FOR AGENDA

EBS/84/50

CONFIDENTIAL

March 9, 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

Attached for consideration by the Executive Directors is the staff report for the 1983 Article IV consultation with Chile and the consultation under the stand-by arrangement. Draft decisions appear on pages 29-31.

This subject has been tentatively scheduled for discussion on Friday, April 6, 1984.

If Executive Directors have technical or factual questions relating to this paper prior to the Board discussion, they should contact Mr. van Houten, ext. (5)8624.

Att: (1)

CONFIDENTIAL

INTERNATIONAL MONETARY FUND

CHILE

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

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

March 9, 1984

Contents | Page

I. Introduction 1

II. Background and Performance Under the 1983 Program 2

III. Economic Prospects and Policies for 1984 11

1. Pricing policy 11
   a. Exchange rate policy and balance of payment objective 11
   b. Interest rates 13
   c. Wage policy 14
2. Demand management policies 14
   a. Public sector policy 16
   b. Monetary policy 18
3. External debt policy 21
4. Policies affecting the exchange and trade system 22

IV. Performance Criteria 24

V. Staff Appraisal 26

Text Tables

1. Projected Fund Position, March 31,1984-December 31, 1984 3
2. Performance Under the Stand-By Program 5
3. Operations of the Consolidated Nonfinancial Public Sector 7
4. Selected Economic Indicators 9
5. Balance of Payments 10
6. Projection of Debt Service and Current Account Ratios 13
7. Real Wage Index 15
8. Monetary Indicators 20
9. Quantitative Performance Criteria for Period Through December 31, 1984 25

Contents

		Page
Appendices		
I.	Fund Relations	31
II.	Basic Data	34
III.	Summary of the Financial Program for the Second Period of the Stand-By Arrangement	36
Appendix Text Tables		
10.	Selected Economic and Financial Indicators 1981-84	40
11.	Macroeconomic Flows	41
12.	Balance of Payments Medium-Term Projections, 1984-89	42
Attachments		
I.	Letter of Intent	43
II.	Memorandum on the Economic Policies of Chile	45
Chart		
1.	Exchange Rate Indices	12a

I. Introduction

The 1983 Article IV consultation discussions and consultation under the stand-by arrangement with Chile were held in Santiago during October 26-November 16 and December 15-16, 1983; in Washington on January 3, 1984; and again in Santiago during January 26-February 9, 1984.1/

The Chilean representatives in the consultation discussions included the Ministers of Finance, Economy, Labor, Mines, and Planning; the President and Vice President of the Central Bank of Chile; officials of the principal public corporations, the Superintendency of Banks, the National Statistics Institute, and the Ministry of Agriculture. The Fund resident representative in Santiago, C. Muniz, provided assistance throughout the consultation discussions.

On January 10, 1983, the Executive Board completed the 1982 Article IV consultation (EBS/82/227, 12/13/82, and Supplement 1, (1/7/83), approved a two-year stand-by arrangement for Chile in an amount equivalent to SDR 500 million (EBS/82/227, Supplement 2, 1/11/83), and approved a request for a purchase equivalent to SDR 295 million under the compensatory financing facility (EBS/82/228, 11/13/82). On July 27, 1983, the Executive Board granted a waiver and modification of performance criteria under the stand-by arrangement, and approved certain exchange measures (EBS/83/134, 6/28/83, and Supplement 1, 7/25/83).

The consultation under the stand-by arrangement had as its primary objective the reaching of understandings on the policies and performance criteria relating to the period of the arrangement after December 31, 1983. These understandings are contained in the attached letter and economic policy memorandum from the Minister of Finance and Central Bank President. An amount equivalent to SDR 216 million remains to be purchased under the stand-by. The phasing of the purchases of this amount is described in paragraph 2(a) of the stand-by arrangement. It is expected that the authorities will request a purchase of SDR 54 million immediately following Executive Board approval of the attached draft decision. Under the phasing provisions of the stand-by arrangement, this amount became available as of February 15, 1984, subject to the performance clauses of the stand-by, including the requirement that suitable performance criteria for the second year of the arrangement be established in consultation with the Fund.

As of January 31, 1984, the Fund's holdings of Chilean pesos amounted to 231.4 percent of Chile's quota of SDR 440.5 million, of which 25 percent corresponded to use of the reserve tranche and 67.0 percent to purchases under the compensatory financing facility. Full use of

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1/ Staff representatives during these discussions were J. van Houten (Head), P. Brenner (WHD), A. Gomez-Oliver (INST), J. Leimone (WHD), P. Molajoni and A. Pera (both ETR), M. Silva de Berta (Secretary-WHD), and M. Ortega (Secretary-ADM).

the remaining resources under the stand-by arrangement would raise the Fund's holdings of pesos to 280.5 percent of quota by the end of the stand-by period, of which 180.5 percent would correspond to total outstanding Fund credit (Table 1). Further information on Chile's relations with the Fund is presented in Appendix I. Chile accepted the obligations of Article VIII, Sections 2, 3, and 4 on July 27, 1977.

II. Background and Performance Under the 1983 Program

During 1982, the Chilean economy experienced a large contraction, with real GDP falling by some 14 percent and unemployment rising to 25 percent in the Santiago Metropolitan Area. The sharp drop in economic activity reflected recession in the industrial countries, declining prices for Chile's main export commodities, especially copper, a reduction in net capital inflows, higher interest rates abroad, and a substantial weakening of Chile's international competitiveness. These conditions triggered a high rate of business failure that in turn led to a crisis of the financial system in January 1983. The loss of official net international reserves during 1982 amounted to about US$1.3 billion, or about 40 percent of the stock at end-1981.

To redress the country's economic difficulties, in June 1982 the Chilean authorities undertook a sizable depreciation of the peso and abolished the policy of wage indexation to past inflation. Later that year they adopted a medium-term adjustment program that was supported by a two-year stand-by arrangement approved on January 10, 1983. The basic objective of the program was to establish policies that would restore confidence and would lay the bases for economic recovery in the context of an improved balance of payments performance and a reduction in the rate of inflation.

The program faced difficulties from the start. On January 13, 1983, the authorities declared a bank holiday and intervened and liquidated a number of privately owned financial institutions. When the authorities initially declined to guarantee the foreign debt (totaling US$400 million) of the liquidated financial institutions, foreign banks stopped all lending to Chile, precipitating a loss of confidence in the domestic financial system. As a consequence, central bank emergency support of the banking system expanded very rapidly, financing not only the shortfall of programmed net foreign bank loan disbursements but also a reduction in the private sector's net foreign indebtedness. The result was that the country's international reserves declined sharply. While credit policy was affected adversely by the January 1983 financial crisis, fiscal policy remained tight; indeed, the deficit of the nonfinancial public sector in the first quarter of 1983 was only about half the deficit programmed for that period.

In March 1983 a staff mission visited Santiago to discuss economic prospects and to review the status of the program. Subsequent to this mission, the authorities announced an emergency plan designed to regain

Table 1. Chile: Projected Fund Position,
March 31, 1984-December 31, 1984

	Outstanding March 31, 1984	Operations During Second Year of Program 1984 Apr.-June	July-Sept.	Oct.-Dec.
	(In millions of SDRs)			
Transactions under tranche policies (net) 1/				
Purchases		108	54	54
Ordinary resources		(54)	(27)	(27)
Enlarged access resources		(54)	(27)	(27)
Repurchases		--	--	--
Ordinary resources		(--)	(--)	(--)
Enlarged access resources		(--)	(--)	(--)
Transactions under special facilities (net) 2/		--	--	--
Purchase		(--)	(--)	(--)
Repurchases		(--)	(--)	(--)
Total Fund credit outstanding (end of period)	579.00	687.00	741.00	795.00
Under tranche policies 1/	284.00	392.00	446.00	500.00
Special facilities 2/	295.00	295.00	295.00	295.00
	(As percent of quota)			
Total Fund credit outstanding (end of period)	131.44	155.96	168.22	180.48
Under tranche policies 1/	64.47	88.99	101.25	113.51
Special facilities 2/	66.97	66.97	66.97	66.97

Source: Fund staff estimates.

1/ Ordinary and enlarged access resources.
2/ Compensatory financing facility.

control of the financial situation, stem the loss of international reserves, and return to the path of the stand-by program by September 1983, with interim targets for June 30, 1983.

Under the emergency plan, monetary policy was revised to allow an additional net credit expansion equal to the shortfall of net bank capital inflow from the program level. Similarly, the net international reserve target was adjusted for the shortfall of net bank capital inflow. The emergency monetary program also included provisions for support of domestic debtors and of the financial system. In addition, to cover outlays for new health and employment programs, the emergency plan included fiscal revenue measures expected to total about 2 percent of GDP during the remainder of 1983. The principal measure was an import surcharge of 10 percentage points, raising the effective tariff to a uniform 20 percent and yielding revenues of about 1.5 percent of GDP. The emergency plan also involved a number of exchange measures, including the tightening of restrictions on the sale of exchange for invisible transactions, the introduction of a 120-day deferment period for the payment of imports, and the temporary imposition of a tax on the sale of exchange for certain import payments for which licenses already had been issued. At the same time, it was announced that the peso would depreciate with respect to the U.S. dollar at the Chilean rate of inflation (previously the depreciation was at the Chilean rate of inflation less the world rate of inflation, assumed to be 0.5 percent a month).

An integral part of Chile's emergency plan was the negotiation of foreign bank financing equal to that projected in the stand-by program. On January 31, 1983 the authorities, by agreement with the Advisory Committee of Chile's foreign bank creditors, had already announced a 90-day moratorium on amortization of foreign loans. The foreign banks agreed to (1) a refinancing arrangement of principal payments falling due in 1983 and 1984; (2) new medium-term financing totaling US$1.3 billion for 1983; (3) the maintenance of short-term trade credits outstanding as of January 31, 1983 for a period of 18 months; and (4) the refinancing of short-term working capital credits to the financial system outstanding on January 31, 1983 into a medium-term loan. The government agreed to extend a guarantee on the public and financial sectors' rescheduled maturities and the foreign banks agreed to reschedule private sector debt if requested by the debtors.

By June 30, 1983 Chile's economic performance was in conformity with the emergency plan but, as expected, was still off course in relation to the stand-by program owing to the absence of external financing in the amount programmed (Table 2). On the basis of the performance under the emergency plan, a waiver of the observance of the performance criterion of the net international reserves of the Central Bank for the deviation from the June 30, 1983 target was granted and increases of the ceilings on the net domestic assets of the Central Bank and on contracting and guaranteeing of foreign debt by the nonfinancial public sector were approved by the Executive Board on July 27, 1983.

Table 2. Chile: Performance Under the Stand-By Program

	1983 March 31	1983 June 30	1983 Sept. 30	1983 Dec. 31
(In billions of Chilean pesos)				
Net domestic assets of the Central Bank 1/				
Limit	-6.0	4.1	13.3	24.0
Actual	51.4	59.9	4.0 2/	24.0 3/
Margin	-57.4	-54.8	9.3	--
Outstanding indebtedness of the nonfinancial public sector 4/				
Limit	437.0	452.0	459.0	455.0
Actual	429.7	444.0	449.9	468.7
Margin	7.3	8.0	9.1	-13.7
(In millions of U.S. dollars)				
Net international reserves of the Central Bank				
Target	1,307.0	1,177.0	1,052.0	1,052.0
Actual	641.0	470.0	1,220.0 2/	1,055.0 3/
Deviation	-666.0	-706.0	168.0	3.0
Contracting and guaranteeing of external debt by the nonfinancial public sector				
Limit	2,050.0	2,050.0	5,500.0 5/	5,500.0 5/
Actual	399.4	399.4	1,700.0 6/	1,700.0 6/
Margin	1,650.6	1,650.6	3,800.0 6/	3,800.0 6/

Source: Central Bank of Chile.

1/ For purposes of calculating net domestic assets through June 30, 1983, all foreign currency entries are valued at an accounting rate of Ch$74 per U.S. dollar. After June 30, 1983 all foreign currency entries are valued at Ch$77 per U.S. dollar.

2/ Includes the effects of US$1,070 million of new foreign loans disbursed during the third quarter of 1983.

3/ Includes the effects of US$230 million of new foreign loans disbursed during the fourth quarter of 1983.

4/ For purposes of calculating these limits, all foreign currency entries are valued at an accounting rate of Ch$77 per U.S. dollar.

5/ As revised by the waiver and modification of performance granted by the Executive Board on July 27, 1983.

6/ Does not include US$2.1 billion of anticipated refinancing of medium-and long-term debt coming due in 1983 and 1984 and does not include US$1.3 billion of short-term noncommercial debt that is to be converted to a medium-term loan. These transactions had not been formally completed as of December 31, 1983.

These Executive Board actions cleared the way for Chile to make drawings equivalent to SDR 108 million. As had been arranged, the foreign banks subsequently disbursed a total of US$1,070 million in new loans to Chile prior to the September 30, 1983 quarterly test date.

As some margins were available under the limits of the emergency program at midyear, during the third quarter the authorities introduced several new measures that raised the rate of credit expansion. These included special lines of credit to provide working capital for private enterprises and for the construction of low-income housing. Data for September 30 indicated that Chile was in full compliance with the stand-by program. Official net international reserves at the end of the third quarter were about US$170 million (0.8 percent of GDP) above the target level, the net domestic assets of the Central Bank were Ch$9.3 billion (US$120 million) below the third quarter ceiling and the indebtedness of the nonfinancial public sector was below the limit by a similar amount.

In view of the substantial slack in the economy, in the fourth quarter of 1983 the authorities eased fiscal policy by increasing outlays on housing and other spending with a high labor content, but continued to adhere to the programmed path for central bank net domestic assets. On December 31, 1983 the net international reserves of the Central Bank were slightly above the target level and the net domestic assets were at the program ceiling. Official debt contracting remained below the established ceiling, but the financing requirements of the nonfinancial public sector exceeded the programmed limit by Ch$13.7 billion.

The deficit of the nonfinancial public sector for the year 1983 as a whole is estimated at 3 percent of GDP. This figure compares with a programmed deficit equivalent to 1.7 percent of the originally projected GDP, or 2 percent in relation to the latest estimated GDP for 1983 (Table 3). As was mentioned, the larger than programed fiscal deficit reflected an increase in fiscal spending in the last quarter of 1983 to help ease the high level of unemployment. Until that quarter, the authorities had cut fiscal spending and had taken new revenue measures to keep the fiscal program on track.

General government revenue for 1983 as a whole registered a shortfall of 1.5 percent of GDP, principally because of smaller than expected income and sales tax receipts, and less than anticipated transfers from the public enterprises. A doubling of import duties to a uniform level of 20 percent in March 1983 did not fully offset these lower receipts. General government current expenditures rose by 2.2 percent of GDP principally because of larger than anticipated unemployment and family support benefits and interest payments, while wages were held below programmed levels. These higher outlays were compensated in part by a cut of 0.9 percent of GDP in capital spending from programmed levels, notwithstanding the increase in such spending in the last quarter of 1983. An improvement in the operational surplus of the

Table 3. Chile: Operations of the Consolidated Nonfinancial Public Sector

(In percent of GDP)

	1980	1981	1982	1983 Prog.1/	1983 Est.	Prog. 1984
General government current revenue	32.9	31.7	30.2	29.3	27.8	27.3
Taxes on income and property	7.3	5.7	5.8	5.2	5.0	4.1
Taxes on goods and services	12.3	13.0	13.6	15.1	13.6	13.9
Taxes on international trade	2.0	2.2	1.5	1.7	2.4	2.9
Social security tax	5.6	4.7	3.3	2.5	2.8	2.8
Other tax (net of IVA rebate)	-0.8	-0.7	-1.2	-1.2	-1.1	-1.2
Nontax revenue	6.6	6.8	7.2	6.0	5.3	4.8
Operational surplus of the public enterprises	9.9	5.6	8.3	11.2	11.5	10.2
Net transfers to general government	-7.8	-5.5	-7.1	-9.3	-8.7	-7.5
General government current expenditure	24.5	26.3	32.2	28.5	30.7	29.3
Wages and salaries	8.8	7.7	7.9	7.0	6.7	6.2
Goods and services	3.1	2.9	3.4	3.0	3.2	3.0
Social security payments to private recipients	7.1	8.1	10.9	9.8	9.8	10.0
Transfer and subsidy payments to private sector	4.1	6.8	9.1	7.6	8.9	7.7
Interest on public debt	0.8	0.4	0.6	0.9	1.8	2.1
Other	0.5	0.4	0.4	0.2	0.3	0.2
Current account surplus of the public sector	10.6	5.5	-0.8	2.7	--	0.8
Net capital revenues	0.4	0.4	2.1	1.1	1.9	1.5
Revenue	2.2	3.2	7.9	2.1	3.9	3.2
Less: financial investment	(1.8)	(2.7)	(5.7)	(1.0)	(2.0)	(1.7)
Capital formation	5.4	5.1	4.7	5.8	4.9	6.8
Overall surplus or deficit (-)	5.5	0.8	-3.4	-2.0	-3.0	-4.5
Financing	-5.5	-0.8	3.4	2.0	3.0	4.5
External	-0.1	2.7	1.1	2.0	-1.0	2.2
Internal	-5.4	-3.5	2.3	--	4.0	2.3
Memorandum item						
Nominal GDP (Ch$ billion)	1,075	1,289	1,229	1,550	1,550	1,941

Sources: Ministry of Finance; and Fund staff estimates.

1/ Program percentages are based on latest estimated GDP for 1983. The program had projected nominal GDP at Ch$1,740 billion.

public enterprises, and larger net capital revenues related to the sale of assets by the public social security funds, also helped to keep the deficit of the public sector under control in the course of the year.

The program for 1983 had contemplated that the entire deficit of the nonfinancial public sector would be financed from net foreign loans, including borrowing from foreign banks. In fact, all new foreign bank borrowing in 1983 was directed to the Central Bank which in turn channelled these resources to the rest of the financial system and the private sector. The deficit of the nonfinancial public sector was financed entirely by the sale of government paper on the domestic financial markets at market interest rates, as the Central Bank is constitutionally prohibited from providing credit to the public sector.

The stand-by program had anticipated that recovery from the recession of 1982 would be modest because of weak economic growth in the industrial world, protectionist tendencies in a number of foreign markets, and the sharp rise in the debt service burden of the private sector. The January 1983 financial crisis contributed to a delay of the economic recovery in Chile. Signs of economic recovery began to appear by mid-year 1983 and became more pronounced during the second semester as agricultural output benefited from good weather and adequate price incentives, industrial production picked up, and construction was boosted by increased fiscal spending on housing and road building. In the fourth quarter of 1983 real GDP was 5.6 percent higher than in the same period of 1982 and industrial production was up 13.5 percent over the same period (Table 4). The large degree of slack in the economy contributed to a rapid abatement of inflation, from an annual rate of inflation of 44 percent in the second half of 1982 to about half that rate in 1983, and to under 6 percent in the four-month period ended February 1984.

The overall balance of payments for 1983, as measured by the change in the net international reserves, registered a deficit of US$600 million, somewhat more than originally envisaged as a stronger-than-expected performance in the current account was more than offset by weakerthan-expected capital inflows (Table 5). The current account deficit was US$1.1 billion compared with a projected level of US$1.6 billion as service payments were some US$500 million below expectations. The improvement in services account reflected lower than projected foreign interest rates and a larger than expected incidence of default or nonpayment by private debtors. The trade balance improved as expected from US$200 million in 1982 to US$1,000 million in 1983, but exports were US$600 million below projections because of sluggish prices and imports were below expectations in reflection of the decline in GDP.

Net capital inflows in 1983 amounted to US$400 million, some US$600 million less than in 1982 and US$700 million less than envisaged in the program. The shortfall from the projected flow is explained by

Table 4. Chile: Selected Economic Indicators

(Percentage change or as indicated)

	1980	1981	1982	1983 1/	1983 I	1983 II	1983 III	1983 IV
Real GDP (1977=100) 2/	7.8	5.7	-14.3	-0.8	-7.6	-1.4	0.8	5.6
Relative to previous quarter					1.3	4.9	-1.6	1.1
Industrial production (SOFOFA) 2/	4.0	0.1	-17.6	4.6	-4.0	4.0	5.1	13.6
Relative to previous quarter					-1.8	14.0	0.2	1.2
Exports (in U.S. dollars) 2/	22.7	-18.5	-3.4	3.9	1.9	3.6	4.6	5.7
Copper 2/	12.6	-18.2	-3.1	10.6	5.4	9.6	-1.4	31.3
Relative to previous quarter					8.7	18.7	-9.3	12.3
Noncopper 2/	32.5	-18.7	-3.7	-1.7	-0.7	-1.4	10.7	-13.9
Relative to previous quarter					6.3	1.1	-8.2	-12.8
Imports 2/	30.5	17.1	-44.1	-22.1	-45.3	-27.6	-9.4	8.1
Relative to previous quarter					-11.3	9.8	5.9	4.9
Consumer prices (1978=100) 2/	35.1	19.7	9.9	27.3	23.3	30.8	30.9	24.3
Relative to previous quarter					4.4	5.8	6.1	6.1
Unemployment rate (Greater Santiago) 3/ (as percent of the labor force)	10.1	11.0	21.9	16.5	21.7	19.5	18.0 4/	16.5 4/
Nominal effective exchange rate (Dec. 1978=100) 2/	6.6	23.2	5.5	-13.8	-29.4	-25.6	-9.2	11.6 5/
Relative to previous quarter					-2.1	8.8	2.9	1.9 5/
Real effective exchange rate (CPI/Dec. 1978=100) 2/	15.2	18.8	-7.7	-16.5	-31.8	-25.3	-10.0	2.5 5/
Relative to previous quarter					-4.5	7.4	0.7	-0.8 5/

Sources: Central Bank of Chile; and Fund staff estimates.

1/ Preliminary.
2/ Quarterly changes are relative to the same period of the previous year.
3/ Annual figures based on October-December survey.
4/ Change in series; refers to Santiago Metropolitan region after June 1983.
5/ Several components are partly extrapolated.

Table 5. Chile: Balance of Payments

(In millions of U.S. dollars)

	1981	1982	1983 Prog.	1983 Prel.	1984 Prog.
Current account	-4,733	-2,304	-1,602	-1,068	-1,250
Trade balance	-2,677	63	1,000	1,014	995
Exports	(3,836)	(3,706)	(4,450)	(3,851)	(4,100)
Copper	/1,738/	/1,685/	/1,950/	/1,863/	/1,867/
Other	/2,098/	/2,021/	/2,500/	/1,988/	/2,223/
Imports	(-6,513)	(-3,643)	(-3,450)	(-2,837)	(-3,105)
Nonfinancial services	-701	-555	-648	-471	-498
Financial services	-1,463	-1,921	-2,054	-1,703	-1,848
Transfers	108	109	100	92	100
Capital account	4,698	1,015	1,117	410	1,250
Direct investment	362	384	450	152	160
Medium- and long-term capital	3,132	1,371	591	1,063	980
Public sector	(-258)	(728)	(464)	(1,285)1/	(1,166)
Private sector 2/	(3,390)	(643)	(127)	(-222)	(-186)
Short term	1,205	-740	76	-806	110
Public sector	(521)	(42)	(--)	(-337)	(83)
Private sector	(684)	(-782)	(76)	(-469)	(27)
Errors and omissions	105	-76	--	18	--
SDR allocation	28	--	--	--	--
Overall balance	98	-1,365	-485	-640	--
Valuation adjustment	-90	-28	--	40	--
Change in net international reserves (increase -)	-7	1,393	485	600	--

Sources: Central Bank of Chile; and Fund staff estimates.

1/ Does not include the consolidation of US$1.3 billion of short-term debt.
2/ Includes Banco del Estado.

an unexpected net outflow of short-term capital as a result of the financial crisis in January 1983, and lower than programmed direct investment inflows. Net medium- and long-term capital inflows to the public sector (including the Central Bank) were larger than programmed and offset in part the net short-term capital repayments which took place in the initial months of 1983.

III. Economic Prospects and Policies for 1984

In the following sections, the report on the Article IV consultation discussions has been combined with the presentation of the Chilean authorities' policies and objectives for 1984 in the framework of the stand-by arrangement.

The authorities noted the return to the path of the financial program following the implementation of the emergency plan in March 1983, and were encouraged by the indications of a moderate upturn in economic activity in the latter part of the year. The authorities stated that for the second year of the stand-by program they intended to pursue policies designed to consolidate the progress made in 1983 in re-establishing financial stability and strengthening the financial system while nurturing the economic recovery which appears to be under way. The authorities believe that in the very short term public sector support of aggregate demand continues to be needed to avoid a stagnation of the economy because they considered private confidence in economic and financial management continues to be fragile.

The authorities agreed with the staff that the basic strategy as described in the initial stand-by program remained applicable. Hence, the authorities intend to continue placing reliance on market forces and price incentives to guide resource allocation in the economy. These policies are to be supported by prudent monetary and fiscal management to achieve the desired progress toward external and internal equilibrium. Accordingly, the program for 1984 incorporates an expansion of GDP of about 4 percent, a decline of inflation to below 20 percent, and a further rise in gross domestic savings to 15.3 percent of GDP from 13.3 percent in 1983 and 8.5 percent in 1982. (For a summary of the program, see Appendix III.)

1. Pricing policy

The key element underlying the strategy of the Chilean authorities is the pursuit of market-based pricing policies with respect to the exchange rate, interest rates, and wages to guide economic decisions over the medium term.

a. Exchange rate policy and balance of payment objective

Exchange rate policy is aimed at assuring the competitiveness of the Chilean economy required in order to shift resources to the tradable goods sector and to help ensure the orderly servicing of Chile's sizable external debt in future years. Indications are that the real effective exchange rate of the peso has returned to the average level existing during 1977-78, a period of relative balance of payments equilibrium prior to the fixing of the exchange rate (Chart 1). Present policy is to adjust the exchange rate daily, and since December 1983 the rate of depreciation is based on the difference between domestic inflation in the previous month and the external rate of inflation estimated, for these purposes, at no more than 0.5 percent per month.

The authorities noted that realistic and consistent exchange rate management had been instrumental in re-establishing credibility in the exchange rate in the course of 1983. In particular, they pointed out that the sizable spread between the official and parallel market exchange rates that had appeared early in 1983, following the financial crisis, had narrowed substantially and recently had been in the range of 6 percent to 10 percent. They expected the spread to narrow further during 1984 as confidence in economic management strengthened with the pursuit of appropriate policies.

The authorities were confident that the present real effective exchange rate is consistent both with a reduction in the current account deficit from 5.7 percent of GDP in 1983-84 to 3.5 percent of GDP over the medium term, and with maintaining an annual growth of GDP of 4 percent. On this basis, total debt would decline from 88 percent of GDP in 1984 to 71 percent in 1989, and interest payments would decline, in relation to GDP and to goods and nonfactor services (Table 6). These projections are sensitive to assumptions with respect to the medium-term trend of a number of important variables, including world market interest rates and copper prices.1/ Hence, the authorities plan to keep exchange rate policy under continuous review to ensure the achievement of their balance of payments and external debt objectives over the medium term.

For 1984 the overall balance of payments is projected to be in equilibrium. The trade balance surplus is expected to be US$1 billion, about the same level as in 1983. Exports are projected to increase by 6.5 percent, with virtually no increase in the value of copper exports, because of projected weak copper prices. Noncopper exports are projected to rise by 12 percent on the basis of increased world demand and the improved competitiveness of Chile. Import growth is expected to remain low as a consequence of prudent demand policy.

On the basis of scheduled interest payments of the foreign debt, net financial service payments are projected to rise by US$150 million. The level of foreign interest rates has been assumed to remain unchanged from 1983, while the spread and fees charged by foreign banks are expected to be somewhat lower. The worsening of the financial services account is reflected in a US$200 million larger current account deficit compared with 1983. This 1983 deficit, however, was US$600 million below the program

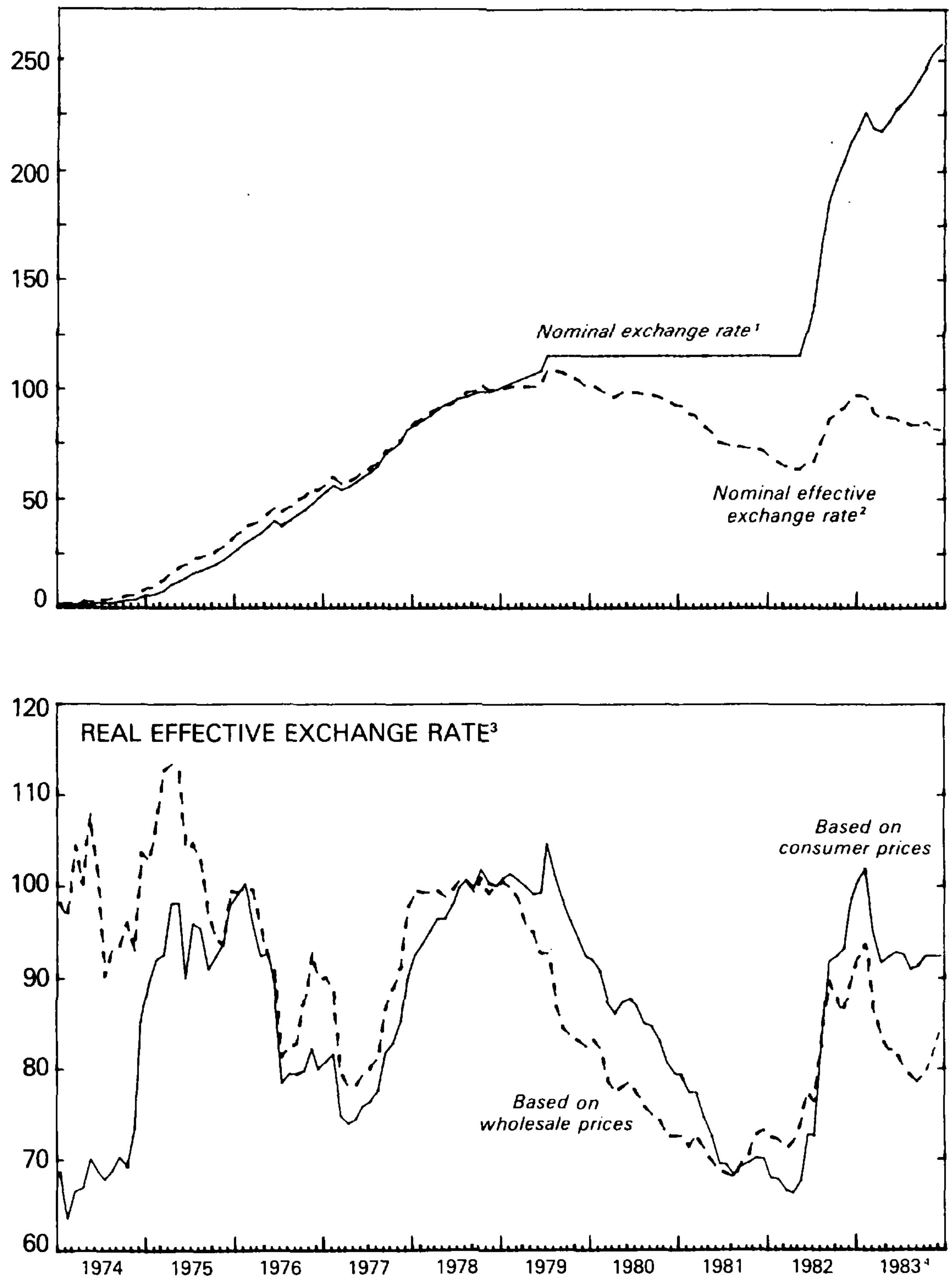
1/ The projections in Table 6 and Table 12 are based on interest rates of 9 percent in international capital markets and the maintenance of real copper prices at projected 1984 levels.

CHART 1

CHILE

EXCHANGE RATE INDICES

(Dec. 1978=100)



Sources. Central Bank of Chile; *International Financial Statistics*, and Fund staff estimates.

[1]Pesos per U.S. dollar at end of period.

[2]Nominal exchange rate index adjusted by a weighted index of exchange rate movements of major trading partners

[3]Real exchange rate index adjusted by weighted indices of prices and exchange rate movements of major trading partners

[4]Partly estimated.

level, and the 1984 projected current account deficit is close to the level anticipated for 1984 in the original program. The current account deficit would be fully financed by US$160 million in direct investment and US$1.1 billion in new foreign indebtedness (the net capital flows for 1984 are discussed in subsection 3 below).

Table 6. Chile: Projection of Debt Service and Current Account Ratios

	1984	1985	1986	1987	1988	1989
Current account deficit as percent of GDP	6.0	5.0	4.0	3.8	3.5	3.3
Debt service as percent of GDP	17.7	19.4	20.2	18.6	20.5	17.9
Amortization 1/	(8.1)	(9.9)	(11.0)	(9.5)	(12.0)	(10.1)
Interest	(9.6)	(9.5)	(9.3)	(9.0)	(8.5)	(7.8)
Debt service as percent of exports of goods and nonfactor services	74.2	80.2	82.9	74.7	82.2	71.5
Amortization 1/	(34.0)	(40.8)	(44.8)	(38.5)	(48.3)	(40.3)
Interest	(40.2)	(39.4)	(38.1)	(36.2)	(33.9)	(31.2)
Memorandum items:						
GDP (in billions of US$)	20.9	23.0	24.9	26.9	29.1	31.5
Exports of goods and nonfactor services (in billions of US$)	5.0	5.6	6.1	6.6	7.2	7.9

Sources: Fund staff projections, based on Table 12 in Appendix III.

1/ Scheduled amortization; after rescheduling the debt service for 1984 is projected at 53.9 percent of goods and nonfactor services.

b. Interest rates

For a brief period in December 1982 the Central Bank provided guidelines to domestic financial institutions on the maximum nominal interest rate to be paid on 30-day deposits, determined on the basis of expected domestic inflation plus a premium. Financial institutions were free to set interest rates on all other deposit and credit operations. The guidance of interest rates was abandoned in early 1983, but was soon reinstated as the financial crisis and subsequent bank intervention and massive support of the banking system by the Central Bank considerably reduced the scope for the operation of market forces.

The Government intends to continue with the present interest rate policy until the domestic financial system has strengthened. Meanwhile, the authorities intend to give greater weight to the level of foreign interest rates when setting the indicated 30-day deposit rate to help promote domestic savings and protect the capital account of the balance of payments. Moreover, to help guide domestic interest rates, the Central Bank will set interest rates on its domestic credit operations on the basis of the cost of its external resources, and it will gradually eliminate in the course of the next 12 months the practice of paying interest on swap operations and of paying a premium on foreign currency deposits.

c. Wage policy

The third main element in the authorities' pricing policy relates to wages. The abandonment in June 1982 of automatic wage indexation, together with the lowering of the wage floor as the basis for collective bargaining, set the stage for a substantial reduction in real wages. The adjustment of wages has helped to re-establish the external competitiveness of the Chilean economy to the average level of 1977-78, a period of approximate balance in the external accounts (Table 7).

Government wage policy for 1984 is expected to remain substantially unchanged from that pursued during 1983. The Government sets the wage for general government civil servants and top management in the public enterprises. Since June 1982, civil servants have received a 5 percent wage increase in July 1983 and a 15 percent increase in January 1984, while inflation totaled 48 percent in that period. No further increase in civil servants' wages are planned for 1984. Starting in early 1984 the salaries of top management in the principal state enterprises were cut by 15 percent as a further signal of public wage restraint. The Government does not intend to announce general wage increases applicable to private sector workers. Wage settlements in the private sector will continue to be determined either through collective bargaining or individual agreements. The authorities expect that the high rate of unemployment will continue to dampen private wage demands in 1984.

2. Demand management policies

The emergency monetary and fiscal measures adopted in March 1983 enabled the authorities to regain control of the financial situation by September. As was mentioned above, a review of the economic situation at that time led the authorities to ease the fiscal stance moderately in the final quarter of 1983 to provide a measure of stimulus to aggregate demand and help lower unemployment. They are planning to maintain a moderately expansionary fiscal stance during the first semester of 1984 as private sector expectations are not yet believed to have firmed sufficiently. At the same time, monetary policy is programmed to remain cautious to protect the net international reserves.

Table 7. Chile: Real Wage Index

(December 1982 = 100)

	Index			Real Wages	
	Nominal Wage	Exchange Rate	U.S. Wholesale Price	Index 1/	Percent Over Same Month of Previous Year
April of each year					
1977	17.1	25.8	0.646	1.026	
1978	28.5	42.2	0.687	0.983	-4.2
1979	42.6	49.4	0.765	1.127	14.6
1980	63.4	53.9	0.874	1.346	19.4
1981	82.5	53.9	0.974	1.491	10.8
1982 2/	95.7	53.9	0.991	1.792	20.2
1983	103.3	101.6	1.001	1.016	-43.3
November 1983	115.5	117.9	1.017	0.963	-4.9

Sources: National Institute of Statistics, IFS, and Fund staff estimates.

1/ Real wage index in U.S. dollars. The index is calculated by converting the nominal wage index in pesos to a U.S. dollar equivalent wage index and deflating with the U.S. wholesale price index.
2/ Survey includes an increase in coverage beginning in 1983.

If private demand were to show more strength than is currently expected, the fiscal stance in the first semester of 1984 entails an element of risk of crowding out private demand for financial resources. The authorities have carefully weighed these risks and have concluded that the evidence so far indicates that the fiscal easing that took place in late 1983 has not jeopardized progress toward financial stability. Inflation has declined, the net domestic assets of the Central Bank have been held within the program ceiling, and the net international reserve targets have been achieved. Even so, the authorities plan to review the fiscal stance continuously in the light of changes in relevant economic indicators, as the maintenance of fiscal discipline continues to be a principal element in Chile's economic strategy.

a. Public sector policy

The public sector program for 1984 contemplates an overall deficit of 4.5 percent of GDP, some 1.5 percentage points above the estimated 1983 level; while public sector saving is expected to increase as a percentage of GDP from 1983 to 1984, public investment is expected to rise even more. Approximately 0.5 percentage point is explained by a decline in the net sales of financial assets by the state-owned social security funds.1/ Whereas in 1983 the entire public deficit was financed domestically, about half the overall deficit for 1984 is expected to be financed from foreign sources, almost entirely from multilateral development banks (1.5 percent of GDP) and suppliers' credits relating to the hydroelectric project. The remainder of the deficit is to be financed through the sale of government securities on the domestic financial market at market related interest rates.

The program contemplates an increase in public investment from 4.9 percent of GDP in 1983 to 6.8 percent in 1984 (see Table 3). The bulk of the higher investment for 1984 is expected to contribute to an improvement of the trade balance in future years. Specifically, outlays relating to the final stage of the Colbun-Machicura hydroelectric complex are projected to increase by 0.9 percent of GDP in 1984. Once this complex is put into operation it will reduce the use of petroleum in

1/ In 1981 the social security system was transformed from an underfunded state-owned system to an individually funded system operated by the private sector. In the transition phase, the state continues to to pay pensions to existing claimants but contributions are paid into the new privately operated funds. To finance pension payments the Government has been using general revenues and has been selling off the remaining financial assets held by the public social security funds. According to standard methodology, these resources are treated as capital revenue just as net purchases of assets by social security funds are treated as capital expenditures. A decline in net sales of assets by the public social security funds from one year to the next thus results in a higher overall deficit of the consolidated nonfinancial public sector but does not affect that sector's net demand for financial resources.

thermal electric power plants. The increase in investment in copper mining in 1984 amounts to 0.6 percent of GDP and is aimed at arresting and reversing the trend toward reduced production brought on by declining mineral content. Since the bulk of the hydroelectric spending is scheduled to take place during the first semester of 1984, about 65 percent of the public sector deficit for the year is expected to fall in the first semester.

Total general government expenditures are projected to decline by about 1 percent of GDP compared with 1983, as a result of restraint on current spending that should more than offset a 0.4 increase in outlays on housing and road construction. The wage bill is expected to decline by 0.5 percent of GDP in 1984; spending on goods and other services by 0.3 percent of GDP, and transfers to the private sector by about 1 percent of GDP. However, higher interest payments related to the indexation of outstanding government securities and social security payments, taken together, are projected to increase by 0.5 percent in relation to GDP.

General government revenues for 1984 are projected to decline by 0.5 percent of GDP compared with 1983, notwithstanding higher taxes on luxury goods and property enacted in late 1983 and a full year's impact of price increases on petroleum derivatives and of a higher uniform import tariff put into effect in March 1983. The principal factors behind the projected decline in revenues in relation to GDP are a decrease of 1.3 percent of GDP in net transfers to the general government from the public enterprises and a drop in tax revenue by 0.3 percent of GDP because of the initiation of the first stage of a tax reform that is aimed at stimulating savings and investment.1/

The operational surplus of public enterprises is projected to decline by 1.3 percent of GDP in 1984 compared with 1983, but the transfers to the general government from the enterprises are programmed to decline by a similar amount and thus the retained surplus of the enterprises is expected to remain unchanged from 1983 to 1984 in relation to GDP. The principal factors accounting for the expected decline in the operating surplus of the enterprises in 1984 are a drop in the peso value of copper exports by CODELCO in relation to GDP, and higher imports of petroleum products by ENAP (the state petroleum company). The authorities pointed out that the prices and rates for goods and services sold by public enterprises were at market levels in the case of tradeable goods and in all other instances at levels which covered operating costs and provided for a margin to finance investment. It is the intention of the Government to maintain these pricing policies.

1/ The tax reform reduces the tax burden to productive enterprises, provides tax benefits for reinvestment of earnings, reduces personal income tax rates, and permits a deduction for personal savings from taxable personal income up to a maximum of 20 percent.

The program envisions a substantial reduction in the financing requirements of the public sector in the second semester of 1984. However, in the event that the recuperation of private investment spending were to lag, the program contemplates a contingency investment plan equivalent to up to 0.8 percent of GDP to be activated in the second semester of 1984. The implementation of this plan is contingent upon the existence of domestic private excess financial saving and will be determined in the course of a midyear review on the basis of several factors. The investment plan would allow for increased spending up to 0.3 percent of GDP in the third quarter, and up to 0.5 of GDP in the last quarter of the year. Two thirds of the contingency spending relates to the public enterprises, including CODELCO, ENAP, and ENAMI (the state mining company), and the remainder is to consist of additional construction projects carried out by the general government.

The basis of the contingency spending plan is the possibility that during 1984 private demand might fall short of that contemplated in the financial program and thus give rise to an excess supply of resources. To reduce the chances that economic activity would fall below that projected, the program provides for the use of excess financial resources by the public sector in the second semester of 1984. The two basic indicators of the availability of additional resources are the behavior of the trade balance and the behavior of real money balances in relation to the program projections. Other relevant indicators, including the rate of inflation, the level of real interest rates, and the behavior of the net international reserves are to be taken into account in the midyear review that will assess the advisability of activating the contingency plan.

To monitor and control the public sector deficit in 1984, the financial program includes limits on the total net indebtedness of the nonfinancial public sector. Moreover, to help ensure that the private sector will not be crowded out of domestic financial markets, sublimits have been placed on all domestic indebtedness of the nonfinancial public sector.

b. Monetary policy

The above-described fiscal policy for 1984 is supported by a cautious monetary policy designed to safeguard the level of net international reserves of the Central Bank and to help ensure a further deceleration of the rate of inflation.

The role of the Central Bank in Chile has changed considerably in the course of the past two years as a result of adverse developments in world financial markets and the domestic banking crisis. Whereas previously viously the Central Bank pursued a policy of minimum interference in domestic financial flows, the Central Bank has become the primary domestic financial intermediary since the bulk of foreign bank loan disbursements are channeled through that institution. The authorities emphasized that this expanded role had been thrust on the

Central Bank by circumstances, but that their policy was to reduce the Central Bank's discretionary role by phasing out special short-term credit facilities not related to past emergency support of the financial system, and by relying increasingly on open-market operations to re-channel resources to the rest of the financial system.

The monetary program for 1984 assumes a 4 percent growth in real GDP, no further decline in the real demand for financial assets, and disbursements of medium-term foreign bank loans in an amount of US$780 million. The program is consistent with a deceleration of inflation to below 20 percent and maintenance of the level of net official international reserves. The monetary program incorporates certain medium-term credit lines that were established in 1983 to assist the private sector.1/ These include a subsidy on debt service payments on dollar-indexed loans outstanding on August 6, 1982, a medium-term rescheduling of approximately 30 percent of the domestic bank debt owned by the productive sectors of the economy, and credit facilities for the housing industry.2/ The financial program establishes ceilings on the net domestic assets of the Central Bank consistent with the balance of payments and price objectives of the program.

In 1984, the net domestic credit expansion of the consolidated banking system is financed by a 25 percent growth in liabilities to the private sector and by the medium-term foreign borrowing by the Central Bank mentioned earlier (Table 8). Net foreign borrowing by the rest of the banking system is expected to be small. Bank credit to the private sector is expected to account for 70 percent of the net bank credit expansion.

A major aim of financial management in 1984 will be to achieve further progress toward re-establishing a sound financial system, an objective which is crucial for the full restoration of confidence. After the financial crisis in January 1983 the authorities adopted a number of measures to stabilize the system and to recapitalize financial institutions. To preserve the liquidity of the banking system, all private bank deposits existing at the time of the banking crisis received a government guarantee until December 31, 1983, provided they remained at the same institution. The guarantee was later extended to December 31, 1984 while the authorities develop a new system of deposit insurance with technical assistance from the Fund.

1/ The central bank program does not contain any provision for central bank credit operations with the nonfinancial public sector as the Central Bank is constitutionally prohibited from providing credit to the public sector. Public sector financing requirements are met by the sale of paper on the open market.

2/ These programs are explained in detail in the Report on Recent Economic Developments (SM/84/).

Table 8. Chile: Monetary Indicators 1/

	December		1983					Projected
	1981-1980	1982-1981	Mar.-Dec. 1982	June-Mar.	Sept.-June	Dec.-Sept.	Dec. 1983 Dec. 1982	Dec. 1984-Dec. 1983
A. Central Bank								
(Change in millions of U.S. dollars)								
International reserves	5	1,395	1,002	-188	749	-161	-602	--
Medium- and long-term foreign liabilities	-400	93	-6	-11	1,076	225	1,284	756
(Percentage change) 2/								
Net domestic assets	-20.1	33.2	149.9	17.8	58.1	82.8	313.0	159.9
Liabilities to the private sector 3/	15.0	-3.1	6.5	-6.3	4.3	14.9	19.5	21.4
B. Banking System								
(Change in millions of U.S. dollars)								
International reserves	-247	-1,464	-673	-288	829	-26	-158	-166
Medium- and long-term foreign liabilities	2,050	345	-44	-109	1,102	301	1,250	770
(Percentage change) 2/								
Net domestic assets	55.7	82.6	7.3	3.5	19.5	21.6	56.1	48.0
Credit to the public sector (net)	-10.2	9.6	3.9	-1.1	1.3	16.6	23.1	8.7
Credit to the private sector	53.2	80.5	-3.9	4.8	4.4	11.9	19.3	33.8
Liabilities to the private sector	32.2	23.8	5.4	-1.4	10.6	11.5	28.1	24.8
Memorandum item								
Inflation rate (CPI)	9.5	20.7	3.8	6.0	7.1	4.4	23.1	20.0
Exchange rate Ch$ per US$	--	88.6	--	5.8	6.3	6.3	19.0	13.1

Sources: Central Bank of Chile; and Fund staff estimates.

1/ Changes based on end-of-period data; foreign currency components are valued at end-of-period exchange rates.
2/ As percent of liabilities to the private sector at the beginning of the period.
3/ Does not include central bank notes (pagares) in the hands of the private sector.

As a result of the domestic debt rescheduling mentioned above, the liquidity position of the financial system improved and the ratio of substandard assets to total assets of the commercial banking system declined in the fourth quarter of 1983 (for the first time since the financial crisis). Nevertheless, at the end of 1983, substandard loans still accounted for about 15 percent of total bank assets.

To recapitalize the financial system, the Central Bank has announced the purchase of the substandard loan portfolio of banks up to 150 percent of the capital and reserves of each bank.1/ The proceeds of the portfolio sale are to be used by the commercial banks to repay emergency loans from the Central Bank and to purchase medium-term central bank notes. Accruing dividends can be distributed to share holders only after all substandard loans have been fully repurchased from the Central Bank; however, dividends accruing to new capital contributions would not be affected by this repurchase provision.

The scheme just described has been offered to all privately owned domestic financial institutions excluding the five intervened banks for which the scheme will be applicable once the problems associated with substandard loans to major bank shareholders have been resolved. The authorities believe that these problems will be resolved in the course of 1984.

3. External debt policy

Chile's total outstanding debt is estimated to have amounted to US$17.4 billion at the end of 1983, equivalent to 88 percent of that year's GDP. The main elements of the medium-term debt strategy of the authorities are: a sustained rate of economic growth based on export expansion that would allow for the servicing of the external debt in an orderly manner; tight control of new external indebtedness to reduce over time the ratio of external debt to GDP; a concerted effort to shift from the present heavy reliance on foreign bank loans to credits from multilateral and official sources to improve the average financing terms; and limiting the extension of official guarantees on private external debt and, in particular, on such debts of the nonbank private sector.

The authorities' program of external indebtedness for 1984 was designed along the lines of this strategy. Total medium-term net capital inflows are projected to decline from US$1.3 billion in 1983 to US$1.1 billion in 1984. Net borrowing from official sources is programmed to increase from US$300 million in 1983 to US$480 million in 1984, and

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1/ The substandard loans purchased by the Central Bank in mid-1982 under a previous scheme providing for a ten-year repurchase period are included in the new plan. The new plan also provides for central bank purchase of substandard loans up to an amount equivalent to an additional 100 percent of capital under the ten-year write-off scheme introduced in mid-1982.

new medium-term money from foreign banks is expected to decline from US$1.3 billion in 1983 to US$780 million in 1984. Short-term capital movements are projected to be approximately in balance in 1984, whereas they showed a substantial outflow in 1983. The projected total net borrowing is consistent with a reduction in the net use of foreign resources during 1983-84 in relation to previous years as called for under the stand-by program.

In July 1983 Chile obtained the rescheduling of 1983-84 principal payments due to foreign banks. Given the projected heavy amortizations due to banks after 1984, the authorities plan to request a rescheduling of at least a part of these principal payments in the course of 1984.

To monitor Chile's external debt and to help control the path of future debt service payments, the program includes a ceiling of US$3,850 million on the contracting and guaranteeing of external debt by the public sector, including the Central Bank and the Banco del Estado, of external debt with maturities of over one year but less than ten years. This amount includes US$2,300 million of rescheduling operations and US$1,550 million of new indebtedness. A subceiling amounting to US$125 million on debt maturities of over one year but less than five years is also included to help improve the external debt profile.

The above ceilings do not include external debt contracted and guaranteed by the private financial system because the authorities would like to avoid any suggestion that new external debt by commercial banks requires approval by the Central Bank and thus carries an implicit official guarantee. In any event, the private financial system is unlikely to attract new foreign credits in 1984 and at best it will maintain its existing level of medium-term foreign indebtedness. As to short-term debt, the policy is to maintain the existing level of such debt, which consists mainly of trade credits since the short-term working capital debt was refinanced into a medium-term loan in 1983. Given the difficult foreign market conditions, growth of short-term debt is expected to be limited to trade financing. The authorities are aware that the excessive foreign borrowing by private banks in past years has contributed to the present financial difficulties of Chile; accordingly, they are reviewing existing regulations on foreign borrowing by the financial system.

4. Policies affecting the exchange and trade system

The uncertainties generated by the banking crisis in January 1983 resulted in the development of a sizable spread between the official and the parallel market exchange rates. As was mentioned above, the spread has declined to the range of 6 percent to 10 percent and the authorities expect that the spread will decline further with the pursuit of the flexible exchange rate policy and the prudent demand management described earlier in this paper. The size of spread, meanwhile, gives rise to a multiple currency practice subject to approval under Article VIII, Section 3.

In March 1983, the authorities introduced a number of temporary measures affecting the exchange system to help ease the pressure on the official reserves.1/ The multiple currency practice arising from the 12 percent tax applied to purchases of foreign exchange for imports for which import licenses had been obtained before March 23, 1983, will have ceased to exist by March 23, 1984. The restrictions on the sale of foreign exchange for travel and for certain other invisible transactions that were intensified at that time, have been eased somewhat, but the exchange restrictions were retained beyond December 31, 1983, and hence require a waiver of the observance of the performance criterion on the on the elimination of such restrictions set out in paragraph 4(b) of the stand-by arrangement. The Central Bank has established maximum allowances for tourism and business travel. All bona fide requests for foreign exchange requiring central bank authorization, except those for tourism, are being approved without delay. In the course of 1984, as domestic confidence improves further, the authorities intend to relax the current exchange regulations including those affecting sales of exchange for tourism. At the same time, the authorities are of the view that the balance of payments has not strengthened sufficiently to reduce the existing 120-day deferment period applicable to import payments during the course of 1984. This measure gives rise to an exchange restriction subject to approval under Article VIII, Section 2.

Since late August 1982, the Central Bank has subsidized debt service payments with respect to debt outstanding as of August 6, 1982. The subsidy is the difference between the official exchange rate and a reference rate, and presently is about 20 percent. No exchange transactions take place at the reference exchange rate which is adjusted automatically in line with the rate of inflation. Rather, foreign exchange is purchased at the official rate and the subsidy is provided through an interest-bearing central bank note. The subsidy is paid on interest payments on debts (the principal of which has been rescheduled) of the private nonbank sector to foreign creditors. In those cases where principal payments have not been rescheduled, the subsidy is paid to the debtor when purchasing foreign exchange for the purpose of both interest and principal payments. This subsidy scheme involves a multiple currency practice. As the stand-by had called for the unification of the exchange system as stated in paragraph 4(b) of the arrangement, a waiver of the observance of this clause is necessary. The authorities have stated that it continues to be their intention to reduce the scope of the subsidy and, hence, of the multiple currency practice as the situation of debtors improves. In accordance with this intention, the authorities have recently excluded from the subsidy scheme debt payments by exporters and public entities, have reduced the real interest rate paid on the central bank note from 7 percent to 3 percent, and have lengthened the maturity from a range of three to five years to one of six to ten years.

1/ These measures were described in EBS/83/134, June 28, 1983, and necessary waivers were granted by the Executive Board on July 27, 1983.

The trade system of Chile remains free of quantitative import restrictions. The Chilean authorities were concerned by the imposition of restrictions to Chile's exports by certain trading partners and they feared in particular a possible increase of trade barriers to exports of copper; such action would seriously undermine Chile's export performance and would thus diminish its import capacity and ability to meet debt service payments. The authorities stated that they will refrain from raising trade barriers and will maintain a unified level of tariff protection of 20 percent. This unified tariff was raised to its present level in March 1983 as a temporary measure. The authorities believe that this level of protection is a moderate one in the absence of any quantitative import restrictions and, moreover, the current tariff gives rise to substantial fiscal revenue.

During the past year, the Central Bank has investigated, at the request of local industry, a number of alleged foreign subsidy practices. In a small number of cases such practices were confirmed and surcharges, up to a maximum of 15 percent, have been applied on these imports for periods not exceeding six months. At the present time, surcharges apply to less than 5 percent of total imports. The authorities intend to continue to protect Chilean producers against foreign subsidies according to strict technical standards and to review each case every six months.

IV. Performance Criteria

The financial program for the second year of the stand-by arrangement includes five quantitative performance criteria (Table 9), including: (1) a quarterly target for the net international reserves of the Central Bank; (2) quarterly limits on the stock of total nonfinancial public sector debt, whether of domestic or foreign origin; (3) a sublimit on net domestic credit to the nonfinancial public sector to ensure adequate financing for the private sector; (4) a set of ceilings on the public sector's contracting and guaranteeing of foreign indebtedness with a maturity of over one year and less than ten years, and a subceiling on such contracting with a maturity of over one year and less than five years (these ceilings include the contracting and guaranteeing of foreign debt by the Central Bank and the Banco del Estado, a state-owned commercial bank); (5) a ceiling on the net domestic assets of the Central Bank of Chile, to be tested continuously throughout the year. The net domestic assets of the Central Bank are defined as the difference between (1) the sum of its currency liabilities to the private sector and its medium- and long-term foreign liabilities and (2) its net international reserves.

In addition to these quantitative performance criteria, the program also contains performance criteria on a mid-term review with the Fund and on the introduction of restrictions on payments and transfers for current international transactions, multiple currency practices, bilateral payments agreements inconsistent with Article VIII, and import restrictions for balance of payments reasons.

Table 9. Chile: Quantitative Performance Criteria for Period Through December 31, 1984

	Stock on December 31 1983	Limits and Targets for 1984 Jan. 1- Mar. 31	Apr. 1- June 30	July 1- Sept. 30	Oct. 1- Dec. 31
	(In billions of Chilean pesos)				
Net domestic assets of the Central Bank 1/	123.22	140.0	160.0	180.0	217.0
Outstanding indebtedness of the nonfinancial public sector 2/	556.31	586.0 3/	628.0 3/	660.0 3/	700.0 3/
Of which: outstanding domestic indebtedness of the nonfinancial public sector (sublimit) 2/	120.79	137.0 3/	148.0 3/	160.0 3/	174.0 3/
	(In millions of U.S. dollars)				
Net international reserves of the Central Bank 2/	1,192.0	1,000.0	1,115.0	1,205.0	1,190.0
Contracting and guaranteeing of external debt by the public sector 4/	--	3,850.0	3,850.0	3,850.0	3,850.0
Of which: debt with maturity of more than one year and less than five years	--	125.0	125.0	125.0	125.0

Source: Memorandum on the Economic Policies of Chile.

1/ Defined as the difference between (i) the sum of the Central Bank's liabilities to the private sector, its medium- and long-term foreign liabilities, and (ii) the net international reserves of the Central Bank.

2/ The limits on the outstanding indebtedness of the nonfinancial public sector, the sublimits on the outstanding domestic indebtedness of the nonfinancial public sector, and the targets for the net international reserves of the Central Bank are tested at the end of each period.

3/ These limits shall be adjusted for revision in the base data for December 31, 1983 and shall be raised in accordance with the provisions of the contingency public spending program for the second semester of 1984. The increase in the limit for September 30, 1984 shall not exceed Ch$6 billion, and that for December 31, 1984 Ch$15.5 billion; the increase in the sublimit for September 30, 1984 shall not exceed Ch$6 billion and that for December 31, 1984 Ch$15.5 billion.

4/ Refers to external debt with maturity of more than 12 months and less than 120 months.

V. Staff Appraisal

The stand-by program for 1983 had anticipated that recovery from the recession of 1982 would be modest because of weak economic growth in the industrial world, protectionist tendencies in a number of foreign markets, and the sharp rise in the debt service burden of the private sector. In January 1983, the Chilean economy suffered a financial crisis that caused the program supported by the stand-by arrangement to move far off course. Adherence to strict fiscal and monetary discipline and the pursuit of flexible pricing policies enabled the authorities to bring the program back into full operation by September 1983. The measures adopted made it possible to bring credit expansion under control, to stop the loss of foreign reserves, and to reduce inflation.

The resumption of compliance with the program targets occurred while the economy was stagnating and unemployment continued at high levels. A moderate recovery was sustained in the fourth quarter of 1983 by increased public sector outlays, mostly related to labor-intensive construction programs.

The authorities believe that the slack in private demand will persist at least through the first half of 1984 and that, with a moderate recourse to foreign financing, a larger fiscal expansion than initially envisaged in the adjustment program would be consistent with the attainment of external and internal objectives. The authorities remain committed to the program's basic economic strategy of relying on market forces to guide resource allocation in the economy, and on cautious monetary and fiscal management to ensure that the effort to sustain the recovery does not impair balance of payments performance and does not thwart the deceleration of inflation. The authorities believe that this strategy will enable them to consolidate the progress made in 1983 in re-establishing financial stability and strengthening the banking system, and will make possible a gradual recovery in private sector activity.

The staff has cautioned the authorities that the fiscal easing programmed for 1984 entails a risk in the short term in that private sector demand could prove to be more vigorous than presently anticipated, so that the progress made toward financial stability could be impaired. There may also be a risk in the medium term to the extent that the fiscal easing involves an increase in indebtedness that could contribute to external debt management problems unless the planned increase in public investment is sufficiently productive. Hence, the staff urged the authorities to implement fiscal policy with great prudence, to monitor developments in the economy carefully, and to be prepared to shift fiscal policy toward restraint in the course of the year if conditions so warrant. However, if the recovery of private demand should be weaker than expected, but at the same time developments in domestic financial savings and the external trade balance prove to be stronger than currently projected, the program contemplates the possibility of some additional public spending in the second semester of 1984. Whether these conditions are appropriate for implementation of this contingency plan will be assessed during the midyear review with the Fund.

Fiscal policy for 1984 is supported by a restrained monetary policy to help ensure the achievement of the balance of payments objective and contribute to a decline in inflation to below 20 percent. The program envisages that the Central Bank will increase the role market forces play in the determination of interest rates on its operations as an intermediary between foreign banks and the rest of the domestic financial system. The staff agreed with the authorities' view that, as long as a sizable part of the financial system is under intervention, the Central Bank will have a part to play in guiding interest rates, and urged that such guidance results in positive real interest rates which are competitive with world market rates.

The staff welcomes the efforts of the authorities to strengthen the financial system through the introduction of deposit insurance, the recapitalization of domestic banks, and a reform of financial legislation. At the same time, the staff would underscore the need for policies to take account of the fact that a large part of the losses sustained by the financial system will constitute a claim on public sector resources in coming years.

A key feature of the economic program for 1984, and indeed of Chile's strategy over the medium term, is the maintenance of international competitiveness along with market-based interest rates and wages. The staff would emphasize that the adequacy of these basic prices must be kept under close scrutiny, and that developments in respect of a number of external variables, including foreign interest rates and world copper prices, may call for the adjustment of policies in order to maintain a viable external situation.

The heavy external indebtedness of Chile has had to be taken into account in shaping the program for 1984 and will continue to exert a major influence over policies in the medium term. The staff view is that the appropriate strategy for Chile is to foster domestic conditions that will lead to export-led growth and a reduction in the reliance on net foreign savings in relation to GDP. The balance of payments in 1984 involves a moderate increase in net external indebtedness in relation to 1983. Net borrowing in 1983, however, had been substantially below the programmed level and the 1984 level is close to that originally envisaged under the stand-by program. In view of the projected heavy principal payments in 1985 and subsequent years, the staff would encourage the authorities to continue seeking understandings with Chile's main foreign creditors toward an orderly settlement of future principal payments.

The staff notes that the changes that were made in Chile's exchange system in 1983 were designed to cope with a particularly difficult balance of payments situation. The spread between the official exchange rate and the parallel market rate gives rise to a multiple currency practice. The spread has declined markedly from its peak in March 1983, however, and should decline further as the economy recovers and confidence strengthens. Another multiple currency practice arises from the subsidy paid on certain interest payments and on some capital repayments on the foreign debt of the private sector. The authorities have recently implemented measures to reduce substantially the scope of these subsidies.

The deferment period on import payments and the limitation on foreign exchange sales for tourism constitute restrictions on the making of payments for current international transactions. The staff notes that foreign exchange is now being made available for all other bona fide invisible transactions without delay. The authorities continue to regard the remaining retrictions as temporary and intend to reduce the restrictiveness of the exchange system further during 1984. Progress made in this area will be assessed during the midyear review with the Fund. In view of their temporary character, the staff recommends approval of these multiple currency practices and exchange restrictions through December 31, 1984. The authorities have requested a waiver of the observance of the performance criteria relating to the unification of the exchange system and to the retention of restrictions on payments for travel and other invisible transactions referred to in paragraph 4(b) of the stand-by arrangement and the staff does not object to the granting of this request.

In summary, the program for 1984 presented by the Chilean authorities represents a continuation of the market-oriented strategy supported by the stand-by arrangement. The staff concurs with the authorities that, under the circumstances they envisage, the objectives of further progress toward external and internal equilibrium and the strengthening of the financial system can be attained with the policies described above. However, as noted above, the staff also would caution that the authorities' strategy entails risks and that successful implementation of the program will require that developments in the economy be monitored closely. In this context, the authorities should give particular attention to the provisions for consultation with the Fund under the stand-by arrangement to ensure a prompt exchange of views with a view to reaching timely understandings of any additional measures that may be needed to ensure that the objectives of the program are achieved.

VI. Proposed Decisions

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

1983 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 ___, 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 __, 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 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 ___, 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.

Chile - Fund Relations
(As of February 1984)

I. Membership Status

(a) Date of memberhip: December 31, 1945
(b) Status: Article VIII

(A) Financial Relations

II. General Department

(a) Quota: SDR 440.5 million.
(b) Total Fund holding of Chilean pesos: 1,019.5 millions of SDRs and 231.4 percent of quota as of January 31, 1984.

Of which:	Millions of SDRs	Percent of Quota
Under CFF	295.0	67.0
SBA: general resources	155.0	35.2
EAR	129.0	29.3

(c) Fund credit to Chile amounts to SDR 579.0 million or 131.5 percent of quota.

III. Current Stand-by or Extended Arrangement and Special Facilities

(a) Current stand-by:
(i) Duration: From January 10, 1983 to January 9, 1985
(ii) Amount: SDRs 500 million
(iii) Utilization: SDRs 284 million
(iv) Undrawn balance: SDRs 216 million

(b) Previous stand-by arrangements since 1974.

Date of Approval	Duration	Amount	Amount Actually Drawn
January 1974	1 year	SDR 70 million	SDR 70 million
March 1975	1 year	SDR 79 million	SDR 20 million

(c) Compensatory financing facility:

Date of approval	Amount
January 10, 1983	SDR 295 million

IV. SDR Department

SDR position:	As of January 31, 1984	Millions of SDRs	Percent of Net Cumulative Allocation
	Net cumulative allocation	121.9	100.0
	Holdings	(10.1)	(8.3)

V. Gold Distribution and Distribution of Profits from Sales of Gold

Gold distribution: Chile has received four distributions totaling 135,220.043 troy ounces of fine gold

Distribution of profits from gold sales: Chile received a total of US$25.1 million.

B. Nonfinancial Relations

VI. Exchange Rate Arrangement: The Chilean peso is pegged to the U.S. dollar. The official rate was set at Ch$87.15 per U.S. dollar on December 16, 1983 and is adjusted daily on the basis of the Chilean rate of inflation during the previous month less the world rate of inflation, assumed for this purpose to be no more than 0.5 percent per month. The official rate on January 31, 1984 was Ch$87.98 per U.S. dollar.

Chile maintains a multiple currency practice arising from a subsidy of approximately 20 percent on certain foreign debt service payments 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 constitutes 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.

VII. Last Consultation: The 1982 Article IV consultation discussion was completed, and request for Stand-by Arrangement and request for Compensatory Financing Facility were approved by the Executive Board on January 10, 1983 (EBS/82/227 and EBS/82/228). A waiver and modification of performance criteria under the stand-by arrangement were approved by the Executive Board on July 27, 1983 (EBS/83/134). The consultation is under the standard 12-month cycle.

VII. Technical Assistance: The Central Banking Department provided a consultant on bank supervision, concerning the system for classification of doubtful and problem loans. The consultant visited Santiago from July 1 to August 23, 1982. It is expected that another Central Banking division consultant will go to Chile for a period of two to four weeks beginning March 1984 to review a feasibility study and legislation on a national deposit insurance scheme.

The Bureau of Statistics provided a technical assistance mission to Chile on January 16-28, 1983. The mission assisted the Central Bank in converting its monetary data system to the new Fund data system. During the first week of August 1983, a representative of the Bureau of Statistics presented a seminar on improving the methodology for producing government finance statistics.

VIII. Resident Representative: Mr. Carlos Muniz was assigned to Chile for a one-year appointment beginning November 1982. In November 1983 his assignment was extended for six months.

Chile--Basic Data

Area and population	
Area	756,626 sq. kilometers
Population (1983 Prel.)	11.6 million
Annual rate of population increase (1978-83)	1.7 percent
Unemployment rate (Oct.-Dec. 1983--Greater Santiago)	16.5 percent
GDP (1983)	SDR 18,467 million US$19,748 million Ch$1,550,200 million
GDP per capita (1982)	SDR 1,901

Origin of GDP	1980	1981	1982	Prel. 1983
		(percent)		
Agriculture, forestry, and fishing	8	8	9	9
Mining and quarrying	7	7	9	9
Manufacturing	22	21	19	20
Construction	5	6	5	5
Commerce	18	18	18	17
Other	40	40	40	40
Ratios to GDP				
Exports of goods and services	22.8	17.1	21.8	26.5
Imports of goods and services	27.0	27.1	23.5	23.8
Current account of the balance of payments	-7.1	-14.3	-9.6	-5.4
General government revenues	32.8	31.8	31.9	29.9
General government expenditures	27.3	28.9	34.2	32.9
Public sector savings	10.6	5.5	-0.8	--
Public sector overall surplus or deficit (-)	5.5	0.8	-3.4	-3.0
External public debt (end of year)	17.1	13.4	21.4	38.2
Gross national savings	13.8	6.4	0.3	5.0
Gross domestic investment	21.0	20.7	9.9	10.3
Money and quasi-money (end of year)	30.0	33.8	38.6	34.8
Annual changes in selected economic indicators				
Real GDP per capita	6.0	3.9	-15.3	-2.5
Real GDP	7.8	5.7	-14.3	-0.8
GDP at current prices	39.3	19.9	-4.7	26.2
Domestic expenditures (at current prices)	41.1	26.7	-11.9	20.8
Investment	(64.2)	(18.4)	(-54.4)	(31.7)
Consumption	(36.2)	(28.7)	(-2.1)	(19.6)
GDP deflator	29.2	13.4	11.3	27.3
Consumer prices (annual averages)	35.1	19.7	9.9	27.3
General government revenues	37.1	16.2	-4.2	18.0
General government expenditures	35.1	26.9	13.2	21.1
Money and quasi-money	68.9	35.6	9.1	13.6
Money	(56.4)	(-4.6)	(6.3)	(27.7)
Quasi-money	(73.5)	(48.8)	(9.5)	(10.7)
Net domestic bank assets 1/	79.5	63.4	66.5	54.9
Credit to nonfinancial public sector (net)	(-27.6)	(-11.9)	(13.0)	(9.7)
Credit to private sector	(110.7)	(83.0)	(63.2)	(41.9)
Merchandise exports (f.o.b., in U.S. dollars)	22.7	-18.4	-3.4	3.9
Merchandise imports (f.o.b., in U.S. dollars)	30.5	19.1	-44.1	-22.1

General government finances	1980	1981	1982	Prel. 1983
	(billions of Chilean pesos)			
Revenues	352.3	409.3	392.0	462.7
Expenditures	293.2	372.2	421.3	510.1
Current account surplus or deficit (-)	90.4	70.2	-24.3	-44.2
Overall surplus or deficit (-)	59.0	37.1	-28.4	-47.4
External financing (net)	-8.1	-6.7	-4.2	-1.8
Internal financing (net)	-50.9	-30.4	32.6	49.2
Balance of payments	(millions of U.S. dollars)			
Merchandise exports (f.o.b.)	4,705	3,836	3,706	3,851
Merchandise imports (f.o.b.)	-5,469	-6,513	-3,643	-2,837
Investment income (net)	-930	-1,463	-1,921	-1,703
Other services and transfers (net)	-277	-593	-446	-379
Balance on current and transfers accounts	-1,971	-4,733	-2,304	-1,068
Official capital (net)2/	43	542	823	1,283
Private capital (net)	3,142	4,157	192	-873
Errors and omissions	30	105	-76	18
Allocation of SDRs	30	28	--	--
Valuation adjustment	-30	-92	-28	40
Change in net official reserves (increase -)	-1,244	-7	1,393	600

International reserve position 3/	Dec. 31 1980	Dec. 31 1981	Dec. 31 1982	Oct. 31 1983
	(millions of U.S. dollars)			
Central Bank (gross)	3,220.1	3,189.5	1,993.9	1,987.1
Central Bank (net)	3,182.2	3,189.5	1,794.0	1,231.0 4/
Rest of banking system (net)	-900.2	-1,151.9	-1,220.3	-813.9

1/ Changes in net domestic assets as percent of liabilities to the private sector at the beginning of the period.
2/ Includes Banco del Estado.
3/ Gold valued at US$42.22 per ounce.
4/ Excludes position of banks liquidated in January 1983.

Summary of the Financial Program for the Second Period of the Stand-By Arrangement

I. Major Assumptions

1. Real GDP is estimated to grow by 4 percent in 1984, on the basis of strong growth in agriculture and fishing, a recovery of manufacturing, and some growth in construction and commerce.

2. The value of exports is projected to rise by 6.5 percent. The value of copper exports is expected to remain virtually unchanged on the basis of no change in either average copper price or shipments. Non-copper exports led by increased value of agricultural and fishing products are projected to increase by 11.8 percent.

3. The real stock of money and quasi-money is projected to increase by 4 percent in 1984, in line with the growth rate of real GDP. Developments in January and February 1984 give strong support to the assumption of real growth in money and quasi-money.

4. The net domestic assets of the financial system are projected to increase in 1984 by about 48 percent, somewhat less than the 56 percent rate for 1983.1/ Net domestic credit to the nonfinancial public sector, which is estimated to have increased by about 23 percent in 1983, is projected to increase by 9 percent in 1984. Credit to the private sector, which is estimated to have increased by about 19 percent in 1983, is projected to increase by 34 percent in 1984. Measured in relation to its own initial stock, real bank credit to the private sector declined by about 9.6 percent in 1983, and is projected to increase by almost 2 percent in 1984.

II. Targets

1. During 1984, inflation, as measured by the change in consumer prices is projected to increase by no more than 20 percent, compared with 23 percent in 1983.

2. For 1984, the net official international reserves are projected to remain unchanged, compared with a loss of US$600 million in 1983. A reserve loss of about US$200 million during the first quarter of 1984 is expected to be reversed in the second quarter as new foreign bank loans are disbursed.

3. The current account deficit of the balance of payments, which amounted to the equivalent of 9.6 percent of GDP in 1982, is estimated to have declined to 5.4 percent of GDP in 1983 and is projected at 6 percent of GDP in 1984.

1/ All of the changes are expressed in relation to the outstanding stocks of liabilities to the private sector.

III. Principal Elements of the Program for 1984

1. Fiscal policy

a. The overall deficit of the nonfinancial public sector for 1984 has been set at 4.5 percent of GDP. The deficit may be raised by 0.8 percent of GDP during the second semester of 1984 on the basis of a review of relevant economic variables indicating excess private savings. The increase in the public sector deficit is attributable to an increase in public investment equivalent to 1.9 percent of GDP related mainly to the timing of the last stage of a major hydroelectric plant. In addition, net capital revenue (financial disinvestment) is projected to decline by 0.4 percent of GDP, and the savings performance of the nonfinancial public sector is projected to rise by 0.8 percent of GDP principally on account of a restraint on current expenditures of the General Government. In summary, the increase in the public sector deficit reflects the following:

	Effect as Percent of GDP
Current account surplus of the public sector	0.8 1/
Net capital revenue	-0.4
Capital formation	-1.9
	-1.5

b. The financial program includes as performance criteria limits on the outstanding indebtedness of the nonfinancial public sector, with sublimits on the outstanding domestic indebtedness of the nonfinancial public sector. These limits and sublimits are to be tested quarterly beginning March 31, 1984. The limits and sublimits for the second semester of 1984 are adjustable in accordance with the provisions of the contingency spending plan.

2. Monetary policy

a. After expanding by almost 150 percent 2/ in the first quarter of 1983, the net domestic assets of the Central Bank expanded by a further 153 percent during the remainder of the year. For 1984, the net domestic asset expansion of the Central Bank is to be limited to 160 percent financed by the projected base money growth related to a

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1/ The surplus is calculated after imputing to interest payments the nominal increase in the existing stock of public debt indexed to inflation.

2/ In relation to liabilities to the private sector at the beginning of the period.

25 percent increase in money and quasi-money, and US$780 milion in medium-term borrowing from foreign banks. As performance criteria the financial program includes quarterly limits on the net domestic assets of the Central Bank. These limits, which are subject to continuous testing, cover the period January 1-December 31, 1984. The financial program also includes as performance criteria quarterly targets for the net international reserves of the Central Bank. These targets will be tested quarterly, beginning March 31, 1984.

b. The present central bank policy of indicating to domestic financial institutions the maximum nominal interest rate to be paid on 30-day deposits will be continued, but a larger weight will be given to the level of comparable foreign interest rates when setting the domestic indicated rate. Moreover, as an additional guide to interest rates, the Central Bank will reduce substantially its losses related to interest differentials arising from its domestic and foreign operations and eliminate interest paid on swaps and premiums on dollar deposits.

c. Strengthening the financial system will be continued by recapitalizing the affected units of the financial system, modifying the legislation covering financial institution, and introducing a permanent deposit insurance scheme.

3. Wage policy

a. Wage settlements in the private sector will continue to be determined either through collective bargaining or individual agreements, without any required indexation mechanism.

b. During 1984, nominal wage increases for public sector employees are to be held below the projected rate of inflation.

4. External sector policies

a. The authorities intend to maintain the competitiveness of the Chilean economy through the pursuit of a flexible exchange rate policy. Since December 16, 1983 the exchange rate has been adjusted daily, with the rate of depreciation based on the difference between domestic inflation in the previous month and the external rate of inflation, estimated, for these purposes, at no more than 0.5 percent per month.

b. Import duties are projected to remain at the present uniform 20 percent level.

c. As performance criteria, the financial program includes ceilings on the contracting and guaranteeing by the public sector of external loans with maturities above 12 months and below 120 months. In addition, there is a subceiling on contracting above 12 months and below 60 months. These ceilings are to be tested continuously.

d. The program also contains the standard performance clause on the introduction of restrictions on payments and transfer for current international transactions, multiple currency practices, bilateral payments agreements inconsistent with Article VIII, and import restrictions for balance of payments reasons.

Table 10. Chile: Selected Economic and Financial Indicators, 1981-84

	1981	1982	Est. 1983	Proj. 1984
(Annual percent changes, unless otherwise specified)				
National income and prices				
GDP at constant prices	5.7	-14.3	-0.8	4.0
GDP deflator	13.4	11.2	27.3	20.4
Consumer prices (average)	19.7	9.9	27.3	21.5
Consumer prices (Dec.-Dec.)	9.5	20.7	23.1	20.0
External sector (on the basis of U.S. dollars)				
Exports, f.o.b.	-18.5	-3.5	3.9	6.5
Imports, c.i.f.	19.1	-44.1	-22.2	9.4
Non-oil imports, c.i.f.	22.8	-45.6	-25.1	8.7
Export volume	-7.0	17.2	2.8	6.0
Import volume	18.0	-41.9	-20.6	7.0
Terms of trade (deterioration -)	-13.2	-14.6	3.4	-1.7
Nominal effective exchange rate (depreciation -) 1/	29.9	-25.5	18.1	-15.0
Real effective exchange rate (depreciation -) 1/2/	13.5	-28.9	6.6	--
General government operations				
Revenue	16.2	-4.2	18.0	18.9
Total expenditure (excluding amortization)	26.9	13.2	21.1	20.8
Money and credit				
Net domestic assets 3/	55.7	82.6	56.1	48.0
Public sector	-10.2	9.6	23.1	8.7
Private sector	53.0	80.5	19.3	33.8
Money and quasi money (M2)	32.2	23.8	28.1	24.8
Interest rate (effective annual rate, short-term deposit rate)	40.8	47.8	27.9	...
(In percent of GDP)				
Public sector savings	5.5	-0.3	--	0.8
Overall public sector surplus or deficit (-)	0.8	-3.4	-3.0	-4.5
Net domestic financing	-3.5	2.3	4.0	2.3
Net foreign financing	2.7	1.1	-1.0 4/	2.2
Gross domestic investment	20.7	9.9	10.3	12.5
Gross national savings	6.4	0.3	5.0	6.5
Current account deficit	14.3	9.6	5.4	6.0
Medium- and long-term public and private external debt (end of year)	38.0	57.3	76.6	77.6
Debt service ratio (in percent of exports of goods and nonfactor services)	58.0	72.0	51.6	53.9
Interest payments (in percent of exports of goods and services)	35.9	46.3	37.2	40.2
(In millions of U.S. dollars, unless otherwise specified)				
Overall balance of payments	98.0	-1,365.0	-640.0	--
Gross official reserves (months of imports) (end of year)	5.9	6.6	6.4 5/	5.9 5/
Gross official reserves (months of current payments)	3.6	3.1	3.0	2.8
External payments arrears (defaults) (end of year)	--	--	--	--

Sources: Central Reserve Bank of Chile; and Fund staff estimates.

1/ At the end of the year.
2/ On the basis of consumer prices.
3/ In percent of liabilities to the private sector at the beginning of the period. Based on end-of-period actual exchange rates.
4/ Excludes external loans obtained by the nonfinancial public sector to provide balance of payments support.
5/ Excludes projected net use of IMF credits.

Table 11. Chile: Macroeconomic Flows

(As percent of GDP)

	1981	1982	1983 Prog. 1/	1983 Est.	Prog. 1984
I. Balance of Payments					
Current account surplus or deficit (-)	-14.3	-9.6	-8.1	-5.4	-6.0
Trade balance	-8.1	0.3	5.1	5.1	4.8
Exports	(11.6)	(15.5)	(22.5)	(19.5)	(19.6)
Imports	(-19.7)	(-15.1)	(-17.5)	(-14.4)	(-14.9)
Net factor payments	-4.4	-8.0	-11.3	-8.6	-8.8
Other services and transfers	-1.8	-1.9	-1.9	-1.9	-1.9
Capital account	14.2	4.2	5.6	2.6	6.0
Private capital	12.7	2.7	3.6	-2.9	0.2
Financial public sector	-1.2	0.4	--	6.5 2/	3.6 2/
Nonfinancial public sector	2.7	1.1	2.0	-1.0	2.2
Net official international reserves (increase -)	--	5.8	2.5	2.8	--
II. Public Sector					
Savings 3/	5.5	-0.3	2.7	--	0.8
Net capital revenue	0.4	2.1	1.1	1.9	1.5
Capital expenditure	5.1	4.7	5.8	4.9	6.8
Overall surplus or deficit (-)	0.8	-3.4	-2.0	-3.0	-4.5
Net foreign financing	2.7	1.1	2.0	-1.0	2.2
Net domestic financing	-3.5	2.3	--	4.0	2.3
III. Saving and Investment					
Gross domestic investment	20.7	9.9	17.4	10.3	12.5
Public sector	5.1	4.7	5.8	4.9	6.8
Private sector	15.6	5.2	11.6	5.4	5.7
Investment = savings	20.7	9.9	17.4	10.3	12.5
External savings	14.3	9.6	8.1	5.4	6.0
Gross national savings	6.4	0.3	9.3	5.0	6.5
Public sector	(5.5)	(-0.3)	(2.7)	(--)	(0.8)
Private sector	(0.9)	(0.6)	(6.6)	(5.0)	(5.7)
Memoranda items					
Annual growth rate of real GDP	5.7	-14.3	...	-0.8	4.0
GDP (in billions of Chilean pesos)	1,289.0	1,229.0	1,550.0	1,550.0	1,941.0
GDP (in billions of U.S. dollars)	33.0	24.1	19.7	19.7	20.9
Exchange rate (pesos per U.S. dollar)	39.0	50.9	...	78.5	93.0

Sources: Central Bank of Chile; and Fund staff estimates.

1/ Based on actual estimated GDP for 1983 of Ch$1,550 billion, or US$19.7 billion. The program had projected 1983 GDP at Ch$1,740 billion or US$22.2 billion.

2/ Foreign medium-term bank disbursements are channeled to the financial public sector.

3/ Includes as a current expenditure the full inflation correction of outstanding domestic indexed public debt.

Table 12. Chile: Balance of Payments Medium-Term Projections, 1984-89

	1984	1985	1986	1987	1988	1989
	(In millions of U.S. dollars)					
Trade balance	1.0	1.3	1.6	1.8	1.9	2.0
Exports	(4.1)	(4.6)	(5.1)	(5.5)	(6.0)	(6.6)
Imports	(-3.1)	(-3.3)	(-3.5)	(-3.7)	(-4.1)	(-4.6)
Nonfactor services	-0.5	-0.6	-0.6	-0.7	-0.7	-0.8
Factor services	-1.8	-2.0	-2.2	-2.2	-2.3	-2.3
Transfers	0.1	0.1	0.1	0.1	0.1	0.1
Balance on current account	-1.3	-1.2	-1.0	-1.0	-1.0	-1.0
Direct investment	0.2	0.2	0.2	0.3	0.3	0.3
Amortization	-1.7	-2.3	-2.7	-2.6	-3.5	-3.2
Of which: to commercial banks	(-1.0)	(-1.6)	(-2.0)	(-2.0)	(-2.7)	(-2.2)
Medium-term capital inflows	2.7	3.2	3.5	3.3	4.2	3.9
Short-term capital inflows	0.1	--	--	--	--	--
Overall balance	--	--	--	--	--	--
	(As percent of GDP)					
Memoranda items						
Current account	6.0	5.0	4.0	3.8	3.5	3.3
Interest payments on the external debt	9.6	9.5	9.3	9.0	8.5	7.8
Total external debt outstanding at year end	88.5	84.3	81.1	77.7	74.2	70.8

Sources: Central Bank of Chile; and Fund staff estimates.

Santiago, Chile
February 9, 1984

Mr. Jacques de Larosiere
Managing Director
International Monetary Fund
700 - 19th Street, N.W.
Washington, D.C. 20431

Dear Mr. de Larosiere:

1. In December 1982 the Chilean authorities addressed to you a letter requesting your support in obtaining a two-year stand-by arrangement from the Fund in the amount of SDR 500 million. The economic policies which Chile intended to pursue in this period were described in the economic policy memorandum attached to that letter.

2. A weakening of the financial system beginning in 1981 led to a financial crisis early in 1983, causing serious difficulties in implementing our plans, and resulting in substantial deviations from the stand-by program. As we remained committed to the program objectives, in March 1983 we formulated and began to implement an emergency plan to stabilize the financial system, stem the loss of international reserves, and return to the program path. In July 1983, we communicated to you that the emergency plan was taking hold and that we were confident that Chile would return to the path of the stand-by program by September 30, 1983, under the assumption of timely disbursements of resources by Chile's foreign creditor banks.

3. We are now in a position to report to you that our short-term stabilization efforts have been successful. The loss of international reserves has been stemmed, inflation has been reduced, and economic recovery is under way.

4. Our policies for the second year of the stand-by arrangement are directed toward defending the stabilization already achieved, strengthening further the financial system and nurturing the moderate economic recovery currently under way. These policies are described in the attached Memorandum on Economic Policies.

5. In support of these objectives and policies, the Government of Chile requests that the remaining resources under the existing stand-by arrangement, equivalent to SDR 216 million, be made available to Chile in the course of 1984. In addition, the Government of Chile requests a waiver of the observance of the performance criteria relating to the unification of the exchange system and to the elimination of the restriction on payments for travel and other invisible transactions referred to in paragraph 4(b) of the stand-by arrangement.

6. During the remaining period of the stand-by arrangement, the authorities of Chile and the Fund will consult periodically in accordance with the policies on such consultations about the progress being made in the implementation of the program described in the attached memorandum and about the policy adaptations judged to be appropriate for the achievement of its objectives. As on previous occasions, the Government and the Fund will consult midway through 1984 on the policies affecting demand management and relative prices.

Sincerely yours,

Hernan Felipe Errazuriz
President
Central Bank of Chile

Carlos Caceres
Minister of Finance

Memorandum on the Economic Policies of Chile

1. During 1982, the Chilean economy experienced a large contraction, with real GDP falling by 14 percent and unemployment rising to as high as 25 percent. The sharp drop in economic activity reflected recession in industrial countries, declining prices for Chile's main export commodities, especially copper, a reduction in net capital inflows, high interest rates abroad, and a weakening of Chile's competitiveness. These conditions triggered a high rate of business failure that in turn seriously weakened the domestic financial system.

2. To redress the country's economic difficulties, the authorities in June 1982 re-established Chile's competitiveness through a sizable depreciation of the peso and the abandonment of wage indexation, and in late 1982 adopted a medium-term financial program. The objectives of this program were to restore economic growth and confidence in a framework of a satisfactory balance of payments performance and declining inflation. The program rests on a consistent set of basic price and demand management policies, in addition to measures in support of the financial and private sectors. It also builds upon Chile's basic economic strategy which is to rely on market forces and the private sector to promote economic development over the medium term. In support of this program, on January 10, 1983 the International Monetary Fund approved a two-year stand-by arrangement in the amount of SDR 500 million.

3. The financial program faced serious difficulties at the start. The weakening of the financial system led the Government on January 13, 1983 to intervene and liquidate a number of privately owned financial institutions. This action was necessary to begin restoring the soundness of the domestic financial system. As foreign banks reacted by stopping lending to Chile, net international reserves declined sharply, and confidence in the financial system was shaken. In these circumstances, the Central bank extended substantial amounts of emergency credits to banking institutions in difficulty.

4. In March 1983 the authorities formulated and began to implement an emergency plan to stabilize the financial system, stop the loss of international reserves and return to the path of the program. Under the emergency plan, the Government applied a disciplined credit and fiscal policy. In addition, it began negotiations with foreign banks to refinance principal payments falling due in 1983 and 1984 and obtain the financing initially contemplated in the 1983 program.

5. The Government carried out the emergency program and in July 1983 obtained a modification of the stand-by from the International Monetary Fund, and also successfully completed negotiations with the international financial community. Since March 1983, Chile has made progress toward financial stabilization and economic growth. Credit expansion and reserve loss have been controlled, inflation has been reduced and the

exchange rate policy has been credible. As a result, the end of year quantitative performance criteria with respect to Central Bank credit and net international reserves were met. The annual rate of inflation declined from 45 percent in the second half of 1982 to 23 percent in the second half of 1983. The trade surplus rose from the equivalent of less than 1 percent of GDP in 1982 to 5 percent of GDP in 1983 and the current account deficit of the balance of payments declined from 10 percent of GDP in 1982 to 5 1/2 percent of GDP in 1983. In addition, economic activity, which had remained stagnant during most of the first half of 1983, registered a moderate recovery later in the year. This recovery, together with the impact of special public employment programs have led to increased employment and to a decline in the rate of unemployment from about 20 percent of the labor force in 1982 to 14.6 percent in the last quarter of 1983.

6. During 1984, the second year of the stand-by program, the Government intends to foster economic activity while consolidating the progress made in 1983 in re-establishing financial stability and strengthening the financial system. To achieve these objectives the authorities will pursue policies with respect to basic prices, demand management and external indebtedness, as described in the following paragraphs.

7. The adequacy of the exchange rate is crucial not only for the success of the program but also for the medium-term growth of the economy which must be export-oriented for Chile to meet its external debt commitments over time. Since late 1982 the Central Bank has followed a flexible exchange rate policy to maintain the real value of the peso. Since December 1983 the exchange rate is adjusted daily, with the rate of depreciation based on the difference between domestic inflation in the previous month and the external rate of inflation estimated, for these purposes, at no more than 0.5 percent per month. This policy will be maintained during the second year of the program, as the Government considers that Chile's present exchange rate policy is adequate to sustain economic growth in the context of balance of payments stability, taking into account Chile's future debt service payments and the continued availability of foreign financing. Nevertheless, the Government will closely observe developments abroad during the course of the year and take appropriate action to safeguard Chile's competitive position. The uncertainties generated by the banking crisis early in 1983 resulted in a sizable spread between the official and parallel market exchange rates. Since then, with the return to more normal market conditions and the pursuit of a flexible exchange rate policy as described above, the spread has narrowed as expected and fluctuates between 6 and 10 percent. The Government expects this spread to decline further in the course of 1984, as confidence strengthens further.

8. The Government's wage policy is designed to strengthen external competitiveness, dampen inflationary pressures and raise the level of employment. After the June 1982 depreciation of the peso, the Government abolished wage indexation and lowered the wage floor for private sector collective bargaining. Since then, public sector remunerations have

declined in real terms. The Government intends to continue its prudent policy with respect to wages in the general government and public enterprises. Wage settlements in the private sector will continue to be determined either through collective bargaining or individual agreements.

9. The Government has adopted demand management policies that are consistent with an economic growth of 4 percent in 1984, in a framework of financial stability characterized by overall balance of payments equilibrium and a further reduction of inflation to less than 20 percent. The pursuit of fiscal discipline has been and continues to be a key element in Chile's economic strategy. During 1982 and 1983 public finances were adversely affected by the reform of social security system, economic recession, a depressed price of copper, and public employment programs to help cushion the high level of unemployment. Even in these circumstances, however, the overall public sector deficit was kept to 3.5 percent of GDP in 1982 and 3.0 percent of GDP in 1983.

10. In the second half of 1983, a review of economic and financial trends indicated that the emergency plan adopted in March 1983 was achieving its intended objective of stabilizing the financial system, and that a moderate easing of the fiscal stance was compatible with continued progress toward financial stability. The Government plans to maintain a moderately expansionary fiscal stance mainly supporting increased capital expenditure during the first semester of 1984, as private sector demand and expectations are not yet sufficiently firm to support the economic recovery because of the combined effects of the devaluation and the financial crisis on domestic confidence. However, this strategy runs the risk of crowding out the private sector in the domestic capital markets if private demand were to pick up strongly. Hence the Government will implement fiscal policy with great prudence, and in the first semester of 1984, prior to the midyear review with the Fund, it will strive to keep the public sector financing requirement under the established limits.

11. The public sector program for 1984 entails an overall deficit of 4.6 percent of GDP. The program includes an increase in public invest- from 4.9 percent of GDP in 1983 to 6.8 percent in 1984, reflecting principally an expansion of capital spending in the electricity and mining sectors. General government expenditures are projected to decline by about 1 percent of GDP, compared with 1983, mainly as a result of restraint on current expenditure, since outlays on housing and road construction are projected to increase. The policy of the Government continues to be to control the size of the nonfinancial public sector. In this regard the authorities consider that the above described level of expenditures are adequate to pursue their plans for 1984. General government revenues in 1984, which incorporate higher taxes on luxury goods, petroleum derivatives and real estate, are projected to increase in real terms. Nevertheless, the level of receipts is projected to decline somewhat in relation to GDP compared with 1983 as a result of the implementation of the first stage of a tax reform aimed at stimulating private saving and investment. The operating surplus of the public

enterprises is projected to decline by about 1 1/4 percent of GDP principally because of depressed copper prices as operating costs continue to be under control. Rates on public services will be maintained in real terms and will be increased further as required to cover operating costs or to help finance investment outlays.

12. In addition to the fiscal policy for 1984 described above, the program contemplates a contingency investment expenditure plan equivalent to up to 0.8 percent of GDP for the second semester of 1984. The implementation of this plan is contingent upon the availability of domestic unutilized sources of finance and will be determined in the course of a midyear review on the basis of a number of relevant factors, including the behavior of monetary variables, the trade balance, inflation and interest rates. The program establishes ceilings on the stock of debt of the nonfinancial public sector to all lenders, as well as subceilings on the stock of domestic indebtedness. These ceilings are shown in the annexed Table 1.

13. The Government's fiscal policy is supported by a prudent monetary policy. During 1983, as a result of the crisis of the financial system and adverse developments in world financial markets, monetary management became increasingly complex. The Central Bank obtained medium-term loans from foreign banks, extended emergency support to the financial system, and implemented a set of short- and medium-term credit programs to reduce the debt burden of the private sector, improve the liquidity of banking institutions and support economic activity. In addition, to encourage financial institutions to maintain their level of net external indebtedness, the Central Bank authorized swap operations and accepted foreign currency deposits from the rest of the financial system. The above developments have reduced the flexibility of monetary management and have exposed the Central Bank to potential exchange risks. Accordingly, during 1984 the Central Bank intends to reduce its discretionary role in the financial system by phasing out special short-term credit facilities not related to past emergency support of the financial system, and by relying increasingly on traditional open-market techniques to rechannel resources to the rest of the financial system. These policies have been incorporated in a monetary program and ceilings have been established on the net domestic assets of the Central Bank as indicated in Table 2. At the same time, as a guide to credit policy, targets have been established for the net international reserves of the Central Bank as shown in Table 3.

14. Since late 1982, the Central Bank has been indicating to domestic financial institutions the maximum nominal interest rate to be paid on 30-day deposits. Financial institutions are free to set interest rates on all other deposits and credit operations. The indicated rate is determined on the basis of expected domestic inflation plus a premium. This policy, which is intended to provide for positive real interest rates, has been useful in guiding interest rates during a period of difficult financial conditions, and also has contributed to a shift toward longer-term deposits. The Government's objective is to expand the role of market forces in the determination of interest rates. Until the domestic financial system has strengthened further, however, the authorities intend to continue with the present interest rate policy

but will give a much greater weight to the level of comparable foreign interest rates when setting the domestic indicated rate. During the course of 1984 the Central Bank intends to reduce substantially its losses related to interest differentials arising from its domestic and foreign operations. In particular, the Central Bank will set interest rates on its remaining short-term domestic credit operations on the basis of the real cost of its external resources and will gradually eliminate in the course of the next twelve months the practice of paying interest on swap operations and the premium on foreign currency deposits. Progress in the areas of monetary management will be reviewed at midyear with the Fund.

15. The re-establishment of a sound financial system is crucial for the recovery of the economy and the full restoration of confidence. The economic recession, the high level of private debt, and the depreciation of the peso, led to serious business difficulties which in turn caused major strains to the financial system. These problems were compounded in certain instances by unsound banking practices. In anticipation of some of these developments, the Government introduced in late 1981 a number of prudential controls including a system of loan classification, provisions for special reserves on bad loans, and limits on the amount of lending to a single enterprise. Notwithstanding these efforts, the deterioration of the financial system led to an intervention by the Superintendency of Banks of a major part of the financial system in January 1983. Since that time, stabilization of the financial system has been promoted by the establishment of emergency protection to depositors and by the implementation by the Central Bank of a set of domestic debt rescheduling arrangements that has assisted private debtors and improved the loan portfolio of financial institutions.

16. The improvement of the financial system is expected to continue during 1984 as the economy recovers and the authorities put in place a number of institutional reforms. The latter include the recapitalization of the affected units of the financial system, modification of the legislation covering financial institutions, and the introduction of a permanent deposit insurance scheme. In accordance with Chile's basic economic principles, the recapitalization of the affected financial institutions will be carried out in a noninflationary manner and will safeguard the principle of private sector ownership of the financial system. In this framework, and starting with the nonintervened institutions, the Central Bank has offered to buy the substandard loan portfolio up to an amount equivalent to 150 percent of their capital and reserves. With the proceeds of the sale, the banks will prepay emergency loans owed to the Central Bank and invest the balance, if any, in medium-term Central Bank notes. The banks will repurchase their loan portfolio from the Central Bank during the next ten years. As long as the full repurchase has not been completed, a bank can distribute dividends only on new capital contributions. Similar policies will be applied to the intervened financial institutions on a case by case basis. The authorities are confident that these measures will improve the solvency and liquidity of the affected financial institutions and thus will contribute to the restoration of a sound financial system.

17. The size of Chile's external debt and the resulting debt service burden indicate that to finance economic development Chile must increase its domestic saving and reduce its reliance on external financial resources. Accordingly, the Government's program for 1984 contains measures raising domestic savings further, while increasing the stock of net external debt moderately. The projected borrowing is consistent with a reduction in the net use of foreign resources during 1983-84 in relation to previous years as originally called for under the program. The Government has approached its principal foreign creditors and is confident that the required financing for 1984 can be obtained as planned. The bulk of principal payments falling due in 1983 and 1984 has been rescheduled. In view of the heavy schedule of principal payments due in 1985 and subsequent years, the Government intends to seek rescheduling of at least part of these payments in the course of 1984. To monitor the size of Chile's external debt and help control the path of future debt service payments, the program includes ceilings on the contracting and guaranteeing by the public sector of external debt maturities of over one year but less than ten years. A subceiling on debt maturities of over one year but less than five years, has also been established. These ceilings are shown in the annexed Table 4. The Government will continue to abstain from offering a public guarantee on new borrowing by the privately owned domestic financial system. Nevertheless, it recognizes that the avoidance in the future of a recurrence of a banking crisis requires appropriate modifications of the regulations governing foreign borrowing by the financial system. To this effect, a review of existing regulations is in process with the objective of introducing any required modifications in the course of 1984.

18. The financial crisis in early 1983 gave rise to a period of intense speculation against the exchange rate that compounded the already difficult balance of payments position in Chile. To help ease the pressure on the official reserves, a minimum external financing requirement for imports was established, and the regulations governing sale of exchange for a number of invisible transactions were temporarily tightened with the objective of impeding unauthorized capital outflows. In accordance with its commitments, the Government has relaxed certain aspects of these regulations as speculative pressures have eased. At the present time, the Central Bank has established maximum travel allowances for tourism and business travel. All bona fide requests for foreign exchange requiring Central Bank authorization, except those for tourism, after normal processing, are approved without delay. In the course of 1984 the Government intends to relax further its exchange regulations including those affecting sales of exchange for travel, as domestic confidence is expected to continue improving. Progress in this area will be reviewed at midyear with the Fund. The elimination of the minimum term of import financing is not expected to be feasible during 1984, barring an unexpected strengthening of the balance of payments.

19. Since late August 1982, the Central Bank has subsidized debt service payments with respect to debt outstanding as of August 6, 1982. At the present time the subsidy scheme involves a number of elements

that give rise to a multiple currency practice. The subsidy is determined by the difference between the official exchange rate and a referential exchange rate. No exchange transactions take place at the referential exchange rate. It continues to be the intention of the Government to reduce the scope of the subsidy, and hence of the multiple currency practice over time, as the domestic economic situation improves. In accordance with this intention, the authorities have excluded from the subsidy scheme debt payments of exporters and public entities.

20. The trade system of Chile remains free of quantitative or qualitative import restrictions, notwithstanding the imposition of a number of such barriers to Chile's exports by certain trading partners. It is the Government's intention to continue to refrain from imposing such import restrictions and to maintain a unified level of tariff protection of 20 percent. This unified tariff, which was raised to its present level in March 1983 as a temporary measure, appears to be moderate in the absence of quantitative import restrictions, and is necessary for the fiscal performance. During the past year, the Central Bank has verified a small number of subsidization practices and has applied temporary surcharges up to a maximum of 15 percent on all such imports for periods not exceeding six months. The Government intends to continue to protect Chilean producers against foreign subsidies according to technical standards and to review each case on a six-month basis.

Table 1. Chile: Limits on the Indebtedness of the Nonfinancial Public Sector

(In billions of pesos)

Date	Total limit	Sublimit on Domestic Indebtedness
March 31, 1984	586	137
June 30, 1984	628	148
September 30, 1984	660	160
December 31, 1984	700	174

The above limits shall be adjusted for revisions in the base data for December 31, 1983 and shall be raised in accordance with the provisions of the contingency public spending program for the second semester of 1984 in the course of the midyear review with the Fund. The increase in the limit for September 30, 1984 shall not exceed Ch$6 billion, and that for December 31, 1984, Ch$15.5 billion; the increase in the sublimit for September 30 shall not exceed Ch$6 billion, and that for December 31, 1984, Ch$155 billion.

Table 2. Chile: Ceilings on the Net Domestic Assets of the Central Bank

(In billions of pesos)

Period	Ceilings
January 1 - March 31, 1984	140
April 1 - June 30, 1984	160
July 1 - September 30, 1984	180
October 1 - December 31, 1984	217

Table 3. Chile: Targets of the Net International Reserves of the Central Bank

(In millions of U.S. dollars)

Date	Targets
March 31, 1984	1,000
June 30, 1984	1,115
September 30, 1984	1,205
December 31, 1984	1,190

Table 4. Chile: Ceilings on the Contracting and Guaranteeing of Foreign Debt by the Public Sector

(In millions of U.S. dollars)

Period	Ceiling 1/	Subceiling 2/
January 1 - December 31, 1984	3,850	125

1/ Foreign debt with maturity of over 12 months and below 120 months.
2/ Subceiling on debt with maturity of over 12 months and below 60 months.

These ceilings include refinancing and rescheduling operations. For this purpose any nonpayment of a scheduled debt service payment by the public sector and the national banking system will be treated as a rescheduling operation as it occurs. The same treatment will apply to the deposits made at the Central Bank on account of debt service payments.