CONTEXT

1. **Chile's economy is undergoing a necessary transition towards sustainable growth in a difficult external environment.** Thanks to an effective, sizable, and multi-pronged policy response, the economy recovered very fast from the fallout of the COVID-19 pandemic, but macroeconomic imbalances built up. Amid a positive output gap, inflationary pressures, and an elevated CA deficit, the authorities adequately tightened macroeconomic policies to cool down the economy, preserve macroeconomic stability, and rebuild buffers. Policy tightening is taking place against a gloomy and uncertain global outlook.

2. **The constitutional reform process will continue, but uncertainty over possible outcomes has narrowed.** Following the rejection of a draft constitution in a national referendum in September, the authorities are advancing a roadmap for a new reform process (Box 1). There is broad consensus on the need to amend some of the most contentious proposals of the previous draft, including those entailing substantial changes to the form of government, while preserving Chile's very strong institutional framework and responding to social demands.

Box 1. Chile: Constitutional Reform[1]

On September 4, Chilean voters overwhelmingly rejected a draft constitution proposal. Amid record turnout (roughly 86 percent of the electorate), 62 percent of voters rejected the proposal, a significantly wider margin than the 10 percentage points anticipated by polls.

The constitutional reform process will continue. On December 12, politicians reached an agreement on a new reform process that will need to be approved as a constitutional amendment by both houses of Congress. Under the agreement, Congress would appoint 24 experts to begin drafting an initial proposal in January. A new 50-member constitutional council would be elected in April 2023, with mandatory voting and following the election rules of the Senate. A new draft proposal would be delivered by October 2023, with a referendum with mandatory voting in November 2023.

[1] For additional details on the reform process, see IMF Country Report 2022/283.

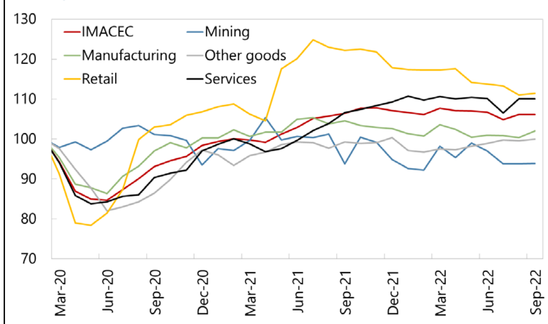
3. **The FCL arrangement augmented precautionary buffers and provides substantial insurance against unusually large global risks.** Considering the worsening of external conditions and the marked increase in risks, the IMF Executive Board approved on August 29, 2022, a two-year FCL arrangement in the amount of SDR 13.954 billion (800 percent of quota) to enhance buffers and provide insurance against adverse scenarios. The authorities intend to treat the arrangement as precautionary and exit at its expiry, conditional on favorable developments in risk scenarios.[1] Chile qualified for the FCL by virtue of its very strong fundamentals and institutional policy frameworks, sustained track record of implementing very strong policies, and the authorities' commitment to maintaining very strong policies in the future.

[1] For further details, see IMF Country Report 2022/283.

RECENT DEVELOPMENTS

4. **Economic activity is rapidly cooling down to more sustainable levels.** Buoyed by a large, effective, and multi-pronged COVID-19 policy response; widespread vaccination; and high copper prices, growth surged to 11.7 percent in 2021, substantially above potential. The authorities rapidly tightened fiscal and monetary policies, and growth in the seasonally adjusted monthly activity indicator (IMACEC) has slowed from a peak of 21.4 percent y/y in mid-2021 to -0.8 percent in October. The slowdown has been driven by a decline in fiscal spending, while private consumption has been more resilient, including due to lingering support from the exceptional pension fund withdrawals implemented during the pandemic. Employment growth plateaued in March, with the employment rate still about 3.5 percentage points below pre-pandemic trends in September.

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



Sources: Haver and Central Bank of Chile.

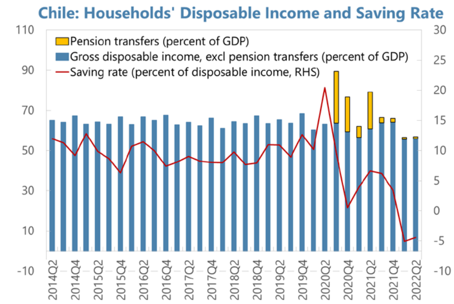
5. **The CA deficit remains elevated, as more adverse terms of trade have counteracted the ongoing adjustment of domestic demand.** The CA deficit increased to 6.3 percent of GDP in 2021 (from 1.7 percent of GDP in 2020), mostly due to a transitory surge of imported durable goods financed with generous COVID-19 stimulus measures, particularly the exceptional pension fund withdrawals (Box 2). Higher transport costs also weighed on the CA deficit. While the 2021 external position is assessed as moderately weaker than the level implied by medium-term fundamentals and desirable policy settings, the real effective exchange rate (REER) was close to its equilibrium level (Annex II). The CA deficit remained sizeable in the first three quarters of 2022, given a sharp deterioration in terms of trade;[2] lagged effects from COVID-19 support measures; and robust investment in renewable energy, mining, and transport mostly financed by FDI. However, real goods imports started to decline in October-November, and the CA deficit is projected to narrow to 5.3 percent of GDP in the last quarter of 2022, on the back of stronger import contraction amid tight macroeconomic policies.

[2] Chile's terms of trade have been negatively affected by: (i) a sharp drop of 30 percent in copper prices between June and mid-July (to levels still above pre-pandemic trends), triggered by fears of a global recession; and (ii) high global energy and food prices due to spillovers from the war in Ukraine.

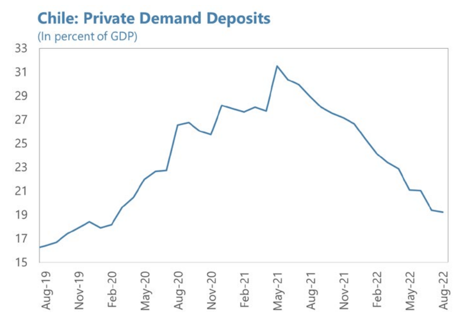
Box 2. Chile: Current Account Developments[1]

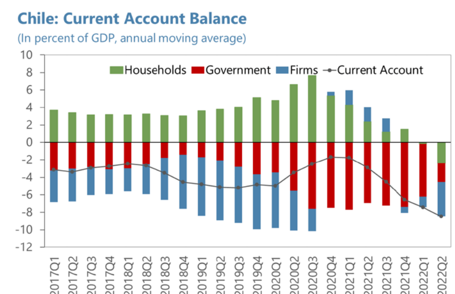
The exceptional pension withdrawals played a major role in the transitory deterioration of the CA deficit.

- The relaxation of COVID-19 restrictions, pension withdrawals of 20 percent of 2020 GDP, and sizable fiscal support led to an unprecedent and temporary increase in imports of almost 3 percent of GDP in 2021 relative to pre-pandemic levels. Real goods import growth surged to 35 percent in 2021, compared to 11.7 percent growth in real GDP. The lingering impact of the pension withdrawals, coupled with a negative terms-of-trade shock, continued to weigh negatively on the CA in 2022. However, real goods imports started to contract in the third quarter of 2022, in line with the decline in private domestic consumption, driven by tight macroeconomic policies.
- Pension withdrawals and fiscal transfers substantially increased households' disposable income, and a large share has already been consumed, as reflected in the sharp decline in the households' saving rate and private demand deposit account balances. Based on the increase in households' disposable income (7 percent of GDP in 2021), as well as the decline in private demand deposits, staff estimates on a conservative basis that pension withdrawals led to a transitory increase of the CA deficit of about 0.8-1.2 percent of GDP in 2021, and of about 1.2 percent of GDP between January and August 2022.[2]
- The large fiscal deficit also weighed on the CA deficit in 2021, but ongoing policy tightening is projected to deliver a fiscal surplus of 1.6 percent of GDP in 2022.
- An increase in remittances, including due to pension withdrawals, also contributed to a deterioration of the current account of about 0.6 percent of GDP in 2021 relative to the pre-pandemic average.



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





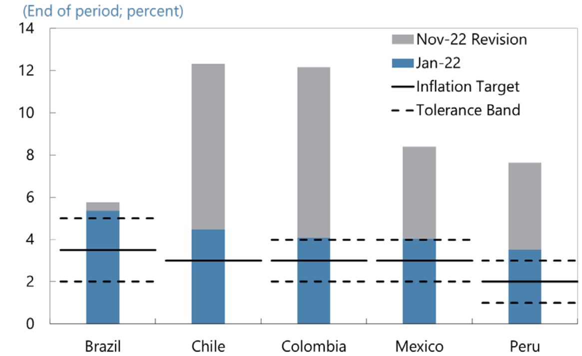
Source: Central Bank of Chile.

[1] Barrero, A., M. Kirchner, C. Pérez, and A. Sansone, 2020, *"Estimación del impacto del COVID-19 en los ingresos de hogares, medidas de apoyo y efectos en el consumo,"* Minuta in the December 2020 IPoM.

[2] Assuming a marginal propensity to consume of 0.5, as estimated in Barrero and others (2020), and an import content of consumption of 0.33.

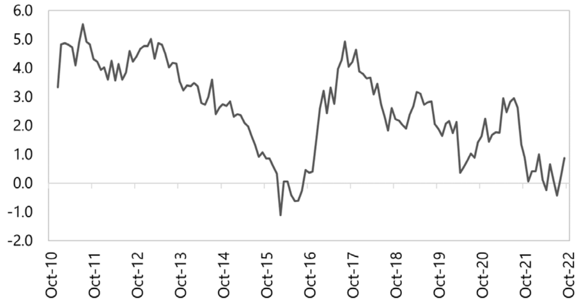
6. **Price pressures have been persistent, but inflation seems to have peaked.** Many economies have been affected by global price spillovers from the war in Ukraine and supply bottlenecks from the pandemic. However, inflation shocks have been compounded by domestic factors in Chile, including a very strong (yet rapidly narrowing) cyclical position and depreciation. Inflation surprises have been positive and persistent, but inflation seems to have peaked alongside the weakening of domestic demand, with headline (core, excluding food and energy) inflation declining to 13.3 (9.5) percent in November, from 14.1 (10.9) percent in August. Wage bargaining pressures have remained contained, while wholesale inflation is decelerating fast.

Chile: Consensus Forecast of Inflation for 2022
(End of period; percent)



Sources: Haver Analytics; IMF, World Economic Outlook database; and IMF staff calculations.

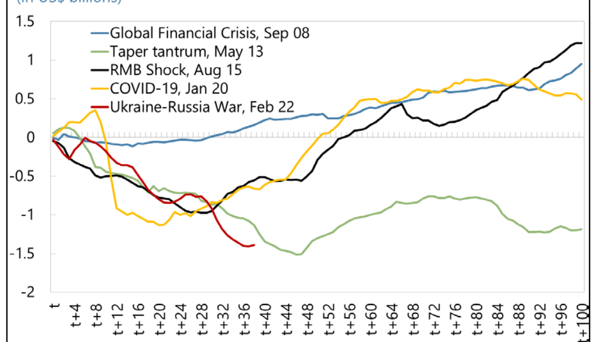
Chile: Real Wages 1/
(y/y growth, percent)



Source: INE.
1/ Deflated with core inflation.

7. Chile's financial sector remained resilient despite tighter global financial conditions. Since the onset of the war in Ukraine, global financial conditions have tightened driven by a stronger US dollar, higher external borrowing costs, stubbornly high inflation, volatile commodity markets, and heightened uncertainty about the global economic outlook. However, Chilean longer-term yields in peso-denominated sovereign bonds have remained relatively stable, while the equity index increased unlike in other LA5 economies.[3]

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



Sources: Haver, EPFR, Bloomberg, and IMF staff calculations.

Authorities' Views

8. The authorities agreed that macroeconomic imbalances that built up during the pandemic are unwinding and the economy is transitioning towards sustainable growth. On the external position, they agreed that the exceptional pension withdrawals and fiscal support in the context of the pandemic contributed to large CA deficits in 2021 and 2022 on a temporary basis, in addition to other factors, such as high transportation costs. They concurred that the ongoing tightening of macroeconomic policies and exchange rate flexibility are expected to narrow the CA deficit in the near to medium term. They noted that elevated uncertainty since 2019 makes it more difficult to determine the equilibrium REER level but stressed that the REER reached its weakest level in four decades in 2022.

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

OUTLOOK AND RISKS

9. The near-term outlook is challenging. GDP growth is projected to slow, from 11.7 percent in 2021, to 2.7 percent in 2022 and -1.5 percent in 2023, before returning to an estimated potential rate of 2.5 percent over the medium term. Given the BCCh's decisive monetary tightening, inflation is projected to converge to target by end-2024 amid a negative output gap. The structural fiscal deficit is projected to decline from 11.7 percent of GDP in 2021 to 0.7 percent of GDP in 2022 and broadly balanced over the medium term. The CA deficit in 2022 is projected to remain elevated at 8.7 percent of GDP but gradually revert to historical averages of about 3 percent of GDP, supported by the authorities' adequate structural fiscal consolidation plan and the flexible exchange rate, with FDI flows projected to continue financing the bulk of mining investment.

10. The balance of risks is tilted to the downside, but very strong fundamentals and policies underpin Chile's resilience. External risks include the possibility of an abrupt global slowdown or recession, with an associated spike in global risk premia and commodity price volatility; a possible de-anchoring of inflation expectations in major economies alongside further tightening of global financial conditions; commodity price shocks; or an intensification of spillovers from Russia's war in Ukraine (Annex III).[4] Domestic risks relate to 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 is expected to continue but uncertainty over possible outcomes has narrowed. Low public debt, ample liquidity buffers (comprising international reserves, FX liquidity lines, assets in the sovereign wealth funds, and the FCL), a sustainable external position, 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.

11. Macroeconomic policies would need to be adjusted in an adverse scenario. In a stagflation global scenario with persistently high inflation, macroeconomic policies would need to remain relatively tight to ensure a convergence of inflation to target. In contrast, in a global recession scenario where inflationary pressures abate, macroeconomic policies could be eased, starting with monetary policy as it can adjust more rapidly, and given medium-term structural fiscal consolidation goals. In both scenarios, the exchange rate should continue to play its role as a shock absorber. In addition, fiscal policy should target relief to the most vulnerable, while allowing automatic stabilizers to operate to provide further support and given existing fiscal space.

Authorities' Views

12. The authorities concurred that external risks are high but assessed the balance of risks on the domestic front to be broadly neutral. On inflation, they agreed that there are

[4] Chile has not imposed sanctions on Russia or Belarus.

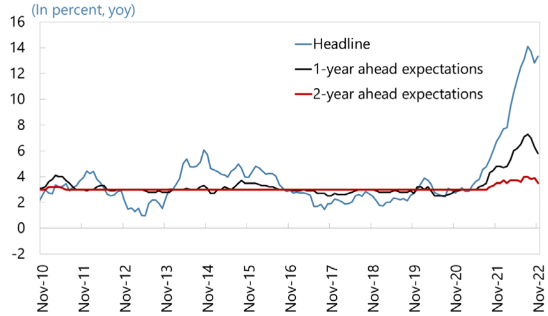
upside risks to inflation in the short term, but also emphasized downside risks over the medium term. They agreed that domestic uncertainty over possible outcomes from the constitutional reform process has narrowed and, as staff, expect a reform proposal that preserves Chile's very strong institutional framework. They agreed that Chile remains resilient and stand ready to adjust policies as needed to preserve macroeconomic stability and protect the most vulnerable.

MACROECONOMIC POLICIES AND REFORMS

A. Navigating Growth-Inflation Trade-Offs

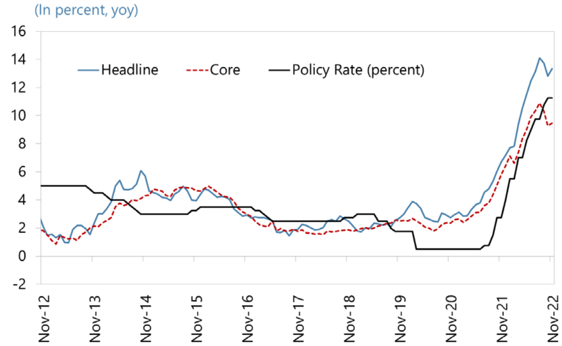
13. The BCCh's monetary policy response has been forceful and fully in line with the inflation targeting framework. The BCCh quickly raised the policy rate from a low of 0.5 percent in July 2021 to 11.25 percent in October (substantially above the neutral rate) and kept it at that level in December. Two-year ahead inflation expectations, measured by the BCCh's Economic Expectations Survey, edged down to 3.5 percent in November (from a peak of 4.0 percent in August), while longer-term inflation expectations have remained firmly anchored at the 3 percent target. The BCCh has communicated that that the policy rate will remain at its current level for as long as necessary to ensure inflation converges to target over the policy horizon.

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



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

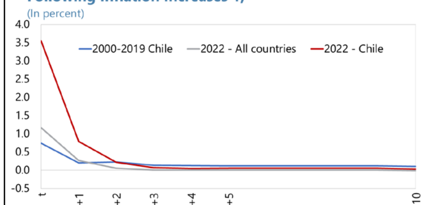
Chile: Inflation and Monetary Policy Rate
(In percent, yoy)



Sources: INE, Haver, and IMF staff calculations.

14. If upside risks to inflation prevail, further tightening would be needed, notwithstanding short-term output costs. Staff analysis shows that near-term inflation expectations in Chile responded more to inflation increases in 2022 than in the past and when compared to other countries (Annex IV). However, inflation expectations remain firmly anchored at longer horizons, testament to Chile's highly credible inflation-targeting framework. Effective communication will continue to be key to preserving the long-term gains of low inflation and well-anchored expectations. If upside risks to inflation prevail, the BCCh might need to extend the tightening cycle.

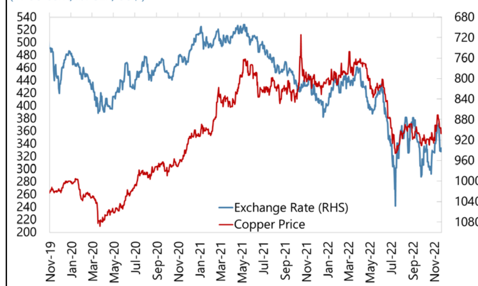
Chile: Revision to Inflation Expectations Following Inflation Increases 1/
(In percent)



Sources: Consensus Economics and IMF staff calculations.
1/ Regression of revisions of inflation expectations at different horizons on changes in realized inflation for a panel of Advanced Economies and Emerging Markets.

15. The FX intervention program, that ran from mid-July until end-September, succeeded in preventing disorderly market conditions. The sharp fall in copper prices between June and mid-July triggered a fast and large depreciation, alongside unusually high FX volatility. Stress in the FX market was aggravated by capital outflows and a domestic capital market that was less effective in cushioning the shock than in the past after the pension withdrawals. To prevent disorderly market conditions, the BCCh launched an FX intervention and liquidity provision program that ran from mid-July until end-September. The program was effective in reducing unusually high FX volatility, restoring price formation signals, and preventing broader spillovers (Annex V). Interventions were implemented with high standards of transparency and fully sterilized to ensure consistency with the monetary policy framework.

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



Sources: Haver, EPFR, Bloomberg, and IMF staff calculations.

16. The flexible exchange rate should continue to play its role as a shock absorber, while a replenishment of external buffers is desirable when conditions allow. As monetary policy rates in major economies continue to rise and global financial conditions tighten further, exchange rate flexibility will remain instrumental to absorb shocks. FX intervention should be used only in exceptional circumstances to prevent disorderly market conditions. The BCCh's has ample FX liquidity buffers, comprising about US$40 billion in reserves, US$9 billion in FX liquidity lines, and US$18 billion from the FCL.[5] When market conditions are conducive, a substantial reserve accumulation program would be advisable to replenish buffers.[6]

Authorities' Views

17. The BCCh considered the monetary stance to be sufficiently contractionary to ensure the convergence of inflation to target over the policy horizon. They acknowledged that there are upside risks to inflation in the short run but emphasized that they also see downside risks over the medium run, as they expect domestic demand to contract rapidly. They stressed that they remain vigilant to risks to the macroeconomic scenario and stand ready to alter the policy stance if the balance of risks deteriorates or shocks materialize.

18. The authorities remain strongly committed to the flexible exchange rate. They agreed that exchange rate flexibility remains a critical shock absorber and reaffirmed their intention to rebuild reserve buffers when market conditions are conducive. They intend to continue treating the FCL as precautionary.

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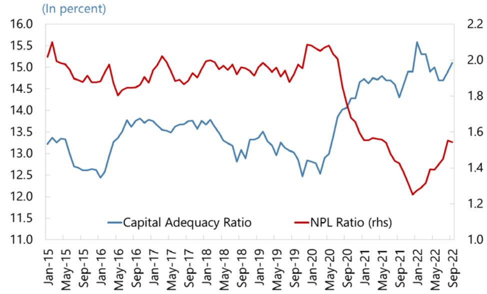
[5] The liquidity lines comprise a bilateral swap facility with the PBOC (US$8 billion) and a liquidity line with FLAR (US$1.25 billion). The BCCh is also a subscriber of the FED's FIMA repo facility and has secured a new swap line with the BIS for about US$3.7 billion (the precise amount to be confirmed upon effectiveness in 2023).

[6] Gross international reserves corresponded to 72 percent of the IMF's Emerging Markets (EMs) adequacy metric at end-November.

B. Safeguarding Financial Sector Stability

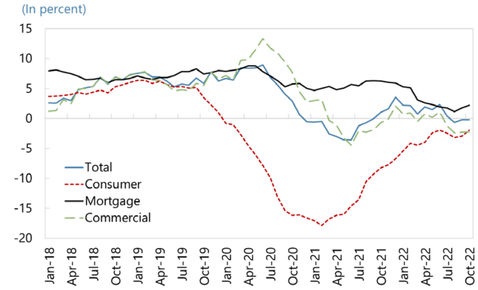
19. The banking sector is sound, but pockets of vulnerability should be monitored closely. Banks' capital adequacy ratio stood at 15.1 percent in September (comfortably above the regulatory requirement), liquid assets accounted for about 20 percent of total assets, and profitability has returned to pre-pandemic levels.[7] Although NPL ratios remain low (1.5 percent in September), pockets of vulnerability have emerged among low-income indebted households, smaller firms, and in sectors more affected by the pandemic and higher costs. A persistent deterioration of repayment capacity could pose credit risks to the banking sector. The authorities intend to continue to ensure that banks hold adequate liquidity and provisions to absorb shocks. A tighter monitoring of loans to real estate developers and the construction sector, which account for 26 percent of commercial loans, is being considered. Banks should also carefully assess the quality of credit exposures and maintain prudential lending standards.

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



Source: CMF, CEIC, and IMF staff calculation.

Chile: Real Loan Growth Rate
(In percent)



Source: BCCh.

20. The BCCh is taking steps to ensure banks are prepared for the unwinding of extraordinary liquidity measures deployed during the pandemic. The US$42 billion temporary funding-for-lending facilities (FCIC) for banks will expire in March and June 2024. As the FCIC accounts for about 8 percent of banks' liabilities, banks need to adjust their term mismatches and diversify their financing sources preemptively. The authorities have communicated their firm intention to allow the expiration of FCIC and are engaging with banks to ensure the transition proceeds smoothly.

21. There has been remarkable progress on 2021 FSAP recommendations and follow-up actions (Annex VI). The BCCh strengthened its collateral framework by modifying haircuts and collateral requirements. The Financial Market Commission (CMF), together with the BCCh, have pursued with the adoption of Basel III, the review of the deposit insurance scheme, and the implementation of consolidated supervision. The authorities intend to continue following up on FSAP recommendations, such as implementing a risk-based capital framework in insurance companies and strengthening the mutual fund liquidity management framework. They have also initiated efforts to strengthen the effectiveness of the AML/CFT framework in line with the recent

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

Mutual Evaluation Report recommendations.[8] These efforts should be supported with adequate resources, while further enhancing (i) AML/CFT risk-based supervision of banks and virtual assets service providers, and (ii) compliance with preventive measures (e.g., customer due diligence and beneficial ownership).

22. The new Fintech Law provides an umbrella to align regulation with fintech developments and digital assets. The recently approved Fintech Law is a momentous achievement that brings fintech activities, including cryptoassets and open finance, into the regulatory perimeter and aims to fill the regulatory gap between new entrants and incumbent financial companies (Annex VII). The CMF is now empowered to establish a regulatory framework and supervise financial services provided by fintech firms. The law also considers crypto-assets as financial instruments subject to CMF's regulations, while stablecoins (i.e., crypto-assets whose value is determinable and backed by fiat currencies) and payment initiation services providers will be subject to BCCh's regulations. The BCCh has also advanced discussions on Central Bank Digital Currency (CBDC) with public and private stakeholders, and the authorities will also assess financial integrity risks related to virtual assets and CBDC.

Authorities' Views

23. The authorities agreed that the financial sector remains resilient and emphasized their proactiveness in adopting FSAP recommendations and keeping pace with fintech. They concurred that nascent pockets of vulnerability should be monitored closely. They highlighted their commitment to further advance the FSAP agenda and were grateful for the Fund's support through Technical Assistance. They underscored their efforts to strengthen the collateral framework, complete the implementation of Basel III, update the resolution framework, review the deposit insurance scheme, and implement consolidated supervision. They were encouraged by the prospects of fintech enabling innovation, competition, and inclusion within a sound regulatory framework.

C. Maintaining Fiscal Sustainability While Protecting the Most Vulnerable

24. The 2022 fiscal position is projected to be markedly stronger than the target in the authorities' pre-announced medium-term fiscal consolidation plan. The 2022 headline fiscal balance is projected to improve to 1.6 percent of GDP (the first surplus in over a decade), substantially above the 2022 headline deficit consistent with the budget's structural target (1.7 percent of GDP) and the 2021 deficit (7.7 percent of GDP). About half of this extraordinary consolidation was underpinned by the removal of COVID-19 stimulus measures and the rest by revenue overperformance, supported by high yields from the January 2020 tax reform and one-

[8] The AML/CFT National Risk Assessments and National Strategy and review of the laws governing Fintech and Beneficial Ownership are at different implementation stages. A national plan against organized crime is under preparation, and supervisory agencies have improved coordination and supervisory cycles. The list of Designated Non-Financial Businesses and Professions was expanded, but there are yet no legal initiatives on gatekeepers.

off factors. The government also replenished US$6 billion in the sovereign wealth fund and US$0.5 billion in the pension reserve fund in the first half of 2022 and 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.[9]

25. The 2023 Budget focuses on social spending and public investment consistent with the authorities' medium-term plan. Amid a negative output gap, the Budget envisions higher mandated spending on universal guaranteed pensions (PGU) and other social areas and aims to increase public investment and productivity within a sustainable medium-term path. At the same time, staff estimates that the fiscal stance would be expansionary (with stimulus of about 0.5 percent of GDP, measured as the change in the non-mining structural primary fiscal balance), while inflation and the CA remain elevated.[10] To continue supporting the contractionary monetary stance, and the convergence of inflation and the CA, it would be advisable to save any stronger than projected revenues and wait to disburse unallocated funds, aiming to achieve a broadly neutral fiscal stance, while continuing to target support for vulnerable households.

Chile: Staff's Baseline Fiscal Projections
(In percent of GDP)

	2022	2023
Revenues	**25.6**	**22.2**
Of which:		
Non-mining tax revenues	19.1	17.4
Income on assets	1.5	0.8
Expenditure	**24.0**	**24.6**
Of which:		
Transfers and grants	9.5	9.1
Social benefits, inc. PGU	4.0	4.6
Public investment	1.4	1.7
Headline Fiscal Balance	**1.6**	**-2.4**
Structural Non-Mining Primary Balance	**-2.6**	**-3.1**

Source: Authorities and IMF staff calculations.

26. Achieving a broadly balanced fiscal position over the medium term is essential for maintaining fiscal sustainability. Delivering on the authorities' plan would require a fiscal effort of about 3 percent of GDP in the next five years, accompanied by targeted measures to protect to the most vulnerable. The PGU approved in March entails additional spending of about 0.8 percent of GDP per year, [11] while the expansion proposed in the draft pension reform would cost an extra 0.4 percent of GDP per year. This heightens the consolidation effort in other spending categories to achieve a broadly balanced structural fiscal position over the medium term. Approval of the tax reform would create fiscal space for a less ambitious expenditure rationalization than in the baseline scenario. Staff assesses that public debt would remain

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

[10] The 2023 Budget is consistent with a headline fiscal deficit of 2.7 percent of GDP. Compared to the budget, staff's projections are based on lower GDP growth and copper prices and somewhat less ambitious public investment execution consistent with historical patterns, resulting in a 2023 headline fiscal deficit projected at 2.4 percent of GDP.

[11] The annual cost of the PGU is estimated at about 2.2 percent of GDP, which is partly financed by a rationalization of tax exemptions (0.6 percent of GDP) and the discontinuation of the solidarity pension (1.1 percent of GDP).

sustainable with high probability (Annex VIII), with the debt ratio stabilizing somewhat below the authorities' prudent ceiling of 45 percent of GDP.

27. Efforts to refine Chile's very strong fiscal framework are welcome. Recent enhancements to parameters in the structural balance rule, the adoption of a medium-term fiscal path, the introduction of a prudent debt ceiling, and the disclosure of the sensitivity of fiscal projections to macroeconomic shocks, support Chile's long-standing fiscal framework. The introduction of an explicit escape clause and a natural disaster fund, under consideration by congress, are also positive steps. Further enhancements would be desirable, including to strengthen the analysis and management of assets and liabilities and of fiscal risks, and broaden the supervisory and advisory role of the Autonomous Fiscal Council.

Authorities' Views

28. The authorities emphasized their resolute commitment to their medium-term fiscal consolidation plan. They underscored that the revenue projections in the 2023 Budget are conservative to ensure compliance with the fiscal path and the prudent debt ceiling. They noted that their pre-announced targets are making fiscal policy more predictable, hence supporting macroeconomic stability and the disinflationary process. The authorities agreed that ongoing refinements to the fiscal framework reinforce Chile's very strong framework.

D. Advancing Structural Reforms

29. The authorities aspire to far-reaching reforms to boost strong, inclusive, and green growth within a sustainable macroeconomic framework. Ambitious tax and pension reforms are under discussion in congress. Potential revenue gains are not yet included in staff's baseline scenario but entail an upside risk to staff's revenue projections. Advancing the climate agenda, deepening capital markets, and boosting productivity are also key government priorities.

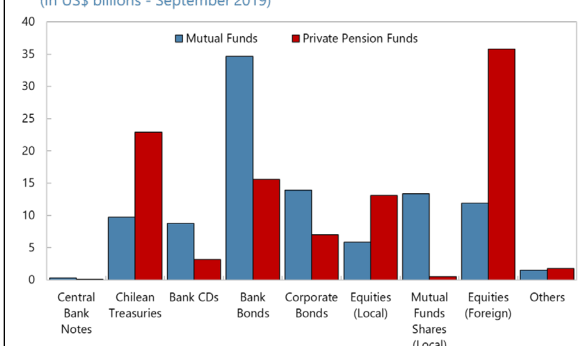
30. The tax reform plan is ambitious and comprehensive but spending reforms should advance conditional on revenue performance and medium-term fiscal consolidation goals. The tax reform plan (unveiled in June) pursues worthwhile goals, including raising revenues for an expansion of social services; increasing the progressivity of the tax system; simplifying and lowering compliance costs; reducing incentives for aggressive tax planning; and fostering a green economy (Annex IX and forthcoming 2022 Selected Issues Paper). The reform to the personal income tax would reinforce one of the weakest pillars in the system, but the exemption threshold would remain high, and tax rates for low and middle brackets modest, by international standards. Moreover, cross-country experience suggests that the expected yields from tax administration and the wealth tax could be difficult to realize. To preserve fiscal sustainability, higher public spending should advance conditional on revenue performance and medium-term fiscal consolidation goals.

31. Pension reform remains critical to improve inadequate pensions. Chile's pension system has low replacement rates due to a combination of low contribution rates, low

contribution density, declining returns, and rising life expectancy. Gender and intergenerational equity have also been noteworthy challenges. The introduction of the PGU in March, financed with general tax revenues, virtually eliminated risks of old-age poverty at a sizable fiscal cost. However, many Chileans still face inadequate pensions, a predicament aggravated by the pension withdrawals. The draft reform (presented in November) proposes to further expand the PGU contingent on approval of the tax reform, overhaul the existing private capitalization pillar, and introduce a new contributory social security pillar (Annex X). However, the retirement age (65/60 for men/women) would continue to lag life expectancy. Moreover, careful design should aim to mitigate risks related to (i) an increase in redistribution spending that needs to be sustainably financed; (ii) higher cost of formal labor; (iii) weaker incentives to save; and (iv) a possibly uneven level playing field among the (new) public and private investment managers. New pension withdrawals should be avoided.

32. The authorities are considering measures to deepen capital markets. Chile has one of the deepest and most sophisticated capital markets among EMs. APFs have played a critical role by serving market segments not covered by other institutional investors, favoring local equities and corporate bonds, showing more appetite for longer-term maturities, and acting as shock absorbers. However, pension withdrawals and uncertainty about the future of AFPs have hurt the depth and liquidity of the domestic capital market (see forthcoming 2022 Selected Issues Paper). The envisaged pension reform strives to improve pensions but should also be mindful of the capital market and macroeconomic implications, including the need to increase aggregate savings and finance long-term investment. The authorities' plans to establish a repo market, develop a primary dealer system, promote fintech, and foster the internalization of the Chilean peso provide additional avenues to deepen capital markets.

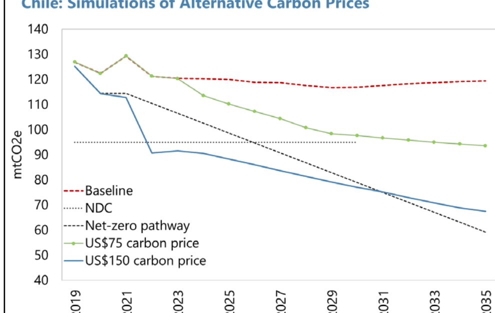
Chile: Portfolio Shares by Asset Class and Holder
(In US$ billions - September 2019)



Sources: CMF, Superintendencia de Pensiones, and IMF staff calculations.

33. A higher carbon price would support Chile's ambitious climate goals. Chile continues to enhance its climate strategy, including with the recent Framework Law on Climate Change (published in June). It is a global leader in the issuance of ESG bonds and aspires to become the lowest-cost green hydrogen producer by 2030. It has committed to decommissioning coal-fired power plants by 2040 and achieving carbon neutrality by 2050. Chile was also a pioneer adopter of a carbon tax in Latin America and the Caribbean, but the rate has remained low (US$5/tCO2e). Simulations based on the IMF-WB *Climate Policy*

Chile: Simulations of Alternative Carbon Prices



Source: Fund staff estimates based on CPAT.

Assessment Tool (CPAT) suggest that a gradual increase in the carbon price to US$60/tCO2e by 2030, coupled with higher excises for diesel, would be needed to reach NDC goals, while US$150/tCO2e would keep Chile on track to net-zero (see forthcoming 2022 Selected Issues Paper). These estimates would vary if combined with complementary measures to curb CO2 emissions. The proceeds from carbon pricing (of up to 2 percent of GDP) could be recycled for targeted transfers and public investment to offset the impact on vulnerable households and boost potential growth.

Authorities' Views

34. The authorities see structural reforms as central in their overarching strategy to foster inclusion, tackle inequality, and counter climate change. They were encouraged by progress in congressional discussions of the tax reform. As implementation may be protracted, they agreed on the need to proceed cautiously with spending commitments until after permanent revenues are secured. They underscored that the ambitious pension reform aims to address long-standing problems, improve the overall functioning of the system, and foster solidarity. They concurred that a successful implementation of the Fintech Law, measures to deepen capital markets, efforts to develop an institutional framework for lithium, and progress on the climate agenda could foster productivity and potential growth. They stressed that the calibration of the gradual increase in carbon taxes would need to consider that climate goals can be achieved by a combination of tools.

STAFF APPRAISAL

35. The Chilean economy is undergoing a necessary transition towards sustainable growth. Thanks to an effective, sizable, and multi-pronged policy response, the economy recovered very fast from the fallout of the pandemic, but macroeconomic imbalances built up. The authorities have adequately tightened macroeconomic policies to maintain macroeconomic stability and mitigate risks, while protecting the most vulnerable and advancing ambitious reforms. In 2021, the external position was assessed as moderately weaker than the level implied by fundamentals and desirable policies but is projected to improve supported by very strong policies and exchange rate flexibility.

36. The outlook is challenging, but very strong fundamentals and institutional policy frameworks continue to underpin Chile's resilience and capacity to respond to shocks. Very strong fundamentals, including a low public debt ratio, a sustainable external position, and ample liquidity buffers (comprising international reserves, FX liquidity lines, and assets in the sovereign wealth funds), reinforce a favorable medium-term assessment even in the face of significant risks. The FCL provides additional external buffers on a precautionary basis and substantial insurance against tail risk scenarios, further supporting resilience.

37. The contractionary monetary stance is adequate and expected to prevail until inflationary pressures have firmly abated. The BCCh has appropriately tightened monetary

policy to tame inflationary pressures, in line with the highly credible inflation targeting framework. The policy rate is consistent with inflation converging to target over the policy horizon. However, if upside risks to inflation prevail, further tightening would be needed, notwithstanding short-term output costs. Considering upside risks to inflation, the BCCh's commitment to maintain a tight monetary stance until price pressures and inflation expectations are on a firm downward trend is appropriate. Effective communication continues to be key to preserving the long-term gains of low inflation and well-anchored expectations.

38. The flexible exchange rate continues to play its role as a shock absorber, while a replenishment of external buffers is desirable when conditions allow. The FX intervention program was successful in reducing FX volatility, restoring price formation signals, and preventing spillovers from disorderly market conditions. As monetary policy rates in major economies continue to rise and global financial conditions become tighter, exchange rate flexibility remains instrumental to absorb shocks, with FX interventions used only in exceptional circumstances. When market conditions are conducive, a substantial reserve accumulation program would be advisable to replenish buffers.

39. The financial sector remains resilient, and the authorities are vigilant of emerging of pockets of vulnerability. The banking sector is sound, with adequate funding and profitability, and low impairments. The adoption of Basel III standards and of consolidated supervision, progress in addressing FSAP recommendations, and efforts to strengthen the effectiveness of the AML/CFT framework are further supporting financial sector resilience. Against the backdrop of tightening financial conditions, closely monitoring emerging vulnerabilities is key to identify early signs of stress and prevent disorderly consequences.

40. The authorities are delivering on their multi-year fiscal consolidation plan, while protecting the most vulnerable. The 2022 headline fiscal balance is projected to reach the first surplus in over a decade, a significant overperformance compared to the authorities' pre-announced plan. Amid a negative output gap, the 2023 Budget is consistent with the authorities' path and debt sustainability, but results in an expansionary fiscal stance. To support inflation and external convergence, it would be advisable to save any revenue overperformance and wait to disburse unallocated funds, while continuing to target support to the most vulnerable. The authorities' commitment to fiscal consolidation of about 3 percent of GDP over the next five years, to achieve a broadly balanced structural fiscal position and keep gross public debt below a prudent ceiling of 45 percent of GDP, is essential for preserving sustainability.

41. Ongoing refinements to Chile's very strong fiscal framework are welcome. Recent enhancements to parameters in the structural balance rule, the adoption of a medium-term fiscal path, the introduction of a prudent debt ceiling, and the disclosure of the sensitivity of fiscal projections to macroeconomic shocks support Chile's long-standing fiscal framework. The introduction of an explicit escape clause and a natural disaster fund, under consideration by congress, are also positive steps. Enhancing, (i) the analysis and management of assets and liabilities and of fiscal risks, and (ii) the supervisory and advisory role of the Autonomous Fiscal Council, would further buttress the existing very strong foundations.

42. Social spending reforms should advance as yields from tax reform materialize. The tax reform plan is ambitious and comprehensive and pursues worthwhile goals. In particular, the reform to the personal income tax would reinforce one of the weakest pillars in the system, but the exemption threshold would remain high, and the tax rates for low and middle brackets modest, by international standards. The expected yields from tax administration measures and the wealth tax could be difficult to realize. To preserve fiscal sustainability, higher spending should advance conditional on revenue performance and consistent with medium-term fiscal consolidation goals.

43. Tackling inadequate pensions is a priority. The PGU protects vulnerable retirees, but many Chileans still face inadequate pensions. The reform proposal strives to improve pensions, foster redistribution, and enhance competition. However, the retirement age would remain low compared to life expectancy. Careful design and implementation will be essential to ensure sustainability, strengthen incentives for labor formalization and savings, and ensure a level playing field among investment managers. New pension withdrawals should be avoided as they would undermine pensions, fiscal sustainability, and capital markets.

44. After sizable pension withdrawals, measures to deepen capital markets are essential. Pension withdrawals have hurt the depth and liquidity of the domestic capital market. Pension reform should be mindful of the capital market and macroeconomic implications, including the need to increase aggregate savings and finance long-term investment. Plans to establish a repo market, develop a primary dealer system, promote fintech, and foster the internalization of the Chilean peso provide additional promising avenues to deepen capital markets.

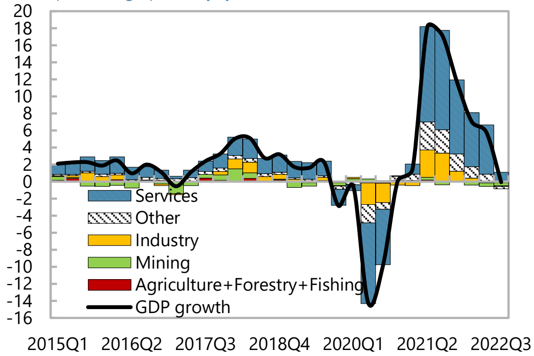
45. A broader use of carbon pricing would support Chile's ambitious climate agenda. Chile remains among the few Latin American countries that implemented a carbon tax, is a global leader in the issuance of ESG bonds, and has committed to decommissioning coal-fired power plants by 2040 and achieve carbon neutrality by 2050. A gradual increase in the carbon price, coupled with higher excises for diesel, is needed to reach NDC goals and stay on track to net-zero. The proceeds from carbon pricing can be recycled for targeted transfers and public investment to offset the impact on vulnerable households and boost potential growth.

46. Staff recommends that the next Article IV consultation take place on the standard 12-month cycle.

Figure 1. Chile: Economic Activity

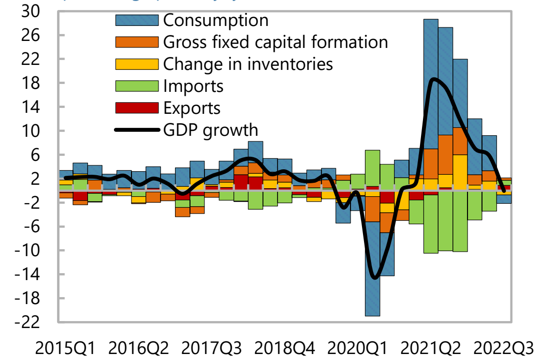
After a strong recovery from the pandemic...

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



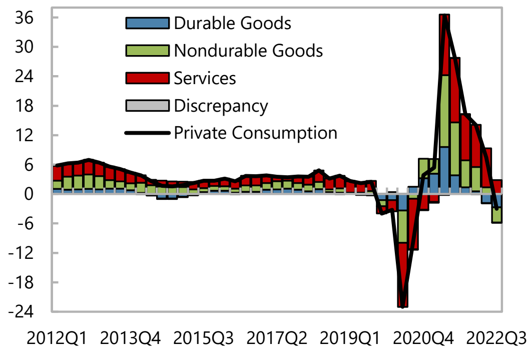
...economic activity is rapidly decelerating.

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



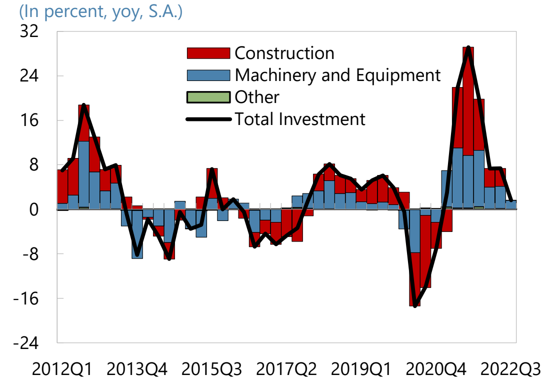
Both consumption and...

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



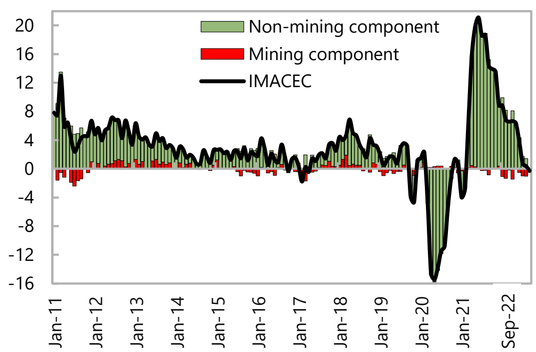
...investment have slowed in all categories.

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



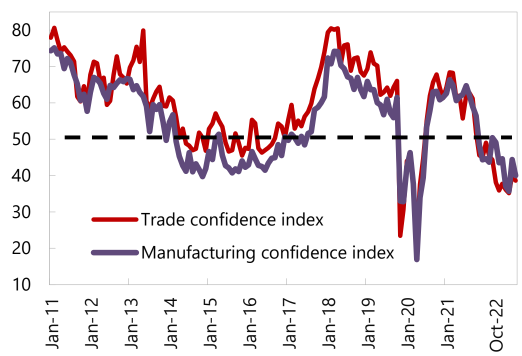
The IMACEC has rapidly declined...

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



...as business confidence deteriorates.

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

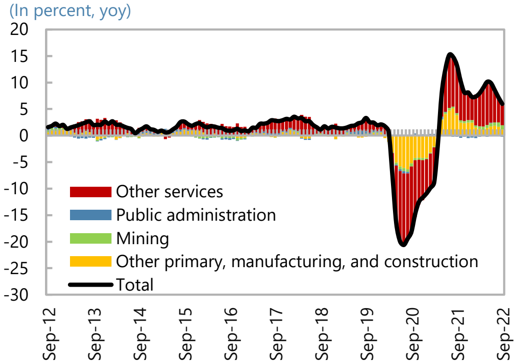


Sources: Central Bank of Chile, Ministry of Finance, Haver Analytics, and IMF staff calculations.
1/ IMACEC is a monthly economic activity indicator.

Figure 2. Chile: Labor Market Developments

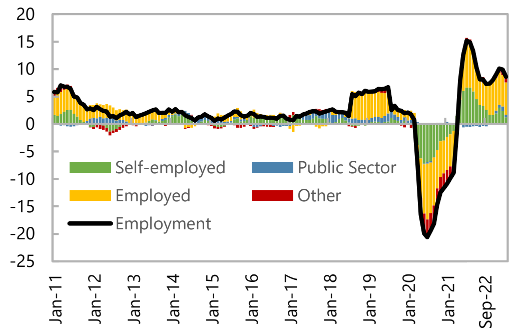
The labor market is still recovering from the fallout of the pandemic...

Contributions to Employment by Sector
(In percent, yoy)



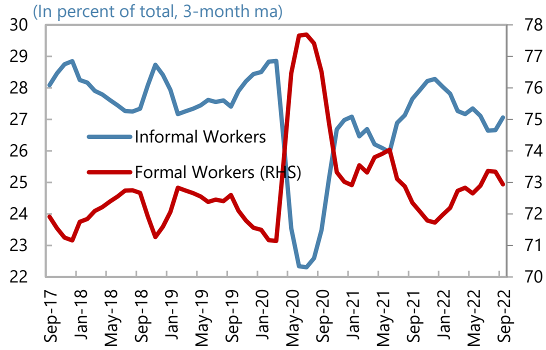
...driven by self-employment and private sector jobs.

Contributions to Employment Growth
(In percent, yoy)



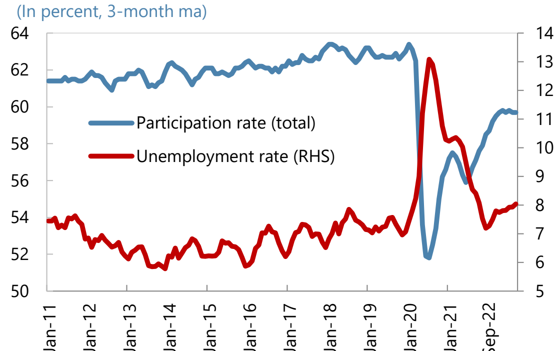
The informality share remains below the pre-pandemic level.

Measures of Informality
(In percent of total, 3-month ma)



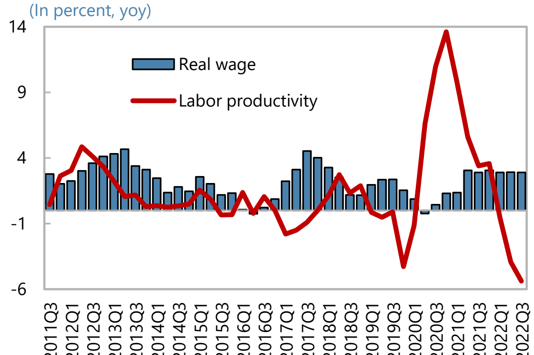
The unemployment rate has declined from its pandemic peak, while labor participation is still below historical levels.

Labor Market
(In percent, 3-month ma)



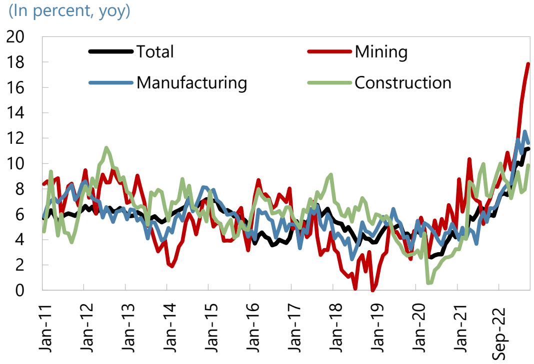
Labor productivity has rapidly decelerated driven by the recovey in employment.

Real Wages and Productivity
(In percent, yoy)



Significant nominal wage increases in mining and manufacturing have exceeded the national average.

Nominal Wages
(In percent, yoy)

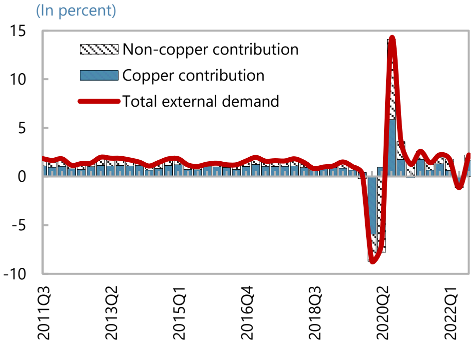


Sources: Central Bank of Chile, Haver Analytics, and IMF staff calculations.

Figure 3. Chile: External Sector

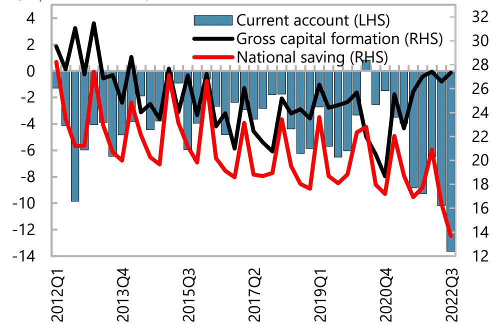
External demand grew 2.2 percent in 2022Q3...

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



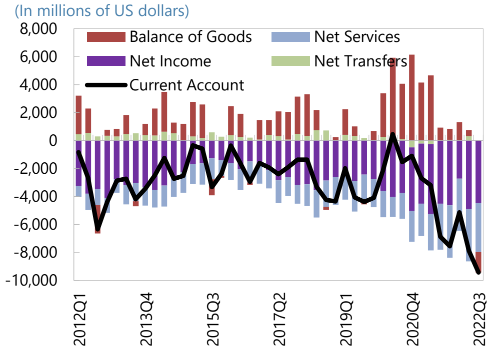
...while the current account deficit remained elevated at at 13.6 percent of GDP in the third quarter of 2022...

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



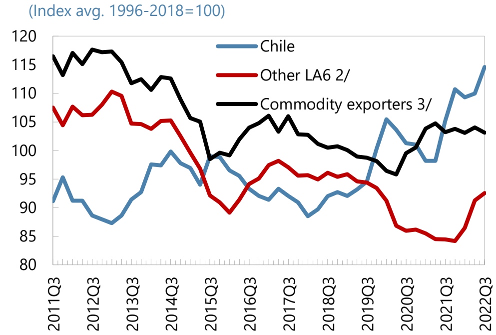
...as the trade balance turned negative.

Current Account Decomposition
(In millions of US dollars)



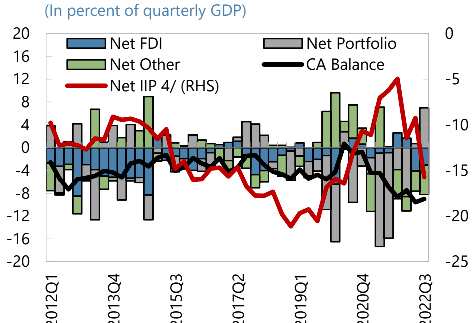
The REER is undervalued and has depreciated more than the currencies of other commodity exporters and LA6 countries.

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



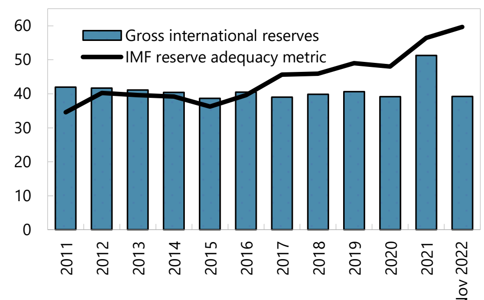
The net IIP has deteriorated since end-2021, reaching -15.8 percent of annualized GDP in 2022Q3...

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



...while gross international reserves declined in 2022.

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

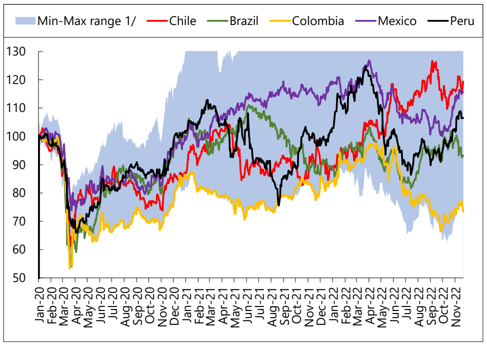


Sources: Central Bank of Chile, Haver Analytics, and IMF staff
1/ Calculated as average real GDP growth of trading partners, weighted by their respective share in Chilean exports.
2/ LA6 includes Brazil, Chile, Colombia, Mexico, Peru, and Uruguay.
3/ Commodity exporters includes Canada, New Zealand,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

Figure 4. Chile: Financial Markets

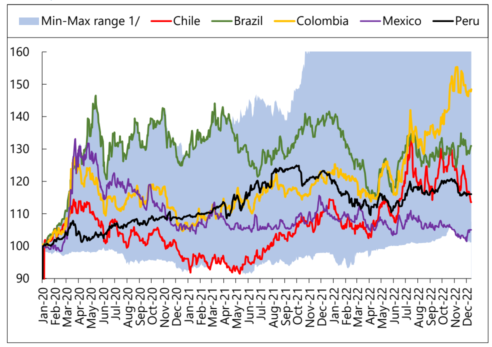
Chile's equity index exceeds its pre-pandemic levels and regional peers.

Domestic Equity Indices 2/
Jan 03, 2020 = 100



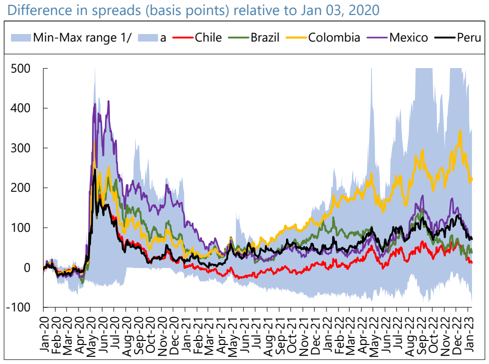
Following a large depreciation between June and mid-July the peso has stabilized.

Local Currency per US Dollar Indices 3/
Jan 03, 2020 = 100



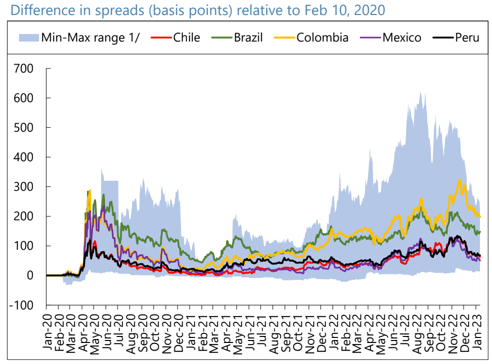
EMBI spreads have stabilized at levels somewhat above pre-pandemic levels,

EMBIG Spreads 4/
Difference in spreads (basis points) relative to Jan 03, 2020



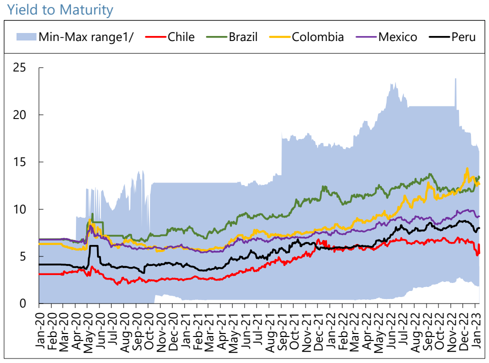
similarly for CDS spreads.

CDS Spreads
Difference in spreads (basis points) relative to Feb 10, 2020



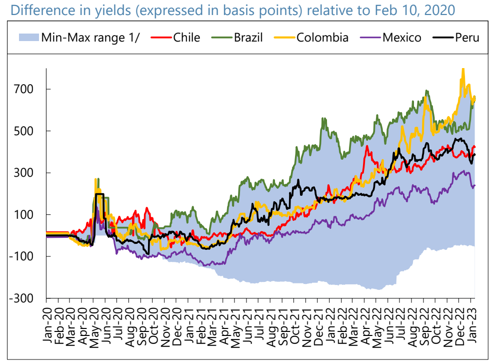
Domestic currency bond yields are consistently below regional peers…

Domestic Currency Sovereign Bond Yields 5/
Yield to Maturity



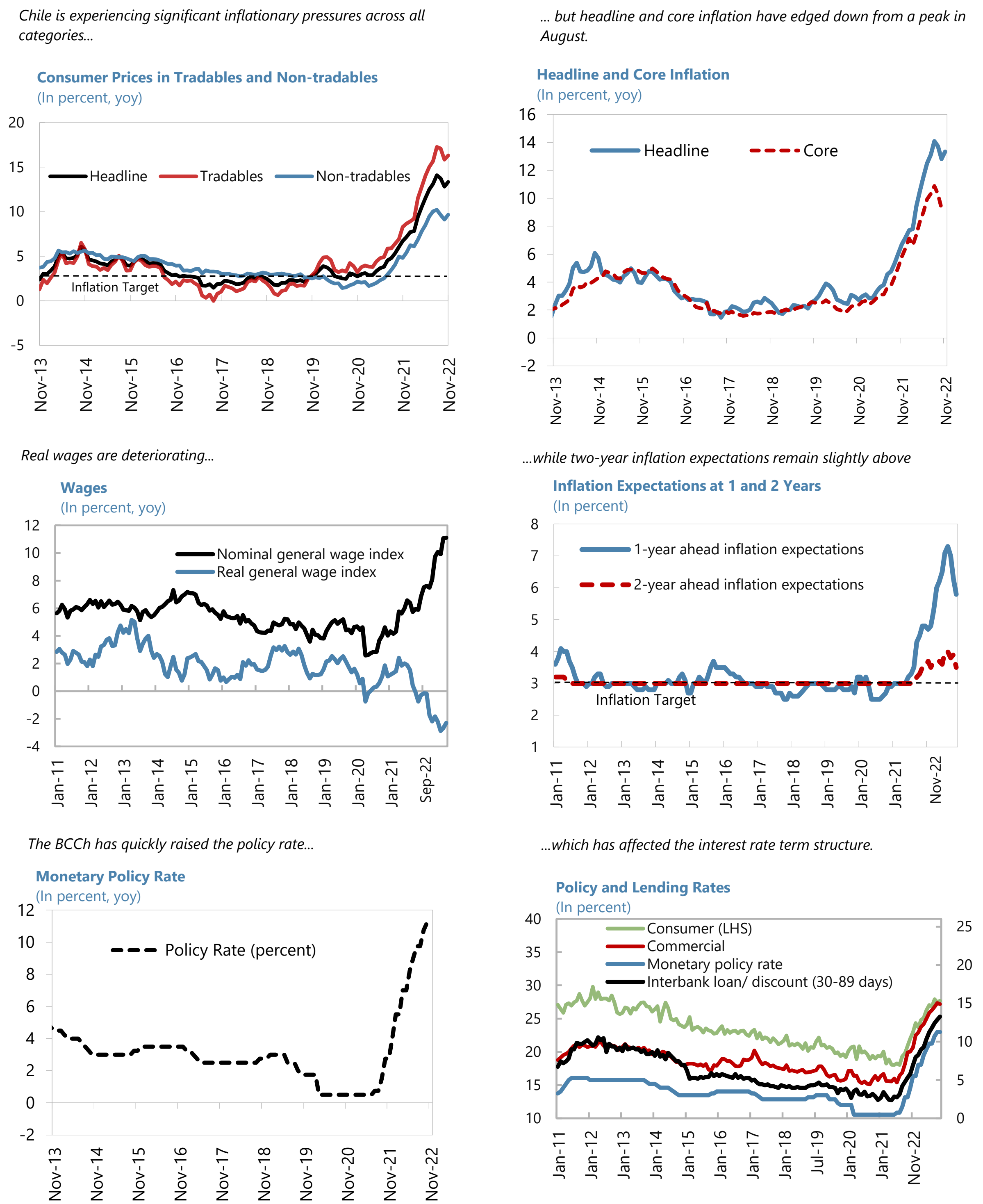
…although they have rapidly increased since the the start of 2021.

Domestic Currency Sovereign Bond Yields 5/
Difference in yields (expressed in basis points) relative to Feb 10, 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 5. Chile: Monetary Policy and Inflation

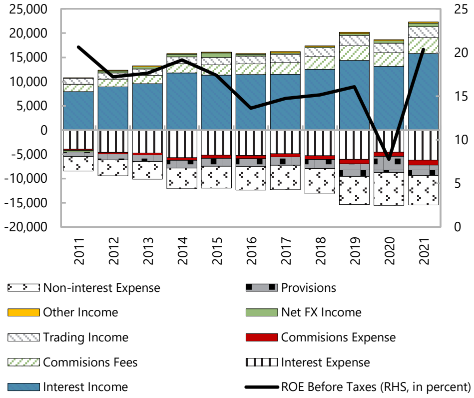


Sources: Central Bank of Chile, Haver Analytics, and IMF staff calculations.

Figure 6. Chile: Financial Sector

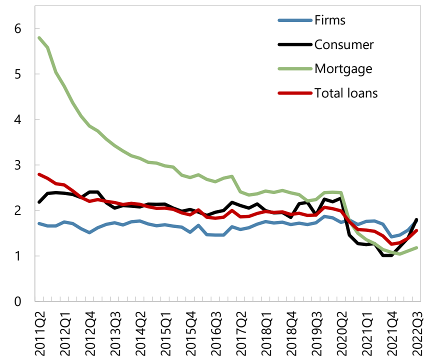
Banks' profitability rose to 20.4 percent in December 2021.

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



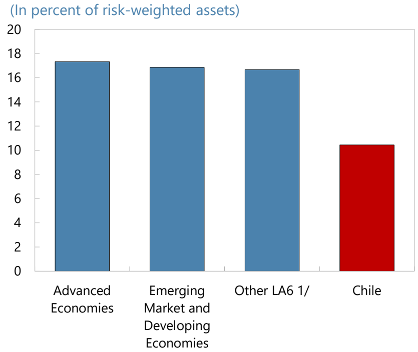
Non-performing loans have edged up.

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



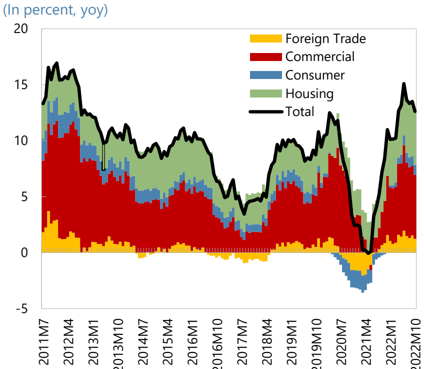
Tier 1 capital ratios are lower than in peer countries but are above regulatory requirements and will continue to

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



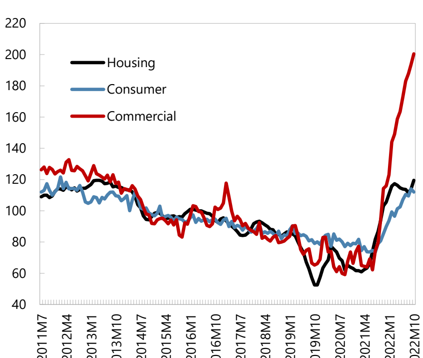
Credit growth has moderated, with a growth rate of 12.6

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



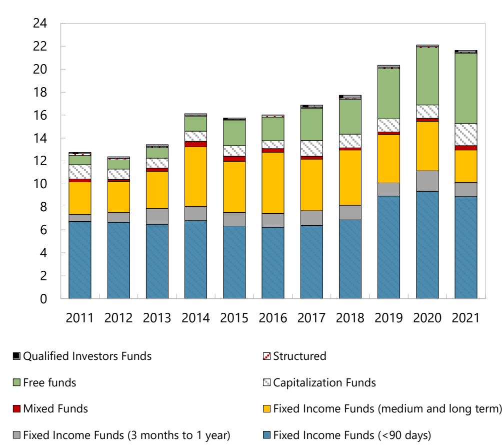
Interest rates have risen along with monetary tightening.

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)

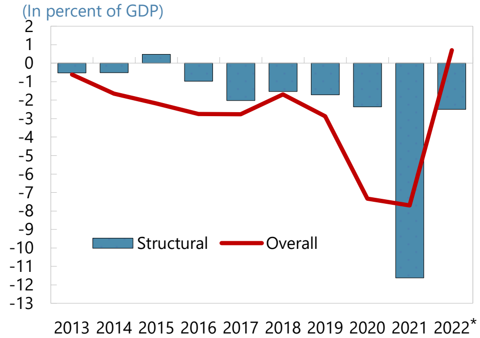


Sources: CMF, Central Bank of Chile, IMF Financial Soundness Indicators 2019, and IMF staff calculations.

Figure 7. Chile: Fiscal Policy and Public Finances

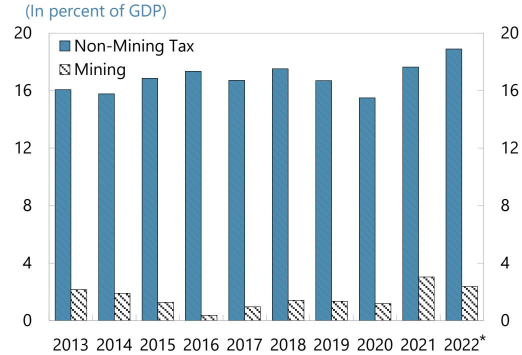
The large fiscal stimulus of 2021 has been withdrawn in 2022...

Central Government Balances 1/
(In percent of GDP)



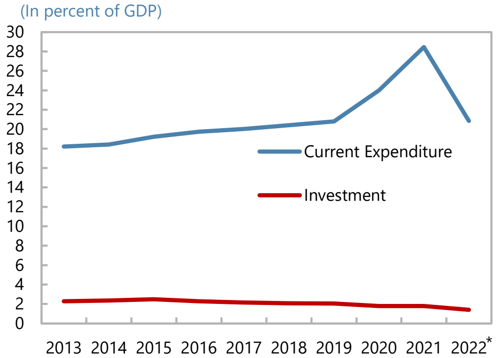
...buoyed by an increase in both mining and non-mining revenues...

Central Government Revenues
(In percent of GDP)



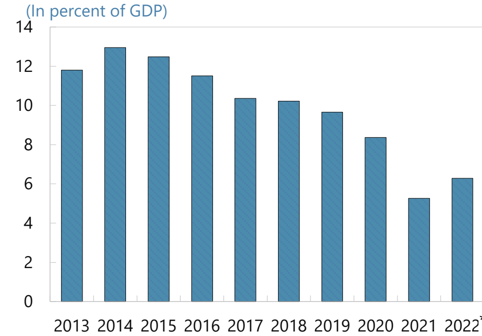
... and the expiration of the COVID-related spending measures.

Central Government Investment and Current Expenditure
(In percent of GDP)



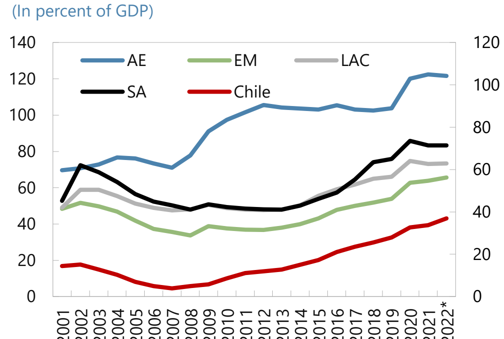
The government has also started to replenish its buffers.

Treasury Assets
(In percent of GDP)



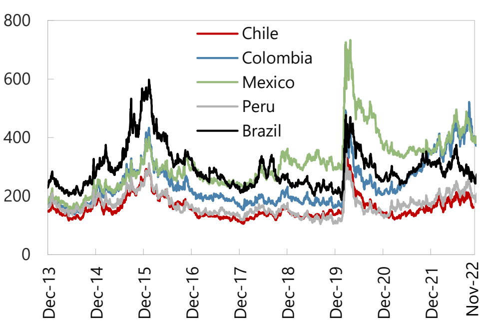
The gross debt-to-GDP ratio remains relatively low by international standards...

General Government Gross Debt 2/
(In percent of GDP)



...and the government continues to borrow at favorable rates.

EMBI Spreads
(basis points)



Sources: Ministry of Finance, Central Bank of Chile, Bloomberg, and IMF staff calculations.
1/ Based on IMF estimates of structural balance.
2/ Source: World Economic Outlook; AE = Advance Economies; EM = Emerging and Developing Economies; LAC = Latin America and the Caribbean, excluding Venezuela; SA= South America, excluding Venezuela.
*2022 IMF staff's estimates.

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

GDP (2021), in billions of pesos	240	Quota	
GDP (2021), in billions of U.S. dollars	316.8	in millions of SDRs	1,744
Per capita (2021), U.S. dollars	16,096	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	2028
	(Annual percentage change, unless otherwise specified)									
Output										
Real GDP	0.9	-6.1	11.7	2.7	-1.5	1.9	2.1	2.2	2.5	2.5
Total domestic demand	0.9	-9.5	21.7	2.2	-4.5	0.9	1.1	1.8	2.1	2.5
Consumption	0.7	-7.4	18.3	2.7	-4.5	2.3	2.5	2.1	2.4	2.6
Private	0.9	-8.2	20.4	3.3	-5.8	2.5	2.4	2.4	2.5	2.5
Public	0.8	-4.0	9.8	2.9	-1.9	1.6	2.6	1.0	2.0	3.2
Investment 2/	1.4	-16.1	33.4	0.9	-4.7	-3.5	-3.5	0.5	1.3	2.1
Fixed	4.7	-9.5	17.7	3.6	-5.0	-0.2	3.3	1.8	3.0	3.2
Private	5.4	-8.9	18.2	6.3	-6.7	-0.4	3.5	2.2	3.0	3.2
Public	-1.3	-15.2	12.7	-26.3	21.8	1.6	1.7	-3.2	2.3	3.6
Inventories 3/	-0.7	-1.7	3.2	-0.6	0.0	-0.8	-1.6	-0.3	-0.4	-0.3
Net exports 3/	-0.2	3.4	-8.8	-0.1	3.2	1.0	1.0	0.4	0.3	0.0
Exports	-2.5	-1.2	-1.5	0.7	1.6	3.8	3.6	3.8	3.7	3.6
Imports	-1.7	-12.8	31.2	0.8	-9.1	0.1	-0.1	2.2	2.4	3.7
Employment										
Unemployment rate (annual average)	7.2	10.7	8.8	8.1	8.4	8.2	7.8	7.3	7.2	7.2
Consumer Prices										
Inflation (End of period, %)	2.9	2.9	7.1	12.5	5.0	3.0	3.0	3.0	3.0	3.0
Inflation (average, %)	2.3	3.0	4.5	11.6	8.2	3.7	3.0	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	25.6	22.2	23.0	23.1	23.2	23.2	22.9
Central government expenditure	24.6	27.4	31.8	24.0	24.6	24.9	24.0	23.1	22.9	22.6
Central government fiscal balance	-2.9	-7.3	-7.7	1.6	-2.4	-1.9	-0.9	0.1	0.3	0.3
Central government structural fiscal balance	-1.7	-1.7	-11.7	-0.7	-2.6	-2.2	-1.0	0.2	0.4	0.3
Structural non-mining primary balance (% of GDP)	-3.0	-2.7	-12.3	-2.6	-3.1	-3.0	-2.1	-1.1	-0.9	-0.7
Central government gross debt	28.3	32.6	36.3	37.3	37.7	39.9	40.9	40.9	40.8	39.5
of which, FX-denominated debt	5.8	7.5	12.8	13.9	14.3	14.9	15.0	15.1	14.3	13.3
Central government debt net of treasury assets	18.6	24.2	31.0	32.1	32.7	35.2	36.4	36.6	36.8	35.7
Public sector gross debt 4/	49.2	57.8	67.9	68.9	69.2	71.4	72.5	72.5	72.4	71.1
of which, share of FX-denominated debt	5.8	7.5	12.8	13.9	14.3	14.9	15.0	15.1	14.3	13.3
	(Annual percentage change, unless otherwise specified)									
Money and Credit										
Broad money	9.4	6.1	10.7	10.9	8.0	5.3	4.8	4.9	5.4	5.6
Credit to the private sector	9.7	3.2	10.1	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.
Balance of Payments										
Current account (% of GDP)	-5.2	-1.7	-6.3	-8.7	-4.9	-4.1	-3.5	-3.3	-3.1	-3.0
Current account (in billions of U.S. dollars)	-14.4	-4.3	-20.1	-26.5	-16.3	-14.5	-12.6	-12.5	-12.2	-12.7
Foreign direct investment net flows (% of GDP)	-1.2	-1.0	-0.3	-3.1	-2.2	-2.1	-2.2	-1.9	-2.2	-2.1
Gross international reserves (in billions of USD)	40.7	39.2	51.3	39.6	39.6	39.6	39.6	39.6	39.6	39.6
Gross reserves (% of gross financing needs)	56.5	53.9	77.0	40.4	47.9	47.7	45.6	44.1	42.6	46.1
Gross external debt (% of GDP)	66.7	77.9	72.4	78.5	73.2	72.4	71.6	71.0	69.4	66.4
Public	6.2	8.9	12.5	14.6	15.4	15.9	15.9	16.0	15.2	14.5
Private	60.5	69.0	59.9	63.9	57.8	56.5	55.7	55.0	54.2	51.9
	(Annual percentage change)									
Relative Prices										
Real effective exchange rate (real appreciation +)	4.7	8.2	0.2	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.
Terms of trade	-1.8	11.6	12.1	-9.3	-3.9	-0.5	-0.4	-0.8	-0.7	0.7
Memorandum Items										
Nominal GDP (trillions of pesos)	196	200	240	267	288	303	318	334	352	372
(percentage change)	3.4	2.1	20.3	10.9	8.0	5.3	4.8	4.9	5.4	5.6
Nominal GDP (billions of USD)	278	252	317	306	335	351	364	379	395	425
(percentage change)	-5.7	-9.3	25.5	-3.4	9.4	4.8	3.9	3.9	4.4	7.5

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: Balance of Payments 1/

(In billions of USD; unless otherwise specified)

	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028
				Proj.						
Current Account	**-14.4**	**-4.3**	**-20.1**	**-26.5**	**-16.3**	**-14.5**	**-12.6**	**-12.5**	**-12.2**	**-12.7**
Trade balance	2.9	19.0	10.7	1.9	7.9	10.7	13.7	15.0	16.1	17.1
Exports	68.8	74.0	94.7	97.7	96.5	100.2	103.8	108.0	112.4	116.7
Copper	32.7	38.3	53.3	43.3	41.5	43.2	44.3	45.7	47.2	48.7
Non-copper	36.1	35.8	41.4	54.4	55.0	57.0	59.5	62.3	65.2	68.0
Imports	65.9	55.0	84.0	95.8	88.6	89.5	90.0	93.0	96.3	99.6
Net services	-8.1	-7.4	-12.0	-13.4	-9.8	-10.3	-10.7	-11.4	-11.6	-12.5
Net income	-10.4	-15.9	-18.4	-15.5	-16.0	-16.6	-17.5	-18.0	-18.8	-19.5
Net transfers	1.0	0.0	-0.4	0.6	1.7	1.7	1.9	2.0	2.1	2.2
Capital account balance	1.0	0.0	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**	**-14.8**	**-16.3**	**-14.5**	**-12.6**	**-12.5**	**-12.2**	**-12.7**
Foreign direct investment	-3.2	-2.5	-0.8	-9.5	-7.2	-7.4	-7.9	-7.3	-8.7	-9.1
Abroad by Chilean residents	10.3	6.7	14.5	13.4	9.3	10.8	10.9	11.8	11.3	10.8
In Chile by foreign residents	13.6	9.2	15.3	22.9	16.6	18.2	18.9	19.1	20.0	19.9
Of which, debt instruments	1.8	0.3	1.1	0.6	0.7	1.1	0.9	0.9	0.9	1.0
Portfolio investment	-10.6	-13.2	-30.6	-1.8	-4.0	-5.1	-4.9	-4.1	-4.8	-4.7
Abroad by Chilean residents	0.8	-5.9	1.6	7.5	1.1	1.1	2.9	3.3	2.2	2.4
In Chile by foreign residents	11.4	7.2	32.2	9.3	5.1	6.2	7.8	7.4	7.0	7.1
Of which, equities	3.0	0.2	2.4	0.7	0.4	0.5	0.6	0.6	0.5	0.5
Of which, debt	8.5	7.0	29.8	8.6	4.7	5.7	7.2	6.9	6.5	6.6
Financial derivatives	1.5	2.5	0.0	1.4	1.4	1.4	1.4	1.4	1.4	1.4
Other investments	1.7	10.0	-3.2	-4.9	-6.4	-3.4	-1.2	-2.4	-0.1	-0.2
Abroad by Chilean residents	3.1	7.8	8.1	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	12.9	14.4	11.5	9.2	10.5	8.2	8.3
Change in Reserves Assets	**-0.2**	**-2.9**	**12.2**	**-11.7**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**
Errors and omissions	2.6	-1.7	-2.3	0.0	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	39.6	39.6	39.6	39.6	39.6	39.6	39.6
						(In percent of GDP)				
Current Account	**-5.2**	**-1.7**	**-6.3**	**-8.7**	**-4.9**	**-4.1**	**-3.5**	**-3.3**	**-3.1**	**-3.0**
Trade balance of Goods	1.1	7.5	3.4	0.6	2.4	3.0	3.8	4.0	4.1	4.0
Exports	24.7	29.3	29.9	31.9	28.8	28.6	28.5	28.5	28.4	27.4
Copper	11.7	15.2	16.8	14.2	12.4	12.3	12.2	12.1	11.9	11.5
Non-copper	13.0	14.2	13.1	17.8	16.4	16.3	16.3	16.4	16.5	16.0
Imports	23.7	21.8	26.5	31.3	26.5	25.5	24.7	24.6	24.4	23.4
Net services	-2.9	-2.9	-3.8	-4.4	-2.9	-2.9	-2.9	-3.0	-2.9	-2.9
Net income	-3.7	-6.3	-5.8	-5.1	-4.8	-4.7	-4.8	-4.8	-4.7	-4.6
Net transfers	0.3	0.0	-0.1	0.2	0.5	0.5	0.5	0.5	0.5	0.5
Financial Account Balance 2/	**-3.8**	**-1.2**	**-10.9**	**-4.8**	**-4.9**	**-4.1**	**-3.5**	**-3.3**	**-3.1**	**-3.0**
						(Annual change in percent)				
Total export volume	-2.1	2.6	-0.9	-1.7	1.5	3.8	3.6	3.8	3.7	3.6
Total import volume	-2.1	-10.2	34.8	-0.3	-9.2	0.1	-0.1	2.2	2.4	3.7
Terms of trade	-1.8	11.6	12.1	-9.3	-3.9	-0.5	-0.4	-0.8	-0.7	0.7
Export prices	-5.9	5.0	29.0	5.1	-3.0	0.0	0.1	0.3	0.3	0.2
Copper export price	-7.5	16.0	43.5	-12.5	-4.6	-0.1	0.0	0.1	0.0	0.0
Import prices	-4.3	-5.9	15.1	16.0	0.8	0.6	0.5	1.1	1.1	-0.4
Memorandum Items										
Copper price (WEO; U.S. cents per pound)	273	280	423	398	358	357	357	357	357	357
Volume of copper exports (2004=100)	104	106	102	95	95	99	101	105	108	111

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 3. 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 4. Chile: Summary Operations of the Central Government

(In percent of GDP; unless otherwise specified)

						Proj.				
	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028
Revenues	**21.7**	**20.1**	**24.1**	**25.6**	**22.2**	**23.0**	**23.1**	**23.2**	**23.2**	**22.9**
Taxes	17.7	16.2	18.8	20.6	18.4	19.1	19.2	19.2	19.2	19.1
Private mining companies	1.0	0.7	1.2	1.6	1.0	0.9	1.1	1.1	1.0	0.9
Other tax revenues, non-mining	16.7	15.5	17.6	19.1	17.4	18.2	18.2	18.1	18.2	18.2
Social contributions	1.5	1.6	1.2	1.2	1.2	1.2	1.2	1.2	1.2	1.2
Grants	0.1	0.1	0.0	0.1	0.0	0.1	0.1	0.1	0.1	0.1
Other revenue	2.4	2.3	4.0	3.7	2.7	2.7	2.7	2.7	2.8	2.6
Codelco revenues	0.4	0.5	1.8	0.8	0.4	0.6	0.6	0.6	0.7	0.5
Income on assets	0.6	0.4	0.2	1.5	0.8	0.8	0.8	0.8	0.8	0.8
Operating income	0.5	0.4	0.5	0.4	0.4	0.5	0.5	0.5	0.5	0.5
Other income	1.0	1.0	1.4	1.0	1.1	0.8	0.8	0.8	0.8	0.8
Expenditures	**24.6**	**27.4**	**31.8**	**24.0**	**24.6**	**24.9**	**24.0**	**23.1**	**22.9**	**22.6**
Expense	22.5	25.6	30.0	22.7	22.9	23.2	22.3	21.4	21.2	20.9
Compensation of employees	5.0	5.3	4.8	4.6	4.5	4.5	4.6	4.6	4.6	4.6
Purchases of goods and services	2.0	2.2	2.0	1.8	1.8	1.8	1.8	1.7	1.7	1.7
Interest payments	0.9	1.0	0.9	1.0	1.1	1.2	1.2	1.3	1.3	1.2
Subsidies and grants	8.8	11.1	16.8	9.5	9.1	9.3	8.3	7.3	7.2	7.0
Social benefits	4.0	4.4	3.9	4.0	4.6	4.6	4.6	4.6	4.6	4.6
Other expense	1.8	1.7	1.6	1.8	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	1.7	1.7	1.7	1.7	1.7	1.7
Investment	2.1	1.8	1.8	1.4	1.7	1.7	1.7	1.7	1.7	1.7
Net Lending/Borrowing	**-2.9**	**-7.3**	**-7.7**	**1.6**	**-2.4**	**-1.9**	**-0.9**	**0.1**	**0.3**	**0.3**
Non-mining overall balance	-4.2	-8.5	-10.7	-0.8	-3.8	-3.4	-2.6	-1.6	-1.4	-1.1
Net Financial Transactions	**-2.9**	**-7.3**	**-7.7**	**1.6**	**-2.4**	**-1.9**	**-0.9**	**0.1**	**0.3**	**0.3**
Net acquistion of financial assets	-0.6	-3.2	-1.6	2.5	0.7	1.7	1.5	1.5	1.8	1.4
Net incurrence of liabilities	2.2	4.1	6.0	1.0	3.1	3.6	2.4	1.4	1.5	1.1
Domestic	2.0	2.5	1.3	-0.6	1.2	2.5	1.8	0.8	1.7	0.7
External	0.5	1.8	4.8	1.6	2.0	1.2	0.6	0.7	-0.2	0.4
Recognition bonds	-0.2	-0.2	-0.1	-0.1	-0.1	-0.1	0.0	0.0	0.0	0.0
Memorandum Items										
Primary balance	-2.5	-6.8	-7.1	1.0	-2.0	-1.4	-0.4	0.6	0.8	0.7
Structural Fiscal Balance	-1.7	-1.7	-11.7	-0.7	-2.6	-2.2	-1.0	0.2	0.4	0.3
Structural Revenue	22.9	25.7	20.1	23.3	22.0	22.7	23.1	23.2	23.3	22.9
Fiscal Impulse 1/	0.5	-0.3	9.6	-9.7	0.6	-0.2	-0.9	-1.0	-1.2	-0.4
Expenditure growth (in real terms; annual percent change)	4.2	10.4	33.4	-24.8	2.2	2.8	-1.8	-2.2	1.6	1.3
Central Government debt net of treasury assets	18.6	24.2	31.0	32.1	32.7	35.2	36.4	36.6	36.8	35.7
Central Government gross debt	28.3	32.6	36.3	37.3	37.7	39.9	40.9	40.9	40.8	39.5
Public Sector Gross Debt 2/	49.2	57.8	67.9	68.9	69.2	71.4	72.5	72.5	72.4	71.1
Public Sector debt net of treasury assets 2/	39.6	49.5	62.6	63.7	64.3	66.7	68.0	68.2	68.4	67.3
General Government Fiscal Balance 3/	-2.7	-7.1	-7.5	1.8	-2.2	-1.7	-0.7	0.3	0.0	0.0
Nominal GDP (trillions of pesos)	196	200	240	267	288	303	318	334	352	372

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 5. Chile: Medium-Term Macroeconomic Framework 1/

				Proj.						
	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028
National Accounts	(Annual percentage change, unless otherwise specified)									
Real GDP	0.9	-6.1	11.7	2.7	-1.5	1.9	2.1	2.2	2.5	2.5
Total domestic demand	0.9	-9.5	21.7	2.2	-4.5	0.9	1.1	1.8	2.1	2.5
Consumption	0.7	-7.4	18.3	2.7	-4.5	2.3	2.5	2.1	2.4	2.6
Private	0.9	-8.2	20.4	3.3	-5.8	2.5	2.4	2.4	2.5	2.5
Public	0.8	-4.0	9.8	2.9	-1.9	1.6	2.6	1.0	2.0	3.2
Investment 2/	1.4	-16.1	33.4	0.9	-4.7	-3.5	-3.5	0.5	1.3	2.1
Fixed	4.7	-9.5	17.7	3.6	-5.0	-0.2	3.3	1.8	3.0	3.2
Private	5.4	-8.9	18.2	6.3	-6.7	-0.4	3.5	2.2	3.0	3.2
Public	-1.3	-15.2	12.7	-26.3	21.8	1.6	1.7	-3.2	2.3	3.6
Inventories 3/	-0.7	-1.7	3.2	-0.6	0.0	-0.8	-1.6	-0.3	-0.4	-0.3
Net exports 3/	-0.2	3.4	-8.8	-0.1	3.2	1.0	1.0	0.4	0.3	0.0
Exports	-2.5	-1.2	-1.5	0.7	1.6	3.8	3.6	3.8	3.7	3.6
Imports	-1.7	-12.8	31.2	0.8	-9.1	0.1	-0.1	2.2	2.4	3.7
Consumer prices										
End of period	2.9	2.9	7.1	12.5	5.0	3.0	3.0	3.0	3.0	3.0
Consumer prices (average)	2.3	3.0	4.5	11.6	8.2	3.7	3.0	3.0	3.0	3.0
Nominal GDP growth	3.4	2.1	20.3	10.9	8.0	5.3	4.8	4.9	5.4	5.6
Potential growth	2.1	-0.6	1.5	2.7	2.7	1.7	2.0	2.2	2.5	2.5
Output gap (percent)	0.0	-5.5	4.0	4.0	-0.3	-0.1	0.0	0.0	0.0	0.0
Balance of Payments	(In percent of GDP)									
Current account	-5.2	-1.7	-6.3	-8.7	-4.9	-4.1	-3.5	-3.3	-3.1	-3.0
Trade balance	1.1	7.5	3.4	0.6	2.4	3.0	3.8	4.0	4.1	4.0
Financial account balance	-3.8	-1.2	-10.9	-4.8	-4.9	-4.1	-3.5	-3.3	-3.1	-3.0
Of which, foreign direct investment (net)	-1.2	-1.0	-0.3	-3.1	-2.2	-2.1	-2.2	-1.9	-2.2	-2.1
Change in reserves assets	-0.1	-1.1	3.9	-3.8	0.0	0.0	0.0	0.0	0.0	0.0
Errors and omissions	0.9	-0.7	-0.7	0.0	0.0	0.0	0.0	0.0	0.0	0.0
REER (in percent y/y, +=appreciation)	4.7	8.2	0.2	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.
	(Annual percentage change)									
Total export volume	-2.1	2.6	-0.9	-1.7	1.5	3.8	3.6	3.8	3.7	3.6
Of which, copper export volume	-1.1	1.4	-3.2	-7.5	0.3	4.0	2.7	3.2	3.2	3.2
Total import volume	-2.1	-10.2	34.8	-0.3	-9.2	0.1	-0.1	2.2	2.4	3.7
Terms of trade	-1.8	11.6	12.1	-9.3	-3.9	-0.5	-0.4	-0.8	-0.7	0.7
Export prices	-5.9	5.0	29.0	5.1	-3.0	0.0	0.1	0.3	0.3	0.2
Copper export price	-7.5	16.0	43.5	-12.5	-4.6	-0.1	0.0	0.1	0.0	0.0
Import prices	-4.3	-5.9	15.1	16.0	0.8	0.6	0.5	1.1	1.1	-0.4
External Debt	(In percent of GDP)									
Gross external debt	66.7	77.9	72.4	78.5	73.2	72.4	71.6	71.0	69.4	66.4
Public	6.2	8.9	12.5	14.6	15.4	15.9	15.9	16.0	15.2	14.5
Private	60.5	69.0	59.9	63.9	57.8	56.5	55.7	55.0	54.2	51.9
Gross int. reserves (in billions of U.S. dollars)	40.7	39.2	51.3	39.6	39.6	39.6	39.6	39.6	39.6	39.6
Savings and Investment										
Gross domestic investment	25.0	21.6	25.3	26.5	25.6	24.3	23.1	22.8	22.6	22.5
Public	2.3	2.0	2.0	1.6	1.9	1.9	1.9	1.9	1.9	1.9
Private	22.7	19.6	23.3	24.9	23.7	22.4	21.2	20.9	20.6	20.6
National saving	19.8	19.9	18.7	17.9	20.8	20.2	19.6	19.5	19.5	19.5
Public	-0.4	-5.1	-5.5	3.3	-0.3	0.2	1.2	2.2	2.4	2.4
Private	20.3	25.1	24.2	14.5	21.0	20.0	18.4	17.3	17.0	17.1
Operations of the Central Government										
Central government gross debt	28.3	32.6	36.3	37.3	37.7	39.9	40.9	40.9	40.8	39.5
Central government debt net of treasury assets	18.6	24.2	31.0	32.1	32.7	35.2	36.4	36.6	36.8	35.7
Central government balance	-2.9	-7.3	-7.7	1.6	-2.4	-1.9	-0.9	0.1	0.3	0.3
Total revenue	21.7	20.1	24.1	25.6	22.2	23.0	23.1	23.2	23.2	22.9
Total expenditure	24.6	27.4	31.8	24.0	24.6	24.9	24.0	23.1	22.9	22.6
Central government structural balance	-1.7	-1.7	-11.7	-0.7	-2.6	-2.2	-1.0	0.2	0.4	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	1.2
Labor force	2.0	-8.9	3.4	0.5	0.8	0.9	1.0	1.0	1.0	1.0
Employment	2.1	-12.3	5.5	1.3	0.3	1.2	1.3	1.5	1.2	1.0
Unemployment rate (in percent)	7.2	10.7	8.8	8.1	8.4	8.2	7.8	7.3	7.2	7.1

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
(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	12.1
REER (annual percent change, period average)	-0.9	-2.9	-2.6	-1.3	4.7	8.2	0.2
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	-6.3
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) 1/	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 2/	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) 3/	14.9	15.9	16.5	15.6	17.6	19.1	17.8
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	228.0
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) 4/	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/ Gold valued at end-period market prices.
2/ Includes amortization of medium/long-term debt due during the following year.
3/ Assessing Reserve Adequacy (IMF, 2011 Policy Paper).
4/ Morgan Stanley Capital International Index (Dec1987 = 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	146.4
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.

Annex I. Recommendations of the 2021 Article IV Consultation and Authorities' Actions

Fund Recommendation	Policy Action
Monetary Policy	
Monetary stimulus should remain guided by the inflation targeting framework, contingent on development and risks.	The central bank pro-actively reacted to the buildup of inflationary pressures and raised the policy rate from a low of 0.5 percent in July 2021 to 11.25 percent in October.
Financial Sector	
Financial vulnerabilities should continue to be closely monitored. After the pandemic recedes, the authorities should shift focus towards accelerating needed regulatory reforms.	The authorities are closely monitoring financial sector vulnerabilities, while reinforcing an already sound regulatory framework, including by (i) placing under the same umbrella the supervision of insurance, securities, and banks: (ii) advancing the implementation of Basel III standards; and (iii) addressing other FSAP recommendations.
Fiscal Policy	
Fiscal policy should progressively shift from supporting an inclusive recovery in the near term to strengthening medium-term sustainability.	The authorities' structural fiscal consolidation is advancing much faster than planned, while reallocating spending to support the most vulnerable.
Medium-term revenue and expenditure measures will be needed to address rising social demands and rebuild buffers.	An ambitious tax reform aims to finance additional social spending, improve tax progressivity, and foster a green economy. The authorities also replenished the sovereign wealth fund to pre-pandemic levels.
Further pension withdrawals should be avoided. Pension reform remains critical.	A proposal for a fourth pension withdrawal was rejected in congress. A draft pension reform proposal was submitted to congress in November.
The credibility of the fiscal framework would benefit from an explicit medium-term anchor with a buffer and a formal escape clause.	The authorities introduced a medium-term *prudent* level of public debt of 45 percent of GDP and a structural fiscal consolidation path consistent with debt below the prudent threshold. They also refined the output gap estimates.
Structural Reforms	
Structural and social reforms should help stimulate investment, confidence, and social convergence in support of inclusive growth.	Following the tax reform proposal, planned reforms of social protection systems aim to complement the PGU approved in 2022, enhance the role of public service provision, and improve quality and access. The government is also advancing the climate and productivity agenda.

Annex II. External Sector Assessment

***Overall Assessment:** The external position of Chile in 2021 was moderately weaker than the level implied by fundamentals and desirable policies, driven by exceptional pension withdrawals and fiscal support in the context of the pandemic, which contributed to a large current account (CA) deficit on a temporary basis. Given the depreciation related to higher domestic uncertainty after 2019, the 2021 REER gap was assessed to be 0-5 percent.*

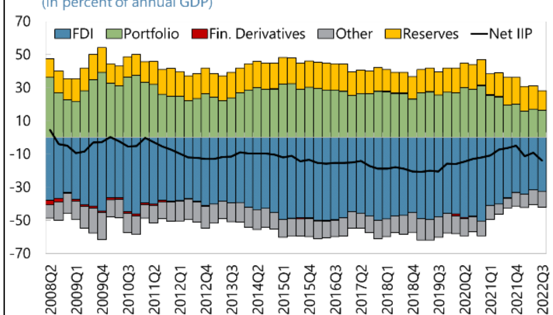
***Potential Policy Responses:** The authorities responded appropriately to the Covid-19 outbreak, with effective and multi-pronged fiscal, monetary, and financial support, which resulted in a very fast recovery from the pandemic. Amid a positive output gap, inflationary pressures, and an elevated CA deficit, the authorities adequately tightened macroeconomic policies. While fiscal stimulus remained elevated in 2021, structural fiscal consolidation advanced significantly faster than planned in 2022. In response to inflationary pressures and above-target inflation expectations, the BCCh pro-actively began a monetary tightening cycle in July of 2021. These policies, alongside exchange rate flexibility, are projected to help maintain a sustainable external position.*

Foreign Assets and Liabilities: Position and Trajectory

Background. Chile's net international investment position (NIIP) improved from -12.0 percent of GDP in 2020 to -4.9 percent of GDP in 2021, as exchange rate depreciation and valuation effects more than offset the large negative financial account balance. From a sectoral perspective, the deterioration in the NIIP of the government and pension funds by 5 and 9 percent of GDP, respectively, was more than compensated by a NIIP improvement for non-financial corporations (NFCs) of about 18 pp of GDP, due to the effect of the exchange rate depreciation on foreign direct investment (FDI), among other factors. External debt stood at 75 percent of GDP at end-2021, of which 31 percent of GDP was owed by NFCs, 18 percent of GDP was in the form of FDI, and 14 percent of GDP was owed by the general government. The NIIP stood at -14.6 percent of GDP at the end of 2022Q3, as foreign assets fell more than foreign liabilities, amid weak performance of international stock markets and the peso depreciation.

Chile: Net IIP

(In percent of annual GDP)



Sources: Central Bank and IMF staff calculations.

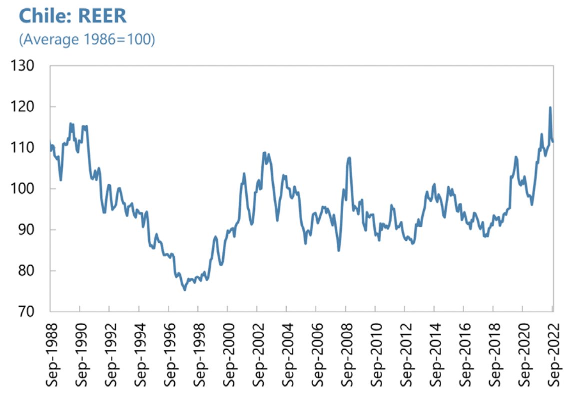
Assessment. Chile has large gross external liabilities, but these are largely offset by gross foreign assets. Moreover, the weight of FDI (and equities broadly) in gross liabilities is significant, and most sectors have positive net positions: the public sector, pension funds, and other non-bank financial institutions, all have positive NIIPs. Banks and NFCs have negative net positions of about 8.7 and 36.3 percent of GDP, respectively. However, about 66 percent of NFC's liabilities are FDI. FDI is comfortably the largest type of liability by instrument, representing 54 percent of gross liabilities, and banks' short FX positions due in thirty days cannot exceed long positions by more than the banks' capital by regulation. In sum, external vulnerability due to the negative NIIP remains limited.

2021 (% GDP)	NIIP: -4.9	Gross Assets: 142.6	Reserve Assets: 16.2	Gross Liab.: 147.4	Debt Liab.: 75.4

Current Account
Background. The CA deficit widened to 6.3 percent of GDP in 2021 (from 1.7 percent of GDP in 2020), driven by a strong rebound in domestic demand supported by sizable fiscal support measures and the exceptional pension fund withdrawals (about 19 percent of 2020 GDP). The cyclically adjusted CA deficit stood also at 6.3 percent of GDP, as the negative contribution of the positive output gap was offset by the improvement in the terms of trade. The large CA deficit in 2021 is partly explained by the impact of the exceptional pension withdrawals and fiscal support, including a boost in consumption due to the transitory increase in disposable household income and the increase in remittances. From a saving-investment perspective, the decline in households' net saving was a major driver of the CA deficit, while the large fiscal deficit also weighed negatively. Over the medium term, IMF staff projects that the CA deficit will narrow to about 3 percent of GDP, supported by continued structural fiscal consolidation and the flexible exchange rate. **Assessment.** The EBA model estimates a CA norm of -1.4 percent of GDP, which compares to a cyclically adjusted CA of -6.3 percent of GDP. IMF staff estimates CA adjustments related to COVID-19 at 2.4 percent of GDP, driven by higher transportation costs (1.1 percent of GDP), changes in household consumption composition (0.8 percent of GDP), imports of medical goods (0.3 percent of GDP), and increased remittances (0.2 percent of GDP). The CA is also adjusted by -1.5 percent of GDP to account for measurement biases due to inflation and portfolio equity retained earnings.[1] The resulting adjusted EBA model CA gap is -1.0 percent of GDP. On this basis, Chile's 2021 external position was moderately weaker than the level implied by medium-term fundamentals and desirable policy settings. However, methodological revisions to historical data launched in 2021 make comparisons with past EBA assessments difficult, as they increased the historical CA deficit by one percent of GDP on average during 2013-20, including by incorporating imports of services by digital platforms and enhancing the calculation of exports' commissions.

2021 (% of GDP)	Actual CA: -6.3	Cycl. Adj. CA: -6.3	EBA CA Norm: -1.4	EBA CA GAP: -4.9	COVID-19 Adj.: 2.4	Other Adj.: 1.5	Adj. CA gap: -1.0

Real Exchange Rate



Source: Central Bank of Chile

Background. The REER (CPI-based) remained constant in 2021 relative to its 2020 average but 11 percent below its 2010-19 average. The latter is mainly explained by an almost 30 percent depreciation of the peso/USD exchange rate in 2021 relative to its 2010-19 average, given higher domestic uncertainty following the 2019 protests. In July 2022, the REER was at its weakest level in four decades, reflecting continued domestic uncertainty as well as copper price declines.

Assessment. The EBA REER index and level models suggest a REER undervaluation of 14.7 and 24.5 percent, respectively. In contrast, the EBA CA model implies an overvaluation of 4.5 percent (applying an estimated elasticity of 0.22). Staff assessed the 2021 REER gap to be between 0-5 percent. Considering the recent sharp depreciation of the REER in 2022, leading to a REER which was in the first three quarters on average 8 percent more depreciated than in 2021, staff estimates the REER to be currently undervalued by 0-10 percent, which will support an improvement in the CA balance in coming periods.

Capital and Financial Accounts: Flows and Policy Measures

Background. Portfolio flows accounted for the bulk of net inflows in 2021 (10 percent of GDP), with general government net debt issuance representing the largest share (80 percent). Non-residents were net buyers of Chilean assets (gross inflows totaled US$47 billion), while residents were net buyers of foreign assets (gross outflows totaled US$24 billion), driven by FDI investment by NFCs (US$14 billion) and the accumulation of reserve assets by the central bank (US$12 billion), which more than offset the liquidation of foreign assets by pension funds (US$7 billion). Between January and September 2022, net inflows totaled US$24 billion, led by the decline of international reserves (US$10 billion) and net inflows to NFCs (US$9 billion).

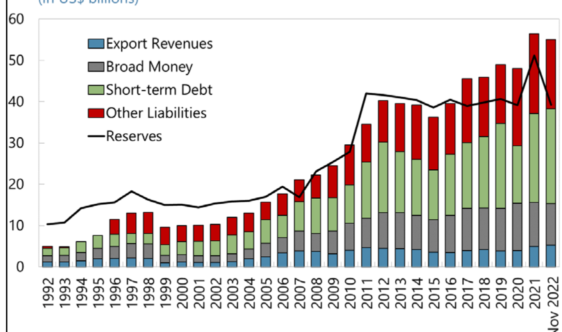
Assessment. Chile has demonstrated ample capacity to absorb short-term capital flow volatility. Chile's government has a large stock of liquid assets that limit financial markets risks.

FX Intervention and Reserves Level

Background. The peso is floating, and FX interventions have been limited to preventing disorderly market conditions. In January 2021, the central bank announced a reserve accumulation program of US$12 billion over 15 months to reach 18 percent of GDP. In October, the BCCh put an early end to the program, given the achieved purchases (US$7.4 billion; about 62 percent of the target) and market conditions. The stock of gross international reserves reached US$51.3 billion at the end of 2021. The sharp fall in copper prices between June and July 2022 triggered a fast and large peso depreciation, alongside unusually high volatility. In July, the BCCh launched an FX intervention program to address disorderly market conditions that ended in September. The program comprised 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, but only a portion was used. By end-September, the BCCh had sold US$6.2 billion in the spot market and US$10 billion in the forwards' market. As of November 2022, reserves stood at US$39.6 billion, with the decline compared to end-2021 mostly driven by FX sales, lower banks' deposits at the BCCh, and valuation effects. The July FX intervention program was successful in stabilizing FX markets and preventing broader financial and real sector spillovers.

Assessment. Gross international reserves were 91 and 72 percent of the IMF's EMs adequacy metric at end-2021 and November 2022, respectively. 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, reserves act as a second line of defense against potential financial sector's FX funding needs, and Chile's reserves more than amply cover estimated potential short-term banks' needs. In September, banks' foreign assets amounted to US$32.4 billion, compared with banks' external debt of US$29.4 billion. Second, if counted as reserves, the central government's usable liquid FX assets (about US$17.0 billion in October, including US$7.1 billion in the sovereign wealth fund and US$6.5 billion in the pension reserve fund) would correspond to approximately 30 percent of the ARA metric. Third, reserves are complemented with several FX liquidity lines totaling US$9.5 billion. The BCCh is also a subscriber of the FED's FIMA repo facility. Finally, 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.

[1] Chile's net portfolio equity position is positive due to the pension funds' investment abroad and net FDI position is negative due to foreign investment in the mining sector. This adjustor accounts for the fact that retained earnings on portfolio equity are not recorded in the income balance (while they are for FDI), and higher nominal interest rate due to inflation are recorded as a negative income stream for net debtor countries. Chile's NIIP valuation changes tend to be positive, which means that the NIIP does not deteriorate as much as implied by the CA deficits, which reflect large mining investment financed by FDI. This is a further indication of a negative measurement bias, understating the CA balance.

Annex III. Risk Assessment Matrix[1]

Source of Risks	Likelihood	Impact	Policy Advice
External Risk			
Abrupt global slowdown or recession. Global and idiosyncratic risk factors combine to cause a synchronized sharp growth slowdown, with outright recessions in some countries, spillovers through trade and financial channels, and downward pressures on some commodity prices. **EMDEs**: Sharp tightening of global financial conditions, combined with volatile commodity prices results in a spike in risk premia and capital outflows.	High	High	In a global recession scenario, use existing policy space to support the economy and protect the most vulnerable, consistent with the inflation targeting framework and fiscal sustainability. The strength and mix of the monetary and fiscal response would depend on Chile's cyclical position and the impact of shocks. Allow the exchange rate to play its role as shock absorber.
Commodity price shocks. A combination of continuing supply shocks disruptions (e.g., due to conflicts and export restrictions) and negative demand shocks causes recurrent commodity price volatility and social and economic instability.	High	High	Allow the exchange rate to play its role as a shock absorber. If inflationary pressures build up, extend the tightening cycle within the inflation-targeting framework. Provide targeted fiscal support to vulnerable groups. Advance reforms to address social demands.
Intensifying spillovers from Russia's war on Ukraine. Further sanctions resulting from the war and related uncertainties exacerbate trade and financial disruptions and commodity price volatility, with Europe, LICs, and commodity-importing EMs among the worst hit.	High	Medium	Chile has been affected by the war in Ukraine mainly through the commodity price channel, with a negative impact on Chile's terms of trade. If inflationary pressures build up, extend the tightening cycle within the inflation-targeting framework. Allow the exchange rate to play its role as a shock absorber. Provide targeted fiscal support to vulnerable groups. Improve diversification on export destination and products, enhance productivity growth.
De-anchoring of inflation expectations and stagflation. Supply shocks to food and energy prices sharply increase headline inflation and pass through to core inflation, de-anchoring inflation expectations and triggering a wage-price spiral in tight labor markets. Central banks tighten monetary policy more than envisaged, leading to weaker global demand, currency depreciations in EMDEs, and sovereign defaults. Together, this could lead to the onset of stagflation.	Medium	High	Extend the tightening cycle and continue communicating a strong commitment to the inflation target. Allow the exchange rate to play its role as shock absorber. Use existing fiscal space to provide targeted support of vulnerable groups.
Domestic Risk			
Social unrest. Persistently high inflation, including in energy and food, slowing economic growth, unmet social demands, or the protracted constitutional reform amplify risks of social unrest. Political polarization and instability weaken policymaking and confidence.	Medium	Medium	Advance reforms to tackle social demands, anchored on broad political support. Continue with policies to achieve the inflation target and maintain fiscal sustainability, while providing targeted support to the most vulnerable. Allow the exchange rate to play its role as shock absorber.

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

Annex IV. Passthrough from Inflation to Inflation Expectations[1]

1. Since the second half of 2021, global inflation has persistently surprised on the upside. The distribution of inflation surprises (measured as the difference between monthly realized CPI inflation and analysts' forecasts) shifted markedly to the left in 2021-2022 in advanced economies (AEs) and emerging market economies (EMs).[2] Higher inflation also pushed inflation expectations above target in many countries.

2. To shed light on the expectations' formation process, this annex presents estimates of passthrough from inflation to inflation expectations at different horizons. The data is based on quarterly and monthly inflation expectations from the Continuous Consensus Survey and CPI inflation during 2000-2022 for a sample of AEs and EMs.[3] The following equation is estimated with a standard OLS regression:

$$\Delta\mathbb{E}_t(\pi_{\tau+j}) = \alpha + \beta_j \Delta\pi_t + \epsilon_t$$

where: $\Delta\mathbb{E}_t(\pi_{\tau+j})$ are changes in inflation expectations at horizon j and $\Delta\pi_t$ are changes in CPI inflation. The passthrough, β_j, is estimated for each time horizon separately.

3. Short-term passthrough increased recently. The passthrough to short-term inflation expectations increased in 2022, particularly at one year horizon and for EMs. On the other hand, the passthrough to medium-term inflation expectations (three years or more) remained unaffected and close to zero.

4. In general, short-term passthrough is larger when inflation is high. For both AEs and EMs, during the years 2000-2019, the short-term passthrough was larger in periods of high inflation. However, while for AEs the passthrough appeared to be proportional to changes in inflation, for EMs, large positive changes in inflation seemed associated with more-than-proportional positive increases in inflation expectations.

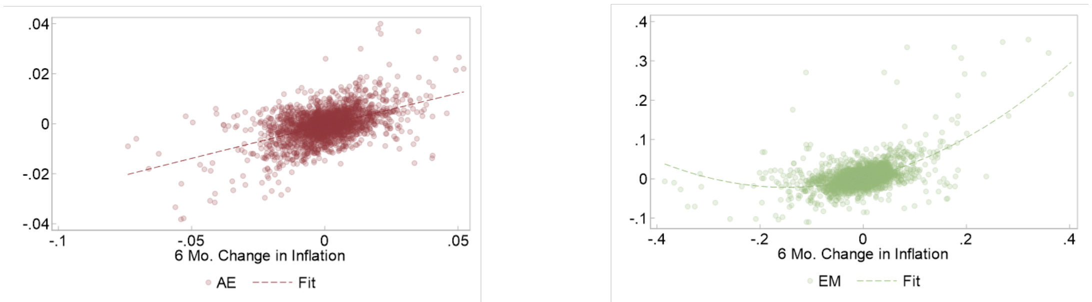
[1] Prepared by Chiara Fratto, based on Adler, Caruso Bloeck, and Fratto (forthcoming).

[2] The sample includes Brazil, Canada, Chile, Colombia, France, Germany, Japan, Mexico, Uruguay, Turkey, South Africa, the UK, and the USA.

[3] The sample includes Armenia, Canada, Chile, China, Colombia, Costa Rica, Czech Republic, Egypt, Guatemala, Hungary, India, Indonesia, Israel, Japan, Kazakhstan, Korea, Mexico, Moldovia, Nigeria, Norway, Paraguay, Peru, Philippines, Romania, Russia, South Africa, Sri Lanka, Sweden, Thailand, Turkey, Uruguay, the UK, and the USA.

Chile: Passthrough from Inflation to Short-Term Inflation Expectations

Advanced Economies | Emerging Market Economies

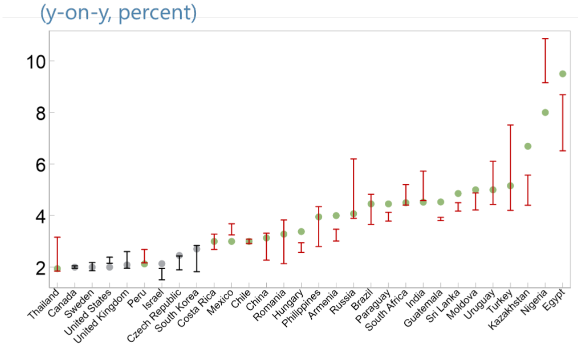


Sources: Consensus Economics, Haver, and IMF staff calculations.

5. **In 2022, the short-term passthrough has been larger in Chile than in other countries.** In the case of Chile, the short-term passthrough was significantly larger in 2022 than in the past and larger than in other countries. This is likely explained by inflation surprises impacting an economy with a very strong cyclical position, alongside an increase in inflation persistence.

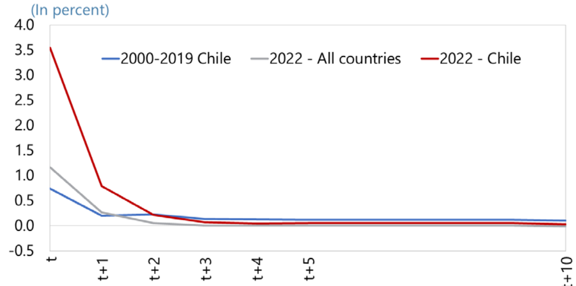
6. **Yet, Chilean medium-term inflation expectations remain tightly centered around the target.** The firm anchoring of inflation expectations is illustrated by the 75 percent confidence interval for Chile's medium-term inflation expectations, which is significantly tighter than in most countries. This is a testament of Chile's very strong and highly credible institutional policy framework.

Chile: 5-year Inflation Expectations
(y-on-y, percent)



Source: Consensus Economics, staff's calculations.
Note: Brackets are 75% confidence interval. Green dot is inflation target.

Chile: Revision to Inflation Expectations Following Inflation Increases 1/
(In percent)



Sources: Consensus Economics and IMF staff calculations.
1/ Regression of revisions of inflation expectations at different horizons on changes in realized inflation for a panel of Advanced Economies and Emerging Markets.

Annex V. Discretionary FX Intervention Programs

1. Since the adoption of inflation targeting and a floating exchange rate in 1999, the BCCh has intervened in FX markets in only four exceptional circumstances.[1]

Chile: Episodes of Discretionary FX Intervention Programs 1/ 2/ 3/

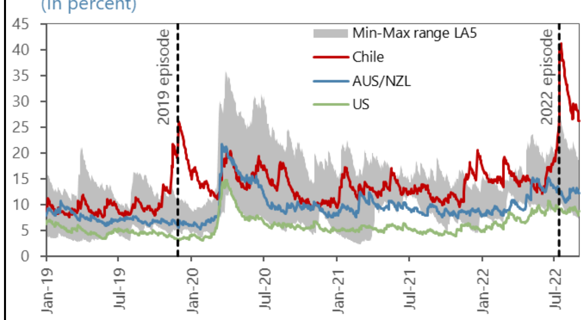
	Date	Trigger	Announcement	Outturn
1	Aug-01	Financial turmoil stemming from the crisis in Argentina, compounded by the September 11 attacks in the US.	Up to US$2 billion in spot markets and up to US$2 billion in forward markets over four months.	US$803 million in spot and US$2 billion in forward markets.
2	Oct-02	Turbulence during Brazil's presidential elections and a complex global scenario.	Up to US$2 billion in spot and US$2 billion in forward markets, until February 2003.	US$1.5 billion, without any spot sales.
3	Nov-19	Social unrest crisis in Chile, coupled with large capital outflows and financial volatility.	Up to US$20 billion, equally split between spot and forward operations.	US$2.5 billion in spot and US$4.5 billion in forward markets, over a period of six weeks.
4	Jul-22	Global financial tightening and fears of a global recession, followed by a sharp drop in copper prices of 30 percent between June and mid-July.	Up to US$20 billion, equally split between spot and forward operations over three months.	US$6.2 billion in the spot market and US$10 billion in forward markets.

1/ De Gregorio, J. and Tokman, A., 2005. "Flexible Exchange Rate Regime and Forex Intervention," BIS Papers No 24.
2/ García Silva, P., 2022. "Política cambiaria e intervenciones en el marco de metas de inflación del Banco Central de Chile," Documentos de Politica Economica No 72, September.
3/ Tapia, M. and Tokman, A., 2004. "Effects of Foreign Exchange Intervention under Public Information: The Chilean Case," Economía Journal, The Latin American and Caribbean Economic Association - LACEA, Vol. 0, Spring 20, January.

2. FX interventions have aimed to address disorderly market conditions without targeting any specific level of the exchange rate. While circumstances and triggers have varied, all FX intervention programs took place in contexts of excessive FX volatility that could not be justified by fundamentals, posing risks to price and financial stability objectives. The maximum intervention amounts, the intervention period, and auction plans and results have been transparently communicated. In addition, FX sales have been fully sterilized to ensure consistency with the monetary policy rate.

3. As in past episodes, the July FX intervention program was successful in stabilizing FX markets and preventing broader financial and real sector spillovers. On the day of the announcement (July 14), even before FX sales started, FX volatility declined, and the peso recovered about half of the 30 percent depreciation between June and mid-July. This suggests that the information and signaling channels operated strongly and the intervention program was highly credible. After the announcement, FX volatility further subsided, and bid-ask FX spreads normalized.

Chile: Currency Volatility
(In percent)



Sources: Central Bank of Chile and IMF staff calculation.
Note: Volatility measured with the Riskmetrics methodology.

[1] The BCCh also implemented three reserve accumulation programs in 2008, 2011, and 2021, justified by the need to replenish buffers and not linked to disorderly market conditions. It also provided FX liquidity swaps during the global financial crisis.

Annex VI. 2021 FSAP Key Recommendations

	Recommendations	Time[1]
Bank Solvency and Liquidity	Ensure banks transition to Basel III-compliant capital structures and complete announced plans for capital raises in a timely manner.	Near-term (NT)
	Improve the collateral valuation and reporting framework.	NT
	Define and communicate clear criteria regarding conditions for the future unwinding of extraordinary liquidity support measures (FCIC and LCL).	Immediate (I)
	Introduce liquidity stress tests for prudential and stability monitoring.	NT
Banking Supervision	Ensure sufficient budget resources to attract and retain specialized talent.	I
	Strengthen credit risk management and asset classification, including provisioning and treatment of restructured loans.	I, NT
	Establish an integrated risk management framework and enhance corporate governance standards and supervision.	NT
	Strengthen the legal framework for licensing to ensure banks' shareholders are fit, proper and financially strong.	NT
	Improve the corrective actions framework.	NT
	Improve consolidated supervision by enhancing the legal framework, supervision practices and organizational arrangements.	NT
Pension Funds	Avoid further pension withdrawals and ensure that the pension system continues to support deep and liquid long-term capital markets.	I
	Improve pension fund regulation and investment options to promote long-term investment and minimize excessive switching.	NT
Insurance	Halt any further liquidations of life annuities.	I
	Implement a modern risk-based capital framework in insurance with due regard to the impact of introducing IFRS 17 and IFRS 9.	NT
Mutual Funds	Strengthen the mutual fund liquidity management framework.	NT
Crisis Management and Bank Resolution	Establish a statutory bank resolution authority with a comprehensive range of crisis management and resolution tools.	I
	Establish and implement recovery and resolution planning and set a loss-absorbing capacity requirement for systemically important banks.	I
	Establish a new industry funded deposit protection scheme.	NT
Systemic Liquidity	Facilitate the development of the interbank repo market.	NT
	Enhance the risk management function of the BCCh through higher haircuts and a stricter approach to unsecured bank bonds.	I
	Finalize the Emergency Liquidity Assistance (ELA) framework.	NT
Macro-prudential Framework and Tools	Increase CEF secretariat resources and through annual publication of official CEF views on macroprudential risks.	NT
	Enhance interagency coordination on the use of the macroprudential toolkit.	NT
	Establish a consolidated and comprehensive public credit registry.	NT
AML/CFT	Ensure a swift implementation of the 2021 AML/CFT MER recommendations.	NT

[1] I=Immediate" is within one year; "NT=Near Term" is 1–3 years.

Annex VII. Fintech Developments and CBDC

1. **Fintech is shaping new financial landscapes across the globe.** It has not only enhanced the efficiency of financial services, but also promoted financial inclusion. Fintech also has the potential to foster the development of capital markets by:

- **Working as Alternative Funding Platforms:** Fintech can utilize the idle capital in the hand of private investors to be circulated in the financial market. Crowdfunding or P2P (peer-to-peer) lending have emerged as an attractive funding model for start-ups and individual investors. Even small amounts of pre-loaded money in payment platforms can be invested in money market funds. Moreover, such new funding models creates an opportunity for the incumbent financial institutions to collaborate with fintech firms to design new securitized products.

- **Enhancing Efficiency:** The explosion of data and new technologies in capital markets have allowed faster financial service with lower costs. The data set includes not only prices, but also information from alternative data source, such as utility payments, insurance claims, and social media. Financial companies benefit from AI/ML algorithms and advanced analytics to handle the vast amount of data and leverage them to create innovative investment products.

- **Facilitating Innovation with CBDC:** Although CBDC design can vary across countries, CBDC can also work as a platform for providing financial services. Lower costs associated with CBDC give incentives to a wider set of providers and users to accept CBDC. In particular, CBDC with programmable functions can deepen capital markets by promoting the development of tokenized assets and the automation of trading through smart contracts.

2. **The Chilean authorities recently took important steps to keep up with the rapidly changing fintech landscape.** The Fintech Law approved in October brings fintech activities into the regulatory perimeter. The law is expected to promote competition, enhance financial inclusion and innovation, and improve consumer data protection. The CMF will issue related regulations, on licensing requirements, risk management, data protection, and open finance, and supervise the new firms and the open finance ecosystem in the widened regulatory perimeter. The law contains three key elements:

- **New Financial Activities:** Financial services regulated by the law include crowdfunding, alternative trading systems, custody of financial instruments, credit and investment advice, trading of financial instruments, and transaction routing. Fintech companies must be authorized and registered by the CMF.

- **Open Finance:** Customers can share their information with new providers (including financial institutions, fintechs, and others) with greater control and autonomy over their financial data and information. With customers' express consent, financial information can be exchanged directly and securely among institutions participating in the open finance system,

through remote and automated access interfaces. The operation and implementation of the open finance system will be regulated by the CMF.

- **Cryptoassets and Stablecoins:** The law also considers crypto-assets as financial instruments that will be subject to CMF regulation. Stablecoins (i.e., cryptoassets whose value is backed by fiat currencies or short-term liquid assets) are instead considered as a payment method and subject to BCCh regulation.

3. **The BCCh established an internal working group to propose a medium-term strategy for digital payments and published an initial report for the *Issuance of a Central Bank Digital Currency in Chile*.** This first report provides a preliminary assessment of the benefits and challenges associated with the issuance of a retail CBDC that people can use for daily transactions. It suggests that a careful evaluation of costs and benefits is needed compared to alternative payment systems. The BCCh will advance broader discussions with the public and private stakeholders.

- **Benefits.** The BCCh expects the CBDC to be not only a form of retail digital money but also a platform for developing innovative payment services. A CBDC would lower barriers to entry into payment markets, promoting competition and innovation. In addition, a CBDC in Chilean pesos could mitigate risks from the potential widespread use of other forms of digital currencies denominated in different units of account.

- **Challenges.** The introduction of a CBDC can weaken banks' intermediation and increase financial stability risks, for example by causing a run to the CBDC during periods of stress. In addition, the BCCh could face significant technological and institutional challenges derived from a closer relationship with the public. Moreover, there are still no international standards or models that have proven to achieve the desired objectives.

Annex VIII. Public Debt Sustainability Analysis

Table 1. Chile: Risk of Sovereign Stress

Horizon	Mechanical signal	Final assessment	Comments
Overall	...	Low	The overall risk of sovereign stress is low, reflecting a relatively low level of vulnerability in the near-term and long-term horizons.
Near term 1/	...	...	
Medium term	Low	Low	Medium-tem risks are assessed as low, reflecting the strength of the fiscal framework in guiding fiscal policy and rebuilding buffers.
Fanchart	Low	...	
GFN	Low	...	
Stress test	...	...	
Long term	...	Low	Long-term risks are assessed as low, as aging-related expenditure linked to health and pension are expected to be paired to higher revenues.
Sustainability assessment 2/		Sustainable with high probability	The projected debt path is expected to stabilize and GFNs will remain at manageable levels. Therefore, debt is assessed as sustainable with high probability.
Debt stabilization in the baseline			Yes

DSA Summary Assessment

Commentary: 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. 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.

Source: IMF staff calculations.

Note: The risk of sovereign stress is a broader concept than debt sustainability. Unsustainable debt can only be resolved through exceptional measures (such as debt restructuring). In contrast, a sovereign can face stress without its debt necessarily being unsustainable, and there can be various measures—that do not involve a debt restructuring—to remedy such a situation, such as fiscal adjustment and new financing.

1/ The near-term assessment is not applicable in cases where there is a disbursing IMF arrangement. In surveillance-only cases or in cases with precautionary IMF arrangements, the near-term assessment is performed but not published.

2/ A debt sustainability assessment is optional for surveillance-only cases and mandatory in cases where there is a Fund arrangement. The mechanical signal of the debt sustainability assessment is deleted before publication. In surveillance-only cases or cases with IMF arrangements with normal access, the qualifier indicating probability of sustainable debt ("with high probability" or "but not with high probability") is deleted before publication.

Table 2. Chile: Debt Coverage and Disclosures

	CG	GG	NFPS	CPS	Other	Comments
1. Debt coverage in the DSA: 1/	CG	GG	NFPS	CPS	Other	
1a. If central government, are non-central government entities insignificant?					Yes	

2. Subsectors included in the chosen coverage in (1) above:

Coverage		Subsectors captured in the baseline	Inclusion	Comments
CPS / NFPS / GG: expected / CG	1	Budgetary central government	Yes	
CPS / NFPS / GG: expected / CG	2	Extra budgetary funds (EBFs)	No	Not applicable
CPS / NFPS / GG: expected / CG	3	Social security funds (SSFs)	No	
CPS / NFPS / GG: expected	4	State governments	No	Debt issuance not allowed
CPS / NFPS / GG: expected	5	Local governments	No	Debt issuance not allowed
CPS / NFPS	6	Public nonfinancial corporations	No	
CPS	7	Central bank	No	
CPS	8	Other public financial corporations	No	

3. Instrument coverage:

Currency & deposits	Loans	Debt securities	Oth acct. payable 2/	IPSGSs 3/

4. Accounting principles:

Basis of recording		Valuation of debt stock		
Non-cash basis 4/	Cash basis	Nominal value 5/	Face value 6/	Market value 7/

5. Debt consolidation across sectors:

Consolidated	Non-consolidated

Color code: chosen coverage; Missing from recommended coverage; Not applicable

Reporting on Intra-government Debt Holdings

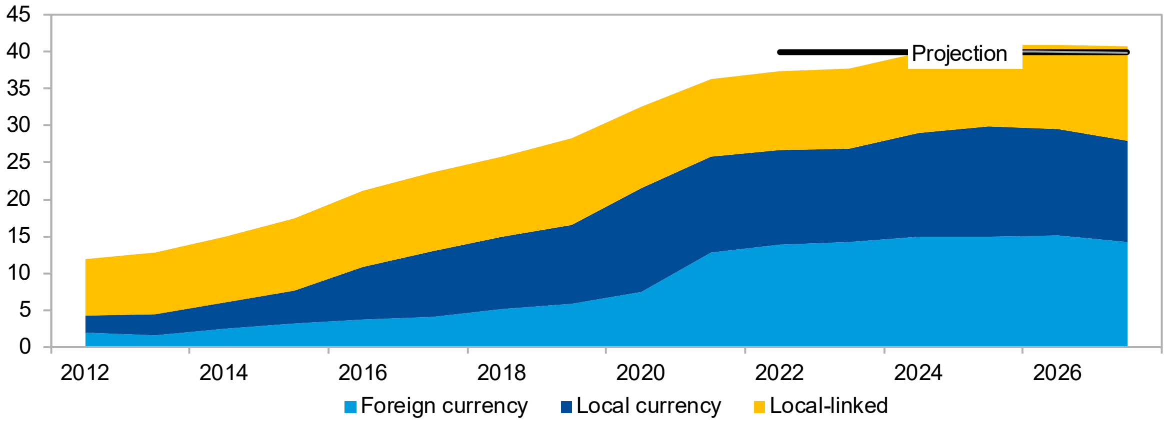
Issuer \ Holder			Budget. central govt	Extra-budget. funds (EBFs)	Social security funds (SSFs)	State govt.	Local govt.	Nonfin. pub. corp.	Central bank	Oth. pub. fin corp	Total
CPS / NFPS / GG: expected / CG	1	Budget. central govt									0
CPS / NFPS / GG: expected / CG	2	Extra-budget. funds									0
CPS / NFPS / GG: expected / CG	3	Social security funds									0
CPS / NFPS / GG: expected	4	State govt.									0
CPS / NFPS / GG: expected	5	Local govt.									0
CPS / NFPS	6	Nonfin pub. corp.									0
CPS	7	Central bank									0
CPS	8	Oth. pub. fin. corp									0
		Total	0	0	0	0	0	0	0	0	0

1/ CG=Central government; GG=General government; NFPS=Nonfinancial public sector; PS=Public sector.
2/ Stock of arrears could be used as a proxy in the absence of accrual data on other accounts payable.
3/ Insurance, Pension, and Standardized Guarantee Schemes, typically including government employee pension liabilities.
4/ Includes accrual recording, commitment basis, due for payment, etc.
5/ Nominal value at any moment in time is the amount the debtor owes to the creditor. It reflects the value of the instrument at creation and subsequent economic flows (such as transactions, exchange rate, and other valuation changes other than market price changes, and other volume changes).
6/ The face value of a debt instrument is the undiscounted amount of principal to be paid at (or before) maturity.
7/ Market value of debt instruments is the value as if they were acquired in market transactions on the balance sheet reporting date (reference date). Only traded debt securities have observed market values.

Commentary: The authorities continually manage state-contingent debts, which are clearly detailed in an annual report. Both the withdrawal of private pensions and the expansion of credit guarantees (FOGAPE) are only expected to result in modest fiscal costs in the medium term.

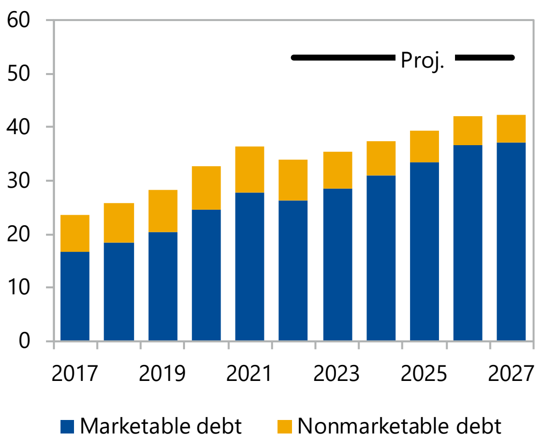
Table 3. Chile: Public Debt Structure Indicators

Debt by Currency (percent of GDP)



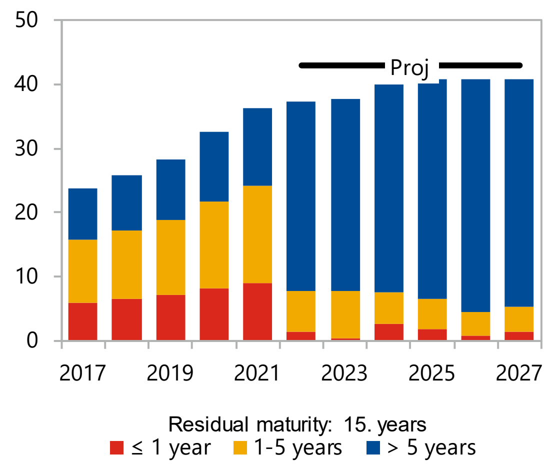
Note: The perimeter shown is central government.

Debt by Instruments (percent of GDP)



Note: The perimeter shown is general government.

Public Debt by Maturity



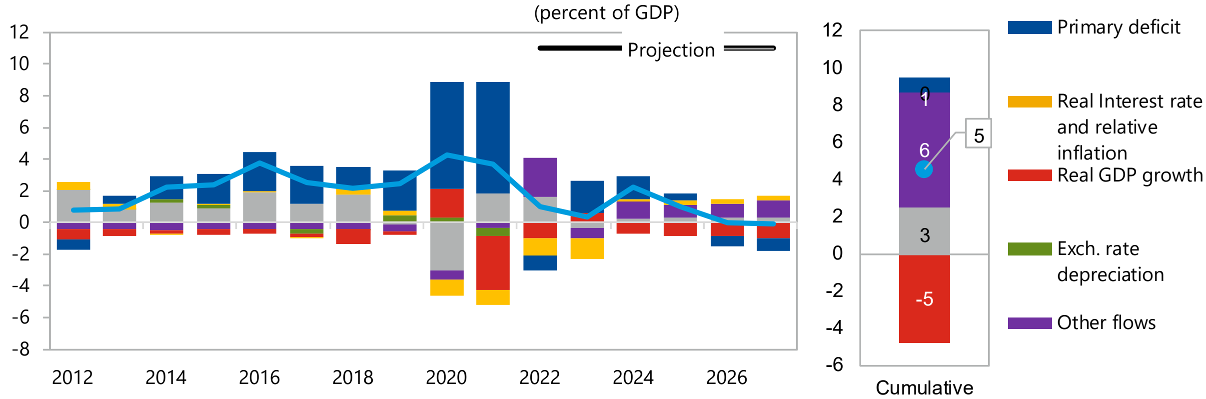
Note: The perimeter shown is general government.

Commentary: Debt in foreign currency increased the last year, but remains a small fraction. Over the medium term, the share of external debt is projected to converge to historical values.

Table 4. Chile: Baseline Scenario
(In percent of GDP unless indicated otherwise)

	Actual	Medium-term projection					
	2021	2022	2023	2024	2025	2026	2027
Public debt	36.3	37.3	37.7	39.9	40.9	40.9	40.8
Change in public debt	3.7	1.0	0.3	2.2	1.0	0.0	-0.1
Contribution of identified flows	1.9	-0.6	0.7	2.0	0.7	-0.3	-0.4
Primary deficit	7.1	-1.0	2.0	1.4	0.4	-0.6	-0.8
Noninterest revenues	23.8	24.1	21.5	22.2	22.4	22.4	22.4
Noninterest expenditures	30.9	23.1	23.5	23.7	22.8	21.8	21.6
Automatic debt dynamics	-4.8	-2.0	-0.7	-0.5	-0.5	-0.5	-0.7
Real interest rate and relative inflatior	-1.0	-1.1	-1.3	0.2	0.3	0.3	0.3
Real interest rate	-1.2	-1.7	-2.2	0.0	0.2	0.2	0.2
Relative inflation	0.2	0.6	0.9	0.1	0.1	0.1	0.1
Real growth rate	-3.4	-1.0	0.6	-0.7	-0.8	-0.9	-1.0 .
Real exchange rate	-0.5	…	…	…	…	…	… .
Other identified flows	-0.4	2.4	-0.6	1.0	0.8	0.8	1.1
Contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other transactions	-0.4	2.4	-0.6	1.0	0.8	0.8	1.1
Contribution of residual	1.8	1.6	-0.4	0.3	0.3	0.3	0.3
Gross financing needs	11.2	-0.6	4.3	2.3	4.0	4.0	0.4
of which: debt service	4.4	1.9	3.0	1.7	4.4	5.4	1.9
Local currency	3.5	1.3	1.8	1.0	2.6	1.9	0.7
Foreign currency	0.5	0.5	0.4	0.4	1.0	0.9	1.1
Memo:							
Real GDP growth (percent)	11.7	2.7	-1.5	1.9	2.1	2.2	2.5
Inflation (GDP deflator; percent)	7.5	8.0	9.7	3.4	2.7	2.7	2.8
Nominal GDP growth (percent)	20.3	10.9	8.0	5.3	4.8	4.9	5.4
Effective interest rate (percent)	3.2	2.9	3.3	3.5	3.3	3.3	3.2

Contribution to Change in Public Debt
(percent of GDP)



Commentary: Public debt will rise a bit but then stablize, reflecting expectations of a narrowing of primary deficits and stable economic conditions.

Table 5. Chile: Realism of Baseline Assumptions

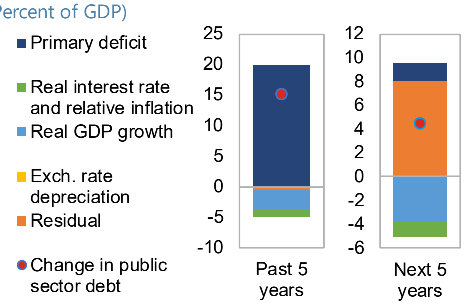
Forecast Track Record 1/	t+1	t+3	t+5
Public debt to GDP			
Primary deficit			
r - g			
Exchange rate depreciaton			
SFA			
	real-time	t+3	t+5
Historical Output Gap Revisions 2/			

Comparator Group:
Emerging Markets, Commodity Exporter, Program

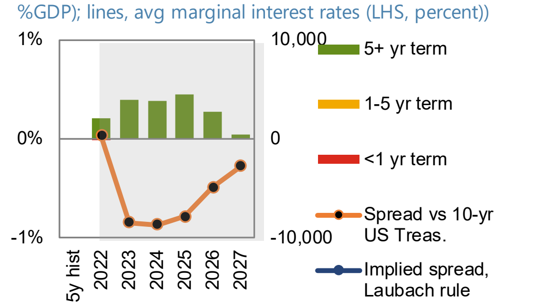
Color code:

Optimistic		> 75th percentile
		50-75th percentile
Pessimistic		25-50th percentile
		< 25th percentile

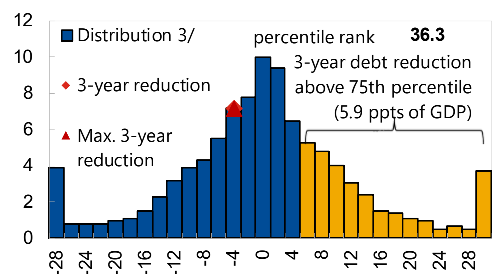
Public Debt Creating Flows
(Percent of GDP)



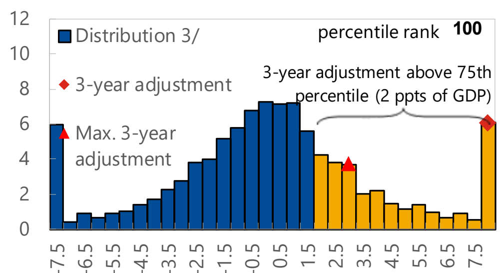
Bond Issuances (bars, debt issuances (RHS, %GDP); lines, avg marginal interest rates (LHS, percent))



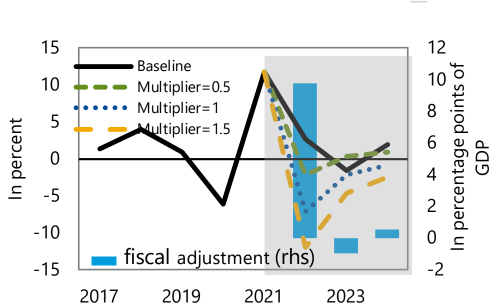
3-Year Debt Reduction
(Percent of GDP)



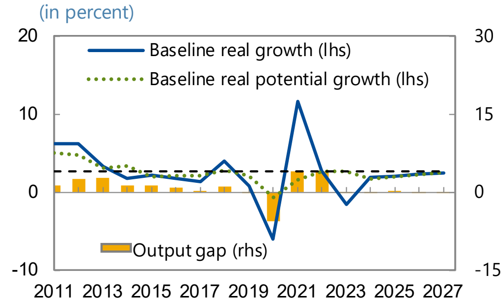
3-Year Adjustment in Cyclically-Adjusted Primary Balance (Percent of GDP)



Fiscal Adjustment and Possible Growth Paths
(lines, real growth using multiplier (LHS); bars, fiscal adj. (RHS)



Real GDP Growth
(in percent)



Commentary: Historically, projections have been optimistic but within reason, and the realism analysis does not point to major concerns: the forecasted debt reduction is realistic in comparison with other countries and economic conditions are expected to be in line with historical data.

Source: IMF staff.
1/ Projections made in the October and April WEO vintage.
2/ Data cover annual obervations from 1990 to 2019 for MAC advanced and emerging economies. Percent of sample on vertical axis.
3/ Starting point reflects the team's assessment of the initial overvaluation from EBA (or EBA-Lite).

Table 6. Chile: Medium-Term Risk Analysis

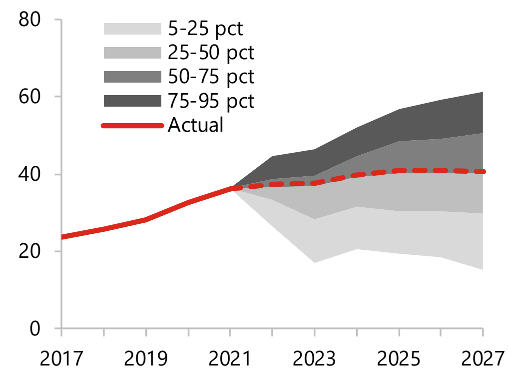
Debt Fanchart and GFN Financeability Indexes

(percent of GDP unless otherwise indicated)

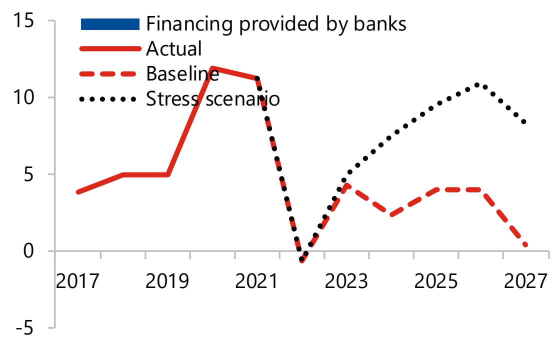
Module	Indicator	Value	Risk index	Risk signal	Adv. Econ., Non-Com. Exp, Program (0 / 25 / 50 / 75 / 100)
Debt fanchart module	Fanchart width	46.3	0.7	...	
	Probability of debt not stabilizing (pct)	5.4	0.0	...	
	Terminal debt level x institutions index	15.5	0.3	...	
	Debt fanchart index	**...**	**1.1**	**Low**	
GFN finance-ability module	Average GFN in baseline	2.4	0.8	...	
	Bank claims on government (pct bank assets)	6.8	2.2	...	
	Chg. in claims on govt. in stress (pct bank assets)	7.0	2.4	...	
	GFN financeability index	**...**	**5.4**	**Low**	

Legend: Interquartile range; Chile

Final Fanchart (pct of GDP)

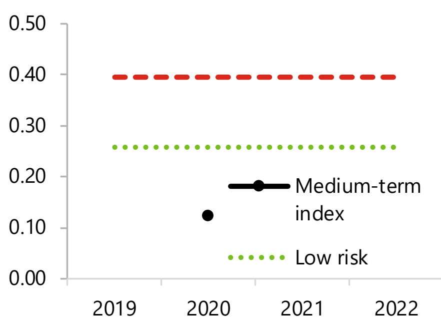


Gross Financing Needs (pct of GDP)



Medium-Term Index

(index number)



Medium-Term Risk Analysis

	Low risk threshold	High risk threhsold	Weight in MTI	Normalized level
Debt fanchart index	1.1	2.1	0.5	0.2
GFN finaceability index	7.6	17.9	0.5	0.1
Medium-term index (MTI)	0.3	0.4	...	0.2, Low

Prob. of missed crisis, 2022-2027 (if stress not predicted): 9.1 pct.

Prob. of false alarm, 2022-2027 (if stress predicted): 61.4 pct.

Commentary: Of the two medium-term tools, the Debt Fanchart Module is pointing to moderate level of risk, while the GFN Financeability Module suggests low levels of risk.

Annex IX. Tax Reform Proposal

1. Following discussions in congress, the government amended some aspects of the tax reform and revised down the estimated net gains to 3.5 percent of GDP by 2026, from 4.1 percent of GDP originally. The pillars of the reform broadly unchanged, but new incentives will lower the overall net gains. Key amendments are highlighted in *italics* below.

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

	2023	2024	2025	2026
Income taxes	0.2	0.6	0.7	0.8
Wealth	0.0	0.3	0.4	0.4
Reduction of exemptions'	0.0	0.0	0.0	0.2
Tax administration	0.4	0.8	1.2	1.6
Royalty	0.0	0.1	0.5	0.5
Corrective taxes	0.0	0.0	0.1	0.3
Total increase in revenues	0.6	1.8	3.0	3.8
Tax expenditures	0.0	-0.4	-0.3	-0.3
Net increase in revenues	0.6	1.4	2.7	3.5
Differences with original proposal	0.0	-0.5	-0.5	-0.6

Sources: Ministry of Finance and IMF staff estimates.

- **PIT**. The reform proposes a move from semi-integrated income taxation to a dual system, with a new tax on capital income. The number of tax brackets would increase from 8 to 10, with higher marginal tax rates at higher incomes. A new tax on retained earnings from firms with a majority of revenues from passive sources would be introduced. *There will be a new treatment of deferred accumulated earnings.*

- **New wealth tax**. A rate of one percent would apply to global net wealth in excess of US$5 million, increasing to 1.8 percent for net wealth in excess of US$15 million. *The total tax burden, considering both PIT and the wealth tax, will be capped at a level still to be determined.*

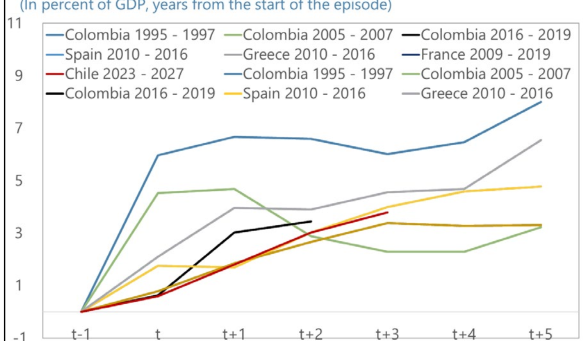
- **Corporate income tax.** The top rate would decline from 27 to 25 percent, but a new 2 percent "development tax" on earnings could be paid with investments in R&D or productivity enhancing measures. *Immediate depreciation and the loss carryforward are expanded*.

- **Adjustments to mining royalties for large-scale copper producers.** An additional ad valorem tax at a fixed rate and higher rates on the current profits-based tax would apply.

- **Carbon tax.** A higher carbon tax and other green taxes will be introduced.

- **Tax administration.** Measures include a new anti-avoidance rule, a fiscal whistleblower program, more relaxed banking-secret restrictions vis-à-vis the tax authority, and more stringent transfer pricing regulations, among others.

OECD: Episodes of Sustainable High Revenue Gains
(In percent of GDP, years from the start of the episode)



Source: IMF, Assessment of Revenue Tool database.

- **Other measures.** *There will be a more favorable tax treatment for small and medium-sized enterprises, and tax credits for productive and green investments (registered as tax expenditures).*

2. **Cross-country experience suggests that the expected gross medium-term yield of 3.8 percent of GDP (before tax expenditures) is ambitious.** As a benchmark, staff looked at the tax to GDP ratio for OECD countries during 1990 – 2019 (pre-pandemic). There have been 24 country episodes of similar (or larger) increases in tax ratios over a similar period, with the tax ratio increasing substantially (over 1.5 percent of GDP) and in a sustainable manner (lasting at least 4 years). Out of this sample, only 6 episodes (about one quarter of all cases) had revenue yields above 3 percent point of GDP in four years (or less) from the start of the episode.

Annex X. Pension Reform Proposal

1. The government submitted to congress in early-November its pension reform proposal. The proposal builds on the existing mixed system aiming to improve pensions while strengthening redistribution towards women and pensioners with below-average income. The main changes are presented below.

- **Expansion of the public non-contributory pillar.** The PGU would be gradually increased by almost one third to CLP250k per month (about US$270) and be expanded to cover for all persons over 65 with pensions below the maximum (from the current 90 percent coverage).

  This expansion can be expected to further tackle low replacement rates (with a fiscal cost estimated at about 0.4 percent of GDP) and would be contingent on the approval of the tax reform.

- **Overhaul of the private capitalization pillar.** AFPs would cease to exist in their current form but could transition into private investment managers (PIMs), which would continue to invest the accumulated stock of savings in individual capitalization accounts (US$154 billion at end-October, about 50 percent of GDP). Workers would be able to choose a PIM to also invest the new flows into their capitalization accounts (from the existing workers' contribution); a new public investment entity (PIE) would be the default option. The commission for PIMs would now depend on assets under management instead of flows. The government expects to lower the commission rate, thus increasing the effective contribution from workers to 10.5 percent (from the current 10 percent).

  Removing the administrative functions from the AFPs (e.g., affiliation, collection, customer service, payments) and centralizing them in a new public autonomous pension administrator (APA) can improve efficiency if well managed. Reforming the commission system would also help remove inefficient frontloading of commission fees. However, fostering competition among PIMs and a PIE raises concerns regarding a level playing field.

- **Creation of a new public contributory solidarity pillar.** This would be financed by a new 6 percent employers' contribution (contributions would increase gradually at a rate of 1 percent per year). 30 percent of the new contribution would be distributed benefiting women and those with below-average incomes (intra-generational redistribution) and finance a transitory pay-as-you go component for current pensions (inter-generational redistribution). The remaining 70 percent would go to individual notional accounts. This new pillar would be managed by the APA. The PIE would manage the notional accounts and would be the default option to manage the new flow of funds from workers' contributions. Individuals may also transfer their stock of savings from AFPs to the PIE.

  Ensuring sustainability will require careful calibration. Notional accounts that strictly adhere to simple sustainable rates of return (e.g., following aggregate wage bill growth) tend to be very volatile. On the other hand, smoothing mechanisms turn them in practice into pay-as-you-go

defined benefit schemes, which if not properly designed, will lead to imbalances, and can potentially undermine sustainability.

At the individual level, notional accounts would weaken incentives to save compared with individual capitalization accounts, while the increase in aggregate savings will depend on the effectiveness of translating higher contributions into forced savings and how fast the inter-generational redistribution cost can be phased out.

Intra-generational redistribution can incentivize formalization, but higher social security contributions will raise the cost of formal labor for firms, adding to costs of the planned increase in the minimum wage and the reduction in the workweek.