INTERNATIONAL MONETARY FUND

CHILE

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

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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.

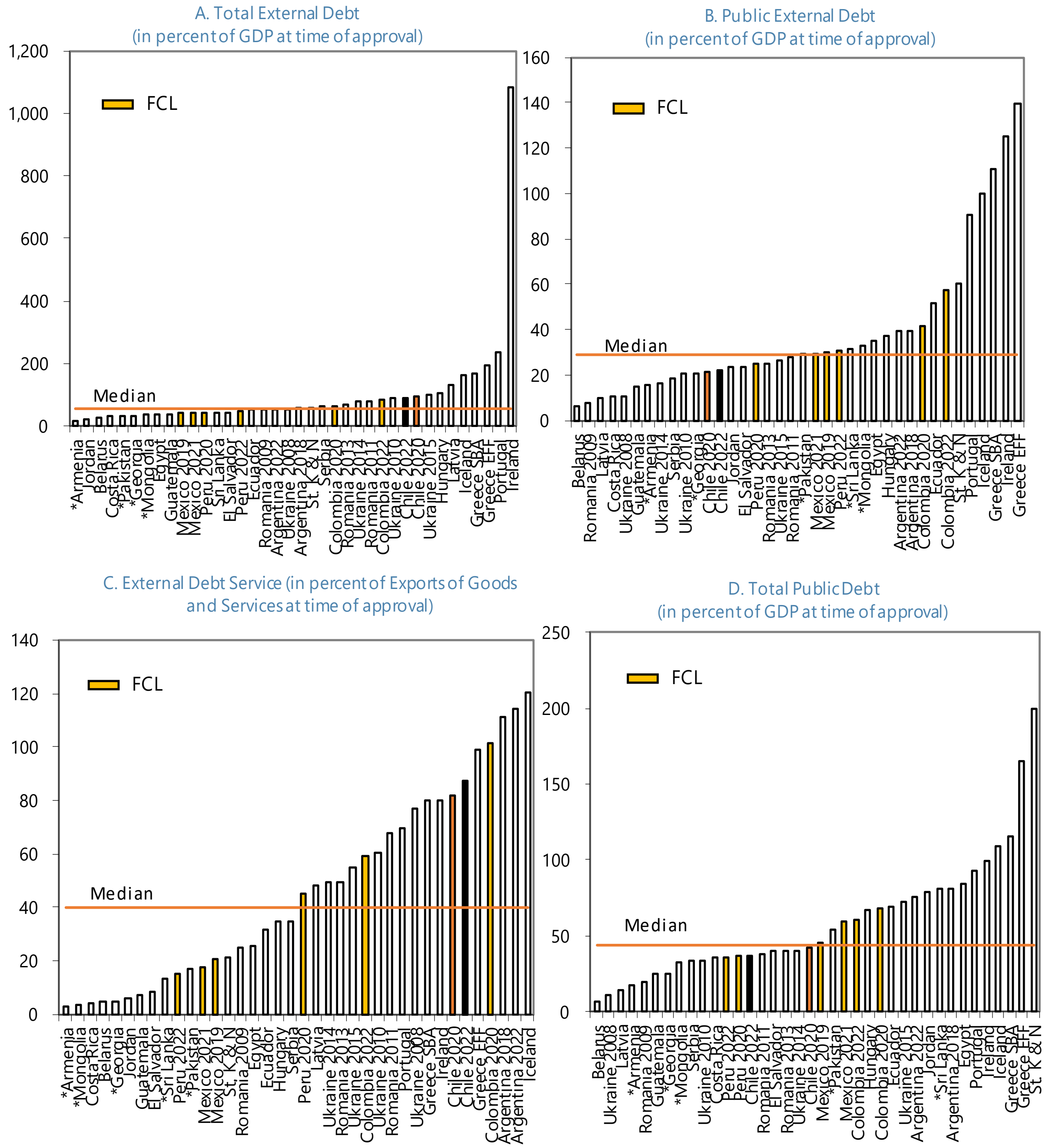
12. At the same time, there are several risk-mitigating factors. Chile has a track record of uninterrupted access to international capital markets at favorable terms for several decades. It maintains investment grade status according to the three major rating agencies and is consistently among the highest-rated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

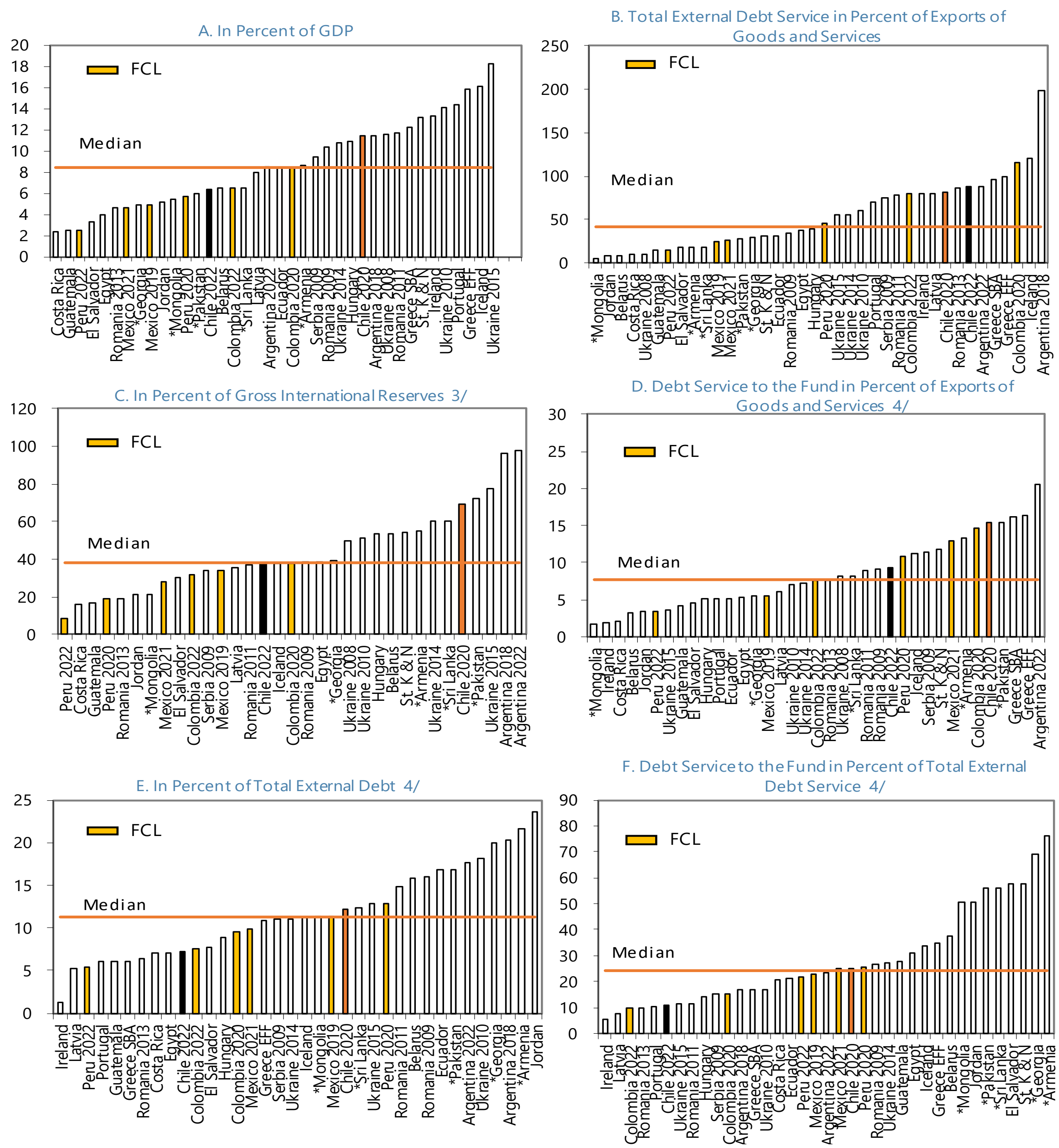
1/ Estimates as reported in relevant staff reports on the request of SBAs or arrangements under the EFF approved since September 2008.

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).

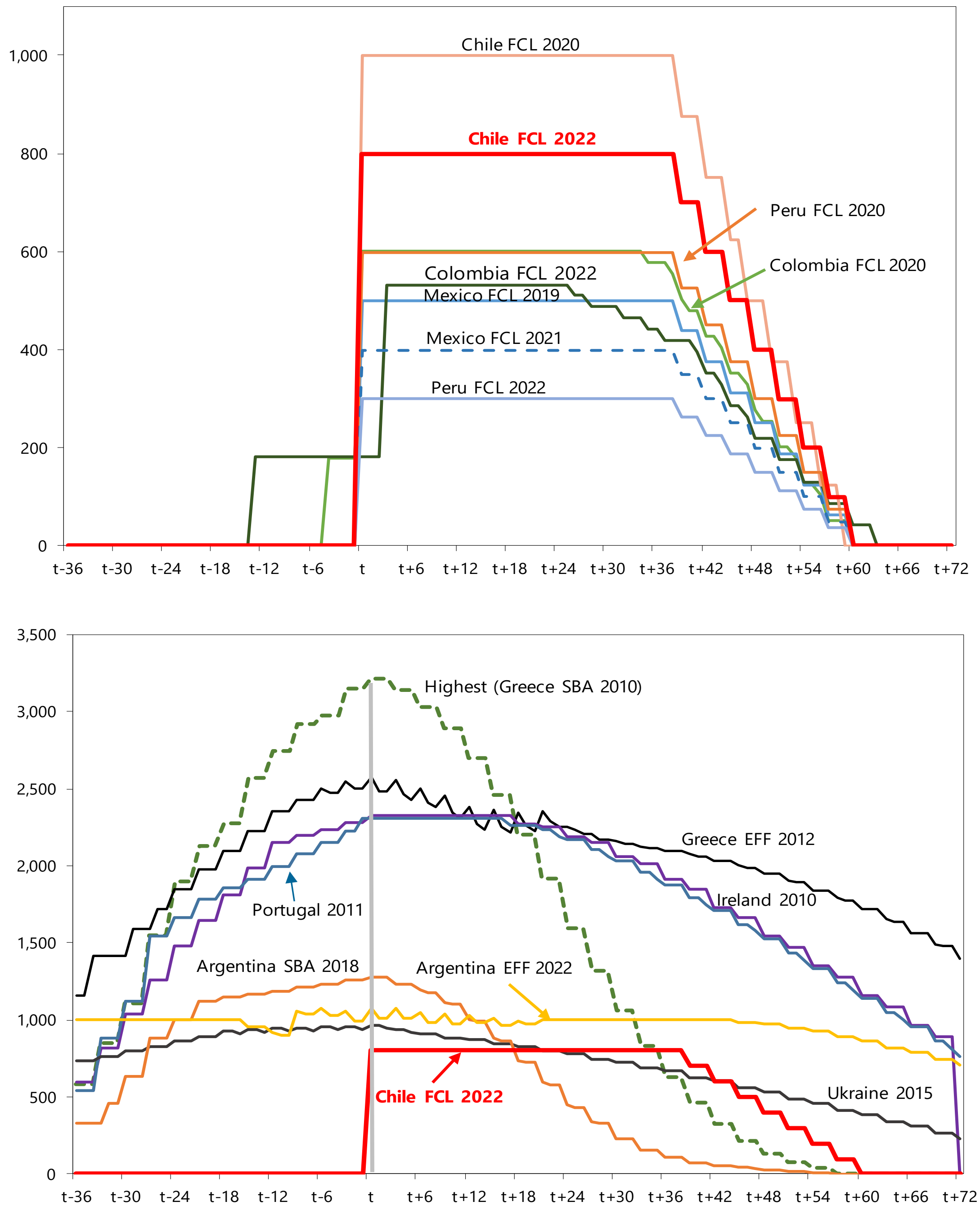
2/ Asterisks indicate PRGT-eligible countries at the time of the program. In Panel F, Georgia's debt service to the Fund includes one from PRGF loan.

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)

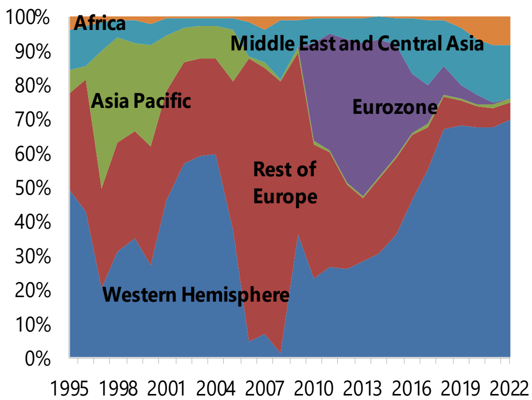


Sources: Finance Department and IMF staff estimates.
1/ t represents the time when outstanding credit to the Fund is at its peak. Time is expressed in months. For illustrative purposes it is assumed that Chile's proposed FCL is fully drawn down at the time of Board approval.

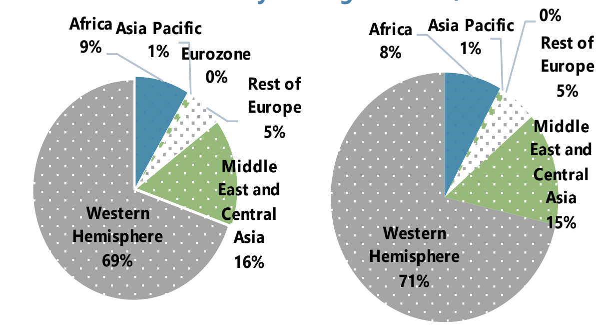
Figure 4. IMF Lending Concentration—By Region and by Lending Instrument

(In Percent, as of August 12, 2022)

Regional Concentration of Credit and Precautionary Arrangements 1/ 2/



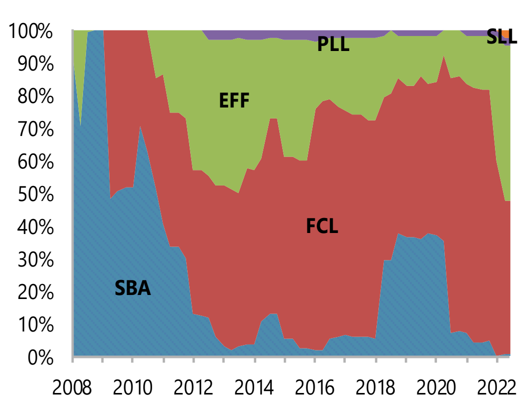
Regional Concentration of Credit and Precautionary Arrangements 1/



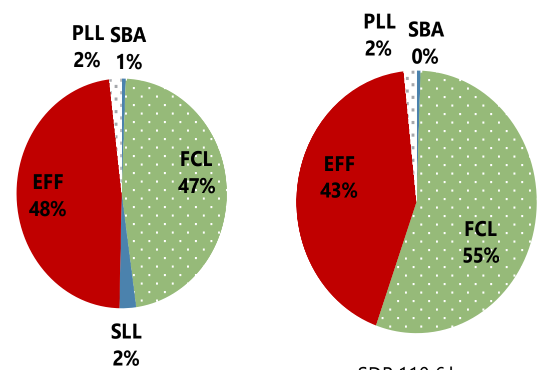
SDR 173.0 bn
without Chile's proposed FCL

SDR 184.4 bn
with Chile's SLL cancellation
and proposed FCL

Commitments under Current GRA Arrangements



Commitments under Current GRA Arrangements



SDR 99.2 bn
without Chile's proposed FCL

SDR 110.6 bn
with Chile's SLL cancellation
and proposed FCL

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.