

CHILE – Public Finance: Reform to bolster SWFs underwhelms

- Chile's fiscal institutional framework has experienced substantial modifications in recent years. This report describes Chile's sovereign wealth funds (SWFs) in the context of recently proposed legislation.

Context

Rules-based fiscal policy has been one of Chile's key macro strengths. However, this pillar has been gradually eroding. In fact, while still in a relatively strong position, Chile's fiscal accounts have been the "weakest link" in the macro policy framework over the past several years, evidenced by non-compliance with the structural deficit targets, the swift accumulation of gross public debt, and continuous drawdowns from the Stabilization Fund (even in the absence of a crisis).

In this context, discussions surrounding the pension reform approved earlier this year focused, among other topics, on additional pressure on the fiscal accounts from the projected broadening and enhancing of benefits of the guaranteed pension program (PGU). In parallel, demographic dynamics and aging are posed to present important headwinds to the fiscal accounts. These concerns were explicitly expressed in the pension reform with a legal obligation to the government to present a bill within 180 days that modifies the fiscal management of the Stabilization Fund and the Pension Reserve Fund (PRF), with the objective of reaching a level target in steady state.

What does the bill propose?

In this context, the government recently presented a bill that introduces minor modifications, in sum:

1. Mandates every incoming administration to include a chapter in the Public Finance Report on the management of the sovereign wealth funds during the administration's four-year plan;
2. When a nominal fiscal surplus greater than 0.4% of GDP is achieved, the surplus will be evenly split between the Stabilization Fund and PRF. Currently, when a surplus is achieved, the first 0.5% of GDP are sent to the PRF and then the rest to the Stabilization Fund.
3. Annual withdrawals from the Stabilization Fund greater than 0.3% of GDP must be authorized by Congress (simple majority). This norm had been incorporated on a transitory basis for 2025 but would now be permanent.

Remarkably, the bill does not include a minimum threshold or target for the SWFs; maintaining the status quo of no targets.

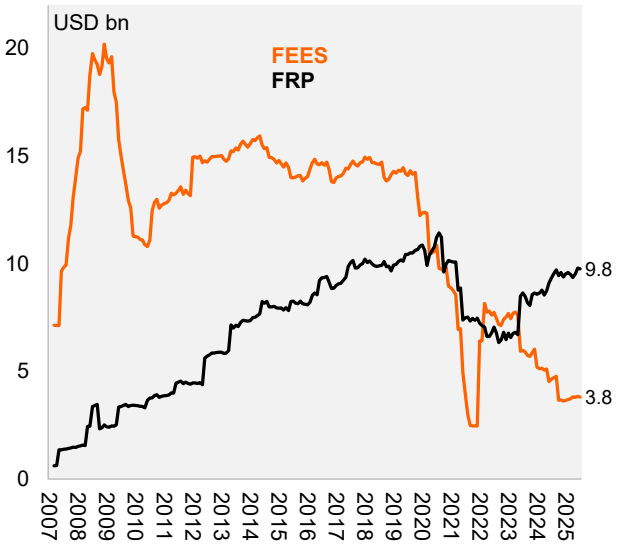
A brief overview of the SWFs

The Stabilization Fund's (commonly known as the FEES) objective is provide stability of Chile's public finance and the provision of public goods and services over time, subject to abrupt changes in the business cycle or extraordinary events.

The Stabilization Fund reached roughly 1.1% of GDP by the end of July, with AUM at ~USD3.8 billion, essentially flat since November 2024. The FEES experienced withdrawals in 2024 totaling USD1.6 billion even though the economy did not experience a major shock. AUM are well below the pre-covid levels of roughly USD12.3 billion, about 4.4% of GDP at the time.

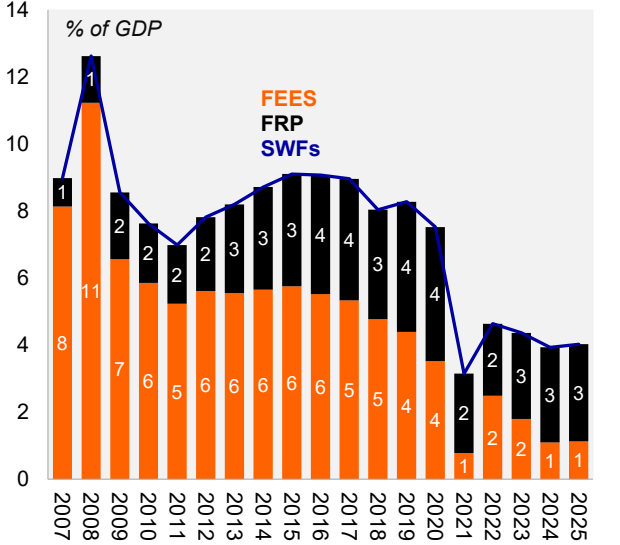
The PRF reached ~USD9.8 billion (2.9% of GDP) by the end of July, having peaked at about USD11.4 billion in August 2020 (4.1% of GDP). Withdrawals for a total of USD900 million are expected in the next few years, in the form of loans to the new Autonomous Pension Fund (FAPP); a first USD200 million withdrawal was reported by the MoF in August.

AUM in SWFs



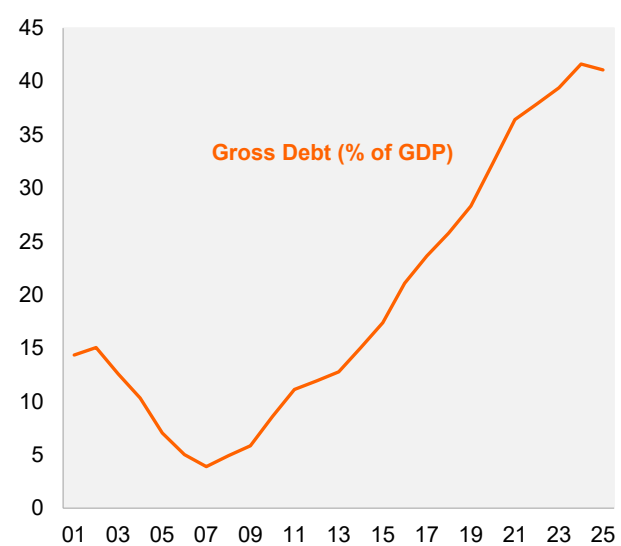
Source: Central Bank of Chile.

AUM in SWFs as a share of GDP



Source: Central Bank of Chile.

Gross Public Debt



Source: Ministry of Finance.

An overview of the flows to the SWFs.

First, on inflows to the PRF, the Fiscal Responsibility Law initially included a mandatory annual contribution of at least 0.2% of GDP (even in the case of a fiscal deficit) capped at 0.5% of GDP when a nominal surplus was achieved at that level, which led to a gradual rise in this fund's AUM. However, mandatory contributions were annulled for two consecutive years during the Covid crisis. Since then, changes to the fiscal institutional framework in 2024¹ eliminated the minimum mandatory annual contribution, leaving it to take place when a nominal fiscal surplus is achieved, capped at 0.5% of the previous year's GDP. Our understanding of the proposed bill is that when a nominal fiscal surplus is (eventually) met, the first 0.4% of GDP would be saved in the PRF, and additional resources would be distributed equally with the FEES.

Withdrawal rules from the PRF have changed a few times since its inception. Since August 2024, withdrawals from the PRF must be determined by the Ministry of Finance and must comply with two objectives: annual withdrawals from the PRF must be stable and predictable, and the inflation adjusted value of the Fund must be maintained over time. In any case, they are capped at 0.5% of GDP per year. As mentioned above, the pension reform approved earlier this year incorporated twenty-year loans of up to USD900 million to the new FAPP, to take place through June 2027.

The Fund is still projected to receive a mandatory inflow equivalent to nominal fiscal surpluses in excess of 0.5% of GDP, whenever these take place. However, these injections are not mandatory when the nominal surplus is below the structural surplus, such as in 2022 when the former reached 1.1% of GDP, and the latter 0.5% of GDP. As such, over time, this cap should lead to even smaller and fewer injections to the Stabilization Fund. Rules on withdrawals remained unchanged, that is, at the discretion of the MoF to finance the deficit, amortizations of public debt, and inflows to the PRF.

The Stabilization Fund reaches roughly 1.6% of GDP (USD4.5 billion in AUM by the end of June), well below the 5-7% of GDP recommended by the IMF (see Technical Assistance report [here](#)) as an adequate size for a liquidity buffer for Chile. The approved legislation does not refer to a minimum or desirable size for the Stabilization Fund. The MoF does not forecast nominal fiscal surpluses over the following years, suggesting inflows to the Stabilization Fund seem unlikely; in fact, its AUM may continue to decline as it continues to be used as a regular source of financing, with withdrawals totaling USD1.6 billion in 2024. The PRF reaches USD9.1 billion (2.7% of GDP) in AUM by the end of June 2024.

In conclusion, an underwhelming bill ...

The bill fails to address the original concern by entirely avoiding establishing an actual target or minimum threshold for the level of the SWFs. That is the crux of the issue. In a Technical Assistance Report², the IMF's simulations suggest a buffer in a Stabilization Fund between 5-7% of GDP may mitigate liquidity needs during tail risks. We were expecting an explicit reference to a medium-term target that would act as an anchor, much like the "prudent debt level" on the liabilities side of the government's balance sheet. The achievement of the target would be referenced by each incoming administration within the first 90 days, along with their structural balance targets, and then monitored on a quarterly basis in the Public Finance Reports.

At roughly 1.1% of GDP, the Stabilization Fund is currently well below the IMF's recommended liquidity threshold of 5-7% of GDP. Current AUM in the Stabilization Fund is also well below the withdrawals that took place during the Global Financial Crisis (5.5% of GDP), and the covid crisis (3.6% of GDP). The MoF does not forecast nominal fiscal surpluses over the following years, suggesting inflows to the Stabilization Fund or the Pension Reserve Fund are unlikely, unfortunately.

Perpetuating Congress' authorization of Stabilization Fund withdrawals greater than 0.3% of GDP per year seems reasonable, as it balances a minor degree of flexibility to manage unexpected swings in the government's liquidity needs, along with greater control on the asset side of the government's balance sheet. Congress already authorizes

¹ See our report [here](#).

² See [IMF Technical Assistance Report-Fiscal considerations in Managing Stabilization Funds \(July, 2023\)](#).

gross debt requirements on an annual basis in the budget bill. If approved, the Budget Office should pre-emptively build up a larger liquidity buffer at the Treasury.

We could benefit from more clarity regarding the decision to decide on 0.4% of GDP as the threshold to then split surpluses between SWFs.

While deterioration of fiscal accounts seems to be a global phenomenon, appropriately and timely addressing improvements to the fiscal institutional framework could allow for Chile to continue to stand out among peers. As such, discussions in Congress are likely to focus on establishing targets and may stress negotiations with the 2026 budget bill to be presented next week.

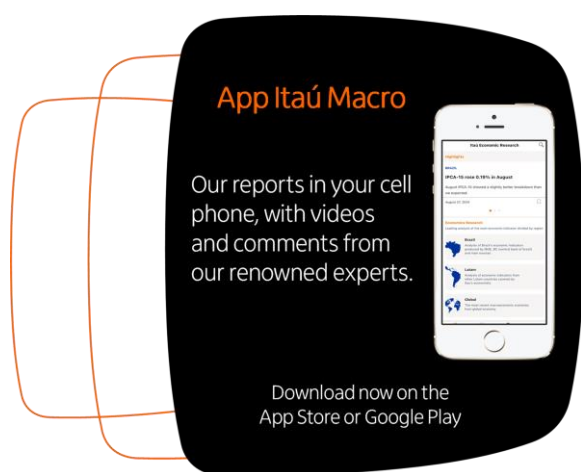
Andrés Pérez M.
Vittorio Peretti
Andrea Tellechea Garcia
Ignacio Martínez

Macro Research – Itaú

Mario Mesquita – Chief Economist

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