April 9, 2020
Approval: 4/16/20

INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 18/91-1

10:00 a.m., November 7, 2018

1. Chile—2018 Article IV Consultation

Documents: SM/18/244 and Correction 1; and Supplement 1; and Supplement 2; SM/18/245; SM/18/261; and Supplement 1; and Supplement 2

Staff: Ricci, WHD; Haksar, SPR

Length: 1 hour, 2 minutes

Executive Board Attendance

M. Furusawa, Acting Chair

Executive Directors	**Alternate Executive Directors**
	O. Odonye (AE), Temporary
M. Raghani (AF)	
	C. Moreno (AG), Temporary
	J. Shin (AP), Temporary
	B. Saraiva (BR)
	S. Fan (CC), Temporary
	A. Guerra (CE), Temporary
L. Levonian (CO)	
R. Kaya (EC)	
H. de Villeroché (FF)	
	K. Merk (GR)
	H. Joshi (IN), Temporary
	I. Lopes (IT), Temporary
	Y. Saito (JA)
J. Mojarrad (MD)	
H. Beblawi (MI)	
A. De Lannoy (NE)	
T. Ostros (NO)	
A. Mozhin (RU)	
M. Mouminah (SA)	
J. Agung (ST)	
P. Inderbinen (SZ)	
	O. Haydon (UK), Temporary
	P. Pollard (US), Temporary

H. Al-Atrash, Acting Secretary
J. Morco, Summing Up Officer
D. Jiang, Board Operations Officer
M. McKenzie, Verbatim Reporting Officer

Also Present
Institute for Capacity Development: B. Hacibedel. Research Department: U. Wiriadinata. Strategy, Policy, and Review Department: V. Haksar. World Bank Group: B. Cunha. Western Hemisphere Department: M. Hadzi-Vaskov, W. Ho, L. Ricci. Executive Director: L. Villar (CE). Alternate Executive Director: J. Di Tata (AG), L. Palei (RU), K.Tan (ST). Senior Advisors to Executive Directors: Z. Abenoja (ST), M. Alle (AF), W. Kuhles (GR),

Y.Liu (CC), R. Morales (AG). Advisors to Executive Directors: A. Abdullahi (AE), M. Albert (FF), A. Arevalo Arroyo (CE), S. Bah (AF), O. Bayar (EC), M. Bernatavicius (NO), J. Corvalan (AG), S. David (AP), M. Josic (NE), P. Snisorenko (RU), M. Sylvester (CO), D. Vogel (AG), S. Alavi (MD), J. Montero (CE).

1. CHILE—2018 ARTICLE IV CONSULTATION

Mr. Lopetegui and Ms. Moreno submitted the following statement:

On behalf of the Chilean authorities, we thank staff for their informative report and selected issues papers related to the 2018 Article IV consultation. The authorities appreciate the open and candid dialogue with staff, as well as the thorough analysis, and look forward to continuing this constructive relationship with the Fund.

Background and Economic Outlook

Chile is one of the most open and globally integrated economies. In the current juncture, when risks arising from international markets are increasing, Chile's domestic conditions allow differentiation from other emerging markets that are showing some macro-financial vulnerabilities. A key element for this differentiation is driven by a macro policy framework of fully-fledged inflation targeting scheme, in which a flexible exchange rate regime permits the absorption of external shocks without major effects in the local financial system. But this is only part of a bigger framework that has allowed for sound macroeconomic policies during financial stress and crisis episodes. This framework includes Chile's recent strong commitment to a fiscal consolidation agenda, in addition to an effective and well communicated monetary policy stance, conducted by an autonomous Central Bank (CBC), and the strengthening of capital requirements in the banking system.

Despite global growth having plateaued in many large economies, and even been revised downward in others, during this year, the Chilean economic data has surprised on the upside in several areas. A most recent positive development is the greater dynamism of investment, especially in machinery and equipment, which outperforms the projected GDP growth for the period 2018-2020.

Inflation has been consolidating its prospects of convergence to the target. Annual headline Consumer Price Index (CPI) inflation has sped up in recent months, reaching 3.1 percent in September—just barely above the 3 percent target. Meanwhile, core inflation—that is, excluding food and energy prices—, remains near 2 percent. Both figures are in line with market expectations. Risks appear to be balanced and inflation is expected to reach 3.1 percent by year-end, in line with a recent depreciation of the Chilean peso and closed activity gaps.

The labor market shows signs of recovery as salaried-jobs growth is on the rise, showing some dynamism in important sectors, such as construction and trade. The perspectives for the labor market are positive as there might be some slack, in part given the strong immigration registered in recent years, which has not been yet captured by the surveys. Analysis of administrative and other alternative data leads the authorities to evaluate that the lag observed between employment and activity is beginning to dissipate.

Overall, the estimation of potential growth was revised up and convergence between potential and trend growth—estimated at 3 to 3.5 percent for the next ten years—will occur sooner than expected. Economic growth projections have been revised up to a range between 4 and 4.5 percent in 2018, and between 3.25 and 4.25 percent in 2019, which are above the staff's estimates.

External Sector

The external environment has been volatile, and risks are becoming more likely to materialize in the near term, compared to what was expected six months ago. Commodity prices dropped, particularly metals. Against this background, the Chilean peso, like most currencies, has depreciated against the dollar. Authorities welcome the staff's analysis and share the view that the Chilean current account and real exchange rate are broadly aligned with fundamentals.

The main risk continues to be an abrupt deterioration of financial conditions facing emerging economies, especially because markets seem to be more reactive to negative news. In this regard, what happens in the United States is still relevant, in terms of both the evolution of inflation and its outlook and the unfolding of the trade conflict. This situation has revived the fears about China, especially the risks implicit in the imbalances it maintains in several of its markets. In Europe, among other issues, the uncertainty surrounding Brexit is cause for concern.

Investors have been able to differentiate among emerging economies staying positive on those with stronger fundamentals. In this regard, our authorities highlight the importance of taking into consideration a set of indices to obtain a holistic view, rather than a partial assessment of the country's external position. For example, Chile stands out for maintaining external assets in sovereign funds. The economic stabilization fund amounts to 14 billion dollars (approximately 5 percent of GDP) as of September 2018 and adds to the 37.4 billion dollars International Reserves of the CBC (approximately 14 percent of GDP). In addition, pension funds are the major private institutional investors, having external assets that amount to 86 billion dollars as of the second half of 2018. Pension funds have shown an interesting behavior in previous volatility events, displaying a behavior that counters that of non-resident investors and, therefore, retrench funds when capital flights are observed.

The long period of loose international financial conditions was followed by an increase in emerging markets indebtedness, and Chile was no exception. Nevertheless, the fact that the Chilean corporate sector appears to be highly leveraged should not be taken as an indicator of vulnerability. A deeper understanding of its composition allows to see that either there is a natural hedge (export and import sectors), or firms buy foreign exchange hedge. Also, a substantial portion is debt with parent companies (FDI debt), which has a different (lower) risk. Finally, it is mostly long-term debt and refinancing risks are small. Overall, considering domestic debt as well, the corporate sector indebtedness as a percent of GDP has stabilized since 2015.

Monetary Policy

The policy framework in place, along with a sound financial system in which exchange rate risks are hedged, allows for monetary policy to be countercyclical, if needed. During the last 16 months, the policy rate was kept at 2.5 percent, becoming one of the most expansive in the region. On the October 2018 monetary policy meeting, the CBC Board decided to raise the policy rate by 0.25 basis points, communicating that if the foreseen scenario is maintained, the normalization process will continue at a gradual and well-communicated pace. Hence, it can be anticipated that monetary policy will remain expansionary for some time, probably making it the longest period of continued monetary expansion since the adoption of the current monetary policy regime. The CBC will be prepared to act countercyclically if downside risks materialize in the external sector.

Since January 2018, the CBC Board changed the frequency of its meetings to only eight times per year (instead of a monthly-based scheme), and the meetings last one and a half day (instead of one day). The communiqué is longer and includes the voting results and the decision. This is an improvement since previously the main issues analyzed and the voting results were only known in the minutes, 11 working days after the meeting. The Monetary Policy Report (IPoM) will continue to be published quarterly, coinciding with the month of a meeting, while the Financial Stability Report (IEF) will be published separate from the IPoM. These changes in communication resulted in improvements from an already high standard, taking the CBC's practices closer to that of the developed countries' monetary authorities.

Fiscal Policy

The fiscal authorities aim to improve the fiscal accounts through a planned gradual consolidation path for the next four years. Although the recently submitted 2019 Budget Law forecasts a sharp decline in the overall fiscal deficit, from 2.8 percent of GDP in 2017 to 1.9 and 1.7 percent of GDP respectively for 2018 and 2019, the proposed bill also supports development needs of the Chilean economy by focusing on education, healthcare, and pensions, and further boosting public investment. Fiscal consolidation is reflected by slower expenditure growth in 2019 (estimated at 3.2 percent in real terms) which, in turn, will be supported by a fiscal austerity package of USD 4.4 billion to be implemented linearly over a four-year horizon.

The authorities remain committed to a gradual reduction of the structural fiscal deficit by approximately 0.2 percent of GDP per year to 1 percent of GDP by 2022. As forecasted by the staff, the trajectory of the public debt-to-GDP ratio is expected to stabilize in the near term, at a low level relative to peers. Sovereign risk spreads remain low from a historical perspective and with respect to peers.

Fiscal authorities are also strengthening their institutional framework by providing legal and financial independence to the Fiscal Council, together with a broader mandate. The proposed Autonomous Fiscal Council bill has received widespread support from Congress and should be approved in the short term. The authorities also submitted a Tax Modernization bill that is expected to significantly simplify the tax payment process, improve efficiency of the system, support small-to-medium enterprises, and foster both investment and growth, while safeguarding fiscal discipline. It is estimated that with the approval of the tax bill GDP growth would increase over 0.5 percent per year over the next decade.

Regarding the staff's comments on the need for the authorities to take the OECD's recommendations into account when designing the new tax on digital services, we would like to point out that the authorities clearly have done so and have publicly stated that the announced tax on digital services is an interim measure adopted while a global consensus is achieved.

Financial Sector

The authorities broadly agree with the staff's assessment of the financial sector in that it remains healthy. Nevertheless, to address areas that are still in need of improvement, the authorities asked the IMF to conduct an FSAP, which has been programmed for 2020. The result of this assessment will help the authorities design a plan to continue working on setting the best practices and enhancing the resilience of the Chilean financial system.

Regarding the current juncture, domestic credit continues to be characterized by low interest rates. As mentioned above, corporate debt has stabilized when compared to GDP. In contrast, household debt continues to grow as a percent of total loans, with a larger contribution of mortgage debt. Risks appear to be contained as non-performing loan ratios remain low (2 percent in the case of bank consumer loans), except for consumer loans in the non-banking sector, which stand around 5.5 percent in February 2018. The authorities recognize the need for a consolidated debt system that includes both bank and no banking institutions.

The recently released Household Finances Survey (Encuesta Financiera de Hogares) exhibits that between 2014 and 2017 there is a 10 percent point increase in the share of households that save (to 36 percent), while the share of indebted households decreased from 73 to 66 percent. Despite this decrease, indebtedness indices increased, namely the debt-to-income ratio and the ratio of financial burden to income. Once debt is decomposed, an increase in mortgage debt is observed in the highest income group. Another important highlight of the survey is that financial inclusion improved significantly.

The development of the real estate sector during the last decade has been healthy, overall, with no evident financial vulnerabilities in foresight. Increases in house prices have gone in tandem with economic growth, household disposable income and urbanization, among other factors. More importantly, the authorities highlight that the growth in the real state sector has been supported by a healthy financing architecture.

Congress recently approved the New Banking Legislation. This landmark legislation is the most important adjustment over the past thirty years, aligning bank capital requirements with international Basel III standards, providing an enhanced new governance for the bank regulator, broadening the range of regulatory tools to deal with weak banks, and extending government guarantees for term deposits, among other important issues. The new law will contribute to further development of Chile’s financial system, while at the same time build on its resilience.

The estimated impact of the implementation of Basel III is low compared to the banking sector average returns of the last six years and more so considering that the implementation will be gradual in a lapse of four years, after the new capital regulation is issued. Banks have been preparing for this for some years now. In addition, they will be able to take palliative actions during the transition, like substituting additional tier 1 (AT1) for tier 2 (T2) capital. During 2019, specifications for countercyclical capital reserve requirements will be applied, becoming the most important macroprudential policy in Chile.

In terms of financial infrastructure, ROSC assessment is that Chile has sound and robust institutions, despite some gaps that were identified. As of July 2018, Chile improved the rating of all financial market infrastructures except one (trade depository; (“Repositorio de Transacciones”)). The CBC is developing an Integrated Information System for Derivatives (“Sistema de Información de Derivados”) that aims to reach a trade depository standard. In addition, the CBC is working on a new regulation to allow compensation and liquidation denominated in US dollars.

Finally, cybersecurity is being addressed very seriously knowing that probably the main challenges to financial stability might come from technologies and finance. A technological observatory was created intended to act as catalyst for enhancing knowledge. Furthermore. the authorities are interested in receiving technical assistance, while also exploring best practices at the international level. In this endeavor, all financial regulators are working in a coordinated way.

Reform Agenda

As highlighted in the staff report, the authorities are committed to an ambitious structural reform agenda that should further raise medium term growth as well as living standards. Several key initiatives are geared towards boosting investment and raising productivity growth squarely back to positive territory. During the past few months, the authorities have announced measures to streamline investment processes and reduce regulatory bottlenecks, while at the same time inaugurating an office that tracks and facilitates the implementation of large-scale sustainable investment projects. In addition, the authorities expect to simplify the processes of environmental permits for investment projects, which should reduce discretion in the approval process, enhance transparency in the decision-making process, and guarantee high environmental standards. The authorities have also announced important initiatives towards modernizing the state by improving availability of e-documentation across the public sector, with the intention of reducing administrative burdens on citizens. Separately, the government has presented a long-awaited bill to modernize and reduce burdensome notary procedures.

As a small open financially integrated economy, Chile's economic authorities are concerned with the impact that rising trade tensions may have on the global economy. Chile's policy-makers have responded by calling for greater dialogue to resolve trade tensions through the agreed multilateral framework. In addition, the authorities have responded to the current juncture by broadening and deepening their wide web of 26 free trade agreements with 64 economies of the world, which cover over 85 percent of global GDP. Negotiations recently concluded to achieve a bilateral trade agreement with Brazil, while efforts towards strengthening financial integration with the Pacific Alliance economies and advancing trade in services liberalization continue.

On a separate note, the authorities recognize the importance of further improving human capital, preparing the labor force for the future of work, and closing gender gaps in the labor market. The authorities aim at enhancing efforts in early childhood education, strengthening technical and professional schooling, and reviewing the curricula of vocational training programs to ensure these are aligned with skills demanded by the new digital economy. Several initiatives have been announced to further improve female labor force participation and add flexibility to participation of younger age groups.

Finally, the authorities share the staff's urgency on the need to reform the pension system and recently announced the major elements of a comprehensive reform. In sum, the proposal considers a gradual increase in mandatory contribution rates to privately-managed individual accounts, greater competition in the overall pension system by allowing new administrators to enter the management of additional mandatory contributions, and a significant increase in current pensions that rely on the publicly funded solidarity pillar. Furthermore, rather than enforce an older retirement age, the proposal considers important incentives to postpone retirement, especially for women.

Mr. Gokarn and Mr. Joshi submitted the following statement:

We thank staff for the informative set of reports and Mr. Lopetegui and Ms. Moreno for their insightful buff statement.

After a prolonged slowdown, the rebound in Chile's GDP growth and the new administration's commitment to accelerate investments bodes well for future economic outlook. Largely insulated from EM volatility, and ringfenced from external shocks by adequate reserves and strong macroeconomic policies as well as commitment to exchange rate flexibility, the Chilean economy with dynamic investment scenario is poised to achieve good momentum going forward. GDP growth estimated at 4.0 percent for 2018 is expected to sustain well in the years ahead amid stable inflation expectations. Although the CAD is likely to increase, both gross public sector and external debt are projected to remain broadly stable in the medium term. However, as suggested in SI paper, this would require careful monitoring and surveillance to forestall building up of any systemic risks.

Even as staff expects the public debt position to stabilize by 2021 under the announced consolidation plan, greater impetus to fiscal rectitude would enhance credibility and confidence in the authorities' policies. Streamlining tax administration, rationalizing taxes, including the PIT, and widening the tax base would constitute key elements of fiscal reforms which would serve to curtail tax evasion and reduce inequality while incentivizing investments. We welcome the submission of the Tax Modernization bill, which would improve tax efficiency and support investment and growth. In addition, as proposed by the authorities, the setting up of an autonomous fiscal council and earmarking a credible fiscal anchor would serve to establish long-term fiscal resilience. As suggested in the SI paper, we concur with staff that a combined assessment of stock and flow indicators, especially debt and structural balance would underpin the credibility of fiscal anchor over the medium to long-term. Could staff comment how well their projected 2018 deficit is likely to be achieved given the assessment of the trends for the rest of the year in expenditures and accretion of mining revenues?

We note that inflation expectations have been anchored around the targeted rate by the strong inflation targeting framework. However, the pickup in inflation in the latter part of 2018 warrants a tighter monetary policy but, as advised by staff, this should be carefully weighed against likely materialization of domestic and external risks. We note and welcome the central bank's commitment on using countercyclical monetary policy to mitigate downside risks to the external sector. We also commend the authorities for improving the communication strategy of the central bank which would enhance the clarity and predictability in the conduct of monetary policy.

Chile’s financial system is resilient, and we welcome the promulgation of a new general banking law which intends to strengthen capital adequacy, solvency and liquidity including macroprudential framework and governance of supervisory and regulatory authorities. At the same time, the authorities could do well to evaluate staff suggestions for overcoming the limitations of the current law, especially inter alia the need for establishing a resolution regime, deposit insurance scheme and credit registry. We commend the authorities for setting up of the financial market commission (CMF) for superintendence of insurance, securities and banking markets which would enhance the overall coordination of the supervisory oversight of the financial system. We note that the CMF would also serve to sharpen the supervision of conglomerates. The technical assistance from IMF to advise on the organizational structuring of the CMF would be helpful. We concur with staff on their advice on strengthening regulation and oversight on the Fintech business which is growing rapidly, to strike a balance between its benefits and the risks to the integrity and stability of the financial system. While the report advises reinjection of capital in Banco del Estado, could staff comment on the longer-term viability of its SME business given the prevailing NPL position?

An array of structural reforms focused at encouraging economic diversification and increasing productivity are needed to propel Chile’s growth on way to achieving advanced economy status. Reforms such as in pension system that focus on long-term care insurance, equalization of retirement age for men and women, comprehensive streamlining of the licensing and permit system, lowering the costs through business friendly regulations and easing administrative bottlenecks, increasing flexibility in labor markets through ALMPs including universal childcare scheme, improving technical and vocational education, supporting R&D and facilitating SME financing which can contribute to diversification would be key to promoting strong and equitable growth. We welcome the authorities’ commitment and the initiatives being taken to implement these key reforms.

We wish the authorities every success in future endeavors.

Mr. Saraiva and Ms. Florestal submitted the following statement:

We thank Fund staff for an insightful set of papers particularly on the different aspects of debt dynamics and Mr. Lopetegui and Ms. Moreno for their informative buff statement.

After a period of growth deceleration, in the first half of 2018, led by exports and investments, growth has rebounded and is projected to reach 4 percent at the end of the year. Disinflationary pressures seem to have rescinded; however, core inflation remains low, with nominal wages still presenting a declining trend. Hence, despite the pickup in headline inflation, we take note of staff's call for caution with the tightening pace of monetary policy stance. Nonetheless, the central bank suggests that some labor market dynamics may have been overlooked by staff. Comments are welcome.

The Chilean economy's fundamentals remain solid and the exchange rate continues to play its shock-absorbing role. Gross debt level remains very low in comparison to other countries and borrowing costs are manageable. In addition, staff expects the negative effect on credit ratings of recent increases in debt to be offset in the medium term by the forceful implementation of fiscal consolidation measures. Staff's suggestions in the selected issues paper on how to better anchor Chile's fiscal framework constitute valuable inputs. Judicious finetuning of the tax system reform is also warranted to safeguard equity and efficiency. Does staff have an estimate of the distributional impact of the reform, considering both the revenue and the expenditure side?

Staff's assessment of medium-term outlook is largely favorable, and risks are estimated to be balanced. The authorities' structural reform agenda, whose implementation could become an upside risk, includes welcome measures to strengthen the business environment, as well as raise productivity. Achieving the right balance between growth-enhancing expenditures (e.g. specialized education and training programs) and maintaining budget equilibrium will be fundamental. Raising potential GDP while closing the inequality gap is also key in Chile's quest to reach high-income status.

The working age population, as well as employment, are projected to register a bout in 2019. While it may be a correction to the recent decline, we wonder what is behind this sudden increase in the labor force and working population. Also, the authorities refer to "some rapid demographic changes" affecting the labor market and price dynamics, as mentioned above. Could staff elaborate on the issue, especially on factors that could have an impact on labor market's evolution going forward beyond the rise in the pension population?

Effective progress in pension reform is instrumental to deliver a better package to retirees and reduce fiscal costs. The gender disparity in replacement rates is striking and is not projected to wane in the medium term. Could staff elaborate on the causes and implications of gender disparity in replacement rates, offer examples of comparable international experiences and suggest measures that could be taken to see an equalization at a faster rate? Also, is there any estimate of the distribution of replacement rates by income levels?

Commendable steps have been taken towards safeguarding financial stability and reducing vulnerabilities in the banking sector and the new general banking law (GBL) should help strengthen financial resilience. Closing the gap with Basel III minimum capital requirements over the next 6 years is considered manageable for the banking system and without significant negative impact on credit. However, the estimation of capital needs for Basel III compliance excludes the "Banco del Estado", which would add according to staff another 0.5 percent of GDP. Staff underscores that the new financial market commission (CFM) would help improve supervision of conglomerates, reduce data gaps and increase synergies. Could staff clarify which new features would make the CFM superior to the previous institutional arrangement. Also, is there any foreseeable risk in the transitional period that staff would like to call the attention to? The report also informs of Chile's success in closing the financial access gender gap and seem to imply that the reduced requirement of holding deposit accounts was the determinant factor. Could staff confirm whether there were no other major accompanying measures and influencing factors?

Mr. Inderbinen and Mr. Imashov submitted the following statement:

We commend the authorities for the solid outcome over the surveillance cycle. Chile's economy proved resilient to the prolonged slow-down, thanks to strong fundamentals and supported by an expansionary monetary and fiscal stance. Financial conditions have remained stable, and the peso has regained territory after this year's depreciation against the dollar. As emphasized in Mr. Lopetegui and Ms. Moreno's informative buff, recent data have surprised on the upside. The downside risks to the outlook stem mainly from the uncertain external environment.

Additional measures may be needed to meet the fiscal targets. We welcome the authorities' strong commitment to the recently announced fiscal targets and the stabilization of government debt. Gross debt has been trending upward over the past decade. Also, we note that staff and the authorities differ in their growth and revenue projections. According to staff, further expenditure restraint will be needed to meet the authorities' targets. Against this background, and given the recent downgrades in Chile's debt rating, should a slower-than-envisaged deficit reduction not be included in the RAM in Annex V? Staff's views on this would be welcome.

The structural fiscal reform agenda is welcome. We commend the work underway to give the Fiscal Council legal and financial independence. Also, the envisaged tax reforms should spur investment and growth. This said, we agree that the tax reforms should be complemented with effective measures to reduce income inequality and tax evasion. Finally, we encourage the authorities to give careful consideration to staff's suggestion to further strengthening the fiscal framework by formulating a fiscal rule based on an adequate anchor.

Monetary policy normalization needs to be cautious. The authorities are well-advised to continue normalizing at a gradual and well-communicated pace. Economic activity has picked up and headline inflation has increased. These developments would call for rapid tightening. At the same time, we concur with staff that remaining slack in the labor market, weak earnings growth, and the further development of external risks should be factored into the monetary policy stance.

We welcome the recent advances in financial sector regulation. We take good note of the legislation to close the gap with Basel III requirements, improve the governance of supervisory and regulatory agencies, and broaden the scope of regulatory instruments. Nevertheless, we concur with staff on the necessary steps to further bolster financial sector resilience. One aspect is deposit insurance. Can staff inform whether the authorities are considering to introduce limits on deposit coverage levels, as prescribed by the IADI Core Principles? We welcome the request to conduct an FSAP in 2020.

A broad set of structural reforms would help accelerate the transition to advanced economy status. We welcome the new administration's commitment to reforms. We share staff's assessment that, in order to meet authorities' goal of reaching advanced-economy status, significant efforts are required to diversify the economy, increase productivity and improve inclusive growth. Pension reforms that ensure adequate benefits for a larger share of retirees would support such a transition.

Mr. Psalidopoulos and Mr. Di Lorenzo submitted the following statement:

We thank staff for the insightful set of reports and Mr. Lopetegui and Ms. Moreno for their informative buff statement.

Resuming income convergence with advanced economies is in our view the main challenge the Chilean economy is currently facing. With economic growth finally accelerating after years of slowdown, Chile is well positioned to escape from the middle-income trap and transition to a higher income level. Boosting productivity and diversifying the production basis requires a number of growth-friendly reforms. The choice of the authorities to focus on investments, innovation and education are intended to address the main growth bottlenecks. However, the gap vis-a-vis advanced economies is still high as far as income inequality and living standards are concerned. In this respect, we are heartened by the commitment from the authorities to take actions to increase labor force participation, especially for female employees, the coverage of unemployment benefits and funding a rise in pension benefits through higher contribution rates. We take favorable note that, for once, staff assess that risks to the outlook are balanced, although we are also surprised that, even though seemingly limited, possible spillovers from financial strain in Argentina have not been mentioned at all. Staff comments are welcome.

The ongoing recovery allows to place the public finances on a sound footing, with due attention to budget composition and to the credibility of the fiscal framework. The deterioration of the fiscal indicators over the recent years seems to reflect a countercyclical fiscal policy, one of the trademarks of the Chilean fiscal framework. On the other hand, it would be interesting to understand to what extent the stimulus has not been fully discretionary, but more the result of a possible ex-ante overestimation of the parameters on long-term economic growth and the developments of copper prices. However, the increase in the debt-to-GDP ratio has somewhat reduced the space available in case of a new slowdown for a policy response. While we agree with staff that the envisaged adjustment at a steady rhythm of 0.2 percent a year strikes a right balance between a halt to the debt increase and providing room for social spending, we also take note that the $4.6 billion (roughly 1.6 percent of GDP) of expenditure cuts envisaged in the next four years are still not considered sufficient by staff to achieve the targets set by the authorities beyond 2019 given the new spending planned in other areas. We invite the authorities to explore avenues to expand the tax bases, as recommended by staff, and to further increase revenues from environmental and property taxes, as suggested by the OECD. It is also important that the tax reform does not reduce the already low level of redistribution of the system, and possibly increase it. We agree with the analysis in the interesting Selected Issue Papers that the fiscal rule would benefit from the adoption of a relevant stock variable as a fiscal anchor, also in view of the relationship between the evolution of the debt ratio and financing costs even at low debt levels. Staff projects that the implementation of the labor market reforms would entail a fiscal cost of around 1 percent of GDP in the short run. How, in staff view, should such a higher outlay be accommodated in the budget?

We welcome the approval of the new banking law and support the current accommodative monetary policy stance. The new law sets capital requirements and introduces macroprudential tools in line with Basel III regulations in a banking system already overall sound. Financial stability will also benefit from the synergies created by the integration of banking supervision activities into the new regulatory body, even though there is room to deepen inter-agency coordination. The expansionary monetary stimulus provided has been appropriate to the severity of the slowdown. We agree with the authorities that the transition to a more neutral stance should remain gradual, flexible, data dependent and well communicated, in line with the strong credibility achieved by the inflation targeting framework in Chile.

Mr. Beblawi and Ms. Al-Riffai submitted the following statement:

Chile’s strong fundamentals, robust institutional frameworks, and sound macroeconomic policies have helped it weather the recent volatility in emerging markets. The current economic recovery, supported by recovering copper prices, strong private consumption, and buoyant investment, has led to growth unsurpassed since the end of 2012. Inflation remains close to the target band and the current account deficit has narrowed, aided by the peso depreciation, reduced investment related imports, and a rebound in copper prices. Both external and internal risks appear balanced and the growth momentum is expected to continue, albeit at a slower pace. We broadly agree with the staff reports and have the following to emphasize.

The announced gradual fiscal consolidation path aims to enhance policy credibility and stabilize debt over the medium term whilst prioritizing spending for the country’s development and social needs. Fiscal targets over the coming four years underscore an improvement in the structural balance of 0.2 percent per year. We commend the authorities on their planned tax reform that includes streamlining the tax system to make it more efficient and pro-growth, and their planned austerity measures that are aimed at reducing government expenditures to attain the targeted structural balance. Should these revenue reforms and the government's announced austerity measures fall short of meeting structural balance targets, however, there could be merit in expanding the tax base for additional revenue. We note a difference between planned expenditures in the 2019 budget (due to the authorities' higher estimates of revenue projections as a result of higher GDP projections) and expenditure suggestions by staff for the same year. Should these differences in projections persist, they may impede the authorities' expenditure planning and policy directives.

The authorities have maintained a robust inflation-targeting framework, successfully anchoring inflation expectations and maintaining inflation around the target band. We see value in staff's advice that monetary policy normalization be undertaken cautiously. We support the central bank's readiness to act countercyclically if downside risks materialize in the external sector, as also noted in the informative buff statement by Mr. Lopetegui and Ms. Moreno.

Chile's financial sector is stable, strong, and has shown resilience to external shocks. Nonetheless, its macro-financial linkages and the series of cyberattacks against the sector warrant broader and closer risk surveillance, as well as strengthened cybersecurity. Staff highlights that the underlying dynamics and drivers behind the high and growing debt levels offer a number of mitigating factors that provide a level of resiliency to the sector. We agree, even though the recently passed New Banking Law is expected to bolster the sector's resilience, further risk mitigating measures are needed. Specifically, there is a need to further strengthen the regulatory and surveillance environment by closely monitoring the upward trend in real housing prices—to avoid any build-up of asset price vulnerabilities, as well as the upward trend in non-bank financing. We positively note the authorities' commitment to putting in place cybersecurity legislation and their plan to expand the regulatory perimeter of FinTech by drawing on international expertise and best practices.

Chile's faster transition to advanced economy status will require broadening and advancing a comprehensive structural reform agenda. To this end, we commend the authorities' commitment to improving competitiveness by streamlining and enabling a business environment that promotes stronger private sector led growth. The 2016 staff report had mentioned the intention to establish an Infrastructure Fund to attract private capital to fund infrastructure projects suitable for PPP, can staff comment on the status of this fund? The authorities plan to make the labor market more flexible and inclusive and are committed to raising living standards through a pension system that delivers adequate benefits to all retirees. Thus, we await the satisfactory resolution of the current legal and regulatory uncertainties surrounding the new labor bill, and the success of passing legislation aimed at improving professional-technical institutes to further enhance workers' skills. Given the importance of pension reform to the Chilean economy, the current administration plans to present a new proposal after the previous proposal did not pass in Congress. Can staff shed some light on the main reasons behind the rejection of the pension reform proposal and expected key modifications?

We wish the Chilean authorities further success in all their efforts.

Mr. Agung and Ms. Rauqeuqe submitted the following statement:

We thank staff for the insightful set of reports and Mr. Lopetegui and Ms. Moreno for their informative buff statement. Chile's sound macroeconomic policies, robust institutional frameworks and solid fundamentals have underpinned the country's resilience amid significant external shocks, including recent emerging market volatility. Nevertheless, given stubbornly-high income inequality and some labor market inflexibility, a carefully calibrated policy mix and enhanced structural reform agenda are needed to achieve potential and inclusive growth, as well as ensure continued macroeconomic stability. We broadly share the thrust of staff's appraisal and limit ourselves to the following comments.

The authorities' gradual fiscal consolidation plan should proceed in a growth friendly and credible manner. Against the relatively tighter 2019 budget and the authorities' intention to gradually reduce the structural fiscal deficit by 0.2 percent of GDP until 2022, we welcome their pro-growth support for spending on education, healthcare, pensions and infrastructure development. Nevertheless, the sustained deterioration in Chile's sovereign balance sheet accounted for the recent downgrade in the country's sovereign credit rating. As such, recent measures to strengthen the operational and financial independence of the Fiscal Council would help to enhance the fiscal framework. In addition, adopting staff's advice on introducing a clear and well-specified medium-term fiscal anchor would further strengthen policy credibility, especially in striking the right balance between stabilizing the public debt-to-GDP ratio and meeting priority spending objectives.

Chile's strong external position is underpinned by a credible inflation-targeting framework, improved central bank communications and a flexible exchange rate. We note positively that monetary policy conduct and communications remain highly predictable and transparent, leading to well anchored inflation expectations. This, and the flexible exchange rate underline the country's sound external position that is broadly in line with medium term fundamentals, and allowed for market differentiation of Chilean financial assets relative to other EMEs in the recent bout of global financial market volatility.

While Chile's financial system remains stable, some vulnerabilities exist. Congress approval of the new banking law is a timely step toward a more integrated approach to supervision by providing authorities with relevant banking resolution and stabilization tools and introducing Basel III capital requirements. However, recent cyberattacks and the increasingly leveraged non-financial corporate and household sectors illustrate the importance of further improvements to the country's supervisory frameworks in the near future, particularly with regard to cybersecurity, data quality and a consolidated debt system that covers both banks and non-bank financial institutions. We note that the authorities have requested an FSAP and TA on addressing regulatory gaps and cybersecurity regulations. While we note that the FSAP is scheduled for 2020, could staff elaborate on their plans for delivering TA on cybersecurity and what exactly this would entail?

Structural reforms are key to lifting potential and inclusive growth. The authorities' efforts at improving the business environment and education quality, as well as increasing spending on R&D and innovation should enhance overall competitiveness, attract additional investments and support job creation. Increased employment and the closing of human capital gaps should also help reduce income inequality and strengthen pension contributions. In this vein, while we note the authorities' proposals, firmly progressing pension reforms will be key to reducing income inequality for retirees and ensuring adequate benefits and stability of pensions into the future.

Mr. Saito and Mr. Minoura submitted the following statement:

We thank staff for the informative reports and Mr. Lopetegui and Ms. Moreno for their insightful statement. We welcome Chile's steady economic growth and its resilience helped by sound policy frameworks and solid fundamentals, which offers one of the best economic and policy environments among emerging markets. However, Chile faces some structural challenges, including demographic pressure, lack of diversification and income inequality. To meet the authorities' goal of reaching an advanced-economy status will require significant efforts to diversify and increase productivity. In this regard, it is encouraging that the new administration aims at reinvigorating investment and economic growth through structural reforms. As we broadly concur with the thrust of the staff appraisal, we will limit our comments to the following points:

Fiscal Policy

We take note of the staff's assessment that the overall fiscal deficit will narrow substantially this year and the authorities' gradual consolidation plans will be sufficient to stabilize debt as a share of GDP by the early 2020s. In contrast to the staff's positive assessment, rating agencies have downgraded Chile's sovereign credit rating recently. Could staff elaborate on backgrounds behind the difference of the view between rating agencies and staff? We agree with staff that it will be important to ensure that the final outcome of the tax reform is equitable and funded. In this light, as staff pointed out, expanding the tax base could be considered in addition to strengthening the tax administration. As for three options staff proposed in paragraph 19, we would like to know more detailed explanation for pros and cons of each measure. We also concur with the importance that design of the new tax on digital services should be in line with and take into account the OECD recommendations.

Monetary Policy

We commend the Central Bank of Chile's strong inflation-targeting framework and monetary policy record, which have anchored inflation expectations better than in other emerging markets as well as the average of advanced economies with inflation targeting regimes. We invite staff to share lessons derived from the Chile's successful experiences, which would be useful inputs for other emerging countries.

Monetary policy normalization should be undertaken cautiously and gradually. While the closing output gap and the convergence of inflation towards the target justify tightening, the pace of the tightening cycle needs to be data dependent and to take in account the evolution of external and domestic risks. The recent weak wage growth reflecting the remaining slack in labor market and the large gap between headline and core inflation are needed to be taken into account and monitored carefully.

Furthermore, we welcome the central bank's plan to revamp the communication strategy, which is expected to further enhance the already strong central bank's communication policy.

Financial Sector Policy

The new general banking law is a welcomed step to increase the financial sector's resilience, while further efforts to address the limitations of the current legislation are needed going forward. Among the recent developments, we welcome the establishment of the financial market commission (CMF), which will offer the potential for exploiting synergies. However, as staff noted, methodological and governance details, including coordination with the central bank, are still left to be clarified and further considerations are needed to improve its effectiveness. Beyond the new banking law agenda, we also commend the authorities plan to tackle issues related to the resolution framework, credit unions (cooperativas), and supervision of conglomerates. Regarding the national deposit insurance scheme, we take note of staff's recommendation to establish a national deposit insurance institution funded by member banks and would appreciate it if staff could share the current developments of discussions with the authorities and a future roadmap for the reform.

At the same time, cybersecurity and FinTech are areas that could affect the integrity and stability of the financial system. We encourage the authorities' further efforts to strengthen regulation and the Fund's appropriate advices using international experiences.

Structural Reform

Given the structural challenges including demographic pressure, lack of diversification and income inequality, a broader set of reforms of pension system, business regulation and labor market would be necessary to speed up transition to advanced economy. At the same time, we agree with the staff's appraisal of enhancing human capital and innovation capacity, which contributes to improving business environment and economic diversification.

Ms. Pollard and Mr. Vitvitsky submitted the following statement:

We thank staff for the comprehensive Article IV report and Selected Issues Papers and Mr. Lopetegui and Ms. Moreno for their buff Statement. Chile's economy is on strong footing, underpinned by a sound macroeconomic framework. Still, Chile's dependence on commodity exports makes it vulnerable to external shocks, and therefore we encourage the authorities to take advantage of the auspicious growth environment to advance the structural reform agenda to diversify the economy and boost potential growth. We broadly agree with staff's assessment and limit our comments to a few specific points.

We welcome recently announced measures to streamline business regulation and licensing, an area where Chile appears disadvantaged relative its OECD peers. We also encourage the authorities to strengthen competition, improve market and financial access for SMEs and new firms, and pursue reforms to enhance human capital. Continuing progress on key structural reforms will boost productivity and potential growth and help Chile move toward advanced economy status.

Given that Chile's fiscal position has deteriorated since 2011, including in recent years of strong growth, a balanced and gradual fiscal consolidation appears warranted. We take note that Chile has now shifted into net debtor status and that credit rating agencies have pointed to sovereign balance sheet deterioration as motivations for recent downgrades. The chapter in the SIP on Chile's fiscal framework was particularly helpful in this regard. We welcome the discussion of net debt in the report but would appreciate staff's assessment on whether gross or net debt is a more appropriate benchmark for Chile. Further, while the SIP had an extensive discussion about anchoring the fiscal rule, we would welcome staff comments on an appropriate anchor for Chile.

Additionally, we concur with staff that Chile's new banking law will help support the financial sector's resilience. Closing the gap with Basel III minimum capital requirements, providing the central bank with additional macroprudential tools, and improving governance of supervisory and regulatory agencies are all appropriate. In this context, we applaud the authorities for their strong engagement with staff on financial sector issues, including the request for an FSAP to take place in 2020.

At the same time, legal uncertainty regarding shareholder rights has been a common hindrance to the smooth functioning of resolution regimes in recent years in other countries. As such, we encourage the authorities to clarify the tools available to the resolution authority (CMF) with respect to shareholders' rights. We strongly support staff's recommendation in that regard. We also support staff's recommendation to establish a deposit insurance institution funded by member banks. Even if Chile has the fiscal space to support deposit guarantees, the lack of a funded backstop can undermine the effectiveness of a deposit guarantee as a tool to build the confidence to prevent bank runs.

Mr. De Lannoy and Mr. Josic submitted the following statement:

We thank Mr. Lopetegui and Ms. Moreno for their informative buff statement and staff for their comprehensive set of reports. We welcome staff's view that overall, Chile continues to enjoy one of the best economic and policy environments among emerging markets, enabling the authorities to continue with an ambitious set of reforms. If implemented, such reforms would raise medium-term growth and speed up the convergence of income levels to advanced economies. We share the trust of the staff appraisal and have the following comments for emphasis.

Sound fiscal policies in recent years have contributed to macroeconomic stability. Considering the large foreign assets, we share staff's assessment about the available fiscal space. However, the trend of a steady rise in public gross debt calls for caution. In this vein, we welcome the authorities' announced plans for fiscal consolidation, as emphasized in Mr. Lopetegui and Ms. Moreno's buff statement. At the same time, we note the large inherited unbudgeted health expenditures as well as an increase in current pensions with a focus on the solidarity pillar. Staff's comments on the need for health care reform as well as the impact of the increased pensions on the fiscal consolidation would be welcome. Lastly, we note that the DSA is based on the central government level data without specific stress test scenarios. What is the expected impact on the DSA when a broader definition of the public sector is included?

We share staff's assessment that caution is warranted in deciding the pace of the monetary policy normalization. At the same time, we welcome the authorities' recent improvements in their monetary policy communication framework, which should further improve the already high efficiency of the central bank. However, considering risks from both the domestic and external environment, as well as still somewhat stubborn core inflation, we caution against a tightening cycle that is too early and too fast.

A broad set of reforms as well as further diversification would raise medium-term growth and speed up convergence of income levels to advanced economies. The Chilean economy remains a small open-economy highly dependent on commodity exports, and thus highly vulnerable to external demand shocks. In this vein, we welcome the authorities' recent efforts to streamline the investments processes as well as modernize the state administration, which proved to serve as impediments for further diversification. However, we share staff's views which were acknowledged by Mr. Lopetegui and Ms. Moreno's in their buff statement, that further reform of vocational training and higher education, as well as efforts to increase R&D development and innovation capacity will be needed to uphold the authorities' strategic goal to reach an advanced economy level.

We welcome the chapter on FinTech and cybersecurity developments. Recent cyberattacks stress the importance of continued monitoring of various aspects of FinTech developments and being vigilant about their risks while enabling financial innovations. We also take note of the authorities' request for technical assistance on the assessment of the regulatory gaps. Could staff be more specific about the type of technical assistance offered to countries on FinTech and cybersecurity issues, particularly in the context of the recently adopted Bali FinTech agenda.

Mr. Ostros and Mr. Bernatavicius submitted the following statement:

We thank staff for their reports and Mr. Lopetegui and Ms. Moreno for their informative BUFF statement. The Chilean economy has strong fundamentals and a track record of sound macroeconomic policies. The recently revamped communication strategy by the central bank and a proposal to enhance Fiscal council could further solidify a strong institutional framework. However, some important long-term challenges remain: further policy action is needed to increase potential growth, reduce dependence on commodity sector, and contain public and private sector debt growth. We broadly agree with the thrust of the staff appraisal.

Solid institutional framework and sound macroeconomic policies helped to avoid spill-overs from recent volatility in the region. Well-anchored inflation expectations under the strong inflation-targeting framework could provide an opportunity to undertake cautious and adequate pace of tightening with due account for the remaining slack in labor market and relatively slow wage growth. We welcome the revamped communication strategy by the central bank, which will further increase transparency and effectiveness of monetary policy decisions.

The steady rise in public debt and recent sovereign downgrades call for a more ambitious fiscal consolidation plan. Although public debt-to-GDP ratio is relatively low compared to other EM countries and reached only 23.6 percent in 2017, it increased by 20 percentage points over the past ten years. According to staff forecasts, public debt-to-GDP ratio will only stabilize in the medium term. Additionally, there are significant uncertainties regarding compensation of revenue loss from recently announced tax reform. We thus see the need to speed up the announced fiscal consolidation path. We welcome the recent proposal to strengthen Fiscal council and agree with staff's recommendation to further strengthen the fiscal framework by embedding a solid medium-term anchor.

To speed up convergence with advanced economies, the Chilean authorities will need to implement broader set of reforms. The average GDP per capita growth in past for years constituted only 1 percent (compared to 4 percent during 1990-2013). Further policy action is needed to boost productivity and competitiveness by seeking higher economic diversification, labor force participation, and labor market flexibility. Universal childcare through contributions by all employees could lower female hiring costs and increase female labor force participation, which is currently below 50 percent.

Relatively high and increasing private sector debt in Chile calls for close monitoring and policy action if needed. We agree with staff that high private sector debt does not present an imminent threat, but intensified risks in the global economy, increasing non-bank financing, and rising real estate prices call for deeper financial surveillance, strengthened regulatory environment, and better data collection.

Mr. Kaya and Mr. Bayar submitted the following statement:

We thank staff for the comprehensive set of papers, and Mr. Lopetegui and Ms. Moreno for their helpful buff statement. As a small and very open economy, Chile is exposed to swings in the global economic outlook. Nevertheless, against a series of several adverse shocks, the economy has demonstrated remarkable resilience and avoided an outright recession thanks to its strong fundamentals, robust institutional frameworks, and a sound track record of macroeconomic policies. We broadly share the thrust of the staff appraisal and would like to add the following comments for emphasis.

A gradual fiscal consolidation would support Chile's policy credibility and stabilization of debt over the next few years. The authorities have judiciously used the fiscal space as a cushion against external shocks, leading to an estimated 20 percentage-point rise in the gross public debt-to-GDP ratio in the last decade. Notwithstanding the still strong balance sheet position of the sovereign, the headline fiscal indicators have started to put pressure on Chile's perceived riskiness, as exemplified by recent rating downgrades. Against this backdrop, we welcome the authorities' plans to embark on a gradual consolidation path which would stabilize debt by the early 2020s, while allowing for a much-needed emphasis on enhancing jobs, education, and health. The recent announcement of a broad-based tax reform is a crucial step to refine the fiscal framework in Chile, with elements that would aim to streamline the tax system and improve its fairness. As such, we are confident that the authorities would strike the right balance between the fiscal needs and concerns on inequality. We broadly concur with staff's detailed analysis on anchoring Chile's fiscal framework, and encourage the authorities to consider augmenting their policy setup by a rules-based framework on the government debt and balance sheet.

Accommodative monetary policy has served Chile's economy well, keeping expectations firmly anchored to the inflation target while helping to preserve financial stability and avoid an excessive slowdown in economic activity. As the output gap is estimated to close in 2018, and with the headline and core inflation edging up towards the target of 3 percent, the authorities rightly commenced the tightening cycle. Nevertheless, we concur with staff's advice in that monetary normalization should be undertaken cautiously and guided by evidence on the persistent convergence of inflation towards the target.

The new banking law has appropriately raised the regulatory standards in Chile's financial system. While the financial system remains broadly sound, some areas still require further improvement. In this vein, the new banking law is a welcome step to facilitate the closure of the identified gaps with respect to Basel III capital requirements, introduce new financial stability tools, and enhance the governance structure of regulatory agencies. We commend the authorities for their decision to have a new Financial Sector Assessment Program (FSAP) in 2020 and encourage them to further their efforts by addressing all remaining recommendations of the 2011 FSAP, particularly those pertaining to the powers for a consolidated supervision and resolution regime. We note that private sector indebtedness has risen fast and remains relatively high, albeit with mitigating factors, and call on the authorities to err on the side of caution, particularly in an environment where global risks are elevated.

The authorities rightly focus on a comprehensive reform agenda that would remove bottlenecks to growth and expedite Chile's transition to Advanced Economy status. As highlighted in the buff statement, the economy has benefitted from a wide-ranging set of initiatives that have raised the living standards. Nevertheless, creating a more diversified and inclusive economy remains a challenge, and calls for continued efforts, including in the areas of business environment, labor market, gender inclusivity, education and human capital, and innovation and R&D. We welcome the ongoing steps to strengthen cybersecurity and FinTech regulation frameworks.

Mr. Merk and Ms. Kuhles submitted the following statement:

We thank staff for its well-focused set of reports and Mr. Lopetegui and Ms. Moreno for their informative buff statement. We broadly agree with the thrust of staff's appraisal and the recommendations given. It is particularly noteworthy that the Chilean economy appears to have been more resilient to external shocks than regional peers due to its relatively strong institutional setting, credible macroeconomic framework and a flexible exchange rate regime. Recently, growth rates improved markedly, while core inflation was slightly below the target level. In the medium-term, growth is expected to slow down as the output gap closes and monetary policy is assumed to normalize. As risks appear overall balanced, the authorities should maintain sound macroeconomic policies, strive to tackle structural impediments to higher potential growth and ensure that the financial sector remains healthy and resilient against potential shocks.

Against the backdrop of the deterioration of the fiscal position over the past years, we welcome the authorities' announcement to pursue a gradual fiscal consolidation going forward. Commitment to the announced path is important to further strengthen policy credibility and stabilize public debt. While the planned consolidation path appears reasonable for now, the authorities should stand ready for a more ambitious adjustment path in case of a better-than-expected economic performance. In the medium-term the authorities should consider establishing a solid fiscal anchor in order to limit a further build-up of public debt and thus increase fiscal policy predictability and credibility. Further strengthening fiscal institutions could also prove beneficial in this regard.

While we welcome the focus of the 2019 budget on enhancing jobs, education, health and pensions, the authorities should ensure that these expenditures are fully financed within the budget envelope. In this respect, we highlight staff's assessment, that meeting the structural balance targets in 2019 would require additional spending cuts. On the revenue side, we welcome the authorities' proposal to make the tax system more efficient and pro-growth. In line with staff's advice, we strongly encourage the authorities to ensure that the overhaul of the tax system will not increase inequality and is fully funded. Should the final outcome result in lower tax revenues, the authorities should stand ready to make further amendments to offset these revenue losses, such as a broadening of the tax base.

A judicious approach to the envisaged normalization of monetary policy appears warranted. We encourage the authorities to make their policy rate decisions conditional on strong evidence of a persistent increase in inflation towards the target, while paying due regard to the evolution of external and domestic risks. We welcome the improved communication strategy of the central bank and encourage the authorities to continue their transparent and highly predictable monetary policy approach, in order to further strengthen monetary policy effectiveness and keeping inflation expectations well anchored.

We welcome the resilience of the financial sector, supported by the implementation of the new general banking law, but encourage the authorities to remain vigilant to remaining vulnerabilities. In this regard, we encourage the authorities to implement the remaining recommendations of the 2011 FSAP in order to further strengthen the current legislation. Improving the FinTech regulation and cybersecurity protection and legislation will be important tasks going forward.

We encourage the authorities to tackle the remaining impediments to higher and more inclusive growth. The implementation of an ambitious structural reform agenda will be key in this regard. As laid out by staff, closing the structural gaps relative to OECD countries will be beneficial in various aspects. We thus welcome the authorities' commitment to implementing structural reforms to improve the business climate and increase competitiveness. In particular, strengthening human capital and innovation will be crucial to converge towards higher per capita income levels.

Mr. Ray, Mr. Shin and Mr. David submitted the following statement:

We thank staff for their reports and Mr. Lopetegui and Ms. Moreno for their buff statement on Chile's 2018 Article IV Consultations.

We take note of Chile's resilience against adverse shocks given its strong macroeconomic fundamentals, institutional framework and policy settings. Growth is projected to increase in 2018-2019 and into the medium term, with the authorities attributing that to the effects of planned reforms. Staff did not include that in their projections. Could staff comment on why their projections did not reflect those effects? We broadly concur with the staff's recommendation to strengthen fiscal consolidation and discipline by enhancing the fiscal rules given recent increases in fiscal deficits. It seems striking that 3 major credit rating companies downgraded Chile's sovereign rating seemingly because of insufficient fiscal consolidation, when considering its manageable debt levels (23.6 percent of GDP in gross term, 4.4 percent in net term of end-2017) and still negative output gap. We wonder if there is any special background or context to explain why more emphasis needs to be placed on fiscal consolidation. Staff's view would be welcome.

We encourage the authorities to strengthen the cybersecurity framework. The proposed cybersecurity legislation and FinTech regulation would help to mitigate the threat of cyberattacks while promoting the growth of the FinTech industry. It is important that the Fund continue to provide support, including policy advice and capacity development to the Chilean authorities to implement these plans.

We welcome the enhancements to the supervision and regulatory framework of the financial sector. The new general banking law and creation of the financial market commission would help streamline and improve supervision efforts. Given the changes, it is important staff provide necessary assistance (advice and TA) as requested as well as cater for the FSAP request. Staff updates on assistance provided are welcome.

We are encouraged by the authorities' ongoing structural reforms to improve productivity, diversify the economy and ensure a more inclusive growth. We welcome efforts to improve the business environment, reform the pension system, enhance education, improve the labor market, address obstacles facing SMEs and improve social protection.

Mr. Mouminah, Mr. Alkhareif and Mr. Keshava submitted the following statement:

We thank staff for the well-written set of reports and Mr. Lopetegui and Ms. Moreno for their informative buff statement. We are in broad agreement with the thrust of staff's analysis and policy recommendations and would limit our remarks to a few issues.

Chile's economy continues to benefit from strong institutional frameworks and a track record of sound macroeconomic management. In this context, we welcome the continuing growth momentum after a prolonged slowdown and note that GDP growth is projected to converge to its medium-term potential estimated at about 3 percent. It is also encouraging that Chile's CDS and bond spreads have remained stable, despite increasing pressure in some emerging market economies, and are generally lower than regional peers. Here, we would welcome staff elaboration on the impact on spreads due to lowering of Chile's rating in July 2018 by Moody's, which followed the rating downgrades by Fitch and Standard & Poor's in 2017Q3.

We welcome the announcement of gradual fiscal consolidation and the strengthening of the institutional framework on fiscal responsibility. The envisaged consolidation rightly aims at balancing the debt stabilization objective with meeting development and social spending needs over the medium term. Notably, we take positive note of the focus in the 2019 budget on jobs, education, health, and pensions and echo staff's recommendations to continue adequate provisions for these expenditures over the medium term. On the revenue side, we see a sizable divergence in staff's and the authorities' revenues projections (footnote 2) and wonder whether there will be scope for reducing non-priority spending to protect development and social spending in case of revenue shortfalls? We welcome the envisaged strengthening of the Fiscal Council with independent funding, more independence, and a broader mandate than the exiting one, which is a step in the right direction for reinforcing fiscal credibility.

We agree that the current monetary policy stance remains appropriate and policy normalization going forward should be cautious. As rightly noted by staff, caution is warranted in deciding the pace of the monetary policy normalization due to subdued core inflation and remaining labor market slack. Indeed, the tightening should be guided by evidence of persistent inflation convergence toward the target. We welcome the steps taken to enhance communication framework, as elaborated in the buff statement, which will further enhance the already strong framework.

While we welcome the approval of the new banking law, we agree with staff on the importance of additional measures, including a national deposit insurance scheme funded by member banks and strengthened resolution regime, to enhance the financial sector's resilience. Notably, we are pleased with the steps taken to close the gap with Basel III minimum capital requirements, provide additional macroprudential tools, and improve the governance of supervisory and regulatory agencies. Going forward, we encourage the authorities to continue their reform efforts and welcome their request for a FSAP, which is expected in early 2020.

Finally, the authorities should step up implementation of their reform agenda to boost medium-term growth and make it more inclusive. Priorities include further strengthening the business environment, addressing skill mismatches, enhancing social protection, and increasing labor participation. We also look forward to the authorities' pension system reform plan for addressing issues related to low replacement rates.

With these remarks, we wish the authorities continued success.

Mr. Gonzalez and Mr. Guerra submitted the following statement:

We would like to thank staff for an informative and insightful report and Mr. Lopetegui and Ms. Moreno for a valuable buff statement.

Chile is an example of sound macroeconomic management among emerging economies with growth accelerating to potential after several years of slow pace, inflation close to target and well anchored expectations, an external position in line with fundamentals and significant policy space. Furthermore, its policy framework and institutions have helped the country adjust to external shocks and allowed it to focus on a medium and longer-term agenda.

We broadly agree with the assessment presented in the report. On the monetary front, we acknowledge that a negative output gap, core inflation being comfortably below headline inflation and signs of a slower pace in industrial production support the current accommodative policy stance. But the fact that output is projected to grow this year beyond potential, added to the recent developments that put headline inflation slightly above target and the identified external risks call for a cautious approach. This is especially so, since the output gap was revised recently by the monetary authorities and set above staff's estimates, the labor market is seeing as more dynamic and core inflation is accelerating faster. Could staff comment on these differences and their implications for policy moving forward?

The recently approved financial law and the creation of the Financial Market Commission are steps in the right direction. As highlighted by staff, the former should improve the system's resilience by accelerating the move to Basel III capital requirements, providing new stabilization and macroprudential tools and strengthening regulation. So is the case with the Commission that, through integration and better coordination, should be able to exploit synergies to improve overall supervision throughout the system. We thus welcome the list of limitations of the current legislation identified by staff and encourage authorities to treat it as an input for the resilience agenda they plan to follow in the coming years. Given the risks highlighted in the report, we encourage authorities to take a cautious approach in the implementation of the fintech framework.

On the fiscal side, the gradual path of consolidation should help balance spending needs and debt stabilization. The combination of the announced tightening in the structural balance, reallocation of spending over the next four years and overhaul of the tax system are in line with fiscal targets and should help both revert the fiscal deterioration experienced in the past years and enhance the credibility of policy. Even more so with the proposed changes to give the fiscal council greater autonomy, more resources and an expanded scope for analyses and evaluation.

We note, however, that despite broad agreement differences persist. Staff suggests authorities should consider alternative sources of revenue and imply the effect of electronic invoicing may be overstated. They also point to the fact that meeting the structural balance will "require constraining expenditure below the committed path announced in the 2019 budget." Could staff provide a more detailed explanation of these differences and what are authorities' views on the additional sources of revenue suggested?

Finally, structural reforms are emphasizing the need for higher productivity and inclusive growth. Making the pension system more equitable, streamlining regulation to raise investment, and enhancing human capital formation and labor market flexibility go all in the direction of inclusion and productivity. Unfortunately, the report does not provide an estimation of the impact of these reforms beyond the effect of closing policy gaps to the level of OEDC's 25th percentile. Based on this analysis, could staff point more precisely at the expected effects of the proposed structural reforms? Furthermore, why do authorities doubt the adequacy of international measures of R&D and how are these views impacting policy?

Ms. Levonian, Ms. McKiernan and Mr. Sylvester submitted the following statement:

We thank staff for their useful set of papers and Mr. Lopetegui and Ms. Moreno for their informative buff statement.

We broadly agree with the main thrust of staff's appraisal and recommendations. The Chilean economy has demonstrated good resilience in the face of shocks, supported by strong fundamentals, solid institutional frameworks, and a sound track record of appropriate macroeconomic policies. With a strong recovery underway and risks to outlook assessed as balanced, the immediate priorities should be on further strengthening the fiscal position and framework, continuing supportive monetary and exchange rate policies, further bolstering financial sector resilience, and sustaining the implementation of key structural reforms. Looking further ahead, a broader set of structural reforms would help diversify the Chilean economy and improve productivity to support the authorities' goal of reaching advanced-economy status, and also to deal with potential unexpected impacts from trade tensions or financial conditions. We offer the following additional comments for emphasis.

We welcome the efforts by the Chilean authorities to further strengthen their fiscal position and framework. This would enhance Chile's ability to address development and social spending needs, stabilize debt, and build resilience against shocks. We welcome the authorities' strong commitment to fiscal prudence, including their efforts to reform the tax system, to improve their fiscal responsibility framework, and to limit government spending in coming years to help fiscal consolidation.

We urge the authorities to carefully consider staff's advice on the pace of monetary policy normalization. While some indicators point to the need for a faster tightening cycle, the signal from other indicators, including subdued core inflation and remaining labor market slack, do not yet point in this direction. Accordingly, we concur with staff's recommendations that the authorities should be cautious and consider all factors in determining the pace of monetary policy normalization going forward. The revamped communication framework of the central bank should ensure that the pace is adequately communicated.

We stress the importance of further efforts to bolster financial sector resilience. We commend the Chilean authorities for their strong efforts on financial sector stability, notwithstanding the prolonged economic slowdown. The growth in indebtedness of the household and corporate sectors should be monitored closely for further buildup of risks, and we welcome the additional information on these provided in the buff. Recent efforts to bolster financial sector resilience, including the passage of the new general banking law, are also noteworthy, but remaining weaknesses in the legal and institutional framework need to be addressed. We welcome the request, and plan, for an FSAP in 2020. We take positive note of the authorities' planned efforts related to cybersecurity and Fintech and also their request for TA to exploit opportunities and safeguard financial sector integrity; the Bali Fintech Agenda should provide a helpful framework for these efforts. Staff's comments on this would be appreciated.

Finally, significant reforms are needed to help steer Chile in the direction of advanced-economy status. We welcome the authorities' planned reforms aimed at improving competitiveness, labor market flexibility and inclusiveness, and raising living standards with a better pension system. We welcome the helpful Selected Issues Paper on Chile's export composition, and the findings that Chile has potential to gain comparative advantage in skills-intensive and technology-intensive export, while lowering dependence on commodities. Broader reforms related to facilitating further economic diversification, reducing income inequality, and boosting social mobility will be critical to help secure high, sustained, and inclusive growth.

Mr. Raghani and Mr. Alle submitted the following statement:

We thank staff for an informative set of papers and Mr. Lopetegui and Ms. Moreno for their insightful buff statement.

The Chilean economy has strongly rebounded from a prolonged slowdown. Thanks to strong fundamentals, it has also been sheltered from the volatility observed in most of emerging markets. Growth is projected to stand at 4 percent in 2018 and inflation is under control. Likewise, the fiscal position is improving, and financial conditions are stable, despite remaining challenges including the country’s debt level. Going forward, the authorities should step up structural reforms to support the transition to advanced economy status. We share the staff’s overall assessment and would like to emphasize a few points.

We take good note of the authorities’ gradual fiscal consolidation plan aimed at reducing debt and supporting growth. Although the overall fiscal position has remained solid over the past decade, gross debt has risen substantially. The recent sovereign downgrades point to a negative perception of markets and calls for action. We are therefore encouraged by the authorities’ planned tax reform which emphasizes measures to broaden the tax base, improve efficiency, and spur investment and growth. We are hopeful that these efforts will contribute to stabilize the public debt-to-GDP ratio in the medium term, as staff forecast. We also see merit in the authorities’ intention to enhance the fiscal council for strengthening fiscal responsibility.

We commend the authorities for an accommodative monetary policy that has served the economy well and for the free-floating exchange rate regime as a shock absorber. Furthermore, this policy toolkit has helped preserve financial stability notwithstanding the prolonged economic slowdown. The banking system is generally well-capitalized and NPLs remained low at about 2 percent of total loans. We welcome the new banking law as a good step to bolster the financial sector’s resilience. It is noteworthy that its main features include measures aimed at closing the gap with Basel III minimum capital requirements, providing new financial stabilization tools, and improving the governance of supervisory and regulatory agencies. We also welcome the authorities’ readiness to take additional measures to further enhance the financial system, as recommended by staff, including: strengthening the early intervention regime, establishing a national deposit insurance institution, and establishing a consolidated public credit registry across the entire financial industry.

We encourage the authorities to step up structural reforms for diversifying the economy and transitioning to advanced economy status. Escaping from the middle-income trap remains a key challenge. Embarking on labor market reforms, improving business regulation to raise investment, productivity and competitiveness are essential steps to further develop the private sector and reduce the dependence on mining. Furthermore, we encourage the authorities to make efforts to improve structural indicators related to bottlenecks to economic activity compared to OECD.

Mr. Mozhin and Mr. Snisorenko submitted the following statement:

We thank staff for their comprehensive report and Mr. Lopetegui and Ms. Moreno for their informative buff statement. Sound macroeconomic policies allowed for smooth adjustment to sizable external shocks and made it possible to avoid an outright recession. Overall, the outlook is favorable as economic growth has gained momentum in 2018, while inflation remains moderate and risks are balanced. However, Chile needs a broad set of reforms to diversify the economy and raise medium-term growth. We share the trust of the staff appraisal and have the following comments for emphasis.

Chile’s fiscal position deteriorated over the past decade that has triggered the credit rating downgrades from all three rating agencies in 2017. In this context, gradual fiscal consolidation announced by the authorities is very welcome. However, the proposed consolidation path will stabilize debt levels no sooner than by the early 2020s. Hence, a more ambitious consolidation might be needed to restore market confidence and “to move to a virtuous cycle of lower debt and lower financing costs” as outlined in the Selected Issues paper on the impact of debt on sovereign credit ratings and spreads. In this vein, we encourage the authorities to ensure that the tax reform is fully financed and will contribute to more substantial revenue mobilizations, especially given the Chilean quite generous tax regime. We also welcome the recommendation by staff to embed a solid medium-term anchor in the fiscal framework. Such an anchor would strengthen predictability and credibility of fiscal policy and balance out social objectives with fiscal discipline, as outlined in the respective SIP. Could staff elaborate on the current state of the Chilean stabilization fund and whether and how it could be built into a prospective fiscal framework?

In the context of tightening fiscal policy, we agree that special caution is needed in deciding the pace of the monetary policy normalization. We welcome the revamped communication framework which should further improve the efficiency of the Chilean central bank.

The financial sector remains healthy with risks properly mitigated as concluded in the SIP. However, recent developments in the household debt dynamics highlight the importance of broadening the financial sector surveillance and systemic risk. In this regard, we support the adoption of the new general banking law and creation of the financial market commission that will allow to supervise conglomerates and to close the regulatory gaps.

We thank staff for the informative SIP on the trends in Chile's composition of exports. According to the analysis, Chile's export basket remains less diversified than in the 1990s. Even consideration of services will not change the picture as the share of services in total exports/GDP has been declining. Could staff elaborate on particular measures and reforms that could finally lead to increasing share of skill and technology-intensive exports?

Finally, we agree with staff that structural reforms are the key to Chile's transitioning to advanced economy status. We are encouraged by the authorities' comprehensive reform agenda that encompasses streamlining business regulation and increasing the labor market flexibility. Nevertheless, enhancing human capital and innovation capacity will be crucial to converge towards higher per capita income levels. Could staff remind what the numerical criteria for the attribution to the advanced economy status are?

Mr. de Villeroché, Mr. Castets and Ms. Albert submitted the following statement:

We thank staff for the comprehensive set of reports, as well as Mr. Lopetegui and Ms. Moreno for their insightful buff statement. The macroeconomic framework of Chili remains robust as significant progress has been made during the past years and the outlook appears globally positive. Against this background, we encourage the authorities to continue to carefully adapt the policy mix and implement the necessary structural reforms to increase potential growth and promote a more inclusive economic model, as recommended by staff. We share the thrust of staff's analysis and would like to add a few comments for emphasis:

Outlook and Risks

After experiencing a relatively modest growth level over the past years, activity is now recovering, and Chile should perform well this year thanks to strong internal demand. A comfortable level of foreign reserves, the economic stabilization fund and a low level of public debt constitute buffers. Nonetheless, and while being cognizant of growth projections, we consider that downside risks remain and should not be underestimated. Financial tensions in emerging economies or a more severe slowdown than anticipated in China could negatively affect the price of copper (copper production amounts to close to 10 percent of GDP), and thus growth. In this regard, we welcome the country's willingness to diversify its trade partners and the recent bilateral agreement with Brazil.

Fiscal Policy

We concur with staff on the fact that Chile has some fiscal space in a context where the public debt, and even more so, the net public debt remains low. In view of the authorities' objective of a gradual reduction of the structural fiscal deficit in order to stabilize the public debt in the near term mentioned in Mr Lopetegui and Ms Moreno's buff statement, we share staff's views that enhanced domestic revenue mobilization could be explored. Indeed, the debt to GDP ratio remains relatively low (26 percent) and the progressivity of the tax and transfers system remains limited, while income inequality is at a relatively high level. Against this background, we commend the authorities' efforts to improve the tax system through a strengthened fiscal framework and the streamlining of the system. We also note that the authorities announced the introduction of a tax on digital services. Could staff indicate what the main features of this tax will be?

Exchange Rate, Monetary and Financial Policy

We concur with staff that monetary policy remains appropriately managed and that improving the communication of the Central bank is welcome. The significant depreciation of the peso played a role in the inflation increase over the last months while core inflation remains well within the targeted band. Could staff comment on the magnitude of the pass through and to which extent the depreciation has an impact since the beginning of the year on inflation? In the context of increasing financial tensions in emerging countries, monetary policy should be managed with caution and remain data-driven to ensure that inflation remains within the target band.

As regards the financial sector, the banking sector appears well capitalized. We commend the authorities for the progress towards the implementation of Basel III. We also commend staff for the focus on the necessity to tackle some new financial risks such as cybersecurity and the rapid development of FinTech, especially considering the increased numbers of cyberattacks. Considering the increase of corporate indebtedness, we agree with staff on the necessity to closely monitor the evolution of the private debt level but it should be considered in the light of the composition in terms of maturity and hedging.

Structural Reforms and Potential Growth

Significant progress has been made over the past years in terms of structural reforms. We encourage the authorities to pursue on this path notably to further improve the business environment and promote a more inclusive growth model. We thank staff for the useful quantitative analysis provided in the report which shows that if significant reforms, aiming notably at streamlining business environment and enhancing RD expenditures were implemented, growth could increase by up to 6 percent over 5 years. We agree that such reforms would play a key role to enhance productivity. We also see improving the performance of the education system as a major priority. As regards the pension reform, we concur with staff that the authorities should aim at increasing contribution rates and we encourage them to pursue their efforts with a new proposal as the last draft bill has not been approved by the congress.

Mr. Mojarrad and Mr. Alavi submitted the following statement:

We thank staff for a set of well-written papers and Mr. Lopetegui and Ms. Moreno for their informative buff statement. We agree with the thrust of the staff appraisal and limit our comments to the following:

Chile stands out as a prosperous, stable and open economy. Its robust economic recovery, after a few years of subdued growth due to the slump in the copper market, reflects the authorities' prudent fiscal-monetary policy mix and the build-up of sizeable buffers, which together with a flexible exchange rate acting as a shock absorber, also increased the economy's resilience to adverse external dynamics. It is encouraging that, thanks to its strong economic fundamentals and policy flexibility, Chile has been fairly immune to economic distress in some other key emerging markets, but its export concentration in primary commodities still leaves it exposed to international trade tensions and global slowdown in economic activity. We welcome

Chile’s support for free trade and a multilateral framework for resolving trade disputes, as echoed in Mr. Lopetegui and Ms. Moreno’s statement.

On the fiscal front, we welcome the authorities’ commitment to gradually reduce the structural deficit and stabilize the debt ratio at a level lower than those of peers by 2022. Such a medium-term consolidation strategy, implemented resolutely, will help restore market confidence and create fiscal space to smooth growth shocks and support social inclusion programs and priority spending. At the same time, efforts to modernize Chile’s revenue system should aim to limit the unintended consequences of tax reforms on income distribution. We welcome the greater independence and expanded mandate of the fiscal council that should further reinforce the fiscal responsibility framework.

Thanks to a strong track record and a robust inflation-targeting framework, inflation expectations are well anchored and the current monetary policy stance seems appropriate. Going forward, we agree with staff that, in view of offsetting forces, caution is warranted in setting the pace of monetary policy normalization. The central bank’s transparent communication strategy has also been effective in enhancing its creditability. Further, enforcement of the recently approved banking law, including the Basel III capital requirements, financial stabilization tools and strengthened governance of regulatory and supervisory bodies should better align the banking sector with the best international standards, and bolster its resilience.

Chile’s well-grounded aspiration to move to advanced economy status is backed by its sound and far-sighted policies and strong institutions. The pace of transition to the higher economic status, however, is predicated on the strength of efforts to raise the medium-term growth prospects and boost productivity through structural reforms, particularly in areas of competitiveness, diversification, business environment for SMEs, and the labor market.

With these comments, we wish the authorities every success.

The Acting Chair (Mr. Furusawa) remarked that the Chilean economy had been recovering after a prolonged slowdown, with first-half year growth reaching its highest level since 2012. Given the solid fundamentals and sound macroeconomic policy record, the economy had been largely sheltered from the recent volatility in the region. The outlook was favorable, and risks appeared balanced.

Mr. Fan made the following statement:

We thank the staff for the comprehensive report and Mr. Lopetegui and Ms. Moreno for their informative buff statement.

We are encouraged to see Chile’s economic rebound, supported by accommodative monetary and fiscal policies, stabilized domestic demand, and a balanced risk profile. We broadly concur with the thrust of the report and would like to make the following comments.

It is good to note that Chile’s fiscal position remains solid, despite the continuous deterioration over the past decades, which has created ample fiscal space for priority spending now. We commend the authorities’ grandiose fiscal consolidation plan, their reform measures to streamline the tax system, and their plan to embed a solid anchor into the fiscal framework.

In addition to strengthening tax administration, more can be done to reduce income inequality. The newly proposed Autonomous Fiscal Council is expected to help strengthen the institutional framework. It is critical for the council to be transparent to ensure its credibility. The pace of monetary policy normalization should be carefully managed.

Due to the large gap between headline inflation and core inflation, remaining labor market slack, the weak earnings growth, and the evolution of domestic and external risks, we agree with the staff that the tightening cycle should be guided by evidence of a persistent convergence of inflation toward the target.

We welcome the launch of the new general banking law to enhance the resilience of Chile’s financial system with additional macroprudential tools. The newly established Financial Market Commission can create synergy in regulations.

We encourage the authorities to remain agile in fintech, while striking the right balance between financial system protection and innovation.

Closing policy gaps through structural reforms could help increase productivity and speed up economic upgrading. We encourage the authorities to reform the pension system. We welcome the plan to streamline business regulation, improve coordination among public institutions, increase labor participation, and enhance social protection.

Mr. De Lannoy made the following statement:

I commend the authorities for the strong policies that they have been pursuing. I also commend the staff for the chapter on fintech and cybersecurity developments. During the Annual Meetings, one of the big themes was lessons learned 10 years after the start of the global financial crisis. One of the lessons we learned from the crisis was the need to integrate financial sector vulnerabilities better into our surveillance.

The question is: What would be a source of vulnerability that could lead potentially to the next crisis? In that sense, we are happy to see that the staff is having a discussion with the authorities on fintech and related cybersecurity risks, which have also been highlighted by Mr. Lipton on several occasions. We hope other country teams will follow that example.

Mr. Haydon made the following statement:

We did not issue a gray statement, but we have a few comments to make.

Overall, we support the staff's judgment that Chile enjoys one of the best economic and policy environments among emerging markets, but that further structural reforms, particularly on streamlining business regulations, will be needed to transition to the advanced economy status.

Like Mr. De Lannoy, we welcome the discussion on the recent cyber attacks, which have highlighted the vulnerability of Chile's financial sector and show that improving cybersecurity will require public-private collaboration. We also echo the comment that this is an important component of risk for staff to look at in Article IV consultations more generally.

Finally, the selected issues paper on private sector indebtedness is appreciated. We felt there was relatively little discussion on how a sustained decline in copper prices might affect debt sustainability, particularly given that the staff acknowledged that Chile's external debt levels are reasonably high overall, although they are fairly reassuring on the risk side. We would appreciate the staff's view on this point.

Mr. Saraiva made the following statement:

I appreciate the attention the staff gave to Directors' questions, and I look forward to the staff's response to our question on monetary policy and labor market dynamics. The staff should consider the number of questions we asked as a sign of appreciation for the quality of the report and the interest that the Chilean economy raised in the region.

The first comment I want to make regards the soundness of the fiscal framework and the fiscal accounts in Chile. Even after a slippage and almost doubling of the public debt, it is still at around 25 percent of GDP and is projected to peak at 27 percent. The fiscal adjustment path that is conceived by the government is reasonable, feasible and ensures debt sustainability in a clear way.

I acknowledge that the new proposal for the Autonomous Fiscal Council seems to have several advantages with respect to the previous arrangement. But what in the previous arrangement did not prevent those slippages? Is it something that is identifiable? Is there some lesson that we could take for other countries as well?

I have another point, which concerns the new banking law. It is a landmark legislation. It will allow a full implementation of Basel III, new governance for bank regulators, and so on. On the other hand, looking at the staff report, we see that there are several issues that were left behind. I am always on the side of prioritizing reforms. We always know that having a laundry list does not help. But when one takes a step, like this one, which was a new initiative on regulating banks, why was it not possible to make it broader and include the other issues identified, such as the resolution regime, deposit insurance, credit registry? Is there any major obstacle to taking care of those questions?

Having said that, I want to commend the staff for the report, and Ms. Moreno and the Chilean authorities for the very good management of the Chilean economy.

Ms. Pollard commended the Chilean authorities for their strong macro policy framework. She remarked that the selected issues paper on anchoring the fiscal framework was interesting, but she did not know whether the staff was suggesting a specific debt limit for the Chilean authorities.

Mr. Saito made the following statement:

We thank the staff for the informative papers and Mr. Lopetegui and Ms. Moreno for their insightful statement. As we have issued a gray statement, we would like to offer two comments for emphasis.

First, on fiscal policy, we positively note that, overall, the fiscal deficit will narrow substantially this year. We welcome the authorities' consolidation plan that rightly takes account of the spending needs from education, health care, pensions, and infrastructure. Having said that, the accumulation of public debt and the recent downgrades in its sovereign credit ratings have called for the need for further fiscal consolidation, if necessary. In this light, we echo Mr. Merk that the authorities should stand ready for a more ambitious adjustment path in case of the better-than-expected economic performance. We also encourage the authorities to introduce a solid fiscal anchor to limit the debt level and to strengthen policy credibility.

Second, on monetary policy, while we note that closing the output gap and converging inflation toward the target could justify the tightening, the recent weak wage dynamics and subdued core inflation should also be taken into account. Against this background, monetary policy normalization should be undertaken gradually, and in a data-dependent and well-communicated manner.

Related to data, we see in the staff report that the wage growth, in nominal and real terms, declined sharply over the course of the last year. We would ask staff to elaborate on the reasons behind the sharp slowdown in wage growth, which may be related to the labor market dynamics that the authorities raised.

Mr. Kaya made the following statement:

We thank the staff for the well-written set of reports, and Mr. Lopetegui and Ms. Moreno for their helpful buff statement. We issued a gray statement; and would like to follow up with two points.

First, Chile has a commendable track record of sound macroeconomic policies and a very robust institutional frameworks, which have helped the economy demonstrate remarkable resilience in the face of several shocks. The economy has avoided a recession and is now successfully embarking on a fast recovery path. The challenge is to retain the credibility of the fiscal and monetary policy frameworks while balancing the cyclical and structural needs of the economy. In that regard, the gradual fiscal consolidation plan that instills a balanced and medium-term perspective appears appropriate under the current circumstances. Should the conditions change, we are confident that the authorities will stand ready to take the necessary measures. We also encourage the authorities to remain vigilant against the possible pressures that may arise when renegotiating the pension reform bill.

My second point will be on the financial sector. Chile's financial sector is in good shape, and we positively note the authorities' steps to address and identify gaps in the regulatory framework.

Beyond the points that we highlighted in our gray statement, I just wanted to follow up on the technical questions about the deposit insurance. We concur with the staff's recommendation to establish a national deposit insurance scheme, funded by member banks. We wonder, however, about the magnitude of the costs induced by such a self-funded scheme and whether this would constitute a significant burden for the banking sector, given the recapitalization requirements imposed upon it.

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

Mr. Mouminah made the following statement:

We thank the staff for the well-written set of reports and Mr. Lopetegui and Ms. Moreno for their informative buff statement. We have issued a gray statement, and have additional two points.

We believe that the favorable economic outlook provides an opportunity to step up the reforms, which will boost productivity, competitiveness, and diversification, and speed up the transition to the advanced country status, which the authorities have set as a goal. In this context, we note that the needed reforms, including the comprehensive streamlining of the licensing and permitting system, improved access for small- and medium-sized enterprises (SMEs), more labor market flexibility, and strengthening human capital innovation capacity, are extremely important. We look forward to continued progress in these areas in the period ahead.

Given the recent cyber attacks affecting the financial system, which was highlighted by other Directors as well, we agree on the importance of strengthening cybersecurity. We take positive note of the authorities' initiatives. We also welcome the plans to ensure adequate regulations of fintech based on international experience. In this regard, mitigating risks while encouraging innovation will be especially important.

We note the staff's answers to the questions on the 10-percent tax on digital services that the authorities have proposed. I would welcome further comments from the staff on whether the design of the proposed tax is in line with best practices.

Mr. Guerra made the following statement:

Chile, without doubt, is a good example of what can be done to build a resilient macro framework. It has proven that investing in building this resilient framework during the past decades has resulted in a resilient economy and in the welfare of its population.

Let me address two issues. One has to do with monetary policy. Taking into account the staff's analysis regarding the labor market, we have to acknowledge that in a labor market that is going through structural changes, including immigration, we have to be careful in how to interpret the data. As I understand, there are also some micro indicators that point toward some tightening conditions in the labor markets.

Additionally, we are beginning to see a labor market that is tight but where there is not an increase in wages. This is something that we have witnessed in many economies. It is a conundrum. It is a question that we do not have an answer to, in the sense that although we see historically tight labor conditions, we do not see an increase in wages.

Nevertheless, these dynamics can have non-linear effects. We know the right policies to have a gradual and robust monetary policy. We believe that the authorities have chosen the right path in taking a conservative vision of how monetary policy can evolve in a gradual manner, but taking into consideration where the policy decision can take place, they would have to take the steps necessary to ensure that they reach the inflation target and they keep inflationary expectations well-anchored.

Related to the issue of cyber risks, while we understand and concur that those are some of the risks that we all face, in an economy like Chile's, which has such a strong macro framework and the risks are relatively few, cyber risks stand out. But at the end of the day, all of our economies have these kinds of risks. It is not something that is peculiar to the Chilean economy.

In that regard, I would like to ask the staff about the technical assistance that they will give, if they could talk a bit about Mexico's experience too. One point is that is important to know how to alert the public after one of these cyber risk events has occurred.

Mr. Inderbinen made the following statement:

We are grateful to the staff for the good report and also for the written answers that they have provided. We also thank Ms. Moreno and Mr. Lopetegui for their helpful buff statement.

We commend the Chilean authorities for the solid outcome over the surveillance cycle that we are concluding today. The resilience of the economy during the past downturn testifies to their skillful policymaking and, importantly, to the quality of Chile's economic institutions.

As we note in our gray statement, we welcome the authorities' renewed commitment to fiscal prudence, as manifested in the authorities' recently announced adjustment targets. This is important since breaking the trend of the increase in public debt witnessed over the last decade will be central to maintaining a sound macroeconomic framework.

Reducing the public debt level will also be important to maintain confidence in the financial markets, as the recent sovereign credit rating downgrades of Chile underline. The analysis in the staff's selected issues paper is illustrative in this regard.

This is the background to our question of why a slower-than-envisaged fiscal consolidation should not be included in the risk assessment matrix, particularly since the authorities' growth and revenue projections are more sanguine than the staff's. We are looking forward to Mr. Ricci's elaboration on this.

Like others, we also welcomed the important advances in financial sector regulatory reforms, including integrating oversight into one single agency and broadening the scope of the regulatory instruments. The staff lists the important areas of further regulatory reforms. Mr. Saraiva has just commented on the length of the list that is provided in the report. The 2020 Financial Sector Assessment Program (FSAP) will be a timely occasion to address these.

One area that we had mentioned was the currently unlimited guarantee that the deposit insurance scheme provides. Mr. Kaya has just commented on the possible costs to the banking system on funding the scheme. But there are also the important costs of having an open-end guarantee scheme in terms of the large contingent liabilities that pose for the government and the fiscal position. Addressing these will be one area that the FSAP would normally take up.

One other area is corporate governance in the financial sector, as mentioned by staff in the staff appraisal. We would like to learn if corporate governance issues are particularly the concern of Banco del Estado, which is in need of recapitalization with public funds. We would welcome if the staff could offer some comments on this.

With this, we wish the authorities well in their endeavors.

Mr. Mozhin asked why all the fiscal data in the report were central government data and not general government data.

Mr. Agung made the following statement:

We issued a gray statement, and we would like to limit our intervention to two points.

First, Chile has quite a solid track record of sound macroeconomic management. The country has robust institutions, and the rule of law is upheld. In that sense, the constraint to higher potential and inclusive growth is structural.

Second, on inequality, we note that this hardly moved in Chile, despite the positive macroeconomic outcomes and the authorities' efforts to improve the level of education. The question is whether there are more structural issues in this regard, such as land ownership or an infrastructure problem that could create difficulties in reducing inequality.

The staff representative from the Western Hemisphere Department (Mr. Ricci), in response to questions and comments from Executive Directors, made the following additional statement: [1]

I would like to mention that in the last few weeks, since the document was finalized, the incoming data on the real sector show a continuation of the softening that we highlight in the document and are exactly in line with the projections that we have. In particular, the September data for economic activity accumulated over the quarter and transformed into a projection for GDP give us a projection of about 3 percent year-on-year for the quarterly growth rate, which is embedded in our annual forecast for the year.

[1] Prior to the Board meeting, SEC circulated the staff's additional responses by email. For information, these are included in an annex to these minutes.

Turning to the questions that were in the gray statements, there were several questions related to the difference between the staff's and the authorities' revenues projections and what this entailed for fiscal policy and possible risks.

The main reason why the staff has lower revenue projections is twofold. We have a lower GDP, nominal GDP, in particular, than the authorities. The authorities include in their projections, starting in 2020, the impact of the tax reform. As is customary practice in the World Economic Outlook (WEO) forecast, we do not include reforms that have not been finalized. The tax reform will take several months to be discussed in Congress. If it gets approved, then we will include the projections in that case.

Nonetheless, we believe strongly that the authorities are highly committed to their targets, which means that if our revenue projections would end up materializing, they will adjust spending accordingly and maintain the structural balance target that they have announced. In this sense, we do not consider this as an important risk to be included in the risk assessment matrix.

There were a few questions related to monetary policy and to what extent the staff's views are different from those of the central bank. We would like to highlight that there is virtually no divergence of views between the staff and the central bank. We are supportive of the start of the monetary policy normalization in Chile, and we agree with the central bank on the importance of continuing to monitor closely developments pertaining to any indicator that allows us to understand how headline inflation persistently remains close to the target.

Clearly understanding the turning points, which is what happened during monetary policy normalization, is not always easy. In particular, there has been mentioning in the questions about output gaps. Output gaps are notoriously difficult to assess in real time. It is much easier to know three years down the line what the output was today, but it is hard to know what it is now. We do not want to rely just on the output gaps and how close the headline inflation is to the target. We want to look at the core inflation, wage patterns, unemployment, and all sorts of broad indicators, which the central bank is looking at. If it really believed that headline inflation is at target and the output gap is closed, it should have been already normalizing the monetary policy. We see eye-to-eye with the central bank, and I wanted to clarify that.

There has been a question about wages, which I can bring into this conversation. This morning, there was the release of the new wage data. The authorities have revised the entire series upward in terms of wage growth. The wage decline that we discuss in the staff report is still correct as a trend, just the extent is not as deep as we had in our charts.

There was an interesting question. What are the lessons from Chile in terms of its successful inflation-targeting framework that could be valuable for other countries? This is an important point and is something we are discussing with the Central Bank of Chile in terms of digging further into some of the other elements that we think are important. We are planning an analytical piece on that over the next year.

Let me highlight some key thoughts that we have at the moment. The success of Chile in terms of delivering a strong inflation-targeting framework, with well anchored inflation expectations, does not rely just on the monetary policy institutions. It is much broader. One factor is central bank independence—the central bank is celebrating next year several decades of independence. Good and improving central bank communications are very important, but they are not the only items. Chile has sound fiscal discipline, has a fiscal rule that smoothens the fluctuations associated with both the real cycle and the copper price cycle, and has a well-functioning flexible exchange rate regime. They intervened only twice in the last 10 years and on the upward, not on the downward. When we wonder why this year the peso moved 15 percent but no one in the country complained—unlike in many other countries—some of the features we see are an effective hedging market and limited balance sheet exposures. All of the above are ingredients which are useful when thinking about how an inflation-targeting framework can work and what kind of background macroeconomic conditions it needs.

Turning to the questions in the Board, in terms of debt sustainability and the fiscal situation, it is important to remark that although debt has increased substantially over the past 10 years—about 20 percent of GDP, both in the gross and in net terms; maybe a little bit more in net terms—it remains low by international standards. Gross debt is about 24 percent to GDP. That is low by international standards in emerging markets. Net debt—including the assets of the government—is 5 percent of GDP.

It is true that Chile got downgraded in its sovereign credit rating, but the rating is still high. That is why we do not present a picture where we see significant concerns on the fiscal situation.

In terms of sustainability and where things are going, what is important to highlight is that on the basis of our projections, we see debt as peaking in the next few years, particularly in 2021, and then declining over time. We believe the debt is appropriate. Whether it should be contained further is an important political choice. We still have to remember that Chile, although a well-advanced emerging market, is a country that needs investment to grow. There are social needs. There is income convergence to be achieved. We believe it would not be necessary to advise Chile to tighten fiscal policy much further to achieve a stronger reduction in debt while these and other pressing needs are in place.

In terms of the fiscal council, there are some key features that have been introduced. In particular, the council has been given a clear mandate in terms of its role in advising the government on the functioning and the assessment of the fiscal rule. It has been given resources which it did not have before. People were nominated almost on a voluntary basis. It has independence, like now, and the head of the council does not have the same political cycle as the regular administration. These are all valuable and useful features.

In terms of the banking sector reform, the authorities share the staff's view that additional reforms in the financial sector are important, and they are committed to looking at those going further. The authorities were eager to close this chapter on the banking law, which has been discussed for several years in Congress. They were concerned that adding more pieces into the same project would have delayed unnecessarily the approval of the law. They were eager to make sure that Basel III gets approved as soon as possible, because there is a significant delay in the implementation. One needs to give time to banks to build up their capital. But they assured us that they are committed to bringing forward the agenda now that the banking law has been passed; although in the near term, they will be busy with the implementation of the banking law, which is a significant endeavor.

In terms of the selected issues paper on anchoring debt, the observation is absolutely correct. We do not deliberately point to a particular debt limit at present. We wanted to first offer a broad overview on how this particular type of anchor within the fiscal framework could be implemented. Then if there is interest from the authorities, we could go deeper into the individual components of the debt anchor and develop a particular analysis for a debt ceiling. Otherwise, it will be dangerous to venture now within a public document on a particular debt number which created wrong expectations.

In terms of the tax on digital services, this is part of a much broader tax reform, the main aspects of which are the tax integrations and tax incentives. The details are not yet spelled out. They will be clarified at a later stage of the implementation, and we will be able to assess more deeply whether they will be in line with the OECD standards or not. But for the moment, we have encouraged the authorities to make sure they look at those guidelines when they go forward with the implementation details.

In terms of why central government data are used, as opposed to other indicators, this has been a tradition for this country. The central government data are what the country uses to judge the authorities' behavior. All the numerical targets are based on central government data. In addition, municipalities cannot borrow, so they would not pose a fiscal threat. Some public companies, like the copper company, are providing resources to the government, as opposed to potentially extracting resources. At the moment, the central government data seem to be the best way of communicating fiscal policy with the public.

In terms of structural issues, Chile has high income inequality compared with other countries, but it has been improving significantly over the past decade. Income inequality is notoriously difficult to move fast. Nonetheless, the decline has been significant. In part, it has been associated with the large growth rate that Chile experienced before copper price decline. Nonetheless, structural reforms will help in improving income inequality. The most important one will be improving the quality of education as much as possible.

Chile has done a massive advancement in terms of access to education, associated with the quantity of education, including free tertiary education for the poorest 60 percent of the population. This was the last education reform by the previous administration. Nonetheless, improving the quality, which seems to be a bit lacking—we are looking at the Program for International Student Assessment (PISA) score—will help the country both in terms of a higher growth potential but also improving directly the income inequality pattern.

The staff representative from the Strategy, Policy, and Review Department (Mr. Haksar), in response to questions and comments from Executive Directors, made the following statement:

I will speak on some of the questions that Directors raised on the cybersecurity topic and what is going on in the technical assistance (TA) front out here. I am speaking on behalf of our colleagues from the Monetary and Capital Markets Department (MCM) who are leading the charge.

The overall approach is guided by two considerations. One is that, given the nature of the strong financial interconnections globally, shocks or problems that happen in any part of the world spread fast. We all have an interest in providing resources to all of the members to ensure that the cybersecurity risk is understood and managed.

The second one is that it is a very fast-moving area. There are significant resource constraints. We have to be quite nimble in how we have tried to leverage the resources available in order to provide assistance.

With those two background points, let me give a flavor of what is going on and some of the things that are being considered.

First, for the low-income countries (LICs), MCM is providing TA for financial supervisors through regional workshops that are being done in conjunction with the regional technical assistance centers (RTACs). Three of these have already been completed, and I believe there are five more such regional workshops that are in the planning stage. There is also a program of bilateral TA in developing and enhancing regulatory and supervisory frameworks for cybersecurity.

The second one that I would like to draw your attention to is a global workshop for financial supervisors from low- and middle-income countries, which has been conducted here at the Fund. It is a very effective way of leveraging knowledge quickly. At this workshop, which is kindly funded by the Central Bank of Belgium, the home regulator for the Swiss system, one can imagine that there is a lot of interest, given the connection there. We are able to bring experts from around the world to give advice to a large group of supervisors from around our emerging market and developing country membership, and frankly, have a good peer learning and sharing of experiences exchange as well.

On the broader question about, where are things going on the TA front on the Bali Fintech Agenda, it is very early days. I gather information from colleagues in MCM that they are going to be thinking about a number of areas. One is, what aspects of the supervisory and regulatory system will need to be looked at again, given the challenges that are being posed by technical innovation. I know this is very general right now, but that is a broad area. We will have to wait for guidance from the standard-setters regarding how the standards are going to evolve. But from a practical perspective, what will this mean for individual countries is something that has to be developed.

Another thing which will be a focus is how will regulation supervision and operational risk management for payment systems evolve and how will this need to be thought about going forward? There is great emphasis on infrastructure issues with the technological changes that are taking place.

I will make one footnote on the question on the digital asset taxation. This is being discussed in various international fora, including most recently at the G20. We will see it in the Ministerial Declaration. This is a topic where many members have given much space for development and innovation in digital services provision, with favorable tax treatment initially to foster innovation and to reap those benefits. There are various approaches to that being proposed and taken now. There is a desire to have a coordinated approach and an understanding about how we should go about the taxation of such services. I believe that there will be work done with the OECD, and some interim work will be presented in 2019, with a goal to have some common consensus framework for discussion by 2020.

Mr. Mozhin made the following statement:

I appreciate the response regarding data on central government fiscal accounts, rather than general government fiscal accounts. I understand this is a tradition. I understand that municipalities cannot borrow. But from the data, it is difficult to have a view on the overall tax burden in the economy. The central government revenue is around 21 percent of GDP, which is very low by any standards. I understand that Chile is a unitary state. I would presume that the municipalities’ share in the overall fiscal account must be rather small; nonetheless, it would be interesting, even from the point of view of international comparisons, to have at least some idea of the general government level of revenue, and the overall level of the tax burden on the economy.

On a related matter, on the public debt issue, we see another number. We see that central government net debt is very small. But then there is another line on public sector gross debt. That is at the level of 43 to 45 percent of GDP, which is not small. I presume that municipalities do not play any role in this because they cannot borrow. This must be mainly on top of the central government debt. It should be a debt of public sector enterprises, mainly. This makes me be even more curious about the presentation of fiscal accounts in the report.

Mr. Inderbinen asked the staff to respond to his question on corporate governance issues in the financial sector and whether they were related to state-owned Banco del Estado.

He was struck by the staff's response to the question on the long-term viability of the lending portfolio of the bank. The staff had noted that profitability and economic viabilities were not the sole criteria to assess credit provision. He asked the staff to elaborate on that comment.

The staff representative from the Western Hemisphere Department (Mr. Ricci), in response to further questions and comments from Executive Directors, made the following additional statement:

> Mr. Mozhin is right. The municipalities have a very small budget, around 2 to 3 percent, and we actually do the Debt Sustainability Analysis also on the basis of the public sector. We see the fiscal situation as sustainable, similarly as we see it in terms of central government debt. Going forward, we can consider adding additional fiscal indicators that give a more complementary picture.
>
> In terms of Banco del Estado, the bank has an important role in a country where there is substantial income inequality and where there is more difficult access to finance for smaller enterprises. The authorities do not actually see a viability concern. That is more our judgment; that we believe that if the model of lending practices will not change, some small recapitalization needs over time might be necessary. Although the authorities indicated that they might change that model over time. The current recapitalization plan is for the next few years. This is a problem that this administration or even the next administration might take into account. Nonetheless, it is not a massive bank. It is a pretty small bank, if one compares it to other countries that use a public bank for development purposes. It does not pose a significant threat to either the financial stability or to public finances.

Ms. Moreno made the following concluding statement:

> I thank Directors for their thoughtful comments. I would like to start by thanking the mission chief, Mr. Ricci, for his work and for maintaining a candid and open line of communication with my authorities while coordinating a successful mission. I am also very grateful for the excellent job done by Messrs. Hadzi-Vaskov and Ho. Finally, I appreciate the special contributions of Ms. Pescatori, Mr. Dudine, and Ms. Hacibedel at different stages of the mission. The entire team was supervised by Ms. Alonso-Gamo, who also joined us for a staff visit, in which we benefitted from her insightful interactions with the authorities.

Chile is one of the most open and globally integrated economies. Capital controls are history. Non-resident investors are increasingly more interested in investing in Chile. The Chilean corporate sector is investing abroad, both in the financial and in the non-financial sectors. This strategy of integration has rendered many benefits for Chile but has also challenged our domestic markets. At the current juncture, when risks arising from international markets are increasing—in particular, rising protectionism—domestic markets and institutions have proven resilient. Chile has differentiated from other emerging markets that are showing some macro financial vulnerabilities. This has been recognized by the staff and many Directors as well.

A key element for this differentiation is driven by a macro policy framework, a fully-fledged inflation targeting scheme in which a flexible exchange rate regime permits the absorption of external shocks without major effects in the local financial system. But getting to this point of credible policies was not an easy task, and my authorities are committed to defending this policy combination.

As we pointed out in our buff statement, this is only part of a bigger framework that has allowed for sound macroeconomic policies during financial stress and crisis episodes. This framework includes Chile's strong commitment to proven fiscal policy, whose trademark is the fiscal rule that has been in place since the early 2000s. It has been recently reinforced by a fiscal consolidation agenda. Monetary policy is conducted in an effective and well-communicated manner by a central bank that has been autonomous for the last 30 years, and it is raising its standards to meet international best practices.

Overall, the financial system is sound, but challenges remain. One of them is how to deal with the adoption of technologies to financial services, as we were talking about fintech. My authorities take this matter seriously and are learning from international experience, requesting assistance from the Fund, and exploring by means of a domestic technology laboratory. Cybersecurity and financial stability are of the utmost importance.

A full assessment of the Chilean financial system will be conducted in early 2020, when the new FSAP is scheduled. The adoption of the recommendations may contribute to having a more resilient financial system.

Regarding the structural reforms, my authorities have an ample agenda to foster the Chilean economy's growth capacity. Education, pensions, fostering investment, supporting SMEs, and reducing gender gaps in the labor market are at the heart of it. Our commission of experts from different political parties was appointed by the president to produce a document called: 100 Proposals for the Integral Development of Chile. It was released this week and is the result of months of work of a pluralist group representing academia, unions, firms and workers, former ministers, and former central bank board members. The successful implementation of these reforms may result in a positive bias on medium-term growth and, as agreed by most Directors, could foster a more inclusive and diversified economy, and promote convergence with advanced economies.

I would like to end by conveying our authorities' appreciation for the work done by staff and, on their behalf, wish that the relations between the Fund and the Republic of Chile continue to be as open and candid as they have been.

The Acting Chair (Mr. Furusawa) voted that Directors had emphasized that a gradual fiscal consolidation should enhance the policy credibility and stabilize debt, while prioritizing development and social spending; the pace of monetary policy normalization should be data-dependent, while financial supervision should be strengthened; and that progress with structural reforms would speed up the convergence of income levels to advanced economies and diversify the economy. He noted that Chile is an Article VIII member and no decision was proposed.

The following summing up was issued:

Executive Directors agreed with the thrust of the staff appraisal. They noted that the economic recovery is under way, the outlook is favorable, and risks are balanced. They agreed that the economy has been largely shielded from the recent volatility in the region, supported by strong fundamentals and a free-floating exchange rate that has played the role of a shock absorber. Going forward, Directors emphasized the importance of tackling structural impediments to higher potential growth.

Directors agreed that the announced gradual fiscal consolidation should enhance policy credibility while striking a balance between stabilizing debt and addressing development and social spending needs. They noted that strengthening the fiscal framework via an appropriate fiscal anchor, or deepening the consolidation in case of better-than-expected economic performance, could further enhance credibility and market confidence. In this context, Directors welcomed the authorities' plans to broaden the mandate of the fiscal council while ensuring its independence. Directors also took positive note of the authorities' proposal to streamline the tax system to make it more efficient and pro-growth. They underscored the importance of ensuring that the final outcome is equitable and funded. Directors recommended strengthening tax administration and broadening the tax base if revenue turns out lower than projected.

Directors underlined that further monetary policy normalization should be undertaken cautiously. They emphasized that the tightening cycle should be guided by analyzing the behavior of different indicators, in order to gauge the evidence of persistent convergence of inflation toward the target. In this context, Directors welcomed the revamped communication framework of the central bank.

Directors noted that the financial sector remains healthy, but stressed that macro-financial linkages deserve close monitoring. They welcomed the recently approved general banking law, which will bolster the resilience of the banking sector by closing the gap with Basel III minimum solvency requirements, enhancing stabilization tools, and improving corporate governance. Directors highlighted the importance of strengthening the tools for early intervention and bank resolution, while establishing a national deposit-insurance scheme funded by member banks. Directors underlined that cybersecurity and FinTech regulation frameworks need to be strengthened, and welcomed the authorities' ongoing efforts in these areas.

Directors concurred that advancing the structural reform agenda would support stronger, more inclusive growth. They welcomed the authorities' commitment to streamline business regulation, improve the investment climate, increase competitiveness, and reform the pension system. Directors also emphasized that a broader set of reforms, such as those aimed at strengthening innovation capacity, improving the quality of education, deepening labor market flexibility, and enhancing the business environment for SMEs, would help improve productivity, increase diversification, and speed up the transition to advanced economy status.

It is expected that the next Article IV consultation with Chile will be held on the standard 12-month cycle.

APPROVAL: April 16, 2020

JIANHAI LIN
Secretary

Annex

The staff circulated the following written answers, in response to technical and factual questions from Executive Directors, prior to the Executive Board meeting:

Outlook/Risks

1. ***We take favorable note that, for once, staff assess that risks to the outlook are balanced, although we are also surprised that, even though seemingly limited, possible spillovers from financial strain in Argentina have not been mentioned at all. Staff comments are welcome.***

- The direct trade and financial linkages between Chile and Argentina are limited. For instance, Argentina only accounts for about 1½ percent of Chilean exports. The correlation between financial assets is also limited and Chile has been quite resilient in recent volatility in emerging markets (Box 1).

2. ***Growth is projected to increase in 2018-2019 and into the medium term, with the authorities attributing that to the effects of planned reforms. Staff did not include that in their projections. Could staff comment on why their projections did not reflect those effects?***

- Staff projections are made at unchanged policies and the planned reforms yet have to be approved by congress. Hence, staff considers them as an upside risk.
- The significant depreciation of the peso played a role in the inflation increase over the last months while core inflation remains well within the targeted band. *Could staff comment on the magnitude of the pass through and to which extent the depreciation has an impact since the beginning of the year on inflation?*
- Staff's analysis (WP/16/129) finds evidence of limited exchange rate pass-through (about 0.1 after one year) to prices using data from recent years. In 2018, the peso's appreciation in the first four months has contributed to keeping inflation below or close to the lower bound of the target band. Since late-April, inflation has been picking up with peso's depreciation and the change in fuel prices.

Fiscal Policy

3. ***Could staff comment how well their projected 2018 deficit is likely to be achieved given the assessment of the trends for the rest of the year in expenditures and accretion of mining revenues?***

- Most recent fiscal outturn data (until September) confirmed the continuing improvement in government's mining revenue but also non-mining tax revenue. The annualized figure (seasonally-adjusted) is close to the revenue forecast. Staff is also confident that the authorities will adjust the level of expenditure further should revenue fall short of expectation in order to comply with the structural balance target in 2018.

- Does staff have an estimate of the distributional impact of the [tax] reform, considering both the revenue and the expenditure side?

- The direct impact of the tax integration is expected to benefit more-than-proportionally the richer segments of the income distribution. However, the overall loss in revenues from this measure is estimated at about 0.2 percent of GDP, and as such, the distributional effect should be limited. However, other segments of the population (especially the middle class) may benefit from the growth effect of the overall tax reform.

4. ***According to staff, further expenditure restraint will be needed to meet the authorities' targets. Against this background, and given the recent downgrades in Chile's debt rating, should a slower-than-envisaged deficit reduction not be included in the RAM in Annex V? Staff's views on this would be welcome.***

5. ***On the revenue side, we see a sizable divergence in staff's and the authorities' revenues projections (footnote 2) and wonder whether there will be scope for reducing nonpriority spending to protect development and social spending in case of revenue shortfalls?***

6. ***They also point to the fact that meeting the structural balance will "require constraining expenditure below the committed path announced in the 2019 budget." Could staff provide a more detailed explanation of these differences and what are authorities' views on the additional sources of revenue suggested?***

- Staff will respond to these questions during the Board meeting.

7. ***Staff projects that the implementation of the labor market reforms would entail a fiscal cost of around 1 percent of GDP in the short run. How, in staff view, should such a higher outlay be accommodated in the budget?***

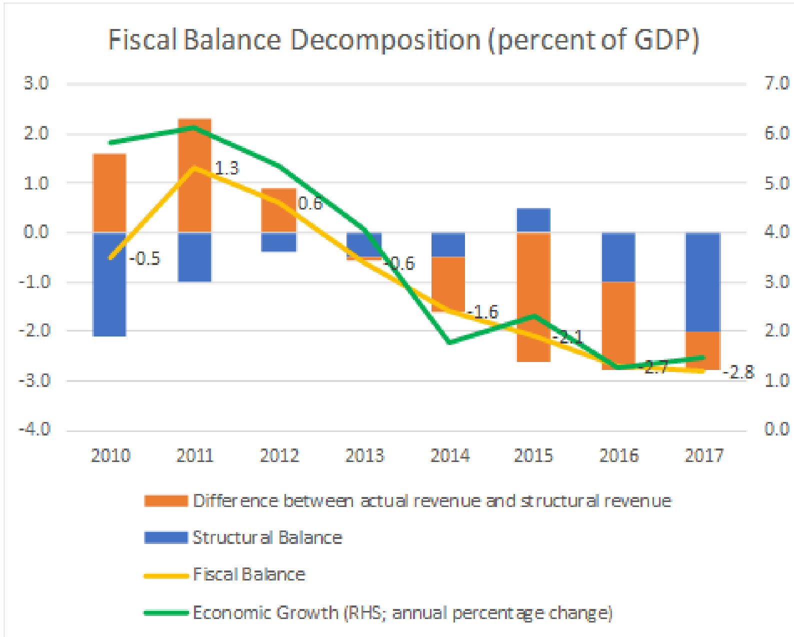
- Staff's analysis (see chart on p.21) estimates these costs at about ½ percent of GDP, if the objective is to reach the 25th percentile of the OECD. In light of the authorities' strong commitment to meeting the fiscal targets, one possible source of needed financing could be through streamlining and further prioritization of current expenditure. The authorities are undertaking a comprehensive evaluation of the effectiveness of expenditure measures.

8. ***Staff's comments on the need for health care reform as well as the impact of the increased pensions on the fiscal consolidation would be welcome.***

- The authorities aim to improve access and quality of healthcare services through reform of both public and private components of the healthcare system. The main lines of the pension reform were unveiled on October 28 and they encompass an increase in the government contribution from the current 0.8 percent of GDP to 1.12 percent of GDP that are planned to be incorporated within the authorities' fiscal targets.

9. ***The deterioration of the fiscal indicators over the recent years seems to reflect a countercyclical fiscal policy, one of the trademarks of the Chilean fiscal framework. On the other hand, it would be interesting to understand to what extent the stimulus has not been fully discretionary, but more the result of a possible ex-ante overestimation of the parameters on long-term economic growth and the developments of copper prices.***

- The attached chart shows that the difference between the structural revenues and actual revenues has been highly correlated with the overall deficit, suggesting that the increase in fiscal deficit was not only due to a lowering of the structural balance target. However, this gap has also been well correlated with growth, suggesting that the fiscal rule is offering good countercyclical properties. This being said, it is difficult to assess precisely whether the parameters imbed an overcorrection of the cycles. In this respect, it is however important to note that the parameters related to potential growth and long term copper price are not chosen by the authorities but are given to the Ministry of Finance by two independent committees of experts.



10. ***In contrast to the staff's positive assessment, rating agencies have downgraded Chile's sovereign credit rating recently. Could staff elaborate on backgrounds behind the difference of the view between rating agencies and staff?***

11. ***It seems striking that 3 major credit rating companies downgraded Chile's sovereign rating seemingly because of insufficient fiscal consolidation, when considering its manageable debt levels (23.6 percent of GDP in gross term, 4.4 percent in net term of end-2017) and still negative output gap. We wonder if there is any special background or context to explain why more emphasis needs to be placed on fiscal consolidation. Staff's view would be welcome.***

12. ***Here, we would welcome staff elaboration on the impact on spreads due to lowering of Chile's rating in July 2018 by Moody's, which followed the rating downgrades by Fitch and Standard & Poor's in 2017Q3.***

- Rating agencies provided the following reasons for the downgrades: the increase in debt over the past years which they do not expect to be reversed even with the planned consolidation measures, the limited diversification, and the secular decline in potential output over the past years.
- The impact of the three downgrades did not result in visible impact on sovereign spreads, probably because the market had already anticipated and priced the effects of the underlying drivers behind the downgrade before the credit rating actions took place.
- Staff considers that Chile's fiscal position still remains solid, with one of the lowest levels of debt across regional peers. Staff expects that the envisaged fiscal

consolidation will generate a decline in debt starting in the early 2020s. Staff advises the authorities to consider further strengthening the fiscal framework or deepening the fiscal consolidation in order to further enhance credibility and market confidence.

13. ***We welcome the discussion of net debt in the report but would appreciate staff's assessment on whether gross or net debt is a more appropriate benchmark for Chile. Further, while the SIP had an extensive discussion about anchoring the fiscal rule, we would welcome staff comments on an appropriate anchor for Chile.***

- Both measures are relevant. Net debt would be a better measure to assess the overall fiscal position of the country, especially in light of the possible asset accumulation associated with commodity revenues. Gross debt remains quite important, not only because it is more commonly used in international comparisons, but also for communication purposes as it is the main indicators highlighted by the authorities when discussing the debt position of the government. Overall, when looking at the change over time, the two measures of debt offer a similar picture, as both increased by about 20 percent of GDP over the past 10 years.

14. ***Such an anchor would strengthen predictability and credibility of fiscal policy and balance out social objectives with fiscal discipline, as outlined in the respective SIP. Could staff elaborate on the current state of the Chilean stabilization fund and whether and how it could be built into a prospective fiscal framework?***

- The Economic and Social Stabilization Fund (ESSF) was about US$14 billion as end of September 2018 (or about 4.8 percent of GDP).
- The ESFF is already part of the fiscal framework. The contribution to ESSF depends on the whether a fiscal surplus is attained: the ESSF receives each year the remainder of the fiscal surplus (if any), after the mandatory payment to the Pension Reservation Fund is made (PRF, the minimum annual contribution to the PRF is 0.2 percent of previous year's GDP). The ESSF resources can be used at any time with a view to help finance public expenditure, amortization (regular or extraordinary) of public debt, or for funding the PRF. The decision to use resources from the ESSF is made by the Minister of Finance, on a discretionary basis. The main use was in 2009 (about US$9bn) mainly to support the economy following the outbreak of the global financial crisis, but also to pay down public debt and to contribute to the PRF. For 2014, 2015, 2016 and 2018 (in September), ESSF was used to contribute to the PRF.

15. ***Lastly, we note that the DSA is based on central government level data without specific stress test scenarios. What is the expected impact on the DSA when a broader definition of the public sector is included?***

- Staff's definition of public sector debt includes gross liabilities of the central bank, gross liabilities of non-financial public enterprises (excluding liabilities to the central government) and the gross liability of the central government (see footnote [3] in Table 1). Staff expects that the gross liabilities of the central bank and non-financial public enterprises will remain relatively flat (as a share of GDP), over the forecast horizon. As such, the dynamics of public sector gross debt will be driven mainly by the projected dynamics of the central government gross debt, and is also expected to peak in 2021.

Tax Reform

16. ***As for three options staff proposed in paragraph 19, we would like to know more detailed explanation for pros and cons of each measure.***

- The three measures proposed in paragraph 19 aim to expand the tax base with the lowest distortions. The extension of VAT coverage to professional services will help level the field and align Chile with international practice. A reduction of special tax regimes (such as *renta presunta*) and better screening are likely to limit options for tax loopholes and increase revenues. Excise taxes on gasoline are about four times higher than taxes on diesel and do not properly correct for the different externalities associated with the two fuels; gradually aligning the excises on these two fuel types will help address these issues and raise additional revenues.

17. ***We also note that the authorities announced the introduction of a tax on digital services. Could staff indicate what the main features of this tax will be?***

- The proposed tax on digital services envisages a 10 percent tax rate on all digital services provided to Chilean customers through online platforms. This is part of the tax measures that are currently being debated in Congress.

Monetary Policy

18. ***Nonetheless, the central bank suggests that some labor market dynamics may have been overlooked by staff. Comments are welcome.***

- The output gap was revised recently by the monetary authorities and set above staff's estimates, the labor market is seeing as more dynamic and core inflation is accelerating faster. Could staff comment on these differences and their implications for policy moving forward?

- Staff will respond to this question during the Board meeting.

- We commend the Central Bank of Chile’s strong inflation-targeting framework and monetary policy record, which have anchored inflation expectations better than in other emerging markets as well as the average of advanced economies with inflation targeting regimes. *We invite staff to share lessons derived from the Chile’s successful experiences, which would be useful inputs for other emerging countries.*

- Staff will respond to this question during the Board meeting.

Financial Sector

19. ***While the report advises reinjection of capital in Banco del Estado, could staff comment on the longer-term viability of its SME business given the prevailing NPL position?***

- To the extent that part of the bank continues to fulfill developmental objectives, profitability or economic viabilities will not be the sole criterion to assess performance, and hence, could imply the need for additional injection of capital.

- Could staff clarify which new features would make the CFM superior to the previous institutional arrangement. Also, is there any foreseeable risk in the transitional period that staff would like to call the attention to?

- The establishment of an integrated supervisor offers potential benefits related to: an integrated and consolidated view of the financial sector, enhanced efficiency and coordination, better information sharing, improved perspective and understanding of financial conglomerates, and better monitoring of system-wide trends.

- This kind of integration processes, however, involve downside risks in the short term, such as the need to focus on the integration and not on core objectives, and the possible loss of experienced staff. In addition, integration could potentially dilute the attention that banking supervision gets in the new integrated authority. All this (transition and balancing of mandates) will need to be carefully managed by the CMF Board.

20. ***The report also informs of Chile’s success in closing the financial access gender gap and seem to imply that the reduced requirement of holding deposit accounts was the determinant factor. Could staff confirm whether there were no other major accompanying measures and influencing factors?***

- This issue is investigated in Staff Discussion Note 18/05. Indeed, this study identifies Chile’s simplified deposit accounts, which require only a form of national identification to open, as a key reason behind the rapid closing of the financial access gender gap.

21. ***One aspect is deposit insurance. Can staff inform whether the authorities are considering to introduce limits on deposit coverage levels, as prescribed by the IADI Core Principles?***

- The are no plans to change the current coverage levels but it cannot be discarded in the medium term.

22. ***Regarding the national deposit insurance scheme, we take note of staff's recommendation to establish a national deposit insurance institution funded by member banks and would appreciate it if staff could share the current developments of discussions with the authorities and a future roadmap for the reform.***

- The authorities are aware of the importance of a privately funded deposit insurance scheme and will consider it within the context of their financial sector reform agenda going forward.

23. ***While we note that the FSAP is scheduled for 2020, could staff elaborate on their plans for delivering TA on cybersecurity and what exactly this would entail?***

24. ***Could staff be more specific about the type of technical assistance offered to countries on FinTech and cybersecurity issues, particularly in the context of the recently adopted Bali FinTech agenda.***

25. ***We take positive note of the authorities' planned efforts related to cybersecurity and Fintech and also their request for TA to exploit opportunities and safeguard financial sector integrity; the Bali Fintech Agenda should provide a helpful framework for these efforts. Staff's comments on this would be appreciated.***

- The Fund TA mission on cybersecurity, which took place in late July, aimed at: (i) assessing Chile's ICT/cyber-risk regulatory framework in the context of operational risk; (ii) evaluating the supervisory capacity focusing on examination capabilities; and (iii) identifying gaps and developing plans/recommendations for improvement.
- With respect to the twelve points in the Bali FinTech agenda, the authorities are working mainly on point I (embracing the promise of fintech) and points V through XII (monitoring, regulation and supervision, integrity, modernization, stability, infrastructure, international cooperation, surveillance)

26. ***The new general banking law and creation of the financial market commission would help streamline and improve supervision efforts. Given the changes, it is***

important staff provide necessary assistance (advice and TA) as requested as well as cater for the FSAP request. Staff updates on assistance provided are welcome.

- The recent TA supported the authorities' efforts for establishing an integrated supervisor. In particular, the TA mission advised the authorities on: (i) the integration of the current banking superintendence into the Financial Markets Commission (CMF); (ii) the different organizational and internal governance issues that will need to be considered as a result of the integration; and (iii) the coordination and cooperation between the resulting integrated supervisory authority and the rest of the financial sector.

Pensions

27. ***Could staff elaborate on the causes and implications of gender disparity in replacement rates, offer examples of comparable international experiences and suggest measures that could be taken to see an equalization at a faster rate? Also, is there any estimate of the distribution of replacement rates by income levels?***

- Replacement rates for women are significantly lower due to: (i) lower contribution densities over the work life (especially at the middle of the work life); (ii) earlier retirement ages; and (iii) higher life expectancies (taken into account when calculating the pensions). The gender gap in replacement rates is mitigated somewhat by the solidarity pillar.
- The table below reports the replacement rate by income quintile. The problem is mainly in the middle class, while the poorest quintile has a very high replacement rate when including redistribution via the pension system.

Pension Replacement Rate
(Median rate for individuals who retired between 2007-2014)

Income Quintile	Self-Financed (% of last salary)	Total, Including Solidarity Pillar (% of last salary)
1	14%	110%
2	10%	55%
3	18%	41%
4	26%	35%
5	26%	27%
Total	20%	40%

28. ***Given the importance of pension reform to the Chilean economy, the current administration plans to present a new proposal after the previous proposal did not***

pass in Congress. Can staff shed some light on the main reasons behind the rejection of the pension reform proposal and expected key modifications?

- The project had been approved in a parliamentary commission, but was never subject to vote during the previous administration. The project was then withdrawn by President Piñera and replaced with an alternative proposal unveiled to the public on October 28, 2018. The new reform envisages: a gradual increase in contribution rates from the current 10 percent to 14 percent of pre-tax income over 8 years; a strengthened solidarity pillar and higher social pension supplements; pension supplements for middle-class contributors as a function of years of contribution; higher supplements for women in order to partially compensate for less years of contribution and lower salaries; additional benefits to contributors who decide to remain voluntarily in the labor force beyond the minimum retirement age; and the right for contributors to choose who will manage their funds (beyond current pension funds).

Structural

29. ***While it may be a correction to the recent decline, we wonder what is behind this sudden increase in the labor force and working population.***

30. ***Also, the authorities refer to "some rapid demographic changes" affecting the labor market and price dynamics, as mentioned above. Could staff elaborate on the issue, especially on factors that could have an impact on labor market's evolution going forward beyond the rise in the pension population?***

- In the past three, years migrant population increased from 2.3 to 5.9 percent, representing 6.3 percent of labor force. The main factors that are likely to affect the demographics evolution in the next few years in addition to ageing are the likely increase of female labor force participation (owing among others to the childcare reform and the recently announced pension reform) and the effect of immigration. This is a topic that we will investigate further during the next AIV cycle.

31. ***The 2016 staff report had mentioned the intention to establish an Infrastructure Fund to attract private capital to fund infrastructure projects suitable for PPP, can staff comment on the status of this fund?***

- Law N. 21,082 created the Infrastructure Fund. It was legally constituted in March 2018 and become a legal entity in October 2018, created by the Ministry of Public Works. Its goal is to develop infrastructure investment and related services, by facilitating the financing of new projects, focusing on financial sustainability, within the context of a 5-year plan developed by the board with the opinion of the Ministry of Public Works.

32. ***Making the pension system more equitable, streamlining regulation to raise investment, and enhancing human capital formation and labor market flexibility go all in the direction of inclusion and productivity. Unfortunately, the report does not provide an estimation of the impact of these reforms beyond the effect of closing policy gaps to the level of OEDC's 25th percentile. Based on this analysis, could staff point more precisely at the expected effects of the proposed structural reforms?***

- Staff's analysis focuses on reaching the 25th percentile in the OECD, which is an ambitious target given cross-country experience with significant structural reforms undertaken in the past. Hence, the reforms analyzed by staff are larger than the "typical" reforms. In addition, staff analysis (see Duval and Furceri, 2018) suggests that the impact from such structural reforms is likely to be backloaded. Staff's analysis (forthcoming WP) provides estimates for even larger reform measures, such as closing the gaps with the 50th percentile of the OECD.

33. ***Furthermore, why do authorities doubt the adequacy of international measures of R&D and how are these views impacting policy?***

- Authorities indicated that Chilean companies are generally not required to keep precise records of their expenditure on innovation and R&D. In addition, most spending on such activities happens in established sectors in which Chile is very good already, such as fishing, mining, and agriculture, and is considered part of the core expenditures.

- We thank staff for the informative SIP on the trends in Chile's composition of exports. According to the analysis, Chile's export basket remains less diversified than in the 1990s. Even consideration of services will not change the picture as the share of services in total exports/GDP has been declining. Could staff elaborate on particular measures and reforms that could finally lead to increasing share of skill and technology-intensive exports?

- Staff's analysis suggests that upgrades in education and training, and improvements in the quality of infrastructure are key factors that could help increase the share of high-skill and technology-intensive products in total exports.

34. ***Could staff remind what the numerical criteria for the attribution to the advanced economy status are?***

- We attach below the WEO criteria, as published on the external IMF website. While there are no precise numerical criteria, several economic indicators are taken into account. [2]

- “The main criteria used by the WEO to classify the world into advanced economies and emerging market and developing economies are (1) per capita income level, (2) export diversification—so oil exporters that have high per capita GDP would not make the advanced classification because around 70 percent of its exports are oil, and (3) degree of integration into the global financial system. In the first criteria, we look at an average over a number of years given that volatility (due to say oil production) can have a marked year-to-year effect. For the first criterion, the data source is the WEO database; for the second criterion, it is the UN COMTRADE database; and for the last criterion, it is the IMF’s Balance of Payments Statistics Database. Note, however, that these are not the only factors considered in deciding the classification of countries. As it says in the WEO Statistical Appendix, "This classification is not based on strict criteria, economic or otherwise, and it has evolved over time. The objective is to facilitate analysis by providing a reasonably meaningful method of organizing data." Reclassification only happens when something marked changes or the case for change in terms of the three criteria above becomes overwhelming. For example, Lithuania joining the euro area was a significant change in circumstances that warranted a reclassification from an emerging market and developing economy to an advanced economy. Most reclassifications in recent years were related to countries joining the euro area.”

[2] https://www.imf.org/external/pubs/ft/weo/faq.htm#q4b