Executive Board Minutes 21/47-1

May 14, 2021–10:00 a.m.

Chile—Review Under the Flexible Credit Line Arrangement

Documents: EBS/21/38

Staff: Ricci, WHD; Gray, SPR

Length: 48 minutes

ISSUED: September 22, 2022
APPROVAL: September 29, 2022

CEDA OGADA
Secretary

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[1] Minutes are the official record of a formal Board meeting in which the Board may adopt decisions and reach understandings related to the business of the Fund. Staff background documents issued before the meeting are the principal basis for the meeting. Preliminary "gray" or "buff" statements by Executive Directors and staff's responses to Directors' technical questions are circulated prior to the meeting. Adopted decisions and/or summings up—the Chair's "sense of the meeting" or policy conclusions/recommendations—are issued after the meeting. The minutes include all these elements, as well as the discussion record (a verbatim transcript of the discussion lightly edited for clarity). Minutes are made public consistent with the IMF's Transparency Policy and Open Archives Policy.

THE ACTING CHAIR'S SUMMING UP

Executive Directors noted that the COVID-19 pandemic hit the Chilean economy hard as the economy was recovering from the 2019 social unrest. They commended the authorities for their swift and strong policy efforts, including the fiscal and monetary stimulus and the vaccination effort, which have helped mitigate negative impacts and put the recovery on a firmer footing. Directors recognized that the country's resilience to the crisis reflects its very strong economic fundamentals and institutional policy frameworks, anchored in the structural fiscal rule, the inflation-targeting regime, the free-floating exchange rate regime, and the effective financial regulation and supervision.

Directors noted that Chile's external economic stress has diminished but remains high, and that external risks remain tied to the evolution of the pandemic. They noted that the FCL has provided a valuable buffer against tail risks and has helped boost market confidence during the pandemic.

Directors agreed that Chile continues to meet the qualification criteria under the FCL arrangement. They welcomed the authorities' intentions to continue to treat the arrangement as precautionary and to exit once the arrangement expires, conditional on developments and risks. Directors supported the authorities' preparations for a timely, smooth exit, particularly efforts to strengthen external buffers and explore other sources of precautionary financing, including potentially the Short-Term Liquidity Line.

Directors welcomed the authorities' firm commitment to maintain sound and prudent policies going forward. They acknowledged in particular the plans for a gradual structural consolidation and for enhancements to the fiscal rule and the pension system, and ongoing efforts to improve financial regulation and supervision.

EXECUTIVE BOARD DECISION

The Executive Board took the following decision:

Chile—Review Under the Flexible Credit Line Arrangement

1. The Fund has reviewed Chile's continued qualification for a Flexible Credit Line arrangement in accordance with paragraph 2(a) of the Flexible Credit Line arrangement for Chile (EBS/20/100, 5/22/2020) (the "Arrangement").

2. The Fund decides that the review specified in paragraph 2(a) of the Arrangement is completed. (EBS/21/38, 04/30/21)

Decision No. 17043-(21/47), adopted
May 14, 2021

EXECUTIVE BOARD ATTENDANCE[2]

M. Furusawa, Acting Chair

Executive Directors	Alternate Executive Directors
	W. Nakunyada (AE)
A. Andrianarivelo (AF)	
	L. Herrera (AG)
	A. Grant (AP)
A. Bevilaqua (BR)	
	Z. Zhang (CC)
	A. Guerra (CE)
	J. Weil (CO), Temporary
	C. Just (EC)
A. Buisse (FF)	
	K. Merk (GR)
S. Bhalla (IN)	
	F. Spadafora (IT), Temporary
T. Tanaka (JA)	
H. Hosseini (MD)	
	D. Fadhel (MI), Temporary
	V. Rashkovan (NE)
	J. Sigurgeirsson (NO)
A. Mozhin (RU)	
	F. Rawah (SA), Temporary
	F. Mochtar (ST)
	A. Tola (SZ), Temporary
S. Riach (UK)	
E. Shortino (US)	

O. Vongthieres, Acting Secretary
V. Sola, Summing Up Officer
D. Jiang, Board Operations Officer
M. McKenzie, Verbatim Reporting Officer

Also Present
African Department: L. Ricci. Communications Department: D. Sharrock. Finance Department: T. Krueger, Z. Tan. Legal Department: C. DeLong. Monetary and Capital Markets Department: J. Mok, J. Nelmes. Research Department: R. Duval, K. Smuts.

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[2] For countries in each constituency, please see the Constituency Codes in the annex.

Strategy, Policy, and Review Department: W. Gray, S. Hassan, G. Minasyan**.** Western Hemisphere Department: P. Alonso-Gamo, I. Burgara, C. Evans, C. Fratto, M. Hadzi-Vaskov, S. Pienknagura Loor, J. Torres Trespalacios, K. Youssef. Executive Directors: S. Chodos (AG), L. Levonian (CO), M. Mahmoud (MI), P. Moreno (CE), P. Trabinski (SZ), R. von Kleist (GR). Alternate Executive Directors: B. Alhomaly (SA), A. Alhosani (MI), H. Azal (EC), M. El Qorchi (MD), F. Fuentes (BR), S. Geadah (MI), R. N'Sonde (AF), F. O'Brolchain (CO), O. Odonye (AE), L. Palei (RU), J. Romero (CE), P. Rozan (FF), B. Saraiva (BR), F. Sylla (AF). Senior Advisors to Executive Directors: W. Abdelati (MI), H. Andrianometiana (AF), K. Badsi (MD), E. Cartagena (CE), M. Choueiri (MI), J. Damgaard (NO), Patterson C. Ekeocha (AE), I. Fragin (GR), O. Hendrick (AG), B. Lischinsky (AG), C. Sassanpour (MD), R. Velloso (BR), B. Yoo (AP), M. Zhunusbekova (SZ). Advisors to Executive Directors: F. Al-Kohlany (MI), P. Al-Riffai (MI), A. Arevalo Arroyo (CE), Dennis Bautista (ST), S. Belhaj (MD), B. Boostani (MD), E. Boukpessi (AF), I. Bustillo (AG), T. Chrimes (UK), J. Corvalan (AG), A. Maciá (BR), T. Manchev (NE), G. Meizer (EC), M. Merhi (MI), R. Moral Betere (CE), A. Nainda (AE), E. Ondo Bile (AF), B. Piasecki (SZ), D. Shestakov (RU), M. Shimada (JA), B. Singh (IN), L. Sturm (US), J. Yoo (AP), Y. Zhao (CC), J. Barroso (BR), F. Lopez (CE), D. Coelho (BR), C. Roman (FF).

DISCUSSION RECORD[3]

The Acting Chair (Mr. Furusawa):

Chile is recovering from the economic consequences of the 2019 social unrest and the pandemic but continues to face policy challenges posed by an elevated level of COVID cases and the need to safeguard an inclusive recovery. In the gray statements, Directors have noted that the FCL has provided a valuable buffer and has boosted market confidence during the pandemic, and commended the authorities' continued intention to treat the arrangement as precautionary. Directors have also praised the impressive vaccination campaign, the swift and well-coordinated fiscal and monetary response, and the strong institutional framework and macroeconomic fundamentals, which allowed Chile to mitigate the impact of the crisis.

Beyond sustained efforts to adapt policies to the pandemic developments, Directors underlined the need to continue implementing sound and prudent policies, including plans for undertaking a gradual fiscal consolidation and improving financial regulation and supervision, as well as to strengthen the fiscal rule and enhance the pension system.

Mr. Herrera:

On behalf of my authorities, I would like to thank the staff for the focused review on the FCL qualifications, as well as Executive Directors for their supportive gray statements. I issued a buff statement and the Board reviewed Chile's Article IV consultation a few weeks ago, so I will be brief and focus my remarks on the authorities' plans regarding the FCL.

The Chilean economy is recovering from the COVID-19 crisis. Since the start of the year, the extraordinarily high risks associated with the pandemic have decreased, thanks to sustained policy support, rapid vaccinations, and the improvement of the global outlook. However, external uncertainty remains relevant. Two prominent examples are the emergence of aggressive virus strains that could prolong the global pandemic outbreak and the possibility of a sudden tightening of global financial conditions, given the re-evaluation of the inflation and monetary policy path in advanced economies. In this context, my authorities have decided not to make changes to the level of access to the FCL at this mid-term review, while planning to continue treating the FCL as a precautionary and temporary arrangement.

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[3] Edited for clarity.

Under the baseline scenario, the authorities plan to exit the FCL once the regular 24-month period is completed in May next year. Preparations to strengthen the international liquidity position of the central bank have started well in advance, including an ongoing reserve accumulation program, among other actions.

The intentions of the authorities to exit the FCL after the two-year period has been publicly announced but is always contingent on future developments and risks. At the same time, the authorities remain open to explore other precautionary sources of international liquidity, including the Short-term Liquidity Line (SLL).

Finally, I want to reiterate our appreciation for the support received from the Fund, management, staff, and the Executive Board over the last year. Access to the FCL has provided a strong signal of confidence in Chile's fundamentals and policies. It has provided a valuable backstop against tail risks and additional policy space to fight the pandemic crisis.

The staff representative from the Western Hemisphere Department (Mr. Ricci):

I would like to thank the Directors for the questions in their gray statements. We hope to have answered most of them. There were a few that our colleagues in the Strategy, Policy, and Review Department (SPR) will address.

I would like to take this opportunity to indicate that this will be the final cycle for me on Chile. I am moving to take the position of mission chief for Côte d'Ivoire. I would like to thank the authorities for their fruitful collaboration over the past several years; in particular, Mr. Herrera for his kind availability and prompt and direct interaction, as much as the previous Chilean representative to the ED office, Ms. Carola Moreno. I would also like to thank Deputy Director Ms. Alonso-Gamo and Director Mr. Werner for their very inspiring guidance. Last, but not least, I would like to thank the team, which has relentlessly and devotedly dedicated long hours to distill the valuable policy advice and see through the FCL arrangement.

The staff representative from the Strategy, Policy, and Review Department (Mr. Gray):

I will respond to the questions from Directors regarding the authorities' potential interest in a Short-term Liquidity Line, or SLL, the communications strategy around the exit from the FCL, and also the potential for concurrent use of an FCL and the SLL.

On the first point, namely, the authorities' potential interest in an SLL, when they exit from the FCL, I would underscore that the SLL was, indeed, envisaged in part to be a vehicle for those circumstances, namely, for members seeking to step down from higher access FCLs. The qualification criteria for the SLL and the FCL are fully aligned, so members that have qualified for the FCL would also be expected to qualify for an SLL. That said, of course, decisions on exit would need to be taken closer to the date of the expiry of the FCL and will need to take into account the nature of the potential balance of payments facing Chile at that particular point in time.

On communications, the staff very much agrees on the need for a well-structured communication plan to help ensure that the authorities' eventual exit from the FCL is smooth and well received by markets. And Fund staff can help the authorities' efforts on this front.

Finally, there was a question about the potential concurrent use of an FCL and SLL, in other words, to use them simultaneously. For members that meet the qualification criteria, the appropriate instrument will depend on that member's balance of payments needs. The FCL can be used for any balance of payments needs but primarily has been used on a precautionary basis to cover large potential balance of payments needs arising from tail risk events.

By contrast, the SLL is designed to address moderate potential short-term balance of payments needs, reflected in pressures on the capital account or the member's reserve position in the event of volatility on international capital markets. Also, at the outset of an SLL, that need must only be potential, and it cannot exceed 145 percent of quota.

While there is no legal prohibition on the simultaneous use of an FCL and an SLL, in practice, the nature of the member's balance of payments need would tend to suggest that only one instrument would be appropriate. The staff intends to explore this issue further in the context of the review of precautionary instruments, which is planned for next year.

Mr. Sigurgeirsson:

We have not issued a gray statement for this meeting, since we issued a very comprehensive statement for the very recent Article IV consultation. Nevertheless, I will use this opportunity to commend the authorities for their sustained track record of implementing strong policies. In fact, it is the country that my authorities sometimes looked to in the past for economic management on things pertaining to capital flows. We agree with the staff's assessment, that Chile continues to meet the qualification criteria for access to FCL resources, and support the completion of the review.

We note that the FCL has served Chile well as a backstop against tail risks and has supported market confidence through a very challenging period. Sovereign bond spreads and credit default swaps (CDS) levels compare favorably to peers, as do the credit ratings. This is a testament to the sound economic policies that have been implemented by the authorities over the years.

At the same time, it is critical that there is no slippage in policy implementation. Like Mr. Tanaka, Ms. Shortino, and other Directors, we are concerned about the recent approval of the third withdrawal of the pension system which, along with the previous withdrawals, may have exhausted the pension funds of up to five million citizens. As we signaled in the recent Article IV consultation, we urge the authorities to employ more targeted measures and explore ways to strengthen the pension system.

Coming back to the matter at hand, we welcome the authorities' commitment to reserve accumulation and their plan to exit the FCL arrangement in May 2022.

We have been supportive of the FCL from its inception, but we have always considered it a temporary and precautionary instrument by design, and we are pleased to note that the authorities are treating it this way. It is important to keep the revolving nature of the Fund's resources in mind, as even when the FCL is not used, it still ties up considerable Fund resources. And these are generally substantial amounts, big figures.

Like Mr. Trabinski proposed in his gray statement, we could perhaps have seen a case for a gradual reduction in access; but in any case, it is vital that the authorities have a clear and comprehensive communications strategy, in relation to exit plans, so that there will be no surprises. In this regard, I found Mr. Herrera's comments on the FCL very interesting, and as did I the staff's comments.

Mr. Bevilaqua:

We issued a gray statement, fully supporting the completion of the FCL review. I will just highlight three points.

First, at the conclusion of Chile's Article IV consultation discussions last month, we took positive note of Chile's strong macroeconomic fundamentals and robust policy framework, which allowed a swift and bold reaction to the pandemic. Also, we stressed that the FCL arrangement served the country well, providing the authorities with an opportune backstop to minimize tail risks in face of an unprecedented global crisis. We should not minimize, however, the risks that still exist in an environment of high uncertainty and volatility, as noted by Mr. Herrera in his opening remarks.

This leads to my second point. Calibrating the proper level of buffers necessary to overcome those risks is clearly very difficult. But experience shows, including from this ongoing crisis, that maintaining a high level of international reserves pays off, instilling market confidence and leading, in the end, to the use of fewer reserves. That is why we strongly believe that any decision to exit the FCL arrangement should be carefully considered and should be always state-contingent.

Third, let me underscore, once again, that Chile's experience is yet another success story about the use of the Fund's precautionary lines. Like Colombia, Mexico and Peru, Chile's access to the FCL has shown that supplementing the country's own international reserves with precautionary arrangements helps maintain sound policies and strengthen resilience. These arrangements could be further expanded and made available to additional member countries. In this regard, we have suggested for some time that staff should evaluate combining existing FCLs with SLLs. While the former adds buffers to cope with big shocks and tail risks, the latter provides additional layers of protection to cover sharp fluctuations in liquidity. Combining both may be quite effective in supporting vulnerable economies that otherwise are in good shape. We take note of Mr. Gray's initial remarks on why it has not yet been done However, we remain unconvinced by the arguments, and encourage staff to reassess the issue sooner rather than later.

Mr. Guerra:

We issued a gray statement, supporting the staff appraisal, that Chile continues to meet all the qualification criteria for access under the FCL. I will only make some comments and ask one general question.

The first comment is that Chile continues to stand out as one of the most resilient economies in the emerging market asset class. Proof of this is the effective coordination between fiscal and monetary policy that reflects the authorities' commitments under the FCL to adjust the policy stance to evolving economic circumstances in a sound and timely manner.

Second, on the exit strategy, the authorities have been clear and effective in communicating its commitment to treat the FCL as precautionary. Nevertheless, as stated by many Directors, the strategy is contingent and should be contingent on the evolving balance of risks. The authorities have been clear in stating that they are supporting their exit strategy with additional sources of liquidity and increasing reserves. The FCL has served, in this regard, in an effective manner to give Chile the space to adapt to building additional buffers.

Third, I understand the comments by some of our colleagues, that there is the prospect of a brighter outlook in advanced economies, given the important policy support and so, correspondingly, a reduction of risk. Nevertheless, as expressed by Mr. Herrera, this has led to a repricing of inflation and a possible path for monetary policy in advanced economies. This can lead to new episodes of increased global risk aversion, portfolio rebalancing away from emerging markets, and amplified volatility in commodity prices. In the past few weeks, risks to emerging markets have been increasing.

On the pension fund issue, notwithstanding the use of resources and the corresponding challenges, the system in Chile still compares as one of the most resilient and effective in coverage, not only to emerging markets but to most advanced economies. Without a doubt, the use of pension resources will pose as policy challenges in the medium-term for the authorities, in particular, with respect to informal workers. But we are certain, given the strong institutional frameworks in Chile, that the authorities will find a policy path to address the challenges in the medium term.

Last, but not least, and along the lines expressed by Mr. Bevilaqua, on the use of the FCL, I have a general question for the staff. Does the staff believe that an SLL could be used for budget support arising from balance of payments needs? We know that the FCL can be used for budgetary support but is it the case also for an SLL?

Also, is it the case that there could be an FCL that is requested by the authorities, including the ministry of finance but, in contrast, there can also be an SLL requested only by the central bank authorities? I believe that we should discuss this issue further going forward and that there could be complementary uses of both instruments at the same time.

Mr. Tanaka:

As we issued a gray statement and support the completion of the FCL review for Chile, we will briefly touch upon our four core points.

First, we welcome that the FCL arrangement has functioned as an important backstop to anchor market confidence amid the COVID-19 pandemic. We commend the authorities and the staff for their effective external communications to convey the intended intrinsic signal of confidence to the market, that Chile has maintained strong policy and institutional frameworks.

Second, like Ms. Shortino, Mr. Merk, and others, we welcome that the authorities continue to treat the FCL arrangement as precautionary, and they are also making concrete steps toward a timely--toward a timely exit, including the central bank's implementation of a reserve accumulation program. Timely exit is critically important to warrant the revolving nature of the Fund's ample but limited resources.

Lastly, beyond Chile's case, we underscore the importance that the FCL countries in the region and, more generally, Latin American countries, could benefit from strengthening their regional financial arrangements, as well as development of liquid domestic bond markets to address external risks.

Mr. Hosseini:

We appreciate the staff's updates on vaccinations, pension withdrawals, and government policy adjustments since the Article IV discussion not long ago. We have issued a comprehensive gray statement, touching on some of these issues; but here, I would like to briefly stress one point.

As its name suggests, and as Mr. Tanaka mentioned, the FCL is a flexible facility and, like any other line of credit, it is primarily to add to confidence, but its resources are also available when and if needed. Markets also recognize that access to the facility is only available to countries with a very strong policy framework and a solid policy track record, countries like Chile.

As we saw recently in the case of Colombia, withdrawals from the facility could be even viewed positively by markets, but an effective communications strategy is critical. Also, importantly, as is stressed by the staff, in the case of Chile, risks have diminished but still remain significant; and the downside scenario, should it materialize, would have severe effects on the economy. These are important considerations when discussing the role of the FCL, access to its resources, and the exit strategy in general and in the case of Chile, in particular. The Chilean authorities have clearly laid out their exit strategy. Like them, we also believe that any such a strategy should ultimately be state-contingent.

Mr. Merk:

Chile's very strong macroeconomic policy frameworks and prudent policies constitute the country's most crucial line of defense. They enabled the authorities to uphold macroeconomic stability, while implementing strong countercyclical policies during the COVID-19 crisis. We welcome the authorities' commendable clear strategy to exit the FCL, in line with the intended state-dependent yet temporary nature of the instrument.

Mr. Spadafora:

First of all, I would like to commend the Chilean authorities for the strong response to the crisis and the successful vaccination campaign. I also particularly commend the Central Bank of Chile for letting the exchange rate work as a shock-absorber in an asymmetrical way.

Let me also join other chairs, like for example, Brazil, France, U.K., Iran, Australia, Indonesia, in stressing that the exit from the FCL, while respecting the authorities' decisions, should try to be state-contingent, rather than time-contingent. The exit from the FCL is a longstanding issue. I had personally nicknamed the FCL "The Hotel California Facility" because it seems that one can check out at any time, but one can never leave. It is a controversial issue. But let me also add some qualifications on this.

We know that Chile's FCL access is really high. It is 1,000 percent of quota, compared to Peru, 600 percent; Colombia, 600 percent; and Mexico, 500 percent.

Now, going from 1,000 percent of quota to 145 percent of quota, as foreseen by the SLL, is completely understandable. But I wonder if a gradual strategy, as suggested by Mr. Trabinski, would be maybe worth considering on the side of the authorities.

I take note of Mr. Herrera's openness to considering the SLL. But I would like to ask the staff, because of this huge gap between the current access and the access that could be gained from the SLL, if this kind of strategy is worth considering.

Mr. Mochtar:

We issued a joint gray statement, which expressed our support for the completion of this review to allow Chile to continue the precautionary FCL and secure a carefully planned and managed safe exit from the arrangement. We would like to stress two points for emphasis.

First, while Chile is well positioned to a recovery, there remain external risks pertaining to the pandemic and global uncertainties that need close monitoring. To respond to the downside external scenario, access to the FCL will provide the needed support for liquidity and ensure market confidence, while SLL access could provide extra buffers, as needed.

Relatedly, we welcome that the authorities are already working on the exit strategy and are communicating this publicly. However, we underscore and share the views of many Directors, including previous speakers, on the importance of a state-contingent strategy, rather than a time-contingent one.

Second, we echo Ms. Levonian and other Directors on their recommendation for fiscal prudence and a gradual structural consolidation. In this context, we support targeted spending in the near term and apply it toward fiscal consolidation over the medium-term that balances social concerns and fiscal credibility and sustainability. One of the key policies needing attention is the strengthening of the pension system and, of course, its implications on the credit, which we support, along with the staff and many Directors, as well as the efforts of the authorities on the refinement of the fiscal rule.

Ms. Riach:

We remain strongly supportive of the authorities' proactive decision to seek this arrangement. So far, it has been a textbook use of a precautionary arrangement, amid exceptionally challenging circumstances. We understand the authorities' intention to exit the arrangement next year, and we can see the appeal of that. But, equally, we are keen that they should not box themselves in too tightly, as none of us can be sure that the global circumstances will evolve as favorably as they hope. As Mr. Guerra set out, risks for emerging markets remain real and substantial. As others have said, exit from this arrangement should be state-contingent, not driven by artificial deadlines.

More broadly, I would like to support the comments made by Mr. Bevilaqua and Mr. Guerra on the importance of precautionary facilities and the potentially complementary role that the SLL can play, including for Chile, as part of the management of its eventual exit from the FCL.

Mr. Palei:

We issued a comprehensive gray statement. We certainly support the completion of the review.

The Chilean authorities were able to respond forcefully to the pandemic, and I think their response was very effective, especially if we compare it to its regional peers. One of the signs of their success, of course, is the rapid speed of the vaccination of the population, which is supposed to be largely completed in about five or six weeks. This should provide the Chilean economy the necessary boost in its recovery from the severe crisis due to the pandemic.

In terms of the authorities' policies, we generally agree that Chile has strong policy frameworks. Like other Directors, we are concerned about the withdrawals from the pension funds. Staff told us that about five million accounts will be empty after the withdrawals have been affected. And if I am not mistaken, it would be almost half of all accounts in the country. Our concern is that such an approach may undermine the quality of the pension system and may pose questions about its sustainability for the future.

I understand that the staff offered us relatively modest estimates of the costs of this exercise, but I think we may consider this issue in a little bit broader terms because Chile went through a sequence of pension reforms, and it was a very painful process. I believe in 2018, an overhaul of the pension system took place, and now we see that the lawmakers are treating it just as a readily available reserve, while the government is against such use. This is not a good sign, with respect to the policy coordination between lawmakers and the executive branch. For us, I think, this is an alarm. We had a good discussion at the time of the Article IV. And certainly, the staff and the authorities will keep track of these issues.

On the use of the FCL and the impossible combination with the SLL, we believe that, as of now, there were no takers for the SLL. So, from our point of view, this facility is simply not attractive, just because it has a very low limit of access. From this point of view, the FCL is much more versatile. The notion of the different nature of risks for two facilities was always a questionable proposition. I support my colleagues when they say that we should use the FCL for a much broader group of countries, as the quality of policies of the FCL users differs a lot. We had a good discussion on Colombia, which faces many challenges in the policy area, and the spreads on its sovereign bonds are rather large; on the other hand, we have Chile and Peru performing very well.

Here, we need to expand the use of FCL beyond the one region and apply it to similar emerging markets more frequently. So, that is how we see our path forward, but I understand there is a group of Directors that wants to combine different facilities and fine-tune these combinations, to a certain extent.

With these remarks, I wish the Chilean authorities well. I look forward to Chile's exit from the FCL in a similar fashion as Poland did it in the past. This is a very strong economy with very good policy frameworks, so they can do it after the pandemic subsides.

The staff representative from the Western Hemisphere Department (Mr. Ricci):

If I understand correctly, there are questions on the exit for the Western Hemisphere Department, and SPR will take over the questions on the SLL and FCL.

I want to reassure the Board that the staff will continue to work with the authorities on the exit and, in particular, on the communications strategy and the other decisions associated with that, and that the staff and the authorities fully see the FCL exit as state-contingent, in line with what virtually all Directors have stated. The staff will make sure that there is agreement between staff and the authorities in terms of exiting in an orderly fashion with advanced communication, as appropriate.

I would like to indicate that the authorities have always seen the FCL as a transitory tool until global conditions have restored in order. They see their policies and institutions not only as very strong but strong enough to stand on their own and provide confidence to the market in normal times. The issue today is, when do normal times come back? And this is exactly what virtually every Executive Director has mentioned as state-contingent. The plan will remain state-contingent, in the staff's view. We have a clear indication that the plan remains state-contingent from the authorities' view, and the staff will continue coordinating with the authorities on the appropriate steps.

The staff representative from the Strategy, Policy, and Review Department (Mr. Gray):

There were two questions, which I will tackle. The first one was whether the SLL could be used for balance of payments needs, which are associated with the need for budget support. On that, I would emphasize the nature of the ex-ante question. What is the SLL designed to tackle? We refer to it as being a special potential balance of payments need. It is designed for circumstances when a country has a potential moderate balance of payments difficulty in the event that there are pressures on the capital account, on reserves arising from volatility in international capital markets; in other words, an external shock which would be moderate. And, of course, there are also qualification criteria. Like the FCL is designed for countries which have extremely strong fundamentals.

I think at the point when an SLL was being considered, it would be critical for the staff, in conjunction with the authorities, to assess that question: Is, indeed, this is a country where we see that as being a risk? If the risks are much more broadly designed, then quite possibly the SLL is not the right instrument.

All that said, I think it is an important question, and we should reflect on this further.

Similarly, on the question: could there be a concurrent use of an SLL and an FCL but with the authorities committing to one instrument and the central bank involved in the others? In principle, yes. Actually, the guidance has specified that in the case of an SLL, that we could have a case where only the central bank is a signatory; whereas for the FCL, generally, it would be the central bank and the finance minister. So, in principle, yes, that seems feasible, but I think there is a more fundamental policy question which has been highlighted by today's discussion and previous discussions. The staff is going to come back to this, as I mentioned earlier, in the case of the review of precautionary instruments, which is envisaged next year. And we will explore these issues which came up today more thoroughly

Mr. Herrera:

I just want to reiterate my appreciation to my colleagues for their comments and strong support this morning. I will carefully convey their views and concerns to my authorities.

We agree with the views expressed by several Directors, that the exit strategy must and will remain state-contingent on the evolving nature of risks. If the world economy continues to evolve, as envisaged in the baseline scenario, while at the same time, Chile strengthens its international liquidity position, as planned, the conditions should be in place to allow for a smooth exit from the FCL a year from now.

Let me also clarify that the potential access to the SLL must be viewed as part of a more comprehensive exit strategy from the FCL, together with the other actions that have been taken since May last year, an enhanced swap line with the People's Bank of China (PBOC) and the ongoing accumulation of international reserves. Together, these actions should add up to something similar to the current FCL.

Finally, there was a lot of good advice in this meeting. My authorities would like to thank Mr. Alejandro Werner, Mr. Luca Ricci, Mr. Metodij Hadzi-Vaskov, and the rest of the team, for their continuing engagement and support in the last years, and particularly during the difficult circumstances that the country has experienced in the last 20 months.

The Acting Chair (Mr. Furusawa) adjourned the session.

ANNEX

- Gray Statements
- Staff Responses to Executive Directors' Technical Questions
- Constituency Codes

DOCUMENT OF INTERNATIONAL MONETARY FUND AND FOR OFFICIAL USE ONLY

BUFF/ED/21/51

May 11, 2021

Statement by Mr. Herrera on Chile
Executive Board Meeting
May 14, 2021

On behalf of my Chilean authorities, I thank staff for the review of Chile's continued qualification for a Flexible Credit Line arrangement (FCL). Over the last year, the FCL arrangement has provided a valuable backstop against tail risks and, along with Chile's very strong policy and institutional framework, has contributed to bolster market confidence and provide additional policy space in a period of extraordinary uncertainty as the global pandemic. Access to the FCL in the next twelve months will continue to protect the Chilean economy against downside scenarios until the global risks abate.

The Chilean economy is recovering from the COVID-19 shock. After a sharp contraction of activity in mid-2020, a gradual recovery started in the second half of last year bolstered by supportive monetary and fiscal policies. The policy response to the pandemic has been swift and comprehensive. The outlook for 2021 and 2022 has improved in recent months, buttressed by the continuation of accommodative policies, a more favorable global environment, and rapid vaccine deployment. As of May 10, 56 percent of the adult population in Chile has received at least one dose of a COVID-19 vaccine and 47 percent has been fully vaccinated. Real GDP is projected to grow between 6 to 7 percent in 2021, and 3 to 4 percent in 2022, after contracting 5.8 percent in 2020. The recovery, however, remains uneven across sectors, with lags in contact-intensive activities, slowing down the pick-up in employment, and a temporary setback is likely in the second quarter amid the surge of infections observed last March and the reimposition of lockdowns. Meanwhile, the institutional process towards the New Constitution continues to advance in accordance with the procedures and safeguards envisaged in the constitutional amendment of November 2019 and is expected to culminate in mid-2022.

Very strong policies and policy frameworks

Chile has a long track record of very strong economic fundamentals and institutional policy frameworks, which has been sustained during the pandemic. In the face of the 2019 social unrest and the COVID-19 shock, the Chilean economy has demonstrated resilience owing to its very strong policies, including a credible inflation targeting framework, a mature flexible exchange rate regime, a prudent fiscal rule, and a well-regulated financial system. The authorities remain firmly committed to maintain sound and prudent policies going forward. Nevertheless, given the economy's high openness to international trade and financial flows, it remains exposed to elevated external downside risks, including those related to the path of the COVID-19 pandemic and global financial conditions.

Low and stable inflation in the context of sound monetary and exchange rate policy. Chile has maintained inflation around 3 percent for the last two decades. Since 1999, the Central Bank of Chile (CBC), an autonomous and accountable institution, conducts monetary policy through a fully-fledged inflation targeting and free-floating regime. In addition, Chile counts with a deep domestic financial system, where households and firms can access short- and long-term credit in local currency, and exposure to FX risk is limited. Over the last year, the CBC has implemented a broad set of measures aimed at boosting the monetary impulse, stimulating credit, and easing the adjustment of financial markets, while inflation has hovered around the policy target, and inflation expectations have remained well anchored.

The peso is free floating, and the flexible exchange rate plays a useful role as shock absorber. The exposure of local agents to FX risk is limited, and the pass-through of currency fluctuations to inflation expectations, in contrast to headline inflation, is low. FX interventions have been rare and limited to curb disorderly market conditions as those observed in late 2019 in the wake of the social unrest. Over the past year, the nominal (and real) exchange rate has flexibly adjusted to changes in global financial conditions and commodity prices. Despite increased volatility, the CBC did not intervene in 2020 allowing the exchange rate to act as a shock absorber.

The authorities remain committed to fiscal prudence and plan a gradual consolidation of the structural deficit to stabilize the debt ratio. Since the early 2000s, Chile's fiscal policy has been guided by a structural rule and complemented by a sovereign stabilization fund, underpinned by the *Fiscal Responsibility Law* and the *Autonomous Fiscal Council* (CFA). The consistent implementation of this design over time has contributed to restrain public debt and accumulate important liquidity buffers, as well as sustain favorable conditions in international capital markets, underpin macroeconomic stability, and a more effective countercyclical fiscal policy. During the pandemic crisis, the government of Chile has delivered an unprecedented multi-year fiscal package amounting to 13 ppt of GDP. The fiscal deficit reached 7.3 ppt of GDP in 2020, and gross debt increased to 32.5 ppt of GDP, while Treasury assets declined to 8.3 ppt of GDP. The headline deficit is expected to decline to 3.8 ppt of GDP in 2021, as revenues are bolstered by the growing economy, deferred taxes, and higher copper-related revenues, while the structural deficit will increase to 5.0 ppt of GDP reflecting the accommodative fiscal stance. Beyond 2021, the extraordinary measures will be phased out and the structural budget is planned to return to a gradual consolidation path to stabilize the gross debt around 40 ppt of GDP by 2025. At the same time, the authorities are considering enhancements to Chile's fiscal rule, including the adoption of dual targets on net public debt and the structural balance, formal escape clauses, and correction mechanisms.

The financial sector in Chile remains liquid, solvent, and well capitalized, supported by effective supervision and regulation. During the pandemic, the *Financial Market Commission* (CMF) and the CBC provided regulatory flexibility to lenders. Measures included an easing of the liquidity coverage ratio; a transitory regime for provisions on deferred loans; improvements on the capital treatment of public credit-guarantees; and a delay in phasing in additional capital requirements under Basel III. Even though the profitability of banks has declined through the last year, as interest margins have been compressed and prospective credit provisions have increased, the actual deterioration of bank portfolios has been limited. Stress tests carried out by the CBC show that the banking systems remains resilient and adequately capitalized. Going forward, the authorities have resumed the agenda of reforms to strengthen the financial system. Last December, the CMF finalized the issuing of all new Basel III regulations. The phasing-in process is scheduled to be completed in 2025. Other reforms include strengthening the bank resolution framework and the regulation of financial conglomerates, expanding the scope of the public credit registry, and implementing a risk based capital and enhanced supervision powers for the insurance sector.

FCL access and exit strategy

Authorities agree with staff that the extraordinary global risks associated to the pandemic have abated, but they are still relevant. Downside risks to global growth and financial stability continue elevated considering uncertainty about the pandemic and the pace of exit policies in systemic economies. Slow vaccine distribution in some regions and new virus strains could prolong the COVID-19 outbreak and the pattern of intermittent growth across the world, while policy space has become more limited. Also, in recent months, prospects of a brighter outlook in advanced economies have led financial markets to reprice inflation and the monetary policy path, despite reassurances by the Federal Reserve. While global markets stabilized and retraced some of the yield steepening in April, new bouts of volatility cannot be ruled out. Abrupt adjustments in financial conditions in some of the systemic economies could trigger negative spillovers into emerging market economies, resulting in new episodes of increased global risk aversion, capital flow volatility, and portfolio rebalancing away from emerging markets, as well as volatility in commodity prices.

Chile remains exposed to downside external risks, including lower copper prices or a sudden spike of global risk aversion. Chile's financial system is highly integrated to global markets. A sudden repricing of risk in international financial markets, such as the one experienced during the Global Financial Crisis or in April 2020, could create severe stress in the capital account. Likewise, Chile's position as the world's leading copper exporter exposes the economy to the sharp swings in commodity prices, which may coincide with bouts of volatility in international financial markets. As highlighted in the staff report, the external economic stress index (ESI) for Chile has eased since mid-2020 as global conditions improve and should continue easing along the baseline scenario. However, the ESI remains at negative levels (stress) and could suffer a relevant setback in a downside external scenario. Against this backdrop, the FCL continues to provide an important buffer of international liquidity for the Chilean economy.

The authorities will maintain access unchanged at this midterm review but will continue treating the FCL as a precautionary and temporary arrangement. Conditional on a reduction of global risks, the authorities intend to exit the FCL arrangement once the 24-month period is completed. As intended at the time of request, preparations have started well in advance to strengthen the external liquidity position of CBC, including participation in the FIMA Repo Facility of the NY Federal Reserve, a Bilateral Swap Agreement with the People's Bank of China for three years, and since last January, the implementation of a reserve accumulation program to lift these to approximately 18 percent of GDP. All these actions have been publicly announced along the intention of the CBC to exit the FCL in May 2022, conditional on external developments. The authorities remain open to explore other precautionary sources of international liquidity, including access to the Short-Term Liquidity Line (SLL).

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

The authorities are grateful to Mr. Luca Ricci, mission Chief, and his team for their continuing engagement with Chile's authorities and hard work to prepare the recent comprehensive Article IV consultation and this focused review.

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GRAY/21/1202

May 11, 2021

Statement by Mr. Mohieldin and Ms. Fadhel on Chile (Preliminary) Executive Board Meeting May 14, 2021

We thank staff for the report and Mr. Herrera for the helpful Buff Statement. Chile's economic fundamentals and institutional frameworks continue to be very strong and supported by a record of sound policy implementation. Chile continues to meet the qualification criteria for access to FCL resources. The FCL arrangement has served the economy well and will continue to provide important buffers against tail risks. **We, therefore, support the completion of the review of Chile's Flexible Credit Line (FCL) arrangement.** We note the authorities' intention to continue to treat the FCL as precautionary and to exit as soon as the 24-month period is completed, conditional on developments and risks.

We positively note the continued strong vaccination deployment – one of the fastest in the world - which will provide further impetus to the economic recovery this year, along with a rebound in copper prices and more favorable global environment. Chile has had a plan to vaccinate most of the 15 million adult population during H1-2021 (almost 80 percent of its total population). *We would appreciate staff's comments on whether the authorities are on track to achieve this target and to what extent they find their vaccination program successful in containing the latest surge in cases.*

In the recent Article IV discussion, we welcomed proposed pension reforms to help support the vulnerable and address income inequality. Staff's report indicates that the first two rounds of pension withdrawals may have exhausted the accounts of about 3 million people (or ¼ of pension system participants). It also estimates that a further 2 million pensioners might exhaust their accounts in the anticipated third withdrawal. *We welcome staff comments on the possible implications of these withdrawals on poverty and income inequality in the medium term. We also appreciate staff's updates on the pension reform proposal that was recently submitted to the Congress.*

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GRAY/21/1203

May 11, 2021

Statement by Mr. Bevilaqua, Mr. Velloso, and Mr. Coelho on Chile
(Preliminary)
Executive Board Meeting
May 14, 2021

We thank staff for the report and Mr. Herrera for the helpful statement.

We agree with staff and the authorities that Chile continues to meet the qualification criteria for FCL access. As we already had the opportunity to stress during the 2021 Article IV consultation discussions, Chile's strong macroeconomic fundamentals and robust policy framework have allowed a swift and bold reaction to the global pandemic. The FCL continues to serve the country well, providing the authorities with an additional layer of protection against risks posed by heightened uncertainty and volatility in the global economy. Overall, the country is well positioned for a strong recovery.

The decision to exit the FCL arrangement should be very carefully considered and should be state-contingent. Although Chile has so far managed well its response to the economic and health crisis, significant downside risks remain. The strategy of rebuilding international reserves to exit the FCL seems sensible. It would be important, however, to avoid setting deadlines that down the road may prove elusive. The decision should be state-contingent.

Chile's positive experience with the FCL is another success story in the use of the Fund's precautionary instruments. Chile's access to the FCL has shown that supplementing one's defense mechanisms with a precautionary arrangement helps maintain sound policies and strengthen resilience. Equally important, the combination of sound policies and high defenses, including precautionary defenses, provides an important externality to the broader membership, by reducing the likelihood of systemic crises that would put IMF resources under pressure. With this in mind, we call on staff to explore the convenience of combining existing FCLs with SLLs. While the former adds to the defenses needed to cope with big shocks and tail risks, the latter provides additional ammunition to cover for sharp fluctuations in liquidity. In the post-pandemic world, unforeseen circumstances could lead to excessive volatility and tightening of financial conditions.

Combining existing FCLs with SLLs may prove to be an effective tool in supporting vulnerable economies that otherwise are in good shape. *Staff comments are welcome.*

With these remarks we wish the Chilean authorities success in their future endeavors.

GRAY/21/1205

May 12, 2021

Statement by Mr. Nakunyada and Mr. Ekeocha on Chile
(Preliminary)
Executive Board Meeting
May 14, 2021

We thank staff for the concise report and Mr. Herrera for his informative Buff statement.

The Chilean economy is recovering from the negative repercussions of the COVID-19 pandemic benefitting from the implementation of strong response measures. In addition, the track record of sound macroeconomic management and strong economic fundamentals and institutional policy frameworks, enhanced resilience to the pandemic shock and laid the groundwork for the recovery. The recovery is largely underpinned by sufficient policy stimulus, existing fiscal space, an impressive vaccination program, well-anchored inflation expectations, and resilient exports. Additionally, the Flexible Credit Line (FCL) arrangement has served the country well as an insurance against COVID-related external risks and boosted market confidence. **Against this background, we support completion of the review under the Flexible Credit Line Arrangement (FCL).**

Chile continues to meet the FCL qualification criteria in the context of strong macro-economic fundamentals and institutional policy frameworks. To this end, the strategy for medium term resilience, has delivered satisfactory performance with all core indicators consistently met over the past five years. Specifically, we positively note the strong current account position, ample reserve buffers, favourable market access, sustainable public finance and debt positions, a sound financial sector, as well as low and stable inflation anchored by a credible inflation targeting framework. Importantly, we note that the flexible exchange rate has continued to act as an effective shock absorber against external shocks.

The FCL continues to provide a buffer against volatile copper prices and sudden repricing of risk in international financial markets. We, therefore, see merit in the authorities' intention to treat access under the FCL as precautionary with plans to exit in May 2022, subject to macro-financial developments and the evolution of risks. Moreover, we view the authorities' proactive efforts to accumulate reserves to strengthen the external liquidity position through foreign exchange interventions, including participation in the FIMA Repo Facility of the NY Federal Reserve and Swaps, as important to enhance resilience to external shocks.

Finally, we are encouraged by the authorities' steadfast commitment to implement sound macroeconomic policies, including during the pandemic. We, therefore, support the well-calibrated fiscal and accommodative monetary policies aimed to mitigate the impact of the pandemic, while advancing broader structural reforms to support more inclusive and sustainable growth. We are encouraged to note that the authorities remain committed to fiscal prudence to ensure debt sustainability and help build liquidity buffers, foster macroeconomic stability, and reinforce favorable market access. We urge the authorities to sustain targeted fiscal policy measures to protect vulnerable households and firms, enhance revenue and expenditure measures in the medium term, and eventually phase out extraordinary support, once the recovery takes hold. Concurrently, accommodative monetary policy measures should be maintained alongside the provision of liquidity and credit support, until the recovery is firmly established.

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GRAY/21/1207

May 12, 2021

Joint Statement by Ms. Grant, Mr. Mochtar, Mr. Bautista, and Mr. Yoo on Chile (Preliminary)
Executive Board Meeting
May 14, 2021

We thank staff for the well written report and Mr. Herrera for his informative Buff statement.

Chile's economic recovery that has been aided by flexible and swift policy actions illustrates its continuing resilience. The sustainable external position and public debt, strong institutional frameworks, and a proven track record of implementing strong macroeconomic policies enabled Chile to continue to meet the qualification criteria for access to the Flexible Credit Line (FCL) arrangement. We welcome both staff and the authorities' assessment that the FCL arrangement is effective in providing insurance against tail risks and maintaining confidence in the economy. **We support the completion of this review, noting that the authorities are not requesting a change in access and are intending to continue to treat the FCL as precautionary and exit from the arrangement in May 2022.** Access to the FCL will continue to provide an important buffer against external tail risks that could persist unexpectedly and will sustain the needed boost to market confidence to fasten its recovery.

We take note of the authorities' strong adherence to sound macroeconomic policies. We support authorities' strategy to pursue a broad set of fiscal measures to mitigate the negative effects of the pandemic through targeted measures to protect health, income, and jobs, especially for the most vulnerable. Monetary policy will be conducted to maintain a credible inflation targeting framework with a free-floating exchange rate. The commitment to a structural consolidation over the medium term will be continued to rebuild buffers and preserve debt stability.

We see merit to carefully plan and manage a timely and safe exit strategy to avoid financial instability and strengthen further the economic resilience to shocks. We are of the view that the exit from precautionary arrangements should be state-contingent, reflecting risks, rather than being time-contingent. An access to the Short-Term Liquidity Line may be a good option to explore as part of an exit strategy. The relevant risks should be carefully assessed and that there are sufficient policy efforts and prospective policy responses that would address the current and future risks. Given the still significant global risks and volatility in asset prices, authorities are encouraged to continue to closely monitor financial vulnerabilities by identifying early signs of stress especially in credit, and to continue strengthening further the financial sector regulatory and supervisory framework.

Maintaining external buffer would be beneficial to safeguard the exit strategy. We note that Chile's reserves currently fall below the ARA and while the intention to accumulate further will improve it, it is still at the lower end of the ARA threshold. *In this context and as Chile indicated a timeline for its intent to exit, staff comments are sought on the sufficiency of policy measures that would lead to a safe exit. Staff comments are also welcome on the adequacy of the buffer after the exit from FCL considering the external uncertainties and significant downside risks, exploration of other sources of precautionary financing, and its consequent effect on market confidence.*

GRAY/21/1208

May 12, 2021

Statement by Mr. Tanaka, Mr. Chikada, and Mr. Shimada on Chile
(Preliminary)
Executive Board Meeting
May 14, 2021

We thank staff for the well-written paper and Mr. Herrera for his informative Buff statement. While Chile has been hit hard by the pandemic, the swift and decisive policy responses underpinned by the strong policy and institutional framework as well as the Fund's FCL arrangement have mitigated its impacts. **We fully agree with staff that Chile continues to meet the qualification criteria for the access to the Fund resources under the FCL arrangement, and we thus support the completion of the review.** As we broadly agree with the staff appraisal, we will provide the following comments.

We welcome that the FCL arrangement has functioned as an important backstop to anchor market confidence amid the extraordinary uncertainty stemming from the pandemic. On this point, we also commend the authorities and staff for their effective external communication which has enabled the FCL arrangement to convey the intended signal to the market while a relatively large size of the FCL could have conveyed an unintended signal to the market by highlighting potential vulnerabilities of the country if not communicated well.

We take good note that Chile's strong policy and institutional frameworks have enabled the country to address the current crisis in an effective manner. Chile has good records of overcoming the past crises well under its strong policy framework. In the current crisis, as discussed in the board meeting on the country's Article IV, the decisive and effective policy responses have mitigated the economic impact from the pandemic. At the same time, in the medium term, it is indispensable for the authorities to tackle long-standing structural issues, including pension, health care system and labor market reforms, in order to achieve strong and inclusive recovery. We believe that such reforms would strengthen the country's status in the international financial market, thereby increasing the resilience against the external shocks in the future. *In connection to that, we note with concern that Congress approved third pension withdrawal, which would make the pension reform more challenging. Could staff elaborate more on this issue?*

Last but not least, we welcome that the authorities continue to treat the FCL arrangement as precautionary and are making concrete steps towards a timely exit, conditional on interim developments. Timely exit is important to warrant the revolving nature of the Fund's ample but limited resources. In this regard, we welcome that BCCh has steadfastly started its preparation for timely exit including the implementation of a reserve accumulation program to strengthen the external liquidity position. Finally, as mentioned in some other board meetings, we reiterate our view that that the FCL countries in the region, and more generally Latin American countries, could benefit from strengthening their regional financial arrangement to address external risks.

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GRAY/21/1209

May 12, 2021

Statement by Ms. Levonian, Mr. O'Brolchain, and Mr. Weil on Chile
(Preliminary)
Executive Board Meeting
May 14, 2021

Thanks to staff for their insightful report and to Mr. Herrera for his thoughtful Buff statement in which he underscored how the FCL has contributed to bolster market confidence in Chile and provided additional policy space in a period of extraordinary uncertainty.

We support staff's conclusion that Chile continues to meet the qualification criteria for the FCL. Chile has enjoyed a long track record of very strong economic fundamentals and institutional policy frameworks that have served it well through the ongoing COVID-19 crisis. While the economy is recovering, supported by a world class vaccination campaign, the pandemic persists and continues to demand exceptional policy support in the near-term. External risks have lessened since FCL approval, but we agree with staff that the external environment remains fragile. In particular, Chile remains vulnerable to a sudden spike in global risk aversion. A drop in copper prices is a potential risk and source of external pressure that staff have appropriately captured in the ESI, but we are currently seeing an unprecedented recovery in copper prices which are now at record levels given strong demand and still tight supply. We see strong copper demand (and lagging supply) as an important upside risk into the medium-term.

We welcome the authorities' commitment to fiscal prudence and plans for a gradual structural consolidation over the medium-term. In the near-term, the recent spike in COVID-19 cases serves as an important reminder of the risks of a premature withdrawal of policy support. Congress' recent approval of a third round of pension withdrawals makes questionable intertemporal tradeoffs, particularly as the staff report seems to suggest that such a measure was unnecessary, inefficient, and regressive. We urge the authorities to support vulnerable households through targeted cash transfers rather than by further straining the pension system. We see improved targeting of fiscal support as needed in the baseline rather than to be implemented “if necessary”. We support staff’s view that an improved fiscal framework, including a medium-term debt anchor, would help strengthen fiscal policy credibility.

Reserve levels are comfortable but well below the level recommended for emerging markets. We agree that high levels of useable liquid external assets in the sovereign wealth fund, banks’ liquid foreign assets, as well as a large swap line with the People’s Bank of China are important mitigating factors when assessing Chile’s reserve adequacy. However, it remains important for Chile to build its external buffers, including as part of a strategy to exit the FCL as planned after the 24-month period. We therefore welcome the BCCh’s plan to make $12 billion in reserve purchases over the next 15 months. *Could staff discuss how the impending general SDR allocation will interact with the BCCh’s planned reserve purchases and how the allocation will support reserve adequacy more generally?*

We encourage the authorities to revisit delayed financial sector reforms, including the implementation of the new Basel III standard. We look forward to the conclusion of the forthcoming update of the FSAP.

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GRAY/21/1212

May 12, 2021

Statement by Mr. Merk and Mr. Fragin on Chile
(Preliminary)
Executive Board Meeting
May 14, 2021

We thank staff for an informative and concise report and Mr. Herrera for the helpful Buff statement. We concur with the thrust of the assessment. Chile's very strong macroeconomic policy frameworks and prudent policies constitute the country's most crucial line of defense. They enabled the authorities, once again, to uphold macroeconomic stability while implementing strong countercyclical policies during the Covid-19 crisis. We welcome the authorities' commendably clear strategy to exit the FCL in May 2022 in line with the intended state-dependent, yet temporary nature of the instrument.

We concur with staff that Chile continues to meet the qualification criteria for the FCL. We agree with the authorities that implementing strong fiscal policy reforms, consolidating public finances, and gradually building additional international reserves remain important priorities. While very strong policy frameworks are a prerequisite for accessing the FCL, by signaling strength they also constitute the best safeguard for a smooth exit.

In this context, we also read with interest that baseline stress levels in the External Economic Stress Index (Box 1) have decreased considerably. Moreover, projections under the baseline envisage further subsidence of risks while the adverse scenario has become more benign than at the time of the FCL approval. Such estimates suggest that Chile's overall risk situation is gradually improving. Barring an abrupt reversal of this positive trend, we see such developments as counting towards a steadfast implementation of the exit strategy.

We take positive note that the authorities intend to continue to treat the access under the FCL as precautionary and commit to exit the facility in May 2022, conditional on economic and financial developments. We welcome that the BCCh has started accumulating additional reserves to further strengthen Chile's external position. Moreover, we note that the central government holds liquid external assets worth USD 22 bn, which would currently amount to 20 percent of ARA. While not counted under the definition of official currency reserves, such supplementary buffers may constitute an important mitigation factor should adverse external risks materialize. In this context, we also note Chile's access to FX liquidity through swap facilities with the FED and the PBoC.

Finally, we welcome that staff has completed the safeguards procedures for the 2020 FCL arrangement with Chile and that "no significant issues emerged from the conduct of these procedures".

GRAY/21/1213

May 12, 2021

Statement by Mr. Zhang and Ms. Zhao on Chile
(Preliminary)
Executive Board Meeting
May 14, 2021

We thank staff for their informative report and Mr. Herrera for his helpful Buff statement. We broadly agree with staff's proposal and would like to offer the following comments for emphasis.

Thanks to the strong institutional frameworks and wide-ranging policy responses, Chile has been recovering from the pandemic with a strong expected rebound. We take positive note that the FCL arrangement is serving the country well and providing an important buffer against tail risks. Going forward, we agree with staff that Chile's economic stress index (ESI) remains significant in midst of elevated uncertainties, and the FCL still has a role to play in supporting Chile's policy and institutional strength. We support that the country continues to meet the FCL qualification criteria and welcome the completion of the FCL review.

We welcome the authorities' intention to continue treating the FCL as precautionary and their continued commitment to gradually phase out the country's use of the FCL once conditions allow. During this process, we encourage the authorities to continue to carefully communicate with the market to ensure financial stability.

We commend the authorities for their strong policy framework and swift policy responses that helped to support the economy and lay the foundation for the recovery. On the fiscal front, we welcome the authorities' commitment in fiscal prudence and in reducing the structural deficit towards 0.9 percent of GDP by 2025 despite relatively low gross debt by international standards. We would like to know the medium-term impact of the three rounds large withdraws to the withdrawers and to the sustainability of the private pension funds. On the monetary and financial fronts, we take positive note that the flexible exchange rate has continued to play the shock-absorber role during the pandemic and commend the authorities for letting the exchange rate adjust without intervention in 2020. Despite a relatively resilient financial system, we encourage the authorities to devote further attention to pending deficiencies in the current regulatory framework.

With these remarks, we wish the authorities all the best in these challenging times.

GRAY/21/1214

May 12, 2021

Statement by Mr. Hosseini and Mr. Sassanpour on Chile
(Preliminary)
Executive Board Meeting
May 14, 2021

We thank staff for the concise report and Mr. Herrea for his helpful Buff statement.

Chile's solid track record of sound policies and very strong economic fundamentals and institutional policy frameworks are well established. The significant buffers accumulated over the years, together with a timely, broad-based and proportional policy response at the onset of the pandemic, helped Chile to weather the health and economic impacts of the crisis well. The sharp rise in copper prices to their highest levels in a decade, and the robust economic rebound of Chile's main trading partners, were also important contributing factors to its speedy recovery, while the flexible exchange rate policy served its main purpose of acting as the first line of defense against external shocks. In the context of the authorities' strong policy creditability, the FCL arrangement was also a major source of market confidence and an important buffer against tail risks. **We agree with staff that Chile continues to meet the stringent qualification criteria for access to the FCL and support the completion of the review**.

We take note of the authorities' decision to continue treating the FCL as precautionary and to exit the arrangement at its expiration, conditional on developments and risks. We reiterate our standing position that, in an environment of great external uncertainty, the exit strategy and timing would need to be state-contingent, and that FCL resources are there to be drawn upon to supplement reserves should downside risks materialize. The planned accumulation of foreign reserves is sensible, although we feel that, even at current levels, foreign reserves are comfortable, especially considering the government's large holdings of usable liquid external assets and the central bank's strong commitment to a free-floating exchange rate.

We laud Chile's rapid progress in vaccinating its population. *Could staff indicate whether the pace of vaccination is strong enough to meet the government's target of fully vaccinating most of its adult population by end-June? Could staff also reconcile the progress in* *vaccination with the apparent continued surge in new cases through April, which seems as steep as those of peers with much lower vaccination rates (Figure1)?*

We support the authorities' cautious policy to maintain their accommodative fiscal, monetary and financial stance until the recovery is on a firm steady track. There is however still some fiscal space to tap into in case demand falters. We welcome the authorities' commitment to continue implementing targeted measures to protect health, employment and incomes of the population, especially the most vulnerable. Addressing the social needs should be a key component of the medium term fiscal program going forward. *Related to monetary policy, we would welcome staff comments on the "lagging components of expenditure" (¶19) and the likely impact of the accumulation of private savings from pension withdrawals on the effectiveness of monetary policy.*

The rapid rundown of pension accounts and the exhaustion of accounts of 5 million pensioners are worrisome, given their lasting negative impact on pension replacement rates and public pension costs. *We would welcome staff comments on the internal government debate on this issue and the degree of concern on the part of the authorities. In staff's view, is the discourse on the New Constitution Process supportive of a major overhaul of the pension system?* We urge the authorities to redouble their efforts to bring the pension reform proposals to early fruition and strengthen the self-financed pension system.

We wish the Chilean authorities and people all the success.

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GRAY/21/1217

May 12, 2021

Statement by Mr. Guerra and Ms. Arevalo Arroyo on Chile
(Preliminary)
Executive Board Meeting
May 14, 2021

We thank staff for the detailed report and Mr. Herrera for the comprehensive Buff statement. **We support staff's appraisal that Chile continues to meet all the qualification criteria for access under the FCL**. Chile continues to stand out as a country with very strong economic policies and institutional frameworks, with a low level of public debt, well-anchored inflation expectations, and a financial system that has proven resilient to shocks.

Significant risks to the global outlook remain, given the uncertain effects of the COVID-19 pandemic on global growth. While commodity prices have recovered and global financial conditions have stabilized, there is still a very uncertain global environment in comparison to other crises' episodes. In addition, we agree with Mr. Herrera, as noted in the Buff statement, that the prospect of a brighter outlook in advanced economies has led to a repricing of inflation and the monetary policy path in financial markets. In this regard, new bouts of volatility and abrupt adjustments in financial conditions cannot be ruled out. These corrections can lead to new episodes of increased global risk aversion, portfolio rebalancing away from emerging markets, and amplified volatility in commodity prices. Going forward, the FCL will continue to play an essential role to underpin confidence, and the IMF should contribute in a flexible manner to assure a durable and timely recovery in Chile. In this regard, we take note of the authorities' openness to consider the use of an instrument like the Short-Term Liquidity Line.

Chile continues to have a track record of steady sovereign access to international capital markets on favorable terms and is increasing international reserves to cope with the uncertain global outlook. The country has continued to actively secure additional sources of external liquidity, in the context of a net international reserve position that has narrowed considerably. Furthermore, the authorities' commitment to a free-floating exchange rate has served as an effective strategy to confront the considerable external shocks without envisaging the use of any capital flow management measures.

The effective coordination between fiscal and monetary policy reflects the authorities' commitment under the FCL to adjust the policy stance to evolving economic circumstances in a sound and timely manner. The authorities remain committed to fiscal prudence and plan a gradual consolidation of the structural deficit to stabilize the debt ratio. The buffers accumulated over time have allowed for an effective countercyclical fiscal policy to address the economic effect of the pandemic. The Central Bank reacted in a timely manner with a comprehensive agenda of policy actions in order to diminish the economic scaring of the crisis and ensure the continued flow of credit. All of these measures were implemented while successfully keeping inflation expectations well anchored.

With these remarks we wish the authorities success in their policy endeavors.

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GRAY/21/1219

May 12, 2021

Statement by Mr. Rashkovan and Mr. Manchev on Chile
(Preliminary)
Executive Board Meeting
May 14, 2021

We welcome the review of the FCL arrangement with Chile and thank Mr. Herrera for his concise Buff statement. The FCL has provided a valuable buffer to Chile and has helped boost market confidence during the COVID-19 pandemic. As widely recognized in the staff report and during the recent Board discussion of the 2021 Article IV consultation, Chile continues to meet the qualification criteria for access to FCL resources. Amid a very uncertain environment, the authorities have acted in a coordinated and efficient manner to guide the Chilean economy. Going forward, a broader consensus over the New Constitution and needed structural reforms is critical to address the underlying uncertainty, stimulate investment, especially in human capital, and promote social cohesion and inclusive growth. The significant vaccination effort will help the economy on its recovery path.

The Board should be kept up to date on the program. Chile's economy started to recover gradually since 2020H2, supported by the broad-based stimulus, sound policy frameworks, and the recent progress with inoculation. The authorities' very strong policy track record and commitment to properly address the underlying issue of high inequality have also helped ease political uncertainty in a complex domestic and external environment. However, the external economic stress index for Chile indicates a level of stress which, although lower than at the time of the FCL request, remains significant.

We welcome the authorities' intention to continue treating the FCL as precautionary and to exit as soon as the 24-months are completed, conditional on developments and risks. We also know from experience with other FCL users that exiting the FCL has proven more difficult than initially anticipated. We note that as a program with exceptionally high access, it blocks a substantial part of IMF resources for an extended time, as well. In this context, we encourage authorities to increase resilience to prepare for exit and to effectively manage external risks.

The authorities' overall strategy for medium-term resilience should remain anchored in very strong macroeconomic policies and in further strengthening the regulatory environment and buffers. The Central Bank of Chile's (CBC) adequate monetary policy response to the pandemic, together with the well-anchored inflation and expectations have facilitated a smooth implementation of the 2020 reserve accumulation program, consistent with the FCL commitments. However, the growing complexity of the CBC policies and operations poses challenges. Thus, we welcome the forthcoming pilot review of the CBC transparency system.

Finally, we underscore that Chile needs to maintain a strong reform momentum in the coming years. Given the still high inequalities, the authorities' major challenge is the fiscal policy trade-off between increased social demand and rising public debt levels. These fiscal structural reforms should be well synchronized with the active labor market policies to reduce informality and further increase flexibility of the labor market, and measures to sustainably recover the obligatory private pension system, which promotes inclusiveness and reduce inequalities. Thus, we welcome the ongoing strengthening of the institutional framework to further increase fiscal responsibility and transparency. The IMF's technical assistance should also help the authorities to further elevate institutional standards and enhance the fiscal framework through establishing a medium-term debt anchor, a formal escape clause, and an adjustment mechanism to further strengthen policy credibility.

GRAY/21/1224

May 12, 2021

Statement by Mr. Mouminah, Mr. Alhomaly, and Mr. Rawah on Chile
(Preliminary)
Executive Board Meeting
May 14, 2021

We thank staff for the well-focused report and Mr. Herrera for his helpful Buff statement. We are in broad agreement with the staff's analysis and policy recommendations. Since we had issued a detailed Gray at the time of the recent Board discussion on the 2021 Article IV consultation, we will limit our comments to a few issues.

1. We support the completion of the FCL review and agree with staff that Chile continues to meet all FCL qualification criteria. In this connection, we positively note that the FCL arrangement is serving the country well, providing a significant buffer against tail risks and supporting market confidence in the context of strong economic fundamentals and institutional policy frameworks, together with a sustained track record of macroeconomic policy implementation. In addition, we are encouraged by the staff's assessment that the safeguards procedures for Chile's FCL arrangement have been completed.

2. **We welcome the authorities' intention to continue to treat the FCL as precautionary and exit from the Fund supported arrangement in May 2022.** Here, we support the steps taken to facilitate a timely exit from the FCL arrangement, including the launch of the reserve accumulation program. While Chile has comparatively comfortable international reserve position with a track record of steady sovereign access to international capital markets on favorable terms, it remains exposed to downside risks and significant near-term uncertainty. We therefore encourage the authorities, once conditions permit, to develop and announce a clear roadmap to exit the FCL facility underpinned by a comprehensive communication strategy to manage market expectation.

With these remarks, we wish the authorities every success in their policy endeavors.

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GRAY/21/1229

May 12, 2021

Statement by Mr. Buissé, Mr. Rozan, and Ms. Albert on Chile
(Preliminary)
Executive Board Meeting
May 14, 2021

We thank staff for their informative report, as well as Mr. Herrera for his comprehensive Buff statement. We agree with the thrust of staff's appraisal and offer the following comments:

We support the completion of this review as all the qualification criteria for access to the FCL's resources continue to be met. The FCL has been a useful additional buffer and the important ex-ante conditionality associated to this instrument continue to confirm the very strong macroeconomic framework of the country. While the impressive evolution of vaccination is highly welcome, and significant buffers exist (exchange rate flexibility, adequate gross international reserves, Sovereign Wealth Fund…), the monitoring of external risks remains important. Indeed, the External Economic Stress Index is still higher than the 2019 level, and a tightening of financial conditions or the volatility of the copper prices could negatively impact the activity and increase financing needs. A lower-risk external environment as well as an entrenched economic recovery appear necessary to gradually reduce the access level, and we note that the authorities remain intent on exiting the FCL arrangement in May 2022 conditional in interim developments. Overall, it is important that the exit from the instrument remains state contingent. We also welcome that the Buff statement's mention that the authorities remain open to explore other precautionary sources of international liquidity, including the Short-Term Liquidity Line (SLL). *Does staff have more information on this issue?*

On international reserves, maintaining an appropriate coverage is critical, though we are wondering how staff defines their appropriate level and thus the adequate path of reserves accumulation. Staff considers the current level as comfortable (despite being below the 100 percent ARA metric, at 74 percent for the commodity-augmented ARA metric) due to several mitigating factors (the fact that Chile is a mature market economy, the reserves coverage of potential short-term net foreign exchange needs, the sovereign wealth fund, and the swap line with China). In parallel, we also note that the central bank is now accumulating reserves, anticipating the exit of the FCL and wants to lift them to approximately 18 percent of GDP. *In light of this, we are wondering how staff sees the authorities' strategy to increase* *reserves. More generally we would be interested in further elaboration on how staff defines the appropriate level of reserves.*

Putting social concerns at the core of policy decision making is the critical challenge for Chile to build a more sustainable and inclusive growth in the long term, and we welcome initial steps taken, including support measures during the crisis, and the initiation of a new Constitution. The Covid-19 crisis has exacerbated pre-existing challenges, and as we highlighted previously in our article IV statement, ambitious reforms to answer to the social needs and in particular to reinforce the social safety nets and the pensions system are paramount. The weakness of pensions has contributed to poverty and inequality issues and are one of the triggers of social tensions in 2019. Avoiding further pensions withdrawals is paramount, as it would be detrimental to fiscal credibility, and it would limit the possibility of the population to get a decent retirement pension. More globally, to face the multidimensional aspects of poverty, improving the domestic revenue mobilization (for example by giving more weight to the carbon tax) and the tax system towards more progressivity will be important. Finally, we are looking forward to seeing the outcome of the New constitution debate, to answer to the new social requests from the Chilean society.

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GRAY/21/1230

May 12, 2021

Statement by Mr. Trabinski and Mr. Tola on Chile
(Preliminary)
Executive Board Meeting
May 14, 2021

We agree with staff's assessment that Chile continues to meet the qualification criteria for the Flexible Credit Line (FCL). The FCL complements the authorities' strong and swift policy efforts to mitigate the economic impact of the pandemic. It adds an additional buffer to Chile's strong institutional framework and helped protect against the negative economic and social consequences of the pandemic. The economic outlook is positive thanks to an impressive vaccination program and continued support from accommodative policies. At the same time, the external environment remains fragile, with persisting risks related to the pandemic.

We welcome the authorities' clear exit strategy with a fixed exit point in May 2022 and their continued intention to treat the access under the FCL as precautionary. We are of the view, however, that a gradual and earlier reduction in FCL access should be considered. We commend the authorities for their well-prepared exit strategy that includes efforts to increase international reserves. Given the sustainable external position, the authorities should consider a gradual and earlier reduction in FCL access. A reduction by USD 5-6 billion would, for example, correspond to the increase in reserves since the time of the FCL approval. Such a reduction would appear feasible, considering that i) the international reserve position is relatively comfortable, ii) economic activity is expected to rebound in 2021 and will be boosted further by higher copper prices and growth expectations for major trading partners, and iii) the external economic stress index is lower and the external position stronger than at the time of the FCL request. *Could staff comment?*

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GRAY/21/1231

May 12, 2021

Statement by Ms. Riach and Mr. Chrimes on Chile
(Preliminary)
Executive Board Meeting
May 14, 2021

We thank staff for the clear paper. We also thank Mr. Herrera for his helpful buff statement. We welcome the authorities' view that the Flexible Credit Line arrangement has provided "a strong signal of confidence in the strength of Chile's policy frameworks and fundamentals, as well as an important buffer and additional policy space amid unprecedented uncertainty and volatility in global financial markets." **We agree with staff's assessment that Chile continues to meet the qualification criteria for the FCL, and we support the completion of the review.**

We again commend the authorities for seeking an FCL arrangement early during the COVID-19 crisis. Alongside a suite of other proactive policy measures in both the health and economic domains, Chile's very strong policy and institutional frameworks, and some supportive external developments, this has likely contributed to Chile's relative macroeconomic stability in the last year (in the context of the large global shock), and positions it well for the recovery, though there are still real challenges and risks.

While we welcome the authorities' continued confidence that they will be in a position to exit the FCL arrangement smoothly in a year's time, we also draw attention to the important caveat in Mr. Herrera's statement that this is conditional on a reduction in external risks. We remain of the view that access under (and exit from) precautionary arrangements should be state-contingent, reflecting external downside risks the member economy is exposed to, rather than being time-bound. We also note that the paper stops short of offering a staff view on the authorities' exit intentions. Beyond the central bank's program of gradual reserve accumulation, announced and begun in January 2021, *could staff comment on any communications plans to help ensure that the intended exit – assuming conditions are conducive – is well-received by markets?*

On a related point, we note with interest that the authorities are open to exploring other precautionary sources of international liquidity, including access to the IMF's Short-Term Liquidity Line. We wonder whether an SLL could help Chile's smooth exit from the much larger FCL arrangement. *Have staff discussed the possibility of using the SLL in this way with the authorities?*

GRAY/21/1233

May 12, 2021

Statement by Mr. Fanizza and Mr. Spadafora on Chile
(Preliminary)
Executive Board Meeting
May 14, 2021

We thank staff for an excellent report and Mr. Herrera for his candid Buff statement. We agree with the thrust of the staff's appraisal and its recommendation for completion of the review under the Flexible Credit Line (FCL) arrangement for Chile. We offer a few additional comments.

- **Despite the ongoing economic recovery** – supported by the authorities' swift and strong policy response and Chile's very strong institutional frameworks – **external risks persist and remain tied to the evolution and the impact of the pandemic**. On the positive front, the rise in copper prices and the fast pace of the vaccination program are important offsetting factors. In this context, **we agree that the FCL has contributed to the country's resilience** by providing a valuable buffer and boosting market confidence amid a very uncertain environment resulting from the pandemic.
- **We commend the Central Bank of Chile for letting the exchange rate play its role as a shock absorber in a symmetrical way**, first to mitigate the brunt of the pandemic and now to reflect the increase in copper prices; a wide range of well-thought monetary policy measures has also supported liquidity and preserved financial stability.
- **We share the staff's assessment that Chile continues to meet the qualification criteria for access to FCL resources** and welcome the authorities' expectation of continuing to treat the FCL as precautionary while remaining committed to maintaining prudent policies in the future.
- **We welcome the authorities' intention of exiting the FCL arrangement at the end of the 24-month period** (May 28, 2022), conditional on economic and financial developments, and support their preparatory work to increase reserves through intervention purchases of FX.

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GRAY/21/1234

May 12, 2021

Statement by Mr. Azal, Mr. Just, and Mr. Meizer on Chile
(Preliminary)
Executive Board Meeting
May 14, 2021

We thank staff for the concise report and Mr. Herrera for his informative Buff statement.

Owing to the authorities' decisive measures, strong institutional framework, and supported by the Flexible Credit Line (FCL), Chile's recovery is on a firmer footing after the dual shocks of the 2019 social unrest and the COVID-19 pandemic. We share staff's view that the FCL has served Chile well. **In view of staff's appraisal that Chile continues to meet the strict qualification criteria for access to FCL resources, we support the completion of the mid-term review. We continue to encourage the authorities to take advantage of the room for maneuver provided by the FCL and take further steps to strengthen their macroeconomic policy framework.**

We welcome the authorities' swift and sound policy response, which have helped cushion the pandemic shock and ensure that the Chilean economy rebounds in 2021. The authorities' wide range of measures to safeguard health, lessen the effects of the pandemic, provide liquidity, and preserve macro-financial stability have proven effective. Given that the withdrawals from the private pension funds have played a key role in strengthening the liquidity position of households*, could staff further elaborate on the implications of the new round of withdrawals on the capital market, as well as the expected impact on household saving and consumption behavior?* Considering that the sharp rise in inflation rates has caused concerns globally in recent weeks, *we would also like to know staff's view on the anticipated inflationary pressures in the Chilean economy, even if the inflation expectations are considered to be well-anchored.*

Although the uncertainty around the pandemic remains elevated globally, the risks are no longer just tilted to downside in Chile. As a result of the fast pace of the vaccination campaign and the booming copper price, Chile has a good opportunity to rebuild its economy and lay the foundation for a resilient recovery. However, the path of the pandemic continues to remain a decisive factor, not least because of Chile's openness to international trade and financial markets. The authorities should also be mindful of the results of the external economic stress index, which still shows a high stress level, despite having eased since mid-

2020. While the financial system seems sound even after the delay of the implementation of the Basel III standards, we share staff's view, and encourage the authorities to continue to closely monitor financial stability risks and remain ready to step in, if needed. We also encourage the authorities to use the New Constitution process to mitigate the risks of high inequality and strengthen social cohesion.

The FCL has not only provided a substantial buffer for the Chilean economy, but has also helped boost market confidence amidst a challenging environment. However, in order for the FCL to continue to fulfill its intended role, the authorities need to maintain their strong policy and institutional framework. We also welcome that no significant issues emerged from the conduct of safeguard procedures.

We welcome that that authorities continue to treat the FCL as precautionary and maintain their intention to exit this facility once the 24-month period is completed, depending on the evolution of risks and macrofinancial developments. In this context, we take positive note that the Central Bank of Chile has launched several programs to strengthen its external liquidity position through swap facilities, and has started lifting its international reserves by pre-announced purchases. *Could staff provide further details on the effectiveness and capital-market effects of daily FX purchases so far? We would also appreciate if staff could elaborate on the authorities' potential intention to access the Short-Term Liquidity Line.* Close engagement with the authorities and careful communication continues to be key to properly prepare for the exit, which should continue to be state-dependent.

We encourage the authorities to use the additional policy space provided by the FCL in the next twelve months to pursue structural reforms. We welcome the authorities' firm commitment to maintain sound and prudent policies, as well as plan a gradual fiscal consolidation going forward. We also positively note that the authorities are considering additional enhancements to Chile's fiscal rules.

GRAY/21/1236

May 12, 2021

Statement by Ms. Shortino and Mr. Sturm on Chile
(Preliminary)
Executive Board Meeting
May 14, 2021

We thank staff for the report and Mr. Herrera for his helpful Buff statement. Chile's continued strong economic fundamentals and policy frameworks as well as its flexible exchange rate have helped the country to weather the COVID-19 pandemic shock. In addition, the authorities' response to the pandemic was robust and swift, including a multi-year fiscal package complemented by a robust monetary stimulus and unconventional measures. **We support this review and agree that Chile remains eligible for the FCL arrangement.** Notably, Chile boasts strong institutions, a low level of public debt, well-anchored inflation expectations, and a resilient financial system.

We agree with staff's assessment that the FCL arrangement remains an important buffer against future external risks. Despite easing of the external stress index, the uncertain course of the pandemic alongside continued uncertainty around the country's constitutional reform process pose substantial risks for the country in the coming year. We welcome that the authorities intend to exit from the FCL when it expires in May 2022 and support their decision to treat access under the FCL arrangement as precautionary.

We strongly support the authorities' commitment to its freely floating exchange rate regime and reiterate that the exchange rate has served the country well as a shock absorber. We agree that under IMF metrics gross international reserves are broadly adequate. At the same time, we note that the central government holds substantial liquid external assets and that Chile has access to FX liquidity through swap facilities. We underscore the importance of the rules-based, transparent nature of the reserve accumulation plan. *How does staff view a potential general SDR allocation interacting with the central bank's pre-announced purchases and will the SDR allocation change staff's assessment of reserve adequacy?*

We reemphasize the importance of reforms to the pension system. The recent approval of a third withdrawal from the pension system further weakens the pension system and raises future fiscal costs. We note that the announcement, and perhaps speculation over a fourth withdrawal, has contributed to some domestic financial market volatility. Further, as staff note, withdrawals through three rounds may leave 5 million people, one third of the adult population, out of the system. We strongly encourage the authorities to explore more targeted household liquidity assistance programs in lieu of additional early pension withdrawals. *Could staff provide an update on the estimated fiscal costs of this third withdrawal as well as the implications for the sustainability of the pension system?*

GRAY/21/1237

May 12, 2021

Statement by Mr. Bhalla and Mr. Singh on Chile
(Preliminary)
Executive Board Meeting
May 14, 2021

1. We thank the staff for their well-prepared report and Mr. Herrera for his informative Buff statement.

2. We agree with the staff assessment that the FCL arrangement has proved useful in providing insurance to the country against tail risks. As Chile continues to meet the qualification criteria for the FCL, we support the staff's recommendation for completion of the review under the FCL arrangement.

3. Though Chile's public debt level is moderate, the private sector's external indebtedness is relatively high, which could be a potential source of external vulnerability for an open economy, alongside volatile commodity prices. Large stock of externally held domestic securities could be a potential source of risk to a sudden change in the external risk environment.

4. We understand that the FCL was conceived to instill confidence in the backdrop of volatility arising from rising capital outflows and have helped countries in restoring market confidence and facilitating continued access to global capital markets. We appreciate the authorities' intent to continue treating the FCL as precautionary and exit from the FCL arrangement in May 2022 once the external risks subside.

5. We wish the authorities all the very best in their policy endeavors.

GRAY/21/1238

May 12, 2021

Statement by Mr. Palei and Mr. Shestakov on Chile
(Preliminary)
Executive Board Meeting
May 14, 2021

We thank staff for the concise report and Mr. Herrera for his informative Buff statement. Chile has a track record of implementing sound economic policies and maintaining strong and rules-based institutional frameworks, which allowed the authorities to reduce the adverse impact of the COVID-19 pandemic that hit Chile in the wake of the 2019 social unrest. The FCL arrangement with the Fund created an additional buffer to support market confidence. **We agree with the staff appraisal that Chile continues to meet the qualification criteria for access under the FCL and support the completion of the review.** We would like to emphasize the following points.

The FCL has provided a necessary support for the authorities' policy efforts in an uncertain environment. Multi-year fiscal stimulus helped to protect lives and jobs, while monetary accommodation supported liquidity. A freely floating exchange rate continued to play its important shock absorbing role against commodity prices volatility. Due to timely vaccination efforts Chile is expected to achieve herd immunity in the second half of 2021, which would allow for uplifting most of the containment measures and restrictions and create a strong boost for economic activity.

Chile remains vulnerable to downside external risks of volatile commodity prices and a sudden change in investors' sentiments. According to staff's economic stress assessment, external environment for Chile, while less stressful than in 2020, remains fragile. The extended impact of the pandemic both within the country and in its key trading partners is another risk that might prolong the need for economic stimulus and suppress the emerging recovery. Yet, continuing disagreements between the administration and Congress on the withdrawals of funds from pension accounts represent another important risk for post-pandemic policy frameworks.

We support the authorities' decision to treat the FCL as precautionary and their plan to exit the FCL arrangement in May 2022 conditional on external developments. We believe that plans for fiscal consolidation would be sufficient to safeguard debt sustainability, but remaining fiscal space allows the Chilean authorities to remain data-driven in their decisions to withdraw or preserve stimulus over the medium term. The authorities also have plans to increase reserves through purchases of FX. *How large, according to staff, should these purchases be to provide a proper buffer against the projected external stress?* We also welcome the authorities' interest in other precautionary sources of international liquidity.

With these remarks, we wish the Chilean authorities every success in their policy endeavors.

GRAY/21/1241

May 12, 2021

Statement by Mr. Andrianarivelo and Mrs. Boukpessi on Chile
(Preliminary)
Executive Board Meeting
May 14, 2021

We thank staff for the informative report and Mr. Herrera for the helpful Buff statement. The Chilean's authorities' swift and strong policy responses to the Covid-19 pandemic, together with the country's solid macroeconomic fundamentals, institutional policy frameworks and track records of policy implementation have been instrumental to help support the economy during the crisis and lay the foundation for the recovery. Furthermore, the precautionary access to the Flexible Credit Line arrangement (FCL) approved in May 2020, has provided additional buffer and supported market confidence. **Against this backdrop, we support the completion of the review under the FCL arrangement** and Chile's continued qualification for access to FCL resources. We would like to offer the following comments for emphasis.

The FCL arrangement is serving the Chilean economy well. We welcome staff's External Stress Index (ESI) analysis in Box 1. While the impressive vaccine rollout and increased copper prices may positively impact the outlook, in a period of elevated uncertainty surrounding the pandemic, we agree that the FCL will continue to provide confidence and additional policy space as significant domestic and external risks still remain, albeit lower than at the time of the FCL approval. We, thus, welcome the authorities' intention to continue to treat the FCL as precautionary and exit the arrangement at its expiration date in May 2022, subject to economic and financial developments. We encourage a continued engagement between the Fund and the authorities, which is fundamental in the implementation of any exit strategy.

Fiscal policy should continue to be supportive in 2021 while being targeted in protecting the most vulnerable households and firms. Once the recovery takes hold, a gradual withdrawal of supportive measures should proceed, while fiscal consolidation should mimic both revenue and expenditure pace. Additional social spending should be prioritized to address social needs while anchoring public debt at a sustainable level by 2025.

The accommodative monetary policy stance remains appropriate and we agree that monetary policy should continue to be guided by the inflation targeting framework with

a free-floating exchange rate. We note the steps taken by the *Banco Centrale de Chile (BCCh)* to increase FX reserves *Could staff give us an update on the reserves program accumulation as of today?* This is key for a safe and timely exit of the FCL arrangement. Close monitoring of the financial sector vulnerabilities remains critical to safeguard macroeconomic stability and foster the recovery. When appropriate, pressing ahead with the financial sector reform agenda will be important to improve the regulatory and supervisory framework, notably aimed at strengthening the bank resolution regime, enhancing insurance companies' framework and FinTech activities.

Finally, as underscored during the last Board discussions on the Article IV Consultations in April, stepping efforts in the implementation of wide-ranging structural reforms notably to increase labor market flexibility and strengthen the pension and health system, is needed to lift the country growth prospects while promoting inclusiveness and social cohesion.

With these comments, we wish Chile and its people success in their endeavors.

Chile

Staff's Responses to Technical Questions Posed by Executive Directors in Advance of

EBM/21/47, May 14, 2021

Staff's responses to technical and factual questions are below.

Outlook/Risks

1. ***We would appreciate staff's comments on whether the authorities are on track to achieve this target and to what extent they find their vaccination program successful in containing the latest surge in cases.***

   Could staff indicate whether the pace of vaccination is strong enough to meet the government's target of fully vaccinating most of its adult population by end-June?

   Could staff also reconcile the progress in vaccination with the apparent continued surge in new cases through April, which seems as steep as those of peers with much lower vaccination rates (Figure1)?

   - Chile has made rapid progress in the impressive vaccination effort as more than 15 million doses have been administered with 47% of the target population having received their 2nd dose as of early-May. Using a linear trend from the start of March, if the pace of vaccination continues, then the majority of the adult population should be vaccinated by end-June. At mid-May, Chile has received about 18 million doses of vaccines with agreements that will ensure coverage of their entire population. The coronavirus vaccine 14 days after the second shot has shown to be effective in: reducing symptoms, by 67 percent; hospitalization, by 85 percent; ICU usage, by 89 percent; and deaths, by 80 percent. The impressive vaccination effort has helped to limit new deaths even with the surge in new cases. For the over 70s, the age group where the majority have been fully vaccinated, ICU bed usage has been decreasing since mid-March. Moreover, since mid-April ICU bed usage has also been decreasing for the over 50s. The increase in cases has decreased since its peak in mid-April, helped by continued vaccinations and a strict quarantine imposed at end-March.

2. ***We welcome staff comments on the possible implications of these withdrawals on poverty and income inequality in the medium term. We also appreciate staff's updates on the pension reform proposal that was recently submitted to the Congress.***

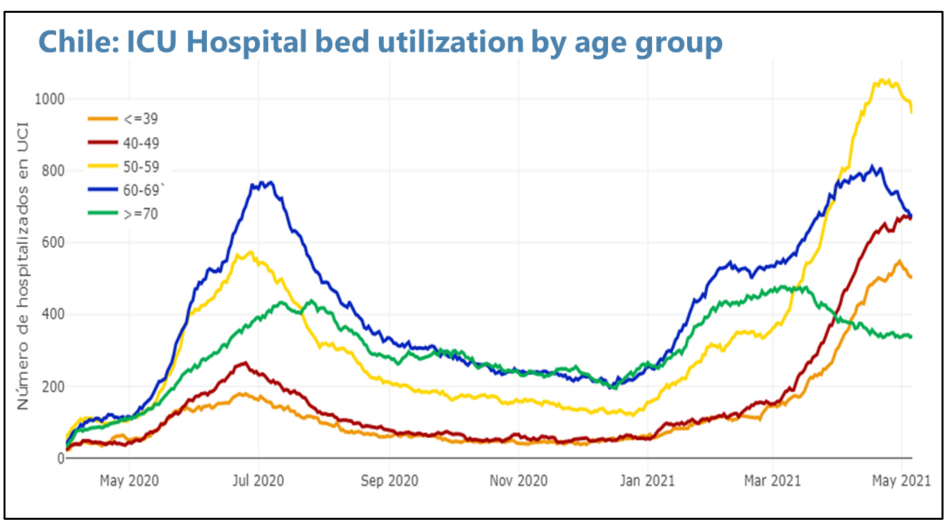
   In connection to that, we note with concern that Congress approved third pension withdrawal, which would make the pension reform more challenging. Could staff elaborate more on this issue?

   Could staff further elaborate on the implications of the new round of withdrawals on the capital market, as well as the expected impact on household saving and consumption behavior?

We would like to know the medium-term impact of the three rounds large withdraws to the withdrawers and to the sustainability of the private pension funds.

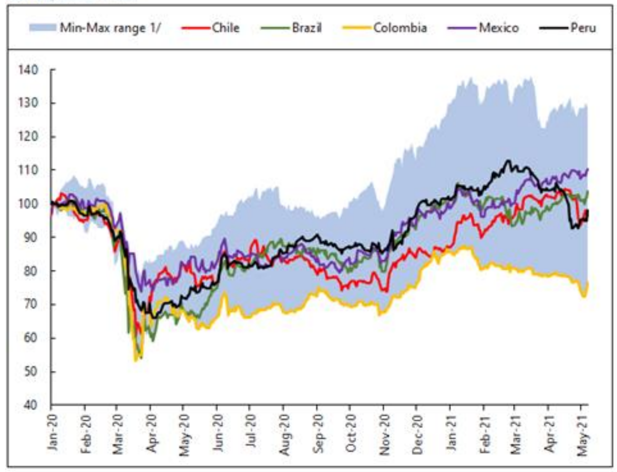
Could staff provide an update on the estimated fiscal costs of this third withdrawal as well as the implications for the sustainability of the pension system?

- Research from the Banco Central de Chile estimates that the third withdrawals, as with the first and second withdrawals, are expected to more than compensate for the loss in income suffered due to the pandemic for every income quintile. However, after successive withdrawals, it is estimated that about 5 million people—those that have accumulated the least, notably the young and those most exposed to informal jobs—will have exhausted their pension accounts. The young that have exhausted their pension accounts still have time to rebuild their savings. Informal/occasional workers, who infrequently contribute to the system, were already expected to rely heavily on the solidarity pillar for support before the withdrawals. Those close to retirement are the ones who will experience a more drastic reduction in their expected replacement rate. However, the solidarity pillar, which subsidizes pensions that fall below a minimum threshold, as well as providing disability support, will help subdue the medium-term effects on effective replacement rates and inequality from the withdrawals. This of course will add further pressure on the solidarity pillar of the pension system, increasing the fiscal cost. Staff calculations show that the additional fiscal cost stemming from withdrawals over the next few decades is expected to peak at approximately 0.17 percent of GDP in 2060, and its net present value is estimated at 3 to 6 percent of GDP in 2020, depending on assumptions. Although the solidarity pillar will dampen the negative impact on pension payments at retirement, they are still expected to decrease, which increases the importance of a reform to restore the adequacy of the system. The recent pension reform proposed by the government, which would further expand the solidarity pillar and oblige employers to contribute to workers' savings accounts, is under discussion in the Senate Finance Committee but progress is unlikely to be made as elections approach.



- Earlier pension withdrawals have been associated with higher private savings and consumption. We expect this to continue with the third withdrawal. The Chilean equity market has experienced a 10% drop following the announcement of a third withdrawal. However, the index has already partially recovered, and we do not see a cause for concern. We expect the central bank to continue providing liquidity to financial markets as needed, in line with the policy measures implemented for the first two pension withdrawals.

Domestic Equity Indices 2/
Jan 03, 2020 = 100



3. ***The rapid rundown of pension accounts and the exhaustion of accounts of 5 million pensioners are worrisome, given their lasting negative impact on pension replacement rates and public pension costs. We would welcome staff comments on the internal government debate on this issue and the degree of concern on the part of the authorities. In staff's view, is the discourse on the New Constitution Process supportive of a major overhaul of the pension system?***

- The government was of the opinion that a new round of pension withdrawals was not necessary given the ongoing transfers to vulnerable households and the middle-class, and fiscal policy is a better way to target support for the population. Nonetheless, they also estimate that the fiscal costs will be felt mainly in the long term. It is unlikely that the new Constitution will imply a major overhaul of the pension system, given that any change to the Constitution can be vetoed with just 1/3 of the votes. The election of the members of the Constitutional Assembly will take place on May 15-16 and the center-right coalition seems well placed to secure enough votes to preserve the main pillars of the Chilean pension system.

Monetary and Financial Policy

4. ***Related to monetary policy, we would welcome staff comments on the "lagging components of expenditure" (¶19) and the likely impact of the accumulation of private savings from pension withdrawals on the effectiveness of monetary policy.***

- Based on preliminary data, we expect investment to be lagging in the recovery, while consumption should recover more quickly supported by pension withdrawals. The increased private savings from pension withdrawals might in principle weaken the effectiveness of the credit channel with respect to consumption but less so with respect to investment. Nonetheless the central bank is monitoring the spending and saving patterns associated with pension withdrawals, and we are confident that they will continue to assess the credit channels and the inflationary pressures in the economy and to adjust the monetary policy course if necessary.

5. ***Considering that the sharp rise in inflation rates has caused concerns globally in recent weeks, we would also like to know staff's view on the anticipated inflationary pressures in the Chilean economy, even if the inflation expectations are considered to be well-anchored.***

- Rising prices of food and basic services (which includes gas) caused 12-month inflation to reach 3.3 percent in April, slightly above the target rate of 3 percent but below the peak seen in 2020 when inflation reached 3.9 percent in February. Core inflation remains below target at 2.8 percent in April. Given offsetting effects from the appreciation of the peso and strict quarantine measures we do not expect a continued a significant surge in inflation, but nonetheless expect a slight increase over the next few months before inflation converges back to the target. We expect the central bank to continue assessing the situation and adjust the monetary policy as needed.

External Sector

6. ***In this context and as Chile indicated a timeline for its intent to exit, staff comments are sought on the sufficiency of policy measures that would lead to a safe exit. Staff comments are also welcome on the adequacy of the buffer after the exit from FCL considering the external uncertainties and significant downside risks, exploration of other sources of precautionary financing, and its consequent effect on market confidence.***

In light of this, we are wondering how staff sees the authorities' strategy to increase reserves. More generally we would be interested in further elaboration on how staff defines the appropriate level of reserves.

The authorities also have plans to increase reserves through purchases of FX. How large, according to staff, should these purchases be to provide a proper buffer against the projected external stress?

- Policies are assessed to be supportive of a safe exit. The external position remains sustainable, the sovereign continues to access international markets at favorable rates, and official reserve assets are at a comfortable level. Public debt remains sustainable, and supported by a strong fiscal framework. Inflation is low and stable, supported by a credible inflation targeting framework. The financial sector is sound and effectively supervised.

- Staff's assessment of Chile's international reserves as relatively comfortable for precautionary purposes draws on multiple considerations, reflecting Chile's specificities—an EM with mature markets and external buffers other than reserves. Staff took into account of several factors: the authorities' holdings of additional liquid external assets, through sovereign wealth funds, which represent a significant external buffer on top of the central bank's reserves; the categorization of Chile as a mature market, reflecting market depth and capacity to adjust to external shocks (which limit the applicability of the ARA metric); the central banks' limited and rare recourse to intervening through sales of FX; and access to a central bank swap line. The reserve accumulation program ahead of the planned exit from the FCL (contingent on developments), which staff deem as feasible and easily absorbed by the market, is expected to further improve the adequacy of external buffers.

- Authorities are confident that their policies and reserves will be adequate at the exit, indicated their intention to exit from FCL support in May 2022, conditional on economic and financial developments (given ongoing uncertainty).

7. ***Could staff discuss how the impending general SDR allocation will interact with the BCCh's planned reserve purchases and how the allocation will support reserve adequacy more generally?***

   How does staff view a potential general SDR allocation interacting with the central bank's pre-announced purchases and will the SDR allocation change staff's assessment of reserve adequacy?

- We are not aware of any decision made on whether the reserve accumulation program will be modified to reflect the SDR allocation. At present the default assumption is that the authorities' reserve accumulation program will continue as planned. The SDR allocation will increase Chile's gross international reserves by US$2.38bn, which corresponds to approximately 5 percent of the IMF's ARA metric for Chile. It is expected that the resources will be kept in the CBC's balance sheet.

8. ***Could staff provide further details on the effectiveness and capital-market effects of daily FX purchases so far?***

   Could staff give us an update on the reserves program accumulation as of today?

- The purchases have been effective in increasing the stock of reserves as planned. Staff expect any effect in the FX market to be limited. The program envisages regular purchases of US$40m daily, corresponding to about 1 percent of average turnover in the CLP spot market—daily average FX turnover is estimated by the BIS at US$8bn about half of which in spot transactions. As of May 12, 2021, the central bank had bought US$ 3.280 million (27% of the planned total) and continues with sterilized daily purchases of US$ 40 million.

9. ***The authorities should consider a gradual and earlier reduction in FCL access. A reduction by USD 5-6 billion would, for example, correspond to the increase in reserves since the time of the FCL approval. Such a reduction would appear feasible, considering that i) the international reserve position is relatively comfortable, ii) economic activity is expected to rebound in 2021 and will be boosted further by higher copper prices and growth expectations for major trading partners, and iii) the external economic stress index is lower and the external position stronger than at the time of the FCL request. Could staff comment?***

- The authorities remain intent on exiting the FCL arrangement at the end of the 24-month period (May 28, 2022), but conditional on economic and financial developments, and have not requested a reduction in access. As the staff report explained, while risks have diminished since the FCL request, they remain significant. The external economic stress index (ESI) for Chile indicates a level of stress which, although lower than at the time of the FCL request, remains sizable. A downside scenario, in which the effects of the pandemic are prolonged, could keep

Chile under high external stress for longer than previously experienced, with severe effects on the economy and the balance of payments.

Will be answered orally

10. ***Combining existing FCLs with SLLs may prove to be an effective tool in supporting vulnerable economies that otherwise are in good shape. Staff comments are welcome.***

11. ***Beyond the central bank's program of gradual reserve accumulation, announced and begun in January 2021, could staff comment on any communications plans to help ensure that the intended exit – assuming conditions are conducive – is well-received by markets?***

12. ***We wonder whether an SLL could help Chile's smooth exit from the much larger FCL arrangement. Have staff discussed the possibility of using the SLL in this way with the authorities?***

13. ***We also welcome that the Buff statement's mention that the authorities remain open to explore other precautionary sources of international liquidity, including the Short-Term Liquidity Line (SLL). Does staff have more information on this issue?***

14. ***We would also appreciate if staff could elaborate on the authorities' potential intention to access the Short-Term Liquidity Line.***

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Russian Federation and Syrian Arab Republic

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