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IMF Country Report No. 11/260

CHILE

2011 ARTICLE IV CONSULTATION

August 2011

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the 2011 Article IV consultation with Chile, the following documents have been released and are included in this package:

- **Staff report** for the 2011 Article IV consultation, prepared by a staff team of the IMF, following discussions that ended on July 8, 2011, with the officials of Chile on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on August 9, 2011. The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.

- **Public Information Notice** (PIN) summarizing the views of the Executive Board.

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

Selected Issues Paper
Financial System Stability Assessment

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

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International Monetary Fund
Washington, D.C.

CHILE

STAFF REPORT FOR THE 2011 ARTICLE IV CONSULTATION

August 9, 2011

KEY ISSUES

Context. The economy has recovered rapidly from the global financial crisis and the February 2010 earthquake and the output gap has closed. The unemployment rate is at historically low levels and the external current account surplus has narrowed despite favorable terms of trade. Headline inflation moved above the 3 percent target in the first half of 2011, although core inflation remained contained. Strong economic growth is expected to continue through 2012.

Normalization of policies. The central bank appropriately accelerated the pace of policy normalization in early 2011, helping bring inflation expectations closer to the target. A more ambitious withdrawal of fiscal stimulus is also warranted as it would help reduce domestic demand pressures and improve the macroeconomic policy mix. Staff recommended aiming for a positive structural fiscal balance over the medium term, and frontloading the consolidation.

Mitigating risks to financial stability. Continued monitoring is warranted to prevent a buildup of leverage in the corporate and household sectors. In the context of heightened risks of a resurgence of global financial stress, it also would be prudent to continue to maintain high levels of liquidity in the banking system. In case concerns arise about the speed of credit or asset price growth, it would be advisable to strengthen prudential measures to maintain stability. As discussed in the companion FSSA report, efforts to improve the regulatory and supervisory framework are welcome.

Structural challenges. The government has launched several initiatives aimed at boosting productivity, including reducing the cost of doing business, increasing competition, and supporting innovation. Improving labor market efficiency and raising labor force participation should remain on the structural reform agenda going forward.

Approved By
Miguel Savastano and Tamim Bayoumi

This report is based on discussions conducted in Chile during June 28-July 8, 2011. The team comprised Dora Iakova (head), Jorge Chan-Lau, Nicolas Magud, Jiri Podpiera, and Yi Wu (WHD). Miguel Savastano (WHD), Marina Moretti (MCM), and Pablo Garcia (OED) participated in the concluding meetings.

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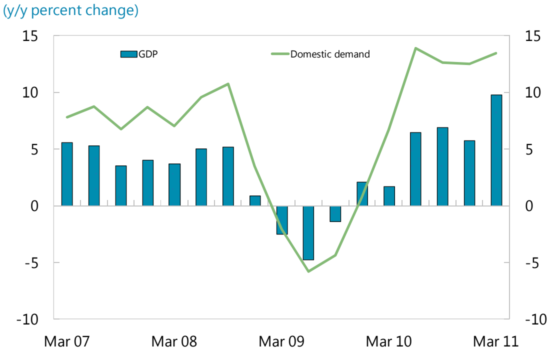
ANNEX

I. THE CURRENT CONJUNCTURE

1. **Chile's economy has recovered rapidly from the global financial crisis and the February 2010 earthquake.** Its resilience was underpinned by solid policy frameworks (including a fiscal rule, inflation targeting and exchange rate flexibility), a sound banking system and a strong policy response, facilitated by the existence of large fiscal buffers. Real GDP increased 5.2 percent in 2010, and the expansion continued in the first quarter of 2011.

2. **Spare capacity in the economy has diminished and some constraints are emerging.** Supportive macroeconomic policies and large reconstruction spending have boosted domestic demand growth to double digit levels (see figure). The unemployment rate has declined to a historically low level, although wage growth has remained moderate so far. The rapid growth of domestic demand has fueled import growth and the external current account surplus has narrowed, despite favorable terms of trade. While the nominal appreciation of the peso has helped moderate the rise in consumer prices, headline inflation moved above the 3 percent target in the first half of 2011, although core inflation remained contained.

Real GDP and Domestic Demand
(y/y percent change)



3. **Credit growth has strengthened.** Credit conditions have eased significantly over the last twelve months for both firms and households, and credit growth has accelerated in line with the rising income. Commercial and mortgage bank loans grew by 9 percent in real terms year-on-year in May, and consumer loans increased by 13 percent. External borrowing by non-financial corporations has also increased significantly. Nonetheless, the ratios of corporate debt-to-GDP and household debt-to-disposable income remain broadly stable.

4. **Withdrawal of the large crisis-related policy stimulus is under way.**

- **Monetary policy.** From mid-2010 to June 2011, the policy rate was raised from 0.5 percent to 5.25 percent and markets expect some further tightening in the remainder of the year. In January 2011, the central bank announced a daily schedule of foreign exchange purchases to increase its gross reserve by US$12 billion by year-end.

- **Fiscal policy.** The structural fiscal deficit is projected to decline to

1.6 percent of GDP by end-2011 (½ percentage point lower than in 2010). Reflecting high copper prices, the headline fiscal balance is expected to post a surplus of 1.3 percent of GDP (from a deficit of 0.4 percent the previous year). The medium-term fiscal goal of the government is to reduce the structural fiscal deficit to 1 percent by 2014.

5. **Despite a pickup in gross capital inflows, net capital inflows remain moderate.** Higher portfolio investments abroad by domestic pension funds have largely offset rising gross portfolio inflows. In early 2011, however, large foreign borrowing by banks and corporate resulted in a sizable surplus in the financial account.

6. **The real effective exchange rate continued its gradual appreciation, in line with improving fundamentals.** In nominal terms, the peso appreciated 14 percent vis-à-vis the U.S. dollar in the year to May. In real effective terms, however, the appreciation was only 4 percent. The strengthening of the peso is consistent with improvement in the terms of trade and other fundamentals. Staff estimates, using CGER-type methodologies and sectoral analysis, suggest that the real effective exchange rate is broadly in line with equilibrium (Selected Issues Paper, Chapter 1).

7. **The FSAP update concluded that the financial system was overall sound**. Banks are well capitalized (with high quality of capital and low leverage), liquid, and highly profitable. Non-performing loans declined in 2010, and provision coverage increased. Despite the recent rise in external borrowing, banks' reliance on foreign funding remains limited and there are no significant currency mismatches in the banking and corporate sectors.

II. OUTLOOK AND RISKS

8. **Looking ahead, rapid economic growth is likely to continue.** Staff projects real GDP growth of about 6½ percent in 2011, slowing down to 5 percent in 2012. Large scale private and public construction spending is expected to sustain investment growth, while strong employment and wage growth would support consumption. The external current account balance is likely to deteriorate further as imports continue to grow faster than exports. CPI inflation is projected to increase in the second half of 2011 as spare capacity diminishes further, and then decline gradually towards the central bank target during 2012 as the effect of interest rate increases filters through.

9. **In staff's view, risks to the near-term outlook are tilted to the upside.** While staff's central scenario envisages that growth would slow down towards potential in the second half of 2011, the risk of overheating remains a concern. Domestic demand may grow faster

than expected, driven by strong confidence and easy global financing conditions. Near-term risks to headline CPI inflation have diminished as commodity prices have moderated, however, core inflation may rise faster than anticipated given uncertainty about potential output growth and the size of the output gap. Downside risks are mainly related to the global outlook. An intensification of financial tensions in Europe, especially if they spill over to the United States, could drive up risk premia and reduce global liquidity. However, Chile's economic activity would be most affected in the event of a sharp slowdown in China accompanied by a large decline in commodity prices—a relatively low probability scenario (Box 1).

10. **The authorities agreed with staff's characterization of the key risks, although they viewed them as broadly balanced.** They expected that economic growth would moderate as higher interest rates start to affect domestic demand, and durable consumption and investment in machinery and equipment decline from the high post-earthquake levels. They also noted that risks of overheating would be mitigated by the increase in potential output brought about by the recent high rates of investment. In their view, upside risks to core inflation are limited since real wage increases have remained broadly in line with productivity growth so far.

III. POLICY CHALLENGES

Chile's main near-term policy challenge is managing successfully the transition to a more sustainable growth path. The authorities remain committed to unwinding the crisis-related policy stimulus. Staff suggested taking advantage of the favorable economic conditions to withdraw fiscal stimulus and rebuild public sector assets faster than originally envisaged to help contain domestic demand growth and keep inflation close to the target. Raising productivity growth is the key long-term policy goal.

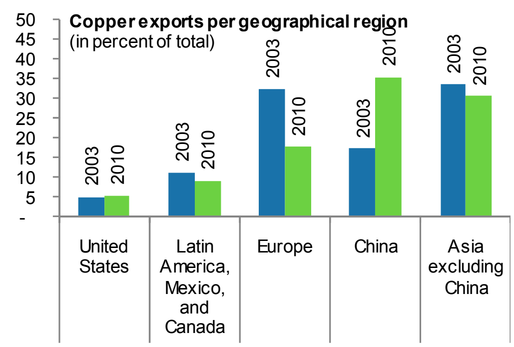
A. Containing Inflation Pressures

11. **There was broad agreement that the output gap has closed and that capacity constraints are starting to emerge.** Against this background, the central bank accelerated the pace of normalization of the policy rate in early 2011, which helped bring inflation expectations close to the 3-percent target. Staff and central bank officials agreed some further tightening may be needed in the coming months to ensure that domestic demand growth settles on a more sustainable path. The timing of any future changes in the policy rate, however, will depend on domestic and global economic developments, as well as on the pace of fiscal consolidation.

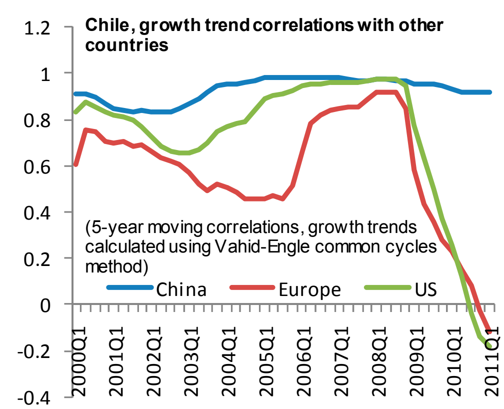
Box 1: Chile's Trade Linkages

Chile's exports have been increasingly dominated by commodity products. The share of copper exports in Chile's total exports increased from 36 percent in 2003 to 57 percent in 2010. Copper exports increased from US$7.8 billion to US$40.3 billion over the same period, and the ratio of mineral exports proceeds to GDP increased from 11 to 20 percent.

China is Chile's main export partner. Chile's share of world copper exports almost doubled during 2003–10 to 44 percent. The top five markets for Chile's copper exports (China, Japan, South Korea, the United States, and Italy) account for about two thirds of total copper exports, with China alone accounting for 35 percent. While the United States remains the main destination for Chile's non-mining exports, its share has declined (from 51 percent to 41 percent for agricultural exports; and from 23 percent to 12 percent for industrial exports), China's share has doubled over the same period.



The rising importance of China as a trade partner is reflected in the strong correlation between growth trends in Chile and China. The correlation of growth trends in the two countries (calculated using Vahid-Engle's common cycles method) has been very high since the early 2000s. In contrast, Chile's growth trend has recently decoupled from those of the US and Europe.



B. Withdrawing the Fiscal Stimulus

12. **Staff argued that it would be appropriate to speed up the withdrawal of fiscal stimulus in the near term.** Earlier this year, the government announced a reduction of public expenditure of about 0.3 percent of GDP, which would lower the structural fiscal deficit in 2011 to 1.6 percent of GDP, below budget plans. Staff welcomed this measure and suggested that the structural deficit could be reduced further through continued strict expenditure control in the remainder of 2011. For 2012, the last official projections (in the 2011 budget) implied a tightening of only ¼ percent of GDP, which is relatively modest given the strength of domestic demand. Staff argued that more ambitious fiscal consolidation in 2012 would help reduce

overheating risks and contribute to a more balanced macroeconomic policy mix.

13. **Staff also recommended reassessing the medium-term fiscal target during the forthcoming budget discussions.** Chile's high dependence on volatile commodity income and vulnerability to natural disasters make large fiscal buffers particularly useful. Rebuilding these buffers at a faster pace than currently envisaged by the government would increase the country's capacity to respond to adverse shocks in the future and would help it confront longer-term fiscal challenges. Staff argued that under the current favorable macroeconomic conditions, it would be feasible to achieve structural balance by 2014, and to move to a structural surplus target thereafter.

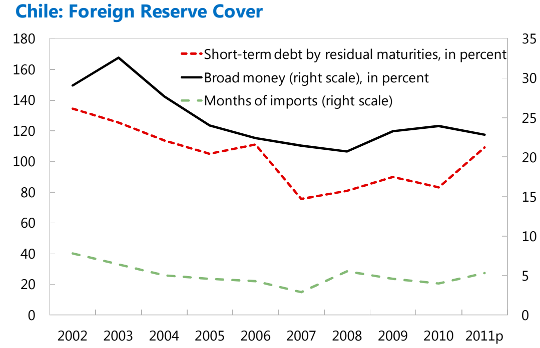
14. **The authorities agreed that fiscal restraint is appropriate in the current phase of the cycle.** They emphasized that they had reduced the growth of fiscal spending substantially during 2010-11 and had also introduced some temporary tax increases. They noted that real government expenditure would grow by less than real GDP in 2011, and reiterated their commitment to keep the rate of public spending growth below GDP growth in the medium term. The appropriate fiscal stance for 2012 would be deliberated in the forthcoming budget exercise.

C. Maintaining Exchange Rate Flexibility

15. **The flexible exchange rate system continues to serve Chile well.** Exchange rate flexibility has helped contain speculative capital inflows by reducing one-sided bets on the currency, and the nominal appreciation has mitigated inflationary pressures. Staff analysis based on cross-country data suggests that that exchange rate flexibility could help restrain the expansion of credit (especially foreign exchange-denominated credit) during episodes of large capital inflows (see Selected Issues Paper, Chapter 2).

16. **There was agreement that there was no strong case for extending the program of foreign exchange intervention beyond the end of 2011.** The pre-announced intervention was consistent with the flexible exchange rate regime as no particular level of the exchange rate was targeted. The nominal exchange rate vis-à-vis the U.S. dollar depreciated temporarily after the initial announcement, but has now returned to pre-intervention levels. Staff and the authorities agreed that the reserve level at end-2011 would be fully adequate based on various reserve metrics (see chart). In addition, the

Chile: Foreign Reserve Cover



interest rate carry cost of intervention has increased. A careful cost-benefit analysis would be warranted in future intervention decisions.

D. Mitigating Risks to Financial Stability

17. **The main near-term risks to financial stability are related to potential disruptions in global financial markets.** Stress tests conducted by the FSAP mission last April suggest that banks' capital ratios will remain above minimum requirements, even if economic conditions deteriorate and the cost of funding increases relative to baseline projections. The main external risk is a resurgence of global financial stress (prompted by concerns about debt sustainability in peripheral Europe or the US, for example), spilling over to the domestic financial system. However, staff agreed with the authorities that the impact of such shock on the domestic financial system should be contained. On average, only 10 percent of bank funding comes from external sources, most of it long-term. Market measures also suggest a low risk of contagions—the correlations between stock prices of domestic banks and Spanish banks are currently quite low. Nonetheless, staff cautioned that some banks rely more heavily on foreign and wholesale funding than others, and these banks are likely to be affected in the event of a sudden increase in global risk aversion. There was agreement that it would be prudent for banks to continue to maintain high levels of liquid assets on their balance sheets, lengthen the maturity of funding, and diversify their non-deposit funding sources.

18. **Staff and the authorities agreed that containing vulnerabilities should be the main focus of prudential policies.** The easing of credit conditions, in the context of strengthening credit demand, is likely to sustain high rates of credit growth. Against this backdrop, staff welcomed the authorities' efforts to enhance provisioning practices in the banking sector (see Selected Issues Paper, Chapter 3). Staff also noted that Chile's banks face strong competition from non-bank providers of credit, which could create incentives for greater risk-taking. Staff noted that one area of potential concern is the fast growth of credit card debt (though from a relatively low base), a large share of it extended by department stores, outside the scope of banking regulation. Continued monitoring of corporate foreign borrowing is also warranted. The authorities acknowledged these potential vulnerabilities, but noted that the strengthening of credit growth observed thus far has been commensurate with the rise in income.

19. **The option of using prudential measures to limit the rate of credit growth was discussed.** As interest rate differentials continue to widen and pension fund outflows moderate, capital inflow pressures may intensify, raising the risk of credit and asset price bubbles. There was agreement that if this

risk materializes, it would be advisable to supplement the macroeconomic policy response (tighter fiscal policy and exchange rate flexibility) with prudential measures. The choice of measures would depend on the specific problems that arise and could include, for example, caps on loan-to-value and debt-to-income ratios. Staff also recommended allowing for countercyclical capital buffers in the revised Banking Law, in line with Basel III proposals. The authorities noted that they would consider carefully these suggestions.

20. **Staff supported the authorities' plans to strengthen the financial system's regulatory and supervisory framework.** The proposed improvement in the governance structure of the supervisory agencies should enhance their operational independence and increase accountability. Plans to modernize the General Banking Law and the Insurance Law, provide an adequate legal framework for derivative contracts, and strengthen consumer protection in the area of financial services are also welcome. The creation of a high-level Financial Stability Committee, announced in July 2011, is an important step towards enhancing macroprudential oversight (see the companion FSSA report for further discussion). Despite the progress, there is scope for further reforms, including the development of a legal framework for consolidated supervision and the adoption of uniform regulatory standards for institutions providing similar financial services (see Box 2 for a summary of the FSAP recommendations).

21. **Efforts to reduce information gaps in financial and credit market should continue.** Staff noted that the proposed consolidated credit registry (including information from both banks and department stores) will help improve the assessment and pricing of credit risk. Staff also urged the authorities to give priority to the construction and publication of standardized house and commercial property price indices. The authorities explained that they are currently working on a house price index based on tax records, and should be able to publish it by year-end.

Box 2. Chile FSAP Update: Main Recommendations[1]

Recommendation	**Priority (H/M)**	**Time Frame (S/M)**
Addressing system- wide risks		
Reduce information gaps, including through a consolidated credit registry and standardized residential and commercial property price indices (§ 5)	M	M
Develop a strategy to ensure adequate replacement rate for retirees (§ 18)	H	M
Financial Sector Oversight		
Strengthen the independence and legal protection of regulatory agencies (§ 22)	H	M
Complete the incorporation of Basel bank capital standards (§ 21)	H	M
Strengthen enforcement powers of securities regulators (§ 27)	H	S
Establish legal framework to enable the consolidated oversight of financial conglomerates (§ 30–33)	H	M
Enhance uniformity in business conduct regulation for asset management services and investment advice (§ 35)	H	M
Introduce comparable transparency standards for fixed income securities traded outside exchanges (§ 36)	H	M
Adopt a comprehensive approach to custodial, clearing and settlement infrastructure (§ 36)	M	M
Establish appropriate arrangement for system-wide monitoring and oversight (§ 38–40)	M	M
Further enhance the AML/CFT framework (§ 28)	M	M
Resolution Framework		
Strengthen legal framework for bank resolution (§ 41–42)	H	M
Consider introduction of a premium-based limited deposit insurance system (§ 43–44)	M	M
Examine options to establish a framework for dealing with a systemic crisis and with the potential failure of a financial conglomerate (§ 41)	M	M

[1] H/M: High or medium priority. S/M: suggested timetable for implemented (short or medium term).

E. Strengthening the Fiscal Policy Framework

22. **Staff welcomed continued efforts to strengthen Chile's fiscal policy framework.** The expert commission established last year by the government to review and propose changes to the fiscal rule framework made its recommendations in two reports (made public in December 2010 and June 2011). Most suggestions for improving the calculation of the structural fiscal balance made in the first report have been adopted. In addition, work is under way to improve the medium-term fiscal framework. The more detailed recommendations in the commission's June 2011 report (Box 3) are in line with last year's staff analysis of options to strengthen Chile's fiscal rule.[1] On that basis, staff supported the report's suggestions to make the calculation of the structural balance more transparent; reduce the procyclicality caused by large changes in long-term copper prices; and add an explicit escape clause to the rule. The proposed formation of an independent Fiscal Council in charge of assessing fiscal policy would be an important addition to the institutional framework.

23. **Staff stressed the importance of establishing a clear link between near-term and long-term fiscal targets.** The consistency of current fiscal targets with long-term sustainability and intergenerational objectives should be discussed in the budget document. A careful analysis of long-term fiscal challenges, policy trade-offs, and risks would help anchor policy decisions about the appropriate medium-term fiscal goals. Long-term projections should take into account rising health care spending related to demographic trends as well as the revenue effects of rising mineral extraction costs. The authorities agreed that the report on contingent liabilities should be extended to present a more realistic picture of expected long-term fiscal pressures and risks.

[1] See 2010 Selected Issues Paper for Chile, Chapter 1 ("Strengthening Chile's Rule-Based Fiscal Framework").

Box 3. The Advisory Committee's Recommendations for Reforming the Fiscal Rule

The expert committee appointed by the Government to propose reforms to the fiscal rule published its final report in June 2011. Its main recommendations are the following:

- The cyclically adjusted balance (or structural balance) should reflect adjustments to fiscal revenues only to the extent that they are affected by the economic cycle and by deviations of copper and molybdenum prices from trend.
- The structural balance should be calculated at the central government level. It should not make cyclical adjustment for interest income or interest payments. It is recommended to transition to a primary balance indicator in the future to eliminate the effects of exogenous changes in interest rates, the procyclicality induced by the accumulation and withdrawal of net financial assets, and to establish a more direct link with fiscal sustainability analysis.
- The fiscal rule should be complemented by a mechanism giving the fiscal authority scope to implement countercyclical fiscal policy. The parameters governing the mechanism would be set at the beginning of a new administration.
- In the case of substantial changes to fiscal rule parameters that affect cyclically adjusted revenues (such as long-term copper prices), the government should use partial adjustment mechanisms to smooth the convergence towards a new long-run equilibrium.
- The introduction of exit clauses would allow the administration to waive the requirement to meet the rule strictly under exceptional circumstances. In case exit clauses are invoked, it is necessary to define policies to ensure a return to the original fiscal path.
- The fiscal authority should be held accountable for meeting the fiscal goals established in the budget. To this end, the mid-year fiscal update report should discuss the causes of any deviations from budget goals.
- The fiscal target should be set at the beginning of each administration for the duration of its term. The choice of the target should be guided by a Value-at-Risk approach that accounts for contingent liabilities and factors that could affect fiscal assets in the future, for example expected changes in the mines' mineral concentration.
- Establish an independent Fiscal Council to evaluate fiscal policy. The proposed functions of the Council include evaluating the fiscal rule methodology; providing assumptions and projections for variables required to calculate the cyclical adjustment; assessing fiscal policy, the application of the fiscal rule, and medium-term and long-term sustainability; issuing a report in case there are changes to the principles and methodologies governing the budget; evaluating cases when exit clauses are invoked and the proposed strategy to converge to the structural balance target; and issuing an opinion on the coverage of the contingent liabilities report.

F. Raising Productivity Growth

24. **Staff commended government's efforts to enhance productivity growth.** Initiatives aimed at reducing the cost of doing business, creating incentives for research and development, facilitating the entry of new firms, and reforming the corporate bankruptcy procedures are welcome. Staff noted that another important task remains increasing labor market flexibility and female participation rates, and encouraged the authorities to persist in their efforts to build a political consensus for labor market reforms. The ratio of minimum-to-average wage is higher in Chile than in most OECD countries, which could hinder employment growth and contribute to the expansion of the informal sector.

IV STAFF APPRAISAL

25. **Chile has recovered rapidly from the global financial crisis and strong growth is expected to continue.** Real GDP is expected to grow by 6½ percent in 2011 on the back of buoyant domestic demand. Consumption will benefit from strong employment growth and firming wages, while large reconstruction spending will support investment. Domestic risks to the outlook are mostly to the upside. The main downside risks are related to the possibility of a sharp slowdown of economic activity in Asia, or an intensification of global financial stress.

26. **The key task of macroeconomic policies at the current juncture is to ensure a smooth transition to a sustainable path for domestic demand.** The output gap has closed and some capacity constraints are emerging. The current account balance has narrowed, despite favorable terms of trade, and is expected to deteriorate further as rapid import growth continues to outpace export growth. Upward pressures on headline CPI have eased in line with commodity price developments, but core inflation is likely to continue to rise as spare capacity diminishes further.

27. **The authorities have appropriately started to withdraw policy stimulus.** Fiscal expenditure growth moderated in 2010 (from very high levels during the crisis), and is expected to be somewhat lower than GDP growth in 2011. The rapid pace of policy rate increases in the first half of 2011 reinforced market confidence that inflation pressures will be contained, bringing inflation expectations closer to the target. Staff agrees with the authorities that the magnitude and timing of any future policy rate moves would depend on domestic and global economic developments.

28. **Staff urges the authorities to accelerate the pace of fiscal tightening and**

set more ambitious medium-term fiscal targets. Rebuilding fiscal buffers at a faster pace than currently envisaged would optimize the contribution of fiscal policy to macroeconomic stability. In the near term, greater fiscal restraint would help guard against upside inflation risks and improve the policy mix, reducing the risk of a surge in capital inflows and easing pressures on the exchange rate. In the long term, larger fiscal buffers will help preserve the government's ability to respond to adverse shocks and prepare it to deal better with challenges related to population aging. Staff recommends aiming for a structural surplus in the medium term, and frontloading the adjustment.

29. **Ongoing efforts to improve Chile's fiscal policy framework are welcome.** Staff supports the thrust of the recommendations of the commission for improving the functioning of Chile's fiscal rule and its institutional framework. In particular, it supports the recommendations to improve the calculation of the structural balance, reduce unintended policy procyclicality caused by assumptions about long-term copper prices, and add an explicit escape clause to the rule. Introducing an explicit link between medium- and long-term budget targets would help improve the policymaking process. Staff believes that the establishment of an independent fiscal council would strengthen the framework and enhance the assessment of fiscal policy.

30. **The flexible exchange rate system continues to serve Chile well.** It has helped limit speculative capital inflows and mitigate inflationary pressures. Staff analysis suggests that the current level of the exchange rate is broadly in line with fundamentals. Foreign exchange reserves at end-2011 would be fully adequate based on various reserve measures and staff sees no case for extending the intervention program beyond the end of the year.

31. **Although financial soundness indicators remain strong, continued vigilance is necessary to contain vulnerabilities.** In the context of heightened risks of a rise in global financial stress, it would be prudent to continue to maintain high levels of liquidity in the financial system. In addition, continued monitoring is needed to prevent an excessive buildup of leverage in the corporate and household sectors. In case concerns arise about the speed of credit or asset price growth, prudential measures could be considered to help maintain stability.

32. **Staff supports the planned enhancements to the regulatory and supervisory framework for the financial system discussed during the FSAP update.** Staff commends the authorities for advancing measures aimed at modernizing Chile's regulatory framework, including the establishment of a financial stability committee, the strengthening of consumer protection in financial services, the adoption

of a commission structure for the supervisory agencies, and planned changes in the Banking Law. As the FSSA points out, it would also be advisable to strengthen the legal basis for oversight of financial conglomerates, the framework for anti-money laundering and combating the financing of terrorism, and the procedures for resolution of failed financial institutions.

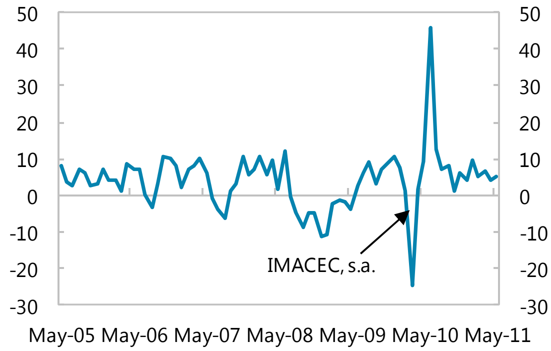
33. **Boosting productivity remains the key long-term challenge.** Government initiatives to reduce the cost of doing business, increase competition, support research and development, and reform the corporate bankruptcy code are welcome. Another important goal is increasing labor market efficiency and raising labor force participation.

34. **Staff recommends that the next Article IV consultation takes place on the standard 12-month cycle.**

Figure 1. Domestic Demand and Net Exports
(Through May 2011)

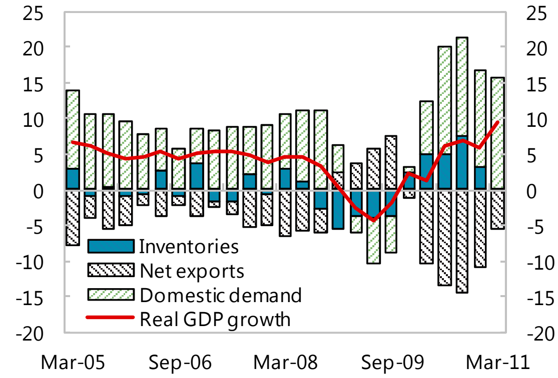
Economic activity rebounded after the earthquake.

Economic Activity Indicator
(In percent, 3 month average annualized percent change)



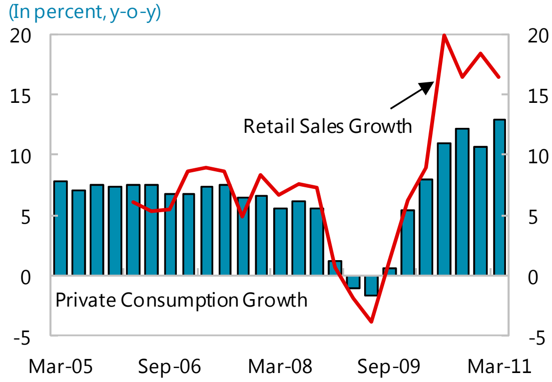
Domestic demand is very strong...

Contribution to GDP Growth
(In percent, y-o-y)

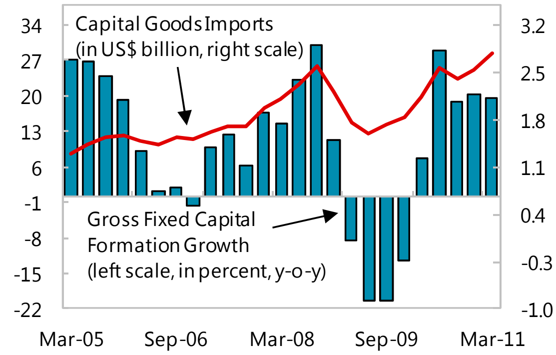


...as both private consumption...

(In percent, y-o-y)

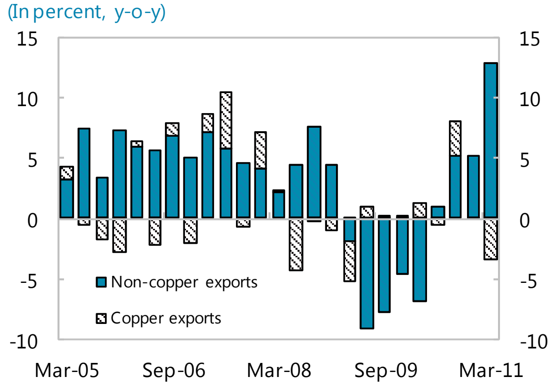


...and investment are growing fast.



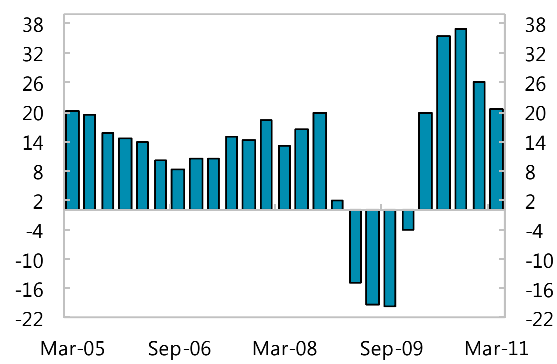
The recovery of exports...

Contribution to Export Volume Growth
(In percent, y-o-y)



...has been outpaced by strong import growth.

Import Growth
(In percent, y-o-y)

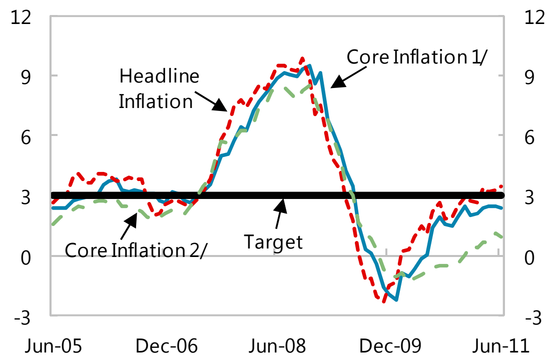


Sources: Haver Analytics Inc., Chilean authorities, and Fund staff calculations.

Figure 2. Inflation, Labor Markets and Monetary Policy
(Through July 2011)

The rise in headline CPI inflation...

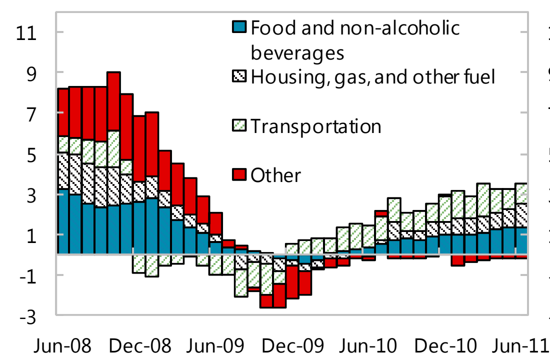
(In percent, y-o-y)



1/ CPI less food and energy (IPCX).
2/ CPI less energy, perishables and administered prices.

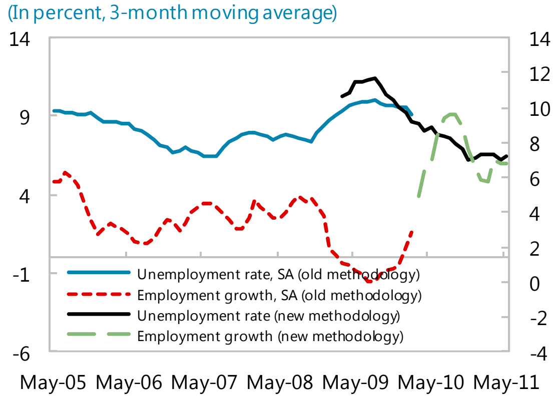
...has been driven largely by high commodity prices.

Contribution to CPI Inflation
(In percent, y-o-y)



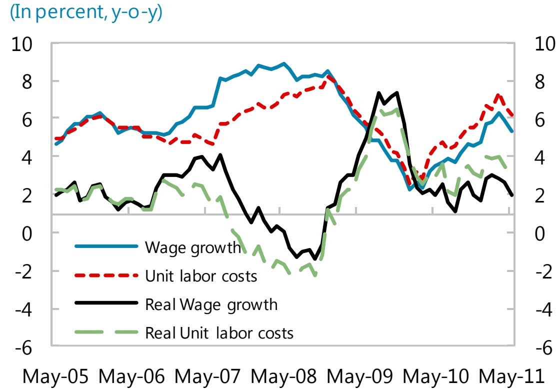
Unemployment is near historical lows...

(In percent, 3-month moving average)



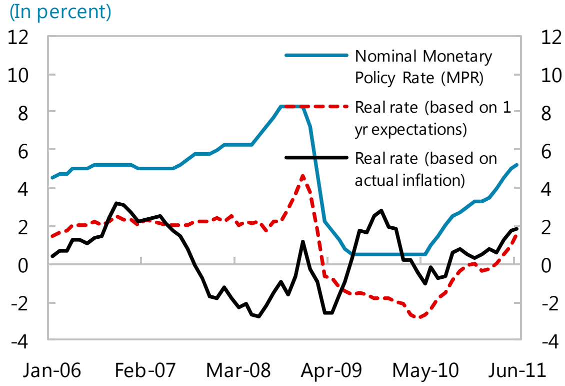
...and wage growth firmed.

(In percent, y-o-y)



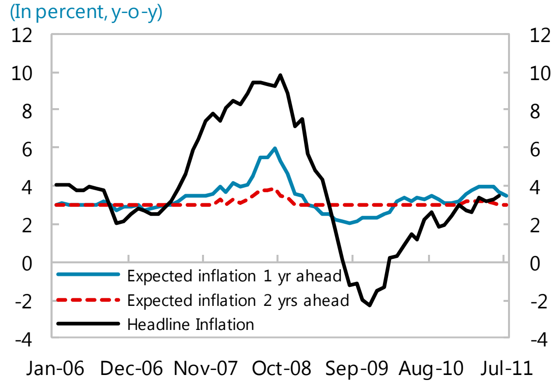
The policy rate has been raised to 5.25 percent by end-June.

(In percent)



Inflation expectations have come down close to the 3-percent target after the latest policy rate increase.

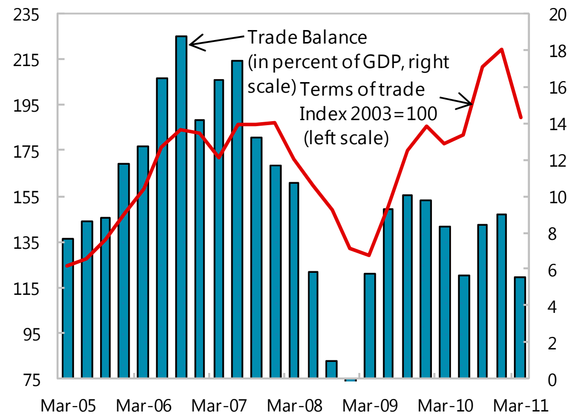
(In percent, y-o-y)

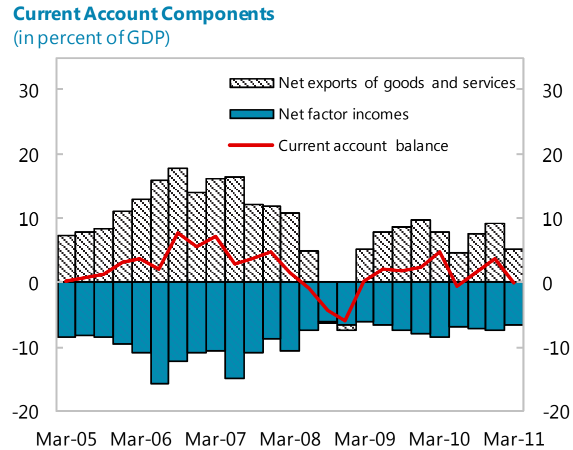


Source: Haver Analytics Inc.

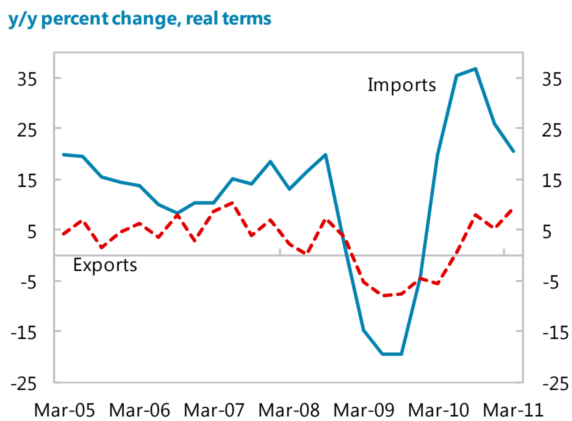
Figure 3. External Current Account Balance
(Through May 2011)

Favorable terms of trade are supporting the nominal trade balance.

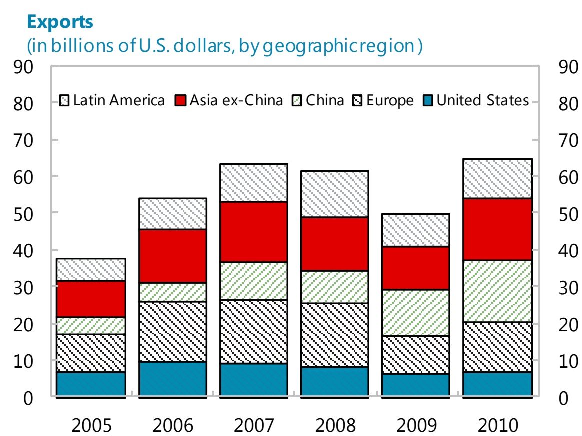




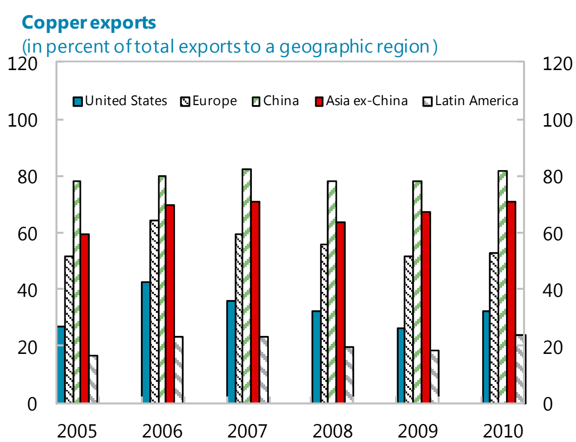
However, in real terms, the trade balance has deteriorated.

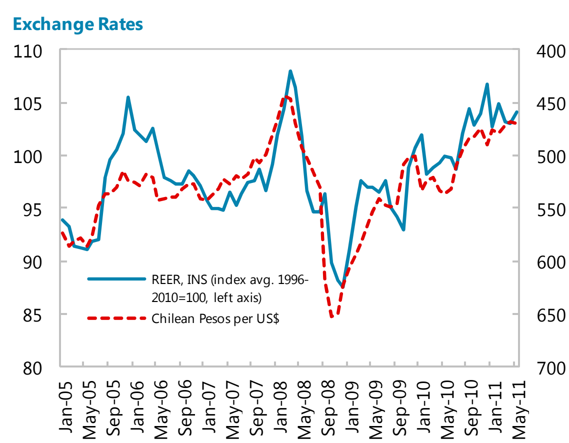


Exports are particularly vulnerable to a slowdown in Asia...



...since copper and copper products account for the main share of exports.



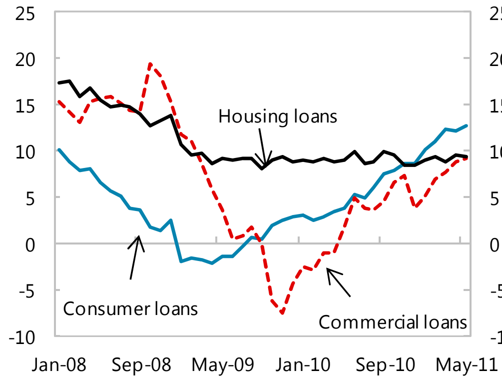


Sources: Central Bank of Chile and Fund staff calculations.

Figure 4. Financial Markets
(Through June 2011)

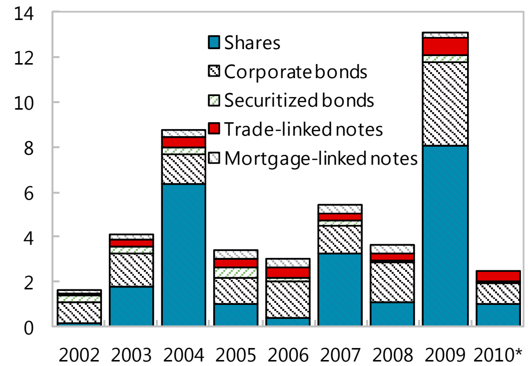
Bank lending has recovered...

(Percent change, in real terms, y-o-y)



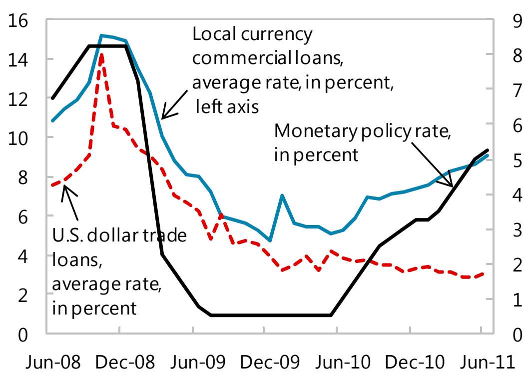
...while domestic market financing has returned to normal level.

Domestic Securities Issuance
(In trillions of pesos)

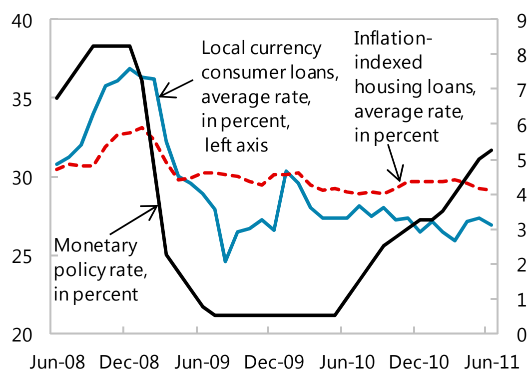


* Does not include Mortgage-linked notes

Rates on corporate loans remain relatively low...

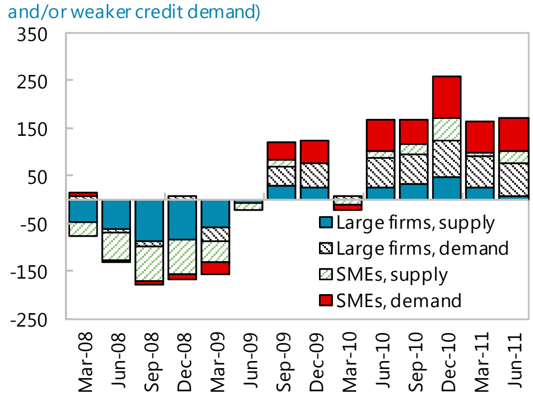


...and consumer lending rates have stabilized.

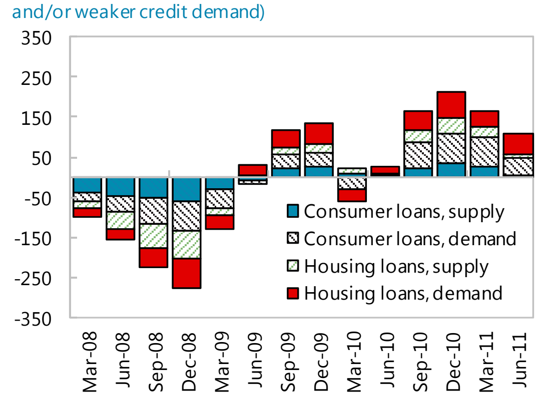


Credit conditions continue to ease.

Credit Conditions, Corporate Sector
(Negative values indicate tigher credit supply and/or weaker credit demand)



Credit Conditions, Households
(Negative values indicate tigher credit supply and/or weaker credit demand)

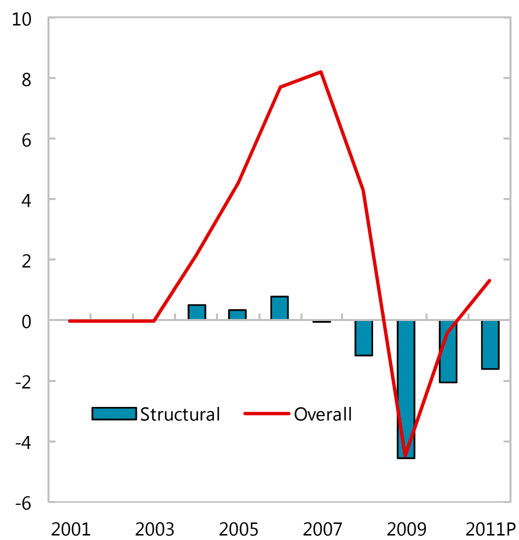


Sources: Central Bank of Chile, SVS, and Fund staff calculations.

Figure 5. Fiscal Policy
(2001–11)

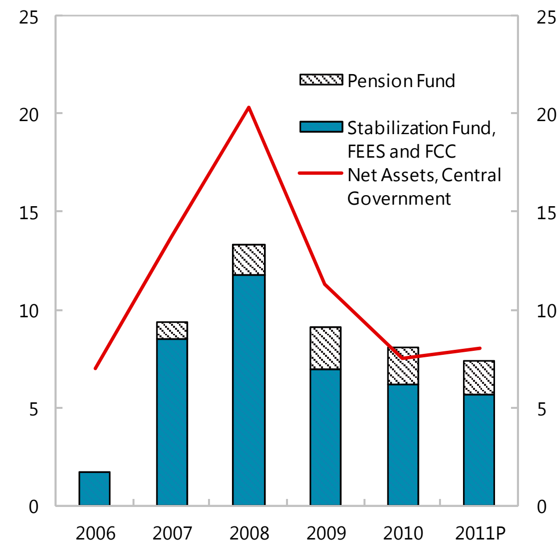
Fiscal balances are improving...

Central Government Balances
(In percent of GDP)



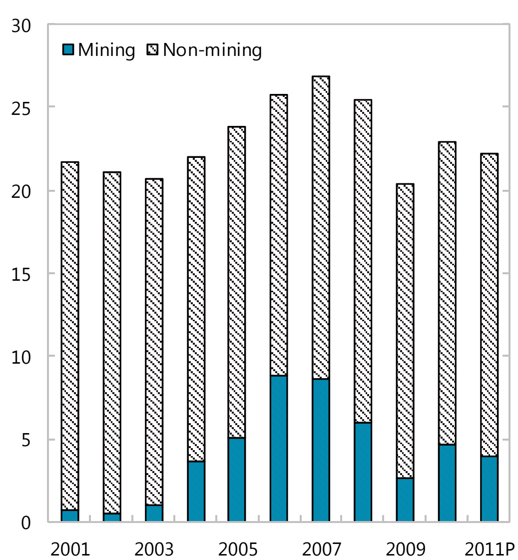
...and net government assets stabilized.

Government Assets
(In percent of GDP)



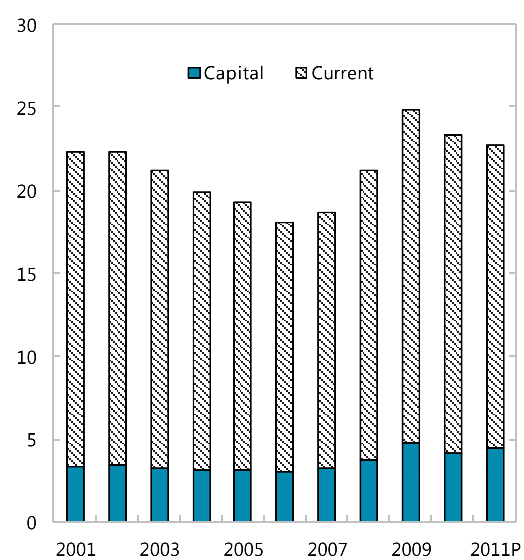
Fiscal revenues have recovered since the crisis...

Central Government Revenues
(In percent of GDP)



...and expenditure growth has moderated.

Central Government Expenditure
(In percent of GDP)

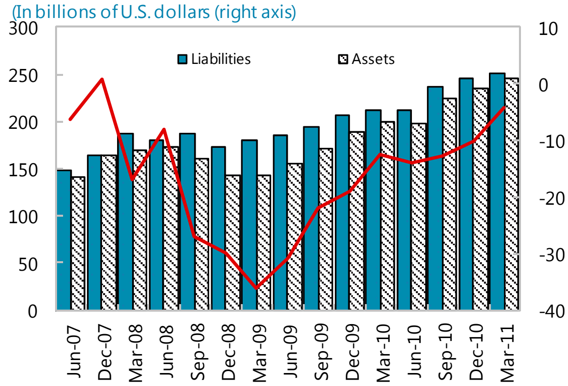


Sources: Minister of Finance and Fund staff calculations.

Figure 6. Net IIP and Capital Flows
(Through May 2011)

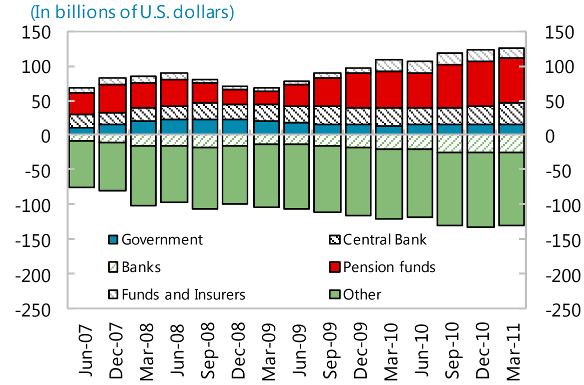
The net international investment position continues to improve…

Net International investment position
(In billions of U.S. dollars (right axis)

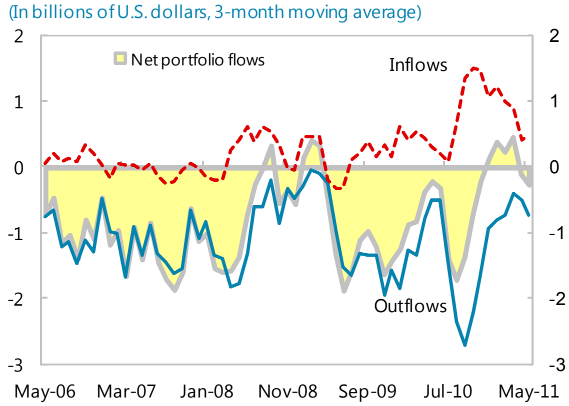


…due to valuation changes and higher foreign investments by pension funds.

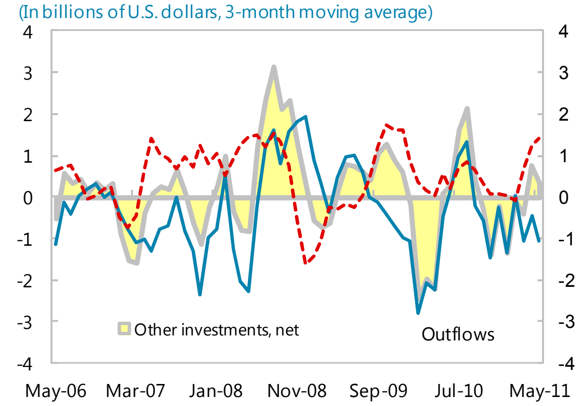
Net international investment position by sectors
(In billions of U.S. dollars)



Portfolio Flows
(In billions of U.S. dollars, 3-month moving average)

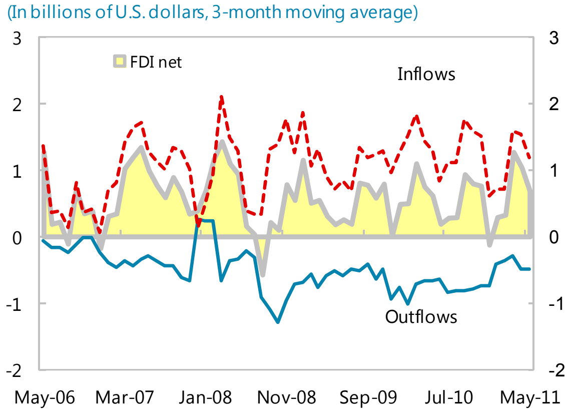


Other Investments
(In billions of U.S. dollars, 3-month moving average)

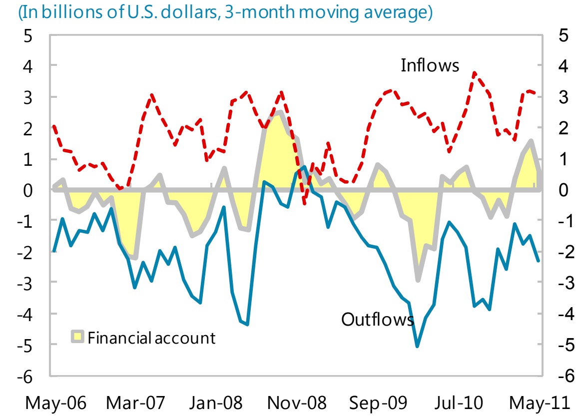


Net capital inflows remain moderate.

Foreign Direct Investment
(In billions of U.S. dollars, 3-month moving average)



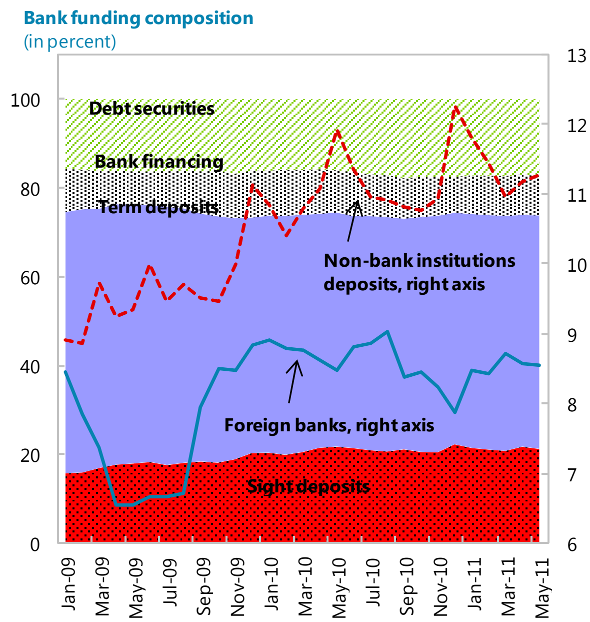
(In billions of U.S. dollars, 3-month moving average)



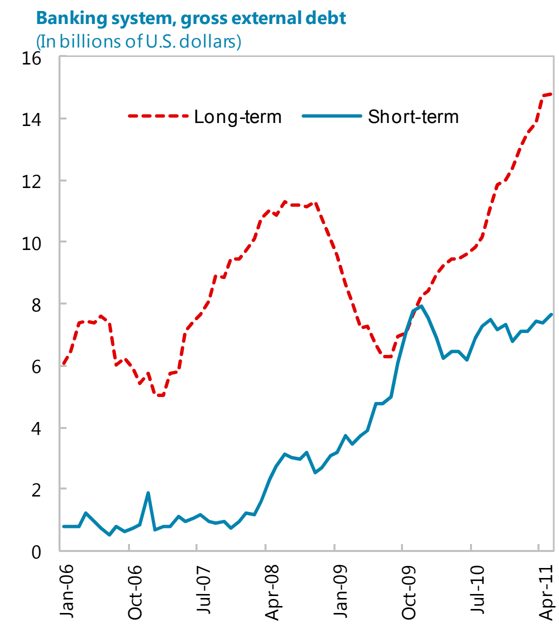
Sources: Central Bank of Chile and Fund staff calculations.

Figure 7. Banking Developments
(Through May 2011)

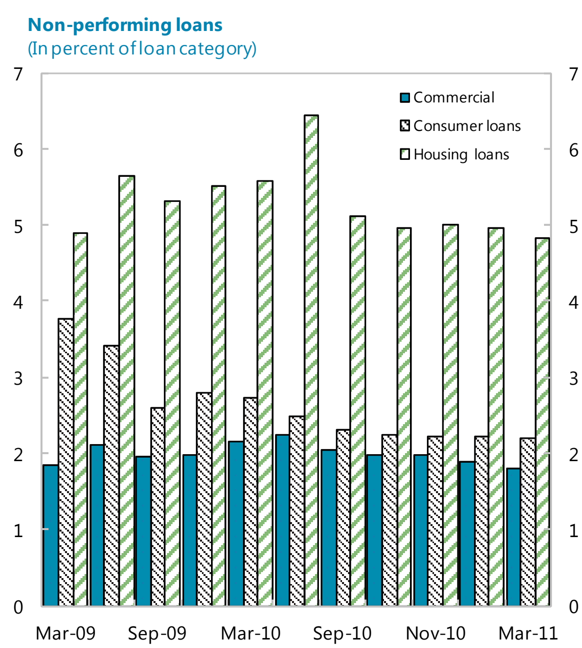
Deposits continue to provide the bulk of bank funding...



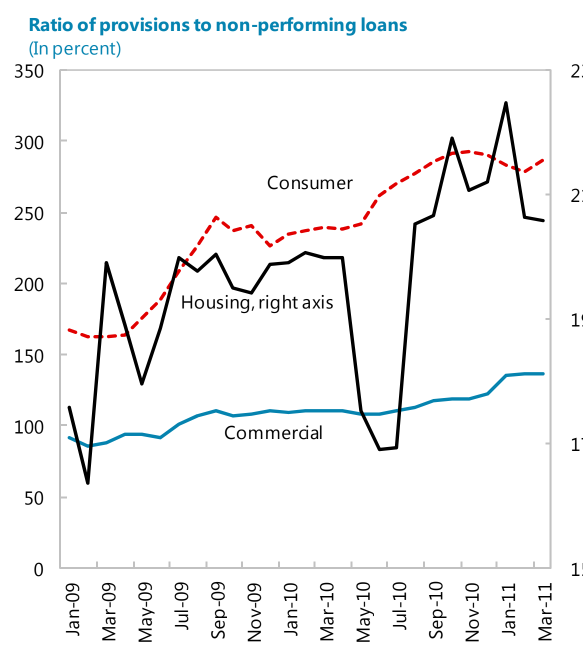
...although external long-term debt has increased recently.



Non-performing loans are relatively low...

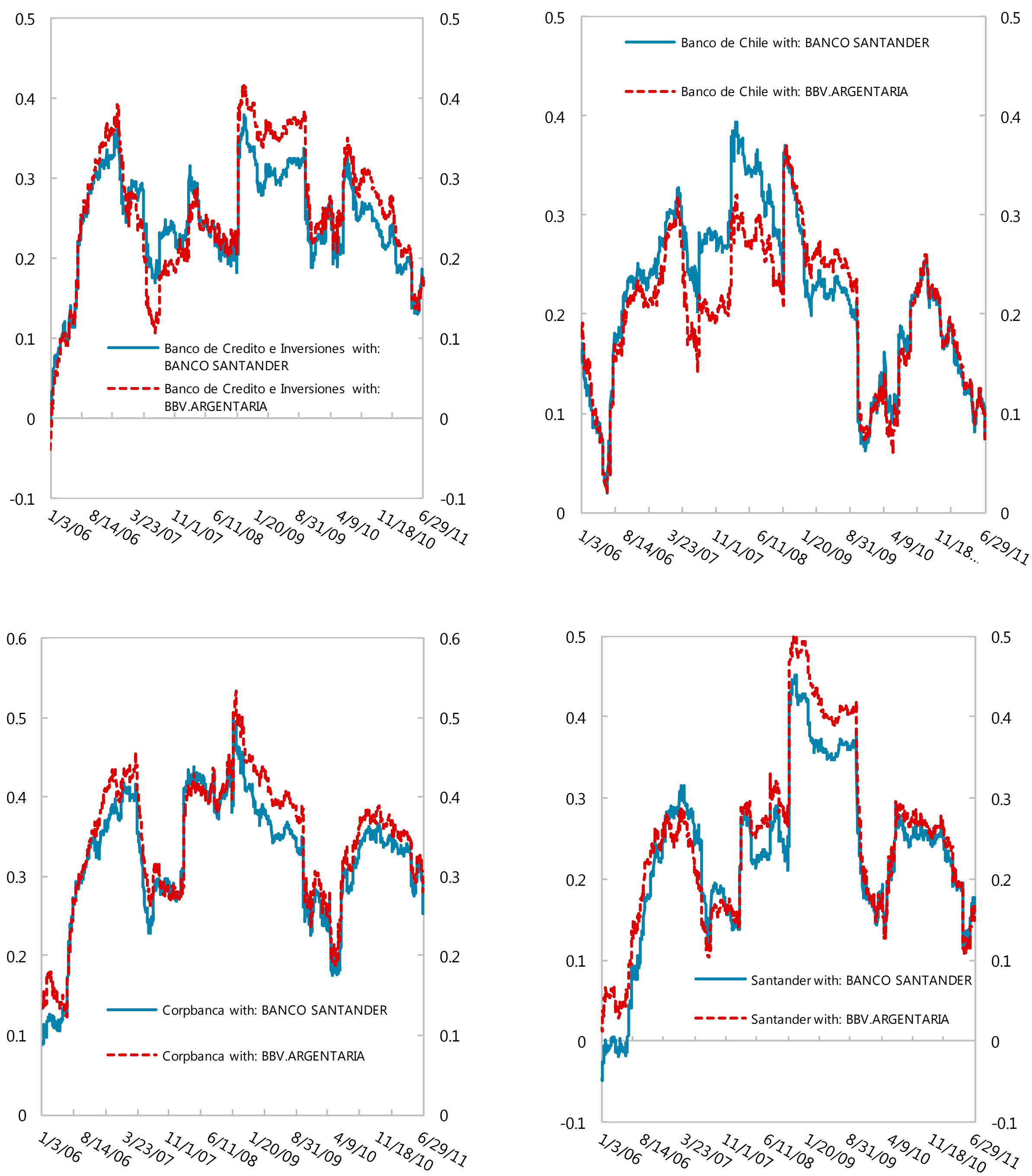


...and provisioning ratios have improved.



Sources: Central Bank of Chile, SBIF, and Fund staff calculations.

Figure 8. Equity Return Pairwise Correlation, Spanish and Chilean Banks [1/]
(January 2005–June 2011)



Sources: Datastream, LLC and Fund staff calculations.

1/ Corresponds to the 12-month daily equity return correlation between Chilean and Spanish banks, where returns are calculated in Chilean pesos. An increase indicates a greater correlation.

Table 1. Chile: Selected Social and Economic Indicators

I. Social and Demographic Indicators

GDP (2010)	103,742	**Poverty rate (2009)**	15.1
U.S. dollars (billions)	203.3	Indigent	3.7
Per capita (U.S. dollars)	11,981	Poor, not indigent	11.4
Population characteristics (2009)		**Income distribution (2009)**	
Total (in millions)	17.0	Richest 10% of households	40.2
Urban population (percent of total)	88.7	Poorest 20% of households	3.6
Life expectancy at birth (years)	78.7	Gini coefficient	0.55

II. Economic Indicators

						Proj.	
	2006	2007	2008	2009	2010	2011	2012
	(Annual percentage change, unless otherwise specified)						
National accounts and employment							
Real GDP	4.6	4.6	3.7	-1.7	5.2	6.5	5.0
Total domestic demand	7.0	7.3	6.5	-5.1	16.5	7.8	6.0
Consumption	7.0	7.0	3.9	1.8	9.3	6.6	5.9
Private	7.1	7.0	4.6	0.8	10.4	8.2	5.4
Public	6.4	7.2	0.5	7.5	3.2	-1.9	9.0
Investment	7.1	8.3	14.3	-23.7	42.9	11.0	6.4
Private	1.4	9.5	21.7	-21.9	25.3	11.0	8.8
Public	12.0	24.7	3.1	36.4	-14.7	16.5	2.4
Fixed	2.5	11.2	19.5	-15.8	18.6	11.7	8.0
Inventories 1/	1.2	-0.5	-1.1	-2.3	5.1	0.1	-0.3
Net exports 1/	-2.6	-3.1	-3.3	3.9	-12.3	-2.6	-2.2
Exports	5.0	7.5	3.3	-6.4	2.0	5.4	3.4
Imports	11.2	13.9	9.9	-13.0	29.9	8.5	6.2
Consumer prices							
End of period	2.6	7.8	7.1	-1.4	3.0	4.0	3.2
Average	3.4	4.4	8.7	1.7	1.5	3.3	3.2
Unemployment rate (annual average) 2/	8.0	7.0	7.4	9.6	8.3	7.2	7.2
Money and credit							
Broad money	17.5	20.5	18.6	-5.3	9.3	...	...
Credit to the private sector (end of period)	16.8	21.0	18.7	-10.6	8.1	...	...
External Debt and Balance of Payments	(In percent of GDP, unless otherwise specified)						
Current account	4.9	4.5	-1.9	1.6	1.9	0.3	-1.3
Current account (in billions of U.S. dollars)	7.2	7.5	-3.3	2.6	3.8	0.7	-3.2
Trade Balance (goods and services)	15.1	14.0	4.4	7.9	7.3	6.2	5.0
Exports of goods and services	45.3	46.8	45.2	38.9	40.2	40.4	41.3
Imports of goods and services	-30.2	-32.9	-40.7	-31.0	-33.0	-34.2	-36.3
Gross external debt	33.7	33.9	37.4	45.3	42.7	39.0	37.4
Public	7.8	7.8	7.2	8.4	8.6	7.7	7.2
Private	25.9	26.2	30.2	36.9	34.1	31.3	30.2
Gross International Reserves (in billions of U.S. dollars)	19.4	16.9	23.2	25.4	27.9	39.9	39.9
	(Annual average percentage change)						
Terms of Trade	31.1	4.3	-16.5	4.8	23.5	-1.7	-0.3
Real Effective Exchange Rate 3/	3.6	-2.9	1.0	-1.4	5.4	...	...
Savings and investment	(In percent of GDP)						
Gross domestic investment	20.0	20.4	25.2	18.9	22.4	23.8	24.1
Public	2.0	2.4	2.6	3.0	2.5	2.8	2.7
Private	17.9	18.1	22.6	15.9	19.9	21.0	21.4
National saving	24.9	25.0	23.3	20.5	24.3	24.1	22.8
Public 4/	9.2	9.0	8.4	-3.3	0.7	2.4	2.9
Private	15.7	16.0	14.9	23.8	23.6	21.7	19.9
Public sector finance							
Net Debt	-1.8	-10.0	-17.7	-6.9	-2.4	-2.5	-7.5
Excluding public enterprises	-6.1	-13.5	-23.8	-12.9	-8.3	-8.5	-13.5
Public sector gross debt 5/	26.9	19.9	26.0	29.3	27.7	32.8	30.3
Central government gross debt	5.3	4.1	5.2	6.2	9.2	10.4	10.5
Public sector balance	7.7	8.2	4.3	-4.5	-0.4	1.3	1.8

Sources: Central Bank of Chile, Ministry of Finance, Haver Analytics, and Fund staff estimates.
1/ Contribution to growth.
2/ The methodology to compute the unemployment rate changed in 2009.
3/ INS REER. A positive change implies a real appreciation; a negative change implies a real depreciation.
4/ Gross saving of the general government sector, including the deficit of the central bank.
5/ Gross consolidated debt of the public sector (central bank, non-financial public enterprises, and general government).

Table 2. Chile: Summary Operations of the Central Government

(In percent of GDP)

				Staff Projections 1/			
	2008	2009	2010	2011	2012	2013	2014
Overall balance	4.3	(4.5)	(0.4)	1.3	1.8	1.7	1.5
Non-mining balance	(1.7)	(7.1)	(5.2)	(4.2)	(3.6)	(4.0)	(4.0)
Total revenue	25.5	20.4	23.0	24.0	24.1	23.8	23.4
Taxes	18.5	14.8	16.9	18.1	17.9	17.6	17.4
Mining related	2.4	0.9	1.8	2.3	2.4	2.5	2.4
Nonmining	16.1	13.9	15.1	15.8	15.5	15.1	15.0
Codelco Revenues	3.6	1.8	2.9	3.2	3.0	3.2	3.1
Social contributions	1.4	1.5	1.4	1.4	1.4	1.3	1.3
Grants	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Income on assets	0.9	0.7	0.5	0.4	0.5	0.5	0.6
Operating income	0.6	0.6	0.5	0.5	0.5	0.5	0.5
Other	0.4	0.8	0.6	0.4	0.6	0.5	0.5
Total expenditure	21.2	24.9	23.4	22.7	22.3	22.1	21.9
Wages and salaries	4.0	4.7	4.5	4.0	4.1	4.1	4.1
Goods and services	1.9	2.3	2.2	2.0	2.1	2.0	2.0
Interest payments	0.5	0.5	0.5	0.6	0.6	0.6	0.6
Subsidies and grants	6.4	7.5	7.2	7.4	6.3	6.3	6.2
Social benefits	4.6	5.1	4.7	4.3	4.7	4.7	4.6
Gross investment	2.3	2.7	2.3	2.5	2.5	2.4	2.4
Net capital transfers	1.5	2.0	2.0	2.0	1.9	1.9	1.9
Net assets of the central government	20.3	11.3	7.5	8.0	10.1	10.8	12.5
Gross debt	5.2	6.2	9.2	10.4	10.5	10.5	10.6
Peso-denominated assets	6.0	6.5	6.6	8.6	9.6	11.3	12.8
Foreign currency-denominated assets	19.5	11.0	10.1	9.8	11.0	10.1	10.3
Memorandum items							
Structural balance 2/	(1.2)	(4.5)	(2.1)	(1.6)	(1.3)	(1.0)	(0.9)
Expenditure growth (in real terms)	8.2	16.6	6.7	5.1	3.6	2.9	3.4
Current Expenditure	7.3	15.0	8.1	3.0	3.6	2.9	3.4
Investment	3.6	20.8	(6.7)	19.7	3.6	2.9	3.4
Nonmining structural primary balance 3/	(2.9)	(7.9)	(5.8)	(5.5)	(4.5)	(5.0)	(4.9)
Net debt of general government.	(23.8)	(12.9)	(8.3)	(8.4)	(13.4)	(12.7)	(14.3)
Nominal GDP (trillions of pesos)	89.1	90.1	103.7	115.8	126.4	135.2	145.1
Output gap (staff estimates)	1.9	(3.2)	(1.6)	0.1	0.3	0.2	0.1
Copper price, USD per pound (WEO)	3.16	2.34	3.42	4.15	4.31	4.21	4.08
Long term price of copper, USD per pound (authorities' estimates)	1.37	1.99	2.13	2.59	2.59	2.59	2.59

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

1/ Based on the authoriites' medium-term fiscal projections in the 2011 Budget Law, adjusted for staff's GDP and copper price projections.

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

3/ In percent of non-mining GDP.

Table 3. Chile: Summary Operations of the Public Sector 1/

				Staff Projections			
	2008	2009	2010	2011	2012	2013	2014
Central Government							
Balance	4.3	(4.5)	(0.4)	1.3	1.8	1.7	1.5
Total revenue	25.5	20.4	23.0	24.0	24.1	23.8	23.4
Of which: Intragovernmental receipts	1.2	1.1	0.9	0.9	0.9	0.9	0.9
Total expenditures 2/	21.2	24.9	23.4	22.7	22.3	22.1	21.9
Of which: Intragovernmental transfers	1.1	0.9	0.8	0.8	0.8	0.8	0.8
Current	17.4	20.1	19.2	18.3	17.9	17.7	17.6
Capital	3.8	4.8	4.2	4.5	4.4	4.3	4.3
Net Assets	20.3	11.3	7.5	8.0	10.1	10.8	12.5
Municipalities 3/							
Balance	0.0	0.1	0.1	0.1	0.1	0.1	0.1
Total revenue	2.9	2.7	2.8	2.7	2.8	2.8	2.8
Of which: Intragovernmental receipts	1.1	0.9	0.8	0.8	0.8	0.8	0.8
Total expenditures	2.8	2.6	2.6	2.6	2.7	2.7	2.6
Of which: Intragovernmental transfers	1.2	1.1	0.9	0.9	0.9	0.9	0.9
Current	2.5	2.4	2.4	2.3	2.4	2.4	2.4
Capital	0.3	0.2	0.3	0.3	0.3	0.3	0.3
Central Bank							
Balance	2.6	(0.3)	(0.3)	(0.3)	(0.3)	(0.3)	(0.3)
Net Operating Balance 2/	2.6	(0.3)	(0.2)	(0.2)	(0.2)	(0.2)	(0.2)
Net administrative expenses	(0.0)	(0.1)	(0.1)	(0.1)	(0.1)	(0.1)	(0.1)
Net assets	3.5	1.6	0.8	0.4	3.4	1.8	1.7
State-owned non-financial enterprises							
Balance	1.0	1.7	1.2	1.0	0.8	0.6	0.7
Total revenue	21.7	13.4	11.5	11.0	10.7	10.2	9.9
Of which: Intragovernmental receipts	0.4	0.8	0.1	0.1	0.1	0.1	0.1
Total expenditures	20.7	11.6	10.3	10.0	9.8	9.6	9.2
Current	18.3	9.7	8.8	8.5	8.4	8.2	7.9
Capital 4/	2.4	1.9	1.5	1.4	1.4	1.4	1.3
Net Assets	(6.2)	(6.1)	(5.9)	(6.0)	(6.0)	(6.0)	(6.0)
Consolidated Public Sector							
Balance	8.0	(2.9)	0.6	2.1	2.5	2.2	2.0
Net Assets	17.5	6.8	2.4	2.5	7.5	6.7	8.3

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

1/ This table reflects the authorities' revisions to historical official data to bring the fiscal accounts in line with GFSM 2001.
2/ Includes the effects of valuation changes (inflation) to the stock of UF debt and accured interest on Treasury debt, excludes administrative expenses and provisions.
3/ On a cash basis. Municipalities hold neither sizable financial assets nor debt.
4/ The data reported here does not include depreciation as an expense.

Table 4. Chile: Balance of Payments

				Projections					
	2008	2009	2010	2011	2012	2013	2014	2015	2016
	(In millions of U.S. dollars)								
Current account	-3,307	2,570	3,802	737	-3,240	-4,448	-5,471	-5,859	-6,183
Trade balance	8,529	14,117	15,855	17,346	15,785	14,375	13,899	14,214	14,557
Exports	66,259	54,005	71,029	86,685	90,558	93,036	96,498	100,865	105,282
Copper	32,842	27,702	40,257	49,686	52,637	53,002	52,973	52,592	52,141
Non-copper	33,417	26,302	30,772	37,000	37,921	40,034	43,525	48,273	53,141
Imports	-57,730	-39,888	-55,174	-69,339	-74,773	-78,661	-82,600	-86,651	-90,725
Net services	-964	-1,444	-1,019	-2,113	-3,335	-3,643	-3,699	-3,985	-4,780
Net income	-13,802	-11,666	-15,424	-18,741	-19,754	-19,397	-20,031	-20,575	-20,539
Net transfers	2,930	1,563	4,390	4,245	4,063	4,217	4,361	4,487	4,578
Capital Account Balance 1/	3	15	5,641	0	0	0	0	0	0
Financial Account Balance	8599	-1711	-5884	11263	3240	4448	5471	5859	6183
Foreign direct investment (net)	7,109	4,813	6,351	10,212	9,960	11,498	12,607	13,815	14,220
Abroad	-8,041	-8,061	-8,744	-6,758	-6,771	-6,440	-6,127	-5,830	-6,048
In Chile	15,150	12,874	15,095	16,970	16,731	17,938	18,734	19,646	20,269
Portfolio investment (net)	-7,619	-11,769	-7,071	-3,047	-6,483	-6,921	-7,567	-8,826	-9,615
Abroad	-10,252	-13,691	-16,503	-12,243	-11,245	-11,160	-11,438	-12,370	-13,266
In Chile	2,633	1,922	9,432	9,196	4,762	4,239	3,871	3,543	3,651
Financial Derivatives	-952	-295	-922	-196	-200	-209	-218	-233	-249
Other Investments	10,062	5,541	-4,242	4,294	-36	80	648	1,103	1,828
Abroad	3,715	-1,412	-7,393	-2,887	-6,889	-6,668	-5,979	-6,190	-6,960
In Chile	6,346	6,953	3,152	7,181	6,853	6,749	6,627	7,293	8,788
Change in Reserves Assets (increase -)	-6,444	-1,648	-3,024	-12,000	0	0	0	0	0
Errors and Omissions	1,150	774	-534	0	0	0	0	0	0
Change in official reserves ($ billion)	6.3	2.2	2.5	12.0	0.0	0.0	0.0	0.0	0.0
Central bank operations with commercial banks	6.3	0.0	0.0	12.0	0.0	0.0	0.0	0.0	0.0
Other 2/	0.0	2.2	2.5	0.0	0.0	0.0	0.0	0.0	0.0
Gross official international reserves	5.6	4.5	4.0	5.3	5.0	4.7	4.5	4.2	3.9
(In months of imports of goods and services)									
	(In percent of GDP)								
Current account	-1.9	1.6	1.9	0.3	-1.3	-1.7	-2.0	-2.0	-2.0
Trade balance	5.0	8.8	7.8	7.1	6.3	5.5	5.1	4.9	4.7
Exports	38.8	33.5	34.9	35.4	36.3	35.6	35.5	34.6	33.8
Copper	19.3	17.2	19.8	20.3	21.1	20.3	19.5	18.1	16.7
Non-copper	19.6	16.3	15.1	15.1	15.2	15.3	16.0	16.6	17.0
Imports	-33.8	-24.8	-27.1	-28.3	-30.0	-30.1	-30.4	-29.7	-29.1
Net services	-0.6	-0.9	-0.5	-0.9	-1.3	-1.4	-1.4	-1.4	-1.5
Net income	-8.1	-7.2	-7.6	-7.7	-7.9	-7.4	-7.4	-7.1	-6.6
Net transfers	1.7	1.0	2.2	1.7	1.6	1.6	1.6	1.5	1.5
Financial Account Balance	5.0	-1.1	-2.9	4.6	1.3	1.7	2.0	2.0	2.0
	(Annual change in percent)								
Total export volume	-0.1	-5.7	1.4	2.9	3.4	4.3	4.3	4.5	4.7
Copper export volume	-0.9	-2.9	3.1	0.4	3.2	3.1	3.0	3.0	3.0
Agricultural exports volume	10.9	-0.8	2.2	9.1	4.0	4.0	4.0	4.0	5.0
Industrial exports volume	1.9	-10.2	-2.8	7.1	4.0	6.0	6.0	6.5	6.5
Total import volume	10.9	-15.0	27.0	9.0	6.2	5.5	4.8	4.7	4.7
Terms of trade	-16.5	4.8	23.5	-1.7	-0.3	-0.8	-0.8	-0.3	-0.5
Total export prices	-4.3	-12.9	30.5	17.0	1.0	-1.5	-0.5	0.0	-0.3
Copper export prices	-12.0	-33.6	45.9	23.0	2.4	-2.4	-3.0	-3.6	-3.7
Total import price	14.1	-16.5	5.8	18.7	1.4	-0.7	0.3	0.3	0.2
Memorandum items:									
Copper price (LME; U.S. cents per pound) 3/	316	234	342	421	431	421	408	394	379
Volume of copper exports (2004=100)	100	97	100	100	104	107	110	113	117

Sources: Central Bank of Chile, Haver Analytics, and Fund staff estimates.
1/ In 2010 reflects insurance payment associated with the earthquake.
2/ "Other" variations in reserves largely reflect changes in deposits by commercial banks and the government with the central bank.
as well as the repayment of foreign currency bonds, completed in 2006.
3/ Updated staff forecasts, average.

Table 5. Chile: Monetary Survey

(In billions of pesos; unless otherwise indicated)

	2006	2007	2008	2009	2010
Central Bank					
Net foreign assets	10,425	8,423	14,630	12,254	12,508
Net international reserves	10,383	8,384	14,572	12,849	13,051
Net international reserves (In millions of US$)	19,428	16,909	23,163	25,372	27,865
Other foreign assets, net	42	39	58	-595	-543
Net domestic assets	-7,019	-4,751	-10,400	-7,672	-6,983
Net credit to general government	308	634	738	580	559
Net claims on banks and financial corporations	-2,357	-1,228	-1,659	-2,854	-2,964
Credit to the private sector	924	946	957	904	861
Other items (net)	-5,894	-5,103	-10,436	-6,302	-5,439
Monetary base	3,406	3,672	4,230	4,582	5,525
Currency	2,149	2,429	2,676	2,935	3,423
Required reserves	1,257	1,243	1,554	1,647	2,102
Other depository institutions					
Net foreign assets	-1,763	-1,929	-3,395	-4,014	-4,767
Net foreign assets (In millions of US$)	-3,299	-3,891	-5,397	-7,926	-10,178
Net domestic assets	45,613	54,178	63,777	64,965	66,513
Net credit to general government	-3,052	-3,599	-3,923	3,914	-2,240
Credit to the private sector	48,645	58,849	69,870	62,459	67,488
Other items (net)	20	-1,072	-2,170	-1,408	1,265
Liabilities to the private sector	43,850	52,249	60,382	60,951	61,746
Demand deposits	7,072	8,368	8,417	11,150	13,465
Quasi-money	36,778	43,881	51,965	49,801	48,281
Financial system					
Net foreign assets	8,661	6,494	11,235	8,240	7,741
Net domestic assets	42,922	52,098	57,936	61,147	61,552
Net credit to general government	-2,744	-2,965	-3,185	4,494	-1,681
Credit to the private sector	49,569	59,795	70,827	63,363	68,349
Other items (net)	-3,903	-4,732	-9,705	-6,710	-5,116
Liabilities to the private sector	51,583	58,592	69,171	69,387	69,293
Money	9,221	10,797	11,093	14,086	16,861
Quasi-money	42,362	47,795	58,078	55,301	52,432
Memorandum Items					
			(Percent changes)		
Monetary base	16.3	7.8	15.2	8.3	20.6
Liabilities to the private sector	11.5	13.6	18.1	0.3	-0.1
Credit to the private sector	16.4	20.6	18.4	-10.5	7.9
			(In percent of GDP)		
Monetary base	4.4	4.3	4.7	5.1	5.3
Liabilities to the private sector	66.3	68.3	77.6	77.0	66.8
Credit to the private sector	63.7	69.7	79.5	70.3	65.9

Sources: Central Bank of Chile and Haver Analytics.

Table 6. Chile: Medium-Term Framework

	2008	2009	2010	2011	2012	2013	2014	2015	2016
				Projections					
	(Annual percentage change, unless otherwise specified)								
National accounts and employment									
Real GDP 1/	3.7	-1.7	5.2	6.5	5.0	4.4	4.4	4.4	4.4
Total domestic demand	6.5	-5.1	16.5	7.8	6.0	4.9	4.6	4.5	4.5
Consumption	3.9	1.8	9.3	6.6	5.9	4.5	4.2	4.0	3.9
Private	4.6	0.8	10.4	8.2	5.4	4.7	4.3	4.1	4.0
Public	0.5	7.5	3.2	-1.9	9.0	3.4	3.4	3.4	3.4
Investment	14.3	-23.7	42.9	11.0	6.4	6.1	5.9	5.9	5.9
Inventories 2/	-1.1	-2.3	5.1	0.1	-0.3	-0.1	0.0	0.0	0.0
Net exports 2/	-3.3	3.9	-12.3	-2.6	-2.2	-1.5	-1.2	-1.1	-1.0
Consumer prices									
End of period	7.1	-1.4	3.0	4.0	3.2	3.0	3.0	3.0	3.0
Average	8.7	1.7	1.5	3.3	3.2	3.0	3.0	3.0	3.0
	(In percent of GDP unless otherwise specified)								
Balance of Payments									
Current account	-1.9	1.6	1.9	0.3	-1.3	-1.7	-2.0	-2.0	-2.0
Current account (in billions of U.S. dollars)	-3.3	2.6	3.8	0.7	-3.2	-4.4	-5.5	-5.9	-6.2
Trade Balance	5.0	8.8	7.8	7.1	6.3	5.5	5.1	4.9	4.7
Exports of goods	38.8	33.5	34.9	35.4	36.3	35.6	35.5	34.6	33.8
Imports of goods	33.8	24.8	27.1	28.3	30.0	30.1	30.4	29.7	29.1
Financial Account Balance	5.0	-1.1	-2.9	4.6	1.3	1.7	2.0	2.0	2.0
Foreign direct investment (net)	4.2	3.0	3.1	4.2	4.0	4.4	4.6	4.7	4.6
Portfolio investment (net)	-4.5	-7.3	-3.5	-1.2	-2.6	-2.6	-2.8	-3.0	-3.1
Financial Derivatives	-0.6	-0.2	-0.5	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1
Other Investments	5.9	3.4	-2.1	1.8	0.0	0.0	0.2	0.4	0.6
Change in Reserves Assets	-3.8	-1.0	-1.5	-4.9	0.0	0.0	0.0	0.0	0.0
Errors and Omissions	0.7	0.5	-0.3	0.0	0.0	0.0	0.0	0.0	0.0
	(Annual percentage change)								
Total export volume	-0.1	-5.7	1.4	2.9	3.4	4.3	4.3	4.5	4.7
Copper export volume	-0.9	-2.9	3.1	0.4	3.2	3.1	3.0	3.0	3.0
Agricultural exports volume	10.9	-0.8	2.2	9.1	4.0	4.0	4.0	4.0	5.0
Industrial exports volume	1.9	-10.2	-2.8	7.1	4.0	6.0	6.0	6.5	6.5
Total import volume	10.9	-15.0	27.0	9.0	6.2	5.5	4.8	4.7	4.7
Terms of Trade	-16.5	4.8	23.5	-1.7	-0.3	-0.8	-0.8	-0.3	-0.5
Total export prices	-4.3	-12.9	30.5	17.0	1.0	-1.5	-0.5	0.0	-0.3
Copper export prices	-12.0	-33.6	45.9	23.0	2.4	-2.4	-3.0	-3.6	-3.7
Total import price	14.1	-16.5	5.8	18.7	1.4	-0.7	0.3	0.3	0.2
External Debt				(In percent of GDP)					
Gross external debt	37.4	45.3	42.7	39.0	37.4	36.6	36.2	34.8	33.6
Public	7.2	8.4	8.6	7.7	7.2	6.5	6.2	5.8	5.4
Private	30.2	36.9	34.1	31.3	30.2	30.0	30.0	29.0	28.2
Gross int. reserves (in billions of U.S. dollars)	23.2	25.4	27.9	39.9	39.9	39.9	39.9	39.9	39.9
Savings and investment									
Gross domestic investment	25.2	18.9	22.4	23.8	24.1	24.6	25.0	25.3	25.6
Public	2.6	3.0	2.5	2.8	2.7	2.7	2.7	2.7	2.7
Private	22.6	15.9	19.9	21.0	21.4	21.9	22.3	22.6	23.0
National saving	23.3	20.5	24.3	24.1	22.8	22.9	23.0	23.3	23.7
Public 3/	8.4	-3.3	0.7	2.4	2.9	2.9	2.7	2.4	2.1
Private	14.9	23.8	23.6	21.7	19.9	20.0	20.3	20.9	21.5
Public sector finance									
Net Debt	-17.7	-6.9	-2.4	-2.5	-7.5	-6.7	-8.3	-7.9	-8.3
Excluding public enterprises	-23.8	-12.9	-8.3	-8.5	-13.5	-12.7	-14.3	-13.9	-14.3
Public sector gross debt 4/	26.0	29.3	27.7	32.8	30.3	30.3	30.5	29.7	29.3
Central government gross debt	5.2	6.2	9.2	10.4	10.5	10.6	10.6	10.7	10.9
Central government balance	4.3	-4.5	-0.4	1.3	1.8	1.7	1.5	1.2	0.9
Total Revenue	25.5	20.4	23.0	24.1	24.1	23.8	23.4	23.0	22.6
Total Expenditure	21.2	24.9	23.4	22.8	22.3	22.1	21.9	21.8	21.6
Memorandum Items:									
Copper prices (LME; U.S. cents per pound) 5/	316	234	342	421	431	421	408	394	379
Volume of copper exports (2004=100)	100	97	100	100	104	107	110	113	117

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

1/ Medium-term projections are consistent with potential growth of 4.5 percent for 2013-2016.
2/ Contribution to growth.
3/ Gross saving of the general government sector, including the deficit of the central bank.
4/ Gross consolidated debt of the public sector (central bank, non-financial public enterprises, and general government).
5/ IMF staff forecasts, average.

Table 7. Chile: Indicators of External Vulnerability

(In percent; unless otherwise indicated)

	2006	2007	2008	2009	2010
Financial indicators					
M3 (percent change)	11.4	14.7	19.1	-1.4	11.2
Less pension funds' deposits (annual percentage change)	12.7	13.5	23.3	4.8	13.2
Private Sector Credit to GDP	62.5	68.6	78.4	69.3	65.1
90-day central bank promissory note (nominal) interest rate (avg.)	4.8	5.2	6.7	1.7	2.1
Share of foreign currency deposits in total deposits	10.1	10.1	14.5	13.2	15.4
Share of foreign currency loans in total credit	10.2	10.7	11.8	10.8	10.0
External indicators					
Exports, U.S. dollars (annual percentage change)	42.2	15.8	-2.5	-18.5	31.5
Imports, U.S. dollars (annual percentage change)	17.7	22.6	31.1	-30.9	38.3
Terms of trade (annual percentage change)	31.1	4.3	-16.5	4.8	23.5
REER (annual percent change, period average)	3.6	-2.9	1.0	-1.4	5.4
Exchange rate (pesos per U.S. dollar, period average)	530	522	522	560	510
Current account Balance (percent of GDP)	4.9	4.5	-1.9	1.6	1.9
Financial account less reserves accumulation (percent of GDP)	-3.5	-6.5	5.7	-0.6	-3.2
Gross official reserves (in billions of U.S. dollars) 1/	19.4	16.9	23.2	25.4	27.9
Gross official reserves, months of imports of goods and services	4.3	2.9	5.6	4.5	4.0
Gross official reserves to M3	15.9	11.9	13.7	16.3	14.7
Gross official reserves to short-term external debt 2/	111.2	75.6	80.8	90.0	83.0
Total external debt (percent of GDP)	33.7	33.9	37.4	45.3	42.7
Of which: External public sector debt	7.8	7.8	7.2	8.4	8.6
Total external debt to exports of goods and services	74.4	72.4	82.7	116.5	106.0
External interest payments to exports of goods and services	2.3	2.0	1.9	2.6	1.9
External amortization payments to exports of goods and services	28.9	22.8	31.2	45.4	34.6
Financial market indicators					
Stock market index (in U.S. dollars; period average) 3/	1256	1757	1629	1601	2362
Sovereign long-term foreign-currency debt rating (end of period)					
Moody's	A2	A2	A2	A1	Aa3
S&P	A+	A+	A+	A+	A+
Fitch Ratings	A	A	A	A	A

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

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

Table 8. Chile: External Debt and Debt Service

	2006	2007	2008	2009	2010	Proj. 1/ 2011
	(In billions of U.S. dollars, end of period)					
Total debt outstanding	**49.5**	**55.7**	**63.7**	**73.0**	**86.7**	**95.4**
Of which: External private debt	38.1	43.0	51.4	59.5	69.3	76.6
External public debt	11.4	12.8	12.3	13.5	17.4	18.8
Medium- and long-term debt	40.2	44.8	49.0	55.1	66.9	73.9
Public sector	10.1	10.3	9.4	11.3	15.9	17.2
Of which: Central government	4.2	3.6	2.9	2.5	4.2	5.6
Private sector	30.1	34.4	39.6	43.7	51.1	56.7
Financial sector	5.6	9.0	9.8	8.2	11.5	13.9
Non-financial sector	24.5	25.4	29.7	35.5	39.6	42.8
Short-term debt: original maturity basis	9.3	11.0	14.7	17.9	19.8	21.5
residual maturity basis	17.5	22.4	28.7	28.2	33.6	36.6
Total medium- and long-term debt service	**13.7**	**9.8**	**14.5**	**15.4**	**11.9**	**12.7**
Amortization	12.1	8.2	13.1	13.8	10.4	11.1
Interest	1.5	1.6	1.4	1.6	1.5	1.6
	(In percent of GDP)					
Total external debt, end-period	**33.7**	**33.9**	**37.4**	**45.3**	**42.7**	**39.0**
Of which : External private debt	25.9	26.2	30.2	36.9	34.1	31.3
External public debt	7.8	7.8	7.2	8.4	8.6	7.7
Gross change (in percent)	-5.3	0.2	3.4	8.0	-2.6	-3.7
Gross change of nominal stock (in percent)	7.1	12.6	14.4	14.5	18.8	10.0
Interest payments on external debt	1.1	1.0	0.8	1.0	0.8	0.7
	(In percent of exports of goods and services)					
Total medium- and long-term debt service	20.6	12.8	18.9	24.6	14.6	12.8
Of which : Interest	2.3	2.0	1.9	2.6	1.9	1.7
Total external debt outstanding	74.4	72.4	82.7	116.5	106.0	96.4
	(In billions of U.S. dollars)					
Memorandum items:						
Gross international reserves	19.4	16.9	23.2	25.4	27.9	39.9
GDP 2/	146.8	164.2	170.6	161.1	203.3	245.0

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

ANNEX I. CHILE - DEBT SUSTAINABILITY ANALYSIS

1. **Chile's external debt is relatively low (Figure A1)**. Total external debt declined slightly from 45 percent in 2008 to 43 percent in 2009. Debt levels are not very sensitive to growth or interest-rate shocks, but are somewhat sensitive to a depreciation of the peso, as nearly all of Chile's external debt is denominated in foreign currency.

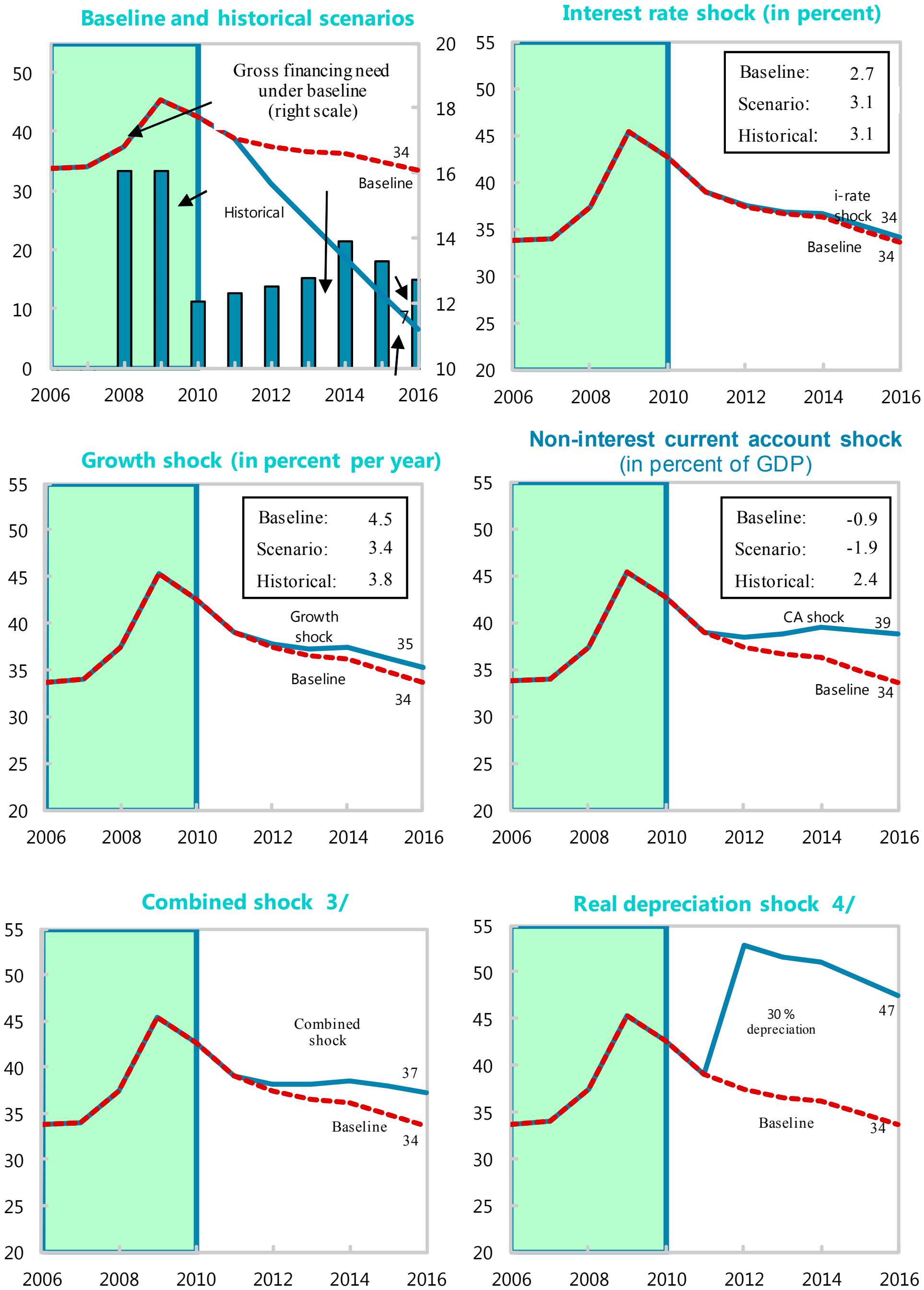
2. **Chile remained a net public creditor in 2010.** Relative to GDP, net central government assets declined to 7½ percent from 20¼ percent in 2008. Going forward, high copper prices and robust GDP growth would contribute to overall balance surpluses and further improve the net creditor position of the country. Gross government debt is low, at 10½ percent of GDP in 2011. The public debt sustainability analysis suggests that under various shocks (Figure A2), the net asset position of the government remains comfortable in the medium term.

3. **The government's report on contingent liabilities suggests that they are relatively small.** According to the 2010 report, the net present value of contingent liabilities amount to 4 percent of 2010 GDP (or 0.03 percent of 2010 GDP on an annual flow basis), of which deposit guarantees and guarantees on the debt of state enterprises account for 1½ percentage points.

4. **However, the report does not include long-term projections of health care or education expenditure.** Health care spending tends to rise very fast with aging, as spending is heavily skewed towards the elderly. In addition, health care inflation tends to be much higher than CPI inflation. In 2009, public health care expenditure amounted to 4 percent of GDP. Staff calculations suggest that demographic changes alone would increase annual public health care spending to about 6 percent of GDP in 2050, if per capita health care spending for a given age group grows in line with nominal GDP per capita. It could rise to almost 9 percent of GDP, if annual per capita health care spending growth for a given age group exceeds per capita nominal GDP growth by 1 percent.[1]

[1] The calculations use UN projections for population growth by age group and assume that relative health care spending across age groups in Chile are the same as in the United Kingdom during 2002/03.

Figure A.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 2010.

Table A.1. Chile: External Debt Sustainability Framework, 2006-16

	Actual					Projections						
	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	**Debt-stabilizing non-interest current account 6/**
Baseline: External debt	33.7	33.9	37.4	45.3	42.7	**39.0**	**37.4**	**36.6**	**36.2**	**34.8**	**33.6**	**-7.8**
Change in external debt	-5.3	0.2	3.4	8.0	-2.6	-3.7	-1.6	-0.8	-0.3	-1.4	-1.3	
Identified external debt-creating flows (4+8+9)	-17.3	-16.0	-9.3	-7.6	-19.6	-9.7	-7.4	-6.9	-6.6	-6.4	-6.1	
Current account deficit, excluding interest payments	-5.9	-5.5	1.1	-2.6	-2.6	-1.0	0.7	1.2	0.7	0.8	0.9	
Deficit in balance of goods and services	-15.1	-14.0	-4.4	-7.9	-7.3	-6.2	-5.0	-4.1	-3.7	-3.5	-3.1	
Exports	45.3	46.8	45.2	38.9	40.2	40.4	41.3	40.7	40.9	40.3	39.6	
Imports	30.2	32.9	40.7	31.0	33.0	34.2	36.3	36.6	37.1	36.8	36.5	
Net non-debt creating capital inflows (negative)	-4.9	-7.9	-10.0	-8.2	-8.3	-7.1	-6.8	-7.0	-7.0	-6.9	-6.6	
Automatic debt dynamics 1/	-6.5	-2.6	-0.4	3.2	-8.7	-1.6	-1.3	-1.1	-0.3	-0.3	-0.3	
Contribution from nominal interest rate	1.1	1.0	0.8	1.0	0.8	0.7	0.6	0.5	1.3	1.2	1.1	
Contribution from real GDP growth	-1.4	-1.4	-1.2	0.7	-1.9	-2.3	-1.9	-1.6	-1.5	-1.5	-1.4	
Contribution from price and exchange rate changes 2/	-6.1	-2.2	-0.1	1.5	-7.5	...	...	...	...	...	...	
Residual, incl. change in gross foreign assets (2-3) 3/	12.0	16.2	12.8	15.5	16.9	6.0	5.9	6.0	6.2	5.0	4.8	
External debt-to-exports ratio (in percent)	74.4	72.4	82.7	116.5	106.0	96.4	90.6	89.9	88.6	86.5	84.6	
Gross external financing need (in billions of US dollars) 4/	12.1	10.1	27.4	25.9	24.5	30.1	31.2	33.4	37.8	38.7	39.6	
in percent of GDP	8.2	6.2	16.0	16.1	12.1	12.3	12.5	12.8	13.9	13.3	12.7	
Scenario with key variables at their historical averages 5/						**39.0**	**31.1**	**24.9**	**18.6**	**12.5**	**6.5**	**-7.4**
Key Macroeconomic Assumptions Underlying Baseline												
Real GDP growth (in percent)	4.6	4.6	3.7	-1.7	5.2	6.5	5.0	4.4	4.4	4.4	4.4	
GDP deflator in US dollars (change in percent)	18.7	7.0	0.2	-4.0	20.0	13.1	-3.0	0.4	-0.4	2.6	2.5	
Nominal external interest rate (in percent)	3.4	3.2	2.6	2.6	2.1	1.9	1.7	1.4	3.6	3.5	3.4	
Growth of exports (US dollar terms, in percent)	37.4	15.7	0.2	-18.7	30.6	21.0	4.0	3.3	4.5	5.5	5.3	
Growth of imports (US dollar terms, in percent)	16.0	21.7	28.8	-28.1	34.1	25.1	8.1	5.7	5.6	6.1	6.2	
Current account balance, excluding interest payments	5.9	5.5	-1.1	2.6	2.6	1.0	-0.7	-1.2	-0.7	-0.8	-0.9	
Net non-debt creating capital inflows	4.9	7.9	10.0	8.2	8.3	7.1	6.8	7.0	7.0	6.9	6.6	

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

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

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

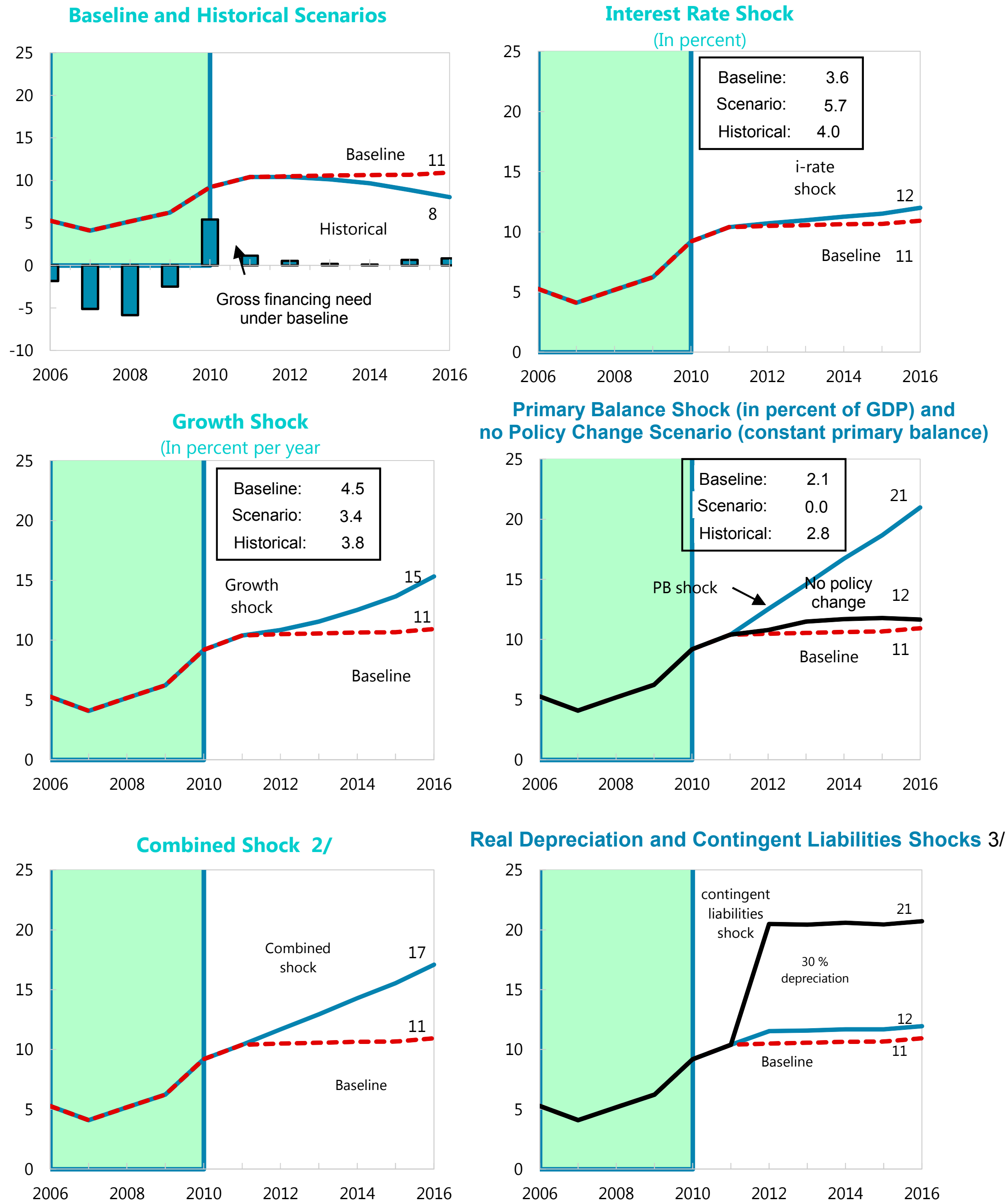
4/ Defined as current account deficit, plus amortization on medium- and long-term debt, plus short-term debt at end of previous period.

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 A.2. Chile: Public Debt Sustainability: Bound Tests 1/

(Public debt in percent of GDP)



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

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

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

3/ One-time real depreciation of 30 percent and 10 percent of GDP shock to contingent liabilities occur in 2010, with real depreciation defined as nominal depreciation (measured by percentage fall in dollar value of local currency) minus domestic inflation (based on GDP deflator).

Table A.2. Chile: Debt Sustainability Framework, 2006-16
(In percent, unless otherwise indicated)

	Actual					Projections						
	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	Debt-stabilizing primary balance 9/
Baseline: Central Government debt 1/	5.3	4.1	5.2	6.2	9.2	**10.4**	**10.5**	**10.6**	**10.6**	**10.7**	**10.9**	**0.0**
o/w foreign-currency denominated	3.6	2.1	2.1	1.4	1.6	2.2	2.1	1.9	1.8	1.7	1.6	
Change in central government debt	-2.0	-1.2	1.1	1.1	3.0	1.2	0.1	0.1	0.1	0.0	0.3	
Identified debt-creating flows (4+7+12)	-8.6	-9.0	-3.8	3.9	-0.5	-2.2	-2.7	-2.4	-2.2	-1.9	-1.6	
Primary deficit	-8.4	-8.8	-4.8	4.0	-0.1	-1.9	-2.4	-2.4	-2.1	-1.8	-1.6	
Revenue and grants	25.8	26.9	25.5	20.4	23.0	24.1	24.1	23.8	23.4	23.0	22.6	
Primary (noninterest) expenditure	17.4	18.1	20.7	24.3	22.9	22.2	21.7	21.5	21.3	21.1	21.0	
Automatic debt dynamics 2/	-0.2	-0.2	1.0	0.0	-0.4	-0.4	-0.2	0.0	-0.1	-0.1	-0.1	
Contribution from interest rate/growth differential 3/	-0.4	0.1	0.3	0.5	-0.3	-0.4	-0.2	0.0	-0.1	-0.1	-0.1	
Of which contribution from real interest rate	-0.1	0.3	0.5	0.4	0.0	0.2	0.2	0.4	0.3	0.4	0.4	
Of which contribution from real GDP growth	-0.3	-0.2	-0.1	0.1	-0.3	-0.5	-0.5	-0.4	-0.4	-0.4	-0.4	
Contribution from exchange rate depreciation 4/	0.2	-0.3	0.7	-0.5	-0.1	...	...	...	...	...	...	
Other identified debt-creating flows	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Privatization receipts (negative)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Recognition of implicit or contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Other (specify, e.g. bank recapitalization)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Residual, including asset changes (2-3) 5/	6.6	7.8	4.9	-2.9	3.5	3.4	2.8	2.5	2.3	1.9	1.9	
Central Government debt-to-revenue ratio 1/	20.4	15.2	20.3	30.6	40.0	43.2	43.5	44.3	45.4	46.4	48.5	
Gross financing need 6/	-1.8	-5.1	-5.8	-2.5	5.4	1.1	0.5	0.2	0.1	0.6	0.8	
in billions of U.S. dollars	-2.7	-8.4	-10.0	-4.0	11.0	2.8	1.3	0.5	0.3	1.9	2.5	
Scenario with key variables at their historical averages 7/						**10.4**	**10.4**	**10.1**	**9.7**	**8.9**	**8.0**	**0.1**
Scenario with no policy change (constant primary balance) in 2011-2016						**10.4**	**10.8**	**11.5**	**11.7**	**11.8**	**11.7**	**-0.1**
Key Macroeconomic and Fiscal Assumptions Underlying Baseline												
Real GDP growth (in percent)	4.6	4.6	3.7	-1.7	5.2	6.5	5.0	4.4	4.4	4.4	4.4	
Average nominal interest rate on public debt (in percent) 8/	11.2	12.7	12.5	10.3	9.6	7.2	6.8	6.5	6.4	6.3	6.3	
Average real interest rate (nominal rate minus change in GDP deflator, in percent)	-1.2	7.3	12.3	7.4	0.2	2.5	2.8	4.1	3.6	3.7	3.8	
Nominal appreciation (increase in US dollar value of local currency, in percent)	-3.8	7.8	-21.2	24.2	8.1	...	...	...	...	...	...	
Inflation rate (CPI, in percent)	12.4	5.4	0.2	2.9	9.4	4.7	4.0	2.4	2.9	2.6	2.5	
Growth of real primary spending (deflated by CPI deflator, in percent)	-1.4	9.1	18.5	15.5	-1.1	3.2	2.5	3.5	3.6	3.7	3.7	
Primary deficit	-8.4	-8.8	-4.8	4.0	-0.1	-1.9	-2.4	-2.4	-2.1	-1.8	-1.6	

1/ Indicate coverage of central government.
2/ Derived as $[(r - \pi(1+g) - g + \alpha\varepsilon(1+r)]/(1+g+\pi+g\pi))$ times previous period debt ratio, with r = interest rate; π = growth rate of GDP deflator; g = real GDP growth rate; α = share of denominated debt; and e = nominal exchange depreciation (measured by increase in local currency value of U.S. dollar).
3/ The real interest rate contribution is derived from the denominator in footnote 2/ as $r - \pi (1+g)$ and the real growth contribution as -g.
4/ The exchange rate contribution is derived from the numerator in footnote 2/ as $\alpha\varepsilon(1+r)$.
5/ For projections, this line includes exchange rate changes.
6/ Defined as central government deficit, plus amortization of medium and long-term public sector debt, plus short-term debt at end of previous period.
7/ The key variables include real GDP growth; real interest rate; and primary balance in percent of GDP.
8/ Derived as nominal interest expenditure divided by previous period debt stock.
9/ Assumes that key variables (real GDP growth, real interest rate, and other identified debt-creating flows) remain at the level of the last projection year.

INTERNATIONAL MONETARY FUND

CHILE

STAFF REPORT FOR THE 2011 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

August 9, 2011

Prepared By	Western Hemisphere Department

CONTENTS

ANNEX 1. CHILE: FUND RELATIONS

(As of June 30, 2011)

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

II. General Resources Account:

	SDR Million	Percent Quota
Quota	856.10	100.00
Fund holdings of currency	607.37	70.95
Reserve Position	248.73	29.05
Holdings Exchange Rate		

III. SDR Department:	**SDR Million**	**Percent Allocation**
Net cumulative allocation	816.89	100.00
Holdings	790.23	96.74

IV. Outstanding Purchases and Loans: None

V. Latest Financial Arrangements:

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

VI. Projected Payments to Fund (in SDR Million)

			Forthcoming		
	2011	2012	2013	2014	2015
Principal					
Charges/Interest	0.07	0.16	0.16	0.16	0.16
Total	0.07	0.16	0.16	0.16	0.16

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

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

ANNEX 2. CHILE: STATISTICAL ISSUES APPENDIX

(As of August 2, 2011)

I. Assessment of Data Adequacy for Surveillance	
General: Data provision is adequate for surveillance. The National Institute of Statistics (INE) regularly publishes a full range of economic and financial data. The Central Bank of Chile also publishes comprehensive macroeconomic and financial data. The Ministry of Finance publishes fiscal data. Key publicly accessible websites for macroeconomic data and analysis are: National Institute of Statistics: http://www.ine.cl/canales/chile_estadistico/home.php Central Bank of Chile: http://www.bcentral.cl/ Ministry of Finance: http://www.minhda.cl/	
II. Data Standards and Quality	
Subscriber to the Fund's Special Data Dissemination Standard (SDDS) since May 17, 1996.	A data ROSC was published September 17, 2007.

Chile: Table of Common Indicators Required for Surveillance

As of August 2, 2011

	Date of latest observation	Date received	Frequency of Data[6]	Frequency of Reporting[6]	Frequency of Publication[6]	Memo items[7]:	
						Data Quality – Methodological Soundness[8]	Data Quality Accuracy and reliability[9]
Exchange Rates	July 29, 2011	August 2, 2011	D	D	D		
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	July 29, 2011	August 2, 2011	W	W	W		
Reserve/Base Money	July 2011	August 2, 2011	M	M	M	O, O, LO, O	O, O, O, LO, O
Broad Money	June 2011	August 2, 2011	M	M	M		
Central Bank Balance Sheet	July 2011	August 2, 2011	M	M	M		
Consolidated Balance Sheet of the Banking System	June 2011	August 2, 2011	M	M	M		
Interest Rates[2]	August 2,2011	August 2, 2011	D	D	D		
Consumer Price Index	June 2011	August 2, 2011	M	M	M	LO, LNO, LNO, LO	LO, LO, LO, O, LO
Revenue, Expenditure, Balance and Composition of Financing[3] – General Government[4]	Q2 2011	July 29, 2011	Q	Q	Q	O, LO, LNO, LO	LO, O, O, LO, O
Revenue, Expenditure, Balance and Composition of Financing3– Central Government	June 2011	July 29, 2011	M	M	M		
Stocks of Central Government and Central Government – Guaranteed Debt[5]	Q1 2011	June 29, 2011	A	Q	Q		
External Current Account Balance	July 29, 2011	August 2 , 2011	W	W	W	O, O, LO, LO	O, O, O, O, O
Exports and Imports of Goods and Services	July 29, 2011	August 2 , 2011	W	W	W		
GDP/GNP	Q1 2011	June 20, 2011	Q	Q	Q	O, LO, LO, LO	LO, LO, LO, LO, O
Gross External Debt	June 2011	July 29, 2011	M	M	M		
International Investment position[10]	Q1 2011	June 29, 2011	Q	Q	Q		

[1] Any reserve assets that are pledged or otherwise encumbered should be specified separately. Also, data should comprise short-term liabilities linked to a foreign currency but settled by other means as well as the notional values of financial derivatives to pay and to receive foreign currency, including those linked to a foreign currency but settled by other means.

[2] Both market-based and officially-determined, including discount rates, money market rates, rates on treasury bills, notes, and bonds.

[3] Foreign, domestic bank, and domestic nonbank financing.

[4] The general government consists of the central government (budgetary funds, extra budgetary funds, and social security funds) and state and local governments.

[5] Including currency and maturity composition.

[6] Daily (D); weekly (W); monthly (M); quarterly (Q); annually (A); irregular (I); and not available (NA).

[7] Reflects the assessment provided in the data ROSC, (published September 17, 2007 and based on the findings of the mission that took place during April 18-May2, 2007) for the dataset corresponding to the variable in each row. The assessment indicates whether international standards concerning concepts and definitions, scope, classification/sectorization, and basis for recording are fully observed (O); largely observed (LO); largely not observed (LNO); not observed (NO); and not available (NA).

[8] Same as footnote 7, except referring to international standards concerning source data, assessment of source data, statistical techniques, assessment and validation of intermediate data and statistical outputs, and revision studies.

[9] Same as footnote 8, except referring to international standards concerning source data, statistical techniques, assessment and validation of source data, assessment and validation of intermediate data and statistical outputs, and revision studies.

[10] Includes external gross financial asset and liability positions vis-à-vis nonresidents.

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

Title	Products	Provisional Timing of Missions	Expected delivery date*
1. Bank work program	**A. Technical Assistance Loans**		
	1. Santiago Urban Transport Technical Assistance Project (P086689)		December 2011
	2. Additional Financing for the Social Protection Technical Assistance Project (P114774)		December 2012
	3. Second Public Expenditure Management Project (P1035441)		June 2013
	4. Ministry of Public Works Institutional Strengthening TAL (P102931)		January 2013
	B. Technical Assistance		
	1. Chile Infrastructure for Territorial Development (P076807)		December 2011
	2. Additional financing for the Chile Infrastructure for Territorial Development (P126500)		N/A (new project)
	C. Adaptable Programs Loans		
	1. Tertiary Education Finance for Results 2 (P111661)		N/A (new project)
2. Fund work program	Staff visit	January 2012	
	2012 Article IV Consultation	June 2012	Staff report August 2012

* Delivery date refers to the Board date in lending projects and to delivery to client in case of AAA.

INTERNATIONAL MONETARY FUND
Public Information Notice
EXTERNAL RELATIONS DEPARTMENT

Public Information Notice (PIN) No. 11/116
FOR IMMEDIATE RELEASE
August 24, 2011

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

IMF Executive Board Concludes 2011 Article IV Consultation with Chile

On August 23, 2011 the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with Chile[1], on a lapse-of-time basis[2].

Background

Chile's economy has recovered rapidly from the global financial crisis and the February 2010 earthquake. Its resilience was underpinned by solid policy frameworks (including a fiscal rule, inflation targeting and exchange rate flexibility), a sound banking system and a strong policy response, supported by the large fiscal buffers. Growth rebounded to 5.2 percent in 2010, and is expected to pick up further to 6.5 percent in 2011 on the back of strong domestic demand.

The slack in the economy has diminished and some constraints are emerging. The unemployment rate has reached a historically low level and wage growth is picking up. The rapid growth of domestic demand has fueled import growth, leading to a narrowing of the current account surplus despite favorable terms of trade. While the nominal appreciation of the peso has helped moderate the rise in consumer prices, headline inflation moved above the 3 percent target in the first half of 2011, although core inflation remained contained. Inflation is projected to increase in the second half of the

[1] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board. At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities.

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

year as spare capacity diminishes further, before declining during 2012 as the effect of interest rate increases passes through.

Credit conditions have eased significantly over the last twelve months, and commercial and consumer loan growth has accelerated. External borrowing by non-financial corporations has also increased significantly. Nonetheless, the ratios of corporate debt-to-Gross Domestic Product (GDP) and household debt-to-disposable income remain broadly stable.

The authorities are withdrawing policy stimulus. Against a backdrop of rising inflation, the central bank raised the policy rate from 0.5 percent in mid-2010 to 5.25 percent in June 2011. The rapid increases in the policy rate in the first half of 2011 helped bring down inflation expectations close to the official target. In January 2011, the central bank announced a daily schedule of foreign exchange purchases to increase its gross reserve by US$12 billion by year-end.

In early 2011, the government announced a reduction of public expenditure of about 0.3 percent of GDP, which would lower the 2011 structural fiscal deficit to 1.6 percent of GDP (0.5 percentage point lower than in 2010). The headline fiscal balance is expected to move from a deficit of 0.4 percent of GDP in 2010 to a surplus of 1.3 percent in 2011 on the back of high copper prices.

Despite a pickup in gross capital inflows, net capital inflows remain moderate. Rising gross portfolio inflows have been largely offset by higher portfolio investments abroad by domestic pension funds. In early 2011, however, large foreign borrowing by banks and corporates resulted in a sizable surplus in the financial account. The peso appreciated 14 percent vis-à-vis the US dollar (although only 4 percent in real effective terms) in the year to May. The strengthening of the peso is consistent with improvement in the terms of trade and other fundamentals.

The financial soundness indicators are favorable. Banks are well capitalized, liquid, and highly profitable. Stress tests suggest that banks' capital ratios will remain above minimum requirements even if economic conditions deteriorate and the cost of funding increases. Non-performing loans declined in 2010 and banks have increased their provision coverage. Despite the recent rise in external borrowing, banks' foreign funding remains moderate and there are no significant currency mismatches in the banking and corporate sectors.

Executive Board Assessment

In concluding the 2011 Article IV consultation with Chile, Executive Directors endorsed staff's appraisal, as follows:

Chile has recovered rapidly from the global financial crisis and strong growth is expected to continue. Real GDP is expected to grow by 6.5 percent in 2011 on the back of buoyant domestic demand. Consumption will benefit from strong employment growth and firming wages, while large reconstruction spending will support investment. Domestic risks to the outlook are mostly to the upside. The main downside risks are related to the possibility of a sharp slowdown of economic activity in Asia, or an intensification of global financial stress.

The key task of macroeconomic policies at the current juncture is to ensure a smooth transition to a sustainable path for domestic demand. The output gap has closed and some capacity constraints are emerging. The current account balance has narrowed, despite favorable terms of trade, and is expected to deteriorate further as rapid import growth continues to outpace export growth. Upward pressures on headline Consumer Price Inflation (CPI) have eased in line with commodity price developments, but core inflation is likely to continue to rise as spare capacity diminishes further.

The authorities have appropriately started to withdraw policy stimulus. Fiscal expenditure growth moderated in 2010 (from very high levels during the crisis), and is expected to be somewhat lower than GDP growth in 2011. The rapid pace of policy rate increases in the first half of 2011 reinforced market confidence that inflation pressures will be contained, bringing inflation expectations closer to the target. Staff agrees with the authorities that the magnitude and timing of any future policy rate moves would depend on domestic and global economic developments.

Staff urges the authorities to accelerate the pace of fiscal tightening and set more ambitious medium-term fiscal targets. Rebuilding fiscal buffers at a faster pace than currently envisaged would optimize the contribution of fiscal policy to macroeconomic stability. In the near term, greater fiscal restraint would help guard against upside inflation risks and improve the policy mix, reducing the risk of a surge in capital inflows and easing pressures on the exchange rate. In the long term, larger fiscal buffers will help preserve the government's ability to respond to adverse shocks and prepare it to deal better with challenges related to population aging. Staff recommends aiming for a structural surplus in the medium term, and frontloading the adjustment.

Ongoing efforts to improve Chile's fiscal policy framework are welcome. Staff supports the thrust of the recommendations of the commission for improving the functioning of Chile's fiscal rule and its institutional framework. In particular, it supports the recommendations to improve the calculation of the structural balance, reduce unintended policy procyclicality caused by assumptions about long-term copper prices, and add an explicit escape clause to the rule. Introducing an explicit link between medium- and long-term budget targets would help improve the policymaking process. Staff believes that the establishment of an independent fiscal council would strengthen the framework and enhance the assessment of fiscal policy.

The flexible exchange rate system continues to serve Chile well. It has helped limit speculative capital inflows and mitigate inflationary pressures. Staff analysis suggests that the current level of the exchange rate is broadly in line with fundamentals. Foreign exchange reserves at end-2011 would be fully adequate based on various reserve measures and staff sees no case for extending the intervention program beyond the end of the year.

Although financial soundness indicators remain strong, continued vigilance is necessary to contain vulnerabilities. In the context of heightened risks of a rise in global financial stress, it would be prudent to continue to maintain high levels of liquidity in the financial system. In addition, continued monitoring is needed to prevent an excessive buildup of leverage in the corporate and household sectors. In case concerns arise about the speed of credit or asset price growth, prudential measures could be considered to help maintain stability.

Staff supports the planned enhancements to the regulatory and supervisory framework for the financial system discussed during the Financial Sector Assessment Program update. Staff commends the authorities for advancing measures aimed at modernizing Chile's regulatory framework, including the establishment of a financial stability committee, the strengthening of consumer protection in financial services, the adoption of a commission structure for the supervisory agencies, and planned changes in the Banking Law. As the Financial System Stability Assessment points out, it would also be advisable to strengthen the legal basis for oversight of financial conglomerates, the framework for anti-money laundering and combating the financing of terrorism, and the procedures for resolution of failed financial institutions.

Boosting productivity remains the key long-term challenge. Government initiatives to reduce the cost of doing business, increase competition, support research and development, and reform the corporate bankruptcy code are welcome. Another important goal is increasing labor market efficiency and raising labor force participation.

Chile: Selected Social and Economic Indicators

I. Social and Demographic Indicators

GDP (2009)	103,742	**Poverty rate (2009)**	15.1
U.S. dollars (billions)	203.3	Indigent	3.7
Per capita (U.S. dollars)	11,981	Poor, not indigent	11.4
Population characteristics (2008)		**Income distribution (2009)**	
Total (in millions)		Richest 10% of households	
Urban population (percent of total)	17.0	Poorest 20% of households	40.2
Life expectancy at birth (years)	88.7	Gini coefficient	3.6

II. Economic Indicators

						Projections	
	2006	2007	2008	2009	2010	2011	2012
	(Annual percentage change, unless otherwise specified)						
National accounts and employment							
Real GDP	4.6	4.6	3.7	-1.7	5.2	6.5	5.0
Total domestic demand	7.0	7.3	6.5	-5.1	16.5	7.8	6.0
Consumption	7.0	7.0	3.9	1.8	9.3	6.6	5.9
Private	7.1	7.0	4.6	0.8	10.4	8.2	5.4
Public	6.4	7.2	0.5	7.5	3.2	-1.9	9.0
Investment	7.1	8.3	14.3	-23.7	42.9	11.0	6.4
Private	1.4	9.5	21.7	-21.9	25.3	11.0	8.8
Public	12.0	24.7	3.1	36.4	-14.7	16.5	2.4
Fixed	2.5	11.2	19.5	-15.8	18.6	11.7	8.0
Inventories 1/	1.2	-0.5	-1.1	-2.3	5.1	0.1	-0.3
Net exports 1/	-2.6	-3.1	-3.3	3.9	-12.3	-2.6	-2.2
Exports	5.0	7.5	3.3	-6.4	2.0	5.4	3.4
Imports	11.2	13.9	9.9	-13.0	29.9	8.5	6.2
Consumer prices							
End of period	2.6	7.8	7.1	-1.4	3.0	4.0	3.2
Average	3.4	4.4	8.7	1.7	1.5	3.3	3.2
Unemployment rate (annual average) 2/	8.0	7.0	7.4	9.6	8.3	7.2	7.2
Money and credit							
Broad money	17.5	20.5	18.6	-5.3	9.3	...	...
Credit to the private sector (end of period)	16.8	21.0	18.7	-10.6	8.1	...	...
External Debt and Balance of Payments	(In percent of GDP, unless otherwise specified)						
Current account	4.9	4.5	-1.9	1.6	1.9	0.3	-1.3
Trade Balance (in billions of U.S. dollars)	15.1	14.0	4.4	7.9	7.3	6.2	5.0
Exports of goods (in billions of U.S. dollars)	45.3	46.8	45.2	38.9	40.2	40.4	41.3
Imports of goods (in billions of U.S. dollars)	-30.2	-32.9	-40.7	-31.0	-33.0	-34.2	-36.3
Gross external debt	33.7	33.9	37.4	45.3	42.7	39.0	37.4
Public	7.8	7.8	7.2	8.4	8.6	7.7	7.2
Private	25.9	26.2	30.2	36.9	34.1	31.3	30.2
Gross International Reserves (in billions of U.S. dollars)	19.4	16.9	23.2	25.4	27.9	39.9	39.9
	(Annual percentage change)						
Terms of Trade	31.1	4.3	-16.5	4.8	23.5	-1.7	-0.3
Real Effective Exchange Rate 3/	3.6	-2.9	1.0	-1.4	5.4	...	...
Savings and investment	(In percent of GDP)						
Gross domestic investment	20.0	20.4	25.2	18.9	22.4	23.8	24.1
Public	2.0	2.4	2.6	3.0	2.5	2.8	2.7
Private	17.9	18.1	22.6	15.9	19.9	21.0	21.4
National saving	24.9	25.0	23.3	20.5	24.3	24.1	22.8
Public 4/	9.2	9.0	8.4	-3.3	0.7	2.4	2.9
Private	15.7	16.0	14.9	23.8	23.6	21.7	19.9
Public sector finance							
Net Debt	-1.8	-10.0	-17.7	-6.9	-2.4	-2.5	-7.5
Excluding public enterprises	-6.1	-13.5	-23.8	-12.9	-8.3	-8.5	-13.5
Public sector gross debt 5/	26.9	19.9	26.0	29.3	27.7	32.8	30.3
Central government gross debt	5.3	4.1	5.2	6.2	9.2	10.4	10.5
Public sector balance	7.7	8.2	4.3	-4.5	-0.4	1.3	1.8

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

1/ Contribution to growth.

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

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

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

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