Macro Vision

June 25, 2024

An update on Chile's fiscal dynamics

- In our recent monthly Global (link) we highlighted fiscal risks in LatAm as an important watchpoint, especially due to revenue weakness in many economies. In this note we provide an update on Chile's fiscal dynamics in the year through April, financing needs, dollar sales, and the reform agenda. The note updates several issues that were discussed in a January report (link).

I. On the 2024 Budget Execution

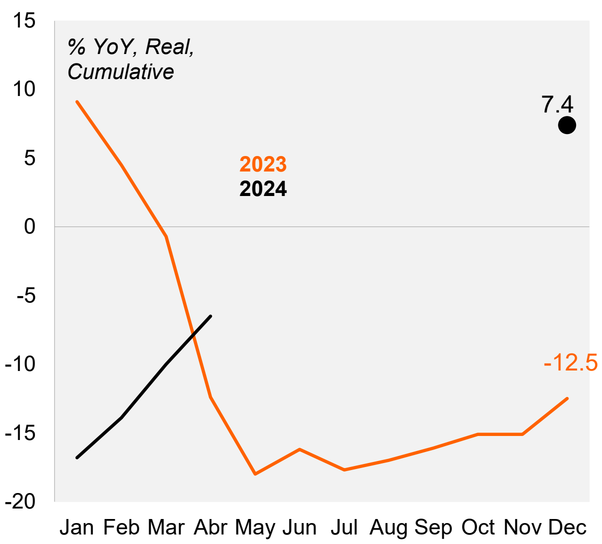
- **How have revenues performed in 2024?**

Chile's fiscal dynamics since 2023 have been mainly a story of revenue underperformance, consistent with a slowing economy… In fact, revenues in 2023 fell by 12.5% YoY, driven by cyclically weak sources, lower copper-related payouts, and a normalization of lithium payments, among others.

… however, they seem to have finally turned the corner. Revenues started off the year on the same weak foot of 2023 with a real contraction of 10% YoY during 1Q24. However, April (a key month for fiscal revenues due to the Tax Season, averaging 14% of annual revenues between 2012-2019, 13.2% in 2023), finally showed a better picture, printing slightly positive at 0.6% YoY.

Cyclically related revenues and copper payouts both rose significantly, while lithium-related payments contracted (mainly reflecting lower lithium prices). However, even though revenue growth turned positive, they appear below target as we estimate that the shortfall in cyclically related revenues (tributación resto contribuyentes, 79% of the total 2024 revenue forecast) through April is equivalent to 5% of the official forecast. Altogether, real revenues as of April have declined by 6.5% YoY (-10% as of March), implying a significant improvement would be needed to achieve the +7.4% official 2024 forecast. So, in a nutshell, w**hile dynamics improved further in April, they remain far from the momentum needed to achieve the official revenue growth forecast.**

Central Government's Revenues

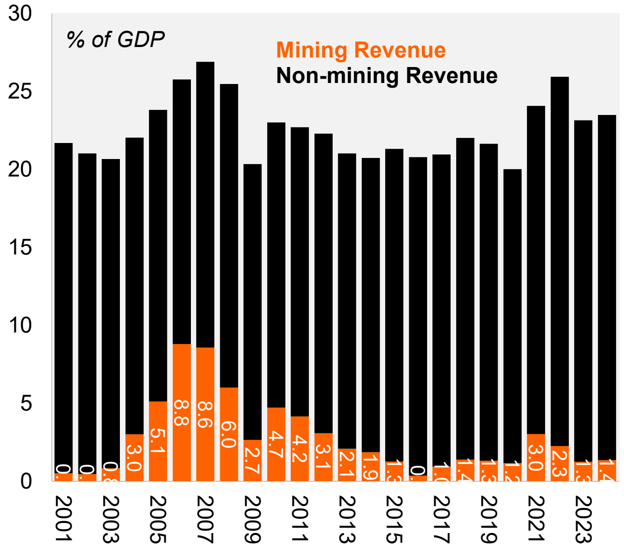


Source: Budget Office, Itaú.

- **What is the projected impact of higher copper prices?**

Copper revenues are relevant for Chile's fiscal coffers, yet arguably less so than in the past. Mining revenue peaked at 8.8% of GDP in 2006 and has since trended down, due to a combination of higher costs, the deterioration of ore grades, and lower production from CODELCO, among other factors. Mining revenue is projected to reach 1.4% of GDP in 2024, according to the MoF.

Central Government's Revenues



Source: Budget Office, Itaú.

In the recent Public Finance Report, the MoF revised the copper price forecast up to an annual average of USD 4.20 per pound, up from USD3.84 in the previous report. Despite higher projected copper prices, the MoF's total revenue forecasts practically did not change for the year (+7.4% YoY, 8% in the previous forecast) because they partly compensate for lower projected lithium-related revenue (0.25% of GDP, down from 0.5% of GDP).

However, in an optimistic scenario in which copper prices average USD5,00 per pound for the remainder of 2024 (well above the USD4.57 average of the last month), we estimate that additional fiscal revenue would only reach roughly 0.4% of GDP. The MoF usually estimates an additional USD300 million in annual revenues for every additional USD0,1 in average copper prices.

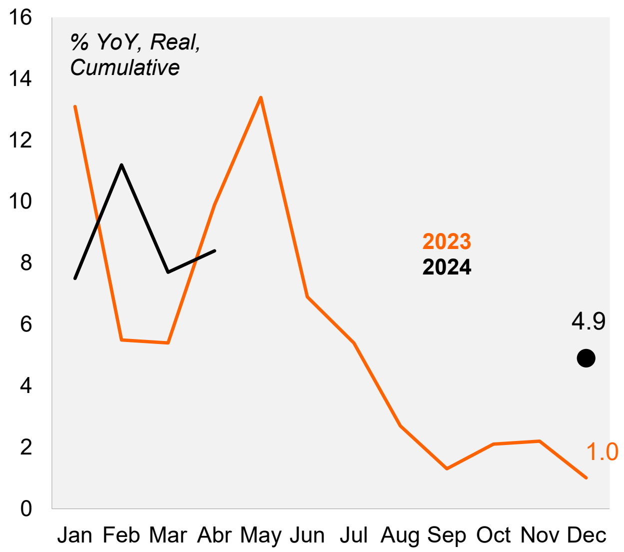
- **Why has expenditure growth been so strong this year?**

Spending remains unexpectedly strong through April. The central government's real expenditures rose by a whopping 10.6% YoY in April (+7.7% in 1Q24). Current expenditures rose by 11.6% (1.2% in March), with increases across the board, especially in subsidies & donations, personnel, and pension payouts. Capital expenditures rose by 4.8% YoY, down again from the large increases in public investment and capital transfers to regions from the first two months of the year.

Spending growth remains unusually strong and front-loaded rising by 8.4% YoY year-to-date, well above the MoF's 2024 projected 4.9% YoY rise. As of April, expenditures have reached 32.3% of the approved Budget, above 2023 (31.3%) and 2022 (30.8%). A faster execution of the budget relative to previous years is primarily driven by capital expenditures (24% of the annual budget), above 2023 (19.7%) and 2022 (18.4%). The pace of current expenditures relative to this year's budget sits at 33.8% of the total, only slightly above previous years (2023: 33.6%; 2022: 33.5%). In our view, frontloaded capital expenditures might be related to the municipal elections scheduled for October 27, 2024.

Tightening on the horizon. The MoF must implement an adjustment this year with spending and revenue measures equivalent to roughly 0.4% of GDP to meet the 2024 structural deficit target (1.9% of GDP).

Central Government's Expenditures

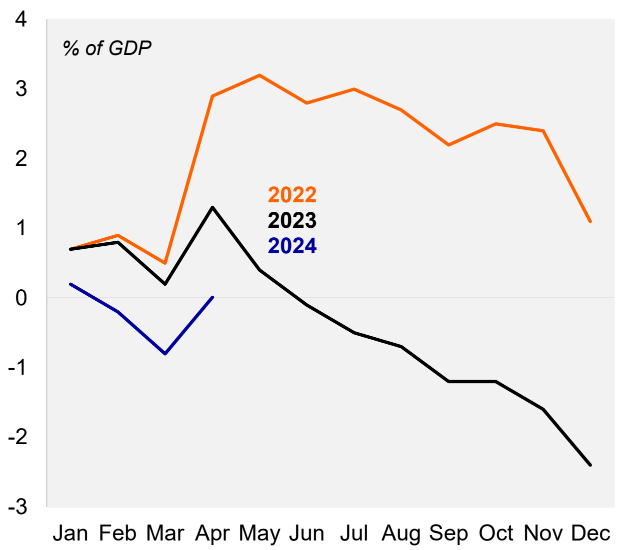


Source: Budget Office, Itaú

- **How does the fiscal balance compare relative to previous years?**

The monthly fiscal balance in April snapped back to a surplus of 0.8% of GDP (-0.7% in March), below the 1.0% surplus of April 2023. The year-to-date fiscal balance now reaches 0.01% of GDP (1.3% YTD as of April 2023). The MoF's 2024 nominal (structural) fiscal balance forecast is 1.9% (2.2%) of GDP, implying a moderate fiscal consolidation from the 2.4% of GDP and 2.7% of GDP nominal and structural deficits in 2023.

Cumulative Fiscal Balance



Source: Budget Office, Itaú.

- **How large is the fiscal impulse?**

According to the recent Public Finance Report, the 2023 cyclically adjusted primary balance reached a deficit of 1.9% of GDP, which is projected to narrow this year to a deficit of 1.2% of GDP. As such, even though fiscal expenditures through April have been strong, this year's fiscal impulse measured by the annual change in the cyclically adjusted primary balance is projected to be contractionary at -0.5% of GDP.

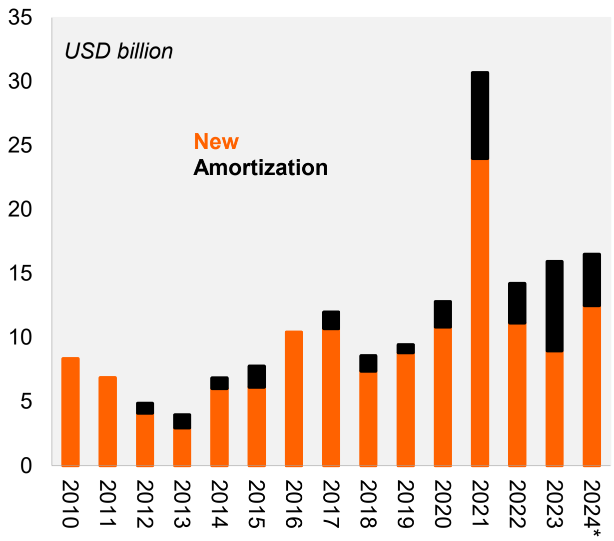
II. Financing

- **What are the government's financing needs for 2024 and how will they be sourced?**

The Ministry of Finance announced the 2024 gross debt issuance plan totaling USD16.5 billion, which covers deficit financing and below-the-line financing needs (amortizations, capitalizations of certain funds, and a needed replenishment of low cash buffers). The planned amount is equivalent to the gross amount issued in 2023, according to our estimates, yet slightly below the annual USD18 billion cap authorized by the 2024 Budget Law, suggesting that the debt issuance plan could eventually be revised up slightly and/or is likely to be complemented by financing from multilateral organizations such as the World Bank or the IADB.

While the total gross issuance plan for 2024 is similar in size to the amount issued in 2023, the composition between net financing and amortizations is different. The 2024 issuance plan considers net financing needs for USD12.7 billion, above the USD9.7 billion from 2023, while the refinancing of maturing debt reaches USD3.8 billion, below the USD6.8 billion of 2023. See the chart below.

Central Government's Debt Issuance per Year

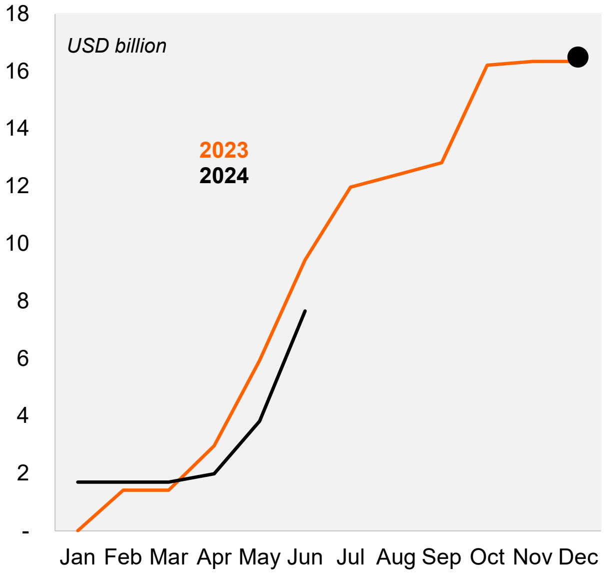


Source: Ministry of Finance.

Consistent with efforts to gradually reduce the share of foreign currency debt (estimated at 35.7% of the total in 2023), the Ministry of Finance plans on increasing the planned gross flow of local currency debt to 90%, up from our estimate of 81.6% in 2023. A higher share of local currency financing could face headwinds considering the lingering effects of the large pension fund withdrawals that significantly reduced domestic savings.

We estimate that the MoF will have issued a total of USD 7.7 billion in the year through June, suggesting an important USD 7.8 billion should be issued during the second semester of this year to reach the USD 16.5 billion annual plan. In any case, the flow of issuance seems to follow a similar pattern as last year (see chart below). Rates at the long end may remain pressured due to the levels of the US Treasury yields, but also due to other factors. First off, the sovereign's higher financing needs exceed our estimates of total household savings inflows (somewhat above USD8 billion on an annual basis) in individual pension savings accounts. Second, pension fund withdrawal discussions in Congress are likely to take place on an annual basis, which even if they are not approved, should weigh on risk premium.

Cumulative Debt Issuance in the year



Source: Ministry of Finance, Itaú.

- **How many dollars is the MoF expected to sell in 2024?**

As we have mentioned in previous reports, the MoF has been an active participant in the local foreign exchange spot market in recent years. For context, in March of 2020 the MoF announced they would competitively auction dollars from the Treasury to finance the high and rising expenditure needs related to the pandemic, further enhancing fiscal transparency, and providing additional guidance regarding the Government's participation in the local FX market.

Dollar sales through auctions have been implemented to finance the government's fiscal needs (primarily in pesos), disregarding exchange rate considerations, in line with Chile's free-floating exchange rate regime. The Central Government's official dollar holdings are mainly booked in the Treasury and the sovereign wealth funds (Stabilization Fund and the Pension Reserve Fund). The SWFs are entirely invested abroad, with the Stabilization Fund reaching roughly USD5 billion (1.6% of GDP) by the end of April, and the Pension Reserve Fund at USD8.5 billion (2.6% of GDP). Separately, the Central Bank also manages international reserves, which as of the end of May reached USD 46 billion (14% of GDP). Dollar assets in the Treasury are accumulated primarily from offshore bond sales, loans from multilateral financial institutions, copper-related revenue, and to a lesser extent periodic withdrawals from the sovereign wealth funds. The MoF enjoys a dollar surplus on a flow basis, as dollar inflows largely exceed dollar outflows. The latter are mainly in the form of foreign currency denominated debt amortization and interest payments, periodic injections to the SWFs and other funds.

After being on the sidelines since March 21 this year, the Ministry of Finance announced by the end of May that dollar sales would resume between June and August at a weekly maximum of USD200 million. The guidance suggests the MoF's participation in the spot dollar market in the following months would be below the roughly USD150 million daily average in which the MoF had sold dollars in the year (only 13 days through the end of May). The MoF had a total of USD 425.6 million in liquid dollar denominated assets by the end of April 2024 (report available here). In our view, dollar sales are likely to be sourced from copper related revenues (we estimate these inflows at USD400 million per month), and one-off inflows from sovereign wealth funds (net inflow of USD304 million in June) and offshore issuances (roughly USD 500 million from the local currency issuance from end of May in which foreigners purchase the bonds in dollars).

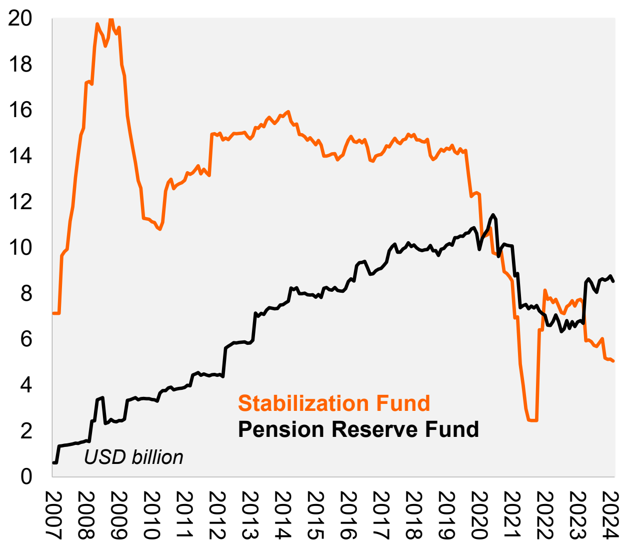
The MoF has sold USD 2.52 billion in 2024 through June 21, below the USD 5.85 billion sold during the same period in 2023. We expect the MoF to sell up to a total of USD6 billion this year, including the USD2.52 billion sold so far, below 2023's USD12.2 billion.

- **Should we expect any changes on the asset side of the government's balance sheet?**

The government's asset side of the balance sheet are mainly composed of the two sovereign wealth funds, both of which were an important source of financing in the context of the elevated financing needs of the pandemic.

The Stabilization Fund (FEES, acronym in Spanish), at roughly USD 5 billion by the end of April, has been a source of short-term financing needs by the government. In fact, USD 800 million were withdrawn from the FEES in January, and another USD 607 million were taken out to finance the annual injection to the Pension Reserve Fund (0.2% of GDP) in June 2024. The FEES may be resorted to in case of additional revenue shortfalls, and to cover amortization payments, without additional congressional approval. The Pension Reserve Fund reached USD 8.5 billion by the end of April 2024 and received a net injection of 0.1% of GDP in June (considering the annual withdrawal of 0.1% of GDP also took place in June).

Sovereign Wealth Funds



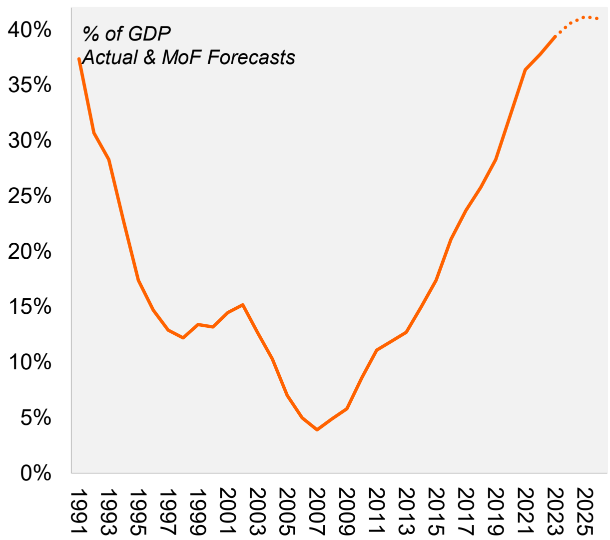
Source: Budget Office.

III. Medium-term Fiscal Accounts

- **Where is public debt projected to stabilize?**

According to official medium-term forecasts (2025-2028), the economy is projected to grow at an average annual rate of 2.2% and revenues at 3.5% YoY. Expenditure growth is projected at an average of 0.43% YoY for the 2025-2028 period, substantially below the 4.9% average of 2010-2019. Of note, expenditure forecasts consider approved legislation, and hence are more likely a floor. In any case, the combination of an economy growing roughly at trend, with revenue rising, and constrained expenditure growth contributes to the stabilization of gross public debt at roughly 41% of GDP in 2025. Gross public debt reached 40.7% of GDP by the end of 1Q24, and the MoF projects a rise to 40.6% of GDP by the end of 2024.

Central Government's Gross Public Debt



Source: Budget Office.

- **How have Chile's contingent liabilities evolved?**

According to the Budget Office's annual report, the central government's contingent liabilities continue to increase, reaching 11.15% of GDP by the end of 2023. The most relevant liability is the state guarantee on deposits, followed by obligations with multilateral financial institutions, and then state-guaranteed student loans.

Central Government's Contingent Liabilities (*% of GDP of each year*)				
	2020	2021	2022	2023
State guarantee for deposits	3.34	3.9	4.15	4.38
Obligations with Multilateral Financial Institutions	2.52	2.14	2.33	2.08
State guarantee for student loans (CAE)	1.53	1.42	1.49	1.56
State guarantee for SOE debt	0.99	0.84	0.83	0.81
Solidarity Loans from the COVID-19 shock	0	0.87	0.76	0.74
State guarantees on bank loans (FOGAPE)	0.38	0.41	0.45	0.37
Public works concessions controversy system	0.3	0.25	0.26	0.25
Demands against the State	0.22	0.24	0.24	0.25
CORFO Hedge program	0.31	0.22	0.2	0.2
Public Works concessions minimum income guarantee	0.15	0.15	0.12	0.08
Electricity Prices Stabilization Fund				0.43
Total	**9.74**	**10.44**	**10.83**	**11.15**

Source: Budget Office.

IV. Reforms & Key Dates

- **Where do the tax and fiscal framework reforms stand?**

First, the new mining royalty law, approved in May-23, came into effect in 2024 and is expected to raise revenue by 0.45% of GDP per year in steady state, already incorporated into the MoF's revenue projections.

The administration's original tax reform that aimed to raise revenue by 2.7% of GDP per year in steady state was rejected in Congress in March of 2023. These additional resources were expected to finance the administration's spending plans. Following the rejection, the administration set up discussions at the technical level with representatives of political parties that led to a Fiscal Pact which also plans on raising fiscal revenue by 2.7% of GDP per year.

The Ministry of Finance plans on presenting a bill that raises personal income tax rates for high wages and lowers the corporate income tax rate (from 27% to 25%) prior to the delivery of the 2025 budget bill (end of September 2024). The proposed measures are part of a broader set of initiatives that the administration has prioritized, including the anti-tax evasion bill in discussion in the Senate (after being approved by the Lower House in mid- April).

The MoF had also announced plans to present green and health tax bills that would raise fiscal revenue by up to 0.4% of GDP per year yet has not presented them so far.

The administration's tax reforms are likely to be adjusted, considering the Executive's minority representation in both houses. The opposition has called for pro-growth measures, including lower taxes, expenditure reviews, and spending cuts. As has been the case in previous years, elections scheduled for 2024 (municipal elections on October 27, 2024) and 2025 (legislative and presidential elections on November 23, 2025) may also pose challenges to reach consensus on structural reforms.

Regarding changes to the fiscal framework, as recommended by the Autonomous Fiscal Council, the Senate approved the bill that modifies the fiscal responsibility law to explicitly complement the structural balance rule with a prudent limit on public debt, introduces escape clauses, and strengthens the Autonomous Fiscal Council's oversight over fiscal policy, among other changes (more information here). The bill, originally presented to Congress in September 2021 (during president Piñera's administration) was approved by the Lower House in December 2021, and now returns to the Lower House for a final vote (following the Senate's changes).

- **What are the key dates for the remainder of 2024?**

The following table includes official and our estimate for publication of key fiscal data.

Category	Detail	Estimated Date
Financing	3Q24 Local Currency Issuance Calendar	end of June
	4Q24 Local Currency Issuance Calendar	end of September
	Dollar Sales (September - December)	end of August
Budget Execution	Data for May	June 28
	Monthly data thereafter	last working day of each month
Macro-Fiscal Forecasts	2Q24 Public Finance Report	July 23
	3Q24 Public Finance Report	October 2
2025 Budget	Experts present Structural Parameter estimates	end of August
	Presentation of 2025 Budget Bill	end of September
	Approval of the 2025 Budget Bill	end of November
Reforms	State-guaranteed Student loan program	September 2024
	Tax Reforms	September 2024

Source: Budget Office, Itaú.

Andrés Pérez M.
Vittorio Peretti
Ignacio Martinez Labra

Macro Research – Itaú
Mario Mesquita – Chief Economist

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