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Fixed Income in Chile: attractive opportunities in a market that requires disciplined execution and proper selectivity

Interest rates in Chile, both sovereign and corporate, are at attractive levels and well above their historical averages. This backdrop represents a highly compelling opportunity for conservative investors or those requiring inflation-linked fixed income for portfolio construction, but implementation must be carefully managed in order to seek appropriate compensation, particularly in credit spreads, which are currently tight.

Over the past 10 years, Chile's financial market has experienced periods of higher risk and volatility relative to its long-term history, increasing the risk premium demanded by both local and international investors.

This situation began with the 2019 social unrest and was followed by the Covid-19 crisis, excess liquidity resulting from government support measures to mitigate the crisis, three pension fund withdrawals totaling approximately USD 50 billion, two constitutional reform processes, the debate over changing the individual capitalization pension model, and the emergence of inflation, which reached 14% year-on-year and led the Central Bank to raise the policy rate from 0.5% to 11.25%.

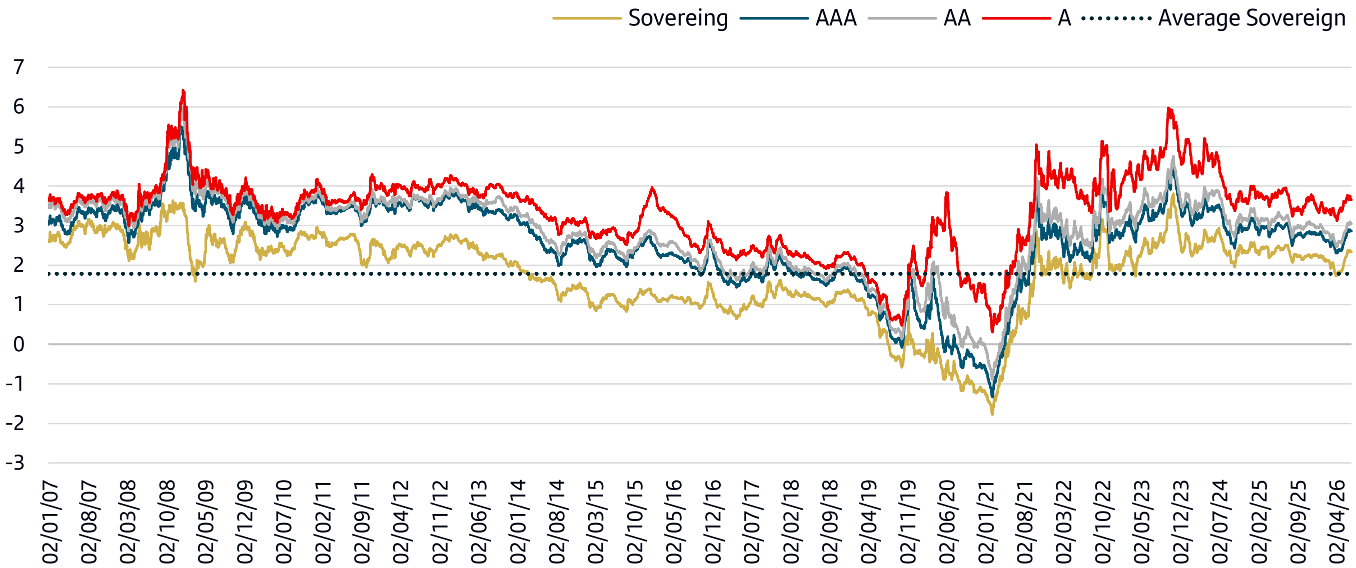
Today, the outlook is more benign, with conditions that should allow the Chilean market to converge back toward its long-term risk premium levels. The constitutional reform processes were not approved, and in 2025, after decades of discussion, a pension reform was approved that consolidates the role of individual capitalization within the AFP system and incorporates a Social Security pillar, increasing the contribution rate from the current 10% to 16%. This could lift pension savings stock from the current USD 250 billion to nearly USD 400 billion over the next 10 years.

In addition, we are nearing the end of the Central Bank's rate normalization process, with the policy rate having been cut from its 2023 peak of 11.25% to the current 4.5%, while medium- and long-term inflation expectations remain aligned with the Central Bank's 3% target.

In the current environment of greater institutional stability and a stronger local capital market, we see attractive interest rate levels in Chilean fixed income, with absolute yields that are high versus their historical levels across both sovereigns and credit.

Graph 1: Real Rates in 5 year tenor

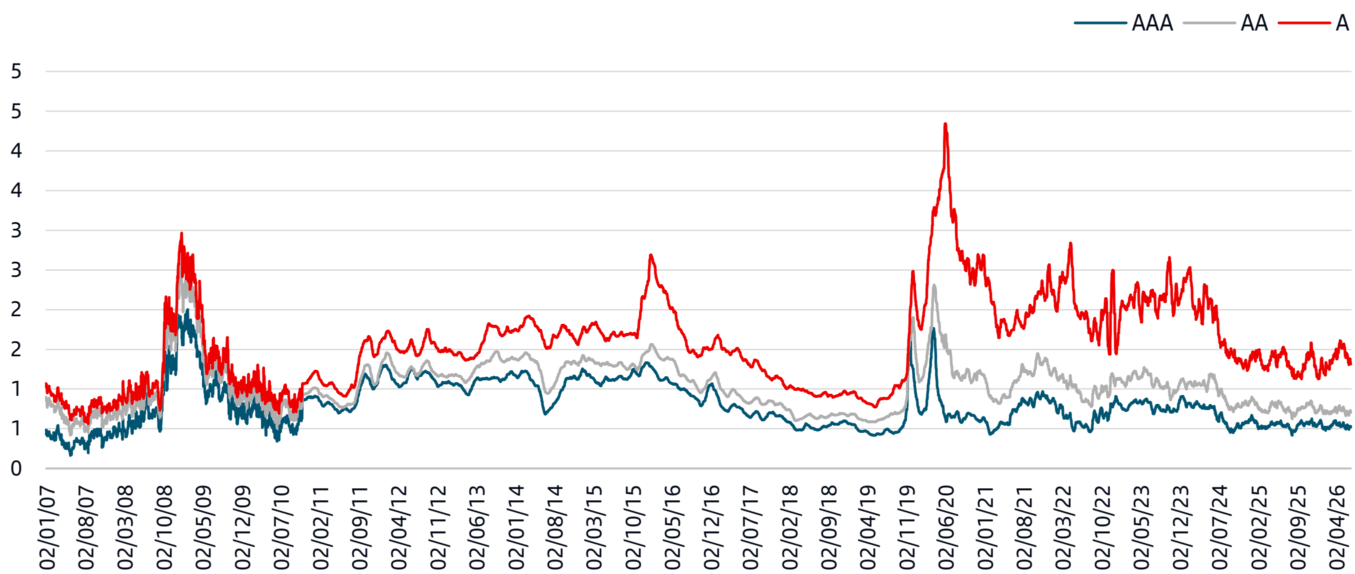
Sources: RiskAmerica and SAM calculations



High rate levels conceal a less obvious reality: a significant part of their attractiveness comes from the sovereign base-rate component, while spreads are low by historical standards and offer less compensation for the credit risk assumed. As a reference, the AAA spread is in the 18th percentile relative to its history since 2007, while AA is in the 16th percentile and A in the 35th percentile.

Graph 2: Spreads in 5 year tenor

Sources: RiskAmerica and SAM calculations



Another way to visualize this lower compensation for taking credit risk is by comparing the share of total nominal return—real rate plus inflation breakeven—that is explained by the spread. Under this metric, an investor buying AAA securities obtains only 9% of the nominal return from the spread, which is in the 17th percentile versus history; the figure is 12% for AA, in the 15th percentile, and 20% for A, in the 32nd percentile[1].

Spread behavior can be attributed to two effects. First, inflows into Chilean fixed income mutual funds have totaled more than USD 11 billion since 2024, adding to demand from local life annuity companies, for which local fixed income is the foundation of their asset allocation, representing an additional USD 1.7 billion since 2024[2]. Second, local investors' search for yield has led them to maintain high levels of credit exposure within their local fixed income portfolios to increase carry.

This search for higher carry, together with inflows, has made the dominant segments of the local credit market by outstanding stock—AAA at 41% and AA at 52%—the most expensive in relative terms, while the A segment remains the least expensive on a relative basis.

A compressed-spread environment may also affect selectivity and the market's ability to properly price the risk of each instrument. Historically, lower aggregate spreads have often been accompanied by lower dispersion among issuers with the same rating. This can result in issuers with different credit-risk profiles but the same rating not having an adequate spread differential to compensate for differences in fundamentals.

From a portfolio construction perspective, the points outlined above highlight the need for disciplined execution, proper selectivity, and diversification when gaining exposure to Chilean fixed income today, with an active and dynamic approach aimed at identifying the best risk-return compensation.

Ultimately, fixed income in Chile is at attractive levels and above its historical averages. However, investors that want to take advantage of this opportunity must be careful to seek adequate compensation when taking risk, in a context where credit spreads remain compressed. Particular care should be taken in selecting the issuers and sectors that best compensate for the credit risk assumed, avoiding a passive approach or one based merely on credit ratings, while maintaining diversification that allows portfolios to navigate potential episodes of volatility.

1. Sources: RiskAmerica and SAM calculations
2. Sources: RiskAmerica, Asociación de Aseguradores de Chile and SAM calculations

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