INTERNATIONAL MONETARY FUND

IMF Country Report No. 21/83

CHILE

April 2021

2021 ARTICLE IV CONSULTATION—PRESS RELEASE; STAFF REPORT; AND STATEMENT BY THE EXECUTIVE DIRECTOR FOR CHILE

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the 2021 Article IV consultation with Chile, the following documents have been released and are included in this package:

- A **Press Release** summarizing the views of the Executive Board as expressed during its April 19, 2021 consideration of the staff report that concluded the Article IV consultation with Chile.
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on April 19, 2021, following discussions that ended on March 5, 2021, with the officials of Chile on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on April 2, 2021.
- An **Informational Annex** prepared by the IMF staff.
- A **Statement by the Executive Director** for Chile.

The document listed below has been or will be separately released.

Selected Issues

The IMF's transparency policy allows for the deletion of market-sensitive information and premature disclosure of the authorities' policy intentions in published staff reports and other documents.

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PRESS RELEASE

PR21/113

IMF Executive Board Concludes 2021 Article IV Consultation with Chile

FOR IMMEDIATE RELEASE

Washington, DC – April 23, 2021: On April 19, 2021, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation[1] with Chile.

The pandemic hit Chile as it was recovering from the economic consequences of the social unrest in October 2019. Economic activity is projected to have declined by 5.8 percent in 2020, about 7 percentage points below staff's pre-pandemic projection. Inflation has hovered around the central bank's target of 3 percent and inflation expectations remain well-anchored. Although employment has recovered from a contraction of 20.6 percent in mid-2020, it remains below its pre-pandemic level. At end-March 2021, due to rapidly increasing COVID-19 cases, the government tightened mobility restrictions but expanded existing fiscal measures to mitigate their impact, while the vaccination process is proceeding expeditiously (in this respect Chile is not only the regional leader but also among the top performers globally).

The government adopted a wide-ranging and well-planned set of fiscal, monetary, and financial policy actions to ease the effects of the pandemic. The government is implementing a multi-year fiscal package, amounting to about 13 percent of GDP, focused on safeguarding health, protecting incomes and jobs, and facilitating credit, refinancing, and repayments. The Central Bank introduced a broad range of unconventional measures to support liquidity, including through funding-for-lending facilities, asset purchase programs, and an expanded collateral framework. Financial sector policies have been introduced, aimed at facilitating the flow of credit, especially to households and SMEs, including by relaxing liquidity requirements, and facilitating the issuance and placement of securities. The IMF's Flexible Credit Line has contributed to the ability to withstand external stress, while the exchange rate has been allowed to freely float and act as a shock absorber.

Economic activity is expected to grow at 6.5 percent in 2021, as the fallout from the pandemic gradually recedes and mobility restrictions are relaxed, while the economy continues to get support from accommodative policies and the strong vaccination process. Over the medium term, growth is projected to converge to its potential of 2.5 percent. The current account balance is expected to remain close to zero in 2021, owing to strong terms of trade and despite the surge in imports associated with the recovery, before gradually moving over the medium term towards a small deficit.

Risks remain amid high uncertainty, but the country exhibits strong resilience, thanks to its large policy response, the remaining fiscal space, and the very strong institutional policy framework. External risks are largely related to the dynamics of the pandemic, though the fast pace of the vaccination program is expected to contain such risks. Movements in the price of

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[1] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board.

copper would significantly affect exports, fiscal revenues, and prospects for investment and growth. Domestic risks stem primarily from a series of elections and the outcome of a New Constitution process—scheduled to finish in mid-2022—which are expected to shape the public discourse and influence the policy agenda.

Executive Board Assessment[2]

Executive Directors recognized that Chile's strong policies enabled the authorities to respond swiftly to the health and economic impact of the COVID-19 pandemic, including the rapid rollout of vaccines. Directors noted that although the economy is beginning to recover, uncertainties remain. They emphasized that continued strong policies and advancing structural reforms will be key to mitigating the impact of the pandemic and supporting inclusive growth.

Directors commended the authorities' fiscal efforts in response to the crisis, while maintaining a very strong fiscal position. They emphasized that, as the recovery strengthens, medium-term revenue and targeted spending measures will be needed to address social needs, protect the vulnerable, and rebuild buffers, while preserving debt sustainability. Directors encouraged steps to strengthen the fiscal rule and revisit exemptions, deductions, and special regimes, increase direct taxation, and raising green taxes towards international standards.

Directors highlighted that further pension withdrawals should be avoided, as they have weakened the pension system. They recommended that if additional support is needed, it should be delivered via targeted fiscal measures which are more effective in reaching those in need.

Directors welcomed the Central Bank's broad range of conventional and unconventional measures to support liquidity and facilitate the flow of credit, especially to households and SMEs. They also highlighted that financial sector vulnerabilities should continue to be closely monitored and that financial sector reforms would need to resume their pace as the recovery advances.

Directors highlighted the urgency of reaching broad agreements to unlock structural and social reforms which would invigorate confidence, support the recovery and growth, and promote social cohesion. In particular, they stressed the need for comprehensive pension and health reforms. Directors noted that improving education quality and financial integration, reducing labor market inefficiencies and informality, promoting trade integration, and responding to climate change will also be crucial to foster productivity and inclusiveness.

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[2] At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities. An explanation of any qualifiers used in summings up can be found here: http://www.IMF.org/external/np/sec/misc/qualifiers.htm.

Chile: Selected Social and Economic Indicators 1/

GDP (2019), in billions of pesos	196,397	Quota	
GDP (2019), in billions of U.S. dollars	279.3	in millions of SDRs	1,744
Per capita (2019), U.S. dollars	14,621	in % of total	0.37
Population (2019), in millions	19.1	Poverty rate (2017)	8.60
Main products and exports	Copper	Gini coefficient (2017)	46.60
Key export markets	China, Euro area, U.S.	Literacy rate (2015)	99.2

			Est.	Proj.					
	2018	2019	2020	2021	2022	2023	2024	2025	2026
	(Annual percentage change, unless otherwise specified)								
Output									
Real GDP	3.7	1.0	-5.8	6.5	3.7	2.7	2.6	2.5	2.5
Total domestic demand	4.5	0.9	-9.3	8.8	3.8	2.8	2.5	2.4	2.4
Consumption	3.7	0.9	-6.9	8.9	4.2	2.8	2.3	2.4	2.3
Private	3.8	1.1	-7.7	10.2	4.9	3.2	2.3	2.8	2.6
Public	3.4	0.0	-3.7	3.4	0.6	0.8	1.9	0.7	0.5
Investment 2/	7.3	1.0	-17.7	8.5	2.4	2.6	3.6	2.5	2.8
Fixed	5.1	4.5	-11.5	7.2	3.9	3.8	4.2	2.2	1.4
Private	6.1	5.2	-11.2	6.2	2.3	5.3	4.6	2.8	1.9
Public	-2.7	-1.3	-14.4	16.4	16.9	-7.2	1.0	-3.8	-3.0
Inventories 3/	0.5	-0.7	-1.4	0.1	-0.3	-0.3	-0.2	0.0	0.3
Net exports 3/	-0.9	0.0	3.5	-2.0	-0.1	-0.1	0.0	0.0	0.1
Exports	5.3	-2.6	-1.1	1.9	4.6	3.2	2.8	2.7	2.7
Imports	8.1	-2.3	-12.8	9.1	5.1	3.5	2.7	2.6	2.3
Employment									
Unemployment rate (annual average)	7.4	7.2	10.8	8.9	8.2	7.7	7.4	7.2	7.2
Consumer prices									
Inflation (End of period, %)	2.1	3.0	2.9	3.0	3.0	3.0	3.0	3.0	3.0
Inflation (average, %)	2.3	2.3	3.0	3.1	3.0	3.0	3.0	3.0	3.0
	(In percent of GDP, unless otherwise specified)								
Public sector finances									
Central government revenue	22.0	21.7	19.9	23.1	22.6	22.4	23.1	23.1	23.1
Central government expenditure	23.7	24.5	27.2	26.4	25.6	24.7	24.7	24.0	24.0
Central government fiscal balance	-1.7	-2.9	-7.3	-3.3	-3.0	-2.3	-1.6	-0.9	-0.9
Structural Fiscal Balance	-1.5	-1.7	-2.7	-5.1	-3.9	-2.9	-1.9	-0.9	-0.9
Structural Non-Mining Primary Balance (% of NGDP)	-2.4	-3.0	-3.7	-5.5	-4.4	-3.5	-2.7	-1.8	-1.8
Central Government Gross Debt	25.6	28.2	32.5	33.9	37.2	39.9	41.6	42.0	41.7
of which, FX-denominated Debt	5.1	5.8	7.3	8.7	9.3	10.0	10.7	10.7	10.7
Central Government Net Debt	5.7	8.2	8.7	11.5	14.2	16.2	17.0	17.5	17.9
Public sector gross debt 4/	45.5	49.1	55.2	56.5	59.8	62.5	64.2	64.7	64.3
Of which, share of FX-denominated Debt (in %)	19.8	20.6	22.6	25.5	25.0	25.1	25.6	25.4	25.8
	(Annual percentage change, unless otherwise specified)								
Money and credit									
Broad money	11.2	9.4	1.9	9.9	6.4	5.1	4.9	4.9	5.2
Credit to the private sector	10.1	9.7	3.2	…	…	…	…	…	…
Balance of payments									
Current account (% of GDP)	-3.9	-3.7	1.4	0.0	-0.3	-0.5	-0.7	-0.8	-0.9
Current account (in billions of U.S. dollars)	-11.6	-10.4	3.4	0.0	-1.1	-1.6	-2.6	-3.2	-3.7
Foreign direct investment net flows (% of GDP)	-2.2	-1.2	1.3	-1.5	-1.0	-1.0	-0.8	-0.7	-1.0
Gross international reserves (in billions of U.S. dollars)	39.9	40.7	39.2	48.2	51.2	51.2	51.2	51.2	51.2
Gross Reserves (Months of next year import)	6.4	5.7	5.9	8.7	7.3	7.0	6.8	6.5	6.2
Gross external debt (% of GDP)	59.1	66.4	72.0	64.1	63.5	63.0	62.6	61.6	60.5

Public	5.4	6.2	9.0	9.1	9.7	10.4	11.0	11.0	11.1
Private	53.7	60.2	63.1	55.0	53.8	52.6	51.6	50.5	49.4
					(Annual percentage change)				
Relative prices									
Real effective exchange rate (real appreciation +)	1.4	-4.8	-8.2	…	…	…	…	…	…
Terms of trade	-2.8	-1.7	10.1	6.6	-0.3	-1.3	-2.0	-1.9	-1.0
Memorandum items									
Nominal GDP (in billions of pesos)	190,722	196,397	200,224	220,091	234,225	246,285	258,473	271,219	285,428
(percentage change)	6.2	3.0	1.9	9.9	6.4	5.1	4.9	4.9	5.2
Nominal GDP (in billions of USD)	297.4	279.3	252.8	308.8	328.2	345.2	362.4	379.9	399.2
(percentage change)	7.4	-6.1	-9.5	22.2	6.3	5.2	5.0	4.8	5.1

Sources: Central Bank of Chile, Ministry of Finance, Haver Analytics, and IMF staff calculations and projections.

1/ The annual numbers occasionally show a small discrepancy with the authorities' published figures, as they are calculated as the sum of the quarterly series seasonally-adjusted by staff.

2/ Investment is defined as: gross fixed capital formation + changes in inventories.

3/ Contribution to growth.

4/ Includes liabilities of the central government, the Central Bank of Chile and public enterprises. Excludes Recognition Bonds.

INTERNATIONAL MONETARY FUND

CHILE

STAFF REPORT FOR THE 2021 ARTICLE IV CONSULTATION

April 2, 2021

KEY ISSUES

Context: The Chilean economy has been hit by the pandemic while recovering from the social unrest in late 2019, requiring substantial adjustment of economic policies and the appropriate use of existing policy buffers. Following a sharp decline in mid-2020, economic activity started recovering in 2020H2 in the wake of ample policy stimulus. Inflation remains near the policy target, with inflation expectations anchored, and the current account balance has improved amid a sharp drop in imports and relatively resilient exports. Fiscal and monetary policies remain guided by the structural fiscal balance rule and the inflation-targeting framework, respectively. Beyond the pandemic-related risks, there is uncertainty stemming from a series of elections and the outcome of a New Constitution process—scheduled to finish in mid-2022—which are expected to shape the public discourse and influence the policy agenda.

Policies: Chile’s commendable macroeconomic policy response to the pandemic has been swift and wide-ranging, and its strong institutional framework has supported economic resilience in the face of an unprecedented shock. The government’s multi-year package has focused on safeguarding health, protecting incomes and jobs, and facilitating credit, refinancing, and repayments. The Central Bank of Chile’s monetary stimulus leveraged on a broad range of unconventional measures to support liquidity, including through funding-for-lending facilities, asset purchase programs, and an expanded collateral framework. Financial sector policies have also aimed at facilitating the flow of credit, especially to households and SMEs.

Recommendations. In staff’s view, continuing to refine targeting of spending measures is likely to be required to continue supporting an inclusive recovery, while in the medium term revenue and expenditure measures will be needed to address rising social demands. Monetary policy should remain data driven and within Chile’s inflation targeting framework, and postponed financial sector reforms should resume their pace as the recovery advances. Quick and broad agreement over structural and social reforms would also help to stimulate investment, confidence, and promote social convergence and inclusive growth.

- *Fiscal policy*. In the near term, supporting the recovery will require continuing targeted efforts to protect health, income, and jobs, such as through possible reallocation from public investment to household transfers. At the same time, the authorities should further simplify and ensure the accessibility of transfer programs for the neediest segments of the population. Further pension withdrawals should be avoided, as they are difficult to target, highly regressive, and weaken the pension system. Over the medium term, permanent revenue and spending measures would be needed to finance possible additional spending to address social needs, face fiscal contingencies, and rebuild buffers, while preserving debt stability. The credibility of the fiscal policy framework would benefit from the introduction of an explicit medium term anchor—encompassing a debt ceiling coupled with a buffer—and a formal escape clause with an adjustment mechanism to offset potential deviations from fiscal targets in the medium term.

- *Monetary and Financial policy*. Monetary stimulus should remain guided by the inflation targeting framework, encompassing economic developments, the policy mix, and risks (see Annex III). Financial sector vulnerabilities should continue to be closely monitored. After the pandemic recedes, the authorities should shift focus towards accelerating needed regulatory reforms including: strengthening bank resolution regimes; establishing a national deposit insurance scheme funded by member banks; strengthening regulation of insurance companies; and regulating financial conglomerates.

- *Advancing the reform agenda would be crucial to enhance inclusive growth*. Ensuring adequate pension coverage will require adjustments to the contribution rate, retirement age (especially for women), and solidarity parameters, coupled with reforms to reduce informality. Reforming the health system should remain a key priority, to improve its efficiency, eliminate discrimination based on pre-existing conditions, increase competition, and reduce the out-of-pocket cost of medicines. Financing additional spending to address social demands, absorb fiscal contingencies, and rebuild buffers will require: increasing direct taxation and green taxes; strengthening tax administration; reducing exemptions, deductions, and special regimes; and rationalizing existing expenditure. Improving education quality and financial integration, reducing labor market inefficiencies and informality, as well as continuing to promote trade integration and responding to climate change, will all foster productivity and inclusiveness.

Approved By
Patricia Alonso-Gamo (WHD) and Gavin Gray (SPR)

Discussions took place virtually during February 22 – March 5, 2021. The team comprised Luca Antonio Ricci (Head), Metodij Hadzi-Vaskov, Karim Youssef, José Torres, Samuel Pienknagura, Christopher Evans, Chiara Fratto (all WHD), Shakill Hassan (SPR), Junghwan Mok (MCM), and Roberto Schatan (FAD). Mr. Herrera (OED) also participated in the discussions. The mission held discussions with the Central Bank Governor, the Minister of Finance, the Minister of Economy, regulatory and supervisory bodies, other senior officials, private-sector representatives, and academics.

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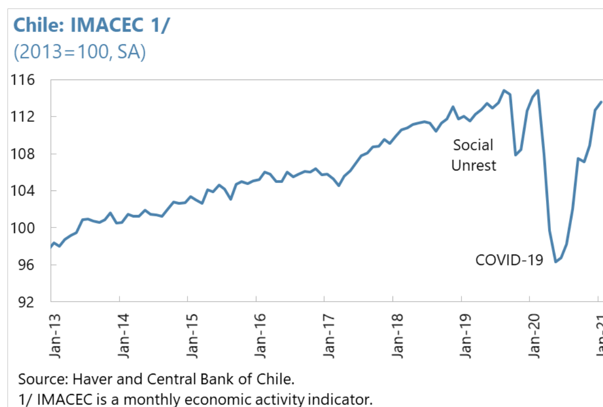
CONTEXT

1. The pandemic hit Chile while it was recovering from the impact of social unrest in October 2019. The economic performance before the unrest was solid, with growth averaging 3 percent in the preceding two years. The unrest triggered broad policy actions (see Country Report 2020/183) and the economy started recovering. Then, the Covid-19 outbreak induced a larger decline in growth, and prompted wide-ranging and unprecedented policy responses, accompanied by the approval of an FCL arrangement in May 2020.

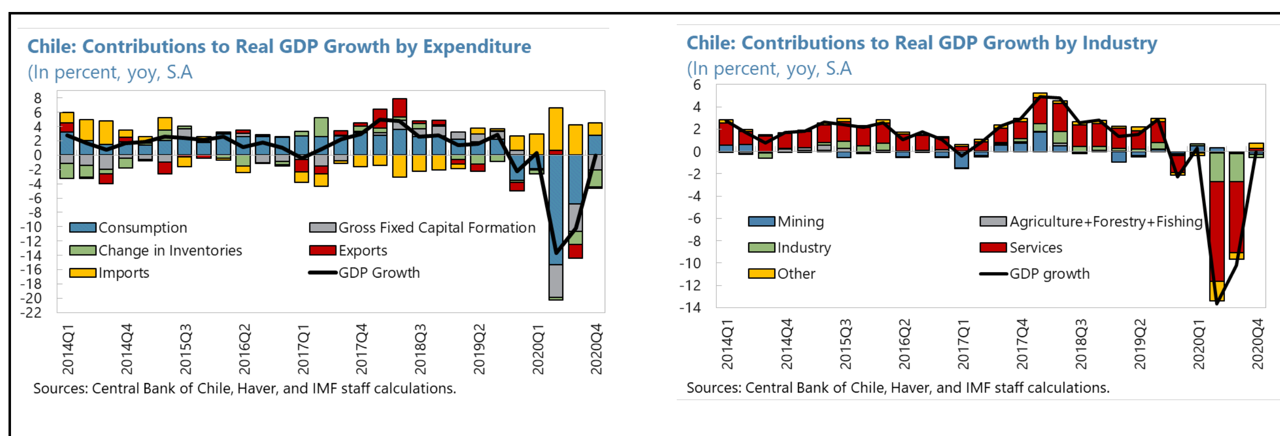


Source: Haver and Central Bank of Chile.
1/ IMACEC is a monthly economic activity indicator.

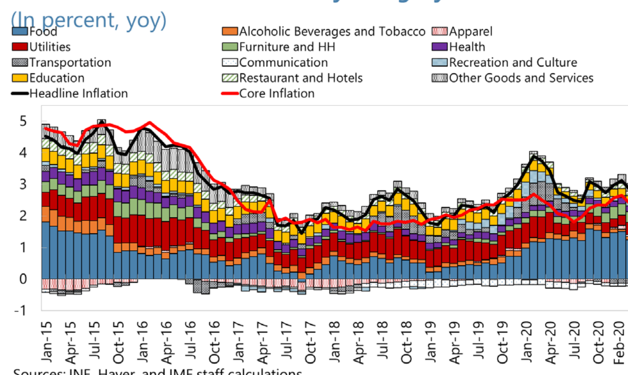
THE ECONOMY IS RECOVERING

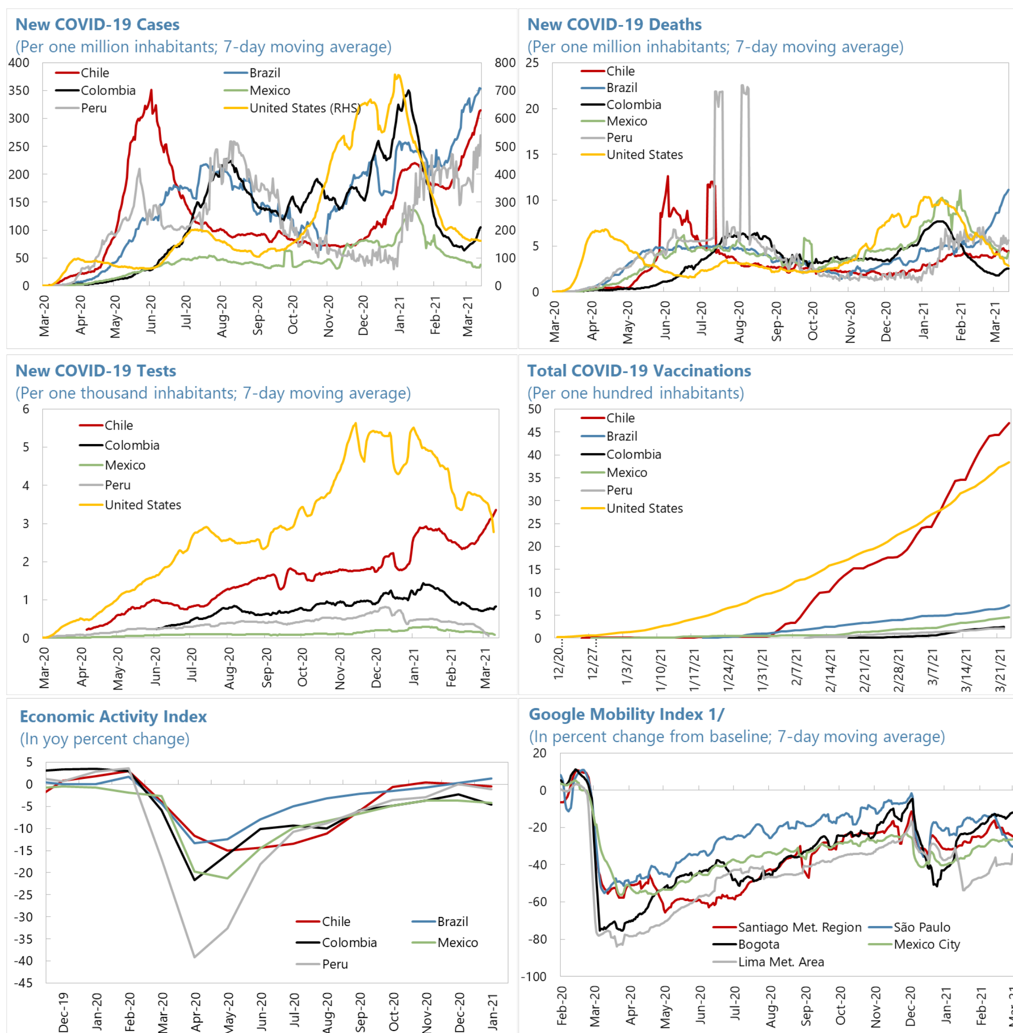
2. The pandemic hit hard, but a strong vaccination process is underway. As of mid-March 2021, Chile confirmed 942,958 cases of Covid-19 and 22,384 deaths, in a population over 19 million. At end-March, due to rapidly increasing cases, the government tightened restrictions with nearly 3/6 of all municipalities in quarantine, about 2/6 in transition, 1/6 in preparation towards reopening. However, Chile started vaccinating in December 2020 and is leading LA countries. About 5.9 million have received their first dose by mid-March and the authorities plan to vaccinate most of the adult population (about 15 million people) during 2021H1.

3. Economic activity started to recover from the pandemic, supported by ample policy stimulus. Economic activity is projected to have declined by 5.8 percent in 2020, about 7 ppts below staff's pre-pandemic projection, which had already been revised down by about 2 ppts relative to the pre-unrest scenario. Activity started gradually recovering in 2020H2 and yoy growth is estimated to have reached almost zero in 2020Q4, with copper production remaining mostly steady in 2020 despite the pandemic.

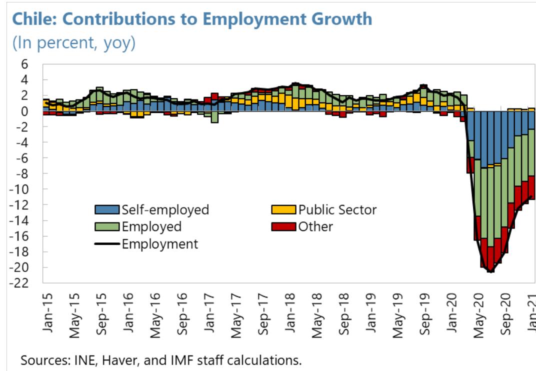


4. Annual headline inflation moderated in mid-2020 and then hovered around the policy target. Following a pickup in early-2020 owing to the pass-through from exchange-rate depreciation, annual headline inflation moderated in mid-2020 amid the decline in economic activity. Since Q3, it keeps hovering close to 3 percent, the policy target, mainly due to temporary factors associated with food and beverages, while core inflation continues to remain below target, at 2.4 percent. Inflation expectations (over the two-year policy horizon) remain well anchored.



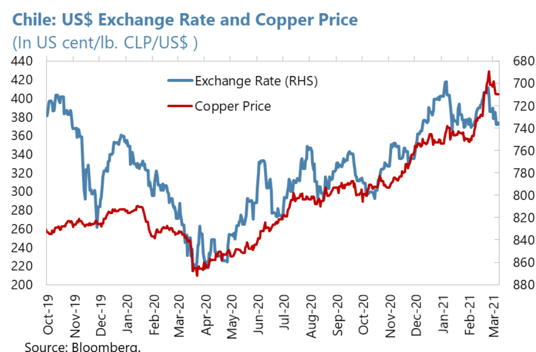


5. Employment contracted sharply and unemployment spiked. Employment started declining in April 2020. It reached its largest contraction of 20.6 percent in mid-2020—reflecting a large reduction of self-employed and domestic workers. Since then it started recovering, albeit in January 2021 it was still about 10 percent lower than a year before. Following a spike at 13.1 percent in mid-2020, unemployment has come down to 10.2 percent in January, still about 3 ppts above the 2020 figure.



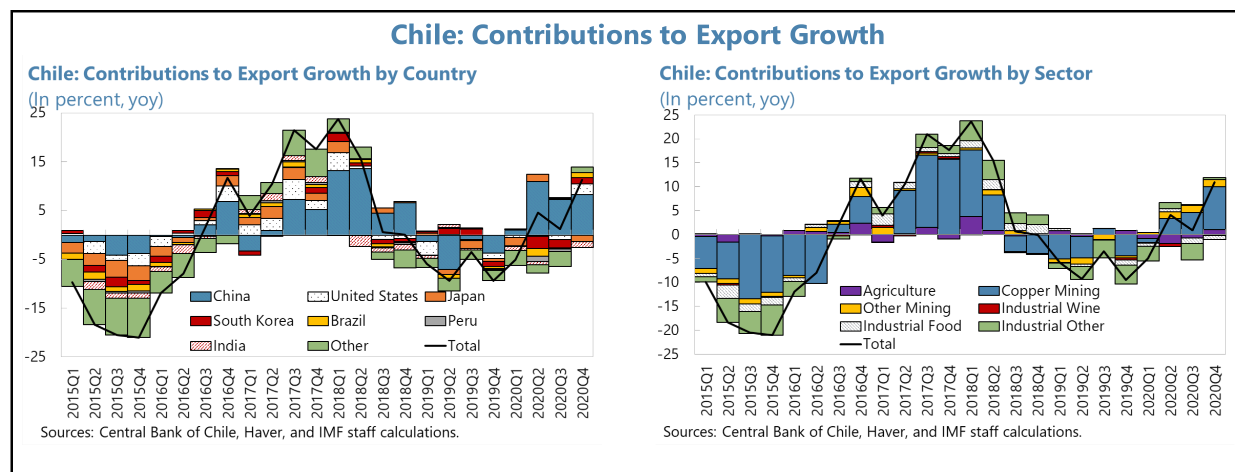
Sources: INE, Haver, and IMF staff calculations.

6. The current account improved amid substantial exchange rate volatility. After a significant depreciation following the unrest and the pandemic (by almost 20 percent from September 2019 to April 2020), the peso recovered vigorously, boosted by the rising international price of copper. As imports fell abruptly but exports held steady, the 2020 current account is in surplus. The external position in 2020 is assessed to be moderately stronger than envisaged by medium-term fundamentals and desirable policy settings (Annex II).



Source: Bloomberg.

7. Asset repatriations by residents offset capital outflows by non-residents. The net purchases of Chilean assets by non-residents declined in 2019Q4 due to the social unrest, and turned cumulatively negative due to the pandemic in 2020. This was offset by net sales of foreign assets by residents, including pension funds (especially of portfolio securities, see Annex II). The resulting increased holdings of safe domestic assets in funds' portfolios helped them meet the demand for pension withdrawals, approved as part of the exceptional measures in response to Covid-19 (see SIP). International reserves were US$39.6bn by end-2020 (above the US$36.8bn level at the time of approval of the FCL arrangement), and in January 2021 the BCCh initiated a gradual program to increase FX reserves by US$12bn over 15 months.



8. The Central Bank of Chile (BCCh) expanded the monetary stimulus and undertook a wide range of measures to support liquidity (see Annex I). Following the liquidity and FX intervention measures in the aftermath of the social unrest (see Country Report 2020/183), the BCCh cut the policy rate twice in March 2020 (totaling 125 basis points) to 0.5 percent—considered as the "effective lower bound"—and introduced a set of unconventional measures to support liquidity. Such actions included: (i) three funding-for-lending facilities for banks (in the total amount of about US$40bn) which were extended in January 2021 to include refinanced loans; (ii) banks bonds and special assets purchase programs (in the total amount of US$16bn); and (iii) expansion of BCCh's collateral framework through inclusion of corporate securities. The FCL arrangement continues to serve the country well, by supporting market confidence.

9. In response to developments, the authorities unveiled a broad set of fiscal measures. First, various social and fiscal measures were adopted in response to the unrest (see Country Report 2020/183). In January 2020, a tax reform was adopted which is expected to gradually raise tax revenues by about 1 ppt of GDP in the medium term. To lessen the effects of the pandemic, the government is implementing a multi-year fiscal package of about US$34bn (13 percent of GDP, after an addition of 2 percent of GDP was announced in March 2021 to lessen the effects of tighter mobility restrictions) to safeguard health, protect incomes and jobs, keep funding costs low, support credit, and buttress the recovery (see Annex I). Both the 2021 Budget (Law 21.289) and the law that created the COVID-19 Emergency and Transitory Fund (Law 21.288) include enhanced and stricter transparency and accountability requirements—including publication requirements of project details, and beneficial ownership information for public procurement awardees. Congress is currently discussing important reforms for pensions and health (more below).

- The main elements of the 2020 tax reform include: (i) unifying the CIT regime to a semi-integrated system with a 27 percent flat rate; (ii) a new simplified regime for SMEs (cash-flow based, with a fully-integrated system and a 25 percent rate); (iii) a higher top PIT marginal rate at 40 percent; (iv) a VAT for digital services by non-resident providers; and (v) digital sales receipts.
- The fiscal package to counter the effects of the pandemic includes: (i) higher healthcare spending; (ii) enhanced subsidies and unemployment benefits;[1] (iii) a set of tax deferrals; (iv) credit provision for SMEs, via *Banco Estado* (a publicly owned bank); (v) transfers for the most vulnerable and the middle-class; (vi) a credit-guarantee scheme for firms (via the public credit-guarantee fund FOGAPE) and for the households; and (vii) enhanced public investment. As women were disproportionately affected by the pandemic, the authorities enacted a series of gender-targeted measures encompassing a hiring and a childcare subsidy, as well as parenting and telework protection legislation.[2]

[1] The Employment Protection Law allows for the suspension or the reduction of the work schedule. When a contract is suspended, workers receive monthly payouts from the unemployment insurance (total payments of about 1.2 percent of GDP have occurred until February 2021).

[2] Women tend to work in sectors that were hit the most by the pandemic (due to high person-to-person contact), such as hospitality, childcare, restoration, and hotels. Women also tend to be hit disproportionally more by the closing of schools and daycare facilities.

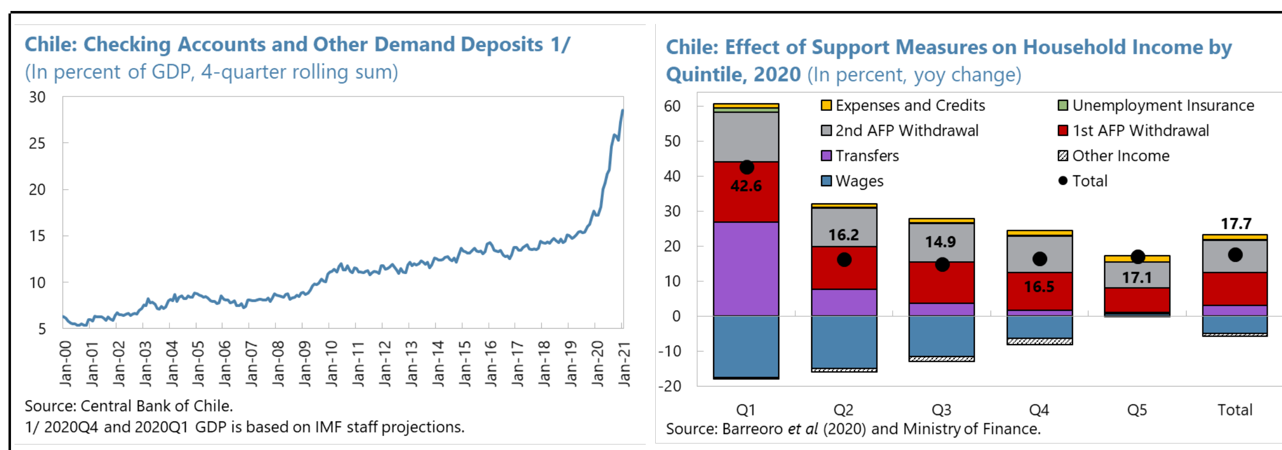
10. The economic contraction and stimulus measures resulted in a deterioration of the fiscal accounts. About one third of the stimulus is financed with debt issuance and the rest with disposal of assets (including from the repeal of the reserved copper law). In 2020, the structural deficit increased to 2.7 percent of GDP from 1.7 percent in 2019, while the headline fiscal deficit rose to 7.3 percent of GDP from 2.9 percent in 2019. About 2/3 of the deterioration in the overall fiscal balance is due to higher spending (mostly subsidies and grants) and 1/3 by declines in taxes (due to the economic contraction and tax deferrals). The large difference in the overall and structural balance (about 4.6 percent of GDP) is explained by adjustments to the cycle, copper prices, tax deferrals with automatic reversion, and other one-off events.

11. These measures were accompanied by large withdrawals from the private pension funds. Congress allowed in July and December 2020 two rounds of withdrawals, which reached US$36bn (or about 14 percent of GDP, and 18 percent of June 2020 pension assets) by February 2021 (see text table for details). Over 10 and 7 million people have used the first and second withdrawal, respectively. The withdrawals overcompensated the loss of income due to the pandemic for people in all income quintiles (see text chart), but are expected to lower pension replacement rates while raising public pension costs (by a net present value of about 3½ percent of 2020 GDP in staff calculations); they also often contributed more to an increase in savings (see text chart) than in spending, and the first one was regressive (as it was tax-exempt for all, see text table). About 3 million people exhausted their pension funds (or ¼ of pension system participants). The impact on financial markets from both withdrawals was muted, cushioned by the fast and ample reaction by the BCCh (which included a facility with cumulative purchases of US$8.5bn; see Box I).

Chile: Description of Pension Withdrawal Rules

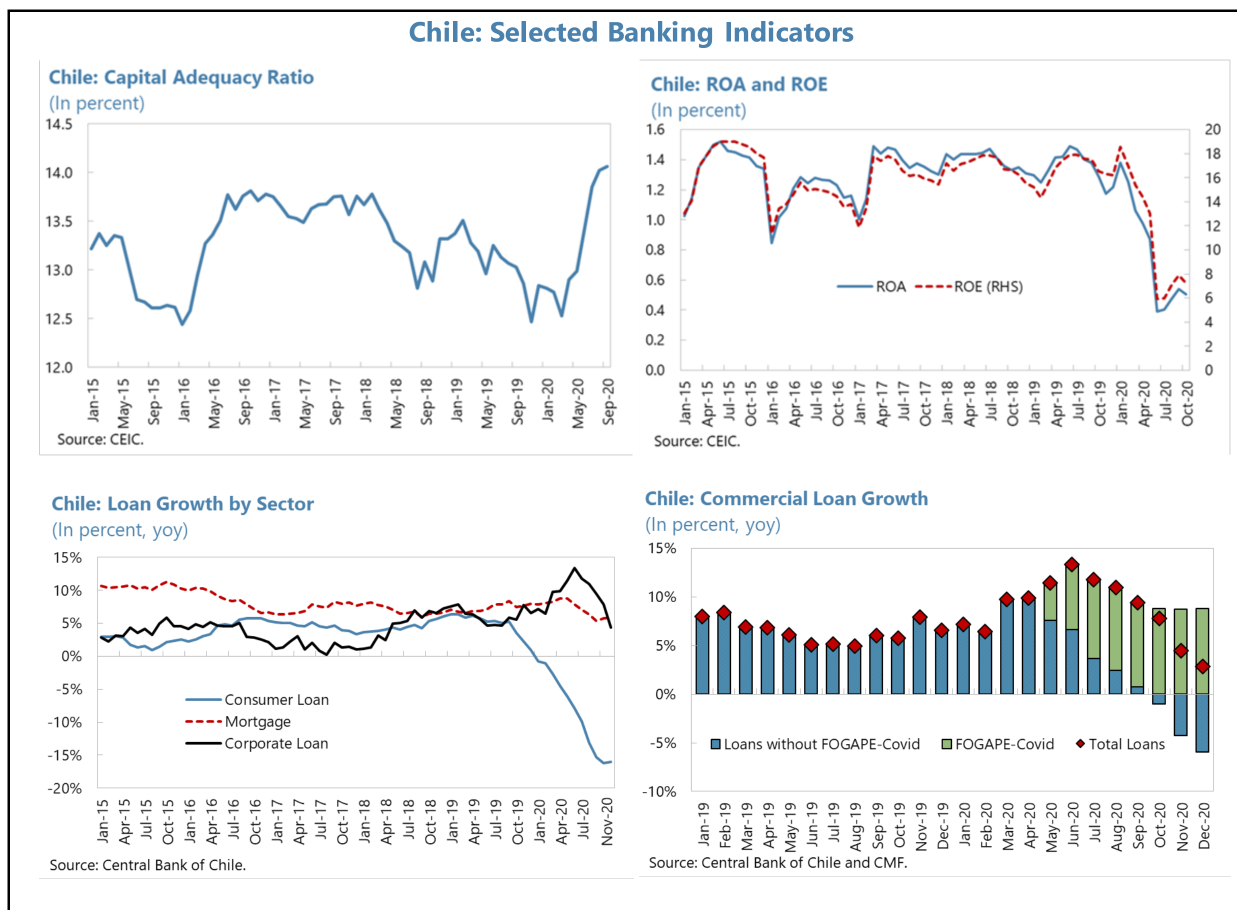
Main Characteristics		1st Withdrawal	2nd Withdrawal
Withdrawal Amount:	Up to 10% of funds:	✓	✓
	Maximum amount:	US$ 5,593 (150 UF as of 23-Jul)	US$ 5,769 (150 UF as of 3-Dec)
	Minimum amount:	US$ 1,305 (35 UF as of 23-Jul)	US$ 1,346 (35 UF as of 3-Dec)
	Those below minimum may withdraw all	✓	✓
Tax exempt:	Earn < US$1,986 a month ($1.5 MM as of 3-Dec)	✓	✓
	Earn > US$1,986 a month ($1.5 MM as of 3-Dec)	✓	✗
Legal Status:		Constitutional reform	Law
Date of Publication:		30-Jul-20	10-Dec-20

Source: Ministry of Finance.



12. Financial sector policies were adjusted to facilitate the flow of credit to businesses and households (see Annex I). The Financial Market Commission (CMF) introduced a package of measures that include: (i) special treatment in the establishment of provisions for deferred loans; (ii) use of mortgage guarantees to safeguard SME loans; (iii) adjustments in the treatment of assets received as payment and margins in derivative transactions; and (iv) revision of the timetable for the implementation of Basel III standards. In addition, the BCCh relaxed the liquidity coverage ratio, allowing for temporary deviations on a case-by-case basis.

13. The Chilean banking system appears resilient despite lower profitability. The capital adequacy ratio increased from 12.8 percent in 2019Q4 to 14.3 percent in 2020Q3 and liquid assets account for about 20 percent of total assets. The banking system's profitability declined, with return on equity dropping below 8 percent (from 16.2 percent in 2019Q4), due to higher provisions and the decreasing trend in net interest income. The non-performing loan ratio remains low at 1.6 percent in 2020Q3 owing to the broad set of government policies. Credit growth slowed amid negative consumer loan growth in 2020H1 (see SIP), but is expected to recover on the back of Central Bank measures and governments guarantees (FOGAPE loans of about 5 percent of GDP were awarded in 2020).

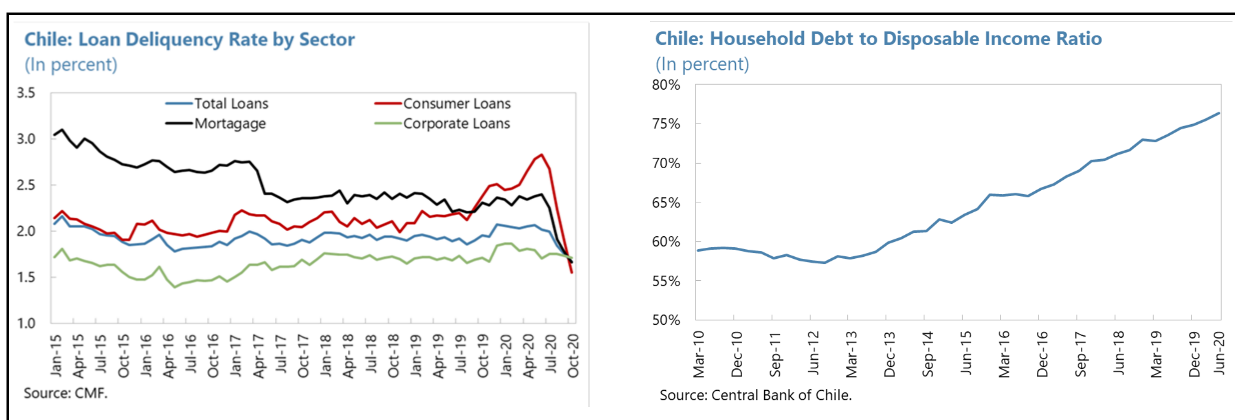


14. Chile started a process leading towards a New Constitution. In an October-2020 Referendum—agreed in November 2019 in response to the social protest—Chileans voted overwhelmingly in favor of drafting a New Constitution, starting a process that is expected to finish in mid-2022. It is anticipated that the constitutional process will include consideration of social rights and the role of the State in the provision of basic goods and services, but would preserve the main pillars of the current system.

A. Outlook and Risks

15. The prospects for a strong recovery are subject to high uncertainty. Economic activity is expected to rebound strongly in 2021, as the fallout from the pandemic gradually recedes on the back of a strong vaccination program and as mobility restrictions are eventually relaxed, while the economy continues to get support from accommodative policies. Over the medium term, growth is projected to converge to its potential of 2.5 percent and the unemployment rate to gradually decline to about 7 percent. Thanks to the improvement in Chile's terms of trade the current account balance is expected to remain close to zero in 2021 despite the strong import demand associated with the recovery, before slowly moving over the medium term towards a small deficit.

16. Risks remain and uncertainty looms high (Annex II), but the strong policy track record is a mitigating factor and the country exhibits strong resilience. *External risks* are largely related to the dynamics of the pandemic, though the fast pace of the vaccination program is expected to contain such risks. In this context, an accelerating de-globalization would reduce trade and growth opportunities. Movements in the price of copper would significantly affect exports, fiscal revenues, and prospects for investment and growth. *Domestic risks* stem primarily from the uncertain outcome of the New Constitution process as well as a possible resurgence of social unrest, which would also lead to a reassessment of market fundamentals and in turn result in higher risk premia. A delay in the recovery could increase delinquency rates, posing a source of risk to financial stability in the presence of leveraged non-financial corporates and households; however, banks capital appears adequate at present and corporate leverage is largely related either to obligations to parent companies or hedged against foreign exchange risk. Overall, the country exhibits significant resilience in the face of these shocks, not only because of the large policy response and the remaining fiscal space, but also due to the country's very strong institutional policy settings, the demonstrated sound record of policy reaction, and the low level of public debt by international standards.



Chile: Loan Deliquency Rate by Sector
(In percent)
Source: CMF.

Chile: Household Debt to Disposable Income Ratio
(In percent)
Source: Central Bank of Chile.

MACROECONOMIC POLICIES

A. Fiscal Policy

17. Chile's fiscal position remains very strong notwithstanding the debt increase over the past decade. The central government gross debt-to-GDP ratio has increased by almost 30 percentage points since 2007, but at 33 percent of GDP it remains low by international standards. Despite downgrades of the sovereign rating (most recently by S&P and Fitch, to A in March 2021 and A- in October 2020, respectively), which had a limited impact, the country has maintained some fiscal space and steady access to international markets at low rates, and spreads have returned to pre-pandemic levels, as shown in recent Environmental Social and Governance issuances.

18. Staff views the fiscal stance in 2021 as broadly appropriate. The headline fiscal deficit is expected to decline to 3.3 percent of GDP in 2021 from 7.3 percent in 2020, while the structural balance deficit is expected to worsen from 2.7 to 5.1 percent of GDP, as copper prices are higher, some tax deferrals expire, and economic growth improves. The 2021 fiscal impulse based on the non-mining primary structural balance is expected to be positive. Stimulus measures have been effective in counteracting the effects of the crisis, but depending on pandemic developments, fiscal policy may need to continue supporting those in need. In particular, given the pandemic's adverse impact on poverty and inequality (including across gender, see SIP), as well as the inadequate targeting from pension withdrawals, ongoing targeted efforts will be essential to continue protecting health, income, and jobs (particularly for the most vulnerable population including those without savings, informal workers, and women).

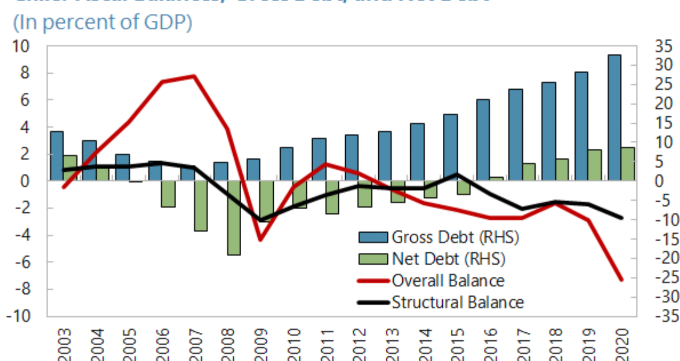
- In this respect, recent initiatives are welcome. The extension of FOGAPE in January 2021 to include refinancing for existing loans and for investments will allow firms to rollover debt and finance the recovery. The new round of family benefits, middle-class bonus, concessional loans, support for SMEs, employment protection measures introduced in March 2021, and the extension of household transfers until June 2021 will continue to support those most affected by the pandemic. The reopening of schools, for communes where the pandemic is contained, will facilitate women to return to the labor force and reduce human capital scarring. Moreover, the March 2021 enhancements to employment subsidies for females, youth, and workers with disabilities will help limit labor market impact for those groups.

- Additional steps may be necessary, conditional on developments. To magnify their effectiveness and reach, transfer programs could be further simplified and made more easily accessible. Reductions in the deductible for FOGAPE public guarantees for small firms could be considered, to incentivize banks to extend credit to this riskier category. If additional support to firms is needed, tax deferrals could be extended. While the recovery strengthens, identifying solvent firms would become more important, requiring an assessment of firm viability and network externalities. Staff cautions against additional pension withdrawals considering the aforementioned shortcomings, and if additional support is needed it should be delivered via fiscal measures.

19. Going forward, fiscal policy should support an inclusive recovery in the near term and strengthen macro sustainability in the medium term, identifying permanent financing sources to address social demands and other fiscal needs. The authorities remain committed to their plan for a gradual structural consolidation, reducing the structural deficit by about 1 percent of GDP per year starting in 2023, to reach a structural deficit target of 0.9 percent of GDP by 2025, which they estimate would stabilize the gross debt at about 43 percent of GDP (close to staff estimates, see Annex IV). Staff's view is that the consolidation path is currently appropriate, but will need to remain contingent on developments. Once the health crisis is controlled, the authorities will need to tackle medium term fiscal pressures arising from: possible additional spending to address social needs; the risk that the expected revenues from the 2020 tax reform may not materialize; contingent liabilities, including from the health sector; the fiscal implications of the pension reforms; and the need to rebuild buffers. Such fiscal pressures would likely require in the medium term a stronger fiscal effort through permanent revenue and spending measures, to achieve a higher fiscal balance target while accommodating larger spending needs, and still ensure macro stability (see below the discussion on medium-term revenue mobilization).

20. In this context, complementing the structural balance rule with an explicit medium-term anchor would contribute to strengthening credibility.[3] The structural balance rule has helped the country enhance fiscal discipline and build buffers ahead of the global financial crisis. However, the flexibility allowed within the fiscal rule did not prevent a large increase in gross debt since 2007. Complementing the current rule with an explicit anchor, that encompasses a debt ceiling coupled with a buffer, will help further enhance credibility and support medium-term planning.

Chile: Fiscal Balances, Gross Debt, and Net Debt
(In percent of GDP)

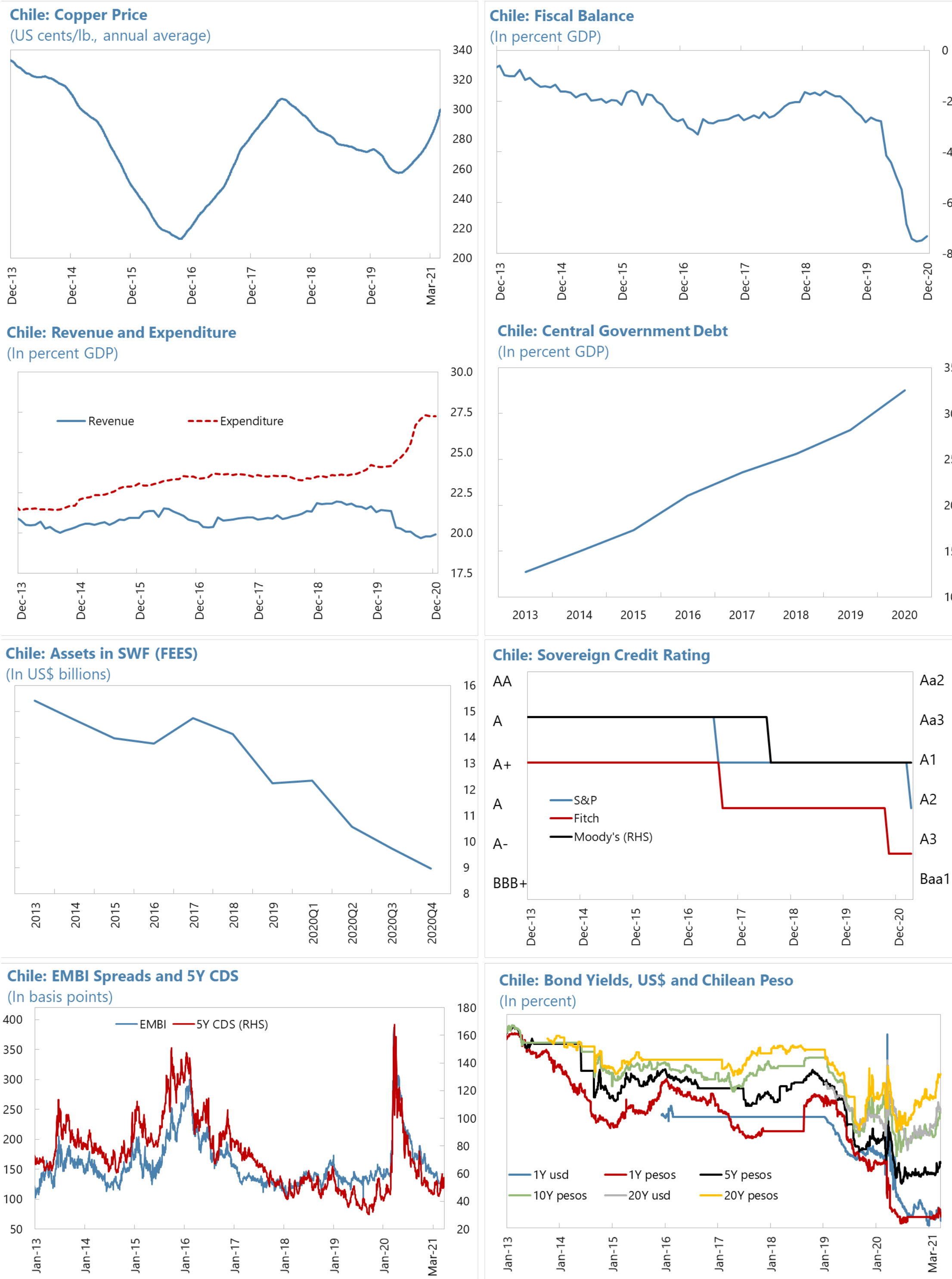


Sources: Ministry of Finance of Chile, Central Bank of Chile, and IMF staff calculations.

21. The introduction of a formal escape clause and an adjustment mechanism would explicitly clarify the criteria for responding to large shocks and offsetting deviations from fiscal targets in the medium term. A formal escape clause would facilitate countercyclical fiscal support in case of adverse shocks, by envisaging the temporary relaxation or suspension of the structural balance target. International experience envisages such clauses in the case of serious natural disasters or other calamities, or shocks that temporarily lower growth by a significant margin below the medium-term trend or threaten macroeconomic stability. An adjustment mechanism will help avert the adverse impact on debt in case the structural balance target is not met (either via an escape clause or not), and will help revert the debt path in cases when the structural balance rule is observed but debt rises above the ceiling due to significant or persistent cyclical factors.

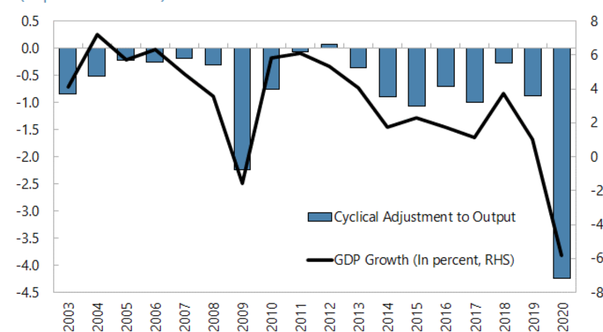
[3] The policy discussion of the fiscal rule draws of the discussion illustrated in International Monetary Fund, *Enhancing Chile's Fiscal Framework*, 2019.

Figure 1. Chile: Fiscal Indicators



Sources: Haver, Wall Street Journal, Dipres, Bloomberg and IMF staff calculations.

22. The authorities need to address the bias in the cyclical adjustment for output. Such an adjustment has been mainly one-sided since the inception of the rule, allowing a higher deficit than desirable under the rule (see text chart and footnote 3). A first step would be to ask the Committee of experts to offer not only projections for potential GDP but also for an output gap closing in the medium term.

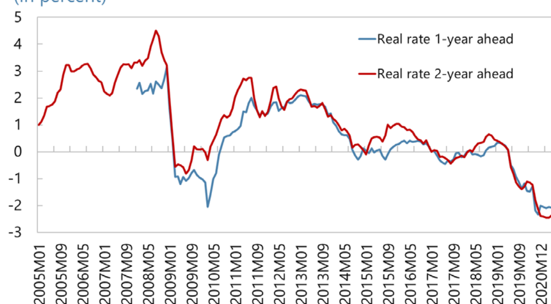


23. Staff welcomes the ongoing strengthening of the institutional framework for fiscal responsibility and transparency. The empowerment of the Autonomous Fiscal Council with own resources and broader mandate will help increase the accountability of the budgetary process. Also, the Ministry of Finance recently asked the IMF for a fiscal transparency evaluation, with the goal of further elevating the standards in this matter.

24. The authorities generally share the staff's assessment. The authorities agree with the staff view that the 2021 fiscal position is broadly appropriate, but composition changes in fiscal expenditures may be necessary to appropriately respond to the evolution of the pandemic and its impact on economic and sanitary conditions. They recognize the need for medium-term revenue and spending measures to address rising social spending demands, absorb risks in revenue projections, and gradually rebuild buffers, while preserving macroeconomic stability. To that end, they are considering the recommendations from a Commission of Experts on changes to tax expenditures, including deductions and exemptions. The authorities agreed on the need to make the fiscal rule more binding and are looking forward to the incoming recommendations of the Autonomous Fiscal Council on enhancing the fiscal framework with a medium-term debt anchor, a formal escape clause, and an adjustment mechanism to further strengthen policy credibility.

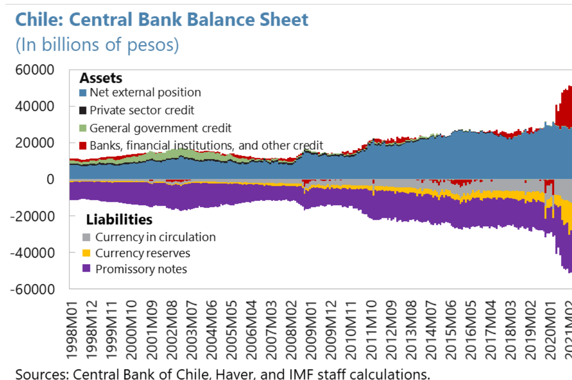
B. Monetary Policy

25. The monetary response has been well-conceived, adequate, and unprecedented in magnitude. The monetary authorities' policy response has helped support liquidity, maintain interest rates low (see Box II), and contain the adverse impact of the pandemic, while maintaining inflation expectations well-anchored. The authorities did not engage in foreign exchange intervention during the pandemic, though temporarily resorted to small interventions during the social unrest episode (see SIP). Staff supports the aforementioned plan to increase foreign exchange reserves. The inclusion of bank and corporate securities as eligible Central Bank



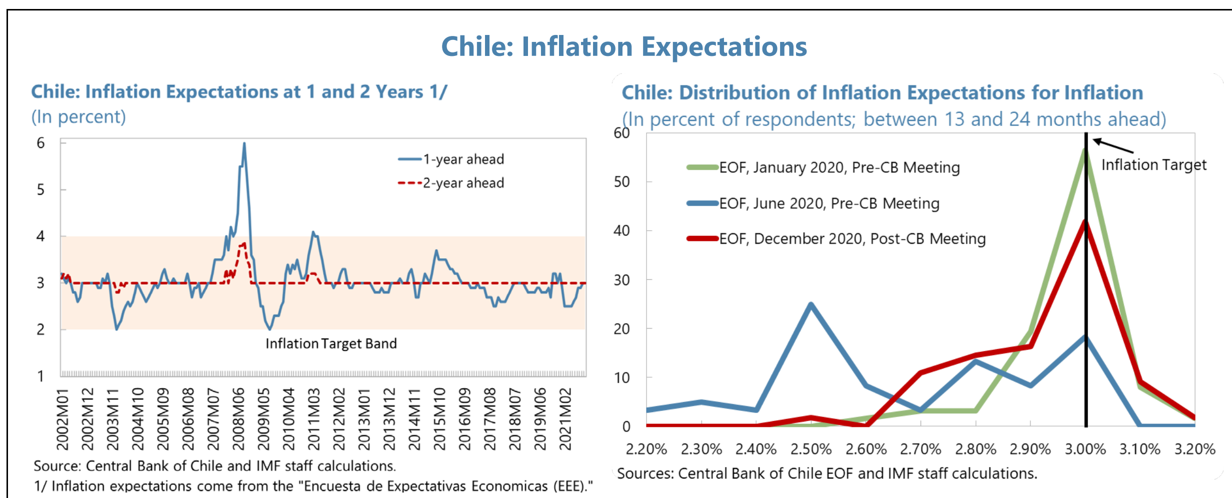
collateral helped provide ample liquidity to the market; the associated exposure of the Central Bank's balance sheet to some credit risk was mitigated by imposing a haircut and limits on the stock of collateral accepted.

26. The monetary stimulus appears appropriate at the current juncture, and going forward should continue to be contingent on developments and risks. Underlying economic weaknesses—as reflected in a large negative output gap, still high unemployment, and depressed labor participation—amid well-anchored inflation expectations, provide space for maintaining the current monetary stimulus. Going forward, the extent of the monetary stimulus should continue to be guided by the inflation targeting framework, encompassing economic developments, the policy mix, and risks (see Annex III).



Sources: Central Bank of Chile, Haver, and IMF staff calculations.

27. The authorities broadly concurred with the staff's assessment. The authorities broadly concurred with the staff's assessment. At the January 2021 policy meeting, the BCCh reaffirmed its intention to keep the policy rate at its technical minimum for most of the next two years, while maintaining the reinvestment of coupon payments on its bank bonds holdings in coming months. Regarding the operations of the credit line (FCIC), the monetary authorities highlighted the continuation of its operations through a broader set of eligible collaterals, in line with the latest modifications to the FOGAPE (FOGAPE-*Reactiva*). They expect the FCIC to continue facilitating credit flows to SMEs, as well as the refinancing of their current debt to smooth out repayments in line with revenue flows. Finally, the authorities stressed that the main goal of the reserve accumulation program announced last January is a timely preparation to exit the FCL arrangement in May 2022. As indicated when requesting access to this arrangement, the intention of BCCh is to treat the FCL as a precautionary and temporary instrument. The FX purchases will be conducted through a prolonged 15 months period using fixed amount daily auctions in line with a flexible and market-driven exchange rate.

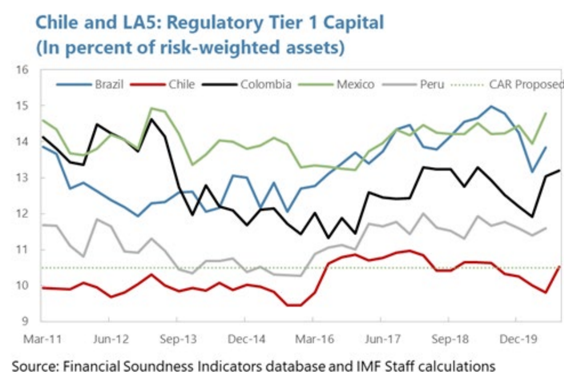


FINANCIAL SECTOR

A. The Changing Environment of Financial Sector Regulation and Supervision

28. In light of the pandemic, it was necessary to delay the phase in of financial sector reforms. The New Banking Law sets the stage for transforming the financial sector's regulatory and supervision environment. Amid the pandemic, the implementation of Basel III was delayed by one year (see Box III), and additional capital needs are expected at about $2.3bn by 2025 (of which about ½ for *Banco Estado*). Congress passed legislation enhancing financial portability (facilitating customer movement across financial institutions, thus promoting competition in the financial sector), improving financial market functioning and facilitating access to financing in the local capital market, regulating financial advisors, and strengthening CMF powers to prevent financial market abuse. Pending legislation in Congress aims at enhancing personal data protection. The Ministry of Finance has also indicated that it would present legislation to expand the scope of the public credit registry for the financial sector, thereby facilitating access of credit data and fostering competition among financial institutions. Such legislative initiatives should be finalized swiftly. When the pandemic is over, authorities should devote further attention to pending deficiencies in the current regulatory framework, including the need to: i) strengthen bank resolution regimes; ii) establish a national deposit insurance scheme funded by member banks; iii) enhance regulation of insurance companies; iv) and regulate financial conglomerates (the CMF is working on most of these initiatives).

Chile and LA5: Regulatory Tier 1 Capital
(In percent of risk-weighted assets)



Source: Financial Soundness Indicators database and IMF Staff calculations

29. Financial sector vulnerabilities will need to continue to be monitored. Emergency measures promoting lending, supporting income, and facilitating refinancing have been very effective in keeping borrowers afloat. Stress tests performed by the authorities indicate that financial stability appears well guarded at this juncture. It will be essential to continue monitoring the situation to identify early signs of stress in the system and to stand ready to intervene to avoid disorderly conditions. Also, when the situation normalizes, commercial banks should be encouraged to prudently restructure loans, as needed, on a commercial basis, while maintaining both prudential (lending) standards and adequate reporting. In addition, banks should continue to carefully assess the credit quality of exposures. The FSAP will look into vulnerability issues in more detail.

30. The FSAP, which has been delayed to 2021 due to COVID-19, will conduct a detailed analysis of the financial system, focusing on:

- **Financial institutions and interlinkages.** Stress tests will examine potential degradation of asset quality and the impact of forbearance measures. Interconnectedness and systemic

liquidity analyses will consider market functioning during recent volatility episodes and backstops provided by the authorities.

- **The reorganization of supervisory arrangements.** The key focus will encompass an assessment of banking supervision and a review of the macro-prudential framework.
- **Crisis management, bank resolution arrangements, and the need for deposit insurance.** These were noted as critical deficiencies in the previous FSAP.

31. Regulation needs to keep pace with the expansion in FinTech and looming cybersecurity threats. Following a series of cyberattacks on financial institutions in recent years, the authorities have enhanced regulation and supervision of cybersecurity risks. The CMF published a white paper and proposed a legal text to the Ministry of Finance on Fintech, that expands the CMF perimeter to include crowdfunding, trading platforms (including those for trading digital assets), robo-advisors, amongst others. The documents propose that regulatory requirements should be proportional to the risks the firm generates (criteria of proportionality), differentiated by the type of financial services it provides and not by the intensity in technology (technological neutrality), and embracing the other criteria of comprehensiveness, flexibility, and modularity. The CB has created a technological observatory and is investigating issues related to digital payments, Central Bank Digital Currencies, and cryptoassets, with particular emphasis on efficiency and speed of payment, financial inclusions, legal aspects, and risks. In this context, it is important to address the key policy challenge: promoting innovation, competition, and efficiency, while minimizing financial stability risks and protecting consumer rights.

32. On the AML/CFT front, Chile is currently undergoing an assessment against the Financial Action Task Force (FATF) anti-money laundering/combating the financing of terrorism (AML/CFT) standard by GAFILAT (FATF Latin America regional body). The assessment process, which was subject to some delays due to the Covid-19 outbreak is planned to be discussed and adopted in July 2021 at GAFILAT's Plenary meeting. The report's recommendation should aim at further strengthening the overall AML/CFT regime.

33. A recent assessment highlights the strong independence of the Central Bank. In 2019, The Central Bank of Chile has voluntarily undergone an independent external evaluation of the conduct of monetary and financial policy, which highlighted high standards of policy analysis, conduct, and independence, of comparable level to advanced economies. The Chile CB is undergoing a pilot review of its transparency system in light of the new IMF Central Bank Transparency Code.

34. Staff has completed the safeguards procedures for Chile's FCL arrangement. The BCCh external audit and financial reporting reflect leading practices. KPMG Chile issued an unmodified (clean) audit opinion on the BCCh financial statements for 2019, which are prepared and audited in accordance with international standards. The financial statements include comprehensive disclosures and are published on a timely basis. Staff reviewed the 2019 audit results and held discussions with the BCCh and KPMG Chile. No significant issues emerged from the conduct of these procedures.

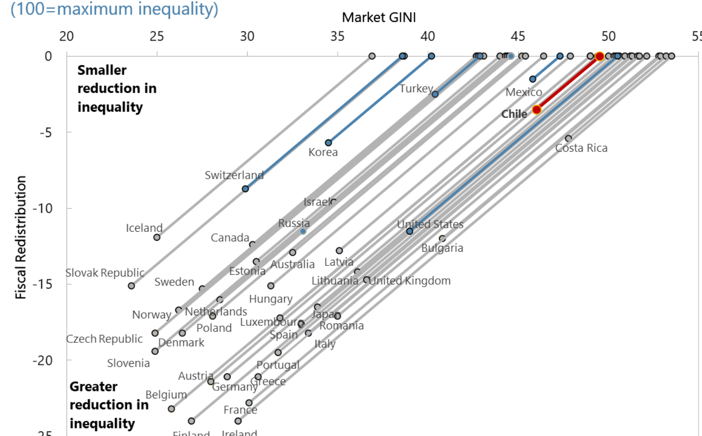
35. The authorities broadly shared the staff's assessment. They also stressed that, while they believe their policies will significantly contain financial sectors risks, careful vigilance and supervision will be essential going forward. At the same time, authorities highlighted their concerns regarding specific legislation being discussed in Congress that in their view could weaken the financial sector. Regarding the financial sector agenda, the authorities underlined that they are working on the pending issues in the current regulatory framework highlighted by staff, which will become a priority once the pandemic is under control. These include the regulation of interchange fees charged by card issuers, strengthening bank resolution framework, expanding the coverage of the public credit registry, implementing a risk based capital and enhanced supervision powers for the insurance sector, and submitting FinTech legislation to Congress.

ADVANCING THE REFORM AGENDA

36. Expeditiously reaching broad agreements over policy reforms would be essential to improve inclusiveness, address social needs, and support domestic confidence in the current period of heightened global and domestic uncertainty. A broad structural and social agenda should deepen efforts to enhance productivity and investment, while supporting economic and social conditions of vulnerable groups, thereby ensuring that growth prospects are more equitably shared and social cohesion is strengthened. Indeed, income inequality has improved substantially over recent years but remains high by international standards. Such an agenda may need to be complemented in the medium by higher revenues and spending rationalization, such that the debt ratio can stabilize at the level envisaged in the authorities' projections.

Chile and OECD: Market and Disposable GINI 1/

(100=maximum inequality)

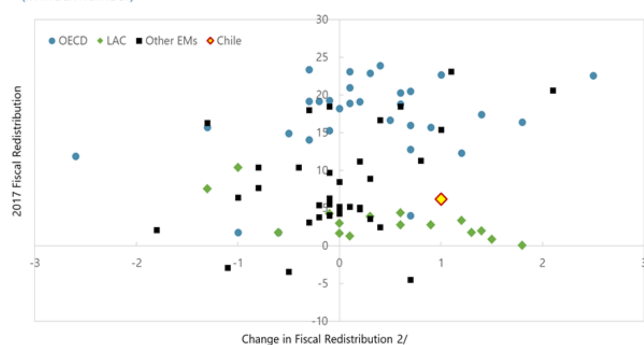


Source: OECD and IMF staff calculations.

1/ Latest available data from 2015-2018. Market GINI is defined as income before taxes and transfers; Disposable GINI is defined as income post taxes and transfers.

Chile and ROW: Change in Fiscal Redistribution (2007-2017) vs 2017 Fiscal Redistribution 1/

(In index number)



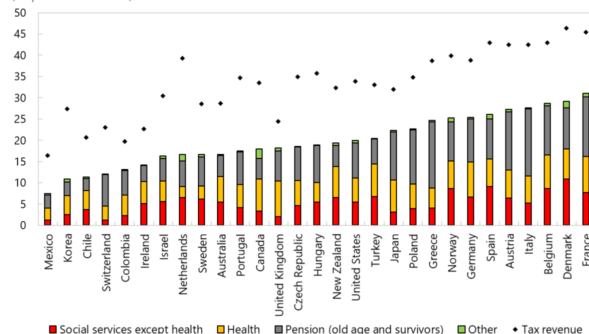
Sources: The Standardized World Income Inequality Database (Version 8) and IMF staff calculations.

1/ Fiscal redistribution is calculated as the difference between market GINI and disposable GINI.

2/ Difference between 2017 fiscal redistribution and 2007 fiscal redistribution.

Chile and OECD: Social spending and tax revenue 1/

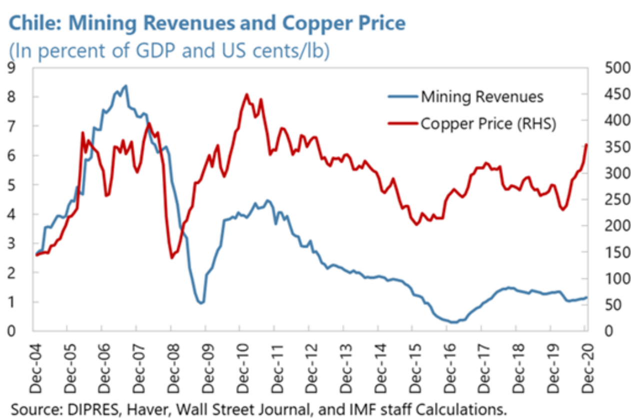
(In percent of GDP)

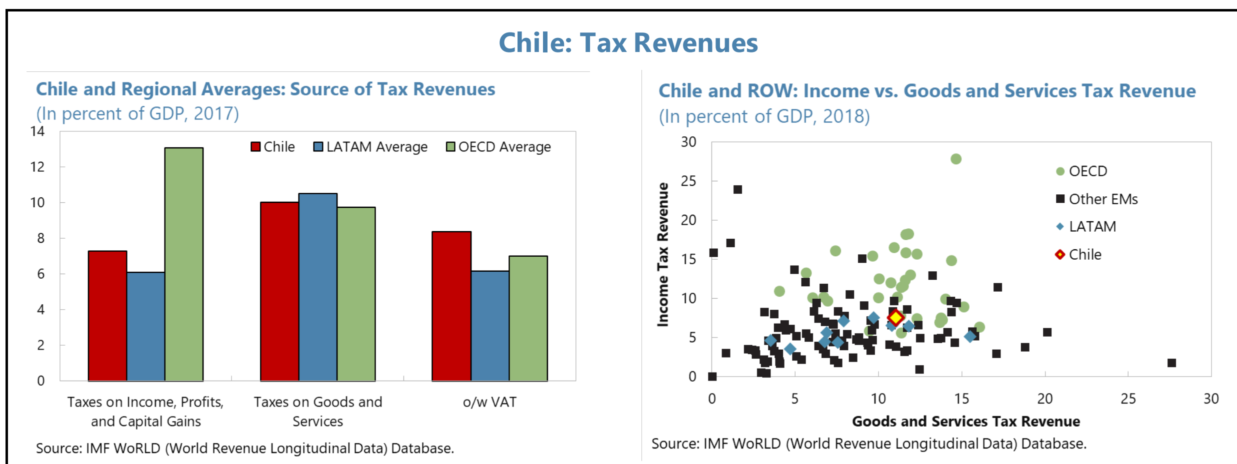


Source: OECD and IMF staff calculations.

1/ Selected OECD countries for 2019 or latest available data.

37. A more developed social support system would require higher revenues and a rationalization of expenditure, in the medium term, when the recovery is well-advanced. Chile relies largely on indirect taxation. Instead, its reliance on direct taxation is close to levels prevailing in Latin American and most EM countries, but below most OECD countries. While the need to increase direct taxation was subdued when copper revenue was high, the higher demand for public provision of goods and services, coupled with copper's price volatility, have exposed the need for additional permanent sources of revenues. The recent comeback in copper prices should not delay revisiting beneficial tax treatments, in light also of a declining trend in ore grade. The Commission of Experts called by the Minister of Finance in October 2020 issued a first report in January 2021 (in line with a recent IMF/OECD joint report) with a set of recommendations for gradually (as the economic recovery gains ground) reducing tax exemptions, deductions, and special regimes, such as for: (i) presumptive income (*renta presunta*, which could be substituted by the recent SME regime); (ii) VAT exemption to professional services and construction; (iii) excise on diesel; (iv) cooperatives; (v) investment funds; (vi) mortgage interest payments; (vii) some housing rental income. Beyond curtailing those exemptional tax treatments, overall revenues could be raised by (see SIP): (i) increasing direct taxation, including via revisiting the PIT exemption threshold and rate schedule, reconsidering the capital gains tax exemption, strengthening tax administration and tax enforcement, and possibly revisiting mining taxation in light of international practices; and (ii) raising green taxes (e.g. gradually bringing carbon tax—currently at $5 per ton of CO_2 emission—towards levels consistent with Chile's commitments under the Paris agreement). At the same time, authorities should sustain efforts towards increasing efficiency in spending.





38. Many Chileans face inadequate pension benefits. Under the current system, expected replacement rates compare unfavorably with international standards, reaching on average only about 40 percent even with the government-funded pension supplement (they would be

significantly lower in the absence of such a supplement). Indeed, pensions are very low for a large part of the pensioners, about 70 percent of which receive the public pension supplement. There are several reasons for this: the contribution rates are low (10 percent); the contribution density (about 60 percent for males and 50 percent for females) is poor and heavily affected by high worker turnover and informality; the retirement age (65/60 for men/women) has not followed the increases in life expectancy; and the historical global decline in interest rates has affected returns on pension assets. These problems will be compounded by the recent withdrawals of US$36bn (about 18 percent of June 2020 pension assets). An expected increase in the dependency ratio implies that Chile will need to strengthen the self-financed pension system, while adequately designing the solidarity component for those in need during the transition towards higher replacements rates (see SIP).[4]

39. To improve pensions and replacement rates, it has become urgent to increase contribution rates and density, broadening solidarity terms, and adjusting the retirement age. The authorities pension proposal, currently with Congress, is an important step in the right direction, by envisaging in particular an increase in the contribution rate from 10 to 16 percent (funded by the employer), with half of this increase (3 percent) going to employees' individual pension savings, and the rest to a new collective contributory pillar to support solidarity benefits and dependency care insurance. However, an increase in the contribution rate to the individual account by 3 percentage points would not be enough to adequately increase the replacement rate and thus (gradual) changes to the retirement age should also be urgently considered (see SIP).[5] At the same time, it would be preferrable to finance the solidarity components via the general budget as opposed to a labor tax, which entails distortions that increase labor costs and informality. Also, it will be crucial to ensure an efficient management of the assets resulting from the 6 percentage points increase in the contribution rate: the new management entity envisaged by the proposal should operate in a competitive environment (without monopoly power) and be subject to strict scrutiny. Pension reforms should also consider the impact of portfolio allocation and switching rules on long-run returns and broader financial stability matters, such as systemic liquidity. As contribution density remains low, authorities should consider broadening the base for mandatory contributions to the informal sector, intensifying efforts to reduce informality, and facilitating employment for senior people (more below, on labor market flexibility and informality).[6] Going forward, pension adequacy will continue to require future adjustments to contribution rates, retirement age, and solidarity parameters, depending on demographic trends, employability, economic developments, expected replacement rates, and expected returns on pension savings. Such adjustments should be done at regular intervals (say 5 years), possibly via a commission of experts. The authorities should also aim

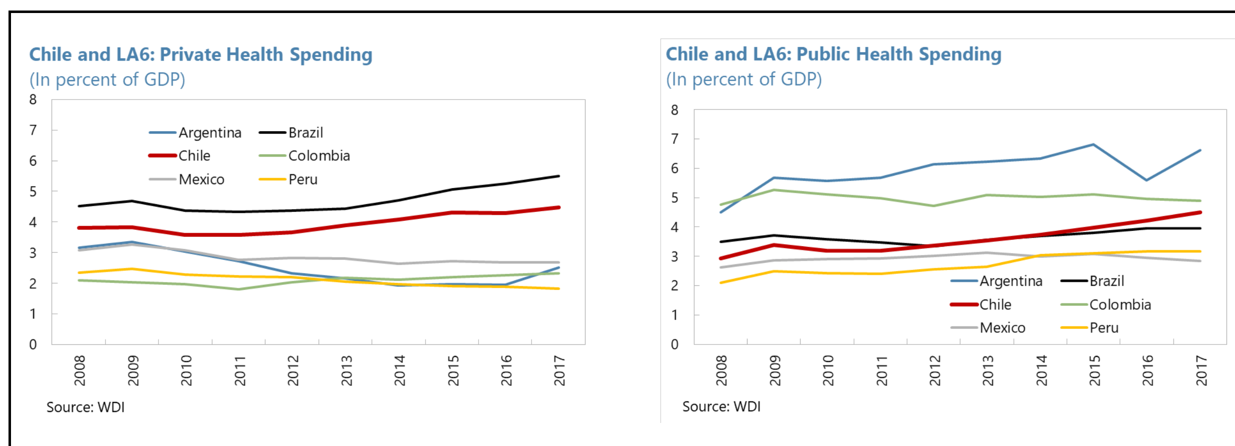
[4] People after retirement age are expected to raise from about 3 million at present to about 6 million in 2050, while the working age population will decrease from 13 to 12 million over the same period. As a consequence, a pension system fully funded by the government would be soon very expensive: for example, a flat pension equal to 50 or 75 percent of the 2020 real minimum wage—even if remaining constant in real terms—can imply in 2050 a cost of about 5-8 percent of GDP.

[5] A higher retirement age would increase pensions in three ways: allowing contributors to build more assets and accumulate additional returns on past assets, while reducing the number of years the pension is expected to cover.

[6] Broadening pension contribution to groups not currently in the system could be achieved in some cases by leveraging on sales invoice (for example via a small increase in the VAT from 19 to 20 percent, with the extra amount accruing to the individual pension account) or on permits (a fee at renewal, again accruing to the individual pension account).

to identify measures to increase pension managers competition by revisiting the rules and fees for collection, management, and administration of the pension assets, against international best practices.[7]

40. The health care system needs to be reformed. Chile has adequate health outcomes given its level of development. But the existing system is intensely criticized, largely due to its complexity and limited competition; the elevated out-of-pocket costs of medicines; the inferior service provided by the public system (such as long wait times); and the link of access and costs of private insurances to gender and pre-existing conditions. These issues have led to rising health costs, segmentation—about 80 percent of the population relies on the public system (FONASA), while the relatively well-off 20 percent are served by private providers (ISAPRES)—and expensive litigations[8]. In January 2020, the government aimed to lower the out-of-pocket cost of medicines, by allowing the import of all medicines approved for consumption in Chile (while previously only medicines not available could be imported), and expanding the list of generic brands. In addition, the government has a current proposal in congress de-emphasizing the importance of medicine brands, by requesting that doctors prescribe medicines based on the key active ingredient (based on the International Common Denomination) and not the brand, while an alternative proposal would envisage pharmacies to charge a fixed amount rather than a percentage mark-up. More broadly, going forward, Congress is considering a government's proposal that includes: i) strengthening FONASA in term of efficiency, autonomy, governance, and risk management (the recent effective management of the vaccination process has shown the high potential of the public system); ii) creating a basic universal health plan, envisaging same coverage in both the private and public sector, which would increase transparency and competition; iii) increasing the solidarity of ISAPRES by eliminating pre-existing conditions and gender discrimination (a better risk sharing across public and private sector would be achieved via the creation of a fund that would compensate providers based on the age, gender, and health conditions of their insured population); iv) ensuring that private providers guarantee the same price to men and women of a given age. While recognizing the complexity of the issue, staff agrees that the authorities' plan offers an important step in the right direction.



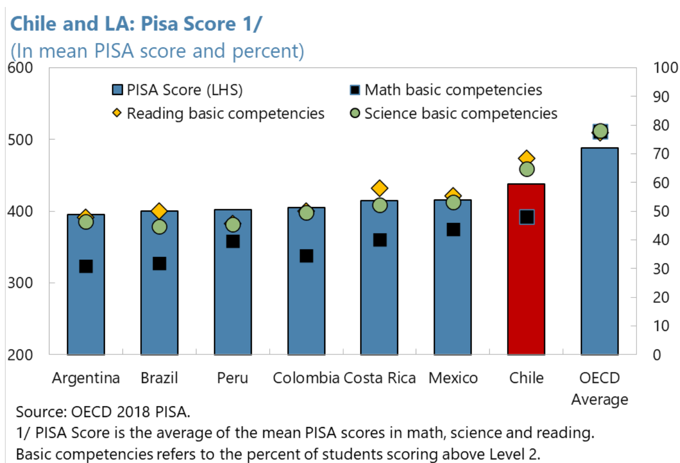
[7] Chilean pension management fees are broadly in line with most other countries, but tend to fare high compared to older and mandatory pension systems.

[8] In 2018, there were 18,000 judicial complaints (80 percent of the total) regarding the increase in ISAPRES premia, prompting the president of the Supreme Court to request legislation to address the problem.

41. Building on recent progress in education coverage, policies need to focus on improving education quality and reducing labor market mismatches between the supply and demand for skills. Chile has been significantly expanding access to higher education over past decades. Now efforts need to be devoted to enhancing its quality. Students performance tend to rank better than Latin American peers but significantly below OECD countries, both in terms of high school standardized international tests (PISA) and basic competencies. While some institutions are among the best in the region, returns to education are quite heterogenous and often quite low (see Ferreyra et al. 2017). Moreover, firms lament that the educational system appears to produce workers that do not appropriately meet the needs of the labor market. Further improving the quality of education requires expanding and strengthening programs that monitor teacher performance and that align teacher career incentives to student performance.[9] To tackle skill mismatches, the regulatory agency could provide more transparent and up-to-date career information to students, and promote a more active engagement between employers and education providers (such as via internships): in this respect the recent pilot for a centralized platform for job placement and training system is welcome.

Chile and LA: Pisa Score 1/

(In mean PISA score and percent)



Source: OECD 2018 PISA.
1/ PISA Score is the average of the mean PISA scores in math, science and reading.
Basic competencies refers to the percent of students scoring above Level 2.

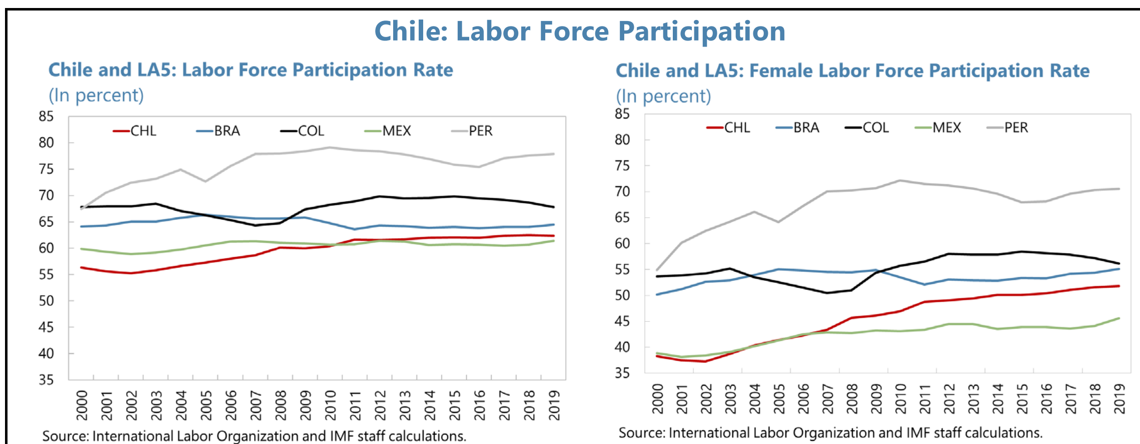
42. Enhancing labor market flexibility will be essential. Staff welcomes the 2019 law facilitating formal youth employment by promoting a combination of work and study, and the 2020 law regulating tele-work under the pandemic. Staff encourages the authorities to bring quickly to fruition the current plans to introduce a universal childcare system, which should eliminate a source of discrimination and promote female labor force participation, a longstanding challenge in Chile. Introducing flexibility in the working schedule and location would facilitate labor participation—particularly for women and senior citizens, thus also helping them reach a better pension through higher contribution density—and facilitate an adjustment towards new remote-working practices prompted by the pandemic. More broadly, reviewing severance costs and dismissal procedures, and widening the eligibility for severance benefits coverage could be considered, to support job creation, improve labor market resilience[10], and facilitate labor mobility.

43. Reducing informality would be essential to promote inclusiveness. Almost one third of the workforce is in the informal sector. Although this is among the lowest in the region, informal employment excludes workers from receiving unemployment insurance and contributing to pensions, and undermines the taxation system. Reducing informality will be a complex task that requires a comprehensive set of reforms that lower the costs of formality (via regulations), while increasing its benefits (via public services). In 2019, Congress extended the obligation of pension and health contribution to self-employed (including professional services), to be gradually

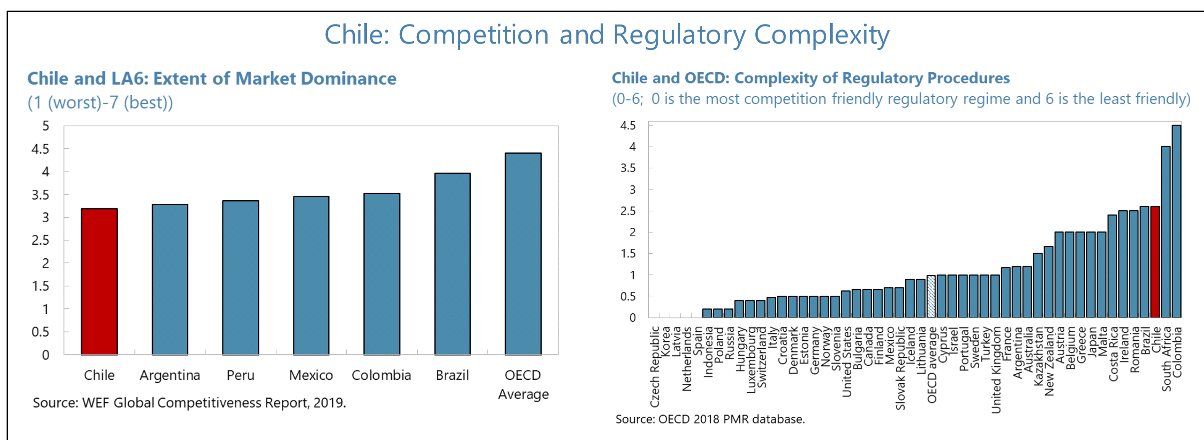
[9] See Bruns, Barbara, and Javier Luque (2015, World Bank) and OECD (2017) "Education in Chile, Reviews of National Policies for Education".

[10] As shown in David, Pienknagura and Roldós (2020, IMF), policies that enhance labor market flexibility, such as lower severance costs, are associated with a faster speed of adjustment of employment to shocks.

introduced over eight years. Further steps would include making employee dismissal regulation less administratively burdensome, incentivizing formal work (particularly among women) through earned income tax credit, and enhancing training programs that allow vulnerable workers to acquire relevant skills and facilitate access to formal employment.



44. Enhancing competition, streamlining bureaucracy, and promoting access to finance can foster efficiency gains. Chile was a regional pioneer in the development of a legal competition framework, and legislation over the past five years has introduced harsher penalties for anti-competitive behavior and increased the powers of the competition agency. However, the business community laments limited growth opportunities for new entrants and high price-cost margins. OECD studies indicate that the time and cost needed to comply with regulation—which in part reflects its low efficiency and high complexity—is disproportionately larger for new and small firms, discouraging entry and scaling-up. Also, the restrictive regulatory stance in some key sectors (such as maritime transport services) and state involvement and barriers to entry in the railway and telecommunication services weigh on integration in global value chains and investment (see OECD 2018 and 2021). Thus, to further improve competition and efficiency, policies should be geared towards streamlining regulation, reducing barriers to entry, promoting efficiency in the public sector, and leveling the playing field in key services sectors (particularly network industries). Smaller firms would also benefit from easier access to credit and digitalization training programs. In this respect, FinTech initiatives should be promoted, while the recent law allowing financial collateral portability (facilitating the change of finance provider, particularly for SMEs) should help increase efficiency and competition in the financial sector and promote inclusion.



45. The authorities have demonstrated their firm commitment to free trade by broadening and deepening existing trade arrangements. Chile has signed 30 free trade agreements with 64 economies, that account for most of global GDP. In late 2018, the authorities signed a free trade agreement with Brazil, and in January 2019 a Trade Continuity Agreement with the UK. The authorities are updating trade agreements with the European Union, and the European Free Trade Association, among others. Separately, the authorities have signed a Digital Economy Partnership Agreement with New Zealand and Singapore, aiming to support the development of digital economy platforms. It is important to finalize expeditiously the domestic approval of the CP-TPP agreement, currently in the final stages of congressional approval.

46. Climate action. Chile was the first sovereign in Latin America to issue green bonds, with proceeds used for energy efficiency projects, green buildings, and electric buses. Recently, Chile successfully issued also several "social" bonds, aimed to finance programs that support households, health, education, and social services amid the pandemic. More broadly, the financial strategy for climate change published in December 2019 aims to develop a framework for measuring green components in the budget and capacity building related to green finance in the private sector.

47. Regional financial center. With the aim of further diversifying the economy, the Ministry of Finance launched an initiative to transform Chile into a regional financial center, by simplifying procedures and regulations as well as adopting international best practices that can be expected to enhance regional financial integration and cross-border flows. This goal is also supported by the CB agenda on the internationalization of the peso (related to its mandate on financial stability), such as the CB authorization to use the peso in cross-border transactions.

48. The authorities broadly shared the staff's assessment and underlined their commitment to enhance productivity and investment, while supporting economic and social conditions of vulnerable members of the society. They acknowledge that a pension reform that helps improve pensions is urgently needed, in line with their updated pension reform proposal presented in March 2021. The authorities concurred that improving the health care system is also a priority, and are going forward with their proposal in this respect. They acknowledge the importance of improving education quality, reducing labor market mismatches, enhancing labor market flexibility, and reducing informality. The authorities are currently working on a universal childcare system to facilitate labor force participation. They remain committed to promoting trade integration and taking actions addressing climate change.

STAFF APPRAISAL

49. Chile maintains very strong economic fundamentals and institutional policy frameworks and is implementing very strong policies—with a sustained implementation track record, including during the pandemic. Following a good performance until late-2019, the pandemic hit the Chilean economy when it was recovering from the 2019 social unrest. The country has responded with wide-ranging and unprecedented policy responses, accompanied by the approval of an FCL arrangement in May 2020. While policy buffers have appropriately narrowed somewhat owing to the crisis response, Chile's macroeconomic policies and institutional frameworks remain very strong.

The Chilean economy is now recovering amid significant uncertainty,

50. Economic activity is recovering, supported by accommodative policies, and a strong economic rebound is expected in 2021. A recovery in output and employment picked up in the fourth quarter, while inflation expectations remain anchored. Economic activity is expected to expand by 6.5 percent in 2021 and to converge to its potential of 2.5 percent in the medium term.

51. Risks remain amid high uncertainty, but the country exhibits strong resilience. External risks are largely related to the dynamics of the pandemic, though they are expected to be mitigated by the fast vaccination process. De-globalization demands may reappear, reducing trade and growth opportunities. Large movements in the copper price would significantly affect exports, fiscal revenues, and prospects for investment and growth. Domestic risks stem primarily from the uncertain outcome of the New Constitution process as well as a possible resurgence of unrest. A delay in the recovery could increase delinquency rates, though bank capital appears adequate at present. Overall, the country presents significant resilience in the face of these risks, not only because of the large policy response and the remaining fiscal space, but also due to the country's very strong institutional policy frameworks, the demonstrated sound record of policy reaction, and the low level of public debt by international standards.

Macroeconomic Policies Remain Appropriately Accommodating

52. The authorities have implemented a wide-ranging and largely appropriate set of fiscal, monetary, and financial policy actions in response to the pandemic. The plans have constantly evolved and have greatly benefitted from close coordination between the Ministry of Finance, the Central Bank, and the CMF. The government is implementing a multi-year fiscal package to safeguard health, protect incomes and jobs, promote credit, facilitate refinancing and repayments, and buttress the recovery. Main policies include: additional health spending, transfers to households, tax deferrals, employment subsidies, and state guarantees for credit to firms. The Central Bank of Chile greatly expanded the monetary stimulus and introduced a broad range of unconventional measures to support liquidity, including through funding-for-lending facilities, asset purchase programs, and an expanded collateral framework. Financial sector policies have been adjusted to facilitate the flow of credit, especially to households and SMEs, and the implementation of Basel III standards has been delayed.

53. Chile's fiscal position remains very strong notwithstanding the debt increase over the past decade. Despite the increase in debt over the past fifteen years, Chile still presents low indebtedness by international standards (33 percent of GDP) and maintains steady and favorable access to international markets at low rates.

54. Staff views the fiscal policy stance in 2021 as broadly appropriate. The multi-year fiscal stimulus package has been effectively helping counter the effects of the crisis. Fiscal policy will need to remain data driven. Additional stimulus might be needed if the pandemic is prolonged, such as through targeted household transfers and an extension of tax deferrals. Staff cautions against additional pension withdrawals: although the ones in July and December 2020 are supporting the recovery, they were poorly targeted, regressive, and have weakened the pension system.

55. Fiscal policy should progressively shift from supporting an inclusive recovery in the near term to strengthening sustainability in the medium term. The authorities remain committed to their plan for a gradual consolidation, reducing the structural deficit towards a target of 0.9 percent of GDP by 2025. Once the health crisis is under control and the recovery strengthens, permanent revenue and spending adjustment measures would be needed to provide additional space to address social needs, absorb risks in revenue projections, and rebuild buffers, while preserving macroeconomic stability.

56. Going forward, enhancing the fiscal framework with a medium-term debt anchor, a formal escape clause, and an adjustment mechanism would further strengthen policy credibility. It will be crucial to complement the current rule with an explicit medium-term debt anchor (encompassing a debt ceiling and buffer zone), introduce a formal escape clause that envisages temporary relaxation or suspension of the structural balance target, and an adjustment mechanism to offset temporary deviations from targets.

57. The monetary policy response has been well-conceived, adequate, and unprecedented in magnitude. The adjustment in the policy rate and the set of unconventional measures have helped contain the adverse impact of the pandemic, while maintaining inflation expectations well-anchored.

58. The monetary stimulus appears appropriate, and should continue to be guided by the inflation targeting framework, and contingent on developments and risks. Underlying economic weaknesses—as reflected in a large negative output gap, high unemployment, and depressed labor participation—amid well-anchored inflation expectations provide space for maintaining the current monetary stimulus.

59. Monitoring financial sector vulnerabilities will remain critical. Temporary emergency measures to facilitate the flow of credit and support income are preventing a deterioration in credit quality. It is essential to continue monitoring developments closely, to identify early signs of stress in the system and to stand ready to intervene to avoid disorderly conditions. As normalcy returns, financial institutions should continue to assess credit quality carefully, be encouraged to restructure loans prudently if needed, and maintain both prudential lending standards and adequate reporting.

60. Financial sector reforms have set the stage for boosting financial resilience and transforming the financial sector's regulatory and supervisory landscape. As the recovery continues, the implementation of the new Banking Law in compliance with Basel III should proceed in line with the revised timeline. Passed legislation enhancing financial portability, improving financial market functioning, regulating financial advisors, and strengthening CMF powers is welcome. In addition, it will be important to focus on bank resolution, deposit-insurance, and regulation of insurance companies and of financial conglomerates. Regulation needs to keep pace with the expansion in FinTech and looming cybersecurity threats, and the authorities' initiatives and recent advances in this area are welcome. The upcoming 2021 Financial Sector Assessment Program (FSAP) will conduct a detailed analysis of financial stability policies and risks.

Advancing the Reform Agenda

61. Quickly reaching a broad agreement over structural and social reforms while preserving macroeconomic stability would help to stimulate investment, productivity, and confidence as well as promote social convergence, thus supporting inclusive growth.

- **Finalizing the pension reform is an urgent step towards improving adequacy and coverage.** The end-2019 legislation which increased the solidarity pillar, as well as the most recent government's proposals to increase contribution rates and further strengthen the solidarity pillar, are important steps in the right direction. Going forward, it will be essential to adjust contribution rates, retirement age (especially for women), and solidarity parameters on the basis of demographics, employability, economic developments, expected replacement rates, and expected returns on pension assets. Furthering efforts to reduce informality would increase the contribution density. Ensuring competition in the management of the pension system will be crucial to promoting efficiency and containing costs.

- **It is also pressing to reform the health system.** Key challenges on this front relate to creating a basic universal health plan (pooling risks from the public and private members), eliminating discrimination based on pre-existing conditions in the private system, improving efficiency in the public system, increasing competition, and reducing the out-of-pocket spending on medicines.

- **Addressing medium term fiscal needs, including for social spending, will require increasing revenues and rationalizing expenditure when the recovery is well-advanced.** Valuable recommendations for gradually reducing tax exemptions, deductions, and special regimes have been recently offered by a Commission of Experts. Additional efforts should be directed towards increasing direct taxation (including by revisiting PIT exemptions thresholds and strengthening tax administration) and raising green taxes. At the same time, authorities should sustain efforts towards increasing spending efficiency.

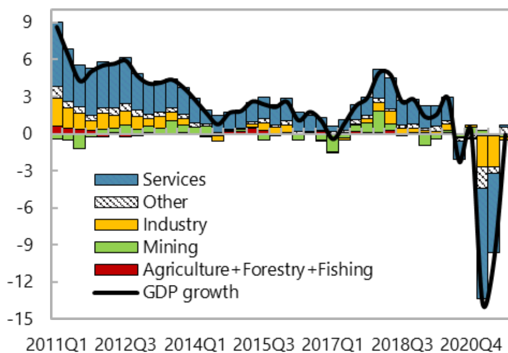
- **In the medium term, broader structural reforms will be important to increase productivity and promote inclusiveness.** A broad agenda is needed, encompassing continued efforts to: enhance the quality of education, address labor market mismatches, promote labor market flexibility, reduce informality, strengthen competition, streamline bureaucracy, continue trade and financial integration, and support policy actions in response to climate change.

62. Staff proposes to hold the next Article IV Consultation on the standard 12-month cycle.

Figure 2. Chile: Economic Activity

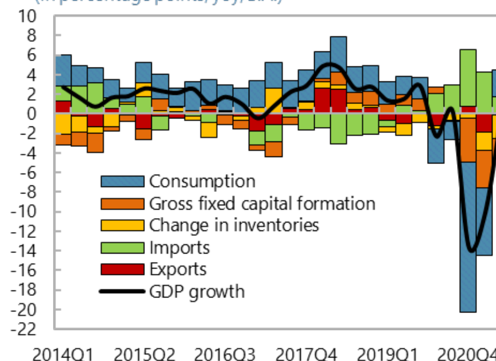
Economic activity started recovering after a sharp drop in 2020Q2, growing -0.1% yoy in 2020Q4...

Contributions to Real GDP Growth
(In percentage points, yoy, S.A.)



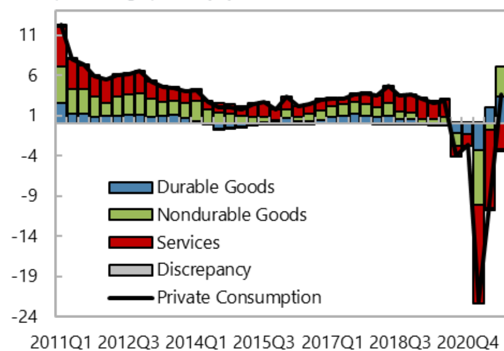
...with an increase in consumption counteracting the fall in investment...

Contributions to Real GDP Growth
(In percentage points, yoy, S.A.)



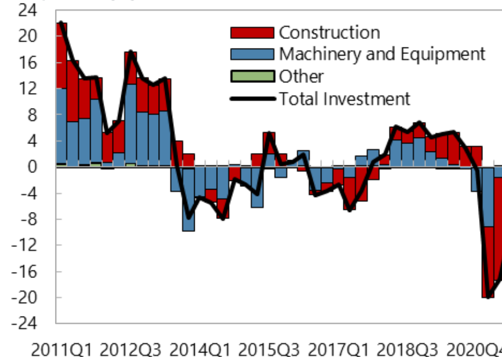
...while growth in durable and nondurable goods outweighed the fall in services consumption...

Contributions to Private Consumption Growth
(In percentage points, yoy, S.A)



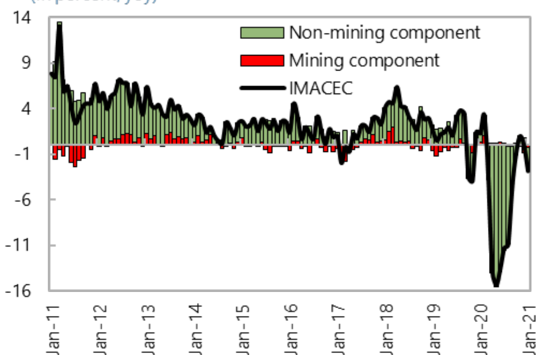
...and investment continued to contract, mainly reflecting the construction segment.

Contributions to Real Investment Growth
(In percent, yoy, S.A.)



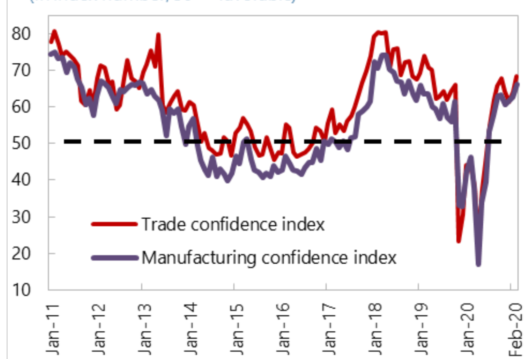
IMACEC in January fell -2.8%, reversing gains seen up to November...

Contributions to IMACEC Growth 1/
(In percent, yoy)



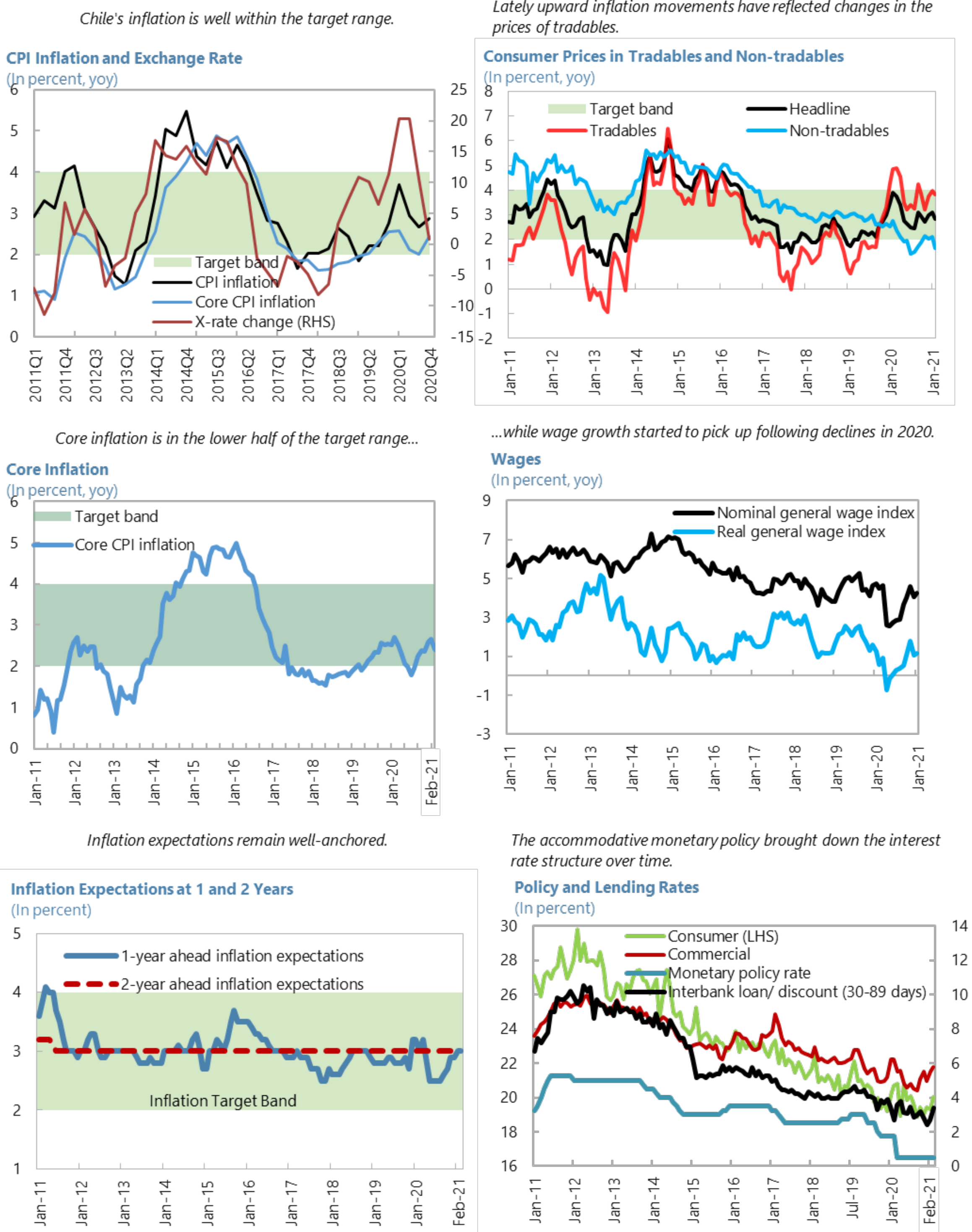
...but business confidence has robustly recovered from the decline experienced in 2019Q4 and 2020H1.

Business Confidence
(In index number, 50+=favorable)



Sources: Central Bank of Chile, Ministry of Finance, Haver Analytics, and IMF staff calculations.
1/ IMACEC is a monthly economic activity indicator.

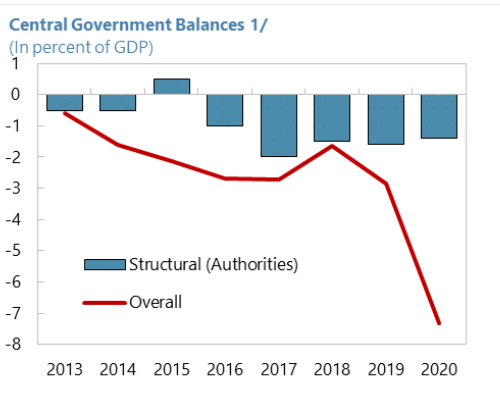
Figure 3. Chile: Monetary Policy and Inflation



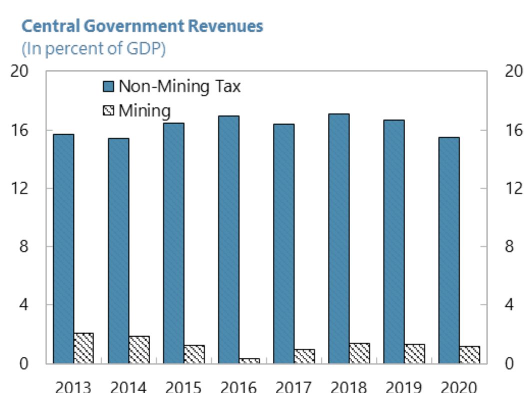
Sources: Central Bank of Chile, Haver Analytics, and IMF staff calculations.

Figure 4. Chile: Fiscal Policy and Public Finances

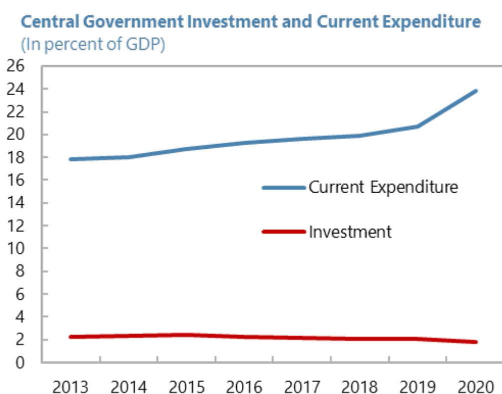
In 2020 the fiscal deficit sharply deteriorated...



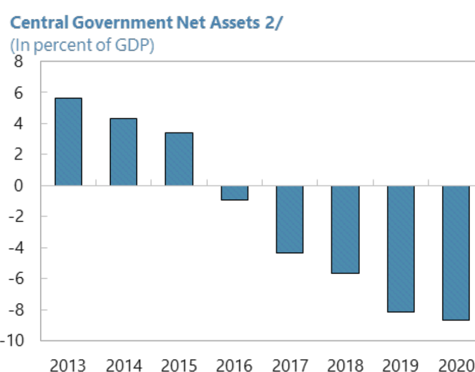
...as both mining and non-mining revenues declined...



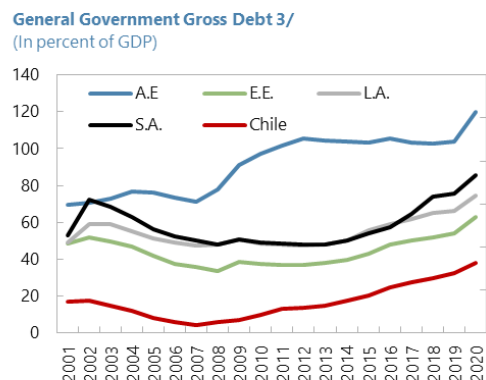
... and spending increased (both as a result of the contraction in GDP growth and of fiscal stimulus measures).



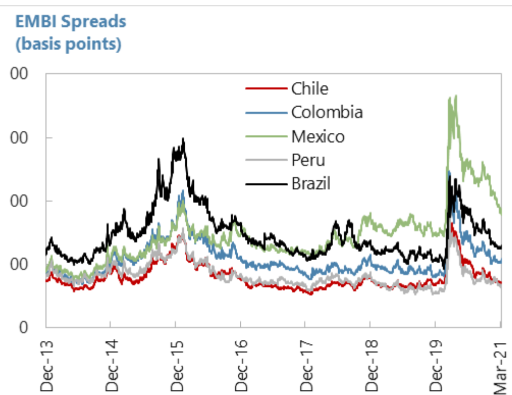
The deterioration in the central government's net asset position continued...



...but the gross debt-to-GDP ratio remains relatively low by international standards.



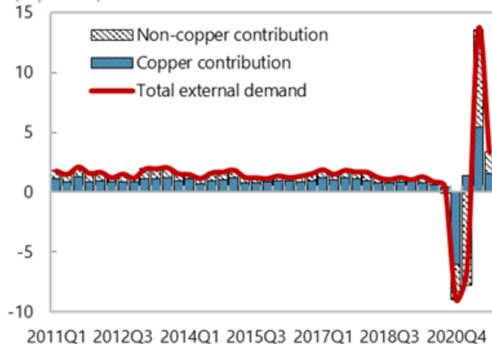
Borrowing costs, which surged at the onset of the pandemic, returned to pre-pandemic levels.



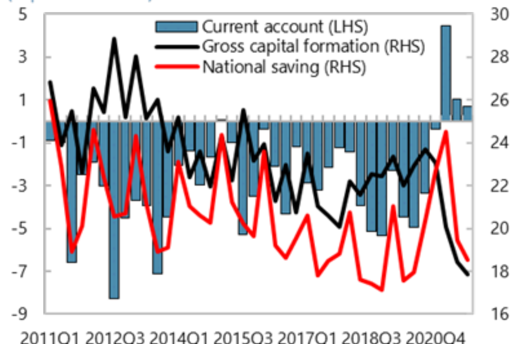
Sources: Ministry of Finance, Central Bank of Chile, Bloomberg, and IMF staff calculations.
1/ Based on the authorities' structural balance, at current or constant parameters.
2/ Authorities' definition of net assets.
3/ Source: World Economic Outlook; A.E = Advance Economies; E.E. = Emerging and Developing Economies; L.A. = Latin America and the Caribbean: Excluding Venezuela; S.A. = South America.

Figure 5. Chile: External Sector

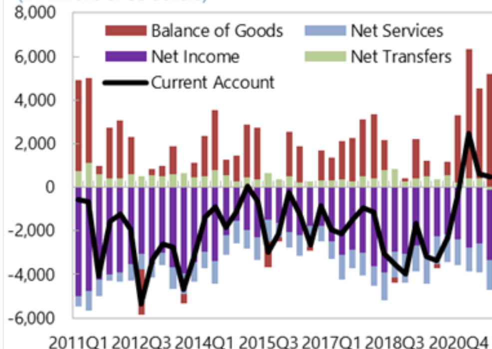
External demand fell to 3.4% in 2020Q4 after a sharp recovery in 2020Q3...



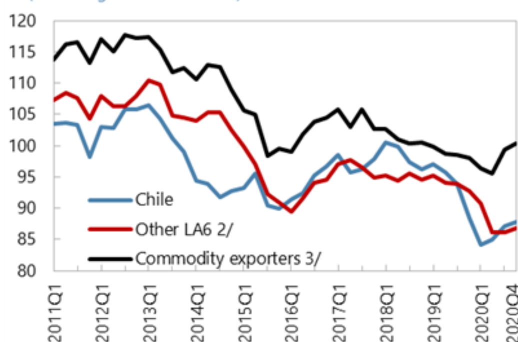
...while the current account remained positive at 0.7% of GDP...



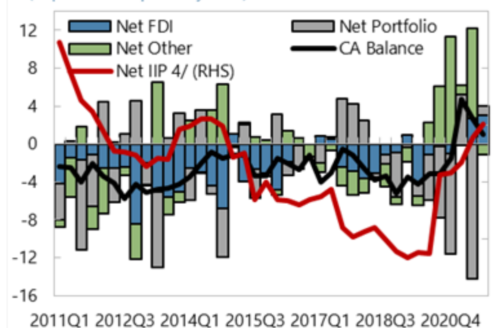
... largely owing to a larger goods trade surplus.



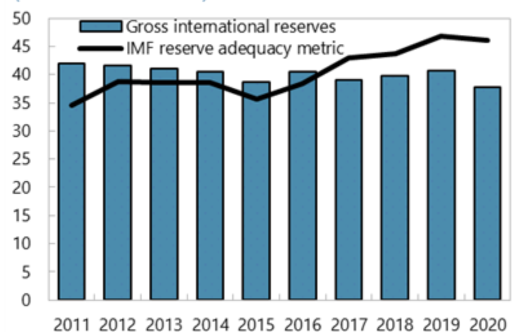
The peso depreciated more than the currencies of other commodity exporters, but strengthened lately.



Net IIP continues on an increasing trend, reaching -9.9% of annual GDP in 2020Q4...



...while gross international reserves remain close to the ARA metric.



Sources: Central Bank of Chile, Haver Analytics, and IMF staff calculations.

1/ Calculated as average real GDP growth of trading partners, weighted by their respective share in Chilean exports.

2/ LA6 includes Brazil, Chile, Colombia, Mexico, Peru and Uruguay.

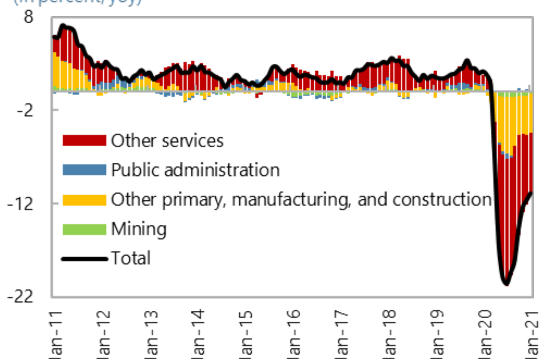
3/ Commodity exporters includes Canada, New Zealand, and Australia.

4/ As a percent of annual GDP.

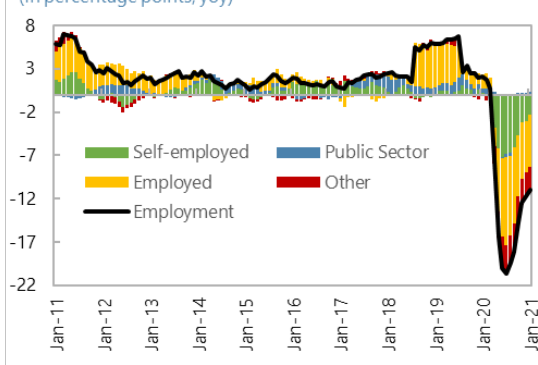
5/ *Assessing Reserve Adequacy*, IMF.

Figure 6. Chile: Labor Market Developments

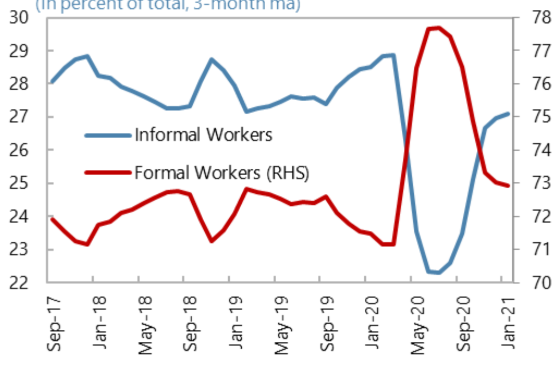
Employment is gradually recovering after falling by 20 percent in mid-2020...



... with the fall in employment being driven by self-employment and the private sector...

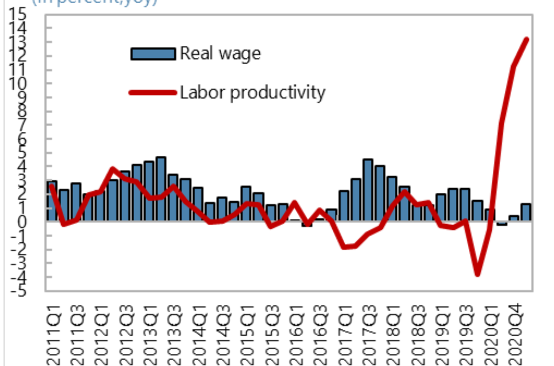


...while the informality share is still below the pre-pandemic level...

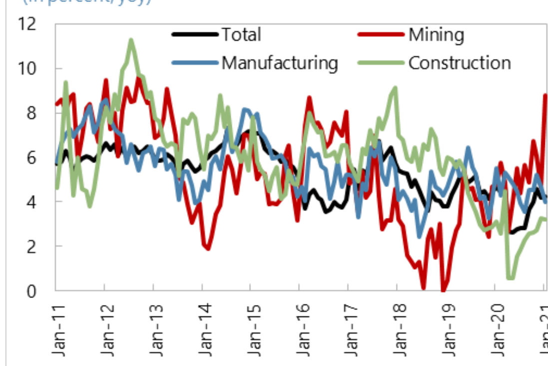


...and unemployment remains at record highs despite a sharp contraction in labor participation.

Real wage growth started to pick up again, while the sharp contraction of employment implied an increase in productivity



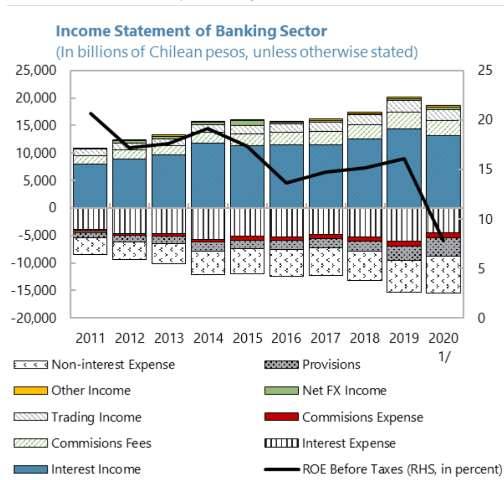
...as wages in mining and manufacturing have recovered while construction wages remain low.



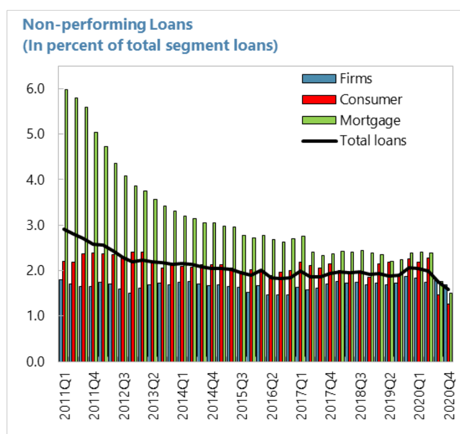
Sources: Central Bank of Chile, Haver Analytics, and IMF staff calculations.

Figure 7. Chile: Financial Sector

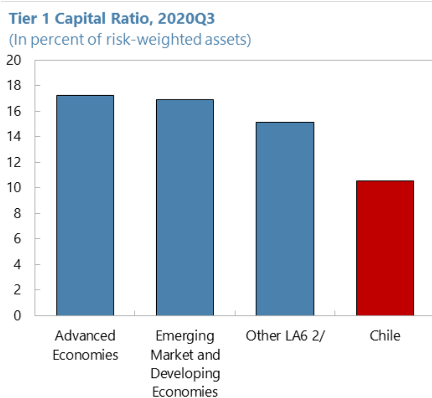
Banks' profitability fell in 2020...



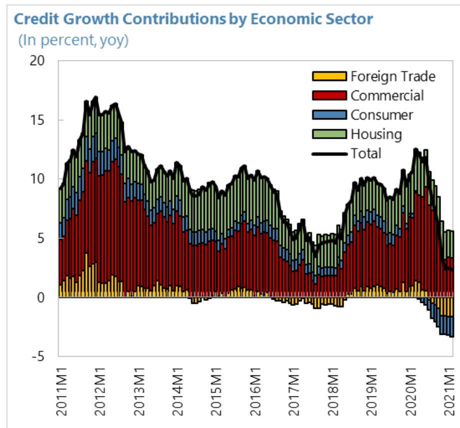
... and non-performing loans have remained low.



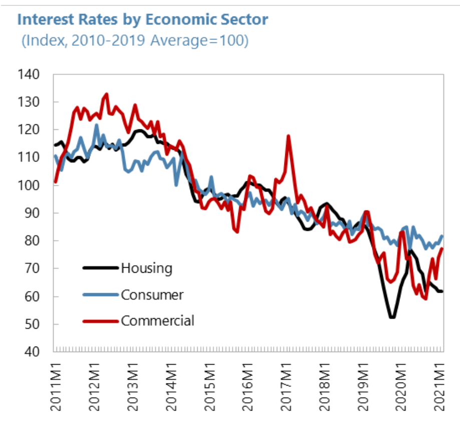
While capital ratios are lower than in other countries, they are expected to increase in line with Basel III.



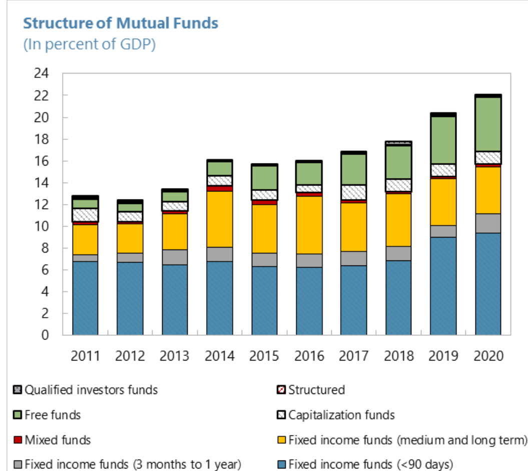
Credit growth fell sharply, mostly led by a fall in commercial and consumer loans...



...while interest rates have been coming down.



Mutual funds have continued to grow .



Sources: Comision Para el Mercado Financiero (CMF), Central Bank of Chile, IMF Financial Soundness Indicators 2015, and IMF staff calculations.
1/ December, 2020.
2/ Includes Argentina, Brazil, Colombia, Mexico, and Peru.

Table 1. Chile: Selected Social and Economic Indicators 1/

GDP (2019), in billions of pesos	196,397	Quota	
GDP (2019), in billions of U.S. dollars	279.3	in millions of SDRs	1,744
Per capita (2019), U.S. dollars	14,621	in % of total	0.37
Population (2019), in millions	19.1	Poverty rate (2017)	8.60
Main products and exports	Copper	Gini coefficient (2017)	46.60
Key export markets	China, Euro area, U.S.	Literacy rate (2015)	99.2

			Est.	Proj.					
	2018	2019	2020	2021	2022	2023	2024	2025	2026
	(Annual percentage change, unless otherwise specified)								
Output									
Real GDP	3.7	1.0	-5.8	6.5	3.7	2.7	2.6	2.5	2.5
Total domestic demand	4.5	0.9	-9.3	8.8	3.8	2.8	2.5	2.4	2.4
Consumption	3.7	0.9	-6.9	8.9	4.2	2.8	2.3	2.4	2.3
Private	3.8	1.1	-7.7	10.2	4.9	3.2	2.3	2.8	2.6
Public	3.4	0.0	-3.7	3.4	0.6	0.8	1.9	0.7	0.5
Investment 2/	7.3	1.0	-17.7	8.5	2.4	2.6	3.6	2.5	2.8
Fixed	5.1	4.5	-11.5	7.2	3.9	3.8	4.2	2.2	1.4
Private	6.1	5.2	-11.2	6.2	2.3	5.3	4.6	2.8	1.9
Public	-2.7	-1.3	-14.4	16.4	16.9	-7.2	1.0	-3.8	-3.0
Inventories 3/	0.5	-0.7	-1.4	0.1	-0.3	-0.3	-0.2	0.0	0.3
Net exports 3/	-0.9	0.0	3.5	-2.0	-0.1	-0.1	0.0	0.0	0.1
Exports	5.3	-2.6	-1.1	1.9	4.6	3.2	2.8	2.7	2.7
Imports	8.1	-2.3	-12.8	9.1	5.1	3.5	2.7	2.6	2.3
Employment									
Unemployment rate (annual average)	7.4	7.2	10.8	8.9	8.2	7.7	7.4	7.2	7.2
Consumer prices									
Inflation (End of period, %)	2.1	3.0	2.9	3.0	3.0	3.0	3.0	3.0	3.0
Inflation (average, %)	2.3	2.3	3.0	3.1	3.0	3.0	3.0	3.0	3.0
	(In percent of GDP, unless otherwise specified)								
Public sector finances									
Central government revenue	22.0	21.7	19.9	23.1	22.6	22.4	23.1	23.1	23.1
Central government expenditure	23.7	24.5	27.2	26.4	25.6	24.7	24.7	24.0	24.0
Central government fiscal balance	-1.7	-2.9	-7.3	-3.3	-3.0	-2.3	-1.6	-0.9	-0.9
Structural Fiscal Balance	-1.5	-1.7	-2.7	-5.1	-3.9	-2.9	-1.9	-0.9	-0.9
Structural Non-Mining Primary Balance (% of NGDP)	-2.4	-3.0	-3.7	-5.5	-4.4	-3.5	-2.7	-1.8	-1.8
Central Government Gross Debt	25.6	28.2	32.5	33.9	37.2	39.9	41.6	42.0	41.7
of which, FX-denominated Debt	5.1	5.8	7.3	8.7	9.3	10.0	10.7	10.7	10.7
Central Government Net Debt	5.7	8.2	8.7	11.5	14.2	16.2	17.0	17.5	17.9
Public sector gross debt 4/	45.5	49.1	55.2	56.5	59.8	62.5	64.2	64.7	64.3
Of which, share of FX-denominated Debt (in %)	19.8	20.6	22.6	25.5	25.0	25.1	25.6	25.4	25.8
	(Annual percentage change, unless otherwise specified)								
Money and credit									
Broad money	11.2	9.4	1.9	9.9	6.4	5.1	4.9	4.9	5.2
Credit to the private sector	10.1	9.7	3.2	...	...	...	...	...	...
Balance of payments									
Current account (% of GDP)	-3.9	-3.7	1.4	0.0	-0.3	-0.5	-0.7	-0.8	-0.9
Current account (in billions of U.S. dollars)	-11.6	-10.4	3.4	0.0	-1.1	-1.6	-2.6	-3.2	-3.7
Foreign direct investment net flows (% of GDP)	-2.2	-1.2	1.3	-1.5	-1.0	-1.0	-0.8	-0.7	-1.0
Gross international reserves (in billions of U.S.	39.9	40.7	39.2	48.2	51.2	51.2	51.2	51.2	51.2
Gross Reserves (Months of next year import)	6.4	5.7	5.9	8.7	7.3	7.0	6.8	6.5	6.2
Gross external debt (% of GDP)	59.1	66.4	72.0	64.1	63.5	63.0	62.6	61.6	60.5
Public	5.4	6.2	9.0	9.1	9.7	10.4	11.0	11.0	11.1
Private	53.7	60.2	63.1	55.0	53.8	52.6	51.6	50.5	49.4
	(Annual percentage change)								
Relative prices									
Real effective exchange rate (real appreciation +)	1.4	-4.8	-8.2	...	...	...	...	...	...
Terms of trade	-2.8	-1.7	10.1	6.6	-0.3	-1.3	-2.0	-1.9	-1.0
Memorandum items									
Nominal GDP (in billions of pesos)	190,722	196,397	200,224	220,091	234,225	246,285	258,473	271,219	285,428
(percentage change)	6.2	3.0	1.9	9.9	6.4	5.1	4.9	4.9	5.2
Nominal GDP (in billions of USD)	297.4	279.3	252.8	308.8	328.2	345.2	362.4	379.9	399.2
(percentage change)	7.4	-6.1	-9.5	22.2	6.3	5.2	5.0	4.8	5.1

Sources: Central Bank of Chile, Ministry of Finance, Haver Analytics, and IMF staff calculations and projections.

1/ The annual numbers occasionally show a small discrepancy with the authorities' published figures, as they are calculated as the sum of the quarterly series seasonally-adjusted by staff.

2/ Investment is defined as: gross fixed capital formation + changes in inventories.

3/ Contribution to growth.

4/ Includes liabilities of the central government, the Central Bank of Chile and public enterprises. Excludes Recognition Bonds.

Table 2. Chile: Summary Operations of the Central Government
(In percent of GDP; unless otherwise specified)

			Est.	Proj.					
	2018	2019	2020	2021	2022	2023	2024	2025	2026
Revenues	**22.0**	**21.7**	**19.9**	**23.1**	**22.6**	**22.4**	**23.1**	**23.1**	**23.1**
Taxes	18.0	17.6	16.1	18.7	18.5	18.4	19.1	19.1	19.1
Private mining companies	0.8	1.0	0.7	1.0	1.2	1.1	1.0	1.0	0.9
Other tax revenues, non-mining	17.2	16.6	15.5	17.6	17.3	17.3	18.1	18.2	18.2
Social contributions	1.5	1.5	1.6	1.6	1.6	1.6	1.6	1.6	1.6
Grants	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Other revenue	2.5	2.4	2.2	2.8	2.5	2.4	2.4	2.3	2.3
Codelco revenues	0.6	0.4	0.5	1.0	0.9	0.9	0.8	0.7	0.7
Income on assets	0.5	0.6	0.4	0.8	0.6	0.6	0.6	0.6	0.6
Operating income	0.5	0.5	0.4	0.4	0.4	0.4	0.4	0.4	0.4
Other income	1.0	1.0	0.8	0.7	0.6	0.6	0.6	0.6	0.6
Expenditures	**23.7**	**24.5**	**27.2**	**26.4**	**25.6**	**24.7**	**24.7**	**24.0**	**24.0**
Expense	21.7	22.5	25.4	24.4	23.4	22.7	22.7	22.1	22.1
Compensation of employees	4.8	5.0	5.3	5.2	5.0	5.0	5.0	5.0	5.0
Purchases of goods and services	1.9	2.0	2.2	2.0	1.9	1.8	1.8	1.7	1.7
Interest payments	0.8	0.9	1.0	1.1	1.1	1.2	1.3	1.3	1.4
Subsidies and grants	8.4	8.8	11.0	10.3	9.5	8.9	8.8	8.3	8.3
Social benefits	4.0	4.0	4.3	4.0	4.0	4.0	4.0	4.0	4.0
Other expense	1.7	1.8	1.7	1.8	1.8	1.8	1.8	1.8	1.8
Capital transfers	1.6	1.7	1.6	1.7	1.7	1.7	1.7	1.7	1.7
Net acquistion of nonfinancial assets	2.0	2.0	1.8	2.0	2.3	2.0	2.0	1.9	1.9
Investment	2.0	2.1	1.8	2.0	2.3	2.0	2.0	1.9	1.9
Sale of physical assets	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Net lending/borrowing	**-1.7**	**-2.9**	**-7.3**	**-3.3**	**-3.0**	**-2.3**	**-1.6**	**-0.9**	**-0.9**
Non-mining overall balance	-3.0	-4.2	-8.5	-5.3	-5.2	-4.2	-3.4	-2.6	-2.5
Net financial transactions	**-1.7**	**-2.9**	**-7.0**	**-3.3**	**-3.0**	**-2.3**	**-1.6**	**-0.9**	**-0.9**
Net acquistion of financial assets	0.0	-0.6	-2.9	0.6	1.8	1.8	1.5	1.1	0.4
Net incurrence of liabilities	1.7	2.2	4.1	3.8	4.8	4.1	3.1	1.9	1.3
Domestic	1.3	1.9	2.7	2.2	3.8	3.0	2.1	1.5	0.7
External	0.7	0.5	1.6	1.8	1.1	1.2	1.1	0.5	0.6
Recognition bonds	-0.3	-0.2	-0.2	-0.1	-0.1	-0.1	-0.1	0.0	0.0
Memorandum items									
Primary balance	-1.3	-2.5	-6.8	-3.0	-2.5	-1.7	-0.9	-0.1	-0.1
Structural Fiscal Balance 1/	-1.5	-1.7	-2.7	-5.1	-3.9	-2.9	-1.9	-0.9	-0.9
Structural Revenue 1/	22.2	22.8	24.5	21.3	21.7	21.8	22.8	23.1	23.1
Fiscal Impulse 2/	0.1	0.6	0.8	1.8	-1.1	-0.9	-0.8	-0.9	-0.1
Expenditure growth (in real terms; annual percent change)	3.6	4.2	9.9	3.2	0.5	-1.5	1.7	-1.1	2.2
Central Government Net Debt	5.7	8.2	8.7	11.5	14.2	16.2	17.0	17.5	17.9
Gross debt	25.6	28.2	32.5	33.9	37.2	39.9	41.6	42.0	41.7
Peso-denominated assets	7.6	8.0	8.2	7.7	7.9	8.2	8.4	8.5	8.2
Foreign currency-denominated assets	12.3	12.1	15.7	14.8	15.0	15.4	16.1	16.0	15.6
Central Government Net Debt (Excl Pension Reservation Fun	9.2	12.3	12.7	15.3	18.0	20.0	20.9	21.4	21.7
Public Sector Gross Debt 3/	45.5	49.1	55.2	56.5	59.8	62.5	64.2	64.7	64.3
Public Sector Net Debt 3/	9.8	11.8	12.8	15.6	18.4	20.3	21.2	21.7	22.1
Nominal GDP (trillions of pesos)	190.7	196.4	200.2	220.1	234.2	246.3	258.5	271.2	285.4
General Government Fiscal Balance 4/	-1.5	-2.7	-7.1	-3.1	-2.9	-2.1	-1.4	-0.7	-0.7

Sources: Ministry of Finance and IMF staff calculations and projections.

1/ The output gap used for the structural adjustment calculation is measured as the difference between staff's real GDP and the potential GDP of the committee of experts for years for which it is available and binding. Beyond those years, the output gap is progressively closed over time taking into account staff's assessment of the state of the economy.

2/ The Fiscal Impulse is defined as the negative of the annual change of the structural non-mining primary balance.

3/ Includes liabilities of the central government, the cental bank of Chile and non-financial public enterprises. Excludes Recognition Bonds.

4/ Includes the central government and municipality governments.

Table 3. Chile: Balance of Payments 1/

(In US$mn; unless otherwise specified)

	2018	2019	Est. 2020	Proj. 2021	2022	2023	2024	2025	2026
Current account	-11,632	-10,372	3,425	49	-1,061	-1,616	-2,650	-3,181	-3,650
Trade balance of Goods	4,220	2,886	18,425	22,367	22,734	22,141	21,222	20,334	20,483
Exports	74,697	68,773	73,477	91,217	94,458	96,534	98,800	101,232	104,411
Copper	35,645	32,601	37,784	51,392	53,201	54,033	54,686	55,488	57,057
Non-copper	39,052	36,171	35,693	39,825	41,257	42,501	44,115	45,744	47,355
Imports	70,477	65,887	55,052	68,850	71,724	74,393	77,579	80,898	83,929
Net services	-4,670	-5,104	-4,999	-5,167	-5,665	-6,178	-6,685	-7,002	-7,154
Net income	-13,532	-10,144	-10,963	-18,086	-18,993	-18,366	-17,887	-17,131	-17,582
Net transfers	2,350	1,840	962	936	862	787	701	618	603
Capital account balance	43	672	1	0	0	0	0	0	0
Financial account balance	-12,748	-9,047	3,890	-8,951	-4,061	-1,616	-2,650	-3,181	-3,650
Foreign direct investment	-6,450	-3,247	3,197	-4,686	-3,346	-3,428	-2,829	-2,720	-3,951
Abroad by Chilean residents	1,309	9,340	11,725	6,878	6,555	7,161	8,332	8,130	7,411
In Chile by foreign residents	7,760	12,587	8,528	11,564	9,901	10,589	11,161	10,850	11,363
Of which, debt instruments	-616	1,997	924	1,086	611	842	1,146	967	978
Portfolio investment	-2,536	-9,517	-12,304	-5,413	-7,921	-9,241	-9,151	-8,322	-9,112
Abroad by Chilean residents	2,396	1,667	-5,377	3,803	662	198	-187	1,174	486
In Chile by foreign residents	4,934	11,184	6,926	9,215	8,583	9,439	8,963	9,496	9,598
Of which, equities	-1,557	2,968	204	271	252	277	263	279	282
Of which, debt	6,490	8,217	6,723	8,944	8,330	9,162	8,700	9,217	9,316
Financial derivatives	882	1,520	2,524	2,523	2,523	2,523	2,523	2,523	2,523
Other investments	-4,643	2,198	10,474	-1,375	4,682	8,530	6,807	5,338	6,890
Abroad by Chilean residents	-712	2,974	7,845	7,845	7,845	7,845	7,845	7,845	7,845
In Chile by foreign residents	3,930	777	-2,629	9,221	3,163	-685	1,038	2,507	955
Change in reserves assets	1,397	-153	-2,895	9,000	3,000	0	0	0	0
Errors and omissions	238	501	-2,431	0	0	0	0	0	0
Gross official international reserves (In months of imports of goods and services)	6.4	5.7	5.9	8.7	7.3	7.0	6.8	6.5	6.2
				(In percent of GDP)					
Current account	-3.9	-3.7	1.4	0.0	-0.3	-0.5	-0.7	-0.8	-0.9
Trade balance of Goods	1.4	1.0	7.3	7.2	6.9	6.4	5.9	5.4	5.1
Exports	25.1	24.6	29.1	29.5	28.8	28.0	27.3	26.6	26.2
Copper	12.0	11.7	14.9	16.6	16.2	15.7	15.1	14.6	14.3
Non-copper	13.1	13.0	14.1	12.9	12.6	12.3	12.2	12.0	11.9
Imports	23.7	23.6	21.8	22.3	21.9	21.5	21.4	21.3	21.0
Net services	-1.6	-1.8	-2.0	-1.7	-1.7	-1.8	-1.8	-1.8	-1.8
Net income	-4.5	-3.6	-4.3	-5.9	-5.8	-5.3	-4.9	-4.5	-4.4
Net transfers	0.8	0.7	0.4	0.3	0.3	0.2	0.2	0.2	0.2
Financial account balance 2/	-4.3	-3.2	1.5	-2.9	-1.2	-0.5	-0.7	-0.8	-0.9
				(Annual change in percent)					
Total export volume	6.1	-2.4	3.0	3.5	4.6	3.2	2.8	2.7	2.7
Total import volume	8.5	-2.5	-10.4	10.8	5.1	3.5	2.7	2.6	2.3
Terms of trade	-2.8	-1.7	10.1	6.6	-0.3	-1.3	-2.0	-1.9	-1.0
Total export prices	2.5	-5.6	3.8	19.5	-1.0	-1.0	-0.4	-0.2	0.4
Copper export prices	0.5	-7.3	15.0	33.9	-1.5	-2.2	-2.1	-1.8	-0.5
Total import price	5.5	-4.0	-5.6	12.0	-0.7	0.3	1.7	1.7	1.5
Memorandum items									
Copper price (WEO; U.S. cents per pound)	296	273	280	377	372	363	356	349	348
Volume of copper exports (2004=100)	105	104	105	106	111	115	119	123	127

Sources: Central Bank of Chile, Haver Analytics, and IMF staff calculations and projections.

1/ The annual numbers occasionally show a small discrepancy with the authorities published figures, as they are calculated as the sum of the quarterly series seasonally-adjusted by staff.

2/ Excluding change in reserves.

Table 4. Chile: Monetary Survey
(In billions of pesos; unless otherwise specified)

	2014	2015	2016	2017	2018	2019	2020
Central bank							
Net foreign assets	23,937	26,645	26,391	23,332	27,043	29,547	27,222
Net international reserves	24,567	27,333	27,021	23,983	27,731	30,274	27,881
Net international reserves (in millions of US$)	40,447	38,643	40,494	38,983	39,861	40,657	39,200
Other foreign assets, net	-630	-688	-630	-651	-688	-727	-659
Net domestic assets	-15,754	-17,493	-16,049	-12,226	-15,747	-17,212	3,034
Net credit to general government	-1,102	-124	-476	-9	-553	-392	327
Net claims on banks and financial corporations	-5,854	-6,306	-5,028	-3,403	-5,163	-4,599	6,640
Credit to the private sector	518	406	319	189	47	-33	-31
Other items (net)	-9,317	-11,469	-10,863	-9,003	-10,077	-12,187	-19,135
Monetary base	8,183	9,152	10,343	11,106	11,296	12,335	30,256
Currency	5,371	5,858	6,275	6,528	6,740	7,576	12,180
Required reserves	2,812	3,294	4,068	4,577	4,556	4,760	18,077
Other depository institutions							
Net foreign assets	-5,085	-6,120	-5,394	-7,237	-10,199	-6,048	1,798
Net foreign assets (in millions of US$)	-8,372	-8,652	-8,083	-11,763	-14,660	-8,122	2,528
Net domestic assets	112,450	126,310	132,992	139,488	156,578	171,157	163,806
Net credit to general government	890	-532	-256	2,965	3,463	4,629	12,541
Credit to the private sector	117,658	130,465	137,324	144,061	158,792	174,225	179,836
Other items (net)	-6,098	-3,623	-4,076	-7,538	-5,677	-7,697	-28,571
Liabilities to the private sector	107,365	120,190	127,598	132,251	146,379	165,109	165,604
Demand deposits	20,453	23,562	24,044	27,038	30,116	36,058	56,384
Quasi-money	86,912	96,628	103,554	105,213	116,263	129,051	109,220
Banking system							
Net foreign assets	18,852	20,526	20,997	16,095	16,844	23,499	29,020
Net domestic assets	102,556	113,683	120,876	129,252	142,030	152,531	158,216
Net credit to general government	-212	-656	-732	2,956	2,910	4,237	12,868
Credit to the private sector	118,176	130,871	137,643	144,250	158,839	174,192	179,805
Other items (net)	-15,408	-16,531	-16,035	-17,954	-19,715	-25,898	-34,457
Liabilities to the private sector	121,408	134,209	141,873	145,347	158,874	176,030	187,236
Money	25,824	29,420	30,319	33,566	36,856	43,633	68,564
Quasi-money	95,584	104,789	111,554	111,781	122,018	132,397	118,672
Memorandum items							
	(Annual percentage change)						
Monetary base	-6.5	11.8	13.0	7.4	1.7	9.2	145.3
Liabilities to the private sector	9.9	10.5	5.7	2.4	9.3	10.8	6.4
Credit to the private sector (banking system)	10.2	10.7	5.2	4.8	10.1	9.7	3.2
	(In percent of GDP)						
Monetary base	5.5	5.7	6.1	6.2	5.9	6.2	15.2
Liabilities to the private sector	81.7	84.1	83.7	80.9	83.1	88.7	93.8
Credit to the private sector (banking system)	79.5	82.0	81.2	80.3	83.1	87.8	90.1

Sources: Central Bank of Chile, Haver, and IMF staff calculations.

Table 5. Chile: Medium-Term Macroeconomic Framework 1/

			Est.	Proj.					
	2018	2019	2020	2021	2022	2023	2024	2025	2026
National accounts	(Annual percentage change, unless otherwise specified)								
Real GDP	3.7	1.0	-5.8	6.5	3.7	2.7	2.6	2.5	2.5
Total domestic demand	4.5	0.9	-9.3	8.8	3.8	2.8	2.5	2.4	2.4
Consumption	3.7	0.9	-6.9	8.9	4.2	2.8	2.3	2.4	2.3
Private	3.8	1.1	-7.7	10.2	4.9	3.2	2.3	2.8	2.6
Public	3.4	0.0	-3.7	3.4	0.6	0.8	1.9	0.7	0.5
Investment 2/	7.3	1.0	-17.7	8.5	2.4	2.6	3.6	2.5	2.8
Fixed	5.1	4.5	-11.5	7.2	3.9	3.8	4.2	2.2	1.4
Private	6.1	5.2	-11.2	6.2	2.3	5.3	4.6	2.8	1.9
Public	-2.7	-1.3	-14.4	16.4	16.9	-7.2	1.0	-3.8	-3.0
Inventories 3/	0.5	-0.7	-1.4	0.1	-0.3	-0.3	-0.2	0.0	0.3
Net exports 3/	-0.9	0.0	3.5	-2.0	-0.1	-0.1	0.0	0.0	0.1
Exports	5.3	-2.6	-1.1	1.9	4.6	3.2	2.8	2.7	2.7
Imports	8.1	-2.3	-12.8	9.1	5.1	3.5	2.7	2.6	2.3
Consumer prices									
End of period	2.1	3.0	3.0	3.0	3.0	3.0	3.0	3.0	3.0
Consumer prices (average)	2.3	2.3	3.0	3.1	3.0	3.0	3.0	3.0	3.0
Output gap	-0.7	-1.3	-5.6	-1.4	-0.2	0.0	0.0	0.0	0.0
Potential growth	2.6	1.6	-1.5	1.9	2.4	2.5	2.5	2.5	2.5
Nominal GDP	6.2	3.0	1.9	9.9	6.4	5.1	4.9	4.9	5.2
Balance of payments	(In percent of GDP)								
Current account	-3.9	-3.7	1.4	0.0	-0.3	-0.5	-0.7	-0.8	-0.9
Trade balance	1.4	1.0	7.3	7.2	6.9	6.4	5.9	5.4	5.1
Financial account balance	-4.3	-3.2	1.5	-2.9	-1.2	-0.5	-0.7	-0.8	-0.9
Of which, foreign direct investment (net)	-2.2	-1.2	1.3	-1.5	-1.0	-1.0	-0.8	-0.7	-1.0
Change in reserves assets	0.5	-0.1	-1.1	2.9	0.9	0.0	0.0	0.0	0.0
Errors and omissions	0.1	0.2	-1.0	0.0	0.0	0.0	0.0	0.0	0.0
REER (in percent y/y, +=appreciation)	1.4	-4.8	-8.2	...	...	...	...	...	...
	(Annual percentage change)								
Total export volume	6.1	-2.4	3.0	3.5	4.6	3.2	2.8	2.7	2.7
Of which, copper export volume	5.4	-1.3	1.2	0.7	5.1	3.8	3.4	3.3	3.3
Total import volume	8.5	-2.5	-10.4	10.8	5.1	3.5	2.7	2.6	2.3
Terms of trade	-2.8	-1.7	10.1	6.6	-0.3	-1.3	-2.0	-1.9	-1.0
Total export prices	2.5	-5.6	3.8	19.5	-1.0	-1.0	-0.4	-0.2	0.4
Copper export price index	0.5	-7.3	15.0	33.9	-1.5	-2.2	-2.1	-1.8	-0.5
Total import price	5.5	-4.0	-5.6	12.0	-0.7	0.3	1.7	1.7	1.5
External debt	(In percent of GDP)								
Gross external debt	59.1	66.4	72.0	64.1	63.5	63.0	62.6	61.6	60.5
Public	5.4	6.2	9.0	9.1	9.7	10.4	11.0	11.0	11.1
Private	53.7	60.2	63.1	55.0	53.8	52.6	51.6	50.5	49.4
Gross int. reserves (in billions of U.S. dollars)	39.9	40.7	39.2	48.2	51.2	51.2	51.2	51.2	51.2
Savings and investment									
Gross domestic investment	22.1	22.9	19.8	19.9	19.7	19.8	20.1	20.3	20.4
Public	2.3	2.3	2.0	2.2	2.5	2.3	2.3	2.1	2.1
Private	19.9	20.7	17.8	17.7	17.2	17.5	17.9	18.1	18.3
National saving	18.1	19.2	21.2	19.9	19.4	19.3	19.4	19.4	19.5
Public	0.8	-0.4	-5.1	-0.9	-0.4	0.2	0.8	1.4	1.4
Private	17.4	19.6	26.3	20.8	19.7	19.2	18.6	18.0	18.1
Public sector finance									
Central government gross debt	25.6	28.2	32.5	33.9	37.2	39.9	41.6	42.0	41.7
Central government net debt	5.7	8.2	8.7	11.5	14.2	16.2	17.0	17.5	17.9
Central government balance	-1.7	-2.9	-7.3	-3.3	-3.0	-2.3	-1.6	-0.9	-0.9
Total revenue	22.0	21.7	19.9	23.1	22.6	22.4	23.1	23.1	23.1
Total expenditure	23.7	24.5	27.2	26.4	25.6	24.7	24.7	24.0	24.0
Central government structural balance 4/	-1.5	-1.7	-2.7	-5.1	-3.9	-2.9	-1.9	-0.9	-0.9
Employment	(Annual percentage change, unless otherwise specified)								
Working age population	2.2	2.2	2.0	1.6	1.3	1.2	1.2	1.2	1.2
Labor force	2.6	2.0	-8.9	6.8	0.5	0.8	0.9	1.0	1.0
Employment	2.2	2.1	-12.3	8.8	1.3	1.3	1.2	1.2	1.1
Unemployment rate (in percent)	7.4	7.2	10.7	8.9	8.2	7.7	7.4	7.2	7.2

Sources: Central Bank of Chile, Ministry of Finance, National Statistics Institute, Haver Analytics, and IMF staff calculations and projections.

1/ The annual numbers occasionally show a small discrepancy with the authorities published figures, as they are calculated as the sum of the quarterly series seasonally-adjusted by staff.

2/ Investment is defined as: gross fixed capital formation + changes in inventories.

3/ Contribution to growth.

4/ The output gap used for the structural adjustment calculation is measured as the difference between staff's real GDP and the potential GDP of the committee of experts for years for which it is available and binding. Beyond those years, the output gap is progressively closed over time taking into account staff's assessment of the state of the economy.

Table 6. Chile: Indicators of External Vulnerabilities 1/
(In percent; unless otherwise specified)

	2014	2015	2016	2017	2018	2019
Financial indicators						
M3 (percent change)	11.1	12.4	8.7	4.8	11.0	10.9
Less pension funds' deposits (annual percentage change)	9.1	13.5	10.1	5.0	12.3	9.7
Private sector credit to GDP	79.5	82.0	81.2	80.3	83.1	87.8
90-day central bank promissory note (nominal) interest rate (avg.)	4.0	2.7	3.5	2.6	2.8	3.3
Share of foreign currency deposits in total deposits	16.6	15.4	15.2	13.0	12.8	14.9
Share of foreign currency loans in total credit	13.7	13.9	13.0	11.4	11.0	11.8
External indicators						
Exports of goods, U.S. dollars (annual percentage change)	-2.2	-17.4	-2.1	13.4	9.3	-7.0
Imports of goods, U.S. dollars (annual percentage change)	-8.2	-14.6	-4.8	10.1	14.8	-6.8
Terms of trade (annual percentage change)	-2.1	-3.0	4.1	10.2	-2.3	-0.8
REER (annual percent change, period average)	-9.3	-1.0	1.8	3.4	1.4	-4.8
Exchange rate (pesos per U.S. dollar, period average)	570.4	654.1	676.9	648.9	641.2	703.3
Current account balance (percent of GDP)	-2.0	-2.4	-2.0	-2.3	-3.6	-3.8
Financial account less reserves accumulation (percent of GDP)	-2.5	-2.2	-1.9	-0.7	-3.9	-3.0
Gross official reserves (in billions of U.S. dollars) 2/	40.4	38.6	40.5	39.0	39.9	40.7
Gross official reserves, months of imports of goods and services	5.4	5.6	6.8	6.8	6.4	5.7
Gross official reserves to M3	15.0	14.9	13.5	11.5	11.9	11.7
Gross official reserves to short-term external debt 3/	92.9	110.4	107.9	89.1	109.4	91.7
Gross official reserves (percent of GDP)	15.5	15.8	16.2	14.1	13.4	14.4
IMF reserve adequacy metric (percent of GDP) 4/	14.8	14.7	15.5	15.6	14.9	15.6
Total external debt (percent of GDP)	57.9	65.6	65.3	62.6	58.9	65.7
Of which: External public sector debt	2.5	3.2	4.0	4.6	4.9	5.6
Total external debt to exports of goods and services	175.9	223.7	232.8	220.5	206.8	233.9
External interest payments to exports of goods and services	3.9	6.1	5.4	7.1	5.7	5.8
External amortization payments to exports of goods and services	49.9	57.4	51.8	52.0	42.1	53.7
Financial market indicators						
Stock market index (in U.S. dollars; period average) 5/	1726	1465	1409	1731	1869	1512
Sovereign long-term foreign currency debt rating (end of period)						
Moody's	Aa3	Aa3	Aa3	Aa3	A1	A1
S&P	AA-	AA-	AA-	A+	A+	A+
Fitch ratings	A+	A+	A+	A	A	A

Sources: Central Bank of Chile, Haver Analytics, WEO, and IMF staff calculations.

1/ The annual numbers occasionally show a small discrepancy with the authorities published figures, as they are calculated as the sum of the quarterly series seasonally-adjusted by staff.

2/ Gold valued at end-period market prices.

3/ Includes amortization of medium/long-term debt due during the following year.

4/ Assessing Reserve Adequacy (IMF, 2011 Policy Paper).

5/ Morgan-Stangley Capital International Index (Dec/1987 = 100).

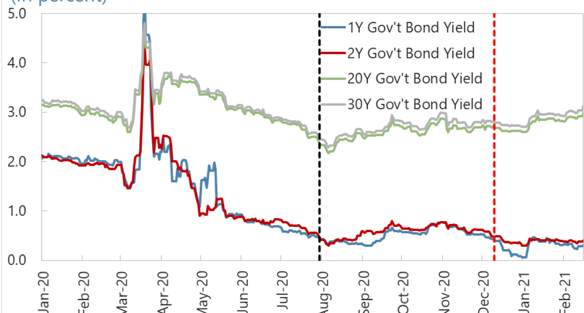
Table 7. Chile: Financial Soundness Indicators
(In percent; unless otherwise specified)

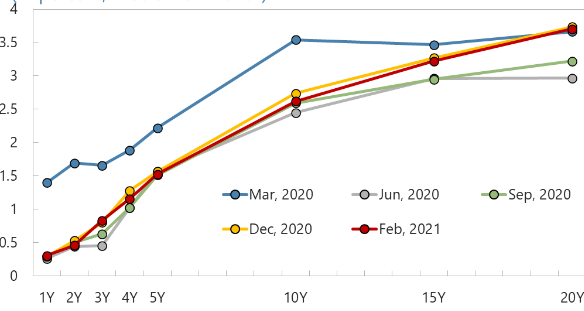
	2014	2015	2016	2017	2018	2019	2020 1/
Total Assets							
Total assets (In billions of Chilean pesos)	180,846	203,609	211,687	220,365	246,266	290,500	319,546
Percent of GDP	121.7	127.6	124.9	122.6	128.8	146.4	160.1
Capital Adequacy							
Regulatory Capital to Risk-Weighted Assets	13.4	12.6	13.8	13.8	13.3	12.8	14.3
Regulatory Tier 1 Capital to Risk-Weighted Assets	10.0	9.4	10.9	11.0	10.7	10.3	10.6
Capital to Assets	8.0	7.6	8.4	8.4	8.4	7.5	6.9
Credit Risk							
NPLs Net of Provisions to Capital	-2.1	-3.3	-5.2	-4.6	-4.5	-4.3	-9.0
NPLs to Gross Loans	2.1	1.9	1.8	1.9	1.9	2.1	1.6
Profitability							
Return on Assets	1.5	1.3	1.2	1.3	1.3	1.2	0.5
Return on Equity	19.3	17.7	13.8	15.4	15.5	16.2	7.3
Interest Margin to Gross Income	67.8	66.6	66.8	67.1	67.6	67.1	68.2
Trading Income to Gross Income	10.8	10.6	10.1	8.5	8.7	9.6	9.8
Non-interest Expenses to Gross Income	47.4	48.6	52.1	51.1	49.3	46.8	54.3
Liquidity							
Liquid Assets to Total Assets	13.6	13.8	14.7	15.3	14.2	15.3	19.8
FX and Derivative Risk							
FX Loans to Total Loans	18.4	20.0	18.2	16.6	18.4	18.9	17.5
FX Liabilities to Total Liabilities	25.5	27.1	25.8	24.0	25.5	26.7	25.1

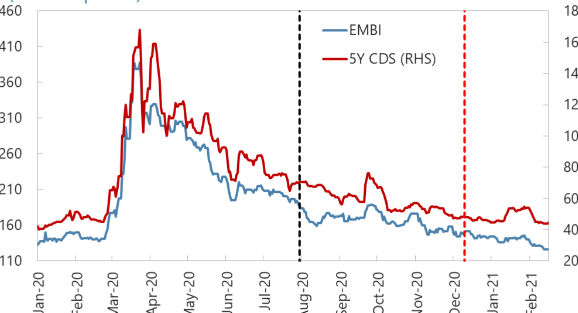
Sources: IMF Financial Soundness Indicators, Moody's Investor Service and IMF staff calculations.
1/ As of October, 2020.

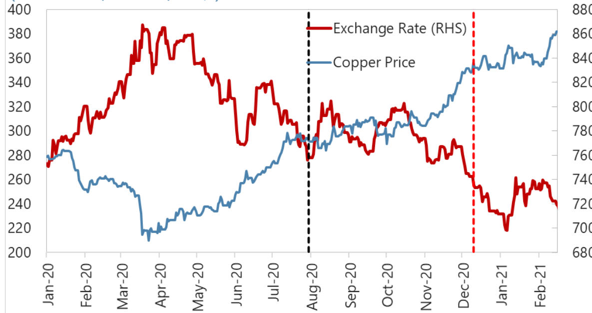
Box 1. Financial Market Reaction to Pension Withdrawals 1/

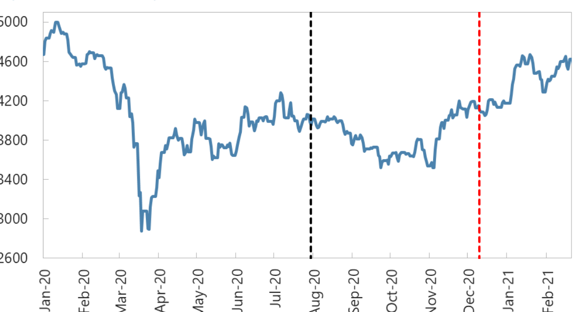
The impact of the withdrawals from individual pensions accounts on financial markets and asset prices has been muted, supported by the fast and ample reaction by the BCCh as well as the depth of Chile's financial markets. Overall, there has not been an increase in bond yields or spreads, and the yield curve did not move markedly in the period around the start of withdrawals. Similarly, EMBI and CDS spreads continued their downward trends. Across pension funds, most liquidations seem to have taken place from the relatively riskier funds—A, B, and C—which include considerable share of foreign assets. The exchange rate depreciated by about 7 percent over the two weeks following the first withdrawal announcement, and then recovered quickly, while it remained on an appreciating trend following the second withdrawal. The market resilience can be ascribed to the quick policy responses by BCCh (purchases of bank term deposits and bank bonds, see Annex I for details) as well as to the financial market depth in Chile.

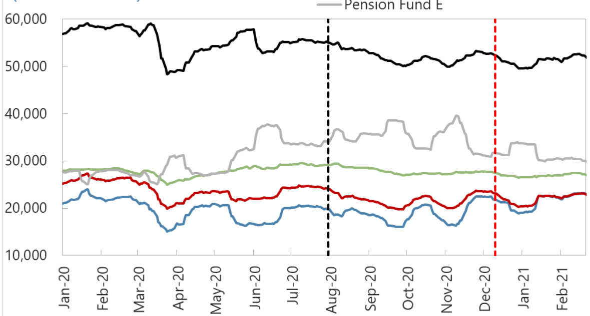












Sources: Bloomberg and IMF staff calculations.

1/ Vertical dashed black line represents July 30, 2020, vertical red line represents December 10, 2020. Representing the start of the pension withdrawal process for the first and second pension withdrawals respectively.

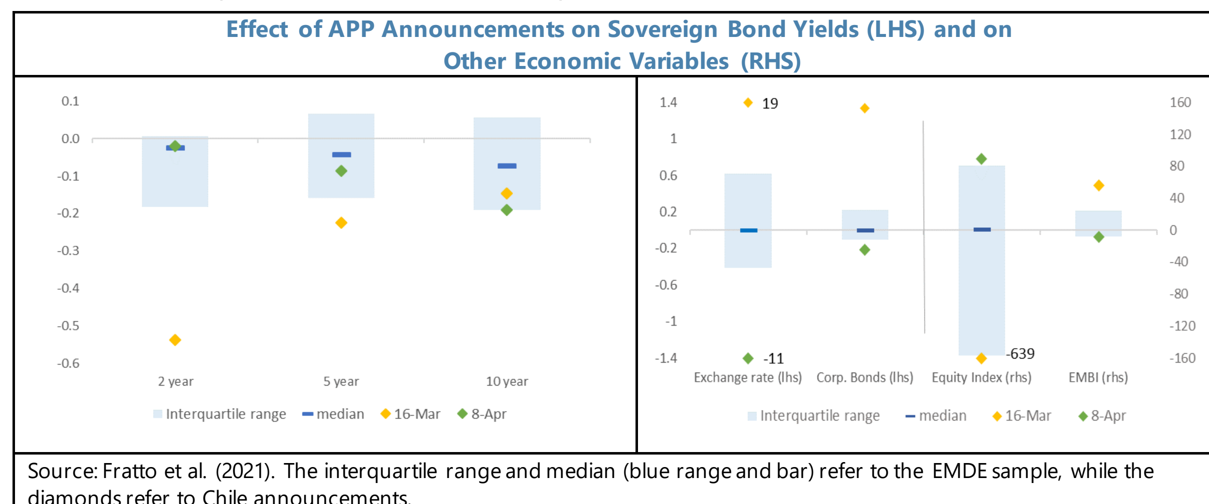
2/ Ranging from riskiest (Pension A) to most conservative (Pension E).

Box 2. Unconventional Monetary Policy in Chile[1]

As part of its monetary policy measures to counter the effects of the pandemic, Chile—as many other countries—introduced asset purchase programs (APP) largely to tackle market dysfunctionalities. As the COVID pandemic intensified with a corresponding rise in investor risk aversion, several countries, including Chile, responded by announcing APPs, predominantly with the explicit goal of boasting confidence and tackling market dysfunctionalities. Between March and June 2020, twenty-seven emerging markets and developing economies (EMDEs) announced APPs.

The Chilean experience differs from other EMDEs in the use of a price-based target and the class of assets purchased. BCCh made its first announcement on March 16, and a month later it announced a doubling of the APP size.[2] Chile APPs programs were price-based, while more than 9 out 10 programs in other countries were predominantly quantity-based. While BCCh purchased bank bonds, most central banks purchased sovereign bonds or a combination of government and private securities.

Effect of APP Announcements on Sovereign Bond Yields (LHS) and on Other Economic Variables (RHS)



Source: Fratto et al. (2021). The interquartile range and median (blue range and bar) refer to the EMDE sample, while the diamonds refer to Chile announcements.

In line with the international experience, the Chilean APP succeeded in lowering bond rates but effects on external borrowing costs were mixed. The results of a multi-day event study, using a sample of 15 EMDEs, point to heterogeneous effects for the average sample.[3] On average, the estimated effect on sovereign bond yields is negative and statistically significant, and higher in EMDEs than in advanced economies. With respect to Chile, the first APP announcement—combined with a policy rate cut—coincided with a particularly large drop in sovereign bond yields, particularly for shorter maturities. While the estimated effects on the exchange rate are inconclusive on average, the bilateral exchange rate between Chilean peso and US dollar strongly responded to BCCh announcements. Looking at the second-round effects, the announcements generally had an insignificant effect on the EMBI, corporate bond yields, and equities.

Differences in central bank credibility can partially explain the effectiveness of the Chilean experience. On average, high central bank credibility was correlated with a larger impact of APPs on sovereign bond yields. On the contrary, no statistically significant differences were found for inflation-targeting regimes, floating exchange rate regimes, or between purchasing assets on the primary and the secondary market.

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[1] Prepared by Chiara Fratto (WHD). This Box draws on Fratto, Chiara, Brendan Harnoys Vannier, Borislava Mircheva, David de Padua, and Hélène Poirson. 2021. "Unconventional Monetary Policies in Emerging Markets and Frontier Countries." IMF Working Paper, International Monetary Fund, Washington, D.C. and it is based on a dataset of APP announcements and implementation during March-August 2020.

[2] Between March and August, BCCh made three announcements on APPs, on March 16, March 19, and April 8. The first and latter announcements coincided with interest rate cuts.

[3] Robustness checks include panel regressions controlling for global and domestic factors, restricting the analysis to first announcements, excluding interest rate cuts, and studying the impact on the dates of implementation. Robustness checks confirm the results.

Box 3. Schedule for Basel III Implementation in Chile

In March 2020, Financial Market Commission (CMF) decided to postpone the implementation of Basel III requirements for one year. This table presents the new timetable. The CMF issued anyhow according to the original schedule (on Dec. 1, 2020) all new Basel III regulations were issued, including capital discounts, systemic charges, counter-cyclical capital buffer, capital conservation buffer, new Additional Tier 1 capital instruments, and public disclosure standards related to Pillar 3.

Basel III Phase-in Schedule

Framework	Dec. 1, 2021	Dec. 1, 2022	Dec. 1, 2023	Dec. 1, 2024	Dec. 1, 2025
Risk-weighted Assets	Full	Full	Full	Full	Full
D-SIB capital surcharge	0% of the final charge	25%	50%	75%	100%
Art 35 BIS surcharge	75% of surcharge	50%	25%	0%	0%
Capital Buffers: CCoB, CCyB	0.625%	1.25%	1.875%	2.5%	2.5%
Regulatory Capital Deductions	0% of total adjustment	15%	30%	65%	100%
Pillar 2 - SREP	Simplified IAPE (credit risk)	Simplified IAPE (credit risk, operation risk, market risk)	Full	Full	Full
Pillar 3	-	-	Full	Full	Full

Annex I. Policy Responses to COVID-19 Pandemic

The government put in place a comprehensive, timely and successful set of fiscal, monetary, and financial policies to lessen the impact of the pandemic. The plans have constantly evolved and have greatly benefitted from close coordination between the Ministry of Finance, Central Bank, and the financial regulator.[1]

A. Fiscal Policy Measures

1. **To mitigate the impact of the pandemic, the government is implementing a multi-year fiscal package (of US$34bn or 13 percent of GDP).** The measures aimed at buttressing the recovery while safeguarding health, and protecting incomes, jobs, and credit. Starting in 2021, when the pandemic is contained, the composition of the measures will gradually shift towards buoying the recovery while supporting social and economic groups that continue to face hardship.

2. **Initial measures were announced in mid-March 2020, and were successively complemented in June 2020 and March 2021.** The overall package combines temporary liquidity measures (already expired throughout 2020, with no impact in the end-year fiscal deficit), tax deferrals (that provide liquidity in 2020 and expire in 2021), additional spending (health related-expenses, transfers to vulnerable households, and employment subsidies), and below-the-line measures (to capitalize public institutions to provide loan guarantees and concessional loans).

3. **The government has the flexibility to spend up to US$18bn, financed with debt issuance and from accumulated savings in the Sovereign Wealth Fund.** About ½ of the stimulus package was allocated in 2020, with the remaining part (for 2021 and 2022), contingent on pandemic developments. In the past two quarters, the surge in contagions resulted in new mobility restrictions, which hampered the implementation of public investment and led the government to enlarge the existing package and expand existing measures including transfers for vulnerable segments of the population and the middle class. As vaccination progresses and mobility restrictions are eased, the government intends to devote more resources to prop the recovery, including with subsidies for firms that formalize workers, create jobs, or rehire workers with suspended contracts.

4. **The fiscal deficit deteriorated by about 3.7 percent of GDP in 2020 due to the stimulus measures**. Tax deferrals (including the suspension of CIT payments, VAT delays and the suspension of the stamp tax) lowered tax revenues by about 1.2 percent of GDP in 2020, but such stimulus will be partially reversed as some of these liabilities are due in 2021. Additional spending of 2.5 percent of GDP occurred in 2020. About ¼ of the additional spending was health related and the rest was used to provide transfers to vulnerable households and the middle class. In 2021, additional spending of 3.3 percent of GDP is envisaged, to continue protecting the most affected. But, as the health crisis is controlled, the spending composition will gradually shift to support the recovery, with additional resources allocated to public investment and employment subsidies.

[1] The measures were complemented with the approval by Congress of two rounds of pension withdrawals approved in July and December 2020 (see SIP for more details).

Table 1. Chile: Size of the Fiscal Stimulus Package

(In Percent of GDP)

	Announced [1/]	Revised [2/]	Cumulative [3/]	2020	2021	2022-2025
Total size of the stimulus package (percent GDP):	11.3	13.3	12.5	6.1	4.2	2.1
1. On Budget:	8.7	10.8	10.0	5.0	2.9	2.0
a. Temporary (no effect on end-year deficit):	1.3	1.3	1.3	1.3		
i. Defered taxes:	**0.5**	**0.5**	**0.5**	**0.5**		
CIT for SMEs	0.2	0.2	0.2	0.2		
Property taxes	0.3	0.3	0.3	0.3		
ii. Accelerated pay of liabilities (no affect on the accrual deficit):	**0.8**	**0.8**	**0.8**	**0.8**		
Early CIT refunds for SMEs	0.4	0.4	0.4	0.4		
Accelerated pay of public procurement obligations	0.4	0.4	0.4	0.4		
b. Permanent:	7.4	9.5	8.7	3.7	2.9	2.0
i. Revenues	**2.5**	**1.6**	**0.8**	**1.2**	**-0.4**	**0.0**
Suspension of CIT payments	1.0	0.9	0.3	0.9	-0.5	-0.1
VAT delay	0.6	0.2	0.0	0.2	-0.2	
Reduction of the stamp & seals tax	0.2	0.2	0.2	0.2		
Reduction CIT rate to 12.5%	0.3	0.0	0.0	0.0	0.0	0.0
Instantatenous 100% depreciation	0.4	0.4	0.4	0.0	0.3	0.1
ii. Spending	**4.9**	**7.9**	**7.9**	**2.5**	**3.3**	**2.0**
Additional Fiscal Resources for health expenditures	0.9	0.6	0.6	0.5	0.1	0.0
Other spending	0.0	0.2	0.2	0.1	0.1	0.0
Transfers for most vulnerable	1.8	2.9	2.9	1.5	1.3	0.0
Middle-class bonus	0.4	0.9	0.9	0.4	0.5	0.0
Public investment	1.2	1.2	1.2	0.0	0.4	0.8
Employment subsidies	0.6	1.0	1.0	0.0	0.7	0.3
Unallocated	0.0	1.1	1.1	0.0	0.2	0.9
2. Off-Budget (below the line):	2.6	2.5	2.5	1.1	1.3	0.1
Injection to the UI Solidarity Fund	0.8	0.0	0.0	0.0	0.0	0.0
Banco Estado capitalization	0.2	0.3	0.3	0.1	0.2	0.0
Public loan guarantees (FOGAPE), including Fogape Reactiva	1.2	0.8	0.8	0.4	0.3	0.1
Solidarity loan for middle class	0.4	1.2	1.2	0.6	0.6	0.0
Unallocated	0.0	0.2	0.2	0.0	0.2	0.0

1/ Annouced as of June 2020.
2/ Revised in March 2021 with outturns for 2020.
3/ Nets out the effect of tax deferrals.

5. **In 2020, below-the-line measures amounted to 1.1 percent of GDP.** They were used to fund liquidity provisions for SMEs (via *Banco Estado*), a credit-guarantee scheme for firms (via the public credit-guarantee fund FOGAPE, extended in January 2021 to include refinanced and investment loans) and a solidarity loan for the middle class. In 2021, below-the-line-measures of about 1.3 percent of GDP are expected, including solidarity loans for the middle class, and capital transfers to both FOGAPE and *Banco Estado* depending on the demand for credit and liquidity from firms.

6. **The most important measures, both in terms of allocated resources and economic significance, are:**

- **Tax deferrals**
  - **CIT** – introduced in April 2020, allowed for the suspension of monthly preliminary payments (for companies that experienced a reduction of their income of at least 30 percent in

2020Q2). The final declaration occurs in April 2021, when the deferred amount must be balanced out.

  - **VAT –** suspension for 6 months of monthly VAT payments for SMEs (that experienced a reduction of their income of at least 30 percent in 2020Q2). Payments are due in 2021 in 6 or 12 installments (depending on the companies' size).

  - **Stamp tax** – suspended between April and September 2020 (applies to mortgages, consumer loans, promissory notes, and bills of exchange).

  - **CIT** – reduction for SMEs of monthly preliminary payments and CIT rate to 10 percent (from 25 percent) for income generated in 2020-2022.

  - **Instantaneous depreciation** – introduced in June 2020, allows firms to reduce for tax purposes the value of fixed assets acquired until 2022.

- **Transfers to households**

  - **IFE (emergency family income)** – introduced in April 2020, provides monthly payments to vulnerable households. Has had several extensions. Qualification criteria and amounts disbursed have constantly evolved depending on circumstances. Payments have varied between 60 and 140 USD per person, and the latest payments are based on the degree of quarantine experienced in the region where the person lives. About 8.3 mn persons have benefitted.

  - **Middle-class bonus** – introduced in August 2020, provides a one-time payment for individuals with monthly income between US$500 and 2,500 (before the pandemic) whose income fell by at least 30 percent. The amount disbursed gradually falls from about US$630 to zero as the average monthly pre-pandemic income increases. About 1.7 mn persons have benefited. In March 2021, a new payment was approved but the amounts to be disbursed were increased by about ¼ for families with kids, seniors, or persons with disability.

- **Employment Protection Law:** introduced in April 2020, allows for the temporary suspension of work contracts (for up to six months) or for the reduction of up to 50 percent of the work schedule. At the peak about 600 thousand workers had a suspended contract but now only about 90 thousand remain. When a contract is suspended, firms continue paying health and pension contributions (but not the wage), while workers maintain contractual rights and receive monthly payouts from the unemployment insurance system (with normal withdrawal rules). On March 2021, the temporary suspension period has been extended until June 2021 and withdrawal rules were amended such that the unemployment insurance continues to make payments.

- **Employment Subsidies:** introduced in September 2020, awarded to firms (that had a fall in their sales of at least 20 percent in the second quarter of 2020) that hire new workers (government

pays ½ of the wage up to US$350) or rehire those with suspended contracts (about US$200 per worker). Subsidies are paid for 8 months for large firms and for 10 months for SMEs. The subsidy increases if the worker is young, female, or has some disability (to 60 percent of the wage up to US$350). About 600 thousand subsidies have been requested (80 percent for new hires and 20 for rehires). In March 2021, new subsidies for employment formalization were introduced, paid directly to workers, amounting to 15% of the minimum salary or 20% in case of women, youth, and workers with disabilities. It is expected, that with the changes about 500 thousand workers will benefit.

- **Measures to support credit**

  - **FOGAPE-COVID:** introduced in April 2020 (for 12 months), to provide state guarantees (60 to 70 percent for large companies with a 2.5 percent deductible, 80 percent for medium-size companies, and 85 percent for small companies) for commercial bank loans for SMEs (with annual sales of up to 40mn usd) for working capital. The maximum loan is for about ¼ of annual sales, has a grace period of 6 months, with no pre-payment charges, has a maximum maturity of four years (later increased to five years in January 2021) and a maximum interest rate of 300bps above the monetary policy rate (which was set at a technical minimum of 0.5 percent as a response to the pandemic; hence these loans were granted with a real rate close to zero which was much lower than normally experienced by firms, especially SMEs). At end-February, about 13bn usd of financing had been awarded.

  - **FOGAPE-Reactiva:** introduced in January 2021 (for 10 months), to provide state guarantees for commercial bank loans for SMEs for working capital but also for investments or to refinance loans from the previous program. The maximum loan was increased to ½ of annual sales (for the sectors most affected by the pandemic), the maximum interest rate was raised to 7.2 percent (0.6 per month) above the monetary policy rate and the maximum maturity was increased to 7 years (but without a grace period).

  - **Mortgage Payment Delays:** introduced in January 2021. Fogape provides state guarantees for commercial banks to provide delays for up to six months of mortgage instalments, for real estate properties with a commercial value below about US$400,000 and for persons with a fall of at least 25 percent in their monthly income.

  - **Commercial Loan Payment Delays for SMEs:** introduced in March 2021, allowing SMEs to delay up to three installments of loans with Banco Estado at zero interest rate.

    Middle-Class Loans: introduced in August 2020, granting loans for up to US$3,500 to cover up to 70 percent of the fall in monthly income for about four months (for persons with monthly earnings of at least US$500, whose income fell by at least 30 percent). They are requested to the tax authority and paid by the treasury in four installments. They carry one-year grace period, a maturity of four years, and a zero real interest rate. They have benefitted about 3.3mn persons (of which 2.4mn are workers, 0.8mn self-employed, and 0.1mn entrepreneurs). In March 2021, a new round of loans was approved but the maximum

loan was lowered to about US$2,600 (to cover for three months of lost income instead of four).

B. Monetary Policy Measures

7. BCCh cut the monetary policy rate twice (for a total of 125 bps) to 0.5 percent, which is considered as the "effective lower bound" by BCCh:

- On March 16, two days before the formal declaration of State of Catastrophe in Chile, the policy rate was reduced by 75 bps to 1 percent.

- On March 31, the policy rate was reduced by an additional 50 bps to 0.5 percent—a historical minimum which was also reached during the GFC in 2009.

8. With the goal of supporting credit activity, BCCh introduced three funding-for-lending facilities (FCIC) in the overall amount of up to US$40bn:

- In March 2020, BCCh announced the establishment of *the first "Conditional Financing Facility for Increased Loans (FCIC)"* to provide financing to commercial banks at the monetary policy rate (the lowest policy rate during lifetime of the facility), conditional on banks increasing lending to consumers and businesses (particularly small and medium sized businesses). This first FCIC (or *FCIC1*, entailing a total amount of US$24bn, which has been fully employed) consisted of two parts:

    - *Initial line* corresponding to 3 percent of the banks' base portfolio (commercial portfolio plus the consumer loan portfolio, measured at end-February 2020);

    - *Additional line* conditional on an increase in banks' lending, with an additional limit of 12 percent of the base portfolio.

- In June 2020, BCCh announced *a second lending facility (FCIC2)* that started operations in July and had a maximum lending capacity of up to US$16bn, allocated to banks depending on the growth of their credit portfolios. About US$5.3bn of this facility have been employed until early February 2021.

- In January 2021, BCCh announced the establishment of *a third facility (FCIC3)* that will start operations in March and be active for the following 6 months, with a total amount of up to about US$10bn, i.e. equivalent to the unused amount from FCIC1 and FCIC2. The key novelty is that FCIC3 will also apply to refinanced loans, thereby aligning it with the latest modifications to the FOGAPE credit-guarantee scheme (FOGAPE-Reactiva). The main reason was that there was not much market appetite for more credit in the context of the original FOGAPE and FCIC2, but it started becoming important to ensure that firms would not face a sudden stop in their access to credit during the recovery.

9. BCCh introduced two asset purchase programs, amounting up to US$16bn in total:

- On March 20, BCCh began a *bank bonds purchase program* for all participants of its open market operations system (SOMA) that includes banks and other financial institutions, for an equivalent of US$8bn (the initial US$4bn was expanded by an additional US$4bn at end-March). In total, about US$3.9bn in bank bonds have been purchased under this program.

- On June 22, BCCh started a *special assets purchase program*, encompassing purchase of bank bonds as well as buyback of BCCh securities, in the total amount of US$8bn. About US$4.8bn have been purchased so far (US$4bn in bank bonds and about US$0.8bn in buyback of BCCh securities).

10. In March 2020, BCCh also introduced modifications to its collateral framework and the FX reserve requirements:

- BCCh expanded its collateral framework by incorporating corporate bonds as well as corporate loans as eligible collateral for its operations.

- BCCh implemented a temporary modification to its FX reserve requirements, allowing banks to meet the FX requirements not only in US dollars, but also in Euros, Japanese yen, and Chilean pesos.

11. BCCh announced a set of extraordinary measures to smoothen the impact of the pension withdrawals on financial markets:

- Two key measures were announced on July 30, 2020, in response to Congress' approval of pension savings withdrawals.
  - Purchase of bank bonds for up to US$10bn with a sale back of these bonds to the banks within 1 to 3 months.
  - Purchase of banks' term deposits of up to US$8bn.

- In December, following Congress approval of a second pension withdrawal, BCCh re-activated the same measures it had adopted in response to the first withdrawal:
  - Purchase of bank securities (and resale back to banks within 3 months) of up to US$8.5bn, which corresponded to the remaining (unused) portion of the US$10bn that were announced in July 2020;
  - Purchase of bank term deposits in the amount of up to US$7.75bn, which also corresponded to the unused portion of the US$8bn announced in July 2020.

- Overall, the cumulative purchases of bank securities amounted to US$8.5bn, with the outstanding amount standing at about US$2.8bn (as of early February 2021); in addition, about US$0.5bn of bank term deposits have been purchased until early February 2021.

Table 2. Chile: BCCh Extraordinary Measures

(In US$mn)

Measures		Amount of the Program	Cumulative Usage Since Announcement 1/	
Domestic Currency Liquidity	BCCh Debt Buyback 2/ (Start date November 9th, 2019)	**8,514** Outstanding Amount of BCP/BCU/PRC/CERO at the start of the program	BCP	5,595
			BCU	983
			Others	83
			Cumulative Buybacks	**6,662**
	Bank Bonds Purchase Program (Start date March 20th, 2020)	**8,000**	Inflation Linked Bank Bonds	3,621
			CLP Denominated Bank Bonds	240
			Cumulative Purchases	**3,861**
	Special Assets Purchase Program (Start date June 22th, 2020)	**8,000**	**Total Bought (Whole Program)**	**4,785**
			BCP	628
			BCU	187
			Cumulative Buybacks (BCP and BCU)	815
			Inflation Linked Bank Bonds	3,940
			CLP Denominated Bank Bonds	30
			Cumulative Purchases	3,970
	Purchase of Bank Securities (August 3rd, 2020)	10,000	Cumulative Purchases	8,455
			Outstanding Amount	2,777
	Purchase of Bank Term Deposits (August 7th, 2020)	8,000	Cumulative Purchases	521
Domestic Currency Liquidity-With-Credit Expansion Incentives	FCIC 1-LCL March 30th, 2020-March 30th, 2024)	**24,000**	**Current Usage**	**25,240**
	Initial Line 3%	4,800	FCIC Usage	2,140
			LCL Usage	3,150
			Total Usage, Initial Line	5,290
	Additional Line 12%	19,200	FCIC Usage	16,163
			LCL Usage	3,786
			Total Usage, Initial Line	19,949
	FCIC 2 3/ (July 9th, 2020- July 1st, 2024)	**16,000**	**Current Usage**	**5,428**

Source: Central Bank of Chile.

1/ Last Updated on March 1, 2021.

2/ Bond buybacks are reported with one day of delay; amounts correspond to the total liquidity injection related to the buyback of bonds.

3/ Amount of the program dollarized using the average exchange rate of February, while the usage is dollarized using the last observed exchange rate.

C. Financial Policy Measures

12. In March 2020, the Financial Market Commission (CMF) announced a package of measures to facilitate the flow of credit to households and firms:

- Borrowers who were paying their mortgage at the time when the State of Emergency was declared, could reschedule up to three mortgage installments, without such rescheduling being treated as renegotiations for provisioning purposes.

- Banks and cooperatives were exempt from adding provisions corresponding to rescheduling and refinancing operations. The maximum grace or deferral extension was set to 6 months (for mortgage loans), 4 months (for commercial loans, which later extended to 6 months), and 3 months (for consumer loans), for debtors who were are up to date with their obligations or had a default of no more than 30 days within the indicated period of validity. This measure was implemented in April 2, 2020 and was set to expire on July 31, 2020 (later extended to August 31, 2020 for mortgage and commercial loans).

- Financial institutions could use their surplus mortgage collaterals to guarantee commercial loans to SMEs (implemented in May 25, 2020).

- The CMF authorized an exceptional extension of 18-months for banks' disposition of assets received as payment, which aimed to avoid sales at prices lower than normal market prices.

- The CMF ordered an amendment to the treatment of the cash amount that banks must post as collateral for the variation margin of bilaterally cleared derivatives transactions.

- The implementation of Basel III risk-weighted-assets requirement was postponed by one year and will become effective in December 2021. The additional capital charges for systemically important banks were also postponed by one year.

13. Several regulatory changes were implemented to promote the credit flow through FOGAPE:

- On June 26, the Ministry of Finance lowered the deductible for banks participating in FOGAPE and increased the maximum amount of loans for firms with sales less than UF 1,000.

- On August 21, to enhance banks' capacity to loan to SMEs, the CMF allowed banks to recognize up to 15 percent of state guarantees as part of the voluntary provisions that make up their effective capital. This applied to the amounts guaranteed by the Chilean Treasury, the Production Development Corporation (CORFO), and the Guarantee Fund for Small Entrepreneurs (FOGAPE). This was later replaced by a mitigation treatment that allow for the risk weights on the guaranteed part of those assets to be reduced from 100 to 10 percent.

14. The Central Bank of Chile adopted liquidity provision measures:

- The liquidity requirement for maturity mismatch on bank assets has been suspended for 90 days since March 2020 (later extended until April 15, 2021).

- The BCCh delayed the strict implementation of the liquidity coverage ratio (LCR) of 70 percent in 2020, as was required with the implementation plan announced in 2019.

15. The CMF implemented a series of measures to facilitate issuance and placement of securities:

- On June 15, 2020, the CMF temporarily exempted the presentation of required documents in application for registration of publicly offered securities (bonds, commercial papers, and shares). (effective from June 15, 2020 and until June 30, 2021)

- On October 19, 2020, the process for issuing debt securities in the stock market was streamlined.

- On January 25, 2021, the requirements to record securities under the automatic registration system were eased.

- On February 23, 2021, the CMF issued adjusted conditions, requirements, and parameters governing securities offerings that did not require a registration in the CMF.

16. On April 2, 2020, Congress enacted legislation approving a US$500mn capital contribution to *Banco Estado*, with the purpose of providing financing to individuals and SMEs. As a result, *Banco Estado*'s lending capacity increased by about US$4,400mn.

Annex II. External Sector Assessment

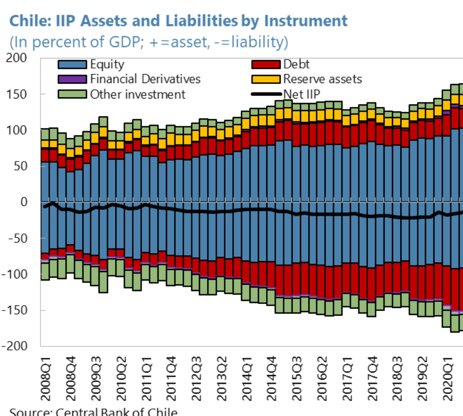
Overall Assessment: *The external position of Chile in 2020 is assessed as moderately stronger than indicated by medium-term fundamentals and desirable policies*. The CA balance increased significantly from the 2019 level, due to lower imports coupled with broadly steady exports of goods, in a context of a relatively larger fiscal expansion in advanced economies. The net international investment position is expected to improve, while international reserves are assessed as adequate.

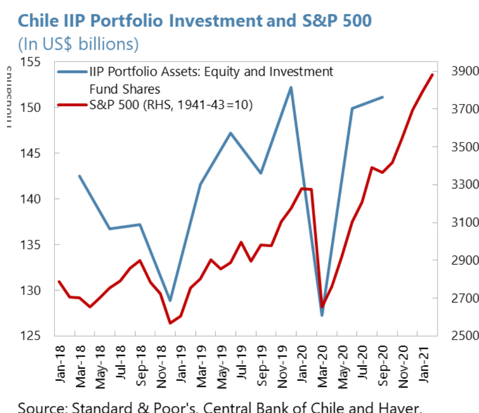
Potential Policy Responses: The authorities responded promptly to the sequence of shocks, first the social unrest in the last quarter of 2019 (into early 2020), then the Covid-19 outbreak in the first quarter of 2020, with substantial fiscal and monetary stimuli, and accommodative financial policies.

Foreign Asset and Liability Position and Trajectory

Background. Chile's net international investment position (NIIP) increased by US$5.6bn during the first three quarters of 2020 (close to 2 percentage points of GDP, from -14 percent of GDP in 2019), reflecting a current account surplus and some valuation effects, as the local equity market fell by about 20 percent, while safe-haven markets (US equities in particular) gained.

Assessment. Chile has large gross external liabilities, but these are largely offset by gross foreign assets. Moreover, the weight of FDI (and equities broadly) in gross liabilities is significant, and most sectors have positive net positions: the public sector, pension funds, and other non-bank financial institutions, all have positive NIIPs. Banks and non-financial corporations have negative net positions of about -10 and -50 percent of GDP, respectively. About 60 percent of NFC's liabilities are however FDI. (FDI is comfortably the largest type of liability by instrument, representing 60 percent of gross liabilities.) In sum, external vulnerability due to the negative NIIP is limited.

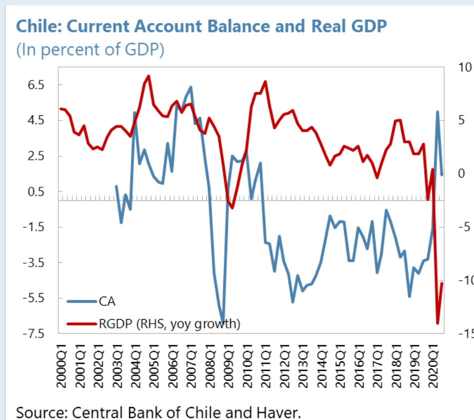




2019 (% GDP)	NIIP: –14.1	Gross Assets: 143.8	Reserve Assets: 14.4	Gross Liab.: 158.0	Debt Liab.: 65.7

Current Account

Background. The 2020 CA balance is 1.4 percent of GDP (from -3.9 in 2019). This turnaround is exceptional and a reflection of the extreme shocks. It is Chile's largest CA balance and the first surplus in a decade: it has had a CA deficit in each year since 2011, averaging 3 percent of GDP. The switch reflects the combination of weak domestic demand, induced by the Covid-19 shock, and strong demand for copper, Chile's main export. Largely due to temporary factors related to Covid-19, imports fell by about US$10bn, or 4 percent of 2020 GDP, while exports of goods held steady. (Like other economies where growth is import intensive, Chile's CA balance tends to rise when output falls.) The current account is expected to return to deficit in the near term, by 2022.



Assessment. The EBA model estimates a CA norm of -0.8 percent of GDP, against a cyclically adjusted CA of 0.9 percent of GDP. The difference is a gap of 1.7 percent of GDP. Multilaterally consistent adjustors to the underlying CA, for the temporary effects of Covid-19 on tourism and oil balances, are negligibly small for Chile (approximately -0.01 percent of GDP). Accordingly, staff assesses the overall 2020 external position to be moderately stronger than indicated by medium-term fundamentals and desired policy settings, mainly owing to the impact of the relatively larger fiscal expansion in advanced economies.

Est 2020 (% GDP)	Actual CA: 1.4	Cycl. Adj. CA: 0.9	EBA CA Norm: -0.8	EBA CA Gap: 1.7	Staff Adj.: -0.01	Staff CA Gap: 1.7

Real Exchange Rate	**Background**. The REER (CPI-based) appreciated by 3.5 percent in 2020 (yoy December), reversing some of the 10 percent drop in 2019. (The REER had appreciated on average 2.2 percent per annum in each preceding year since 2016.) The main driver of the REER in 2020 was a nominal appreciation in the peso-dollar rate of approximately 10 percent, closely tied to the boost to copper prices that accompanied the rebound in economic activity in China. (The NEER increased by 2.3 percent.) **Assessment.** Staff assesses the real exchange rate gap to be small. The EBA REER index model suggests an undervaluation of 12.5 percent and the EBA REER level model implies an undervaluation of 26.2 percent, both for 2020, after multilateral consistency adjustments, and both associated with very large residuals. Staff's assessment is anchored by the REER gap derived from the current account gap, through an estimated elasticity (of the CA-to-GDP ratio to change in the REER) of 0.27: this implies a slight real exchange rate undervaluation of 6 percent in 2020.
Capital and Financial Accounts: Flows and Policy Measures	**Background.** Portfolio flows accounted for the bulk of net inflows in 2019 (3 percent of GDP), followed by FDI. In 2020 non-residents were net sellers of Chilean assets—gross inflows were minus US$7.2bn. These flows were however offset by gross outflows of minus US$7.1bn: residents were net sellers of foreign assets, particularly of long-term debt securities held abroad. (Residents had increased sharply their holdings of portfolio securities and deposits abroad after the social unrest in late 2019 to early 2020). **Assessment.** Chile has demonstrated ample capacity to absorb short-term capital flow volatility. **Gross Inflows by Instrument** (In US$ billions, 12-month moving average) FDI, Portfolio, Equity, Portfolio, Debt, Other 1/, Liabilities **Gross Outflows by Instrument** (In US$ billions, 12-month moving average) FDI, Portfolio, Equity, Portfolio, Debt, Other 1/, Assets Source: Central Bank of Chile and IMF staff calculations.
FX Intervention and Reserves Level	**Background.** The peso is free floating and FX interventions have been limited to preventing disorderly market conditions. Accordingly, the authorities sold reserves in the overall amount of US$2.55bn between December 2019 and January 2020, in response to social unrest and the Covid-19 outbreak. In January 2021, the BCCh announced a program of gradual reserve accumulation—US$12bn over fifteen months—to lift these towards circa 18 percent of GDP. The stock of international reserves (US$39bn, end-2020) has been stable, oscillating between US$38bn and 42bn since 2011 (year-end stocks). Predetermined net short-term drains are less than US$2bn as of Nov-2020. **ARA Metric Decomposition: Chile** Export revenues (BXGS), Broad money (FMB_USD), Short-term Debt (D_SRM), Other Liabilities (OL), Reserves **Assessment.** Gross international reserves in 2020 were approximately 90 percent of the IMF's adequacy metric for EMs. The recently announced reserve accumulation program will gradually lift reserves to 108 percent of 2019 ARA. In addition to foreign assets held by the central bank, in Nov-2020 the central government held approximately US$24bn in usable liquid external assets, including US$10bn in the sovereign wealth fund for economic stabilization which, if counted as reserves, raise these to over 100 percent of ARA. Chile is classified as a mature market economy for reserve assessment purposes (IMF, 2015): its reserves may need to act mainly as a second line of defense against potential FX funding needs of the financial sector. Banks' external debt in Nov-2020 was US$24.9bn (from 31.2bn at end-2020), significant part of which is covered by the most liquid segments of banks' US$24.9bn in external assets. Hence, international reserves give ample cover to estimated net FX funding needs of banks. Lastly, the FCL arrangement with the IMF and a bilateral swap facility with the PBoC provide additional buffers of about US$24bn and US$7bn, respectively. Taking all these factors into account, staff assess Chile's official reserves are adequate.

Annex III. Risk Assessment Matrix[1]

Source of Risks	Likelihood	Impact	Horizon	Policy Advice
External Risk				
Prolonged pandemic. The disease proves harder to eradicate (e.g., due to new virus strains, short effectiveness of vaccines, or widespread unwillingness to take them), requiring costly containment efforts and prompting persistent behavioral changes rendering many activities unviable.	Medium	High	ST	Maintain accommodative monetary policy stance, and if necessary use policy space to provide further liquidity and allow slower pull back of fiscal stimulus, to limit scarring, protect the most vulnerable, and facilitate adjustment to post-pandemic normal.
Sharp rise in global risk premia. A reassessment of market fundamentals (e.g., in response to adverse Covid-19 developments) triggers a widespread risk-off event. Risk asset prices fall sharply and volatility spikes, leading to significant losses in major non-bank financial institutions.	Medium	Medium	ST	Allow the exchange rate to play its role as shock absorber; provide temporary liquidity and public guarantees to the financial sector.
Accelerating de-globalization. Despite renewed efforts to reach multilateral solutions to existing tensions, geopolitical competition leads to further fragmentation. Reshoring and less trade reduce potential growth.	Medium	Medium	ST, MT	Speed up reforms to reduce trade barriers, improve diversification on export destination and products, enhance productivity growth. Continued support for multilateralism and the global trading system.
Widespread social discontent and political instability. Social tensions erupt as the pandemic and inadequate policy response cause socio-economic hardship (unemployment, poverty, and shortages and higher prices of essentials—often exacerbating pre-existing inequities), or due to unequal access to vaccines. Growing political polarization and instability weaken policymaking and confidence.	High	High	ST	Continue to enhance social policies. Aim to reach a broad consensus over policy priorities.
Domestic Risk				
Uncertainty stemming from the process leading to a New Constitution and a possible reemergence of social protests.	Medium	High	ST,MT	Aim to reach a broad consensus over policy priorities to buttress domestic confidence.
Stronger-than-anticipated impact of pension withdrawals on economic activity and inflation.	Medium	Medium	ST	Reduce policy stimulus and allow the exchange rate to play its role as shock absorber.
Risk of default of leveraged non-financial corporates due to diminished earnings and impairment on assets.	Low	High	ST,MT	Ease monetary policy, manage impaired debt to maintain confidence and low funding costs of healthy corporates. Preventive measures encompass speeding up adoption of Basel III capital requirements.
Weather-related factors affecting activity in mining as well as agriculture, fishing, forestry, and energy.	Medium	Medium	ST,MT	Continue to incorporate environmental objectives in macroeconomic policies.

[1] The Risk Assessment Matrix (RAM) shows events that could materially alter the outlook (both the current policies and staff's proposal scenarios). The relative likelihood of risks listed is the staff's subjective assessment of the risks surrounding the scenarios projections ("low" is meant to indicate a probability below the 10 percent, "medium" a probability between 10 and 30 percent, and "high" a probability of 30 percent or more). The RAM reflects staff views on the source of risks and overall of concerns as of the time of discussions with authorities. Non-mutually exclusive risks may interact and materialize jointly.

Annex IV. Debt Sustainability Analysis

Staff's assessment is that debt in Chile is sustainable with a high probability. The authorities remain committed to a medium-term structural fiscal consolidation, that would provide space for the necessary stimulus in the short run while stabilizing the debt ratio in the medium run. If the structural consolidation is implemented, the debt would still stabilize under plausible shock scenarios. The authorities continually manage state-contingent debts, which are clearly detailed in an annual report. Both the withdrawal of private pensions and the expansion of credit guarantees (FOGAPE) are expected to result in modest fiscal costs in the medium term.

Figure 1. Chile: Public Sector Debt Sustainability Analysis (DSA) – Baseline Scenario

(In percent of GDP unless otherwise indicated)

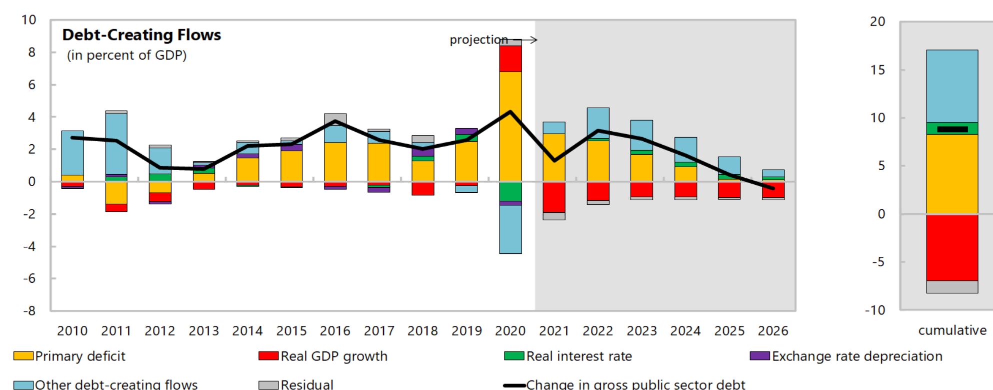
Debt, Economic and Market Indicators [1/]

	Actual			Projections					
	2010-2018 [2/]	2019	2020	2021	2022	2023	2024	2025	2026
Nominal gross public debt	16.3	28.2	32.5	33.9	37.2	39.9	41.6	42.0	41.7
Public gross financing needs	3.0	5.0	11.9	5.2	3.1	3.5	1.4	3.7	4.1
Real GDP growth (in percent)	3.6	1.0	-5.8	6.5	3.7	2.7	2.6	2.5	2.5
Inflation (GDP deflator, in percent)	4.2	2.0	8.3	3.2	2.6	2.4	2.3	2.4	2.7
Nominal GDP growth (in percent)	7.9	3.0	1.9	9.9	6.4	5.1	4.9	4.9	5.2
Effective interest rate (in percent) [4/]	5.5	3.7	3.5	3.4	3.2	3.2	3.2	3.2	3.3

As of March 25, 2021		
Sovereign Spreads		
EMBIG (bp) 3/		128
5Y CDS (bp)		59
Ratings	Foreign	Local
Moody's	A1	A1
S&Ps	A	A+
Fitch	A-	A-

Contribution to Changes in Public Debt

	Actual			Projections							
	2010-2018	2019	2020	2021	2022	2023	2024	2025	2026	cumulative	debt-stabilizing primary balance [9/]
Change in gross public sector debt	2.2	2.6	4.3	1.3	3.2	2.7	1.6	0.4	-0.4	8.8	
Identified debt-creating flows	2.0	2.6	3.9	1.8	3.4	2.9	1.8	0.6	-0.3	10.1	
Primary deficit	0.9	2.5	6.8	3.0	2.5	1.7	0.9	0.1	0.1	8.3	-0.4
Primary (noninterest) revenue and grants	20.9	21.1	19.5	22.3	22.0	21.9	22.5	22.5	22.5	133.7	
Primary (noninterest) expenditure	21.9	23.6	26.3	25.3	24.5	23.5	23.4	22.6	22.6	141.9	
Automatic debt dynamics [5/]	-0.2	0.5	0.2	-1.9	-1.0	-0.7	-0.7	-0.7	-0.8	-5.8	
Interest rate/growth differential [6/]	-0.3	0.2	0.4	-1.9	-1.0	-0.7	-0.7	-0.7	-0.8	-5.8	
Of which: real interest rate	0.1	0.4	-1.2	0.0	0.2	0.3	0.3	0.3	0.2	1.2	
Of which: real GDP growth	-0.4	-0.3	1.6	-1.9	-1.2	-0.9	-1.0	-1.0	-1.0	-7.0	
Exchange rate depreciation [7/]	0.1	0.4	-0.3	...	...	...	...	...	...	...	
Other identified debt-creating flows	1.2	-0.4	-3.0	0.7	1.9	1.9	1.6	1.1	0.4	7.6	
Net acquistion of Financial Assets (negative)	0.7	-0.6	-3.2	0.6	1.8	1.8	1.5	1.1	0.4	7.1	
Contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Net Repayment of Recognition Bond	0.5	0.2	0.2	0.1	0.1	0.1	0.1	0.0	0.0	0.5	
Residual, including asset changes [8/]	0.2	0.0	0.4	-0.5	-0.2	-0.2	-0.2	-0.1	-0.1	-1.3	



Source: IMF staff.

1/ Public sector is defined as central government.

2/ Based on available data.

3/ EMBIG.

4/ Defined as interest payments divided by debt stock (excluding guarantees) at the end of previous year.

5/ Derived as $[(r - \pi(1+g) - g + ae(1+r)]/(1+g+\pi+g\pi))$ times previous period debt ratio, with r = interest rate; π = growth rate of GDP deflator; g = real GDP growth rate; a = share of foreign-currency denominated debt; and e = nominal exchange rate depreciation (measured by increase in local currency value of U.S. dollar).

6/ The real interest rate contribution is derived from the numerator in footnote 5 as $r - \pi(1+g)$ and the real growth contribution as $-g$.

7/ The exchange rate contribution is derived from the numerator in footnote 5 as $ae(1+r)$.

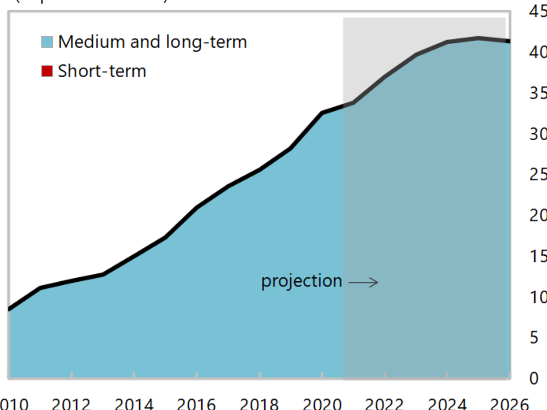
8/ Includes asset changes and interest revenues (if any). For projections, includes exchange rate changes during the projection period.

9/ Assumes that key variables (real GDP growth, real interest rate, and other identified debt-creating flows) remain at the level of the last projection year.

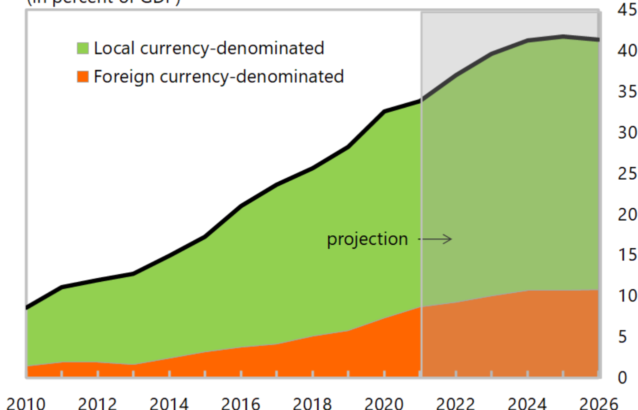
Figure 2. Chile: Composition of Public Debt and Alternative Scenarios

Composition of Public Debt

By Maturity
(in percent of GDP)



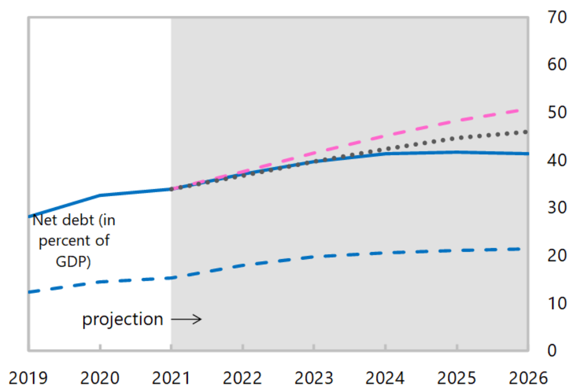
By Currency
(in percent of GDP)



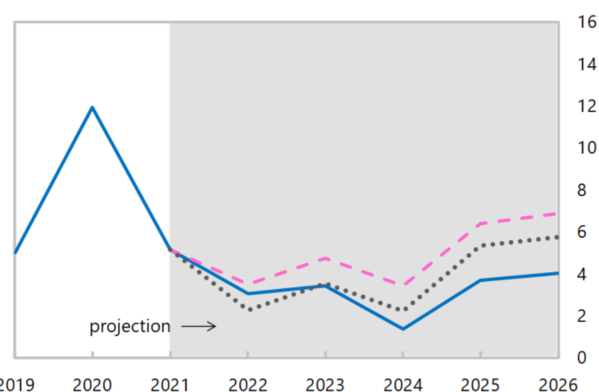
Alternative Scenarios

Baseline Historical Constant Primary Balance

Gross Nominal Public Debt
(in percent of GDP)



Public Gross Financing Needs
(in percent of GDP)



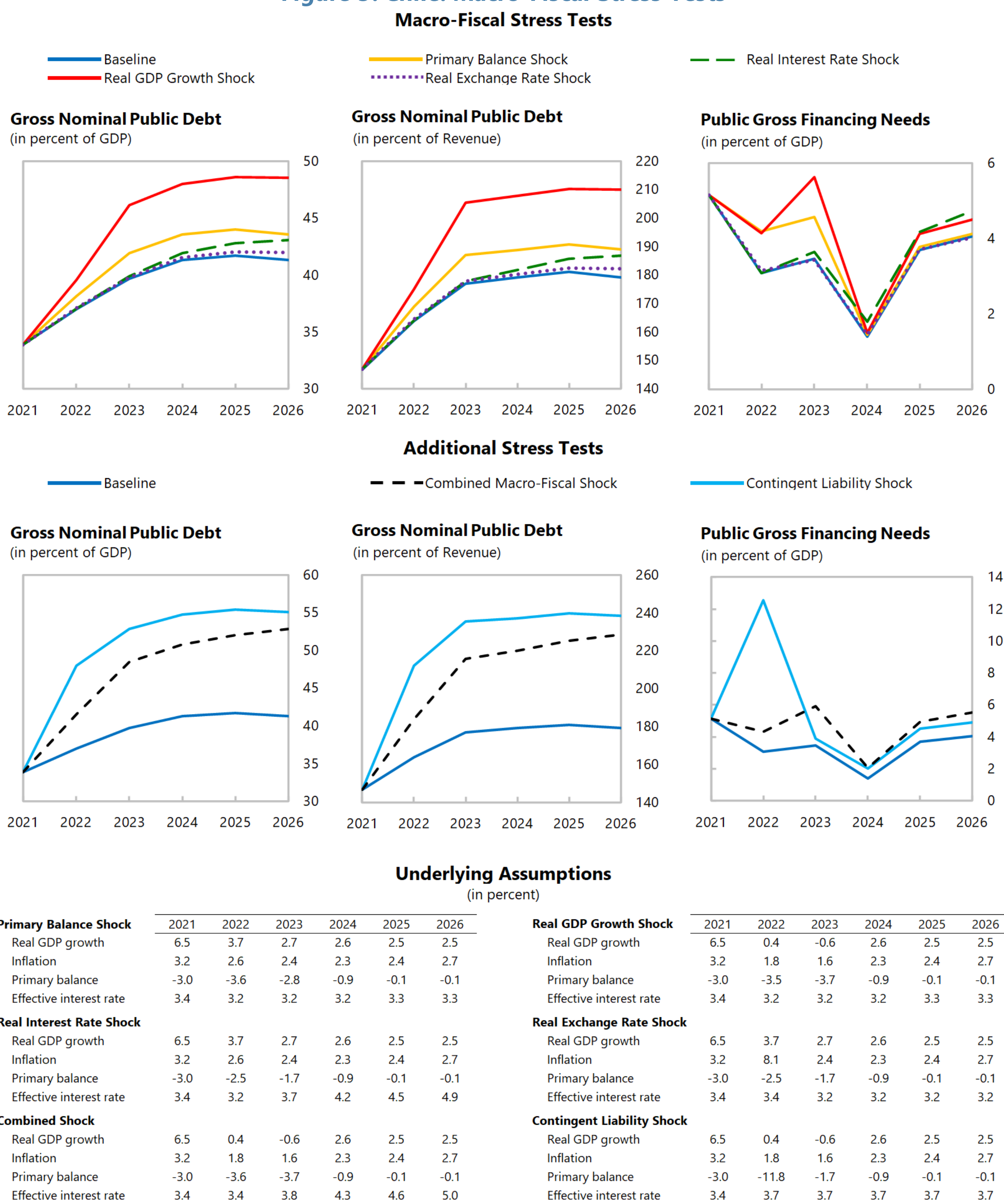
Underlying Assumptions
(in percent)

Baseline Scenario	2021	2022	2023	2024	2025	2026
Real GDP growth	6.5	3.7	2.7	2.6	2.5	2.5
Inflation	3.2	2.6	2.4	2.3	2.4	2.7
Primary Balance	-3.0	-2.5	-1.7	-0.9	-0.1	-0.1
Effective interest rate	3.4	3.2	3.2	3.2	3.2	3.3
Constant Primary Balance Scenario						
Real GDP growth	6.5	3.7	2.7	2.6	2.5	2.5
Inflation	3.2	2.6	2.4	2.3	2.4	2.7
Primary Balance	-3.0	-3.0	-3.0	-3.0	-3.0	-3.0
Effective interest rate	3.4	3.2	3.2	3.2	3.1	3.1

Historical Scenario	2021	2022	2023	2024	2025	2026
Real GDP growth	6.5	2.1	2.1	2.1	2.1	2.1
Inflation	3.2	2.6	2.4	2.3	2.4	2.7
Primary Balance	-3.0	-1.7	-1.7	-1.7	-1.7	-1.7
Effective interest rate	3.4	3.2	3.2	3.3	3.3	3.3

Source: IMF staff.

Figure 3. Chile: Macro-Fiscal Stress Tests



Underlying Assumptions

(in percent)

Primary Balance Shock	2021	2022	2023	2024	2025	2026
Real GDP growth	6.5	3.7	2.7	2.6	2.5	2.5
Inflation	3.2	2.6	2.4	2.3	2.4	2.7
Primary balance	-3.0	-3.6	-2.8	-0.9	-0.1	-0.1
Effective interest rate	3.4	3.2	3.2	3.2	3.3	3.3
Real Interest Rate Shock						
Real GDP growth	6.5	3.7	2.7	2.6	2.5	2.5
Inflation	3.2	2.6	2.4	2.3	2.4	2.7
Primary balance	-3.0	-2.5	-1.7	-0.9	-0.1	-0.1
Effective interest rate	3.4	3.2	3.7	4.2	4.5	4.9
Combined Shock						
Real GDP growth	6.5	0.4	-0.6	2.6	2.5	2.5
Inflation	3.2	1.8	1.6	2.3	2.4	2.7
Primary balance	-3.0	-3.6	-3.7	-0.9	-0.1	-0.1
Effective interest rate	3.4	3.4	3.8	4.3	4.6	5.0

Real GDP Growth Shock	2021	2022	2023	2024	2025	2026
Real GDP growth	6.5	0.4	-0.6	2.6	2.5	2.5
Inflation	3.2	1.8	1.6	2.3	2.4	2.7
Primary balance	-3.0	-3.5	-3.7	-0.9	-0.1	-0.1
Effective interest rate	3.4	3.2	3.2	3.2	3.3	3.3
Real Exchange Rate Shock						
Real GDP growth	6.5	3.7	2.7	2.6	2.5	2.5
Inflation	3.2	8.1	2.4	2.3	2.4	2.7
Primary balance	-3.0	-2.5	-1.7	-0.9	-0.1	-0.1
Effective interest rate	3.4	3.4	3.2	3.2	3.2	3.2
Contingent Liability Shock						
Real GDP growth	6.5	0.4	-0.6	2.6	2.5	2.5
Inflation	3.2	1.8	1.6	2.3	2.4	2.7
Primary balance	-3.0	-11.8	-1.7	-0.9	-0.1	-0.1
Effective interest rate	3.4	3.7	3.7	3.7	3.7	3.7

Source: IMF staff.

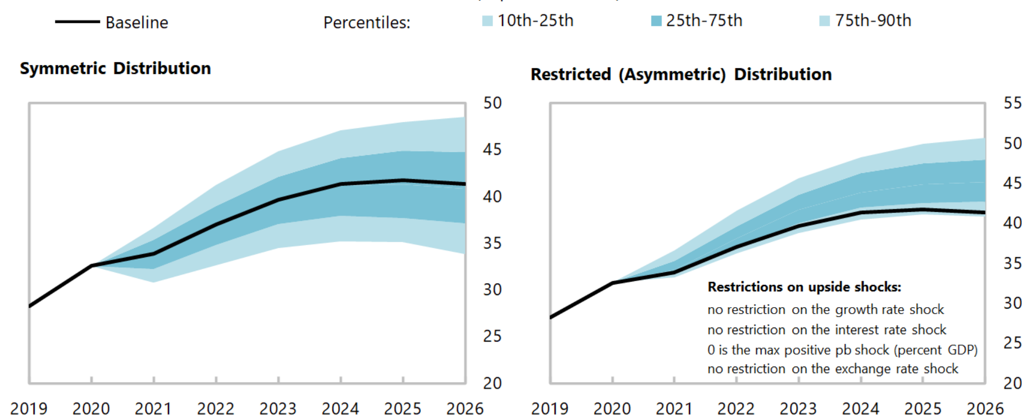
Figure 4. Chile: Risk Assessment

Heat Map

Debt level 1/	Real GDP Growth Shock	Primary Balance Shock	Real Interest Rate Shock	Exchange Rate Shock	Contingent Liability shock
Gross financing needs 2/	Real GDP Growth Shock	Primary Balance Shock	Real Interest Rate Shock	Exchange Rate Shock	Contingent Liability Shock
Debt profile 3/	Market Perception	External Financing Requirements	Change in the Share of Short-Term Debt	Public Debt Held by Non-Residents	Foreign Currency Debt

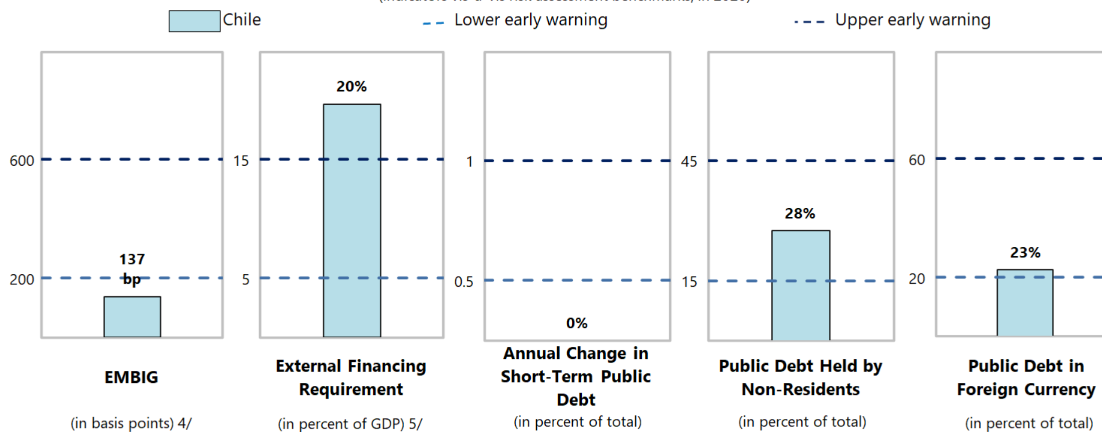
Evolution of Predictive Densities of Gross Nominal Public Debt

(in percent of GDP)



Debt Profile Vulnerabilities

(Indicators vis-à-vis risk assessment benchmarks, in 2020)



Source: IMF staff.

1/ The cell is highlighted in green if debt burden benchmark of 70% is not exceeded under the specific shock or baseline, yellow if exceeded under specific shock but not baseline, red if benchmark is exceeded under baseline, white if stress test is not relevant.

2/ The cell is highlighted in green if gross financing needs benchmark of 15% is not exceeded under the specific shock or baseline, yellow if exceeded under specific shock but not baseline, red if benchmark is exceeded under baseline, white if stress test is not relevant.

3/ The cell is highlighted in green if country value is less than the lower risk-assessment benchmark, red if country value exceeds the upper risk-assessment benchmark, yellow if country value is between the lower and upper risk-assessment benchmarks. If data are unavailable or indicator is not relevant, cell is white.

Lower and upper risk-assessment benchmarks are:

200 and 600 basis points for bond spreads; 5 and 15 percent of GDP for external financing requirement; 0.5 and 1 percent for change in the share of short-term debt; 15 and 45 percent for the public debt held by non-residents; and 20 and 60 percent for the share of foreign-currency denominated debt.

4/ EMBIG, an average over the last 3 months, 25-Dec-20 through 25-Mar-21.

5/ External financing requirement is defined as the sum of current account deficit, amortization of medium and long-term total external debt, and short-term total external debt at the end of previous period.

Annex V. Recommendations of 2018 Article IV Consultation and Authorities' Actions

Fund Recommendation	**Policy action**
Monetary Policy	
Caution is warranted in deciding the pace of the monetary policy normalization, which should be guided by evidence of a persistent convergence of inflation towards the target that is supported by a broad set of indicators.	The authorities swiftly reacted to a series of shocks within their inflation-targeting framework, ensuring well-anchored inflation expectations over the policy horizon.
Fiscal Policy	
To further enhance credibility and market confidence, the authorities could consider strengthening the fiscal framework or deepening the fiscal consolidation.	The authorities and the IMF organized a conference on options to enhance Chile's fiscal framework. The new Autonomous Fiscal Council is also exploring such options.
The authorities' proposal to enhance the fiscal council will help strengthen the institutional framework on fiscal responsibility.	The proposal was approved, and the Autonomous Fiscal Council started operations.
Structural Reforms	
Pension reform remains urgent, as the current system is not delivering adequate benefits for a large share of retirees.	The authorities' latest proposal to raise mandatory contributions, with particular emphasis on the socially vulnerable, elderly, and women, is being discussed in Congress.
In order to address concerns about the impact of the tax reform on income inequality and tax evasion and avoidance, the authorities should consider further strengthening tax administration and explore additional measures.	In 2020, Congress approved a long-delayed tax reform which is expected to permanently increase annual revenue by a higher PIT bracket, electronic invoicing, and a reduction of tax benefits for the financial system and corporates. The authorities introduced modifications to the original reform proposal that aim to strengthen the tax administration.
Financial Sector	
It will be important to strengthen bank resolution regime, establish a national deposit-insurance scheme, and enhance regulation of insurance companies and of financial conglomerates.	The CMF has started investigating most of these issues.
Cybersecurity and FinTech regulation frameworks need to be strengthened.	Draft legislation on cybersecurity is being finalized. FinTech regulation is also being considered.

INTERNATIONAL MONETARY FUND

CHILE

April 2, 2021

STAFF REPORT FOR THE 2021 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

Prepared By | The Western Hemisphere Department (in consultation with other departments)

CONTENTS

FUND RELATIONS ____ 2

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RELATIONS WITH OTHER INTERNATIONAL FINANCIAL INSTITUTIONS ____ 5

FUND RELATIONS

(As of February 28, 2021)

Membership Status: Joined: December 31, 1945; Article VIII

General Resources Account:	**SDR Million**	**Percent Quota**
Quota	1,744.30	100.00
Fund holdings of currency	1,304.29	74.77
Reserve Tranche Position	440.02	25.23
Lending to the Fund		
New Arrangements to Borrow	29.64	

SDR Department:	**SDR Million**	**Percent Allocation**
Net cumulative allocation	816.89	100.00
Holdings	468.57	57.36

Outstanding Purchases and Loans: None

Latest Financial Arrangements:

Type	**Date of Arrangement**	**Expiration Date**	**Amount Approved** (SDR Million)	**Amount Drawn** (SDR Million)
FCL	May 29, 2020	May 28, 2022	17,443.00	0.00
Stand-By	Nov 8, 1989	Nov 7, 1990	64.00	64.00
EFF	Aug 15, 1985	Aug 14, 1989	825.00	806.25
Stand-By	Jan 10, 1983	Jan 9, 1985	500.00	500.00

Projected Payments to Fund (in SDR Million)

			Forthcoming		
	2021	**2022**	**2023**	**2024**	**2025**
Principal					
Charges/Interest	0.15	0.19	0.19	0.19	0.18
Total	**0.15**	**0.19**	**0.19**	**0.19**	**0.18**

Exchange Rate System

Chile's de jure exchange rate arrangement is free floating. The de-facto exchange rate arrangement has been reclassified to free-floating from floating, effective June 4, 2020. Chile has accepted the obligations of Article VIII, Sections 2, 3, and 4 and maintains an exchange rate system free of restrictions on the making of payments and transfers for current international transactions.

STATISTICAL ISSUES

(As of March 17, 2021)

I. Assessment of Data Adequacy for Surveillance

General: Data provision is adequate for surveillance. The National Institute of Statistics (INE) regularly publishes a full range of economic and financial data. The Central Bank of Chile (CBC) also publishes comprehensive macroeconomic and financial data. The Ministry of Finance publishes fiscal data.

Key publicly accessible websites for macroeconomic data and analysis are:

National Institute of Statistics: http://www.ine.cl/
Central Bank of Chile: http://www.bcentral.cl/
Ministry of Finance: http://www.minhda.cl/

Real Sector: Since January 2019, the INE compiles and publishes a new Consumer Price Index (CPI) 2018=100, which is based on the 2016/17 Household Budget Survey.

Monetary and Financial Sectors: The CBC uses the standardized report forms (SRFs) to report to STA monthly data for the central bank, other depository corporations (ODCs), other financial corporations (OFCs), and monetary aggregates. However, data for the ODCs exclude savings and credit cooperatives, and OFCs exclude financial auxiliaries. The CBC reports most core and seven encouraged financial soundness indicators on a monthly basis. The CBC reports data on several indicators of the Financial Access Survey (FAS), including the two indicators (commercial bank branches per 100,000 adults and ATMs per 100,000 adults) adopted by the UN to monitor Target 8.10 of the Sustainable Development Goals (SDGs).

II. Data Standards and Quality

In March 2020, Chile completed the requirements for adherence to the IMF's Special Data Dissemination Standard (SDDS) Plus—the highest tier of the Data Standards Initiatives. This made Chile the second country in Latin America to adhere to the SDDS Plus.	A data ROSC was published September 17, 2007.

Table 1. Chile: Table of Common Indicators Required for Surveillance

(As of March 17, 2021)

	Date of Latest Observation	Date Received	Frequency of Data[6]	Frequency of Reporting[6]	Frequency of Publication[6]
Exchange Rates	March 4, 2021	March 4, 2021	D	D	D
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	February 19, 2021	March 1, 2021	W	W	W
Reserve/Base Money	January 29, 2021	February 8, 2021	W	W	W
Broad Money	January, 2021	February 8, 2021	M	M	M
Central Bank Balance Sheet	February, 2021	February 23, 2021	M	M	M
Consolidated Balance Sheet of the Banking System	December, 2020	February 23, 2021	M	M	M
Interest Rates[2]	March 4, 2021	March 4, 2021	D	D	D
Consumer Price Index	February, 2021	March 9, 2021	M	M	M
Revenue, Expenditure, Balance and Composition of Financing[3] – General Government[4]	Q3 2020	December 30, 2020	Q	Q	Q
Revenue, Expenditure, Balance and Composition of Financing[3] – Central Government	January, 2021	March 2, 2021	M	M	M
Stocks of Central Government and Central Government–Guaranteed Debt[5]	December, 2020	February 16, 2021	M	M	M
External Current Account Balance	Q3 2020	November 18, 2020	Q	Q	Q
Exports and Imports of Goods	January, 2021	February 8, 2021	M	M	M
GDP/GNP	Q3 2020	November 18, 2020	Q	Q	Q
Gross External Debt	December, 2020	February 8, 2021	M	M	M
International Investment Position[7]	Q3 2020	November 18, 2020	Q	Q	Q

[1] Any reserve assets that are pledged or otherwise encumbered should be specified separately. Also, data should comprise short-term liabilities linked to a foreign currency but settled by other means as well as the notional values of financial derivatives to pay and to receive foreign currency, including those linked to a foreign currency but settled by other means.

[2] Both market-based and officially-determined, including discount rates, money market rates, rates on treasury bills, notes, and bonds.

[3] Foreign, domestic bank, and domestic nonbank financing.

[4] The general government consists of the central government (budgetary funds, extra budgetary funds, and social security funds) and state and local governments.

[5] Including currency and maturity composition.

[6] Daily (D); weekly (W); monthly (M); quarterly (Q); annually (A); irregular (I); and not available (NA).

[7] Includes external gross financial asset and liability positions vis-à-vis nonresidents.

RELATIONS WITH OTHER INTERNATIONAL FINANCIAL INSTITUTIONS

- World Bank: https://www.worldbank.org/en/country/chile
- Intern-American Development Bank: https://www.iadb.org/en/countries/chile/overview

Statement by Luis Oscar Herrera, Alternate Executive Director for Chile
April 19, 2021

On behalf of the Chilean authorities, I wish to thank staff for their open and constructive dialogue during the Article IV consultation, as well as the insightful report on the Chilean economy. The authorities attach great importance to staff's assessment and policy recommendations.

Chile entered the crisis with a healthy economy, a solid fiscal position, and a sound financial system. The policy response to the pandemic has been swift and comprehensive, anchored in a very strong policy and institutional framework. Using the buffers accumulated in previous years, buttressed by access to the Flexible Credit Line (FCL), the authorities have provided unprecedented support to households and firms. Initially, a broad range of measures were introduced to ensure an adequately resourced health care system, protect households' jobs and incomes, ease financial conditions, and provide a liquidity bridge to firms, especially small and medium enterprises (SMEs). In contrast to historical downturns, interest rates stayed at historical lows, corporate credit expanded, and the banking system remained solid. Activity and domestic demand are recovering, while jobs lag. More recently, new measures aim at stimulating investment and job creation, facilitating and extending refinancing terms, and limiting scarring effects, while remaining nimble to adapt to the unfolding health and economic situation. Vaccination is progressing rapidly, raising hopes of a broader upturn in the second half of the year. However, if necessary, the authorities are prepared to maintain policy support until the recovery takes hold.

Recent developments and economic outlook

The Chilean economy is recovering from the COVID-19 shock despite high uncertainty. After a sharp drop in activity in mid-2020, a gradual recovery started in the second half of last year bolstered by supportive monetary and fiscal policies. At the end of the first quarter, output was already back at the pre-pandemic level. The outlook for 2021 and 2022 has strengthened in recent months, buttressed by a stronger starting point, rapid vaccine deployment, a more favorable global environment, and the continuation of accommodative policies. Real GDP is projected to grow between 6 to 7 percent in 2021, and 3 to 4 percent in 2022, after contracting 5.8 percent in 2020. The recovery, however, remains uneven across sectors, with significant lags in contact-intensive activities, slowing down the pick-up in employment. A temporary setback in output is likely in the coming weeks amid a new surge of infections and tightening of lockdown measures.

Vaccine deployment is making fast progress in Chile. As of April 12, 48 percent of the adult population in Chile has received at least one dose of a COVID-19 vaccine and 31 percent has received two. If vaccination continues unfolding as planned, most of the adult population is expected to be fully inoculated by mid-2021. Based on the limited international experience, such vaccine coverage should reduce the severity of new cases, relieve emergency services, decelerate contagion

and, conditioned on these projections, allow a broader opening of the economy in the second half of the year.

As a small, open economy, Chile will receive a boost from improved global conditions. Besides favorable financial conditions and robust growth of trading partners, terms of trade are expected to be – on average – more than 10 percent higher than in 2020. Copper prices have peaked above USD4/lb, its highest since 2011. Since mid-2020, the sovereign has continued to place debt in the local and international markets at very favorable terms.

Domestic demand is expected to lead the recovery in 2021 and 2022. After a sharp contraction in mid-2020, consumption turned around in the second half of last year on the back of government emergency support and pension fund withdrawals. This impulse will last well into 2021, adding to the gradual reopening of the contact-intensive activities, for a real growth above 11 percent. Investment is expected to bounce back with support from public infrastructure investment and large mining and energy projects under way. However, non-mining private investment is proceeding at a slow pace due to high uncertainty and heavier financial burden of many companies. As domestic demand continues to pick up, the authorities expect the current account balance to turn into a moderate deficit in 2021 and beyond.

Although the economy has gained momentum, the recovery of employment is lagging, especially in contact-intensive activities. Only half of jobs lost since the outbreak of the pandemic have been recovered. Labor-intensive sectors, like commerce, services, and transportation activities, suffered the most in the early stages of the crisis and have not fully recovered due to continuing social distancing and the adoption of new, less labor-intensive, delivery modalities. Inactivity remains high for women. The government has implemented a temporary hiring subsidy, with special incentives for women and youth.

The authorities concur with staff that downside risks related to the pandemic are still high. The evolution of the pandemic, both locally and globally, remains highly uncertain. Exit policies in advanced economies could tighten global financial conditions and trigger negative spillovers into emerging market economies. And scarring effects, through reduced labor participation or weaker corporate balance sheets, could reduce potential output in the medium term. The authorities are prepared to respond to these emerging risks, as they have done in recent weeks, when, amid a new surge of cases and lockdown measures, they have allocated considerable resources to provide additional emergency relief to households.

Monetary policy, exchange rate, and external buffers

Low and stable inflation in the context of sound monetary and exchange rate policy. Chile has maintained inflation around 3 percent for the last two decades. Since 1999, the Central Bank of Chile (CBC), an autonomous and accountable institution, conducts monetary policy through a fully-fledged

inflation targeting and free-floating regime. In addition, Chile can count on a deep domestic financial system, where households and firms can access short- and long-term credit in local currency, and exposure to FX risk is limited. The CBC continues enhancing its policy framework. In recent years, the CBC has voluntarily undergone an independent evaluation of the conduct of monetary and financial policy, which highlighted its par with high international standards. Currently, the CBC is undergoing a Fund review considering the new IMF Central Bank Transparency Code.

Headline and core inflation are expected to converge to the 3 percent target by the end of 2022. Inflation has remained close to the policy target in recent months. In the coming months, headline inflation is expected to post a transitory increase to nearly 4 percent mainly due to higher prices of energy and other volatile items, to resume converging to the 3 percent target in the second half of the year. This is granted by the combination of currency appreciation and a still large output gap. Core inflation (excluding volatile items) is expected to fall to 2.6 percent by year-end, and then return to 3 percent. Inflation expectations remain well anchored to the target.

The CBC has implemented a broad set of measures aimed at boosting the monetary impulse, stimulate credit, ease the adjustment of financial markets and gain policy space. The monetary policy rate (MPR) completed a year at its technical lower bound (0.5 percent), while unconventional measures have mobilized resources equivalent to 13 ppt of GDP. Extraordinary measures include: (i) a new "funding-for-lending" facility (FCIC), which works in tandem with the public credit guarantee-scheme (FOGAPE); (ii) asset purchase programs to curb disorderly conditions in local bond markets; (iii) an expanded collateral framework to scale up liquidity operations; and (iv) temporary repo facilities to smoothen the financial impact of extraordinary pension funds withdrawals. These measures have allowed the economy to navigate this crisis with interest rates at historical lows and a countercyclical behavior of corporate credit.

The authorities concur that the monetary stance is appropriate. The CBC considers that, even as the economic outlook has improved, the convergence of inflation to the target in the policy horizon requires that monetary policy remains highly expansionary. The MPR will be held at its 0.5 percent minimum until the economic recovery takes hold and spreads to the more lagging components of expenditure, which will take several quarters. The unconventional measures will continue to operate under the stated conditions, complementing the low MPR. Future adjustments will depend on the macroeconomic outlook and its implications for inflation.

The peso is free floating, and the flexible exchange rate plays a useful role as shock absorber. The exposure of local agents to FX risk is limited, and the pass-through of currency fluctuations to inflation expectations, in contrast to headline inflation, is low. Over the past year, the nominal (and real) exchange rate has flexibly adjusted to dramatic changes in global financial conditions and commodity prices. Despite sharp fluctuations in the peso-dollar parity, medium-term inflation expectations remain stable, while the financial impact of exchange rate volatility has been limited due to currency hedging. FX interventions have been rare and limited to curb disorderly market

conditions as those observed in late 2019 in the wake of the social unrest. CBC did not intervene in 2020.

The authorities intend to continue treating the FCL as a precautionary and temporary arrangement. Since May last year, the CBC has taken several steps to strengthen its external liquidity position and broaden its policy toolkit, including access to the FCL, participation in the FIMA Repo Facility of the NY Federal Reserve, and a Bilateral Swap Agreement with the People's Bank of China for three years. Last January, the CBC announced a program of reserve accumulation – USD12 billion over fifteen months – to lift these to approximately 18 percent of GDP. The main goal of the program is to build an additional buffer to prepare for a smooth and timely exit of the FCL in May 2022, conditional on economic and financial developments. The program is proceeding through fixed daily purchases that do not interfere with the free-floating FX regime. The FCL arrangement, along with a comfortable reserve position and other precautionary arrangements, has provided confidence and additional policy space in a period of extraordinary uncertainty as the global pandemic.

Fiscal policy

Chile entered the pandemic crisis with a strong fiscal position that allowed to deliver an unprecedented multi-year fiscal package amounting to 13 ppt of GDP. Since the early 2000s, Chile's fiscal policy has been guided by a structural rule and complemented by a sovereign stabilization fund, underpinned by the *Fiscal Responsibility Law* and the *Autonomous Fiscal Council* (CFA). The consistent implementation of this design over time has contributed to restrain public debt and accumulate important liquidity buffers, as well as favorable financial conditions in international capital markets, macroeconomic stability, and a more effective countercyclical fiscal policy.

Since the beginning of the pandemic, the government of Chile has taken swift and bold actions to protect lives and livelihoods. Initially, emergency measures included extraordinary transfers to vulnerable and middle-class households, tax deferrals to households and firms, adjusting the unemployment insurance scheme to support temporary suspended workers, and an expanded credit-guarantee scheme to protect loans to SMEs and mortgages. As the economy exits the crisis, policies have been targeted to support investment and job creation through temporary tax and subsidy measures, increase public investment, and enhance the credit-guarantee scheme to facilitate refinancing of SMEs over a long horizon. At each stage, the authorities have adjusted and recalibrated their policy programs as necessary to adapt to the economic and health situation. The most recent example is the emergency fiscal package exceeding 2 ppt of GDP approved in early April to support households in the second quarter.

Fiscal policy will remain supportive in 2021 and a gradual consolidation is anticipated thereafter to anchor public debt at a safe and sustainable level. Initially in the wake of social unrest and then later after the outbreak of the COVID-19 pandemic, the government loosened the target of the structural or cyclically adjusted deficit to allow for a stronger fiscal response. The

headline deficit reached 7.4 ppt of GDP by the end of 2020, and gross debt increased to 32.5 ppt of GDP. The deficit is expected to decline in 2021, as revenues are bolstered by the growing economy, deferred taxes, and higher copper-related revenues. However, the structural deficit will increase this year reflecting the accommodative stance of fiscal policy and added impulse. Beyond 2021, the extraordinary measures will be phased out and the structural budget is planned to return to a gradual consolidation path to stabilize the gross debt below 45 ppt of GDP by 2025.

The authorities concur with staff on the need to enhance Chile's fiscal rule and are considering the best way forward. In late 2020, the government asked the CFA to prepare a proposal to enhance the current fiscal framework. In early April, the CFA issued its recommendations including the adoption of a dual rule on net public debt and the structural balance, formal escape clauses, and correction mechanisms. The authorities are considering these suggestions and plan to work with the CFA on their implementation. In parallel, they have requested a Fund review considering the Fiscal Transparency Code.

The authorities concur that revenue and expenditure reforms could be considered in the medium term, but the immediate priority is to achieve a solid recovery. At the start of 2020, the administration passed a tax reform to increase revenues by 1 ppt of GDP and finance an increase in social benefits. More recently, the authorities requested a *Commission of Experts* to prepare a critical review of tax deductions and exemptions in Chile, based on a report prepared by a joint IMF-OECD team. The commission's review and recommendations were issued last January, and the administration is considering their implementation. The authorities agree that more ambitious revenue and expenditure measures could be considered once the recovery is well entrenched to finance additional social spending, rebuild buffers, and strengthen public finances. In the near-term, the priority is to achieve a broad and solid economic and job recovery to limit the scope of scarring effects.

Financial sector

During the pandemic, the *Financial Market Commission* (CMF) and CBC provided regulatory flexibility to lenders. Measures included an easing of the liquidity coverage ratio; a transitory regime for provisions on deferred loans; improvements on the capital treatment of public credit-guarantees; and a delay in phasing in additional capital requirements under Basel III. The financial system has adequately transmitted the easing of monetary and financial conditions to the economy. Corporate credit accelerated strongly in mid-2020 as firms faced extraordinary liquidity demands but it has slowed down since then.

The financial sector in Chile remains liquid, solvent and well capitalized, supported by effective supervision and regulation. The authorities concur with staff that potential vulnerabilities, particularly in the corporate sector should continue to be closely monitored. The pandemic crisis has hurt banks' profitability as interest margins have compressed and credit provisions increased even as

non-performing loans remain low. Compared to other countries, however, Chile avoided compulsory across-the-board measures and relied on the banks' knowledge of their customers for refinancing and the allocation of new credit, including the use of partial credit guarantees for SMEs and banks' exposure to the first loss in the guaranteed loan portfolio. Larger companies have relied on their continued access to bank credit and capital markets and, when necessary, have undergone debt restructuring procedures. Therefore, the deterioration of bank portfolios is likely to be more limited and well absorbed by the public guarantee scheme and increased provisions. Stress tests carried out by the CBC show that banks remain adequately capitalized, but the buffers to cope with a severe stress scenario have been reduced. Liquidity in the banking sector remains high, and well above regulatory requirements.

Authorities have resumed the agenda of regulatory reforms to strengthen the financial system. In December 2020, the CMF finalized the issuing of all new Basel III regulations, including systemic bank capital charges, the counter-cyclical capital buffer, the capital conservation buffer, new Tier-1 capital instruments, capital discounts, capital charges related to Pillar 2, and public disclosure standards related to Pillar 3. The phasing-in schedule for the new regulations was delayed by a year, giving banks more time to adjust to the new capital requirements. The process is planned to be completed in 2025. Going forward, the financial reform agenda of the authorities comprises many of the issues highlighted by staff, including strengthening the bank resolution framework and the regulation of financial conglomerates, expanding the scope of the public credit registry, implementing a risk based capital and enhanced supervision powers for the insurance sector, and submitting FinTech legislation to Congress. The authorities look forward to the conclusions and recommendations of the ongoing FSAP.

Social agenda and structural policies

We thank staff for valuable recommendations to continue advancing the social agenda and other reforms. Pensions and other social policies have remained at the top of the government's agenda but reaching a "quick and comprehensive" agreement has not been easy, particularly in a political environment as complex as the social unrest of late 2019, the pandemic in 2020, and a packed calendar of elections in 2021. An example of these difficulties is the approval by Congress of the massive withdrawals of pension savings, which will deepen the deficiencies of the contributory pillar in the pension system. Despite these difficulties, the government has already implemented an important enhancement of the solidarity pillar of the pension system (50 percent increase in the minimum pension and 34 percent increase in private pensions that receive a public supplement), and a new scheme that tops up wages to guarantee a minimum labor income above the minimum wage. In the near term, the administration's priority is to pass a reform on the pension system, which among other changes, increases gradually the contribution rate from 10 to 16 percent (funded by the employer), and further extends the coverage of the solidarity pillar.

Chile is strongly committed to climate action and has pioneered the issuance of sovereign green bonds in the Americas since 2019. Proceeds of these issuances primarily finance clean transportation projects, contributing to the decarbonization of the energy matrix, and advancing the country's Paris Agreement commitments.

Chile has embarked on a deep reform to write a New Constitution. Over the past three decades, Chile has been able to combine rapid growth and social development, reduce poverty and income inequality, and expand opportunities for all. In turn, these changes have altered the fabric and aspirations of society creating new demands on the political system that need to be addressed. In November 2019, an agreement was reached in Congress to initiate a profound constitutional reform. This is a historic opportunity to strengthen democracy and achieve a broad agreement that fosters social development and shared prosperity in Chile. Despite some delays related to the pandemic, the institutional process towards the New Constitution is moving steadily and is expected to culminate with a ratification plebiscite in mid-2022. Although uncertainty about the content of the New Constitution is inevitable, the authorities trust that the process will continue to evolve in accordance with the procedures and safeguards envisaged in the constitutional amendment of November 2019.