SUMMARY PUBLIC FINANCE REPORT Q1 2022

Dirección de Presupuestos

Gobierno de Chile

SUMMARY OF THE 2021 MACROECONOMIC AND FISCAL SCENARIO

- The world economy grew vigorously in 2021, recovering from the sharp drop in output caused by the pandemic. Many countries implemented or maintained multiple programs to mitigate the effects of the health crisis, which carried significant fiscal costs. Commodity prices grew strongly, in part because supply was not able to adjust to increased demand as countries reopened and trade normalized. When combined with supply chain problems, the output recovery, and higher energy prices, this translated into an increase in inflation across a broad spectrum of countries.

- Locally, the Chilean economy consolidated its recovery from the COVID-19 crisis, with output exceeding pre-pandemic levels. GDP grew 11.7% annually, underpinned by dynamic domestic demand, which was reflected in a strong expansion of private consumption and investment. The gradual reopening of the economy, the unprecedented fiscal support measures, and the partial withdrawal of pension funds drove the dynamism of private consumption in the period. The output expansion peaked in the third quarter and then eased through the end of the year, influenced by the slowdown in private consumption. By economic activity, seasonally adjusted data reveal that some sectors, such as manufacturing, construction, and trade, recorded a quarter-on-quarter contraction, while others began to see a decline in growth rates.

- Annual inflation reached 7.2% in December, the highest rate since 2008. The upward trend was driven by the significant increase in private consumption following the massive fiscal transfers and pension fund withdrawals, which was exacerbated by the reopening of the economy, the reincorporation of volatile components in the CPI measure, the disruption of global supply chains, and the commodity price hike at the world level.

- With regard to the fiscal accounts, the total revenues of the total central government were CLP 57,882,140 million (24.1% of GDP) in 2021, which implies a real annual increase of 37.9% relative to 2020. The biggest component in this result was non-mining tax revenues, which grew 31.0% in real annual terms. This mainly reflects the higher level of economic activity recorded in 2021 as a result of the recovery from the economic and health crisis.

- The accrued expenses of the total central government were CLP 76,379,807 million (31.7% of GDP), representing real growth of 33.4%. This is the highest level on record, both as a percentage of GDP and as a real annual growth rate, and it reflects the multiple spending measures implemented to face the economic and social consequences of the pandemic.

- As a result of these trends, the overall balance of the total central government recorded a deficit of CLP 18,497,666 million (7.7% of GDP), which is the largest deficit of the last 30 years and larger even than the deficit in 2020 (7.3%). The structural balance was CLP 25,902,387 million, equivalent to –10.8% of GDP, which represents a significant deviation from the target proposed by the authority due to the greater spending on transfers (see table 1).

Table 1
Total Central Government: Overall and Structural Balance, 2021
(millions of 2021 CLP and % of GDP)

		PFR Q1 2022		
		CLP MM	% OF GDP	%. REAL ANNUAL CHANGE
(1)	TOTAL OVERALL REVENUE	57,882,140	24.1	37.9
(2)	Total cyclically adjusted revenue	50,477,418	21.0	–2.4
(3)	Total expenditures	76,379,806	31.7	33.4
(1) - (3)	**Overall balance**	**–18,497,666**	**–7.7**	
(2) - (3)	**Cyclically adjusted balance**	**–25,902,387**	**–10.8**	

Includes Fonasa electronic vouchers.
Source: Dipres.

UPDATE OF THE 2022 MACROECONOMIC AND FISCAL SCENARIO

- Following a fast and historic global economic recovery, economies are expected to see a slowdown in growth rates in 2022, in a context of a high basis of comparison, the withdrawal of fiscal stimulus measures, a higher inflation outlook, and a tightening of monetary policy.

- The Chilean economy is expected to experience a correction, which should allow the resolution of the macroeconomic imbalances caused by the pandemic. In this context, fiscal policy will contribute through the normalization of public spending after the extraordinary stimulus applied in 2021, returning to levels compatible with the pre-pandemic period. As with the intensification of the monetary stimulus withdrawal by the Central Bank, the objective is to mitigate the harmful long-term effects of a possible unmooring of inflation expectations in the monetary policy horizon, a high current account deficit in the balance of payments, or unsustainable increases in the debt level, all of which could cause substantial damage to the well-being of the country's households and firms in the future.

- In line with the above scenario, and in order to establish the foundation for the necessary adjustment, fiscal policy will continue supporting households and firms that were strongly affected by the pandemic and that have not yet managed to recover. In the most recent period, the new government announced a significant fiscal stimulus package, which will mobilize resources estimated at US$3,700 million. The magnitude is consistent with the support the economy needs to adjust and, at the same time, with fiscal sustainability, thereby supporting a recovery that is both inclusive and sustainable.

- In 2022 domestic demand is expected to adjust downward, due to less dynamic consumption and investment. The adjustment process will be compounded by a weaker external stimulus, with tighter financial conditions for emerging economies and less favorable terms of trade. This reflects the fact that the increase in the oil price will more than offset the higher copper price in the year.

- Inflation, in turn, has substantially exceeded private expectations thus far in the year, recording higher cost pressure on commodity prices, wages, transport, etc. This has occurred in a context in which inflation expectations are above the Central Bank's 3% target in the policy horizon (see table 2).

Table 2
2022 Macroeconomic Assumptions

	PFR Q3 2021 FORECAST	PFR Q4 2021 FORECAST	PFR Q1 2022 FORECAST
GDP (annual change, %)	2.5	3.5	1.5
DOMESTIC DEMAND (annual change, %)	1.7	2.6	−1.0
CPI[1] (annual change, % average)	4.4	6.5	8.9
EXCHANGE RATE[1] (CLP/USD, average, nominal value)	739	825	811
COPPER PRICE[1] (USD cents/lb, average, LME)	395	410	445
WTI OIL PRICE (USD/bbl)	62	69	95

Source: Ministry of Finance.

- Consistent with the macroeconomic scenario described above, the overall revenue forecast presented in this Report is $57,442,256 million for 2022, equivalent to 21.7% of GDP, which represents a reduction of 1.5% relative to the forecast in the PFR for the fourth quarter of 2021. This downward adjustment incorporates the worsening macroeconomic scenario for the period, which affects VAT and income tax revenue forecasts. Gross copper revenues have also been revised downward, due to an increase in costs (supplies, energy, oil, etc.) and Codelco's decision to apply the instantaneous depreciation regime in the 2021 and 2022 tax periods. However, the estimate for private mining tax revenues has increased somewhat due to the higher copper price forecast this year, although the increase is moderate based on preliminary data for the first quarter.

- On the spending side, committed expenditures are estimated at $61,823,200 million, representing 23.4% of GDP and an increase of 1.3% relative to the last reported estimate. The increase is explained by the extension of the Emergency Family Income (EFI) program from April to June, the implementation of Law N°21,419 creating the Universal Guaranteed Pension, and the recalculation of interest on debt.

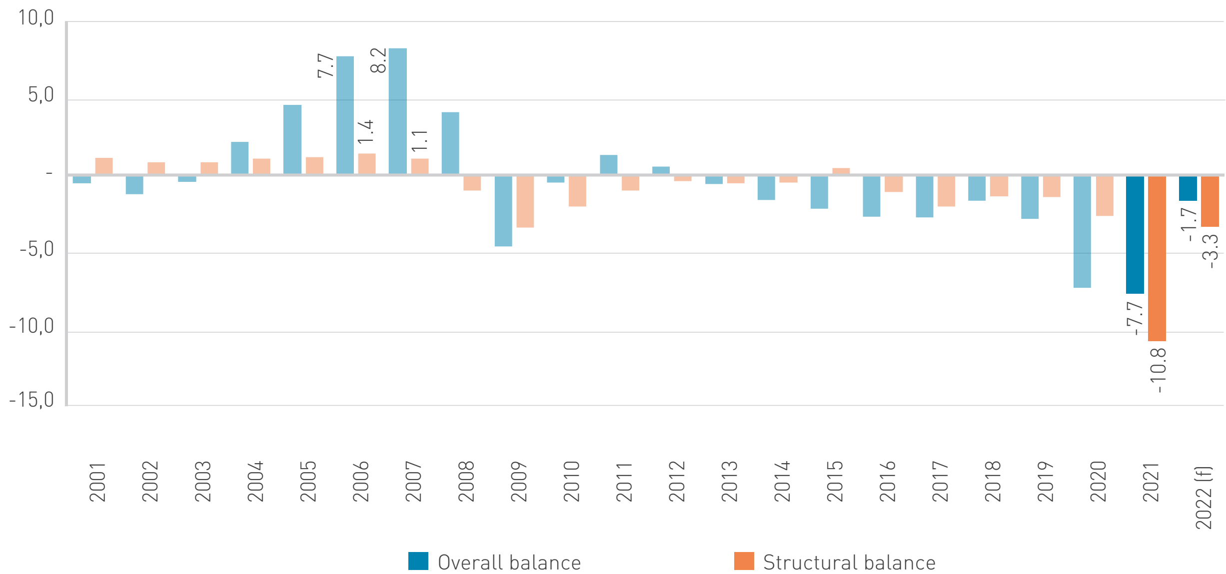
- Thus, an overall deficit of $4,380,944 million (1.7% of GDP) is projected for 2022, with a structural deficit of $8,866,908 million (3.3% of GDP). This is larger than the deficit forecast in the last report (see table 3 and figure 1). However, the structural deficit is lower than the forecast used for the 2022 Budget Law, and it continues to comply with the target of reaching a structural deficit of 3.9% of GDP, defined in Finance Ministry Decree N°1,579 of 2020, which establishes the fiscal policy targets. All in all, the structural balance presented in this report is consistent with the commitment to begin the process of normalizing public finances in order to ensure sustainability.

Table 3
Total Central Government: Balance, 2022
(millions of 2022 CLP and % of GDP)

		PFR 3Q 2021 FORECAST		PFR 4Q 2021		PFR 1Q 2022	
		CLP MM	% OF GDP	CLP MM	% OF GDP	CLP MM	% OF GDP
(1)	TOTAL OVERALL REVENUES	53,641,577	21.1	58,326,420	22.1	57,442,256	21.7
(2)	Total cyclically adjusted revenues	50,676,867	19.9	53,532,939	20.3	52,956,292	20.0
(3)	Total expenditures	60,698,005	23.8	61,002,334	23.1	61,823,200	23.4
(1) - (3)	**Overall balance**	**−7,056,428**	**−2.8**	**−2,675,914**	**−1.0**	**−4,380,944**	**−1.7**
(2) - (3)	**Structural balance**	**−10,021,138**	**−3.9**	**−7,469,395**	**−2.8**	**−8,866,908**	**−3.3**

GDP forecast in each report.
Source: Dipres.

Figure 1
Overall and Structural Balance, 2001–2022
(% of GDP)



Note: The figures for 2001 to 2010 use the 2003 National Accounts; the figures for 2011 to 2015 use the 2008 National Accounts 2008; and the figures for 2016 to 2020 use the 2013 National Accounts. Finally, 2021 uses the 2018 Accounts and the 2022 GDP forecast presented in this report.
Source: Dipres.
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UPDATE OF THE MEDIUM-TERM MACROECONOMIC AND FISCAL SCENARIO: 2023–2026

- The structural balance target for the current presidential period will be based on an analysis of the medium-term sustainability of the gross debt, moving toward a dual-rule fiscal policy for Chile. This innovation is based on recommendations by the Organization for Economic Cooperation and Development (OECD) and Chile's independent fiscal council (Consejo Fiscal Autónomo), which suggest that the introduction of a dual rule is a necessary element for ensuring fiscal sustainability while at the same time addressing the country's structural (social) needs.
- The new fiscal policy framework will be designed such that, in the medium term, there is a low probability that the gross debt will exceed a prudent threshold. Therefore, starting from a structural deficit of –3.3% of gross domestic product (GDP), a demanding, but realistic convergence process has been defined, namely, 0.75 points of GDP per year during the presidential period.
- The medium-term scenario considers GDP growth of 0.4% in 2023, in line with the forecast in the most recent Monetary Policy Report. In 2024–2026, growth will average 3.0%, according to forecasts by the Committee of Independent Experts on Trend GDP. Domestic demand is expected to gradually return to growth rates comparable to the pre-pandemic average.
- The copper price should converge to nominal values around its long-term level more slowly than projected in the last PFR, while the exchange rate should reach about CLP 740 to the dollar toward the end of the forecast horizon. Finally, the scenario assumes that inflation will begin to converge to the Central Bank's target late this year and will be around 3.0% from 2023 through the end of the forecast horizon (see table 4).

Table 4
Macroeconomic Assumptions, 2023–2026

	2023		2024		2025		2026	
	PFR 4Q 2021	PFR 1Q 2022	PFR 4Q 2021	PFR 1Q 2022	PFR 4Q 2021	PFR 1Q 2022	PFR 4Q 2021	PFR 1Q 2022
GDP (annual change, %)	1.0	**0.4**	2.3	**3.0**	2.9	**3.0**	3.0	**3.0**
DOMESTIC DEMAND (annual change, %)	0.0	**−1.0**	2.1	**2.2**	2.6	**2.9**	2.8	**2.8**
CPI (annual change, % average)	3.2	**3.6**	3.0	**3.0**	3.0	**3.0**	3.0	**3.0**
EXCHANGE RATE (CLP/USD, average, nominal value)	794	**786**	758	**768**	737	**754**	730	**745**
COPPER PRICE (USD cents/lb, average, LME)	385	**424**	369	**403**	349	**383**	335	**370**

Source: Ministry of Finance.

- The revenue forecast for the total central government in the 2023–2026 period considers the macroeconomic scenario described above, the current tax structure, changes in tax revenue related to the Tax Modernization Law that entered into effect in 2020, and the projected surpluses transferred from public companies consistent with their current strategic plans and the profit distribution policies defined by the authority. The forecast also takes into account the effects of estimated changes in income deriving from the measures implemented under the COVID Agreement, for the protection of family income and the reactivation of the economy and employment, and other tax measures to support MSMEs, as well as the projected revenue from the reduction and elimination of tax exemptions (see Table 5).

- The updated estimates of committed expenditures for the 2023–2026 period are based on the committed expenditures outlined in the PFR for the 2022 Budget Law, plus the estimated expenditures included in the Financial Reports on new bills or Instructions on bills that were sent to Congress for discussion between September 2021 and March 2022, including the update for the increased spending associated with the Universal Guaranteed Pension (Law N°21,419) and the new estimate of interest expense in line with the debt requirements estimated in this Report.
- Thus, the updated expenditure of the total central government presents a decrease of 0.7% in 2023, real increases of 1.6% in 2024 and 1.7% and 2025, and finally a real increase of 0.9% in 2026 relative to the 2025 forecast.

Table 5
Total Central Government:
Overall and Structural Balances, 2023–2026
(millions of 2022 CLP, millions of USD, and % of GDP)

		2023	2024	2025	2026
(1)	Total overall revenues	59,915,125	62,120,825	64,052,776	65,255,698
(2)	Total committed expenditure	60,260,123	61,231,763	62,283,842	62,869,433
(3)	Cyclically adjusted revenues	58,018,062	61,144,078	63,964,188	65,794,678
(4)	**CAB target (% of GDP)**	**−2.6**	**−1.8**	**−1.1**	**−0.3**
(5)	Spending level compatible with the target	64,837,754	66,088,900	66,958,282	66,768,245
(6)	Buffer: Difference in expenditure: (5)–(2)	4,577,631	4,857,137	4,674,439	3,898,813
(7)	Difference in expenditure (millions of USD)	6,033	6,749	6,810	5,923
(8)	Difference in expenditure (% of GDP)	1.7	1.8	1.7	1.4
(9)	**Overall balance compatible with the target: (1)–(5) (% of GDP)**	**−1.9**	**−1.5**	**−1.1**	**−0.5**

Source: Dipres.

- Thus, the current PFR estimates that the central government's gross debt, consistent with the structural balance target, will be USD 185,752 million at year-end 2026, equivalent to 43.9% of GDP, while the net financial position is forecast at –39.2% of GDP in the same period (see table 6).

Table 6
Total Central Government: Estimated Net Financial Position,
Year-end 2023–2026
(millions of USD and % of GDP, 31 December of each year)

	2023		2024		2025		2026	
	USD MM	% GDP	USD MM	% GDP	USD MM	% GDP	USD MM	% GDP
Total Public Treasury assets	18,716	5.4	18,814	5.1	19,445	4.9	20,173	4.8
Total gross debt	143,934	41.6	159,291	42.9	173,896	43.9	185,752	43.9
Net financial position	**−125,218**	**−36.2**	**−140,478**	**−37.8**	**−154,451**	**−38.9**	**−165,579**	**−39.2**

Source: Dipres.

- Additionally, this PFR expands and institutionalizes the use of alternative medium-term scenarios, in line with international best practices, in order to explore the sensitivity of the results presented earlier.

- In general, only in the optimistic scenario would overall revenues exceed the forecast in the PFR for the fourth quarter of 2021, whereas structural revenues would be below the projections in that report in all the scenarios (baseline and alternative). Thus, in terms of fiscal buffers, the calculations point to a smaller cushion, relative to the last PFR, by at least USD $3,516 million and up to USD 5,486 million for the 2023–2026 period, considering the highest- and lowest-growth scenarios, respectively.

- Finally, the different macroeconomic scenarios generate different dynamics for the gross debt in the forecast horizon. Specifically, the optimistic scenario leads to a debt path under the baseline scenario, reaching 42.8% of GDP toward the end of the projection horizon. In contrast, the pessimistic scenario leads to gross debt of around 46.7% by late 2026.