free-Trade Area of the Americas (FTAA) during the remainder of his term. A right-

wing government would probably follow most of these policies. Importantly, the Chilean government has suggested that the country will not join the FTAA unless the other members of Mercosur also do so, giving a left-wing government (following 2005) scope to delay Chilean entry (as Brazil and Argentina, and prospective associate member Venezuela, are likely to take longer to agree to the FTAA).

Labour Market Reform: Following reform in 2001 that helped to ignite Lagos' bid for the presidency, the government has proposed further labour reforms (in time for the December 2005 presidential election). Proposed changes aim to accelerate the decision-making process of labour tribunals, which would tend to please businesses. However, some changes will accentuate a worker bias in labour disputes. For instance, tribunal judges could notify workers' lawyers of legal mistakes in their cases so that they can amend them in time. Another measure would reduce the amount of evidence required to corroborate workers' allegations. Chances of successfully reversing a case would also be limited by denying appeals tribunals the right to re-examine the evidence on which the initial verdict was founded. Labour market reform prior to the elections may win the Concertacion popular support, but may further alienate business sector voters, and, by slowing job creation (as the business sector ponders the proposed legislation), will keep unemployment high.

Healthcare: In mid-August 2004, after four years of debate, Congress approved the Auge healthcare reform plan, a key element in Lagos's electoral programme. The reform plan establishes legal guarantees for healthcare protocols, including detailed treatment specifications and limits to treatment delays, covering 25 pathologies from April 2005, 40 from April 2006 and 56 from April 2007. Plan Auge is forcing major investment in equipment and infrastructure as well as a decentralisation of the public healthcare service.

Corruption: In August 2004, the Chilean Senate approved a bill to boost transparency in the management of government concessions, a significant step in the creation of an independent regulator for public works projects. The APC initiated the project after members of the ruling Concertacion were convicted of acts of corruption within the Ministry of Public Works. Lagos is likely to give the project warm reception to limit the political capital the APC expects to win.

Reconciliation: The government must continue to investigate human rights abuses and acts of corruption and fraud carried out under the military government of General Augusto Pinochet. Some 3,000 people were murdered under the Pinochet regime, but he has yet to stand trial, claiming that his position granted him immunity from prosecution. On 26 August 2004, the Supreme Court ruled that Pinochet has no immunity. Although stripping Pinochet of his immunity will allow him to be prosecuted, whether he ever will be is in doubt as he is in bad health and has powerful supporters. The problems finding the disappeared and charging those responsible for their disappearance will therefore continue; even if Pinochet reveals some secrets he knows that he will not go to prison (because of his health) and he is unlikely to betray the military. Reconciliation with the crimes committed under military rule remains a painful but important aspect of Chile's new democracy and elicits strong emotions from the political right and left.

Socio-Political Risk

Internal Stability

Following the transition to democracy in 1990, the rule of law has been established and successive governments have reinstated widespread respect for human rights as an important policy objective. The current government has sought to reconcile the families of the victims of the 1973-90 dictatorship (represented by the Group of Families of the Detained-Disappeared, AFDD) and alleged perpetrators, but pressure to deal with cases of alleged human rights violations remains considerable and

finding evidence against perpetrators is exceedingly difficult. Since 1990, there have been eight attempts at reaching a political or legislative solution to nearly 1,200 forced disappearances. The government continues to look for ways of encouraging former officers to provide the information that will help to locate the disappeared. Prosecutors have managed to exploit loopholes in the 1978 amnesty law and are currently charging several retired officers for kidnapping.

On the whole, there are no major internal security concerns, with interest groups seeking to lobby parliament through democratic means. Nevertheless, high rates of poverty (some 20% of the population live in poverty and Chile has a very unequal distribution of income) and unemployment mean that common crime rates are high. Organised crime and money laundering is present, although not as widespread as in some other Latin American nations with weaker political and legislative systems. The presidential election in December 2005 is likely to bring heightened social protest (mainly union sponsored and largely peaceful) and more agitated political debate, although overall stability will not be threatened.

Interest Groups

The Military: The military played a major role in shaping the country's recent history. However, Lagos accelerated the reduction of its power by limiting the military budget. The military is now subservient to the country's executive and no longer influences the government's policy agenda as it did during the Pinochet era.

The Catholic Church: As in many Latin American countries, the Catholic Church is an important political player. Pinochet actively and unsuccessfully sought Church support during his period in office, although during military rule, the Church, guided by an ethos of Christian social justice, sought to defend human rights and provided shelter for some of the persecuted. The Church continues to represent the under-privileged and plays an important role in education through Catholic universities.

Business Groups: The main business groups are the Society for the Promotion of Manufacturing (SOFOFA) and the Confederation for Production and Commerce. SOFOFA is generally supportive of government policy and at times has an input into policy-making. However, the association was critical of the government's labour reform policy, which it claimed would increase employment costs and slow the reduction in unemployment. We believe that businesses remain sceptical about the Concertacion's ability to manage the economy and are often unduly critical of government initiatives, despite the administration's successes in recent times.

Labour Relations

Industrial strife is minimal in Chile, partly reflecting the repression of unions during the military era. Union membership is still limited and most wage bargaining is conducted at company level. Nevertheless, since the late 1990s when democracy became more entrenched, the public sector labour unions (allied to the ruling Concertacion) have become more vocal, seeking concessions from the government in terms of welfare spending and labour legislation. Chile's ports have been intermittently hit by disruptive strike action ahead of privatisation. We believe that labour protest will be more frequent in the run up to the presidential and congressional elections in December 2005.

External Political Risk

The democratic governments of the 1990s worked hard to reintegrate Chile into the world and end its status as an international pariah. Over the last decade, Chilean foreign relations have been increasingly entwined with the government's desire to develop trading relations. The country joined the Asia Pacific Economic Cooperation (APEC) forum in November 1994 and in 1995, became an associate member of Mercosur, the trade group that links Argentina, Brazil, Paraguay and

Uruguay (Bolivia and Peru are also associate members). Chile has pushed hard to align Mercosur members in dealings with third parties and strengthen internal regulation and dispute resolution mechanisms. The present government has suggested that Chile will not enter the FTAA unilaterally but will act in unison with other Mercosur members. Meanwhile, in recent years Chile has signed a number of bilateral trade treaties, most notably with the EU, the US and South Korea.

Elsewhere, in mid-2004, Peru and Chile clashed over borders created by the 1929 Treaty. Both Peru and Chile suggested that they had the military capability to deal with any threat; Chile is presently upgrading its naval strength. However, we believe that the issue arose from Peru-Bolivia talks aimed at providing the latter with Pacific Ocean access along the Peru-Chile border. We do not believe that any military conflagration will result between the two countries and believe that Chile remains committed to finding practicable ways to offer Bolivia access to the Pacific Ocean.

Political Risk Outlook

With congressional and presidential elections due in December 2005 and a 57% approval rating for Lagos and the Concertacion, the government must focus on maintaining its popularity and buttressing business sector confidence in the Concertacion's ability to manage the economy. The government must reduce the high level of unemployment and focus on increasing tax receipts. However, as the government still needs the support of the opposition APC for its legislative programme to be approved, and the APC is ready to launch its own candidate for the presidency, we believe that policy implementation is likely to be difficult in 2005.

We believe that the presidential election will be close run. At present, the leading contender to represent the Concertacion is Bachelet (PS). She has yet to declare her intentions to stand, although public opinion (as of mid-2004) suggests she would narrowly beat likely opposition leader Lavin (APC). Alvear (PDC) holds significantly less public support than Bachelet but will be supported by the powerful PDC faction of the Concertacion alliance. We believe that a Bachelet candidacy would test the PDC's commitment to the Concertacion, especially if she lost the election or her presidency lost public support early in its tenure. The PDC may play a part in reducing Bachelet's effectiveness if it obstructs the left-wing policy orientation of her government.

Furthermore, many voters remain sceptical of the Concertacion's ability to manage the economy effectively. In July 2004, Lagos' popularity had risen to 57%, but the same poll suggested only 50% were happy with his handling of the economy; however, only 9% thought the economy would worsen in the short term. Any significantly negative economic data posted in the run up to the elections or populist rhetoric from the Concertacion candidate could alienate voters. However, if the PDC wins the Concertacion nomination, it will probably position itself to the right of its coalition allies in a bid to stem the flow of potential PDC voters backing the APC.

Meanwhile, Lavin should win support for his proposals to boost investment opportunities by cutting individual and corporate taxes and easing restrictions on hiring and firing labour, probably highlighting Lagos' labour market reforms that raised employment costs for business and have left the unemployment rate stubbornly high. Lavin's business-friendly proposals, combined with possible promises to raise healthcare and public education standards, may win over centrist support (especially if Bachelet takes the Concertacion further to the political left).

Many factors remain that could alter the outcome of the 2005 presidential election, but at present the poll will be closely fought. However, while there are a number of policy differences between the major parties, we do not believe that Chile's risk rating will suffer (or improve) significantly from the election of any of the current major presidential contenders.

Macroeconomic Risk

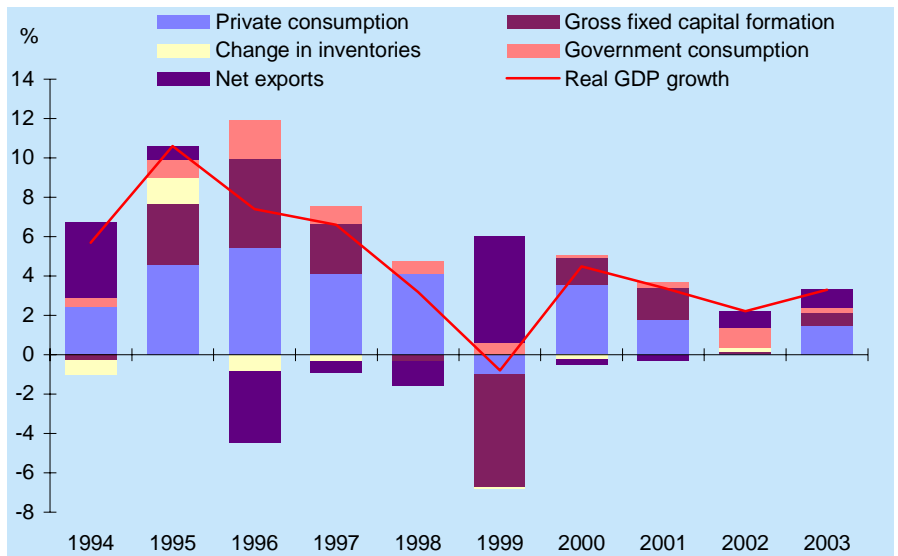
Key Point: The export sector, a traditional engine of growth, will drive Chilean economic expansion in 2004. A strengthening of private consumption and a recovery in investment will also buoy growth. The authorities must manage monetary policy deftly to limit inflation and promote consumption.

Short-Term Economic Performance

Chile's economic successes over the past 20 years reflect sound and consistent policy measures based on trade and exchange rate flexibility and, in recent years, inflation targeting and fiscal prudence. Real GDP growth averaged 3.4% a year during 2000-03, following recession in 1999 (when real GDP fell by 0.8%). The economy posted respectable growth of 4.5% in 2000, with exports performing particularly well as international copper prices recovered. Industrial output also grew, prompted by steady activity in the hydroelectric energy, transport and communications sectors. In 2001, the combination of deteriorating investor sentiment towards emerging markets and increased risk aversion in the US cut foreign investment into Chile and damaged economic performance: real GDP grew by only 3.4%. Furthermore, high unemployment stifled consumer confidence, while the government's prolonged indecision over labour market reform and the weaker global economic environment hurt domestic business confidence.

Chart 1

Yearly GDP Growth Contribution by Demand



Source: Banco Central de Chile, *Boletín Mensual*, <http://www.bcentral.cl>

Economic growth was weaker still in 2002, with real GDP expanding by just 2.2%. Private consumption was stymied by high unemployment, while business costs rose in the wake of labour market reform; reform also constrained the pace of job creation in expanding sectors. The Chilean economy registered growth of 3.3% in 2003 owing to increased industrial production, a slow fall in joblessness, rising copper prices and low international interest rates. Expansion has continued into 2004, with Chile benefiting from copper prices that are nearly double the end-2002 level and continued low world interest rates. Partly reflecting these developments, real GDP grew by 6.5% year on year in seasonally adjusted terms during the first quarter of 2004, the strongest quarterly growth in three years. We believe that Chile will post real GDP growth of around 4.9% in 2004 as a whole (economic growth reached 4.8% year on year during the first six months of 2004) and 4.2% in 2005.

Components of Growth

Table 3

Contribution to Growth

	2001	2002	2003
<i>Real growth rate (%):</i>			
Private consumption	2.8	0.1	2.3
Gross fixed capital formation	7.7	0.4	3.0
Government consumption	2.5	8.8	2.0
Exports	-4.9	-0.5	15.8
Imports	-3.9	-3.1	13.3
Real GDP	3.4	2.2	3.3
<i>Share of GDP (%):</i>			
Private consumption	65.1	63.7	63.1
Gross fixed capital formation	21.6	21.2	21.2
Change in inventories	0.2	0.5	0.5
Government consumption	11.6	12.3	12.2
Net exports	1.5	2.3	3.1
<i>Contribution to real GDP growth (percentage point):</i>			
Gross fixed capital formation	1.6	0.1	0.6
Government consumption	0.0	0.2	0.0
Change in inventories	0.3	1.0	0.3
Net exports	-0.3	0.8	0.9

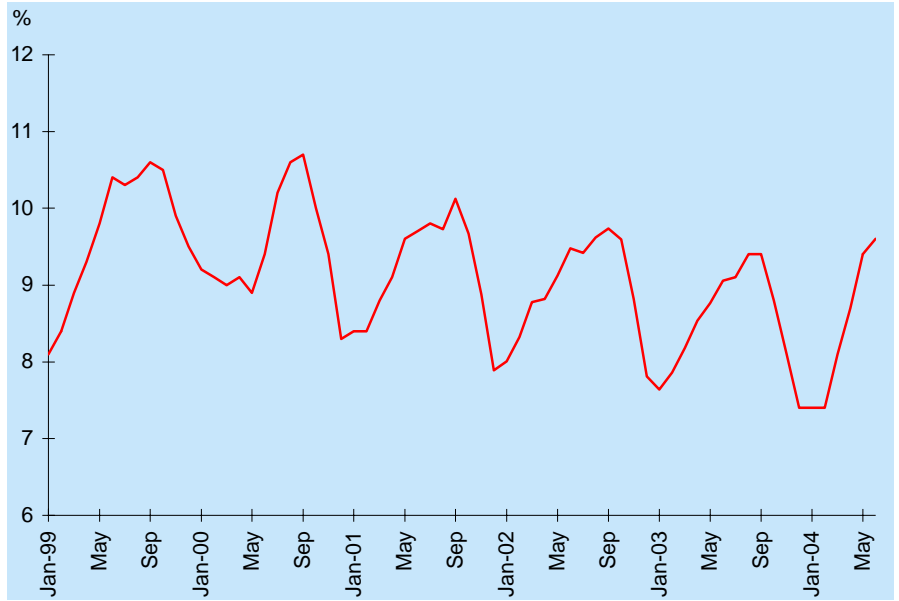
Source: Banco Central de Chile, *Boletín Mensual*, <http://www.bcentral.cl>

Private Consumption

Private consumption has increased in year-on-year terms since 2000 (consumption fell by around 0.4% during the economic recession of 1999). In recent years, the steady fall in interest rates has buttressed private consumption (of consumer durables in particular) (see **Monetary Environment**). Thus, although joblessness remains high and disposable incomes have been largely unchanged (real wages increased by only 1.5% per annum on average between 2000-03), households' perceptions about their current and future conditions are buoyant. A mid-2004 survey showed only 9% of respondents believe that the economy will worsen in the foreseeable future. Nonetheless, Chile suffers a high rate of structural unemployment of between 8-9% of the workforce. This frustrates higher private consumption growth, and as such, faster overall real GDP growth rates.

The persistent high level of joblessness will pressure the authorities to retain stimulating monetary policies, such as low interest rates, despite the rise in the level of inflation owing to robust GDP growth and high energy prices. As such, we believe that private consumption will post healthy returns in 2004 and 2005. That said, the monetary authorities will increase interest rates slowly from late 2004 onwards to keep inflation within the 2-4% target. Given the sensitivity of private consumption growth to interest rates changes, monetary policy must be gradually normalised (from present record lows) to prevent a slowdown in private consumption growth.

Chart 2
Unemployment

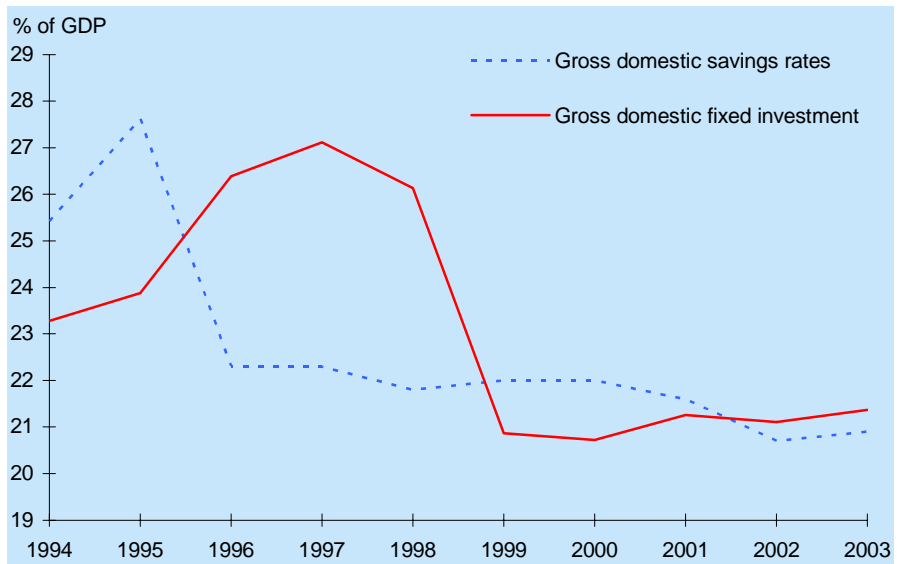


Source: Banco Central de Chile, *Boletín Mensual*; <http://www.bcentral.cl>

Gross Fixed Capital Formation

Over the period 1999-2003, investment spending, which represents around 21% of total GDP, has been sluggish by Chilean standards. Barring a rise of around 14% in 2000 (partly a reflection of the 20.1% fall during the economic recession of 1999), investment growth has averaged only 3.7% annually over 2001-03. We believe that the slow rate of investment growth reflects the domestic and foreign business sectors' lack of confidence in the Lagos government to implement consistent, business- and investment-friendly policies. At the same time as cutting interest rates, the government has formulated populist labour market and healthcare reforms, and devised plans for a royalty tax on mining companies. The weak external environment in 1999-2002 has also affected domestic business confidence; Chilean companies with significant investments in Brazil and Argentina have seen their profits slashed and cut their investment plans accordingly.

Chart 3
Saving and Investment



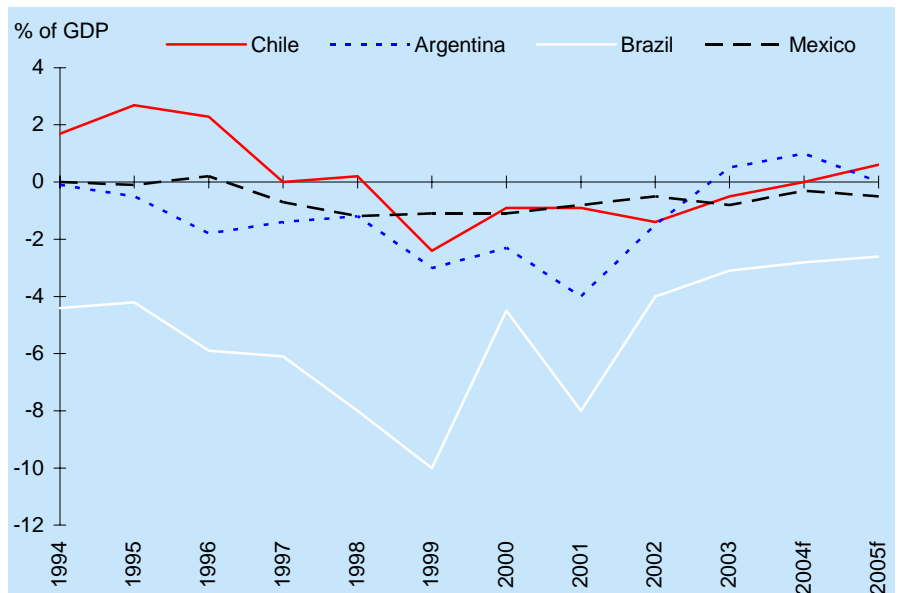
Source: D&B

Going forward, we believe that investment will increase by around 5.6% in 2004 owing to booming output and exports, and accommodative monetary policy. Commercial loans are expected to grow by 10% in 2004; total lending in the first quarter of the year was up by 8.8% year on year and loans for foreign trade increased by 15.3% year on year in the first half of 2004. However, investment will slow in 2005 to around 4.1% as presidential and congressional elections cap business enthusiasm, and domestic and international interest rates increase (see **Global Economic Outlook**).

Government Consumption

In general, successive Chilean governments have shown commitment to prudent fiscal policy, reinforced by the current administration by adherence to a structural balance rule that calls for a surplus of 1% of GDP in the central government’s fiscal accounts. Over the last few years, the Lagos government has made a concerted attempt to reallocate spending to social priorities, in the context of falling overall spending commitments, which helped to ensure a government deficit of just 0.5% in 2003.

Chart 4
Government Balance



Sources: Ministry of Finance, <http://www.minhda.cl>; D&B

Meanwhile, high copper prices have fed the Copper Stabilisation Fund, which receives surplus earnings when the copper price is above US\$0.96 per pound and transfers holdings to the Treasury when the world price falls below US\$0.96. The government also uses accrued surpluses to selectively prepay government debt. The copper industry remains a huge source of income for the state, a factor behind the government’s recent proposal to introduce a royalty tax of 3%. The tax (which was defeated in the legislature in August and cannot be reintroduced for one year) would collect an estimated US\$100 million annually to fund research and development, and would have come into effect in 2007. The International Monetary Fund (IMF) cautiously approved to the royalty tax, suggesting that a levy could be introduced sooner rather than later. The royalty tax also forms part of the government’s broader plan to improve tax receipts, often hindered by evasion and the almost constant reduction in import tariffs as free-trade deals come into force. Increasing receipts will form an integral strand in funding anti-poverty policies over the short to medium term.

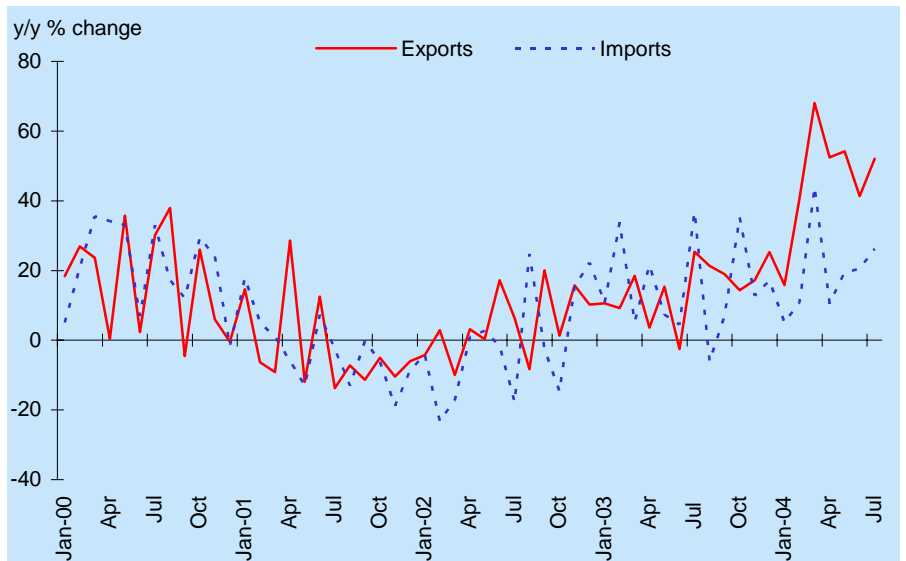
Going forward, we believe that the government’s fiscal policies are supportive of overall GDP growth, not only through well-directed pro-growth capital outlays, but also in terms of buttressing domestic and foreign investor sentiment in the economy. Despite concerns surrounding the upcoming presidential election, fiscal prudence, inflation targeting and trade integration will help to protect the Chilean economy from temporary external shocks such as higher global interest rates, bullish energy prices and possible negative changes in copper prices.

Meanwhile, the IMF has recently applauded the central bank’s debt management strategy, including the introduction of long-term peso-denominated bonds as a means of deepening domestic financial markets. At the same time, the bank will seek to gradually redeem part of its US dollar-indexed debt using foreign exchange reserves, thereby reducing the risk of external shocks. Overall, debt management practices are sound and do not add to the risk environment over the two-year forecast period.

Net Exports

With overseas trade accounting for a much larger proportion of GDP in Chile than Brazil or Argentina for instance, net exports have been an important source of GDP growth. One of the major determinants of whether net exports positively contribute to GDP or detract from it is the international price of copper. At present, the high copper price will provide a fillip for the external accounts following relatively barren years since 1999. Global demand will contribute to improving exports across other sectors (see **Trade Balance**). During the last economic expansion the trade sector was the main engine of GDP growth.

Chart 5
Export and Import Growth



Source: Banco Central de Chile, *Boletín Mensual*, <http://www.bcentral.cl>

On the debit side, Chile is vulnerable to a large and sustained rise in international fuel prices. Furthermore, the relative price of imports is likely to continue downwards given the rapid liberalisation of trade tariffs, thereby fuelling consumer demand for imported goods. Real tariffs on products imported into Chile fell to a record low of 1.5% in July 2004. Owing to robust GDP growth over the two-year forecast period, we expect import demand to increase, partially offsetting the rise in export receipts. However, the trade sector will make a healthy contribution to overall GDP in 2004 before moderating in 2005.

Monetary Environment

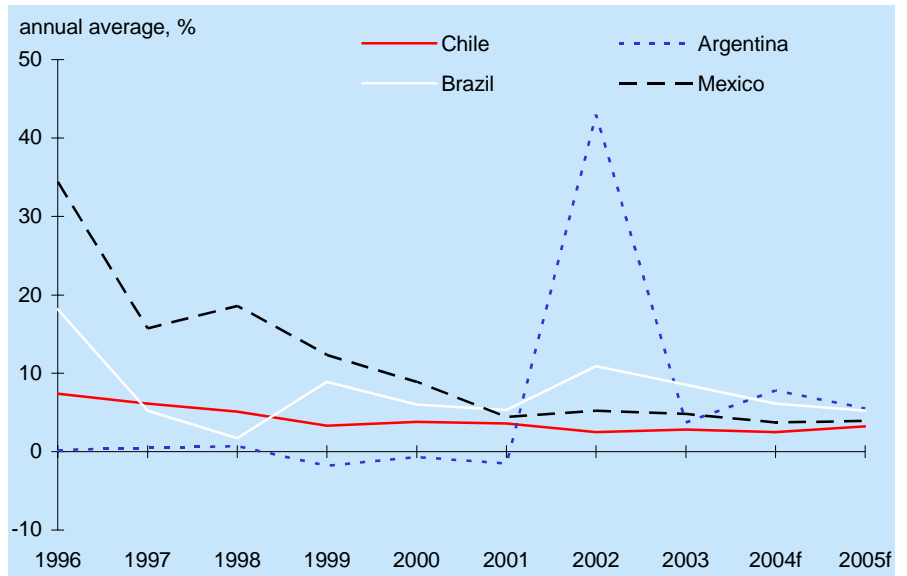
Inflation

The monetary authorities have had considerable success in reducing and containing inflation. Chile’s inflation performance compares favourably with that of its regional counterparts, with the rate falling since the early 1990s. The central bank operates an inflation target of between 2-4%.

Low price inflation over the last few years is a reflection of anaemic consumer demand and excess idle capacity in industry that has allowed the monetary authorities to reduce interest rates in a bid to stimulate GDP growth. Interest rates have fallen consistently since the beginning of 2002. The central bank cut its policy interest rates in December 2003 and January 2004, by 50 basis points on each occasion, bringing the benchmark lending rate to an all-time low of 1.75%. In addition, the improvement in terms of trade registered in late 2003 and 2004 contributed to an appreciation of the peso that, in turn, led to downward pressure on domestic prices. In 2003, the end of year inflation rate was 1.1%, the lowest rate registered in the country since 1935 (while average inflation came in at 2.8%).

Chart 6

Consumer Price Inflation

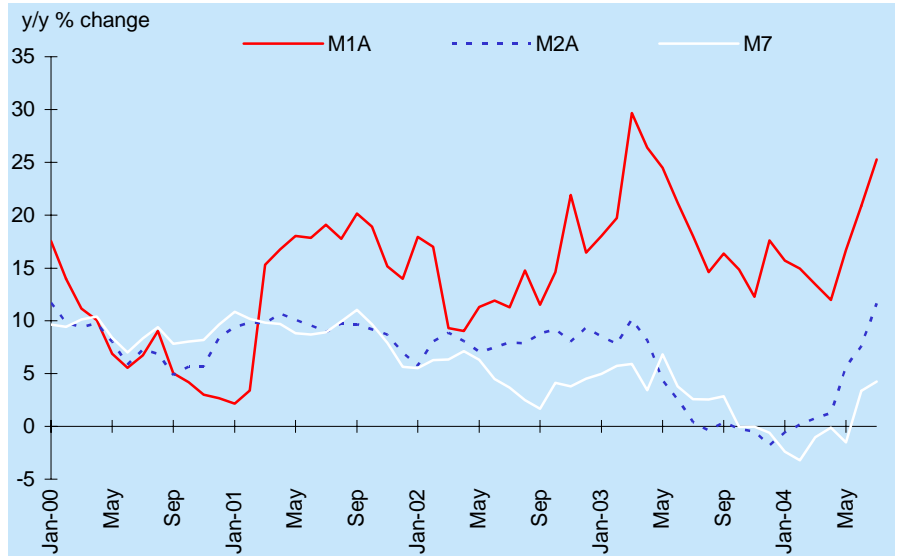


Sources: Banco Central de Chile, <http://www.bcentral.cl>; D&B

Money Supply

Interest rates have generally been adjusted in response to GDP trends, while money supply has acted passively (although some credit limits are used). The central bank sets an offer rate, which is effectively the target for the daily inter-bank rate, in real terms (as a premium over the Unidad de Fomento, an inflation index).

Chart 7
Money Supply

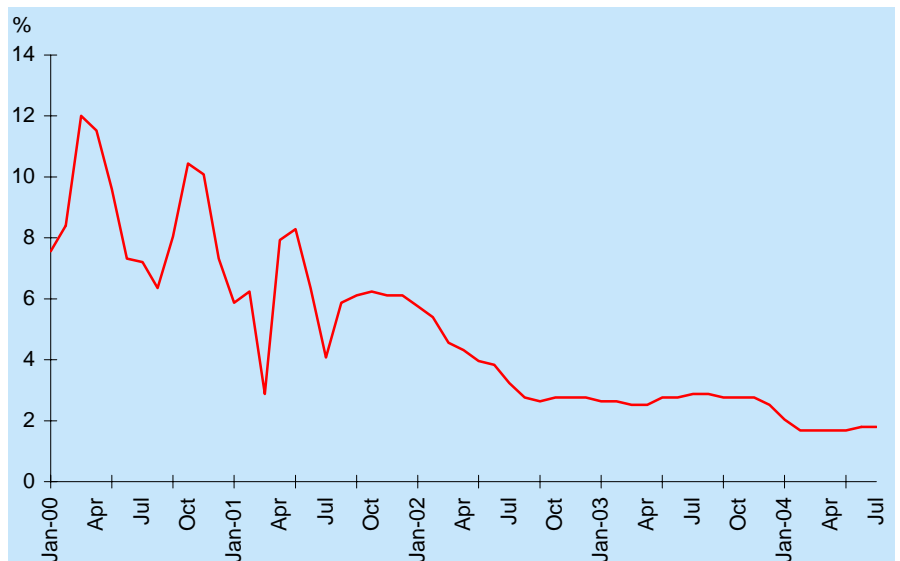


Source: Banco Central de Chile, *Boletin Mensual*, <http://www.bcentral.cl>

Interest Rates

We believe that the authorities’ monetary stimulus has helped to push up private consumption, despite the high level of unemployment and static real wage increases. With external demand improving prospects in the trade sector, we believe that real GDP growth over the two-year forecast period will lift consumer prices back into the central bank’s target range. Given the high jobless rate (important because of the proximity of presidential and congressional elections in December 2005) and remaining excess capacity, interest rates rises from late 2004 onwards will be moderate. However, a consistent tightening of monetary policy from early 2005 onwards will be necessary to keep inflation within the 2-4% target band and to avoid large readjustments later.

Chart 8
Interest Rates



Source: International Monetary Fund, *International Financial Statistics*

Short-Term Growth Forecast

We believe that real GDP will grow by 4.9% in 2004 followed by growth of 4.2% in 2005. In both years, growth will be led by resurgent private consumption and investment; both of these components will benefit from the propitious external environment, namely high international copper prices and an upturn in demand for Chilean goods from major markets like the US, the EU and Asia. As of July 2004 Chile's cumulative trade surplus had reached US\$5.6 billion, 184% more than in the same period of 2003 (and 86% more than the US\$3.0 billion surplus registered in 2003). The 2004 trade surplus will easily exceed the US\$7.0 billion targeted by the central bank, ensuring that net exports contribute positively to overall GDP growth. The trade sector is the traditional driver of Chilean economic growth. The Chilean economy expanded by 4.8% year on year in the first six months of 2004 (the highest figure recorded since the first quarter of 2000).

Reflecting improved economic conditions, imports increased by 18.4% year on year in the first half of 2004. This indicates an increase in consumer demand for imports as well as demand for investment goods for domestic industry. Another sign of improving investment is the growth in commercial loans (probably around 10% in 2004). Loans for foreign trade increased by 15.3% year on year in the first half of 2004.

Despite bullish economic growth, we believe that inflation and interest rates movements will be small. As such, we foresee an interest rate rise in the final quarter of 2004 given that inflation is rising back towards the central bank's target band of 2-4%. It is important that the monetary authorities ensure a gradual normalisation of monetary policy from present historic lows, thereby capping inflationary pressures without stifling consumer demand and investment. We expect interest rates to end 2004 at 2.00% and 2005 at 2.75%.

Table 4

Short-Term Economic Forecasts

<i>Forecast</i>	<i>2004f</i>	<i>2005f</i>
<i>Real growth rate (%):</i>		
Private consumption	4.2	4.4
Gross fixed capital formation	5.6	4.1
Government consumption	1.3	1.5
Exports	16.8	8.6
Imports	14.9	9.1
Real GDP	4.9	4.2
<i>Contribution to real GDP growth (percentage point):</i>		
Private consumption	2.6	2.8
Gross fixed capital formation	1.2	0.9
Change in inventories	-0.3	0.2
Government consumption	0.2	0.2
Net exports	1.2	0.2
Inflation, annual average (%)	2.5	3.2
Interest rate (lending, domestic currency, %)	2.00	2.75

Source: D&B

Meanwhile, government revenues remain relatively sound. The significant hike in copper prices (to around US\$1.30 per pound in August 2004) will see large contributions to the Copper Stabilisation Fund; the gain is likely to fund the repayment of US-dollar denominated debt. Government spending on poverty reduction has so far been well targeted and should continue to slowly reduce the proportion of Chileans that live in poverty. However, spending needs to be prioritised in the healthcare and education sectors; moreover, Chile still suffers a 20% poverty rate and a highly skewed level of income distribution that will hinder long-term economic development.

The high level of structural unemployment is also a concern. Despite economic growth, joblessness has not fallen significantly and will average around 8.5% in 2004. Structural defects remain in the Chilean labour market; these must be addressed over the short to medium term to improve economic efficiency and growth prospects.

Long-Term Economic Potential

Chilean growth has generally been impressive, with healthy economic returns during the past two decades, and the country is now the most developed in the region. Growth has been stimulated by numerous factors, including sound macroeconomic management and structural reforms initiated by the Pinochet regime. The rapid growth of the world economy (driven by the US) allowed Chile to benefit from fast export growth during the 1990s.

Trade liberalisation, privatisation and social security reforms date back to the 1970s and early 1980s. These reforms have helped to promote private initiative, with the public sector playing a relatively small role. On the downside, the economy remains vulnerable to structural imbalances, especially its exposure to developments in commodities markets. Moreover, gains from development have not been evenly distributed and around 20% of the population lives in poverty.

Chile's relatively long history of structural reform has helped to create a modern industrial base and infrastructure. The country has a well developed and dynamic services sector and a flexible, albeit small, manufacturing sector, dominated by processed primary goods, particularly, food and drink products, cellulose, paper products and chemicals. Efforts to diversify the economy have yielded mixed results and Chile continues to rely on the primary sector, notably agriculture, forestry, fisheries, and mining and quarrying. Consequently, the economy is vulnerable to changes in commodity prices and demand for goods. This exposure can have additional effects on the economy given the importance of the primary sector as a source of employment and its significant linkages with the rest of the economy, including the processing industries.

Primary sector crops include traditional wheat, oats, maize, potatoes, sugar beet and rice, as well as new market garden vegetable crops. Since the early 1970s, Chile has been a major exporter of a wide range of fruit, taking advantage of the country's diverse topography (for example, the grape season is unusually long, spanning from November to April). A well-developed agro-processing industry has also added value to the production of these agricultural goods. Nevertheless, some restructuring will be necessary in the medium term, particularly as world agricultural trade flows rise. The amalgamation of small producers will allow exploitation of economies of scale and productivity gains.

Chile has the world's largest known copper deposits and is regarded as the most efficient producer. Copper production was boosted in the 1990s by the opening of new facilities, including La Escondida, the world's third largest copper mine. However, the volatility of copper prices has often undermined the fiscal and external accounts. In the past 30 years, the price of copper has fluctuated between US\$0.24 and US\$1.60 per pound, often doubling and halving over two- or three-year periods, with severe consequences for macroeconomic stability. With global economic

growth expected to be relatively sound over the two-year forecast period, we believe that prices will remain positive for Chilean producers. We expect the government to impose a royalty tax on mining companies (see **Political Risk**) over the next couple of years. This may stem foreign investment initially, although we expect flows will soon resume given Chile's vast reserves and developed mining infrastructure.

Population

Chile's population was 15.2 million in 2000. Average annual population growth was stable at 1.25% from 1990 to 2000, unchanged from the previous two decades. The population is also relatively young. In 1995, 29.5% of the population was under 14 (although this is below the regional average of 33.8%). The United Nations (UN) expects population growth to slow to 0.7% in 2020-25. This trend is predicated on a fall in the crude birth and reproduction rate given increased participation of women in the labour market and improving healthcare provision (which will also engender a fall in the infant mortality rate).

Slower population growth will lead to a reduction in the dependency ratio in the first decade of the 21st century. According to the UN, the ratio will fall to a low of 0.55 in 2010. This favourable demographic trend will reduce the burden on scarce fiscal resources such as housing, education and healthcare. However, the increase in the workforce will put greater pressure on job creation, necessitating greater efforts to reduce structural unemployment and initiatives to improve labour market flexibility. After 2010, a rise in the number of people over 65 (as well as improved basic health) will raise the dependency ratio once again.

The quality of human capital is relatively high, reflecting the country's good level of economic development and the government's continued emphasis on improving social provision. The UN Human Development Index places Chile in the 'high human development' category. Increased public spending on healthcare provision, rising incomes, and improved diet and sanitation have extended life expectancy to the level of many developed countries. Education has also been a policy priority, reflected in a sustained rise in education spending over the past decade. Consequently, enrolment rates are high, particularly at the primary and secondary levels, and the literacy rate is 95.2%. However, large disparities in the distribution of education across different income groups persist, with poorer children in some regions having reduced access to education.

Technological Progress

Chile's relatively long history of trade liberalisation, deregulation and privatisation has helped to modernise the economy and promote competitive pressures. Privatisation has encouraged restructuring and investment in new, more efficient, (mainly imported) technologies, as well as introducing progressive managerial and organisational practices. This has produced a modern economic infrastructure and an efficient primary sector, albeit one exposed to weather patterns.

Investment

The domestic savings rate is relatively high by regional standards. This is partly due to entrenched macroeconomic stability since the 1982 recession, most notably low inflation, rising incomes, successive budget surpluses and a strong banking system. Significantly, Chile's high savings rate is often considered a consequence of pension reforms introduced in 1980, which implemented a private pension system. However, recent assessments have dampened enthusiasm for the reforms, particularly given a decline in the savings rate in the mid-1990s. Nevertheless, the pensions reforms have contributed to a deepening of the financial markets, as well as reducing potential fiscal liabilities in the long term (in the medium term, the government must pay out the contributions made under the old state system) and raising a general awareness of the need to save.

Demographic shifts will result in a rise in savings over the next five years, although as the dependency ratio increases, domestic savings will come under pressure. Moreover, Chile's usually high domestic investment rate is not fully financed by domestic savings. Hence, domestic investment financing needs are met using foreign capital, underpinning previous current account deficits and likely to underpin those deficits going forward (see **External Economic Risk**).

Long-Term Economic Outlook

D&B expects Chile's annual real GDP growth to average 4-5% over the coming ten years. Macroeconomic stability and a strong spirit of free enterprise and competition will help to underpin growth. Like many Latin American nations, Chilean demographic trends will be favourable in the early part of the 21st century. However, the window of opportunity created by a decline in the dependency ratio (which will have a positive effect on savings) is relatively small. The government must continue to push savings vehicles, such as private pensions, and make regulatory changes that allow private pension funds more freedom in financial markets.

Moreover, additional investment in skills and vocational training will be necessary to ensure further productivity gains. The public education system remains in need of modernisation and a large body of structural unemployment must be reduced before the working population begins to rise. Finally, although successive governments have been successful in diversifying the Chilean economy, copper still accounts for a significant proportion of GDP, and as such, represents a degree of risk to Chile's relatively stable economy.

External Economic Risk

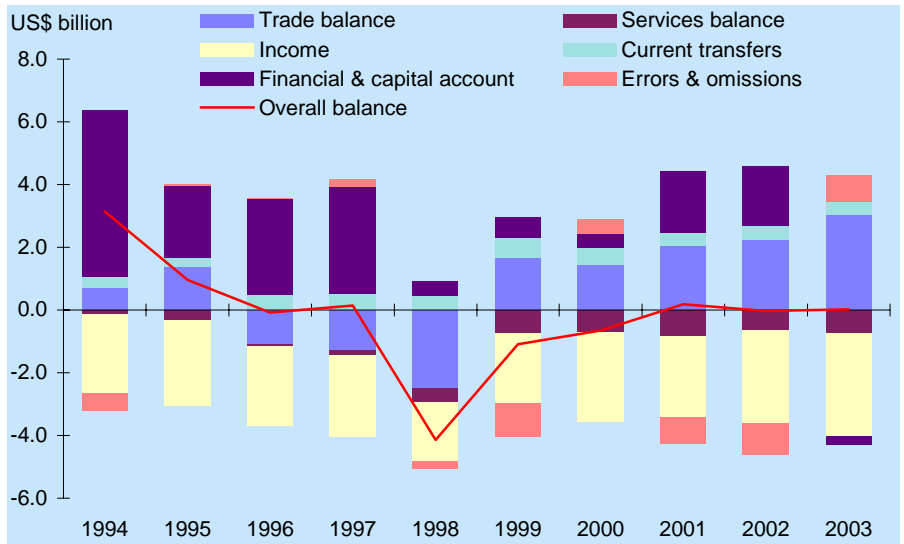
Key Point: The trade sector will be a significant driver of Chilean GDP growth over the two-year forecast period. We expect the trade surplus to support a current account surplus in 2004 and 2005. The floating exchange rate benefits the economy and allows it to adjust smoothly to external shocks.

Balance of Payments Performance

Chile's external accounts are among the most stable in Latin America and the trade sector is traditionally the driver of Chilean economic growth. Manageable current account deficits have generally been financed by sizeable surpluses on the financial and capital account (a result of healthy foreign direct investment flows), leading to frequent balance of payments surpluses.

Chart 9

Balance of Payments



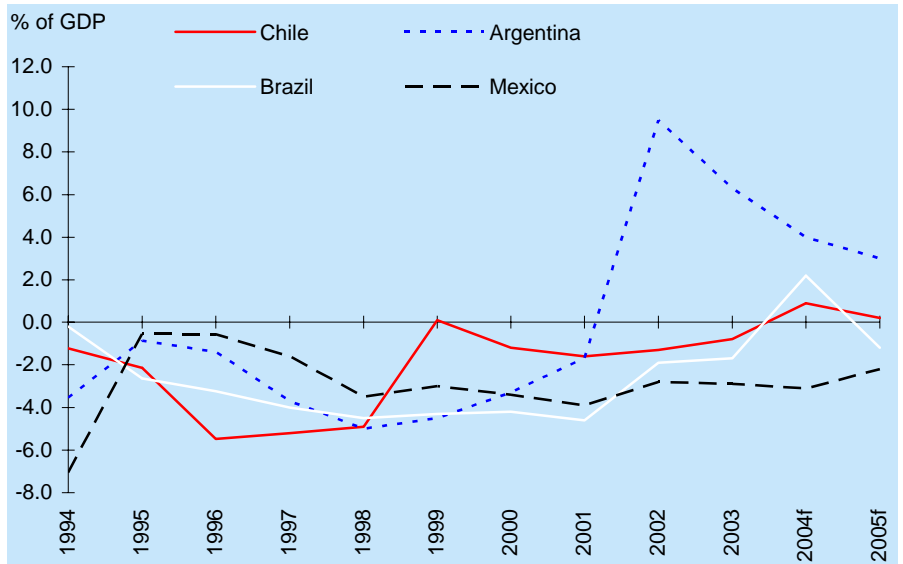
Source: Central Bank of Chile <http://www.bcentral.cl>

We believe that the balance of payments will remain manageable over the two-year forecast period, with high international copper prices offsetting the increase in import costs caused by rising domestic demand and bullish oil prices. Foreign investment should recover over the short to medium term, especially as copper prices are high and economic fundamentals are sound. Profit remittance, especially from the mining industry, will continue to see money leave on the income account. A proposed royalty tax on mining companies (see **Political Risk**) may have a negative effect on investment in 2004 and into 2005.

Current Account

Chile has registered a trade surplus in every year since 1999 (averaging US\$1.1 billion annually) and will do so again over the two-year forecast period. The trade sector is the traditional engine of Chilean economic growth. Exports are dominated by the copper sector. However, the trade surplus is often offset by sizeable deficits on the income and services balances, reflecting the repatriation of payments and profits on investment (mainly from companies in the mining industry) and, over the last few years at least, a decline in tourist visits.

Chart 10
Current Account Balance



Sources: Central Bank of Chile, <http://www.bcentral.cl>; Central Bank of Brazil <http://www.bcb.gov.br>; Central Bank of Mexico, <http://www.banamex.com>; D&B

As such, in 2001 the current account deficit equalled US\$1.1 billion (1.6% of GDP), falling slightly in 2002 to US\$885 million (1.3%) as the trade balance improved. In 2003, the current account deficit fell further to US\$594 million (0.8%); an improvement in the trade balance again helped to offset expanding services and income deficits. We believe that the trade surplus will grow significantly in 2004 and into 2005, dwarfing income and service outflows and contributing to a forecast current account surplus of 0.9% of GDP in 2004 and 0.2% in 2005.

Trade Balance

The trade balance has been in surplus since 1999; the average value of imports over 1999-2003 has been US\$17.5 billion, while the average value of exports has been US\$16.4 billion. Trade figures improved markedly in 2003 when exports equalled US\$19.9 billion owing to a sharp uplift in copper exports (the annual value of which rose by 19.1%). As is often the case in Chile, during years of robust economic growth, import demand increases as domestic consumer demand rises and business demands for investment goods and intermediate inputs expands. Nevertheless, the trade surplus was US\$2 billion in 2003.

Chilean authorities have forecast a trade surplus of US\$7 billion in 2004, while we believe this will be exceeded given robust international demand for Chile’s primary exports and healthy international copper prices. Import values will increase in 2004 and 2005, especially as oil prices remain bullish; however, import growth rates will be dwarfed by export growth.

Export Profile

Chile’s export profile is more varied than that of many of its regional counterparts both in terms of export products and the geographical distribution of trade. Export diversification has seen forestry and fishing exports increase in importance; several non-traditional exports have also grown strongly in the past decade, with notable examples including the fresh fruit and wine industries and the industrial sector (mainly food and drink, processed fishmeal and forestry products). However, copper remains the single most important source of foreign sales, accounting for around 40% of total export revenues in most years.

Table 5

Principal Exports

<i>US\$ billion</i>	1997	1998	1999	2000	2001	2002	2003
Minerals	7.5	6.1	6.8	8	7.3	7.1	8.5
<i>Of which: copper</i>	6.6	5.2	6.0	7.3	6.5	6.3	7.5
Agriculture, forestry & fishing	1.7	1.7	1.7	1.7	1.7	1.8	2.0
Industrial	6.8	6.7	7.2	8.0	8.0	8.2	9.4

Source: Banco Central de Chile, *Boletín Mensual*

Traditionally, Chile's trading relations have been broad enough to offset adverse weather or economic conditions in any given location that might otherwise undermine Chile's overall economic performance. Successive Chilean governments have signed bilateral and multilateral free-trade agreements that have expanded Chilean market access and reduced the cost of doing trade with Chile. Chile now has duty-free access to over 50% of the global marketplace. This figure will only increase as the Free-Trade Area of the Americas (FTAA) comes into operation over the short to medium term. In addition, in August 2004, Chile and China began feasibility studies for a free-trade deal. Annual trade between the two countries is worth US\$3 billion.

Table 6

Exports by Destination

<i>US\$ million</i>	1999	2000	2001	2002
Latin America	3,295	3,953	3,974	3,519
US	3,133	3,247	3,408	3,484
Asia	2,194	2,817	2,474	2,964
Japan	2,199	2,556	2,131	1,928
Middle East	152	305	207	255
Other industrialised countries	9,567	10,378	5,121	4,705
Other	116	227	291	332
Total	11,089	13,105	17,607	17,714

Sources: Banco Central de Chile, *Boletín Mensual*; International Monetary Fund, *Direction of Trade Statistics*

Import Profile

During economic expansions, Chile imports growing levels of consumer, intermediate and capital goods to meet expanding domestic consumer and industrial demand. Capital goods import growth tends to be driven by substantial investment in infrastructure, often associated with mining and, in previous years, privatisation. In 2003, when real GDP grew by 3.3%, imports increased by US\$1.9 billion to around US\$17.9 billion. The most significant growth rate was recorded in intermediate goods. This reflected higher international oil prices (Chile is a net oil importer) and also expanded domestic economic production.

Table 7

Principal Imports

<i>US\$ billion</i>	1997	1998	1999	2000	2001	2002	2003
Capital goods	5.2	4.8	3.1	3.4	3.6	3.5	3.7
Consumer goods	3.4	3.1	2.6	3.1	2.9	2.9	3.2
Intermediate goods	10.1	9.6	8.8	10.5	10.0	9.6	11.0
Total	18.7	17.5	14.5	17.0	16.5	16.0	17.9

Source: Banco Central de Chile, *Boletín Mensual*

We believe that import costs will continue to rise over the two-year forecast period as domestic production and consumer demand strengthen and oil prices remain bullish. Indeed, import costs were up by around 18% year on year in the first half of

2004. However, the rise was dwarfed by the increase in export receipts; as such, the large rate of import growth does not form any risk to the external accounts.

Table 8

Imports by Source

US\$ million	1999	2000	2001	2002
Latin America	4,447	6,020	6,064	6,094
Of which: Argentina	2,024	2,877	3,064	3,016
Asia	1,694	2,152	1,848	2,262
US	3,167	3,339	2,889	2,162
Japan	643	710	1,053	948
Middle East	75	87	82	52
Other industrialised countries	6,675	6,948	3,484	3,582
Other	373	676	1,761	1,853
Total	13,982	16,680	17,181	17,288

Source: International Monetary Fund, *Direction of Trade Statistics*

Chilean import suppliers are geographically varied. Reflecting Chile's participation in the region's largest trade bloc (Mercosur), imports are primarily sourced from Latin America. The US is also a major seller, a trend cemented by a bilateral trade deal that came into effect in January 2004. Asia was the second largest source of imports and reflects sales of copper and import of components for the maquila.

Financial and Capital Account

Healthy net foreign direct investment (FDI) and portfolio inflows sustained a surplus on Chile's financial account in the 1990s, securing balance of payments sustainability. However, with increasing economic stability, Chilean investment overseas has increased considerably with the Chilean private sector investing in Argentina, Brazil and in the US. Moreover, Chilean pension funds were encouraged to invest abroad as limits to their foreign interests were eased.

A sizeable surplus on the financial and capital account was recorded in 2000. Although net FDI was negative (with Chilean direct investment abroad reaching US\$4.8 billion), net portfolio flows were more than twice the FDI deficit. This was due to global investor sentiment that favoured Chile's equity markets over other markets in the region. Significantly, net flows of other capital were also positive. In April 2001, Chile's central bank lifted the last remaining controls on international capital flows. Authorisation was no longer needed for capital outflows related to capital gains, dividends and other benefits, and the reserve requirement obliging investors to deposit a portion of their investment with the central bank for up to one year was eliminated. Although more funds left Chile, encouraged by the legislative changes, FDI recovered, and a sovereign bond sale boosted net portfolio flows.

Table 9

Financial and Capital Account¹

US\$ billion	1998	1999	2000	2001	2002	2003
Foreign direct investment	3.1	6.2	0.9	2.6	1.6	1.6
Portfolio flows	-2.5	-3.2	0.6	0.1	-2.1	-3.6
Other short term flows	1.4	-2.7	-0.7	-1.3	2.7	1.3
Other capital	2.1	0.7	-0.3	0.5	-0.3	0.5
Financial & capital account	4.2	1.0	0.5	2.0	1.9	-0.3

Note: ¹Data are for net flows.

Source: Banco Central de Chile, *Boletín Mensual*

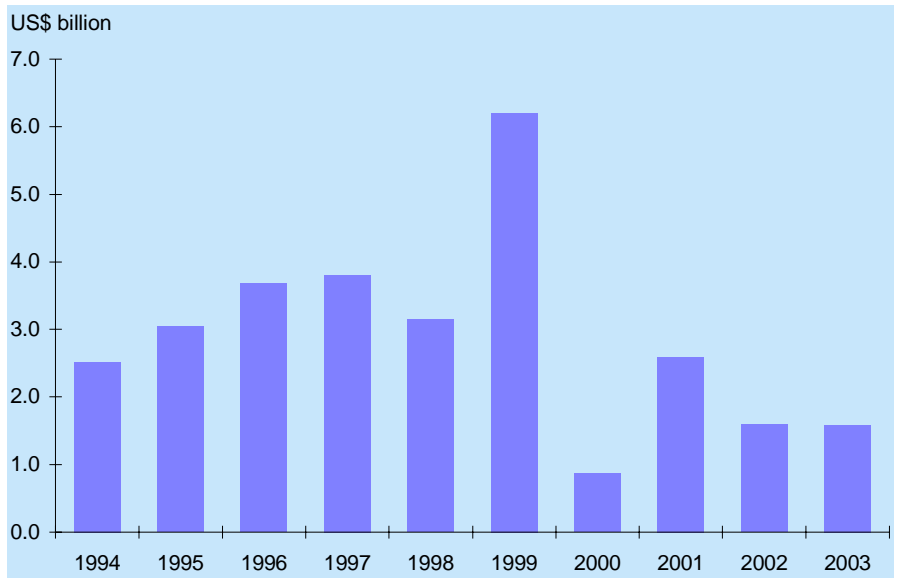
We believe that the financial and capital account will return deficits over the two-year forecast period, although these shortfalls will be easily manageable. We expect investment flows from Chilean firms to increase, especially towards other Mercosur

economies. Furthermore, given the rapid growth of the Chilean trade sector through the early part of 2004, short-term capital outflows, mainly in the form of trade credits to the US, will negatively affect the financial account. Foreign investment flows are likely to strengthen, although the rise may be stymied by the government’s proposed royalty tax on mining companies and elections in December 2005 (see **Political Risk**).

Foreign Direct Investment Flows

Net inflows of FDI accelerated sharply in the mid-1990s, rising to US\$6.2 billion in 1999. Most of this fixed investment was in the utilities and service sectors and came from Spanish and US investors. Since 1999 net FDI has moderated, averaging US\$1.7 billion annually. Some of the main beneficiaries have been the transport and telecommunications sectors, while the major sources of FDI are Italy, Spain and the US. Chile remains an attractive FDI location given sound economic fundamentals, a stable regulatory environment and minimal trade tariffs.

Chart 11
Foreign Direct Investment Inflows



Source: Banco Central de Chile, *Boletín Mensual*

That said, Chile is an emerging market and does suffer from crises of confidence when global economic growth slows or, as in recent months, when politicians threaten to alter the operating environment (e.g. by introducing a royalty tax). Furthermore, Chilean businesses are also active in investments abroad, mainly to other Mercosur economies and the US. As such, FDI outflows can often outweigh inflows. Over the two-year forecast period, we believe that investment in Chile will strengthen only slightly as concern over 2005 presidential and congressional elections (which engenders policy uncertainty) will limit total inflows.

Equities

Following the sharp increase in credit risk during 1998-99, a result of the deteriorating global trading environment, conditions began to pick up in 2000. Part of this improvement reflected healthier macroeconomic conditions. However, legislative changes also encouraged credit growth. Where local businesses used to be restricted to American Depositary Receipts (ADR) listings in the US, new legislation gave them more freedom in the way they financed themselves. This reduced borrowing costs, as companies were permitted to raise equity in international markets. The main beneficiaries of this change were second-tier companies, which lacked the capital base to list in New York, internet start-ups and small groups

aspiring to public offerings on the NASDAQ. Larger foreign-owned companies are now free to raise equity in their home markets.

D&B believes that economic conditions in Chile are very healthy. This will buoy domestic investment (and many Chilean companies will access money through the stock market) and buttress overseas investor confidence in the Chilean market. Indeed, the General Stock Price Index (IGPA) index has risen, virtually uninterrupted, since January 2003, reaching 7,949 points as of mid-2004. The rise reflects the upturn in international copper prices, robust domestic economic output and a strengthening of the peso.

On the down side, we expect Chilean and US interest rates to increase over the next year, perhaps tempering the slight upward increase in the IGPA. Finally, with presidential and congressional elections in December 2005, investors may decide to protect investments and withdraw from the market. Furthermore, like all emerging markets, Chile's securities market is often vulnerable to deteriorating overseas sentiment that does not represent the true prospects for profit-making in Chile. As such, a downturn in the IGPA index can be the result of economic meltdown in Argentina or political instability in Brazil (as has often been the case recently).

On balance, D&B believes that equity market performance will remain positive over 2004, levelling off in the second half of 2005; however, we do not consider there to be any significant risks attached to the equity market.

Debt

During the last ten years, US\$2.1 billion has been collected by the local sector through capital increases and bond floats. This reflects the increasing use of both the equity market and also debt creation as a means of funding investment. In emerging market terms, Chile remains a solid performer (although not as lucrative as Mexico or Brazil). When sentiment turns against emerging markets, Chilean private debt tends to become less attractive; however, given the strength of the sovereign, public debt issues tend to do relatively well even when conditions are not ideal.

We do not believe that there will be any significant public debt offerings over the two-year forecast period given the strength of copper prices (and hence the public purse), however, companies dedicated to mass consumption will undergo a constant process of expansion and are likely to tap the debt market.

Bank Lending

Chile has a sustainable international bank balance compared with other countries in the region. Total bank debt reached US\$21.4 billion at the end of 2003, 3.2% higher than end-2002. Around 49% of all debt is short term, up 3.1% on 2002 and likely to reflect trade credits; 32.2% of all loans have a maturity date over two years. We do not consider bank lending to form a significant risk; we believe that lending will remain moderate over the medium to long term as the Chilean financial sector strengthens and the public sector moves away from bank debt in favour of issuing debt on the domestic and international bond markets.

Table 10

Maturity and Sectoral Distribution of Bank Lending to Chile

<i>US\$ million</i>	1999	2000	2001	2002	2003
<i>Maturities:</i>					
Up to & including one year	8,275	9,584	8,346	10,158	10,470
Over one year & up to two years	3,069	3,007	2,222	1,106	1,481
Over two years	10,587	9,697	8,768	8,802	8,195
Unallocated	433	420	592	719	1,295
Total	22,364	22,708	19,928	20,785	21,441
<i>Sectors:</i>					
Banks	1,972	1,803	2,018	3,095	4,863
Public sector	1,647	1,527	1,315	1,723	2,433
Non-bank private sector	18,728	19,353	16,592	15,964	14,145
Unallocated	17	25	3	3	-
Total	22,364	22,708	19,928	20,785	21,441

Source: Bank for International Settlements, *International Banking and Financial Market Developments*

Foreign Debt and Default Risk

Slow economic growth, low tax collection and low copper prices forced the authorities to issue US\$1 billion worth of debt in January 2003. Nevertheless, Chile's external accounts remain among the most manageable in the region and have picked up as the economy has expanded since the beginning of 2003. The country's debt stock poses no threat to economic stability. The International Monetary Fund (IMF) is generally supportive of the government's debt management strategy, supporting the central bank's initiatives to deepen domestic financial markets by introducing long-term peso-denominated bonds. The IMF has also given support to the central bank's plans to gradually redeem part of its US dollar-indexed debt with foreign exchange reserves.

Table 11

Debt Indicators

<i>US\$ billion</i>	2000	2001	2002	2003	2004f
Public sector	6.0	6.1	7.2	9.3	9.5
<i>Of which:</i> general government	2.5	3.0	3.6	4.6	4.7
monetary authorities	0.1	0.0	0.0	0.0	0.0
banks	0.2	0.1	0.1	0.3	0.2
other sectors	3.2	3.1	3.4	4.4	4.6
Private sector	31.2	32.4	33.5	34.1	34.0
<i>Of which:</i> banks	1.5	2.5	3.7	5.1	5.2
other sectors	29.6	29.9	29.8	29.0	28.9
non-bank financial corporations	0.2	0.1	0.1	0.1	0.1
non-financial corporations (companies)	29.4	29.8	29.7	28.8	28.7
Total	37.2	38.5	40.7	43.4	43.6

Source: Banco Central de Chile, *Boletín Mensual*

Some 78% of external indebtedness is held by the private sector; only an estimated US\$9.5 billion is held by the public sector in 2004. Chilean private companies hold 66% of private debt. A manageable 17.4% of private companies' debt is short term. Auspiciously, healthy economic conditions mean that the credit environment for most private companies will improve over the two-year forecast period (see **Commercial Risk**). Significantly, 81.2% of external debt (US\$35.4 billion) is long term, including 79.2% of privately held debt and 88.3% of public liabilities. Reflecting Chile's relative economic development, 44.2% of debt is owed to banks, while only 2.6% of credit is from multilateral organisations

Foreign Exchange Reserves

Chile's reserve balance has increased steadily over the last few years, ending 2003 at US\$15.9 billion. This level represented 10.7 months of imports, which is below previous totals but representative of minimal risk. Reserves have funded the government's debt management strategy of paying off expensive debt to minimise the ripples emanating from emerging market crises, such as the collapse of the Argentine economy, and as a means of reducing holdings of US dollar-denominated debt. As of June 2004, reserve holdings had stabilised at US\$15.9 billion; we do not associate any risk with Chile's foreign exchange holdings.

Table 12

Foreign Exchange Reserves

	1998	1999	2000	2001	2002	2003
Foreign exchange (US\$ billion)	16.3	14.9	15.1	14.4	15.4	15.9
As months of imports	11.2	12.3	10.7	10.5	11.6	10.7
Foreign exchange/GDP (%)	20.4	19.9	20.1	21.0	22.9	22.1
Foreign exchange/external debt (%)	50.0	42.9	40.6	37.4	37.9	36.6

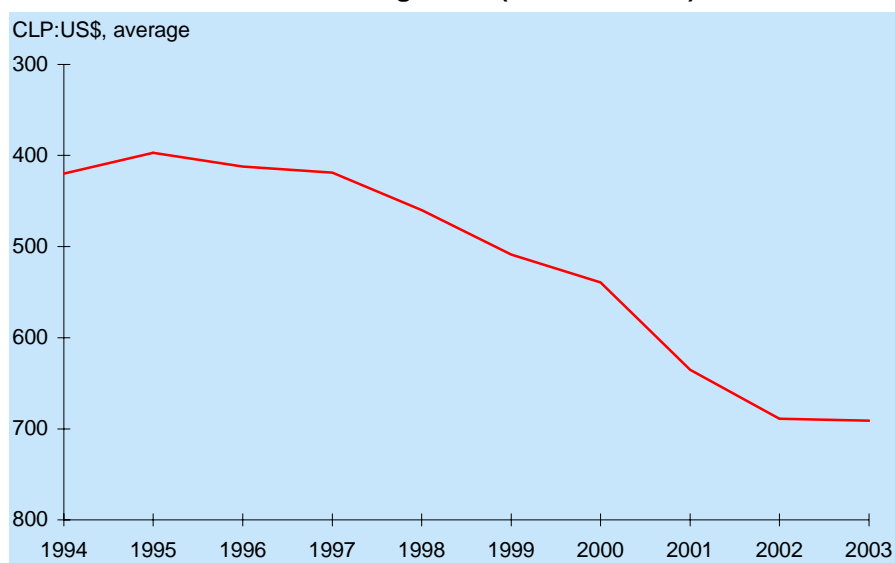
Sources: International Monetary Fund, *International Financial Statistics*; Banco Central de Chile, *Boletín Mensual*

Exchange Rate Risk

After devaluation in 1982, following the abandonment of the fixed peg to the US dollar in 1981, Chile's exchange rate policy was conducted through a crawling peg whereby a central reference rate of the peso was gradually devalued against the US dollar. In 1992, the reference rate was set against a basket of currencies comprising the US dollar, Japanese yen and euro. In an effort to boost exports and make economic policy more flexible, the authorities floated the peso on 2 September 1999.

Chart 12

Chilean Peso:US Dollar Exchange Rate (Inverted Scale)



Source: International Monetary Fund, *International Financial Statistics*

The rate of depreciation of the peso against the US dollar accelerated almost continually for seven quarters from January 2000. The monetary authorities intervened in the market in 2001 and early in 2002, when it was believed that the peso's fall did not reflect the true value of Chilean goods and services vis-à-vis the rest of the world, but rather the deteriorating sentiment towards emerging markets. However, when the peso hit a fresh low of CLP722.65:US\$ in September 2002, the authorities did not intervene, explaining that this value was a true reflection of

Chile's worsening terms of trade. As Chile's terms of trade improved in late 2003 and early 2004, contributing to an appreciation of the peso, which in turn led to downward pressure on domestic prices (see **Monetary Environment**), the central bank once more refused to intervene. Such actions support market confidence in Chile's monetary authorities and in the permanence of the floating exchange rate regime. Over the two-year forecast period, we believe that exchange rate risk is minimal.

External Economic Risk Outlook

D&B is holding a positive stance on the short- to medium-term outlook for Chile's external accounts. On the positive side, Chilean exports have boomed through 2004 owing to export demand from major markets; the signing of bilateral and multilateral free-trade agreements over the last decade gives Chile room to exploit the global recovery. Furthermore, international copper prices have been robust since late 2003, significantly underpinning total export earnings. Meanwhile, the growth in import demand has been dwarfed by the surge in exports. As such, the trade surplus will exceed the central bank's targeted US\$7 billion, underpinning a forecast current account surplus of 0.9% in 2004 and 0.2% in 2005.

In addition, we expect debt accumulation to be minimal over the two-year forecast period. The central bank's debt strategy should also see the reduction in short-term and US dollar-denominated debt (largely owing to healthy foreign exchange holdings). The medium term deepening of domestic (peso-denominated) financial markets should also boost the availability of domestic credit for Chilean companies and reduce risks from adverse exchange rate movements. Finally, the floating exchange rate regime has worked well over the last few years, allowing the economy to adjust smoothly to external shocks. We believe that the floating exchange rate will continue to be employed over the foreseeable future. D&B expects the average exchange rate to stand at CLP630:US\$ in 2004 and at CLP660:US\$ in 2005.

Table 13

External Economic Forecast

<i>% of GDP</i>	<i>2004f</i>	<i>2005f</i>
Current account balance	0.9	0.2
Financial & capital account balance	-0.4	-0.3
Overall balance of payments	0.5	-0.1
Import cover (months)	10.4	11.0

Source: D&B

On the negative side, the economy is heavily dependent on copper exports. The price of copper is highly vulnerable to demand and so forms a moderate risk element. Elsewhere, presidential and congressional elections in 2005 and the possibility of a royalty tax (some companies have suggested that the imposition of the tax would question the government's commitment to business and investment) may stymie FDI inflows. The boost in trade (and thus trade credits) will also weigh heavily on the financial account. Other than these small concerns, external account risks remain moderate and manageable over the two-year forecast period.

Trade Environment

Key Point: The Chilean government is committed to a liberal trade regime. Free-trade agreements with the most major markets, including the US, have all been signed in recent years. Real tariffs on products imported into Chile fell to a record low of 1.5% in July 2004.

Trade Overview

Chile has an open trade regime having liberalised its trade in the 1970s. Since then, governments have actively sought to promote trade ties; as such, the dynamic growth of Chile's economy since 1990 has largely been export-led. Trade deals have mainly been on a bilateral basis, but also through associate membership of Mercosur and ultimately as part of the Free-Trade Area of the Americas (FTAA) initiative. The favourable trading environment means that Chile is the most open economy in South America. Indeed, real tariffs on products imported into Chile fell to a record low of 1.5% in July 2004. We expect Chile to sign and to begin negotiations on further free-trade deals over the two-year forecast period (most notably with China).

Relations with the EU

In August 2000, Chile began talks with EU trade officials aimed at reaching a free-trade agreement (FTA) by the close of 2002. Chilean officials placed a high priority on talks with the EU, as Europe is currently Chile's second largest export market (ahead of Mercosur). An agreement was initialled in June 2002, and came into effect from January 2003. The deal appears to have resolved the issue of agricultural trade (which has consistently caused EU-Mercosur free-trade talks to stall), and EU companies will now be able to form joint ventures with Chilean companies. Their output will enjoy barrier-free entry into both markets.

Relations with Europe (Non-EU)

Chile signed a free-trade pact with the European Free-Trade Association (EFTA), which includes Norway, Switzerland, Iceland and Liechtenstein, in June 2003, giving around 90% of Chilean exports to the EFTA immediate free access.

Relations with the US

The government began talks with the US in December 2000 regarding entry to the North American Free-Trade Area (NAFTA) for Chilean exports. Early expectations were for talks to conclude by the close of 2001. However, negotiations were postponed and then suspended in June 2002. Free-trade negotiations resumed in early 2003, and in July the US Congress voted to accept Chile as a free trade partner from January 2004. Under the deal, more than 85% of bilateral trade in consumer and industrial productions become tariff free immediately, with most remaining tariffs eliminated within four years. Since the bilateral deal came into effect, real tariffs on US imports have slipped from 2.0% to 1.3%. The agreement requires that each country enforce its own labour standards. The deal also reintroduces the US generalised system of preferences (GSP), which expired in September 2001, and which gives favourable tariff treatment to 16% of Chile's total exports to the US. The main export benefits are methanol, wood, refined copper and vegetable seeds.

Mercosur

Chile became an associate member of Mercosur in 1995. Argentina, Brazil, Paraguay and Uruguay are full members, while Bolivia and Peru are the other associate members. In 2001, President Ricardo Lagos Escobar announced that Chile would apply for full membership; however, this is unlikely to be achieved over the

two-year forecast period as there remain a number of fundamental differences between Chile and the Mercosur economies. In economic terms, Chile has already reached free-trade deals with the EU and the US, reducing the need for Chile to increase its bargaining strength by joining Mercosur. Furthermore, Mercosur's tariff levels are much higher than those of Chile. In political terms, Chilean politicians have embraced free trade whereas those in Brazil and Argentina (in particular) are more indifferent. It would be impossible for Chile to join Mercosur without undermining its free-trade philosophy.

Free-Trade Area of the Americas: Although the Chilean government has shown enthusiasm for the project, Lagos confirmed in 2004 that Chile would be unlikely to sign up to the FTAA if other Mercosur economies do not also join. The FTAA is supposed to come into effect in 2005 but may take longer as many countries are procrastinating, including Argentina, Brazil and Venezuela. The FTAA will come into effect in the short term but will not be a workable and practical trade bloc until well into the medium term.

Mercosur-Andean Pact: In August 2004, Mercosur and the Andean Pact countries (Bolivia, Colombia, Ecuador, Peru and Venezuela) agreed a free-trade deal to be implemented over the following year. Integration will occur at different speeds depending on each country's economic development. There will also be a Structural Fund with US\$100 million to provide support for the weakest Mercosur economies. A 0.1% levy on all Mercosur internal and external transactions will help to finance the fund.

Argentina: In April 2003, Chile and Argentina began to set terms for the negotiation of a free-trade agreement. The deal is expected to allow Argentina to export an additional US\$500 million worth of goods and make investments by Chilean businesses in Argentina more flexible.

Bolivia: Chilean and Bolivian representatives have resumed negotiations and were expected to conclude a deal by the close of 2003. However, a conclusion has not yet been reached. Initially, the deal will cover 7,000 items. One of the pending questions is Bolivia's sugar export quota to Chile.

Relations with Mexico

In November 2004, Lagos will meet with President Vicente Fox of Mexico to evaluate the feasibility of enlarging the free-trade agreement that has bound the two countries since 1999 into a wider association agreement encompassing economic, political and co-operation matters. The deal would also co-ordinate Chilean and Mexican entry into the Asian market.

Relations with Asia

South Korea: Chile is developing relations with economies in the Far East. Chile became a member of the Asia Pacific Economic Co-operation (APEC) forum in 1994 and the Chilean authorities recently negotiated a free-trade agreement with South Korea. It was the first such agreement between an Asian and Latin American economy. South Korea hopes to use the agreement as a springboard to increase investment and trade within the region as a whole (Chile currently runs a trade surplus with South Korea).

Chile and China plan to start talks over a free-trade agreement during the APEC summit, which takes place in November 2004. Chile is also holding preliminary free-trade deal talks with India and Japan.

Current Account Exchange Regulations

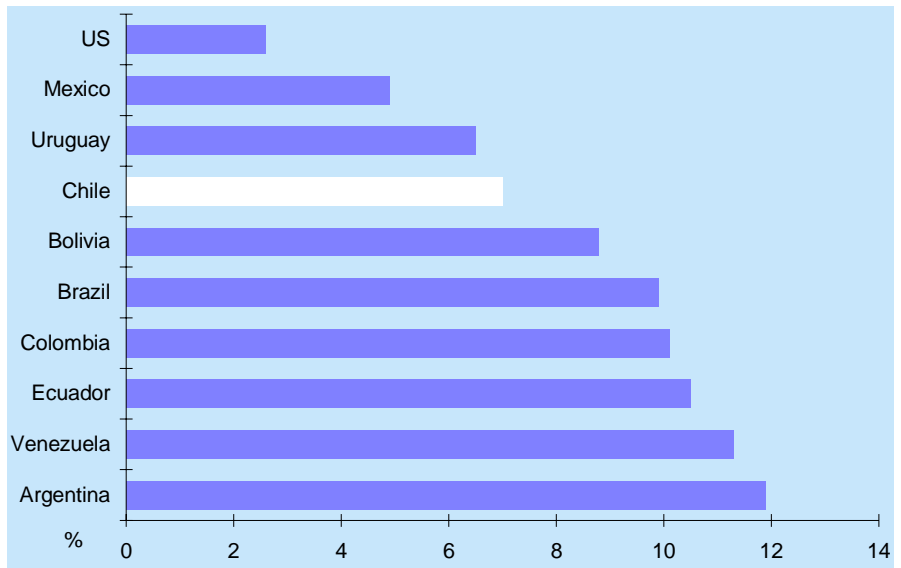
The central bank is responsible for implementing exchange control policy. Since 1 March 2001, import declarations issued by the National Customs Service have been required to purchase foreign exchange in the formal exchange market. The requirement for a central bank-issued import report was eliminated from 28 February 2001.

Tariff Barriers

The previous government was committed to reducing tariff barriers and enacted an across-the-board cut in tariffs to 10% in 1999. The current administration maintained this stance dropping the tariff by a percentage point per year, to 6% in 2003. However, there are some exceptions: used goods have a tariff of 16.5% (second-hand cars are not permitted), while computer goods enter duty-free.

While general import tariffs are 6%, there are many discounts due to bilateral free-trade agreements with many countries or by special discounts on specific imports, such as computer-related goods. As a result of the free-trade agreement between Chile and South Korea that became effective in April 2003, duties on imports from South Korea dropped 4.5 percentage points to 1.6%, fuelling a general tariff decrease. Since the bilateral agreement between Chile and the US came into effect in January 2004, real tariffs on US imports have fallen from 2.0% to 1.3%. Real tariffs on all products imported into Chile fell to a record low of 1.5% in July 2004.

Chart 13
Weighted Mean Tariffs for All Products, 2002¹



Note: ¹Data for Bolivia and Uruguay are for 2001; data for Venezuela are for 2000.
 Source: World Bank, *World Development Indicators*

The maximum tariff on most goods is 25%. Flour, vegetable oil and wheat have a tariff set at 31.5% in accordance with World Trade Organisation (WTO) requirements, and the tariff on sugar imports was raised to 98% in July 2002 (a move backed by the WTO). Nonetheless, tariffs are sometimes subject to change; for example, tariffs on wheat were increased to protect domestic industry from falling international prices. The government imposes minimum customs valuations on agricultural imports for the same reason.

A few items are exempted from the present tariff regime. Exemptions include tariffs negotiated with Latin American Integration Association (LAIA) countries and under a number of bilateral trade agreements.

Non-Tariff Barriers

All imports require a licence, largely as a means of registering imports. Although these are granted as routine for most goods; pharmaceuticals and weapons are subject to tighter licensing requirements. A registration certificate is also needed for goods over US\$3,000. The import of used passenger and cargo transportation is prohibited. Exceptions are ambulances, armoured cars, public road cleaning vehicles and cement-making vehicles. These goods pay 11% import duty plus value-added tax.

Non-tariff barriers are also present in the form of strict animal and phytosanitary requirements, often designed to protect domestic food-producing industries. Nevertheless, numerous controls on agricultural goods (including wheat and various fruits) have been lifted. Similar licensing, registration, phytosanitary and quality controls are imposed on exports.

Documentation

Bill of Lading: Original plus two copies usually required. Should show gross weight of each item, made out to order. 'To order' bills of lading are legally recognised in Chile.

Certificate of Origin: Not needed unless specifically required.

Commercial Invoice: The invoice should be prepared in a minimum of four copies. Those covering automobiles should be the invoices of the manufacturer or an authorised dealer. The commercial invoice should contain a detailed and specific description of the goods, giving the net, legal and gross weights, the free on board (f.o.b.) value of the merchandise, unit price of each item, date of insurance covering shipment (if applicable) and other usual particulars of such documents. Notarisation or Chamber of Commerce certification is not required, but a sworn statement of declaration of origin, in English or Spanish, in a prescribed text is required.

Consular Fee: Since fees are payable at destination, all original documents should be sent to the importer. Fees are collected on commercial invoices, bills of lading or air waybills.

Import Licence: Imports valued over US\$3,000 must be covered by a registration certificate (*informe de importacion*) issued by the central bank.

Insurance Certificate: This should follow the importer's instructions.

Marking of Goods: Country of origin must be shown in most cases. The importer's name should also be shown on canned foods and consumer goods.

Packing Lists: This should be issued in accordance with the importer's request.

Samples: Samples of negligible value are subject to special duty.

US Shipper's Export Declaration: Required if the value is more than US\$2,500.

Commercial Risk

Key Point: Low interest rates and healthy prospects for the export-oriented industries (based on a global recovery) should improve commercial risk. We expect that payments performance will improve owing to the expansion in output and profits.

Credit Risk

Over the last few years credit conditions have been relatively weak, reflecting weak domestic and global demand and low world commodity prices. As such, Chilean firms have postponed investments. However, we believe that the upturn in copper prices, global demand for Chilean exports (especially from the large number of countries with free-trade agreements with Chile) and the rise in domestic private consumption will encourage investment and a recovery in payments performance. Indeed, commercial loans (in both local and foreign currencies) are expected to grow by 10% in 2004.

Demand for commercial lending is likely to be evenly distributed between large, medium and small companies, as most sectors of the economy are experiencing growth, although loans for foreign trade have risen substantially, increasing by 15.3% year on year in the first half of 2004, and are expected to see a 25% expansion for the year as a whole. We also expect equity financing to increase (see **Financial and Capital Account**). Despite a projected rise in interest rates and inflation (see **Monetary Environment**), we predict that credit risks will moderate over the two-year forecast period for companies and individuals.

Payments Experience

Payments made by Chilean corporations are relatively slow, with some 49.2% of firms making payments 30 days beyond terms in the first quarter of 2004; 18.9% of businesses paid 90 days or more beyond terms. In the same period, 46.8% of payments were made promptly, an improvement on the final quarter of 2003 figure of 43.0%. D&B believes that late payments will continue to fall over the two-year forecast period as economic conditions improve. Importantly, given the liberal terms on which most trade with Chile is done, firms have the room to pay late (unlike trade on more stringent terms).

Table 14

Chile's Payments Performance

Days overdue	Prompt	1-29	30-59	60-89	90-119	120+
Q3-02	38.2	6.5	17.7	15.6	15.7	6.3
Q4	32.5	6.3	19.9	17.0	20.2	4.0
Q1-03	34.3	6.4	19.5	15.1	19.3	5.4
Q2	35.1	5.9	20.2	14.7	18.8	5.3
Q3	39.7	5.3	20.6	12.4	16.3	5.7
Q4	43.0	4.7	20.5	11.1	15.3	5.4
Q1-04	46.8	4.0	20.3	10.0	13.4	5.5

Source: D&B

Usual Terms: D&B recommends that exporters use sight drafts in transactions with Chilean firms. Trade terms tend to be more liberal for Chile than for many other Latin American countries.

Usual Terms

Minimum Terms	Sight Draft
Recommended Terms	Sight Draft
Usual Terms	30-60 days

Transfer Risk: The transfer situation is generally favourable, aided by ample foreign exchange liquidity (see **Foreign Debt and Default Risk**) and limited bank delays owing to a sound and competitive banking system. Import cover, at an estimated 10.4 months in 2004 and 11.0 months in 2005, is well beyond the International Monetary Fund's (IMF) recommended minimum of 3.0 months.

Transfer Situation

Local Delays	0-3 months
Foreign Exchange/Bank Delays	0-1 month
Import Cover	10.4 months

Export Credit Agencies: The level of cover offered to businesses involved in transactions with Chilean firms compares favourably with cover offered on trade with other countries in the region, reflecting a stable macroeconomic and political climate.

Export Credit Agencies

US Eximbank	Full cover available
Atradius	Full cover available
ECGD	Full cover available
Euler Hermes UK	Full short-term cover available

Financial Sector Risk

The banking sector has been relatively resilient during the recent turmoil in Latin America. This is due to restructuring and the mergers and acquisitions that occurred after the 1980s debt crisis. Moreover, the banking superintendency tightly supervises the banking system with extensive disclosure requirements, which makes the system very transparent. Following the November 1997 banking law, regulations were brought into line with the capital-risk adequacy and lending guidelines recommended by the Bank of International Settlements (BIS).

Table 15

Top Six Chilean Banks

Bank	Tier One capital (US\$m)	Total assets (US\$bn)	Pre-tax profit/loss (US\$m)	Return on assets (%)
Banco Santander Chile	1,131	16.4	247	1.5
Banco de Chile	794	12.1	48	0.4
Banco del Estado de Chile	483	9.3	79	0.8
BBVA Banco BHIF	332	4.4	30	0.7
Banco de Credito & Inversiones	332	6.3	103	0.6
Corp Banca	215	3.0	42	1.4

Source: *The Banker*

Chile's long debated tender law was signed onto the statute books in December 2000, setting the framework for some of the most sophisticated governance legislation in the world. The law requires that any merger and acquisition that leaves a single institution with more than 15% of market share needs special approval from the banking superintendency. The institution also has to demonstrate a capital

adequacy ratio of at least 10% compared with the Basel Committee requirement of 8%. These reforms follow Spanish BSCH's acquisition of Banco Santiago, which left it in control of the country's two largest banks (BSCH also controls Banco Santander Chile) and with 28% of the country's loan market.

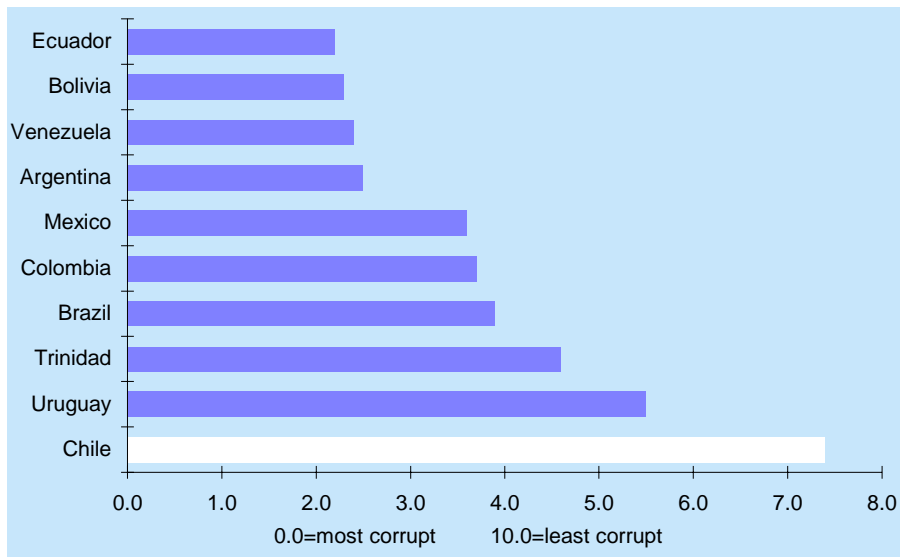
In mid-2004, the International Monetary Fund (IMF) praised the country's regulation of its financial system and welcomed the authorities' intention to tighten regulation further, especially to reduce risks in the insurance industry and strengthen regulation and supervision of the securities industry. The Fund also saw room to improve anti-money laundering legislation and laws aimed at combating the financing of terrorism legislation. The IMF also suggested that there was scope for improving financial system efficiency. It suggested that investment restrictions on pension funds could be liberalised to take advantage of economies of scale and increased competition.

The IMF also highlighted the need for the regulatory system to adapt to the increasing sophistication of financial markets, where distinctions between entities had become more blurred, by moving to a high-quality risk-based regulatory system that would take into account the interconnections between different components of the financial system. It also noted that there was room to further improve competition regarding the financing of small- and medium-sized enterprises. Changes aimed at fulfilling these recommendations are currently on the legislative agenda (contained within the Capital Markets II draft law) and should take effect over the short to medium term.

Corruption

Measuring what is corruption and what is local business culture is a difficult task. However, Transparency International's survey of corruption perceptions gives some idea of the relative level of corruption between countries. Each country is given a corruption perception rating between 1.0 (most corrupt) and 10.0 (least corrupt). The 2003 *Corruption Perceptions Index* shows Chile as the least corrupt country in Latin America. Chile was rated at 7.4 in 2003, compared with 6.9 in 2001, a healthy improvement.

Chart 14
Corruption Perceptions for Selected Countries, 2003



Source: Transparency International, *Corruption Perceptions Index*

Since the 2003 survey, Chile has suffered a number of political corruption scandals that may be reflected in the next *Corruption Perceptions Index*. That said, those accused of corruption were dealt with quickly and legislation was rapidly introduced

to reduce the room for further public sector corruption (see **Political Risk**). We believe that fighting corruption is a political priority in Chile and will continue to be legislated against over the medium term.

Other Commercial Risks

Intellectual Property Rights

Chile is a member of the World Intellectual Property Organisation (WIPO) and party to the Paris, Berne and Rome Conventions. It also signed the WIPO Copyright and Performance and Phonograms treaties in April 2001, both of which came into effect in 2002. Chile's Trade Related Aspects of International Property Rights (TRIPS) obligations came into effect on 1 January 2000.

Although Chile's intellectual property laws, promulgated in 1991, provide protection for industrial patents and are generally compatible with international norms, patent protection remains insufficient by international standards. The current laws do not provide adequate protection for confidential test data. Patent approval remains slow, with the approval time averaging over four years. In addition, copyright and trademark enforcement is still weak. In view of these deficiencies, Chile has been on the US Trade Representative's 'Special 301' Watch List since 1989.

It is estimated that two thirds of the software programmes used in Chile have been copied illegally, costing the industry US\$200 million. The level of piracy is worrying considering that Chile promised to make changes to its copyright laws (before 2008) when it signed its free-trade agreement with the US at the start of 2004. If the Chilean authorities do not start to make changes soon, they may find themselves subject to legal action for non-compliance with the treaty. However, D&B believes that Chile will make the necessary changes prior to 2008 and that legal action over the next year or two would be premature.

Commercial Risk Outlook

D&B believes that strengthening domestic demand and investment, and robust export growth will drive overall economic growth. Credit conditions will improve over the two-year forecast period as firms seek to expand output to meet export and internal demand. Higher receipts will also improve payments performance, reducing the level of late payments to counter-parties. Despite forecast higher interest rates and inflation, credit conditions will remain buoyant and overall trading risks when dealing with Chile are minimal.

Meanwhile, conditions in the financial sector are good, with regulation and transparency in line with international norms. Further reform over the short to medium term will also strengthen the system. Reform of the copyright law should also be a priority before 2008 (part of Chile's free-trade deal with the US) as Chile could otherwise face legal action for widespread breaches of the law.

Finally, corruption is not as widespread as in the rest of the region, but recent events show that all countries are vulnerable to corrupt activity. A general political consensus against corruption and new laws designed to minimise the chance for corruption to occur should safeguard Chile's 'clean' reputation.

Investment Environment

Key Point: Chile welcomes foreign investment into large areas of the economy, and the removal of capital controls should boost overall investment levels. Sound economic fundamentals and a relatively transparent regulatory environment make Chile an attractive investment location.

Investment Overview

Chile has one of the most liberal and transparent foreign investment regimes in Latin America. Foreign participation through inward investment is encouraged as a means of sustaining long-term economic growth and development. Such investment enables existing and potential resources to be more efficiently utilised. It also creates the conditions needed for structural economic diversification through greater access to new technology. The Chilean foreign investment supervisory authority is the *Comite de Inversiones Extranjeras* (CIE), which authorises most investments.

Foreign firms are generally treated on a par with local companies. There are no limitations regarding foreign share ownership in a Chilean company, except in the media and hydrocarbon industries. However, there are some restrictions. Investments over US\$5 million, or those proposed in state-controlled industries, require the approval of the whole committee. For other cases, the CIE executive committee has approval powers.

Capital Account Exchange Regulations

The central bank lifted the last remaining controls on international capital flows in April 2001. The changes eliminated the following requirements: that investors secure central bank authorisation for capital inflows related to loans, portfolio investment and foreign direct investment (FDI); that authorisation be sought for capital outflows related to capital gains dividends and other benefits; and the need for the reserve requirement, which obliged investors to deposit a portion of their investment with the central bank for up to one year.

Foreign Direct Investment Environment

Foreign Investment Laws

Decree Law 600 (DL600), introduced in 1974 and since subject to various modifications, specifically encourages FDI in order to underpin development and technological flows. DL600 specifically prohibits discrimination against FDI.

Under DL600, all applications for investment must be lodged with the Foreign Investment Committee. Profits and capital can be repatriated immediately. Following reform in 1997, the minimum investment allowed under DL600 was increased to US\$1 million from US\$25,000 (technology, machinery and equipment are exempt). Equity now has to be at least 50% of the investment (rather than 30%), with the remainder as debt. Exemptions to reserve requirements were also tightened. Investments below US\$100,000 (rather than US\$200,000) are now exempt.

Investment Incentives

Various investment incentives are available in certain sectors, including the petroleum and nuclear industries (particularly on imported machinery). There are also investment incentives according to region, which are designed to promote development in some of the less developed areas of the country.

Free-Trade Zones

There are free-trade zones at the ports of Arica, Iquique and Punta Arenas. Companies located in a free-trade zone are exempt from corporate income tax, value-added tax (VAT) and duties on imported inputs and parts.

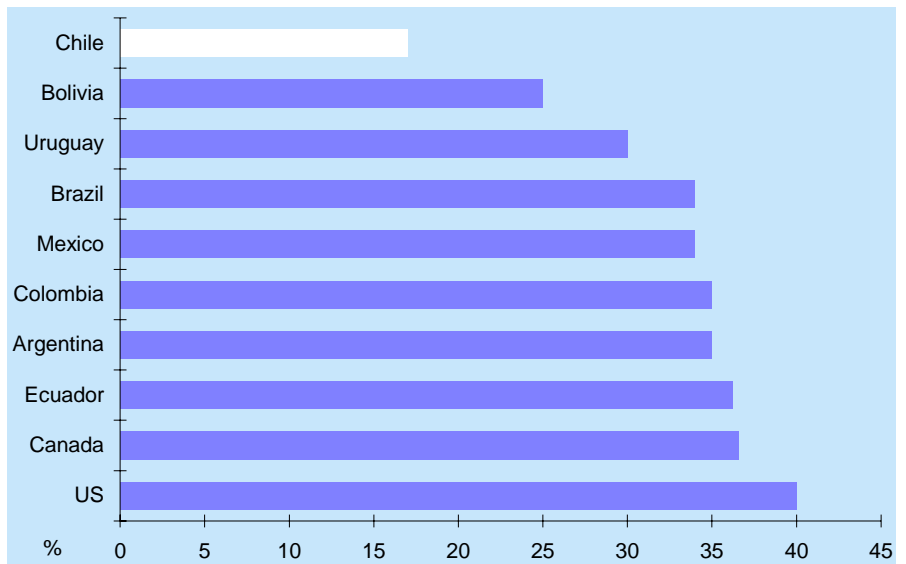
Taxation

During 2001, a new law governing corporate tax rates was issued. Accordingly, the corporate tax rate will increase from 15% to 17% over a three-year period. This means that corporate income earned in 2002 will be subject to a 16.0% tax rate; income earned in 2003 will be subject to a 16.5% rate and income earned in 2004 and subsequent years will be subject to a 17.0% tax rate. If corporate profits are distributed abroad, the withholding tax rate is 35%, with a credit for the tax previously paid on undistributed profits (the amount of the credit will depend on the tax rate paid by the profits distributed, 15.0%, 16.0% or 16.5%). Profits distributed to persons in Chile are subject to a progressive rate applicable to the recipient of the distribution. Profits distributed to legal entities domiciled or resident in Chile are not subject to income tax.

Capital gains are treated as normal income. Dividends paid by a resident company to resident shareholders are not taxable, although those paid to non-residents are subject to a 35% withholding tax (subject to a credit). Interest paid on loans from abroad is also subject to a 35% withholding tax. If the loan is granted by a foreign or international bank or financial institution that rate is 4%. VAT is levied at 18% (exports are exempt). Various municipal and real estate taxes are also levied.

Chart 15

Corporate Tax Rates in Selected Countries, 2004



Source: KPMG, *Corporate Tax Survey*

Double taxation and tax evasion agreements have been signed with numerous countries including Argentina, Canada and Mexico, although there is no agreement with the US. There have been some encouraging moves regarding the tax treatment of foreign investors. Capital gains tax on portfolio foreign investment was lowered to 15% from 35% in 2002. However, a reduction in dividend tax, which is levied at 35%, is unlikely, given the government’s need to minimise the fiscal deficit.

Company Organisation

There are seven basic forms of company organisation in Chile:

- *Corporation (Sociedad Anonima, S.A.):* There are two forms of corporations: open and closed. Open corporations are quoted on the stock exchange. When they have less than 500 shareholders, 100 shareholders or more must hold at least 10% of the capital. Open corporations must publish their financial statement annually. Closed corporations must have a minimum of two shareholders. They are not submitted to any of the above requirements and are used for small ventures.
- *Sociedad de Responsabilidad Limitada (S.R.L):* Limited liability company.
- *Branch of a Foreign Corporation (Agencia):* Branches of foreign companies must be registered with a Chilean notary. They must produce documents relative to the legal existence of the company in its country of origin and a copy of its bylaws. Power of attorney must also be given to the agent representing the company in Chile. A copy of the branch's annual accounts must be published in a local newspaper within four months of the end of the financial year.
- *Sociedad Colectiva:* General partnership.
- *Limited Partnership (Sociedad en Comandita):* These are most favoured in cases of association, either of persons or of corporations. The liability of each partner is limited to the amount of his initial investment. The parties are legally bound once a partnership deed has been drawn. Partnerships are under no obligation to publish any financial statements.
- *Asociacion o Cuentas en Participacion:* Silent partnership joint venture.
- *Empresario Individua:* Sole proprietorship.

The most common forms of association selected by foreign investors (apart from branches) are corporations and limited partnerships.

Portfolio Investment

The Santiago Stock Exchange is Chile's only stock exchange. The main stock market index is the General Stock Price Index (IGPA), which consists of most of the stocks quoted on the Santiago exchange. The IPSA index is a selective price stock exchange and includes the 40 most actively traded stocks on the exchange. The INTER 10 index reflects the main Chilean stocks that are quoted in foreign exchange markets and also have a major local presence. It is made up of the ten stocks with the biggest market value, which have also issued American Depository Receipts. Investors wishing to buy or sell shares on the exchange do so via a broker's bureau. Transactions are executed by brokers or through a daily auction system.

Additional Sources of Information

Banco Central de Chile

Agustinas 1180
Santiago, Chile
Tel: (562) 670.2000
Fax: (562) 670.2231
<http://www.bcentral.cl>

Chilean-American Chamber of Commerce

Av. Americo Vespuccio Sur 80,
9 Piso
82 Correo 34
Santiago, Chile
Tel: (562) 208.4140/3451
Fax: (562) 206.0911
<http://www.amchamchile.cl>

Corporacion Nacional del Cobre de Chile (Codelco)

Huerfanos 1270, Casilla 150-D
Santiago, Chile
Tel: (562) 698.8801
Telex: 24.06.72
<http://www.codelco.com>

US Embassy in Chile

2 Bello Avenue, Las Condes
Santiago, Chile
Tel: (562) 232.2600
Fax: (562) 330.3710
<http://www.usembassy.cl>

ProChile

510 W Sixth Street, Suite 1206
Los Angeles
CA 90014, USA
Tel: (213) 624.6302
Fax: (213) 489.9889
<http://www.chileinfo.com>

North American-Chilean Chamber of Commerce Inc

220 E 81st Street
New York, NY 10028
USA
Tel: (212) 288.5691

US Department of Commerce

Trade Information Center
International Trade Administration
14th and Constitution Ave, NW
Washington, DC 20230
Tel: 800-USA-TRADE
Fax: (202) 482.4726
<http://www.ita.doc.gov>

Chilean Trade Bureau

510 W Sixth Street, Suite 1204
Los Angeles
CA 90014, USA
Tel: (213) 624.6302

Credit Information

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International Risk & Payment Review: Provides timely economic, political and commercial information and analysis on 132 countries. Available as a subscription-based internet service (www.dnbcountryrisk.com) and monthly update journal, the IRPR carries essential information on payment terms and delays. It also includes the unique D&B Country Risk Indicator to help monitor changing market conditions.

Exporters' Encyclopaedia: Information on 220 world markets to help customers decide where they can safely and profitably do business. Data provided include key contacts, transportation information, legislation affecting export commerce and tips on foreign business travel. Published annually in August plus ad hoc updates, English Language Edition.

Country Risk Indicator Definition

D&B's Country Risk Indicator provides a comparative, cross-border assessment of the risk of doing business in a country. The indicator seeks to encapsulate the risk that country-wide factors pose to the predictability of export payments and investment returns over a time horizon of two years. The risk indicator comprises a composite index of four over-arching country risk categories:

<i>Political risk -</i>	internal and external security situation, policy competency and consistency, and other such factors that determine whether a country fosters an enabling business environment;
<i>Macroeconomic risk -</i>	the inflation rate, government balance, money supply growth and all such macroeconomic factors that determine whether a country is able to deliver sustainable economic growth and a commensurate expansion in business opportunities;
<i>External economic risk -</i>	the current account balance, capital flows, foreign exchange reserves, size of external debt and all such factors that determine whether a country can generate enough foreign exchange to meet its trade and foreign investment liabilities;
<i>Commercial risk -</i>	the sanctity of contract, judicial competence, regulatory transparency, degree of systemic corruption, and other such factors that determine whether the business environment facilitates the conduct of commercial transactions.

The DB risk indicator is divided into seven bands, ranging from DB1 through DB7. Each band is subdivided into quartiles (*a-d*), with an *a* designation representing slightly less risk than a *b* designation and so on. Only the DB7 indicator is not divided into quartiles.

Indicator Meaning Explanation

DB1	Lowest risk	Lowest degree of uncertainty associated with expected returns, such as export payments, and foreign debt and equity servicing.
DB2	Low risk	Low degree of uncertainty associated with expected returns. However, country-wide factors may result in higher volatility of returns at a future date.
DB3	Slight risk	Enough uncertainty over expected returns to warrant close monitoring of country risk. Customers should actively manage their risk exposures.
DB4	Moderate risk	Significant uncertainty over expected returns. Risk-averse customers are advised to protect against potential losses.
DB5	High risk	Considerable uncertainty associated with expected returns. Businesses are advised to limit their exposure and/or select high-return transactions only.
DB6	Very high risk	Expected returns subject to large degree of volatility. A very high expected return is required to compensate for the additional risk or the cost of hedging such risk.
DB7	Highest risk	Returns are almost impossible to predict with any accuracy. Business infrastructure has, in effect, broken down.