



FUND LAUNCHED

**2005**

FUNDS UNDER MANAGEMENT

**£517.3**  
MILLION

NET ASSET VALUE PER SHARE

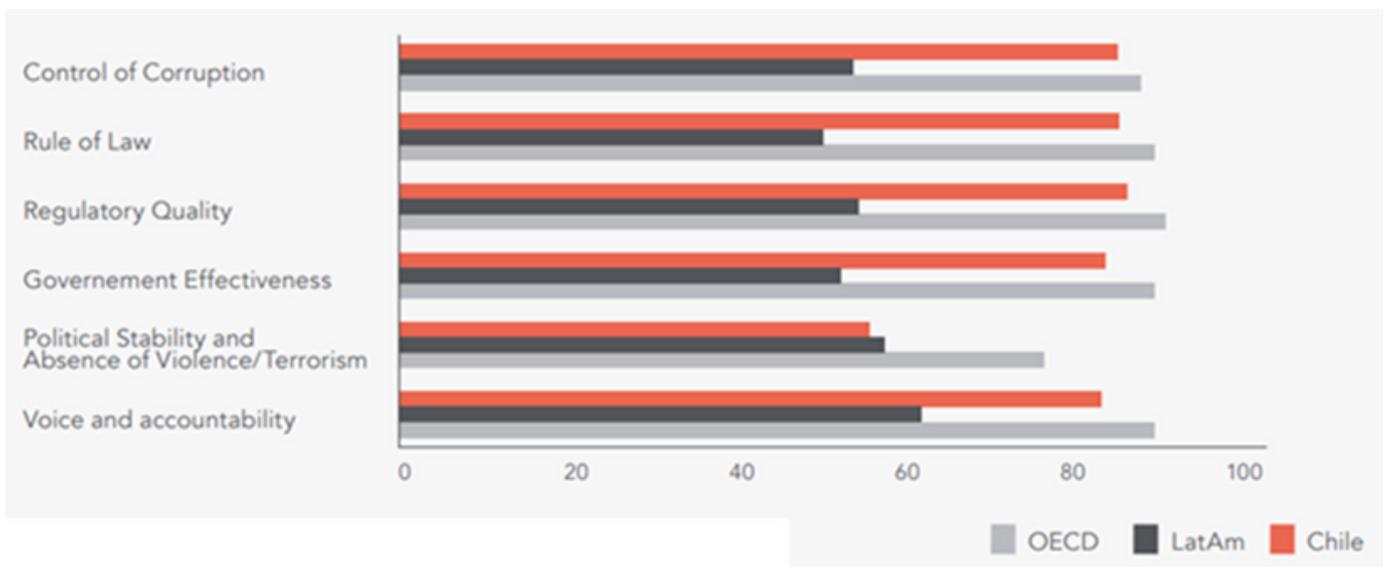
**410.3%**  
SINCE INCEPTION\*



# Country Insight: Chile

October 2023

Latin America is a region well-known for its strong swings in both politics and economic cycles. Amid this backdrop, Chile has differentiated itself, exhibiting more stability and offering investors greater visibility when considering long-term prospects in the country. Unlike many of its neighbours, historically Chile has been known for its political and economic steadiness. With robust institutions and a commendable history of policy continuity, even amidst changes in political leadership, the nation traded at a premium compared to its peers in the region. Further enhancing its investment attractiveness, Chile has signed numerous free trade agreements and double taxation treaties with key markets, actively facilitating international business. In terms of regulatory efficiency and business-friendly environment, Chile ranks well in global indexes that measure ease of doing business, transparency, and competitiveness. In fact, it holds the highest ranking in Latin America in these domains.



Source: World Governance Indicators 2020 – World Bank<sup>1</sup>

## **Constitutional Process: Chile Embarks on More Moderate Approach**

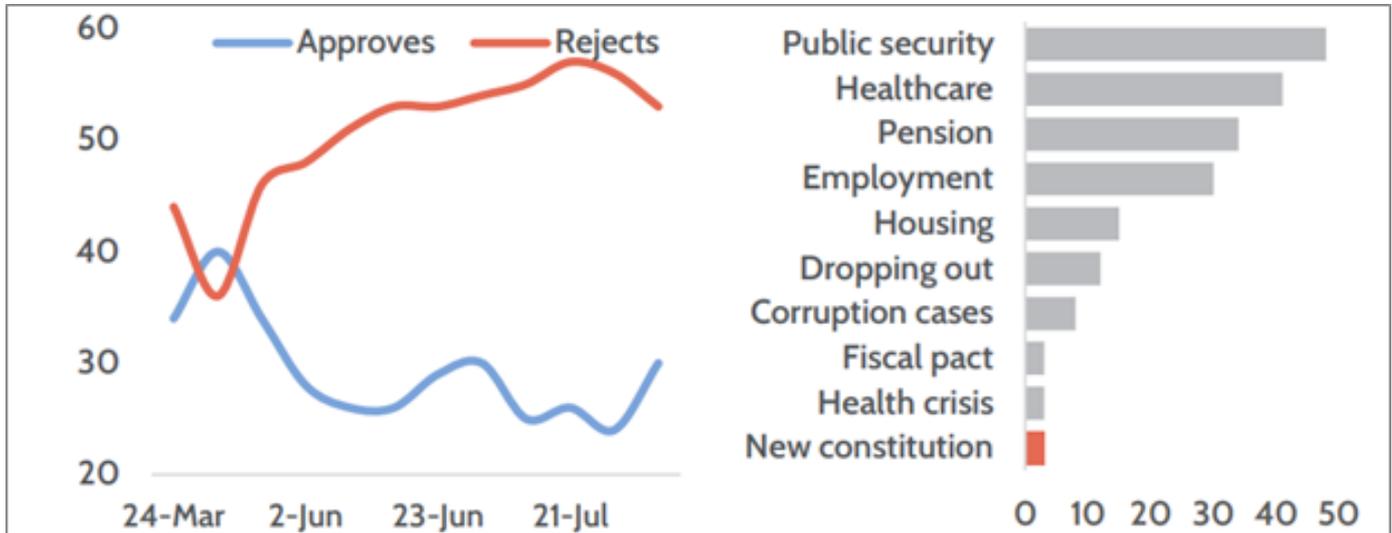
In contrast to Chile's decades of stability, the year 2019 marked a significant deviation with the eruption of massive protests throughout the country. What began as a reaction to a metro fare hike in Santiago soon escalated, exposing systemic problems. By December of that year, pensions, healthcare, and inequality emerged as the main demands of the protesters. The unrest exposed the flaws in a privatised pension system, disparities in healthcare access, and extreme income inequality despite economic success. This period of national reflection led to a historic decision: the rewriting of the country's constitution, which had been in place since Augusto Pinochet's rule. Despite its economic success, Chile remained one of the countries with the highest level of income inequality in the OECD. In a 2021 plebiscite, 78% of voters supported the creation of a new constitution, signalling a desire for reform and a more equitable future.

On September 4, 2022, Chile rejected the proposed new constitution in a referendum. The vote was 61.9% against, with a margin of 24 percentage points. The rejection was due to the constitution's progressive tilt, which did not align with the centrist majority. While the constitution advocated for increased government spending on social programs, it also included controversial provisions on property rights, environmental standards for businesses, water rights, and the boundaries of judicial and legislative powers.

In response to the rejection, Chile has embarked on a more moderate approach. A Council of Experts appointed by Congress and a Constitutional Council with a majority of conservative members will now draft a new constitution. This new constitution is expected to be more balanced and reflect the views of a wider range of Chileans. It will be put to a referendum in December this year. The rejection of the proposed constitution is a setback for those who hoped for a more progressive Chile. However, the more moderate approach is seen as a positive development by investors and those who value democratic norms.

There is still a significant chance that the process will not succeed. Recent polls indicate that more than 55%<sup>2</sup> of respondents are likely to vote against the proposal in the December referendum. However, the more moderate approach gives Chile a better chance of success than the previous approach. There is a growing sense of exhaustion among Chileans with the constitutional reform process. The discussion has stalled, and Chileans' top priorities are now public security, healthcare, pension, employment, and housing. The new constitution is not a top priority for the population. As the referendum date approaches, it is expected that there will be a greater flow of news in the press, and that this will lead citizens to pay more attention to the project's guidelines. This could potentially lead to an increase in approval, but the final result is still highly uncertain. We understand that the ideal outcome would be the approval of this moderate version, as Chileans, and investors, would then be able to move on from this topic. Not approving it could lead to a feeling of disenfranchisement among some Chileans and could potentially spark new protests in the country in the future. However, it is unlikely to have the same magnitude as the ones in 2019, and the current pro-market constitution will remain.

## Approves or rejects the new constitution – Gov. priorities (% of respondents)



Source: Public Polls, Creditcorp<sup>3</sup>

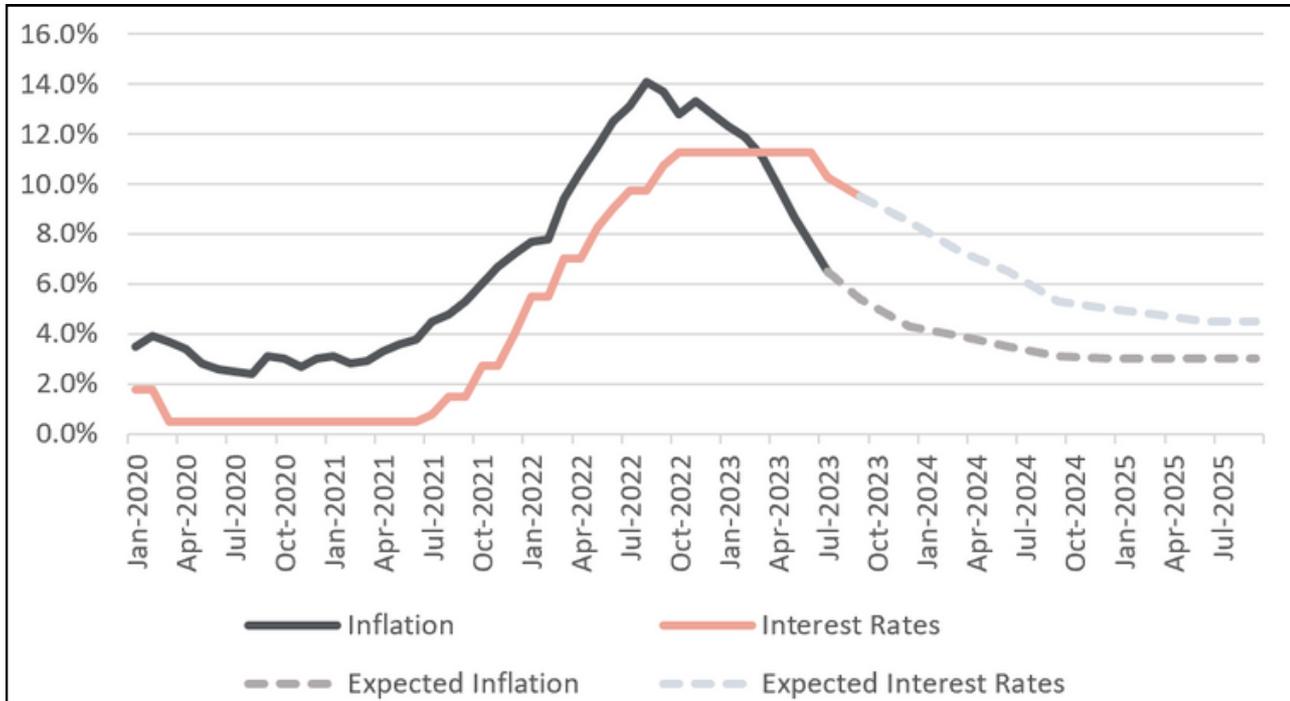
## Monetary Policy: Chile leading the crowd

In 2021, the Chilean economy expanded by 11.7%, more than offsetting the 6.1% contraction in 2020 caused by the Covid outbreak. On top of the economy reopening, this strong recovery is mostly explained by the unprecedented stimulus at the start of the pandemic, when government transfers reached 90% of households and individuals withdrew more than USD 50bn from their pensions. During this period, the Chilean economy grew beyond its potential and, from 2022, it started to slowdown, when GDP expanded by only 2.4%. A combination of an overheated economy and cost pressures from challenges in the global supply chain and commodities prices drove the Chilean CPI to its peak in August 2022 to 14.0%.

The Chilean economy is following a typical economic cycle pattern: growth, overheating, escalated inflation, fiscal and monetary tightening, economic downturn, and eventually a significant decrease in inflation. Currently, Chile is transitioning into the latter stages where economic expansion slows and inflation notably diminishes.

After two years of tightening fiscal and monetary policies, real economic growth began to contract in 4Q22. The Chilean GDP is expected to contract by 0.3% this year while we are seeing core inflation tumbling and expected to end the year at 4.2%. On the positive side, monetary and fiscal policies have been rather orthodox, and policymakers have acted decisively to deal with the inflation surge.

**Chilean Inflation and Interest Rates**



Source: BCCh, Factset, ICM

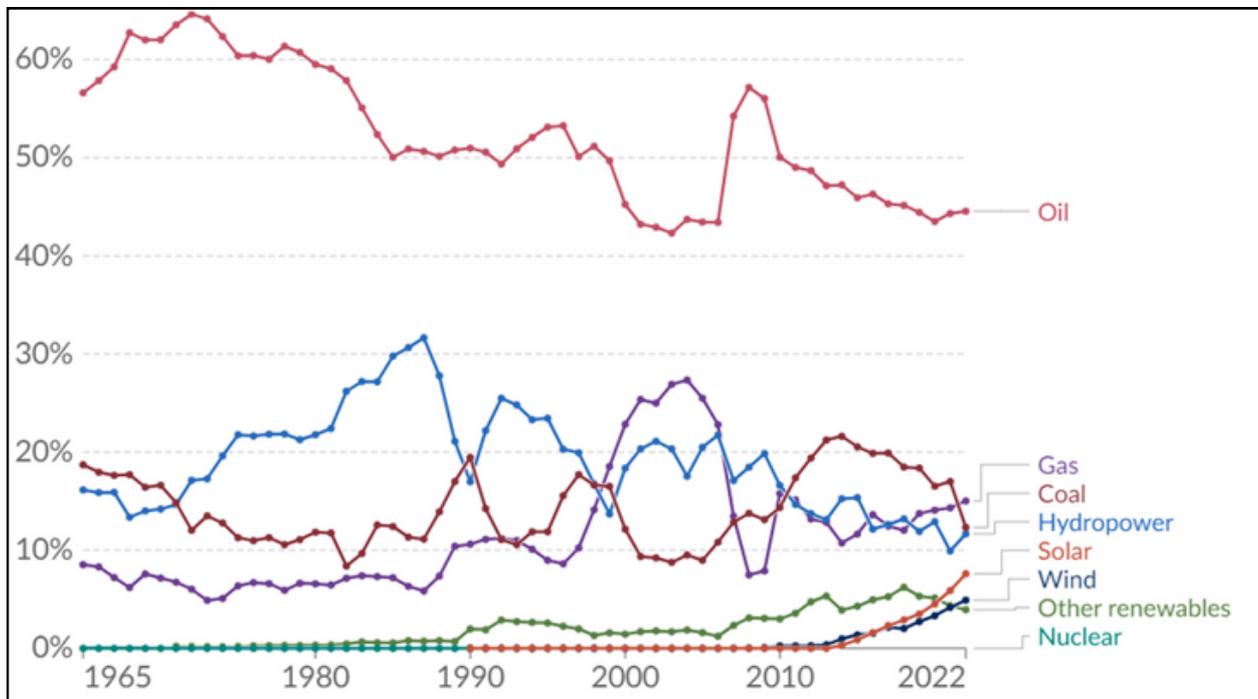
While many countries around the world are still struggling to curb inflationary pressures, the Chilean Central Bank's (BCCh) decision to start an early and aggressive tightening cycle – it has been hiking interest rates since July 2021 to a terminal rate of 11.25% – has allowed them to be one of the first countries to start cutting rates. In June 2023, Chile started an easing cycle with a 100bps cut, followed by a 75bps cut in the first week of September. The BCCh explicitly said that for this year the cuts would be of no more than 350bps, taking the local rates to 8.0%. In 2024, the easing cycle should continue moving rates to 5.0% by December 2024, which is expected to enable a further improvement in the local equity market.

**Charting a Cleaner Path: Chile's Energy Transition**

Chile embarked on a notable energy transition journey in 2015 when it launched the National Energy Policy 2050, targeting net-zero carbon emissions by 2050 and 80% renewable energy generation by 2030. At that inception point, Chile's energy mix was dominated by fossil fuels, which constituted more than 70%.<sup>4</sup>

The country's proactive approach has led to tangible advancements. Two clear trends are identified in the chart below. The first is the phase-out of coal. Chile has committed to discontinuing coal-fired power generation by 2040, and several coal-fired power plants have already been shut down in this direction. The second trend is the growth in wind and solar energy generation driven by numerous renewable energy auctions organised by the Chilean government.

### Share of Energy Consumption by Source in Chile



Source: Energy Institute Statistical Review of World Energy (2023), Our World in Data.org<sup>5</sup>

One of UEM's holdings in Chile, Engie Chile (E-CL), plays a pivotal role in the country's energy transition. The company ranks as the fourth largest energy generator, boasting an installed capacity of 2.4 GW. Engie Chile is committed to decarbonising its coal-fired assets with renewables and has made significant progress over the years, aiming to achieve zero coal exposure by 2025. In 2022 alone, the company added 300 MW in renewable energy capacity while phasing out more than 400 MW of coal-fired assets from its portfolio.

### Outlook for Chilean equities

Since the beginning of 2022, the Chilean market has witnessed a significant de-risking due to several major political developments, coupled with a successful soft landing and economic rebalancing. From January 2022 to August 2023, the IPSA equity index has surged by 39.71% (47.72% in GBP terms). Notably, the utilities sector outperformed during this period, with companies like Aguas Andinas and Engie Chile, both among UEM's top 30 positions, delivering impressive total returns of 122.58% and 72.2% in GBP terms, respectively. This remarkable performance can also be attributed to a decrease in the country's hydrological risk. It began with indications of the La Niña weather pattern's end, which had caused severe droughts in Chile in recent years, impacting water reservoirs and hydro generation capacity.

Despite this strong performance, Chile is still trading at a 23% discount (based on a P/BV basis) compared to its pre-Covid levels. While there remains potential for further appreciation, we believe that much of the re-rating and risk reduction has already occurred in the past two years. In other words, the low-hanging fruits are over and investors must be more selective in Chile.

The ongoing monetary easing cycle is poised to exert a significant impact on the local equity market. Interest rates are anticipated to decline to approximately 5.0% by 2024, a substantial reduction from their starting point at 11.25%. This level is notably high by Chilean standards.

To put it in perspective, the real rates were nearly 2x standard deviations above average prior to the BCC's initiation of the easing cycle.

Local economic activity is expected to recover from 2024, following the conclusion of most necessary adjustments in the first half of 2023. The BCC's 3Q23 Business Perceptions Report reveals increasing optimism among local businesses. Although confidence levels are still below neutral, they have consistently improved month after month. Businesses anticipate stable product prices, easing inflation, and a reduction in cost pressures.

The Capital Goods Corporation's 2Q23 report brings positive news, announcing an investment increase of nearly USD 12 billion over the next five years, marking the largest upward revision. The total projected investment for 2023 - 2027 now stands at USD 52 billion, which is primarily driven by new mining and energy ventures. This surge in investment promises broader economic benefits, particularly in construction and employment. Traditionally, an increase in mining investment has significant ripple effects on other economic sectors.

Over the next 12 months, several key developments warrant close attention. Domestically, these include the referendum on the new constitutional propose, as well as pension and tax reforms. On the international front, a further deceleration in China's economy could impact the demand for Chile's crucially exported commodities, such as copper and lithium. On the flip side, many metals stand to benefit from the global push toward green energy transition, particularly copper, which is in high demand for renewable energy sources and electrical conductivity.

## **Eduardo Greca**

26 September, 2023

Source Data: ICM Limited, Chilean Central Bank, Factset as of September 15th, 2023

[1] World Governance Indicators 2020 – World Bank. Retrieved from: <https://info.worldbank.org/governance/wgi/>

[2] Bloomberg Linea. Retrieved from: <https://www.bloomberglinea.com/latinoamerica/chile/nuevo-proceso-constituyente-en-chile-las-encuestas-reflejan-poco-interes/>

[3] Quarterly Andean + Mexico Macro Report from September 8th, 2023 by Creditcop

[4] Transición Energética de Chile. Retrieved from: [https://energia.gob.cl/sites/default/files/documentos/pen\\_2050\\_-\\_actualizado\\_marzo\\_2022\\_0.pdf](https://energia.gob.cl/sites/default/files/documentos/pen_2050_-_actualizado_marzo_2022_0.pdf)

[5] Our World in Data. Retrieved from: <https://ourworldindata.org/energy/country/chile>

\*Total return is calculated based on undiluted Net Asset Value, plus dividends reinvested and adjusted for the exercise of warrants and subscription shares

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