Fitch Revises Chile's Foreign Currency Outlook to Positive

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Fitch Ratings-New York-February 2, 2004: Fitch Ratings, the international rating agency, today revised the Rating Outlook on Chile's long-term foreign currency rating to Positive from Stable. It also affirmed Chile's long-term foreign and local currency (Chilean Peso) ratings at 'A-' and 'A+', respectively. The Rating Outlook on the local currency rating remains Stable. The foreign currency rating outlook revision reflects advances in economic policies that could enhance the structural foundations for GDP and export growth in the medium term; the resilience of Chilean corporations with heavy external debt burdens in weathering a recent period of low growth and currency depreciation; and improvements in fiscal and monetary transparency. The local currency rating outlook remains Stable, pending further de-indexation of public debt and clear signs of sustained higher GDP growth. While reviving copper prices and record low interest rates are providing a cyclical boost, recent policy advances could also enhance the structural basis for growth in Chile. Building on Chile's unilateral lowering of tariffs since 1974, the recent implementation of free trade agreements with the U.S. and EU should help underpin export growth and enhance external debt servicing capacity. The elimination of tariff escalation on value-added goods should aid Chile's continuing diversification in processed natural resource exports, while lowered uncertainty of market access should help counter potential trade protectionism. Capital markets reform has been supportive of domestic financial deepening and resulted in a stabilizing of Chile's comparatively high private external debt burden. Private domestic debt issuance has risen from 5% of GDP in 2000 to 14% in 2003, while non-financial private external debt has remained flat since 2000. Furthermore, a number of large, heavily-indebted corporates were able to refinance external debt and receive equity infusions last year, often with the support of foreign parents. The expected retirement of US$3.5 billion in central bank dollar-linked debt using international reserves, a move Fitch views favorably, should improve the profile of public debt, most of which is either inflation-indexed or foreign currency-linked. This will hold down near-term growth in general government debt (currently 38.3% of GDP, as Fitch includes central bank obligations), while both the net public external creditor position and the sovereign's external liquidity position should remain comfortable at just over 10% of GDP and around 125%, respectively, by 2005. With the general government deficit, as calculated by Fitch, averaging 2.2% of GDP over the last four years and likely to narrow with the cyclical upturn, public finances in Chile remain on a sound footing. Ongoing improvements in fiscal and monetary transparency also support increased policy credibility. Adoption of the IMF's government finance statistics accounting standards and resolution of the central bank's quasi-fiscal deficit will add further credibility to the rules-based structural balance approach for public finances instituted in 2001. Among rating constraints, a high dependence on natural resources, with copper representing 39% of merchandise exports, leaves the economy vulnerable to terms of trade shocks, although the technological content of Chilean exports is rising. Per capita income is low relative to rating peers and income disparity is high, constraining Chile's ability to raise tax revenues substantially beyond the comparatively low 17% of GDP and therefore to some extent the government's ability to provide increased social investment. An upgrade of Chile's foreign currency rating would hinge on clear evidence that structural reforms will yield enhanced GDP and export growth over the medium term, suggesting that such an upgrade is not imminent. Fitch would view positively robust growth in non-traditional processed exports, a sustained recovery in private investment, higher total factor productivity growth, further lowering in non-financial private external debt from its current 107% of external receipts, reduced public debt indexation, and the maintenance of a comfortable external liquidity position. Fitch will host a teleconference call to discuss the recent action on Tuesday, Feb. 3 at 11:00 a.m. EST. Contact: Therese Feng +1-212-908-0230 or Morgan Harting +1-212-908-0820, New York. Media Relations: James Jockle +1-212-908-0547, New York.