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Chile: 2009 Article IV Consultation—Staff Report; Staff Statement and Supplement; Public Information Notice on the Executive Board Discussion; and Statement by the Executive Director for Chile

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the 2009 Article IV consultation with Chile, the following documents have been released and are included in this package:

- The staff report for the 2009 Article IV consultation, prepared by a staff team of the IMF, following discussions that ended on June 5, 2009, 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 8, 2009. The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.

- A staff statement of July 22, 2009, updating information on recent developments.

- A staff supplement of July 8, 2009, updating information on recent developments

- A Public Information Notice (PIN) summarizing the views of the Executive Board as expressed during its July 22, 2009 discussion of the staff report that concluded the Article IV consultation.

- A statement by the Executive Director for Chile.

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

Selected Issues Paper

The policy of publication of staff reports and other documents allows for the deletion of market-sensitive information.

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INTERNATIONAL MONETARY FUND

CHILE

Staff Report for the 2009 Article IV Consultation Discussions

Prepared by the Western Hemisphere Department

(In consultation with other departments)

Approved by Miguel Savastano and Michele Shannon

July 8, 2009

- **Mission.** A staff team comprising Messrs. Cerisola (head), Chan-Lau and Di Bella (all WHD), and Gracia (FAD) conducted the 2009 Article IV consultation discussions during May 26–June 5. Staff met with Central Bank Governor De Gregorio, Minister of Finance Velasco, Budget Director Arenas, other key senior officials, and representatives of the private sector. Mr. Rojas-Olmedo (OED) participated in several meetings.

- **Previous consultations.** There has been broad agreement between the authorities and staff on macroeconomic policies in recent years. At the time of the 2008 Article IV Consultation on July 11, 2008, Directors commended Chile's adherence to a prudent, rules-based macroeconomic policy framework, which had been instrumental for managing the copper boom and several adverse shocks. They also noted the economy's remarkable resilience to the impact of global food and fuel price shocks, which have been exacerbated by domestic energy shortfalls and a severe drought, and considered that monetary policy had been appropriately geared to returning inflation toward the 3-percent target. Directors also commended the government's strict adherence to the structural fiscal surplus rule, the focus on improving the already high quality of public spending, and the ongoing efforts to strengthen further the management of Sovereign Wealth Funds.

- **Analytical work.** Topics for selected issues papers were discussed with the authorities early in the process and preliminary results were presented in a seminar hosted by the Central Bank of Chile during the mission. The Selected Issues paper includes work on: (i) the global financial crisis and risks in the domestic banking system; (ii) a longer-term approach to fiscal policy; (iii) the role of new investment in machinery and equipment, and its implications for productivity.

- **Exchange System.** Chile has accepted the obligations of Article VIII and maintains a free floating exchange rate system free of restrictions on the making of payments and transfers for current international transactions.

- **Statistical Issues**. Chile is in observance with the Special Data Dissemination Standards (SDDS).

Contents Page

I. Staff Appraisal and Executive Summary

1. **Chile's economy is in a significantly better position than most economies to face the global crisis**. This owes much to its policy framework and track record of exemplary policies. Large fiscal savings over the past several years have been critical to preserve stability and cover financing needs. The imbalances in the financial and corporate sectors witnessed elsewhere have been absent—the banking system is well-capitalized, the supervisory framework is strong, and domestic capital markets are well-developed.

2. **The policy response also played a critical role in buffering the impact of unprecedented global headwinds**. The response has been vigorous, well balanced, and coordinated. Macroeconomic conditions have begun to stabilize in the second quarter of 2009, and bode well for early recovery prospects. Nevertheless, economic growth performance is expected to be less favorable than prior to the crisis, as global uncertainty still remains high, the global recovery could be sluggish, and global trend growth prospects have been marked down. All these factors could drag real GDP growth down in Chile in 2009–10. Risks to inflation appear balanced and highly dependent on external developments.

3. **The global crisis may present additional challenges to the macroeconomic policy outlook**. Chile's skillful handling of the global crisis has been reflected in a marked appreciation of the peso in real effective terms during recent months, following the sharp depreciation in late 2008. Nonetheless, staff estimates the real exchange rate to be broadly in line with fundamentals. Were downside risks to materialize, further countercyclical measures would be required—a task to be led by monetary policy, given that the scope for further fiscal measures in 2009 is exhausted and potential challenges facing fiscal policy in 2010.

4. **Alternative means of monetary policy easing may have to be carefully contemplated**. With inflation expectations anchored around the 3 percent target, the reduction in policy interest rates, along with measures to facilitate access to credit and promote competition, should take increasing hold, support demand ahead and thus bring inflation back to the target. Imparting monetary policy with more countercyclical impulse could involve announcing a more explicit contingent commitment to maintain a low policy interest rate for an extended period; and extending the tenor of new liquidity instruments. Any "quantitative easing" should be limited to operations involving central bank securities. Other forms of easing, including those involving private instruments, would entail significant departures from the policy framework and could add credit risks to the central bank's weak capitalization levels.

5. **The effectiveness of additional large fiscal stimulus will need to be balanced against the economy's high degree of openness**. Staff recognizes the extraordinary circumstances that have contributed to a structural deficit in 2009. With global downside risks still clouding the outlook, staff is of the view that the fiscal stimulus should not be withdrawn too soon. The authorities could consider extending several of the measures

implemented in 2009 through end-2010, while also ensuring that a balanced structural target is reinstated. Once the recovery is well entrenched, most of those measures should be unwound and consideration should be given to specifying a structural target. While Chile is in a privileged position to implement a strong countercyclical fiscal response, it is also essential that this does not compromise the structural rule framework.

6. **Bringing more of a longer-term view to short-term fiscal policy formulation would help in this regard**. The structural rule has embedded fiscal policy with a medium-term perspective, high predictability, transparency, and credibility, and should be preserved. However, this would benefit from bringing more of a long-term view to the existing 2–3 year fiscal policy formulation, as is done in many advanced economies.

7. **Building on the significant progress made in recent years, staff sees further scope to deal with contingent liabilities**. Staff welcomes the commitment to conduct long-term assessments of pension-related and central bank-related liabilities. Prospective budget deficits would limit the likelihood of fully recapitalizing the BCCh. The financial condition of some companies providing public services has deteriorated recently, and risks a potential call on public finances. Staff commends the authorities for the strengthening of governance and transparency in these companies and encourages them to persevere with such efforts.

8. **Within a long-term approach to fiscal policy, there is a need to continue advancing reforms to boost per capita income growth**. The cost of doing business in Chile compares unfavorably with the average for OECD countries and there is some scope to improve the balance between security and flexibility in the labor market.

9. **The large presence of foreign-owned banks does not pose systemic risks**. A new round of severe distress in global and some regional financial institutions—given the interconnectedness of their exposures—could affect domestic banks' creditworthiness. Such risks, while manageable, could merit keeping some of the new liquidity instruments that have helped preserve orderly conditions. By contrast, the need to implement the recommendation of the Financial Advisory Committee to permanently expand the menu of SWF investments to deposits in the domestic financial system seems less urgent.

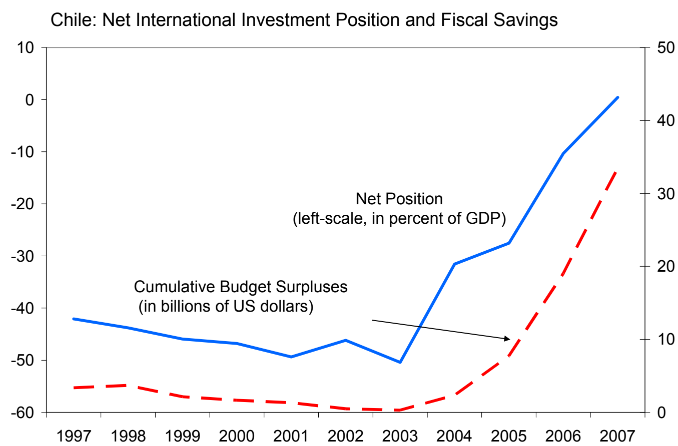
10. **Credit risks to the banking system suggest contemplating some reforms, including broadening the perimeter of regulation**. Staff commends the authorities for their sound prudential and supervisory framework. Staff's stress tests confirm the authorities' assessment that capital levels are adequate to withstand potential credit losses. With the full adoption of IFRS accounting standards in January 2009, some banks that appear to have lower provisioning levels relative to nonperforming loans are somewhat more dependent on external financing and could be more exposed to credit risks. Given the intrinsic uncertainty in the different models banks use to estimate provisions, it would be important to continuously assess the effectiveness of those models and provisioning levels, while exploring options to reduce procyclicality. It would be important to further solidify and broaden the perimeter of regulation to nonbank entities outside the Superintendency of Banks

and Financial Institutions' direct purview. Staff also commends the authorities for the progress in advancing capital market reforms.

11. **It is expected that the next Article IV Consultation with Chile will take place on the standard 12-month cycle**.

II. The Global Crisis and The Policy Response

12. **The 2009 Article IV Consultation provided an opportunity to take stock of the policies implemented to safeguard the economy from the global crisis and to ensure sustained economic success**. Chile's economic policies over the past several years have been instrumental to face with relative more ease an exceptionally complex global environment. This owes much to a sound and exemplary policy framework—underpinned by the structural fiscal rule—which has allowed large savings of the terms of trade windfall and lower government liabilities. The economy entered the global financial crisis in a fundamentally robust position, especially when compared with 1998—the last time when the economy faced a major adverse external shock (Figure 1). With Presidential and congressional elections scheduled for December 2009, there is broad recognition among different sectors that prudent policies will be preserved and that the next administration (to take office in March 2010) will need to advance important reforms, including to enhance the business environment and productivity over the medium term.



The Impact of the Global Crisis: A Severe and Synchronized Contraction

13. **Being highly-integrated to the global economy, the Chilean economy was severely affected by global trends**. Chile is the most open economy in Latin America, comparing favorably with OECD members.[1] With domestic financial and capital markets among the deepest in Latin America, the global financial turmoil manifested quickly, mostly following the demise of Lehman Brothers in mid-September 2008, but the impact was less than in other emerging markets.

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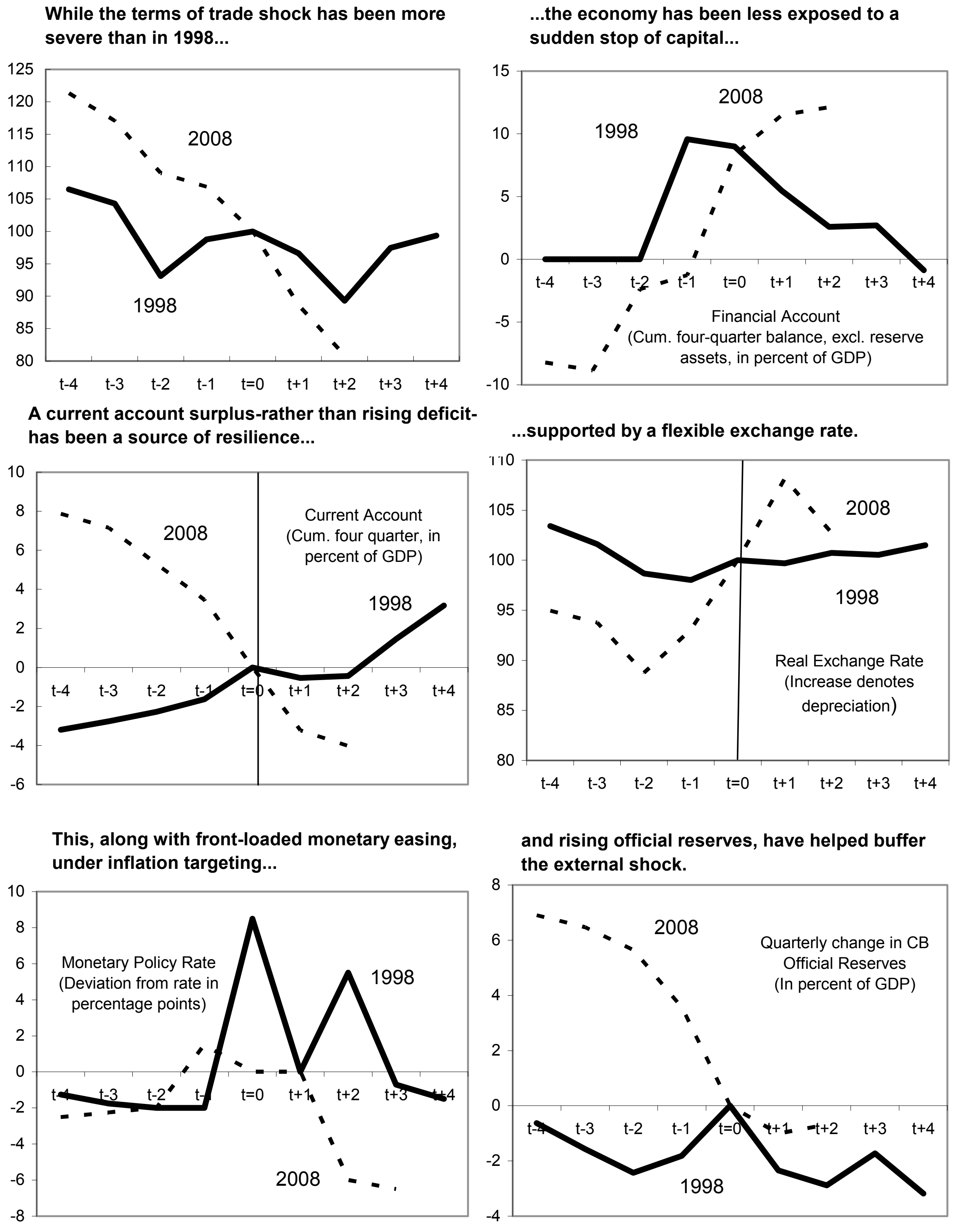
[1] The OECD Council began accession discussions with Chile in May 2007.

Figure 1. Chile: A Short Tale of Two External Shocks, 1998 and 2008



Source: IMF staff calculations.

Trade and Financial Indicators 1/
(In percent of GDP, unless otherwise indicated)

	Chile	Brazil	Mexico	New Zealand	OECD 3/
Trade Openness					
Exports and Imports (percent of GDP, in real terms)	91	22	65	69	106
Industrial Production 4/					
Industrial Production (percent of GDP, in real terms)	32	24	30	20	…
Financial Integration					
Broad money, end-2008 2/	101	66	53	114	60
Stock market capitalization, end-2008	76	37	21	23	75
Pension funds assets, end-2008	44	16	7	8	59
Mutual funds assets, end-2008	15	30	6	8	42
Domestic government bond market 6/	9	35	16	14	63
Corporate bond markets 5/	15	20	13	…	72

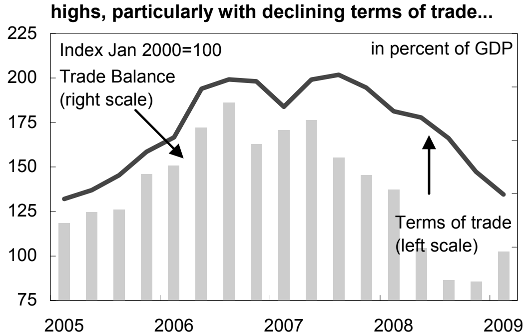
Sources: BIS, IMF Staff calculations; Investment Company Institute (ICI), OECD, National Authorities,and World Federation of Exchanges.
1/ End 2008, unless otherwise indicated.
2/ Corresponds to M3.
3/ Correspond to the average of an OECD country. Pension and mutual funds assets as end-2007.
4/ Includes mineral extraction, manufacturing, construction, production and distribution of enery, gas and water.
5/ Domestic debt securities: Corporate issuers and Financial Institutions. Data as at December 2008
6/ Domestic Debt Securities: Governments. Data as at December 2008

- ***The external current account shifted from a surplus of 4½ percent of GDP in 2007 to a deficit of 2 percent of GDP in 2008***. This shift was led by the sharp decline in copper prices and buoyant growth in imports, which reduced the trade balance in 2008 to roughly one-third of the US$23½ billion surplus in 2007 (Figure 2 and Table 1). The balance of payments posted a US$6½ billion surplus in 2008, as a result of continued strong net foreign direct investment. Following a trade deficit of about US$600 million in the fourth quarter of 2008 (driven by a 21 percent decline in the value of exports), the trade and current account balances shifted to surpluses in the first quarter of 2009, consistent with the sharp contraction in domestic demand.

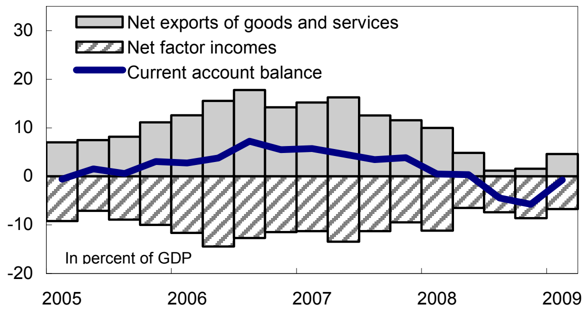
- ***The uncertain external environment prompted a sharp tightening in banks' lending conditions***. Banks' credit conditions tightened severely, partly as their funding had become more reliant—at the margin—on external and domestic wholesale markets. In fact, over the past two years, private pension funds' had shifted part of their investment portfolio to foreign assets, inducing banks to increase their external borrowing. Banks' default probabilities also increased, reflecting partly the domestic presence of foreign-owned institutions, the rise in cross-border claims of creditor countries, and an expected rise in non-performing loans due to the economic slowdown. Bank credit growth to the private sector, particularly consumers, slowed markedly in real terms by April 2009.

Figure 2. Current Account and Capital Flows

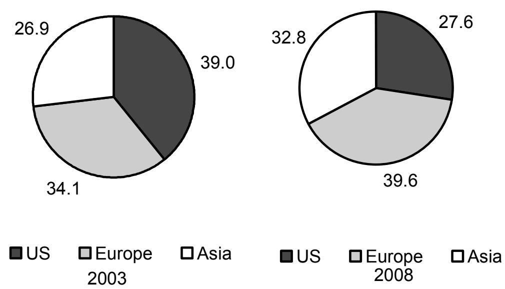
The trade balance has receded steadily from recent highs, particularly with declining terms of trade...



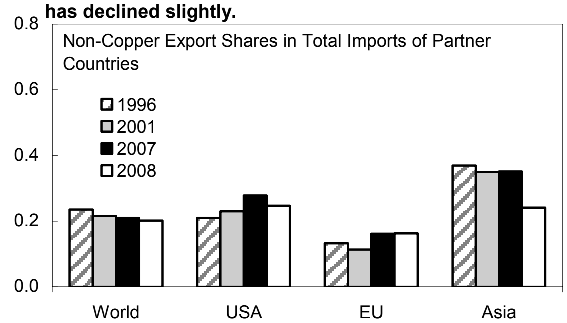
...and still high profit repatriation.



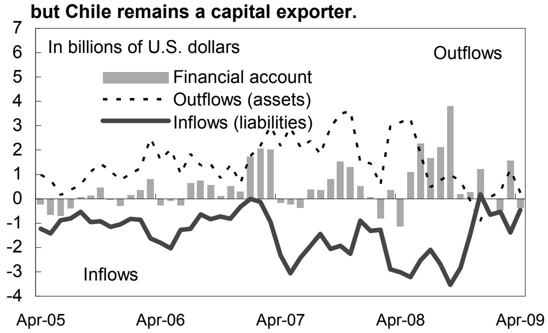
Non-copper export markets are more diversified as exports to Asia and to Europe have grown...



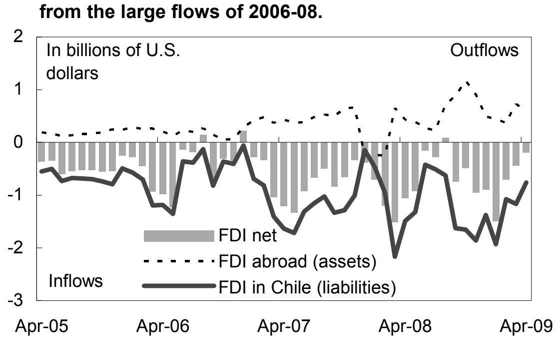
...while Chile's market share in non-copper products has declined slightly.



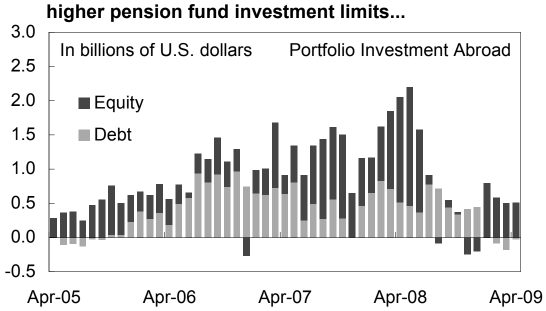
Financial flows have recently declined from high levels, but Chile remains a capital exporter.



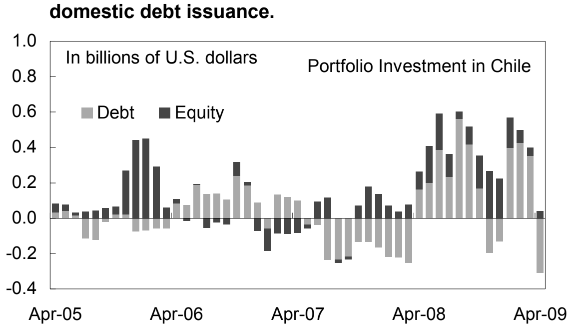
Foreign Direct Investment has also declined somewhat from the large flows of 2006-08.



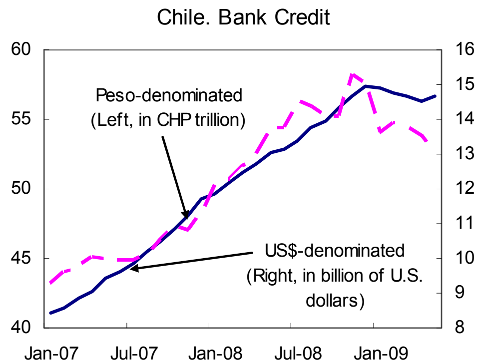
Outward portfolio investment has declined despite higher pension fund investment limits...

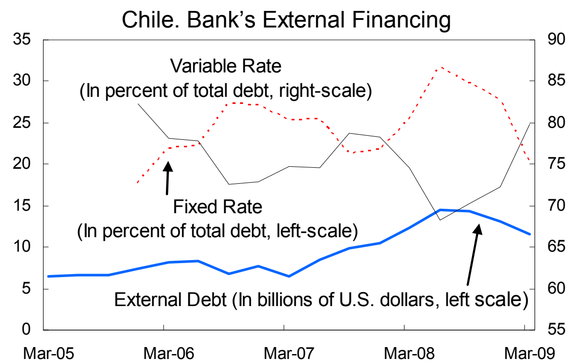


...while portfolio investment has risen with booming domestic debt issuance.

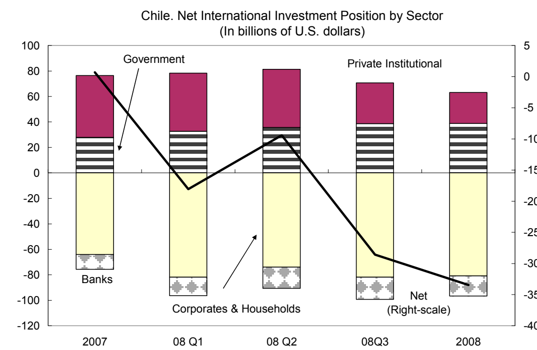


Sources: Haver and Banco Central de Chile





- ***The global asset price correction led to a sharp unwinding of the past gains of Chile's international investment position***. The value of the assets held by institutional investors (mostly private pension funds) declined by about 50 percent during 2008, mostly reflecting lower equity prices. Private banks and corporations also faced a deterioration in their net debtor position, while the public sector's (including the central bank) creditor status improved to US$50 billion, about 30 percent of GDP. As a result, Chile's net international investment position shifted to a debtor status of US$33½ billion by end-2008, equivalent to 20 percent of GDP.



14. **Against this backdrop, the economy experienced a sharp shift in growth momentum**. After growing at 4¼ percent on average (year-on-year) during the first three quarters of 2008, real GDP slowed sharply to 0.2 percent (y/y) in the fourth quarter of 2008 and declined by 2.1 percent (y/y) in the first quarter of 2009, led by an abrupt decline in inventories and private fixed investment (Figure 3).

15. **Global disinflation pressures spilled rapidly onto domestic inflation**. After peaking at 9.9 percent in October, 12-month inflation decelerated to 1.9 percent by June 2009 (Figure 4).[2] The disinflationary impulse associated with the global crisis was assisted by

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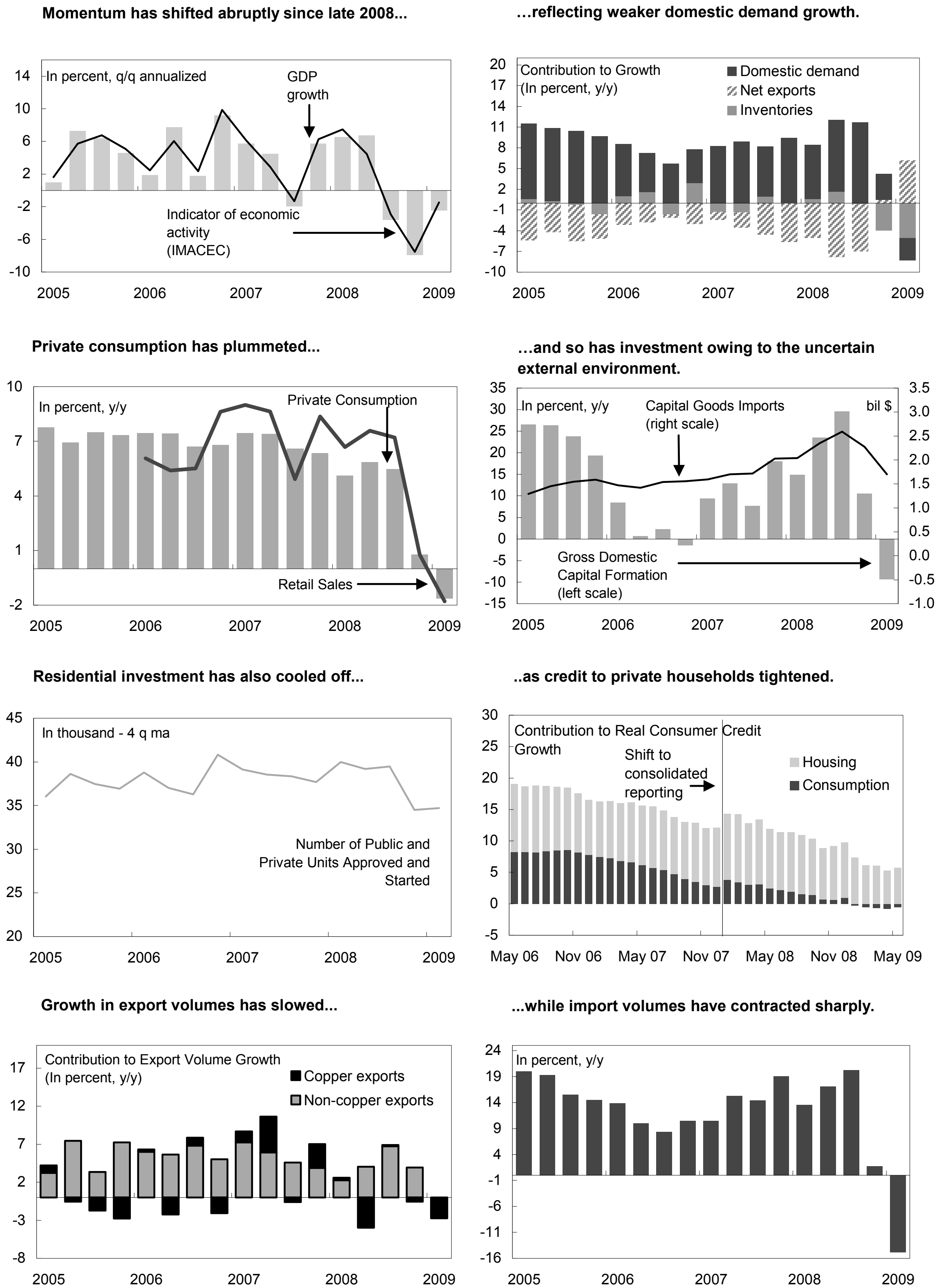
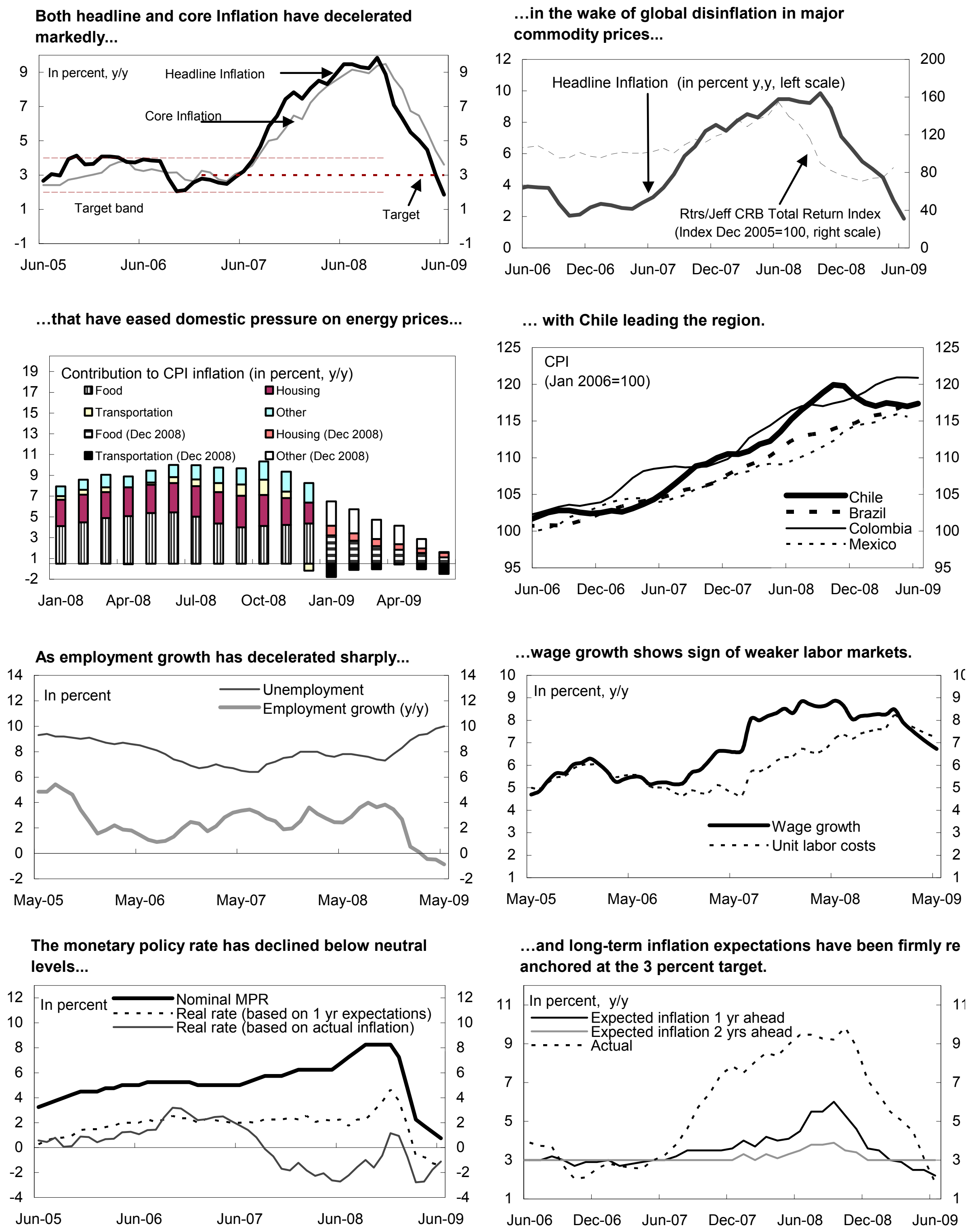
[2] In January 2009, the National Institute of Statistics (INE) introduced several methodological changes to the consumer price index. These include an updated basket (based on the 2007 Household survey) that reflects a shift in consumption toward services. The index will continue to report prices in the Santiago Metropolitan region; however, INE expects to include regional capitals in 2010.

Figure 3. Domestic Demand and Net Exports



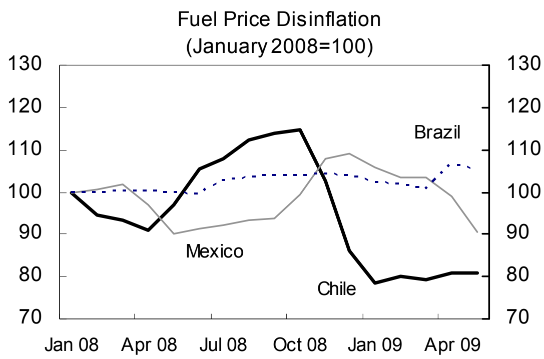
Sources: Haver, Chilean Authorities and Fund Staff estimates.

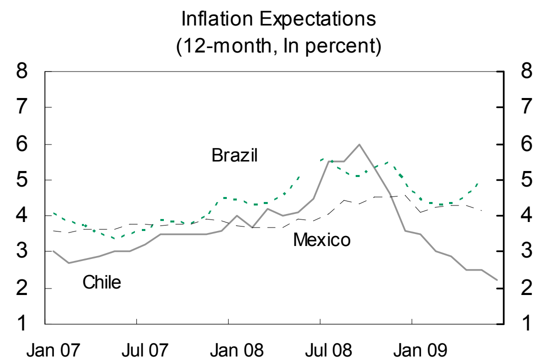
Figure 4. Inflation, Labor Markets and Monetary Policy



Sources: Haver Analytics Inc, Reuters Group plc.

reforms to the Fuel-Price Stabilization Fund (FEPC), that accelerated the pass-through from international to domestic prices, as well as by an easing of energy constraints (Figure 5).[3] Core inflation measures are hovering around 3–4 percent (y/y) and inflation expectations have also declined sharply, while wage and other cost pressures have begun to subside, with the seasonally-adjusted unemployment rate increasing to 9.9 percent in May 2009.

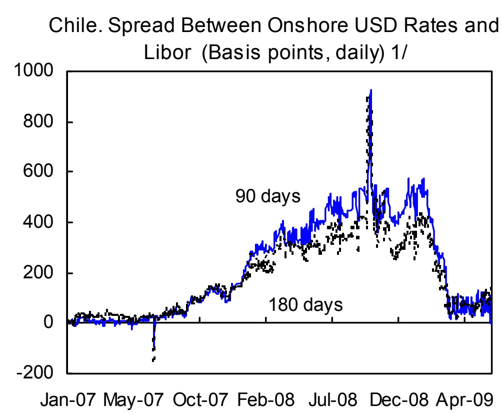




The Policy Response: Sizable, Well Balanced, and Coordinated

16. **The authorities implemented several measures to minimize the strains from tighter credit conditions and maintain financial stability**.

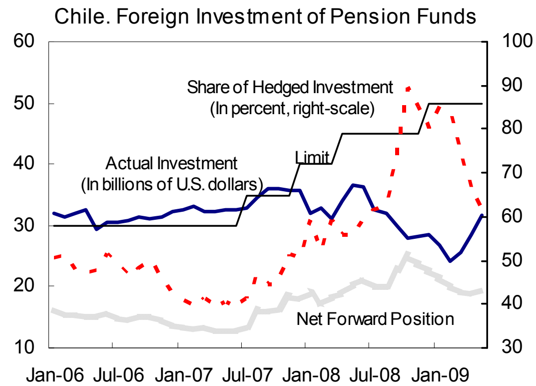
- ***Liquidity management***. Following foreign exchange purchases of US$6 billion between May and mid-September 2008, the Central Bank of Chile (BCCh) suspended its program of international reserve accumulation in late September. Several measures to support peso and U.S. dollar liquidity were also implemented, including repos and swap lines; collateral requirements were eased, while liquidity instruments were extended, eventually through end-2009 (Figure 6). In October, the Ministry of Finance shifted US$1 billion in deposits held abroad to domestic banks, to take advantage of lower risk in domestic banks and support domestic liquidity conditions. In mid-November, it established bank deposit auctions of its U.S. dollar cash flow, conducted by the BCCh.



1/ Onshore rates calculated form currency forwards and domestic currency deposits.

[3] New legislation was introduced in October 2008 that allows the reference price for fuels to be determined by a moving average for the crude oil price comprised of past and future international prices.

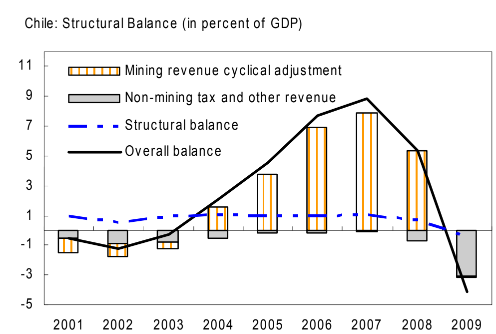
- ***Regulatory and other measures.*** In October, the Superintendency of Pensions (SP) extended the period to reduce pension funds' position in foreign currency forwards in the domestic market from 10 to 90 working days, to minimize strains in the foreign exchange market and dollar liquidity. The Ministry of Finance also suspended the diversification of financial assets under sovereign wealth funds (SWFs) into corporate fixed-income and equity in November, and in January 2009, the Financial Advisory Committee recommended incorporating domestic banks' deposits into the menu of SWFs investment options.[4]



17. **At the same time, the authorities adopted several countercyclical measures to support domestic demand**.

- ***Front-loaded monetary policy easing***. The BCCh shifted the stance of monetary policy from an "easing bias" in the fourth quarter of 2008 to slashing its policy interest rate from 8¼ percent in January 2009 to a historic low of ¾ percent by June 2009.

- ***Sizable fiscal stimulus***. In January 2009, the government announced a stimulus package of US$4 billion, with measures representing about 2.9 percent of GDP. These measures entailed an increase in public investment, a transitory reduction in stamp taxes and other taxes (of almost 1 percent of GDP), and higher direct transfers and subsidies for low-income families, housing, and transportation (for about ½ percent of GDP). The structural surplus target of ½ percent of GDP was reduced to zero for 2009. The measures also included the recapitalizations of state-owned Banco Estado (announced in 2008) and Copper Corporation (CODELCO), as well as an increase in the operational capital of Chile's Development Agency (CORFO) and the Insurance Fund for Small Enterprises (FOGAPE) (all amounting to about 1 percent of



[4] The recommendation is to include domestic banks with a domestic credit rating no less than N1+ (those with the strongest capacity to repay short-term senior unsecured debt) and for deposits not to exceed US$150 million or 15 percent of the bank's capital.

GDP), to support credit to exporters and small corporations, through guarantees. Since March, the government announced a series of initiatives to stimulate credit and competition in the financial system, employment, and further direct support to low-income groups (Table 9).

- ***Fiscal savings for deficit financing***. In mid-June, the authorities updated the 2009 Budget, projecting an overall deficit of 4.1 percent of GDP by end-year (compared with a deficit of 2.9 percent of GDP expected in January). The authorities also announced that a structural fiscal deficit of 0.4 percent of GDP would be expected in 2009, with staff estimating a fiscal impulse of about 5 percent of nonmining GDP.[5] About US$10.7 billion in gross financing needs would be covered by US$8 billion from past savings under the Economic and Social Stabilization Fund (FEES) and from issuing bonds domestically.

- ***Policy coordination to support the countercyclical response***. To limit the impact of the government's additional financing needs on long-term interest rates, the BCCh suspended the issuance of long-term securities (5-year and up maturities) for the remainder of 2009 (about US$0.7 billion are due) and would buyback up to US$1 billion of similar securities currently outstanding. The BCCh would also conduct open market operations to compensate the monetary impact of these measures.

Chile. Central Government's Financing Needs in 2009
(In millions of U.S. dollars, unless otherwise indicated)

	Budget 2/	Fiscal Stimulus Package 3/	Budget Update 4/
Gross Financing Need	**-3,458**	**8,300**	**10,700**
Fiscal Deficit	-6,691	4,132	6,132
Revenues	45,118	33,339	31,689
Expenditures	38,427	37,471	37,821
Debt Amortization	2,733	2,568	2,568
Social Security-related	1,852	1,718	1,718
Sovereign-Debt	455	455	455
Other	426	395	395
Capital Transfers 1/	500	1,600	2,000
CODELCO	0	1,000	1,000
State Bank	500	500	500
Credit Guarrantees	0	100	500
Financing	**-3,458**	**8,300**	**10,700**
Stabilization Fund decreases (FEES)	-3,458	5,600	8,000
Domestically-issued Bonds	0	2,700	2,700
Memorandum item:			
Fiscal Deficit (in percent of GDP)	-3.7	2.9	4.1

Sources: Chilean authorities and Fund Staff calculations.
1/ Below the line.
2/ Original Budget, published in the Official Gazette on 12/12/2008.
3/ Fund staff estimates based on announcements made by the authorities, beginning with the fiscal package of January 5, 2009.
4/ "Budget update of 2009 forecasts," presented to Congress on June 15.

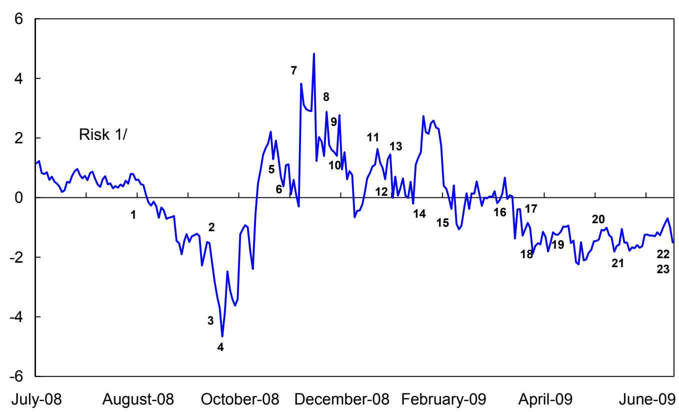
18. **Domestic financial market conditions have improved considerably, with incipient signs that the economy is bottoming out**. Market interest rates have declined, liquidity conditions—particularly in U.S. dollars—have eased and the yield curve has steepened (Box 1). Chilean banks and corporates have been able to rollover most of their maturing external debt with domestic debt, with the issuance of fixed-income instruments by highly-rated corporates in domestic markets increasing markedly since October 2008, as institutional investors have provided a stabilizing source of financing. With credit risk diminishing, Moody's upgraded the sovereign's long-term foreign currency rating by one

[5] The fiscal impulse is defined as the change in the nonmining structural balance as percent of nonmining GDP. The nonmining structural balance is defined as nonmining structural revenues minus expenditures; nonstructural revenues exclude all mining-related revenues and are cyclically adjusted.

Box 1: A Sequence of Policy Action and Risk during the Crisis

The chart below presents the difference between a put and call option for the U.S. dollar and Chilean peso, net of the VIX and copper price, providing a useful metric to assess risk and how it may have been influenced by the measures implemented by the authorities since September 2008.

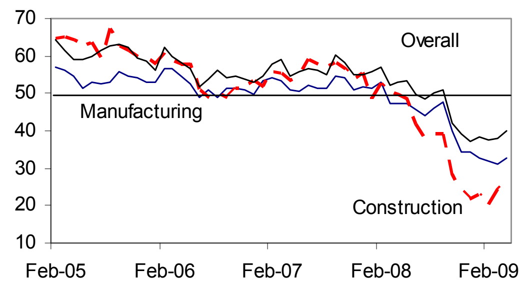
1	Sept. 4, 2008	BCCh raises its policy rate by 50 basis point, to 8.25 percent.
2	Sept. 29, 2008	BCCh suspends reserves accumulation program and announces FX swap program.
3	Oct. 9, 2008	BCCh maintains policy rate unchanged; stresses high inflation and rising external risks.
4	Oct. 10, 2008	BCCh announces measures to flexibilize liquidity management for financial system. These include extension and broadening of FX swap program and repos in pesos; accepts bank deposits as collateral for repos.
5	Nov. 12, 2008	BCCh initiates first auction of government deposits.
6	Nov. 13, 2008	BCCh maintains policy rate unchanged; highlights drastic change in external environment and updates IPOM scenario.
7	Nov.24, 2008	BCCh releases BOP and NIIP for Q3; sharp decline in current account and net debtor position
8	Dec. 3, 2008	BCCh extends terms for FX swap program to 180 days through end-December.
9	Dec. 10, 2008	BCCh extends liquidity management measures through end-2009; from January 2009 new mechanism that includes government securities and bank deposits as collateral.
10	Dec. 11, 2008	BCCh maintains policy rate; notes domestic slowdown and lower policy rates ahead.
11	Jan.5, 2009	Government announces Fiscal Stimulus Package; financing of deficit with FEES.
12	Jan. 8, 2009	BCCh reduces policy rate by 100 basis points, to 7.25 percent; process to continue.
13	Jan. 12, 2009	Financial Committee recommends incorporating domestic banks to SWF investments.
14	Jan. 23, 2009	Treasury announces financing of fiscal deficit with FEES; FX sales auction program.
15	Feb. 12, 2009	BCCh lowers policy rate by 250 basis points; hints large cuts ahead.
16	Mar. 12, 2009	BCCh lowers policy rate by 250 basis points; future cuts in line with history.
17	Mar. 27, 2009	BCCh initiates FX sales auction program; $50 million daily.
18	Mar. 30, 2009	The government announces additional measures to promote credit and competition.
19	Apr. 9, 2009	BCCh lowers policy rate by 50 basis points; future cuts in line with history.
20	May 7, 2009	BCCh lowers policy rate by 50 basis points; future cuts in line with history.
21	May 21, 2009	President Bachelet announces new subsidies aimed at amelliorating the impact of the crisis.
22	Jun. 15, 2009	Government announces larger than expected fiscal deficit and financing plan.
23	Jun. 16, 2009	BCC lowers policy rate by 50 basis points.



1/ Difference between call and put options for US dollar/Chilean Peso, net of VIX and copper price. Staff estimates based on Bloomberg.

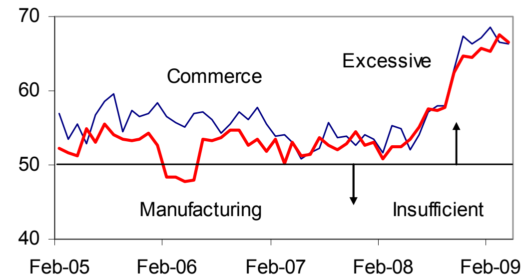
notch in late March. Recent indicators suggest that confidence has begun to rebound from recent lows, the peso has appreciated by almost 20 percent by early July, from its lows in late October 2008, tight bank lending standards are easing, although the monthly indicators for economic activity showed that the economy remained weak in April and May.

Business Confidence



1/ Source: ICARE

Business Inventories

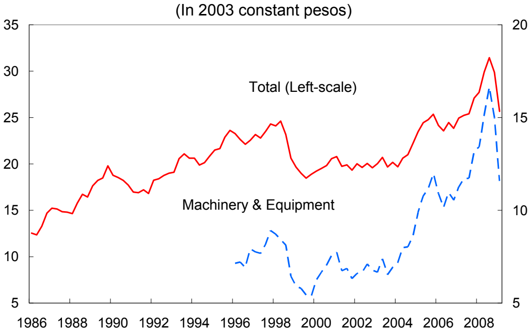


1/ Source: ICARE

III. The Economic Outlook and Risks

19. **The short-term outlook remains uncertain, with risks largely external**. Having reached an all-time high in 2008, the share of private investment to GDP (in real terms) is unlikely to sustain in the current global environment. Nevertheless, the current account deficit would deteriorate to around 3 percent of GDP in 2009, owing to lower copper exports and a sharp contraction in trading partner demand, which is particularly skewed toward the United States, the EU, and China. Net foreign direct investment would decline from recent highs but would still represent a high share of the current account deficit. The government's decision to finance the bulk of its fiscal deficit with FEES assets, along with a decline in Chile's risk premia relative to other economies, also bode well for financing large external needs in 2009–10. Institutional investors have played a stabilizing role by repatriating portfolio investment and would be expected to return to global markets gradually. Were global financial conditions to deteriorate, the high external rollover needs of banks and corporates (about US$30 billion) in 2009, could bring renewed pressures on credit, balance sheets, and investment. Public and private financial assets provide a significant buffer.

Chile. Fixed Capital Formation in percent of GDP
(In 2003 constant pesos)



Chile. External Financing Needs, 2009-10 1/

	2009	2010
Total needs	29.3	21.8
Current account	4.6	4.7
Debt amortization	24.8	17.1
Public sector	0.5	0.2
Private sector	24.2	16.9
Banks	7.9	3.4
Non-banks	16.3	13.5
FDI, net:		
in percent of needs	16.4	26.4
Reserves and FEES assets:		
in percent of needs	121.8	163.7

Source: IMF staff estimates.
1/ In billions of U.S. dollars, unless otherwise stated.

20. **The economy is well placed for an early recovery, but economic growth is expected be less favorable than previous to the crisis**. Economic activity would be expected to recover starting in the second half of 2009, reflecting the strong countercyclical measures adopted by the authorities and the expected recovery in Chile's main trading partners. Staff expects real GDP growth within a -0.5 to -1 percent range for 2009 and within a 3–4 percent range in 2010. 12-month inflation has declined sharply and is expected to remain below the lower bound of the target range in 2009. Nevertheless, the outlook for 2009–10 remains highly dependent on the strength and speed of the global recovery, and how this affects asset and commodity prices.

21. **Medium-term prospects remain favorable and warrant sustaining the reform momentum**. Significant private investment in recent years has enhanced potential output. However, global trend growth prospects have been marked down considerably, which would likely constrain investment and potential growth in the next few years (Box 2). Notwithstanding the impact of energy shortages on overall productivity growth in recent years, productivity has been lackluster since 1998. Therefore, it is imperative to advance reforms to enhance the business environment and flexibilize labor markets, to improve the contribution of productivity to medium-term per capita growth.

Chile. Labor Participation Rates

	1998	2003	2008
Male	81.1	75.8	75.7
Female	38.5	38.4	44.1

Source: Estudio de Hacienda Publica, 2008.

Contribution of Productivity to Per Capita Growth 1/

	1960-2003	1990-97	1998-2003
Chile	0.42	0.60	-2.52
Australia	0.50	0.46	0.27
Ireland	0.57	0.88	0.67
New Zealand	0.41	0.38	0.45
East Asia 2/	0.27	0.34	-0.54
Average	0.43	0.53	-0.33

1/ Based on Bosworth & Collyns (2003), Brookings Papers on Economic Activity.
2/ Excludes China.

IV. Policy Discussions

22. **Discussions focused on two broad areas**:

- ***The role for macroeconomic policies in the current juncture and the risks from the global financial deleveraging and economic contraction***.
- ***Reforms to solidify the policy framework, the financial system, and capital markets***.

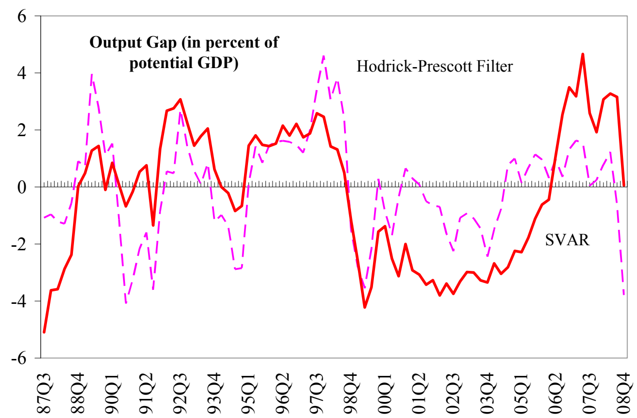
Box 2: The Global Crisis and Potential Output in Chile

The global crisis has negatively affected copper prices, as well as investment and export prospects. These factors have been viewed as important for the determination of potential growth, and in consequence, for estimating the output gap in Chile.

The output gap was estimated using a structural vector autoregression (SVAR). The model includes three variables: real GDP growth, the unemployment rate and real copper prices. Potential output, and thus the output gap, are recovered from the data using an identification procedure similar to that used by Blanchard and Quah (1989). As output gap levels resulting from the SVAR are sensitive to the period chosen as the base, it was assumed that the levels of effective and potential output were similar to each other during 1994Q1, an assumption also used by the BCCh.[1]

The main results are as follows:

- ***The positive output gap (output above potential) that had opened in 2006 seems to have closed during 2008Q4***. In contrast, applying the Hodrick-Prescott filter results in a negative output gap at end-2008. With the economy growing below potential in 2009–10, this would suggest a negative output gap in the next couple of years.



- ***The estimated potential growth rate was 4 percent, on average, since 1998***. This is consistent with a structural break that may have occurred during this year. However, recent estimates by the BCCh using a production-function approach suggest potential growth rates at 4½–5 percent prior to the crisis. Based on these estimations, staff assumes a potential growth of 4 percent for the medium term.

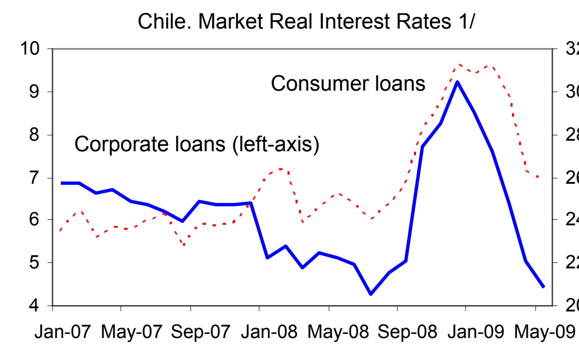
- ***Real copper prices appear to only affect the potential growth rate marginally.*** This is consistent with the structural fiscal rule, which has insulated the economy from copper price shocks. The effect of demand shocks are mostly felt during the year after impact, with is impact lasting for about 3 years. In addition, the variance of output forecast errors is mainly explained by domestic factors.

1/ See Fuentes et al. in *Economia chilena*, vol. 11, August 2008.

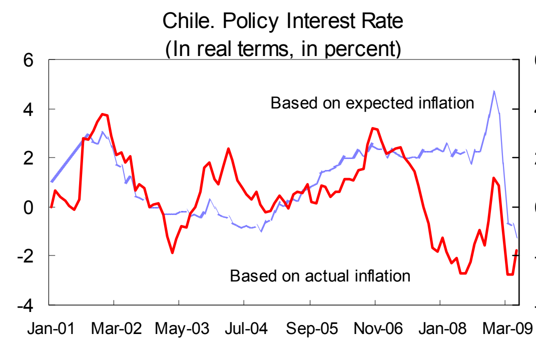
A. The Role for Macroeconomic Policies

Monetary Policy and the Exchange Rate: Facing a Sudden and Sharp Reversal of Risks

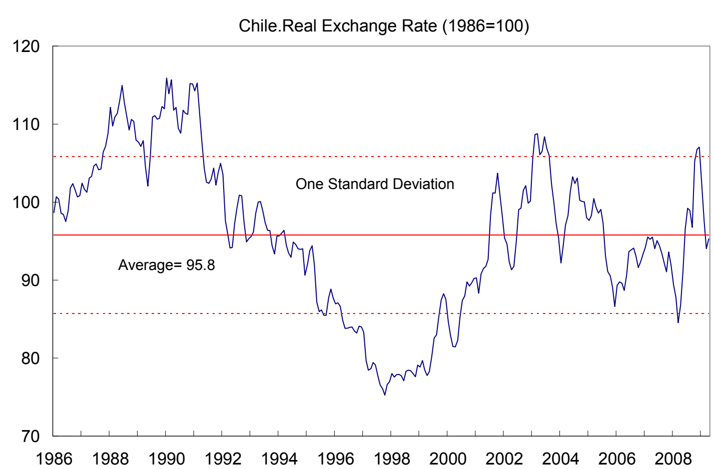
23. **Monetary policy responded swiftly to a rapidly changing inflation outlook**. With evidence that inflation expectations were well-anchored around the target and a widening output gap, the authorities saw plenty of scope to front-load the policy response and bring the policy interest rate to below-neutral-levels swiftly. This was also justified by the sharp tightening of bank lending conditions, reflecting heightened risk aversion (Box 3). The authorities were encouraged that the transmission from the policy rate and other "nonmonetary measures" to stabilize inflation, promote competition, and stimulate credit were taking increasing hold on market rates and lending standards, and expected these trends to intensify and credit growth to pick up ahead.



1/ Deflated by expected inflation



24. **The floating exchange rate was also instrumental in helping the economy absorb the rise in global risk aversion and sharp deterioration of terms of trade**. Following the pre-emptive buildup of foreign exchange reserves in 2008, the authorities were satisfied that the use of new liquidity instruments had been successful in preserving orderly market conditions. The authorities viewed the large depreciation of the peso since the onset of the crisis as mostly reflecting the terms of trade deterioration and global risk aversion.



Box 3: Bank Lending Conditions and Monetary Policy

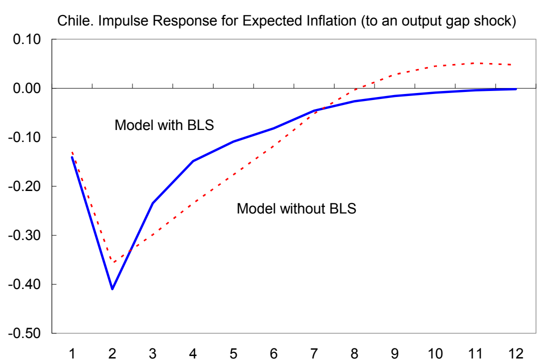
The tightening of global financial conditions has been reflected in a higher bank lending spread (BLS) in Chile. This resulted in a marked increase in the cost of funding, with implications for aggregate demand and inflation.

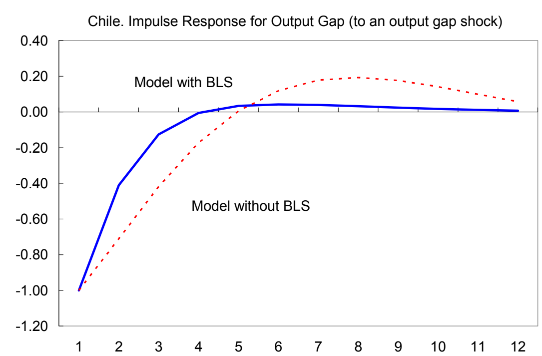
The Global Projection Model (GPM) was used to assess the impact of the BLS on macroeconomic conditions and monetary policy decisions. The GPM was extended to incorporate the BLS as a variable that provides information on factors affecting the output gap. In general, models that incorporate the BLS tend to have better accuracy of forecasts.

The results show that:

- ***By incorporating the BLS, monetary policy decisions could anticipate and buffer the impact of shocks on inflation and output***. The simulations confirm that in response to a negative demand shock, expected inflation tend to decline more pronouncedly when the BLS is factored into the model than otherwise. As a result, the central bank could anticipate and respond more actively so as to reduce output and employment losses.

- ***As the economy recovers and slack vanishes, risks on inflation may intensify***. This seems particularly to be the case when the changes to the policy interest rate are proportional to the BLS shock. Adjusting the policy rate proportionately could bias the direction of the adjustment in favor of demand shocks relative to supply shocks induced by the higher BLS.





25. **The authorities agreed with the assessment that the real exchange rate was close to "equilibrium"**. They recognized that such assessment was difficult to make in light of the nature of the global shock and the potential adjustment of exchange rates for advanced economies and commodity prices over the medium term.

Equilibrium Exchange Rate Estimates: CGER					
	Current Account Estimations			Real Exchange Rate	
	Elasticity	Underlying Balance 1/	Equilibrium Balance 1/	Gap 2/	Adjusted Gap 3/
Macroeconomic Balance 3/	0.35	0.0	-2.0	-7	-5
External Sustainability 3/	0.35	0.0	-2.0	-7	-8
Equilibrium real exchange rate	n.a.	n.a.	n.a.	-1	-1

Source: CGER and IMF staff estimates. Reference period for CGER assessment is March 2009.
1/ Ratio of current account balance to GDP.
2/ Undervaluation ="-".
3/ Based on medium-term projections through 2014.

26. **Going forward, the authorities were concerned about the risks of sustained strong disinflationary pressures**. They expect sustained disinflation to continue for the next six months—with 12-month inflation envisaged to approach zero by end-year. With the policy rate close to its effective lower bound and continued external risks, they felt that ensuring that inflation would return to the 3 percent target over the 24-month horizon could prove potentially challenging, as additional budgetary financing needs could impart further disinflationary pressures, including through an exchange rate appreciation. The authorities were confident that a well-functioning credit market, the strong and preemptive policy response thus far and the credibility of the inflation target would be conducive towards to ensuring a return to the 3 percent inflation target over the 2-year horizon.

27. **While the policy framework has worked well in stabilizing the economy, the authorities and staff agreed that some alternative means of easing may be needed in the event disinflationary pressures were more severe and protracted**. The authorities noted that one possibility would be to announce a more explicit contingent commitment to maintain a path for the policy interest rate for an extended period, and staff pointed out that other options could be to extend the tenor of new liquidity instruments and to incorporate them to the policy framework permanently. The authorities noted that these measures could be supported by additional buybacks involving BCCh securities to affect long-term interest rates. Staff noted that other forms of easing, including by broadening the instruments that qualify for outright purchase, would entail a significant departure from the policy framework and could add credit risks to the BCCh's weak capitalization levels.[6] The authorities agreed but noted that in light of the extraordinary circumstances and lingering risks, they would not rule out any options.

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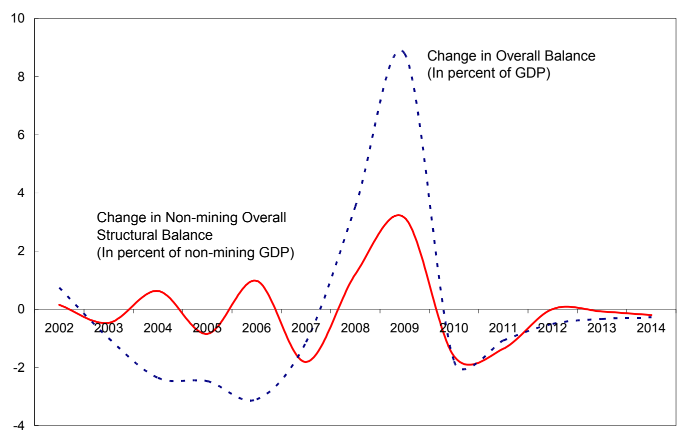
[6] The BCCh Organic Law (article 36) allows for the purchase of banks' loans or investments for up to 90 days; which could be extended with full majority of the BCCh Board and subject to a previous assessment of the banks made by the SBIF.

Fiscal Policy: Imparting a Stronger Countercyclical Stance

28. **The authorities stressed that fiscal policy had to take a leading role in stabilizing the economy in 2009**. They felt it was important for the countercyclical fiscal measures to be large enough to signal Chile's strong capacity to buffer the impact of the global shock on the economy and to be readily implemented. The authorities also noted that public spending would rise by 14½ percent in real terms in 2009 and stressed that the stimulus was comprised of transitory measures, which minimized long-term fiscal costs. With low public sector debt, a broad-mix of spending and tax measures, and the financing provided by past savings under the FEES, they were confident about the effectiveness of countercyclical fiscal policy in stabilizing the economy and supporting an early recovery in activity.

29. **The need to impart fiscal policy with more countercyclical impulse and a larger-than-expected decline in nonmining tax revenue is expected to bring the structural balance into deficit.** The authorities noted that while the structural rule has been instrumental in assisting macroeconomic stability, having maintained a structural balance would have undermined the role of automatic stabilizers and need for a stronger countercyclical response. They felt it was also a good opportunity to advance methodological changes to more accurately estimate nonmining structural revenues.[7] Staff emphasized that the fiscal impulse in train was quite significant and that its effectiveness had to be balanced against the economy's high openness. Mindful of the limits to active stabilization policies, the authorities did not envisage further fiscal measures, as many had been calibrated to be effectively implemented later this year and even through 2010.

Chile. Fiscal Impulse Indicators



30. **Potential challenges to fiscal policy in 2010 limit the scope for sustaining a large fiscal impulse**. Structural revenues could be constrained by a lower long-term price of copper, which together with the temporary tax reductions made in 2009, could constrain public spending and force a more permanent reduction in the structural surplus target. The authorities recognized the uncertainties and challenges facing fiscal policy in 2010, particularly for copper prices and had yet to assess the outlook for the 2010 Budget. Nonetheless, they emphasized the importance of preserving the structural rule as an anchor,

[7] The authorities have updated the elasticities of nonmining tax revenues to GDP to better reflect structural changes in the economy and tax reforms since 2001, the year in which these elasticities were based. These changes provide an additional ½ percent of GDP in structural revenues for 2009. Other methodological changes, including to add a cyclical component to public spending, are likely to be introduced with the 2010 budget.

particularly when its credibility and acceptance have been strengthened with the downturn. They also noted the broad recognition that there would be no scope for sustaining the high public spending growth of recent years. Staff noted that in light of the risks facing the economy, it would also be important to consider not withdrawing the fiscal stimulus too soon. Several of the transitory measures implemented in 2009 could be extended—most notably the reduction in the stamp tax, while also bringing the structural target back to balance. Staff stressed the importance that the 2010 Budget be presented with a balanced target and that the merits of reinstating the ½ percent of GDP surplus target be reassessed, as global economic and domestic conditions normalize.

B. The Reforms to Solidify the Policy Framework, the Financial System and Capital Markets

Fiscal Framework: Extending the Horizon of Policy Formulation

31. **There is a good opportunity to bring more of a medium-term view to fiscal policy formulation, in line with best international practice**. The authorities and staff agreed that the structural surplus rule has been critical in embedding fiscal policy with a medium-term perspective—based on assumptions for the long-term price of copper and trend output provided by an external committee of experts—resulting in high predictability and transparency. The authorities noted that several long-term fiscal issues had been an important part of their ongoing policy agenda, assessments which have been presented in recent years, most notably on contingent liabilities and the pension reform.[8] To further solidify Chile's fiscal framework and better integrate the impact of future spending contingencies into budgetary projections, staff recommended bringing more of a long-term view to the existing 2–3 year horizon for planning and executing fiscal policy. Staff noted that such approach would strengthen the emphasis on demographic and productivity factors, by assessing the growth in public per capita spending relative to income per capita, and its implications for net public assets.

Length of Budgetary Projections

	Years
Australia	
Budget	*3*
Intergenerational Report	*40*
Chile	
Budget	*3*
Mexico	
Gral. Criteria of Econ. Policy	*5*
New Zealand	
Budget	*10*
Statement of Long-Term Fiscal Position	*40*
Norway	
Budget	*50*
Long-Term Perspectives	*50*

Source: Fund staff calculations.

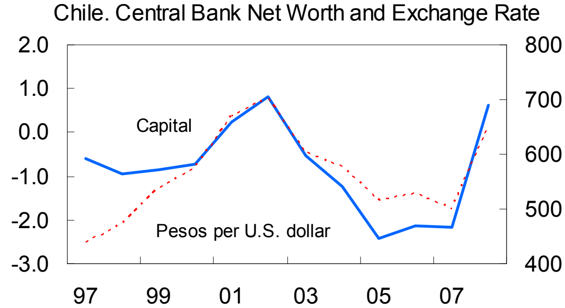
32. **Such an approach would help better integrate the target for the structural rule and the net asset position, with the path of contingent and other fiscal liabilities**. The authorities noted that significant progress has been made in identifying and quantifying contingent fiscal liabilities and some medium- and long-term social spending commitments, and viewed their outlook as manageable. They agreed that there was scope to extend the

[8] "*Informe de Pasivos Contingentes*" (November 2008) and "*La Reforma Previsional Chilena: Proyecciones Fiscales 2009–25*" (December 2008).

framework; indeed they have recently established a division in the Budget Planning Department (DIPRES) to look into medium and long-term fiscal pressures on health, education, and pension-related spending. Staff agreed that the outlook for contingent liabilities appeared manageable, but noted that under certain plausible long-term scenarios, the path for public spending could significantly exceed those associated with different targets for the structural rule and entail a significant deterioration in the government's net asset position. Staff noted that it would be important to continue advancing reforms to minimize the following risks:

- ***Despite significant progress in recent years, the BCCh remains undercapitalized***. By end-2008, the government has retired all its outstanding debt with the BCCh and has made three capital injections totaling US$2.1 billion during 2006–08. This, along with the depreciation of the peso in 2008, brought the net worth to about ½ percent of GDP at end-2008, from -2.8 percent of GDP at end-2007. Nonetheless, staff noted that a value-at-risk approach (based on volatility of revenues) could justify a capital base of about 1–2 percent of 2008 GDP on a permanent basis, and with budget deficits envisaged for 2009-10, the prospect for further capital injections were unlikely to be met.[9] The authorities emphasized that the recent crisis confirmed the BCCh's ability to deal with difficult conditions despite its lack of capital, but acknowledged the importance of full recapitalization and have begun preparations for an analysis of the impact of recapitalization transfers on the BCCh's balance sheet over a 20-year period, in line with commitments under the Fiscal Responsibility Law (FRL), results which they expected to have before end-2009.[10]

Chile. Central Bank Net Worth and Exchange Rate



- ***Financial risks from public sector enterprises (PSEs)***. The strong and transparent policy framework has been important in effectively managing market-related risks, investment, and indebtedness by PSEs, most of which are supervised by the *System of*

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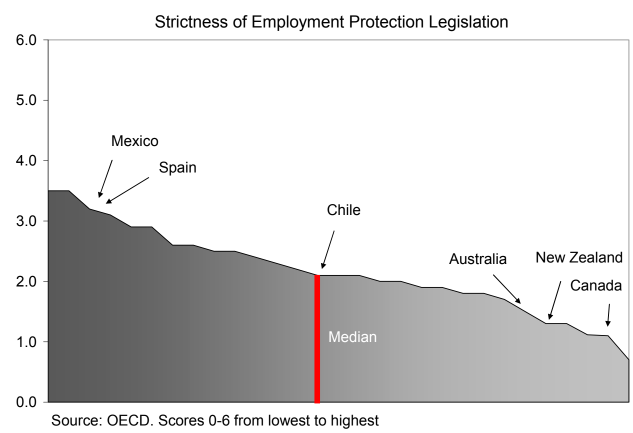
[9] Under the FRL, enacted in 2006, annual transfers to the BCCh cannot exceed ½ percent of the previous year GDP (after subtracting from the budget surplus the contribution to the Pension Reserve Fund, which should be no less than 0.2 percent of the previous year GDP and up to ½ percent of the previous year GDP). Recapitalization transfers to the BCCh can be done for five years.

[10] An October 2008 working paper by BCCh staff suggests that, based on stochastic simulations for key macroeconomic variables, there is a high probability that its net worth would continue to deteriorate over the next 25 years. The probability of further deterioration would be lower conditioned on a slowdown in reserves accumulation, on capital set in real rather than nominal terms, and accrued exchange-rate related profits not distributed.

Public Enterprises (SEP). The authorities submitted to Congress in 2008 proposals to strengthen the corporate governance of CODELCO and other PSEs. While PSEs net public debt stood at only 6¼ percent of GDP at end-2008, several large PSEs have recently faced deteriorating financial conditions, risking a potential call on public finances for recapitalization or debt guarantees. In addition, the authorities explained that the privately-run public bus system (*TranSantiago*) has continued to experience losses and could require direct and permanent budget support from 2010 on. Staff encouraged the authorities to evaluate options for improving their financial condition; including by presenting their current and projected balances in the *Informe Anual de Finanzas Publicas*. The authorities explained that several of these PSEs have been subject to restructuring plans, including the replacement of their management, and that the recent enactment of the *Transparency Law* would support efforts to strengthen their governance. They also noted that efforts would remain geared toward strengthening their governance in line with the proposed framework for CODELCO and a recent proposal to broaden the scope of companies under the SEP.

33. **A longer-term approach to fiscal policy would also help sustain the focus on reforms to boost per capita income growth.** Certain indicators—such as for starting and closing businesses—suggest that the administrative burden on the private sector compares unfavorably with the average for OECD members. One particularly useful international practice would be to review the burden imposed by regulations on all businesses, which could result in an annual agenda of "red-tape" reduction. The authorities indicated that efforts had been recently focused on simplifying regulatory procedures for micro and small and medium-sized firms. Staff also noted scope to improve the balance between security and flexibility in the labor market. The authorities explained that several reform proposals by the *Meller Commission* had been implemented, including to improve in-work benefits, child benefits, and job-related training; as well as to extend the coverage and benefits of the unemployment insurance scheme. The authorities and staff agreed that future efforts could focus on further promoting formal employment, by introducing reforms to the unemployment insurance system that help lower severance payments, as well as by easing some restrictions on contracts.

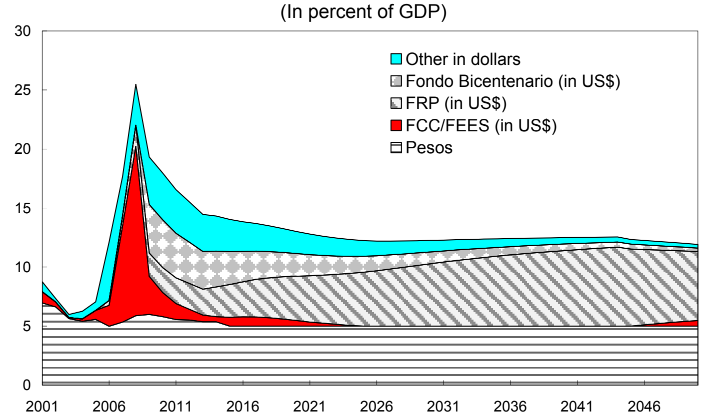


Indicators of Business Environment	Chile	Australia	New Zealand	Latin America	OECD
Overall Ranking 1/	40	9	2	...	...
Starting a Business (ranking)	55	3	1	...	...
Number of Procedures	9	2	1	9.7	5.8
Duration (days)	27	2	1	64.5	13.4
Paying Taxes (ranking)	41	48	12	...	...
Time	316	107	70	393.5	210.5
Closing a Business (ranking)	112	14	17	...	...
Time (years)	4.5	1	1.3	3.3	1.7
Cost (percent of estate)	15	8	4	15.9	8.4

Source: Doing Business, World Bank.

34. **The global financial turmoil and fiscal risks also underscore the need to continue strengthening the framework for Sovereign Wealth Funds (SWFs)**. Chile's SWFs continue to rank among the most transparent, and significant progress has been made in establishing generally accepted principles and practices (the "Santiago principles") and in designing a long-term strategic asset allocation, with technical assistance from MCM. The authorities explained that the decision to postpone the shift in the portfolio structure toward equities and corporate fixed-income securities was justified by current global conditions and that no decision had been made on when to proceed forward. The recommendation to expand SWF investments to deposits in domestic banks was motivated by a need to rebalance risk-return and financial-stability goals vis-à-vis macroeconomic stability and was still under evaluation. Staff also noted that diminishing risks in global financial institutions would lessen the need to implement such recommendation on a permanent basis.

Chile: Central Government Assets
(In percent of GDP)



Source: Fund staff estimates.

35. **With prospective budget deficits for 2009–10, staff noted that government assets could diminish in the years ahead**. The authorities stressed that using FEES assets to finance deficits was critical to legitimize the structural rule framework and felt that there would be plenty of room to finance deficits comfortably, including through debt issuance. It was agreed that there was a good opportunity to continue to work toward embedding investment objectives and projected path for the FEES within a long-term fiscal framework.

The Banking System: Solid but Facing Credit Risks

36. **The authorities stressed that the banking system was sound and well-protected from many of the problems witnessed in advanced economies.** Financial soundness indicators show that banks are on average well-capitalized and liquid, reflected in credit ratings that are among the highest in the region. They explained that financial intermediation in Chile continued to be characterized by a more "traditional banking business" model, with most operations on-balance sheet, high reliance on retail deposits (about one-third of liabilities), limited exposure to structured products and investment in financial instruments (about 10 percent of assets and mostly in BCCh securities). Facing a change in funding associated with pension funds' reallocation of investments abroad, banks have been gradually increasing their share of foreign borrowing, including long-term and for financing external trade operations.

Chile: Financial Soundness Indicators
(In percent; unless otherwise indicated)

	2006	2007	2008	2009 1/
Bank regulatory capital to risk-weighted assets	12.5	12.2	12.5	13.6
Bank capital to assets	6.8	6.7	6.9	7.4
Bank nonperforming loans to total loans	0.8	0.8	1.0	1.2
Bank provisions to nonperforming loans 2/	199	210	179	74
Bank return on assets	1.3	1.1	1.2	1.3
Bank return on equity	18.6	16.2	18.9	17.9
Liquidity ratio 3/	1.7	1.8	1.7	1.7
Current ratio 4/	68.4	67.6	...	...

Sources: BCCh and SBIF

1/ Latest available data April 2009. Data for 2009 reflects new IFRS accounting rules.

2/ Data for 2009 reflects new IFRS accounting. Excluding Banco Estado, the ratio was 94 percent ir

3/ Ratio of cash to deposits by end of year, unless otherwise noted. For 2009, data is as of March 2

4/ Ratio of assets to liabilities with maturity of 1 year or less.

37. **The authorities viewed the presence of foreign-owned banks posing no systemic risks**. Senior officials from the Superintendency of Banks and Financial Institutions (SBIF) noted that while foreign banks represented more than half of the banking system's assets and liabilities, several risks were contained by the prudent regulatory and supervisory framework.[11] For example, most foreign banks are subsidiaries and the largest (foreign-owned) bank was required to keep a capital-to-asset ratio in excess of 11 percent (instead of 8 percent, as most other banks). Most banks had a long-standing presence in Chile and a stable deposit base. They also noted that the share of external funding was, on average, less than 10 percent of liabilities, and banks' faced limited currency-related risk.

[11] Long-term debt ratings of Chilean banks range from BBB+ to A+, according to FitchRatings; and foreign currency deposits are rated A1 by Moody's. Fitch's October 2008 *Bank Systemic Risk Report*, assessed the system's vulnerability to macroeconomic risk as low, with its intrinsic quality—which is derived from Fitch's individual bank ratings—also low and similar to Canada.

38. **Staff agreed with this assessment, noting that the interconnectedness of global financial institutions' exposures and the increasing claims by foreign banks on Chile still presented some risks**. Staff analysis suggest that the banking system could face some deterioration in creditworthiness, were difficulties at global and some regional financial institutions to resurface and become severe. This could potentially be risky in the event parent-bank support was more uncertain. The authorities agreed that the global financial turmoil had heightened the risks of many financial institutions that have traditionally provided liquidity in foreign currency and market-making capabilities for derivatives, stressing that several of the measures recently implemented had successfully contained such risks. The SBIF had been actively monitoring potentially exposed domestic institutions closely, including through the provisions provided by memoranda of understanding with foreign supervisors.

Risk Codependence and Impact on Domestic Banks' Ratings 1/

	Chilean Banks			
			Conditional ratings 4/	
	Current rating 2/	95th rating 3/	Median rating	Minimum rating
U.S. Banks	B1	Ba2	B1	B3
Of which: Wachovia			Ba2	B3
Citi			Ba3	B3
European Banks			Ba2	B3
Of which: Spaniard			Ba1	B3
U.K.			Ba2	B3
Latin American Banks			Ba2	B3
Of which: Brazilian			Ba2	B3

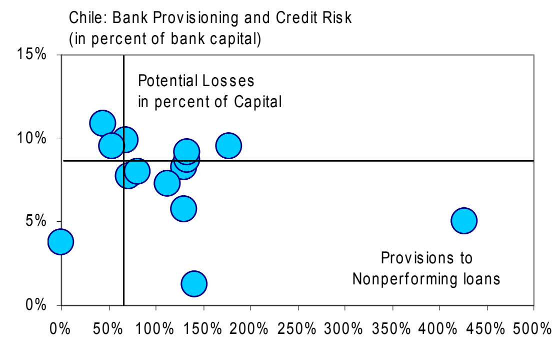
1/ Staff estimates based on Moody's KMV data.
2/ Rating corresponding to the EDF level as of end-February 2009.
3/ Rating corresponding to the 95th percentile of the EDF distribution of Chilean institutions
4/ Ratings calculated based on the EDF of the Chilean institution conditionalon the EDF of the foreign institution at its 95th percentile.

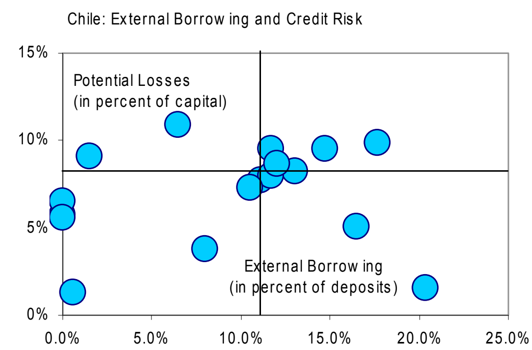
39. **The authorities foresaw rising credit risks for the banking system**. Credit risk indicators for households and corporates were expected to continue deteriorating, partly reflecting rising unemployment and weaker profitability. Stress tests conducted by the BCCh show the banking system would face losses associated with credit risk in the range of 1-8 percent of capital, and of 2 percent of capital for market risk.[12] With the full adoption of IFRS in 2009, some domestic banks have lower provisioning levels relative to their nonperforming loans, which also tend to be more dependent on external financing and could be more exposed to credit risks, with adverse implications for capital requirements.[13] The authorities viewed these risks as minimal—there was no evidence of segmentation in the domestic market and some external borrowing was long-term in nature. They also noted that the state-owned *Banco Estado* was recently recapitalized, that many private banks had

[12] These estimates were published in the January 2009 Financial Stability Report, based on end-September 2008 data and assuming alternative macroeconomic scenarios to those published in the January 2009 Monetary Policy Report. In the July 2009 Financial Stability Report, the authorities presented new estimates, which disentangle the losses due to increased provisions from the lower earnings associated with lower bank credit levels as a result of the crisis. As a resut, the sum of these losses remain within a 2¾-8¼ percent of capital.

[13] Provisions are determined based on expected credit losses, with banks relying on their own models that are approved by the SBIF. Expected losses tend to be low for loans with guarantees, such as mortgages, for which required provisions tend to be less. Nonperforming loans, as defined by IFRS standards, do not account for the existence of guarantees or loan-recovery mechanisms.

recapitalized last year's profits and were continuing to increase provisions relative to nonperforming loans, in recent months.





Source: Staff estimates based on SBIF data as of end-February 2009.

40. **There has been continued progress in strengthening the prudential and supervisory framework**.

- ***Adoption of IFRS and progress toward Basel II***. Starting in January 2009, IFRS accounting standards are in full force for banks, particularly regarding the valuation of assets and liabilities, and the definition of nonperforming loans. On Basel II, the authorities have finalized the draft amendment to the General Banking Law and expect to proceed with such reform during 2009-10. With the intrinsic uncertainty in the different models bank use to estimate provisions, staff encouraged the authorities to continue assessing provisioning levels and the effectiveness of their underlying models, while exploring options to reduce procyclicality, such as by introducing "dynamic provisioning."

- ***Improved coordination among supervisory agencies***. The *Committee of Superintendents* has agreed to prepare a Memorandum of Understanding to strengthen coordination, as well as risk-based and consolidated supervision, particularly for domestic conglomerates. The Committee has begun to discuss implications from work undertaken by the regulatory agencies (such as the Superintendency of Securities, SVS) to better understand ownership and financial linkages among domestic conglomerates. In this regard, the SVS has finalized a draft framework to implement a risk-based supervision framework for the insurance sector.

- ***Perimeter of regulation***. SBIF senior officials agreed with the importance of broadening the perimeter of regulation to bring several nonbank entities that have been expanding their lending operations under the direct purview of the SBIF in order to minimize systemic risks. It was agreed that this could be an area to assess during an FSAP update in 2010.

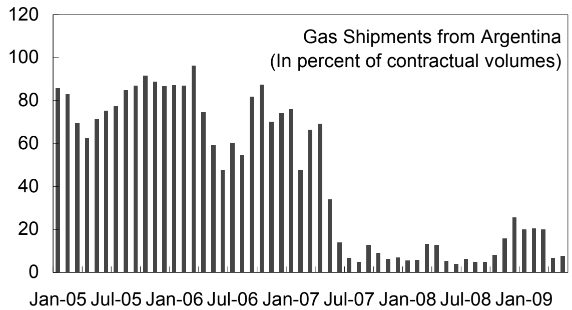
Capital Markets: Promoting Competition and Accountability

41. **The authorities stressed that the ongoing implementation of the pension reform had been timely in dealing with the risks posed by the global turmoil**. Pension fund reform gives more flexibility to pension funds' and contributors' investment decisions, while strengthening oversight and accountability. Investment limits have been relaxed, including for investable securities. Pension funds are required to submit investment guidelines to the Superintendency of Pensions, which will be overseen by the newly established Technical Investment Board (CIT). Similarly, contributors can now switch investment funds provided they acknowledge the risks embedded in their chosen fund. To that end, pension funds need to provide additional information about the funds' risks.

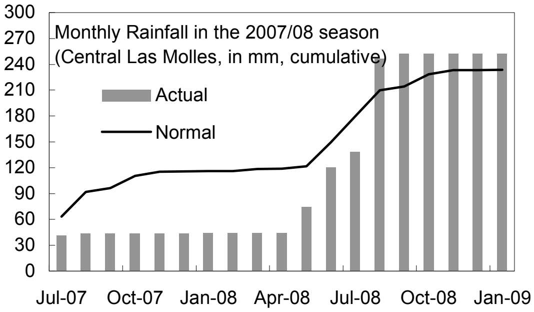
42. **The authorities advanced important capital market reforms envisaged under the MKIII reform that help support the countercyclical policy response.** New tax rules facilitate foreign investor participation in local fixed-income markets. Credit to SMEs could benefit from measures allowing high-yield investments by pension funds and the extension of CORFO's partial guarantees for SME-related securitization. Insurance companies are now allowed to lend to individuals or corporations, as well as to participate in non-related syndicated bank lending up to certain specified limits. The authorities continued to work toward increasing domestic liquidity by allowing the participation of pension funds in repo operations.

Figure 5. Energy Supply: Gradually Normalizing But Still Tight

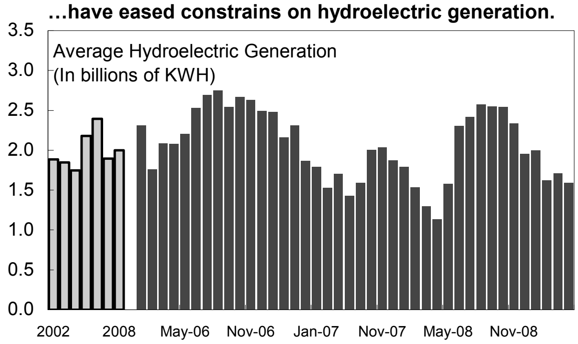
Natural gas imports have begun to rebound from multi-years low...



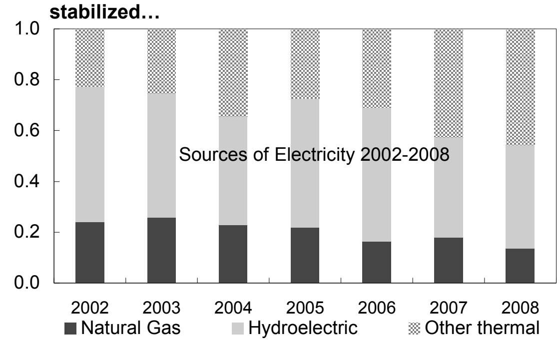
…and improved weather conditions...



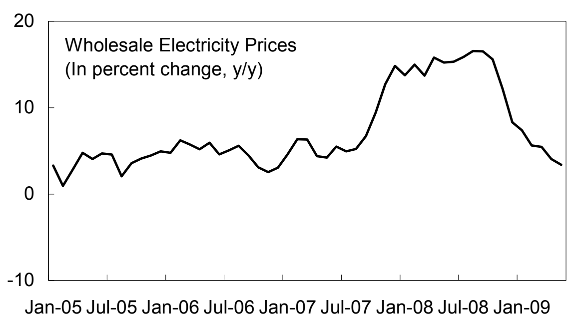
…have eased constrains on hydroelectric generation.



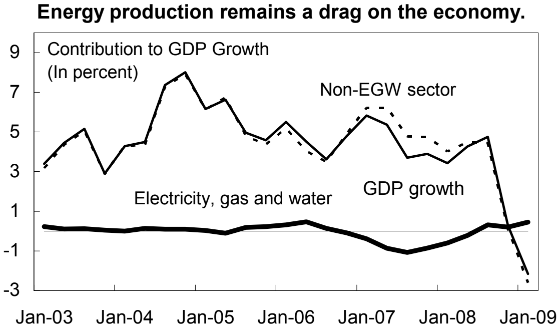
The share of diesel-generated electricity has stabilized…



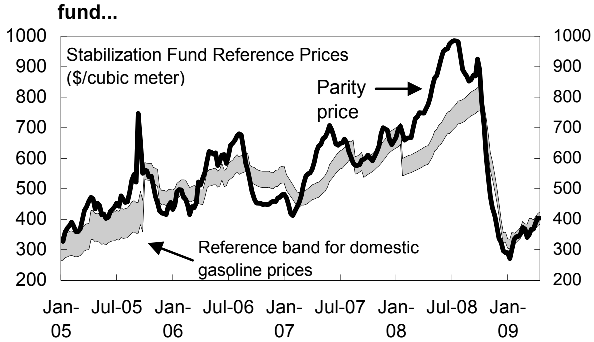
...and the price of electricity has declined.



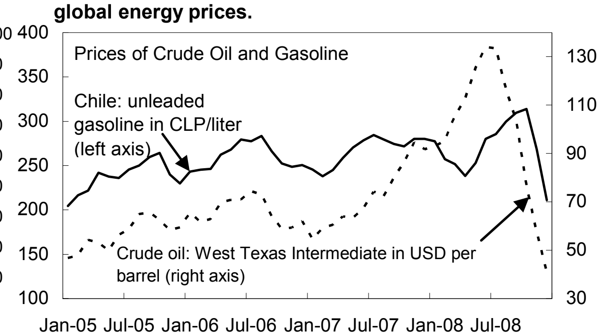
Energy production remains a drag on the economy.



Following regulatory changes to the oil stabilization fund...



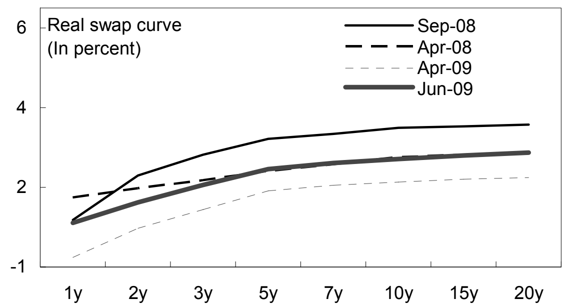
…domestic gasoline prices have re-coupled with global energy prices.



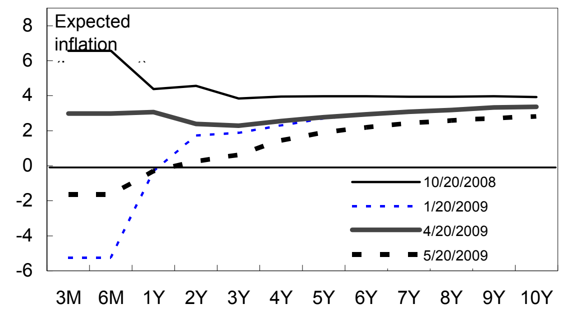
Sources: Chilean Authorities (CDEC-SIC, National Bureau of Energy and National Bureau of Statistics)

Figure 6. Yields, Spreads, and Credit

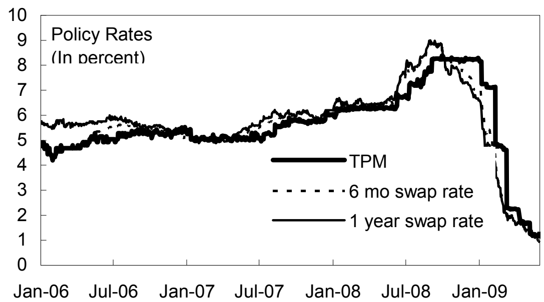
The yield curve has shifted down in line with global developments...



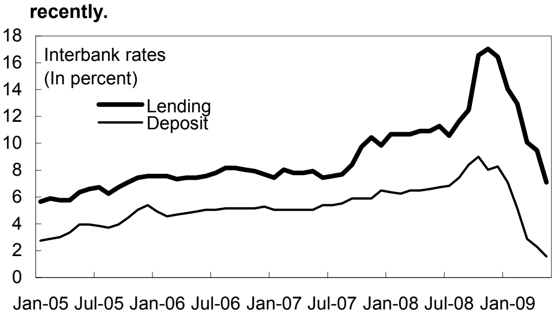
...and Inflation expectations have come back in line with the Central Bank target.



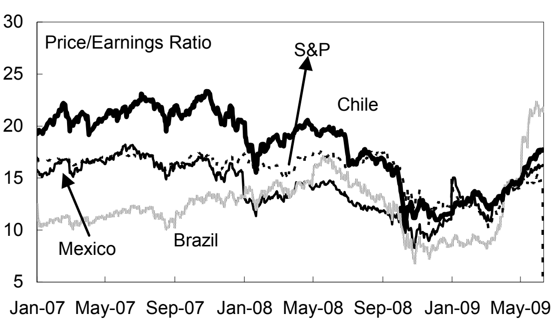
The policy rate is expected to remain low during the next year.



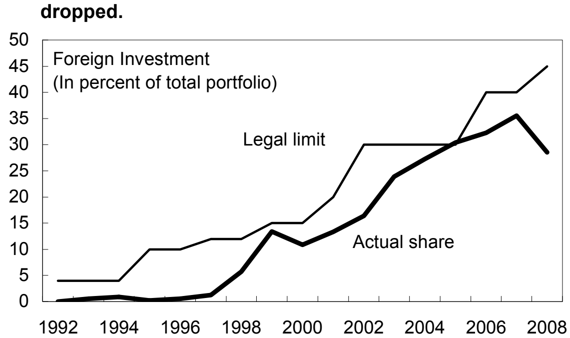
The spread between lending and deposit rates widened as banks have tightened credit standards, but have eased recently.



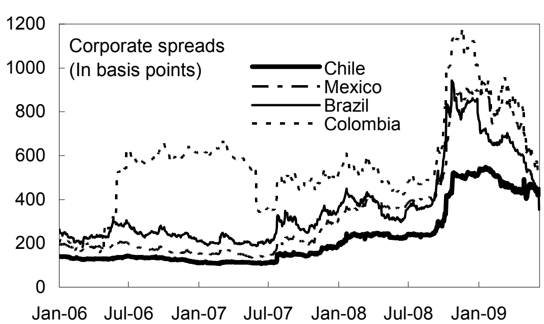
Equity valuations have declined less than in the region...



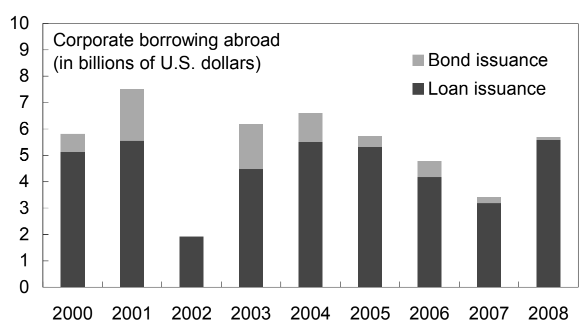
...and pension funds investments abroad have dropped.



Corporate spreads have also increased significantly...



...contributing to a decline in bond issuance abroad.



Sources: Bloomberg, Haver, Credit Suisse, BEL and Chilean Authorities.

Table 1. Chile: Selected Social and Economic Indicators

I. Social and Demographic Indicators

GDP (2008)	88,595	**Poverty rate (2006)**	13.7
U.S. dollars (billions)	172.7	Indigent	3.2
Per capita (U.S. dollars)	10,308	Poor, not indigent	10.5
Population characteristics (2008)		**Income distribution (2006)**	
Total (in millions)	16.7	Richest 10% of households	38.6
Urban population (percent of total)	n.a.	Poorest 20% of households	4.1
Life expectancy at birth (years)	n.a.	Gini coefficient	0.54

II. Economic Indicators

	2005	2006	2007	2008	Projections 2009	Projections 2010
	(Annual percentage change, unless otherwise specified)					
National accounts and employment						
Real GDP	5.6	4.6	4.7	3.2	-0.7	3.6
Total domestic demand	10.4	6.8	7.8	7.4	-3.0	2.6
Consumption	7.1	7.0	7.1	4.2	1.7	1.3
Private	7.4	7.1	6.9	4.3	0.5	1.1
Public	5.9	6.4	8.0	4.0	8.1	2.1
Investment	21.7	6.2	9.9	17.0	-15.8	6.7
Private	25.6	1.3	10.4	21.1	-15.2	5.1
Public	10.8	12.0	24.9	7.9	32.2	-13.4
Fixed	23.9	2.3	12.0	19.5	-10.0	2.1
Inventories 1/	-0.3	1.0	-0.4	-0.5	-1.8	1.1
Net exports 1/	-4.5	-2.3	-3.4	-4.8	2.6	0.8
Consumer prices						
End of period	3.7	2.6	7.8	7.1	0.8	2.5
Average	3.1	3.4	4.4	8.7	2.2	2.7
Unemployment rate (annual average)	9.3	8.0	7.0	7.8	...	...
Money and credit						
Broad money	11.9	11.4	14.7	19.1	...	...
Credit to the private sector (end of period)	19.9	17.7	20.8	8.2	...	...
	(In percent of GDP, unless otherwise specified)					
External Debt and Balance of Payments						
Current account	1.2	4.9	4.4	-2.0	-3.0	-2.9
Trade Balance (in US bn)	10.8	22.8	23.6	8.8	2.3	1.5
Exports of goods (in US bn)	41.3	58.7	67.7	66.5	45.9	48.6
Imports of goods (in US bn)	30.5	35.9	44.0	57.6	43.6	47.1
Gross external debt	39.1	33.7	34.0	38.2	40.6	38.0
Public	8.3	7.8	7.6	7.2	8.1	7.5
Private	30.8	25.9	26.3	31.1	32.5	30.5
Gross international reserves (in US bn) 4/	17.0	19.4	16.9	23.2	24.0	...
	(Annual percentage change)					
Terms of Trade	10.8	31.1	3.6	-15.1	-8.4	-5.9
Real Effective Exchange Rate (eop)	16.0	-7.1	3.6	-12.9	...	...
	(In percent of GDP)					
Savings and investment						
Gross domestic investment	22.2	20.2	21.2	24.7	21.3	21.7
Public	2.1	2.0	2.4	2.6	3.6	3.1
Private	20.1	18.1	18.8	22.1	17.7	18.6
National saving	23.4	25.0	25.5	22.6	18.3	18.8
Public 2/	5.7	10.6	10.8	11.9	0.7	2.2
Private	17.7	14.4	14.8	10.3	18.0	16.5
Public sector finance						
Net Debt	11.8	0.2	-8.3	-14.7	-6.2	-4.8
Excluding public enterprises	2.5	-4.3	-10.8	-21.0	-12.8	-11.5
Public sector gross debt 3/	34.9	25.7	24.1	22.9	24.9	24.3
Central government gross debt	7.3	5.3	4.1	5.2	5.1	4.9
Central government balance	4.6	7.7	8.8	5.3	-4.1	-2.1

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

1/ Contribution to growth.
2/ Gross saving of the general government sector, including the deficit of the central bank.
3/ Gross consolidated debt of the public sector (central bank, non-financial public enterprises, and general government).
4/ Data as of May 2009.

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

	2005	2006	2007	Est. 2008	Proj.1/ 2009	2010
Overall balance	4.6	7.7	8.8	5.3	-4.1	-2.1
Non-Mining Balance	-0.6	-1.1	0.2	-0.8	-6.7	-4.8
Total revenue	23.9	25.8	27.5	26.4	21.6	22.3
Taxes	16.9	17.0	18.9	18.6	16.6	17.2
Nonmining	15.5	13.9	15.1	16.2	15.3	16.1
Mining-related	1.4	3.1	3.8	2.4	1.3	1.1
Codelco revenues	3.7	5.7	4.8	3.6	1.3	1.6
Income on assets	0.3	0.5	1.2	1.4	0.7	0.9
Social contributions	1.4	1.3	1.3	1.5	1.7	1.6
Grants	0.1	0.1	0.1	0.1	0.1	0.1
Other	1.3	1.2	1.2	1.3	1.1	1.0
Total expenditure	19.3	18.1	18.7	21.1	25.7	24.5
Consumption	5.6	5.3	5.6	5.9	6.2	6.3
Social benefits	4.6	4.3	4.2	4.5	5.5	5.4
Subsidies and grants	5.0	4.7	5.0	6.2	7.6	7.5
Interest payments	0.8	0.7	0.6	0.5	0.5	0.5
Gross investment	1.8	1.8	2.1	2.3	3.3	2.7
Defense	1.3	1.2	1.2	...	...	...
Non-defense	0.5	0.6	0.9	...	...	...
Net capital transfers	1.3	1.3	1.1	1.6	2.4	1.8
Net Assets	0.1	7.0	13.7	20.4	14.4	13.2
Gross Debt	7.3	5.3	4.1	5.2	5.1	4.9
Peso-denominated Assets	5.8	5.1	5.5	6.0	6.3	6.2
Foreign currency-denominated Assets	1.5	7.1	12.3	19.6	13.2	11.9
Memorandum Items:						
Nonmining Structural Balance	-0.5	-1.3	0.5	-1.1	-6.1	-3.8
Fiscal Impulse 2/	-1.3	0.8	-1.8	1.6	5.0	-2.3
Nonmining Structural Primary Balance 3/	0.1	-1.0	-0.2	-2.1	-6.3	-4.2
Fiscal Impulse 2/	-1.2	1.1	-0.7	1.9	4.2	-2.1
Net Assets of the Public Sector	-11.8	-0.2	8.3	14.7	6.2	4.8
Excluding public enterprises 4/	-2.5	4.3	10.8	21.0	12.8	11.5
Nominal GDP (trillions of pesos)	66.2	77.8	85.6	88.5	85.7	88.8
Output Gap	-0.5	-1.5	-1.2	-1.1	3.0	2.8

Sources: Ministry of Finance (DIPRES) and staff estimates.

1/ Based on the 2008 Budget and updated staff estimates.

2/ Change in nonmining structural balance (-) as a share of GDP excluding extractive activities.

3/ Excludes interest payments and income from government assets.

4/ General government and Central Bank only.

Table 3. Chile: Summary Operations of the Public Sector

				Est.	Proj.	
	2005	2006	2007	2008	2009	2010
Central government						
Balance	4.6	7.7	8.8	5.3	-4.1	-2.1
Total revenue	23.9	25.8	27.5	26.4	21.6	22.3
Of which: intragovernmental receipts	0.8	0.7	0.7	0.7	0.7	0.7
Total expenditures 1/	19.3	18.1	18.7	21.1	25.7	24.5
Of which: intragovernmental transfers	0.8	0.6	0.6	0.6	0.6	0.6
Current	16.1	15.1	15.4	17.3	20.0	20.0
Capital	3.1	3.0	3.2	3.8	5.7	4.5
Net Assets	0.1	7.0	13.7	20.4	14.4	13.2
Municipalities 2/						
Balance	0.2	0.2	0.1	0.0	0.0	0.0
Total revenue	2.9	2.7	2.7	2.8	2.9	3.0
Of which: intragovernmental receipts	0.8	0.6	0.6	0.6	0.6	0.6
Total expenditures	2.8	2.5	2.6	2.7	2.9	3.0
Of which: intragovernmental transfers	0.8	0.7	0.7	0.7	0.7	0.7
Current	2.5	2.2	2.3	2.4	2.5	2.6
Capital	0.3	0.3	0.3	0.3	0.4	0.4
Central bank						
Balance	-2.1	-0.2	-0.5	2.8	-0.2	-0.2
Net Administrative Expenses	0.0	0.0	0.0	0.0	-0.1	-0.1
Net Operating Balance 1/	-1.8	-0.1	-0.5	2.7	-0.3	-0.3
Net Assets	-2.6	-2.7	-2.9	0.6	-1.6	-1.7
State-owned non-financial enterprises						
Balance	1.2	4.1	3.7	3.5	3.3	3.1
Total revenue	12.2	18.7	17.0	17.4	16.1	15.8
Of which: intragovernmental receipts	0.1	0.2	0.2	0.3	0.4	0.3
Total expenditures	11.1	14.6	13.3	13.9	12.7	12.7
Of which: intergovernmental transfers	4.3	6.2	5.3	4.1	1.6	1.6
Current	9.1	13.1	11.9	12.1	11.2	11.1
Capital	2.0	1.6	1.4	1.7	1.6	1.6
Net Assets	-9.2	-4.5	-2.6	-6.3	-6.6	-6.7

Sources: Ministry of Finance (DIPRES), Central Bank of Chile, and staff estimates.

1/ Includes the effects of valuation changes (inflation) to the stock of UF debt and accrued interest on Treasury debt; excludes administrative expenses and provisions.

2/ On a cash basis.Municipalities hold neither sizeable financial assets nor debt.

Table 4. Chile: Indicators of External Vulnerability

(In percent; unless otherwise indicated)

	2002	2003	2004	2005	2006	2007	2008	2009
Financial indicators								
M3 (percent change)	6.3	3.7	10.6	11.9	11.4	14.7	19.1	…
less pension funds' deposits (annual percentage change)	3.9	6.2	6.6	10.8	27.9	14.7	19.1	…
Private Sector Credit to GDP	66.9	64.3	65.3	66.9	66.1	72.9	83.8	…
90-day central bank promissory note (nominal) interest rate (avg.)	3.9	2.8	1.8	3.5	4.8	5.2	n.a.	…
Share of foreign currency deposits in total deposits	6.3	6.1	5.7	5.5	5.8	5.8	9.2	…
Share of foreign currency loans in total credit	14.5	10.3	10.0	10.0	10.3	10.2	13.9	…
External indicators								
Exports, U.S. dollars (annual percentage change)	-0.5	19.2	50.1	26.9	42.2	15.3	-1.8	-31.0
Imports, U.S. dollars (annual percentage change)	-3.9	13.6	27.8	33.0	17.7	22.6	30.8	-24.4
Terms of trade (annual percentage change)	3.8	9.7	20.6	10.8	31.1	3.6	-15.1	-8.4
REER (end of period, percent change)	-1.2	4.1	-1.0	16.0	-7.1	3.6	-12.9	…
Exchange rate (pesos per US$, period average)	689	691	610	560	530	522	522	566
Current account (percent of GDP)	-0.9	-1.1	2.2	1.2	4.9	4.4	-2.0	-3.0
Financial account less reserves accumulation (percent of GDP)	1.0	0.6	-2.4	0.2	-3.5	-6.4	5.8	4.7
Gross official reserves (in US$ billion) 1/	15.4	15.9	16.0	17.0	19.4	16.9	23.2	24.0
Gross official reserves, months of imports of goods and services	7.8	6.4	5.0	4.6	4.3	2.9	5.3	5.1
Gross official reserves to broad money	23.5	23.6	19.0	16.5	16.0	12.0	13.6	…
Gross official reserves to short-term external debt 2/	134.4	125.4	113.7	104.8	111.2	75.2	79.7	113.0
Total external debt (percent of GDP)	60.2	58.2	45.5	39.1	33.7	34.0	38.2	40.6
Of which: external public sector debt	10.7	12.5	10.3	8.3	7.8	7.6	7.2	8.1
Total external debt to exports of goods and services	179.5	161.1	112.9	95.5	74.4	72.7	83.9	113.9
External interest payments to exports of goods and services	6.4	4.7	3.3	2.9	2.3	2.1	1.9	3.0
External amortization payments to exports of goods and services	25.6	20.4	16.2	17.0	20.6	12.8	17.5	21.3
Financial market indicators								
Stock market index (in US$; period average) 3/	483	600	832	1105	1278	1776	1630	1352
Sovereign long-term foreign-currency debt rating (end of period)								
Moody's	Baa1	Baa1	Baa1	Baa1	A2	A2	Aa2	…
S&P	A-	A-	A	A	A+	A+	A+	…
Fitch Ratings	A-	A-	A-	A	A	A	A	…

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

1/ Gold valued at end-period market prices. Data as at May 2009

2/ As measured by the central bank; includes amortization of medium/long-term debt due during the following year but not trade credits.

3/ Morgan-Stanley Capital International index (Dec/1987=100).

Table 5. Chile: Medium-Term Framework

	2008	2009	2010	2011	2012	2013	2014
		Projections					
	(Annual percentage change, unless otherwise specified)						
National accounts and employment							
Real GDP 1/	3.2	-0.7	3.6	3.9	4.8	5.0	5.0
Total domestic demand	7.4	-3.0	2.6	5.0	5.5	5.6	5.6
Consumption	4.2	1.7	1.3	3.0	5.2	5.1	4.7
Investment	17.0	-15.8	6.7	11.2	6.1	7.0	8.0
Net exports 2/	-4.8	2.6	0.8	-1.5	-1.1	-1.1	-1.1
Consumer prices							
End of period	7.1	0.8	2.5	3.0	3.0	3.0	3.0
Average	8.7	2.2	2.7	3.0	3.0	3.0	3.0
Unemployment rate (annual average)	7.8	...	...	...	...	...	...
	(In percent of GDP)						
Balance of Payments							
Current account	-2.0	-3.0	-2.9	-2.3	-2.1	-2.0	-2.0
Trade Balance (in US bn)	8.8	2.3	1.5	1.9	-0.8	-1.4	-2.2
Exports of goods (in US bn)	66.5	45.9	48.6	53.4	58.2	62.5	67.0
Imports of goods (in US bn)	57.6	43.6	47.1	51.5	59.0	63.9	69.2
Financial Account Balance	7.1	4.2	2.9	2.3	2.1	2.0	2.0
Foreign direct investment (net)	5.8	3.2	3.5	4.0	4.1	3.7	3.7
Portfolio investment (net)	-5.6	-4.5	-2.7	-3.5	-3.7	-3.5	-3.6
Financial Derivatives	0.2	0.3	0.3	0.2	0.2	0.2	0.2
Other Investments	6.7	5.3	1.7	1.6	1.5	1.6	1.7
Reserves Assets	-3.8	-1.2	0.0	0.0	0.0	0.0	0.0
Errors and Omissions	-1.3	0.0	0.0	0.0	0.0	0.0	0.0
	(Annual percentage change)						
Total export volume	-1.3	-1.0	4.1	2.9	4.4	5.4	5.4
Copper export volume	-2.2	0.7	4.1	4.0	4.0	4.0	4.0
Agricultural exports volume	13.4	-2.0	3.9	4.0	6.5	6.0	6.5
Industrial exports volume	1.2	-1.1	4.2	2.0	4.0	6.0	6.0
Total import volume	10.9	-4.2	1.7	5.6	5.9	6.6	6.6
Terms of Trade	-15.1	-8.4	-5.9	2.5	-5.4	0.2	-0.1
Total export prices	-2.8	-29.8	1.7	6.8	4.3	2.1	1.7
Copper export prices	-10.7	-49.1	2.5	1.1	2.8	2.3	2.3
Total import price	14.1	-22.8	8.2	4.2	10.4	1.9	1.8
	(In percent of GDP)						
External Debt							
Gross external debt	38.2	40.6	38.0	37.6	36.3	33.3	31.9
Public	7.2	8.1	7.5	7.2	6.5	5.5	5.2
Private	31.1	32.5	30.5	30.4	29.8	27.8	26.7
Gross international reserves (in US bn) 5/	23.2	24.0	...	...	...	...	...
Savings and investment							
Gross domestic investment	24.7	21.3	21.7	22.9	23.3	23.7	25.0
Public	2.6	3.6	3.1	3.0	3.0	3.0	3.0
Private	22.1	17.7	18.6	19.9	20.3	20.6	22.0
National saving	22.6	18.3	18.8	20.6	21.2	21.7	23.1
Public 3/	11.9	0.7	2.2	3.5	3.9	4.2	4.9
Private	10.3	18.0	16.5	17.1	17.3	17.5	18.2
Public sector finance							
Net Debt	-14.7	-6.2	-4.8	-4.6	-4.6	-4.1	-4.2
Excluding public enterprises	-21.0	-12.8	-11.5	-11.1	-10.6	-9.9	-10.0
Public sector gross debt 3/	22.9	24.9	24.3	22.2	20.4	18.4	17.7
Central government gross debt	5.2	5.1	4.9	4.5	3.8	3.0	2.9
Central government balance	5.3	-4.1	-2.1	-0.8	-0.4	-0.1	0.5
Memorandum Items:							
Copper prices (LME; U.S. cents per pound) 6/	316	182	186	188	193	198	202
Volume of copper exports (2004=100)	98	98	103	107	111	115	120

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

1/ Medium term projections are consistent with potential growth of 4 percent for 2013-2014, and an output gap of zero by the end of 2014.

2/ Contribution to growth.

3/ Gross saving of the general government sector, including the deficit of the central bank.

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

5/ Data as of May 2009.

6/ Updated staff forecasts.

Table 6. Chile: External Debt and Debt Service

				Est.	Projections	
	2005	2006	2007	2008	2009	2010
	(In billions of U.S. dollars, end of period)					
Total debt outstanding 1/	**46.2**	**49.5**	**55.7**	**64.8**	**61.4**	**61.9**
Of which: external private debt	36.4	38.1	43.2	52.6	49.1	49.8
External public debt	9.8	11.4	12.5	12.1	12.3	12.2
Medium- and long-term debt	39.1	40.2	44.6	49.9	50.0	49.9
Public sector	9.0	10.1	10.1	9.3	9.4	9.3
Of which: central government	4.1	4.2	3.6	2.8	3.0	2.9
Private sector	30.1	30.1	34.5	40.6	40.6	40.6
Financial sector	6.1	5.6	9.0	9.9	9.9	9.9
Non-financial sector	24.0	24.5	25.5	30.7	30.7	30.7
Short-term debt 1/	7.1	9.3	11.1	14.9	11.4	12.0
Residual maturity basis	16.2	17.5	22.5	29.0	21.3	17.7
Total medium- and long-term debt service	**8.2**	**13.7**	**9.8**	**13.5**	**11.5**	**7.0**
Amortization	6.8	12.1	8.2	12.1	9.9	5.6
Interest	1.4	1.5	1.6	1.4	1.6	1.3
	(In percent of GDP)					
Total external debt, end-period 1/	**39.1**	**33.7**	**34.0**	**38.2**	**40.6**	**38.0**
Of which: external private debt	30.8	25.9	26.3	31.1	32.5	30.5
External public debt	8.3	7.8	7.6	7.2	8.1	7.5
Gross change (in percent)	-6.4	-5.4	0.2	4.2	2.4	0.4
Gross change of nominal stock (in percent)	3.3	7.1	17.0	16.3	-5.2	0.9
Interest payments on external debt	1.2	1.1	1.0	0.9	1.1	0.8
	(In percent of exports of goods and services)					
Debt-service payments	17.0	20.6	12.8	17.5	21.3	12.2
Of which: interest	2.9	2.3	2.1	1.9	3.0	2.4
Total external debt outstanding 1/	95.5	74.4	72.7	83.9	113.9	108.6
	(In billions of U.S. dollars)					
Memorandum items:						
Gross international reserves	17.0	19.4	16.9	23.2	25.0	25.0
GDP 2/	118.3	146.8	163.9	169.5	151.3	163.0

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

1/ Original maturity basis; end of period basis.
2/ At current prices and exchange rates.

Table 7. Social and Demographic Indicators

GDP (2008)		**Poverty rate (2006)**	**13.7**
Chilean pesos (billions)	88,535	Indigent	3.2
U.S. dollars (billions)	169	Poor, not indigent	10.5
Per capita (U.S. dollars)	9,784		
Population and Country Information (2006)		**Health**	
Total (in millions)	16.6	Population per physician (2003)	917
Urban population (in percent of total)	87.9	Population per hospital bed (2002)	385
Area (thousand sq. km.)	756.1		
Density (per sq. km)	21.9		
Annual rate of growth, 1997-2007	1.3		
Population characteristics (2005)		**Access to electricity (2003)**	
Life expectancy at birth (years)	78.2	Percent of population	98.9
Crude birth rate (per thousand)	15.3	Urban (2003)	99.7
Crude death rate (per thousand)	5.2	Rural (2003)	74.6
Infant mortality rate (per 1000 births)	8.4		
Mortality rate (ages 1-4, per 1000)	9.5		
Income distribution (2006)		**Access to safe water (2004)**	
Percent of total income received:		Percent of population	n.a.
By richest 10 percent of households	38.6	Urban	n.a.
By poorest 20 percent of households	4.1	Rural	n.a.
Gini coefficient	0.5		
Distribution of labor force, in percent of total (2008)		**Education**	
Agriculture and fishing	10.6	Adult literacy rate (2006)	n.a.
Mining	1.4	Gross enrollment rates, percent of the age group	
Industry	12.0	Primary education (2005)	104
Construction	8.1	Secondary education (2005)	91
Services, Public Utilities, and Trade	67.9	Tertiary education (2005)	48

Sources: Haver Analytics, INE, World Bank, Encuesta CASEN, and staff estimates.

Table 8. Chile: Monetary Survey

	2004	2005	2006	2007	2008	2009 1/
			I. Central Bank (In billions of Chilean Pesos)			
Net international reserves	**8,996**	**8,754**	**10,425**	**8,423**	**14,630**	**13,720**
(In millions of U.S. dollars)	16,064	17,031	19,522	16,982	23,259	24,299
Net domestic assets	**-7,369**	**-6,877**	**-8,276**	**-5,994**	**-11,954**	**-11,226**
Net credit to nonfinancial public sector	3,119	1,987	308	634	738	620
Rest of banking system	-1,775	-2,627	-3,614	-2,470	-3,214	-3,447
Pagares	-11,170	-9,929	-7,945	-7,211	-9,686	-10,454
Other	2,457	3,692	2,975	3,053	208	2,055
Currency	**1,627**	**1,877**	**2,149**	**2,429**	**2,676**	**2,494**
			II. Financial System (In billions of Chilean Pesos)			
Net foreign assets	**7,157**	**6,676**	**8,661**	**6,494**	**11,235**	**10,037**
Net domestic assets	**35,045**	**39,588**	**42,922**	**52,098**	**57,937**	**61,229**
Net credit to nonfinancial public sector	1,553	-1,053	-2,744	-2,965	-3,186	-3,026
Net credit to private sector	36,317	42,589	49,569	59,795	70,827	68,951
Other	-2,825	-1,948	-3,903	-4,732	-9,704	-4,696
Liabilities to the private sector	**42,202**	**46,264**	**51,583**	**58,592**	**69,172**	**71,266**
Money	7,149	7,914	9,221	10,797	11,093	11,908
Quasi-Money	35,053	38,350	42,362	47,795	58,079	59,358
Banks	27,624	31,822	36,778	43,881	51,965	51,897
BCCh's *Pagares* and other	7,429	6,528	5,584	3,914	6,114	7,461
			(12-month percentage change) 2/			
Currency	15.6	15.4	14.5	13.0	10.2	4.3
Money	23.4	10.7	16.5	17.1	2.7	9.0
Quasi-Money	5.5	9.4	10.5	12.8	21.5	18.2
Banks	12.2	15.2	15.6	19.3	18.4	13.1
BCCh's *Pagares* and other	-13.6	-12.1	-14.5	-29.9	56.2	72.3
Net credit to private sector	13.3	17.3	16.4	20.6	18.4	10.1
Memorandum item						
End-of-period exchange rate (Chilean Pesos per US$) 3/	560	514	534	496	629	565

Source: Central Bank of Chile.

1/ Figures correspond to end May 2009 for Central Bank's figures, and to April 2009, for the Financial System's figures.
2/ For 2009, it corresponds to the 12-month change to May 2009 for currency in Circulation, and to the 12-month change to April-2009 for Money, Quasi-Money and Net Credit to the Private Sector.
3/ For 2009, it corresponds to the end-May exchange rate.

Table: 9. Chile. Measures announced by Government

Public investment and consumption

New road, irrigation and housing projects targeting 60000 new jobs (estimated cost USD 700 m).
Transitory tax stamp reduction for 2009-10 (estimated cost USD 628 m).
Transitory increase in forestry benefits (estimated cost USD 28 m).
Capitalization of CODELCO (estimated cost USD 1000 m).
Extraordinary contribution to Municipal Fund to support local communities (estimated cost USD 41 m).

Access to credit and Financial system.

1) Additional support for small and medium size companies.

Double the resources of SMEs Promotion Agency (estimated cost Pesos 3600 m).
Increase the size of micro-finance program (estimated cost Pesos 1500 m).
Expand from 1 to 3 years the term in which tax related debts can be rescheduled.

2) Access to financing from banking system

Increase in the complementary credit limit for subsided housing to 90% from 80% of the house value.
Loosen conditions for CORFO's rescheduling program for SMEs; increase the size limit of eligible companies.
Broaden FOGAPE-eligible transactions; reduce guarantee costs; increase the size limit of eligible companies.
Lower capital requirements for credits guaranteed by government agencies (CORFO, FOGAPE and others).
Amendment of tax norms to allow banks to book provisions and write offs as deductible expenses.
Improve valuation of guaranteed assets; extend period during which guaranteed assets can be transferred.

3) Access to financing from non bank institutions.

Increase the credit capacity of the insurance companies to 3% of the capital requirement (up from 2%).
Facilitate the participation of insurance companies in syndicated loans; promote SME loan securitization; homologation of tax treatment for foreign investors.
Encourage bond financing through favorable tax treatment and special benefits for issuers and investors.
Transitory reduction in monthly tax provision payments for SMEs (estimated cost USD 460 m).
Increase CORFO's resources to support factoring and guarantees for credit rescheduling operations.
Capitalization of *Banco Estado* to boost consumer credit and financing of SMEs.

Employment and social protection

One-time bonus payment of 40000 pesos per household in March and August (estimated cost USD 224 m).
Anticipate (to September 2009) the income tax refund corresponding to FY2010.
Implement a country-wide subsidy for public transportation, subject to parliamentary approval.
Subsidies to encourage employment among 18-24 years old (estimated cost USD 102 m)
Allow the netting of training expenditures in provisional tax payment (PPM) (estimated cost USD 147 m).
Implementation of the Pension Reform in advance to increase coverage to 45% (up from 40%).
Extend CORFO guarantees to higher education institutions offering financial aid to students in unemployed families; 15000 new scholarships for low-income students; distribution of 90000 computers in 2009-10.
Mortgage insurance for those unemployed for more than two months; extension of unemployment benefits to temporary workers.

Broaden social programs to cover 60% (up from 40%) of children in most vulnerable sectors by 2011.
Tax exemptions to encourage training of prospective workers; allow leave for training at a reduced salary as an alternative to dismissal; assessment of acquired knowledge by technical institutions; increase resources for working women scholarship program.
Specific tax to gasoline: tax burden on gasoline will be fixed at a new limit established by law.

Source: Ministry of Finance, Chile.

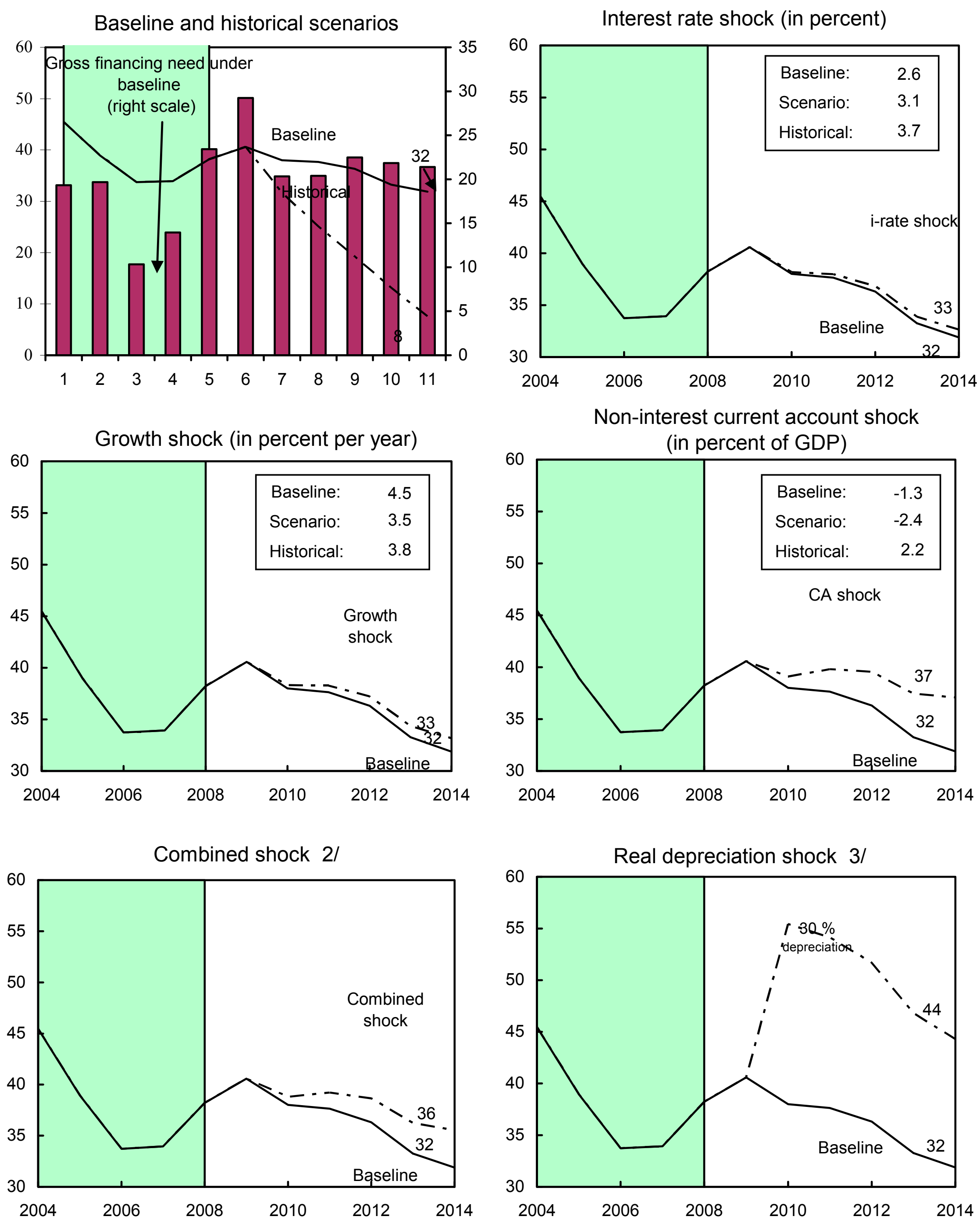
ANNEX CHILE—DEBT SUSTAINABILITY ANALYSIS

Chile improved its net public creditor position in 2008. Gross public sector debt fell to 5 percent of GDP in 2008, and public sector assets held in the wealth funds increased to 16 percent of GDP.

Due to Chile's large public sector assets, the sustainability of public sector debt is not an issue. Notwithstanding the current financial crises, the structural surplus rule has resulted in large fiscal savings over the past several years of high copper prices that have helped build important buffers, thus ensuring financing needs. Additional financing needs stemming from a worse macroeconomic outlook could be covered by the country's Fund for Economic and Social Stabilization as these extrapolate measures that are transitory in nature (like one-off direct transfers and subsidies to low-income families, and housing) or that accelerate the implementation of reforms (like pension reform). Public debt would be sensitive to a large depreciation of the peso but is projected level would still remain low.

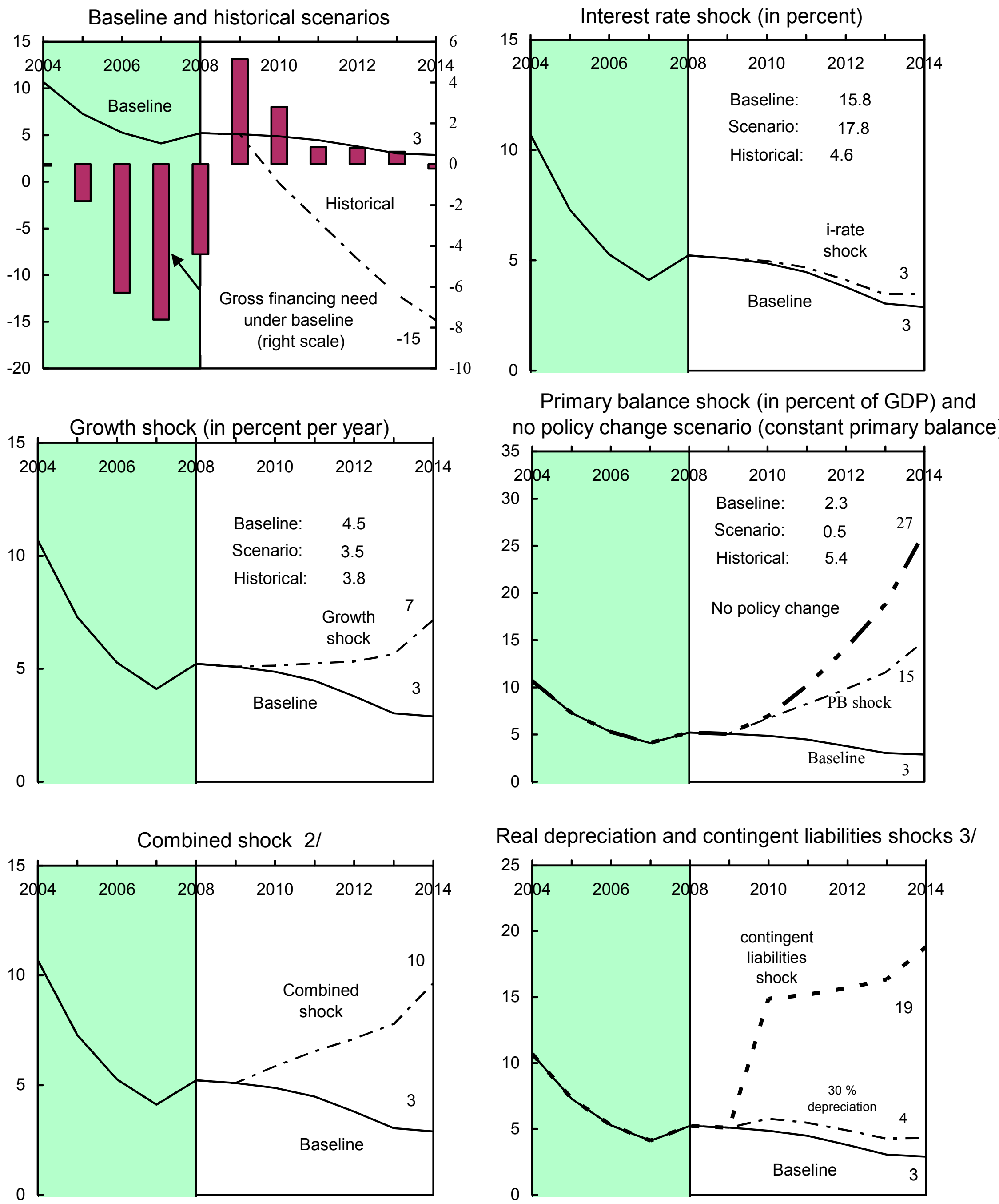
The dynamics of Chile's external debt are relatively stable to shocks. Total external debt increased to 38 percent in 2008 from 34 percent in 2007. FDI flows and substantial withdrawals from the country's sovereign wealth fund are expected to account for a substantial proportion of necessary financing of the projected current account deficits in 2009. Debt levels are not unduly responsive to growth or interest-rate shocks, but are somewhat sensitive to a depreciation of the peso, as all of Chile's external debt is denominated in foreign currency.

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



Sources: International Monetary Fund, Country desk data, and staff estimates.
1/ Shaded areas represent actual data. Individual shocks are permanent one-half standard deviation shocks. Figures in the boxes represent average projections for the respective variables in the baseline and scenario being presented. Ten-year historical average for the variable is also shown.
2/ Permanent 1/4 standard deviation shocks applied to real interest rate, growth rate, and current account balance.
3/ One-time real depreciation of 30 percent occurs in 2009.

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



Sources: International Monetary Fund, country desk data, and staff estimates.

1/ Shaded areas represent actual data. Individual shocks are permanent one-half standard deviation shocks. Figures in the boxes represent average projections for the respective variables in the baseline and scenario being presented. Ten-year historical average for the variable is also shown.

2/ Permanent 1/4 standard deviation shocks applied to real interest rate, growth rate, and primary balance.

3/ One-time real depreciation of 30 percent and 10 percent of GDP shock to contingent liabilities occur in 2009, with real depreciation defined as nominal depreciation (measured by percentage fall in dollar value of local currency) minus domestic inflation (based on GDP deflator).

Table 1. Chile: External Debt Sustainability Framework, 2004-2014
(In percent of GDP, unless otherwise indicated)

		Actual					Projections						
		2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	Debt-stabilizing non-interest current account 6/
1	**Baseline: External debt**	45.5	39.0	33.7	33.9	38.2	**40.6**	**38.0**	**37.6**	**36.3**	**33.3**	**31.9**	**-7.6**
2	Change in external debt	-12.5	-6.5	-5.2	0.2	4.3	2.4	-2.6	-0.4	-1.3	-3.0	-1.4	
3	Identified external debt-creating flows (4+8+9)	-22.8	-17.1	-17.3	-15.8	-10.1	0.2	-3.4	-5.6	-7.0	-6.8	-6.7	
4	Current account deficit, excluding interest payments	-3.5	-2.4	-5.9	-5.3	1.2	1.9	2.1	1.6	1.0	1.0	1.0	
5	Deficit in balance of goods and services	-71.3	-73.0	-75.6	-79.6	-86.3	-70.1	-69.4	-74.9	-80.2	-80.1	-82.5	
6	Exports	40.3	40.8	45.3	46.7	45.6	35.6	35.0	37.8	39.6	39.5	40.5	
7	Imports	-31.0	-32.2	-30.2	-32.9	-40.7	-34.4	-34.4	-37.1	-40.5	-40.7	-42.1	
8	Net non-debt creating capital inflows (negative)	-7.5	-7.2	-4.9	-7.9	-11.0	-3.1	-5.0	-6.4	-7.3	-7.0	-7.1	
9	Automatic debt dynamics 1/	-11.8	-7.5	-6.5	-2.6	-0.3	1.4	-0.5	-0.7	-0.7	-0.7	-0.6	
10	Contribution from nominal interest rate	1.3	1.2	1.1	1.0	0.9	1.1	0.8	0.8	1.1	1.0	1.0	
11	Contribution from real GDP growth	-2.7	-2.0	-1.4	-1.4	-1.0	0.3	-1.4	-1.4	-1.7	-1.7	-1.6	
12	Contribution from price and exchange rate changes 2/	-10.4	-6.6	-6.1	-2.1	-0.1	...	...	...	...	...	...	
13	Residual, incl. change in gross foreign assets (2-3) 3/	10.3	10.6	12.1	16.0	14.4	2.2	0.8	5.2	5.6	3.7	5.4	
	External debt-to-exports ratio (in percent)	112.9	95.5	74.4	72.7	83.9	113.9	108.6	99.6	91.6	84.3	78.8	
	Gross external financing need (in billions of US dollars) 4/	18.5	23.4	15.2	22.9	39.7	44.2	33.1	34.0	39.0	40.9	41.9	
	in percent of GDP	19.3	19.7	10.4	13.9	23.4	29.2	20.3	20.4	22.5	21.8	21.4	
	Scenario with key variables at their historical averages 5/						**40.6**	**31.7**	**25.1**	**19.2**	**13.1**	**7.6**	**-7.6**
	Key Macroeconomic Assumptions Underlying Baseline												
	Real GDP growth (in percent)	6.0	5.6	4.6	4.7	3.2	-0.7	3.6	3.9	4.8	5.0	5.0	
	GDP deflator in US dollars (change in percent)	21.9	17.1	18.7	6.7	0.2	-10.0	4.0	-1.6	-0.8	3.0	-0.4	
	Nominal external interest rate (in percent)	3.0	3.3	3.4	3.2	2.6	2.5	2.2	2.0	3.0	3.0	3.0	
	Growth of exports (US dollar terms, in percent)	44.2	25.5	37.4	15.2	0.8	-30.2	5.9	10.4	9.0	7.6	7.3	
	Growth of imports (US dollar terms, in percent)	25.8	28.7	16.0	21.6	27.9	-24.5	7.5	10.4	13.6	8.6	8.1	
	Current account balance, excluding interest payments	3.5	2.4	5.9	5.3	-1.2	-1.9	-2.1	-1.6	-1.0	-1.0	-1.0	
	Net non-debt creating capital inflows	7.5	7.2	4.9	7.9	11.0	3.1	5.0	6.4	7.3	7.0	7.1	

1/ Derived as $[r - g - \rho(1+g) + \varepsilon\alpha(1+r)]/(1+g+\rho+g\rho)$ times previous period debt stock, with r = nominal effective interest rate on external debt; ρ = change in domestic GDP deflator in US dollar terms, g = real GDP growt
ε = nominal appreciation (increase in dollar value of domestic currency), and α = share of domestic-currency denominated debt in total external debt.

2/ The contribution from price and exchange rate changes is defined as $[-\rho(1+g) + \varepsilon\alpha(1+r)]/(1+g+\rho+g\rho)$ times previous period debt stock. ρ increases with an appreciating domestic currency ($\varepsilon > 0$) and rising inflation (t

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 2. Chile: Public Sector Debt Sustainability Framework, 2004-2014
(In percent of GDP, unless otherwise indicated)

		Actual					10-Year Historical Average	10-Year Standard Deviation	Projections						
		2004	2005	2006	2007	2008			2009	2010	2011	2012	2013	2014	Debt-stabilizing primary balance 9/
1	**Baseline: Public sector debt 1/**	10.7	7.3	5.3	4.1	5.2			**5.1**	**4.9**	**4.5**	**3.8**	**3.0**	**2.9**	**0.6**
	o/w foreign-currency denominated	9.0	5.2	3.6	2.1	2.1			1.8	1.7	1.5	1.0	0.5	0.4	
2	Change in public sector debt	-2.3	-3.4	-2.0	-1.2	1.1			-0.1	-0.2	-0.4	-0.7	-0.8	-0.2	
3	Identified debt-creating flows (4+7+12)	-6.3	-8.6	-10.5	-11.5	-6.9			2.1	-0.3	-1.8	-2.1	-2.3	-2.8	
4	Primary deficit	-5.0	-7.5	-10.3	-11.4	-7.8			1.4	-0.6	-2.1	-2.6	-2.8	-3.4	
5	Revenue and grants	23.9	25.9	27.7	29.5	28.5			23.8	24.6	24.7	24.8	24.5	24.8	
6	Primary (noninterest) expenditure	19.0	18.4	17.4	18.1	20.6			25.2	24.0	22.6	22.3	21.7	21.5	
7	Automatic debt dynamics 2/	-1.4	-1.1	-0.2	-0.1	1.0			0.6	0.3	0.3	0.5	0.4	0.6	
8	Contribution from interest rate/growth differential 3/	-0.6	-0.4	-0.4	0.1	0.4			0.6	0.3	0.3	0.5	0.4	0.6	
9	Of which contribution from real interest rate	0.1	0.1	-0.1	0.4	0.5			0.6	0.5	0.4	0.7	0.6	0.7	
10	Of which contribution from real GDP growth	-0.7	-0.5	-0.3	-0.2	-0.1			0.0	-0.2	-0.2	-0.2	-0.2	-0.1	
11	Contribution from exchange rate depreciation 4/	-0.7	-0.7	0.2	-0.3	0.6			...	...	...	...	...	...	
12	Other identified debt-creating flows	0.0	0.0	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0	
13	Privatization receipts (negative)	0.0	0.0	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0	
14	Recognition of implicit or contingent liabilities	0.0	0.0	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0	
15	Other (specify, e.g. bank recapitalization)	0.0	0.0	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0	
16	Residual, including asset changes (2-3) 5/	4.0	5.2	8.5	10.4	8.0			-2.2	0.1	1.4	1.4	1.6	2.6	
	Public sector debt-to-revenue ratio 1/	44.7	28.1	19.0	13.9	18.3			21.4	19.8	18.1	15.3	12.4	11.6	
	Gross financing need 6/	-0.1	-1.8	-6.3	-7.6	-4.4			5.2	2.8	0.8	0.8	0.6	-0.2	
	in billions of U.S. dollars	-0.1	-2.1	-9.2	-12.5	-7.5			7.8	4.6	1.4	1.4	1.1	-0.4	
	Scenario with key variables at their historical averages 7/								**5.1**	**-0.2**	**-4.2**	**-8.3**	**-12.1**	**-14.9**	**-0.1**
	Scenario with no policy change (constant primary balance) in 2009-2014								**5.1**	**6.9**	**10.2**	**14.1**	**18.8**	**26.5**	**5.2**
	Key Macroeconomic and Fiscal Assumptions Underlying Baseline														
	Real GDP growth (in percent)	6.0	5.6	4.6	4.7	3.2	3.8	1.8	-0.7	3.6	3.9	4.8	5.0	5.0	
	Average nominal interest rate on public debt (in percent) 8/	8.4	8.9	11.2	12.7	12.5	10.0	1.7	8.8	10.0	13.5	17.7	20.7	25.2	
	Average real interest rate (nominal rate minus change in GDP deflator, in percent)	1.0	1.4	-1.2	7.6	12.3	4.6	4.1	11.3	10.0	9.6	15.9	17.7	25.7	
	Nominal appreciation (increase in US dollar value of local currency, in percent)	7.1	8.9	-3.8	7.8	-21.2	-2.1	12.3	...	...	...	...	...	...	
	Inflation rate (GDP deflator, in percent)	7.5	7.6	12.4	5.1	0.2	5.3	3.4	-2.5	0.1	3.8	1.8	3.0	-0.4	
	Growth of real primary spending (deflated by GDP deflator, in percent)	1.2	2.6	-1.1	8.6	17.9	4.5	5.9	21.3	-1.6	-2.2	3.4	2.6	3.8	
	Primary deficit	-5.0	-7.5	-10.3	-11.4	-7.8	-5.4	3.6	1.4	-0.6	-2.1	-2.6	-2.8	-3.4	

1/ Indicate coverage of public sector, e.g., general government or nonfinancial public sector. Also whether net or gross debt is used.

2/ Derived as $[(r - \pi(1+g) - g + \alpha\varepsilon(1+r)]/(1+g+\pi+g\pi))$ times previous period debt ratio, with r = interest rate; π = growth rate of GDP deflator; g = real GDP growth rate; α = share of foreign-currency denominated debt; and ε = nominal exchange rate depreciation (measured by increase in local currency value of U.S. dollar).

3/ The real interest rate contribution is derived from the denominator in footnote 2/ as $r - \pi(1+g)$ and the real growth contribution as -g.

4/ The exchange rate contribution is derived from the numerator in footnote 2/ as $\alpha\varepsilon(1+r)$.

5/ For projections, this line includes exchange rate changes.

6/ Defined as public sector deficit, plus amortization of medium and long-term public sector debt, plus short-term debt at end of previous period.

7/ The key variables include real GDP growth; real interest rate; and primary balance in percent of GDP.

8/ Derived as nominal interest expenditure divided by previous period debt stock.

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.

INTERNATIONAL MONETARY FUND

CHILE

Staff Report for the 2009 Article IV Consultation—Informational Annex

Prepared by the Western Hemisphere Department

July 8, 2009

Contents Page

Appendixes

APPENDIX 1. CHILE: FUND RELATIONS
(As of May 31, 2009)

I. Membership Status: Joined: December 31, 1945; Article VIII

II. General Resources Account:	**SDR Million**	**Percent Quota**
Quota	856.10	100.00
Fund holdings of currency	747.69	87.34
Reserve Position	108.41	12.66
Holdings Exchange Rate	...	...

III. SDR Department:	**SDR Million**	**Percent Allocation**
Net cumulative allocation	121.92	100.00
Holdings	36.74	30.13

IV. Outstanding Purchases and Loans: None

V. 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

VI. Projected Payments to Fund (in SDR Million)

			Forthcoming		
	2009	2010	2011	2012	2013
Principal					
Charges/Interest	0.19	0.40	0.40	0.40	0.40
Total	0.19	0.40	0.40	0.40	0.40

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.

VII. Implementation of HIPC Initiative: Not Applicable.

VIII. Implementation of Multilateral Debt Relief Initiative (MDRI): Not Applicable.

APPENDIX 2. CHILE—STATISTICAL ISSUES APPENDIX

As of June 5, 2009

I. 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 also publishes comprehensive macroeconomic and financial data. Key publicly accessible websites for macroeconomic data and analysis are: National Institute of Statistics: http://www.ine.cl/canales/chile_estadistico/home.php Central Bank of Chile: http://www.bcentral.cl/ Ministry of Finance: http://www.hacienda.cl/	
II. Data Standards and Quality	
Subscriber to the Fund's Special Data Dissemination Standard (SDDS) since May 17, 1996.	A data ROSC was published September 17, 2007.

Chile: Table of Common Indicators Required for Surveillance

As of June 5, 2009

	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	June 4, 2009	June 5, 2009	D	D	D		
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	May 23, 2009	June 1, 2009	W	W	W		
Reserve/Base Money	May 2009	May 25, 2009	M	M	M	O, O, LO, O	O, O, O, LO, O
Broad Money	May 2009	May 25, 2009	M	M	M		
Central Bank Balance Sheet	April 2009	May 25, 2009	M	M	M		
Consolidated Balance Sheet of the Banking System	April 2009	May 25, 2009	M	M	M		
Interest Rates[2]	June 4,2009	June 5, 2009	D	D	D		
Consumer Price Index	May 2009	June 5, 2009	M	M	M	LO, LNO, LNO, LO	LO, LO, LO, O, LO
Revenue, Expenditure, Balance and Composition of Financing[3] – General Government[4]	Q1 2009	April 30, 2009	Q	Q	Q	O, LO, LNO, LO	LO, O, O, LO, O
Revenue, Expenditure, Balance and Composition of Financing3– Central Government	April 2009	May 30, 2009	M	M	M		
Stocks of Central Government and Central Government – Guaranteed Debt[5]	December 2008	March 31, 2009	A	Q	Q		
External Current Account Balance	May 15, 2009	June 1, 2009	W	W	W	O, O, LO, LO	O, O, O, O, O
Exports and Imports of Goods and Services	May 15, 2009	June 1, 2009	W	W	W		
GDP/GNP	Q1 2009	May 18, 2009	Q	Q	Q	O, LO, LO, LO	LO, LO, LO, LO, O
Gross External Debt	March 2009	May 25, 2009	M	M	M		
International Investment position[10]	Q1 2009	May 25, 2009	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.

APPENDIX 3. CHILE: WORLD BANK—FUND COUNTRY-LEVEL WORK PROGRAM UNDER JMAP

Title	Products	Provisional timing of Missions	Expected delivery date
A. Mutual information on relevant work programs			
Bank work program in next 12 months	**A. Lending**		
	1. Chile Social Protection Technical Assistance Project Additional Financing (P114774) (TTL: Theresa Jones)		May 2009
	2. Chile State Modernization (P083866) (TTL: Fernando Rojas)		December 2009
	B. ESW		
	1. Higher Education Report with OECD (P106874) (TTL: Michael F. Crawford)		February 2009
	2. Programmatic DPR - Poverty Country: Chile (P094879) (TTL: Molinas Vega J)		June 2009
	C. Technical Assistance		
	1. Chile Policy Assessment - Lessons from OECD Experience (P115377) (TTL: Fernando Rojas)		December 2008
	2. Chile Gender Equity in Private Sector (P111824) (TTL: Castro-Munoz M)		December 2008
	3. Environmental and Compliance Strategy for the Superintendencia in Chile (P111436) (TTL: Belausteguigoi)		February 2009
	4. Technical Collaboration for the Implementation and Evaluation of the School Preferential Subsidy in Chile (P111888) (TTL: Vegas Emiliana)		February 2009

Title	Products	Provisional timing of Missions	Expected delivery date
	5. Management Models and Development of New Education Institutions in Chile (P111889) (TTL: Vegas Emiliana) 6. Chile (FBS) Innovation (P114196) (TTL: Lasagabaster E) 7. Chile Support for the Development of a National Energy Efficiency Program (P112532) (TTL: Lucia Spinelli) 8. CL (FBS) Design of Educ. Institutions - phase 2 (P106750) (TTL: Vegas Emiliana) 9. CL (FBS) School Preferential Subsidy (P115260) (TTL: Vegas Emiliana) 10. CORFO (FFS) Evaluation of Foreign Investment Program for High Technology Sectors (P116019) (TTL: Esperanza Lasagabaster)		February 2009 April 2009 July 2009 October 2009 December 2009 January 2010
IMF work program in next 12 months	***Technical Assistance*** 1. Strategic Asset Allocation for SFWs ***Article IV Consultation*** ***Staff visit***	 June 2008 April 2008 December 2008	 June 2008 July 28, 2008 -
B. Requests for work program inputs (as needed)			
Fund request to Bank (with summary justification)	None		
Bank request to Fund (with summary justification)	None		
C. Agreement on joint products and missions (as needed)			
Joint products in next 12 months	None		

Statement by the IMF Staff Representative on Chile
July 22, 2009

1. This statement provides additional information that has become available since the circulation of the staff report. It does not alter the thrust of the staff appraisal.

2. **In its July 9 policy meeting, the Central Bank of Chile (BCCh) lowered its policy interest rate and adopted alternative means of monetary policy easing.** The BCCh reduced the policy rate by 25 basis points, to ½ percent, and noted that it would leave the policy rate at this level for a prolonged period of time to support inflation returning to the 3 percent target over the policy horizon. The BCCh also announced complementary measures to better align market rates with the policy rate; including the establishment of a short-term liquidity facility to allow borrowing by banks at the policy rate for 90-180 days; the adjustment of the issuance of short-term bank notes to preserve its consistency with the new liquidity facility, and the suspension of the previously planned issuances of 1-year notes and 2-year nominal bonds for the remainder of 2009. As a result of these measures, interbank interest rates for up to 180 days have converged to the policy interest rate and yields for BCCh bonds have declined.

3. **There has been progress in advancing the agenda for strengthening corporate governance in public sector enterprises and for improving coordination among supervisory agencies**. The reform project for improving CODELCO's corporate governance is in its final stages of approval by the Senate. On July 7, the Superintendency of Banks and Financial Institutions announced that the Committee of Superintendents had signed an MOU to strengthen coordination among the supervisory agencies overseeing financial institutions, pension funds, and securities markets.

INTERNATIONAL MONETARY FUND
Public Information Notice
EXTERNAL RELATIONS DEPARTMENT

Public Information Notice (PIN) No. 09/111
FOR IMMEDIATE RELEASE
September 9, 2009

International Monetary Fund
700 19th Street, NW
Washington, D. C. 20431 USA

IMF Executive Board Concludes 2009 Article IV Consultation with Chile

On July 22, 2009, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with Chile.[1]

Background

The Chilean economy has proved resilient in the face of the global financial crisis. The sound policy framework, underpinned by an inflation target regime, a structural budget rule, and a flexible exchange rate, allowed the economy to enter the crisis with a fundamentally robust position. Large fiscal savings accumulated in past years have been critical to preserve stability and cover financing needs, while the imbalances in the financial and corporate sectors witnessed elsewhere have been absent.

Being highly integrated to the global economy, the global crisis transmitted quickly through trade and financial linkages. Real GDP slowed markedly in the fourth quarter of 2008 and contracted in the first quarter of 2009. Inflationary pressures eased considerably due to the weak domestic demand and the decline in food and energy prices, with the 12-month inflation rate falling from 9.9 percent in October 2008 to 2 percent by June 2009. Weak demand from main trading partners and lower copper prices resulted in an external current account deficit of 2 percent of GDP in 2008. However, the sharp compression of imports that accompanied the decline in domestic demand, shifted the current account into a projected surplus in 2009.

The policy response to the crisis has been sizable, well balanced and coordinated. Liquidity support measures have helped preserve financial stability. Since early 2009, the Central Bank of Chile cut the policy rate by 775 basis points, to an historic low of ½ percent, and the government

[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. At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities.

announced a stimulus package of 2.9 percent of GDP comprising higher public investment, transitory tax reductions and direct transfers and subsidies to low income households. In July, the Central Bank of Chile announced complementary measures to better align market rates with the policy rate; including the establishment of a liquidity facility at the monetary policy rate with tenors of up to six months; adjustments to the issuance of short-term central bank notes to ensure consistency with the new liquidity facility; and the suspension for the remainder of 2009 of the previously-planned issuances of 1-year notes and 2-year nominal bonds.

The government also adopted additional measures to foster employment and credit, and promote competition in the financial system. Fiscal measures are to be financed through the issuance of new government debt and with resources from the Economic and Social Stabilization Fund. The central bank has adjusted its debt management program for 2009 to offset any impact of the government's additional financing needs. The government also has advanced structural reforms in the financial sector and domestic capital markets to strengthen the supervisory framework, as well as to bring forward the implementation of the reform of the pension system.

The 2009-10 outlook remains highly dependent on the external environment, in particular the speed of the global recovery and its impact on commodity prices. A further deterioration of global conditions would impinge on the pace of the domestic recovery and affect expectations on growth and income prospects in the near term. Nevertheless, the Chilean economy is well placed for an early return to sustained growth on the heels of the strong countercylical measures adopted by the authorities and the expected recovery of its main trading partners.

Executive Board Assessment

Executive Directors commended the Chilean authorities for their sound policy framework underpinned by an inflation target regime, a structural budget rule, and a flexible exchange rate regime. As a result of this strong framework and the authorities' track record of exemplary policies, Chile's economy is well placed to face the global crisis, which has caused a sharp deterioration in economic performance since the last quarter of 2008. Directors welcomed the authorities' vigorous, well balanced, and coordinated policy response, which they viewed as critical for preserving financial and macroeconomic stability. While macroeconomic conditions have begun to stabilize in the second quarter of 2009, Directors noted that Chile's near-term growth prospects are affected by the high uncertainty surrounding the timing and pace of the global recovery.

Directors endorsed the Central Bank of Chile's decision to implement alternative means of monetary easing to support activity and a return of inflation to the target, noting the staff's assessment that the exchange rate is broadly in line with fundamentals.

Directors welcomed the countercyclical fiscal stimulus, and recommended caution when deciding to withdraw such stimulus, encouraging the authorities to consider extending several revenue measures through end-2010, if needed. Once the recovery is well entrenched, Directors saw scope for unwinding those measures and specifying a structural target to preserve fiscal credibility and address long-term fiscal pressures.

Directors encouraged the authorities to consider extending the horizon for fiscal policy formulation and focusing on the level and growth in public per capita spending relative to income per capita, and its implications for net public assets. They commended the authorities for the significant progress in dealing with contingent liabilities, and welcomed their commitment to assess the fiscal impact of long-term liabilities related to pensions and central bank recapitalization, as prescribed by the Fiscal Responsibility Law. Directors encouraged the authorities to sustain reforms to lower the cost of doing business and to further promote formal employment.

Directors praised the authorities for their sound prudential and supervisory framework and for the progress in advancing reforms to deepen domestic capital markets. They noted that Chile's capital markets have been a resilient source of corporate financing during the global crisis, and welcomed efforts aimed at facilitating foreign participation and market access for small and medium-sized firms. Directors suggested that the authorities consider keeping some new liquidity instruments and facilities even after the turbulence subsides. With credit risks expected to rise, Directors recommended that the authorities continue assessing the effectiveness of the models banks use to determine provisioning levels, and explore options to reduce their procyclicality. They also encouraged the authorities to consider broadening the perimeter of regulation to non-bank institutions outside the direct purview of the supervisory authorities.

Public Information Notices (PINs) form part of the IMF's efforts to promote transparency of the IMF's views and analysis of economic developments and policies. With the consent of the country (or countries) concerned, PINs are issued after Executive Board discussions of Article IV consultations with member countries, of its surveillance of developments at the regional level, of post-program monitoring, and of ex post assessments of member countries with longer-term program engagements. PINs are also issued after Executive Board discussions of general policy matters, unless otherwise decided by the Executive Board in a particular case.

Table 1. Chile: Selected Social and Economic Indicators

I. Social and Demographic Indicators

GDP (2008)	88,595	**Poverty rate (2006)**	13.7
U.S. dollars (billions)	172.7	Indigent	3.2
Per capita (U.S. dollars)	10,308	Poor, not indigent	10.5
Population characteristics (2008)		**Income distribution (2006)**	
Total (in millions)	16.7	Richest 10% of households	38.6
Urban population (percent of total)	n.a.	Poorest 20% of households	4.1
Life expectancy at birth (years)	n.a.	Gini coefficient	0.54

II. Economic Indicators

					Projections	
	2005	2006	2007	2008	2009	2010
(Annual percentage change, unless otherwise specified)						
National accounts and employment						
Real GDP	5.6	4.6	4.7	3.2	-0.7	3.6
Total domestic demand	10.4	6.8	7.8	7.4	-3.0	2.6
Consumption	7.1	7.0	7.1	4.2	1.7	1.3
Private	7.4	7.1	6.9	4.3	0.5	1.1
Public	5.9	6.4	8.0	4.0	8.1	2.1
Investment	21.7	6.2	9.9	17.0	-15.8	6.7
Private	25.6	1.3	10.4	21.1	-15.2	5.1
Public	10.8	12.0	24.9	7.9	32.2	-13.4
Fixed	23.9	2.3	12.0	19.5	-10.0	2.1
Inventories 1/	-0.3	1.0	-0.4	-0.5	-1.8	1.1
Net exports 1/	-4.5	-2.3	-3.4	-4.8	2.6	0.8
Consumer prices						
End of period	3.7	2.6	7.8	7.1	0.8	2.5
Average	3.1	3.4	4.4	8.7	2.2	2.7
Unemployment rate (annual average)	9.3	8.0	7.0	7.8	...	...
Money and credit						
Broad money	11.9	11.4	14.7	19.1	...	...
Credit to the private sector (end of period)	19.9	17.7	20.8	8.2	...	...
(In percent of GDP, unless otherwise specified)						
External Debt and Balance of Payments						
Current account	1.2	4.9	4.4	-2.0	-3.0	-2.9
Trade Balance (in US bn)	10.8	22.8	23.6	8.8	2.3	1.5
Exports of goods (in US bn)	41.3	58.7	67.7	66.5	45.9	48.6
Imports of goods (in US bn)	30.5	35.9	44.0	57.6	43.6	47.1
Gross external debt	39.1	33.7	34.0	38.2	40.6	38.0
Public	8.3	7.8	7.6	7.2	8.1	7.5
Private	30.8	25.9	26.3	31.1	32.5	30.5
Gross international reserves (in US bn) 4/	17.0	19.4	16.9	23.2	24.0	...
(Annual percentage change)						
Terms of Trade	10.8	31.1	3.6	-15.1	-8.4	-5.9
Real Effective Exchange Rate (eop)	16.0	-7.1	3.6	-12.9	...	...
(In percent of GDP)						
Savings and investment						
Gross domestic investment	22.2	20.2	21.2	24.7	21.3	21.7
Public	2.1	2.0	2.4	2.6	3.6	3.1
Private	20.1	18.1	18.8	22.1	17.7	18.6
National saving	23.4	25.0	25.5	22.6	18.3	18.8
Public 2/	5.7	10.6	10.8	11.9	0.7	2.2
Private	17.7	14.4	14.8	10.3	18.0	16.5
Public sector finance						
Net Debt	11.8	0.2	-8.3	-14.7	-6.2	-4.8
Excluding public enterprises	2.5	-4.3	-10.8	-21.0	-12.8	-11.5
Public sector gross debt 3/	34.9	25.7	24.1	22.9	24.9	24.3
Central government gross debt	7.3	5.3	4.1	5.2	5.1	4.9
Central government balance	4.6	7.7	8.8	5.3	-4.1	-2.1

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

1/ Contribution to growth.

2/ Gross saving of the general government sector, including the deficit of the central bank.

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

4/ Data as of May 2009.

Statement by Pablo Pereira, Executive Director for Chile and Alvaro Rojas, Advisor to Executive Director
July 22, 2009

1. Our authorities would like to thank the staff for the Staff Report and Selected Issues papers and for the thorough discussions on the impact of the international crisis on the Chilean economy, as well as on the policy responses to mitigate its impact on domestic and external stability. Such discussions were undertaken in a collaborative dialogue with the Fund, which became even more relevant given the current global crisis, and reflect the permanent dialogue on policy issues that has characterized the relationship between Chile and the Fund. Given the high degree of integration of the Chilean economy with the world, the marked global downturn of the last quarter of 2008 had a direct impact, changing rapidly the outlook on domestic economic activity, employment, and inflation. However, given the changes in the outlook stemming from these shocks, Chile's rules-based policy framework has been instrumental. It has provided high flexibility in terms of the significant policy responses undertaken by our authorities to mitigate the impact of the global crisis, so as to secure domestic and external stability under exceptionally uncertain times.

Impact of the Global Crisis

2. In 2008, Chile's output grew 3.2 percent, below potential output. The pace over the year showed the sharp impact on confidence of the changing global conditions. During the fourth quarter of 2008, the economy showed a sharp slump, driven by the impact on expectations and confidence of the drastic worsening of the global scenario. Thus, inventory accumulation, house sales, and imports of durables all fell sharply. The tightening of credit conditions and postponements of investment projects affected industrial output and construction (although this sector has been less affected by the crisis than in previous episodes), while lower oil prices and improved hydrological conditions provided some cost relief in terms of energy costs. During the first quarter of 2009, economic activity remained contracting, and preliminary data on the second quarter confirms a moderate contraction in output for the first half of 2009. In line with these developments, unemployment has recently risen slightly above 10 percent due mostly to a significant contraction in employment since the fourth quarter of 2008.

3. In light of these developments, the Banco Central de Chile's (BCC) output growth forecast for 2009 was recently decreased to a range between -0.75 to 0.25 percent, with the balance of risks tilted to the downside. Thus, this downward revision shows the materialization of downside risks, due to a worsening external environment stemming from the recession in the world economy as well as the unresolved complications from the financial crisis and the remaining uncertainties associated with it. The main downside risks are related to the contraction in global growth and how it will impact emerging economies, which include the size and extension of the recession in the U.S. and other trading partners,

the possibility of new, unfavorable, shifts in the prices of copper and/or oil, as well as protracted global uncertainty and lack of confidence.

4. Over most of 2008, annual CPI inflation increased steadily, reaching a peak of 9.9 percent in October. However, the marked and synchronized downturn in the world economy during the fourth quarter triggered a significant shift in the inflation path, characterized by a rapid and steady decline. As a result, inflation decelerated rapidly, and it reached the 3 percent target much earlier than initially envisaged. Given that the output gap is expected to remain negative for some time as potential output is estimated by the Central Bank to be in a range of 4.5 to 5 percent, CPI inflation is expected to remain below the target range in the second half of 2009, converging back to 3 percent by 2010. In line with these developments, the BCC revised downward its inflation forecast to 0.6 percent for year on year inflation by end December 2009, and to 2.3 percent for average inflation in 2009.

5. Given the impact of the global crisis on the Chilean economy as described above, our authorities have undertaken significant and decisive policy responses in terms of monetary policy, fiscal policy, as well as policies to sustain the flow of credit to businesses and individuals in the downturn of the cycle, in order to mitigate as much as possible the direct impact of the global downturn. These policy responses have been possible due to the prevailing sound policy frameworks, which have been instrumental in providing the adequate setup to implement monetary and fiscal stimulus when needed in order to confront the worst global downturn in decades.

Monetary Policy

6. The change in the expected path for inflation, with a much faster convergence towards the target, warranted a shift in monetary policy towards an easing of the monetary policy stance. Therefore, since January of 2009, the Central Bank has aggressively lowered the monetary policy interest rate, with marked reductions in January (100 basis points), February and March (250 basis points each month), and more gradual reductions since April. In the latest meeting of the BCC's Monetary Policy Meeting in July, the BCC lowered the monetary policy rate by an additional 25 basis points, thus lowering the policy rate by a cumulative 775 basis points, bringing it to a level of 0.5 percent in July of 2009. Such aggressive monetary stimulus is unprecedented under the existing inflation targeting framework in terms of both the speed of adjustment and the level of the policy rates. It also reflects the authorities' views that a sizeable monetary stimulus was needed to secure the attainment of the inflation target over the policy horizon.

7. During its Monetary Policy Meeting in July, the BCC also noted in its communiqué that the level of 0.5 percent for the monetary policy rate should be considered the lower bound for the policy rate, and highlighted that given the inflation forecast and the need to maintain monetary stimulus for some time, the policy rate will remain at this lower bound for an extended period of time. In order to reinforce this decision, and to enhance the alignment

of the prices of financial assets with the current monetary policy stance, the BCC announced the introduction a new liquidity facility, the Term Liquidity Facility (TLF) to provide liquidity to banks at the current policy rate for terms of 90 and 180 days. The purpose of this new facility is to effectively extend the current monetary stance throughout the yield curve up to 6 months. The collateral required for this type of operations is the same as those used for the use of the overnight liquidity facility. In addition to the TLF, the BCC also announced an adjustment to the issuance of its short-term notes with a maturity of less than 1 year, and to suspend the issuance of bonds with a maturity of 1 year or more. The BCC also noted that these measures will remain in place as long as needed, and will remain vigilant by evaluating on a permanent basis the need of other complementary measures.

Fiscal Policy

8. In line with the implementation of the structural budget rule and due to continuing high copper prices during most of 2008, the Chilean central government posted an overall surplus of 5.2 percent of GDP in 2008, with a real decrease of 8.1 percent in revenues, while public expenditure grew 7.8 percent in real terms in the same period. In order to manage windfall revenues prudently and in consistence with the Fiscal Responsibility Law, the Chilean government continued saving the surpluses into the Economic and Social Stabilization Fund (ESSF), which as of December 2008 had accumulated USD 20.2 billion. Surpluses have also been saved into the Pension Reserve Fund, in the amount of USD 2.5 billion. The government initially submitted the 2009 budget to Congress, which provided for public expenditure growth of 5.7 percent in real terms, a slower pace relative to recent years, but effectively increasing social spending in health, education, innovation, and social housing, strongly focusing on the execution and quality of public expenditure.

9. Nevertheless, given the significant change in the macroeconomic conditions in the fourth quarter of 2008, the government implemented decisive countercyclical policy responses involving fiscal policy in three fronts: a Fiscal Stimulus Plan to support economic activity and employment; a Pro-Credit Plan to secure the flow of credit to businesses and individuals in the lower phase of the economic cycle; and, the Pro-employment Employment Accord to mitigate the impact of the cycle on employment. The Fiscal Stimulus Plan was announced in early January, with a size equivalent to 2.8 percent of GDP (USD 4 billion) with the purpose of supporting economic activity and employment. The plan included direct transfers to families and individuals, an increase in public investment of up to USD 700 million, recapitalization of Codelco by USD 1 billion to support its investment plan, tax reductions and other incentives for private investment, strengthening small and medium enterprise access to funding, and measures to protect employment. Such increase in spending stems from larger structural income, derived from the exchange depreciation relative to the level envisaged originally in the Budget and from a reduction on a temporary basis in the structural surplus target from 0.5 percent of GDP to 0 percent of GDP.

10. The Pro-Credit Plan was announced in March of 2009. It included twenty measures to stimulate the provision of credit by banks as well as non-banking financial institutions, to promote competition in the financial system, and to widen the scope of available funding alternatives. The pro-credit plan involves three broad dimensions: support to micro-entrepreneurs; measures to facilitate access to bank funding, and measures to facilitate access to non-bank funding. The overall impact of the pro-credit plan was to generate an additional USD 3.6 billion in new credit to the private sector. This plan complements the fiscal stimulus plan announced in early January. This plan also complements other previous measures taken by the government to secure the flow of credit given the downturn in the cycle. In order to enhance access to credit for businesses and individuals, in December of 2008, the government increased the capital of Banco Estado, the state-owned bank, with a USD 500 million injection to spur lending to small and medium sized enterprises by up to USD 2.6 billion, and also increased the Small Enterprise Guarantee Fund by USD 130 million, to a total of USD 200 million.

11. The Pro-Employment Accord is a tri-partite temporary agreement between employers, employees and the government which translates into six specific measures that would benefit a total of 130.000 workers. The first measure is a transitory tax incentive for the retention of workers and for the improvement of their work skills; the second is the establishment of a leave of absence for up to 5 months for the improvement of work skills, where the employee would receive 50 percent of his salary during the leave of absence, and be rehired with a greater set of skills; the third measure consists of an increase in the subsidy for the improvement of working skills for those businesses that are actively increasing hiring of new personnel; the fourth measure includes the establishment of a scholarship for working women who are heads of a household with the purpose of stimulating self-employment through small and micro enterprises; the fifth measure consists of the establishment of program of previous learning recognition which would certify the level of skill of a worker through a standardized and common evaluation; and the final measure protects family income, if the head of the household losses his or her job by enhancing the access to the Unemployment Solidarity Fund for employees with temporary contracts. This program benefits the employers as it increases the productivity of its employees, alleviates the cost of firing and the adjustment cost once the recovery is in place, and also the employees, as they increase their human capital, allowing for better expectations in terms of wages and better skills to improve the chances of finding a job. All the measures included in the Accord were approved by Congress in record time.

12. In addition to the measures described above, in her annual address to Congress on May 21, President Bachelet announced an additional transfer to four million low-income households, bringing forward the benefits of the Pension Reform, the establishment of an insurance plan to cover the mortgage payments of those families whose heads of household loses his or her job, and the expansion of the New Millennium Scholarship Program. All of these measures implied an additional government spending of USD 330 million in 2009.

13. Given the size and scope of the countercyclical fiscal policy measures, public expenditure is expected to grow 14.5 percent in real terms. This represents an increase with respect to what was initially projected in the Budget Law (5.7 percent), and 5.0 percent is due to increased spending committed in the Fiscal Plan of January; 0.9 percent corresponds to additional spending committed in the Pro-Credit Plan, the Pro-Employment Accord and May 21 announcements; 2.9 percent is due to the drop in average 2009 inflation projected for 2009, which was estimated at 5.2 percent in January and is now only expected to reach to 2.3 percent. Therefore, a fiscal deficit of 4.1 percent of GDP is projected for 2009. This is 1.2 percentage points higher than what was projected in January. The difference in projection is broken down into 0.2 percent of GDP of increased spending and 1.0 percent of GDP of lower revenues. Such deficit is the natural outcome of the decisive countercyclical fiscal policy, whose very own definition is to incur deficits during years of contraction of the global economy and to accumulate surpluses in years of boom.

14. Having saved the surpluses derived from the windfall gains in the price of copper of previous years, the Sovereign Wealth Funds has provided plenty of fiscal room for the government to implement countercyclical fiscal policy under current circumstances, as funding of the fiscal stimulus plan will come from the Economic and Social Stabilization Fund. Therefore, the government announced initially that it would withdraw an equivalent of USD 4 billion from the ESSF, of which USD 1 billion will finance investment and expenditure directly in USD, while the other USD 3 billion will finance investment and expenditure in local currency (pesos). In order to conduct the foreign exchange operation, the Ministry of Finance instructed the Central Bank, as a Fiscal Agent, to conduct a program of competitive bids for the sale of USD 50 million on a daily basis since March 27, 2009. By mid-June, the government announced its financing strategy for the rest of 2009, which would include and additional withdrawal of USD 4 billion from the ESSF, to be sold through the Fiscal Agent through competitive bids for the sale of USD 40 million on a daily basis starting in July 1, 2009, and the issuance of USD 1.7 billion in the 5-year and 10-year domestic bond markets. We highlight that the issuance of the bond markets was coordinated directly with the Central Bank, so as to avoid any disruption in the 5 and 10-year segments of the yield curve.

15. Our authorities would like to reiterate that the significant fiscal stimulus undertaken for this year has been possible due to the existence of the structural fiscal rule which has been instrumental in providing plenty of fiscal space to the authorities to conduct countercyclical fiscal policy, while also providing a clear and credible anchor for fiscal policy over the medium term. As such, Chile’s fiscal rule has proven to be a fundamental pillar of the existing macroeconomic framework to secure domestic and external stability. In fact, the financial position of the government will remain sound even after factoring in the significant fiscal stimulus undertaken in 2009, and such strong fiscal financial position will be the legacy of this administration based on the implementation of the fiscal rule.

Financial Sector

16. Chile's sound regulatory framework has contributed to securing the stability of the financial system, and, therefore, insulating the domestic market from the global turmoil. The financial sector has continued to perform well during the crisis, with the banks adequately capitalized so as to withstand potential credit losses stemming from the downturn. The latest available survey of the Central Bank on the overall situation of banking credit up to June 2009 indicates that the number of banks reporting more restrictive credit conditions has been reduced for two consecutive quarters, thus suggesting a sustained improvement in the supply of credit to the economy. In line with this development, the survey shows a marked rebound in the demand of credit by businesses and individuals. Therefore, the flow of credit is on its way to the pre-crisis levels.

17. Our authorities' views are that Chile's regulatory framework has proven to be effective in securing financial stability against the backdrop of the global financial turmoil and the global downturn resulting from it. Therefore, improvements to the framework should be considered as enhancements to an already sound regulatory framework, in line with what could be considered best practice in terms of regulation. In particular, the issue of expanding the perimeter of regulation is an issue that our authorities might consider as potentially relevant for the FSAP Update which will be conducted in 2010, and should not be considered as a necessary modification to the framework to enhance the framework's capacity to deal with potential credit risks, as suggested by the staff. Moreover, steps in the improvement of coordination among regulators have already been taken, as a Memorandum of Understanding (MoU) was signed in late June by the members of the Committee of Superintendents, which includes the banking, pensions, and securities supervisors, in order to formalize the cooperation and coordination channels between them.

Conclusion

18. In light of the unprecedented external shocks stemming from the global downturn, coupled with financial turmoil, our Chilean authorities took decisive and unprecedented policy measures in order to mitigate as much as possible the impact of the crisis on Chile's domestic and external stability, as growth is expected to resume in the second half of 2009 in response to the stimulus already underway. Chile's sound rules-based policy framework has provided enough flexibility in terms of monetary and fiscal policy to respond to these shocks, as it has been recognized by the credit rating agencies, as Chile was recently upgraded by Moody's to A1 from A2, based on the solid fundamentals of its fiscal budget, low debt, and strong macroeconomic management.