



CHILE

August 2023

REVIEW UNDER THE FLEXIBLE CREDIT LINE ARRANGEMENT—PRESS RELEASE; STAFF REPORT; STAFF SUPPLEMENT; AND STATEMENT BY THE EXECUTIVE DIRECTOR FOR CHILE

In the context of the Review Under the Flexible Credit Line Arrangement, the following documents have been released and are included in this package:

- A **Press Release** including a statement by the Chair of the Executive Board.
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on August 23, 2023, following discussions with the officials of Chile on economic developments and policies underpinning the IMF arrangement under the Flexible Credit Line. Based on information available at the time of these discussions, the staff report was completed on July 24, 2023.
- A **Staff Supplement** updating information on recent developments.
- A **Statement by the Executive Director** for Chile.

The IMF's transparency policy allows for the deletion of market-sensitive information and premature disclosure of the authorities' policy intentions in published staff reports and other documents.

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**International Monetary Fund
Washington, D.C.**



IMF Executive Board Concludes Review of Chile's Performance under the Flexible Credit Line Arrangement

FOR IMMEDIATE RELEASE

- The IMF completed the mid-term review of Chile's qualification under the Flexible Credit Line (FCL) arrangement. The arrangement was approved on August 29, 2022, for an amount of about US\$18.5 billion (equivalent to 800 percent of quota).
- Chile continues to qualify for the FCL by virtue of its very strong economic fundamentals and institutional policy frameworks, and sustained track record of very strong macroeconomic policies.
- In view of the still elevated external risks, the authorities have expressed a desire to maintain the current level of access and are committed to gradually exit the arrangement conditional on the evolution of external risks. The authorities intend to continue to treat the arrangement as precautionary.

Washington, DC – August 25, 2023: The Executive Board of the International Monetary Fund (IMF) completed on August 23, 2023, the mid-term review of Chile's qualification under the Flexible Credit Line (FCL) arrangement.¹ The Executive Board reaffirmed Chile's continued qualification to access FCL resources.

The current two-year FCL arrangement for Chile was approved by the IMF's Executive Board on August 29, 2022 (see [Press Release No. 22/294](#)), in the amount of SDR 13.954 billion (800 percent of quota, around US\$18.5 billion²). The Chilean authorities reiterated their intention to continue to treat the arrangement as precautionary. The authorities intend to gradually exit the arrangement conditional on external developments and risks.

Following the Executive Board's discussion on Chile, Ms. Antoinette Sayeh, Deputy Managing Director, made the following statement:

"Following the macroeconomic imbalances that built up in 2021-22, the Chilean economy is approaching the end of its adjustment cycle towards more sustainable growth and lower

¹ The FCL was established on March 24, 2009 as part of a major reform of the Fund's lending framework (see [Press Release No. 09/85](#)). The FCL is designed for crisis prevention purposes as it provides the flexibility to draw on the credit line at any time during the period of the arrangement (one or two years), and subject to a mid-term review in two-year FCL arrangements. Disbursements are not phased nor conditioned on compliance with policy targets as in traditional IMF-supported programs. This large, upfront access with no ongoing conditions is justified by the very strong track records of countries that qualify for the FCL, which gives confidence that their economic policies will remain strong.

² US\$ amounts have been calculated using the exchange rate as of August 2, 2022 (SDR 0.755229/US\$), consistent with the Staff Report for the FCL request.

inflation in a challenging external environment. The authorities are implementing very strong policies to preserve macroeconomic stability and rebuild buffers. The government has reform ambitions to raise tax revenues, reduce inequality, reform pensions and health care, as well as foster a green economy.

The Chilean economy remains exposed to elevated external risks tied to a possible abrupt global slowdown and sharply tighter global financial conditions, which could lead to lower and more volatile commodity prices and a decline in capital inflows. Domestic risks have largely subsided with the narrowing of uncertainty around the constitutional reform process, while the risk of social discontent over unmet demands and security deterioration and uncertainty related to the health care sector remain. However, Chile's very strong economic fundamentals and institutional policy frameworks—anchored in the inflation-targeting framework, the structural fiscal balance rule, a flexible exchange rate, and effective financial regulation and supervision—support Chile's resilience and capacity to respond to shocks.

In this context, the Flexible Credit Line (FCL) will continue to provide a valuable buffer against tail risks and boost market confidence by reinforcing Chile's policy and institutional strengths. The authorities remain committed to treat the FCL arrangement as precautionary and gradually exit conditional on external risk developments.”



CHILE

REVIEW UNDER THE FLEXIBLE CREDIT LINE ARRANGEMENT

July 24, 2023

EXECUTIVE SUMMARY

Context: Following the overheating in 2021–22, the economy is approaching the end of its adjustment cycle towards more sustainable growth and lower inflation in a challenging external environment. The authorities are implementing very strong policies to preserve macroeconomic stability. The government has reform ambitions to raise tax revenues, reduce inequality, reform pensions and health care, and foster a green economy but is encountering strong resistance in a fragmented Congress.

Risks: External downside risks remain tied to a possible abrupt global slowdown and sharply tighter global financial conditions. Domestic risks relate particularly to potential discontent from unmet social demands and a deterioration in security as well as uncertainty related to the health care sector. Risks associated with the outcome of the constitutional reform have significantly narrowed. The global energy transition and Chile's abundant resources in copper, lithium, wind, and solar provide medium/long-term upside opportunities. Very strong fundamentals and institutional policy frameworks, and a strong track-record of implementing prudent policies continue to support Chile's resilience and capacity to respond to shocks.

Flexible Credit Line (FCL): The FCL has provided a valuable buffer against tail risks and boosted market confidence by reinforcing Chile's policy and institutional strengths. Chile's 24-month FCL arrangement was approved on August 29, 2022, in the amount of SDR 13.954 billion (800 percent of quota, around US\$18.5 billion). The authorities intend to continue to treat the FCL as precautionary and gradually exit conditional on external risk developments.

Qualification: In staff's view, Chile continues to meet the FCL qualification criteria specified under the Executive Board decision on FCL arrangements (Decision No. 14283-(09/29), adopted on March 24, 2009, as amended). Staff recommends that the Board complete this review that would allow Chile to make purchases, if needed, until the expiration of the FCL arrangement on August 28, 2024.

Approved By
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CONTEXT

1. The economy is approaching the end of its adjustment cycle in a challenging external environment. To correct the macro imbalances that emerged in 2021–22, the authorities adequately tightened macroeconomic policies to cool down the economy, preserve macroeconomic stability, and rebuild buffers. The economy is transitioning towards more sustainable growth and lower inflation, and the adjustment cycle is winding up. The global outlook remains uncertain as the massive and synchronous global policy tightening has weakened growth, while core inflation has remained sticky and global financial risks have risen.

2. The ongoing constitutional reform process will preserve Chile’s strong institutions. Uncertainty over the possible outcomes of the constitutional reform process has diminished substantially. An elected Constitutional Council has begun its deliberations based on an initial draft prepared by an expert committee, which preserves Chile’s very strong institutional framework (including, the Central Bank’s independence, the principle of fiscal responsibility, and the president’s exclusive right to initiate financial and budgetary matters). The Constitutional Council will present a final proposal in October, and a new referendum will take place in December. Currently, the risk of a new rejection is significant, stemming from polarization and fatigue, but a turnaround in public sentiment towards the upcoming proposal is still feasible as most political parties would benefit from an approval.

3. The government’s reform ambitions are encountering strong resistance in a fragmented Congress. The government has vouched to raise tax revenues, reduce inequality, reform pensions and health care, and foster a green economy but lacks majorities in Congress. In March, the lower house rejected the flagship tax reform, mostly due to disagreement about a proposed wealth tax. The proposed overhaul of the pension system (presented to Congress in November) is encountering strong political opposition due to the envisaged addition of notional accounts and changes to the industrial organization of the sector. The government has started to signal its willingness to pragmatically adjust some reform elements to gather sufficient political support.

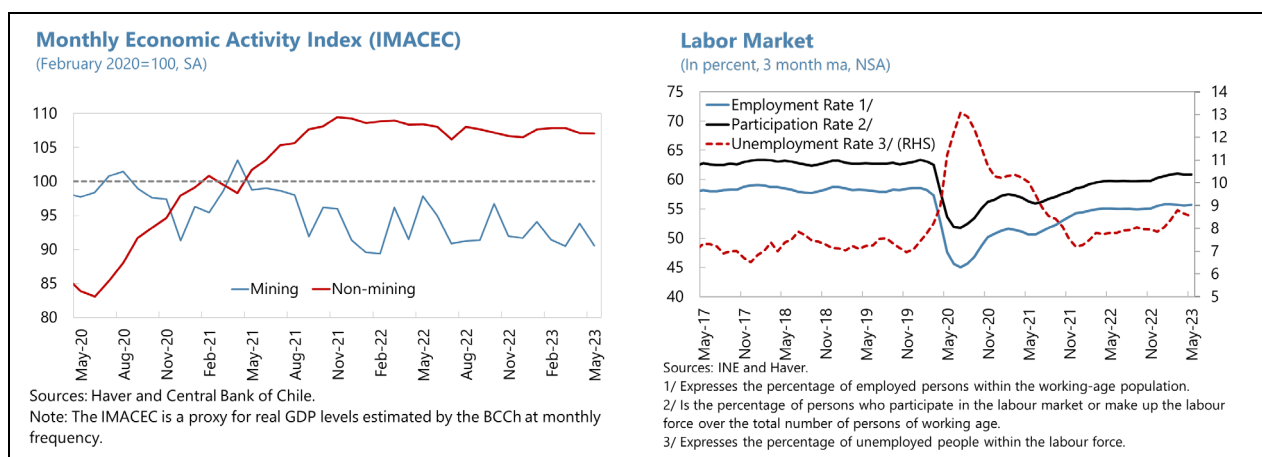
4. The FCL arrangement has substantially augmented precautionary buffers providing insurance against tail risks. Considering the worsening of external conditions and a marked increase in risks, the IMF Executive Board approved on August 29, 2022, a two-year FCL arrangement in the amount of SDR 13.954 billion (800 percent of quota) to enhance buffers and provide insurance against adverse scenarios.¹ The authorities intend to continue to treat the arrangement as precautionary and gradually exit conditional on external risk developments. At the same time, the authorities are rebuilding foreign reserves through a twelve-month reserve accumulation program that started in June.

¹ See [IMF Country Report 2022/283](#).

RECENT DEVELOPMENTS

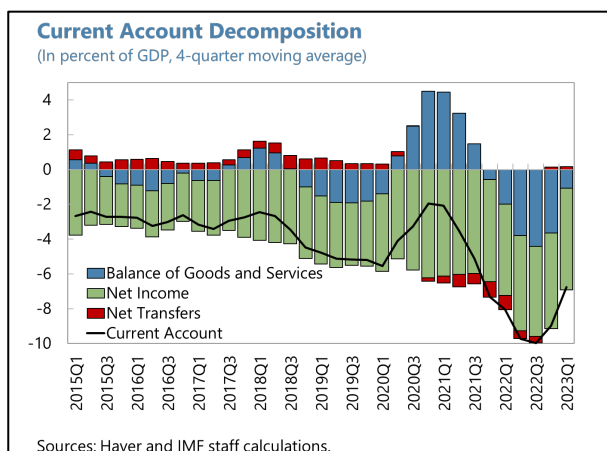
5. Economic activity has transitioned to a more sustainable path helped by tight policies.

After growth surged to 11.7 percent in 2021, substantially above potential, monetary and fiscal policies were significantly tightened to correct macroeconomic imbalances. Since then, GDP growth has rapidly decelerated to -0.6 percent (yoy) in 2023Q1, from 2.4 percent in 2022, led by the normalization of private consumption and investment (Figure 1). The unemployment rate (3-month average) has edged higher to 8.5 percent in May 2023, from 7.9 percent at end-2022, with the employment rate still about 3 percentage points below its pre-pandemic level. The fiscal balance improved to 1.1 percent of GDP in 2022 from a deficit of 7.7 percent in 2021 (the first fiscal surplus in over a decade), underpinned by a 23 percent decline in real spending due to the removal of pandemic-related stimulus measures and one-off revenues (Table 2).

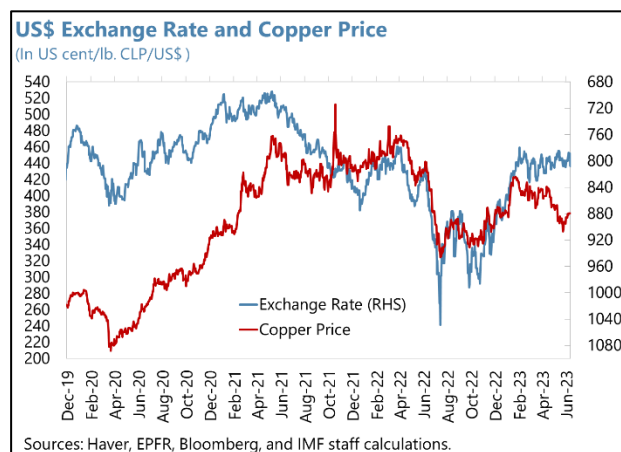


6. Temporary factors that widened the current account deficit over 2021-22 have started to dissipate, leading to a swift correction.

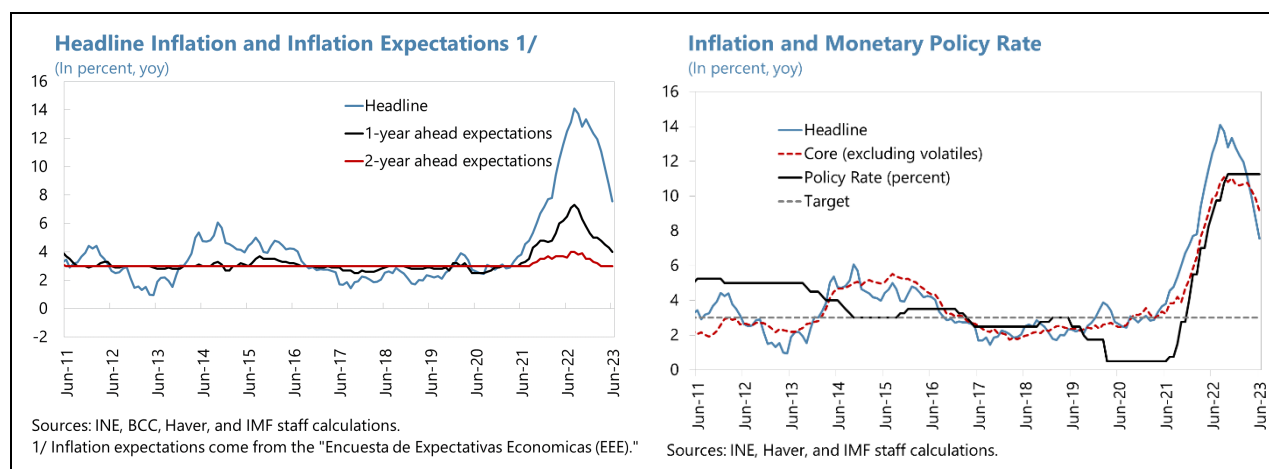
The current account deficit widened to 9 percent of GDP in 2022, due to higher transportation costs, terms of trade shocks, supply disruptions, and ample policy stimulus and exceptional pension withdrawals (over 2020-21) which led to a transitory surge of goods imports. The four-quarter moving average current account deficit peaked at 9.9 percent of GDP in 2022Q3 and is expected to have reverted to about 5 percent of GDP in 2023Q2 (with an estimated average deficit of about 2 percent of GDP in the first six months of 2023). The substantial correction is due to a broad-based decline of imports and improved terms of trade (Figure 2).



7. The exchange rate has recovered from a period of high volatility in 2022. A sharp fall in copper prices in mid-2022 triggered a fast and large depreciation of the Chilean peso. Unusually high volatility prompted the Central Bank (BCCh) to intervene in the FX market over July-September 2022 to prevent disorderly market conditions, involving the sale of US\$6.2 billion in the spot market and US\$10 billion forward sales (settled in Chilean pesos) ([IMF Country Report 2023/036](#)). The exchange rate has since recovered, appreciating by about 7 percent in 2023H1 relative to the average level in 2022. Low volatility during 2023H1 allowed the BCCh to launch in June 2023 a gradual reserve accumulation program to replenish buffers. As in previous reserve accumulation episodes during the inflation targeting regime (2008, 2011, 2021), the program follows high transparency standards and purchases are sterilized to ensure consistency with the monetary policy framework and the flexible exchange rate regime (see ¶26).



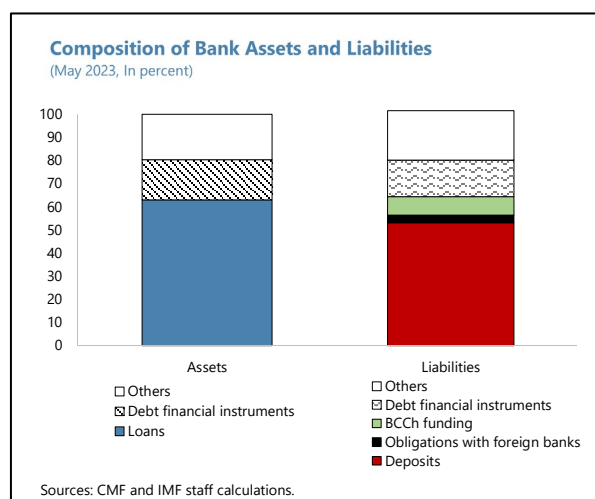
8. Headline inflation is rapidly falling, but core inflation remains persistent. Disinflation accelerated since April with headline inflation declining to 7.6 percent (yoy) in June 2023, from a peak of 14.1 percent in August 2022, led by food, energy, and goods items. Core inflation (excluding volatile items) has come down more slowly to 9.1 percent (yoy, June 2023), mostly due to robust service price increases from indexation to past inflation (Figure 3). Real wages are recovering after bottoming out in September, increasing by 1.2 percent (yoy) in May but remaining 1.6 percentage points below their mid-2021 level (Figure 1). Real wages are set to improve given the ongoing disinflation and increases in the minimum wage.²



² The minimum wage was increased from CLP410,000 in January to CLP440,000 in May. It will continue to increase to CLP460,000 in September and to CLP500,000 in July 2024. It is estimated to impact about 10 percent of employees.

9. The financial sector remains resilient. Banks' capital adequacy and liquidity ratios stand comfortably above regulatory requirements (Figure 4). Return on equity is slightly above its pre-pandemic level. The financial situation of households and corporates remains stable but monetary tightening and rising costs have created pockets of vulnerability in low-income indebted households largely due to greater use of revolving loans, smaller firms especially those with government-guaranteed loans, and in the construction and real estate sectors. The non-performing loan (NPL) ratio has rebounded from historical lows, driven by commercial and consumer loans,³ but remains around its pre-pandemic level and banks' provision coverages are adequate. Credit growth has slowed to 3.4 percent (yoy) in June 2023 (from about 10 percent in 2021 and 2022) due to tighter supply conditions and weakened demand. The liquidity position of fixed-income mutual funds stayed flat as of June 2023 after a deterioration in 2022 due to redemptions caused by the shift of investments to shorter maturities and inflation hedges.

10. The banking turmoil in the US and Europe has not spilled over to Chile. In March 2023, a repricing of risks in the US and European banking sectors was prompted by deposit withdrawals stemming from liquidity concerns and vulnerabilities arising from unrealized losses on long-duration assets. There has not been any evidence of spillovers in Chile, reflecting banks' limited exposure to interest rate risk from securities investment, and a well-diversified funding structure. Hold-to-maturity securities represented only 3.4 percent of the total assets in March 2023.



OUTLOOK AND RISKS

11. The economic outlook has improved since the 2022 Article IV consultation. Real GDP growth is now expected to be around zero percent in 2023, reflecting a more gradual adjustment of domestic demand towards a sustainable path consistent with its pre-pandemic trend. The large positive output gaps in 2021-22 are projected to broadly close during 2023-24. Once the rebalancing of the economy is completed, growth is projected to pick up to 1-2 percent in 2024, supported by net exports and the recovery of consumption, and thereafter to gradually return to the potential growth rate of around 2.5 percent. Inflation is projected to decelerate to 4.5 percent by end-2023 and to converge to the 3-percent target by end-2024, driven by the cooling domestic demand and decline in import prices. The fiscal balance is expected to deteriorate to a deficit of

³ The increase in the NPL ratio of mortgage loans has been moderate as the portfolio is concentrated among higher income households. House prices have recently leveled out. Nevertheless, households' payment burden on mortgage loans, most of which are denominated by an inflation-indexed unit of account (Unidad de Fomento), has increased due to high inflation even though the interest rate has remained stable due to the high share of fixed-rate loans (around 85 percent).

1.9 percent of GDP in 2023 due to lower revenues, before gradually converging to broadly zero over the medium term, in line with the authorities' fiscal medium-term framework. Alongside the adjustment of domestic demand and robust exports, the current account deficit is set to narrow to 3.8 percent of GDP in 2023 (from 9 percent of GDP in 2022) and to gradually converge to its historical average of about 3 percent of GDP, supported by the ongoing structural fiscal consolidation and the flexible exchange rate.

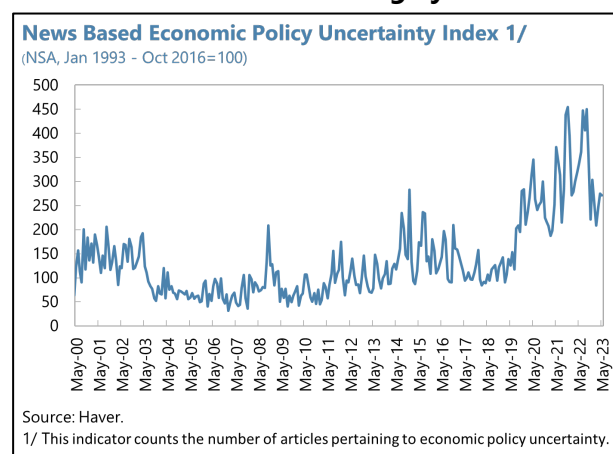
Revisions to the Near-Term Economic Outlook					
	2022	2023		2024	
	Actual	Art. IV	FCL Review	Art. IV	FCL Review
GDP growth	2.4	-1.5	-0.2	1.9	1.5
Inflation (eop, percent)	12.8	5.0	4.5	3.0	3.0
Central government overall balance (% of GDP)	1.1	-2.4	-1.9	-1.9	-1.6
Central government gross debt (% of GDP)	38.0	37.7	38.0	39.9	40.6
Copper price (U.S. cents per pound)	401	358	381	357	372
Current account (% of GDP)	-9.0	-4.9	-3.8	-4.1	-3.7

Source: Haver; and IMF staff projections.

12. External risks continue to be significant while domestic risks have largely subdued. The

main external risks are the possibility of an abrupt global slowdown and sharply tighter global financial conditions, possibly resulting in lower and more volatile commodity prices and net capital inflows. For domestic risks, while social discontent from unmet demands and security deterioration as well as uncertainty related to the health care sector stemming from a Supreme Court ruling against private health insurance companies (Isapres) remain prevalent, risks from the outcome of the constitutional reform have significantly narrowed as the

process is now bound by agreed pillars that will preserve critical institutions and principles. Chile's very strong fundamentals and institutional policy frameworks will continue to support Chile's resilience and capacity to respond to shocks. As the world transitions to greener technologies, the expected surge in the global demand for copper, lithium and green hydrogen represents an important medium/long-term upside risk.

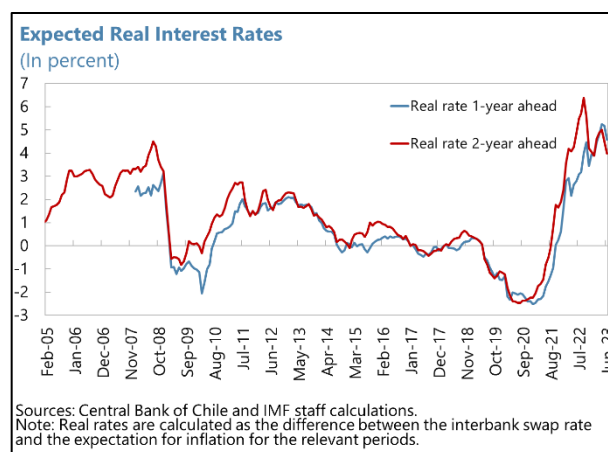


13. The economy remains vulnerable to external shocks. While external stress has moderated recently, it is expected to remain above average historic levels over 2023-24 under the current baseline. In an adverse scenario assuming lower trading partner growth and a lower U.S. Treasury yield in line with the April 2023 WEO adverse scenario as well as a decline in the copper price and

higher emerging market volatility would result in an increase in external stress, comparable to the level seen in late 2022 (Box 1).

MACROECONOMIC POLICIES

14. Monetary policy is approaching an inflection point as macro imbalances and inflation are correcting. In the context of persistent inflation pressures, the BCCh raised the monetary policy rate (MPR) from 0.5 percent in July 2021 to 11.25 percent in October 2022 (Figure 3). Real interest rates, measured as the 1-year inflation-indexed interbank swap rates, have been around 5 percent since late 2022 (compared to an estimated neutral real interest rate of about 0.75 percent). The BCCh is committed to maintaining the monetary stance sufficiently restrictive to ensure the convergence of inflation to the 3-percent target. However, given tight financial conditions, lower production costs, the narrowing of the positive output gap (led by the reduction in private consumption since 2022Q2) and the return of two-year-ahead inflation expectations to target (in June 2023, as measured by inflation-indexed interbank swaps and surveys), the BCCh has signaled that rate cuts could start in the third quarter of 2023 if the resolution of macro imbalances and the disinflation trend continues. Against this background, the stock of assets that were acquired in the context of the unconventional liquidity measures implemented during 2020-21 will substantially decline in 2024 upon maturity.



15. The 2023 budget appropriately focuses on social spending and investment. The 2023 fiscal balance is projected to deteriorate to a deficit of 1.9 percent of GDP in 2023 from a surplus of 1.1 percent of GDP in 2022, mostly due to lower revenues amid the economic slowdown and the fading of one-off effects.⁴ While the budget incorporates higher mandated spending on minimum pensions and aims to increase public investment, overall real expenditures are expected to remain broadly constant relative to 2022 due to a reduction in other spending categories. Overall, staff's projection entails a small fiscal stimulus of about ½ percentage points of GDP, as estimated by the change in the non-mining structural primary balance. To continue supporting the disinflation and the current account convergence, it would be advisable to save any stronger than projected revenues and wait to disburse unallocated funds, aiming for a broadly neutral fiscal stance, while continuing to target support for vulnerable households.

⁴ The 2023 Budget is consistent with a headline deficit of 2.7 percent of GDP but, based on the outturn of the first half of 2023, the authorities and staff now project the deficit to be somewhat smaller.

16. The government remains strongly committed to fiscal sustainability by conditioning spending reforms on revenue performance.

The authorities aspired to increase tax revenues by about 3.5 percent of GDP by 2026. The recently approved overhaul of copper mining taxes is expected to raise revenues by about 0.5 percent of GDP,⁵ and the upcoming government proposal to adjust corrective taxes could yield another 0.4 percent of GDP, including through higher carbon taxes. However, the flagship tax reform package which should yield the remaining 2.7 percent of GDP was rejected by Congress in March, prompting the government to pragmatically adjust its strategy. It is negotiating a fiscal pact which would link measures from the rejected tax reform (tax evasion and avoidance measures, reforms to personal income taxes, introduction of a wealth tax, and reduction of tax exemptions)⁶ with plans for higher social and security spending (to enhance the universal guaranteed pension, the health care system, security, the national system of care, and childcare provision). The proposed fiscal pact also includes incentives for growth and investment and measures to modernize the state and increase spending efficiency. Apart from these reform plans which are not included in the baseline, staff assesses the government's medium-term fiscal commitment of reaching a broadly balanced fiscal position by 2027 to be appropriate and feasible, implying a fiscal effort of about 2 percentage points of GDP.

Proposed Fiscal Pact 1/ (Percent of GDP)	
Tax Reform	
Tax evasion and avoidance measures	1.6
Income taxes	0.7
Wealth tax	0.4
Reduction in exemptions	0.2
Tax incentives	-0.2
Total	2.7
Additional Spending Plans	
Pension reform	1.2
Higher minimum guaranteed pensions	0.8
Higher pension contributions for public employees	0.4
Health system	0.9
Security	0.4
National system of care and childcare	0.2
Total	2.7
<small>1/ Government proposal from June 2023 for permanent medium-term revenue and spending measures. Estimated cumulative yields are those by the authorities. Sources: Chilean authorities, and IMF staff calculations.</small>	

However, in the absence of additional revenue measures, spending would need to be constrained in outer years to achieve the government's medium-term fiscal targets, as assumed in the baseline. Chile's public debt is deemed to be sustainable with high probability (Annex II), with the debt ratio stabilizing below the authorities' prudent ceiling of 45 percent of GDP.

17. Ongoing refinements to Chile's already very strong fiscal framework are welcome.

Recent enhancements, including the introduction of a prudent debt ceiling, cyclical adjustment for lithium revenues for the structural balance rule,⁷ and the disclosure of the sensitivity of fiscal projections to macroeconomic shocks support Chile's long-standing fiscal framework. The introduction of an explicit escape clause, under consideration by Congress, is also positive. Beyond

⁵ A part of the additional mining royalty will be devolved to subnational governments for investment spending.

⁶ The expected yields from the tax evasion measures (1.6 percent of GDP) seem optimistic, as international experience shows that it is difficult to achieve more than ½ percent of GDP. See more details in IMF Country Report No. 23/37.

⁷ The government introduced a prudential adjustment for lithium revenues, in which proceeds that exceed a 5-year historical average (as a share of GDP) are considered cyclical.

these advancements, there is room for broadening the supervisory and advisory role of the Autonomous Fiscal Council, developing an integrated sovereign asset-liability management, and further strengthening fiscal risk reporting and management.⁸ The government is committed to supplement its proposed gradual fiscal decentralization reform, which aims to give greater financial autonomy to regional governments (including higher transfers and ability to borrow subject to approval of the Ministry of Finance), with adequate safeguards for fiscal responsibility. It will be important to accompany these changes by a strengthening of regional public investment management capacity, greater controls for governance risks, and enhancements in regional fiscal transparency and accountability.

18. The authorities are closely monitoring financial sector vulnerabilities, while further strengthening an already sound regulatory framework. The 2021 FSAP concluded that Chile's financial regulatory and supervisory system is robust. The smooth progress in the implementation of Basel III requirements has improved the resilience of the financial sector by enhancing banks' solvency and liquidity. Stress tests performed by the authorities indicate that financial stability appears well guarded. However, the authorities should continue monitoring developments closely, stand ready to intervene to avoid disorderly conditions, and encourage financial institutions to continue carefully assessing credit quality while maintaining prudential lending standards and adequate reporting. Ongoing financial policy measures are in line with recommendations from the 2021 FSAP. The planned introduction of an industry-funded deposit insurance and bank resolution framework, and the strengthening of consolidated supervision of financial conglomerates would further improve financial sector resilience. The BCCh is taking steps to ensure that banks are prepared for the unwinding of extraordinary liquidity measures deployed during the pandemic. It also activated a counter-cyclical buffer (CCyB) of 0.5 percent of risk-weighted assets in May as a precautionary measure in the face of greater external uncertainty, with greater clarity needed on the CCyB's longer-term policy role. In parallel, the authorities are enhancing the implementation of anti-money laundering /combatting the financing of the terrorism (AML/CFT) preventive measures.

19. The government envisions far-reaching reforms to improve the lives of Chileans. Prospects for the adoption of the reform agenda are however uncertain in the context of a fragmented Congress. Pension reform is a priority. The universal minimum pension has substantially mitigated risks of old-age poverty, but many still face inadequate pensions. The government's proposal (submitted to Congress in November) includes additional 6 percent contribution (to be paid by the employer) and strives to (i) foster redistribution through the addition of notional accounts, (ii) further expand the minimum pension, and (iii) increase the government role in the management and investment of pension savings. Design and implementation will be critical to foster capital market deepening and labor formalization as well as to ensure a level playing field. In the context of the global green transition, the government's proposal for a *National Lithium Strategy* attempts to develop a robust institutional framework to foster investors' interest in a sector that could become a significant source of growth. Chile also continues to enhance its climate strategy, including with the recent Framework Law on Climate Change. A broader use of green taxes would

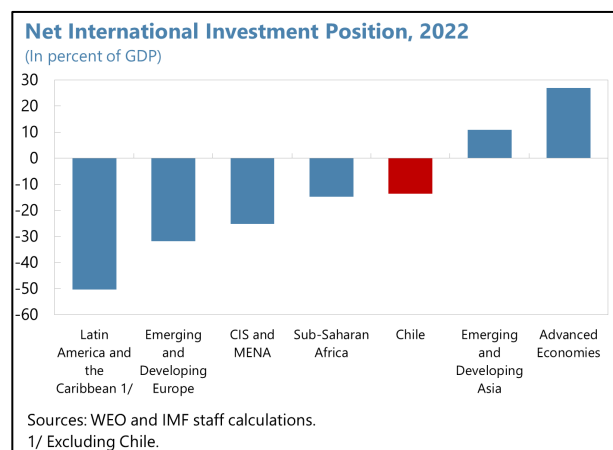
⁸ See [IMF Country Report 2021/241](#).

support Chile's ambitious climate agenda and the authorities are also considering complementary emission reduction schemes.

REVIEW OF QUALIFICATION

20. In staff's assessment, Chile continues to meet the FCL qualification criteria. The Executive Board provided a very positive assessment of Chile's policies in the context of the 2022 Article IV consultation. The external position is sustainable, the sovereign has access to international markets at favorable rates, and official reserve assets are adequate due to several mitigating factors. Public debt is sustainable and supported by a very strong fiscal framework. Inflation peaked in August 2022 and is projected to converge to target by end-2024, supported by a decisive monetary policy response and a credible inflation-targeting framework. The financial sector is sound and effectively supervised.

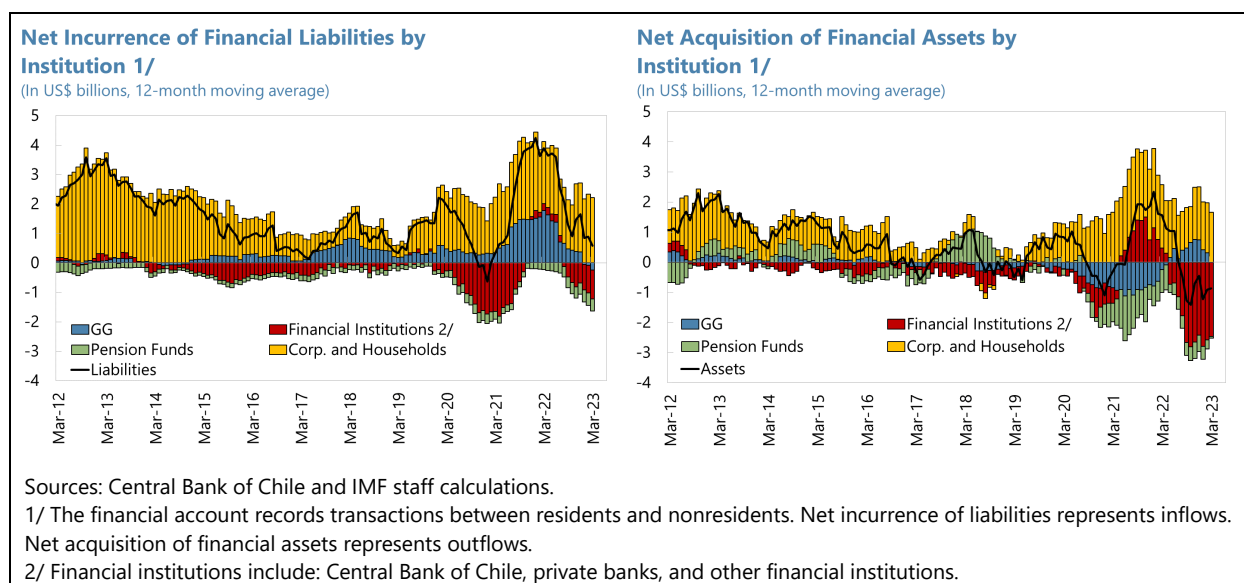
21. Sustainable external position. The 2022 Article IV consultation assessed the 2021 external position as moderately weaker than implied by medium-term fundamentals and desirable policies. Due to transitory pandemic-related factors (¶6), the current account recorded a deficit of 9 percent of GDP in 2022 (compared to 7.3 percent in 2021) despite the depreciation of the REER. However, the current account deficit is projected to fall to 3.8 percent of GDP in 2023 and to around 3 percent of GDP in the medium term, alongside continued very strong macroeconomic policies, exchange rate flexibility and ongoing structural fiscal consolidation. The REER depreciated by more than 13 percent over 2020-22 (relative to its 2010-19 average) due to elevated domestic uncertainty and copper price declines. The REER has fully recovered during January-May 2023, reflecting lower uncertainty over the possible outcome of the constitutional reform (Figure 2). In view of the swift reversals in the current account and REER, staff assesses the external position to be resilient and sustainable. This is consistent with Chile's external debt stabilizing at an expected 70 percent of GDP in the medium term, after increasing to 77.6 percent of GDP in 2022 (from 72 percent of GDP in 2021), primarily due to the deterioration in the current account and exchange rate depreciation (Annex I). Moreover, at -18 percent of GDP at end-2022, Chile's net international investment position compares favorably to most emerging markets.



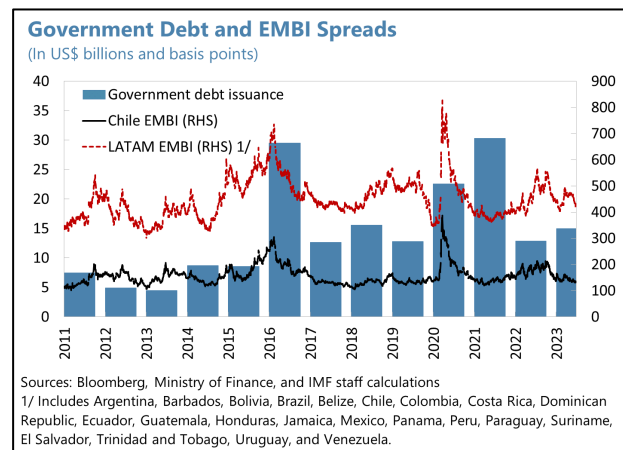
22. Capital account dominated by private flows. Over 2020-22, private flows accounted for 72 percent of total (FDI, portfolio, and other) asset flows and 82 percent of total liability flows.⁹ In 2022, private flows accounted for over 90 percent of total liability flows. Chile's IIP liabilities are dominated

⁹ The 2018 FCL Operational Guidance Note states that public flows should account for less than half of a member's direct, portfolio, and other asset and liability flows, on average in the past three years. In addition to the composition of recent capital flows, an assessment of the international investment position is also relevant.

by FDI and averaged 163 percent of GDP over 2020-22. Over the same period, the private sector accounted on average for about 86 percent of total IIP assets and about 91 percent of total IIP liabilities, and about 95 percent of Chile's external debt is owed to private creditors.

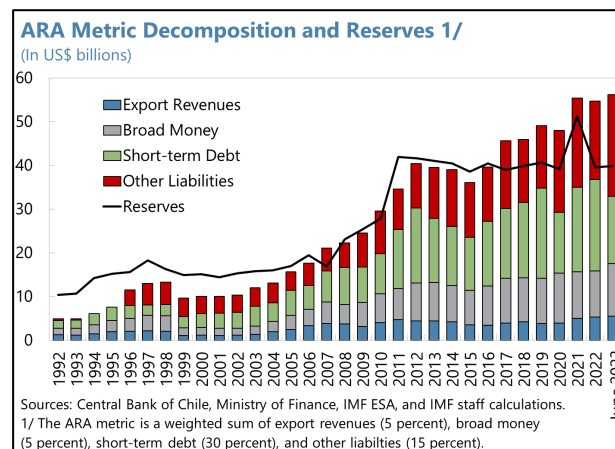


23. Long track record of steady sovereign access to international capital markets at favorable terms. Chile has enjoyed uninterrupted access to international capital markets for several decades. It maintains investment grade status according to the three major rating agencies and is consistently among the highest-rated EMs. Sovereign bond spreads have recently declined to the levels observed prior to the 2019 social unrest and are consistently below those from other EMs (EMBIG and 5-year CDS spreads stood at about 135 and 80 basis points at end-June, respectively). The central government issued external debt in each of the past five years, with a cumulative amount equivalent to about 1,400 percent of Chile's quota in the IMF (well above the 50 percent of quota requirement).



24. Relatively comfortable international reserve position. Gross international reserves stood at 82 percent of the Fund's reserve adequacy metric (ARA) on average over 2020-22 and 70.4 percent in June 2023, below recommended thresholds. The drop since end-2021 primarily reflects US\$6.2 billion foreign reserve sales during disorderly market conditions in the summer of 2022 (numerator effect) and the continuous expansion of external liabilities given Chile's open and integrated financial accounts (denominator effect).

In April, the BCCh began to gradually unwind the FX forward operations from the 2022 intervention program (with a daily reduction of US\$50mn over ten months), and in June, to rebuild buffers through a reserve accumulation program (with daily purchases of US\$40 million over twelve months) which will lift reserves by US\$10 billion to about 14 percent of GDP by 2024 (approximately 77 percent of the ARA metric). Staff assesses reserves to be adequate due to several mitigating factors:



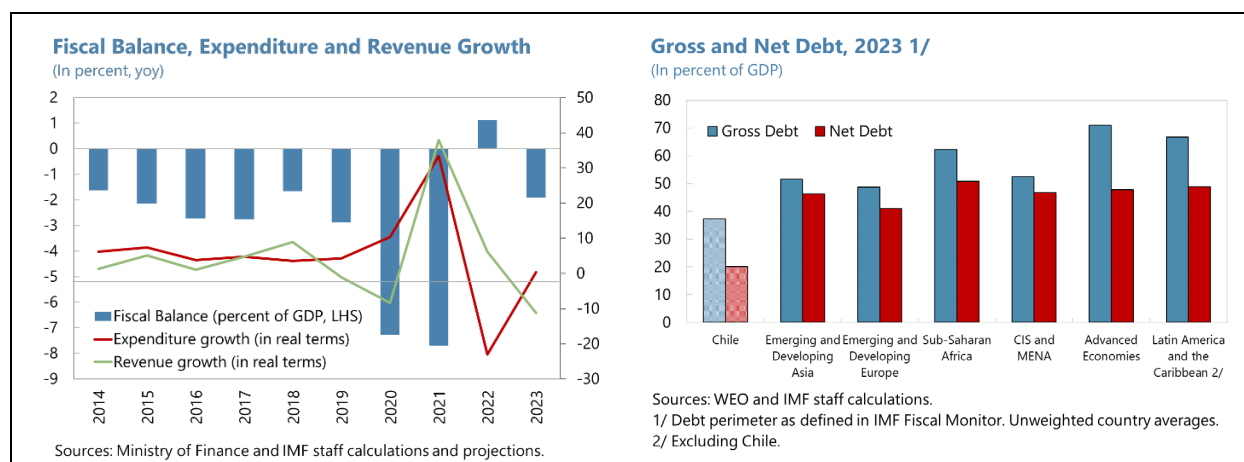
- The government has sizeable usable liquid FX assets (US\$17 billion as of May), including US\$7.6 billion in the sovereign wealth fund and US\$6.7 billion in the pension reserve fund (equivalent to an improvement in reserve coverage of up to 30.3 percentage points).
- More than a quarter of short-term debt represents intercompany loans from foreign direct investors to local firms. These loans are a very stable source of funding with a low probability to result in FX funding needs.
- 70 percent of banks' short-term external debt (US\$21 billion at end-2023Q1)¹⁰ is covered by banks' liquid foreign assets (US\$14.6 billion at end-2023Q1)¹¹ which significantly reduces banks' potential short-term FX funding needs.
- Reserves are complemented with a credit line with FLAR (US\$1.25 billion). The BCCh has access to a bilateral swap facility with the PBOC (US\$7.2 billion) and has signed a contract with the BIS Renminbi Liquidity Arrangement (US\$3.7 billion). The BCCh is also a subscriber of the Fed's FIMA repo facility, which allows for the temporary exchange of U.S. Treasury securities held with the Fed for U.S. dollars (US\$26 billion).
- The authorities remain strongly committed to a flexible exchange rate.

25. Sustainable public debt position and sound public finances. The authorities remain firmly committed to debt sustainability and fiscal responsibility. Gradual fiscal consolidation, guided by the fiscal rule, is expected to rebuild buffers, and stabilize gross public debt below 45 percent of GDP (a level considered by the authorities as prudent and which serves as the new debt anchor), which is low by international standards. Public debt is mostly denominated in domestic currency, with average external debt maturity above ten years. Liquidity risks are mitigated by assets in the sovereign wealth and pension reserve funds, and a large domestic banking sector, with abundant room to absorb sovereign issuances in case of an abrupt tightening of global financial conditions. Staff assesses Chile's public debt to be sustainable with high probability, and a public debt

¹⁰ Includes banks' short-term external debt stock of US\$13.7 billion at end-2023Q1 and US\$7.3 billion of banks' long-term debt due in the next twelve months.

¹¹ By regulation, banks' short FX positions due in thirty days cannot exceed long positions by more than banks' capital. In the non-bank part of the financial system, institutional investors (i.e., pensions funds) have a positive net foreign asset position.

sustainability analysis shows the debt trajectory is robust to standard shocks (Annex II). The 2021 Fiscal Transparency Evaluation concluded that Chile has strong fiscal institutions and sound fiscal transparency practices.¹²



26. Low and stable inflation in the context of a sound monetary and exchange rate policy framework. Chile maintains a highly credible inflation-targeting regime and a flexible exchange rate. In the past five years, monthly (yoy) inflation averaged 5.4 percent. The inflation spike into double digits (from April 2022 to March 2023) was temporary and longer-term inflation expectations remained firmly anchored through that period, as the BCCh quickly tightened monetary policy and demonstrated a firm resolve to tackle inflationary pressures (Figure 3). The episode reflects a well-functioning framework with clear policy guidance. The BCCh maintains a small negative equity, which does not compromise policy solvency nor require immediate recapitalization. The 2021 Transparency Review underscored BCCh's high standards of policy analysis, conduct, and independence.¹³

27. Sound financial system and the absence of solvency problems that may threaten systemic stability. The financial sector appears to be sound overall with pockets of vulnerability. Banks' capital adequacy and liquidity ratios stand comfortably above regulatory requirements. Solvency stress tests from the 2021 FSAP concluded that the banking sector is sufficiently capitalized, and solvency risks are low. More recent stress tests performed by the authorities also indicate that financial stability appears well guarded. The smooth progress in the implementation of Basel III requirements and the activation of the CCyB strengthens buffers in the banking sector.

28. Effective financial sector supervision. The 2021 FSAP assessed the banking supervisory framework as robust and the CMF to be capably staffed with expertise in monitoring individual risks. The 2022 Article IV Consultation report (see IMF Country Report No. 23/36) did not find substantial concerns regarding the supervisory framework. The authorities are assiduously working on

¹² See IMF Country Report No. 21/241 for further details.

¹³ See IMF Country Report No. 21/113 for further details.

implementing the recommendations in 2021 FSAP with significant progress achieved. For example, a bill has been tabled to deepen the repo market and enforce the CMF's regulatory and supervisory powers over mutual funds, and the CMF has implemented its Internal Liquidity Adequacy Assessment Process regulation.

29. Data transparency and integrity. Since March 2020, Chile is an adherent to the Fund's Special Data Dissemination Standard (SDDS) Plus—the highest tier of the IMF's Data Standards Initiatives.

30. Track record and institutional strength. Chile has a sustained track record of implementing very strong policies. Very strong fiscal and monetary institutional frameworks, coupled with high levels of policy credibility and regulatory quality, allow for an effective adjustment to shocks, including during the Global Financial Crisis, the 2019 social unrest and the pandemic. Fiscal and monetary policy have been strongly countercyclical, while at the same time the country benefits from a flexible exchange rate and an open capital account. The authorities have demonstrated agility and commitment to enhance and adjust institutional frameworks in response to new developments.

31. The authorities remain committed to treat the FCL arrangement as precautionary and gradually exit conditional on external risk developments. The authorities' strategy for medium-term resilience remains anchored in very strong macroeconomic policies and in further strengthening the regulatory environment and buffers. They have commenced replenishing their reserves buffers as part of their strategy to gradually exit from the FCL arrangement when external conditions allow. The authorities continue to treat the FCL as precautionary. Under a tail risk scenario that prompts a full drawing under the FCL, Chile's capacity to repay the Fund would remain adequate (Table 8).

32. Safeguards. Staff reviewed the audited FY2022 financial statements and no significant issues were identified.

STAFF APPRAISAL

33. Chile's FCL arrangement has supported the authorities' policy efforts amid an uncertain external environment. The FCL arrangement has contributed to the country's resilience, in the context of very strong policy and institutional frameworks, as evidenced by a relatively low level of public debt, well anchored medium-term inflation expectations, and a sound financial system. The authorities have indicated their intent to continue treating the FCL as precautionary and gradually exit when external conditions allow.

34. Staff assesses that Chile continues to meet the FCL qualification criteria. Chile has very strong economic fundamentals and institutional policy frameworks, along with a sustained track record of implementing very strong macroeconomic policies. The authorities remain strongly committed to continue pursuing prudent policies. Staff recommends the completion of the review under the FCL arrangement for Chile.

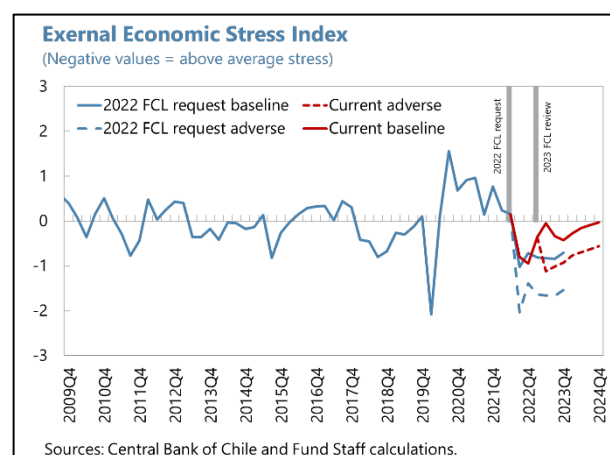
Box 1. External Economic Stress Index

The External Economic Stress Index (ESI) summarizes Chile's exposure to external shocks. The ESI is based on four variables—standardized around their mean—which capture Chile's external risks: U.S. and China real GDP growth to proxy for risks to exports, the change in the copper price to proxy for risks to the copper industry including inward FDI, and the emerging market volatility index (VXEEM) as well as the (detrended) 10-year U.S. Treasury yield to proxy for changes to global financial conditions. Lower values indicate higher stress.¹

The updated ESI for Chile indicates that external stress increased in the second half of 2022 followed by a decline recently. The main drivers for higher external stress were a decline in the copper price, an increase in U.S. yields, and a short-lived increase in emerging market volatility. Subsequently, external stress declined in 2023Q1 due to higher growth in the U.S. and China and a loosening of financial conditions.

Under the new baseline, external stress is expected to decline in 2024 but to remain above-average levels. External stress is projected to peak in 2023Q4 and to then fall gradually until 2024Q4, in line with expectations of improving financial conditions and a relatively stable copper price under the April 2023 WEO baseline. Nevertheless, the index is expected to remain slightly negative, suggesting a moderate level of external economic stress.

An adverse scenario shows that Chile continues to face elevated external risks. This scenario factors in a decline in U.S. and China growth in 2023 followed by a recovery in 2024, and a decline in the U.S. yield in line with the April 2023 WEO adverse scenario. It also assumes a decline in the price of copper and an increase in emerging market volatility as in the adverse scenario for the 2022 FCL request.² The ESI suggests that Chile faces above-average external risks.



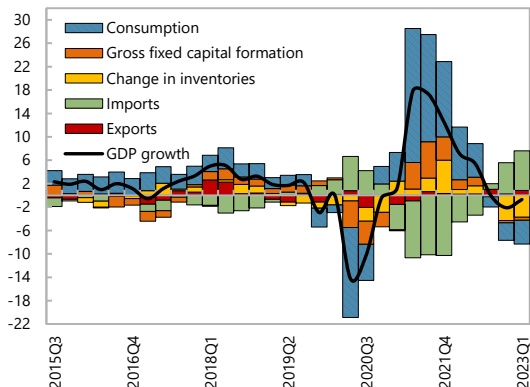
¹ Chile's ESI is computed using the following unchanged weights: (i) output growth in the U.S. and China (0.15); (ii) copper price change (0.35); (iii) the VXEEM index (0.25); and (iv) U.S. long-term yield (0.25). The U.S. long-term yield is detrended. The choice of the weights draws on the balance of payments and international investment position data, expressed as a share of GDP, and normalized. The updated ESI strengthens the methodology somewhat by consistently using the change in the copper price for the baseline and adverse scenarios whereas the ESI at the time of the 2022 FCL approval applied the level of the copper price for the historical series and adverse scenario.

² The adverse scenario makes the following assumptions: (i) a decline of 1.8 percentage points in 2023 and an increase of 0.4 percentage points in 2024 in U.S. growth relative to the baseline as well as a decline of 1.2 percentage points in 2023 and an increase of 0.8 percentage points in 2024 in China's growth relative to the baseline (all in annual terms); (ii) a 15 percent decline in the copper price relative to the baseline; (iii) a two standard deviation increase in the VXEEM index relative to the baseline; and (iv) a decrease in U.S. yields by 0.4 percentage points relative to the baseline (in annual terms). Assumptions (i) and (iv) are in line with the April 2023 WEO downside scenario.

Figure 1. Chile: Economic Activity and Labor Market

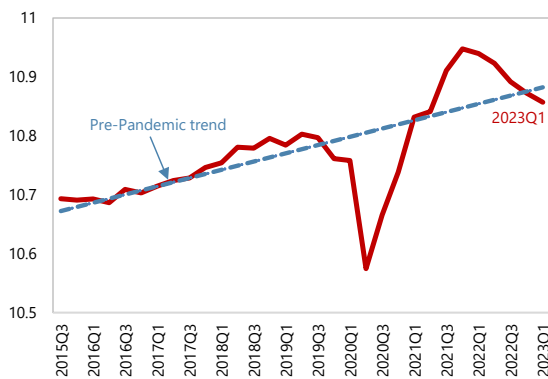
The economy has been cooling down,

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



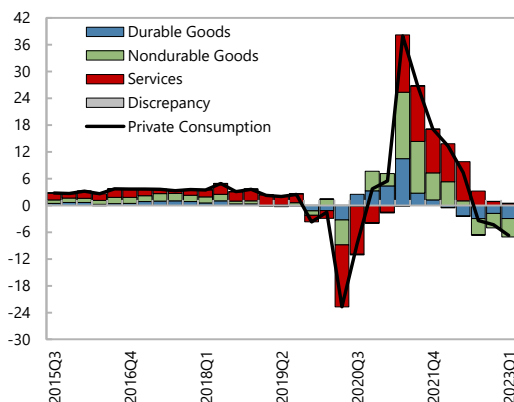
led by the adjustment of private consumption and investment.

Log Real Domestic Demand, SA



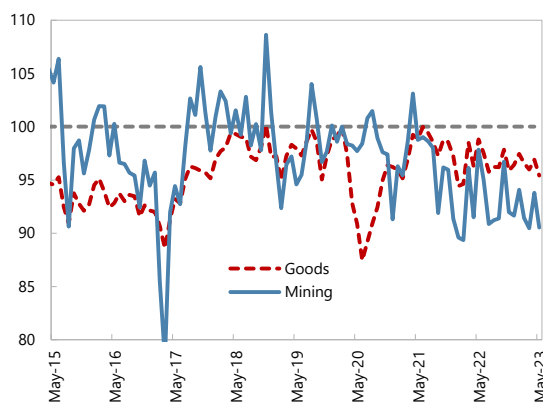
The adjustment of consumption has been more pronounced for goods sectors.

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



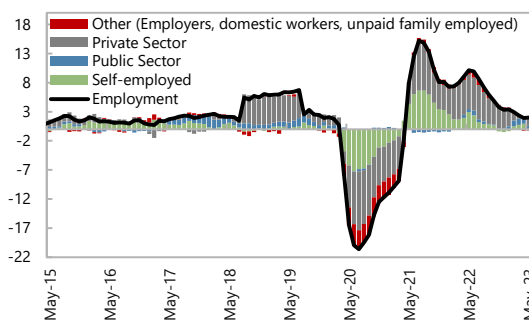
The mining sector continues to operate at a level that is lower than 2019, due to production capacity constraints.

Monthly Economic Activity Index (IMACEC) 1/
(February 2020=100, SA)



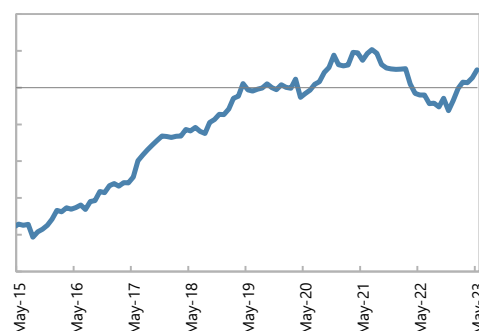
Employment growth has moderated,

Contributions to Employment Growth
(In percent, yoy)



real wage rate is on par with its end-2019 level.

Real Wage Index
(Hourly Remuneration Index - SA, Oct 2019=100)



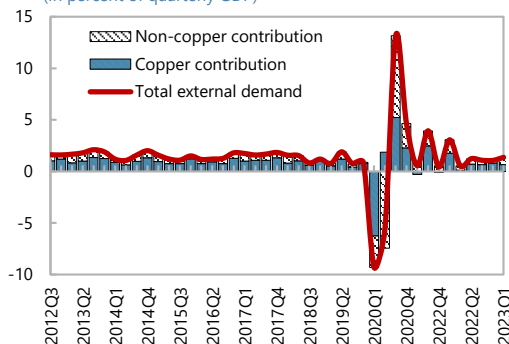
Sources: Central Bank of Chile, Ministry of Finance, INE, Haver Analytics, and IMF staff calculations.

1/ IMACEC is a monthly economic activity indicator compiled by BCCh that can be used as a proxy for real output levels.

Figure 2. Chile: External Sector

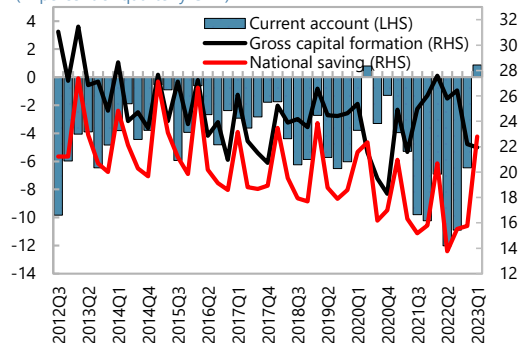
External demand slightly increased in 2023Q1...

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



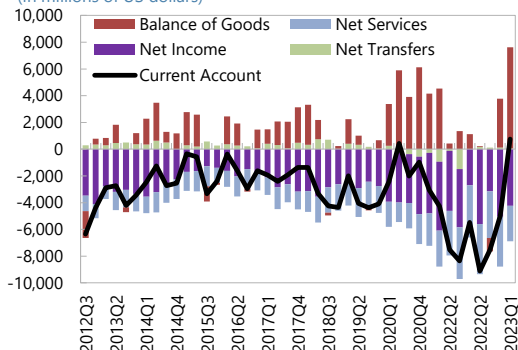
...and the current account reverted back from the large deficit over 2021-22, registering a surplus in 2023Q1...

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



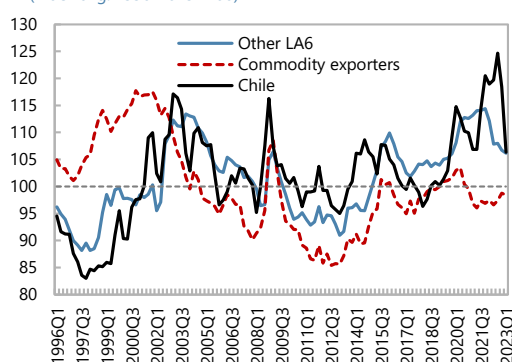
...largely owing to a broad-based import compression.

Current Account Decomposition
(In millions of US dollars)



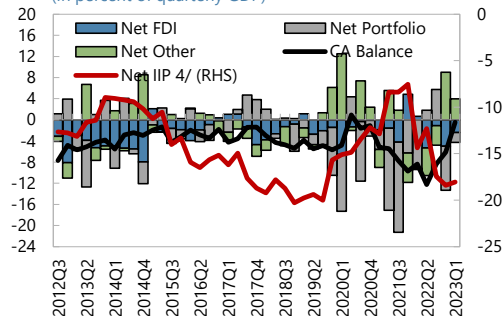
Reflecting lower domestic uncertainty, the REER appreciated sharply over 2022Q4-2023Q1.

Real Effective Exchange Rate
(Index avg. 1996-2019=100)



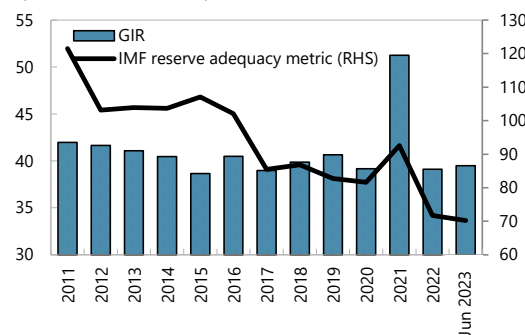
The net IIP has deteriorated since end-2021, reaching -18 percent of GDP in 2023Q1...

Balance of Payments and IIP 4/
(In percent of quarterly GDP)



...while gross international reserves declined in 2022 and remained stable in the first half of 2023.

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



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

1/ Calculated as average real GDP growth of trading partners, weighted by their respective share in Chilean exports.

2/ LA6 includes Brazil, Chile, Colombia, Mexico, Peru, and Uruguay.

3/ Commodity exporters includes Canada, New Zealand, and Australia.

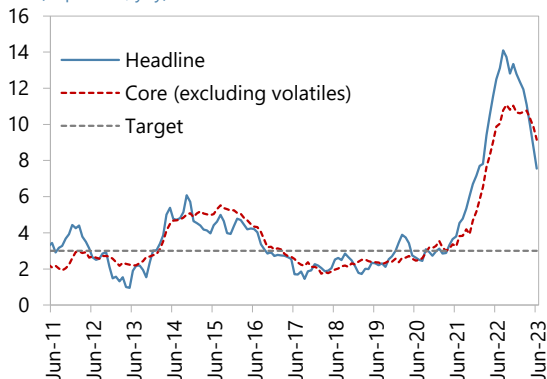
4/ As a percent of four-quarter rolling GDP.

5/ As percent of the IMF reserve adequacy metric. See *Assessing Reserve Adequacy*, IMF.

Figure 3. Chile: Inflation and Monetary Policy

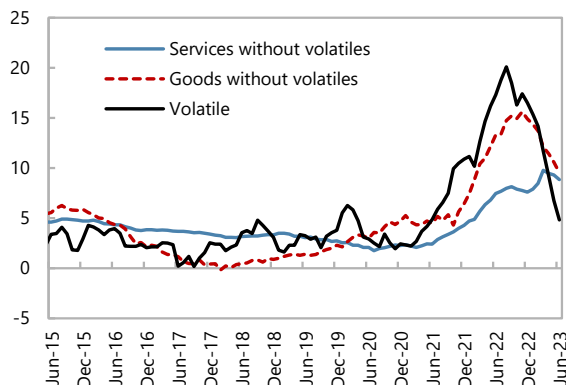
Inflation rates remain high despite the recent decline.

Headline and Core Inflation
(In percent, yoy)



The disinflation has been more pronounced for volatile and goods items, while inflation for service items remain persistent.

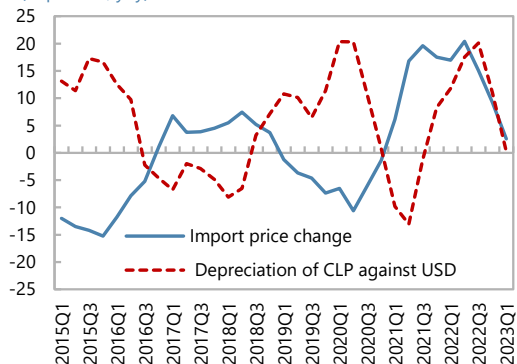
Inflation
(In percent, yoy - NSA, 2018=100)



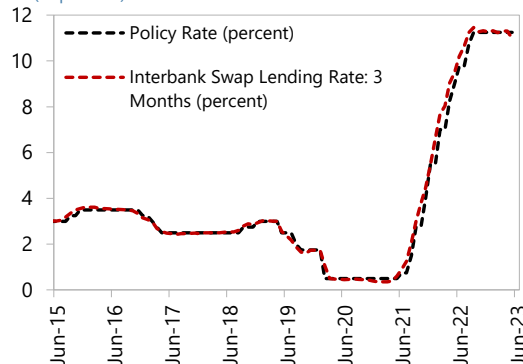
The rapid decline in inflation rates for goods and volatile items can be attributed to the softening of import prices and Chilean peso appreciation.

The BCCCh proactively raised its policy rate.

Movements of Import Price and Exchange Rate
(In percent, yoy)



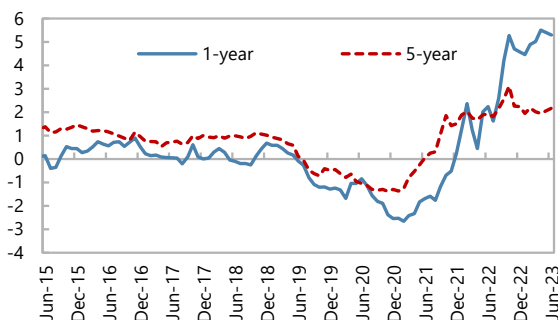
Monetary Policy Rate
(In percent)



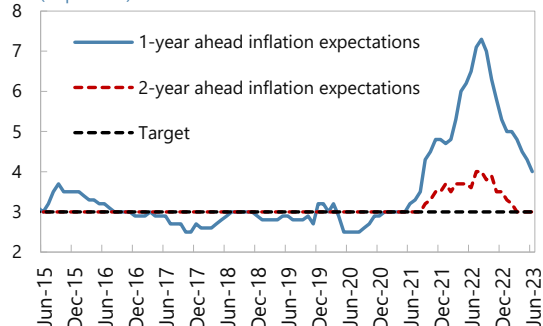
As a result, real interest rates have been high, reflecting the contractionary monetary policy stance.

Inflation expectations from surveys have been converging to BCCCh's inflation target.

Real Interbank Swap Lending Rate



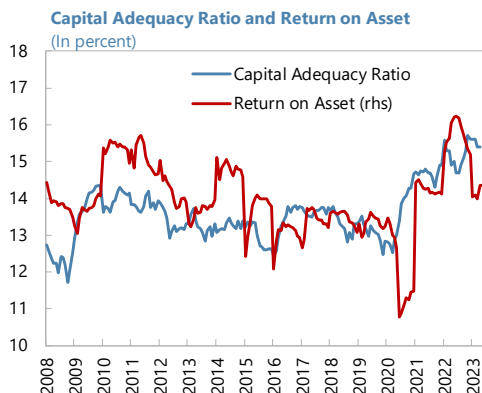
Inflation Expectations at 1 and 2 Years
(In percent)



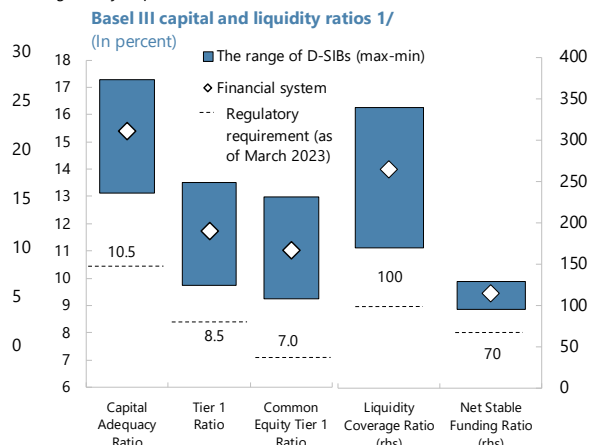
Sources: Central Bank of Chile, Haver Analytics, and IMF staff calculations.

Figure 4. Chile: Financial Sector

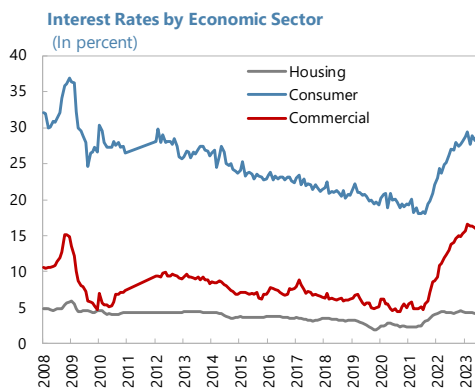
Banks' solvency stands at 15.4 percent in April 2023 while banks' profitability is at 16.3 percent in May 2023.



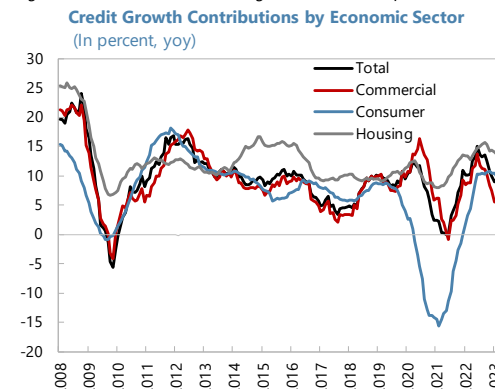
Banks' capital ratios and liquidity ratios are comfortably above the regulatory requirement.



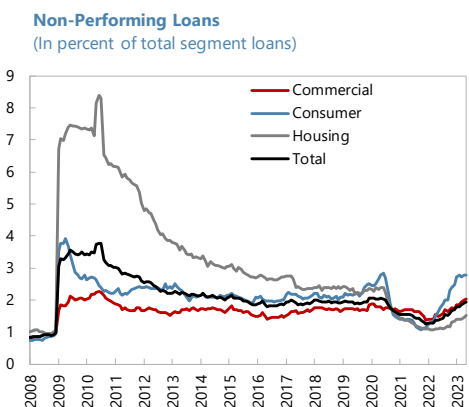
Lending rates have risen along with monetary tightening.



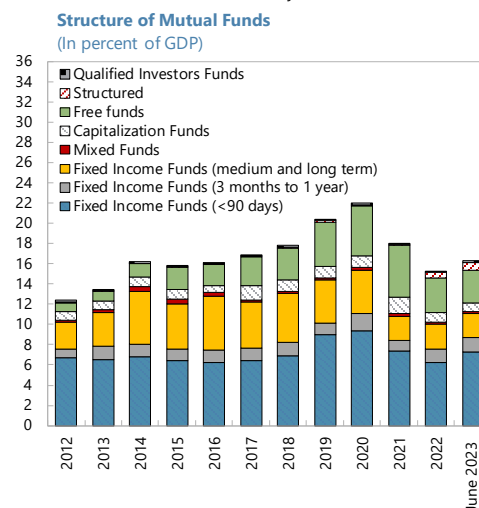
Credit growth has moderated, with a growth rate of 3.4 percent in June 2023.



Non-performing loans have increased to their pre-pandemic level.



Mutual fund assets fell in 2022 and stayed flat as of June 2023.



Sources: Banks' disclosures, CMF, CEIC, Central Bank of Chile, Haver Analytics, and IMF staff calculations.
1/ Capital ratios are as of April 2023. Liquidity ratios of "Financial system" are as of early June 2023 and those of "D-SIBs" are as of March 2023. D-SIBs are Banco de Chile, Banco de Crédito e Inversiones, Banco del Estado de Chile, Banco Santander-Chile, Itaú-Corpbanca, and Scotiabank Chile. "Regulatory minimums" of capital ratios include the conservation buffer but exclude D-SIB buffers.

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

	2019	2020	2021	2022	Proj.					
					2023	2024	2025	2026	2027	2028
Revenues	21.7	19.9	24.1	26.1	23.3	23.4	23.8	23.9	23.8	23.8
Taxes	17.7	16.0	18.8	21.1	18.5	19.4	19.7	19.8	19.8	19.8
Private mining companies	1.0	0.7	1.2	1.5	0.9	1.0	1.2	1.3	1.3	1.3
Other tax revenues, non-mining	16.7	15.4	17.6	19.6	17.6	18.4	18.5	18.5	18.5	18.5
Social contributions	1.5	1.5	1.2	1.0	1.0	1.0	1.0	1.0	1.0	1.0
Grants	0.1	0.1	0.0	0.1	0.0	0.1	0.1	0.1	0.1	0.1
Other revenue	2.4	2.3	4.0	4.0	3.7	3.0	3.1	3.1	3.0	3.0
Codelco revenues	0.4	0.5	1.8	0.7	0.4	0.4	0.6	0.6	0.5	0.5
Income on assets	0.6	0.4	0.2	1.5	1.5	1.0	1.0	1.0	1.0	1.0
Operating income	0.5	0.4	0.5	0.4	0.5	0.5	0.5	0.5	0.5	0.5
Other income	1.0	1.0	1.4	1.3	1.4	1.0	1.0	1.0	1.0	1.0
Expenditures	24.6	27.2	31.8	25.0	25.2	25.0	24.8	24.4	23.8	23.8
Expense	22.5	25.4	30.0	23.5	23.7	23.4	23.3	22.9	22.3	22.3
Compensation of employees	5.0	5.3	4.9	4.7	4.7	4.6	4.6	4.6	4.6	4.5
Purchases of goods and services	2.0	2.2	2.0	2.0	2.0	2.0	1.8	1.8	1.7	1.7
Interest payments	0.9	1.0	0.9	1.0	1.1	1.2	1.3	1.3	1.3	1.2
Subsidies and grants	8.8	11.0	16.8	9.4	8.9	8.4	8.2	7.6	7.1	7.2
Social benefits	4.0	4.4	3.9	4.3	4.7	5.0	5.0	5.2	5.2	5.3
Other expense	1.8	1.7	1.6	2.2	2.2	2.2	2.4	2.4	2.4	2.4
Net acquisition of nonfinancial assets	2.1	1.8	1.8	1.5	1.5	1.6	1.5	1.5	1.5	1.5
Investment	2.1	1.8	1.8	1.5	1.5	1.6	1.5	1.5	1.5	1.5
Net Lending/Borrowing	-2.9	-7.3	-7.7	1.1	-1.9	-1.6	-1.0	-0.5	0.0	0.0
Non-mining overall balance	-4.2	-8.4	-10.7	-1.1	-3.2	-3.0	-2.8	-2.4	-1.8	-1.8
Net Financial Transactions	-2.9	-7.3	-7.7	1.1	-1.9	-1.6	-1.0	-0.5	0.0	0.0
Net acquisition of financial assets	-0.6	-3.2	-1.6	3.5	0.3	2.2	1.7	1.3	1.3	1.4
Net incurrence of liabilities	2.2	4.1	6.0	2.4	2.2	3.8	2.7	1.8	1.2	1.4
Domestic	2.0	2.5	1.3	0.7	1.3	2.9	1.7	1.2	1.5	1.3
External	0.5	1.8	4.8	1.8	1.0	0.9	1.1	0.6	-0.2	0.1
Recognition bonds	-0.2	-0.2	-0.1	-0.1	-0.1	-0.1	0.0	0.0	0.0	0.0
Memorandum Items										
Primary balance 1/	-2.5	-6.7	-7.1	0.7	-2.3	-1.4	-0.8	-0.2	0.3	0.2
Structural Fiscal Balance 2/	-1.7	-1.7	-11.7	-1.9	-3.4	-2.3	-1.8	-1.2	-0.8	-0.7
Structural Revenue	22.9	25.5	20.1	23.1	21.8	22.7	23.0	23.2	23.0	23.1
Fiscal Impulse 3/	0.6	-0.3	9.6	-9.5	0.5	-0.5	-0.3	-0.4	-1.0	-0.5
Expenditure growth (in real terms; annual percent change)	4.2	10.4	33.4	-23.0	0.3	0.3	1.7	0.7	0.0	2.6
Central Government debt net of treasury assets	18.6	24.1	31.0	31.9	32.9	35.6	37.0	37.3	37.1	36.9
Central Government gross debt	28.3	32.4	36.3	38.0	38.0	40.6	41.7	41.8	41.3	41.1
Public Sector Gross Debt 4/	49.2	57.4	67.9	67.3	67.3	69.9	71.0	71.1	70.7	70.4
Public Sector debt net of treasury assets 4/	39.6	49.1	62.6	61.2	62.2	64.9	66.3	66.6	66.5	66.2
General Government Fiscal Balance 5/	-2.7	-7.1	-7.5	1.4	-1.7	-1.4	-0.8	-0.3	0.0	0.0
Nominal GDP (trillions of pesos)	196	201	240	263	282	296	312	329	347	367

Sources: Ministry of Finance and IMF staff calculations and projections.

1/ The primary balance excludes net interest payments (interest payments minus interest receipts). Income on lithium assets (rental contracts) is considered as interest receipt.

2/ The structural fiscal balance includes adjustments for output, copper prices, and lithium revenues based on IMF calculations.

3/ The Fiscal Impulse is defined as the negative of the annual change of the structural non-mining primary balance.

4/ Includes liabilities of the central government, the central bank of Chile and non-financial public enterprises. Excludes Recognition Bonds.

5/ Includes the central government and municipality governments.

Table 3. Chile: Balance of Payments
(In US\$ billions, unless otherwise specified)

	2019	2020	2021	2022	Proj.					
					2023	2024	2025	2026	2027	2028
Current Account	-14.5	-5.0	-23.2	-27.1	-13.3	-13.3	-13.3	-13.4	-13.4	-13.3
Trade balance	3.0	18.9	10.5	3.8	13.2	14.2	16.0	16.7	17.2	18.2
Exports	68.8	74.0	94.8	98.5	102.5	107.5	113.9	118.8	123.4	128.8
Copper	32.6	38.5	52.7	44.7	49.0	51.6	54.1	55.1	55.8	57.3
Non-copper	36.2	35.6	42.0	53.9	53.5	55.9	59.9	63.7	67.7	71.5
Imports	65.8	55.1	84.3	94.7	89.3	93.3	97.9	102.1	106.2	110.6
Net services	-8.1	-7.5	-12.3	-14.8	-10.7	-10.9	-11.6	-12.0	-12.5	-13.0
Net income	-10.4	-15.9	-18.5	-16.5	-16.3	-17.5	-18.5	-19.0	-18.9	-19.4
Net transfers	1.0	-0.5	-2.8	0.4	0.6	0.8	0.7	0.9	0.7	0.8
Capital account balance	1.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Financial Account Balance	-10.7	-4.8	-37.0	-16.2	-18.6	-18.0	-13.3	-13.4	-13.4	-13.3
Foreign direct investment	-3.2	-5.0	-2.0	-8.1	-8.7	-8.0	-9.0	-8.0	-8.8	-9.4
Abroad by Chilean residents	10.3	6.4	13.9	12.8	9.1	10.5	10.5	11.4	10.8	10.5
In Chile by foreign residents	13.6	11.4	15.9	20.9	17.7	18.5	19.5	19.4	19.7	19.9
Of which, debt instruments	1.8	0.9	0.4	1.2	0.9	1.2	1.1	1.0	1.1	1.1
Portfolio investment	-10.6	-13.6	-33.8	-8.4	-6.8	-8.4	-9.2	-8.7	-8.0	-8.7
Abroad by Chilean residents	0.8	-6.4	-1.4	5.9	-0.3	-0.6	1.0	1.6	0.5	0.6
In Chile by foreign residents	11.4	7.2	32.4	14.3	6.6	7.8	10.1	10.3	8.5	9.4
Of which, equities	3.0	0.2	2.4	7.8	3.6	4.3	5.5	5.6	4.6	5.1
Of which, debt	8.5	7.0	30.0	6.5	3.0	3.6	4.6	4.6	3.8	4.2
Financial derivatives	1.5	2.5	0.0	0.6	0.6	0.6	0.6	0.6	0.6	0.6
Other investments	1.7	11.3	-1.2	-0.3	-3.7	-2.2	4.1	2.7	2.8	4.2
Abroad by Chilean residents	3.1	9.5	10.3	8.2	8.2	8.2	8.2	8.2	8.2	8.2
In Chile by foreign residents	1.4	-1.8	11.4	8.5	11.9	10.4	4.0	5.5	5.4	4.0
Change in Reserves Assets	-0.2	-2.9	12.2	-9.2	5.4	4.6	0.0	0.0	0.0	0.0
Errors and omissions	2.6	-2.8	-1.6	1.7	0.0	0.0	0.0	0.0	0.0	0.0
Gross international reserves (in billions of USD)	40.7	39.2	51.3	39.2	44.5	49.2	49.2	49.2	49.2	49.2
	(In percent of GDP)									
Current Account	-5.2	-1.9	-7.3	-9.0	-3.8	-3.7	-3.5	-3.4	-3.2	-3.0
Trade balance of Goods	1.1	7.4	3.3	1.3	3.8	3.9	4.2	4.2	4.1	4.2
Exports	24.7	29.1	29.9	32.8	29.3	29.6	30.0	29.8	29.6	29.5
Copper	11.7	15.1	16.7	14.9	14.0	14.2	14.2	13.8	13.4	13.1
Non-copper	13.0	14.0	13.3	17.9	15.3	15.4	15.7	16.0	16.3	16.4
Imports	23.6	21.7	26.6	31.5	25.5	25.7	25.7	25.6	25.5	25.4
Net services	-2.9	-2.9	-3.9	-4.9	-3.1	-3.0	-3.1	-3.0	-3.0	-3.0
Net income	-3.7	-6.2	-5.8	-5.5	-4.7	-4.8	-4.9	-4.8	-4.5	-4.4
Net transfers	0.3	-0.2	-0.9	0.1	0.2	0.2	0.2	0.2	0.2	0.2
Financial Account Balance 1/	-3.8	-1.9	-11.7	-5.4	-5.3	-5.0	-3.5	-3.4	-3.2	-3.0
	(Annual change in percent)									
Total export volume	-2.2	2.8	-0.8	-1.5	1.9	7.3	4.0	2.2	1.6	1.5
Total import volume	-2.2	-9.8	35.4	-1.5	-6.9	3.0	3.6	3.6	3.2	3.2
Terms of trade 2/	-1.9	11.7	12.2	-8.4	4.1	-3.6	1.1	1.4	1.6	1.4
Export prices 2/	-6.0	4.8	29.0	5.5	2.0	-2.4	2.0	2.0	2.3	2.8
Import prices 2/	-4.2	-6.2	14.9	15.3	-2.1	1.3	0.9	0.6	0.6	1.4
Memorandum Items										
Copper price (WEO; U.S. cents per pound)	273	280	423	401	381	372	373	374	375	376
Copper price (WEO; annual change in percent)	-8.0	2.7	50.9	-5.2	-4.8	-2.5	0.4	0.3	0.3	0.1
Volume of copper exports (2004=100)	104	106	102	95	105	112	119	117	122	126

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

1/ Excluding change in reserves.

2/ Based on a simple average of quarterly price indexes.

Table 4. Chile: Monetary Survey
(In billions of pesos, unless otherwise specified)

	2018	2019	2020	2021	2022
Central Bank					
Net foreign assets	27,043	29,547	27,222	40,891	31,476
Net international reserves	27,731	30,274	27,881	43,643	33,653
Net international reserves (in millions of US\$)	39,861	40,657	39,200	51,330	39,154
Other foreign assets, net	-688	-727	-659	-2,752	-2,177
Domestic assets	-1,862	-3,326	24,086	23,405	24,229
Net credit to general government	-553	-392	327	356	322
Net claims on banks and financial corporations	-5,163	-4,599	21,873	26,894	23,342
Credit to the private sector	47	-33	-31	-38	-33
Other items (net)	3,808	1,699	1,917	-3,807	599
Monetary liabilities	25,181	26,221	5,130	64,297	55,705
Monetary base	11,296	12,335	30,256	21,456	17,641
Currency	6,740	7,576	12,180	15,210	11,608
Required reserves	4,556	4,760	18,077	6,247	6,033
Others	13,885	13,886	21,052	42,840	38,064
Other Depository Institutions					
Net foreign assets	-10,199	-9,700	-1,678	-4,608	-7,158
Net foreign assets (in millions of US\$)	-14,660	-13,027	-2,359	-5,420	-8,328
Domestic assets	156,577	174,810	166,208	186,314	202,600
Credit to general government	3,463	4,615	12,538	17,607	16,945
Credit to the private sector	158,792	174,225	179,836	197,943	217,695
Other items (net)	-5,678	-4,030	-26,166	-29,236	-32,040
Liabilities to the private sector	146,379	165,109	164,528	181,706	195,443
Demand deposits	30,116	36,058	56,393	64,091	47,687
Quasi-money	116,263	129,051	108,135	117,615	147,756
Banking System					
Net foreign assets	16,844	19,846	25,544	36,283	24,318
Domestic assets	142,030	156,183	160,617	177,327	196,243
Net credit to general government	2,910	4,223	12,865	17,963	17,267
Credit to the private sector	158,839	174,192	179,805	197,905	217,662
Other items (net)	-19,715	-22,232	-32,053	-38,541	-38,686
Money and private quasi-money	158,874	176,029	186,161	213,610	220,561
Money	36,856	43,633	68,573	79,301	59,295
Quasi-money	122,018	132,396	117,588	134,309	161,266
Memorandum Items					
	(Annual percentage change)				
Monetary base	1.7	9.2	145.3	-29.1	-17.8
Money and private quasi-money	9.3	10.8	5.8	14.7	3.3
Credit to the private sector (banking system)	10.1	9.7	3.2	10.1	10.0
	(In percent of GDP)				
Monetary base	6.0	6.3	15.0	8.9	6.7
Money and private quasi-money	83.9	89.9	92.4	88.9	84.0
Credit to the private sector (banking system)	83.8	89.0	89.3	82.3	82.9

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

Table 5. Chile: Medium-Term Macroeconomic Framework

	2019	2020	2021	2022	Proj.					2028
					2023	2024	2025	2026	2027	
National Accounts										
(Annual percentage change, unless otherwise specified)										
Real GDP	0.7	-6.1	11.7	2.4	-0.2	1.5	2.2	2.3	2.4	2.5
Total domestic demand	0.9	-9.4	21.7	2.3	-3.1	0.6	2.1	2.7	2.9	3.0
Consumption	0.7	-6.6	19.3	3.1	-2.5	0.3	2.3	2.3	2.7	2.7
Private	0.7	-7.4	20.8	2.9	-3.6	0.6	2.7	2.6	2.9	2.8
Public	0.6	-3.5	13.8	4.1	2.0	-0.5	0.3	1.2	1.7	2.4
Investment 1/	1.7	-18.0	30.1	-0.5	-5.3	1.7	1.6	4.2	3.6	3.8
Fixed	4.5	-10.8	15.7	2.8	-3.5	1.5	2.5	2.8	2.6	2.5
Private	5.1	-10.3	16.0	4.9	-3.7	0.9	3.0	2.8	2.6	2.5
Public	-1.2	-15.5	12.9	-18.9	-0.2	9.5	-3.4	2.5	2.4	2.5
Inventories 2/	-0.6	-1.8	2.8	-0.8	-0.5	0.0	-0.2	0.3	0.2	0.3
Net exports 2/	-0.2	3.3	-9.0	0.1	2.4	1.1	0.0	-0.5	-0.6	-0.6
Exports	-2.5	-0.9	-1.4	1.4	2.2	7.6	3.9	2.2	1.6	1.5
Imports	-1.7	-12.3	31.8	0.9	-6.0	3.1	3.6	3.6	3.2	3.2
GDP Deflator	2.6	9.6	6.8	6.7	7.8	3.3	3.3	3.2	3.0	3.0
Consumer prices										
End of period	3.0	3.0	7.2	12.8	4.5	3.0	3.0	3.0	3.0	3.0
Consumer prices (average)	2.2	3.0	4.5	11.6	7.9	3.7	3.0	3.0	3.0	3.0
Output gap (percent)	-0.1	-5.6	3.9	3.6	0.7	-0.2	-0.2	-0.1	0.0	0.0
Balance of Payments										
(In percent of GDP)										
Current account	-5.2	-1.9	-7.3	-9.0	-3.8	-3.7	-3.5	-3.4	-3.2	-3.0
Trade balance	1.1	7.4	3.3	1.3	3.8	3.9	4.2	4.2	4.1	4.2
Financial account balance	-3.8	-1.9	-11.7	-5.4	-5.3	-5.0	-3.5	-3.4	-3.2	-3.0
Of which, foreign direct investment (net)	-1.2	-2.0	-0.6	-2.7	-2.5	-2.2	-2.4	-2.0	-2.1	-2.2
Change in reserves assets	-0.1	-1.1	3.9	-3.1	1.5	1.3	0.0	0.0	0.0	0.0
Errors and omissions	1.0	-1.1	-0.5	0.6	0.0	0.0	0.0	0.0	0.0	0.0
(Annual percentage change)										
Total export volume	-2.2	2.8	-0.8	-1.5	1.9	7.3	4.0	2.2	1.6	1.5
Of which, copper export volume	-1.1	1.4	-3.2	-6.7	9.9	7.3	5.7	-1.2	3.8	3.8
Total import volume	-2.2	-9.8	35.4	-1.5	-6.9	3.0	3.6	3.6	3.2	3.2
Terms of trade 3/	-1.9	11.7	12.2	-8.4	4.1	-3.6	1.1	1.4	1.6	1.4
Export prices 3/	-6.0	4.8	29.0	5.5	2.0	-2.4	2.0	2.0	2.3	2.8
Copper export price 3/	-7.5	15.9	42.3	-10.2	-1.6	-2.5	0.4	0.3	0.3	0.1
Import prices 3/	-4.2	-6.2	14.9	15.3	-2.1	1.3	0.9	0.6	0.6	1.4
External Debt										
(In percent of GDP)										
Gross external debt	66.7	76.9	72.0	77.6	71.7	72.0	71.9	71.6	70.5	69.8
Public	6.2	8.9	12.6	15.0	14.0	14.4	14.8	14.8	13.9	13.4
Private	60.5	68.0	59.5	62.5	57.8	57.6	57.1	56.8	56.6	56.4
Gross int. reserves (in billions of U.S. dollars)	40.7	39.2	51.3	39.2	44.5	49.2	49.2	49.2	49.2	49.2
Savings and Investment										
Gross domestic investment	25.0	21.1	24.4	25.4	23.5	23.6	23.4	23.8	24.1	24.4
Public	2.3	2.0	2.0	1.7	1.7	1.8	1.7	1.7	1.7	1.7
Private	22.7	19.1	22.4	23.7	21.8	21.7	21.6	22.0	22.3	22.7
National saving	19.8	19.2	17.0	16.4	19.8	19.9	19.9	20.4	20.9	21.3
Public	-0.4	-5.1	-5.5	3.0	0.0	0.5	0.9	1.5	2.0	2.0
Private	20.2	24.3	22.5	13.4	19.7	19.4	18.9	19.0	18.9	19.4
Operations of the Central Government										
Central government gross debt	28.3	32.4	36.3	38.0	38.0	40.6	41.7	41.8	41.3	41.1
Central government debt net of treasury assets	18.6	24.1	31.0	31.9	32.9	35.6	37.0	37.3	37.1	36.9
Central government balance	-2.9	-7.3	-7.7	1.1	-1.9	-1.6	-1.0	-0.5	0.0	0.0
Total revenue	21.7	19.9	24.1	26.1	23.3	23.4	23.8	23.9	23.8	23.8
Total expenditure	24.6	27.2	31.8	25.0	25.2	25.0	24.8	24.4	23.8	23.8
Central government structural balance	-1.7	-1.7	-11.7	-1.9	-3.4	-2.3	-1.8	-1.2	-0.8	-0.7
Employment										
(Annual percentage change, unless otherwise specified)										
Working age population	2.2	2.0	1.4	1.0	1.2	1.2	1.2	1.2	1.2	1.2
Unemployment rate (in percent)	7.2	10.7	8.8	7.9	8.9	9.2	8.6	8.0	7.6	7.5

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

1/ Investment is defined as: gross fixed capital formation + changes in inventories.

2/ Contribution to growth.

3/ Based on a simple average of quarterly price indexes.

Table 6. Chile: Financial Soundness Indicators 1/
(In percent, unless otherwise specified)

	2015	2016	2017	2018	2019	2020	2021	2022 2/
	(As of December)							
Assets								
Total Assets (In billions of Chilean pesos)	203,608	211,687	220,365	246,266	290,500	323,127	361,453	397,298
Percent of GDP	128.4	125.4	122.9	130.0	148.4	160.4	150.4	151.3
Total Loans (In billions of Chilean pesos) 3/	145,597	152,932	159,249	180,957	197,834	204,342	225,485	248,108
Percent of GDP	91.8	90.6	88.8	95.5	101.1	101.4	93.8	94.5
Capital Adequacy								
Regulatory Capital to Risk-Weighted Assets	12.6	13.8	13.8	13.3	12.8	14.7	14.8	15.7
Regulatory Tier 1 Capital to Risk-Weighted Assets	9.4	10.9	11.0	10.7	10.3	10.7	10.6	12.4
Regulatory Tier 1 Capital to Assets	7.4	8.2	8.3	8.2	7.3	6.6	6.7	7.6
Capital to Assets	8.1	8.2	8.4	8.2	8.1	6.9	6.9	6.8
Credit Risk								
Provisions to NPLs	136.1	134.8	128.9	128.4	123.7	171.4	190.6	146.3
NPLs to Gross Loans	1.7	1.8	1.9	1.9	2.1	1.6	1.2	1.6
NPLs Net of Provisions to Capital	-4.5	-4.4	-3.8	-3.8	-3.6	-7.7	-7.5	-4.9
Profitability								
Return on Assets (before tax)	1.5	1.2	1.3	1.4	1.3	0.5	1.5	1.8
Return on Assets (after tax)	1.2	0.9	1.0	1.0	1.0	0.4	1.1	1.5
Return on Equity (before tax)	18.2	14.4	15.9	16.8	16.6	7.7	21.8	25.9
Return on Equity (after tax)	14.7	11.5	12.4	12.5	12.4	5.6	16.6	21.7
Financial Leverage 4/	12.4	12.2	11.9	12.1	12.4	14.5	14.5	14.7
Interest Margin to Gross Income	66.4	66.6	66.2	67.1	66.9	69.4	69.5	74.4
Trading Income to Gross Income	10.5	10.1	8.4	8.6	9.6	8.4	8.2	6.2
Non-interest Expenses to Gross Income	48.7	52.0	50.4	48.9	46.7	54.9	43.6	38.5
Liquidity								
Liquid Assets to Total Assets	13.8	14.7	15.3	14.2	15.3	22.2	20.1	16.4
FX and Derivative Risk								
FX Loans to Total Loans 3/	20.0	18.2	16.6	18.4	18.9	16.1	18.3	19.6
Gross asset position in financial derivatives to capital	54.4	38.4	42.3	46.5	98.3	103.2	102.1	110.6
Gross liability position in financial derivatives to capital	52.7	37.1	42.6	43.1	95.4	106.1	103.2	119.2
Memorandum Items								
Stock Price (IPSA, index, December 2002=1000)	3,680	4,151	5,565	5,105	4,670	4,177	4,308	5,262
General Residential Property Price (index, 2008=100)	161	165	175	188	198	205	220	211
New Residential Property Price (index, 2008=100)	148	153	163	171	178	188	195	204
Used Residential Property Price (index, 2008=100)	175	179	188	208	223	227	250	228
Household debt to GDP 5/	43.7	44.9	46.4	48.6	51.1	50.7	47.2	49.2
Corporate debt to GDP 6/	107.4	103.4	97.4	101.7	109.0	112.5	107.0	102.4

Sources: Chilean Authorities; IMF Financial Soundness Indicators; and IMF staff calculations.

1/ These indicators correspond to depository corporations.

2/ As of November 2022 except for memorandum items.

3/ Gross loans including interbank loans.

4/ Assets to capital.

5/ Debt of households and nonprofit organizations.

6/ Debt of non-financial institutions.

Table 7. Chile: Indicators of External Vulnerabilities
(In percent, unless otherwise specified)

	2015	2016	2017	2018	2019	2020	2021	2022
Financial Indicators								
M3 (percent change)	12.4	8.7	4.8	11.0	10.9	3.1	14.7	3.3
Less pension funds' deposits (annual percentage change)	13.5	10.1	5.0	12.3	9.7	7.0	18.8	3.5
Private sector credit to GDP	82.5	81.6	80.4	83.8	89.0	89.3	82.3	82.9
90-day central bank promissory note (nominal) interest rate (avg.)	2.7	3.5	2.6	2.8	3.3	3.4	3.5	3.6
Share of foreign currency deposits in total deposits	15.4	15.2	13.0	12.8	14.9	14.8	18.8	17.5
Share of foreign currency loans in total credit	13.9	13.0	11.4	11.0	11.8	11.8	9.9	11.8
External Indicators								
Exports of goods, U.S. dollars (annual percentage change)	-17.5	-2.2	13.4	8.6	-8.1	7.6	28.0	4.0
Imports of goods, U.S. dollars (annual percentage change)	-14.7	-4.7	10.0	14.7	-6.6	-16.2	53.0	12.4
Terms of trade (annual percentage change)	-2.8	4.1	10.0	-2.6	-1.9	11.7	12.2	-8.4
REER (annual percent change, period average)	-0.9	-2.9	-2.6	-1.3	4.7	8.2	0.2	7.4
Exchange rate (pesos per U.S. dollar, period average)	654.1	676.9	648.9	641.2	703.3	792.2	759.1	873.2
Current account balance (percent of GDP)	-2.7	-2.6	-2.8	-4.5	-5.2	-1.9	-7.3	-9.0
Financial account less reserves accumulation (percent of GDP)	-1.7	-2.4	-1.2	-4.3	-3.8	-1.9	-11.7	-5.4
Gross official reserves (in billions of U.S. dollars) 1/	38.6	40.5	39.0	39.9	40.7	39.2	51.3	39.2
Gross official reserves to M3	14.9	13.5	11.5	11.9	11.7	10.5	14.3	10.7
Gross official reserves to short-term external debt 2/	96.2	82.2	73.2	69.3	59.2	85.0	79.6	72.0
Gross official reserves (percent of GDP)	15.9	16.2	14.1	13.5	14.6	15.4	16.2	13.0
IMF reserve adequacy metric (percent of GDP) 3/	14.9	15.9	16.5	15.5	17.6	18.9	17.5	18.1
Total external debt (percent of GDP)	65.4	65.6	62.5	59.4	66.7	76.9	72.0	77.6
<i>Of which: External public sector debt</i>	3.2	4.0	4.6	4.9	5.7	8.3	11.4	13.7
Total external debt to exports of goods and services	224.5	235.9	221.1	208.6	240.4	245.7	226.5	217.9
External interest payments to exports of goods and services	7.1	6.4	6.5	5.8	6.8	6.7	4.8	5.8
External amortization payments to exports of goods and services	63.8	57.9	63.1	63.4	74.4	86.2	45.8	60.2
Financial Market Indicators								
Stock market index (in U.S. dollars; period average) 4/	1465	1409	1731	1869	1512	1037	1182	1128
Sovereign long-term foreign currency debt rating (end of period)								
Moody's	Aa3	Aa3	Aa3	A1	A1	A1	A1	A2
S&P	AA-	AA-	A+	A+	A+	A+	A	A
Fitch ratings	A+	A+	A	A	A	A-	A-	A-
Sources: Central Bank of Chile, Haver Analytics, WEO, and IMF staff calculations.								
1/ Gold valued at end-period market prices.								
2/ Includes amortization of medium/long-term debt due during the following year.								
3/ Assessing Reserve Adequacy (IMF, 2011 Policy Paper).								
4/ Morgan Stanley Capital International Index (Dec1987 = 100).								

Table 8. Chile: Capacity to Repay the Fund 1/

	2022	2023	2024	2025	2026	2027	2028
Exposure and Repayments (In SDR millions)							
GRA credit to Chile	--	13,954.0	13,954.0	13,954.0	12,209.8	5,232.8	--
(In percent of quota)	--	800.0	800.0	800.0	700.0	300.0	--
Charges due on GRA credit 2/	0.5	245.4	910.0	909.2	930.1	700.4	174.5
Debt service due on GRA credit 2/	0.5	245.4	910.0	909.2	2,674.3	7,677.4	5,407.2
Debt and Debt Service Ratios 3/							
In percent of GDP							
Total external debt	77.6	81.1	83.0	80.1	77.3	72.2	69.8
Public external debt	15.0	20.3	21.0	20.6	19.3	15.6	13.4
GRA credit to Chile	--	5.6	5.6	5.2	4.2	1.7	--
In percent of Gross International Reserves							
Total external debt	596.7	768.7	797.2	833.2	771.7	681.9	619.4
Public external debt	115.7	192.6	202.1	214.3	193.1	147.5	118.9
GRA credit to Chile	--	53.3	53.4	53.8	42.4	16.2	--
In percent of Exports of Goods and Services							
Total external debt service	66.0	63.6	65.9	61.1	59.4	65.2	63.1
Public external debt service	5.0	2.9	5.3	4.7	5.6	10.7	8.1
Debt service due on GRA credit	0.0	0.3	1.2	1.0	2.8	7.7	5.2
In percent of Total External Debt							
GRA credit to Chile	--	6.9	6.7	6.5	5.5	2.4	--
In percent of Public External Debt							
GRA credit to Chile	--	27.7	26.4	25.1	22.0	11.0	--

Sources: Chilean authorities, IMF Finance Department, World Economic Outlook, and IMF staff estimates.

1/ Assumes full drawing under the FCL upon approval and materialization of an adverse scenario, even though the authorities intend to treat the arrangement as precautionary.

2/ Projections based on the rate of charge as of July 6th, 2023. Includes GRA basic rate of charge, surcharges, service fees, and SDR charges.

3/ Staff projections for external debt, GDP, gross international reserves, and exports of goods and services reflect the adverse scenario (and not the baseline scenario) under which the full FCL drawing is assumed.

Annex I. External Debt Sustainability Analysis

External debt increased to 77.6 percent of GDP in 2022, mainly due to depreciation of the peso and the temporary deterioration in the 2022 current account. Over the medium term, external debt is projected to gradually decline to about 70 percent of GDP by 2028. Despite sensitivity to the exchange rate, external debt remains sustainable under a wide range of shocks. The non-financial corporate sector appears highly leveraged, but a large share of its debt is FDI-related (i.e., intercompany loans) and has foreign exchange hedging or long maturity.

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

	Actual					Projections						Debt-stabilizing non-interest current account 6/ -0.2	
	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028		
Baseline: External debt	59.4	66.7	76.9	72.0	77.6	71.7	72.0	71.9	71.6	70.5	69.8		
Change in external debt	-3.1	7.4	10.2	-4.9	5.5	-5.9	0.3	-0.1	-0.4	-1.1	-0.7		
Identified external debt-creating flows (4+8+9)	3.3	8.0	9.5	-8.0	11.9	5.1	3.3	2.6	2.1	2.3	2.1		
Current account deficit, excluding interest payments	2.8	3.3	-0.2	5.8	7.0	1.5	1.5	1.3	1.1	1.0	0.8		
Balance of goods and services	-1.0	-1.8	4.5	-0.6	-3.7	0.7	0.9	1.2	1.2	1.1	1.2		
Exports	28.5	27.8	31.3	31.8	35.6	32.2	32.7	33.1	32.8	32.7	32.7		
Imports	-29.4	-29.6	-26.8	-32.4	-39.3	-31.5	-31.8	-31.9	-31.7	-31.6	-31.5		
Net non-debt creating capital inflows (negative)	2.9	-0.6	1.5	-0.3	-0.3	1.2	0.7	0.6	0.3	0.7	0.7		
Automatic debt dynamics 1/	-2.4	5.3	8.2	-13.5	5.2	2.4	1.2	0.8	0.7	0.6	0.6		
Contribution from nominal interest rate	1.7	1.9	2.1	1.5	2.1	2.3	2.2	2.2	2.2	2.2	2.2		
Contribution from real GDP growth	-2.3	-0.5	4.5	-7.2	-1.9	0.2	-1.0	-1.5	-1.6	-1.7	-1.7		
Contribution from price and exchange rate changes 2/	-1.7	3.9	1.6	-7.8	5.0	...	...	...	...	...	...
Residual, incl. change in gross foreign assets (2-3) 3/	-6.5	-0.7	0.6	3.1	-6.3	-11.0	-3.0	-2.7	-2.5	-3.4	-2.8		
External debt-to-exports ratio (in percent)	208.6	240.4	245.7	226.5	217.9	222.6	220.3	217.6	217.9	215.4	213.6		
Gross external financing need (in billions of US dollars) 4/	66.5	72.0	73.6	69.3	91.6	67.6	73.1	75.8	78.6	82.5	85.9		
in percent of GDP	22.5	25.9	28.9	21.9	30.4	19.3	20.2	19.9	19.7	19.8	19.7		
Scenario with key variables at their historical averages 5/						71.7	73.9	76.8	79.7	81.4	83.8	1.2	
Key Macroeconomic Assumptions Underlying Baseline													
						Historical Average	Standard Deviation						
Real GDP growth (in percent)	4.0	0.7	-6.1	11.7	2.4	2.3	4.3	-0.2	1.5	2.2	2.3	2.4	2.5
GDP deflator in US dollars (change in percent)	2.8	-6.5	-2.7	11.4	-7.3	-0.8	7.1	16.7	2.1	2.7	2.4	2.0	2.2
Nominal external interest rate (in percent)	2.8	3.0	2.9	2.5	2.7	2.8	0.2	3.4	3.2	3.2	3.3	3.3	3.3
Growth of exports (US dollar terms, in percent)	7.6	-8.1	3.0	26.6	6.3	2.4	11.9	5.3	5.1	6.1	4.1	4.1	4.5
Growth of imports (US dollar terms, in percent)	14.1	-5.4	-17.2	50.6	15.1	4.1	19.6	-6.6	4.4	5.3	4.0	4.2	4.3
Current account balance, excluding interest payments	-2.8	-3.3	0.2	-5.8	-7.0	-2.7	2.3	-1.5	-1.5	-1.3	-1.1	-1.0	-0.8
Net non-debt creating capital inflows	-2.9	0.6	-1.5	0.3	0.3	-0.1	1.7	-1.2	-0.7	-0.6	-0.3	-0.7	-0.7

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

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

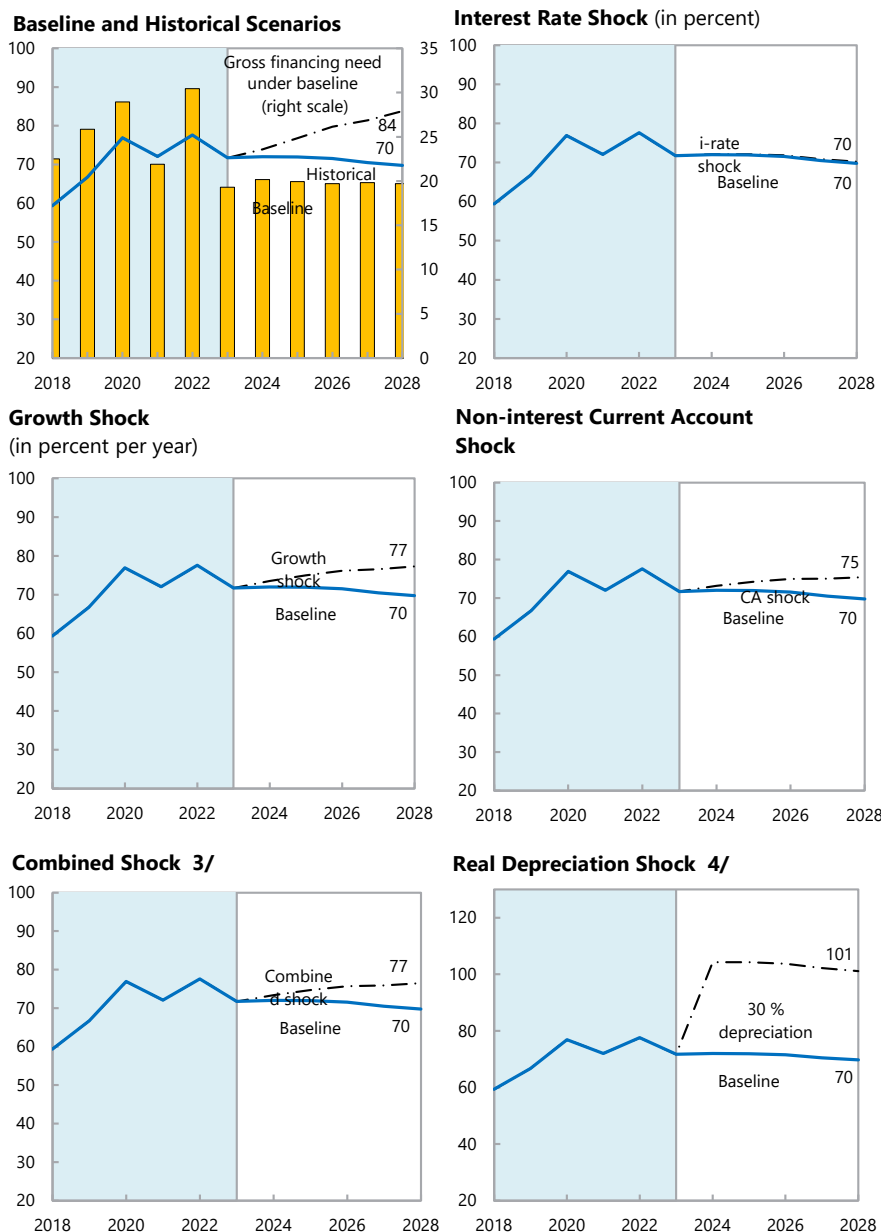
3/ For projection, line includes the impact of price and exchange rate changes.

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

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

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

Figure 1. Chile: External Debt Sustainability: Bound Tests 1/ 2/
(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/ For historical scenarios, the historical averages are calculated over the ten-year period, and the information is used to project debt dynamics five years ahead.
 3/ Permanent 1/4 standard deviation shocks applied to real interest rate, growth rate, and current account balance.
 4/ One-time real depreciation of 30 percent occurs in 2024.

Annex II. Sovereign Risk and Public Debt Sustainability Analysis

Table 1. Chile: Risk of Sovereign Stress

Horizon	Mechanical signal	Final assessment	Comments
Overall	...	Low	The overall risk of sovereign stress is low, reflecting a relatively low level of vulnerability, including in the medium- and long-term horizons.
Near term 1/	...	...
Medium term	Low	Low	Medium-term risks are assessed as low, reflecting the strength of the fiscal framework in guiding fiscal policy and rebuilding buffers.
Fanchart	Low	...	
GFN	Low	...	
Stress test	...	...
Long term	...	Low	Long-term risks are assessed as low, as aging-related expenditure linked to health and pension are expected to be paired to higher revenues.
Sustainability assessment 2/	...	Sustainable with high probability	The projected debt path is expected to stabilize and GFNs will remain at manageable levels. Therefore, debt is assessed as sustainable with high probability.
Debt stabilization in the baseline			No

DSA Summary Assessment

Commentary: Public sector debt is assessed to be sustainable under a wide range of plausible shock scenarios and with high probability, with low medium-term sovereign and financing risks. Medium-term structural fiscal consolidation plans, guided by the structural fiscal balance rule, are fully consistent with fiscal sustainability. The authorities are aiming for an ambitious tax reform, not included in baseline scenario, to finance demands for higher social spending.

Source: Fund staff.

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

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

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

Table 2. Chile: Debt Coverage and Disclosures

						Comments	
1. Debt coverage in the DSA: 1/							
	CG	GG	NFPS	CPS	Other		
1a. If central government, are non-central government entities insignificant?						Yes	
2. Subsectors included in the chosen coverage in (1) above:							
Subsectors captured in the baseline						Inclusion	
CPS	NFPS	GG: expected	CG	1	Budgetary central government	Yes	
				2	Extra budgetary funds (EBFs)	No	Not applicable
				3	Social security funds (SSFs)	No	
				4	State governments	No	Debt issuance not allowed
				5	Local governments	No	
				6	Public nonfinancial corporations	No	
				7	Central bank	No	
				8	Other public financial corporations	No	
3. Instrument coverage:							
	Currency & deposits	Loans	Debt securities	Oth. acct. payable 2/	IPSGSs 3/		
4. Accounting principles:							
Basis of recording			Valuation of debt stock				
Non-cash basis 4/	Cash basis	Nominal value 5/	Face value 6/	Market value 7/			
5. Debt consolidation across sectors:							
Consolidated			Non-consolidated				
Color code:							
■ chosen coverage ■ Missing from recommended coverage ■ Not applicable							

Reporting on Intra-Government Debt Holdings

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

1/ CG=Central government; GG=General government; NFPS=Nonfinancial public sector; PS=Public sector.

2/ Stock of arrears could be used as a proxy in the absence of accrual data on other accounts payable.

3/ Insurance, Pension, and Standardized Guarantee Schemes, typically including government employee pension liabilities.

4/ Includes accrual recording, commitment basis, due for payment, etc.

5/ Nominal value at any moment in time is the amount the debtor owes to the creditor. It reflects the value of the instrument at creation and subsequent economic flows (such as transactions, exchange rate, and other valuation changes other than market price changes, and other volume changes).

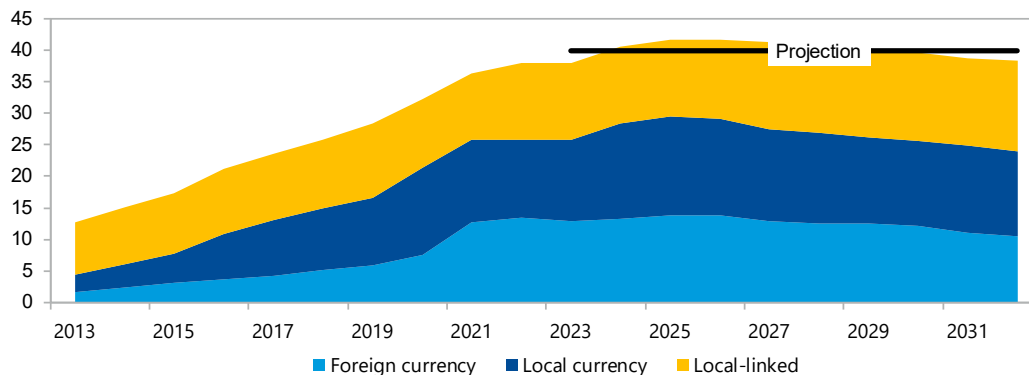
6/ The face value of a debt instrument is the undiscounted amount of principal to be paid at (or before) maturity.

7/ Market value of debt instruments is the value as if they were acquired in market transactions on the balance sheet reporting date (reference date). Only traded debt securities have observed market values.

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

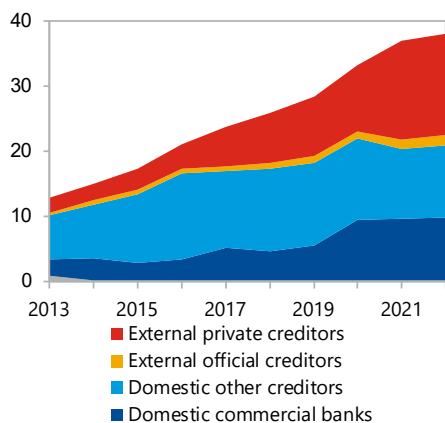
Table 3. Chile: Public Debt Structure Indicators

Debt by Currency (percent of GDP)



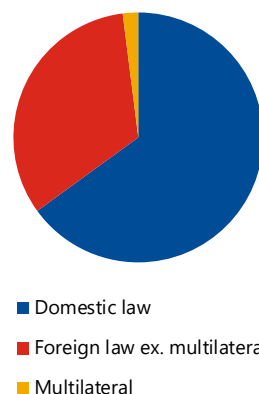
Note: The perimeter shown is central government.

Public Debt by Holder (percent of GDP)



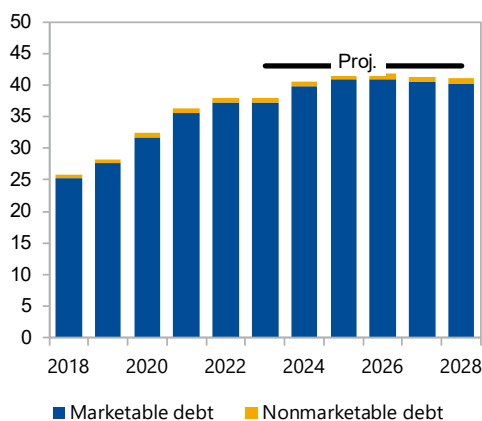
Note: The perimeter shown is central government.

Public Debt by Governing Law, 2022 (percent)



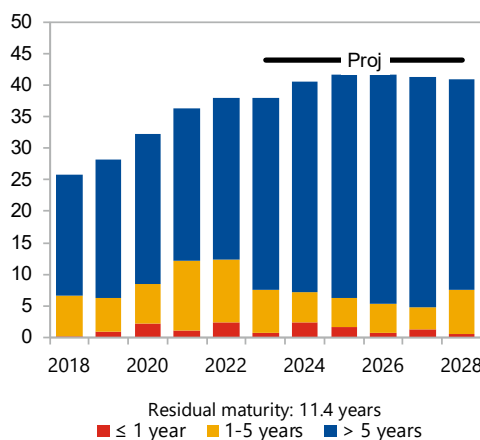
Note: The perimeter shown is central government.

Debt by Instruments (percent of GDP)



Note: The perimeter shown is central government.

Public Debt by Maturity (percent of GDP)



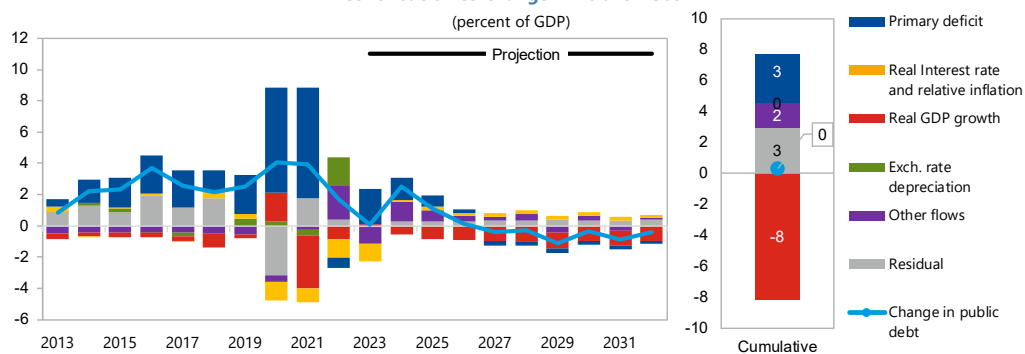
Note: The perimeter shown is central government.

Commentary: Chile has a well-diversified investor base with a large presence of domestic creditors, the share of foreign currency debt increased in 2021 due to the pension withdrawals but is still relatively small and expected to return to historical levels, residual maturity of debt is above 10 years, and most of its debt is traded on secondary markets.

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

	Actual	Medium-term Projection						Extended Projection			
	2022	2023	2024	2025	2026	2027	2028	2029	2030	2031	2032
Public debt	38.0	38.0	40.6	41.7	41.8	41.3	41.1	39.9	39.6	38.7	38.3
Change in public debt	1.7	0.1	2.5	1.1	0.1	-0.4	-0.3	-1.1	-0.3	-0.9	-0.4
Contribution of identified flows	1.3	0.1	2.2	0.8	-0.2	-0.8	-0.6	-1.5	-0.7	-1.3	-0.8
Primary deficit	-0.7	2.3	1.4	0.8	0.2	-0.3	-0.2	-0.3	-0.2	-0.2	-0.2
Noninterest revenues	24.7	21.8	22.4	22.8	22.9	22.8	22.8	22.8	22.8	22.8	22.8
Noninterest expenditures	24.0	24.0	23.8	23.6	23.1	22.5	22.6	22.5	22.6	22.5	22.6
Automatic debt dynamics	-0.2	-1.0	-0.4	-0.7	-0.7	-0.7	-0.8	-0.8	-0.7	-0.7	-0.7
Real interest rate and relative inflation	-1.2	-1.1	0.1	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2
Real interest rate	-1.1	-1.6	0.0	0.0	0.0	0.1	0.0	0.1	0.1	0.1	0.1
Relative inflation	0.0	0.5	0.1	0.2	0.2	0.1	0.1	0.1	0.1	0.1	0.1
Real growth rate	-0.9	0.1	-0.6	-0.9	-0.9	-1.0	-1.0	-1.0	-1.0	-1.0	-0.9
Real exchange rate	1.8	...	...	...	...	...	...	...	...	...	...
Other identified flows	2.2	-1.1	1.3	0.7	0.3	0.3	0.4	-0.5	0.3	-0.3	0.1
Contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
(minus) Interest Revenues 1/	-1.5	-1.5	-1.0	-1.0	-1.0	-1.0	-1.0	-1.0	-1.0	-1.0	-1.0
Other transactions 2/	3.6	0.4	2.3	1.7	1.3	1.3	1.4	0.5	1.3	0.7	1.1
Contribution of residual	0.4	-0.1	0.3	0.3	0.3	0.3	0.4	0.4	0.4	0.4	0.4
Gross financing needs	0.7	4.9	2.4	3.9	3.9	0.7	1.7	0.5	2.3	0.8	0.3
of which: debt service	2.9	4.1	1.9	4.1	4.7	1.9	3.0	1.8	3.5	2.0	1.5
Local currency	2.1	2.9	1.3	2.4	1.8	0.7	1.3	0.6	1.5	0.6	0.6
Foreign currency	0.5	0.4	0.4	1.0	0.9	1.1	1.0	0.9	0.8	1.2	0.7
Memo:											
Real GDP growth (percent)	2.4	-0.2	1.5	2.2	2.3	2.4	2.5	2.5	2.5	2.5	2.5
Inflation (GDP deflator; percent)	6.7	7.8	3.3	3.3	3.2	3.0	3.0	3.0	3.0	3.0	3.0
Nominal GDP growth (percent)	9.2	7.5	4.8	5.5	5.6	5.5	5.6	5.6	5.6	5.6	5.6
Effective interest rate (percent)	3.3	3.2	3.3	3.3	3.3	3.2	3.1	3.3	3.3	3.3	3.2

Contribution to Change in Public Debt

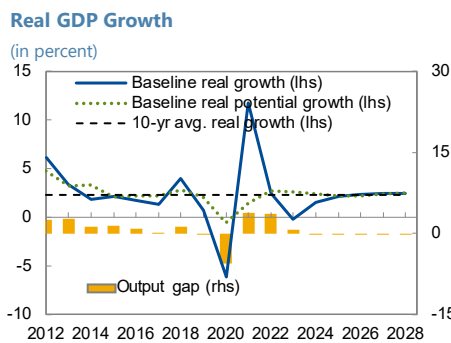
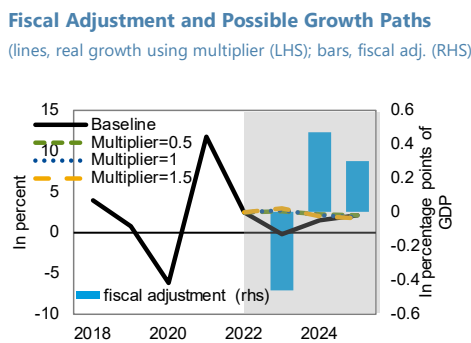
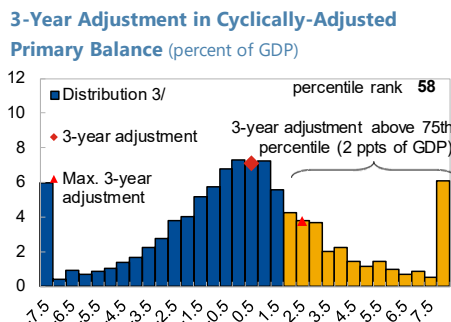
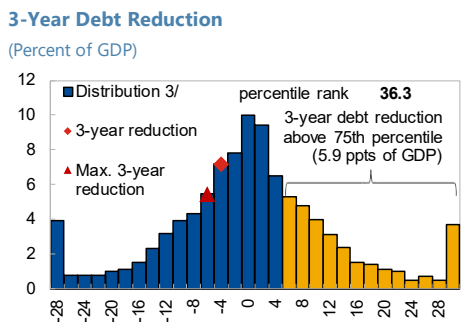
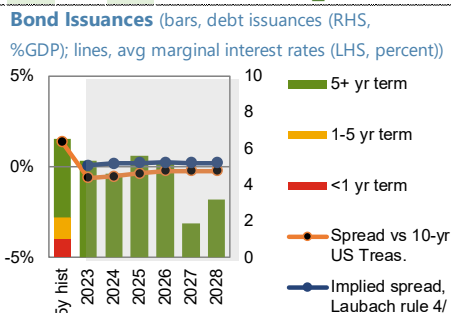
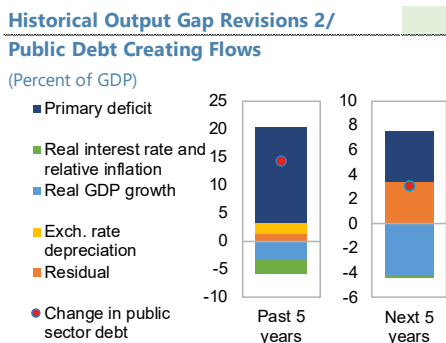
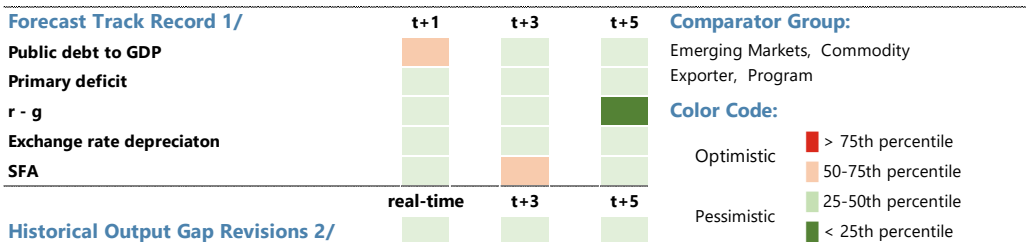


Commentary: Public debt will peak in 2026 and then gradually fall until 2032 under the assumption that the government adheres to its medium-term target of a broadly balanced fiscal position.

1/ Interest revenues include not only interest income on government assets but also lithium rental contracts' revenues, as lithium is considered an asset of the state and this income on assets is currently being considered akin to interest rates.

2/ Other transactions include the use and accumulation of government financial assets.

Table 5. Chile: Realism of Baseline Assumptions



Commentary: The realism analysis does not point to major concerns, and the forecast track record does not reveal any systematic bias. The projected fiscal consolidation is reasonable, when considering Chile's history and other country experiences. Growth in 2023 is expected to be lower than implied by standard fiscal multipliers, as it is largely driven by the normalization of households' liquidity position after the exhaustion of the pension withdrawals.

Source : IMF Staff.
 1/ Projections made in the October and April WEO vintage. Program status not used in creating comparator group due to lack of data.
 2/ Calculated as the percentile rank of the country's output gap revisions (defined as the difference between real time/period ahead estimates and final estimates in the latest October WEO) in the total distribution of revisions across the data sample.
 3/ Data cover annual observations from 1990 to 2019 for MAC advanced and emerging economies. Percent of sample on vertical axis.
 4/ The Laubach (2009) rule is a linear rule assuming bond spreads increase by about 4 bps in response to a 1 ppt increase in the projected debt-to-GDP ratio.

Table 6. Chile: Medium-Term Risk Analysis

	Value	Contrib ^{1/}	Percentile in peer group ^{2/}																				
Final Fanchart (pct of GDP) Debt Fanchart Module																							
	Fanchart width (percent of GDP)	34.2	0.5																				
	Probability of debt non-stabilization (percent)	24.2	0.2																				
	Terminal debt-to-GDP x institutions index	15.9	0.3																				
	Debt fanchart index (DFI)		1.0																				
	Risk signal: ^{3/}		Low																				
Gross Financing Needs (pct of GDP) Gross Financing Needs (GFN) Module																							
	Average baseline GFN (percent of GDP)	2.9	1.0																				
	Banks' claims on the gen govt (pct bank assets)	6.7	2.2																				
	Chg. In banks' claims in stress (pct banks' assets)	2.3	0.8																				
	GFN financeability index (GFI)		3.9																				
	Risk signal: ^{4/}		Low																				
Medium-Term Index (index number)																							
	<table border="1"> <thead> <tr> <th></th> <th>Value</th> <th>Norm. Value</th> <th>Weight</th> <th>Contribution</th> </tr> </thead> <tbody> <tr> <td>Debt fanchart index</td> <td>1.04</td> <td>0.23</td> <td>0.50</td> <td>0.12</td> </tr> <tr> <td>GFN financeability index</td> <td>3.92</td> <td>0.08</td> <td>0.50</td> <td>0.04</td> </tr> <tr> <td>Medium-term index</td> <td></td> <td>0.2</td> <td></td> <td></td> </tr> </tbody> </table>				Value	Norm. Value	Weight	Contribution	Debt fanchart index	1.04	0.23	0.50	0.12	GFN financeability index	3.92	0.08	0.50	0.04	Medium-term index		0.2		
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GFN financeability index	3.92	0.08	0.50	0.04																			
Medium-term index		0.2																					
	Risk signal: ^{5/}		Low																				
	Final assessment:		Low																				
	Prob. of missed crisis, 2023-2028, if stress not predicted: 0.0 pct.																						
	Prob. of false alarms, 2023-2028, if stress predicted: 68.2 pct.																						
<p>Commentary: The debt fanchart and gross financing needs modules point to a low level of risk, underpinned by the government's commitment of keeping debt below a prudent ceiling of 45 percent of GDP, moderate gross financing needs, and the ability of the banking sector to act as a residual creditor under a stress scenario. The medium-term risk analysis also points to a low level of risk under a stress scenario of a natural disaster shock in the magnitude of 4.5 percent of GDP and a commodity price shock.</p>																							
Source: IMF staff estimates and projections.																							
1/ See Annex IV of IMF, 2022, Staff Guidance Note on the Sovereign Risk and Debt Sustainability Framework for details on index calculation.																							
2/ The comparison group is emerging markets, commodity exporter, program.																							
3/ The signal is low risk if the DFI is below 1.13; high risk if the DFI is above 2.08; and otherwise, it is moderate risk.																							
4/ The signal is low risk if the GFI is below 7.6; high risk if the DFI is above 17.9; and otherwise, it is moderate risk.																							
5/ The signal is low risk if the GFI is below 0.26; high risk if the DFI is above 0.40; and otherwise, it is moderate risk.																							



CHILE

REVIEW UNDER THE FLEXIBLE CREDIT LINE ARRANGEMENT—SUPPLEMENTARY INFORMATION

August 18, 2023

Approved By
Patricia Alonso-Gamo
(WHD)

Prepared by the Chile Team of the Western Hemisphere
Department

The information below has become available following the issuance of the staff report. It does not alter the thrust of the staff report.

1. The economy continued to adjust in the second quarter of 2023.

Seasonally adjusted real GDP contracted by 0.3 percent in 2023Q2 relative to 2023Q1, broadly in line with staff's projections. From the demand side, the contraction is mainly attributed to lower exports and the continued weak growth of private consumption. From the production side, the weakening in manufacturing, construction, and trade activities in the second quarter also contributed to lower output. The three-month average of the unemployment rate stayed unchanged at 8.5 percent as of June. Amid the broad-based decline of imports, the current account deficit continued to narrow, with the 4-quarter moving average deficit declining to 4.3 percent of GDP in 2023Q2, from 9 percent in 2022Q4.

2. With inflation moderating further, the Central Bank of Chile (BCCh) started its rate cutting cycle on July 28.

Headline inflation slowed to 6.5 percent (yoy) in July, from 7.6 percent in June. Core inflation decelerated to 8.5 percent in July, from 9.1 percent in June. The BCCh lowered its monetary policy rate by 100 basis points to 10.25 percent, the first rate reduction since the policy rate reached a peak of 11.25 percent in October 2022. The BCCh cited the consolidation of the inflationary convergence process as the driver for the change and communicated that future policy rate cuts will consider the evolution of the macroeconomic scenario and its implications for the trajectory of inflation.

3. The Chilean peso (CLP) experienced higher volatility since July.

After fluctuating at around 800 pesos per U.S. dollar from February to early July 2023, the CLP depreciated to an average of 852 pesos per U.S. dollar in the first half of August. The narrowing of the CLP-USD interest rate differential as well as the slowing growth momentum in China and potential implications for commodity prices could explain part of the depreciation.

4. Gross international reserves (GIR) increased by about US\$1½ billion since early June. As of August 7, GIR stood at US\$40.7 billion, with the increase reflecting purchases by the BCCh under its ongoing reserve accumulation program which started in mid-June and aims to lift reserves by US\$10 billion over twelve months.

5. The government unveiled more details on its fiscal pact reform proposal. In particular, the government aims to proceed sequentially with multiple legislative initiatives through May 2024. The main elements of the proposal, including the envisaged revenue targets and spending priorities, are in line with the summary in the staff report. The detailed proposal comprises five categories: (i) modernizing the tax system, (ii) covering higher envisaged spending on universal guaranteed pensions, health care, care services, and security, (iii) enhancing public spending efficiency, including through spending reviews and governance reforms, (iv) incentivizing investment, enhancing productivity and reducing informality, and (v) adopting an income tax reform. The government also wants to create an expert commission that would monitor the implementation of the fiscal pact and mechanisms for ex post evaluations. The government is working toward garnering political support in the fragmented Congress which is still elusive, in particular for the proposed income tax reform.

**Statement by Luis Oscar Herrera, Executive Director for Chile
and Andrea Ana Mostajo Soto, Advisor to Executive Director
August 23, 2023**

On behalf of the Chilean authorities, we thank staff for the open and constructive discussions during the mid-term Flexible Credit Line (FCL) review. We also acknowledge its assessment that Chile remains eligible for the FCL arrangement. The FCL has been a valuable safeguard against risks in the past year, and, combined with Chile's very strong policy and institutional framework, it has boosted market confidence. Going forward, access to the FCL for the next 12 months will protect the Chilean economy amid ongoing global uncertainty. The authorities will continue to treat FCL access as precautionary and prepare for a gradual exit when external conditions allow.

The Chilean economy is making progress towards sustainable growth despite external challenges. Coordinated monetary and fiscal policies have effectively reduced the positive output gap, inflationary pressures, and current account deficit built up during the pandemic. Recent data indicates that the positive activity gap is closing and may turn negative in the second half of this year. The economy is projected to grow between -0.5 percent and 0.25 percent in 2023, gradually reaching its potential growth rate of 2-3 percent in 2025. Inflationary pressures are receding, and headline inflation is projected to return to the Central Bank of Chile (CBC)'s target of 3 percent in the second half of 2024. The CBC has also started to ease monetary policy from restrictive levels. Additionally, the current account deficit, after reaching historically high levels, is expected to moderate to 3.7 percent of GDP in the fourth quarter of this year and stabilize at around 4 percent in 2024 and 2025.

Compared to a year ago, the peso has strengthened, and domestic financial markets have experienced a positive correction due to reduced idiosyncratic uncertainty and improved inflation expectations. Sovereign risk indicators are currently at historically low levels.

Very Strong Policies and Policy Frameworks

The authorities remain firmly committed to fiscal responsibility and debt sustainability, supported by a very strong fiscal framework. Since 2001, Chile's fiscal policy has been guided by a structural rule, complemented by a sovereign stabilization fund, and backed by the Fiscal Responsibility Law and the Autonomous Fiscal Council. This framework has successfully restrained the growth of public debt, built significant liquidity buffers, and maintained favorable conditions in international capital markets while ensuring macroeconomic stability and effective countercyclical fiscal policy.

The government is implementing a multi-year consolidation plan with the goal to achieve a structural balanced budget by 2026 (-0.3 percent of GDP), while also maintaining public debt below 45 percent of GDP. To support their social agenda, the administration introduced a

new "fiscal pact" proposal, including a comprehensive set of initiatives focused on social spending, revenue mobilization, investment and productivity enhancement, and increased transparency in public spending. The forthcoming phase will involve further engagements with key economic, social, and political stakeholders. A new tax reform bill is expected to be submitted to congress during March-May of next year.

The CBC remains committed to achieving low and stable inflation through very strong monetary and exchange rate policies. Since 1999, the CBC has followed a fully-fledged inflation targeting and a free-floating exchange rate regime. This approach has maintained inflation around the 3 percent target for the past two decades, while allowing monetary policy to act in a counter-cyclical manner when needed. Since mid-2021, the monetary policy rate (MPR) has been adjusted to a restrictive level to address external and domestic inflationary pressures, leading to the effective control of inflation, and promoting sustainable consumption. In late July, as firmer evidence of inflation convergence emerged and inflation expectations moved closer to the target level, the CBC began an easing cycle by reducing the MPR by 100 basis points (10¼ percent). The magnitude and timing of further easing will depend on the macroeconomic scenario's evolution and its impact on inflation. The CBC remains committed to flexible action if internal or external risks arise or when warranted by macroeconomic conditions.

The peso is a free-floating currency, serving as a crucial shock absorber for the economy. Interventions in the foreign exchange market (FXI) have been exceptional, transparent, and limited to addressing disorderly market conditions, as stated in the staff report. In response to excessive volatility observed in mid-2023, the CBC conducted a temporary, transparent, and fully sterilized FXI program, involving interventions in the spot and forward foreign exchange market. The 11-week program effectively stabilized the currency market, reduced price formation frictions, and prevented wider financial and real sector effects. The authorities maintain their commitment to a flexible exchange rate. Recently, they announced a reserve accumulation program to rebuild and expand the international reserve stock by US\$10 billion, along with the gradual roll-off of the stock of FX forwards provision that started last April.

The financial sector remains liquid, solvent, and well capitalized, supported by effective supervision and regulation. Despite the ongoing monetary tightening and the withdrawal of support measures introduced during the pandemic, the banking system remains healthy and capable of withstanding stressed scenarios. The authorities are vigilant to any emerging pockets of vulnerabilities.

Significant steps have been taken to enhance financial sector oversight, following the 2021 FSAP recommendations. The implementation of Basel III has been resumed to strengthen financial buffers in the banking system. As a precautionary measure amid external uncertainty, the CBC activated the counter-cyclical buffer. Currently, the authorities are working on alternatives to improve the crisis management toolkit and bank resolution framework. A set of

reforms to strengthen the policy response to financial distress situations has been submitted to congress. They are confident that the ongoing financial regulation agenda will continue to bolster the resilience of the Chilean financial system.

FCL Access and Exit Strategy

The FCL continues to provide an important buffer of international liquidity for the Chilean economy, especially amidst high external uncertainty and risks. While external pressures have eased since the FCL request, Chile still faces elevated external tail risks. For instance, an abrupt tightening of financial conditions in advanced economies could trigger negative spillovers into emerging market economies, resulting in new episodes of increased global risk aversion, capital flow volatility, and portfolio rebalancing away from emerging markets. Similarly, an increase in commodity price volatility could have further implications on the peso, FDI inflows, and activity. Against this backdrop, the FCL continues to play a vital role in preventing tail risk scenarios with potential negative social and economic consequences for Chile. It also contributes to the stability of the international monetary system, alongside the network of precautionary arrangements across Latin America.

The authorities are committed to treating FCL access as a precautionary arrangement and plan to gradually exit the instrument when external conditions allow. They have already started preparations to strengthen the external liquidity position of the CBC by implementing a reserve accumulation program since June 2023. The goal is to lift reserves to their historical average, at around 14 percent of GDP, which will complement other sources of international liquidity. Similarly, the authorities recognize the importance of a clear and appropriate communication strategy when exiting the instrument. They will continue to collaborate with staff to develop an effective communication strategy for this purpose.

The authorities greatly appreciate the support received from the IMF through the FCL arrangement, which has provided a strong signal of confidence in the strength of Chile's policy frameworks, institutions, and fundamentals, as well as an important buffer amid unprecedented uncertainty and volatility in global financial markets.