

**FOR
AGENDA**

EBS/84/50
Supplement 2

CONFIDENTIAL

May 10, 1984

To: Members of the Executive Board

From: The Secretary

Subject: Chile - Staff Report for the 1983 Article IV Consultation
and Consultation Under Stand-By Arrangement

The attached supplement to the staff report for the 1983 Article IV consultation and consultation under stand-by arrangement for Chile has been prepared on the basis of additional information. The proposed decisions on pages 5-7 include a revision on the stand-by arrangement for Chile.

This subject has been placed on the agenda of the Executive Board for discussion on Monday, May 14, 1984.

If Executive Directors have technical or factual questions relating to this paper prior to the Board discussion, they should contact Mr. Flickenschild (ext. (5)8621).

Att: (1)

INTERNATIONAL MONETARY FUND

CHILE

Staff Report for the 1983 Article IV Consultation and Consultation
Under Stand-By Arrangement--Additional Information
and Revised Proposed Decision

Prepared by the Western Hemisphere and the Exchange
and Trade Relations Departments

(In consultation with the Fiscal Affairs, Legal, and
Treasurer's Departments)

Approved by E. Wiesner and Manuel Guitian

May 10, 1984

In early April 1984 there were a number of changes in Chile's Cabinet. As these changes included the portfolios of economy and finance, Executive Board discussion of the staff report on the Article IV consultation and the consultation under the stand-by arrangement (EBS/84/50, 3/9/84, and Sup. 1 dated 3/30/84) was postponed pending ratification by the Chilean authorities of the economic policies described in the economic policy memorandum attached to the authorities' letter to the Managing Director of March 12, 1984. On April 23, 1984 the Managing Director received a telex from the Minister of Finance of Chile conveying his commitment to the policies and objectives described in the policy memorandum (Attachment II).

At the time of the scheduled Executive Board discussion in early April, Chile had not yet obtained assurances from foreign banks with regard to US\$780 million in new loan disbursements for 1984. Accordingly, the proposed decision on the stand-by arrangement was amended to include a paragraph stating that "...Chile shall not make purchases under the stand-by arrangement until the date, which cannot be later than May 15, 1984, on which the Fund finds that satisfactory arrangements have been made with respect to financing from foreign commercial banks for 1984."

The current expectation is that the Managing Director will receive before May 14, 1984 written confirmation from foreign banks of commitments for a critical mass of external financing equivalent to not less than 90 percent of the total amount of US\$780 million, and the Executive Directors will be informed of this confirmation, on which the Board discussion of the program is contingent. With this procedure, the above-mentioned paragraph no longer is required, and has been deleted from the proposed decision. (See the attached revised proposed decision.)

Since the circulation of Supplement 1 to EBS/84/50 on March 30, 1984, additional information has become available on economic developments and on performance under the economic program in the first quarter of 1984. According to these data, the economic uptrend initiated in the second half of 1983 continued during the first quarter of 1984, inflation remained at a low rate, and demand for financial assets in local currency rose markedly in real terms. Industrial production in the first quarter of 1984 was 12.6 percent above the level of the same period of 1983 and industrial sales were 6.6 percent higher. The annual rate of inflation during the first four months of the year was 12 percent, compared with 23 percent in 1983. Although seasonal factors contributed to the slowdown of inflation, the underlying trend is within the programmed inflation target of 20 percent for 1984. In the same four-month period, private sector holdings of domestic financial assets rose by 5.7 percent in real terms (at an annual rate of 25 percent), which was considerably faster than projected.

The trade surplus in the first quarter was somewhat smaller than projected, as a better-than-expected export performance was more than offset by larger-than-expected imports. Exports, f.o.b., during the first quarter of 1984 were US\$973 million, US\$20 million higher than projected. The value of copper exports was considerably higher than expected because of larger shipments, but the gains were offset to some extent by weaker-than-projected exports of noncopper mining products. Exports of agricultural products were slightly below projected levels, while industrial exports were in line with expectations. Imports, f.o.b., in the first quarter of 1984 were US\$746 million, US\$68 million higher than expected. Imports of consumer goods were in line with projections, and the unanticipated increase in total imports was the result of higher imports of intermediate and capital goods.

The performance under the economic program as of March 31, 1984 generally was satisfactory. The net domestic assets of the Central Bank were below the program ceiling, and the net international reserves of the Central Bank were US\$84 million above the target level (Table 1). The better-than-expected performance of net international reserves was related to larger-than-anticipated net private capital inflows and the postponement of the payment of commissions and fees on refinancing operations. The total outstanding indebtedness of the nonfinancial public sector was below the limit by Ch\$8 billion (0.4 percent of projected GDP). External debt contracting remained well below the established annual limits and the nonquantitative performance criteria of the economic program were observed. However, the sublimit on the domestic indebtedness of the nonfinancial public sector, which had been included in the design of the economic program to ensure that adequate domestic financing would be available for private investment, was exceeded by Ch\$5 billion.

A review of the factors contributing to the larger-than-expected reliance on domestic financing by the nonfinancial public sector reveals that net external disbursements were about US\$130 million less

Table 1. Chile: Performance Under the Stand-By Program

	1984		
	Jan. 31	Feb. 29	March 31
<u>(In billions of Chilean pesos)</u>			
<u>Net domestic assets of the</u>			
<u>Central Bank</u>			
Limit	140	140	140
Actual	116	122	137
Margin	24	18	3
<u>Outstanding indebtedness of the</u>			
<u>nonfinancial public sector</u>			
Limit ^{1/}	590	590	590
Actual	560	571	582
Margin	30	19	8
<u>Outstanding domestic indebtedness</u>			
<u>of the nonfinancial public sector</u>			
Sublimit ^{1/}	138	138	138
Actual	122	128	143
Margin	16	10	-5
<u>(In millions of U.S. dollars)</u>			
<u>Net international reserves</u>			
<u>of the Central Bank</u>			
Target	1,000	1,000	1,000
Actual	1,243	1,213	1,084
Deviation	243	213	84
<u>Contracting and guaranteeing</u>			
<u>of external debt by the</u>			
<u>nonfinancial public sector</u>			
Limit	3,850	3,850	3,850
Actual	...	...	1,472
Margin	...	...	2,378
<u>Contracting and guaranteeing of</u>			
<u>external debt with maturity of</u>			
<u>over 12 months and below 60 months</u>			
Sublimit	125	125	125
Actual	...	...	--
Margin	...	...	125

Source: Central Bank of Chile.

^{1/} The limit and sublimit have been adjusted to reflect revisions in the base data for December 31, 1983 in accordance with the provision of Table 1 of the Memorandum on the Economic Policies of Chile.

than had been projected. Of this amount, US\$100 million was related to an unexpected decline in the net use of short-term external credit lines by Chile's state-owned copper and petroleum enterprises, and the remainder was due to lower-than-planned gross disbursements by multinational institutions.

The lower-than-expected net use of short-term lines of credit by state enterprises stemmed principally from changes in the timing of short-term credit operations relative to projections. In the coming months, the net use of foreign credit lines by the state enterprises is expected to revert to the path that had been envisaged, thus permitting these enterprises to replenish domestic bank deposits run down during the first quarter. The shortfall in disbursements from the multinational development agencies was related in part to some delay in reimbursements by the multinational agencies of domestic financing of certain public sector projects. These reimbursements are expected to be made in the coming months, thus permitting the public sector to repay domestic credits. It should be noted that the relatively strong growth in the private sector's holdings of financial assets in the first quarter has shielded private sector credit from the effects of the limit on the domestic indebtedness of the nonfinancial public sector having been exceeded.

To sum up, it would appear that the shortfall in net foreign credits to the nonfinancial public sector in the first quarter of 1984 is temporary and that the nonobservance of the sublimit on the domestic indebtedness of the nonfinancial public sector is reversible. In view of the fact that the nonobservance relates to a point of time in the past, paragraph 3(a)(i) of the decision proposed in EBS/84/50, Supplement 1 has been modified to provide that purchases will be interrupted during any period in which the data at the end of the preceding period other than the period ending March 31, 1984, i.e., ending June 30, September 30, and December 31, 1984, indicate that the limits described in Table 1 have not been observed.

In view of the decision of the Executive Board adopted at EBM/84/62 (4/23/84) on the inclusion of a new performance criterion concerning overdue obligations to the Fund, another paragraph was added to the proposed decision on the stand-by arrangement to this effect. A revised page 2 of the stand-by arrangement set forth in EBS/82/227, Supplement 2 reflecting this change is attached (Attachment III).

Proposed Decisions

The following draft decisions are proposed for adoption by the Executive Board:

1983 Article IV Consultation

1. The Fund takes this decision relating to Chile's exchange measures subject to Article VIII, Sections 2 and 3, in the light of the 1983 Article IV consultation with Chile concluded under Decision 5392-(77/63) adopted April 29, 1977 (Surveillance Over Exchange Rate Policies).
2. Chile maintains a multiple currency practice arising from a subsidy on certain foreign interest payments and principal repayments by the private sector on foreign debt contracted before August 6, 1982. The size of the spread between the exchange rates in the official market and the parallel market in which a number of current invisible transactions take place also gives rise to a multiple currency practice. Chile maintains exchange restrictions arising from the limitations placed on the sale of foreign exchange for tourism and from a 120-day deferment period on import payments. In view of the temporary nature of these multiple currency practices and exchange restrictions, the Fund grants approval for their retention through December 31, 1984.

Stand-By Arrangement

1. Chile has consulted with the Fund in accordance with paragraph 6 of the letter of December 13, 1982 attached to the stand-by arrangement for Chile (EBS/82/227, Supplement 2) as

modified by the letter dated July 8, 1983 (EBS/83/134), and paragraph 4 of the stand-by arrangement, in order to reach understandings with the Fund regarding the policies and measures that Chile will pursue during the second year of the arrangement.

2. The letter dated March 12, 1984 from the Minister of Finance and the President of the Central Bank, together with the annexed Memorandum on Economic Policy of Chile for the second year of the stand-by arrangement shall be attached to the stand-by arrangement for Chile (EBS/83/227, Supplement 2) and the letter dated December 13, 1982, together with the annexed Memorandum on the Economic Policies of Chile, as modified by the letter dated July 8, 1983 (EBS/83/134), shall be read as supplemented and modified by the letter dated March 12, 1984, together with the annexed Memorandum on Economic Policy.

3. Accordingly, Chile will not make purchases under this stand-by arrangement:

a. during any period in which

(i) the data at the end of the preceding period, other than the period ended March 31, 1984, indicate that the limit on the total indebtedness of the nonfinancial public sector or the sublimit on domestic indebtedness of the nonfinancial public sector described in Table 1 of the memorandum annexed to the attached letter has not been observed, or

(ii) the limit on the net domestic assets of the Central Bank described in Table 2 of the memorandum annexed to the attached letter is not observed, or

(iii) the data at the end of the preceding period indicate that the net international reserve target described in Table 3 of the memorandum annexed to the attached letter has not been observed, or

(iv) the limit or sublimit on the contracting and guaranteeing of external debt by the public sector described in Table 4 of the memorandum annexed to the attached letter is not observed; or

b. after June 30, 1984, until the review contemplated in paragraph 6 of the attached letter has been completed.

4. The Fund finds that in light of the letter dated March 12, 1984, Chile may make purchases under the stand-by arrangement, notwithstanding that the exchange system has not been unified and notwithstanding the retention of the existing restrictions on payments for travel and other invisible transactions, as described in paragraph 4(b) of the stand-by arrangement.

5. Paragraph 4(c) of the stand-by arrangement for Chile in EBS/82/227, Supplement 2, January 11, 1983, shall be amended to read as follows:

"(c) during the entire period of this stand-by arrangement while Chile has any overdue financial obligation to the Fund, or if Chile...."

APRIL 23, 1984

INTERNATIONAL MONETARY FUND

WASHINGTON, D.C.

ATTN. MR. JACQUES DE LAROSIERE, MANAGING DIRECTOR

ON MARCH 12, 1984, MR. HERNAN FELIPE ERRAZURIZ, PRESIDENT OF THE CENTRAL BANK OF CHILE, AND MR. CARLOS F. CACERES, MY PREDECESSOR AS CHILE'S MINISTER OF FINANCE, ADDRESSED TO YOU A LETTER REQUESTING THAT THE REMAINING RESOURCES UNDER THE EXISTING STAND-BY ARRANGEMENT BE MADE AVAILABLE TO CHILE. CHILE'S ECONOMIC OBJECTIVES AND POLICIES FOR 1984 WERE DESCRIBED IN DETAIL IN A MEMORANDUM ATTACHED TO THAT LETTER. AS I CONVEYED TO YOU DURING MY RECENT VISIT TO WASHINGTON, IT IS THE INTENTION OF THE CHILEAN GOVERNMENT TO PLACE HIGH PRIORITY ON REDUCING UNEMPLOYMENT AND SUPPORTING ECONOMIC REACTIVATION. WITH THESE PRIORITIES IN MIND, I HAVE REVIEWED THE LETTER AND ECONOMIC POLICY MEMORANDUM AND REITERATE TO YOU MY COMMITMENT TO THE POLICIES AND OBJECTIVES DESCRIBED THEREIN.

MR. ERRAZURIZ AND I WISH TO THANK YOU FOR YOUR COOPERATION AND UNDERSTANDING AND REQUEST YOUR SUPPORT IN PRESENTING CHILE'S STAND-BY PROGRAM TO THE EXECUTIVE BOARD OF THE FUND AS SOON AS POSSIBLE.

REGARDS,

LUIS ESCOBAR CERDA

MINISTER OF FINANCE

4. Chile will not make purchases under this stand-by arrangement that would increase the Fund's holdings of Chile's currency in the credit tranches beyond 25 percent of quota or increase the Fund's holdings of that currency resulting from purchases of borrowed resources beyond 12.5 percent of quota:

(a) During any period until December 31, 1983 in which:

- (i) the data at the end of the preceding period indicate that the net international reserve target described in Table 1 of the memorandum annexed to the attached letter has not been observed, or
- (ii) the data at the end of the preceding period indicate that the limit on the total indebtedness of the nonfinancial public sector described in Table 2 of the memorandum annexed to the attached letter has not been observed, or
- (iii) the limit on the contracting and guaranteeing of external debt by the public sector described in Table 3 of the memorandum annexed to the attached letter is not observed, or
- (iv) the limit on the net domestic assets of the Central Bank of Chile described in Table 4 of the memorandum annexed to the attached letter is not observed, or

(b) After December 31, 1983, if the exchange system has not been unified as stated in paragraph 14, or if Chile retains the existing restriction on payments for travel and other invisible transactions referred to in paragraph 13 of the memorandum annexed to the attached letter, and if suitable performance criteria for the second year of the arrangement have not been established in consultation with the Fund as contemplated by paragraph 6 of the attached letter, or if such performance criteria, having been established, are not observed, or

(c) During the entire period of this stand-by arrangement while Chile has any overdue financial obligation to the Fund, or if Chile

- (i) imposes restrictions on payments and transfers for current international transactions, or
- (ii) introduces multiple currency practices, or

- (iii) concludes bilateral payments agreements which are inconsistent with Article VIII, or
- (iv) imposes import restrictions for balance of payments reasons.