INTERNATIONAL MONETARY FUND

IMF Country Report No. 15/227

# CHILE

August 2015

## 2015 ARTICLE IV CONSULTATION—PRESS RELEASE; AND STAFF REPORT

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the 2015 Article IV consultation with Chile, the following documents have been released and are included in this package:

- A **Press Release**.
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on a lapse of time basis, following discussions that ended on June 23, 2015, with the officials of Chile on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on July 21, 2015.
- An **Informational Annex** prepared by the IMF staff.

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

Selected Issues

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August 6, 2015

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# IMF Executive Board Concludes 2015 Article IV Consultation with Chile

On August 4, 2015, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation[1] with Chile, and considered and endorsed the staff appraisal without a meeting[2].

GDP growth has remained lackluster over the past year. The main force behind the economic slowdown in 2014 has been the sharp fall in private investment, mainly the consequence of the end of the mining boom but also reflecting the uncertainty and adjustment costs associated with the structural reform agenda. The external position has improved markedly, with a large decline in the current account deficit and a real exchange rate now close to equilibrium.

The economic recovery that started towards the end of 2014 is still fragile and recent economic indicators suggest that private domestic demand is relatively weak. Staff expects growth to increase modestly to 2.5 percent in 2015, mainly thanks to strong fiscal support. Private domestic demand should strengthen somewhat in 2016, primarily as very simulative monetary conditions and a gradual recovery of business confidence sustain private investment.

The balance of risks is on the downside. The main risk is a persistent weakness of private sector confidence and investment, amid continued uncertainty over the structural reform agenda and the external outlook. On the external front, a further decline in copper prices or greater global financial volatility could also derail the recovery. High leverage and heavy reliance on foreign currency debt make Chile's corporate sector vulnerable to a tail-risk

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

[2] The Executive Board takes decisions under its lapse-of-time procedure when the Board agrees that a proposal can be considered without convening formal discussions.

downside scenario, where foreign interest rates increase sharply, the availability of foreign funding dries out, the peso depreciates strongly, and the economic slowdown accentuates.

The financial sector appears generally healthy, with banks showing solid profitability and adequate capital buffers. On the other hand, life insurance companies and pension funds continue to be pressured by the low yield environment and have kept on restructuring their portfolios towards riskier or less liquid assets.

The macroeconomic policy mix has remained highly accommodative. Staff estimates that the cumulative fiscal impulse in 2014–15 was equivalent to 1.7 percent of GDP, mainly reflecting an increase in spending (in infrastructure, education and current transfers). The Central Bank has kept the policy rate at 3 percent after reducing it by 200 basis points between September 2013 and November 2014. The authorities have continued to advance their structural reform agenda. Legislation approved early this year reforms the primary and secondary education systems by ending for-profit education, co-payments and discrimination practices. A labor market reform that aims at expanding the coverage and scope of collective bargaining by empowering trade unions is currently under discussion at Congress.

**Executive Board Assessment**

In concluding the 2015 Article IV consultation with Chile, Executive Directors endorsed the staff's appraisal as follows:

Growth has remained lackluster over the past year, as the economy continues to adjust to the end of the mining boom. The main force behind the slowdown has been the sharp fall in fixed investment. To a large extent, this reflects the inevitable adjustment of the Chilean economy to the end of the commodity boom, which had pushed investment and GDP growth to above potential rates over the past few years. The external position has improved markedly, with a large decline in the current account deficit and a real exchange rate now closer to a level consistent with macroeconomic and policy fundamentals.

But the economy has also been negatively affected by the adjustment costs from the structural reform agenda launched in 2014. The decline in fixed investment partly reflects the fall in business confidence which cannot be fully reconciled with the external shocks, and likely results from the uncertainty generated by the structural reform agenda and its short-term costs. If well implemented, the reforms have the potential to boost productivity and long-term growth, but the higher cost of capital and the complexity of the new tax regime are likely to have a negative effect on economic activity in the short-term. Moreover, the announced constitutional and labor market reforms appear to have increased private sector's uncertainty over Chile's future economic environment.

GDP growth is expected to increase modestly in 2015 and 2016, but the balance of risks is tilted to the downside. In the baseline scenario, GDP growth picks up modestly to 3.1 percent in 2016 from 2½ percent in 2015. Continued accommodative monetary policy conditions and a gradual recovery of business sentiment will improve non-mining business investment, more than offsetting continued weakness in mining investment. The main risk to the baseline scenario is a more persistent weakness of private sector confidence and investment, amid protracted uncertainty over the structural reform agenda and the external outlook. On the external front, a further decline in copper prices from a deeper than expected downturn in China's economy would imply more depressed activity in the mining sector, while renewed bouts of global financial volatility and disruptive asset price shifts may tighten external financial conditions for Chile's highly leveraged corporate sector.

Against this background, the macroeconomic policy mix should combine tighter fiscal policy with continued monetary policy accommodation. As the economy is expected to recover gradually, starting a process of fiscal consolidation next year is warranted. Reaffirming the commitment to fiscal discipline after the fiscal impulse in 2015 would also help boost business confidence. The pace of fiscal consolidation would need to take into account the deterioration of the long-term prospects for GDP growth and copper prices. On the other hand, the beginning of fiscal consolidation, the well-anchored inflation expectations, and the downside risks to growth all give room for monetary policy to remain accommodative until there are strong signs that the economic recovery consolidates.

Nurturing the return of business confidence also requires a careful design and implementation of the structural reform agenda. It is important to minimize the potential for short-term negative effects on growth, including those related to higher uncertainty. In this regard, effective action could be taken to clarify the procedures of the constitutional reform; ensure that the reform of the labor market improves its efficiency; and pursue the education reform with a view to raising the quality of Chile's human capital, increasing productivity, and lowering income inequalities.

The authorities' efforts to strengthen public and private sectors' governance and institutions are commendable. The measures that aims at improving corporate governance, investor protection, and market transparency, could bolster business confidence, increase market liquidity and reduce the cost of capital. Improvements in the institutional framework for PPP arrangements could contribute to mobilizing private financial resources needed to fill Chile's infrastructure gap, as well as promoting the efficient use of public funds. The recent efforts to restore confidence in public institutions are also needed and timely.

While Chile's financial sector is healthy, there are a few areas where financial oversight could be strengthened further. The relatively high level of corporate and household debt does not appear to pose risks to economic and financial stability per se, but it may reduce Chile's resilience to negative shocks and needs to be monitored closely. If the increase in corporate leverage were to accelerate in the future, the authorities could consider adopting additional prudential measures to safeguard Chile's financial sector against these shocks. The adoption of minimum liquidity standards and the authorities' plan to send the new General Banking Law to Congress during the second half of 2015 (which will introduce Basel III bank capital standards) are welcomed. While the Financial Stability Council law represents an important step forward, the authorities should keep strengthening the supervision of financial conglomerates. As the insurance companies' expansion into riskier and less liquid investments continues, it is essential to approve the bill proposal that implements risk-based supervision and introduces new solvency requirements for insurance companies.

## Chile: Selected Social and Economic Indicators

| | | | |
|---|---|---|---|
| GDP (2014), in billions of pesos | 147,166 | Quota | |
| GDP (2014), in billions of U.S. dollars | 258.0 | in | 856 |
| Per capita (U.S. dollars) | 14,480 | in % | 0.36% |
| Population (2014), in millions | 17.8 | Poverty | 14.40 |
| Main products and exports | Copper | Gini coefficient | 50.84 |
| Key export markets | China, Euro area, U.S. | Literacy | 98.9 |

| | | | | | | Proj. | |
|---|---|---|---|---|---|---|---|
| | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 |
| | (Annual percentage change, unless otherwise specified) | | | | | | |
| **Output** | | | | | | | |
| Real GDP | 5.7 | 5.8 | 5.5 | 4.3 | 1.9 | 2.5 | 3.1 |
| Total domestic demand | 13.4 | 9.3 | 7.4 | 3.7 | -0.7 | 3.5 | 3.7 |
| Consumption | 9.7 | 7.8 | 5.7 | 5.5 | 2.5 | 4.4 | 3.3 |
| Private | 10.8 | 8.9 | 6.1 | 5.9 | 2.2 | 2.3 | 3.3 |
| Public | 4.6 | 2.5 | 3.5 | 3.4 | 4.4 | 15.8 | 2.9 |
| Investment | 27.0 | 14.2 | 12.5 | -1.1 | -10.3 | 0.3 | 5.0 |
| Fixed | 11.6 | 15.0 | 11.6 | 2.1 | -6.1 | 0.2 | 3.1 |
| Inventories 1/ | 2.9 | 0.0 | 0.3 | -0.9 | -1.1 | 0.0 | 0.4 |
| Net exports 1/ | -7.6 | -4.2 | -2.0 | 0.5 | 3.2 | -0.8 | -0.6 |
| Exports | 2.3 | 5.5 | 0.1 | 3.4 | 0.7 | 1.5 | 3.0 |
| Imports | 25.5 | 16.0 | 4.8 | 1.7 | -7.0 | 3.4 | 4.3 |
| **Employment** | | | | | | | |
| Unemployment rate (annual average) | 8.2 | 7.1 | 6.4 | 5.9 | 6.4 | 6.5 | 6.6 |
| **Consumer prices** | | | | | | | |
| End of period | 3.0 | 4.4 | 1.5 | 2.8 | 4.6 | 3.3 | 3.0 |
| Average | 1.4 | 3.3 | 3.0 | 1.9 | 4.4 | 3.7 | 3.0 |
| | (In percent of GDP, unless otherwise specified) | | | | | | |
| **Public sector finances** | | | | | | | |
| Central government revenue | 21.6 | 22.6 | 22.2 | 21.0 | 20.7 | 20.4 | 22.1 |
| Central government expenditure | 22.0 | 21.4 | 21.6 | 21.6 | 22.4 | 23.5 | 24.1 |
| Central government fiscal balance | -0.5 | 1.3 | 0.6 | -0.6 | -1.6 | -3.2 | -2.0 |
| Structural fiscal balance 2/ | -2.5 | -1.0 | -0.1 | -1.1 | -1.5 | -2.8 | -1.7 |
| Fiscal impulse | -1.9 | -1.4 | -0.9 | 1.0 | 0.5 | 1.3 | -1.1 |
| Public sector net debt | -2.2 | -4.9 | -1.8 | -1.7 | -1.3 | 2.6 | 4.6 |
| Public sector gross debt | 25.9 | 34.9 | 34.6 | 33.7 | 36.1 | 38.8 | 39.6 |
| Central government gross debt | 8.6 | 11.2 | 12.0 | 12.8 | 15.1 | 17.6 | 19.0 |
| Of which, share of FX-denominated debt (in percent) | 17.3 | 17.2 | 16.1 | 12.9 | 15.9 | 15.3 | 15.7 |
| **Money and credit** | | | | | | | |
| Broad money (percentage change) | 9.3 | 18.5 | 7.6 | 14.9 | 9.3 | ... | ... |
| Credit to the private sector (percentage change) | 7.1 | 16.9 | 12.1 | 10.2 | 10.4 | ... | ... |
| 3-month central bank bill rate (%) | 1.7 | 4.9 | 5.1 | 5.0 | 4.0 | ... | ... |
| **Balance of payments** | | | | | | | |
| Current account | 1.7 | -1.2 | -3.6 | -3.7 | -1.2 | -0.4 | -1.2 |
| Current account (in billions of U.S. dollars) | 3.8 | -3.1 | -9.6 | -10.1 | -3.0 | -1.1 | -3.2 |
| Foreign direct investment inflows | 7.1 | 9.3 | 10.7 | 7.0 | 8.5 | 8.8 | 8.7 |
| Gross international reserves (in billions of U.S. dollars) | 27.9 | 42.0 | 41.6 | 41.1 | 40.4 | 40.4 | 40.4 |
| In months of next year's imports of goods and services | 3.9 | 5.6 | 5.5 | 6.0 | 6.2 | 5.9 | 5.5 |
| Gross external debt | 39.1 | 39.6 | 45.5 | 47.9 | 56.5 | 60.1 | 61.1 |
| Public | 2.6 | 2.9 | 3.1 | 2.6 | 3.3 | 3.8 | 4.1 |
| Private | 36.5 | 36.7 | 42.4 | 45.3 | 53.2 | 56.3 | 57.0 |
| | (Annual percentage change) | | | | | | |
| **Exchange rate** | | | | | | | |
| Real effective exchange rate (real appreciation +) | 5.4 | 0.4 | 3.2 | -0.6 | -8.8 | ... | ... |
| Terms of trade | 22.0 | 1.5 | -6.6 | -2.8 | -1.3 | 1.2 | -1.0 |

Sources: Central Bank of Chile, Ministry of Finance, Haver Analytics, and IMF staff calculations and projections.
1/ Contribution to growth.
2/ Headline balance adjusted for the economic and copper price cycles.

INTERNATIONAL MONETARY FUND

# CHILE

## STAFF REPORT FOR THE 2015 ARTICLE IV CONSULTATION

July 21, 2015

## KEY ISSUES

**Context:** Chile's GDP growth slowed sharply in 2014, as lower copper prices hurt the mining sector while non-mining investment suffered from the decline in business confidence after the launch of an ambitious set of reforms by the new administration. The strong fiscal and monetary policy response helped stabilize the economy, but output is expected to recover only gradually to a lower medium-term growth rate than forecasted in the 2014 Article IV Consultation staff report, and the balance of risks remains tilted to the downside.

**Policy challenges:** Fiscal consolidation is warranted after this year's large fiscal impulse to help anchor expectations and restore confidence. There is room for monetary policy to remain accommodative, given the downside risks to the recovery and well-anchored inflation expectations. The structural reform agenda should be designed and implemented with the objective to minimize the potential for short-term negative effects on growth, including those related to higher uncertainty. In this regard, effective action could be taken to clarify the procedures of the constitutional reform; ensure that the reform of the labor market improves its efficiency; and pursue the education reform with a view to raising the quality of Chile's human capital, increasing productivity, and lowering income inequalities. While the financial sector is generally healthy, prudential measures might need to be considered if corporate debt continues to grow rapidly in order to reduce Chile's vulnerability to adverse shocks. Strengthening the regulatory and supervisory framework for life insurance companies and financial conglomerates would also buttress the resilience of Chile's financial sector.

**Past policy advice:** In last year's report, staff welcomed the structural reforms (as they held the promise to strengthen long-term growth and reduce income inequality) while noting that clarity on the details, timetables, and prioritization would reduce uncertainty. Recent advances in financial regulations are in line with advice in previous staff reports, and a number of further changes recommended by staff in the past are contained in the legislation currently under discussion in Congress.

Approved By
**Jorge Roldos**

Discussions took place in Santiago during June 11–23, 2015. The staff team comprised Messrs. Cardarelli (head), Eyraud, Mmes. Lusinyan, Santoro (all WHD), Mr. Brandao Marques, and Mr. Krznar (all MCM) with research assistance from Mr. Tawfik. Mr. Vicuña (OED) attended some of the meetings. The mission met with the Minister of Energy, the Minister of Economy, the Minister of Social Development, senior officials at the Central Bank, the Ministry of Finance, the Ministry of Labor, the Ministry of Education, and the Budget Office, think tanks, academics, and representatives from banks and industry. Upon return to headquarters, the mission had a concluding meeting via VTC with the Minister of Finance and the Central Bank Governor.

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## TABLES

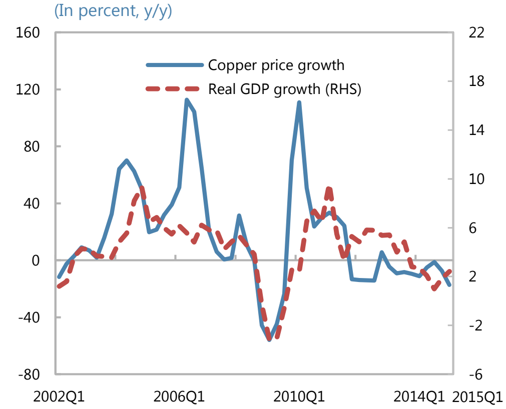


## ANNEXES

# CONTEXT

1. **GDP growth has remained lackluster since last year's staff report, as Chile's economy continues to adjust to the end of the commodity super-cycle.** GDP growth was 1.9 percent in 2014, well below the last decade average of 4¾ percent. The main force behind the slowdown has been the sharp fall in private investment. To a certain extent, a more modest growth path is the inevitable consequence of the end of the mining boom, which boosted investment and GDP growth to above potential rates in the last few years. Staff estimates that the 20 percent decline in copper prices from their average level in 2006–14 may subtract about 3 percentage points (pps) from Chile's GDP growth, cumulatively over the next 5 to 10 years (see Selected Issue Paper, Chapter 1).

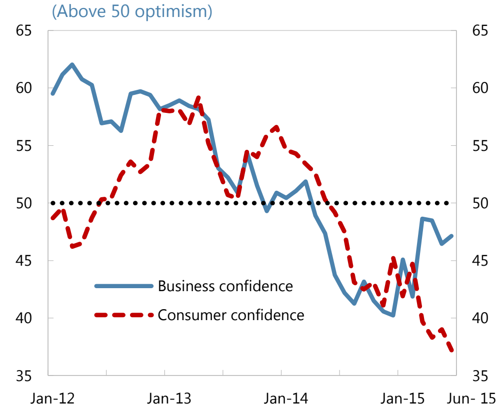
**Copper Price and GDP Growth**
(In percent, y/y)




Source: Central Bank of Chile.

2. **Chile's growth weakness also reflects the uncertainty and adjustment costs from the structural reform agenda launched in 2014**. The decline in investment in 2014 also owes to a sharp fall in business confidence which cannot be fully reconciled with the stage of the business cycle and the external shock (Box 1), but may also reflect the reaction of Chile's business community to the uncertainty associated with the ambitious structural and economic reform agenda announced by the new administration in 2014. This agenda rightly aims at fostering stronger and more inclusive long-term growth, including by addressing well-known gaps in Chile's education system and infrastructure. To help finance spending in these areas, a reform of the tax system was approved in September 2014 which gradually increases capital income taxation. If well implemented, the reforms have the potential to boost productivity and GDP growth, but the higher cost of capital is likely to have a negative short-term impact on activity (see Selected Issues Paper, Chapter 2). Moreover, the announced constitutional and labor market reforms appear to have increased private sector's uncertainty over Chile's future economic environment.[1]

**Business and Consumer Confidence Indices**
(Above 50 optimism)




Source: Haver Analytics, Inc.

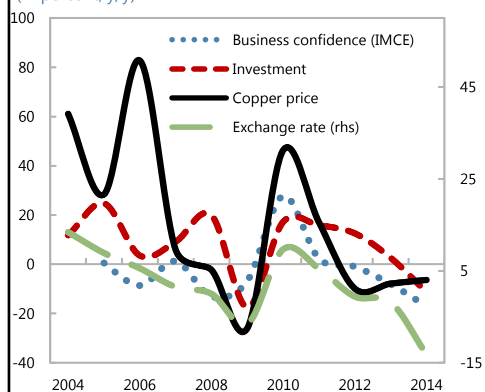
[1] In April 2015, the authorities announced that a dialogue over a constitutional reform would begin in September 2015, but no details were provided on the process. The labor marker reform was passed by the lower House in June 2015 and is currently under discussion at the Senate.

## Box 1. The Role of Domestic and External Factors in the Fall of Private Investment

**Investment fell by about 6 percent in 2014, owing to both external and domestic factors.** While there are no data on private fixed investment in the National Accounts, staff estimates that it fell by about 7 percent in 2014. The strong fall of copper prices (as of June 2015, down 35 percent from their 2011 peak) put an end to the investment boom that began right after the great financial crisis and caused mining investment to reach about 7 percent of GDP in 2012 (from about 2 percent in early 2000s). The strong real effective depreciation of the peso also hurt both mining and non-mining investment, as it made imported capital goods more expensive (in 2013, the value of capital goods imported was more than 60 percent of fixed investment in equipment and machinery). Domestically, the business confidence index fell by 17 percent in 2014, hitting its lowest level since the great financial crisis. Staff analysis (based on a VAR with GDP, copper prices, and business confidence indicators) suggests that the fall in business confidence in 2014 has been much more pronounced than what could be explained by the decline in copper prices and economic activity. An alternative explanation is that it might reflect the negative impact on business sentiment of the reform agenda announced at the beginning of 2014.

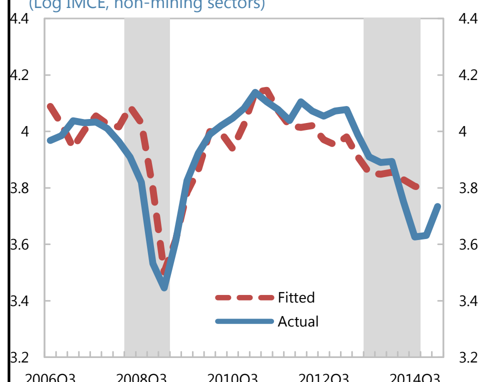
**Staff estimates suggest that external factors were the most important driver of the decline in private fixed investment**. To assess the relative weight of external and domestic factors, we estimated equations for private investment in mining and non-mining sectors. The decline in private fixed investment in 2014 is largely explained by external factors. In particular, the depreciation of the peso and lower copper prices together account for about two-thirds of the decline in overall private fixed investment in 2014. Among domestic factors, an important variable behind the decline in mining investment was the increase in labor costs. Non-mining investment was also affected by the drop in business confidence and the fall in Tobin's Q (proxied by the price-to-book value for listed companies) which may also reflect the higher cost of capital from the tax reform.

**Confidence, External Factors and Investment Growth**
(In percent, y/y)



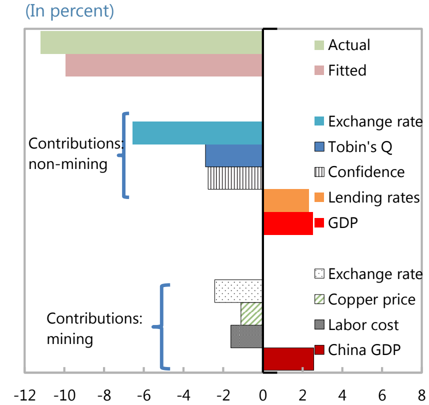

Sources: Central Bank of Chile and Fund staff calculations.

**Business Confidence: Actual Vs. Estimated 1/**
(Log IMCE, non-mining sectors)




Sources: University of Chile and Fund staff calculations.
1/ Estimated from VAR, Grey area indicates downturns.

**Investment Growth in 2014**
(In percent)



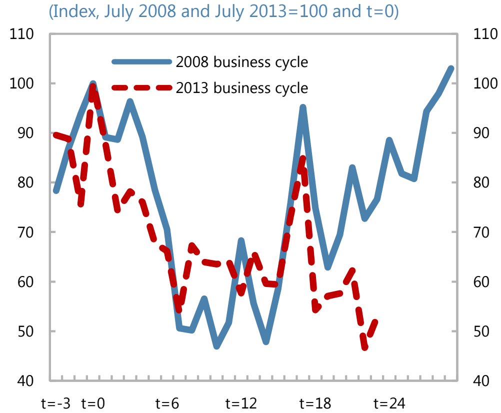

Source: Fund staff calculations.

# RECENT DEVELOPMENTS

**3. Economic activity picked up somewhat towards the end of 2014 and early this year** (Figure 1). The pickup was propelled by very stimulative macroeconomic policies: in particular, fiscal policy has turned highly expansionary in 2014 and this year, with a strong acceleration of infrastructure spending in the last quarter of 2014 (Figure 2). On the monetary side, Central Bank has kept the policy rate at 3 percent (well below its neutral level, estimated by staff at 4½–5 percent) after reducing it by 200 basis points between September 2013 and November 2014. Lower gasoline prices sustained private consumption, while the weaker peso supported non-mining exports, in particular agriculture and forestry products (the real effective exchange rate depreciated by about 15 percent in 2014 relative to early 2013).

**4. However, recent indicators suggest that the economic recovery has lost momentum in the last few months**. After improving in the first quarter of 2015, business confidence deteriorated again in the second quarter. Imports of capital goods have continued to decline on a year-on-year basis. Non-mining export growth has slowed, although partly because of one-off factors. Labor market conditions have been softening, with slower growth in private sector employment and nominal wages since early 2015. After remaining relatively low at about 6 percent in the last six months, the unemployment rate increased to 6.6 percent in May 2015, as labor force participation inched up.

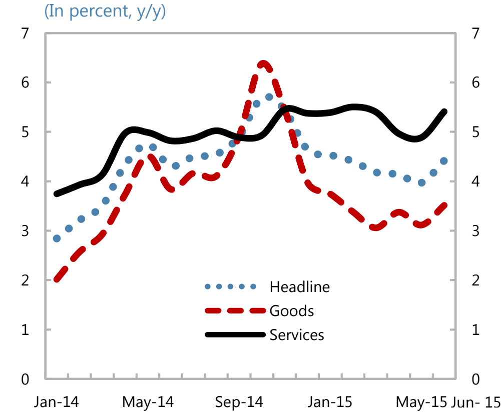
**Imports of Capital Goods**
(Index, July 2008 and July 2013=100 and t=0)




Source: Fund staff calculations.

**5. Inflation has remained stubbornly high.** Headline inflation has exceeded the central bank's target band (2–4 percent) for 15 consecutive months (Figure 3). After peaking at 5.7 percent in October 2014, inflation has declined steadily as the pass-through from the sharp peso depreciation of 2014 dissipated, and has hovered around 4 percent in the last few months. In the non-tradable (service) sector, disinflation has been slower, reflecting the sustained growth of nominal wages (in turn largely explained by the high degree of wage indexation to the CPI). Nonetheless, inflation expectations at the 24-month horizon have remained well anchored at 3 percent.

**CPI Inflation**
(In percent, y/y)



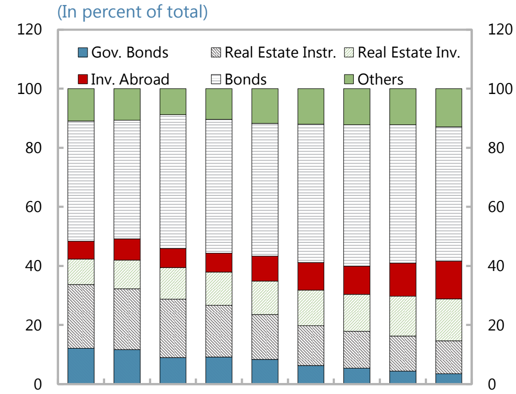

Source: National Statistics Institute (INE).

**6. The external position has improved significantly.** The current account deficit fell by over two percentage points of GDP in one year, from 3.7 percent in 2013 to 1.2 percent in 2014, mainly driven by the strong contraction in investment-related imports (Figure 4). EBA-based estimates suggest that the currency was modestly undervalued in 2014 in real effective terms. However, as the

REER has appreciated somewhat in 2015 (its average in January–May 2015 was about 2½ percent above the 2014 average), the peso may be now closer to its equilibrium value (Annex I).

7. **The financial sector appears generally healthy, although recent developments in Chile's non-banking sector warrant close attention** (Figure 5). Banks' profitability remained strong in 2014, although it has declined so far in 2015 mainly due to a smaller positive impact of inflation. Banks' non-performing loans have decreased slightly from already low levels, and capital ratios are above regulatory thresholds. On the other hand, life insurance companies and pension funds continue to be pressured by the low-yield environment and have kept on restructuring their portfolios towards riskier or less liquid assets, notably, real estate, lower rating domestic and foreign corporate bonds (life insurance companies) and foreign mutual funds and equity (pension funds). Mutual funds grew by almost 40 percent in 2015 compared to end-2013, with the fastest growth observed in mutual funds investing in medium- and long-term fixed-income instruments.

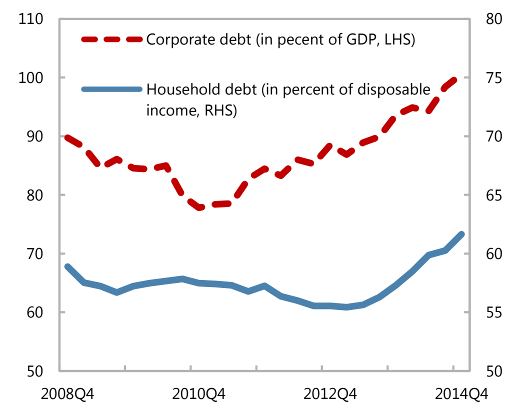
**Structure of Life Insurance Sector's Investments**
(In percent of total)




Source: Superintendencia de Valores y Seguros (SVS).

8. **Non-financial corporate and household debt continues to increase.** The debt-to-GDP ratio of Chilean non-financial firms was about 100 percent at end-2014, a relatively high level compared to other emerging economies (Box 2). Household debt-to-disposable income also rose to about 60 percent in 2014, driven by higher mortgage debt (Figure 6). Mortgage credit has grown at a much faster rate than consumer and commercial credit, with households bringing forward their home purchasing over the last few quarters in anticipation of the scheduled increase in VAT on housing from 2016. Despite higher debt, household debt service-to-income ratios have remained at low level due to low interest rates.

**Corporate (Non-financial) and Household Indebtedness**

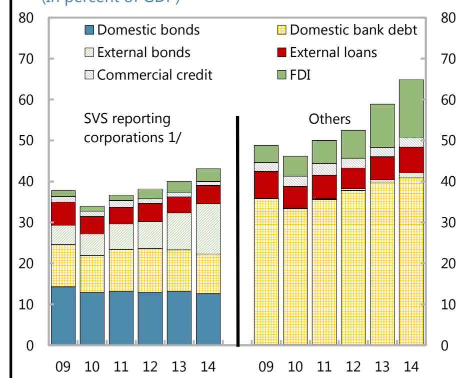



Source: Central Bank of Chile.

## Box 2. Corporate Sector Vulnerabilities

**A significant part of the increase in corporate debt-to-GDP ratio reflects Chilean firms' increasing reliance on foreign currency funding**. Foreign currency funding associated with FDI and external bond issuances accounted for about 90 percent of the increase in the corporate debt-to-GDP ratio in 2014 relative to 2013. At the end of 2014, 52 percent of corporate debt was in foreign currency, compared to 40 percent as of 2010. Given the sharp depreciation of the peso, this increase also reflects valuation effects on the existing stock, rather than "new" debt. Based on staff estimates, roughly half of the increase in the external corporate debt-to-GDP ratio in 2014 can be attributed to valuation effects caused by the depreciation of the peso. While Chilean companies appear to have increasingly relied on FDI and bond issuances, higher debt ratios for non-listed companies also reflect an increased reliance on domestic bank loans.

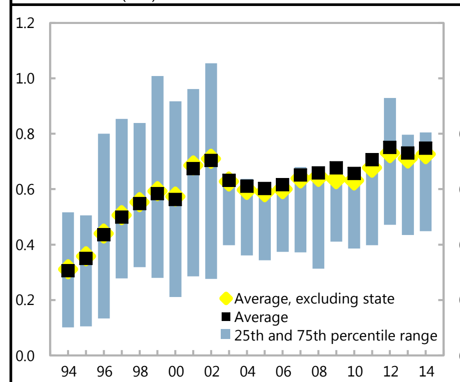
**Corporate Debt-to-GDP Ratio**
(In percent of GDP)




Sources: Central bank of Chile, SVS and SBIF.
1/ Corporations, including their direct subsidiaries, who report to the Chilean regulating institution for Securities and Insurance (SVS).

**While on average the leverage of Chilean non-financial firms has remained stable over the past two years, the share of firms with relatively high leverage has increased.** Leverage (debt-to-equity) for the firms in the top 25 percent of the distribution has moved up over the past few years. On a sectoral basis, the increase in leverage in 2014 was concentrated in retail, forestry, and energy, with a few large firms in these sectors financing their expansion plans abroad. Over the last decade, the increase in leverage appears more broad-based, and leverage for Chilean listed non-financial companies is relatively high compared to other economies in Latin America.

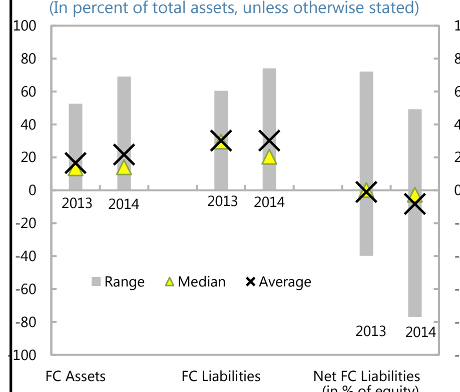
**Corporate Sector Debt-to-Equity Ratio 1/**




Sources: Central Bank of Chile and SVS.
1/ End of period data.

**Risks to financial stability are moderated by a series of mitigating factors.** Rollover risks on domestically issued corporate bonds seem moderate, as the average time to maturity of outstanding issues has increased since 2011 (from 10 to 14 years). Also, the increased reliance on foreign currency funding does not seem to be associated with greater currency mismatches. Data for the 20 largest Chilean corporations as of end 2014 show that, on average, their net foreign currency exposure was small and relatively unchanged since 2013. While a few firms have large net foreign currency liabilities, those are usually associated with significant natural hedges. Moreover, about 40 percent of this foreign currency debt is FDI-related and is typically less sensitive to external financial shocks. Finally, market perceptions of the underlying credit risk of Chilean non-financial firms have remained stable (measured by Moody's CreditEgde+ one-year ahead expected default frequencies).

**Foreign Currency Exposure of Corporations 1/**
(In percent of total assets, unless otherwise stated)

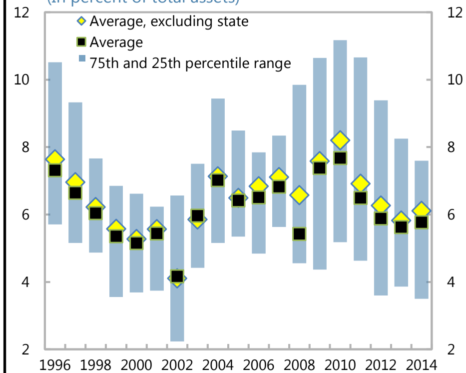



Sources: Orbis, SVS and Fund staff calculations.
1/ Top Chilean coporations, excluding ENAP and affiliates.

**Box 2. Corporate Sector Vulnerabilities (concluded)**

**However, high leverage makes Chilean firms less resilient to a further slowdown of economic activity and external financial shocks.** In 2014, average profitability and liquidity indicators across Chile's non-financial firms have remained at levels close to 2013, but, as in the case of leverage, there are large differences across firms and sectors. While average profitability ticked up in 2014, the distribution had been on a downward trend since 2011. Profitability of firms in retail and construction sectors has been particularly affected, and remains much below historical averages. At the same time, the relatively greater reliance of non-listed firms on bank funding suggests that lower profitability across these firms may affect the banking sector.

EBIT: Profitability of Coporate Sector 1/
(In percent of total assets)




Sources: Central Bank of Chile and SVS.
1/ Twelve months accumulated earnings before interest and taxes.

# OUTLOOK AND RISKS

**9. Growth is expected to firm up this year and the next, though remaining well below its potential.** Staff expects GDP growth to average 2½ percent in 2015, mainly on the back of a strong fiscal impulse, and to accelerate to 3.1 percent in 2016 as private domestic demand gradually strengthens. Inflation is projected to slowly decline towards 3 percent by mid-2016, under the combined effects of the negative output gap and the waning pass-through of the peso depreciation in 2014.

**10. The main assumptions underlying the expected recovery of private domestic demand in 2016 are as follows**:

- A moderate pick-up in non-mining investment, as monetary policy conditions remain highly accommodative and business sentiment gradually improves. This will more than offset continued weakness in mining investment, as copper prices are expected to remain stable in 2016 after falling by another 10 percent in 2015.

- Stronger non-mining exports, mainly thanks to the more competitive real effective exchange rate as trading partners' growth fails to increase substantially (going from 3.2 percent in 2015 to 3.4 percent in 2016, based on the July 2015 update of the *World Economic Outlook*).

- A modest firming of private consumption, reflecting a gradual return of consumer confidence, still easy access to credit, and some pick-up in real income as lower inflation partly offsets slower nominal wage growth in the context of weaker labor market conditions.

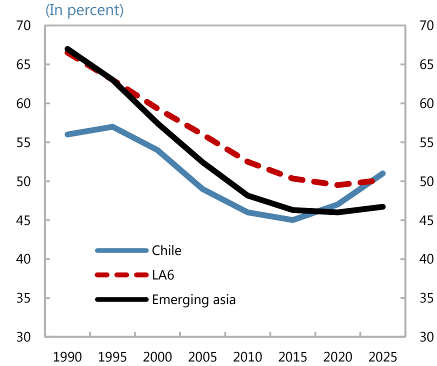
**11. The balance of risks is mainly on the downside** (see Risk Assessment Matrix (RAM), and Annex II on spillovers). The main risk to staff's baseline scenario is a more persistent weakness of private sector confidence and investment, amid continued uncertainty over the structural reform agenda and the external outlook. On the external front, a further decline in copper prices (for example associated with a deeper-than-expected downturn in China) would imply more depressed activity in the mining sector. Tighter and more volatile global financial conditions also pose risks to Chile's economic recovery. Although Chile's deep local capital market, sound macroeconomic fundamentals, and credible policy framework are likely to reduce the risk of a "sudden stop" of capital inflows, a sharp asset price adjustment and decompression of credit spreads could reduce the availability, and increase the cost, of funding for the non-financial corporate sector and banks. Moreover, high leverage and heavy reliance on foreign currency debt make Chile's corporate sector relatively vulnerable to a tail-risk downside scenario, where foreign interest rates increase sharply, the peso depreciates strongly, and the economic slowdown accentuates.

**12. Staff revised down its estimate of medium-term GDP growth, although a successful completion of the reform agenda has the potential to boost growth in the long run**. Capital accumulation is expected to slow from its historical average, as lower copper prices and higher taxes on capital income depress investment (Table). Population aging should reduce labor input growth from 2⅓ in the 2000s to about 1 percent in 2020, lowering total hours worked. The slowdown in TFP growth, from an average 2½ percent in the 1990s to around ¼ percent since the early 2000s, is likely to have an important trend component, reflecting declining productivity in the mining sector and infrastructure bottlenecks. While the positive impact of some of the structural reforms (particularly of the education system) may take a long time to fully materialize, staff expects greater spending on infrastructure to start contributing to TFP and capital growth over the next few years. In particular, TFP growth and capital accumulation are likely to be boosted by recent progress in addressing energy bottlenecks, including by increasing electricity generation capacity (by about 30 percent by 2020) and reducing electricity costs (with spot marginal costs lowered by a more competitive tender process among distributing firms). As a result of all these factors, staff expects potential GDP growth at 3.7 percent in 2020.

**Growth Assumptions: Medium-Term Scenarios**

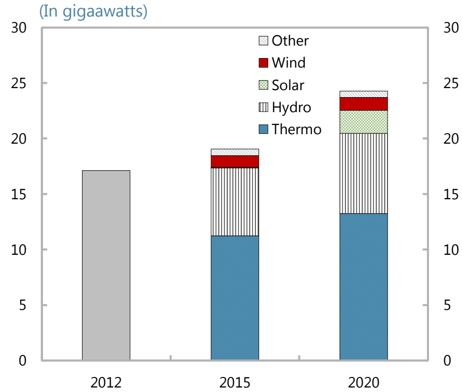
| | Average | Staff estimates, 2020 | |
|---|---|---|---|
| | 1994-2013 | No reforms | With reforms |
| Output | 4.7 | 3.2 | 3.7 |
| TFP | 0.9 | 0.2 | 0.4 |
| Capital | 5.3 | 4.8 | 5.1 |
| Hours | 1.5 | 0.6 | 0.6 |
| Human capital | 0.8 | 0.8 | 0.9 |

**Total Dependency Ratio 1/**
(In percent)




Source: United Nations World Population Prospects (2012).
1/ Share of population aged 0-14 and 65+ in population aged 15-64.

**Electricity Generating Capacity by Technology**
(In gigaawatts)




Sources: Chilean National Energy Commission and OECD.

## Risk Assessment Matrix

| Sources of Risk: Nature of the shock (color = likelihood) | Sources of Risk: Vulnerabilities/ Channels of transmission | Impact if Realized (color = severity) | Policy Response |
|---|---|---|---|
| ***DOMESTIC*** | | | |
| A slower recovery of private sector confidence (for example as the labor market reform worsens industrial relations, or the debate over the reform of the constitution becomes increasingly polarized) | **Real:** A slower rebound of private sector confidence would translate into a weaker recovery of private investment. | A weaker-than-expected investment outlook would depress growth. Lower growth could generate corporate stress in the context of relatively high corporate leverage, have negative repercussions on real estate market, and undermine financial sector health | - Encourage private sector investment by reducing policy uncertainty, including through a careful design and implementation of the reforms.<br>-Maintain an accommodative monetary policy stance. |
| ***EXTERNAL*** | | | |
| Sharp slowdown in China economic growth, possibly due to a severe housing downturn or a shock in the shadow banking sector | **Financial:** Banks have large exposure to non-financial corporate debt (55 percent of total bank credit), even if direct exposure to natural resource sectors is only 11 percent.<br>Leverage<br>**Real:** Copper exports to China represent 40 percent of mining exports and 25 percent of total exports. Spillover effects to other sectors through the value added chain could amplify the first-round effects.<br>Revenue<br>**Fiscal:** Revenue from mining companies constitutes more than 10 percent of total revenues. | Slower than expected growth in China would impair copper sales and spill over to sectors related to copper production. This would also negatively affect the fiscal position. | - The floating exchange rate represents the first line of defense.<br>- Foreign exchange intervention could be used if needed to counter temporary disorderly conditions.<br>- In case of a severe output drop, fiscal balance should be allowed to deteriorate for cyclical reasons. |
| Tighter or more volatile global financial conditions, possibly reflecting Euro area bond market contagion or a sharp reassessment of risk from global investors from a disorderly normalization of monetary policy conditions in the US | **Leverage:** Financial firms and non-financial corporate rely on external sources for 36 and 38 percent of their funding, respectively. More than half of banks' funding is wholesale and non-financial corporate debt stands at about 100 percent of GDP. 45 percent of financial and non-financial corporate sector debt is in foreign currency. | Renewed financial turbulence in Europe or a disorderly exit from unconventional monetary policy in the U.S. could cause a sharp increase in interest rates, a sudden reversal of capital inflows, and a strong depreciation of the peso. The impact, however, is likely to be muted by a series of factors:<br>- A significant share of external debt is FDI-related (70 percent for financial corporate and 40 percent for non-financial corporate sector).<br>- Rollover risk is relatively low, as maturities have been increasing.<br>-There are significant natural hedges and scarce evidence of large currency mismatches.<br>- Institutional investors are likely to act as stabilizers (by investing in domestic assets following broad-based corrections in valuations, as occurred in the past). | - The floating exchange rate represents the first line of defense.<br>- The authorities should be prepared to contain liquidity pressure: expand repo operations, broaden the range of accepted collateral, and set up dollar swap auctions.<br>- Capital flow management measures could be envisaged on a temporary basis but only in crisis type circumstances.<br>- Foreign exchange intervention could be used if needed to counter temporary disorderly conditions. |

Note: Colored boxes on left hand side represent shock likelihood and colored boxes on right hand side represent severity of impact.
Red = High, Yellow = Medium, and Green = Low.

# POLICY DISCUSSION

## A. Policy Mix

**13. Staff argued in favor of a macroeconomic policy mix that combines tighter fiscal policy with continued monetary policy accommodation.**

- **Fiscal policy:** The strong fiscal impulse in 2015 was appropriate, given the severity of the slowdown, the need to cushion the temporary effects of structural reforms, the low level of debt, and the emphasis on infrastructure and education spending (which account for about half of the 9 percent projected increase in public expenditure this year). However, a steady process of fiscal consolidation is warranted beginning from 2016, given that the economy is expected to recover gradually. Reaffirming the commitment to a structural balanced budget position in the medium term would also help anchor expectations and boost private sector confidence. Based on staff's assumptions about long-term GDP growth and copper prices, the structural deficit in 2015 is about 2¾ percent of GDP (against 1.1 percent in the last Budget). Moreover, achieving the target of a balanced structural fiscal position in 2018 would require an average growth of public spending of just below 3 percent in real terms over 2016–2018. Given the strong credibility of Chile's fiscal framework and lack of debt sustainability issues (Table A.2), staff noted that the authorities have room to proceed with a slower pace of fiscal consolidation if the fiscal tightening were to weigh excessively on pro-growth expenditures (such as infrastructure and education). At the same time, if the return of business confidence were to be slower than expected, the fiscal policy stance should not be relaxed, as sticking to the commitment to eliminate the structural fiscal deficit over time would likely contribute more to supporting private sector demand than fine-tuning public spending.

**Authorities' and Staff Fiscal Projections**

| | 2015 | 2016 | 2017 | 2018 |
|---|---|---|---|---|
| *(in percent of GDP unless otherwise specified)* | | | | |
| **Ministry of Finance** | | | | |
| Overall balance | -3.0 | -1.6 | -1.1 | -0.7 |
| Structural balance | -1.1 | -0.8 | -0.4 | 0.0 |
| Output gap (in percent of potential) | -2.8 | -2.9 | -2.5 | -2.1 |
| Copper price (cents per USD) | 275 | 310 | 307 | 307 |
| Real GDP growth (in percent) | 2.5 | 4.3 | 4.7 | 4.8 |
| **Staff estimates** | | | | |
| Overall balance | -3.2 | -2.0 | -1.5 | -1.0 |
| Structural balance | -2.8 | -1.7 | -1.2 | -0.8 |
| Real primary public expenditure (% change) | 8.9 | 4.0 | 3.5 | 4.1 |
| Output gap (in percent of potential) | -0.6 | -0.7 | -0.6 | -0.3 |
| Copper price (cents per USD) | 274 | 277 | 277 | 277 |
| Real GDP growth (in percent) | 2.5 | 3.1 | 3.3 | 3.5 |

Sources: Ministry of Finance of Chile and Staff calculations.
Note: Authorities' figures for 2015 incorporate the 2015 mid-year fiscal projections update (issued July 6th 2015). Staff incorporate 2015 updates and new interests schedule received from authorities.

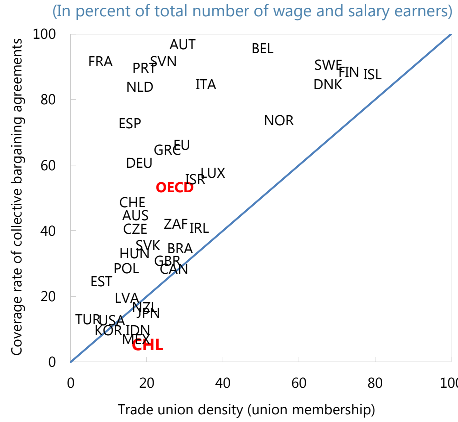
- **Monetary policy** has room to remain accommodative until there are strong signs that the economic recovery consolidates. The central bank's baseline scenario (as presented in the June 2015 *Monetary Policy Report*) projects no interest rate increase until early 2016. Staff sees this stance as appropriate, and noted that there is room to adopt a wait-and-see attitude until the risks surrounding the economic recovery dissipate, given the well-anchored inflation expectations, the projected decline in headline inflation, and the downside risks to growth. Fiscal consolidation would give the Bank more room to maintain an accommodative monetary policy even with a slower return of inflation toward the mid of the target band, and to cut rates if the economy weakened further or the downside risks materialized.

**14. The authorities broadly concurred with staff**. They agreed that the beginning and pace of normalization of interest rates should remain conditional on the strength of the economic recovery, and noted that the large fiscal impulse in 2015 is not sustainable and needs to be followed by a process of fiscal consolidation, safeguarding the credibility of the fiscal framework. They also agreed that restating the commitment to a structural budget over the medium run would support confidence and reduce uncertainty, although the pace of consolidation would depend on the new assumptions on long-term growth and copper prices, which will be made public at the time of the Budget in the fall of 2015. However, they noted that staff's assumptions on long-term GDP growth and copper prices appear relatively pessimistic. Hence, the reduction in real public expenditure growth required to reach a balanced budget in 2018 may not be as pronounced as envisaged by staff. They also highlighted their intention to simplify the implementation of the tax reform by providing more guidance to firms, and are preparing a new fiscal responsibility law that would strengthen the role and governance of the Fiscal Council.

## B. Reforms

**15. The labor market reform, currently under discussion, aims at expanding the coverage and scope of collective bargaining by empowering trade unions** (Table). While its unionization rate is not exceptionally low, Chile has a relatively low coverage of collective bargaining agreements compared to other OECD economies. Chile's labor market is also characterized by a highly dual structure: about one-third of employees have temporary jobs (against the 12 percent OECD average) and nearly 15 percent do not have written contracts. In the authorities' view, the highly fragmented nature of bargaining implies a relatively inefficient and unbalanced system of industrial relations, with frequent illegal strikes and heavy involvement of the legislator in addressing labor market disputes, and may contribute to Chile's high income inequality. They argued that the reform would make industrial relations more balanced, promote social cohesion by enhancing the cooperation between employers and workers, and reduce income inequality.

**Unionization and Coverage of Collective Bargaining Agreements 1/**
(In percent of total number of wage and salary earners)




Source: OECD, Economic Policy Reforms 2015: Going for Growth.
1/ Number of workers covered by wage bargaining agreements can be higher than the number of trade union members as a result of extensions of collective bargaining contracts to non-negotiating parties.

**Labor Reform: Overview of Selected Areas**

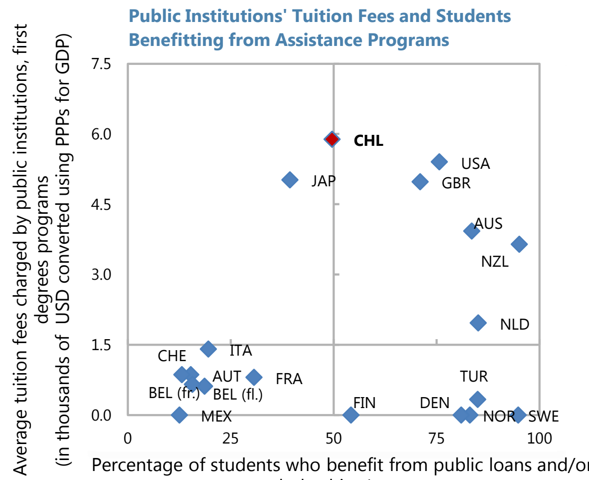
| Area | Current framework | Proposed changes |
|---|---|---|
| Right-to-bargain | Non-union groups can negotiate collectively in the presence of unions. | In companies where they exist, unions will have a priority for collective negotiation. Non-union workers may only bargain collectively by affiliating to the union, or creating a new one. Non-union groups can negotiate in firms where there are no unions. |
| Level of collective negotiation | Company-level negotiation; intercompany unions are allowed to bargain collectively only if the individual employers agreed to negotiate (employers are not obliged to negotiate). | Collective negotiation remains at firm level. Intercompany unions are allowed to negotiate only at the company level (provided that they have a sufficient number of members in that company), and employer must negotiate. |
| Extension of benefits of collective agreements | Employers can unilaterally extend the benefits to non-union workers (who must pay 75% of the union fees) | Both union and employer should agree whether benefits are extended. In order to benefit, non-union workers should pay the total union fee. |
| Coverage of collective negotiation | Workers on apprenticeship or temporary contracts are excluded from collective negotiation. | Workers on apprenticeship and temporary contracts are allowed to negotiate with some restrictions (for example, if they work in SMEs). |
| Adaptability pacts | By law, the workweek is set at six days or 45 hours. The maximum workday length is 10 hours (including two hours of overtime pay), with some exclusions (e.g., caretakers, domestic workers). | Allow negotiation of special work conditions (exceptional work/leave days, overtime, retribution of non-work days) if the company has 30% affiliation in one or more unions. |
| Other terms of collective negotiation | Minimum time period to start negotiating collectively is one year from the beginning of firm's operations. There are no restrictions on employer's response to employees' proposals. | Minimum time period is reduced to six months for new large firms (unchanged for SMEs). Negotiation process starts with a 'floor': the employer cannot offer lower benefits than the ones that already exist, with some exclusions. |
| Right-to-strike | Under certain circumstances and subject to constraints, employers may hire replacement staff (internally or externally). | Employers cannot replace workers on strike; unions must provide necessary personnel to comply with indispensable operations ("minimum services" to be agreed, prior to a strike, by the parties or resolved by the Labor Board otherwise). |

Note: Staff summary based on *Moderniza el sistema de relaciones laborales, introduciendo modificaciones al Código del Trabajo, No. Boletin 9856-13* . The labor reform is presently under discussion in Congress. Therefore, some of the specific changes mentioned in the table may undergo some changes as a consequence of the legislative process.

16. **Staff stressed that fostering Chile's labor market efficiency and flexibility should remain a priority.** Empirical evidence suggests that greater unionization and more extensive collective bargaining may help reduce wage inequality and promote social dialogue. But changes in labor market institutions should not happen at the cost of reducing labor market efficiency. In this regard, it is particularly important that the reform maintains collective bargaining at the firm level and introduces more flexible work arrangements within the collective bargaining process (independently of the level of unionization within the firm). Protecting workers' right to strike should be balanced by clearly defining the range of "minimum services" that are guaranteed in case of strikes while remaining mindful of the effects of the reform on small firms. Staff welcomed recent changes in unemployment insurance (which have increased the amount and duration of the benefits from a relatively low base, and linked them to mandatory training), and the efforts to improve skill training programs for youth and women outside of the labor force. Lowering the relatively high severance payments could also contribute to reducing the duality of Chile's labor market.

17. **The education reform has the potential to raise the quality of Chile's human capital, increase productivity, and lower income inequalities**. The legislation approved early this year (that ends the for-profit education, co-payment, and discrimination practices at primary and secondary levels) could deliver higher quality and equity in education by reducing the level of segregation in Chile's school system. The proposed introduction of a national teaching policy could

also increase the quality of education by raising entry wages for teachers and linking teachers' evaluation with their professional and career development. The authorities reiterated their willingness to extend free tertiary education to all students (beyond those currently covered by scholarships and subsidized loans), but noted that the implementation period would be determined by the growth outlook and availability of public resources. Staff recognized that a reform of higher education appears warranted, in light of the relatively high tuition fees and more difficult access to financing in Chile's public universities compared to many other OECD economies. At the same time, staff stressed that careful consideration should be given to the implications of universal free university education on income distribution (also given the significant private return to tertiary education) in addition to its fiscal costs.



Source: OECD, 2011.

**18. The authorities highlighted the legislative efforts to strengthen public and private sectors' governance and institutions.** A series of political and corporate scandals in the recent past may have undermined investors' confidence in Chile's public and corporate sectors, contributing to the fall in business confidence. The authorities' response has been admirably swift, with a series of legislative and regulatory measures announced over the past few months (under the government's "Transparency Agenda"). A host of measures aim at improving corporate governance, investor protection, and market transparency, including by tightening internal and external audit processes, improving transparency about the composition and practices of publicly trade corporations' boards, and giving additional intervention, enforcement, and sanction powers to the new Securities and Insurance Commission. A series of legislative efforts is also underway that aim at restoring confidence in public institutions, including by regulating funding to both political parties and campaigns and tightening norms over conflicts of interest, corruption, and lobbying. Finally, the institutional framework for PPP arrangements is strengthened by a law proposal that establishes a centralized unit within the Minister of Public Works tasked with the responsibility of assessing, approving and developing new concessions. The bill also improves the transparency and terms of renegotiations of old concessions, and introduces minimum standards of service. Staff welcomed the initiative that, if well implemented, could contribute to mobilizing the private financial resources needed to fill Chile's infrastructure gap, as well as promoting a more efficient use of public funds.

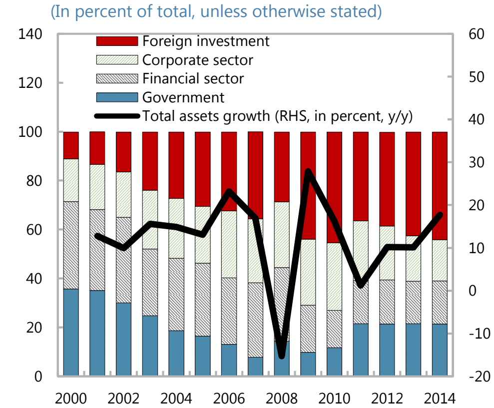
## C. Financial and Corporate Sector

**19. Staff discussed with the authorities the policy implications of high corporate and household debt.** Staff stressed that prudential measures might need to be considered if corporate debt continues to grow, in order to reduce Chile's vulnerability to adverse shocks. In particular, consideration could be given to higher risk weights or higher provisioning for commercial credit, in order to increase the resilience of the banking sector to shocks in the corporate sector. The authorities noted that the best indicator of debt is leverage (debt-to-equity ratio) which has been relatively stable over the past two years and comparable to other economies. They also noted that imposing prudential measures that have a broad reach over the corporate sector may be inappropriate at this stage, given the weak economy and the lack of systemic risks from corporate leverage. On household debt, staff welcomed the new provisioning regulation for mortgage loans, which from 2016 onwards will increase provisions for high loan to value (LTV) ratios and delinquent mortgages. Staff argued that tighter LTVs and debt service-to-income ratios could be considered if mortgage credit growth were to accelerate. The authorities responded that the new regulation on provisions was sufficient to address the risks, particularly because mortgage credit growth should decelerate in 2016, after the VAT on first homes is introduced.

**20. Forthcoming changes in the General Banking Law will bolster the resilience of the banking sector.** The authorities expect to send the new Banking Law to Congress during the second half of 2015. The new law will adapt Basel III capital standards to Chilean banks on a transitional basis and introduce a capital surcharge for domestic systemically important banks. Staff also welcomed the new liquidity regulation (effective from August 2015) and the authorities' plans to specify the minimum requirements for the liquidity coverage ratio (LCR) and net-funding stable ratio (NSFR). This will strengthen liquidity risk management and address the risks stemming from the reliance on wholesale funding, particularly for medium and small banks. The authorities noted that the banking sector in general is well prepared to implement Basel III capital and liquidity requirements on a transitional basis. The authorities are also planning to implement a legal framework for bank resolution, broadly in line with the 2011 FSAP recommendations. While the authorities are willing to strengthen the SBIF operational independence, staff emphasized the importance of ensuring that SBIF is given sufficient financial resources to conduct effective implementation of the new regulatory requirements.

**21. The search for yield by life insurance companies warrants close attention.** Staff stressed the importance of monitoring the potential implications for financial stability from the insurance sector's expansion to riskier investments. The authorities shared the concerns, although their stress tests suggest that the insurance sector is resilient to large shocks. A new regulation was introduced in 2015 that asks insurance companies to define their risk appetite and introduces a concept of own risk and solvency assessment. But the legislative proposal that introduces risk-based supervision for insurance companies is still in Congress. Staff also enquired on the rapid increase in Chilean pension funds' exposure abroad, as this could signal a shift of funds' appetite towards riskier assets. The authorities noted that pension funds are subject to strict regulation regarding their foreign investment, and that the expansion abroad was mainly in response to the lack of investment opportunities in the domestic market.

**Structure of Pensions Funds' Investments**
(In percent of total, unless otherwise stated)



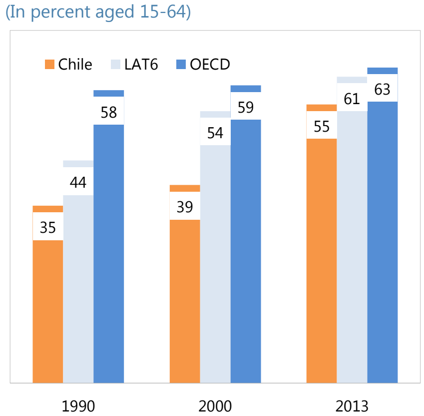

Source: Superintendencia de Pensiones (SP).

**22. Improving the supervision of conglomerates would reinforce the resilience of the financial sector.** The Financial Stability Council (FSC) law represents an important step toward strengthening consolidated supervision of financial conglomerates. The law removed all barriers to information-sharing among supervisors; expanded their power to request information from the final owners of financial institutions within the conglomerate; and established solvency requirements for the controlling shareholders of banks and insurance companies. However, supervisors still lack the powers and authority to conduct comprehensive group-wide supervision (including setting risk-based minimum prudential standards and monitoring conglomerates' compliance with limits on risk exposure). The 2011 FSAP recommended stronger coordination among supervisors and the identification of a group-level supervisor with enhanced powers, including that of establishing risk-based minimum prudential standards for financial conglomerates. The authorities said the biggest challenges are to design a crisis management framework for conglomerates and to supervise mixed conglomerates, and said they are waiting the final report from a recent technical assistance mission of the IMF.

## D. Other Structural Issues

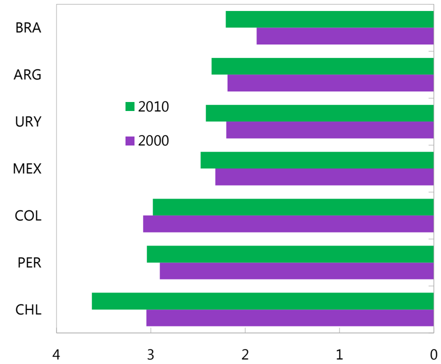
**23. Staff welcomed the authorities' efforts to increase female labor force participation, which is one of the lowest in the OECD and Latin America** (Annex III). Recognizing the main impediments to female participation, the authorities plan to increase the relatively low coverage of early childhood education by building childcare institutions, and are replacing the mandated employer-provided childcare with a universal system. They have also launched an ambitious training program ("*Más Capaz*"), with an objective to train 450,000 youth and women in 2015–18 and facilitate their entrance into the job market. Furthermore, the "adaptability" provisions in the proposed labor market reform could foster female participation, by allowing for more flexible work arrangements. Reducing commuting time by improving transportation infrastructure would also encourage women's participation in the labor market.

**Female Labor Force Participation Rates**
(In percent aged 15-64)



Sources: World Development Indicators and OECD.

Export Diversification
(Index, 5-year rolling average; higher index=less diversification)




Sources: Hausmann, Hidalgo, et. al. (2014); IMF, *World Economic Outlook;* and Fund staff calculations.

**24. The authorities agree with the need to diversify the economy away from copper.** Staff noted that Chile's economic structure is not as diversified as that of neighboring countries, and diversification seems to have declined over time (see WHD *Regional Economic Outlook*, April 2015). In addition to better infrastructure and greater human capital, new policies to boost innovation are needed to address this issue. At 0.4 percent of GDP, Chile's R&D spending is the lowest in the OECD (2 percent of GDP on average), particularly in the private sector. The government has put in place a number of initiatives to boost innovation (such as "*Start-up Chile*", a program that provides seed money to start ups) and productivity, but there is room to expand and rationalize these programs, as well as to strengthen collaboration between firms and universities or other research institutions. The authorities also see potential for developing managerial skills through the creation of a series of Small Business Centers that provide technical assistance to small businesses and aspiring entrepreneurs, following international experience; and for reducing the red tape associated with creating a new company. Staff also welcomed the announcement of a new agency to attract foreign investment with a more proactive strategy. The authorities also emphasized that developing better infrastructures was key to improving access to the international market and boosting non-mining exports.

**25. Access to credit should be strengthened for small and medium-size firms**. The authorities mentioned that the productivity gap between SMEs and large firms in Chile is relatively large (about twice as large as in Europe, for example), and argued that this may also reflect a relatively more difficult access to credit. Staff welcomed the authorities' intention to accelerate the approval of a bill that introduces a Public Credit Bureau. A swift approval of the bill could improve access to credit, particularly for SMEs, by reducing information gaps and improving financial institutions' assessment of credit risks. The authorities also plan to introduce a registry of firms' mobile assets, which will make it easier for banks to assess the value of that type of collateral. Finally, the authorities noted that they intend to implement a regulated crowd-funding framework that will increase competition in the credit market, with greater incentives for non-bank institutions to provide credit to SMEs.

# STAFF APPRAISAL

**26. Growth has remained lackluster over the past year, as the economy continues to adjust to the end of the mining boom.** The main force behind the slowdown has been the sharp fall in fixed investment. To a large extent, this reflects the inevitable adjustment of the Chilean economy to the end of the commodity boom, which had pushed investment and GDP growth to above potential rates over the past few years. The external position has improved markedly, with a large decline in the current account deficit and a real exchange rate now closer to a level consistent with macroeconomic and policy fundamentals.

**27. But the economy has also been negatively affected by the adjustment costs from the structural reform agenda launched in 2014**. The decline in fixed investment partly reflects the fall in business confidence which cannot be fully reconciled with the external shocks, and likely results from the uncertainty generated by the structural reform agenda and its short-term costs. If well implemented, the reforms have the potential to boost productivity and long-term growth, but the higher cost of capital and the complexity of the new tax regime are likely to have a negative effect on economic activity in the short-term. Moreover, the announced constitutional and labor market reforms appear to have increased private sector's uncertainty over Chile's future economic environment.

**28. Staff expects GDP growth to increase modestly in 2015 and 2016, but the balance of risks is tilted to the downside.** In staff's baseline scenario, GDP growth picks up modestly to 3.1 percent in 2016 from 2½ percent in 2015. Continued accommodative monetary policy conditions and a gradual recovery of business sentiment will improve non-mining business investment, more than offsetting continued weakness in mining investment. The main risk to the baseline scenario is a more persistent weakness of private sector confidence and investment, amid protracted uncertainty over the structural reform agenda and the external outlook. On the external front, a further decline in copper prices from a deeper than expected downturn in China's economy would imply more depressed activity in the mining sector, while renewed bouts of global financial volatility and disruptive asset price shifts may tighten external financial conditions for Chile's highly leveraged corporate sector.

**29. Against this background, the macroeconomic policy mix should combine tighter fiscal policy with continued monetary policy accommodation.** As the economy is expected to recover gradually, starting a process of fiscal consolidation next year is warranted. Reaffirming the commitment to fiscal discipline after the fiscal impulse in 2015 would also help boost business confidence. The pace of fiscal consolidation would need to take into account the deterioration of the long-term prospects for GDP growth and copper prices. On the other hand, the beginning of fiscal consolidation, the well-anchored inflation expectations, and the downside risks to growth all give room for monetary policy to remain accommodative until there are strong signs that the economic recovery consolidates.

**30. Nurturing the return of business confidence also requires a careful design and implementation of the structural reform agenda.** It is important to minimize the potential for short-term negative effects on growth, including those related to higher uncertainty. In this regard, effective action could be taken to clarify the procedures of the constitutional reform; ensure that the reform of the labor market improves its efficiency; and pursue the education reform with a view to raising the quality of Chile's human capital, increasing productivity, and lowering income inequalities.

**31. Staff welcomed the authorities' efforts to strengthen public and private sectors' governance and institutions.** The measures that aims at improving corporate governance, investor protection, and market transparency, could bolster business confidence, increase market liquidity and reduce the cost of capital. Improvements in the institutional framework for PPP arrangements could contribute to mobilizing private financial resources needed to fill Chile's infrastructure gap, as well as promoting the efficient use of public funds. The recent efforts to restore confidence in public institutions are also needed and timely.

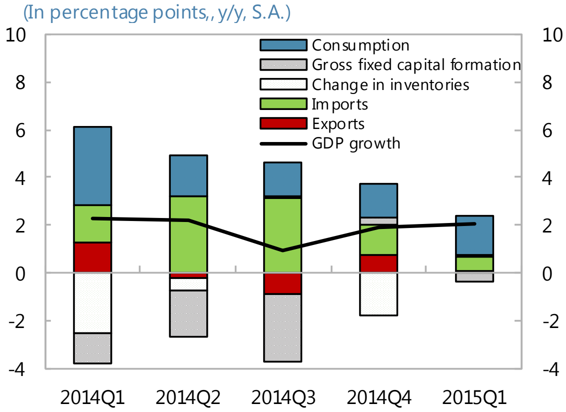
**32. While Chile's financial sector is healthy, there are a few areas where financial oversight could be strengthened further.** The relatively high level of corporate and household debt does not appear to pose risks to economic and financial stability per se, but it may reduce Chile's resilience to negative shocks and needs to be monitored closely. If the increase in corporate leverage were to accelerate in the future, the authorities could consider adopting additional prudential measures to safeguard Chile's financial sector against these shocks. Staff welcomes the adoption of minimum liquidity standards and the authorities' plan to send the new General Banking Law to Congress during the second half of 2015 (which will introduce Basel III bank capital standards). While the Financial Stability Council law represents an important step forward, the authorities should keep strengthening the supervision of financial conglomerates. As the insurance companies' expansion into riskier and less liquid investments continues, it is essential to approve the bill proposal that implements risk-based supervision and introduces new solvency requirements for insurance companies.

**33. Staff proposes to hold the next Article IV consultation on the standard 12-month cycle.**

## Figure 1 .Chile: Economic Activity

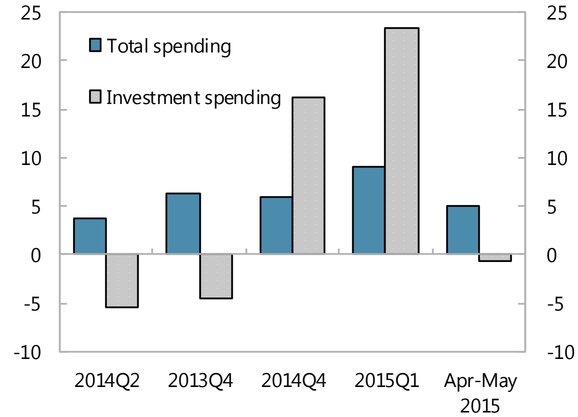
*Growth bottomed out in Q3, 2014...*

### Contributions to Real GDP Growth
(In percentage points,, y/y, S.A.)



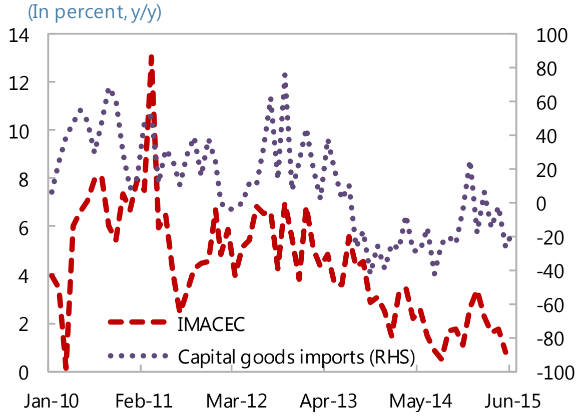

*... mainly thanks to a strong fiscal stimulus.*

### Real Government Expenditure
(In percent, y/y, 2013 pesos)



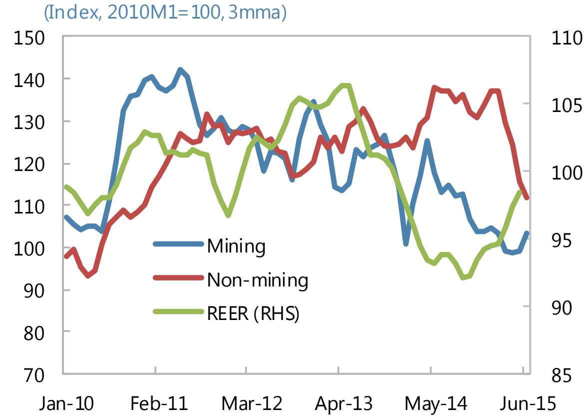

*Recent monthly indicators suggest that the recovery is losing momentum.*

### Selected Economic Activity Indicators
(In percent, y/y)



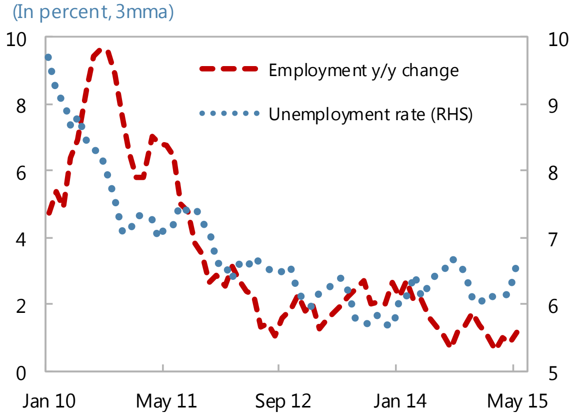

*Non-mining export growth has slowed, although partly because of one-off factors.*

### Mining and Non-Mining Exports
(Index, 2010M1=100, 3mma)



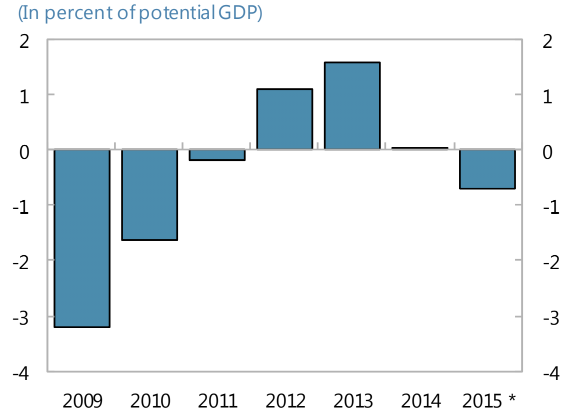

*Despite lower employment growth, the unemployment rate has remained relatively flat thanks to lower labor force participation...*

### Labor Market
(In percent, 3mma)




*...but the output gap has swung into negative territory.*

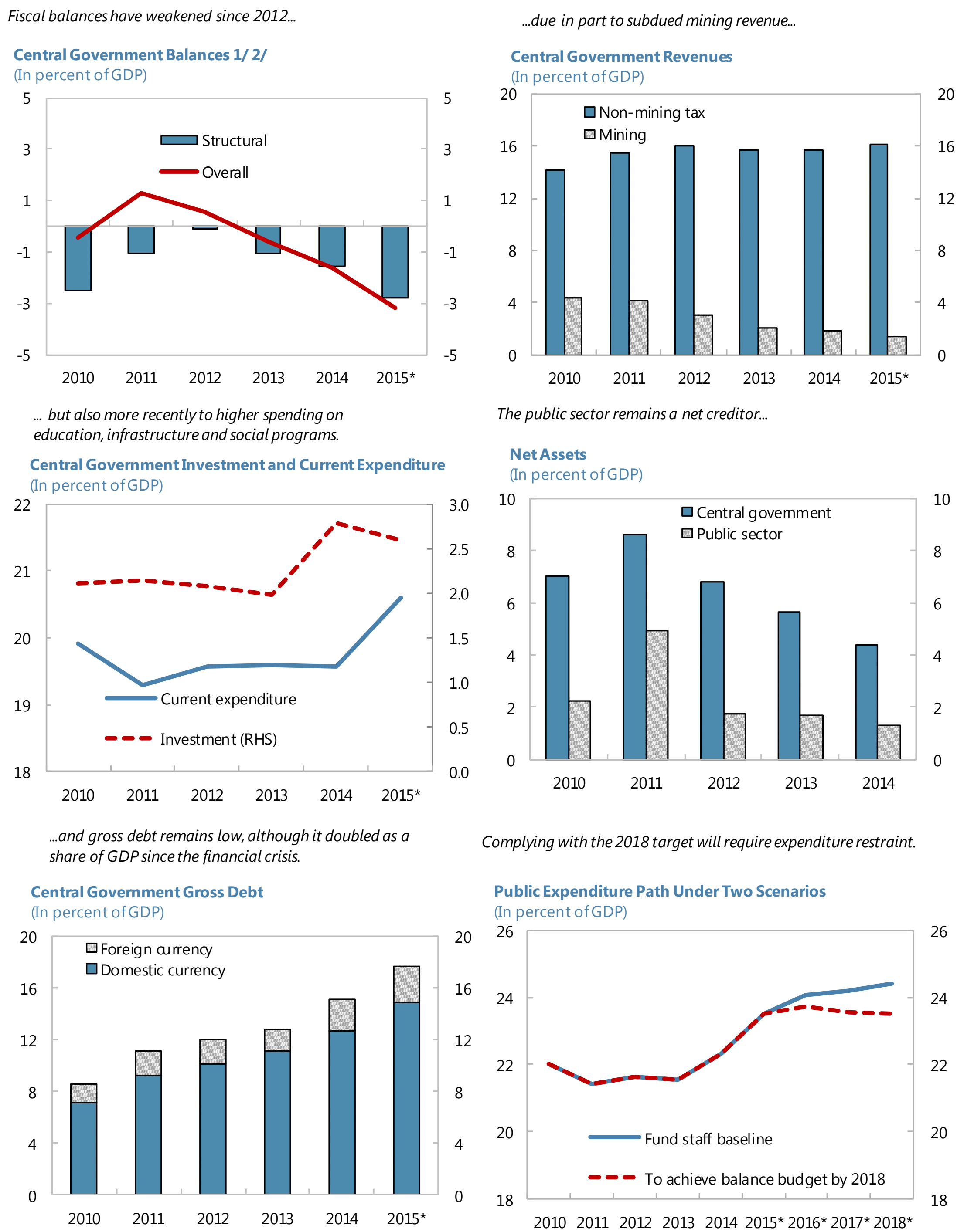
### Output Gap
(In percent of potential GDP)




* Projection

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

## Figure 2. Chile: Fiscal Policy and Public Finances

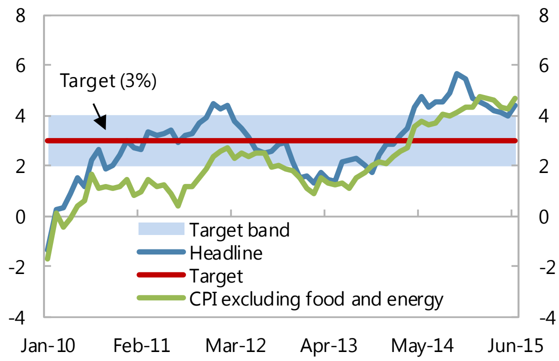



Sources: Ministry of Finance, Central Bank of Chile, and Fund staff calculations.
1/ For 2012, includes capital gains tax windfall.
2/ For 2014, includes the expected yield of the 2014 tax reform as submitted to Congress.
* Projections.

## Figure 3. Chile: Monetary Policy and Inflation

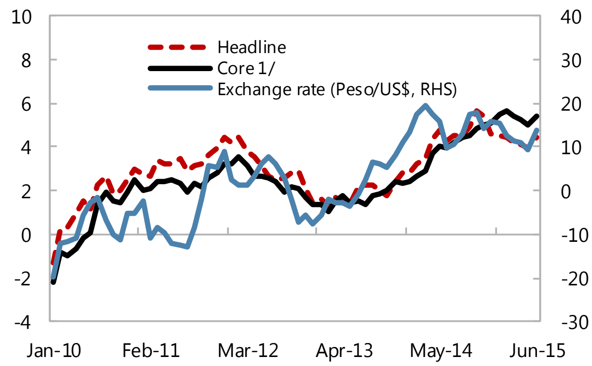
*Inflation has been above the target band since Feb-2014.*

**Consumer Prices**
(In percent, y/y))



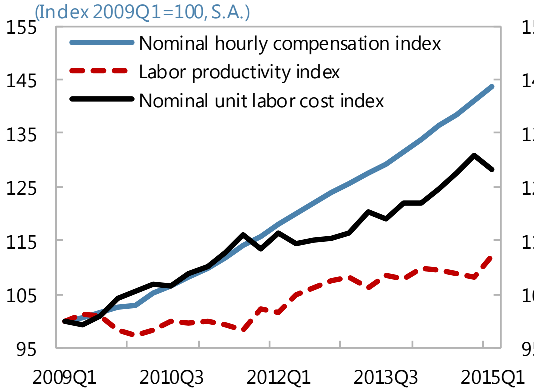

*High inflation mainly reflects the pass-through of the peso depreciation to prices...*

**Consumer Prices and the Exchange Rate**
(In percent, y/y)



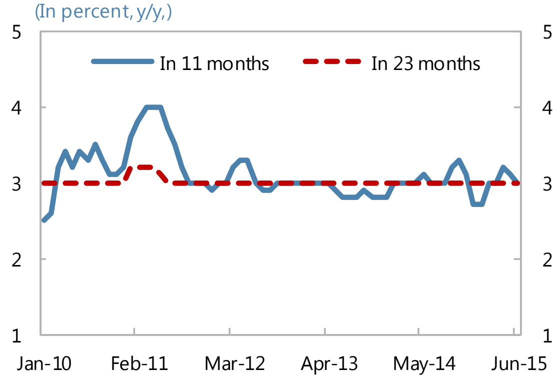

*... as well as rising labor costs.*

**Unit Labor Cost**
(Index 2009Q1=100, S.A.)



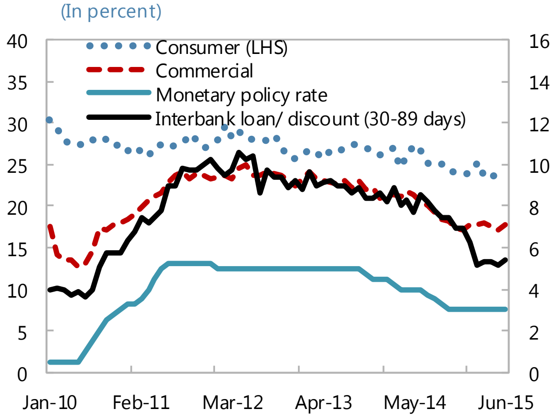

*Inflation expectations remain anchored at 3 percent.*

**Inflation Expectations**
(In percent, y/y,)



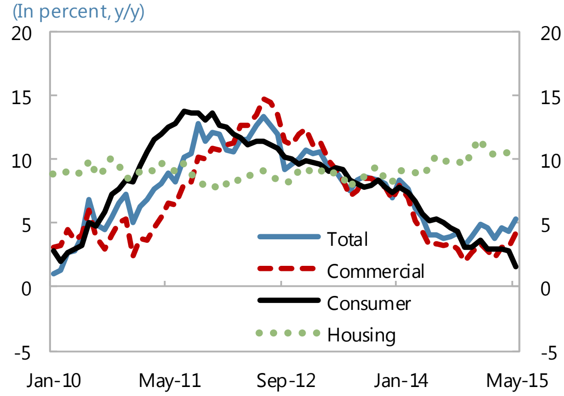

*The policy rate cuts - 200 bps since Sep. 2013 - have translated into lower lending and interbank rates...*

**Policy and Lending Rates**
(In percent)




*... and supported credit growth, particularly in the housing sector.*

**Real Credit Growth**
(In percent, y/y)

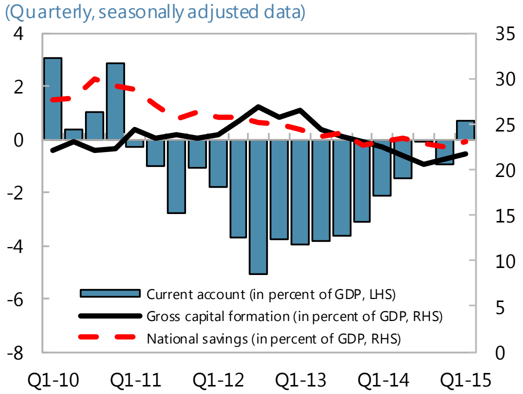



Sources: Central Bank of Chile, Haver Analytics, and Fund staff calculations.
1/ Core inflation excludes fuels, fresh fruits, and vegetables.

## Figure 4. Chile: External Sector

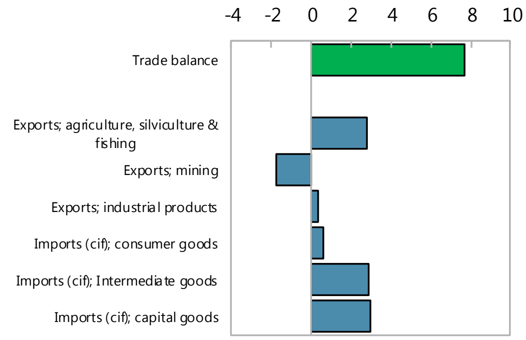
*The current account has improved markedly...*

**Savings, Investment, and the Current Account**
(Quarterly, seasonally adjusted data)



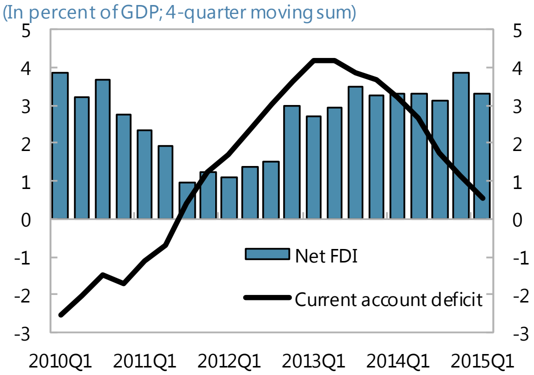

*... with a large decline in capital goods imports.*

**Change in Trade Balance, 2013Q2 - 2015Q1**
(In percent of GDP)



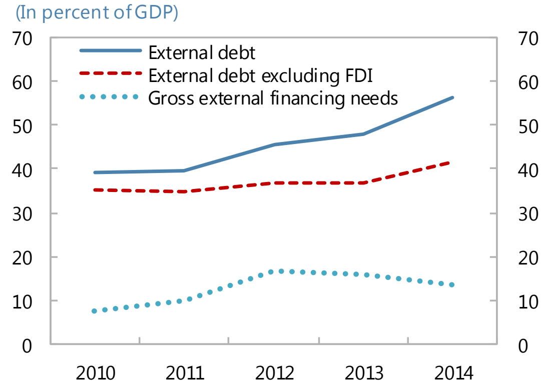

*The current account deficit remains mostly financed by FDI...*

**Balance of Payments and Foreign Direct Investment**
(In percent of GDP; 4-quarter moving sum)



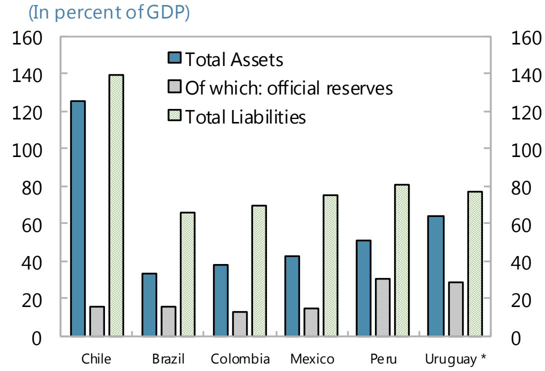

*... but with a growing debt component.*

**Gross External Debt**
(In percent of GDP)




*Still, Chile's international investment position remains strong...*

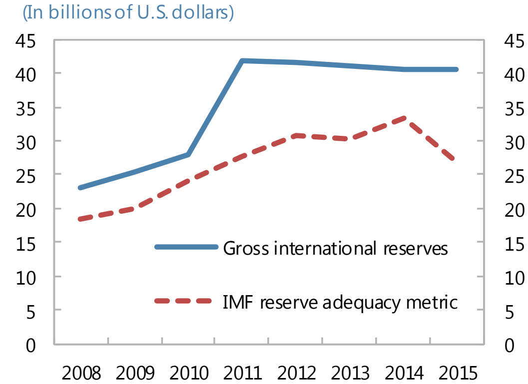
**International Investment Position, 2014**
(In percent of GDP)




* 2013

*...and gross international reserves are adequate.*

**Gross Reserves and Reserve Adequacy Metric 1/**
(In billions of U.S. dollars)

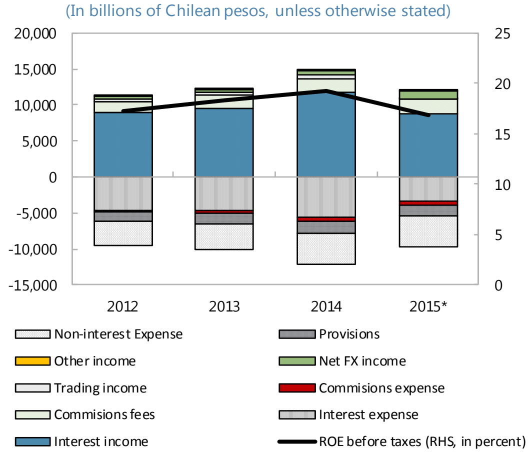



Sources: Central Bank of Chile, Haver Analytics, Inc., World Bank WITS, and Fund staff calculations.
1/ *Assessing Reserve Adequacy*, IMF.

# Figure 5. Chile: Financial Sector

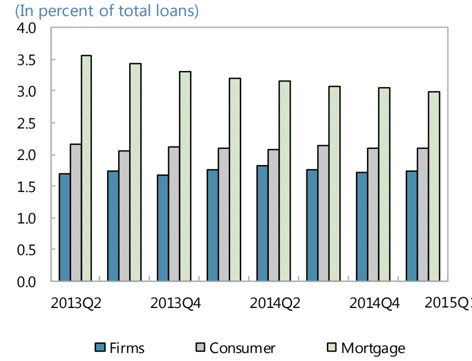
*Profitability of the banking sector is still high despite the fall in 2015Q1 due to lower inflation.*

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



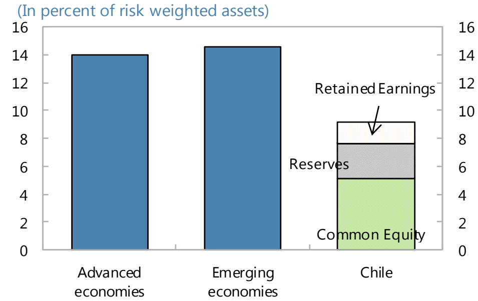

*Non-performing loans have been falling, mainly for mortgages.*

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



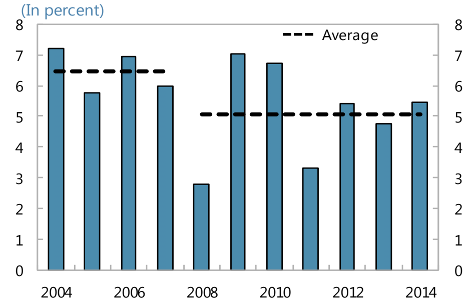

*While capital ratios are lower than other countries, 60 percent of Tier 1 capital is made of common equity.*

**Tier 1 Capital Ratio, end 2014**
(In percent of risk weighted assets)



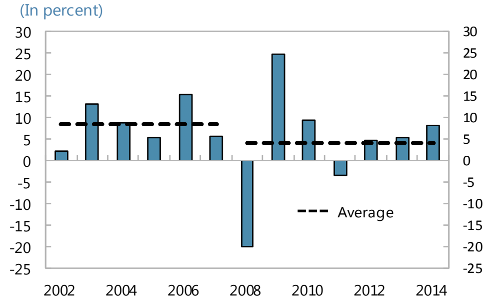

*Due to low interest rates, life insurance companies are facing low returns on their investments…*

**Real Return on Investment of Insurance Sector**
(In percent)



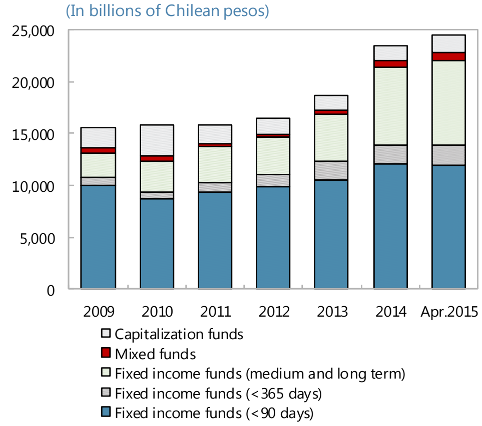

*…and so are pension funds.*

**Real Return of Pension Funds**
(In percent)




*Mutual funds that invest in medium and long-term instruments have grown rapidly.*

**Structure of Mutual Funds**
(In billions of Chilean pesos)

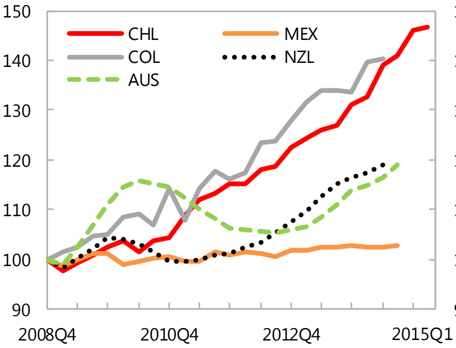



Sources: Superintendiencia Valores y Seguros (SVS), Superintendencia de Bancos e Instituciones Financieras (SBIF), Central Bank of Chile, IMF Financial Soundness Indicators 2015, and Fund staff calculations.
* Projections.

## Figure 6. Chile: Housing Market Developments

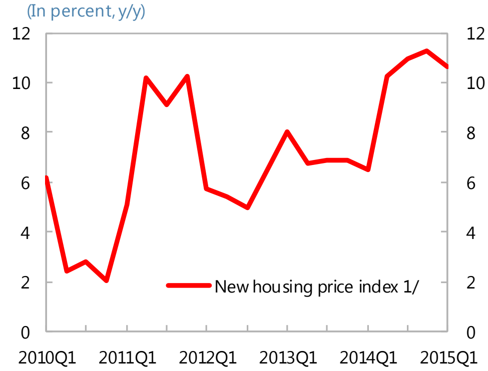
*House prices have grown at a relatively fast pace in Chile…*

**Real Residential Price Indices**
(2008Q4=100)



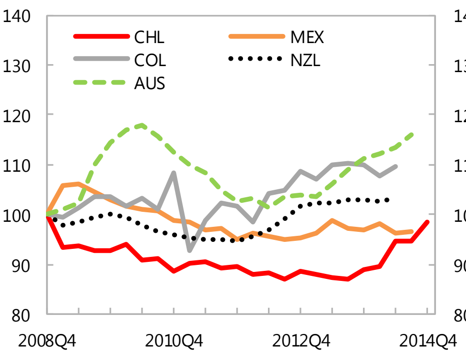

*..with a pick up in the pace since mid 2014, reflecting the impending higher VAT on houses.*

**Real Residential Price Index**
(In percent, y/y)



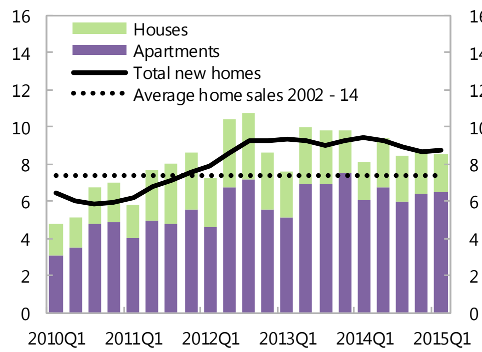

*Still, price to income ratio remains relatively low.*

**Residential Price-to-Income Ratios**
(2008Q4=100)



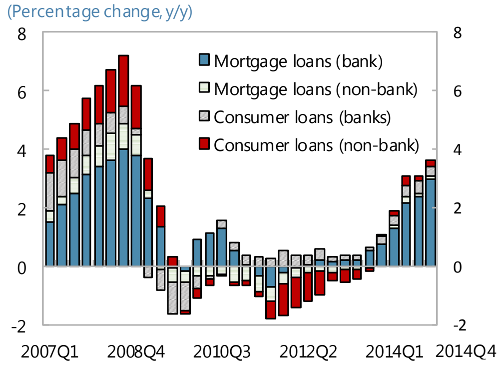

*Residential property sales have stabilized but at levels above the historical average.*

**Residential Property Sales in Greater Santiago 2/**
(In thousands of units)



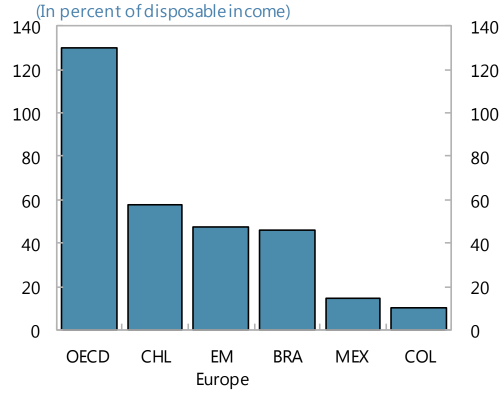

*Household debt has increased, driven by mortgage loans.*

**Loans to the Household Sector**
(Percentage change, y/y)




*Debt-to-income ratio in Chile remains low relative to advanced economies.*

**Household Debt, 2014 /3**
(In percent of disposable income)




Sources: Central Bank of Chile, Superintendence of Banks and Financial Institutions, Chilean Chamber of Construction, Global Property Guide, SuSeso, SVS and Fund staff calculations.
1/ Compiled by the Central Bank of Chile controlling for home characteristics.
2/ Includes purchase commitments.
3/ Latest data available for OECD and EM Europe is 2013. MEX 2012.

## Table 1. Chile: Selected Social and Economic Indicators (2010–16)

| | | | |
|---|---|---|---|
| GDP (2014), in billions of pesos | 147,166 | Quota | |
| GDP (2014), in billions of U.S. dollars | 258.0 | in millions of SDRs | 856 |
| Per capita (U.S. dollars) | 14,480 | in % of total | 0.36% |
| Population (2014), in millions | 17.8 | Poverty rate (2011) | 14.40 |
| Main products and exports | Copper | Gini coefficient (2011) | 50.84 |
| Key export markets | China, Euro area, U.S. | Literacy rate (2011) | 98.9 |

| | | | | | | Proj. | |
|---|---|---|---|---|---|---|---|
| | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 |
| | (Annual percentage change, unless otherwise specified) | | | | | | |
| **Output** | | | | | | | |
| Real GDP | 5.7 | 5.8 | 5.5 | 4.3 | 1.9 | 2.5 | 3.1 |
| Total domestic demand | 13.4 | 9.3 | 7.4 | 3.7 | -0.7 | 3.5 | 3.7 |
| Consumption | 9.7 | 7.8 | 5.7 | 5.5 | 2.5 | 4.4 | 3.3 |
| Private | 10.8 | 8.9 | 6.1 | 5.9 | 2.2 | 2.3 | 3.3 |
| Public | 4.6 | 2.5 | 3.5 | 3.4 | 4.4 | 15.8 | 2.9 |
| Investment | 27.0 | 14.2 | 12.5 | -1.1 | -10.3 | 0.3 | 5.0 |
| Fixed | 11.6 | 15.0 | 11.6 | 2.1 | -6.1 | 0.2 | 3.1 |
| Inventories 1/ | 2.9 | 0.0 | 0.3 | -0.9 | -1.1 | 0.0 | 0.4 |
| Net exports 1/ | -7.6 | -4.2 | -2.0 | 0.5 | 3.2 | -0.8 | -0.6 |
| Exports | 2.3 | 5.5 | 0.1 | 3.4 | 0.7 | 1.5 | 3.0 |
| Imports | 25.5 | 16.0 | 4.8 | 1.7 | -7.0 | 3.4 | 4.3 |
| **Employment** | | | | | | | |
| Unemployment rate (annual average) | 8.2 | 7.1 | 6.4 | 5.9 | 6.4 | 6.5 | 6.6 |
| **Consumer prices** | | | | | | | |
| End of period | 3.0 | 4.4 | 1.5 | 2.8 | 4.6 | 3.3 | 3.0 |
| Average | 1.4 | 3.3 | 3.0 | 1.9 | 4.4 | 3.7 | 3.0 |
| | (In percent of GDP, unless otherwise specified) | | | | | | |
| **Public sector finances** | | | | | | | |
| Central government revenue | 21.6 | 22.6 | 22.2 | 21.0 | 20.7 | 20.4 | 22.1 |
| Central government expenditure | 22.0 | 21.4 | 21.6 | 21.6 | 22.4 | 23.5 | 24.1 |
| Central government fiscal balance | -0.5 | 1.3 | 0.6 | -0.6 | -1.6 | -3.2 | -2.0 |
| Structural fiscal balance 2/ | -2.5 | -1.0 | -0.1 | -1.1 | -1.5 | -2.8 | -1.7 |
| Fiscal impulse | -1.9 | -1.4 | -0.9 | 1.0 | 0.5 | 1.3 | -1.1 |
| Public sector net debt | -2.2 | -4.9 | -1.8 | -1.7 | -1.3 | 2.6 | 4.6 |
| Public sector gross debt | 25.9 | 34.9 | 34.6 | 33.7 | 36.1 | 38.8 | 39.6 |
| Central government gross debt | 8.6 | 11.2 | 12.0 | 12.8 | 15.1 | 17.6 | 19.0 |
| Of which, share of FX-denominated debt (in percent) | 17.3 | 17.2 | 16.1 | 12.9 | 15.9 | 15.3 | 15.7 |
| **Money and credit** | | | | | | | |
| Broad money (percentage change) | 9.3 | 18.5 | 7.6 | 14.9 | 9.3 | ... | ... |
| Credit to the private sector (percentage change) | 7.1 | 16.9 | 12.1 | 10.2 | 10.4 | ... | ... |
| 3-month central bank bill rate (%) | 1.7 | 4.9 | 5.1 | 5.0 | 4.0 | ... | ... |
| **Balance of payments** | | | | | | | |
| Current account | 1.7 | -1.2 | -3.6 | -3.7 | -1.2 | -0.4 | -1.2 |
| Current account (in billions of U.S. dollars) | 3.8 | -3.1 | -9.6 | -10.1 | -3.0 | -1.1 | -3.2 |
| Foreign direct investment inflows | 7.1 | 9.3 | 10.7 | 7.0 | 8.5 | 8.8 | 8.7 |
| Gross international reserves (in billions of U.S. dollars) | 27.9 | 42.0 | 41.6 | 41.1 | 40.4 | 40.4 | 40.4 |
| In months of next year's imports of goods and services | 3.9 | 5.6 | 5.5 | 6.0 | 6.2 | 5.9 | 5.5 |
| Gross external debt | 39.1 | 39.6 | 45.5 | 47.9 | 56.5 | 60.1 | 61.1 |
| Public | 2.6 | 2.9 | 3.1 | 2.6 | 3.3 | 3.8 | 4.1 |
| Private | 36.5 | 36.7 | 42.4 | 45.3 | 53.2 | 56.3 | 57.0 |
| | (Annual percentage change) | | | | | | |
| **Exchange rate** | | | | | | | |
| Real effective exchange rate (real appreciation +) | 5.4 | 0.4 | 3.2 | -0.6 | -8.8 | ... | ... |
| Terms of trade | 22.0 | 1.5 | -6.6 | -2.8 | -1.3 | 1.2 | -1.0 |

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

1/ Contribution to growth.
2/ Headline balance adjusted for the economic and copper price cycles.

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

| | | | | | Projections 1/ | | |
|---|---|---|---|---|---|---|---|
| | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 |
| **Revenues** | **21.5** | **22.7** | **22.2** | **20.9** | **20.7** | **20.3** | **22.1** |
| Taxes | 15.9 | 17.4 | 17.7 | 16.8 | 16.6 | 17.1 | 18.5 |
| Private mining companies | 1.7 | 1.9 | 1.6 | 1.1 | 1.0 | 1.0 | 0.9 |
| Other tax revenues, non-mining | 14.2 | 15.5 | 16.1 | 15.7 | 15.7 | 16.1 | 17.6 |
| Social contributions | 1.3 | 1.3 | 1.4 | 1.4 | 1.4 | 1.4 | 1.4 |
| Grants | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 | 0.0 | 0.1 |
| Other revenue | 4.3 | 3.9 | 3.1 | 2.7 | 2.6 | 1.8 | 2.1 |
| Codelco revenues | 2.7 | 2.3 | 1.5 | 1.0 | 0.9 | 0.4 | 0.7 |
| Income on assets | 0.4 | 0.5 | 0.5 | 0.5 | 0.6 | 0.4 | 0.5 |
| Operating income | 0.5 | 0.5 | 0.5 | 0.5 | 0.5 | 0.5 | 0.5 |
| Other income | 0.6 | 0.7 | 0.6 | 0.7 | 0.6 | 0.5 | 0.5 |
| **Expenditures** | **22.0** | **21.4** | **21.6** | **21.5** | **22.3** | **23.5** | **24.1** |
| Expense | 19.9 | 19.3 | 19.6 | 19.6 | 19.6 | 20.9 | 21.4 |
| Compensation of employees | 4.2 | 4.1 | 4.2 | 4.3 | 4.0 | 4.2 | 4.3 |
| Purchases of goods and services | 2.1 | 2.2 | 2.1 | 2.0 | 1.4 | 1.9 | 1.9 |
| Interest payments | 0.5 | 0.6 | 0.6 | 0.6 | 0.6 | 0.7 | 1.0 |
| Subsidies and grants | 6.7 | 6.3 | 6.7 | 7.0 | 8.2 | 8.4 | 8.8 |
| Social benefits | 4.5 | 4.2 | 4.1 | 4.0 | 3.8 | 3.8 | 3.7 |
| Other expense | 1.9 | 2.0 | 2.0 | 1.7 | 1.5 | 1.8 | 1.7 |
| Capital transfers | 1.8 | 1.9 | 1.9 | 1.7 | 1.5 | 1.8 | 1.7 |
| Net acquistion of nonfinancial assets | 2.1 | 2.1 | 2.0 | 2.0 | 2.8 | 2.6 | 2.6 |
| Investment | 2.1 | 2.1 | 2.1 | 2.0 | 2.8 | 2.6 | 2.7 |
| Sale of physical assets | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| **Gross operating balance** | **1.6** | **3.4** | **2.6** | **1.4** | **1.1** | **-0.6** | **0.7** |
| **Net lending/borrowing** | **-0.5** | **1.3** | **0.6** | **-0.6** | **-1.6** | **-3.2** | **-2.0** |
| Non-mining overall balance | -4.9 | -2.9 | -2.5 | -2.7 | -3.5 | -4.6 | -3.6 |
| **Net financial transactions** | **-0.5** | **1.3** | **0.6** | **-0.6** | **-1.6** | **-3.2** | **-2.0** |
| Net acquistion of financial assets | 2.0 | 3.1 | 1.0 | -0.5 | 0.2 | 0.3 | 0.3 |
| Currency and deposits | -0.2 | -0.2 | 0.3 | -0.5 | 0.0 | 0.0 | 0.0 |
| Securities other than shares | 2.2 | 3.4 | 0.8 | 0.0 | 0.2 | 0.3 | 0.3 |
| Loans | 0.0 | -0.1 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Net incurrence of liabilities | 2.5 | 1.8 | 0.4 | 0.1 | 1.9 | 3.5 | 2.3 |
| Domestic | 2.5 | 2.0 | 0.8 | 1.1 | 1.9 | 3.7 | 2.4 |
| Securities other than shares | 2.8 | 2.4 | 1.3 | 1.6 | 2.7 | 4.4 | 2.4 |
| Amortization | 0.3 | 0.4 | 0.5 | 0.5 | 0.8 | 0.7 | 0.0 |
| External | 0.7 | 0.5 | 0.3 | -0.3 | 0.6 | 0.4 | 0.4 |
| Securities other than shares | 0.7 | 0.5 | 0.6 | 0.0 | 0.9 | 0.5 | 0.5 |
| Amortization | 0.1 | 0.1 | 0.3 | 0.3 | 0.3 | 0.0 | 0.0 |
| Recognizion bonds | -0.7 | -0.7 | -0.6 | -0.6 | -0.6 | -0.6 | -0.5 |
| **Memorandum items** | | | | | | | |
| Primary balance | -0.4 | 1.4 | 0.7 | -0.5 | -1.6 | -2.9 | -1.4 |
| Structural balance 2/ | -2.5 | -1.0 | -0.1 | -1.1 | -1.5 | -2.8 | -1.7 |
| Fiscal impulse | -1.9 | -1.4 | -0.9 | 1.0 | 0.5 | 1.3 | -1.1 |
| Expenditure growth (in real terms) | 7.4 | 2.6 | 4.7 | 3.9 | 7.1 | 8.8 | 5.1 |
| Expense | 8.3 | 2.6 | 4.7 | 4.3 | 2.8 | 10.6 | 5.0 |
| Net acquisition of nonfinancial assets | -6.6 | 7.5 | -0.3 | -4.6 | 20.3 | 7.2 | 1.9 |
| Net assets of the central government | 7.0 | 8.6 | 6.8 | 5.7 | 4.4 | 1.1 | -0.8 |
| Gross debt | 8.6 | 11.2 | 12.0 | 12.8 | 15.1 | 17.6 | 19.0 |
| Peso-denominated assets | 6.2 | 7.8 | 7.2 | 6.6 | 6.2 | 5.9 | 5.8 |
| Foreign currency-denominated assets | 9.4 | 12.0 | 11.6 | 11.9 | 13.3 | 12.8 | 12.5 |
| Nominal GDP (trillions of pesos) | 110.9 | 121.2 | 129.0 | 137.0 | 147.2 | 157.7 | 166.9 |
| Copper price, USD per pound (WEO) | 3.42 | 4.0 | 3.61 | 3.33 | 3.11 | 2.74 | 2.77 |

Sources: Ministry of Finance and Fund staff calculations.

1/ Based on the authorities' medium-term fiscal projections in the 2015 Budget Law, adjusted for staff's GDP and copper price projections.

2/ Based on staff's output gap estimates and WEO copper prices.

## Table 3. Chile: Balance of Payments

| | 2010 | 2011 | 2012 | 2013 | 2014 | Projections 2015 | 2016 |
|---|---|---|---|---|---|---|---|
| | (In millions of U.S. dollars) | | | | | | |
| **Current account** | 3,770 | -3,089 | -9,626 | -10,127 | -2,993 | -1,135 | -3,230 |
| Trade balance | 15,942 | 11,039 | 2,333 | 1,820 | 7,768 | 7,593 | 6,099 |
| Exports | 71,109 | 81,438 | 77,791 | 76,477 | 75,675 | 71,260 | 74,004 |
| Copper | 41,361 | 44,670 | 41,955 | 40,019 | 37,872 | 35,084 | 36,202 |
| Non-copper | 29,748 | 36,768 | 35,836 | 36,458 | 37,803 | 36,177 | 37,801 |
| Imports | 55,167 | 70,399 | 75,458 | 74,657 | 67,907 | 63,667 | 67,905 |
| Net services | -1,897 | -3,073 | -2,745 | -3,404 | -3,757 | -4,429 | -5,016 |
| Net income | -14,686 | -13,920 | -11,273 | -10,730 | -8,856 | -5,784 | -5,813 |
| Net transfers | 4,411 | 2,865 | 2,059 | 2,187 | 1,852 | 1,485 | 1,500 |
| Capital account balance 1/ | 6,240 | 11 | 12 | 12 | 11 | 0 | 0 |
| **Financial account balance** | 5,945 | -17,828 | -8,955 | -11,563 | -3,784 | -1,135 | -3,230 |
| Foreign direct investment | -6,049 | -3,057 | -7,902 | -8,956 | -9,950 | -9,643 | -9,591 |
| Abroad by Chilean residents | 9,461 | 20,252 | 20,556 | 10,308 | 12,052 | 12,916 | 13,666 |
| In Chile by foreign residents | 15,510 | 23,309 | 28,457 | 19,264 | 22,002 | 22,560 | 23,257 |
| Of which, debt instruments | 2,985 | 3,162 | 10,841 | 8,329 | 7,248 | 7,432 | 7,661 |
| Portfolio investment | 6,421 | -11,484 | 3,971 | -5,015 | -3,692 | -3,957 | -4,187 |
| Abroad by Chilean residents | 15,710 | -799 | 15,043 | 10,544 | 8,688 | 9,311 | 9,852 |
| In Chile by foreign residents | 9,289 | 10,685 | 11,072 | 15,559 | 12,380 | 13,268 | 14,038 |
| Of which, equities | 1,764 | 4,650 | 5,633 | 6,268 | 2,321 | 2,487 | 2,632 |
| Of which, debt | 7,525 | 6,035 | 5,439 | 9,291 | 10,059 | 10,781 | 11,407 |
| Financial derivatives | 934 | 2,418 | -10 | 778 | 1,607 | 0 | 0 |
| Other investments | 4,639 | -5,705 | -5,014 | 1,629 | 8,251 | 12,466 | 10,547 |
| Abroad by Chilean residents | 6,385 | -662 | -2,335 | -821 | 4,378 | 1,549 | 1,549 |
| In Chile by foreign residents | 1,746 | 5,043 | 2,679 | -2,450 | -3,873 | -10,916 | -8,998 |
| **Change in reserves assets** | 3,024 | 14,190 | -367 | 311 | 1,057 | 0 | 0 |
| Errors and omissions | -1,042 | -562 | 292 | -1138 | 259 | 0 | 0 |
| Gross official international reserves | 3.9 | 5.6 | 5.5 | 6.0 | 6.2 | 5.9 | 5.5 |
| (In months of imports of goods and services) | | | | | | | |
| | (In percent of GDP) | | | | | | |
| **Current account** | 1.7 | -1.2 | -3.6 | -3.7 | -1.2 | -0.4 | -1.2 |
| Trade balance | 7.3 | 4.4 | 0.9 | 0.7 | 3.0 | 3.0 | 2.3 |
| Exports | 32.7 | 32.5 | 29.3 | 27.6 | 29.3 | 27.8 | 27.8 |
| Copper | 19.0 | 17.8 | 15.8 | 14.5 | 14.7 | 13.7 | 13.6 |
| Non-copper | 13.7 | 14.7 | 13.5 | 13.2 | 14.7 | 14.1 | 14.2 |
| Imports | 25.4 | 28.1 | 28.5 | 27.0 | 26.3 | 24.8 | 25.5 |
| Net services | -0.9 | -1.2 | -1.0 | -1.2 | -1.5 | -1.7 | -1.9 |
| Net income | -6.8 | -5.6 | -4.3 | -3.9 | -3.4 | -2.3 | -2.2 |
| Net transfers | 2.0 | 1.1 | 0.8 | 0.8 | 0.7 | 0.6 | 0.6 |
| **Financial account balance 2/** | 2.7 | -7.1 | -3.4 | -4.2 | -1.5 | -0.4 | -1.2 |
| Total export volume | -0.2 | 4.1 | 1.7 | 3.6 | 1.9 | 2.2 | 3.0 |
| Copper export volume | 0.4 | -2.0 | 2.1 | 5.9 | 1.5 | -0.3 | 2.1 |
| Agricultural exports volume | 2.5 | 12.6 | -0.4 | 6.4 | -7.9 | 17.5 | 6.0 |
| Industrial exports volume | -2.1 | 13.8 | 0.6 | 0.8 | 4.3 | 2.5 | 3.4 |
| Total import volume | 30.8 | 16.5 | 6.9 | 1.3 | -7.4 | 3.7 | 4.3 |
| Terms of trade | 22.0 | 1.5 | -6.6 | -2.8 | -1.3 | 1.2 | -1.0 |
| Total export prices | 28.6 | 10.2 | -6.2 | -5.1 | -2.8 | -7.9 | 0.8 |
| Copper export prices | 40.4 | 11.0 | -8.4 | -9.7 | -6.9 | -7.1 | 1.1 |
| Total import price | 5.6 | 8.7 | 0.4 | -2.4 | -1.6 | -9.0 | 1.9 |
| **Memorandum items:** | | | | | | | |
| Copper price (LME; U.S. cents per pound) | 342 | 400 | 361 | 333 | 311 | 274 | 277 |
| Volume of copper exports (2004=100) | 99 | 97 | 99 | 105 | 107 | 106 | 109 |

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

1/ In 2010 reflects insurance payment associated with the earthquake.

2/ Excluding change in reserves.

## Table 4. Chile: Monetary Survey

(In billions of pesos, unless otherwise indicated)

| | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 |
|---|---|---|---|---|---|---|
| **Central bank** | | | | | | |
| Net foreign assets | 12,254 | 12,508 | 21,307 | 19,396 | 20,943 | 23,937 |
| Net international reserves | 12,849 | 13,051 | 21,891 | 19,933 | 21,523 | 24,567 |
| Net international reserves (in millions of US$) | 25,372 | 27,865 | 41,980 | 42,231 | 45,216 | 51,288 |
| Other foreign assets, net | -595 | -543 | -584 | -537 | -580 | -630 |
| Net domestic assets | -7,672 | -6,983 | -14,456 | -11,505 | -12,189 | -15,754 |
| Net credit to general government | 580 | 559 | 143 | 367 | 738 | -1,102 |
| Net claims on banks and financial corporations | -2,854 | -2,964 | -4,593 | -4,202 | -4,370 | -5,854 |
| Credit to the private sector | 904 | 861 | 805 | 717 | 609 | 518 |
| Other items (net) | -6,302 | -5,439 | -10,811 | -8,388 | -9,166 | -9,317 |
| Monetary base | 4,582 | 5,525 | 6,851 | 7,891 | 8,754 | 8,183 |
| Currency | 2,935 | 3,423 | 3,892 | 4,480 | 4,981 | 5,371 |
| Required reserves | 1,647 | 2,102 | 2,959 | 3,411 | 3,773 | 2,812 |
| **Other depository institutions** | | | | | | |
| Net foreign assets | -4,014 | -4,767 | -6,995 | -6,477 | -6,232 | -4,631 |
| Net foreign assets (in millions of US$) | -7,926 | -10,178 | -13,414 | -13,722 | -13,092 | -9,668 |
| Net domestic assets | 64,965 | 66,513 | 81,620 | 84,909 | 93,481 | 102,801 |
| Net credit to general government | -2,269 | -2,240 | -1,709 | -716 | 445 | 890 |
| Credit to the private sector | 68,879 | 73,786 | 86,276 | 96,702 | 106,586 | 117,658 |
| Other items (net) | -1,645 | -5,033 | -2,947 | -11,077 | -13,550 | -15,747 |
| Liabilities to the private sector | 60,951 | 61,746 | 74,625 | 78,432 | 87,249 | 98,170 |
| Demand deposits | 11,150 | 13,465 | 14,749 | 16,080 | 17,799 | 20,977 |
| Quasi-money | 49,801 | 48,281 | 59,876 | 62,352 | 69,450 | 77,193 |
| **Banking system** | | | | | | |
| Net foreign assets | 8,240 | 7,741 | 14,313 | 12,919 | 14,712 | 19,307 |
| Net domestic assets | 61,147 | 61,579 | 72,887 | 79,803 | 86,751 | 92,908 |
| Net credit to general government | -1,689 | -1,681 | -1,566 | -349 | 1,183 | -212 |
| Credit to the private sector | 69,783 | 74,647 | 87,081 | 97,419 | 107,195 | 118,176 |
| Other items (net) | -6,710 | -11,387 | -12,627 | -17,268 | -21,627 | -25,057 |
| Liabilities to the private sector | 69,387 | 69,320 | 87,200 | 92,722 | 101,463 | 112,215 |
| Money | 14,086 | 16,888 | 18,641 | 20,560 | 22,780 | 26,348 |
| Quasi-money | 55,301 | 52,432 | 68,559 | 72,162 | 78,683 | 85,867 |
| **Memorandum items** | | | | | | |
| | (Annual percentage change) | | | | | |
| Monetary base | 8.3 | 20.6 | 24.0 | 15.2 | 10.9 | -6.5 |
| Liabilities to the private sector | 0.3 | -0.1 | 25.8 | 6.3 | 9.4 | 10.6 |
| Credit to the private sector (banking system) | -1.5 | 7.0 | 16.7 | 11.9 | 10.0 | 10.2 |
| | (In percent of GDP) | | | | | |
| Monetary base | 4.7 | 5.0 | 5.7 | 6.1 | 6.3 | 5.5 |
| Liabilities to the private sector | 71.8 | 62.9 | 72.6 | 71.6 | 73.1 | 75.3 |
| Credit to the private sector (banking system) | 72.2 | 67.7 | 72.5 | 75.3 | 77.2 | 79.3 |

Sources: Central Bank of Chile and Haver Analytics.

## Table 5. Chile: Medium-Term Framework

| | 2010 | 2011 | 2012 | 2013 | 2014 | Projections 2015 | 2016 | 2017 | 2018 | 2019 | 2020 |
|---|---|---|---|---|---|---|---|---|---|---|---|
| **National accounts** | (Annual percentage change, unless otherwise specified) | | | | | | | | | | |
| Real GDP | 5.7 | 5.8 | 5.5 | 4.3 | 1.9 | 2.5 | 3.1 | 3.3 | 3.5 | 3.6 | 3.7 |
| Total domestic demand | 13.4 | 9.3 | 7.4 | 3.7 | -0.7 | 3.5 | 3.7 | 3.6 | 3.5 | 3.6 | 3.6 |
| Consumption | 9.7 | 7.8 | 5.7 | 5.5 | 2.5 | 4.4 | 3.3 | 3.2 | 3.3 | 3.4 | 3.4 |
| Private | 10.8 | 8.9 | 6.1 | 5.9 | 2.2 | 2.3 | 3.3 | 3.1 | 3.3 | 3.4 | 3.4 |
| Public | 4.6 | 2.5 | 3.5 | 3.4 | 4.4 | 15.8 | 2.9 | 3.8 | 3.4 | 3.4 | 3.5 |
| Investment | 27.0 | 14.2 | 12.5 | -1.1 | -10.3 | 0.3 | 5.0 | 5.1 | 4.5 | 4.4 | 4.3 |
| Fixed | 11.6 | 15.0 | 11.6 | 2.1 | -6.1 | 0.2 | 3.1 | 4.0 | 4.1 | 4.4 | 4.3 |
| Private | 17.2 | 15.8 | 12.6 | 2.6 | -11.2 | 0.9 | 2.7 | 3.7 | 3.9 | 4.5 | 4.5 |
| Public | -18.5 | 8.3 | 3.8 | -2.5 | 42.8 | -3.7 | 5.4 | 5.6 | 5.4 | 3.4 | 3.2 |
| Inventories 1/ | 2.9 | 0.0 | 0.3 | -0.9 | -1.1 | 0.0 | 0.4 | 0.2 | 0.1 | 0.0 | 0.0 |
| Net exports 1/ | -7.6 | -4.2 | -2.0 | 0.5 | 3.2 | -0.8 | -0.6 | -0.5 | -0.2 | -0.2 | -0.1 |
| Exports | 2.3 | 5.5 | 0.1 | 3.4 | 0.7 | 1.5 | 3.0 | 4.3 | 5.2 | 5.3 | 5.3 |
| Imports | 25.5 | 16.0 | 4.8 | 1.7 | -7.0 | 3.4 | 4.3 | 5.1 | 5.1 | 5.1 | 5.0 |
| Consumer prices | | | | | | | | | | | |
| End of period | 3.0 | 4.4 | 1.5 | 2.8 | 4.6 | 3.3 | 3.0 | 3.0 | 3.0 | 3.0 | 3.0 |
| Consumer prices (average) | 1.4 | 3.3 | 3.0 | 1.9 | 4.4 | 3.7 | 3.0 | 3.0 | 3.0 | 3.0 | 3.0 |
| Output gap | -1.6 | -0.2 | 1.1 | 1.6 | 0.0 | -0.6 | -0.7 | -0.6 | -0.3 | -0.1 | 0.0 |
| **Balance of payments** | (In percent of GDP) | | | | | | | | | | |
| Current account | 1.7 | -1.2 | -3.6 | -3.7 | -1.2 | -0.4 | -1.2 | -1.7 | -2.0 | -2.2 | -2.2 |
| Trade balance | 7.3 | 4.4 | 0.9 | 0.7 | 3.0 | 3.0 | 2.3 | 1.7 | 1.4 | 1.2 | 1.2 |
| Financial account balance | 2.7 | -7.1 | -3.4 | -4.2 | -1.5 | -0.4 | -1.2 | -1.7 | -2.0 | -2.2 | -2.2 |
| Of which, foreign direct investment (net) | -2.8 | -1.2 | -3.0 | -3.2 | -3.9 | -3.8 | -3.6 | -3.4 | -3.2 | -3.0 | -2.8 |
| Change in reserves assets | 1.4 | 5.7 | -0.1 | 0.1 | 0.4 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| | (Annual percentage change) | | | | | | | | | | |
| Total export volume | -0.2 | 4.1 | 1.7 | 3.6 | 1.9 | 2.2 | 3.0 | 4.3 | 5.2 | 5.3 | 5.3 |
| Of which, copper export volume | 0.4 | -2.0 | 2.1 | 5.9 | 1.5 | -0.3 | 2.1 | 2.5 | 3.0 | 3.0 | 3.0 |
| Total import volume | 30.8 | 16.5 | 6.9 | 1.3 | -7.4 | 3.7 | 4.3 | 5.1 | 5.1 | 5.1 | 5.0 |
| Terms of trade | 22.0 | 1.5 | -6.6 | -2.8 | -1.3 | 1.2 | -1.0 | -1.3 | -1.2 | -0.8 | -0.3 |
| Total export prices | 28.6 | 10.2 | -6.2 | -5.1 | -2.8 | -7.9 | 0.8 | 0.0 | -0.1 | -0.1 | -0.4 |
| Copper export prices | 40.4 | 11.0 | -8.4 | -9.7 | -6.9 | -7.1 | 1.1 | 0.0 | -0.1 | 0.0 | 0.0 |
| Total import price | 5.6 | 8.7 | 0.4 | -2.4 | -1.6 | -9.0 | 1.9 | 1.3 | 1.2 | 0.7 | -0.1 |
| **External debt** | (In percent of GDP) | | | | | | | | | | |
| Gross external debt | 39.1 | 39.6 | 45.5 | 47.9 | 56.5 | 60.1 | 61.1 | 61.5 | 61.9 | 62.2 | 62.1 |
| Public | 2.6 | 2.9 | 3.1 | 2.6 | 3.3 | 3.8 | 4.1 | 4.3 | 4.5 | 4.6 | 4.5 |
| Private | 36.5 | 36.7 | 42.4 | 45.3 | 53.2 | 56.3 | 57.0 | 57.2 | 57.4 | 57.5 | 57.6 |
| Gross int. reserves (in billions of U.S. dollars) | 27.9 | 42.0 | 41.6 | 41.1 | 40.4 | 40.4 | 40.4 | 40.4 | 40.4 | 40.4 | 40.4 |
| **Savings and investment** | | | | | | | | | | | |
| Gross domestic investment | 22.3 | 23.8 | 25.5 | 24.4 | 21.4 | 20.6 | 21.0 | 21.4 | 21.6 | 21.7 | 21.8 |
| Public | 2.4 | 2.4 | 2.4 | 2.3 | 3.2 | 3.0 | 3.0 | 3.1 | 3.2 | 3.2 | 3.2 |
| Private | 20.0 | 21.4 | 23.1 | 22.1 | 18.3 | 17.7 | 17.9 | 18.2 | 18.4 | 18.5 | 18.6 |
| National saving | 24.1 | 22.5 | 21.8 | 20.7 | 20.3 | 20.2 | 19.8 | 19.6 | 19.6 | 19.6 | 19.6 |
| Public | 2.0 | 3.7 | 3.0 | 1.7 | 1.7 | -0.3 | 1.1 | 1.7 | 2.4 | 2.3 | 2.3 |
| Private | 22.1 | 18.8 | 18.9 | 19.0 | 18.6 | 20.4 | 18.7 | 18.0 | 17.2 | 17.3 | 17.3 |
| **Public sector finance** | | | | | | | | | | | |
| Net debt | -2.2 | -4.9 | -1.8 | -1.7 | -1.3 | 2.6 | 4.6 | 6.3 | 7.2 | 8.1 | 9.0 |
| Excluding public enterprises | -7.8 | -10.6 | -7.9 | -7.9 | -7.5 | -3.6 | -1.6 | 0.1 | 1.0 | 1.9 | 2.8 |
| Public sector gross debt 2/ | 25.9 | 34.9 | 34.6 | 33.7 | 36.1 | 38.8 | 39.6 | 40.3 | 40.2 | 39.9 | 39.4 |
| Central government gross debt | 8.6 | 11.2 | 12.0 | 12.8 | 15.1 | 17.6 | 19.0 | 20.1 | 20.6 | 20.9 | 21.1 |
| Central government balance | -0.5 | 1.3 | 0.6 | -0.6 | -1.6 | -3.2 | -2.0 | -1.5 | -1.0 | -0.9 | -0.9 |
| Total revenue | 21.6 | 22.6 | 22.2 | 21.0 | 20.7 | 20.4 | 22.1 | 22.7 | 23.5 | 23.6 | 23.5 |
| Total expenditure | 22.0 | 21.4 | 21.6 | 21.6 | 22.4 | 23.5 | 24.1 | 24.2 | 24.4 | 24.5 | 24.4 |
| Central government structural balance | -2.5 | -1.0 | -0.1 | -1.1 | -1.5 | -2.8 | -1.7 | -1.2 | -0.8 | -0.8 | -0.9 |
| **Employment** | (Annual percentage change, unless otherwise specified) | | | | | | | | | | |
| Working age population | 1.6 | 1.5 | 1.5 | 1.6 | 1.6 | 1.5 | 1.4 | 1.1 | 1.1 | 1.1 | 1.1 |
| Labor force | 4.2 | 3.8 | 1.1 | 1.6 | 2.0 | 1.5 | 1.4 | 1.1 | 1.1 | 1.1 | 1.1 |
| Employment | 7.4 | 5.0 | 1.9 | 2.1 | 1.5 | 1.4 | 1.2 | 1.2 | 1.2 | 1.2 | 1.1 |
| Unemployment rate (in percent) | 8.2 | 7.1 | 6.4 | 5.9 | 6.4 | 6.5 | 6.6 | 6.5 | 6.4 | 6.3 | 6.3 |

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

1/ Contribution to growth.

2/ Gross consolidated debt of the public sector (central bank, non-financial public enterprises, and general government).

## Table 6. Chile: Indicators of External Vulnerability
(In percent, unless otherwise indicated)

| | 2010 | 2011 | 2012 | 2013 | 2014 | Proj. 2015 |
|---|---|---|---|---|---|---|
| **Financial indicators** | | | | | | |
| M3 (percent change) | 11.2 | 18.9 | 6.2 | 13.9 | 11.1 | ... |
| Less pension funds' deposits (annual percentage change) | 16.4 | 19.9 | 5.9 | 14.8 | 9.8 | ... |
| Private sector credit to GDP | 66.6 | 71.2 | 75.0 | 77.8 | 79.9 | ... |
| 90-day central bank promissory note (nominal) interest rate (avg.) | 1.7 | 4.9 | 5.1 | 5.0 | 4.0 | |
| Share of foreign currency deposits in total deposits | 15.4 | 12.8 | 12.7 | 14.0 | 16.7 | ... |
| Share of foreign currency loans in total credit | 10.7 | 12.7 | 12.9 | 13.5 | 13.7 | ... |
| **External indicators** | | | | | | |
| Exports, U.S. dollars (annual percentage change) | 28.2 | 14.5 | -4.5 | -1.7 | -1.0 | -5.8 |
| Imports, U.S. dollars (annual percentage change) | 37.6 | 27.6 | 7.2 | -1.1 | -9.0 | -6.2 |
| Terms of trade (annual percentage change) | 22.0 | 1.5 | -6.6 | -2.8 | -1.3 | 1.2 |
| REER (annual percent change, period average) | 5.4 | 0.4 | 3.2 | -0.6 | -8.8 | ... |
| Exchange rate (pesos per U.S. dollar, period average) | 510 | 484 | 486 | 495 | 570.4 | ... |
| Current account balance (percent of GDP) | 1.7 | -1.2 | -3.6 | -3.7 | -1.2 | -0.4 |
| Financial account less reserves accumulation (percent of GDP) | 2.7 | -7.1 | -3.4 | -4.2 | -1.5 | -0.4 |
| Gross official reserves (in billions of U.S. dollars) 1/ | 27.9 | 42.0 | 41.6 | 41.1 | 40.4 | 40.4 |
| Gross official reserves, months of imports of goods and services | 3.9 | 5.6 | 5.5 | 6.0 | 6.2 | 5.9 |
| Gross official reserves to M3 | 13.5 | 19.0 | 16.3 | 15.5 | 15.9 | ... |
| Gross official reserves to short-term external debt 2/ | 133.8 | 146.2 | 130.6 | 153.4 | 125.9 | 178.2 |
| Total external debt (percent of GDP) | 39.1 | 39.6 | 45.5 | 47.9 | 56.5 | 60.1 |
| *Of which:* External public sector debt | 2.6 | 2.9 | 3.1 | 2.6 | 3.3 | 3.8 |
| Total external debt to exports of goods and services | 103.3 | 105.0 | 133.7 | 149.1 | 168.1 | 190.2 |
| External interest payments to exports of goods and services | 2.3 | 2.3 | 3.7 | 3.8 | 4.3 | 4.7 |
| External amortization payments to exports of goods and services | 24.1 | 23.5 | 38.6 | 38.0 | 37.2 | 39.6 |
| **Financial market indicators** | | | | | | |
| Stock market index (in U.S. dollars; period average) 3/ | 2362 | 2564 | 2434 | 2173 | 1726 | ... |
| Sovereign long-term foreign currency debt rating (end of period) | | | | | | |
| Moody's | Aa3 | Aa3 | Aa3 | Aa3 | Aa3 | ... |
| S&P | A+ | A+ | AA- | AA- | AA- | ... |
| Fitch ratings | A | A+ | A+ | A+ | A+ | ... |

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

1/ Gold valued at end-period market prices.
2/ Includes amortization of medium/long-term debt due during the following year.
3/ Morgan-Stanley Capital International index (Dec/1987=100).

**Table 7. Chile: Financial Soundness Indicators (2009–14)**

(In percent unless otherwise indicated)

| | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 1/ |
|---|---|---|---|---|---|---|
| **Total Assets** | | | | | | |
| Total assets 2/ | 101,903.8 | 108,233.9 | 126,295.0 | 140,536.3 | 158,746.4 | 175,754.5 |
| Percent of GDP | 105.80 | 97.62 | 104.18 | 108.95 | 115.85 | 119.43 |
| **Capital Adequacy** | | | | | | |
| Regulatory Capital to Risk-Weighted Assets | 14.3 | 14.1 | 13.9 | 13.3 | 13.3 | 13.2 |
| Regulatory Tier 1 Capital to Risk-Weighted Assets | 10.9 | 10.1 | 10.1 | 10.0 | 9.9 | 9.9 |
| Capital to Assets | 6.8 | 8.3 | 7.8 | 8.0 | 8.1 | 8.0 |
| **Credit Risk** | | | | | | |
| NPLs Net of Provisions to Capital | 4.7 | 1.7 | 0.2 | -0.6 | -1.6 | -1.8 |
| NPLs to Gross Loans | 2.9 | 2.7 | 2.3 | 2.2 | 2.1 | 2.1 |
| **Profitability** | | | | | | |
| Return on Assets | 1.5 | 1.7 | 1.6 | 1.4 | 1.5 | 1.6 |
| Return on Equity | 21.4 | 20.7 | 20.8 | 17.3 | 18.3 | 20.6 |
| Interest Margin to Gross Income | 60.6 | 63.3 | 64.5 | 64.3 | 64.3 | 67.0 |
| Trading Income to Gross Income | 13.9 | 10.5 | 9.5 | 10.7 | 12.0 | 11.8 |
| Non-interest Expenses to Gross Income | 46.7 | 49.8 | 48.0 | 49.3 | 47.8 | 46.1 |
| **Liquidity** | | | | | | |
| Liquid Assets to Total Assets | 9.8 | 10.1 | 15.2 | 13.3 | 13.2 | 12.8 |
| Customer Deposits to Loans | 65.7 | 64.6 | 63.8 | 62.6 | 61.1 | .. |
| **FX and Derivative Risk** | | | | | | |
| FX Loans to Total Loans | 10.8 | 11.2 | 14.5 | 15.7 | 18.4 | 19.4 |
| FX Liabilities to Total Liabilities | 20.7 | 22.3 | 21.2 | 21.4 | 24.3 | 27.2 |

Sources: IMF FSI database and Fund staff calculations.
1/ September 2014 data.
2/ In billions of Chilean pesos.

# Annex I. Chile: External Sector Assessment Report

| | Chile | Overall Assessment |
|---|---|---|
| **Foreign asset and liability position** | **Background**. Chile's net international investment position (NIIP) has hovered around -15 percent of GDP since 2008, and is stronger than other countries in the region. Chile has a net negative FDI position reflecting large inflows in the mining sector, and a net positive equity position, with the financial sector (pension funds, mutual funds, and insurance companies) being the main holders of foreign assets. The IIP is projected to remain largely unchanged in the next few years amid small current account deficits.<br>**Assessment**. Gross external debt grew rapidly in the last 4 years, from 39 to 56 percent of GDP (as of end 2014) with most of the increase concentrated in the nonfinancial corporate sector. However, the external debt remains sustainable under a range of adverse scenarios (Figure A.1 and Table A.1). | *The external position and the exchange rate are broadly consistent with medium-term fundamentals and desirable policy settings. As discussed in the RAM, the increase in FX private debt warrants close monitoring.* |
| **Current account** | **Background**. Chile's current account (CA) has improved significantly since mid-2013, reflecting lower imports of capital goods and oil, as well as higher non-mining exports (boosted by the peso depreciation). In terms of savings-investment balance, over the last 2 years national savings has remained relatively stable as a percent of GDP, while the investment ratio has declined sharply reflecting lower copper prices and a fall in business confidence.<br>**Assessment**. At 0.4 percent of GDP in 2015, the projected CA deficit is below the EBA norm of 2 percent—the gap being mostly unexplained by the EBA regression (after correcting for the commodity and output cycles). A possible reason is that the CA improvement is partly due to domestic factors not captured by the EBA equation, in particular the deterioration in business confidence. Once confidence and investment recover, the CA deficit should rise and converge towards the norm. | |
| **Real exchange rate and competitiveness** | **Background**. Chile's exchange rate is strongly correlated with copper prices, and, to a lesser extent to the interest rate differential with the US. Reflecting lower copper prices, rising market U.S. interest rates, and weaker portfolio inflows, Chile's REER has depreciated by about 15 percent in 2014 relative to early 2013. Since the fall of 2014, however, the REER has appreciated (partly reflecting high domestic inflation) and its average between January and May 2015 was 2½ percent above its average in 2014.<br>**Assessment**. The peso was moderately undervalued in 2014 (between -4 and -11 percent according to EBA estimates), but the recent real appreciation is likely to have reduced the misalignment, bringing the currency closer to its equilibrium value. | |
| **Capital and financial accounts** | **Background**. The CA deficit is mainly financed from a relatively stable source of FDI inflows. After declining in 2013, FDI inflows partly recovered in 2014. The debt component of FDI has increased gradually in the last decade.<br>**Assessment**. Chile has a fully open capital account. Vulnerabilities are limited by a credible commitment to a floating exchange rate and a strong fiscal position. | |
| **FX intervention and reserves level** | **Background**. Chile has a free floating exchange rate regime. The central bank generally does not intervene in the foreign exchange market. Nonetheless, Chile had two recent intervention programs in 2008 and 2011, both aimed at weakening the peso and both based on purchases of USD. The Bank of Chile has 6 months of reserves, which is estimated as adequate according to standard reserve adequacy metrics.<br>**Assessment**. A flexible exchange rate is the first line of defense in a small economy exporting commodities like Chile, with a large exposure to international shocks. | |

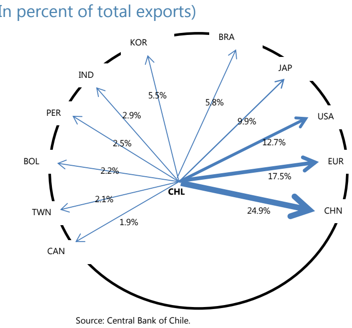
# Annex II. Chile: Trade and Financial Linkages

**As one of the most open economies in Latin America, Chile is subject to important financial and trade spillovers.** Chile's trade openness (sum of exports and imports) at 65 percent of GDP is well above the average of LA-5 countries (Brazil, Colombia, Mexico, Peru, and Uruguay). Chile is also an important recipient of FDI inflows to the region, receiving nearly 15 percent of total FDI to LA-5. It has strong links to the global financial system, with foreign claims on Chile by BIS-reporting banks amounting to over 40 percent of GDP, twice the average of the region. In addition, about one-third of total funding of both financial and non-financial corporate sectors relies on foreign sources and has been on the rise in recent years.

***Inward Spillovers: Trade Channels***

**Chile's economy is particularly vulnerable to shocks originating from China, Europe, the United States, and Japan**, with more than two-thirds of its exports directed to these economies. The exposure is further amplified by the highly concentrated product mix, with copper comprising over half of Chile's exports, followed by fish and wine/grapes (each about 5 percent).

**Top Ten Trading Partners, 2013**
(In percent of total exports)

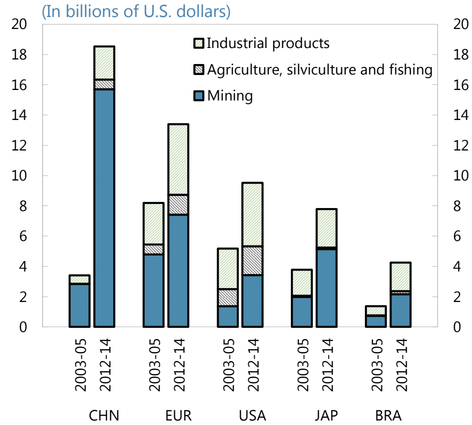



- *China* is Chile's largest trading partner and accounts for 40 percent of mineral (almost exclusively copper) exports. A slowdown in China's growth and a subsequent decline in copper prices can have an important adverse impact on Chile's mining sector: staff estimates that a 1 percentage point decline in China's growth over a four-year horizon will lower Chile's GDP by 0.3 percentage point.

- *Europe*: A slowdown in Europe could also have an important negative impact on Chile, with a one percent fall of GDP in Europe translating into a ¼ percent drop in Chile's GDP in the medium run.

- *United States:* Chile's exports to the U.S. comprise mostly manufacturing goods, including processed food and agricultural products. The direct (trade) impact of lower U.S. GDP growth would be relatively small, and would affect mainly the agricultural sector (which directs one-third of its exports to the U.S. market).

**Evolution of Exports**
(In billions of U.S. dollars)

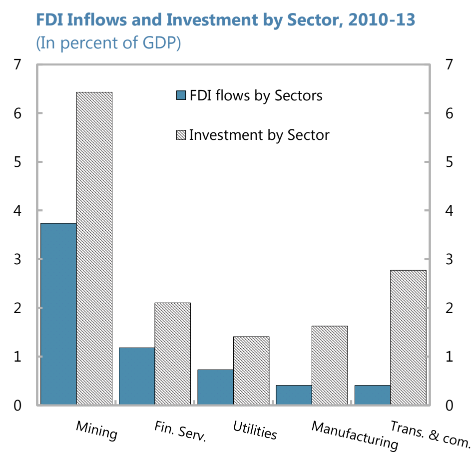



Source: Central Bank of Chile.

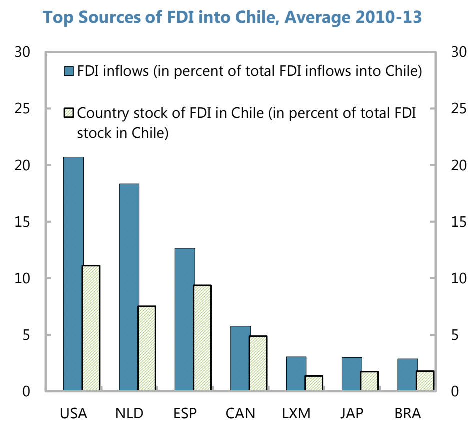
***Inward Spillovers: FDI and Financial Channels***

**There are a number of channels through which spillovers from the international financial market could affect Chile's economy**.

- *FDI inflows*. FDI inflows are an important source of investment in Chile, in particular for the mining, financial and utilities sectors. They have increased from an annual average of 6 percent of GDP in the early 2000s to 8½ percent in recent years. The United States, the Netherlands, and Spain represent the main source markets.

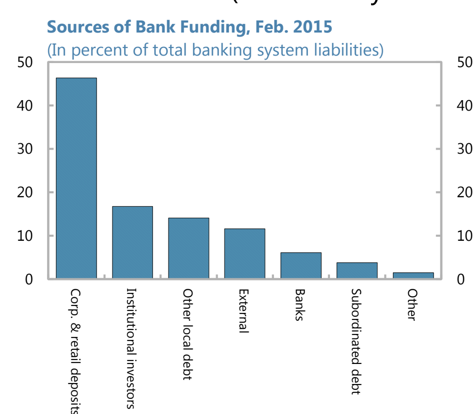



Source: Central Bank of Chile.




Source: Central Bank of Chile

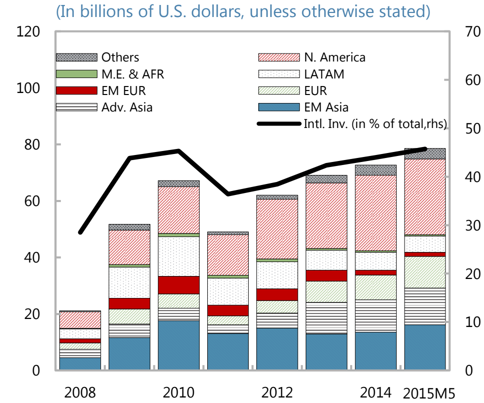
- *Banks*. Chile's banking sector is most directly exposed to Spanish banks. Foreign banks (mainly from Spain and Canada) account for about 35 percent of Chile's total banking sector assets (45 percent of GDP), including Chile's largest bank, Banco Santander-Chile (a subsidiary of the Spanish banking group). The share of foreign banks, however, is not unusually high and is close to the average of LA-5 countries. Chilean banks' reliance on external sources is relatively moderate (at 12¼ percent of their total funding needs, up from about 9½ in August 2012), but a sharp increase in interest rates could raise the cost of funding for banks, both directly and through higher redemptions from mutual funds (an important source of funding especially for medium- and small-sized banks).




Sources: Central Bank of Chile, Superintendencia de Bancos e Institutciones Financieras Chile (SBIF) and Superintendencia de Valores y Seguros (SVS).

- *Pension funds*, with total assets above 70 percent of GDP, are key players in Chile's financial system, and present another import channel for inward spillovers. Their foreign investment amounts on average to 45 percent of total assets up from 35 percent at end-2011. Most of foreign investment is in mutual funds and equities, mainly in the United States and Emerging Asia assets. A rapid expansion of pension funds to investments in foreign assets would make them more vulnerable to shocks from abroad, with adverse effects on domestic financial institutions that rely on pension funds for funding, such as banks.

**Pension Funds International Investments**
(In billions of U.S. dollars, unless otherwise stated)




Source: Superintendencia de Pensiones (SP).

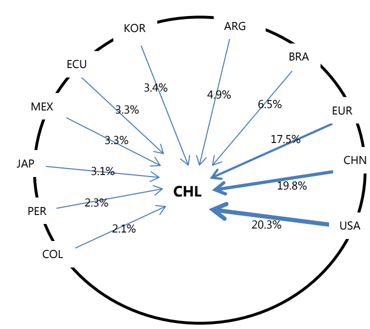
- *Portfolio investment* in Chile amounted to 30 percent of GDP in 2014 (based on IIP data). Chile has a positive net portfolio equity position (about 30 percent of GDP) but this is more than offset by a large negative net FDI position. The U.S. residents hold nearly half of total portfolio investment assets (both equity and debt) vis-à-vis Chile, followed by Luxembourg and the United Kingdom (each 10 percent). Non-residents hold about 5 percent of Chile's sovereign bonds.

- *Risk premium shock*. Staff simulations show that in a scenario where both corporate and sovereign risk premia rise by 100 basis points (for example, following a sharp price adjustment and decompression of credit spreads globally, as described in the text), Chile's GDP would decline by ¼ percent in the medium term.

### *Outward Spillovers*

**Outward trade spillovers from Chile are very small**. About 60 percent of Chile's imports are from the United States, Asia, and Europe. Intermediate goods, mainly energy products and machine parts, comprise about two-thirds of Chile's total imports, followed by capital goods (about 20 percent) and consumption goods and vehicles (each 10 percent). In Latin America, Chile imports primarily from Brazil, Argentina, and Mexico, but even in the case of the major trading partner Brazil, exports to Chile represent only 1¾ percent of Brazil's total exports. Indeed, staff simulations show that a decline in GDP growth in Chile would have a negligible impact on the region's GDP.

**Top Ten Import Partners, 2013**
(In percent of total imports)



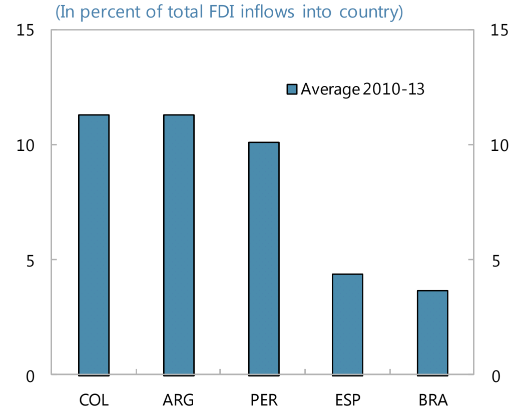

Source: Central Bank of Chile.

**Financial outward spillovers are more relevant, especially for FDI.** Chile is an important source of FDI for other countries in the region, despite its relatively small size (Chile's GDP is less than 4 percent of total Latin America GDP). The share of the Chilean FDI in total FDI inflows in a given host country varies from 4 percent for Brazil to 12 percent for Colombia and Argentina. Thus, an economic slowdown in Chile could negatively affect some of the neighboring economies. Outward spillovers through the banking sector are more limited. Consolidated foreign assets of Chilean banks amount to about 7 percent of Chile's GDP as of end-2014, up from 5 percent in end-2013. However, Chilean banks' claims are generally a very small share of total bank credit to private sector in other Latin American countries (less than 1 percent in Colombia, Brazil, Mexico, and Peru).

**Country's Exports to Chile**
(In percent of country's exports)

| | 2013 |
|---|---|
| Argentina | 3.8 |
| Peru | 3.5 |
| Colombia | 2.3 |
| Brazil | 1.7 |
| Bolivia | 1.0 |

**Top Destinations of Chilean FDI Outflows**
(In percent of total FDI inflows into country)




Source: Central Bank of Chile and Haver Analytics, Inc.

# Annex III. Women in Chile's Labor Market: Addressing the Gender Gap

**Despite the important progress in female labor force participation since the 1990s, the gender gap remains relatively large in Chile.** Women currently comprise 40 percent of Chile's labor force, up from less than one-third in 1990. But at 55 percent, Chile's female labor force participation remains below the average across both OECD and Latin America; is significantly lower than the participation rate for men (80 percent); and is particularly low among low-income households. Also, there is a significant wage gap with men, with women earning 30–40 percent less for the same level of education, reflecting not only job characteristics (Sánchez, 2014) but largely gender discrimination (INE, 2015).

**Gender Gaps and Childcare Support: Selected Indicators**

| | Chile | OECD | LAT6 1/ |
|---|---|---|---|
| Female labor force participation rate 2/ | 55.3 | 62.6 | 60.8 |
| Labor force participation gap 3/ | 24.3 | 17.0 | 23.5 |
| Gender wage gap 4/ | 16.0 | 14.8 | .. |
| Coverage of early childhood education 5/ | 17.6 | 32.6 | .. |
| Public expenditure on childcare and pre-school 6/ | 0.4 | 0.8 | .. |

Sources: OECD, WDI, and Fund staff calculations.
1/ Includes Argentina, Brazil, Colombia, Mexico, Peru, and Uruguay; 2/ Percent of female population 15–64; 3/ Difference between male and female labor force participation rates; 4/ Difference between median earnings of men and women in percent of median earnings of men; 5/ Average enrolment rate of children under 3-years of age in formal childcare; 6/ Percent of GDP.

**A combination of several factors can potentially explain Chile's gender gap:**

- *Low coverage of childcare and early childhood education*, with family reasons being cited as the main reason for inactivity by one-third of women.
- *Mandated provision of childcare services by firms with more than 20 female employees*, which increases the relative cost of employing women, and is shown to reduce starting wages of women by 10–20 percent (Prada, Rucci, and Urzúa, 2015).
- *Strict approach to flexible working hours and poor-quality part-time work*. While part-time work is common, it is mostly informal (leading to lower wages and greater risk of poverty) and involuntary (ILO, 2014; Sánchez, 2014).
- *Long commuting hours and high transport costs*. Transportation is constrained by limited connectivity (with Chile lagging 60 percent in terms of km of road behind the OECD average), and transport costs represent almost 10 percent of the net wage of a part-time worker (6.5 percent for a full-time worker) in Santiago (Rau, 2010).
- *Gender-based legal restrictions*. While mindful of cultural norms, women are economically less independent in terms of ability to access and use property: Chile is one of the very few countries in the world where laws still vest control over marital property in husband's hands, although with a number of exceptions.

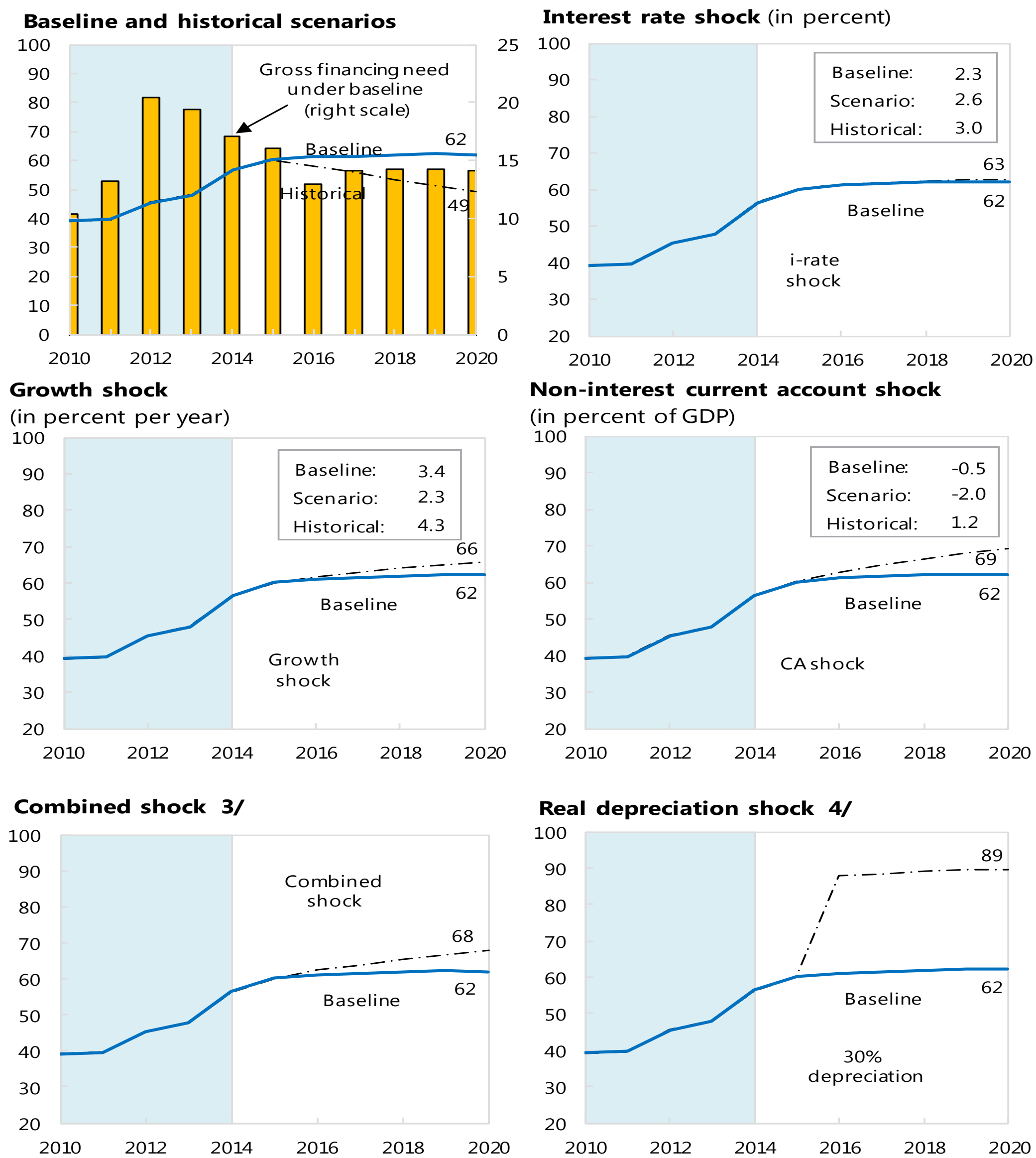
**Narrowing the gender gap would lead to important economic gains for Chile.** A growing literature highlights that gender gaps in labor force participation, entrepreneurial activity, and education impede economic growth (IMF, 2013 and 2015). Cuberes and Teignier (2014) estimate that GDP losses due to economic gender gaps amount to 17 percent of GDP for Chile (12 percent for LAT6 countries). Looking at the labor force participation gap, staff estimates suggest that closing the current gap with LAT6 average (by increasing female participation by 1¼ percent per year over 2015–20) would result in a cumulative GDP gain of about 3 percent by 2020, relative to baseline.

**Reforms enacted in recent years are likely to make Chile's labor market more inclusive.** These reforms include: the extension of early-childhood education and childcare services (since 2006, *Chile Crece Contigo*); the introduction of employment bonuses for low-income women (in 2012, *Ingreso Etico Familiar*, to be expanded in 2015); the extension of maternity leave, with a possibility to share leave with fathers (in 2011); and the ongoing education reform discussed in the text.

**However, there is a need to broaden the recent reforms and increase their take-up.** While it is too early to evaluate most of the recent policies, the empirical evidence over the impact of past policies (particularly, greater childcare provision) on Chile's female participation is mixed. Further efforts would need to focus on:

- *Extending early-childhood education and childcare services* (the administration is planning to open 4,500 new childcare institutions for children under 3 years of age during the next four years), including through longer hours of care and out-of-school care services;
- *Removing the mandated employer-provided childcare* (as currently considered);
- *Improving flexibility in hours of work and promoting a better transition to full-time, permanent jobs*, including through strengthening workers' rights to request changes in working hours and the possibility to "reverse" from part-time to full-time hours, as in other countries (e.g., France, Germany, the Netherlands, and Poland), and more generally addressing labor market duality.
- *Investing in transport infrastructure*—the authorities are planning to nearly double the expenditure in transportation in 2015 relative to 2014 (although this still represents a small fraction of the entire investment plan for the year);
- *Ensuring a desired take-up of policy measures*, such as by making paternal leave non-transferable "take-it or lose-it" (e.g., Norway), and facilitating access to available subsidies for female workers; and
- *Reducing occupational segregation by gender* through education and job training policies that would contribute to improving gender equality in the labor market.

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




Sources: Fund staff calculations.
1/ Shaded areas represent actual data. Individual shocks are permanent one-half standard deviation shocks. Figures in the boxes represent average projections for the respective variables in the baseline and scenario being presented. Ten-year historical average for the variable is also shown.
2/ For historical scenarios, the historical averages are calculated over the ten-year period, and the information is used to project debt dynamics five years ahead.
3/ Permanent 1/4 standard deviation shocks applied to real interest rate, growth rate, and current account balance.
4/ One-time real depreciation of 30 percent occurs in 2016.

## Table A.1. Chile: External Debt Sustainability Framework, 2010-2020

| | Actual | | | | | Projections | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | Debt-stabilizing non-interest current account 6/ |
| **Baseline: External debt** | **39.1** | **39.6** | **45.5** | **47.9** | **56.5** | **60.1** | **61.1** | **61.5** | **61.9** | **62.2** | **62.1** | **-3.0** |
| Change in external debt | -3.1 | 0.5 | 5.8 | 2.5 | 8.5 | 3.7 | 1.0 | 0.4 | 0.4 | 0.2 | -0.1 | |
| Identified external debt-creating flows (4+8+9) | -9.8 | -5.8 | -1.8 | -0.3 | 4.4 | -1.1 | -0.8 | -0.6 | -0.6 | -0.7 | -0.9 | |
| Current account deficit, excluding interest payments | -2.6 | 0.4 | 2.4 | 2.5 | -0.3 | -1.1 | -0.1 | 0.2 | 0.6 | 0.8 | 0.9 | |
| Deficit in balance of goods and services | -69.3 | -72.3 | -68.2 | -64.9 | -65.6 | -62.0 | -62.6 | -62.9 | -63.3 | -63.4 | -63.1 | |
| Exports | 37.9 | 37.7 | 34.0 | 32.1 | 33.6 | 31.6 | 31.5 | 31.4 | 31.4 | 31.4 | 31.3 | |
| Imports | -31.4 | -34.5 | -34.2 | -32.7 | -32.0 | -30.4 | -31.1 | -31.5 | -31.9 | -32.0 | -31.8 | |
| Net non-debt creating capital inflows (negative) | 0.6 | -1.9 | -3.2 | -2.0 | 0.1 | -0.1 | -0.3 | -0.4 | -0.6 | -0.7 | -0.9 | |
| Automatic debt dynamics 1/ | -7.8 | -4.3 | -0.9 | -0.7 | 4.5 | 0.1 | -0.4 | -0.4 | -0.6 | -0.8 | -0.9 | |
| Contribution from nominal interest rate | 0.9 | 0.9 | 1.3 | 1.2 | 1.4 | 1.5 | 1.3 | 1.5 | 1.4 | 1.3 | 1.3 | |
| Contribution from real GDP growth | -1.9 | -1.9 | -2.1 | -1.9 | -0.9 | -1.4 | -1.8 | -1.9 | -2.0 | -2.1 | -2.2 | |
| Contribution from price and exchange rate changes 2/ | -6.7 | -3.2 | -0.1 | 0.0 | 4.0 | ... | ... | ... | ... | ... | ... | |
| Residual, incl. change in gross foreign assets (2-3) 3/ | 6.7 | 6.3 | 7.6 | 2.8 | 4.2 | 4.8 | 1.8 | 1.0 | 1.0 | 0.9 | 0.8 | |
| External debt-to-exports ratio (in percent) | 103.3 | 105.0 | 133.7 | 149.1 | 168.1 | 190.2 | 193.9 | 196.1 | 197.1 | 197.9 | 198.6 | |
| **Gross external financing need (in billons of US dollars) 4/** | **22.7** | **33.1** | **54.1** | **53.8** | **44.1** | **41.2** | **34.5** | **39.5** | **41.9** | **44.2** | **46.2** | |
| in percent of GDP | 10.4 | 13.2 | 20.4 | 19.4 | 17.1 | 16.1 | 12.9 | 14.1 | 14.2 | 14.2 | 14.1 | |
| **Scenario with key variables at their historical averages 5/** | | | | | | **60.1** | **58.1** | **55.8** | **53.5** | **51.4** | **49.2** | **-2.4** |
| **Key macroeconomic assumptions underlying baseline** | | | | | | | | | | | | |
| Real GDP growth (in percent) | 5.7 | 5.8 | 5.5 | 4.3 | 1.8 | 2.5 | 3.1 | 3.3 | 3.5 | 3.6 | 3.7 | |
| GDP deflator in US dollars (change in percent) | 19.4 | 9.2 | 0.2 | 0.0 | -8.4 | -3.1 | 0.9 | 1.7 | 1.6 | 1.8 | 1.9 | |
| Nominal external interest rate (in percent) | 2.6 | 2.5 | 3.4 | 2.8 | 2.8 | 2.6 | 2.3 | 2.6 | 2.4 | 2.3 | 2.2 | |
| Growth of exports (US dollar terms, in percent) | 28.6 | 14.9 | -4.6 | -1.4 | -2.6 | -6.4 | 3.6 | 4.5 | 5.4 | 5.4 | 5.1 | |
| Growth of imports (US dollar terms, in percent) | 34.8 | 26.9 | 4.6 | -0.1 | -8.7 | -5.7 | 6.5 | 6.4 | 6.5 | 5.8 | 4.9 | |
| Current account balance, excluding interest payments | 2.6 | -0.4 | -2.4 | -2.5 | 0.3 | 1.1 | 0.1 | -0.2 | -0.6 | -0.8 | -0.9 | |
| Net non-debt creating capital inflows | -0.6 | 1.9 | 3.2 | 2.0 | -0.1 | 0.1 | 0.3 | 0.4 | 0.6 | 0.7 | 0.9 | |

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

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

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

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

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

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

# Table A.2. Chile: Public Sector Debt Sustainability Analysis (DSA)—Baseline Scenario

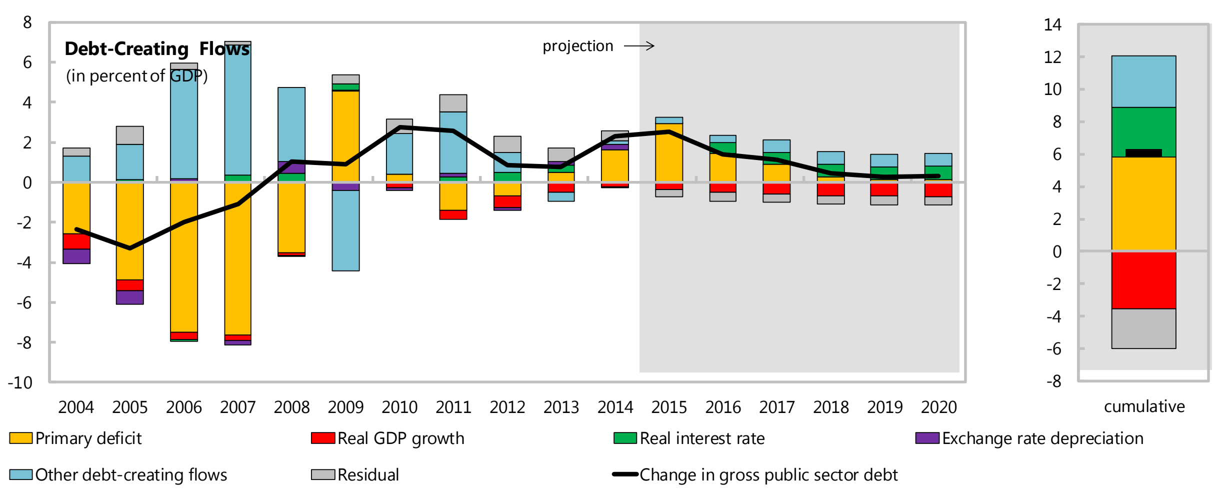
(in percent of GDP unless otherwise indicated)

## Debt, Economic and Market Indicators [1/]

| | Actual | | | Projections | | | | | | As of April 09, 2015 | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | 2004-2012 [2/] | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | Sovereign Spreads | | |
| Nominal gross public debt | 7.6 | 12.8 | 15.1 | 17.6 | 19.0 | 20.2 | 20.6 | 20.9 | 21.1 | Bond Spread (bp) 3/ | 149 | |
| Public gross financing needs | -0.7 | 2.1 | 3.3 | 4.6 | 2.6 | 2.8 | 1.8 | 1.7 | 2.7 | 5Y CDS (bp) | 86 | |
| Net public debt (excludes Pension Reserve Fund) | -6.5 | -2.9 | -1.2 | 2.1 | 4.1 | 5.5 | 6.3 | 7.0 | 7.7 | | | |
| Real GDP growth (in percent) | 4.8 | 4.3 | 1.8 | 2.5 | 3.1 | 3.3 | 3.5 | 3.6 | 3.7 | Ratings | Foreign | Local |
| Inflation (GDP deflator, in percent) | 5.5 | 1.8 | 5.5 | 4.5 | 2.6 | 2.7 | 2.7 | 2.8 | 2.9 | Moody's | Aa3 | Aa3 |
| Nominal GDP growth (in percent) | 10.6 | 6.2 | 7.4 | 7.2 | 5.8 | 6.1 | 6.3 | 6.5 | 6.7 | S&Ps | AA- | AA+ |
| Effective interest rate (in percent) [4/] | 9.6 | 5.2 | 5.1 | 4.6 | 6.0 | 6.0 | 6.1 | 6.3 | 6.3 | Fitch | A+ | AA- |

## Contribution to Changes in Public Debt [1/]

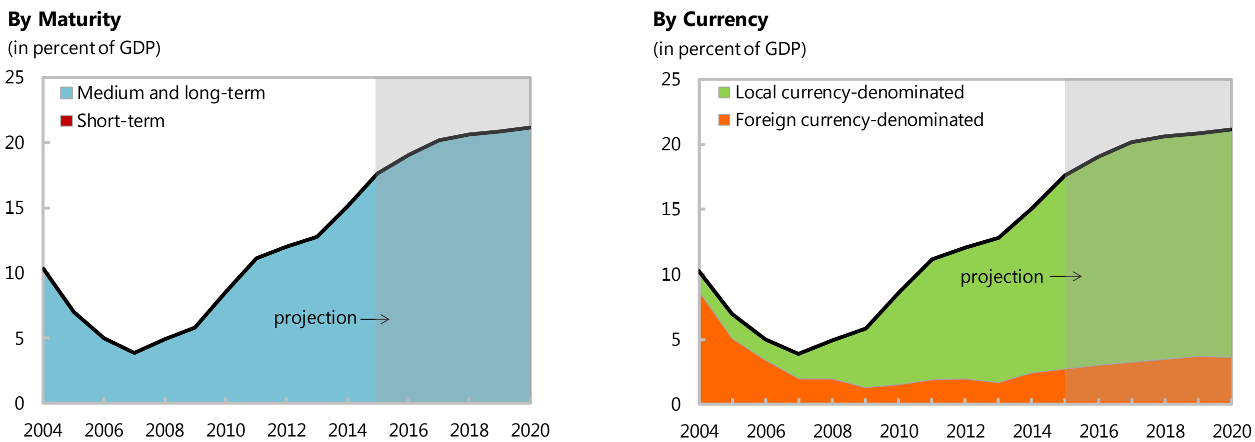
| | Actual | | | Projections | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| | 2004-2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | cumulative | debt-stabilizing |
| Change in gross public sector debt | -0.1 | 0.8 | 2.3 | 2.5 | 1.4 | 1.1 | 0.4 | 0.3 | 0.3 | 6.1 | primary |
| Identified debt-creating flows | -0.6 | 0.1 | 1.8 | 2.9 | 1.8 | 1.5 | 0.9 | 0.7 | 0.7 | 8.5 | balance [9/] |
| Primary deficit | -2.6 | 0.5 | 1.6 | 2.9 | 1.4 | 0.9 | 0.3 | 0.1 | 0.2 | 5.8 | 0.6 |
| Primary (noninterest) revenue and grants | 22.1 | 20.5 | 20.1 | 20.0 | 21.6 | 22.2 | 23.0 | 23.1 | 23.1 | 133.0 | |
| Primary (noninterest) expenditure | 19.5 | 21.0 | 21.7 | 22.9 | 23.1 | 23.1 | 23.3 | 23.3 | 23.2 | 138.9 | |
| Automatic debt dynamics [5/] | -0.3 | 0.1 | 0.0 | -0.4 | 0.0 | 0.0 | 0.0 | 0.0 | -0.1 | -0.5 | |
| Interest rate/growth differential [6/] | -0.2 | -0.1 | -0.3 | -0.4 | 0.0 | 0.0 | 0.0 | 0.0 | -0.1 | -0.5 | |
| Of which: real interest rate | 0.2 | 0.4 | -0.1 | 0.0 | 0.5 | 0.6 | 0.6 | 0.7 | 0.6 | 3.1 | |
| Of which: real GDP growth | -0.4 | -0.5 | -0.2 | -0.4 | -0.5 | -0.6 | -0.7 | -0.7 | -0.7 | -3.5 | |
| Exchange rate depreciation [7/] | -0.2 | 0.2 | 0.3 | … | … | … | … | … | … | … | |
| Other identified debt-creating flows | 2.3 | -0.5 | 0.2 | 0.3 | 0.3 | 0.6 | 0.6 | 0.6 | 0.6 | 3.2 | |
| Deposits/asset accumulation (negative) | 2.3 | -0.5 | 0.2 | 0.3 | 0.3 | 0.6 | 0.6 | 0.6 | 0.6 | 3.2 | |
| Contingent liabilities | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | |
| Residual, including asset changes [8/] | 0.5 | 0.7 | 0.5 | -0.4 | -0.4 | -0.4 | -0.4 | -0.4 | -0.4 | -2.5 | |



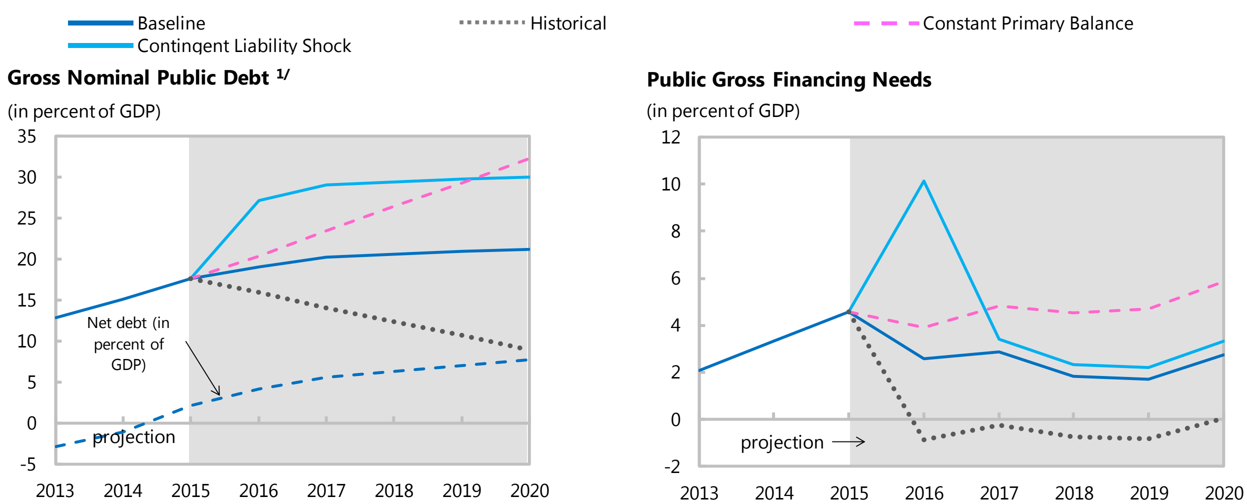

Source: Fund staff calculations.
1/ Public sector is defined as central government.
2/ Based on available data.
3/ EMBIG (bp).
4/ Defined as interest payments divided by debt stock (excluding guarantees) at the end of previous year.
5/ Derived as [r - π(1+g) - g + ae(1+r)]/(1+g+π+gπ) times previous period debt ratio, with r = effective nominal interest rate; π = growth rate of GDP deflator; g = real GDP growth rate; a = share of foreign-currency denominated debt; and e = nominal exchange rate depreciation (measured by increase in local currency value of U.S. dollar).
6/ The real interest rate contribution is derived from the numerator in footnote 5 as r - π (1+g) and the real growth contribution as -g.
7/ The exchange rate contribution is derived from the numerator in footnote 5 as ae(1+r).
8/ Includes asset changes and interest revenues (if any). For projections, includes exchange rate changes during the projection period.
9/ Assumes that key variables (real GDP growth, real interest rate, and other identified debt-creating flows) remain at the level of the last projection year.

## Figure A.2. Chile: Public DSA—Composition of Public Debt and Alternative Scenarios

### Composition of Public Debt




### Alternative Scenarios




### Underlying Assumptions

(in percent)

| Baseline Scenario | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 |
|---|---|---|---|---|---|---|
| Real GDP growth | 2.5 | 3.1 | 3.3 | 3.5 | 3.6 | 3.7 |
| Inflation | 4.5 | 2.6 | 2.7 | 2.7 | 2.8 | 2.9 |
| Primary Balance | -2.9 | -1.4 | -0.9 | -0.3 | -0.1 | -0.2 |
| Effective interest rate | 4.6 | 6.0 | 6.0 | 6.1 | 6.3 | 6.3 |
| **Constant Primary Balance Scenario** | | | | | | |
| Real GDP growth | 2.5 | 3.1 | 3.3 | 3.5 | 3.6 | 3.7 |
| Inflation | 4.5 | 2.6 | 2.7 | 2.7 | 2.8 | 2.9 |
| Primary Balance | -2.9 | -2.9 | -2.9 | -2.9 | -2.9 | -2.9 |
| Effective interest rate | 4.6 | 5.2 | 5.3 | 5.4 | 5.7 | 5.7 |

| Historical Scenario | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 |
|---|---|---|---|---|---|---|
| Real GDP growth | 2.5 | 4.3 | 4.3 | 4.3 | 4.3 | 4.3 |
| Inflation | 4.5 | 2.6 | 2.7 | 2.7 | 2.8 | 2.9 |
| Primary Balance | -2.9 | 1.9 | 1.9 | 1.9 | 1.9 | 1.9 |
| Effective interest rate | 4.6 | 5.2 | 5.3 | 5.5 | 5.8 | 5.9 |
| **Contingent Liability Shock** | | | | | | |
| Real GDP growth | 2.5 | 0.8 | 1.0 | 3.5 | 3.6 | 3.7 |
| Inflation | 4.5 | 2.1 | 2.1 | 2.7 | 2.8 | 2.9 |
| Primary Balance | -2.9 | -8.8 | -0.9 | -0.3 | -0.1 | -0.2 |
| Effective interest rate | 4.6 | 7.0 | 6.0 | 6.0 | 6.2 | 6.2 |

urce: Fund staff calculations.

INTERNATIONAL MONETARY FUND

# CHILE

July 21, 2015

## STAFF REPORT FOR THE 2015 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

Prepared By The Western Hemisphere Department

## CONTENTS

# FUND RELATIONS

(As of April 30, 2015)

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

| **General Resources Account** | **SDR Million** | **Percent Quota** |
|---|---|---|
| Quota | 856.10 | 100.00 |
| Fund holdings of currency | 726.08 | 84.81 |
| Reserve Tranche Position | 130.02 | 15.19 |
| Lending to the Fund | | |
| New Arrangements to Borrow | 138.78 | |

| **SDR Department** | **SDR Million** | **Percent Allocation** |
|---|---|---|
| Net cumulative allocation | 816.89 | 100.00 |
| Holdings | 745.03 | 91.20 |

**Outstanding Purchases and Loans**
None

**Latest Financial Arrangements**

| **Type** | **Date of Arrangement** | **Expiration Date** | **Amount Approved** (SDR Million) | **Amount Drawn** (SDR Million) |
|---|---|---|---|---|
| Stand-By | Nov 08, 1989 | Nov 07, 1990 | 64.00 | 64.00 |
| EFF | Aug 15, 1985 | Aug 14, 1989 | 825.00 | 806.25 |
| Stand-By | Jan 10, 1983 | Jan 09, 1985 | 500.00 | 500.00 |

**Projected Payments to Fund (in SDR Million)**[1/]

| | Forthcoming | | | | |
|---|---|---|---|---|---|
| | **2015** | **2016** | **2017** | **2018** | **2019** |
| Principal | | | | | |
| Charges/Interest | 0.03 | 0.05 | 0.05 | 0.05 | 0.05 |
| **Total** | **0.03** | **0.05** | **0.05** | **0.05** | **0.05** |

[1/] When a member has overdue financial obligations outstanding for more than three months, the amount of such arrears will be shown in this section.

**Exchange Rate System**
Chile has accepted the obligations of Article VIII, Sections 2, 3, and 4 and maintains an exchange rate system free of restrictions on the making of payments and transfers for current international transactions. Chile has a floating exchange rate system.

# STATISTICAL ISSUES

(As of July 1, 2015)

| Assessment of Data Adequacy for Surveillance | |
|---|---|
| **General:** Data provision is adequate for surveillance. The National Institute of Statistics (INE) regularly publishes a full range of economic and financial data. The Central Bank of Chile (CBC) also publishes comprehensive macroeconomic and financial data. The Ministry of Finance publishes fiscal data.<br><br>Key publicly accessible websites for macroeconomic data and analysis are:<br><br>National Institute of Statistics: http://www.ine.cl/<br>Central Bank of Chile: http://www.bcentral.cl/<br>Ministry of Finance: http://www.minhda.cl/<br><br>**Recent Developments:** The Central Bank started to publish housing real estate price data in 2014, and a new series on external debt at market values in 2015 which allows better monitoring and identification of risks. The National Institute of Statistics (INE) has revised the basket and methodology of the Consumer Price Index (CPI) including to address some limitations in the clothing sub-index. | |
| **Data Standards and Quality** | |
| Subscriber to the Fund's Special Data Dissemination Standard (SDDS) since May 17, 1996. In coordination with STA, Chile is in the process to gain adherence to SDSS plus. | A data ROSC was published September 17, 2007. |
| **Reporting to STA (Optional)** | |
| The CBC uses the standardized report forms (SRFs) to report monthly data for the central bank, other depository corporations (ODCs), other financial corporations (OFCs), and monetary aggregates. However, data for the ODCs exclude savings and credit cooperatives and OFCs exclude investment funds, general funds, housing funds, foreign capital investment funds, factoring societies, leasing companies, and financial auxiliaries.<br><br>The CBC reports all core and 7 of 28 encouraged financial soundness indicators on a monthly basis. | |

# Chile–Table of Common Indicators Required for Surveillance

(As of July 1, 2015)

| | Date of Latest Observation | Date Received | Frequency of Data[6] | Frequency of Reporting[6] | Frequency of Publication[6] | Memo items[7]: | |
|---|---|---|---|---|---|---|---|
| | | | | | | Data Quality – Methodological Soundness[8] | Data Quality Accuracy and Reliability[9] |
| Exchange Rates | July 1, 2015 | July 1, 2015 | D | D | D | | |
| International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1] | June 15, 2015 | June 23, 2015 | W | W | W | | |
| Reserve/Base Money | June 15, 2015 | June 23, 2015 | W | W | W | O, O, LO, O | O, O, O, LO, O |
| Broad Money | May 2015 | June 2015 | M | M | M | | |
| Central Bank Balance Sheet | January 2014 | March 2014 | M | M | M | | |
| Consolidated Balance Sheet of the Banking System | January 2014 | March 2014 | M | M | M | | |
| Interest Rates[2] | July 1, 2015 | July 1, 2015 | D | D | D | | |
| Consumer Price Index | May 2015 | June 8, 2015 | M | M | M | LO, LNO, LNO, LO | LO, LO, LO, O, LO |
| Revenue, Expenditure, Balance and Composition of Financing[3] – General Government[4] | 2014 | June 30, 2015 | A | A | A | O, LO, LNO, LO | LO, O, O, LO, O |
| Revenue, Expenditure, Balance and Composition of Financing3– Central Government | May 2015 | June 30, 2015 | M | M | M | | |
| Stocks of Central Government and Central Government –Guaranteed Debt[5] | Q1 2015 | June 30, 2015 | Q | Q | Q | | |
| External Current Account Balance | Q1 2015 | May 18, 2015 | Q | Q | Q | O, O, LO, LO | O, O, O, O, O |
| Exports and Imports of Goods | June 30, 2015 | June 23, 2014 | M | M | M | | |
| GDP/GNP | Q1 2015 | May 18, 2015 | Q | Q | Q | O, LO, LO, LO | LO, LO, LO, LO, O |
| Gross External Debt | March 2015 | May 7 , 2015 | M | M | M | | |
| International Investment Position[10] | Q1 2015 | May 18, 2015 | Q | Q | Q | | |

[1] Any reserve assets that are pledged or otherwise encumbered should be specified separately. Also, data should comprise short-term liabilities linked to a foreign currency but settled by other means as well as the notional values of financial derivatives to pay and to receive foreign currency, including those linked to a foreign currency but settled by other means.
[2] Both market-based and officially-determined, including discount rates, money market rates, rates on treasury bills, notes, and bonds.
[3] Foreign, domestic bank, and domestic nonbank financing.
[4] The general government consists of the central government (budgetary funds, extra budgetary funds, and social security funds) and state and local governments.
[5] Including currency and maturity composition.
[6] Daily (D); weekly (W); monthly (M); quarterly (Q); annually (A); irregular (I); and not available (NA).
[7] Reflects the assessment provided in the data ROSC, (published September 17, 2007 and based on the findings of the mission that took place during April 18-May2, 2007) for the dataset corresponding to the variable in Each row. The assessment indicates whether international standards concerning concepts and definitions, scope, classification/sectorization, and basis for recording are fully observed (O); largely observed (LO); largely not observed (LNO); not observed (NO); and not available (NA).
[8] Same as footnote 7, except referring to international standards concerning source data, assessment of source data, statistical techniques, assessment and validation of intermediate data and statistical outputs, and revision studies.
[9] Same as footnote 8, except referring to international standards concerning source data, statistical techniques, assessment and validation of source data, assessment and validation of intermediate data and statistical outputs, and revision studies.
[10] Includes external gross financial asset and liability positions vis-à-vis nonresidents.

# WORLD BANK—FUND COUNTRY-LEVEL WORK PROGRAM UNDER JMAP

| Title | Products | Expected Delivery Date* |
|---|---|---|
| 1. Bank work program | **A. Investment Loans**<br>1. Tertiary Education Finance for Results Project III (P111661) | March 2012 |
| | **B. Technical Assistance** | |
| | 1. RAS Strengthening the legal framework for Institutional Water Resources Management | June 2015 |
| | 2. RAS Institutional Strengthening of the PPP unit | June 2015 |
| | 3. RAS Chile Distributional Effects of the Tax Reform | September 2015 |
| | 4. RAS CORFO SME finance | June 2015 |
| | 5. RAS Determining the cost of public financing of higher education institutions | June 2015 |
| | 6. RAS Higher Education Public Technical Education Network in Chile: Comparative Analysis of Models | September 2015 |
| | 7. RAS Higher Education Quality Assurance: Definition, Design, and Institutional Arrangement | September 2015 |
| | 8. RAS National System for Social Care | December 2015 |
| | 9. RAS Redesigning Integrated Social Information System for the new model of selection of social protection beneficiaries | December 2015 |
| | **C. Recipient Executed Trust Fund** | |
| | 1. Sustainable Land Management – GEF (P085621) | September 2014 |
| | 2. Market Instruments for climate change mitigation in Chile – PMR (P130378) | August 2014 |
| | 3. Chile Quilleco Hydroelectric Project | May 2014 |
| | 4. Securitization and Carbon Sinks Project | July 2010 |
| | 5. Forest Carbon Partnership Facility - Chile Readiness Preparation Grant | January 2014 |
| | 6. Strengthening Chile's Public Senior Executive Service System | July 2013 |
| | 7. Chile- First Biennial Update Report, Report to Conventions. | August 2014 |

*Delivery date refers to the Board date in lending projects, to delivery to client in case of AAA and to Grant effective date in case of RETF. Technical assistance includes Reimbursable Advisory Services (RAS).