RBC BlueBay Asset Management

Chile: wind of change

Notes from the road

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Christoffer Enemaerke
EM Equity Portfolio Manager

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> **“Chile has been described as the ‘Switzerland of Latin America’ due to its high quality of institutions, political stability, and rule of law.”**

Flying into Chile’s capital, Santiago, in a valley surrounded by the Andes mountains is a beautiful sight – and it reminded us of the vast natural resources that the country possesses.

Chile is the largest copper producer in the world, with almost 50% of the country’s exports coming from copper[1]. The strong long-term demand outlook for this metal from structural tailwinds like AI, decarbonisation and electric vehicles should be something that benefits the country for years to come.

In addition to copper, Chile also has the largest proven lithium reserves in the world[2]. In 2023, Chile’s President Boric announced a plan to bring the lithium industry under state control. Overall, this move was considered negative for the country’s ease of doing business. Historically, Chile has been described as the ‘Switzerland of Latin America’ due to its high quality of institutions, political stability, and rule of law. And while we still see many of these qualities today compared to other Latin American countries, in recent years this reputation has been challenged.

Political volatility has brought Chilean equity market valuations down significantly over the last 6-7 years (Exhibit 1), since peaking in 2018. The de-rating of this market stemmed from several socio-political events, including social unrest and failed attempts of constitutional, tax and pension reforms, given a lack of political consensus and a government with high disapproval ratings. Despite ongoing debates about modifying the country’s economic model, no substantive actions have been implemented. And as we were told from the managements of a number of mall developers who we met during our trip, obtaining construction permits and the length of time it takes is one of the key obstacles for growth and investment in Chile at the moment. In fact, they told us that achieving permits for construction often takes longer than the construction itself.

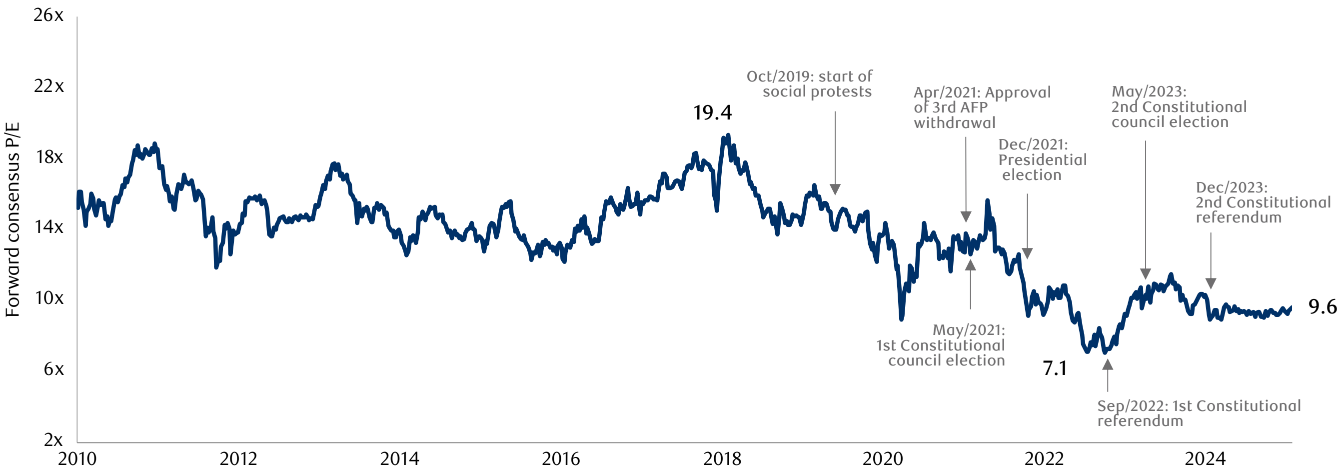
1 Infographic: How Copper Riches Helped Shape Chile’s Economic Story.
2 Lithium Reserves by Country 2024.

From our meetings with company managements and macroeconomic experts, it became clear that the general election at the end of 2025 will represent a pivotal moment for the country. Despite an increase in social spending in the last two presidential terms, current approval ratings for the government and President Boric are low (Exhibit 2). The decline in these ratings has taken place at the same time as an increase in debt-to-GDP levels, from 30% in 2020 to 42% in 2024[3], which could suggest an inclination for political change. Recently, the political landscape has been impacted by regional runoffs, where the centre-right secured additional positions, strengthening the position of presidential frontrunner, Evelyn Matthei.

Some of the most interesting comments we heard from locals on the trip also revolved around the political landscape. It appears that Chileans are increasingly starting to take note of what is happening 'across the mountains', meaning in the neighbouring country of Argentina. It is possible that if Argentina's President, Milei, is able to successfully improve the economic situation in Argentina, this could be a 'canary in the coal mine' for Chile and perhaps for the rest of the Latin American region.

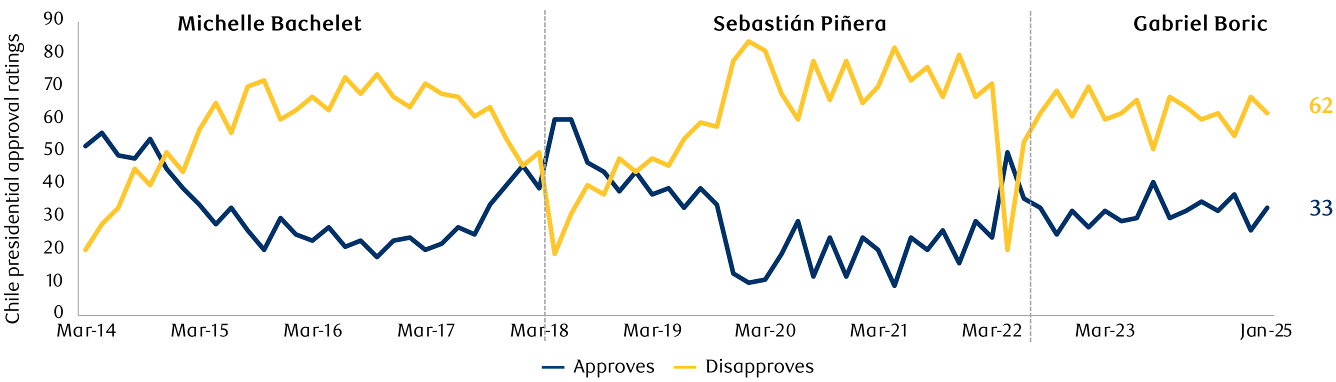
Shopping mall visit in Santiago.

Exhibit 1: Chilean equities have de-rated in recent years



Source: Bloomberg and Morgan Stanley Research, as at November 2024.

Exhibit 2: Low approval rating for current President Boric



Source: CADEM, Invamer, IPSOS and Morgan Stanley Research, as at November 2024.

[3] Bloomberg.

In our opinion, it does seem likely that we will see some level of dogmatic shift towards the centre-right end of the political spectrum at next year's election. This could potentially result in a reduction in the cost of capital for the country and support an increase in FDI. In the past, the perception of a political shift from a left-wing to a right-wing government has generally coincided with strong performance of the equity market.

During our trip, we met with management teams from a number of large, listed companies, ranging from consumer to financials and materials companies, and overall came away impressed with the quality of the professionals. One difficulty of investing in Chile is the limited number of investable companies. As is the case with most other countries in Latin America, the banking sector is one area of the market that investors tend to focus on. Within the context of Latin America, Chilean banks are known as some of the highest quality, with strong profitability, robust management, and corporate governance. However, these banks are also among the most expensive in the region. This is in spite of the relatively less attractive structural growth opportunity in the country; domestic credit to the private sector (as a percentage of GDP) is over 100% in Chile compared to 33% in Mexico and 46% in Peru[4]. Still, with a highly concentrated banking sector and less disruption from fintechs than we have seen in other countries, the banks have been able to maintain strong profitability for many years.

Chile has been undergoing one of the stronger easing cycles in emerging markets, having cut the benchmark interest rate by more than 3% in 2024[5]. This has helped support a recovery in consumer activity that had otherwise declined after the end of pandemic-related stimulus and pension payments. The decrease in interest rates should be positive for companies that are geared to consumption, such as the shopping malls. Lower rates could also support earnings growth expectations – consensus estimates for Chilean corporates in the next couple of years are looking promising at around high single-digit earnings growth in 2025, followed by low double-digit growth in 2026. This is interesting in the context of very cheap equity valuations. In addition to politics, the companies we met are also watching changes in copper prices, the path of interest rates, the amount of FDI into the country, and perhaps most importantly, the progress on longer-term reforms, such as pension reforms.

View from a corporate office in the Las Condes area.

Old bank building in Santiago, Chile.

"Lower rates could also support earnings growth expectations – consensus estimates for Chilean corporates in the next couple of years are looking promising at around high single-digit earnings growth in 2025 followed by low double-digit growth in 2026."

As we leave Santiago and once again look down upon the impressive, snow-covered Andes, it feels that the next couple of years will be very meaningful for Chile, and perhaps the country will once again move towards its strong reputation of the past.

[4] Domestic credit to private sector (% of GDP (World Bank).
[5] Bloomberg.

Author

Christoffer Enemaerke CFA

Portfolio Manager

Christoffer is a portfolio manager on the RBC Emerging Markets Equity team at RBC GAM. In this role, he is responsible for research on Latin America. During his tenure at the organisation, Christoffer has also specialised on India, China, and Taiwan. He assumed this role in 2018, having earlier worked as an associate portfolio manager on the same team for two years. Prior to joining RBC GAM in 2013 as an investment analyst, he worked as a graduate trainee and research associate at the investment management division of a Nordic-based financial services group in Copenhagen. Christoffer started his career in the investment industry in 2010.

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