Chile: 2022 Article IV Consultation-Press Release; Staff Report; Staff Supplement; and Statement by the Executive Director for Chile

INTERNATIONAL MONETARY FUND

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2022 ARTICLE IV CONSULTATION—PRESS RELEASE; STAFF REPORT; STAFF SUPPLEMENT; AND STATEMENT BY THE EXECUTIVE DIRECTOR FOR CHILE

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the 2022 Article IV consultation with Chile, the following documents have been released and are included in this package:

- A **Press Release** summarizing the views of the Executive Board as expressed during its January 12, 2023 consideration of the staff report that concluded the Article IV consultation with Chile.
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on January 12, 2023, following discussions that ended on October 27, 2022, with the officials of Chile on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on December 15, 2022.
- An **Informational Annex** prepared by the IMF staff.
- A **Staff Supplement** updating information on recent developments.
- 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 Concludes 2022 Article IV Consultation with Chile

FOR IMMEDIATE RELEASE

Washington, DC – January 20, 2023: The Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation[1] with Chile.

After an impressive recovery from the COVID-19 pandemic, the Chilean economy is undergoing a necessary transition towards sustainable growth amid a challenging external environment. Economic activity is rapidly cooling down, while inflation seems to have peaked in August. The current account deficit remains elevated, as adverse terms of trade have counteracted the ongoing adjustment of domestic demand.

Policy implementation remains very strong, geared towards correcting macroeconomic imbalances that built up during the pandemic, while protecting the most vulnerable and advancing structural reforms. The Central Bank of Chile's monetary policy response has been forceful and fully in line with the inflation targeting framework. The 2022 fiscal position is projected to be markedly stronger than the target in the authorities' medium-term fiscal consolidation plan, while the 2023 budget envisions higher social spending and public investment within a sustainable medium-term path.

GDP growth on a y/y basis is expected to continue to slow in the last quarter of 2022 and recover by the last quarter of 2023. Given monetary tightening and a negative output gap, inflation is projected to converge to target by end-2024. The current account deficit is expected to gradually revert to the historical average of about 3 percent of GDP, supported by the authorities' adequate structural fiscal consolidation plan and the flexible exchange rate.

Downside risks persist, but very strong fundamentals and policies underpin Chile's resilience. On the external front, risks stem from a possible abrupt global slowdown, sharply tighter global financial conditions, commodity price shocks, or an intensification of spillovers from Russia's war in Ukraine. Domestic risks stem mostly from high inflation persisting for longer than expected, social discontent over high food and energy prices, or slow progress to meet social demands. The constitutional reform process will continue but uncertainty over possible outcomes has narrowed. Low public debt, a sustainable external position, and very strong policies and institutional policy frameworks continue to support Chile's resilience and capacity to respond to shocks. The two-year FCL, approved in August, provides additional external buffers on a precautionary basis and substantial insurance against tail risk scenarios.

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

Executive Board Assessment[2]

Executive Directors broadly agreed with the thrust of the staff appraisal. They commended the authorities' very strong policies geared towards correcting macroeconomic imbalances built up during the pandemic, while protecting the most vulnerable and advancing reforms. Directors emphasized that while risks remain elevated, low public debt, a sustainable external position also supported by the precautionary FCL arrangement, and very strong policies and institutional policy frameworks continue to support Chile's resilience. They recognized that, after an impressive recovery from the COVID-19 pandemic, the Chilean economy is undergoing a necessary transition towards sustainable growth in a challenging external environment.

Directors welcomed the strong fiscal overperformance in 2022. They noted that the 2023 Budget's focus on social spending and public investment is appropriate amid a negative output gap. Directors observed that tax and spending reforms should be sequenced conditional on revenue performance to preserve fiscal sustainability. In that context, they encouraged the authorities to save any revenue overperformance and wait to disburse unallocated funds to support disinflation and external convergence. They also emphasized that the commitment to achieve a broadly balanced structural fiscal position over the next five years and keep public debt below a prudent ceiling of 45 percent of GDP is essential for preserving fiscal sustainability. They also welcomed ongoing refinements to Chile's already very strong fiscal framework.

Directors commended the central bank's decisive monetary policy tightening consistent with the highly credible inflation targeting framework. They welcomed the commitment to maintain a tight monetary stance until price pressures and inflation expectations are on a firm downward trend. Directors noted that the flexible exchange rate should continue to play its role as a shock absorber, while a substantial reserve accumulation program is desirable when conditions are conducive. Directors also noted that the financial sector remains resilient and welcomed efforts to closely monitor pockets of vulnerability, regulate fintech activities, and address FSAP recommendations. Continuing to strengthen the AML/CFT framework is also important.

Directors supported plans to implement far-reaching reforms within a sustainable macroeconomic framework. They emphasized that new pension withdrawals should be avoided, while reforms to improve pension adequacy, labor market formalization, and savings should be carefully designed and managed. They also encouraged the authorities to calibrate the pension reforms to also foster capital market deepening.

Directors also commended Chile's leadership in the region on climate change initiatives. They agreed that a gradual increase of the carbon price, calibrated taking into consideration potential use of other mitigation tools, would contribute to achieving the country's climate goals.

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

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CHILE

STAFF REPORT FOR THE 2022 ARTICLE IV CONSULTATION

December 15, 2022

KEY ISSUES

Context. After an impressive recovery from the COVID-19 pandemic, the Chilean economy is undergoing a necessary transition towards sustainable growth amid a challenging external environment. Policy implementation remains very strong, geared towards correcting macroeconomic imbalances that built up during the pandemic while protecting the most vulnerable and advancing structural reforms, consistent with past Fund Advice (Annex I). On August 29, the IMF Executive Board approved a two-year Flexible Credit Line (FCL) arrangement for Chile in the amount of SDR 13.954 billion (800 percent of quota) to augment precautionary buffers and provide substantial insurance against adverse scenarios.

Outlook and risks. GDP growth is expected to slow markedly in the last quarter of 2022 and turn negative in 2023; the output gap is also projected to turn negative, amid necessary policy tightening. The outlook is clouded with risks. On the external front, these stem from a possible abrupt global slowdown, sharply tighter global financial conditions, commodity price shocks, or an intensification of spillovers from Russia's war in Ukraine. Domestic risks stem mostly from high inflation persisting for longer than expected, social discontent over high food and energy prices, or slow progress to meet social demands. The constitutional reform process will continue but uncertainty over possible outcomes has narrowed. Low public debt, a sustainable external position, and very strong policies and institutional policy frameworks continue to support Chile's resilience and capacity to respond to shocks.

Key policy recommendations. Against a gloomy and uncertain global backdrop, policies need to navigate growth-inflation trade-offs, safeguard financial stability, and maintain fiscal sustainability while supporting the most vulnerable.

Monetary and exchange rate policy. The Central Bank of Chile's (BCCh) rapid tightening of monetary policy has been appropriate to tame inflationary pressures and consistent with the inflation targeting framework. Considering upside risks to inflation, a tight monetary stance should prevail until price pressures and inflation expectations are on a firm downward trend. The flexible exchange rate should continue to play its role as a shock absorber, while a substantial reserve accumulation program is desirable to replenish buffers when conditions are conducive.

Financial sector policies. The financial sector is resilient, non-performing loan (NPL) ratios remain below historical averages, and banks hold adequate capital and liquidity. The adoption of Basel III standards and of consolidated supervision, and progress in addressing FSAP and AML/CFT recommendations are further supporting financial sector resilience. Continuing to monitor closely emerging pockets of vulnerability is critical to safeguard financial stability and prevent disorderly consequences.

Fiscal policy. Following a remarkable fiscal overperformance projected for 2022, the 2023 Budget is consistent with the authorities' medium-term fiscal consolidation plan. To support the disinflationary process and current account (CA) convergence, it would be advisable to save any stronger than projected revenues and wait to disburse unallocated funds, while continuing to target support to the most vulnerable. The authorities' commitment to achieving a broadly balanced structural fiscal position over the medium term and keeping gross public debt below the prudent ceiling of 45 percent of GDP will preserve fiscal sustainability. Ongoing refinements to Chile's very strong fiscal framework are welcome.

Structural reforms. Tax and social spending reforms should be sequenced conditional on revenue performance to preserve fiscal sustainability. Pension reform remains a priority to deliver on better pensions and redistribution goals, while fostering formalization and savings. New pension withdrawals should be avoided. Measures to foster capital market deepening are crucial. A gradual increase of the carbon price would help achieve Nationally Defined Contribution (NDC) and net-zero climate goals.

Approved By
Patricia Alonso-Gamo (WHD) and Bikas Joshi (SPR)

Discussions took place in Santiago during October 18–27, 2022. The team comprised Ana Corbacho (Head), Chiara Fratto and Jose Torres (all WHD), Luiza Antoun de Almeida (SPR), Junghwan Mok (MCM), and Eduardo Camero (FAD). Chris Evans (RES) and Karlygash Zhunussova (FAD) contributed analytical work on climate policies from headquarters. Mr. Herrera (OED) also participated in the discussions. The mission met with the BCCh Governor, the Minister of Finance, the Minister of Labor, the Chairs of regulatory and supervisory bodies, other senior officials, private sector representatives, and academics. Natalia Martinez-Camelo and Grey Ramos (both WHD) provided research and administrative support.

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ANNEXES