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IMF Executive Board Concludes 2012 Article IV Consultation with Chile

On September 5, 2012, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with Chile.¹

Background

Chile's economy has expanded at a robust pace over the past two years. The economy recovered rapidly from the global financial crisis and the February 2010 earthquake, supported by a strong policy framework, favorable copper prices and strong consumer and business confidence. Real GDP increased by about 6 percent during 2010–11 on the back of exceptionally dynamic domestic demand.

The output gap is closed and some pressures on capacity constraints have emerged. The unemployment rate is at a historically low level, leading to strong wage growth. Labor force participation and employment have increased rapidly in 2010–11, although there has been some deceleration in recent months. The surge in domestic demand has fueled import growth, turning the external current account into deficit in 2011, despite record high copper prices. Core and headline inflation increased rapidly in 2011 driven by rising import prices and wages. Price pressures have eased in recent months as food and energy prices declined, and inflation expectations remain well anchored.

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

Bank credit growth has been strong, despite some tightening in credit standards since late 2011. Bank credit in real terms has been growing at around 11 percent year-on-year, with particularly strong growth in the corporate and consumer loans segments. In contrast, non-bank consumer credit, which accounts for about 30 percent of consumer credit, has declined since mid-2011.

The central bank raised the policy rate by 475 basis points from mid-2010 to June 2011 (to 5¼ percent) to withdraw policy stimulus and contain inflation. After a one-off easing in January 2012, amid uncertain global financial conditions, the policy rate has been maintained at 5 percent. The central bank completed the pre-announced US\$12 billion foreign exchange purchases program in December 2011, strengthening the reserve position.

Spillovers to Chile from volatility in global financial markets have been limited. Stock market prices have moved broadly in line with prices in other emerging markets. Despite some increase since mid-2011, bank funding costs remain well below their levels after the Lehman crisis. The temporary liquidity measures implemented by the authorities in December 2011 were successful in containing a rise in liquidity pressures in domestic money markets. Net capital inflows have remained strong, especially in the mining sector. The real effective exchange rate is close to its long-term historical average.

The withdrawal of fiscal stimulus continued in 2011. Public expenditure growth slowed down and a temporary corporate income tax hike boosted revenue. However, an increase in education and other social spending will result in some easing of the fiscal policy stance in 2012. A tax reform has been proposed by the government to help finance the increase in education spending.

Looking ahead, real GDP is expected to grow 4¾ percent in 2012, broadly in line with potential growth. The current account deficit is expected to widen further in 2012 due to less favorable terms of trade. Core and headline inflation are expected to remain close to the target as domestic demand growth moderates and import prices remain subdued.

Executive Board Assessment

Executive Directors commended the authorities' skillful economic management anchored on sound policy frameworks, which has contributed to robust economic growth with low inflation, unemployment, and public debt. Directors underscored, however, that downside risks remain, stemming from global uncertainties and Chile's vulnerability to commodity price shocks. They called for continued vigilance and maintenance of strong and flexible policy frameworks. They were encouraged that the authorities have space for counter-cyclical policies if needed, particularly on the monetary side.

Directors supported the authorities' plans to reduce the structural budget deficit to one percent of GDP by 2014, with a number of Directors observing that the aim eventually should be structural balance or a small surplus. Near-term flexibility should be retained, however, and a more front-loaded reduction would be desirable if conditions remain favorable. Directors encouraged the authorities to build up fiscal buffers and strengthen the medium-term fiscal framework further. Expenditure restraint and higher revenue collection will be essential. New spending commitments, including higher social spending, should be matched by permanent revenue increases. In this context, the tax reform to finance education expenditure is welcome. Directors welcomed plans to create a Fiscal Council and broaden the expenditure forecasting framework to include health care and education spending.

Directors observed that the inflation targeting and flexible exchange rate regimes have served Chile well. They agreed that the current neutral stance of monetary policy is appropriate but should remain responsive to changing economic conditions. Exchange rate flexibility, buttressed by macro-prudential measures as needed and a good communication strategy to maintain market confidence, remains an important buffer and first line of defense against volatile capital flows and terms of trade shocks.

Directors welcomed the soundness and resilience of Chile's financial sector, noting that banks are well-capitalized, liquid, and profitable, a testimony to the authorities' strong financial oversight. Given global uncertainties, banks should maintain adequate liquidity and capital and continue to diversify external funding sources. Directors encouraged the authorities to implement the remaining reforms recommended in the 2011 FSAP report to enhance financial regulation and supervision. In this connection, they welcomed the establishment of a Financial Stability Council and various legislative initiatives being pursued, and recommended the creation of a legal framework for consolidated supervision of financial conglomerates.

Directors saw productivity growth as key to sustaining high economic growth rates in the future. They welcomed recent initiatives to foster female labor participation, and pressed for reforms to enhance labor market efficiency and flexibility, boost investment in the energy sector, and improve the business environment.

Public Information Notices (PINs) form part of the IMF's efforts to promote transparency of the IMF's views and analysis of economic developments and policies. With the consent of the country (or countries) concerned, PINs are issued after Executive Board discussions of Article IV consultations with member countries, of its surveillance of developments at the regional level, of post-program monitoring, and of ex post assessments of member countries with longer-term program engagements. PINs are also issued after Executive Board discussions of general policy matters, unless otherwise decided by the Executive Board in a particular case. The [staff report](#) (use the free [Adobe Acrobat Reader](#) to view this pdf file) for the 2012 Article IV Consultation with Chile is also available.

Chile: Selected Social and Economic Indicators

| | | | | | | | |
|--|--|-------|-------|-------|------|-------------------------|-------|
| GDP (2011), in billions of pesos | 120,158 | | | | | Quota | |
| GDP (2011), in billions of U.S. dollars | 248.4 | | | | | In millions of SDRs | 856 |
| Per capita (U.S. dollars) | 14,403 | | | | | In percent of total | 0.36% |
| Population (2009), in millions | 16.9 | | | | | Poverty rate (2011) | 14.4 |
| Main products and exports | Copper | | | | | Gini coefficient (2011) | 0.52 |
| Key export markets | China, U.S., Japan | | | | | Literacy rate (2011) | 98.9 |
| | | | | | | | Proj. |
| | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 |
| | (Annual percentage change, unless otherwise specified) | | | | | | |
| Output | | | | | | | |
| Real GDP | 5.2 | 3.1 | -0.9 | 6.1 | 5.9 | 4.7 | 4.5 |
| Total domestic demand | 7.0 | 7.4 | -5.0 | 14.8 | 9.7 | 5.7 | 4.6 |
| Consumption | 7.5 | 4.5 | 0.8 | 8.9 | 8.1 | 5.4 | 4.4 |
| Private | 7.7 | 5.2 | -0.8 | 10.0 | 8.9 | 5.7 | 4.8 |
| Public | 6.7 | 0.4 | 9.2 | 3.7 | 4.0 | 3.5 | 1.7 |
| Investment | 6.3 | 21.0 | -23.5 | 35.6 | 13.7 | 9.3 | 3.7 |
| Fixed | 10.7 | 18.1 | -12.2 | 14.2 | 17.7 | 8.0 | 5.6 |
| Private | 9.1 | 20.0 | -17.7 | 20.5 | 18.4 | 7.3 | 5.8 |
| Public | 24.5 | 3.5 | 37.9 | -19.6 | 11.6 | 14.0 | 3.5 |
| Inventories 1/ | -0.8 | 0.7 | -3.1 | 4.0 | -0.6 | 0.4 | -0.4 |
| Net exports 1/ | -1.8 | -3.7 | 4.1 | -8.7 | -4.2 | -0.3 | -0.3 |
| Exports | 7.1 | -0.7 | -4.5 | 1.4 | 4.7 | 4.7 | 4.7 |
| Imports | 14.0 | 9.3 | -15.4 | 27.7 | 14.8 | 4.8 | 4.7 |
| Employment | | | | | | | |
| Unemployment rate (annual average) 2/ | 7.0 | 7.8 | 10.8 | 8.2 | 7.1 | 6.6 | 6.9 |
| Consumer prices | | | | | | | |
| End of period | 7.8 | 7.1 | -1.5 | 3.0 | 4.4 | 2.6 | 3.0 |
| Average | 4.4 | 8.7 | 1.5 | 1.4 | 3.3 | 3.2 | 3.0 |
| | (In percent of GDP, unless otherwise specified) | | | | | | |
| Public sector finance | | | | | | | |
| Central government revenue | 25.6 | 24.2 | 19.0 | 21.7 | 22.9 | 21.7 | 21.0 |
| Central government expenditure | 17.8 | 20.2 | 23.2 | 22.1 | 21.6 | 22.0 | 21.7 |
| Central government fiscal balance | 7.8 | 4.1 | -4.2 | -0.4 | 1.3 | -0.3 | -0.7 |
| Structural fiscal balance 3/ | -0.1 | -1.1 | -4.2 | -2.5 | -1.1 | -1.1 | -1.3 |
| Public sector net debt | -9.5 | -16.8 | -6.5 | -2.2 | -5.0 | -1.1 | 0.1 |
| Public sector gross debt | 18.9 | 24.7 | 27.4 | 26.1 | 35.2 | 34.2 | 34.2 |
| Central government gross debt | 3.9 | 4.9 | 5.8 | 8.6 | 11.3 | 11.5 | 12.4 |
| Of which, share of FX-denominated debt (in percent) | 51.5 | 40.0 | 22.8 | 17.3 | 17.2 | 12.3 | 8.2 |
| Money and credit | | | | | | | |
| Broad money (% change) | 20.5 | 18.6 | -5.3 | 9.3 | 18.5 | ... | ... |
| Credit to the private sector (end of period, percent change) | 21.0 | 18.7 | -1.4 | 8.3 | 17.0 | ... | ... |
| 3-month central bank bill rate (percent) | 5.2 | 7.4 | 1.1 | 2.1 | 5.1 | ... | ... |
| Balance of payments | | | | | | | |
| Current account | 4.1 | -3.2 | 2.0 | 1.5 | -1.3 | -2.9 | -2.7 |
| Current account (in billions of U.S. dollars) | 7.1 | -5.8 | 3.5 | 3.3 | -3.2 | -7.8 | -8.0 |
| Foreign direct investment inflows | 7.3 | 8.6 | 7.5 | 7.1 | 7.0 | 6.9 | 6.7 |
| Gross international reserves (in billions of U.S. dollars) | 16.9 | 23.2 | 25.4 | 27.9 | 42.0 | 42.0 | 42.0 |
| In months of next year's imports of goods and services | 2.9 | 5.5 | 4.5 | 3.9 | 5.6 | 5.4 | 5.2 |
| Gross external debt | 30.9 | 35.5 | 41.6 | 38.9 | 39.7 | 39.3 | 36.9 |
| Public | 6.8 | 6.5 | 7.7 | 7.9 | 8.3 | 8.4 | 7.7 |
| Private | 24.1 | 29.0 | 34.0 | 31.0 | 31.4 | 30.9 | 29.2 |
| | (Annual percentage change) | | | | | | |
| Exchange rate | | | | | | | |
| Real effective exchange rate (real appreciation +) | -2.1 | 1.8 | -2.2 | 5.9 | 0.9 | ... | ... |
| Terms of trade | 3.9 | -15.4 | 6.0 | 21.5 | 0.7 | -7.7 | -1.1 |

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

1/ Contribution to growth.

2/ The methodology to compute the unemployment rate changed in 2009.

3/ The estimate of the structural balance is based on staff estimates of the output gap, and may differ from the authorities' estimate