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### **IMF Executive Board Concludes 2016 Article IV Consultation with Chile**

On December 7, 2016, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation<sup>1</sup> with Chile.

GDP growth has been weak, with activity slowing in October. However, conditions are in place for the economy to recover. After expanding by a moderate 1.7 this year, growth is forecast to increase to 2 percent in 2017. Faster growth in main regional partners and more stable copper prices are expected to lift exports and investment. The recovery is, however, projected to be gradual, held back by slow wage and job growth and still low business confidence. Inflation is expected to continue to decelerate to 2.7 percent next year.

The balance of risks is on the downside. The main external risk is an unexpected slowdown in Chile's main trading partners, China and Brazil. Possible changes to the U.S. policy path have added uncertainty to the outlook. External risks could be magnified by high corporate leverage and reliance on foreign currency debt. Domestically, the main risks are a delayed recovery in business confidence and investment related to larger the expected uncertainties surrounding a new labor bill. Also, should a pension reform be approved, an increase in contribution rates could dampen growth over the medium term. On the upside, a fiscal expansion in advanced economies could raise external demand above expectations.

The financial sector appears healthy. Banks profitability is declining but capital buffers are adequate and non-performing loan rates are low. Discussions about a strengthening of the regulatory framework, especially Basel III, and a strengthening of supervision have been underway for some time.

The macroeconomic policy mix remains accommodative. Amidst fast disinflation and slow activity, the policy rate has remained unchanged throughout 2016 and policy guidance is now

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<sup>1</sup> 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.

setting the tone for an easing cycle. The strong net public-asset position has allowed the use of fiscal space so far, and the envisaged consolidation is gradual and geared toward pro-growth spending.

Structural reforms are setting the stage for stronger growth. Investment in infrastructure, especially roads and electricity, have come underway. Implementations of the previously approved education reform is proceeding. More recently a package of measures aimed at raising productivity has been passed.

### **Executive Board Assessment<sup>2</sup>**

Executive Directors commended the authorities' sound macroeconomic management, which has contributed to Chile's resilience to large terms-of-trade shocks. At the same time, Directors noted that less favorable external conditions, declining trend growth, and an urgent need to address social needs could impact the country's economic prospects. Directors welcomed the authorities' continued commitment to strong policies and reforms aimed at achieving higher and more inclusive growth and tackling the challenges ahead.

Directors welcomed the current monetary policy stance which is based on an inflation-targeting framework and a flexible exchange rate regime. They supported the ongoing monetary policy accommodation and agreed that further easing could be considered in case disinflationary pressures broaden and growth risks intensify. They recommended that monetary policy decisions should continue to be data dependent.

Directors commended the authorities' shift toward fiscal consolidation, given the sizable structural deficit, and recommended a gradual consolidation path so as to minimize the drag on the recovery. They noted that the role of the Advisory Fiscal Council could be strengthened to buttress fiscal credibility.

Directors noted that although Chile's pension system is sound, it is not delivering adequate benefits. They welcomed the authorities' plans to reform the pension system, including ensuring adequate old-age income by strengthening the private and public solidarity pillars, and by reducing the costs of pension fund administration. Directors highlighted that consideration should also be given to increases in contribution rates, retirement ages, and mandatory coverage. In addition, they underscored that economic effects of these reform efforts need to be carefully assessed for their impact on growth as well as on current and future pensions.

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<sup>2</sup> 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. An explanation of any qualifiers used in summings up can be found here: <http://www.imf.org/external/np/sec/misc/qualifiers.htm>.

Directors noted that the financial sector is healthy. However, they encouraged the authorities to closely monitor vulnerabilities as weaker-than-expected growth could strain the solvency of highly leveraged firms and less resilient small-and medium-sized enterprises, with potential for amplification via strong inter-sectoral balance-sheet linkages. Directors underscored the need to further improve resilience by adopting Basel III capital standards and to move towards risk-based supervision of insurers. They also called for more effective oversight of conglomerates and stronger corporate governance and investor protection.

Directors emphasized that ambitious structural reforms are necessary to promote stronger and more inclusive growth. They welcomed the authorities' continued efforts toward improving the quality of education, upgrading key infrastructure, and raising productivity. Directors also underscored the importance of tackling legal uncertainties related to the labor reform.

### Chile: Selected Social and Economic Indicators

GDP (2015), in billions of pesos	157,508	Quota					
GDP (2015), in billions of U.S. dollars	240.8	in millions of SDRs				856	
Per capita (U.S. dollars)	13,374	in % of total				0.36%	
Population (2014), in millions	17.8	Poverty rate (2015)				11.70	
Main products and exports	Copper	Gini coefficient (2015)				49.50	
Key export markets	China, Euro area, U.S.	Literacy rate (2015)				99.2	
						Proj.	
	2011	2012	2013	2014	2015	2016	2017
	(Annual percentage change, unless otherwise specified)						
<b>Output</b>							
Real GDP	5.8	5.5	4.0	1.9	2.3	1.7	2.0
Total domestic demand	9.4	7.4	3.6	-0.3	2.0	1.5	1.8
Consumption	7.8	5.7	5.2	2.8	2.5	2.2	2.1
Private	8.9	6.1	5.5	2.4	1.9	1.7	1.9
Public	2.5	3.5	3.5	5.1	5.8	4.6	3.5
Investment	14.4	12.6	-0.7	-9.9	0.3	-1.0	0.5
Fixed	15.0	11.6	2.2	-4.2	-1.5	0.5	0.5
Private	15.8	12.6	2.7	-4.7	-3.3	0.4	0.7
Public	8.3	3.8	-1.9	0.8	14.5	1.0	-1.7
Inventories 1/	0.0	0.4	-0.8	-1.5	0.5	-0.3	0.0
Net exports 1/	-4.2	-2.0	0.3	2.8	0.4	0.4	0.3
Exports	5.5	0.1	3.3	1.1	-1.9	0.7	2.8
Imports	16.0	4.8	2.1	-5.7	-2.8	-0.4	1.9
<b>Employment</b>							
Unemployment rate (annual average)	7.1	6.4	5.9	6.4	6.2	7.0	7.6
<b>Consumer prices</b>							
End of period	4.4	1.4	2.8	4.7	4.4	3.1	3.0
Average	3.3	3.0	1.9	4.4	4.3	3.9	2.7
	(In percent of GDP, unless otherwise specified)						
<b>Public sector finances</b>							
Central government revenue	22.6	22.2	21.0	20.7	21.3	21.1	21.3
Central government expenditure	21.4	21.6	21.6	22.4	23.5	24.1	24.6
Central government fiscal balance	1.3	0.6	-0.6	-1.6	-2.2	-3.1	-3.3
Structural fiscal balance 2/	-1.0	-0.1	-1.0	-1.5	-2.1	-2.4	-2.1
Fiscal impulse	-1.4	-0.9	0.8	0.6	0.5	0.3	-0.3
Public sector net debt	-4.9	-1.9	-1.1	0.5	1.0	6.2	9.5
Public sector gross debt	34.9	34.3	34.0	37.8	40.6	44.4	48.7
Central government gross debt	11.2	12.0	12.8	15.1	17.5	20.8	25.0
Of which, share of FX-denominated debt (in percent)	17.2	16.1	12.9	15.9	18.3	17.3	17.3
<b>Money and credit</b>							
Broad money (percentage change)	18.5	7.6	14.9	9.3	9.8	...	...
Credit to the private sector (percentage change)	16.7	11.9	10.0	10.2	10.7	8.1	6.0
3-month central bank bill rate (%)	4.9	5.1	5.0	4.0	2.6	...	...
<b>Balance of payments</b>							
Current account	-1.2	-3.5	-3.7	-1.3	-2.0	-2.2	-2.2
Current account (in billions of U.S. dollars)	-3.1	-9.4	-10.3	-3.3	-4.8	-5.4	-5.4
Foreign direct investment inflows	9.3	10.7	7.0	8.6	8.5	8.6	8.8
Gross international reserves (in billions of U.S. dollars)	42.0	41.6	41.1	40.4	38.6	38.6	38.6
In months of next year's imports of goods and services	5.6	5.5	5.9	6.7	6.6	6.3	6.0
Gross external debt	39.6	45.4	48.6	57.8	64.6	64.7	68.3
Public	2.9	3.1	3.4	3.8	4.3	4.9	5.6
Private	36.7	42.4	45.2	54.0	60.4	59.8	62.7
<b>Exchange rate</b>							
	(Annual percentage change)						
Real effective exchange rate (real appreciation +)	0.0	3.2	-0.7	-8.8	1.4	...	...
Terms of trade	1.5	-6.6	-2.9	-2.0	-4.1	-1.7	-2.3

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

1/ Contribution to growth.

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