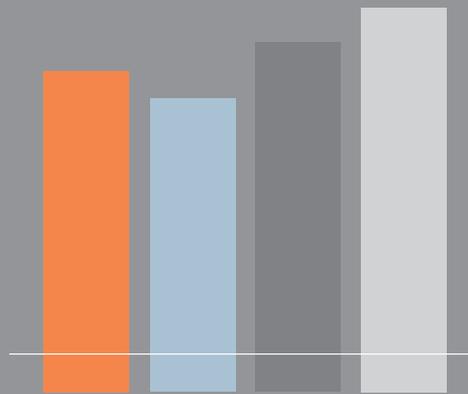


THIRD QUARTER 2021



PUBLIC FINANCE REPORT

(SUMMARY)

SUMMARY

UPDATE OF THE 2021 FISCAL SCENARIO

Global economic activity continues to recover at a good pace, albeit somewhat unevenly among countries. The recovery has been fairly fast in the developed economies, favored by the marked acceleration in vaccination rates and the gradual reopening process, and some countries have even recovered their pre-pandemic output levels as of mid-2021. In the emerging economies, the recovery has been slower and more heterogeneous than in the advanced countries, reflecting uneven progress in their vaccination processes and the more limited space available for implementing fiscal and monetary measures. In this context, the International Monetary Fund projects world GDP growth of 6.0% for the current year.

The more dynamic global activity has kept commodity prices high. The copper price, in particular, has benefited from expectations of a shortage of the metal in the short term and tight inventories, thereby sustaining the high prices recorded since the second quarter. The copper price forecast has therefore been adjusted slightly to USD 4.22 per pound, up from USD 4.11.

In the case of Chile, the local economy has been more dynamic than expected, due to the rapid adaptation of a broad set of sectors to the current health restrictions, the strong fiscal support for households and businesses, and, most recently, the gradual reopening of the country as the spread of COVID-19 has slowed. The latter trend reflects the success of the local vaccination process.

As a result, in the current Public Finance Report (PFR), the 2021 GDP growth forecast has been revised upward to 9.5% (versus 7.5% in the last PFR), based on the better-than-expected performance in the first half, the greater adaptation of the economy, the recovery of confidence indicators, and the additional government support to households, in the context of an external scenario that remains favorable.

Table 1
2021 Macroeconomic Assumptions

	IFP IIT 2021	IFP IIIT 2021
GDP (annual change, %)	7.5	9.5
DOMESTIC DEMAND (annual change, %)	12.6	16.2
CPI (annual change, % average)	3.7	4.1
EXCHANGE RATE (CLP/USD, average, nominal value)	712	741
COPPER PRICE (USD cents/lb, average, LME)	411	422
WTI OIL PRICE (USD/bbl)	64	66

Source: Ministry of Finance.

In the fiscal arena, revenues of CLP 55,233,026 million are forecast for 2021, which represents a marginal increase of 0.1% relative to the last PFR. This reflects the fact that the improvement in the macroeconomic scenario, in particular domestic demand, is almost entirely offset by a lower budget execution than projected in the forecast in the last PFR, according to the data available through the month of July. Consequently, it is estimated that overall central government revenues will grow 33.1% in real annual terms in 2021, representing 23.3% of GDP.

Among the different revenue components, other (non-mining) tax revenues have been revised upward, with estimated real annual growth of 28.0%. This incorporates the updated revenue forecast deriving from the 2020 Tax Modernization Law, as well as the income effects of the reversal of the MTTRA tax relief measures implemented in 2020.¹ Gross copper tax revenues have also increased (267.2% in real annual terms), due to the higher copper price and the more depreciated exchange rate.² Private mining tax revenues (GMP10) have been revised downward slightly relative to the last PFR—in particular due to a decrease in expected revenues from the additional tax—but they will nonetheless recorded significant growth year-on-year (121.5% in real annual terms). Finally, income from the remaining revenue components has been adjusted downward, in line with information obtained from the budget execution in the last three months through July 2021.

Table 2
Total Central Government: Revenues, 2021

(millions of 2021 CLP, % of GDP, and % real annual change)

	CLP MM	REAL ANNUAL CHANGE (%)	(% GDP)
TRANSACTIONS AFFECTING NET WORTH	55,214,127	33.1	23.3
Net tax revenues	44,357,934	31.9	18.7
Private mining taxes	3,085,429	121.5	1.3
Other taxes	41,272,505	28.0	17.4
Gross copper revenues	3,895,886	267.2	1.6
Social security contributions	2,812,929	-13.0	1.2
Donations	127,966	8.0	0.1
Property income	413,049	-54.0	0.2
Operating income	1,285,047	58.5	0.5
Other revenue	2,321,316	33.3	1.0
TRANSACTIONS IN NONFINANCIAL ASSETS	18,899	23.6	0.0
Sale of physical assets	18,899	23.6	0.0
TOTAL	55,233,026	33.1	23.3

Source: Dipres.

¹ The effect of all the implemented tax measures is projected to result in higher revenues of CLP1,079,914 million for 2021, of which CLP24,032 million correspond to measures implemented in response to the COVID-19 pandemic.

² This forecast incorporates the fact that Codelco has absorbed all accumulated tax losses from previous periods—due to the higher copper price—and thus began to pay first-category income taxes, as well as the additional 40% tax assessed on state-owned companies (D.L. 2,398), starting in June of this year. In addition, there has been a greater transfer of surpluses (dividends) to the Treasury, in line with the transfer schedule established for the year.

Considering the adjustment to the macroeconomic scenario and the structural parameters defined by the Committees of Independent Experts for the preparation of the 2021 Budget, cyclically adjusted (or structural) revenues are forecast at CLP 47,831,497 million, which implies a reduction of 3.4% relative to the last PFR.

Central government expenditures, in turn, are projected to reach CLP 74,970,710 million, which represents real annual growth of 32.1% and is 4.8 p.p. higher than forecast in the last report. This is equivalent to 31.7% of GDP, which is the highest level as a share of GDP on record. This reflects the extension of the Universal Emergency Family Income (EFI) program in November and December, the implementation of the Labor EFI for people who were formally employed starting in August of this year or who received the New Employment Subsidy, and the reallocation of resources from the current budget.

Table 3
Total Central Government: Expenditures, 2021

(millions of 2021 CLP and % real change)

	2021 CLP MM	% CHANGE 2021/ 2020 EXECUTION
UPDATED 2021 EXPENDITURES, PFR Q2 2021⁽¹⁾	71,951,215	27.3
Universal EFI extension	4,556,800	
Labor EFI	427,200	
Other social support	142,400	
Resource reallocation: SENCE + Current expenditures and investment	-2,136,000	
Other ⁽²⁾	29,094	
UPDATED 2021 EXPENDITURES, PFR Q3 2021⁽³⁾	74,970,710	32.1

Notes:

(1) Using the inflation and exchange rate assumptions from the PFR Q2 2021: namely, 3.7% and 712.

(2) Change in interest and exchange rate expense.

(3) Updated inflation assumption: 4.1% average in 2021.

Source: Dipres.

Thus, taking the overall and cyclically adjusted revenue forecasts and the updates reported in this PFR, an overall deficit equivalent to 8.3% of GDP is estimated for 2021, which is 1.2 p.p. of GDP higher than estimated in the last PFR and also higher than the deficit of 7.3% of GDP recorded in 2020. This results in a projected structural deficit of 11.5% of GDP, which is 2.0 p.p. higher than estimated in the last PFR. As signaled in past reports, this represents a deviation from the structural balance target and implies that we are facing a de facto escape clause due to the impact of the measures implemented in response to the health and economic crisis caused by COVID-19, but it in no way alters the commitment to return to the structural balance rule in the coming years.

Table 4
Total Central Government: Balance, 2021

(millions of 2021 CLP and % of GDP)

		(CLP MM)	(% OF GDP)
(1)	Total overall revenues	55,233,026	23.3
(2)	Total cyclically adjusted revenues	47,831,497	20.2
(3)	Total expenditures	74,970,710	31.7
(1) - (3)	OVERALL BALANCE	-19,737,683	-8.3
(2) - (3)	CYCLICALLY ADJUSTED BALANCE	-27,139,212	-11.5

Source: Dipres.

Thus, gross debt will reach an estimated 34.9% of GDP at year-end, versus 34.1% in the last PFR, while the net financial position will close the year at -31.5% of GDP, compared to -29.2% in the last PFR.

UPDATE OF THE 2022 FISCAL SCENARIO

For 2022, the global economic recovery is expected to continue. The International Monetary Fund forecasts world GDP growth of 4.9% in the coming year, which will sustain the external boost for the Chilean economy. In this context of highly dynamic activity, a recovery of demand, and tight supply in the short term, the copper price is expected to fluctuate around USD 4.00 per pound.

At the local level, the 2022 annual growth rate has been revised downward to 2.5%, from 2.9% in the last report. This incorporates a more demanding comparison base due to the high growth in 2021. In terms of composition, services consumption and construction investment are expected to play a more important role in the growth dynamics of the coming year.

The exchange rate is projected to maintain an annual average around the level estimated for 2021 (that is, around CLP 740 to the dollar). Inflation, in turn, is expected to begin to slowly converge to the Central Bank's target in mid-2022, with a estimated annual inflation of 3.4% at the end of next year.

Table 5
Macroeconomic Assumptions 2022

	IFP IIT 2021	IFP IIIT 2021
GDP		
(annual change, %)	2.9	2.5
DOMESTIC DEMAND		
(annual change, %)	2.5	1.7
CPI		
(annual change, % average)	3.1	4.4
EXCHANGE RATE		
(CLP/USD, average, nominal value)	713	739
COPPER PRICE		
(USD cents/lb, average, LME)	395	400
WTI OIL PRICE		
(USD/bbl)	62	66

Source: Ministry of Finance.

In the fiscal arena, the projected macroeconomic scenario and the estimated fiscal income for 2021 provide the basis for forecasting the total central government's 2022 revenues, which are estimated at CLP 53,641,577 million (in 2022 currency). This implies a decrease of -7.0% in real terms relative to 2021.

Among the main components, net tax revenues are projected to show a real annual reduction of 8.7%, due to an estimated 11.1% real annual drop in other (non-mining) tax revenues, which will be partially offset by a 22.6% real annual increase in private mining tax revenues. In the case of other taxes revenues, a reversal is expected in 2022, after the end of the demanding comparison base of this year and the effect of other tax measures,³ returning toward levels consistent with their historical relationship with domestic demand.

Table 6
Total Central Government: Revenues, 2022

(millions of 2022 CLP, % of GDP, and % real annual change)

	2022 CLP MM	REAL ANNUAL CHANGE (%)	% OF GDP
TRANSACTIONS AFFECTING NET WORTH	53,627,529	-7.0	21.1
Net tax revenues	42,276,996	-8.7	16.6
Private mining taxes	3,950,349	22.6	1.6
Other taxes	38,326,648	-11.1	15.0
Gross copper revenues	4,055,216	-0.3	1.6
Social security contributions	3,088,884	5.2	1.2
Donations	153,159	14.6	0.1
Property income	994,021	130.5	0.4
Operating income	1,219,037	-9.1	0.5
Other revenue	1,840,216	-24.1	0.7
NET ACQUISITION OF NONFINANCIAL ASSETS	14,048	-28.8	0.0
Sale of physical assets	14,048	-28.8	0.0
TOTAL REVENUES	53,641,577	-7.0	21.1

Source: Dipres.

Regarding the structural parameters, the estimates provided by the Committees of Independent Experts for the preparation of the 2022 Budget result in a trend GDP growth rate 2.6% for 2022 and a reference copper price of USD 3.11 per pound. Taken together with the change in the overall revenue forecast, these estimates give projected cyclically adjusted revenues of CLP 50,676,867 million, which represents 19.9% of GDP and a real increase of 0.7% relative to the estimates in the PFR for the second quarter.

With respect to total central government spending, the draft 2022 Budget Bill was prepared in accordance with spending commitments for 2022, pursuant to the decree establishing the basis for fiscal policy.⁴ Thus, the structural balance will reach -3.9% of GDP next year.

³ The forecast for other (non-mining) tax revenues incorporates the updated tax revenue forecast deriving from the Tax Modernization Law, the revenue effects of the reversal of the MTTTRA tax relief measures implemented in 2020 and 2021, and the effect of other tax relief measures implemented during the pandemic. Thus, it is projected that the total effect of the implemented tax measures will imply lower income of CLP431,784 million in 2022, which includes CLP1,762,987 million in lower income due to the COVID-19 measures.

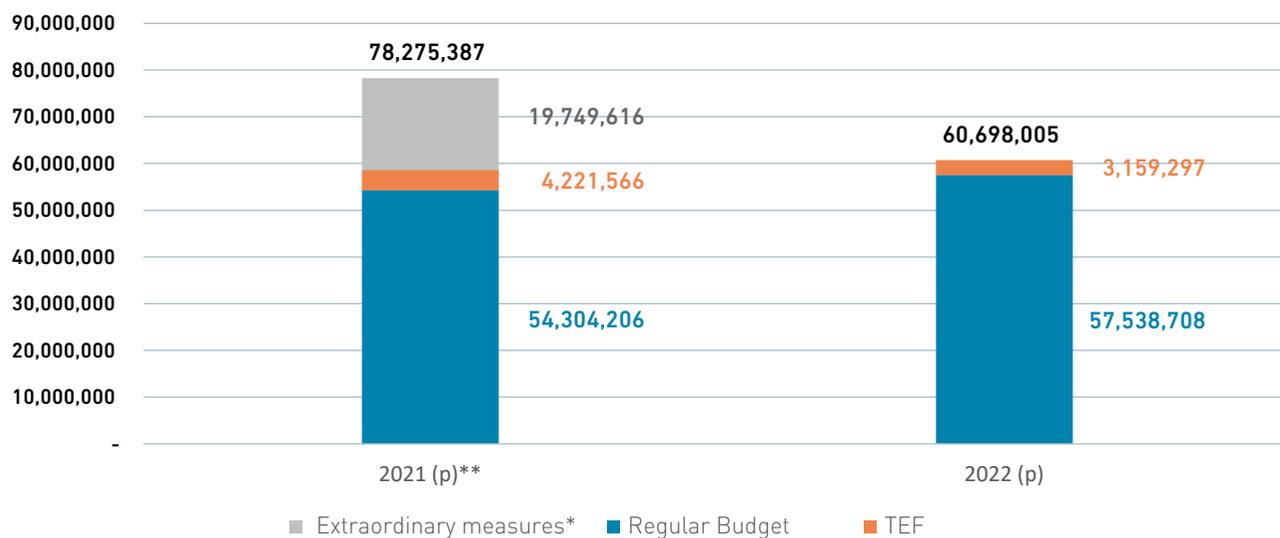
⁴ Ministry of Finance Decree N°1579 of 28 September 2020.

Consequently, the 2022 Budget Bill contemplates total central government spending of CLP 60,698,005 million, which represents real annual growth of 3.7% relative to the approved Budget Law for the 2021 fiscal year and a real annual contraction of 22.5% relative to the projected 2021 budget execution (which incorporates the extraordinary measures implemented to face the health and economic crisis deriving from the COVID-19 pandemic).

The budget is composed of two parts: First, the regular budget drawn up, for the second consecutive year, through a comprehensive spending review and second, the temporary expenditure financed through the Temporary Emergency Fund (TEF), based on the framework established in the June 2020 COVID Agreement, which is aimed directly at continuing to control the pandemic and supporting the economic and employment recovery.

Figure 1
Total Central Government: Expenditure Forecast, 2021–2022

(millions of 2022 CLP)



p: projection.

* The gray area shows the difference between the forecast in the PFR Q3 2021 and the approved 2021 Budget Law.

** 2021 data for the regular budget and the TEF correspond to the approved 2021 Budget Law.

Source: Dipres.

The above implies an overall deficit forecast of 2.8% of GDP for 2022, while gross debt and the net financial position should close the year at 37.5% and -33.7% of GDP, respectively.

Table 8
Total Central Government: Balance, 2022

millions of 2022 CLP and % of GDP

		CLP MM	% OF GDP
(1)	Total overall revenues	53,641,577	21.1
(2)	Total cyclically adjusted revenues	50,676,867	19.9
(3)	Total expenditures	60,698,005	23.8
(1) - (3)	OVERALL BALANCE	-7,056,428	-2.8
(2) - (3)	CYCLICALLY ADJUSTED BALANCE	-10,021,138	-3.9

Source: Dipres.

Figure 2
Overall and Structural Balance, 2002–2022

(% of GDP)



Note: the percentages of GDP are calculated using the National Accounts (CCNN) data for the year 2003 in the period 2001-2010, CCNN 2008 between 2011-2015 and CCNN 2013 between 2016-2020.

Source: Dipres.

UPDATE OF THE MEDIUM-TERM FISCAL SCENARIO: 2023–2026

The medium-term scenario considers GDP growth of 2.5% in 2023, which is above the range projected by the Central Bank in its most recent Monetary Policy Report (IPoM) (between 1.0% and 2.0%), and an average growth forecast of 2.9% for 2024 to 2026. Domestic demand is expected to grow at a higher rate in the medium term, returning to growth rates comparable to the pre-pandemic average, in line with the gradual normalization for both consumption and investment (conditional on the stabilization of the global epidemiological situation), in a context of monetary and fiscal policy normalization.

The copper price is expected to converge to values consistent with the long-term equilibrium price, in nominal terms, while the nominal exchange rate will be around CLP 700 to the dollar toward the end of the forecast horizon.

Table 9
Macroeconomic Assumptions, 2023–2026

	2023	2024	2025	2026
GDP (annual change, %)	2.5	2.8	2.9	3.0
DOMESTIC DEMAND (annual change, %)	2.7	2.7	2.8	2.9
CPI (annual change, % average)	3.3	3.0	3.0	3.0
EXCHANGE RATE (CLP/USD, average, nominal value)	719	705	700	700
COPPER PRICE (USD cents/lb, average, LME)	389	366	339	330
WTI OIL PRICE (USD/bbl)	62	58	55	53

Source: Ministry of Finance

In the fiscal arena, total revenues are projected to reach CLP58,259,781 million in 2026, which implies average annual growth of 2.1% in the 2023–2026 period. Based on the structural parameters estimated by the Committees of Independent Experts in August 2021, cyclically adjusted revenues are projected to record accumulated growth of 13.6% in real terms between 2023 and 2026, that is, an average annual rate of 4.3% in the period.

On the spending side, committed expenditures were updated based on the estimated expenditures in the financial program accompanying the 2022 Budget Bill. This takes into account compliance with current legal and contractual obligations, the operational continuity of public organizations, and all commitments made to date. The convergence path simulated for 2023 to 2026 is demanding,⁵ but even so it maintains a positive cushion throughout most of the period, with an estimated USD 7,249 million accumulated in these years.

⁵ The convergence path consists in reducing the structural deficit to 3.9% of GDP in 2022 and then lowering it by around one point of GDP each year.

Table 10
Total Central Government: Balance, 2023–2026

(millions of 2022 CLP and % of GDP)

	2023	2024	2025	2026
(1) Total overall revenues	53,932,207	56,536,668	57,411,529	58,259,781
(2) Total committed expenditures	58,342,022	59,291,796	60,109,594	60,594,942
(3) Cyclically adjusted revenues	52,830,207	56,568,319	58,658,116	60,025,470
(4) CAB TARGET (% OF GDP)	-2.9	-1.9	-0.9	0.1
(5) Spending level compatible with the target	60,581,779	61,885,148	61,324,815	59,829,436
(6) Buffer: Difference in expenditures (5)–(2)	2,239,757	2,593,352	1,215,221	-765,506
(7) Difference in expenditures (millions of USD)	3,216	3,917	1,904	-1,236
(8) Overall balance compatible with the target (1)–(5) [% of GDP]	-2.5	-1.9	-1.4	-0.5

Source: Dipres.

In this context, the current PFR estimates that the central government's gross debt, consistent with the structural balance target, will be USD 185,011 million at year-end 2026, equivalent to 38.6% of GDP, while the net financial position is forecast at -35.9% of GDP in the same period.

Table 11
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	
	MMUS\$	% PIB						
Total Public Treasury assets	13,724	3.6	13,413	3.2	13,070	2.9	12,711	2.7
Total gross debt	149,138	39.3	164,585	39.6	177,223	39.6	185,011	38.6
NET FINANCIAL POSITION	-135,414	-35.7	-151,172	-36.4	-164,153	-36.7	-172,301	-35.9

Source: Dipres.

MANAGEMENT CONTROL AND EVALUATION SYSTEM

The evaluation system generates public information on the performance of programs and institutions, which is used to support budget decisions. Thus, the results of the evaluation process can contribute not only to determining the amounts of resources allocated, but also to increasing transparency, improving budget planning, and orienting the necessary changes for achieving an adequate performance.

Of the total evaluations completed in 2021, none were given a “Good Performance” rating. The majority (50% or seven evaluations) were graded as “Low Performance,” followed by “Average Performance” (35.7% or five evaluations) and, finally, “Poor Performance” (14.3% or two evaluations). In addition to possible budget adjustments or freezing, the most common consequence of these processes is the signing of commitments, the adjustment of annotations, or the conditioning of processes to improvement in the detected deficiencies.

INSTITUTIONAL ADVANCES AND FISCAL AND BUDGET TRANSPARENCY

While there is a broad consensus on the value of transparency from the perspective of accountability and efforts to recover confidence in institutions, in the area of public finances this is reinforced by the importance of heightening the transparency of the real state of a country’s fiscal situation. In this case, transparency not only serves the objectives of controlling corruption and detecting conflicts of interest, but is also a foundational factor in the credibility of the fiscal institutional framework.

The Budget Office has addressed this challenge from a continuous improvement approach, gradually increasing the availability of information across all segments of government. This can be seen in the growing volume of available information on the budget execution, the public debt, Treasury assets, the structural balance, and so forth. Most recently, progress is reflected in the quarterly publication of the PFR and human resources statistics, the publication of methodological reports with long-term forecasts, the inclusion of more detail in financial reports, and a series of improvements in the publication of open data and official statistics (the budget data platform Presupuesto Abierto, program monitoring, and performance indicators).

To identify gaps and define an improvement agenda, in 2021 Chile voluntarily participated in a Fiscal Transparency Evaluation process led by the IMF. Details on the experience, preliminary results, and a preview of the agenda are provided in this report.

