IMF Country Reports 22/283

Chile: Request for an Arrangement Under the Flexible Credit Line and Cancellation of the Arrangement Under the Short-term Liquidity Line-Press Release; Staff Report; Staff Supplement and Statement by the Executive Director for Chile

INTERNATIONAL MONETARY FUND

IMF Country Report No. 22/283

CHILE

August 2022

REQUEST FOR AN ARRANGEMENT UNDER THE FLEXIBLE CREDIT LINE AND CANCELLATION OF THE ARRANGEMENT UNDER THE SHORT-TERM LIQUIDITY LINE—PRESS RELEASE; STAFF REPORT; STAFF SUPPLEMENT AND STATEMENT BY THE EXECUTIVE DIRECTOR FOR CHILE

In the context of the Request for an Arrangement under the Flexible Credit Line and Cancellation of the Arrangement under the Short-term Liquidity Line, the following documents have been released and are included in this package:

- A **Press Release** including a statement by the Chair of the Executive Board.
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on August 29, 2022, following discussions that ended on August 22, 2022, with the officials of Chile on economic developments and policies underpinning the IMF arrangement under the Flexible Credit Line. Based on information available at the time of these discussions, the staff report was completed on August 24, 2022.
- A **Staff Supplement** on the assessment of the impact of the proposed Flexible Credit Line arrangement on the Fund's finances and liquidity position.
- A **Statement by the Executive Director** for Chile.

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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International Monetary Fund
Washington, D.C.

IMF Executive Board Approves Two-Year US$18.5 Billion Flexible Credit Line for Chile

FOR IMMEDIATE RELEASE

- *The IMF approved today a two-year Flexible Credit Line (FCL) arrangement for Chile of about US$18.5 billion to augment buffers and provide insurance against adverse scenarios. The FCL will be treated as precautionary.*
- *After an impressive recovery from the fallout of the Covid-19 pandemic, the Chilean economy is confronting marked increase in global risks.*
- *Chile qualifies for the FCL by virtue of its very strong economic fundamentals and policies, which continue to support the country's resilience and capacity to respond to shocks.*

Washington, DC – **August 29, 2022:** The Executive Board of the International Monetary Fund (IMF) approved today a two-year arrangement for Chile under the Flexible Credit Line (FCL) in the amount of SDR 13.954 billion (about US$18.5 billion[1]; 800 percent of quota). The Chilean authorities intend to treat the FCL as precautionary. Given that the FCL can address all types of balance of payment needs, the Chilean authorities also notified the Fund of their decision to cancel the existing Short-term Liquidity Line (SLL) of SDR 2.529 billion (about US$3.3 billion; 145 percent of quota), an approach that is consistent with current Fund policies.

The FCL was established on March 24, 2009, as part of a major reform of the Fund's lending framework (see Press Release No. 09/85). The FCL allows its recipients to draw on the credit line at any time and is designed to flexibly address both actual and potential balance of payments needs. Drawings under the FCL are not phased nor tied to ex-post conditionality as in regular IMF-supported programs.

The FCL will augment Chile's precautionary reserve buffers on a temporary basis and provide substantial insurance against a broad range of risks, including from a possible abrupt global slowdown; commodity price shocks; spillovers from Russia's war in Ukraine; or a sharp tightening of global financial conditions.

Chile qualifies for the FCL given its very strong economic fundamentals and institutional policy frameworks, a sustained track record of implementing very strong policies, and the authorities' continued commitment to maintaining very strong policies in the future. Qualification criteria for an arrangement under the FCL are the same as for the SLL.

[1] US$ amounts have been calculated using the exchange rate as of August 2, 2022 (SDR 0.755229/US$), consistent with the Staff Report.

700 19th Street NW
Washington, DC 20431
USA

Following the Executive Board's discussion on Chile, Ms. Kristalina Georgieva, Managing Director, issued the following statement:

"After an impressive recovery from the fallout of the Covid-19 pandemic, Chile is facing a marked increase in global risks.

"Against the backdrop of a challenging external environment, the authorities have continued to implement very strong policies to mitigate risks, preserve macroeconomic stability, and support vulnerable groups, while advancing ambitious reforms. The FCL with access of 800 percent of quota will provide a substantial precautionary buffer against a broad range of risks. The authorities intend to treat the arrangement as precautionary and exit the arrangement when external conditions allow.

"Chile has very strong fundamentals and a sustained track record of implementing very strong policies, anchored in a long-standing structural fiscal balance rule, credible inflation targeting with a flexible exchange rate, and a sound financial system supported by effective regulation and supervision. These very strong fundamentals and policy frameworks continue to support the country's resilience and capacity to respond to shocks."

INTERNATIONAL MONETARY FUND

CHILE

August 24, 2022

REQUEST FOR AN ARRANGEMENT UNDER THE FLEXIBLE CREDIT LINE AND CANCELLATION OF THE ARRANGEMENT UNDER THE SHORT-TERM LIQUIDITY LINE

EXECUTIVE SUMMARY

Context: After an impressive recovery from the fallout of the Covid-19 pandemic, the Chilean economy is confronting an acute deterioration of the external environment. Downside risks have materialized, including a tightening of global financial conditions, a slowdown in global growth, and a substantial drop in Chile's terms of trade. Domestic economic policies are appropriately being recalibrated to mitigate risks and preserve macroeconomic stability, while supporting vulnerable groups. The authorities will continue leveraging on Chile's very strong fundamentals and policy frameworks to implement an ambitious reform agenda in a challenging external environment.

Risks: External risks and global uncertainty have markedly increased since the entry into effect of the Short-term Liquidity Line (SLL) in May. External risks relate to a possible abrupt global slowdown or recession and an associated increase in global risk premia and commodity price volatility; a de-anchoring of inflation expectations alongside further tightening of global financial conditions; additional commodity price shocks; or an intensification of spillovers from Russia's war in Ukraine. Domestic risks continue to stem from social discontent about high energy and food prices, unmet social demands, or the uncertain outcome of the constitutional reform. However, low public indebtedness, a sustained track record of very strong policies, and very strong institutional policy frameworks continue to support Chile's resilience and capacity to respond to shocks.

Flexible Credit Line (FCL): Considering the worsening of external conditions and the marked increase in risks, the authorities wish to augment their precautionary reserve buffers on a temporary basis. To this end, they are requesting a two-year precautionary FCL arrangement in an amount equivalent to SDR 13.954 billion (800 percent of quota, about US$18.5 billion) to cover against a broad range of risks and the cancellation of the current SLL arrangement with access equivalent to SDR 2.529 billion (145 percent of quota, around US$3.3 billion), which became effective on May 20, 2022. The authorities intend to treat the FCL arrangement as precautionary, exiting as soon as the 24-month period is completed, conditional on favorable developments in risks scenarios. In staff's view, Chile continues to meet the qualification criteria for an arrangement under the

FCL (which are identical to the SLL criteria), and staff supports the authorities' request. The last Article IV consultation was concluded in April 2021. The 2022 Article IV is planned for the fall, after the referendum on the new constitution.

Fund liquidity: This proposal would increase the Fund's total commitment to Chile to SDR 13.954 billion. It would have a significant but manageable impact on the Fund's liquidity position, which is expected to remain adequate after the approval of the proposed FCL arrangement.

Process: An informal meeting to consult with the Executive Board on a possible FCL arrangement for Chile was held on August 23, 2022.

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

The report was prepared by a team comprising Ana Corbacho (head), Jose Torres, Chiara Fratto, Antonio Gabriel (all WHD), Luiza Antoun de Almeida (SPR), Eduardo Camero (FAD), and Junghwan Mok (MCM), with support from Natalia Martinez-Camelo, Gabriel Moura Queiroz, and Adriana Veras (all WHD).

CONTENTS

CONTEXT

1. Chile maintains very strong economic fundamentals and institutional policy frameworks, with a sustained track record of implementing very strong policies. Monetary policy is anchored in a highly credible inflation-targeting framework and a flexible exchange rate. The financial system is resilient and functions well within a sound regulatory framework. Fiscal policy has been guided by a structural fiscal balance rule since 2001, which allowed Chile to build ample fiscal space during commodity price booms. Chile has remained resilient even in the face of very large shocks, such as the 2019 social unrest, the Covid-19 pandemic, and the recent deterioration in external conditions. The government is embarking on a far-reaching reform agenda to tackle inequality, improve social services, and foster a green economy, while preserving macroeconomic stability and fiscal sustainability.

2. An FCL arrangement would augment precautionary reserve buffers and provide insurance against a broad range of risks. In May, the authorities exited the FCL arrangement that was about to expire and transitioned to an SLL arrangement, against the backdrop of a rapid economic recovery, lower risks and uncertainty compared to the onset of the pandemic, and the buildup of foreign exchange (FX) liquidity buffers. Since then, the Chilean economy has been hit by large external shocks, including a tightening of global financial conditions and a substantial drop in Chile's terms of trade. External risks and global uncertainty have markedly increased, including risks of an abrupt global slowdown or recession and an associated spike in global risk premia and commodity price volatility. Other key external risks include a possible de-anchoring of inflation expectations alongside further tightening of global financial conditions; additional commodity price shocks; or an intensification of spillovers from Russia's war in Ukraine. A new FCL arrangement would provide a substantial buffer against a broad range of risks on a temporary basis, supporting the authorities' strategy and external resilience. The authorities intend to treat this new FCL arrangement as precautionary and exit after two years, conditional on developments and risks. Given that the FCL can address all types of balance of payment needs, the authorities notified the Fund of their decision to cancel the SLL arrangement, an approach that is in line with current Fund policy.

3. Staff conducted virtual meetings in July to assess qualification. FCL qualification criteria are identical to those for the SLL, and staff had a very positive assessment at the time of the SLL *offer* in May. The most recent Article IV consultation was concluded in April 2021, when the Executive Board provided a very positive assessment of Chile's policies.[1] The 2022 Article IV is planned for the fall, following the national referendum on the constitutional reform proposal (Box 1).

[1] See Chile 2021 Article IV Consultation – IMF Country Report 21/83.

Box 1. Chile: Constitutional Reform[1]

On July 4, the Constitutional Convention proposed a new draft constitution. The proposal will need approval by simple majority in a national referendum with mandatory voting on September 4.

The draft proposes changes to the form of government and emphasizes social and other rights. It defines Chile as a pluri-national state; introduces a regional chamber in lieu of the Senate; and grants regions political, administrative, and financial autonomy. The draft constitution also emphasizes social, indigenous, and water rights; gender parity in government; and the protection of the environment. It establishes state domain over mines and minerals.

With respect to macroeconomic policy frameworks, key highlights include:

- *Central Bank of Chile (BCCh) autonomy maintained.* The BCCh's core mandate remains price stability and the normal functioning of the payments system. In fulfilling its core mandate, the BCCh is called to take into consideration financial stability, FX volatility, employment, the environment, and natural wealth.
- *New provision on fiscal sustainability and responsibility.* This new constitutional clause would apply at all levels of government.
- *Shared prerogative on fiscal proposals.* Compared to the current exclusive presidential prerogative, the lower house would also be able to initiate fiscal proposals, but only with concurrence from the president. Constitutional provisions on the budget process remain broadly unchanged.

If approved, implementing the new constitution would require legislative changes that would unfold slowly over time, avoiding abrupt changes to Chile's policy frameworks. The draft constitution states principles at a high level, while follow-up legislation will need to lay out their implementation, including during a transition period.

[1] For additional details on the reform process, see IMF Country Report 2022/148.

RECENT DEVELOPMENTS AND POLICIES

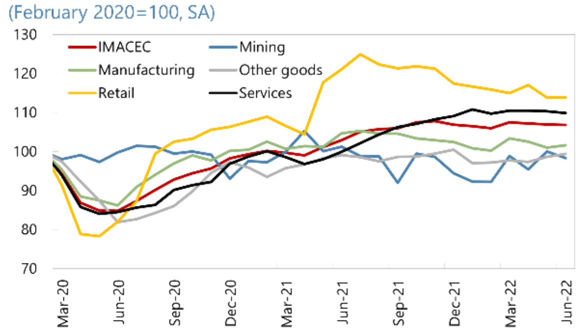
4. The external environment facing Chile has deteriorated considerably in recent months. Global inflationary pressures have proven more persistent than anticipated, including due to spillovers from the war in Ukraine and continued pandemic-related supply constraints. This has prompted sizable increases in monetary policy rates by major central banks,[2] a significant tightening of global financial conditions, and an appreciation of the U.S. dollar. More recently, fears of a global slowdown have led to a correction and volatility in commodity prices, including a sharp and fast drop of about 30 percent in the price of copper between early June and mid-July, with a significant impact on Chile's terms of trade.[3]

[2] Since the entry into effectiveness of the SLL in May, the 1-year U.S. treasury rate has increased from 2 percent to 3.1 percent.

[3] Between mid-July and mid-August, copper prices recovered somewhat, but remain about 20 percent below their level from early June.

5. Following a remarkable recovery from the pandemic, Chile's economy is undergoing a necessary transition towards lower growth. GDP rebounded by 11.7 percent in 2021, buoyed by a large, effective, and well-coordinated Covid-19 policy response, widespread vaccination, and high copper prices.[4] Against a positive output gap, the authorities are adequately tightening macroeconomic policies (see below), and economic activity is cooling down. Growth in the monthly activity indicator (IMACEC) has slowed to 4 percent y/y in June, from a peak of 21 percent in mid-2021. Amid policy tightening, the slowdown is being driven by weak investment while consumption has been more resilient, aided by lingering support from the Covid-19 exceptional pension fund withdrawals. Job creation plateaued in June, with employment still about 3.5 percent below its pre-pandemic level.

Chile: IMACEC by Sector
(February 2020=100, SA)

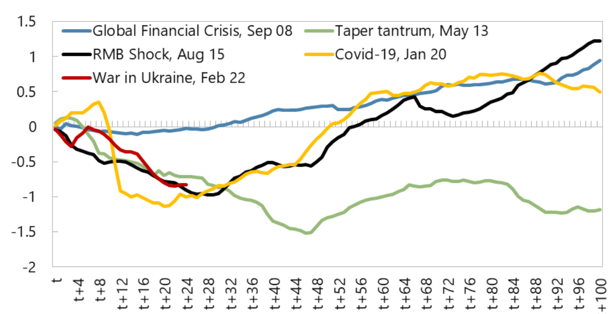


Source: Haver and Central Bank of Chile.

6. Notwithstanding the ongoing adjustment of domestic demand, negative terms of trade shocks have kept the current account deficit elevated. The current account deficit increased to 6.7 percent in 2021, from 1.7 percent of GDP in 2020, due to a surge of imported durable goods following large Covid-19 stimulus measures, in particular the exceptional pension fund withdrawals and large fiscal transfers. The fall in tourism revenues due to travel restrictions, and a worsening of the income balance on the back of large repatriation of dividends from mining companies also contributed. Alongside the adjustment of domestic demand, the current account deficit has started to decline in 2022 (to 8 percent of GDP in the first quarter from 8.6 percent of GDP in the last quarter of 2021) but remains elevated given weak terms of trade.

7. Chile's financial markets have proven resilient among Emerging Markets (EMs). Since the onset of the war in Ukraine, Chile has faced portfolio outflows and a tightening of financial conditions comparable to past episodes of stress. Chilean longer-term yields in peso-denominated sovereign bonds have remained relatively stable, while the decline in equity indices has been less pronounced than in other LA5 economies.[5]

Chile: Cumulative Total Portfolio Flows in Weeks
(In US$ billions)



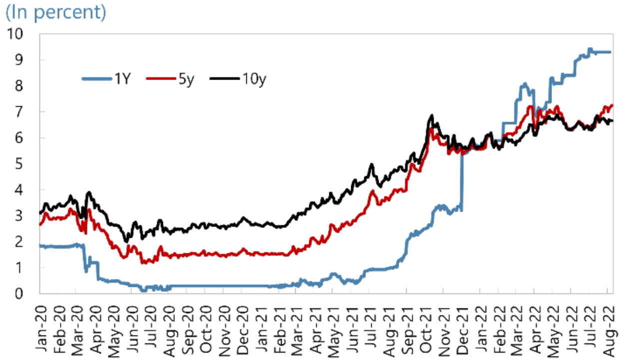
Sources: EPFR, Haver, and IMF staff calculations.

[4] For further details, see IMF Country Report 2022/148.

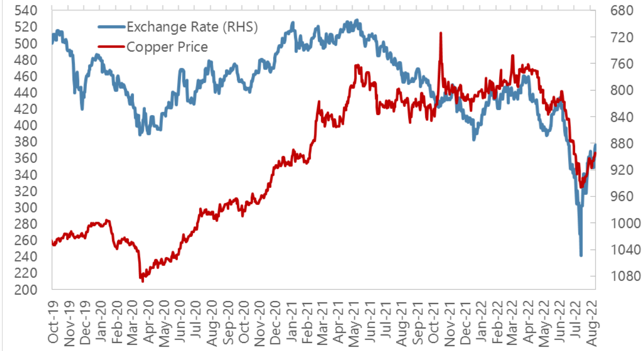
[5] The LA5 group comprises Brazil, Chile, Colombia, Mexico, and Peru.

8. **The exchange rate has continued to play its role as a shock absorber amid high volatility.** After relatively calm FX market conditions in the first five months of 2022, the sharp fall in copper prices since June (to levels still higher than at the onset of the pandemic) triggered a fast and large depreciation, alongside unusually high volatility. The BCCh assessed that, if these conditions persisted, there could be negative spillovers to the proper functioning of financial markets.

Chile: Peso Government Bond Yields
(In percent)



Chile: US$ Exchange Rate and Copper Price
(In US cent/lb. CLP/US$)



Sources: Haver and Central Bank of Chile.

9. **On July 14th, the BCCh launched an FX intervention program to address disorderly market conditions**. Consistent with a very well-established inflation-targeting framework and a flexible exchange rate, the program responds to disorderly market conditions, aiming to facilitate the economy's adjustment to uncertain and changing circumstances. Auction plans and results are being transparently communicated, and FX sales are being duly sterilized to ensure full consistency with the monetary policy rate.[6] Following the announcement of the program in mid-July, FX markets stabilized, and the exchange rate has appreciated by about 9 percent. The program will run until September 30, comprising auctions of up to US$10 billion in the spot market and US$10 billion in the forwards market, and up to US$5 billion in liquidity swaps. By mid-August, the BCCh had sold US$3.6 billion in the spot market and US$7.9 billion in the forwards' market.

10. **The BCCh continued to broaden its FX liquidity management tools.** Between January and October 2021, the BCCh purchased US$7.4 billion as part of its reserve accumulation program, while the 2021 general SDR allocation further boosted reserves by about US$1.8 billion.[7] Reserves stood at US$44.7 billion in July, down from US$51.3 at end-2021, mostly driven by lower

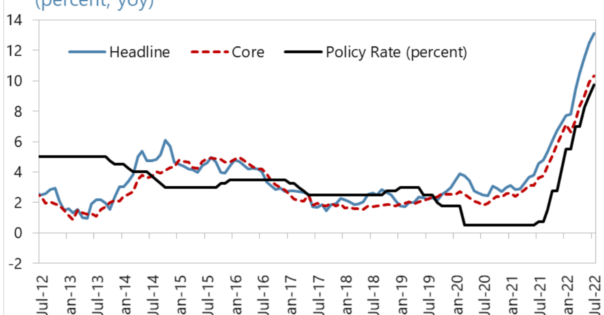
[6] The BCCh has allowed the exchange rate to adjust without discretionary intervention since 2002, except for temporary and small FX interventions during the 2019 social unrest. At the time, the BCCh announced an FX intervention program of up to US$20 billion, but actual intervention amounted to only US$2.5 billion in the spot market and US$4.5 billion in the forwards market over six weeks between the end of 2019 and early 2020.

[7] SDRs allocated to Chile amounted to US$2.4 billion, of which US$0.6 billion were used as a capital contribution to the Latin American Reserve Fund (FLAR) and the remainder was kept in international reserves.

banks' deposits at the BCCh and valuation effects.[8] The BCCh secured a new liquidity line with the BIS (about US$3.7 billion, the precise amount to be confirmed upon effectiveness in 2023), adding to the existing bilateral swap facility with the PBOC (US$8 billion) and the liquidity line with FLAR (US$1.25 billion).[9] In addition, the SLL provided until now a revolving FX liquidity backstop of about US$3.3 billion. Overall, the BCCh's FX liquidity buffers, including reserves and liquidity lines, amounted to about US$61 billion in July, or nearly 20 percent of 2021 GDP.[10] The BCCh is also a subscriber of the FED's FIMA repo facility, which allows the temporary exchange of U.S. Treasury securities held with the FED for U.S. dollars.[11]

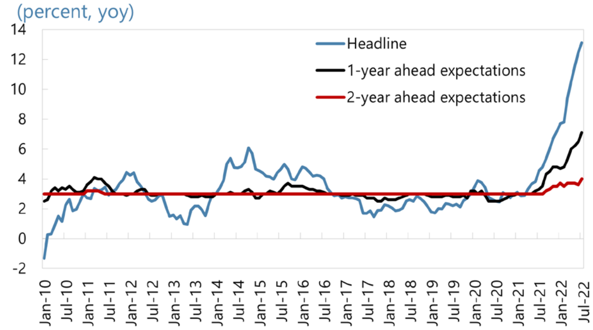
11. In response to inflationary pressures, the BCCh has continued to appropriately tighten monetary policy consistent with the firmly established inflation targeting framework. As in other economies, inflationary pressures in Chile have proven more persistent than anticipated, with headline (core) inflation reaching 13.1 (10.3) percent in July. Two-year ahead inflation expectations edged up to 4 percent, while inflation expectations over longer horizons remain firmly anchored at the 3 percent target. The BCCh has quickly raised the policy rate from a low of 0.5 percent in July 2021 to 9.75 percent in July this year (substantially above the neutral rate).[12] The BCCh has also clearly communicated its intention to continue tightening as needed to ensure inflation returns to the 3 percent target.

Chile: Inflation and Monetary Policy Rate
(percent, yoy)



Sources: INE, Haver, and IMF staff calculations.

Chile: Headline Inflation and Inflation Expectations 1/
(percent, yoy)



Sources: INE, BCC, Haver, and IMF staff calculations.
1/ Inflation expectations come from the "Encuesta de Expectativas Economicas (EEE)."

[8] The fall in reserves since end-2021 is explained by: (i) lower FX deposits from commercial banks and state-owned enterprises at the BCCh (US$2.5 billion); (ii) valuation effects due to higher interest rates and exchange rate depreciation (US$1.8 billion); (iii) affiliation to FLAR (US$0.6 billion); and (iv) FX intervention in the spot (US$1.6 billion) and forward (US$0.2 billion) markets.

[9] For additional details on the PBOC swap facility, see IMF Country Report No. 21/92.

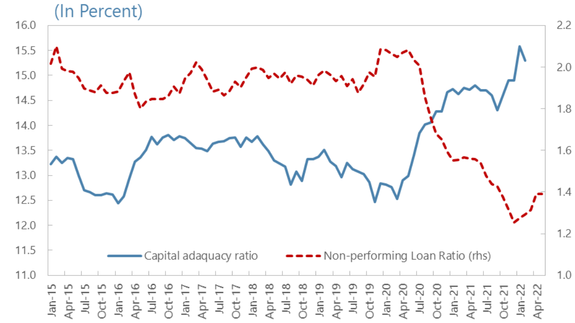
[10] In addition, the government's total liquid assets amounted to US$30 billion in June, of which US$20 billion are in FX.

[11] This facility provides, at a backstop rate, an alternative temporary source of U.S. dollars for foreign official holders of Treasury securities other than open market sales of securities.

[12] The BCCh is also smoothly unwinding the unconventional liquidity measures. The stock of acquired assets has been gradually decreasing since June 2021 upon their expiration.

12. The authorities are closely monitoring financial sector vulnerabilities, while reinforcing an already sound regulatory framework. Banks' capital adequacy ratio stood at 15.3 percent in February, comfortably above the regulatory minimum, and non-performing loan (NPL) ratios remained low at 1.4 percent in May.[13] Banks' return on equity was 16.6 percent at end-2021, and credit growth has resumed at a healthy pace. The restructuring of the Financial Market Commission (CMF) has further strengthened financial sector supervision by placing under the same umbrella the supervision of insurance, securities, and banks. Moreover, the ongoing implementation of Basel III standards will further improve banks' capital buffers and enhance financial sector resilience.

Chile: Capital Adequacy Ratio and NPL Ratio
(In Percent)



Source: CMF, CEIC, and IMF staff calculation

13. The government's structural fiscal consolidation, guided by the fiscal rule, is advancing significantly faster than anticipated, while protecting the most vulnerable. Staff projects that the structural fiscal deficit will decline to 2 percent of GDP in 2022. This is consistent with a headline fiscal deficit of 0 percent of GDP, and well below the structural deficit target in the 2022 budget of 3.9 percent of GDP and the structural deficit outturn of 11.2 percent of GDP in 2021. This impressive consolidation is underpinned by the expiration of the Covid-19 stimulus measures coupled with revenue overperformance, including due to higher yields from the tax reform enacted in January 2020. Within the budget envelope, the government reallocated spending to support the most vulnerable, including: (i) measures to mitigate the impact of high energy and food prices; (ii) employment subsidies in lagging sectors; and (iii) targeted transfers to households.[14] The government is also replenishing the sovereign wealth fund, with deposits of US$6 billion in the first quarter of 2022. Over the medium term, the authorities plan to further reduce the structural fiscal deficit to less than 0.5 percent of GDP and stabilize public debt below 45 percent of GDP, which remains low by international standards.

14. The new administration envisions far-reaching reforms to improve the lives of Chileans within a sustainable macroeconomic framework. The government aspires to improve social services, tackle inequality, and transition to a green economy. An ambitious tax reform unveiled at end-June aims to permanently raise revenues to finance additional social spending and make the tax system more progressive (Box 2). Potential revenue gains are not yet included in staff's baseline scenario, due to uncertainty about the timing and final content of the reform but present an upside risk to staff's revenue projections. Forthcoming reforms of social protection systems would complement the universal basic pension approved earlier this year, enhance the role of public service provision, and improve quality and access. Advancing the climate agenda, deepening capital markets, and boosting productivity are also key government priorities.

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[13] This has been supported by household debt repayments financed with proceeds from pension withdrawals. Regulatory forbearance expired in mid-2021.

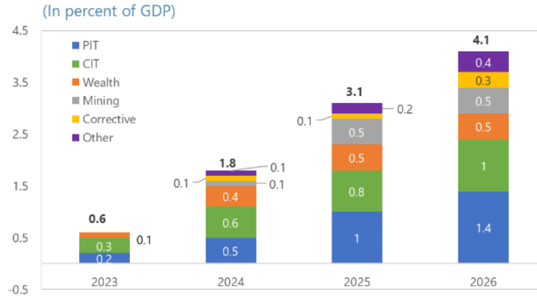
[14] For further details, see IMF Country Report 2022/148.

Box 2. Chile: Tax Reform Plan

The government unveiled a comprehensive tax reform plan in June 2022. The reform aims to increase the progressivity of the tax system; simplify and lower compliance costs; reduce incentives for aggressive tax planning; and raise revenues to fund an expansion of social services.

The government estimates that the reform would gradually raise revenues by 4.1 percent of GDP by 2026. About 1.4 percent of GDP would be raised from personal income taxes (PIT), one percent of GDP from corporate income taxes (CIT), 0.5 percent of GDP from a new wealth tax, 0.5 percent of GDP from mining royalties, and 0.7 percent from "corrective" taxes, including carbon taxes.

Chile: Estimated Revenue Yields from Proposed Changes
(In percent of GDP)



Source: Ministry of Finance.

- *PIT.* The number of tax brackets would increase from 8 to 10, with higher marginal tax rates at higher incomes levels.
- *New wealth tax.* A rate of one percent would apply to global net wealth (including real estate, investment funds, and other financial assets) in excess of US$5 million, increasing to 1.8 percent for net wealth in excess of US$15 million.
- *CIT.* Changes include a new tax for retained profits in non-operating companies (with more than 50 percent of revenues coming from passive sources), and stronger anti-evasion and avoidance rules. In addition, a new 2 percent "development tax" on earnings could be paid with investments in R&D or productivity enhancing measures. Finally, the CIT rate would be reduced from 27 to 25 percent.
- *Higher taxes on capital gains and dividends.* The rate would increase from 10 to 22 percent. Individuals in income brackets with a tax rate below 22 percent could use the excess tax as a credit.
- *Adjustments to mining royalties*. An additional levy for large-scale copper producers would apply, combining an ad valorem tax (which varies with output) with a tax on operational results.
- *Carbon tax.* A higher carbon tax and other green taxes will be introduced.
- *Other measures.* A new register of final beneficiaries will be created.

Reforms will be submitted to congress in three packages: (i) measures related to PIT, CIT, and the wealth tax were presented to congress in July; (ii) changes to mining royalties will proceed as amendments to a bill already before congress; and (iii) "corrective taxes" will be presented by end-2022.

OUTLOOK AND RISKS

15. Against weaker external conditions, the near-term outlook is challenging but very strong fundamentals and policies continue to support Chile's resilience. GDP growth is projected to decline to 1.8 percent in 2022 and drop slightly below 0 percent in 2023, before returning to its potential rate estimated at 2.5 percent over the medium term. Inflation is expected to peak by the third quarter of 2022 and converge to target by end-2024, in light of the BCCh's pro-active tightening of monetary policy, consistent with the inflation-targeting framework. The structural fiscal deficit is projected to decline from about 11.2 percent of GDP in 2021 to 2 percent of GDP in 2022 and under 0.5 percent of GDP over the medium term. Alongside the adjustment of domestic demand, the 2022 current account deficit is projected to continue declining from the peak at end-2021 but remain elevated at 7.7 percent of GDP (due to the deterioration in the terms of trade). The current account deficit is then projected to gradually revert to historical averages on the basis of continued very strong macroeconomic policies, including structural fiscal adjustment guided by the fiscal rule and a flexible exchange rate. Despite the more difficult near-term outlook compared to that prevailing in May when the SLL became effective, Chile's medium-term resilience remains anchored in very strong fundamentals and policy frameworks.

Chile: Summary Comparison of Near-term Outlook, SLL and FCL

	2021	2022		2023	
		SLL	FCL	SLL	FCL
GDP growth (percent)	11.7	1.5	1.8	0.5	-0.3
Inflation (eop)	7.1	6.0	11.2	3.9	5.7
Structural fiscal balance (percent of GDP)	-11.2	-4.4	-2.0	-2.2	-2.0
Central government gross debt (percent of GDF	36.3	38.3	37.3	38.4	38.3
Terms of trade (annual change)	12.0	-5.7	-9.5	0.9	-7.2
Current account (percent of GDP)	-6.7	-4.5	-7.7	-3.4	-4.9

Source: Fund staff estimates.

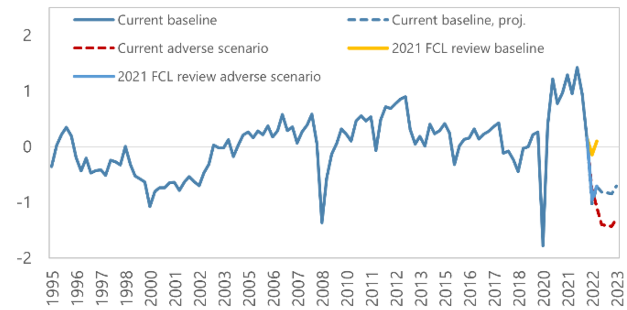
16. External risks and global uncertainty have markedly increased. Notably, as indicated in the July 2022 WEO Update (titled "Gloomy and More Uncertain"), risks of an abrupt global slowdown or recession and an associated spike in global risk premia and commodity price volatility have increased. Other key external risks include a possible de-anchoring of inflation expectations alongside a further tightening of global financial conditions; additional commodity price shocks; or an intensification of spillovers from Russia's war in Ukraine. On the domestic front, risks continue to relate to social discontent over high food and energy prices, unmet social demands, or the uncertain outcome of the constitutional reform.

17. In an adverse scenario, Chile's economic external stress index (ESI) could worsen to levels not seen since the onset of the pandemic.[15] At the onset of the Covid-19 crisis, the ESI deteriorated to unprecedent levels, due to low trading partner growth, a drop in copper prices, and elevated market volatility. The ESI improved rapidly thereafter, alongside coordinated global

[15] Chile's ESI is computed using the same methodology employed in the 2020 FCL request. The index is constructed as the weighted sum of four variables that summarize Chile's external risks: (i) output growth in the U.S. and China (0.15) to proxy risks to exports; (ii) copper prices (0.35) to proxy risks to the copper industry; (iii) the VXEEM index (0.25); and (iv) U.S. long-term yield (0.25). The latter two variables proxy changes in global financial conditions.

Covid-related stimulus and higher copper prices. Due to the impact of the war in Ukraine, Chile's ESI experienced a steep fall in the first quarter of 2022, given low trading partner growth and tighter global financial conditions. Under the current baseline scenario, which is in line with the July 2022 WEO projections, external pressures are expected to be significantly higher than assumed under the baseline scenario of the 2021 FCL mid-term review. In an adverse scenario (Box 3), assuming (i) lower trading partner growth and faster monetary tightening in the U.S. in line with the July 2022 WEO adverse scenario, (ii) a 15 percent decline in copper prices relative to the baseline, and (iii) higher financial market volatility by two standard deviations, the ESI could approach levels comparable to those at the onset of the pandemic.

Chile: External Stress Index
(negative if high)



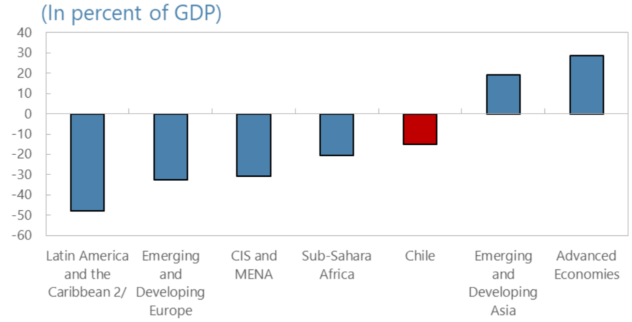
Source: WEO and IMF staff calculations.

QUALIFICATION

18. In staff's assessment, Chile continues to meet the qualification criteria for an arrangement under the FCL. These criteria are identical to those for the SLL, on which there was a very positive assessment in May. The external position is sustainable, the sovereign has access to international markets at favorable rates, and official reserves are adequate. The BCCh is highly credible. Fiscal policy is grounded on a very strong framework and guided by the structural balance rule. Banks are sufficiently capitalized, and the regulatory framework is sound.

19. Sustainable external position. In the 2021 Article IV Consultation, Chile's external position was assessed as moderately stronger than implied by medium-term fundamentals and desirable policies. Staff continues to assess the external position as sustainable. The 2021 current account deficit increased mainly due to the transitory Covid-19 stimulus measures, including the exceptional pension withdrawals and sizable fiscal transfers. The current account is expected to remain elevated in 2022 due to the negative terms of trade shock but is then projected to decline to its historical average alongside continued very strong macroeconomic policies, including ongoing structural fiscal consolidation and exchange rate flexibility. Moreover, Chile's net international investment position compares favorably to most EMs and improved considerably from -12 percent of GDP in 2020 to -4.9 percent of GDP in

Chile: Net International Investment Position, 2021 1/
(In percent of GDP)

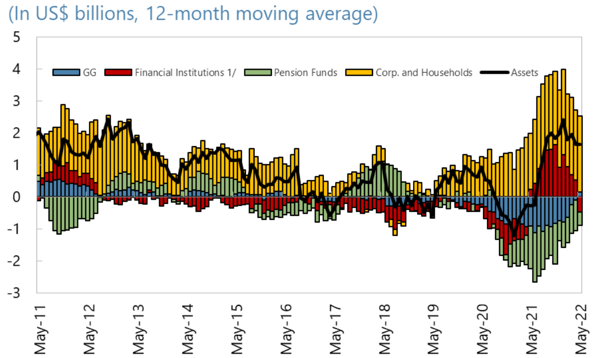


Sources: WEO and IMF staff calculations.
1/ IMF staff estimates for 2021 if official data has not been released.
2/ Excluding Chile.

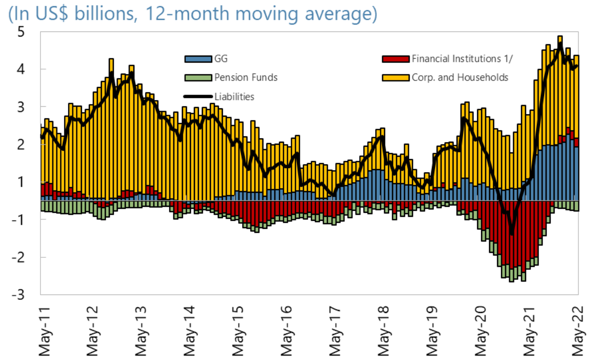
2021.[16] External debt decreased to 72 percent of GDP in 2021 and is robust to standard shocks (Annex 1). In the first half of 2022, the real effective exchange rate was about 10 percent more depreciated than its 20-year historical average and 3 percent more depreciated than its 2021 average.

20. Capital account position dominated by private flows. Capital flows to Chile are predominantly private and nearly 90 percent of Chile's external debt is owed to private creditors. Private flows continue to account for the bulk of total (FDI, portfolio, and other) flows (75 percent of asset flows and 81 percent of liability flows on average over the last three years).[17] The absolute value of general government plus central bank liability flows reached 36 percent of the total in 2021, which is unusually high but explained by the large repatriation of foreign assets to meet pandemic-related needs.[18]

Chile: Gross Outflows by Institution
(In US$ billions, 12-month moving average)



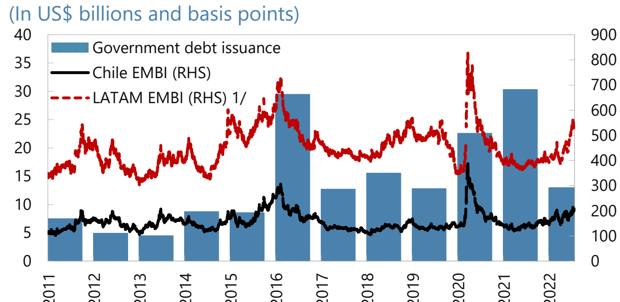
Chile: Gross Inflows by Institution
(In US$ billions, 12-month moving average)



Sources: Central Bank of Chile and IMF staff calculations.
1/ Financial institutions includes: Central Bank of Chile, private banks, and other financial institutions.

21. Long track record of steady sovereign access to international capital markets at favorable terms. Chile has enjoyed uninterrupted access to international capital markets for several decades. It maintains investment grade status according to the three major rating agencies and is consistently among the highest-rated EMs.[19] Sovereign bond spreads have remained relatively stable

Chile: Government Debt and EMBI Spreads
(In US$ billions and basis points)



Sources: Bloomberg, Ministry of finance, and IMF staff calculations
1/ Includes Argentina, Barbados, Bolivia, Brazil, Belize, Chile, Colombia, Costa Rica, Dominican Republic, Ecuador, Guatemala, Honduras, Jamaica, Mexico, Panama, Peru, Paraguay, Suriname, El Salvador, Trinidad and Tobago, Uruguay, and Venezuela.

[16] Chile's external position improved, notwithstanding the liquidation of external assets from pension funds to enable the pension withdrawals, due to valuation effects and new inflows into the pension system.

[17] The 2018 FCL Operational Guidance Note states that public flows should account for less than half of a member's direct, portfolio, and other asset and liability flows, on average in the past three years. In addition to the composition of recent capital flows, an assessment of the international investment position is also relevant.

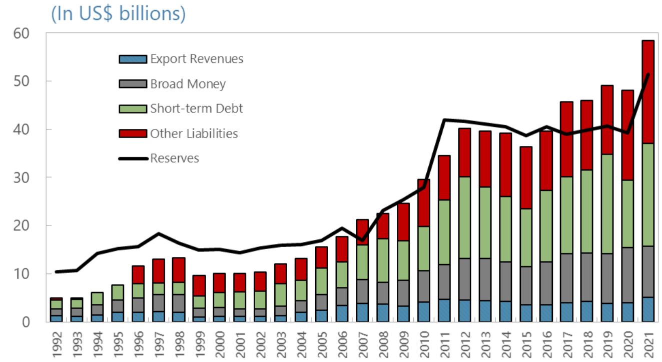
[18] See IMF Country Report No. 21/83 for further details.

[19] Its foreign-currency ratings are A1 for Moody's, A for S&P, and A- for Fitch, after downgrades from S&P in April 2020, and from Fitch in March 2020.

over the past 18 months (after correcting from a sharp deterioration at the onset of the pandemic) and are consistently below those from other EMs (EMBIG and five-year CDS spreads stood at about 200 and 140 bps at end-July, respectively). The central government issued external debt in each of the past five years, with a cumulative amount equivalent to about 1,500 percent of Chile's Fund quota (well above the 50 percent of quota requirement).

22. Relatively comfortable international reserve position. Reserves remain at relatively comfortable levels. Gross international reserves stood at about 82 percent of the Fund's reserve adequacy metric (ARA) on average over three years, and about 76.5 percent in July, below recommended thresholds. At the same time, reserve adequacy metrics based on imports, short-term debt, and monetary base vastly exceed thresholds. Staff assesses reserves to be adequate due to several mitigating factors. First, in mature market economies,[20] reserves act mainly as a second line of defense against potential FX funding needs of the financial sector, and Chile's reserves more than amply cover estimated potential short-term banks' needs. In May, the liquid segment of banks' foreign assets amounted to US$30.1 billion, compared with banks' external debt of US$30.5 billion.[21] Second, if counted as reserves, the central government's usable liquid FX assets (about US$20 billion in June, including US$7.6 billion in the sovereign wealth fund and US$6.8 billion in the pension reserve fund) would correspond to approximately 35 percent of the ARA metric. Third, reserves are complemented with several FX liquidity lines, bringing overall FX liquidity buffers to about US$61 billion, or nearly 20 percent of GDP (as described in paragraph 10). Fourth, the authorities remain strongly committed to a flexible exchange rate, while the BCCh is open to considering a reserve accumulation program to replenish buffers when market conditions are conducive, as done on past occasions.

Chile: ARA Metric Decomposition and Reserves
(In US$ billions)



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

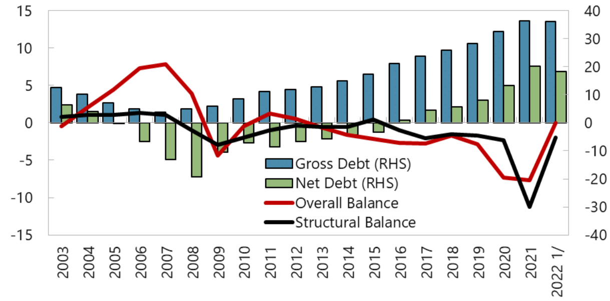
23. Sustainable public debt position and sound public finances. The authorities remain firmly committed to debt sustainability and fiscal responsibility. Gradual fiscal consolidation guided by the fiscal rule is expected to rebuild buffers and stabilize gross public debt below 45 percent of GDP (considered by the authorities as a prudent debt level), which is low by international standards. Public debt is mostly denominated in domestic currency, with average maturity for external debt above ten years. Liquidity risks are mitigated by assets in the sovereign wealth and pension reserve

[20] Chile is classified as a mature market economy for reserve assessment purposes in IMF (2015) "Assessing Reserve Adequacy-Specific Proposals" and IMF (2016) "Guidance Note on the Assessment of Reserve Adequacy and Related Considerations."

[21] By regulation, banks' short FX positions due in thirty days cannot exceed long positions by more than the bank's capital. In the non-bank part of the financial system, institutional investors (i.e., pension funds) have a positive net foreign asset position.

funds, and a large domestic banking sector, with abundant room to absorb sovereign issuances in case of an abrupt tightening of global financial conditions. Staff assesses Chile's public debt to be sustainable with high probability, and a public debt sustainability analysis shows the debt trajectory is robust to standard shocks (Annex 2). The 2021 Fiscal Transparency Evaluation concluded that Chile has strong fiscal institutions and sound fiscal transparency practices.[22]

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.
1/ IMF staff forecasts.

24. Low and stable inflation in the context of a sound monetary and exchange rate policy framework. Chile maintains a highly credible inflation-targeting regime and a flexible exchange rate. In the past five years, monthly (y/y) inflation averaged 3.8 percent. Medium-term inflation expectations have remained anchored over the past decade, reflecting a well-functioning framework with clear policy guidance. In response to the recent spike in inflation, the BCCh demonstrated resolve to quickly tighten monetary policy and tackle inflationary pressures. The BCCh maintains a small negative equity, which does not compromise policy solvency nor require immediate recapitalization. The 2021 Transparency Review underscored BCCh's high standards of policy analysis, conduct, and independence.[23]

25. Sound financial system and absence of solvency problems that might threaten systemic stability. The solvency stress tests from the 2021 FSAP concluded that the banking sector is sufficiently capitalized, and solvency risks are low. Although a few individual banks would fall below the requirement under the adverse scenario, the implementation of Basel III will strengthen banks' capital positions. The banking system appears resilient to both sizeable funding risks and climate-related risks. Systemic risk arising from non-financial sector external debt is low. Stress tests in fixed income mutual funds suggest the need for enhancing liquidity management practices, while pension funds are equipped with sound liquidity management.

26. Effective financial sector supervision. The 2021 FSAP assessed the banking supervisory framework as robust and the CMF to be capably staffed with expertise in monitoring individual risks. In parallel, a regional peer assessment against the Financial Action Task Force (FATF) anti-money laundering/combating the financing of terrorism (AML/CFT) standard by GAFILAT (FATF Latin America's regional body) highlighted strengths and considerable progress in the implementation of AMT/CFT prevention systems.

27. Data transparency and integrity. Since March 2020, Chile is an adherent to the Fund's Special Data Dissemination Standard Plus—the highest tier of the IMF's Data Standards Initiatives.

[22] See IMF Country Report No. 21/241 for further details.

[23] See IMF Country Report No. 21/113 for further details.

28. Institutional strength and track record of strong policies. Chile has a sustained track record of implementing very strong policies. Fiscal and monetary policies have been strongly countercyclical, anchored in very strong institutional frameworks. The flexible exchange rate has been allowed to work as a shock absorber, and FX interventions have been temporary and infrequent, geared to prevent disorderly market conditions. The authorities' response to the pandemic was effective and well-coordinated, making adequate use of Chile's hard-won policy space. The ongoing policy tightening is appropriate to contain inflationary pressures, rebuild buffers, and mitigate risks, while maintaining support to the most vulnerable. The government is committed to maintaining very strong macroeconomic policies.

ACCESS CONSIDERATIONS

29. Authorities' request. To meet their potential balance of payment needs, the authorities are requesting an FCL arrangement with access to the equivalent of SDR 13.954 billion (800 percent of quota, about US$18.5 billion) to increase their precautionary buffers and insure against a broad range of risks on a temporary basis.

30. Staff considers that the proposed FCL access level of 800 percent of quota would be appropriate to provide sufficient insurance against a plausible adverse scenario (Box 3). The adverse scenario assumes that risks surrounding the war in Ukraine and the degree of monetary tightening in advanced economies would further depress global growth and commodity prices, leading to further capital outflows from EMs. The net effect on the current account would likely be moderate (around US$0.5 billion), as the effect of weaker exports, including copper, would be partly offset by a reduction in imports driven by exchange rate depreciation and lower domestic demand, as well as lower repatriation of copper profits. The reduction in capital inflows, in particular portfolio inflows, would contribute to the bulk of the additional financing needs under the adverse scenario (around US$27 billion). Chile is assumed to contribute to the financing by drawing on reserves and the sovereign wealth fund (by about US$8.3–9.5 billion). The residual financing gap would be adequately covered by the proposed FCL. In a disbursing scenario, the FCL resources would not be used for budget financing, in line with Chile's institutional framework.

31. The authorities intend to exit the FCL arrangement at the end of the 24-month period, conditional on favorable developments on risk scenarios. The authorities underscore that the FCL arrangement is requested under the current extraordinary circumstances as a temporary supplement to their existing buffers, while their medium-term resilience remains anchored in very strong macroeconomic policies and fundamentals. The exit strategy will take into consideration the evolution of external risks at the time of the mid-term review. The authorities intend to start preparations for exiting well in advance, as they did with the 2020 FCL.

Box 3. Chile: Illustrative Adverse Scenario

An illustrative adverse scenario shows that a new FCL with access of 800 percent of quota (about US$18.5 billion), would provide sufficient insurance against a broad range of risks in an adverse scenario. Such scenario assumes that risks surrounding the war in Ukraine and monetary tightening in advanced economies further depress global growth and commodity prices, leading to capital outflows from EMs. The calibration of shocks is comparable to Chile's 2020 FCL request and other FCL arrangements.

Current account. Mining exports are assumed to fall by 15 percent due to weaker global demand. This is comparable to shocks applied to key export prices in other FCL arrangements and within the 25th percentile of past EM crisis episodes. Compared to Chile's 2020 FCL request, the size of the shock is somewhat smaller, given that the baseline already incorporates the significant drop in copper prices between April and July 2022. On the back of weaker global prospects, Chile's non-mining exports would also fall by 10 percent (about one standard deviation). The impact of weaker exports on the current account is largely offset by: (i) a decline of 15 percent in oil imports (similar to the copper price decline) and a 10 percent fall in non-oil imports driven by exchange rate depreciation and weaker domestic demand; and (ii) an improvement in net income, driven by a 15-percent drop in FDI-related income outflows (proportional to copper exports decline), which more than offsets a 10-percent drop in FDI-related income inflows (from Chilean companies abroad).

Assumptions Underlying the Illustrative Adverse Scenario
(in percent change vis-à-vis baseline, unless otherwise indicated)

	2022 FCL	2020 FCL
Current account		
Trade balance		
Exports		
Copper price decline	15	27
Decline in non-mining exports	10	10
Imports		
Oil price decline	15	27
Decline in non-oil imports	10	10
Net Income		
Decline in FDI income inflows	10	10
Decline in FDI income outflows	15	27
Financial account		
FDI		
Decline in FDI inflows	15	27
Decline in FDI outflows	10	10
MLT private sector rollover	80	80
ST private sector rollover	80	80
Other portfolio flows decline	1 std	1 std
Other investment decline	1 std	1 std

Foreign Direct Investment. FDI inflows decline by 15 percent relative to the baseline, reaching a level 34 percent below the average of the past three years, in line with assumptions in other FCL arrangements. The reduction in FDI inflows is partly offset by a 10 percent decline in outward FDI by Chileans.

Portfolio flows and other investments. In the adverse scenario, portfolio, and other investment net inflows, by both non-residents and residents, worsen by about 1 standard deviation. Given the importance of capital flows to Chile, both shocks add around US$17.5 billion to external financing needs per year.

External debt. The adverse scenario assumes rollover rates of 80 percent for amortization of short-term and long-term private sector external debt. This is near the 25th percentile of past crisis episodes and in line with other FCL arrangements. The scenario assumes full rollover of public sector external debt, given relatively low public external short-term financing needs compared to public liquid assets. Additional fiscal financing needs in the adverse scenario could be covered by domestic financing or a drawdown of public assets.

Use of reserves and sovereign wealth fund. Additional external financing needs under the adverse scenario would be partly financed by a drawdown of (i) reserves above 80 percent of the ARA metric, and (ii) the sovereign wealth fund. The drawdown from reserves would be smaller than assumed in Chile's 2020 FCL request, while the drawdown from the sovereign wealth fund larger, in line with withdrawals during 2020-21 to finance Covid-19 stimulus measures. The remaining financing gap of about US$18.5 billion would be covered by the FCL.

Box 3. Chile: Illustrative Adverse Scenario (Continued)

Chile: External Financing Requirements and Sources

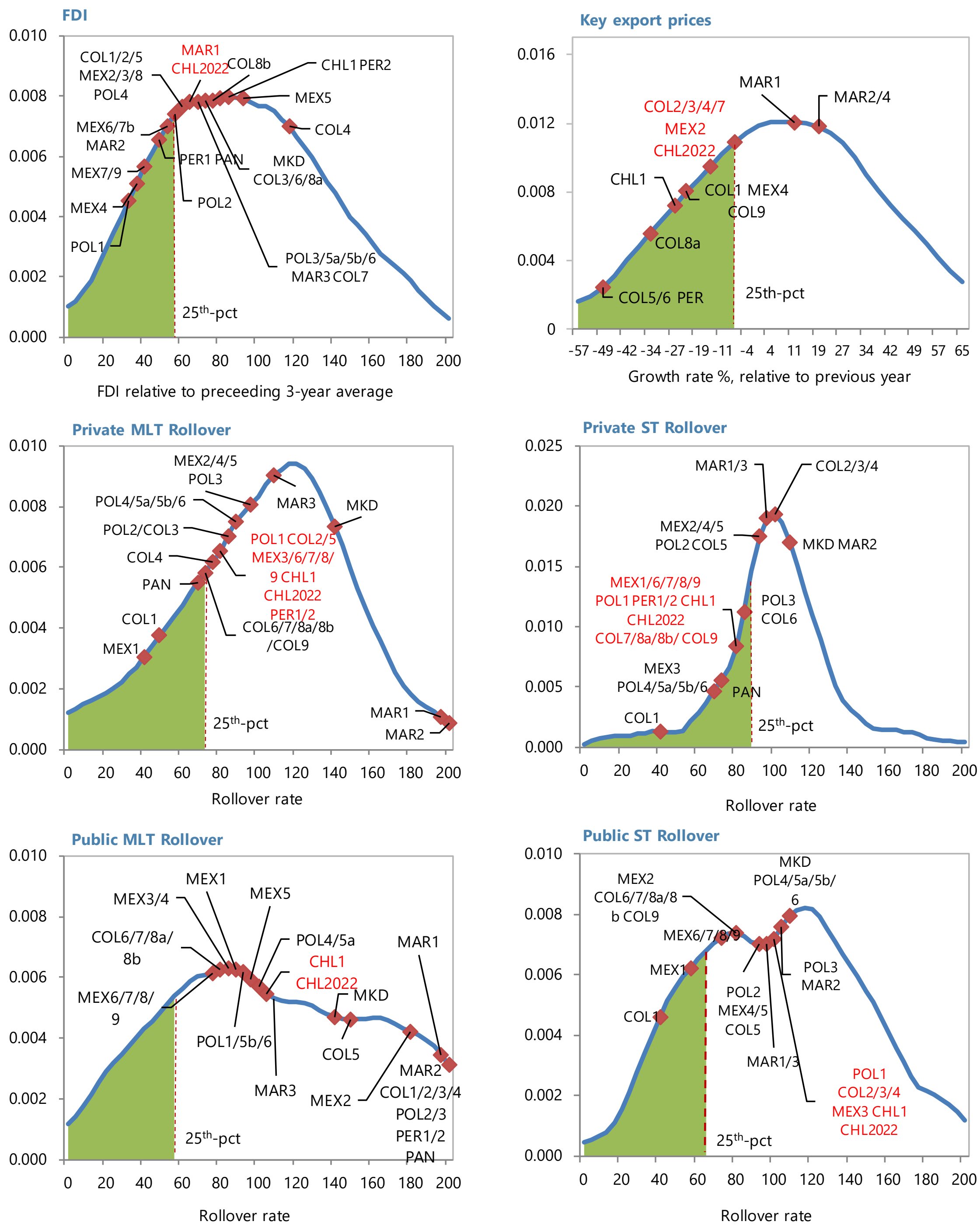
(in billions of U.S. dollars)

	2019	2020	2021	2022	2023	Adverse 2022	Contribution to Gap	Adverse 2023	Contribution to Gap
				proj.					
Gross external financing requirements	**57.4**	**59.9**	**62.1**	**76.5**	**64.8**	**77.0**	**0.5**	**65.2**	**0.4**
Current account deficit	-14.4	-4.3	-21.2	-23.7	-16.6	-24.1	0.5	-17.0	0.4
Amortization of Bonds and Loans	42.9	55.7	40.9	52.9	48.2	52.9		48.2	
Public sector MLT coming due	3.2	4.9	3.4	0.5	0.7	0.5		0.7	
FX denominated bonds									
Local currency bonds									
FX Bank Financing									
Private sector MLT amortization	17.4	31.2	12.2	25.9	20.1	25.9		20.1	
FX denominated bonds									
Bank Financing									
Short term debt coming due	22.2	19.5	25.4	26.5	27.4	26.5		27.4	
Public sector	5.8	9.4	13.8	6.7	8.4	6.7		8.4	
FX denominated									
Local Currency									
Private sector	16.4	10.1	11.6	19.8	19.0	19.8		19.0	
Trade credit									
Available external financing	**57.4**	**59.9**	**62.1**	**76.5**	**64.8**	**58.5**	**18.0**	**46.8**	**18.0**
Net FDI inflows	3.2	2.5	0.8	2.7	4.3	2.0	0.8	3.3	1.1
Net Portfolio Inflows	10.6	13.2	30.6	15.6	18.7	4.4	11.3	7.4	11.3
Financing through Bonds and Loans	42.9	55.7	40.9	52.9	48.2	43.7		40.4	
Public sector MLT financing	3.2	4.9	3.4	0.5	0.7	0.5		0.7	
FX denominated bonds									
Local currency bonds									
FX Bank Financing									
Private sector MLT financing	17.4	31.2	12.2	25.9	20.1	20.7	5.2	16.1	4.0
FX denominated bonds									
FX Bank Financing									
Short-term financing	22.2	19.5	25.4	26.5	27.4	22.5		23.6	
Public sector	5.8	9.4	13.8	6.7	8.4	6.7		8.4	
FX denominated									
Local Currency									
Private sector	16.4	10.1	11.6	19.8	19.0	15.8	4.0	15.2	3.8
Trade credit									
Net other flows	0.4	-14.3	2.0	5.3	-6.4	-1.0		-12.6	
Other investment	-1.7	-10.0	3.2	5.3	-6.4	-1.1	6.3	-12.7	6.2
Derivatives	-1.5	-2.5	0.0	0.0	0.0	0.0		0.0	
Other	3.6	-1.7	-1.2	0.0	0.0	0.0		0.0	
Change in international reserves	-0.2	-2.9	12.2	0.0	0.0	-1.9	-1.9	0.0	0.0
Additional change in SWF assets	0.0	0.0	0.0	0.0	0.0	-7.6	-7.6	-8.3	-8.3
Financing Gap (USD billions)							**18.5**		**18.5**
SDR (0.755229 USD/SDR, August 2, 2022)							14.0		14.0
Percent of quota							800.0		800.0
Memorandum items									
Reserves (in billions of U.S. dollars)	40.7	39.2	51.3	51.3	51.3				

Sources: Chilean authorities and IMF staff estimates.

Box 3. Chile: Illustrative Adverse Scenario 1/ (Concluded)

(Probability Density)



Source: IMF staff calculations.

1/ The countries shown are previous FCL/PCL/PLL arrangements, numbered consecutively by country. CHL2022 is the proposed arrangement for Chile.

IMPACT ON FUND FINANCES, RISKS, AND SAFEGUARDS[24]

32. The proposed arrangement for Chile under the FCL (SDR 13.954 billion, 800 percent of quota) would have a significant but manageable impact on the Fund's liquidity. The Fund's Forward Commitment Capacity (FCC) would decline by slightly less than 7 percent from its current level of SDR 168.6 billion to SDR 157.1 billion. This decline reflects the combined impact of the proposed FCL and the cancellation of the SLL, with the latter having a positive impact on the FCC. If Chile were to draw under the FCL arrangement, it would be automatically excluded from the Financial Transaction Plan (FTP). As a result, the FCC, which is currently only based on quota resources, would decline by another SDR 1.4 billion.[25] Nevertheless, the Fund's overall liquidity position is expected to remain adequate after the approval of the proposed FCL arrangement.

33. If the resources available under the proposed FCL arrangement were fully drawn, the GRA credit exposure to Chile would be the Fund's second largest. Chile would be eligible to draw in full on the proposed FCL arrangement of 800 percent of quota to address the materialization of an adverse scenario, as described in Box 3.

- Fund credit to Chile would represent 13.1 percent of total GRA credit outstanding as of August 12, 2022. Chile would represent the second largest Fund exposure after Argentina (SDR 32.7 billion) and just ahead of Egypt (SDR 13.6 billion). The concentration of Fund credit among the top five users of GRA resources would slightly decline to 68.5 percent (from 69.3 percent).
- Fund credit to Chile would be at almost 67 percent of the Fund's precautionary balances as of end FY2022.

34. Nonetheless, staff judges that risks to the Fund's credit exposures from Chile's FCL request to be moderate, with several mitigating factors.

- If Chile were to draw all the resources available under the proposed FCL arrangement, GRA credit exposure to Chile would be the Fund's second largest (after Argentina), and Chile's total external debt would rise to 88.4 percent of GDP at the end of this year before falling gradually over the medium term. Moreover, some of Chile's capacity to repay indicators, assuming full drawing of 800 percent of quota under an adverse scenario, would indicate relatively moderate credit exposure when compared with recent exceptional access arrangements and FCLs. The peak of the stock of outstanding Fund credit both as a share of GDP and external debt would be relatively moderate, and its share in reserves would be slightly

[24] For more details see: *Chile: Assessment of the Impact of the Proposed Arrangement under the Flexible Credit Line on the Fund's Finances and Liquidity Position*.

[25] Considering resources held as prudential balance, the decline in the FCC would equal 80 percent of Chile's quota.

below the median for these arrangements approved since 2008.[26] The peak of the total debt service to the Fund as a percent of exports of goods and services would however exceed the median of these arrangements.

- At the same time, the Chilean authorities intend to treat the arrangement as precautionary. Moreover, Chile continues to rely on robust institutions with a very strong policy implementation record. The country has a track record of uninterrupted access to international capital markets at favorable terms for several decades and maintains investment grade status. Notably, Chile has also consistently been among the highest-rated EMs.

35. Staff has completed the safeguards procedures for Chile's SLL arrangement. The BCCh external audit and financial reporting continue to reflect leading practices and adhere to international standards. The external auditors, EY Chile, issued an unmodified (clean) audit opinion on the BCCh's 2021 financial statements, which include comprehensive disclosures and are published on a timely basis. Staff reviewed the audit results for 2021 and held discussions with the BCCh and EY Chile. No significant issues emerged from the conduct of these procedures.

STAFF APPRAISAL

36. Staff's assessment is that Chile continues to meet the qualification criteria for an arrangement under the FCL. Chile has very strong fundamentals and policy frameworks, and a sustained track record of implementing very strong policies that have supported the country's resilience in the face of large shocks. The authorities remain committed to maintaining very strong policies in the future. Staff takes note of the authorities' decision to cancel the SLL and considers that Chile continues to meet all the qualification criteria for an FCL (which are identical to those of the SLL).

37. Staff recommends approval of the authorities' request for an FCL arrangement and considers that the proposed access of SDR 13.954 billion (800 percent of quota) is appropriate given the extraordinary downside external risks that have intensified since the entry into effect of the SLL in May and are currently weighing on the global economy. The Chilean economy is confronting an acute deterioration of the external environment. Risks have increased markedly, including from a possible abrupt global slowdown or recession and an associated increase in global risk premia and commodity price volatility. Other key risks include a de-anchoring of inflation expectations alongside further tightening of global financial conditions; additional commodity price shocks; or an intensification of spillovers from Russia's war in Ukraine. Against the backdrop of elevated uncertainty and volatility in global financial markets, an FCL arrangement will enhance Chile's external buffers and provide insurance against a broad range of risks on a temporary basis. The authorities intend to exit the FCL at the end of the 24-month period, conditional on developments.

[26] If the assets of the sovereign wealth fund are counted as reserves, this ratio would drop even further.

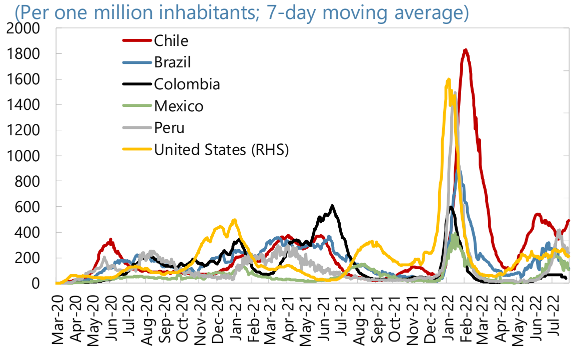
38. Staff considers the impact on Fund finances from the proposed FCL arrangement to be manageable. If fully drawn, GRA credit exposure to Chile would be considerable, but risks would be contained by many mitigating factors. The authorities continue to demonstrate a firm commitment to maintaining prudent policies, including by the adequate increase of the monetary policy rate and the sizeable fiscal overperformance expected for this year. They intend to treat this FCL arrangement as precautionary.

Figure 1. Chile: Covid-19 Developments

COVID-19 cases fell sharply after surging in February…

New COVID-19 Cases

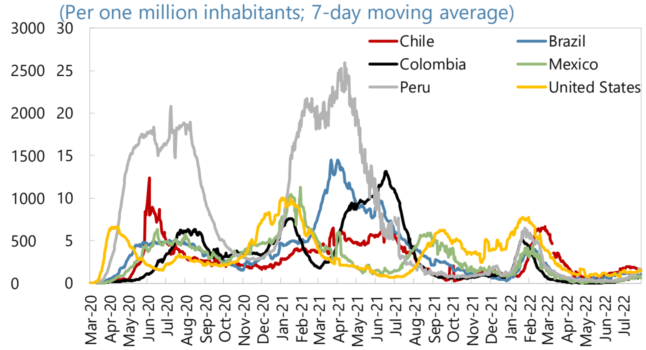
(Per one million inhabitants; 7-day moving average)



…though COVID-19 related deaths also fell, they remain above the levels seen in peer countries.

New COVID-19 Deaths

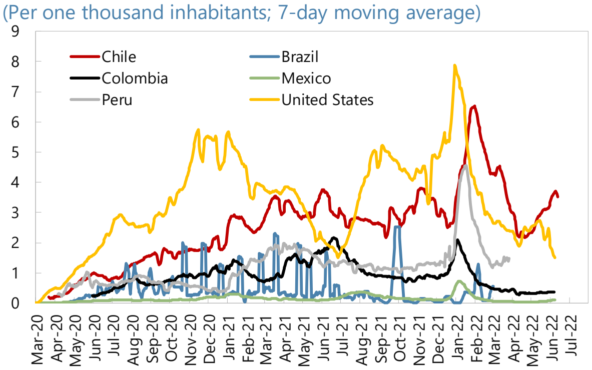
(Per one million inhabitants; 7-day moving average)



Chile remains a regional leader in testing…

New COVID-19 Tests

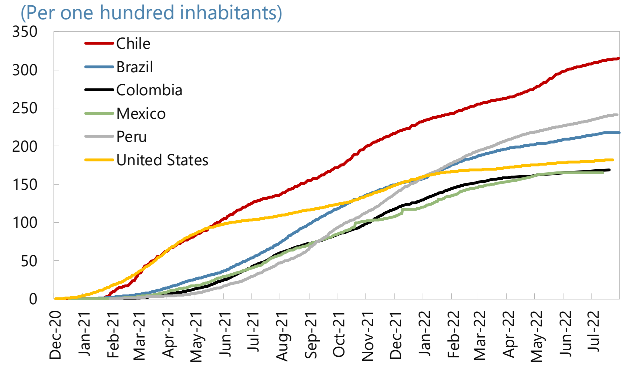
(Per one thousand inhabitants; 7-day moving average)



…as well as in vaccinations.

Total COVID-19 Vaccinations

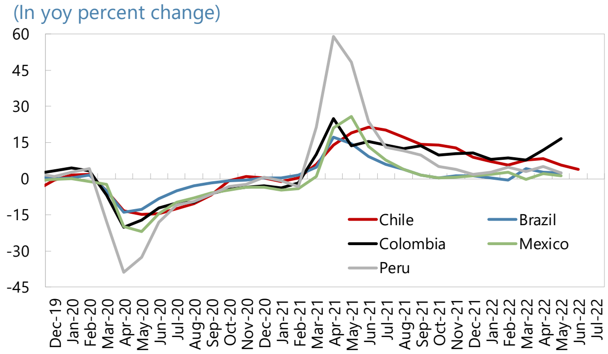
(Per one hundred inhabitants)



Economic activity has recovered past its pre-pandemic levels…

Economic Activity Index

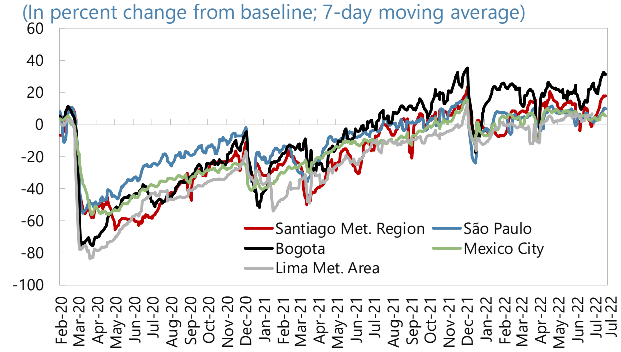
(In yoy percent change)



…in part aided by the easing of mobility restrictions.

Google Mobility Index 1/

(In percent change from baseline; 7-day moving average)



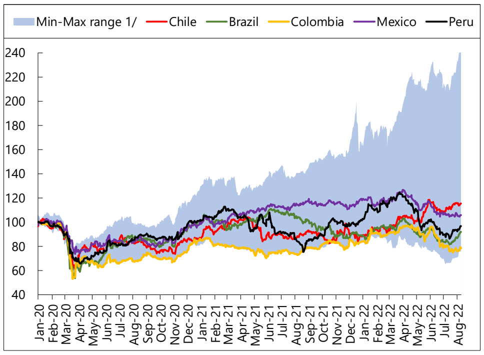
Sources: Our World in Data COVID-19 dataset, Haver, Google Community Mobility Reports, national authorities, and IMF staff calculations.
1/ Baseline is the median value, for the corresponding day of the week, during the 5-week period of January 3- February 6, 2020.

Figure 2. Chile: Financial Comparison with LA5 and Other EMEs 1/

Chile's equity index has only recently recovered to its pre-pandemic levels…

Domestic Equity Indices 2/

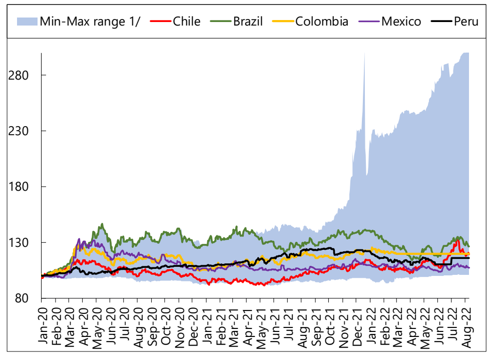
Jan 03, 2020 = 100



…and the peso has recently underperformed peer currencies.

Local Currency per US Dollar Indices 3/

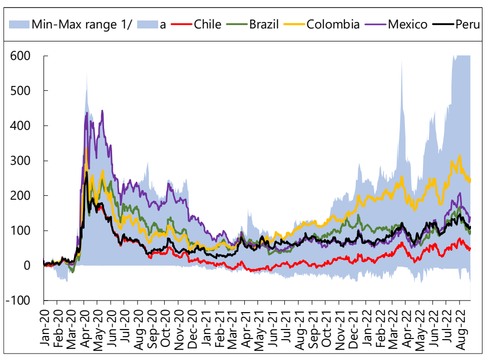
Jan 03, 2020 = 100



After increasing acutely in early 2020, EMBI spreads have stabilized at levels somewhat above those seen pre-pandemic…

EMBIG Spreads 4/

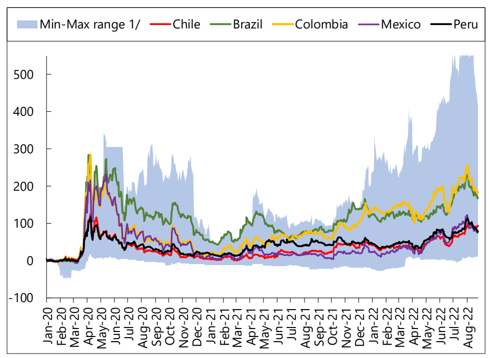
Difference in spreads (basis points) relative to Jan 03, 2020



…as have CDS spreads.

CDS Spreads

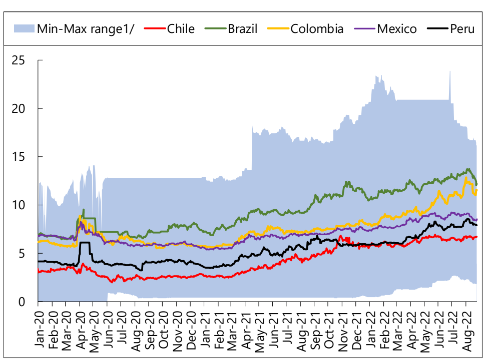
Difference in spreads (basis points) relative to Jan 03, 2020



Domestic currency bond yields are still below the average of emerging market peers…

Domestic Currency Sovereign Bond Yields 5/

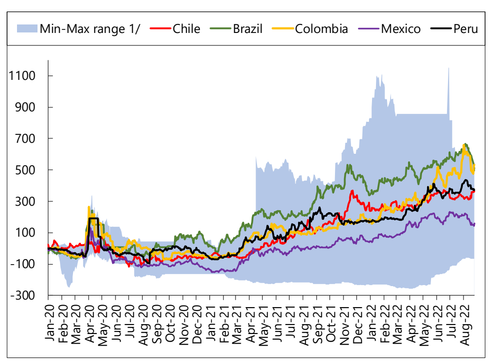
Yield to Maturity



…although they have rapidly increased since the the start of the pandemic.

Domestic Currency Sovereign Bond Yields 5/

Difference in yields (expressed in basis points) relative to Jan 03, 2020



Sources: Haver Analytics and Bloomberg LLP.

1/ Selected sample of emerging market countries including Brazil, Chile, Colombia, Mexico, Peru, Uruguay, Czech Republic, Croatia, Hungary, Poland, Turkey, India, Indonesia, Malaysia, Philippines, Thailand and Vietnam.

2/ National benchmark share price indices.

3/ Index is equal to 100 in the first business day of 2020. As a result, percentage changes in the index cannot be interpreted as percentage changes of the underlying exchange rate.

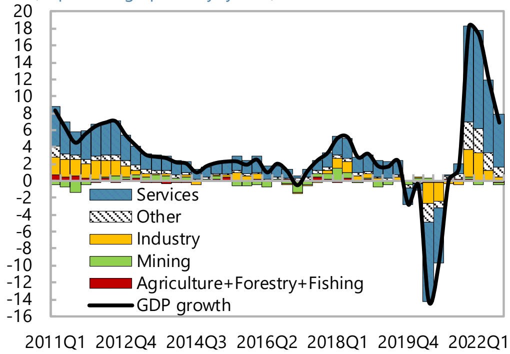
4/ Mexico's EMBIG includes Sovereign and Quasi.

5/ 10 year government bond or closest available maturity.

Figure 3. Chile: Economic Activity

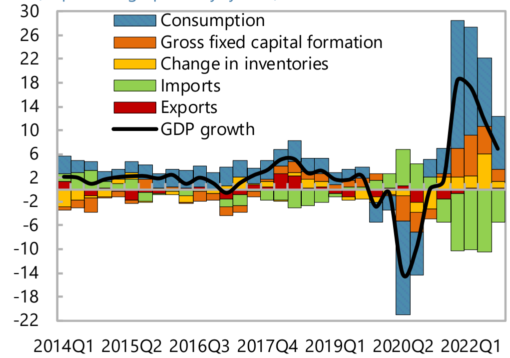
After a strong recovery, the economy is slowing down in 2022...

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



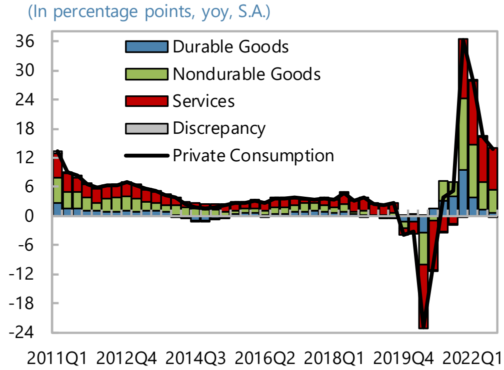
...driven by weak investment while consumption has been more resilient...

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



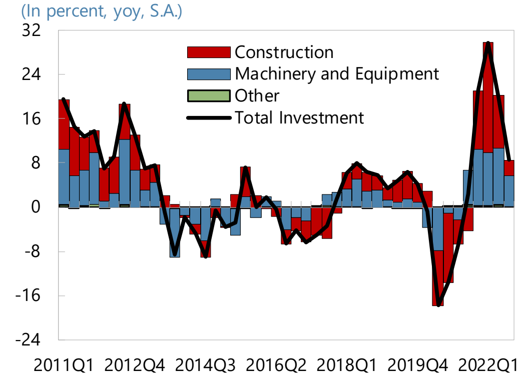
... while services and nondurable goods continue the recovery...

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



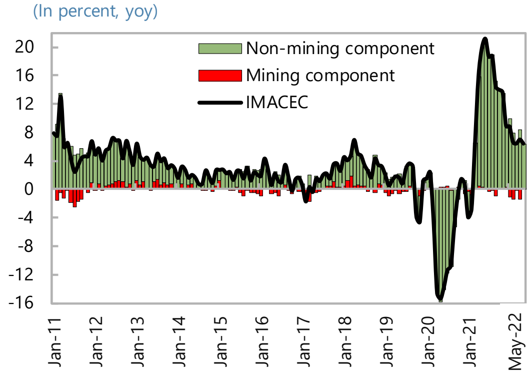
... and investment slows down in all sectors.

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



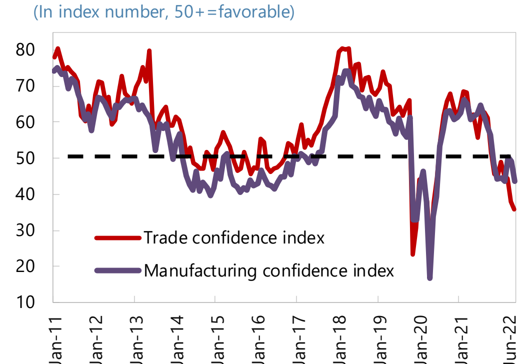
Non-mining IMACEC grew 6.3% in May, as mining IMACEC showed no change

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



...while business confidence deteriorated in 2022Q2.

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

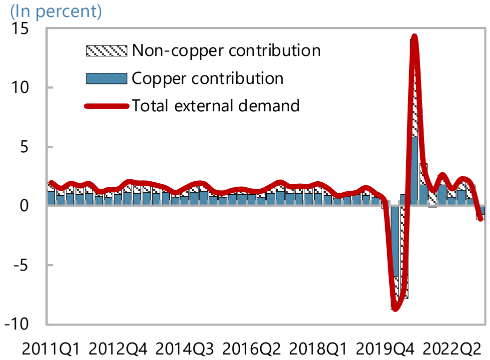


Sources: Central Bank of Chile, Ministry of Finance, Haver Analytics, and IMF staff calculations.
1/ IMACEC is a monthly economic activity indicator.

Figure 4. Chile: External Sector

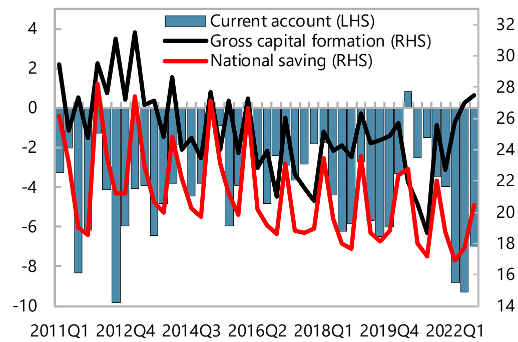
External demand growth fell 1.1% in 2022Q2 after a sharp recovery in 2020Q3...

External Demand Growth from Trading Partners 1/
(In percent)



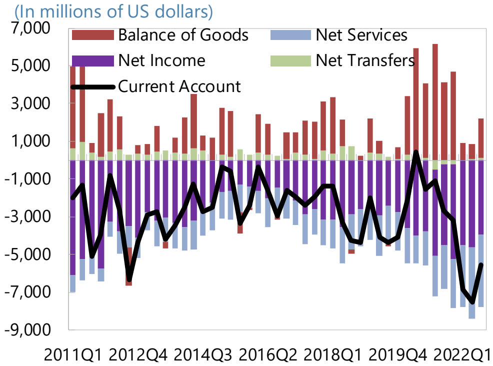
...while the current account in 2022Q1 remained negative at -7.0 % of GDP...

Savings, Investment, and the Current Account
(In percent of GDP)



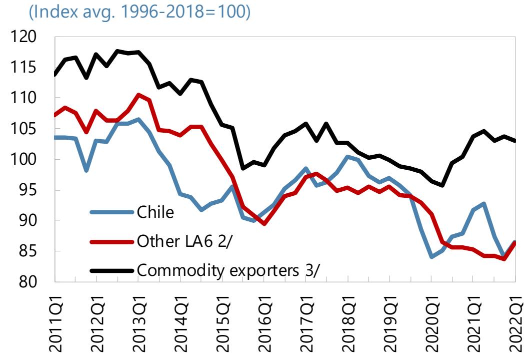
..as a fall in net income and services outweighs a small trade surplus.

Current Account Decomposition
(In millions of US dollars)



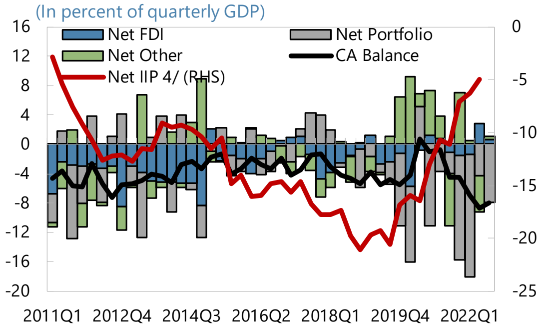
The peso depreciated more than the currencies of other commodity exporters, converging to the LA6 average.

Real Effective Exchange Rate
(Index avg. 1996-2018=100)



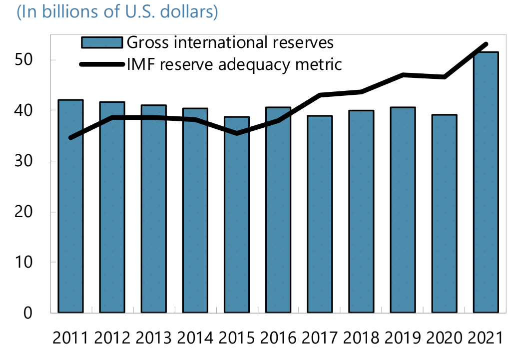
Net IIP continues on an increasing trend, reaching -5.0% of annualized GDP in 2021Q4...

Balance of Payments and IIP
(In percent of quarterly GDP)



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

Gross Reserves and Reserve Adequacy Metric 5/
(In billions of U.S. dollars)

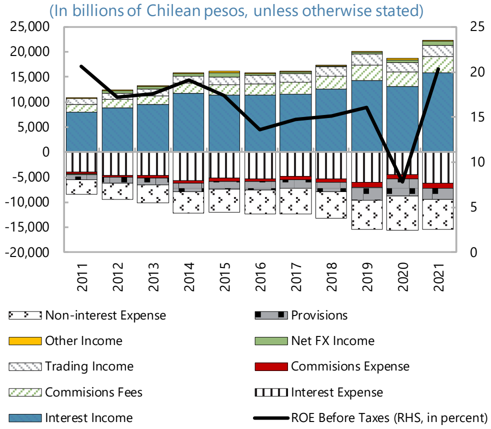


Sources: Central Bank of Chile, Haver Analytics, and IMF staff calculations.
1/ Calculated as average real GDP growth of trading partners, weighted by their respective share in Chilean exports.
2/ LA6 includes Brazil, Chile, Colombia, Mexico, Peru and Uruguay.
3/ Commodity exporters includes Canada, New Zealand, and Australia.
4/ As a percent of annualized quarterly GDP.
5/ *Assessing Reserve Adequacy*, IMF.

Figure 5. Chile: Financial Sector

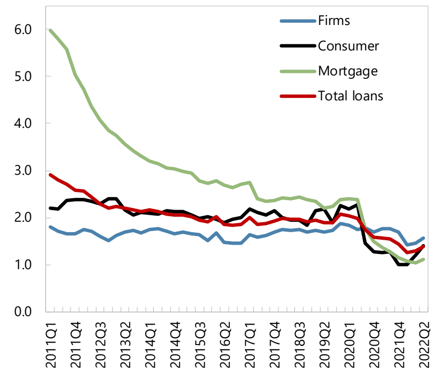
Banks' profitability stood at 20.4% in December

Income Statement of Banking Sector
(In billions of Chilean pesos, unless otherwise stated)



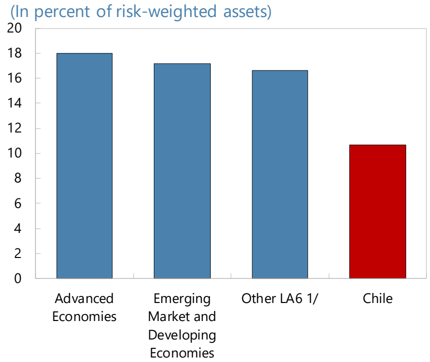
... and non-performing loans have remained low.

Non-performing Loans
(In percent of total segment loans)



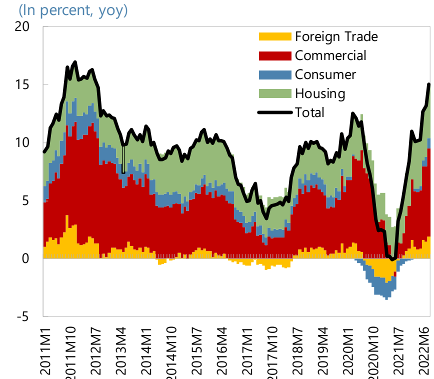
While capital ratios are lower than in other countries, they are expected to increase in line with Basel III.

Tier 1 Capital Ratio, Latest Available Value
(In percent of risk-weighted assets)



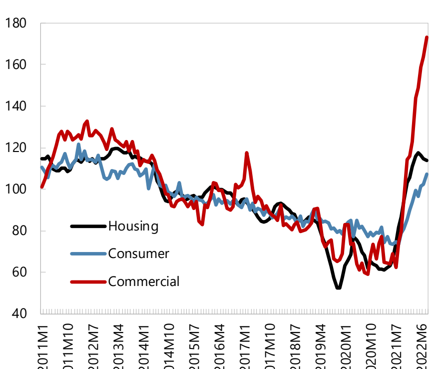
Credit growth has recovered from the sharp drop in 2021H1, reaching a growth rate of 15.0% in June...

Credit Growth Contributions by Economic Sector
(In percent, yoy)



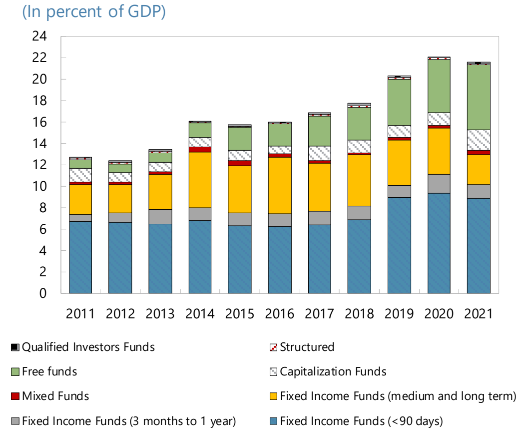
...while interest rates increased in line with monetary tightening.

Interest Rates by Economic Sector
(Index, 2010-2019 Average=100)



Total mutual funds assets fell in 2021, led by medium and long term fixed income funds.

Structure of Mutual Funds
(In percent of GDP)



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

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

GDP (2021), in billions of pesos	240,499	Quota	
GDP (2021), in billions of U.S. dollars	316.8	in millions of SDRs	1,744
Per capita (2021), U.S. dollars	16,099	in % of total	0.37
Population (2020), in millions	19.7	Poverty rate (2020)	10.80
Main products and exports	Copper	Gini coefficient (2017)	44.40
Key export markets	China, Euro area, U.S.	Literacy rate (2017)	96.4

				Proj.					
	2019	2020	2021	2022	2023	2024	2025	2026	2027
	(Annual percentage change, unless otherwise specified)								
Output									
Real GDP	0.9	-6.1	11.7	1.8	-0.3	1.9	2.2	2.4	2.5
Total domestic demand	0.9	-9.5	21.7	1.7	-3.4	0.9	1.7	2.4	2.5
Consumption	0.8	-7.4	18.3	2.6	-2.9	1.2	1.9	2.3	2.4
Private	0.9	-8.2	20.4	3.5	-3.5	1.0	1.8	2.7	2.5
Public	0.8	-4.0	9.8	-0.6	-1.2	2.2	2.3	0.3	1.9
Investment 2/	1.4	-16.1	33.3	-1.1	-4.8	-0.1	1.3	3.0	2.6
Fixed	4.7	-9.5	17.7	-4.8	-3.8	1.1	1.5	3.0	2.8
Private	5.4	-8.9	18.2	-3.1	-3.9	1.1	1.4	3.4	2.8
Public	-1.3	-15.2	12.6	-23.4	-2.2	2.0	2.4	-1.9	2.5
Inventories 3/	-0.7	-1.7	3.2	0.9	-0.4	-0.3	0.0	0.0	0.0
Net exports 3/	-0.2	3.4	-8.8	-0.1	2.9	1.0	0.4	0.0	0.0
Exports	-2.5	-1.2	-1.5	-1.2	-0.1	2.6	2.6	2.6	2.5
Imports	-1.7	-12.8	31.2	-0.5	-9.4	-1.2	0.8	2.6	2.4
Employment									
Unemployment rate (annual average)	7.2	10.8	8.9	7.8	8.2	8.0	7.6	7.2	7.0
Consumer Prices									
Inflation (End of period, %)	2.9	2.9	7.1	11.2	5.7	3.0	3.0	3.0	3.0
Inflation (average, %)	2.3	3.0	4.5	11.2	7.8	4.0	3.0	3.0	3.0
	(In percent of GDP, unless otherwise specified)								
Public Sector Finances									
Central government revenue	21.7	20.1	24.1	23.9	22.2	22.6	23.0	22.9	23.0
Central government expenditure	24.6	27.4	31.8	23.9	23.9	23.8	23.6	23.3	23.4
Central government fiscal balance	-2.9	-7.3	-7.7	0.0	-1.7	-1.2	-0.7	-0.4	-0.4
Central government structural fiscal balance	-1.7	-2.3	-11.2	-2.0	-2.0	-1.4	-0.9	-0.3	-0.3
Structural non-mining primary balance (% of GDP)	-3.0	-3.3	-11.8	-2.4	-2.5	-1.5	-1.2	-0.8	-0.9
Central government gross debt	28.3	32.6	36.3	37.3	38.3	39.1	39.8	40.1	39.7
of which, FX-denominated debt	5.8	7.5	12.8	13.1	14.2	14.4	14.4	14.6	13.7
Central government debt net of treasury assets	18.6	24.2	31.0	30.9	32.8	34.0	34.9	35.5	35.0
Public sector gross debt 4/	49.2	57.8	67.4	68.3	69.4	70.2	70.8	71.2	70.8
of which, share of FX-denominated debt	5.8	7.5	12.8	13.1	14.2	14.4	14.4	14.6	13.7
	(Annual percentage change, unless otherwise specified)								
Money and Credit									
Broad money	9.4	6.1	10.7	8.8	6.7	6.2	5.4	5.4	5.5
Credit to the private sector	9.7	3.2	10.1	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.
Balance of Payments									
Current account (% of GDP)	-5.2	-1.7	-6.7	-7.7	-4.9	-3.5	-2.9	-2.7	-2.5
Current account (in billions of U.S. dollars)	-14.4	-4.3	-21.2	-23.7	-16.6	-12.5	-10.7	-10.5	-10.0
Foreign direct investment net flows (% of GDP)	-1.2	-1.0	-0.3	-0.9	-1.3	-0.9	-0.9	-0.9	-1.0
Gross international reserves (in billions of USD)	40.7	39.2	51.3	51.3	51.3	51.3	51.3	51.3	51.3
Gross reserves (% of gross financing needs)	56.5	53.9	75.7	53.9	61.9	63.5	60.4	58.4	56.4
Gross external debt (% of GDP)	66.7	77.9	72.4	77.9	72.0	71.3	70.4	69.8	68.0
Public	6.2	8.9	12.5	14.8	15.1	15.4	15.3	15.5	14.6
Private	60.5	69.0	59.9	63.2	56.9	56.0	55.1	54.3	53.4
	(Annual percentage change)								
Relative Prices									
Real effective exchange rate (real appreciation +)	-4.7	-8.2	3.3	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.
Terms of trade	-1.8	11.6	12.0	-9.5	-7.2	0.2	0.3	-0.1	-0.1
Memorandum Items									
Nominal GDP (in billions of pesos)	195,792	199,952	240,499	261,625	279,029	296,339	312,341	329,323	347,519
(percentage change)	3.4	2.1	20.3	8.8	6.7	6.2	5.4	5.4	5.5
Nominal GDP (in billions of USD)	278.4	252.4	316.8	306.6	340.9	354.9	369.8	385.8	403.3
(percentage change)	-5.7	-9.3	25.5	-3.2	11.2	4.1	4.2	4.3	4.5

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)

	2019	2020	2021	2022	2023	2024	2025	2026	2027
				Proj.					
Revenues	**21.7**	**20.1**	**24.1**	**23.9**	**22.2**	**22.6**	**23.0**	**22.9**	**23.0**
Taxes	17.7	16.2	18.8	19.6	18.4	19.1	19.2	19.2	19.3
Private mining companies	1.0	0.7	1.2	1.4	0.9	0.7	0.7	0.8	0.8
Other tax revenues, non-mining	16.7	15.5	17.6	18.2	17.5	18.4	18.5	18.5	18.5
Social contributions	1.5	1.6	1.2	1.2	1.2	1.2	1.2	1.2	1.2
Grants	0.1	0.1	0.0	0.1	0.1	0.1	0.1	0.1	0.1
Other revenue	2.4	2.3	4.0	3.0	2.6	2.3	2.5	2.4	2.4
Codelco revenues	0.4	0.5	1.8	0.8	0.7	0.5	0.6	0.5	0.6
Income on assets	0.6	0.4	0.2	0.7	0.5	0.5	0.5	0.5	0.5
Operating income	0.5	0.4	0.5	0.5	0.5	0.5	0.5	0.5	0.5
Other income	1.0	1.0	1.4	1.1	1.0	0.9	0.9	0.9	0.9
Expenditures	**24.6**	**27.4**	**31.8**	**23.9**	**23.9**	**23.8**	**23.6**	**23.3**	**23.4**
Expense	22.5	25.6	30.0	22.5	22.5	22.5	22.2	21.9	22.0
Compensation of employees	5.0	5.3	4.8	5.0	5.0	5.0	5.0	5.0	5.0
Purchases of goods and services	2.0	2.2	2.0	1.8	1.8	1.8	1.8	1.7	1.7
Interest payments	0.9	1.0	0.9	0.9	1.1	1.2	1.3	1.4	1.4
Subsidies and grants	8.8	11.1	16.8	8.9	8.8	8.7	8.4	8.0	8.1
Social benefits	4.0	4.4	3.9	4.0	4.0	4.0	4.0	4.0	4.0
Other expense	1.8	1.7	1.6	1.8	1.8	1.8	1.8	1.8	1.8
Net acquistion of nonfinancial assets	2.1	1.8	1.8	1.4	1.4	1.4	1.4	1.4	1.4
Investment	2.1	1.8	1.8	1.4	1.4	1.4	1.4	1.4	1.4
Net Lending/Borrowing	**-2.9**	**-7.3**	**-7.7**	**0.0**	**-1.7**	**-1.2**	**-0.7**	**-0.4**	**-0.4**
Non-mining overall balance	-4.2	-8.5	-10.7	-2.2	-3.3	-2.3	-2.0	-1.7	-1.8
Net Financial Transactions	**-2.9**	**-7.3**	**-7.7**	**0.0**	**-1.7**	**-1.2**	**-0.7**	**-0.4**	**-0.4**
Net acquistion of financial assets	-0.6	-3.2	-1.6	3.1	1.0	1.3	1.5	1.5	0.8
Net incurrence of liabilities	2.2	4.1	6.0	3.1	2.6	2.5	2.1	1.9	1.2
Domestic	2.0	2.5	1.3	1.4	0.9	1.7	1.6	1.2	1.5
External	0.5	1.8	4.8	1.8	1.8	0.9	0.6	0.8	-0.3
Recognition bonds	-0.2	-0.2	-0.1	-0.1	-0.1	-0.1	0.0	0.0	0.0
Memorandum Items									
Primary balance	-2.5	-6.8	-7.1	0.2	-1.0	-0.4	0.2	0.5	0.5
Structural Fiscal Balance	-1.7	-2.3	-11.2	-2.0	-2.0	-1.4	-0.9	-0.3	-0.3
Structural Revenue	22.9	25.1	20.5	21.9	21.9	22.5	22.7	23.0	23.1
Fiscal Impulse 1/	0.5	0.3	8.5	-9.4	0.1	-1.0	-0.3	-0.4	0.1
Expenditure growth (in real terms; annual percent change)	4.2	10.4	33.4	-26.5	-0.9	1.9	1.4	0.9	2.8
Central Government debt net of treasury assets	18.6	24.2	31.0	30.9	32.8	34.0	34.9	35.5	35.0
Central Government gross debt	28.3	32.6	36.3	37.3	38.3	39.1	39.8	40.1	39.7
Public Sector Gross Debt 2/	49.2	57.8	67.4	68.3	69.4	70.2	70.8	71.2	70.8
Public Sector debt net of treasury assets 2/	39.5	49.4	62.1	62.0	63.9	65.1	66.0	66.6	66.1
General Government Fiscal Balance 3/	-2.7	-7.1	-7.5	0.2	-1.4	-1.0	-0.4	-0.2	0.0
Nominal GDP (trillions of pesos)	195.8	200.0	240.5	261.6	279.0	296.3	312.3	329.3	347.5

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

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

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

3/ Includes the central government and municipality governments.

Table 3. Chile: Balance of Payments 1/

(In US$ billions, unless otherwise specified)

	2019	2020	2021	2022 Proj.	2023 Proj.	2024 Proj.	2025 Proj.	2026 Proj.	2027 Proj.
Current Account	**-14.4**	**-4.3**	**-21.2**	**-23.7**	**-16.6**	**-12.5**	**-10.7**	**-10.5**	**-10.0**
Trade balance	2.9	19.0	10.7	1.9	3.4	6.7	8.7	8.8	9.1
Exports	68.8	74.0	94.7	92.7	86.3	89.3	92.5	95.8	99.1
Copper	32.7	38.3	53.3	45.6	39.7	41.1	42.6	44.2	45.9
Non-copper	36.1	35.8	41.4	47.1	46.5	48.2	49.9	51.5	53.2
Imports	65.9	55.0	84.0	90.7	82.9	82.6	83.8	86.9	89.9
Net services	-8.1	-7.4	-12.0	-13.2	-8.5	-7.7	-7.5	-7.9	-8.2
Net income	-10.4	-15.9	-19.6	-13.8	-13.3	-13.7	-14.2	-13.8	-13.4
Net transfers	1.0	0.0	-0.4	1.5	1.9	2.1	2.3	2.3	2.4
Capital account balance	1.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Financial Account Balance	**-10.7**	**-3.1**	**-34.6**	**-23.7**	**-16.6**	**-12.5**	**-10.7**	**-10.5**	**-10.0**
Foreign direct investment	-3.2	-2.5	-0.8	-2.7	-4.3	-3.2	-3.2	-3.4	-3.9
Abroad by Chilean residents	10.3	6.7	14.5	7.2	8.1	9.4	9.2	9.7	8.7
In Chile by foreign residents	13.6	9.2	15.3	9.9	12.4	12.6	12.4	13.0	12.6
Of which, debt instruments	1.8	0.3	1.1	0.3	0.6	0.8	0.6	0.7	0.6
Portfolio investment	-10.6	-13.2	-30.6	-15.6	-18.7	-20.7	-22.6	-20.5	-21.7
Abroad by Chilean residents	0.8	-5.9	1.6	-0.2	-1.0	-1.5	-0.3	-0.8	-1.0
In Chile by foreign residents	11.4	7.2	32.2	15.4	17.7	19.2	22.3	19.7	20.8
Of which, equities	3.0	0.2	2.4	1.2	1.3	1.4	1.7	1.5	1.6
Of which, debt	8.5	7.0	29.8	14.3	16.3	17.8	20.6	18.2	19.2
Financial derivatives	1.5	2.5	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other investments	1.7	10.0	-3.2	-5.3	6.4	11.4	15.0	13.4	15.7
Abroad by Chilean residents	3.1	7.8	8.1	8.1	8.1	8.1	8.1	8.1	8.1
In Chile by foreign residents	1.4	-2.3	11.3	13.3	1.6	-3.4	-7.0	-5.3	-7.6
Change in Reserves Assets	**-0.2**	**-2.9**	**12.2**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**
Errors and omissions	2.6	-1.7	-1.2	0.0	0.0	0.0	0.0	0.0	0.0
Gross international reserves (in billions of USD)	40.7	39.2	51.3	51.3	51.3	51.3	51.3	51.3	51.3
				(In percent of GDP)					
Current Account	**-5.2**	**-1.7**	**-6.7**	**-7.7**	**-4.9**	**-3.5**	**-2.9**	**-2.7**	**-2.5**
Trade balance of Goods	1.1	7.5	3.4	0.6	1.0	1.9	2.4	2.3	2.3
Exports	24.7	29.3	29.9	30.2	25.3	25.2	25.0	24.8	24.6
Copper	11.7	15.2	16.8	14.9	11.7	11.6	11.5	11.5	11.4
Non-copper	13.0	14.2	13.1	15.3	13.7	13.6	13.5	13.4	13.2
Imports	23.7	21.8	26.5	29.6	24.3	23.3	22.7	22.5	22.3
Net services	-2.9	-2.9	-3.8	-4.3	-2.5	-2.2	-2.0	-2.0	-2.0
Net income	-3.7	-6.3	-6.2	-4.5	-3.9	-3.8	-3.8	-3.6	-3.3
Net transfers	0.3	0.0	-0.1	0.5	0.5	0.6	0.6	0.6	0.6
Financial Account Balance 2/	**-3.8**	**-1.2**	**-10.9**	**-7.7**	**-4.9**	**-3.5**	**-2.9**	**-2.7**	**-2.5**
				(Annual change in percent)					
Total export volume	-2.1	2.6	-0.9	-2.3	-0.1	2.6	2.6	2.6	2.5
Total import volume	-2.1	-10.2	34.8	-1.1	-9.4	-1.2	0.8	2.6	2.4
Terms of trade	-1.8	11.6	12.0	-9.5	-7.2	0.2	0.3	-0.1	-0.1
Export prices	-5.9	5.0	29.0	-0.5	-6.8	0.9	0.9	0.9	0.9
Copper export price	-7.4	16.0	43.4	-11.8	-15.5	0.2	0.5	0.6	0.7
Import prices	-4.3	-5.9	15.1	10.1	0.3	0.7	0.6	1.0	1.0
Memorandum Items									
Copper price (WEO; U.S. cents per pound)	273	280	423	386	326	327	328	330	333
Volume of copper exports (2004=100)	104	106	102	100	103	107	110	114	117

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)

	2015	2016	2017	2018	2019	2020	2021
Central Bank							
Net foreign assets	26,645	26,391	23,332	27,043	29,547	27,222	40,891
Net international reserves	27,333	27,021	23,983	27,731	30,274	27,881	43,643
Net international reserves (in millions of US$)	38,643	40,494	38,983	39,861	40,657	39,200	51,330
Other foreign assets, net	-688	-630	-651	-688	-727	-659	-2,752
Net domestic assets	-17,493	-16,049	-12,226	-15,747	-17,212	3,034	-19,435
Net credit to general government	-124	-476	-9	-553	-392	327	356
Net claims on banks and financial corporations	-6,306	-5,028	-3,403	-5,163	-4,599	6,640	7,838
Credit to the private sector	406	319	189	47	-33	-31	-38
Other items (net)	-11,469	-10,863	-9,003	-10,077	-12,187	-19,135	-46,647
Monetary base	9,152	10,343	11,106	11,296	12,335	30,256	21,456
Currency	5,858	6,275	6,528	6,740	7,576	12,180	15,210
Required reserves	3,294	4,068	4,577	4,556	4,760	18,077	6,247
Other Depository Institutions							
Net foreign assets	-6,120	-5,394	-7,237	-10,199	-9,700	-1,678	-4,608
Net foreign assets (in millions of US$)	-8,652	-8,083	-11,763	-14,660	-13,027	-2,359	-5,420
Net domestic assets	126,310	132,992	139,488	156,578	174,809	166,206	186,314
Net credit to general government	-532	-256	2,965	3,463	4,615	12,538	17,607
Credit to the private sector	130,465	137,324	144,061	158,792	174,225	179,836	197,943
Other items (net)	-3,623	-4,076	-7,538	-5,677	-4,031	-26,168	-29,236
Liabilities to the private sector	120,190	127,598	132,251	146,379	165,109	164,528	181,706
Demand deposits	23,562	24,044	27,038	30,116	36,058	56,393	64,091
Quasi-money	96,628	103,554	105,213	116,263	129,051	108,135	117,615
Banking System							
Net foreign assets	20,526	20,997	16,095	16,844	19,846	25,544	36,283
Net domestic assets	113,683	120,876	129,252	142,030	156,183	160,617	177,327
Net credit to general government	-656	-732	2,956	2,910	4,223	12,865	17,963
Credit to the private sector	130,871	137,643	144,250	158,839	174,192	179,805	197,905
Other items (net)	-16,531	-16,035	-17,954	-19,715	-22,232	-32,053	-38,541
Liabilities to the private sector	134,209	141,873	145,347	158,874	176,029	186,161	213,610
Money	29,420	30,319	33,566	36,856	43,633	68,573	79,301
Quasi-money	104,789	111,554	111,781	122,018	132,396	117,588	134,309
Memorandum Items							
	(Annual percentage change)						
Monetary base	11.8	13.0	7.4	1.7	9.2	145.3	-29.1
Liabilities to the private sector	10.5	5.7	2.4	9.3	10.8	5.8	14.7
Credit to the private sector (banking system)	10.7	5.2	4.8	10.1	9.7	3.2	10.1
	(In percent of GDP)						
Monetary base	5.8	6.1	6.2	6.0	6.3	15.1	8.9
Liabilities to the private sector	84.6	84.1	81.1	83.9	89.9	93.1	88.8
Credit to the private sector (banking system)	82.5	81.6	80.5	83.9	89.0	89.9	82.3

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

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

				Proj.					
	2019	2020	2021	2022	2023	2024	2025	2026	2027
National Accounts	(Annual percentage change, unless otherwise specified)								
Real GDP	0.9	-6.1	11.7	1.8	-0.3	1.9	2.2	2.4	2.5
Total domestic demand	0.9	-9.5	21.7	1.7	-3.4	0.9	1.7	2.4	2.5
Consumption	0.8	-7.4	18.3	2.6	-2.9	1.2	1.9	2.3	2.4
Private	0.9	-8.2	20.4	3.5	-3.5	1.0	1.8	2.7	2.5
Public	0.8	-4.0	9.8	-0.6	-1.2	2.2	2.3	0.3	1.9
Investment 2/	1.4	-16.1	33.3	-1.1	-4.8	-0.1	1.3	3.0	2.6
Fixed	4.7	-9.5	17.7	-4.8	-3.8	1.1	1.5	3.0	2.8
Private	5.4	-8.9	18.2	-3.1	-3.9	1.1	1.4	3.4	2.8
Public	-1.3	-15.2	12.6	-23.4	-2.2	2.0	2.4	-1.9	2.5
Inventories 3/	-0.7	-1.7	3.2	0.9	-0.4	-0.3	0.0	0.0	0.0
Net exports 3/	-0.2	3.4	-8.8	-0.1	2.9	1.0	0.4	0.0	0.0
Exports	-2.5	-1.2	-1.5	-1.2	-0.1	2.6	2.6	2.6	2.5
Imports	-1.7	-12.8	31.2	-0.5	-9.4	-1.2	0.8	2.6	2.4
Consumer prices									
End of period	3.0	3.0	7.2	11.2	5.7	3.0	3.0	3.0	3.0
Consumer prices (average)	2.3	3.0	4.5	11.2	7.8	4.0	3.0	3.0	3.0
Nominal GDP growth	3.4	2.1	20.3	8.8	6.7	6.2	5.4	5.4	5.5
Potential growth	2.1	-1.0	3.4	3.0	1.4	1.7	2.0	2.4	2.5
Output gap (percent)	0.0	-5.1	2.5	1.3	-0.4	-0.2	0.0	0.0	0.0
Balance of Payments	(In percent of GDP)								
Current account	-5.2	-1.7	-6.7	-7.7	-4.9	-3.5	-2.9	-2.7	-2.5
Trade balance	1.1	7.5	3.4	0.6	1.0	1.9	2.4	2.3	2.3
Financial account balance	-3.8	-1.2	-10.9	-7.7	-4.9	-3.5	-2.9	-2.7	-2.5
Of which, foreign direct investment (net)	-1.2	-1.0	-0.3	-0.9	-1.3	-0.9	-0.9	-0.9	-1.0
Change in reserves assets	-0.1	-1.1	3.9	0.0	0.0	0.0	0.0	0.0	0.0
Errors and omissions	0.9	-0.7	-0.4	0.0	0.0	0.0	0.0	0.0	0.0
REER (in percent y/y, +=appreciation)	-4.7	-8.2	3.3	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.
	(Annual percentage change)								
Total export volume	-2.1	2.6	-0.9	-2.3	-0.1	2.6	2.6	2.6	2.5
Of which, copper export volume	-1.1	1.4	-3.2	-1.9	3.0	3.2	3.3	3.2	3.1
Total import volume	-2.1	-10.2	34.8	-1.1	-9.4	-1.2	0.8	2.6	2.4
Terms of trade	-1.8	11.6	12.0	-9.5	-7.2	0.2	0.3	-0.1	-0.1
Export prices	-5.9	5.0	29.0	-0.5	-6.8	0.9	0.9	0.9	0.9
Copper export price	-7.4	16.0	43.4	-11.8	-15.5	0.2	0.5	0.6	0.7
Import prices	-4.3	-5.9	15.1	10.1	0.3	0.7	0.6	1.0	1.0
External Debt	(In percent of GDP)								
Gross external debt	66.7	77.9	72.4	77.9	72.0	71.3	70.4	69.8	68.0
Public	6.2	8.9	12.5	14.8	15.1	15.4	15.3	15.5	14.6
Private	60.5	69.0	59.9	63.2	56.9	56.0	55.1	54.3	53.4
Gross int. reserves (in billions of U.S. dollars)	40.7	39.2	51.3	51.3	51.3	51.3	51.3	51.3	51.3
Savings and Investment									
Gross domestic investment	25.0	21.6	25.3	25.9	25.2	24.7	24.4	24.6	24.6
Public	2.3	2.0	2.0	1.6	1.6	1.6	1.6	1.6	1.6
Private	22.7	19.6	23.3	24.2	23.6	23.1	22.8	23.0	23.0
National saving	19.8	19.9	18.7	18.3	20.4	21.1	21.5	21.9	22.1
Public	-0.4	-5.1	-5.5	1.8	0.1	0.6	1.1	1.4	1.4
Private	20.3	25.1	24.2	16.5	20.2	20.5	20.4	20.4	20.7
Operations of the Central Government									
Central government gross debt	28.3	32.6	36.3	37.3	38.3	39.1	39.8	40.1	39.7
Central government debt net of treasury assets	18.6	24.2	31.0	30.9	32.8	34.0	34.9	35.5	35.0
Central government balance	-2.9	-7.3	-7.7	0.0	-1.7	-1.2	-0.7	-0.4	-0.4
Total revenue	21.7	20.1	24.1	23.9	22.2	22.6	23.0	22.9	23.0
Total expenditure	24.6	27.4	31.8	23.9	23.9	23.8	23.6	23.3	23.4
Central government structural balance	-1.7	-2.3	-11.2	-2.0	-2.0	-1.4	-0.9	-0.3	-0.3
Employment	(Annual percentage change, unless otherwise specified)								
Working age population	2.2	2.0	1.4	1.3	1.2	1.2	1.2	1.2	1.2
Labor force	2.0	-8.9	3.4	0.5	0.8	0.9	1.0	1.0	1.0
Employment	2.1	-12.3	5.5	1.6	0.3	1.1	1.5	1.4	1.2
Unemployment rate (in percent)	7.2	10.7	8.8	7.8	8.2	8.0	7.6	7.2	7.0

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

Table 6. Chile: Indicators of External Vulnerabilities 1/

(In percent, unless otherwise specified)

	2015	2016	2017	2018	2019	2020	2021
Financial Indicators							
M3 (percent change)	12.4	8.7	4.8	11.0	10.9	3.1	14.7
Less pension funds' deposits (annual percentage change)	13.5	10.1	5.0	12.3	9.7	7.0	18.8
Private sector credit to GDP	82.5	81.6	80.5	83.9	89.0	89.9	82.3
90-day central bank promissory note (nominal) interest rate (avg.)	2.7	3.5	2.6	2.8	3.3	3.4	3.5
Share of foreign currency deposits in total deposits	15.4	15.2	13.0	12.8	14.9	14.8	18.8
Share of foreign currency loans in total credit	13.9	13.0	11.4	11.0	11.8	11.8	9.9
External Indicators							
Exports of goods, U.S. dollars (annual percentage change)	-17.6	-2.2	13.4	8.6	-8.0	7.6	27.9
Imports of goods, U.S. dollars (annual percentage change)	-14.7	-4.8	10.1	14.7	-6.5	-16.4	52.6
Terms of trade (annual percentage change)	-2.8	4.1	10.0	-2.5	-1.8	11.6	12.0
REER (annual percent change, period average)	-1.0	1.8	3.4	1.4	-4.7	-8.2	3.3
Exchange rate (pesos per U.S. dollar, period average)	654.1	676.9	648.9	641.2	703.3	792.2	759.1
Current account balance (percent of GDP)	-2.8	-2.6	-2.8	-4.5	-5.2	-1.7	-6.7
Financial account less reserves accumulation (percent of GDP)	-1.7	-2.4	-1.2	-4.3	-3.8	-1.2	-10.9
Gross official reserves (in billions of U.S. dollars) 2/	38.6	40.5	39.0	39.9	40.7	39.2	51.3
Gross official reserves to M3	14.9	13.5	11.5	11.9	11.7	10.5	14.3
Gross official reserves to short-term external debt 3/	94.2	100.7	71.7	73.9	68.5	59.6	97.9
Gross official reserves (percent of GDP)	15.9	16.2	14.1	13.5	14.6	15.5	16.2
IMF reserve adequacy metric (percent of GDP) 4/	15.0	14.7	16.5	15.6	16.5	19.0	18.5
Total external debt (percent of GDP)	65.4	65.7	62.5	59.4	66.7	77.9	72.4
Of which: External public sector debt	3.2	4.0	4.6	4.9	5.7	8.4	11.4
Total external debt to exports of goods and services	224.6	235.9	221.1	208.7	240.4	246.8	227.9
External interest payments to exports of goods and services	7.1	6.4	6.5	5.8	6.8	7.0	4.6
External amortization payments to exports of goods and services	63.9	57.9	63.1	63.4	74.4	86.0	46.3
Financial Market Indicators							
Stock market index (in U.S. dollars; period average) 5/	1465	1409	1731	1869	1512	1037	1182
Sovereign long-term foreign currency debt rating (end of period)							
Moody's	Aa3	Aa3	Aa3	A1	A1	A1	A1
S&P	AA-	AA-	A+	A+	A+	A+	A
Fitch ratings	A+	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

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 Stanley Capital International Index (Dec/1987 = 100).

Table 7. Chile: Financial Soundness Indicators

(In percent, unless otherwise specified)

	2015	2016	2017	2018	2019	2020	2021
Total Assets							
Total assets (In billions of Chilean pesos)	203,609	211,687	220,365	246,266	290,500	323,127	351,920
Percent of GDP	128.4	125.5	123.0	130.1	148.4	161.6	146.3
Capital Adequacy							
Regulatory Capital to Risk-Weighted Assets	12.6	13.8	13.8	13.3	12.8	14.7	14.9
Regulatory Tier 1 Capital to Risk-Weighted Assets	9.4	10.9	11.0	10.7	10.3	10.7	10.7
Capital to Assets	7.4	8.2	8.3	8.2	7.3	6.6	6.7
Credit Risk							
NPLs Net of Provisions to Capital	-4.5	-4.4	-3.8	-3.8	-3.6	-7.7	-7.5
NPLs to Gross Loans	1.7	1.8	1.9	1.9	2.1	1.6	1.2
Profitability							
Return on Assets	1.5	1.2	1.3	1.4	1.3	0.5	1.5
Return on Equity	14.7	11.5	12.4	12.5	12.4	5.6	16.6
Interest Margin to Gross Income	66.4	66.6	66.2	67.1	66.9	69.4	69.5
Trading Income to Gross Income	10.5	10.1	8.4	8.6	9.6	8.4	8.2
Non-interest Expenses to Gross Income	48.5	52.0	50.4	48.9	46.7	54.9	43.6
Liquidity							
Liquid Assets to Total Assets	13.8	14.7	15.3	14.2	15.3	22.2	20.1
FX and Derivative Risk							
FX Loans to Total Loans	20.0	18.2	16.6	18.4	18.9	16.1	18.3
FX Liabilities to Total Liabilities	27.1	25.8	24.0	25.5	26.7	22.7	25.2

Sources: IMF Financial Soundness Indicators, Moody's Investor Service and IMF staff calculations.

Table 8. Chile: Capacity to Repay Indicators 1/

	2021	2022	2023	2024	2025	2026	2027
Exposure and Repayments (In SDR millions)							
GRA credit to Chile	--	13,954.0	13,954.0	13,954.0	12,209.8	5,232.8	0.0
(In percent of quota)	--	800.0	800.0	800.0	700.0	300.0	0.0
Charges due on GRA credit 2/	0.2	169.3	563.1	563.4	581.6	458.1	102.3
Debt service due on GRA credit 2/	0.2	169.3	563.1	563.4	2,325.9	7,435.1	5,335.0
Debt and Debt Service Ratios 3/							
In percent of GDP							
Total external debt	72.4	88.4	83.3	79.8	76.4	71.6	68.0
Public external debt	12.5	21.9	22.1	21.5	20.2	17.3	14.6
GRA credit to Chile	--	6.3	5.9	5.5	4.5	1.8	--
Total external debt service	16.2	26.7	22.9	21.9	23.1	24.3	23.5
Public external debt service	0.3	0.6	0.6	0.6	2.0	3.6	3.0
Debt service due on GRA credit	0.0	0.1	0.2	0.2	0.9	2.6	1.8
In percent of Gross International Reserves							
Total external debt	447.0	520.8	534.5	529.7	539.4	538.4	534.3
Public external debt	77.4	129.0	141.8	142.8	142.5	130.3	114.5
GRA credit to Chile	--	37.4	37.6	36.5	32.1	13.8	--
In percent of Exports of Goods and Services							
Total external debt service	50.9	87.3	84.4	78.1	80.0	86.8	84.6
Public external debt service	0.9	1.9	2.3	2.2	7.0	13.0	10.8
Debt service due on GRA credit	0.0	0.3	0.9	0.8	3.0	9.3	6.5
In percent of Total External Debt							
GRA credit to Chile	--	7.2	7.0	6.9	5.9	2.6	--
In percent of Public External Debt							
GRA credit to Chile	--	29.0	26.5	25.5	22.5	10.6	--
Memo Items:							
U. S. dollars per SDR (period average)	1.42	1.35	1.33	1.34	1.35	1.35	1.36
U. S. dollars per SDR (end of period)	1.40	1.32	1.33	1.34	1.35	1.36	1.37
Oil Price (WEO APSP, US$ per barrel)	69.4	99.9	83.5	77.8	74.1	71.8	70.3

Sources: Chilean authorities, Finance Department, World Economic Outlook, and IMF staff estimates.

1/ Assumes full drawing under the proposed FCL upon approval and materialization of an adverse scenario, even though the authorities intend to treat the arrangement as precautionary.
2/ Projections based on the rate of charge as of August 18, 2022. Includes GRA basic rate of charge, surcharges, service fees, and SDR charges. For 2022 also SLL commitment fee minus time-based refund.
3/ Staff projections for external debt, GDP, gross international reserves, and exports of goods and services reflect the adverse, and not the baseline, scenario under which full FCL drawing is assumed.

Annex I. External Debt Sustainability Analysis

External debt decreased to 72 percent of GDP in 2021, partly due to exchange rate valuation effects and higher growth, and is projected to further decline to about 68 percent of GDP by 2027. External debt remains sustainable under a wide range of adverse scenarios, including shocks to interest rates, growth, and the exchange rate. The non-financial corporate sector appears highly leveraged, but most debt is FDI-related (with parent companies) and has foreign exchange hedging or long maturity.

Table 1. Chile: External Debt Sustainability Framework

(In percent of GDP, otherwise indicated)

	Actual							Projections						
	2017	2018	2019	2020	2021			2022	2023	2024	2025	2026	2027	Debt-stabilizing non-interest current account 6/
Baseline: External debt	62.5	59.4	66.7	77.9	72.4			**77.9**	**72.0**	**71.3**	**70.4**	**69.7**	**68.0**	**-1.0**
Change in external debt	-3.1	-3.1	7.3	11.2	-5.5			5.5	-5.9	-0.7	-0.9	-0.6	-1.8	
Identified external debt-creating flows (4+8+9)	-2.4	3.4	8.0	9.0	-9.7			6.8	5.8	2.5	1.6	1.4	1.2	
Current account deficit, excluding interest payments	0.9	2.9	3.3	-0.5	5.2			5.7	3.3	2.0	1.2	1.1	0.9	
Balance of goods and services	0.7	-1.0	-1.9	4.6	-0.4			-3.7	-1.5	-0.3	0.3	0.3	0.2	
Exports	28.3	28.5	27.8	31.6	31.8			32.9	28.3	28.4	28.3	28.0	27.8	
Imports	-27.6	-29.5	-29.6	-27.0	-32.2			-36.6	-29.8	-28.7	-28.0	-27.8	-27.5	
Net non-debt creating capital inflows (negative)	1.2	2.9	-0.6	0.8	-0.8			0.4	0.7	0.3	0.2	0.3	0.4	
Automatic debt dynamics 1/	-4.4	-2.3	5.2	8.7	-14.1			0.7	1.8	0.3	0.2	0.0	0.0	
Contribution from nominal interest rate	1.8	1.7	1.9	2.2	1.5			2.0	1.6	1.6	1.7	1.7	1.6	
Contribution from real GDP growth	-0.8	-2.3	-0.5	4.5	-7.3			-1.3	0.2	-1.3	-1.5	-1.6	-1.7	
Contribution from price and exchange rate changes 2/	-5.5	-1.7	3.9	2.0	-8.3			...	...	...	...	...	...	
Residual, incl. change in gross foreign assets (2-3) 3/	-0.8	-6.5	-0.7	2.2	4.2			-1.4	-11.6	-3.2	-2.6	-2.0	-3.0	
External debt-to-exports ratio (in percent)	221.1	208.7	240.4	246.8	227.9			236.5	254.1	250.9	249.0	248.7	244.9	
Gross external financing need (in billions of US dollars) 4/	56.9	66.6	71.9	72.8	67.8			**95.2**	**82.9**	**80.8**	**85.0**	**87.9**	**91.0**	
in percent of GDP	20.6	22.6	25.8	28.8	21.4	10-Year	10-Year	31.0	24.3	22.7	23.0	22.8	22.5	
Scenario with key variables at their historical averages 5/								**77.9**	**76.3**	**76.8**	**77.8**	**79.3**	**79.7**	**0.0**
						Historical	Standard							
Key Macroeconomic Assumptions Underlying Baseline						Average	Deviation							
Real GDP growth (in percent)	1.3	3.9	0.9	-6.1	11.7	2.7	4.5	1.8	-0.3	1.9	2.2	2.4	2.5	
GDP deflator in US dollars (change in percent)	9.4	2.8	-6.5	-3.5	12.2	0.0	7.0	-4.8	11.5	2.2	1.9	1.9	2.0	
Nominal external interest rate (in percent)	3.1	2.8	3.0	3.0	2.4	2.9	0.3	2.7	2.3	2.3	2.5	2.5	2.4	
Growth of exports (US dollar terms, in percent)	12.6	7.6	-8.1	3.1	26.3	1.3	12.0	0.4	-4.3	4.4	3.6	3.5	3.4	
Growth of imports (US dollar terms, in percent)	9.1	14.2	-5.3	-17.4	49.8	3.0	19.1	10.2	-9.4	0.1	1.5	3.7	3.5	
Current account balance, excluding interest payments	-0.9	-2.9	-3.3	0.5	-5.2	-2.3	1.8	-5.7	-3.3	-2.0	-1.2	-1.1	-0.9	
Net non-debt creating capital inflows	-1.2	-2.9	0.6	-0.8	0.8	0.1	1.8	-0.4	-0.7	-0.3	-0.2	-0.3	-0.4	

1/ Derived as [r - g - r(1+g) + ea(1+r)]/(1+g+r+gr) times previous period debt stock, with r = nominal effective interest rate on external debt; r = change in domestic GDP deflator in US dollar terms, g = real GDP growth rate, e = nominal appreciation (increase in dollar value of domestic currency), and a = share of domestic-currency denominated debt in total external debt.

2/ The contribution from price and exchange rate changes is defined as [-r(1+g) + ea(1+r)]/(1+g+r+gr) times previous period debt stock. r increases with an appreciating domestic currency (e > 0) and rising inflation (based on GDP deflator).

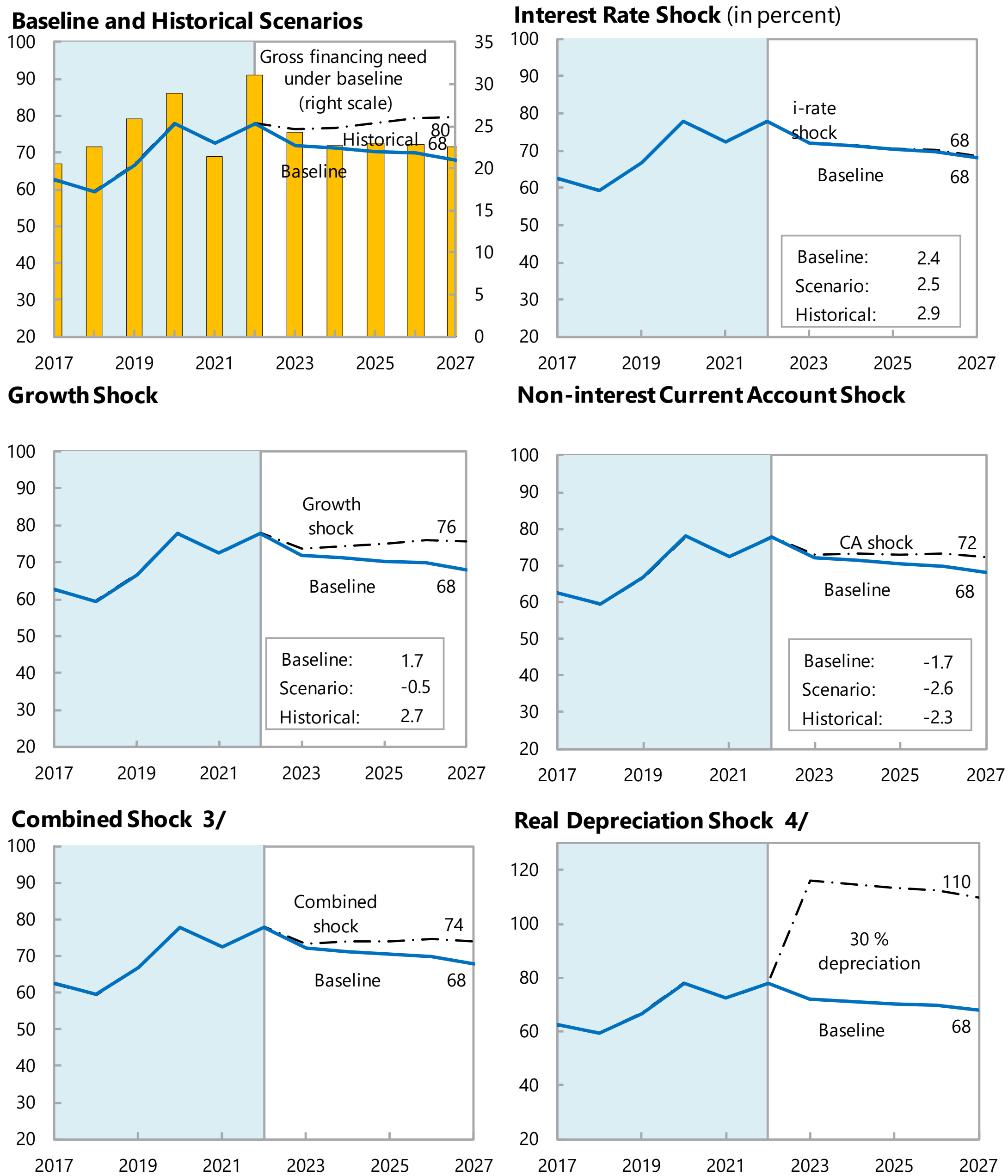
3/ For projection, line includes the impact of price and exchange rate changes.

4/ Defined as current account deficit, plus amortization on medium- and long-term debt, plus short-term debt at end of previous period.

5/ The key variables include real GDP growth; nominal interest rate; dollar deflator growth; and both non-interest current account and non-debt inflows in percent of GDP.

6/ Long-run, constant balance that stabilizes the debt ratio assuming that key variables (real GDP growth, nominal interest rate, dollar deflator growth, and non-debt inflows in percent of GDP) remain at their levels of the last projection year.

Figure 1. Chile: External Debt Sustainability: Bound Tests 1/ 2/
(External debt in percent of GDP)



Sources: International Monetary Fund, Country desk data, and staff estimates.
1/ Shaded areas represent actual data. Individual shocks are permanent one-half standard deviation shocks. Figures in the boxes represent average projections for the respective variables in the baseline and scenario being presented. Ten-year historical average for the variable is also shown.
2/ For historical scenarios, the historical averages are calculated over the ten-year period, and the information is used to project debt dynamics five years ahead.
3/ Permanent 1/4 standard deviation shocks applied to real interest rate, growth rate, and current account balance.

Annex II. Public Sector Debt Sustainability Analysis

Public sector debt is assessed to be sustainable under a wide range of plausible shock scenarios and with high probability, with low medium-term sovereign and financing risks (Annex Box 1). Medium-term structural fiscal consolidation plans, guided by the structural fiscal balance rule, are fully consistent with fiscal sustainability. The authorities are aiming for an ambitious tax reform, not included in baseline scenario, to finance demands for higher social spending.

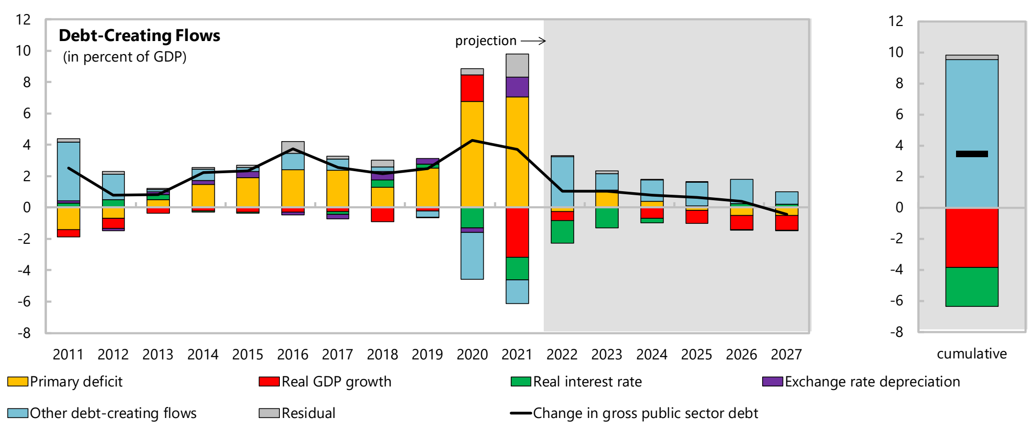
Figure 1. Chile: Baseline Scenario

Debt, Economic and Market Indicators [1/]

	Actual			Projections						As of July 28, 2022		
	2011-2019	2/ 2020	2021	2022	2023	2024	2025	2026	2027	Sovereign Spreads		
Nominal gross public debt	18.6	32.6	36.3	37.3	38.4	39.2	39.8	40.2	39.7	EMBIG (bp) 3/		197
Public gross financing needs	3.5	11.9	11.1	1.0	3.6	1.6	3.8	4.4	1.1	5Y CDS (bp)		133
Real GDP growth (in percent)	3.1	-6.1	11.7	1.8	-0.3	1.9	2.2	2.4	2.5	Ratings	Foreign	Local
Inflation (GDP deflator, in percent)	3.4	8.8	7.5	7.0	6.9	4.2	3.1	2.9	3.0	Moody's	A1	A1
Nominal GDP growth (in percent)	6.6	2.1	20.3	8.8	6.6	6.2	5.4	5.4	5.5	S&Ps	A	A+
Effective interest rate (in percent) [4/]	4.9	3.5	3.2	2.8	3.2	3.5	3.5	3.6	3.6	Fitch	A-	A-

Contribution to Changes in Public Debt

	Actual			Projections							
	2011-2019	2020	2021	2022	2023	2024	2025	2026	2027	cumulative	debt-stabilizing primary balance [9/]
Change in gross public sector debt	2.2	4.3	3.7	1.0	1.1	0.8	0.6	0.4	-0.4	3.5	
Identified debt-creating flows	2.0	3.9	2.2	0.9	0.9	0.8	0.6	0.4	-0.4	3.2	
Primary deficit	1.2	6.8	7.1	-0.2	1.0	0.4	-0.2	-0.5	-0.5	0.0	0.1
Primary (noninterest) revenue and grants	21.0	19.6	23.8	23.2	21.8	22.2	22.5	22.4	22.5	134.5	
Primary (noninterest) expenditure	22.2	26.4	30.9	22.9	22.8	22.6	22.3	21.9	22.0	134.5	
Automatic debt dynamics [5/]	-0.1	0.1	-3.3	-2.0	-1.2	-1.0	-0.7	-0.7	-0.7	-6.3	
Interest rate/growth differential [6/]	-0.2	0.4	-4.6	-2.0	-1.2	-1.0	-0.7	-0.7	-0.7	-6.3	
Of which: real interest rate	0.2	-1.3	-1.4	-1.4	-1.3	-0.3	0.1	0.2	0.2	-2.5	
Of which: real GDP growth	-0.4	1.7	-3.2	-0.6	0.1	-0.7	-0.8	-0.9	-0.9	-3.8	
Exchange rate depreciation [7/]	0.1	-0.3	1.3	…	…	…	…	…	…	…	
Other identified debt-creating flows	0.9	-3.0	-1.5	3.2	1.0	1.3	1.5	1.6	0.8	9.5	
Net acquistion of Financial Assets (negative)	0.4	-3.2	-1.6	3.1	1.0	1.3	1.5	1.5	0.8	9.2	
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	0.1	0.1	0.1	0.1	0.0	0.0	0.0	0.3	
Residual, including asset changes [8/]	0.2	0.4	1.5	0.1	0.2	0.0	0.0	0.0	0.0	0.3	



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 - π(1+g) - g + ae(1+r)]/(1+g+π+gπ)) 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 - π (1+g) and the real growth contribution as -g.

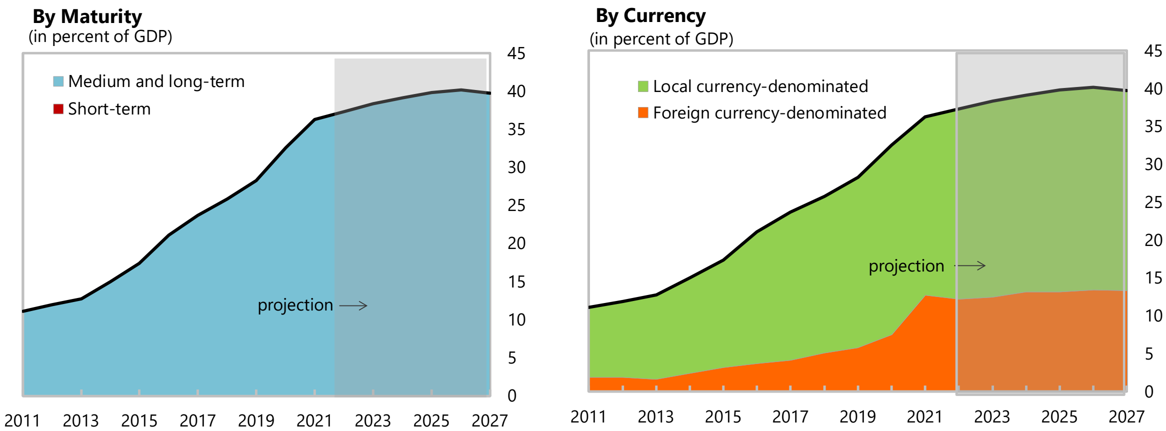
7/ The exchange rate contribution is derived from the numerator in footnote 5 as ae(1+r).

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

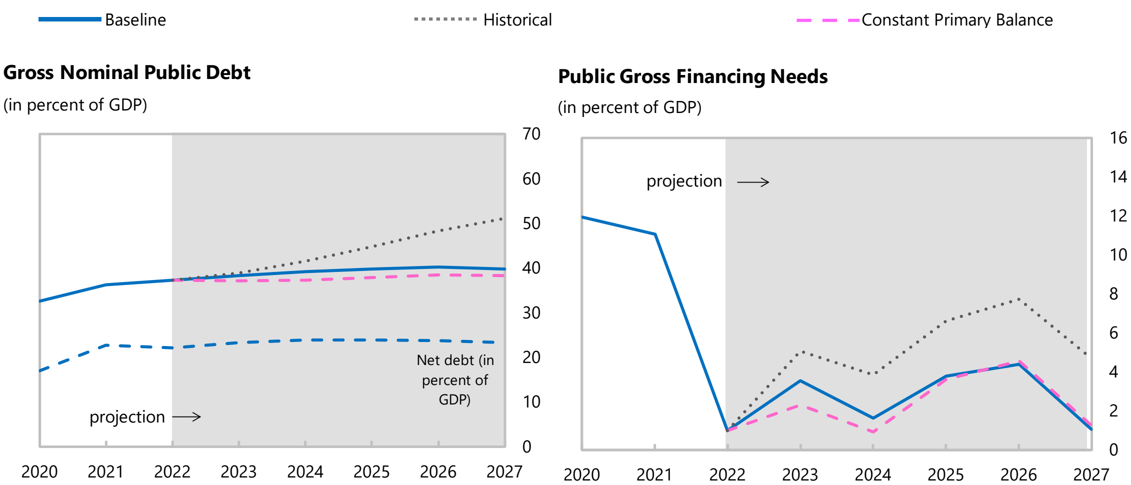
9/ Assumes that key variables (real GDP growth, real interest rate, and other identified debt-creating flows) remain at the level of the last projection year.

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

Composition of Public Debt



Alternative Scenarios



Underlying Assumptions

(in percent)

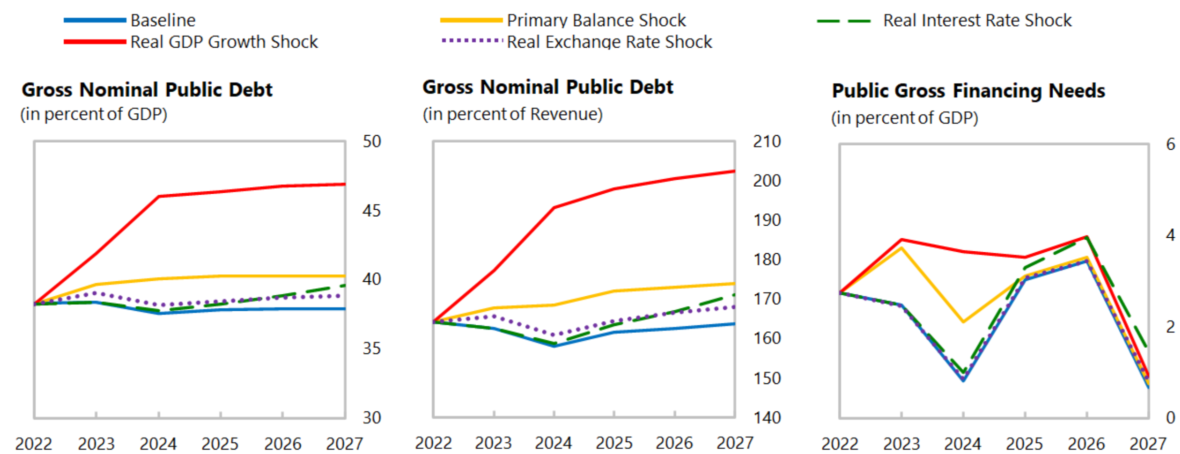
Baseline Scenario	2022	2023	2024	2025	2026	2027
Real GDP growth	1.8	-0.3	1.9	2.2	2.4	2.5
Inflation	7.0	6.9	4.2	3.1	2.9	3.0
Primary Balance	0.2	-1.0	-0.4	0.2	0.5	0.5
Effective interest rate	2.8	3.2	3.5	3.5	3.6	3.6
Constant Primary Balance Scenario						
Real GDP growth	1.8	-0.3	1.9	2.2	2.4	2.5
Inflation	7.0	6.9	4.2	3.1	2.9	3.0
Primary Balance	0.2	0.2	0.2	0.2	0.2	0.2
Effective interest rate	2.8	3.2	3.5	3.5	3.6	3.6

Historical Scenario	2022	2023	2024	2025	2026	2027
Real GDP growth	1.8	2.7	2.7	2.7	2.7	2.7
Inflation	7.0	6.9	4.2	3.1	2.9	3.0
Primary Balance	0.2	-2.6	-2.6	-2.6	-2.6	-2.6
Effective interest rate	2.8	3.2	3.7	3.9	4.2	4.3

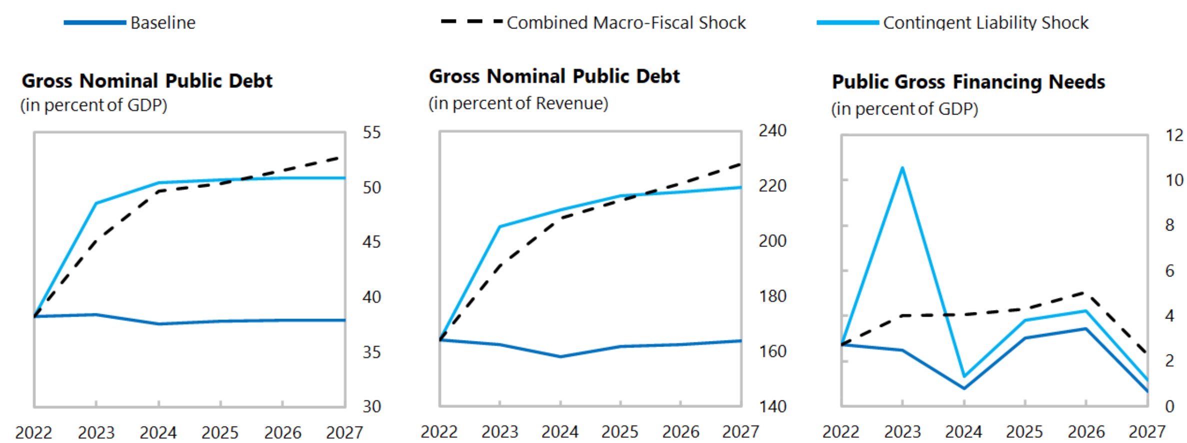
Source: IMF staff.

Figure 3. Chile: Macro-Fiscal Stress Tests

Macro-Fiscal Stress Tests



Additional Stress Tests



Underlying Assumptions
(in percent)

Primary Balance Shock	2022	2023	2024	2025	2026	2027
Real GDP growth	1.5	0.5	1.7	2.2	2.5	2.5
Inflation	6.0	4.9	3.1	2.8	2.6	2.7
Primary balance	-1.3	-1.6	-1.3	0.0	0.0	0.2
Effective interest rate	2.4	2.4	2.4	2.5	2.5	3.1
Real Interest Rate Shock						
Real GDP growth	1.5	0.5	1.7	2.2	2.5	2.5
Inflation	6.0	4.9	3.1	2.8	2.6	2.7
Primary balance	-1.3	-0.3	0.0	0.0	0.0	0.2
Effective interest rate	2.4	2.4	2.9	3.2	3.9	5.1
Combined Shock						
Real GDP growth	1.5	-3.9	-2.7	2.2	2.5	2.5
Inflation	6.0	3.8	2.0	2.8	2.6	2.7
Primary balance	-1.3	-1.7	-2.7	0.0	0.0	0.2
Effective interest rate	2.4	2.7	3.1	3.7	4.3	5.4

Real GDP Growth Shock	2022	2023	2024	2025	2026	2027
Real GDP growth	1.5	-3.9	-2.7	2.2	2.5	2.5
Inflation	6.0	3.8	2.0	2.8	2.6	2.7
Primary balance	-1.3	-1.7	-2.7	0.0	0.0	0.2
Effective interest rate	2.4	2.4	2.4	2.6	2.6	3.1
Real Exchange Rate Shock						
Real GDP growth	1.5	0.5	1.7	2.2	2.5	2.5
Inflation	6.0	11.4	3.1	2.8	2.6	2.7
Primary balance	-1.3	-0.3	0.0	0.0	0.0	0.2
Effective interest rate	2.4	2.7	2.4	2.5	2.5	3.1
Contingent Liability Shock						
Real GDP growth	1.5	-3.9	-2.7	2.2	2.5	2.5
Inflation	6.0	3.8	2.0	2.8	2.6	2.7
Primary balance	-1.3	-8.2	0.0	0.0	0.0	0.2
Effective interest rate	2.4	2.7	2.8	2.9	2.9	3.3

Source: IMF staff.

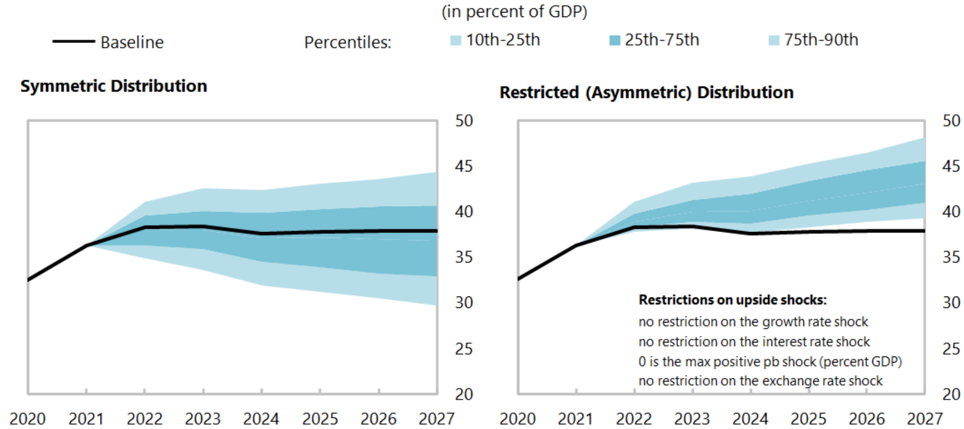
Figure 4. Chile: Risk Assessment

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

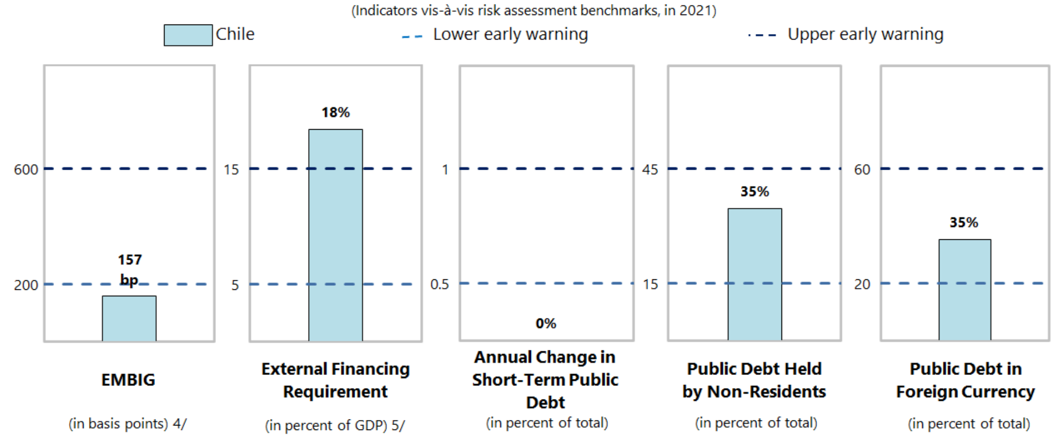
Evolution of Predictive Densities of Gross Nominal Public Debt

(in percent of GDP)



Debt Profile Vulnerabilities

(Indicators vis-à-vis risk assessment benchmarks, in 2021)



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, 10-Nov-21 through 08-Feb-22.

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.

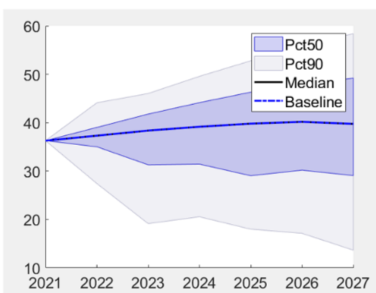
Box 1. Chile: Application of Medium-Term Tools of the Sovereign Risk and Debt Sustainability Framework

Debt is assessed to be sustainable with high probability. This assessment is based on results from: (i) the debt fanchart tool (used to assess medium-term solvency risks); and (ii) the GFN tool (used to assess medium-term financing risks).

- **The debt fanchart tool suggests that medium-term solvency risks are low**, based on three measures: the probability that debt stabilizes by 2027, the width of the fanchart between percentiles 5 and 95, and the debt level in 2027 interacted with a measure of institutional quality. In the case of Chile, the probability of debt stabilization is high, at 89 percent, while the debt level is projected to remain low (at 39.7 percent of GDP in 2027). The fanchart width (at 45 percentage points of GDP) is moderate.

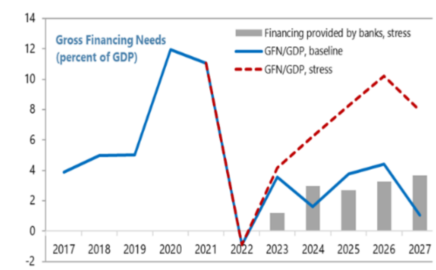
- **The GFN tool suggests that medium-term financing risks are low,** based on the following three measures: the average public gross financing needs during the projection period, the initial level of domestic bank claims on the government in percent of bank assets (a higher ratio typically indicates less space available for additional bank financing to the government), and the increase in domestic bank claims that would be required if the domestic banks were to provide the additional financing needed in a shock scenario (the higher this measure, the higher are financing vulnerabilities). In the case of Chile, the three measures are relatively low.

Debt/GDP Projection



Prob. of debt stabilization	Width of fanchart	Debt in 2027
89.4	44.7	39.7

GFN/GDP Projection and Financing from Banks



Signal from the GFN module

Indicator	Value
Average GFN/GDP, baseline projections	2.3
Initial bank claims on government/assets	6.8
Change in bank claims on govt in stress	4.8
Signal	Low risk
Memo: Bank assets/GDP	137.8%

Appendix I. Written Communication

Santiago, August 23rd, 2022

Ms. Kristalina Georgieva
Managing Director
International Monetary Fund
700 19th Street NW
Washington, DC 20431, USA

Dear Ms. Georgieva,

In recent months, the global outlook has become bleaker and more uncertain. After more than two years of pandemic, new shocks have hit an already fragile international economy: the global rise in inflation, which has triggered tighter financial conditions; a significant slowdown in China; and the prolonged war in Ukraine leading to elevated prices and volatility in energy and food markets.

These adverse external shocks have already resulted in a downward revision of the international scenario facing the Chilean economy, including lower growth in our main trading partners, a significant reduction in our terms of trade, and more restrictive conditions in global financial markets. The immediate impact on Chile's inflation has been significant due to the high pass-through of international prices and exchange rate movements to retail prices, while the repercussions on activity and the labor market will be felt more gradually.

Faced with a more adverse external scenario, we have continued to recalibrate our policies to support medium-term macroeconomic resilience and maintain sustainability.

In response to rising inflation, the Central Bank of Chile (CBC) has raised the benchmark interest rate (now 9.75 percent) to well above the neutral level, triggering a tightening of domestic financial conditions. The exchange rate has flexibly adjusted to the fall in our terms of trade and the tightening of international financial conditions. The peso-dollar exchange rate has depreciated close to 20 percent in the last twelve months (ending in July), while the real exchange rate stands more than 25 percent below its average from 2010 to 2019.

Since mid-2021, the financial authority (CMF) has withdrawn the extraordinary prudential measures adopted during the pandemic and has resumed its agenda to implement Basel III standards and strengthen buffers in the financial system. In the wake of the pandemic crisis, the banking sector has shown resilience and maintains an adequate solvency and liquidity position. Loan delinquencies remain low and stable, and loans are well provisioned amid heightened uncertainty.

The government is implementing a multi-year fiscal consolidation plan to achieve close to a balanced structural fiscal position by 2026 (-0.3 percent of GDP) and keep public debt below 45 percent of GDP. The extraordinary support programs implemented during the pandemic have been wound down. Non-mining tax revenues have significantly increased due to strong growth in 2021 and the tax mobilization plan implemented in the last two years. The overall headline fiscal position is expected to close almost in balance in 2022 (-0.1 percent of GDP), while the structural fiscal deficit is expected to decline to 1.3 percent of GDP, from over 11 percent of GDP last year. Gross public debt is projected to reach 38 percent of GDP by the end of 2022.

Despite the timely and adequate rebalancing of domestic policies, the peso exchange rate has recently been subject to unusual bouts of volatility. In mid-July, the CBC announced an extraordinary and temporary program of foreign exchange intervention and preemptive provision of liquidity in dollars (FXI program) to prevent disorderly market conditions and facilitate the adjustment of the Chilean economy to the uncertain and changing economic conditions. The FXI program commenced on July 18, 2022, and will run until September 30, 2022, and considers sales of foreign exchange in the spot market (up to US$10 billion), currency hedging operations (up to US$10 billion), and currency swaps (up to US$5 billion).

Chile is a small open economy, dependent on the export of commodities, with a sustainable external position. The current account deficit, temporarily high due to the lagged effect on personal consumption of the support programs implemented during the pandemic, is mainly financed by private creditors. By the end of July 2022, international reserves held by CBC stood at US$44.7 billion, supplemented by precautionary liquidity lines of US$9.25 billion. In addition, the government holds substantial international liquid buffers, including as part of their Sovereign Wealth Funds (US$14.8 billion by the end of July 2022).

While the current level of international reserves is adequate considering Chile's mature flexible exchange rate system and fluid access to international financial markets, considering the heightened international uncertainty, the authorities would like to strengthen their access to precautionary liquidity in case of tail risk scenarios.

Against this background, and following the CBC’s initial expression of interest, Chile has requested an arrangement under the Flexible Credit Line (FCL) in the amount of SDR 13.954 billion, equivalent to 800 percent of our quota, with a duration of 24 months, and notified the intention to cancel the Short-term liquidity line (SLL).

The amount of access is justified by the need to provide a strong signal to reinforce market confidence amid heightened uncertainty and volatility in global financial markets, in case of balance of payments difficulties that Chile might encounter. We intend to treat the arrangement as precautionary, underscoring the insurance component of the FCL. If approved, the CBC will also be responsible for managing financial operations associated with the FCL arrangement. If FCL resources were to be drawn, they would not be used for budget financing, consistent with our institutional framework.

Chile has a very high degree of regional and global integration in financial markets, explaining large levels of both assets and liabilities in the international investment position, 138 and 147 percent of GDP respectively (June 2022). A prolonged slowdown in the global economy combined with high uncertainty, a strong US dollar and tight international financial conditions may lead to a sudden shift in investors' confidence in emerging markets, also affecting Chile. A substantial decrease in capital inflows, together with higher portfolio outflows from institutional investors, would explain most of the financing needs in a severe adverse scenario. In addition, Chile's position as the world's leading copper exporter exposes it to a deterioration in its current account because of the sensitivity of commodity prices to global growth, partially offset by lower energy costs and lower income to foreign direct investment. The widening of the current account deficit would be less than that of a financial account reversal, and it is expected to be covered by a reduction in international reserves and the assets of the Sovereign Wealth Funds. Overall, amid an environment of exceptionally high external risks, the external financing gap could amount to about US$18.5 billion.

The policy response to possible shocks has several levels, including exchange rate flexibility, adjustments to domestic monetary policy, and FXI operations in case of disorderly conditions in the foreign exchange market. This also includes a responsible fiscal policy implemented in accordance with the fiscal rule to maintain public debt sustainability and achieve a near balanced structural budget by 2026 and financed in a balanced way between external and internal sources.

The exceptional circumstances justifying this request are expected to be transitory, and hence Chile intends to maintain the FCL arrangement on a temporary basis. At the time of the mid-term review, we will reassess the external conditions and our access level. Conditional on a reduction in external risks, we intend to exit the FCL arrangement once the 24-month period is completed, while starting the exit preparations well in advance, including through an adequate communication strategy.

Chile's very strong institutions ensure preparedness to withstand adverse shocks, and a commitment to maintaining very strong policies in the future. Chile has benefited from its long and excellent track record of very strong macroeconomic performance, based on prudent policies, which we are firmly committed to maintain in the future. Such policies include: (a) an inflation targeting monetary policy framework with a flexible exchange rate; (b) a responsible fiscal policy, based on a structural budget rule, aimed at keeping debt below 45 percent of GDP in the medium term, and (c) a deep and solid financial system, further strengthened by the recent General Banking Law, which strengthens the financial sector regulatory and supervisory framework and adopts the Basel III standards.

We reiterate that the FCL would represent an important complement to our very strong institutional policy frameworks, and we will maintain a productive policy dialogue with the Fund.

The relationship of Chile with the Fund is longstanding, not only as a member, but also as a creditor, with a current position of SDR9.24 million in the NAB, the NAB credit arrangement with the Fund in the total amount of SDR 1,381.94 million, and a commitment that amounts up to SDR 269 million under the bilateral borrowing agreement, as well as its active participation in the Fund's voluntary trading agreements of SDR.

Sincerely yours,

/s/
Rosanna Costa Costa
Governor
Banco Central de Chile

/s/
Mario Marcel Cullell
Minister
Ministry of Finance of Chile

CHILE

August 24, 2022

ASSESSMENT OF THE IMPACT OF THE PROPOSED ARRANGEMENT UNDER THE FLEXIBLE CREDIT LINE ON THE FUND'S FINANCES AND LIQUIDITY POSITION

Approved By
Zuzana Murgasova (FIN) and Gavin Gray (SPR)

Prepared by the Finance and Strategy, Policy, and Review Departments (in consultation with other departments). The main contributors included Beata Jajko (FIN) and Luiza Antoun de Almeida (SPR).

CONTENTS

INTRODUCTION

1. This note assesses the impact of the proposed Flexible Credit Line (FCL) arrangement for Chile on the Fund's finances and liquidity position, in accordance with the policy on FCL arrangements.[1] The proposed arrangement would cover a 24-month period, with an access level amounting to SDR 13,954 million (800 percent of quota). The authorities consider the new FCL as important for augmenting Chile's reserve buffers and providing insurance against a broad range of risks on a temporary basis. The authorities intend to treat this new FCL arrangement as precautionary.

BACKGROUND

2. Chile has an exemplary track record of meeting its obligations to the Fund under past arrangements. Chile had several Fund arrangements during the 1950s to 1980s. Since 1980, Chile has had four arrangements with the Fund: (i) an Extended Fund Facility (EFF) arrangement from August 1985 to August 1989 (SDR 825 million, 187 percent of quota at approval); (ii) two Stand-By Arrangements (SBAs), from January 1983 to January 1985 (SDR 500 million, 154 percent of quota at approval) and from November 1989 to November 1990 (SDR 64 million, 14.5 percent of quota at approval); (iii) and an FCL arrangement from May 2020 to May 2022. The authorities have notified the Fund of their decision to cancel the SLL arrangement approved in May 2022, an approach that is consistent with current Fund policy. Chile has no outstanding credit with the Fund (Annex 1).

3. Chile has very strong economic fundamentals and institutional policy frameworks.[2] The Chilean economy has remained resilient even when facing very large shocks, including the 2019 social unrest and the Covid-19 pandemic. Its monetary policy is anchored in a highly credible inflation-targeting framework, accompanied by a flexible exchange rate regime. The financial system is resilient and well-functioning within a sound regulatory framework. Fiscal policy, guided by a structural fiscal balance rule since 2001, allowed Chile to build ample fiscal space during commodity price booms. Public debt is relatively low by international standards, mostly denominated in domestic currency and with an average maturity above ten years.

4. Chile's open economy is facing increased tails risks from weaker external conditions and heightened global uncertainty. Global inflationary pressures have proven more persistent than anticipated, including due to spillovers from the Russia's war in Ukraine and continued pandemic-related supply constraints. Increases in monetary policy rates by major central banks have led to a significant tightening of global financial conditions. In addition, a correction and volatility in commodity prices, prompted by a risk of global slowdown have had a significant impact on Chile's terms of trade. Following a strong recovery from the pandemic, Chile's economy is transitioning

[1] See "Flexible Credit Line – Operational Guidance Note" (www.imf.org), which documents the requirement for an assessment prepared by FIN/SPR on the impact of the proposed FCL arrangement on the Fund's finances and liquidity position, as a supplement to the staff report.

[2] Chile-2022-Proposal for an Arrangement Under the Short-Term Liquidity Line Chile (IMF Country Report No. 22/148); Chile-2021- Staff Report for the Article IV Consultation (IMF Country Report No. 21/83).

towards lower growth amid policy tightening. GDP growth is projected to decline to 1.8 percent in 2022 and drop slightly below 0 percent in 2023, before returning to its potential rate estimated at 2.5 percent over the medium term.

5. Public debt is sustainable with high probability and debt trajectories are robust to standard shocks. Under staff's baseline scenario, the external debt – largely private-sector debt - is projected to decline to below 70 percent of GDP over the medium term. Public debt is expected to stabilize below 40 percent of GDP, which is within the authorities' prudent ceiling of 45 percent of GDP and low by international standards. Liquidity risks are mitigated by assets in the sovereign wealth and pension reserve funds and a large domestic banking sector.

Table 1. Chile: Total External Debt, 2016-2022

	2016	2017	2018	2019	2020	2021	2022 Proj. 1/
			(In millions of US Dollars)				
Total External Debt	163,624	172,666	175,385	185,734	196,649	229,456	238,973
Private	151,751	158,002	159,356	168,475	174,119	189,705	193,711
Public	11,873	14,664	16,029	17,259	22,530	39,751	45,262
Total External Debt Service	44,659	54,322	58,162	62,749	74,055	51,219	77,687
Private	43,596	53,568	56,686	61,163	72,065	50,269	76,253
Public	1,063	754	1,476	1,586	1,990	950	1,434
			(In percent of GDP)				
Total External Debt	65.7	62.5	59.4	66.7	77.9	72.4	77.9
Private	60.9	57.2	54.0	60.5	69.0	59.9	63.2
Public	4.8	5.3	5.4	6.2	8.9	12.5	14.8
Total External Debt Service	17.9	19.7	19.7	22.5	29.3	16.2	25.3
Private	17.5	19.4	19.2	22.0	28.6	15.9	24.9
Public	0.4	0.3	0.5	0.6	0.8	0.3	0.5

Sources: Chilean authorities and IMF staff estimates.

1/ Baseline scenario.

THE NEW FLEXIBLE CREDIT LINE ARRANGEMENT—IMPACT ON THE FUND'S FINANCES AND LIQUIDITY POSITION

6. Risks and the impact on Fund finances from Chile's FCL arrangement are assessed in the context of an adverse scenario, which assumes the materialization of tail risks. The adverse scenario[3] assumes that risks surrounding the war in Ukraine and monetary tightening in advanced economies further depress global growth and commodity prices, leading to capital outflows from Emerging Markets. Table 2 provides a comparison of the main macroeconomic assumptions underlying the baseline and adverse scenarios.

7. Chile's capacity to repay and the impact of the proposed FCL on the Fund's liquidity are assessed under the assumption that the authorities purchase the total amount available under the proposed FCL, and the SLL is canceled. Chile would be eligible to draw in full on the FCL arrangement of 800 percent of quota to address the materialization of an adverse scenario.

8. If Chile were to purchase the full amount available under the proposed FCL arrangement, key indicators of its capacity to repay the Fund would be as follows (Table 3):

- If Chile were to draw all the resources available under the FCL arrangement at the time of the approval, its external debt would rise to 88.4 percent of GDP, and public external debt would rise to 21.9 percent of GDP at the end of 2022. These ratios would be, respectively, at the 76th percentile and at the 34th percentile of exceptional access arrangements and FCLs approved since 2008 (Figure 1). Chile's GRA credit outstanding would account for 7.2 percent of total external debt and 29.0 percent of public external debt. Fund credit would initially reach 6.3 percent of GDP and 37.4 percent of Chile's gross international reserves.[4] The peak of the stock of outstanding Fund credit both as a share of GDP and external debt would be relatively moderate, and its share in reserves would be slightly below the median for exceptional access arrangements and FCLs approved since 2008.[5] Relative to the 10 recent exceptional access arrangements and FCLs (2020-2022), the peak in Chile's credit outstanding would be the 6th largest as a share in GDP and the 5th largest as a share in reserves (Figure 3).

[3] For further details see: Box 3. *Chile: Illustrative Adverse Scenario* in the main paper.

[4] In addition to official central bank reserves, the central government has usable liquid FX assets (about US$20 billion in June 2022, including US$7.6 billion in the sovereign wealth fund and US$6.8 billion in the pension reserve fund).

[5] Including the assets of the sovereign wealth fund as part of reserve buffers, this ratio would drop even further.

Table 2. Chile: Comparison of Macroeconomic Assumptions Under Baseline and Adverse Scenarios
(In millions of US dollars)

	2021	2022	2023	2024	2025	2026	2027
Baseline scenario							
Real GDP growth (percent)	11.7	1.8	-0.3	1.9	2.2	2.4	2.5
Nominal GDP	316,835	306,649	340,932	354,934	369,809	385,807	403,281
Gross international reserves	51,330	51,330	51,330	51,330	51,330	51,330	51,330
in months of next year's imports of goods and services	5.5	6.0	6.0	6.0	5.7	5.5	5.3
Exports of goods and services	100,662	101,027	96,663	100,935	104,601	108,264	111,998
Total external debt (in percent of GDP)	72.4	77.9	72.0	71.3	70.4	69.8	68.0
of which: public external debt (in percent of GDP)	12.5	14.8	15.1	15.4	15.3	15.5	14.6
Adverse scenario							
Real GDP growth (percent)	11.7	-0.7	-1.5	3.6	3.3	2.4	2.5
Nominal GDP	316,835	291,316	317,067	340,737	362,413	385,807	403,281
Gross international reserves	51,330	49,430	49,430	51,330	51,330	51,330	51,330
in months of next year's imports of goods and services	5.5	6.4	6.1	6.0	5.7	5.5	5.3
Exports of goods and services	100,662	89,227	85,863	95,535	104,601	108,264	111,998
Total external debt (in percent of GDP)	72.4	88.4	83.3	79.8	76.4	71.6	68.0
of which: public external debt (in percent of GDP)	12.5	21.9	22.1	21.5	20.2	17.3	14.6

Sources: Chilean authorities and IMF staff projections.

- External debt service would be high in 2022, but subsequently decline and remain manageable under staff's medium-term macroeconomic projections. Chile's projected debt service to the Fund would represent 0.1-0.2 percent of GDP in 2022-2023, peaking at 2.6 percent of GDP in 2026, reflecting large repurchases.[6] Chile's peak total external debt service and peak debt service obligations to the Fund as a share of exports of goods and services would be above the median of exceptional access arrangements and FCLs approved since September 2008 (Figure 2).
- While public external debt service ratios are moderate, private external debt obligations are projected to rise to slightly over 26 percent of GDP in 2022 before falling to more moderate levels. On the other hand, while non-financial corporations' external debt is large compared to peers, it is largely FDI-related (which reduces roll-over risks) and hedged against exchange rate risk.

9. If the resources available under the proposed FCL arrangements were fully drawn, the GRA credit exposure to Chile would be the Fund's second largest:[7]

- Fund credit to Chile would represent 13.1 percent of total GRA credit outstanding as of August 12, 2022 (including Chile's purchases under the FCL). Chile would be the second largest Fund exposure after Argentina (SDR 32.7 billion) and before Egypt (SDR 13.6 billion). The concentration of Fund credit among the top five users of GRA resources would slightly decline to 68.5 percent, from 69.3 percent.
- Fund credit to Chile would be marginally below 67 percent of the Fund's precautionary balances as of end FY2022.

10. The proposed FCL would have a moderate impact on the concentration of the Fund's lending portfolio, both in terms of regions and among Fund facilities (Figure 4):

- **Regional concentration to Latin America would increase slightly**. Currently, the Western Hemisphere accounts for about 69 percent of GRA credit and undrawn balances, including for precautionary arrangements. With the proposed FCL for Chile, that share would rise to 71 percent. The Fund experienced comparable regional concentration in the past, including in the aftermath of the global financial crisis, when lending to Europe accounted for the bulk of the Fund's lending exposure.

- **Among the Fund's different facilities, the share of FCL commitments would rise moderately**. Commitments under FCLs, which represent the bulk of precautionary arrangements, stood at around SDR 46.8 billion on August 12, 2022, or 47 percent of total GRA

[6] The projected figures on debt service used are calculated assuming that the full amounts available under the FCL arrangement are purchased upon approval, and that all repurchases are made as scheduled.

[7] There is an important distinction between *credit risk* and *credit exposure*. *Credit risk* in this assessment is a combined concept taking into account various factors that could affect the probability that a borrower country will fail to meet its financial obligations to the Fund on time, as reflected partially in Capacity to Repay indicators. *Credit exposure* by contrast is a concept linked more directly to the size of the Fund's commitment to a member country.

commitments (Figure 4). With the proposed FCL for Chile (and the cancelation of the SLL), the share of commitments from FCL arrangements would increase to 55 percent.

Table 3. Chile: Capacity to Repay Indicators 1/

	2021	2022	2023	2024	2025	2026	2027
Exposure and Repayments (In SDR millions)							
GRA credit to Chile	--	13,954.0	13,954.0	13,954.0	12,209.8	5,232.8	0.0
(In percent of quota)	--	800.0	800.0	800.0	700.0	300.0	0.0
Charges due on GRA credit 2/	0.2	169.3	563.1	563.4	581.6	458.1	102.3
Debt service due on GRA credit 2/	0.2	169.3	563.1	563.4	2,325.9	7,435.1	5,335.0
Debt and Debt Service Ratios 3/							
In percent of GDP							
Total external debt	72.4	88.4	83.3	79.8	76.4	71.6	68.0
Public external debt	12.5	21.9	22.1	21.5	20.2	17.3	14.6
GRA credit to Chile	--	6.3	5.9	5.5	4.5	1.8	--
Total external debt service	16.2	26.7	22.9	21.9	23.1	24.3	23.5
Public external debt service	0.3	0.6	0.6	0.6	2.0	3.6	3.0
Debt service due on GRA credit	0.0	0.1	0.2	0.2	0.9	2.6	1.8
In percent of Gross International Reserves							
Total external debt	447.0	520.8	534.5	529.7	539.4	538.4	534.3
Public external debt	77.4	129.0	141.8	142.8	142.5	130.3	114.5
GRA credit to Chile	--	37.4	37.6	36.5	32.1	13.8	--
In percent of Exports of Goods and Services							
Total external debt service	50.9	87.3	84.4	78.1	80.0	86.8	84.6
Public external debt service	0.9	1.9	2.3	2.2	7.0	13.0	10.8
Debt service due on GRA credit	0.0	0.3	0.9	0.8	3.0	9.3	6.5
In percent of Total External Debt							
GRA credit to Chile	--	7.2	7.0	6.9	5.9	2.6	--
In percent of Public External Debt							
GRA credit to Chile	--	29.0	26.5	25.5	22.5	10.6	--
Memo Items:							
U. S. dollars per SDR (period average)	1.42	1.35	1.33	1.34	1.35	1.35	1.36
U. S. dollars per SDR (end of period)	1.40	1.32	1.33	1.34	1.35	1.36	1.37
Oil Price (WEO APSP, US$ per barrel)	69.4	99.9	83.5	77.8	74.1	71.8	70.3

Sources: Chilean authorities, Finance Department, World Economic Outlook, and IMF staff estimates.

1/ Assumes full drawing under the proposed FCL upon approval and materialization of an adverse scenario, even though the authorities intend to treat the arrangement as precautionary.

2/ Based on the rate of charge as of August 18, 2022. Includes GRA basic rate of charge, surcharges, service fee, and SDR charges. For 2022 also SLL commitment fee minus time-based refund.

3/ Staff projections for external debt, GDP, gross international reserves, and exports of goods and services reflect the adverse, and not the baseline scenario under which the full FCL drawing is assumed.

Table 4. Chile: Impact on GRA Finances
(In SDR millions, uncles otherwise indicated)

	As of 8/12/22
Liquidity measures	
Current Forward Commitment Capacity (FCC) 1/	168,557
FCC on approval 2/	157,132
Change in percent	-6.8
Prudential measures, assuming full FCL drawing	
Fund credit to Chile	
In percent of total GRA credit outstanding 3/	13.1
In percent of current precautionary balances	66.9
Fund credit outstanding to five largest debtors	
In percent of total GRA credit outstanding, before approval	69.3
In percent of total GRA credit outstanding including Chile's assumed full drawing 3/	68.5
Memorandum items	
Fund's precautionary balances (April 30th, 2022)	20,873
Total FCL commitments, including proposed FCL	60,764
Quota of FTP members with actual and proposed FCLs, in percent of total quota of FTP members	3.1

Source: Finance Department.

1/ The FCC is defined as the Fund's stock of usable resources less undrawn balances under existing arrangements, plus projected repurchases during the coming 12 months, less repayments of borrowing due one year forward, less a prudential balance. The FCC does not include resources from currently unactivated lines of credit, including the New Arrangements to Borrow or bilateral commitments from members to boost IMF resources.
2/ Current FCC minus access under the proposed FCL arrangement plus current access under the SLL which is being cancelled.
3/ Based on current Fund credit outstanding plus full drawings under the proposed FCL.

ASSESSMENT

11. The proposed FCL arrangement with Chile would have a significant but manageable impact on the Fund's finances. The arrangement would cover a 24-month period with access in an amount of SDR 13.954 billion (800 percent of quota). The Fund's Forward Commitment Capacity (FCC) would decline by SDR 11.4 billion or slightly less than 7 percent from its current level of SDR 168.6 billion to around SDR 157.1 billion (Table 4).[8] This decline reflects the combined impact of the proposed FCL and the cancellation of the SLL, with the latter having a positive impact on the FCC. If Chile were to draw under the FCL arrangement, it would be automatically excluded from the Financial Transaction Plan (FTP), and the FCC, which is currently only based on quota resources, would decline by another SDR 1.4 billion, or an additional 0.8 percent. Nevertheless, the Fund's

[8] Taking into account resources held as prudential balances, the decline in the FCC would be equal to 80 percent of Chile's quota.

overall liquidity position is expected to remain adequate after the approval of the proposed FCL arrangement.

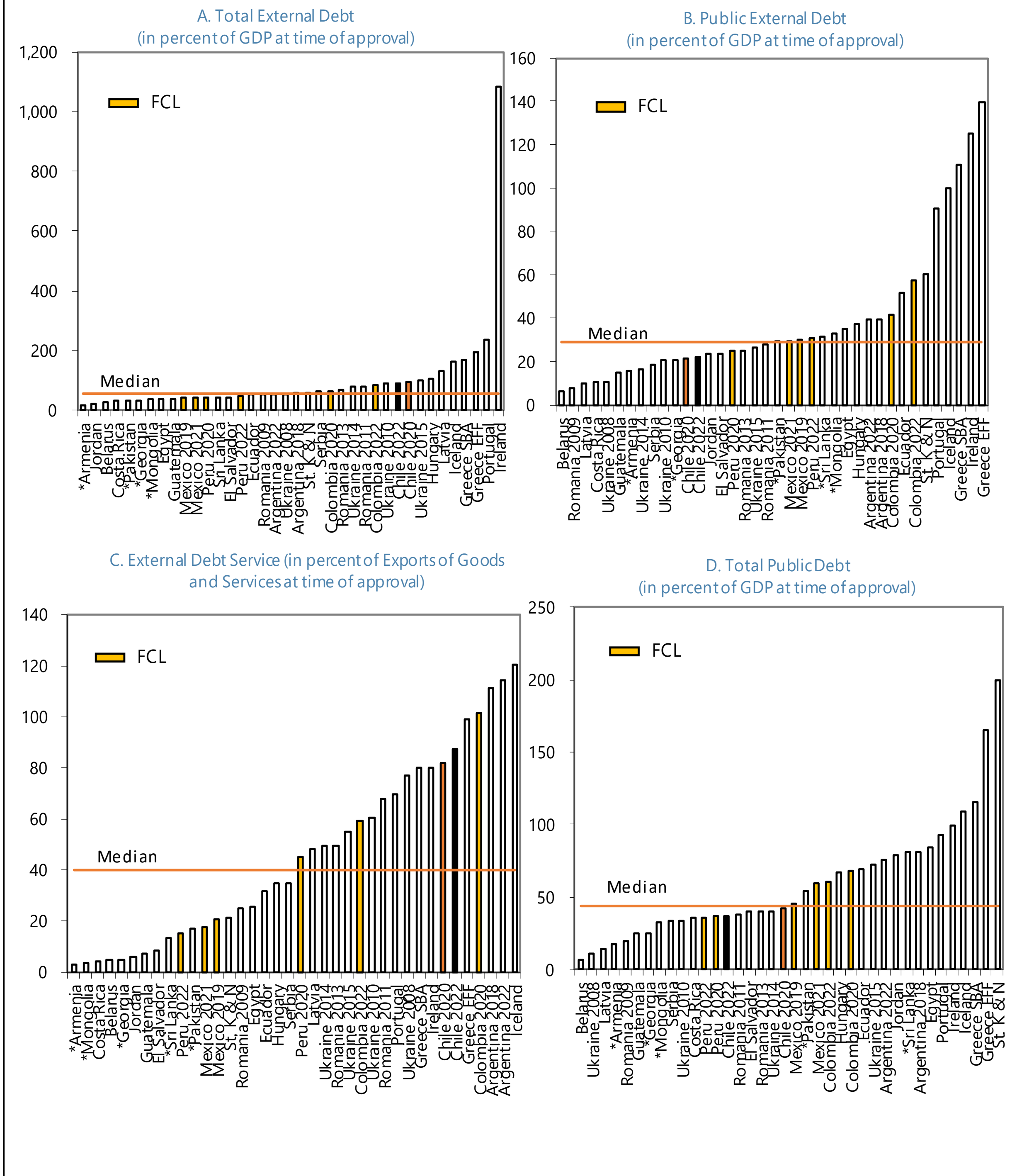
12. At the same time, there are several risk-mitigating factors. Chile has a track record of uninterrupted access to international capital markets at favorable terms for several decades. It maintains investment grade status according to the three major rating agencies and is consistently among the highest-rated emerging market countries. Finally, the authorities intend for the FCL to be precautionary.

13. If the resources available under the proposed FCL arrangements were fully drawn, the GRA credit exposure to Chile would be at 13.1 percent of the Fund's outstanding credit and at almost 67 percent of the Fund's current precautionary balances, but staff judges the credit risk to be moderate. Chile capacity-to-repay the Fund would remain adequate with key-metrics below or close to the median compared to other recent exceptional access arrangements and FCLs. Moreover, Chile has very strong policy and institutional frameworks, which should serve to shelter the economy from the effects of the global COVID-19 pandemic. Chile also has a track record of uninterrupted access to international capital markets at favorable terms for several decades. Finally, the authorities intend for the FCL to be precautionary and temporary.

14. The authorities intend to exit the FCL at the end of the 24-month period, conditional on favorable developments in risks scenarios. The requested level of access is meant to augment their precautionary reserve buffers on a temporary basis to provide insurance against a tail risk scenario.

Figure 1. Debt Ratios of Recent Exceptional Access Arrangements and FCLs [1/ 2/]

(EA cases since September 2008)



Sources: Finance Department and IMF staff estimates.

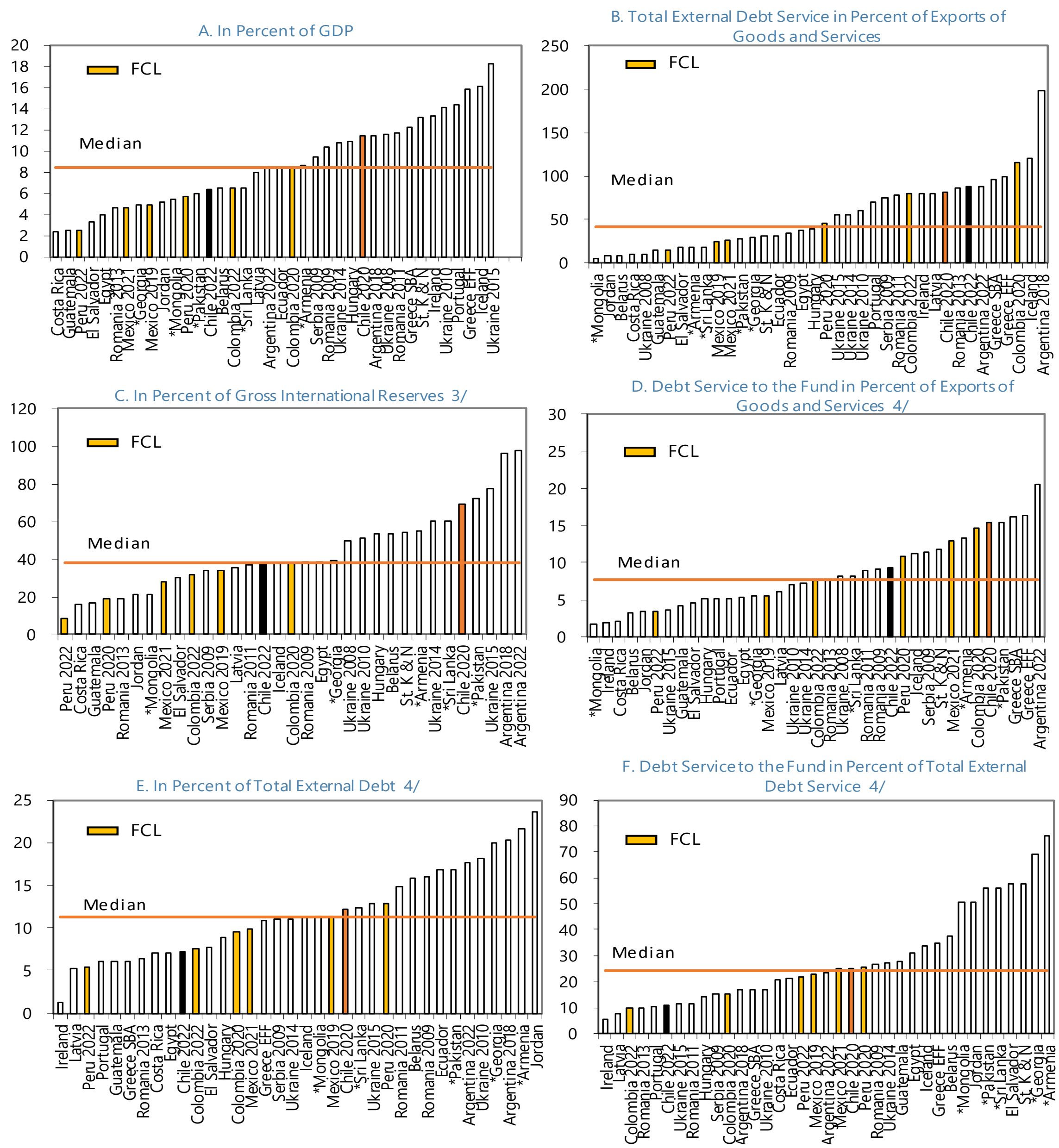
1/ Estimates as reported in relevant staff reports on the request of SBAs or arrangements under the EFF approved since September 2008.

2/ Asterisks indicate PRGT-eligible countries at the time of the program. Also includes ratios reported in relevant staff reports of FCL arrangements for Mexico (2019 and 2021), Colombia (2020 and 2022), Peru (2020 and 2022), and Chile (2020).

Figure 2. Peak Fund Exposure and Debt Service Ratios for Recent Exceptional Access Arrangements and FCLs 1/ 2/

(EA cases since September 2008)

Peak Fund Exposure Ratios ***Peak Debt Service Ratios***



Sources: Finance Department and IMF staff estimates.

1/ Estimates as reported in relevant staff reports on the request of SBAs or arrangements under the EFF approved since September 2008. Also includes ratios reported in relevant staff reports of FCL arrangements for Mexico (2019 and 2021), Colombia (2020 and 2022), Peru (2020 and 2022), and Chile (2020).

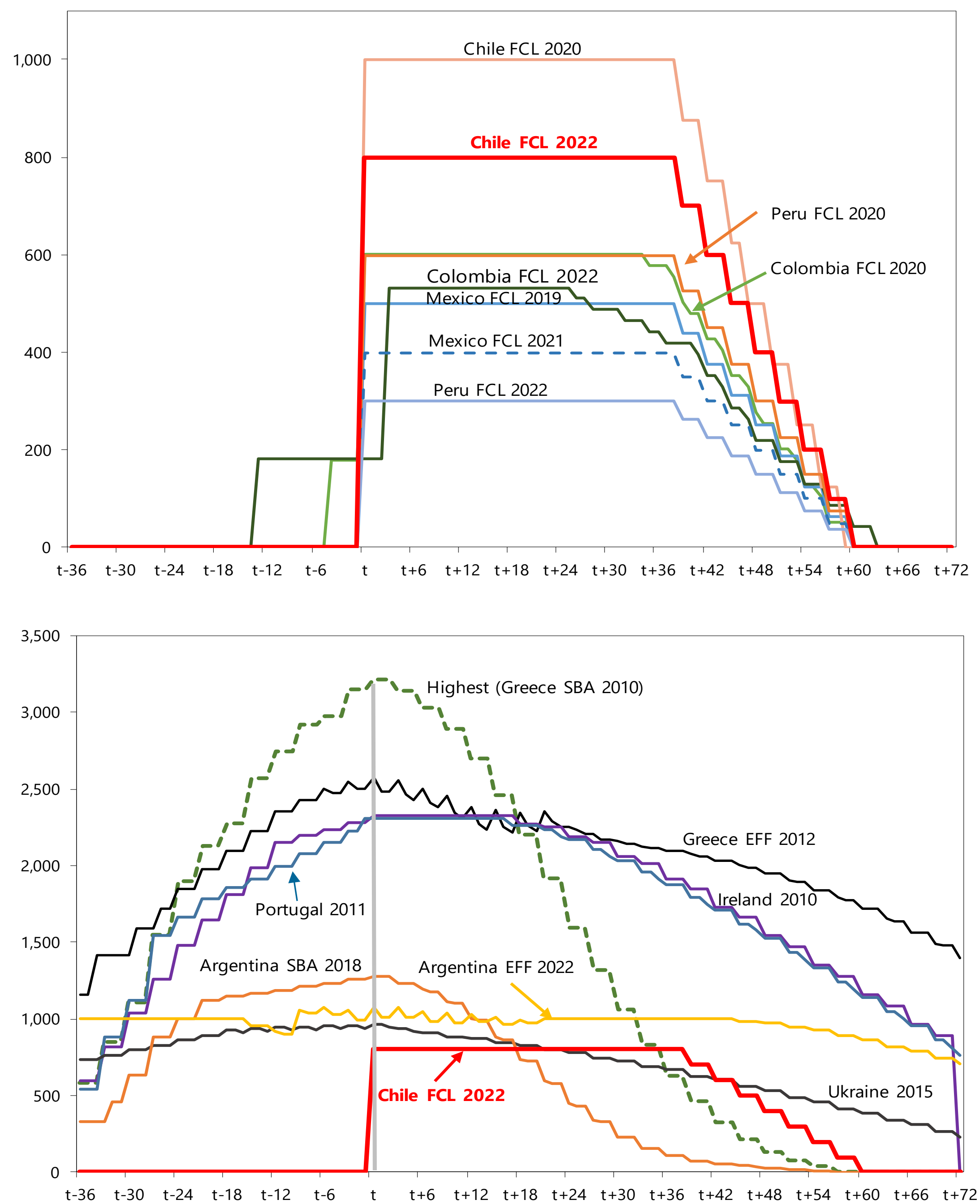
2/ Asterisks indicate PRGT-eligible countries at the time of the program. In Panel F, Georgia's debt service to the Fund includes one from PRGF loan.

3/ Excluding arrangements with members belonging to the euro area at the time of the approval of the arrangement: Greece, Ireland, and Portugal.

4/ For arrangements of which total external debt (or debt service) ratio is not available, public external debt ratio is shown instead.

Figure 3. Projected Fund Credit Outstanding in the GRA Around Peak Borrowing [1/]

(In percent of quota)

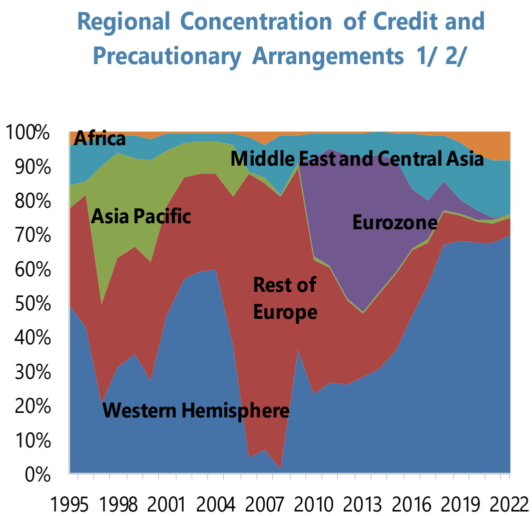


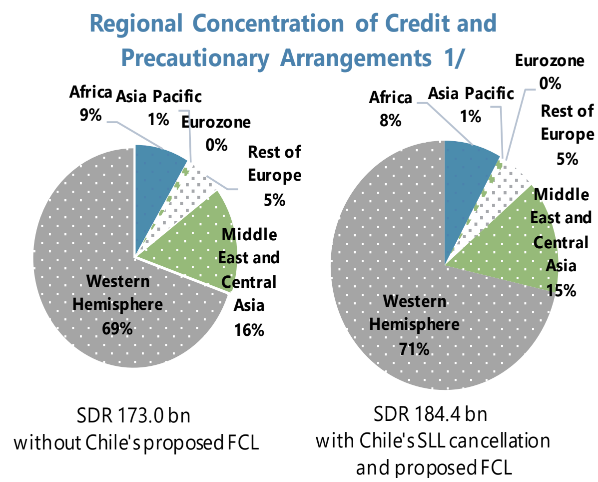
Sources: Finance Department and IMF staff estimates.

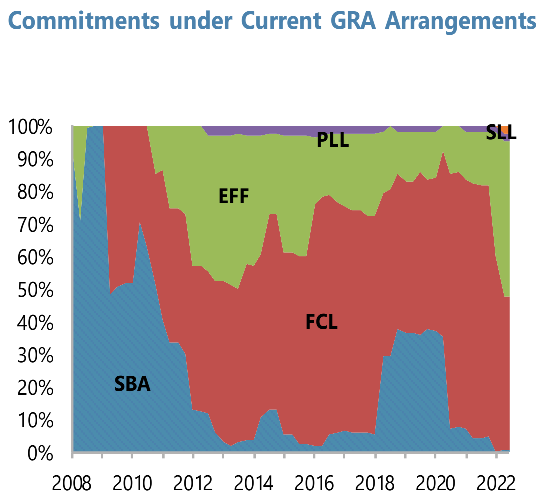
1/ t represents the time when outstanding credit to the Fund is at its peak. Time is expressed in months. For illustrative purposes it is assumed that Chile's proposed FCL is fully drawn down at the time of Board approval.

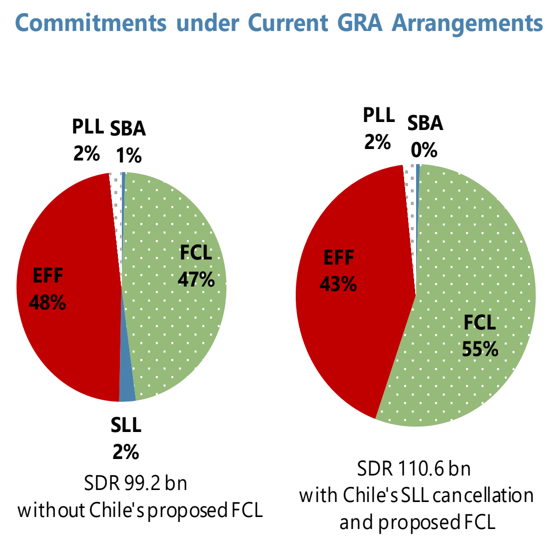
Figure 4. IMF Lending Concentration—By Region and by Lending Instrument

(In Percent, as of August 12, 2022)









Source: IMF Finance Department.

1/ GRA credit outstanding plus undrawn balances by region as a share of total GRA balances and total GRA undrawn balances. The latter include undrawn balances under existing arrangements as well as commitments under precautionary arrangements.

2/ Chile's SLL and proposed FCL are included within the region of Western Hemisphere.

Annex I. History of Arrangements with the IMF

This annex provides a brief overview of Chile's Fund arrangements from 1983 to present[1].

Chile has an exemplary track record of meeting its obligations to the Fund under past purchasing arrangements. Chile had three Fund arrangements in the 1980s and fully repaid its remaining outstanding credit in 1995 (Table I.1).

From 1983 to 1989, Chile had two arrangements under the Stand-By Arrangement (SBA) and one **Extended Fund Facility (EFF)**.

- On January 10, 1983, the Fund approved an SBA equivalent to SDR 500 million (154 percent of quota) when Chile's financial problems were aggravated by the world economic slump and the prices of copper, Chile's principal export product, collapsed. Under that arrangement, Chile made purchases totaling SDR 500 million, and its outstanding credit stood at SDR 795 million (245 percent of quota) at end of 1984. Chile made repurchases after 1986.

- On August 15, 1985, an EFF equivalent to SDR 825 million was approved to support the Government's medium-term economic policy and reform program during the period 1985–89. Solid performance under the program supported by this EFF allowed Chile to fully repay all its outstanding obligations to the Fund.

- On November 8, 1989, a one-year Stand-By Arrangement equivalent to SDR 64 million was approved. Chile made full drawings and the obligations were fully repaid in 1995.

In addition, Chile has had two precautionary arrangements with the Fund:

- In May 2020, the Executive Board approved a two-year Flexible Credit Line Arrangement with Chile for SDR 17,443 million. The arrangement was cancelled on May 20, 2022.

- In May 2022, the Executive Board approved a Short-term Liquidity Line for Chile. The arrangement expires on May 19, 2023. The authorities intend to cancel the SLL on the approval of the requested FCL.

[1] The first IMF program for Chile was approved on April 1st, 1956. This appendix focuses on the most recent arrangements.

Annex Table I.1. Chile: IMF Financial Arrangements, 1983–2022

(In millions of SDR)

Year	Type of Arrangement	Date of Arrangement	Last date when resources are available for purchase	Amount of New Arrangement	Amount Drawn	Purchases	Repurchases	Credit outstanding 1/
1983	Standby Arrangement	10-Jan-83	9-Jan-85	500	500	284	0.0	579
1984						216	0.0	795.0
1985	Extended Fund Facility	15-Aug-85	15-Aug-89	825	806	125	0.0	990.6
1986						250	41.7	1088.3
1987						225	133.4	1032.4
1988						150	154.1	982.6
1989	Standby Arrangement	8-Nov-89	7-Nov-90	64	64	120	119.8	966.5
1990						0	127.1	812.9
1991						0	143.5	669.4
1992						0	142.0	525.0
1993						0	169.2	346.5
1994						0	140.0	199.5
1995						0	199.5	0.0
1996-2019						0	0.0	0.0
2020	Flexible Credit Line	29-May-20	19-May-22	17,443	-	0	0.0	0.0
2022	Short-term Liquidity Line 2/	20-May-22	19-May-23	2,529	-	0	0.0	0.0

Source: Finance Department.

1/ As of end-December. For 2020 FCL and for 2022 SLL as of August 17, 2022. Stock and flow numbers are based on arrangements and do not take into account outright purchases/drawings.

2/ The authorities intend to cancel the SLL on the approval of the requested FCL.

Statement by Luis Oscar Herrera, Alternate Executive Director
August 29, 2022

On behalf of my Chilean authorities, I thank staff for the report on the Flexible Credit Line (FCL) arrangement and the assessment of Chile's qualification criteria for the FCL. An FCL arrangement would augment precautionary reserve buffers and provide a valuable backstop against tail risk scenarios, and, together with Chile's very strong policy and institutional framework, would contribute to bolster market confidence amid a gloomy and more uncertain global outlook.

Since Chile's acceptance of the Short-term Liquidity Line (SLL) *offer* last May, several negative risks for the world economy have materialized: the persistent rise in inflation, the pivot of monetary policy in advanced economies, the continuation of the war in Ukraine, and the slowdown of the Chinese economy. The balance of external risks remains tilted to the downside, including a global recession, further tightening of global financial conditions, new commodity price shocks, or an intensification of the spillovers from Russia's war on Ukraine.

These international developments have negatively affected the outlook for the Chilean economy. Export markets are expected to grow more slowly, terms of trade have fallen around 10 percent, external financing costs have increased moderately, net portfolio inflows have declined, and the Chilean peso has been subject to unusually high volatility. GDP is expected to slowdown in the second half of the year and next year, while short-term inflation projections have been revised downwards.

The immediate impact of global developments on Chile's inflation has been significant due to the high pass-through of international prices and the exchange rate, which have added to domestic pressures stemming from a positive output gap. Headline inflation reached 13.1 percent in the last 12 months (July 2022), while measures of core inflation stand around 10 percent in the same period. Inflation expectations for the next 12 and 24 months have increased above the 3 percent target.

The negative impact on activity, domestic demand, and the labor market is expected to be more gradual. Personal consumption has remained relatively strong, albeit on a moderating path, due to the lingering effects of income support programs during the pandemic and the early withdrawal of pension savings in 2020-21. Other drivers of personal consumption, such as labor income, consumer confidence, and household credit, point downward. Fixed investment and inventory changes are expected to weaken domestic demand in the coming quarters. The current account deficit remains high on the back of lower terms of trade but is expected to decline along with the contraction of domestic demand and a depreciated real exchange rate.

Chile's very strong institutions ensure preparedness to withstand adverse shocks and a commitment to maintaining very strong policies in the future. Chile has benefited from its long and excellent track record of very strong macroeconomic performance, based on prudent policies. Such policies include: (a) an inflation-targeting monetary policy framework with a free-floating exchange rate carried out by the accountable and autonomous Central Bank of Chile (BCCh) since 1989; (b) a responsible fiscal

policy, based on a structural budget target aimed at stabilizing debt in the medium term; and (c) a deep and solid financial system, further strengthened by the recent General Banking Law, which strengthens the financial sector regulatory and supervisory framework and adopts the Basel III standards. Chile's economy has remained resilient on the face of large external and domestic shocks, including the global financial crisis, the social upheaval in 2019, and more recently, the COVID-19 pandemic.

Amid the deterioration of the global outlook, the Chilean authorities have continued to rebalance their policies to mitigate risks, maintain macroeconomic stability, and support vulnerable groups.

In response to rising inflation, the BCCh has continued raising its benchmark interest rate (9.75 percent) to well above the neutral level and has communicated that it will continue to adjust monetary policy as needed to ensure that inflation returns to the 3 percent target. The benchmark yield curve has shifted upwards and credit conditions for firms and households have become more restrictive.

The exchange rate has flexibly adjusted to the fall in terms of trade and the tightening of global financial conditions. The peso-dollar exchange rate has depreciated close to 20 percent in the last 12 months (ending in July), while the real exchange rate stands more than 25 percent below its average from 2010 to 2019.

Since mid-2021, Chile's financial authority (CMF) has withdrawn the extraordinary prudential measures adopted during the pandemic and has resumed its agenda to implement Basel III standards and strengthen buffers in the financial system. In the wake of the pandemic crisis, Chile's banking sector has shown resilience and maintains an adequate solvency and liquidity position. Banks' capital adequacy ratio has risen above 15 percent, while loan delinquencies remain low, stable, and well provisioned.

The government is implementing a multi-year fiscal consolidation plan to achieve close to a balanced structural fiscal position by 2026 (-0.3 percent of GDP) and keep public debt below 45 percent of GDP. The extraordinary support programs implemented during the pandemic have been wound down while continuing to provide targeted support to the most vulnerable within the budget envelope. Non-mining tax revenues have significantly increased due to strong growth in 2021 and the tax mobilization plan which was implemented in the last two years. The overall headline fiscal position is expected to close almost in balance in 2022 (-0.1 percent of GDP), while the structural fiscal deficit is expected to decline to 1.3 percent of GDP, from over 11 percent of GDP last year. Gross public debt is projected to reach 38 percent of GDP by the end of 2022.

Despite the timely and adequate rebalancing of domestic policies, the peso exchange rate has recently been subject to unusual bouts of volatility triggered by international developments. From mid-June to mid-July, the peso experienced an unusually large depreciation over the course of a few weeks. During this period, the bid/ask spreads in the foreign exchange market widened while transaction volumes decreased, and FX market dynamics threatened to distort the transmission of monetary policy and the normal functioning of financial markets.

In response to these developments, in mid-July, the BCCh announced a temporary and transparent program of foreign exchange intervention and preemptive provision of liquidity in dollars (FXI program) to prevent disorderly market conditions and facilitate the adjustment of the Chilean economy to the uncertain and changing economic conditions. The FXI program commenced on July 18, 2022, and will run until September 30, 2022, and considers sales of foreign exchange in the spot market (up to US$10 billion), currency hedging operations (up to US$10 billion), and currency swaps (up to US$5 billion). Since the launch of the program, price formation conditions in the FX market have improved and exchange rate volatility have subsided, while the volume of weekly FX auctions has been reduced.

Chile is a small open economy, dependent on the export of commodities, with a sustainable external position. The current account deficit, temporarily high due to the lagged effect on personal consumption of the support programs implemented during the pandemic, is mainly financed by private creditors. By the end of July 2022, international reserves held by the BCCh stood at US$44.7 billion, supplemented by precautionary liquidity lines of US$9.25 billion. In addition, the government holds substantial international liquid buffers, including as part of their Sovereign Wealth Fund and Pension Reserve Fund (US$14.8 billion by the end of July 2022). The government maintains an investment grade rating in international capital markets with fluid access to external financing in favorable terms.

While the current level of international reserves and liquidity buffers is adequate, considering Chile's mature flexible exchange rate system and access to international financial markets, considering the heightened international uncertainty, the authorities wish to strengthen their access to precautionary reserve buffers in case of tail risk scenarios.

Chile has a very high degree of regional and global integration in financial markets, explaining large asset and liabilities' international investment positions, 139 and 150 percent of GDP respectively. A protracted slowdown in the global economy combined with high uncertainty, a strong US dollar, and tight international financial conditions may lead to a sudden shift in investors' confidence in emerging markets, also affecting Chile. A substantial decrease in capital inflows, together with higher portfolio outflows from institutional investors, would explain most of the financing needs in a severe adverse scenario. In addition, Chile's position as the world's leading copper exporter exposes it to a deterioration in its current account because of the sensitivity of commodity prices to global growth, partially offset by lower energy costs and lower income to foreign direct investment. The widening on the current account deficit would be less than that of a financial account reversal. Overall, amid an environment of exceptionally high external risks, the external financing gap could amount to about US$18.5 billion.

The response to potential shocks would use multiple policy instruments, including exchange rate flexibility, additional tightening of monetary policy, FXI operations in case of disorderly market conditions, and a responsible budget policy implemented in accordance with the fiscal rule and targets and financed in a balanced way between external and internal sources.

Against this background, Chile has requested access to the FCL arrangement in the amount of SDR13.954 billion, equivalent to 800 percent of quota, covering a period of 24 months, and notified the cancellation of the current SLL arrangement with access equivalent to SDR 2.529 billion (145 percent of quota).

Chile meets the qualification criteria for access under the FCL and the authorities are committed to maintain very strong policies in the future. Such policies are embedded in the solid policy framework described earlier.

Chile intends to treat the arrangement as precautionary, underscoring the insurance component of the FCL. If approved, the BCCh will also be responsible for managing financial operations associated with the FCL arrangement. If FCL resources were to be drawn, they would not be used for budget financing, consistent with Chile's institutional framework.

The exceptional circumstances justifying this request are expected to be transitory, and hence Chile intends to maintain the FCL arrangement on a temporary basis. At the time of the mid-term review, the authorities will reassess the external conditions and the access level. Conditional on a reduction in external risks, they intend to exit the FCL arrangement once the 24-month period is completed, while starting the exit preparations well in advance, including through an adequate communication strategy.

The requested FCL is equivalent to bolstering the availability of upfront liquidity of the BCCh by more than 40 percent, and, as such will provide a strong signal to reinforce market confidence amid heightened uncertainty and volatility in global financial markets. The precautionary nature of the liquidity buffer will contribute to prevent a tail risk scenario, with negative social and economic costs to Chile, as well as contributing to the stability of the international monetary system amid heightened uncertainty.

The relationship of Chile with the Fund is longstanding, not only as a member, but also as a creditor, with a current position of SDR9.24 million in the NAB, the NAB credit arrangement with the Fund in the total amount of SDR1,381.94 million, and a commitment that amounts up to SDR269 million under the bilateral borrowing agreement, as well as its active participation in the Fund's voluntary trading agreements of SDR.