



GOBIERNO DE  
**CHILE**  
MINISTRY OF FINANCE

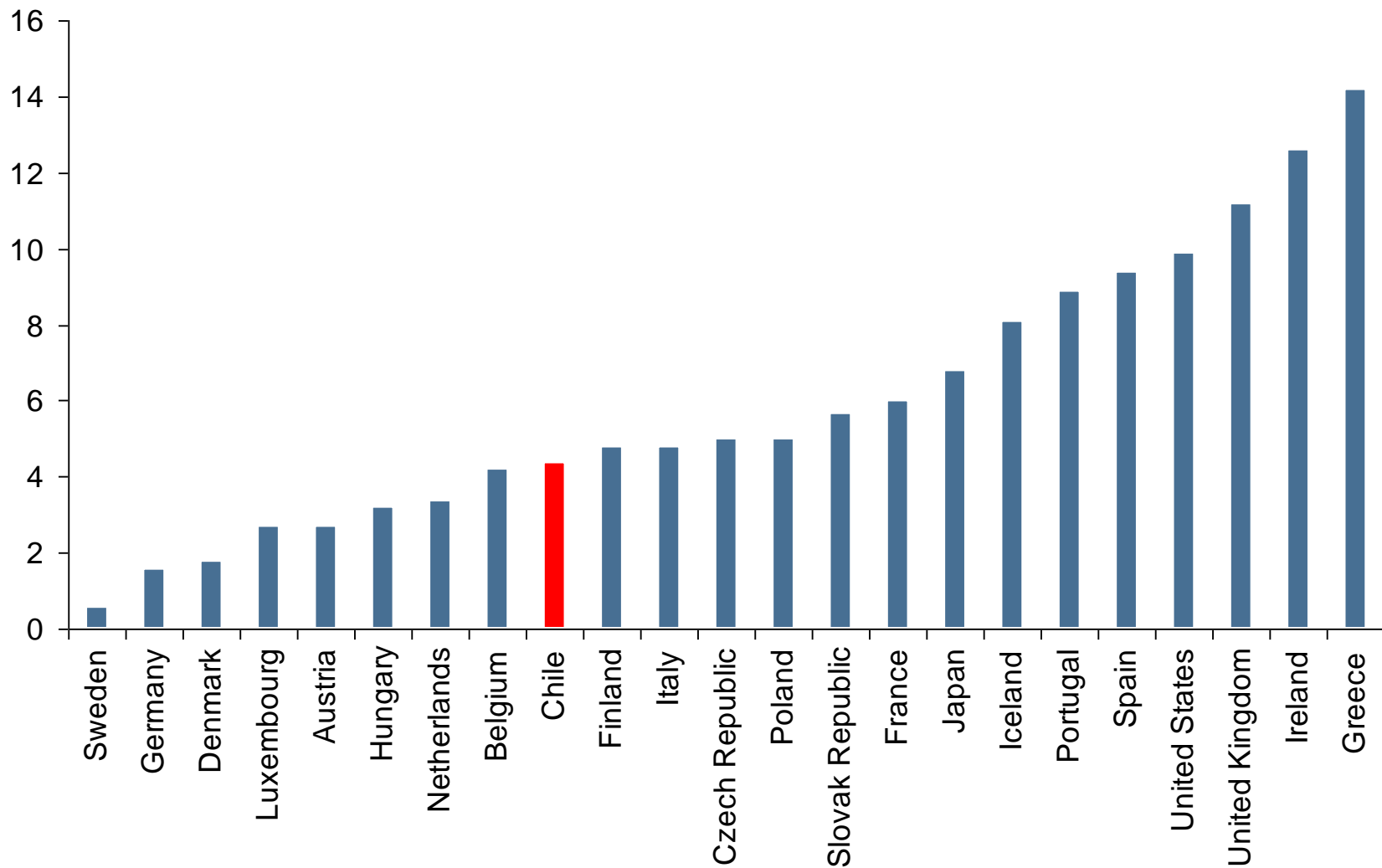
# Chile's Reconstruction Effort, Financing and Future Challenges

Felipe Larraín B.  
Minister of Finance  
July 15, 2010

# **PUBLIC FINANCE: AN INTERNATIONAL COMPARISON**

# Fiscal Deficit During Global Recession

(Central Government, % of GDP, 2009)

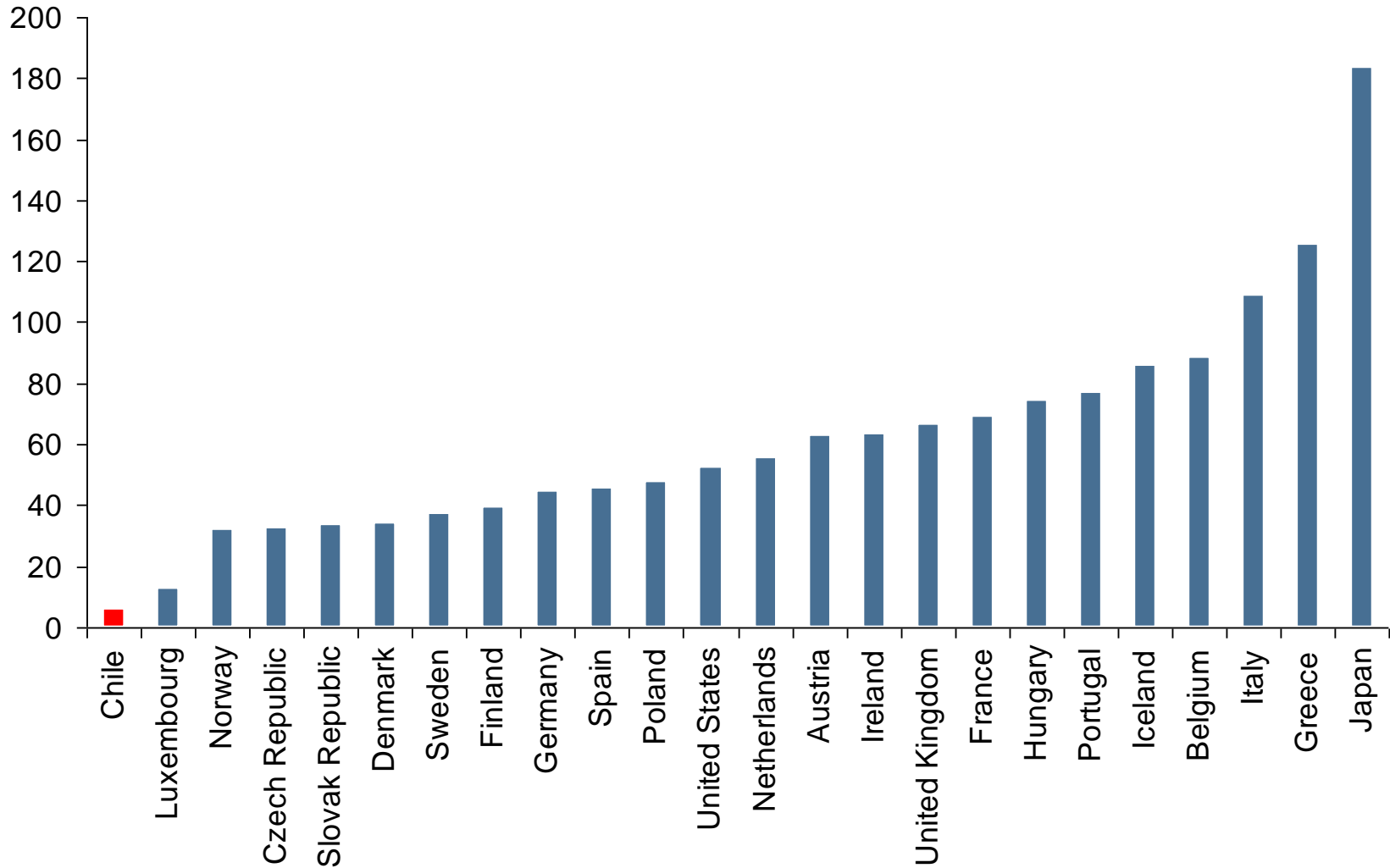


Source: Eurostat, OECD, IMF and DIPRES



# Public Debt Burden: A Comparison

(Gross Central Government Debt, % of GDP, 2009)

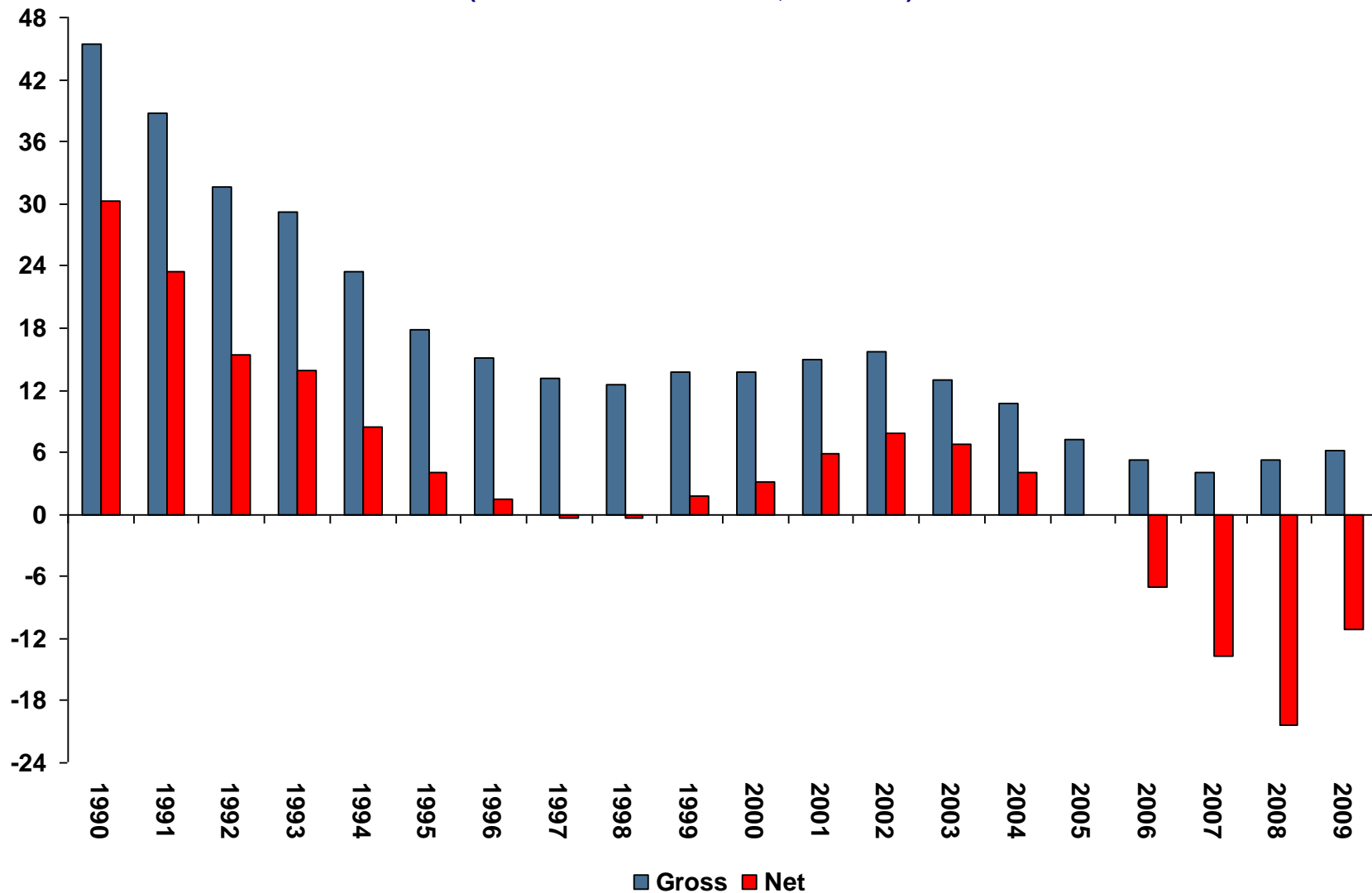


Source: Eurostat, OECD, IMF and DIPRES



# The Government of Chile: A Net Creditor

(Central Government Debt, % of GDP)



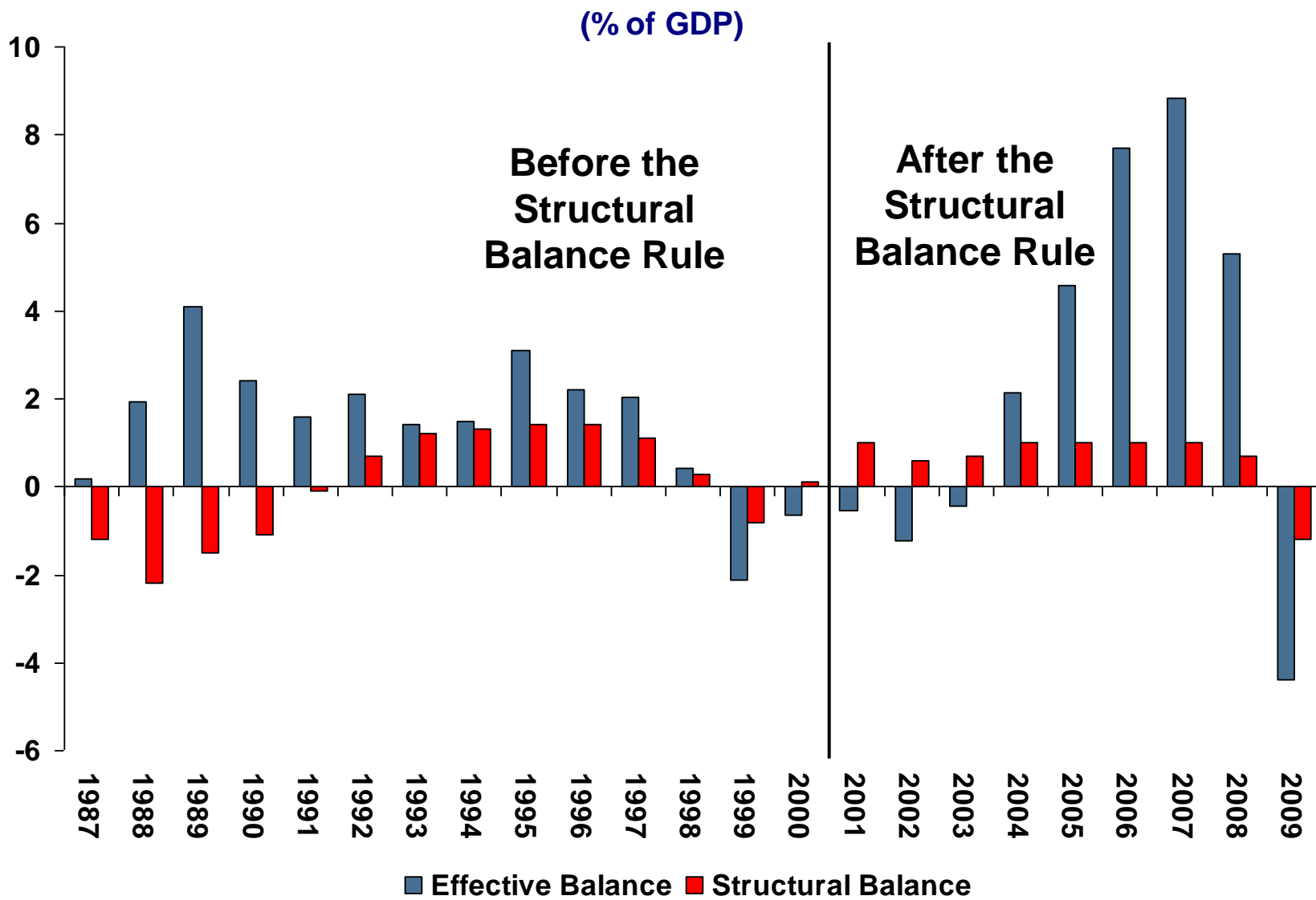
Source: DIPRES



# The Budget: Structural Balance Rule

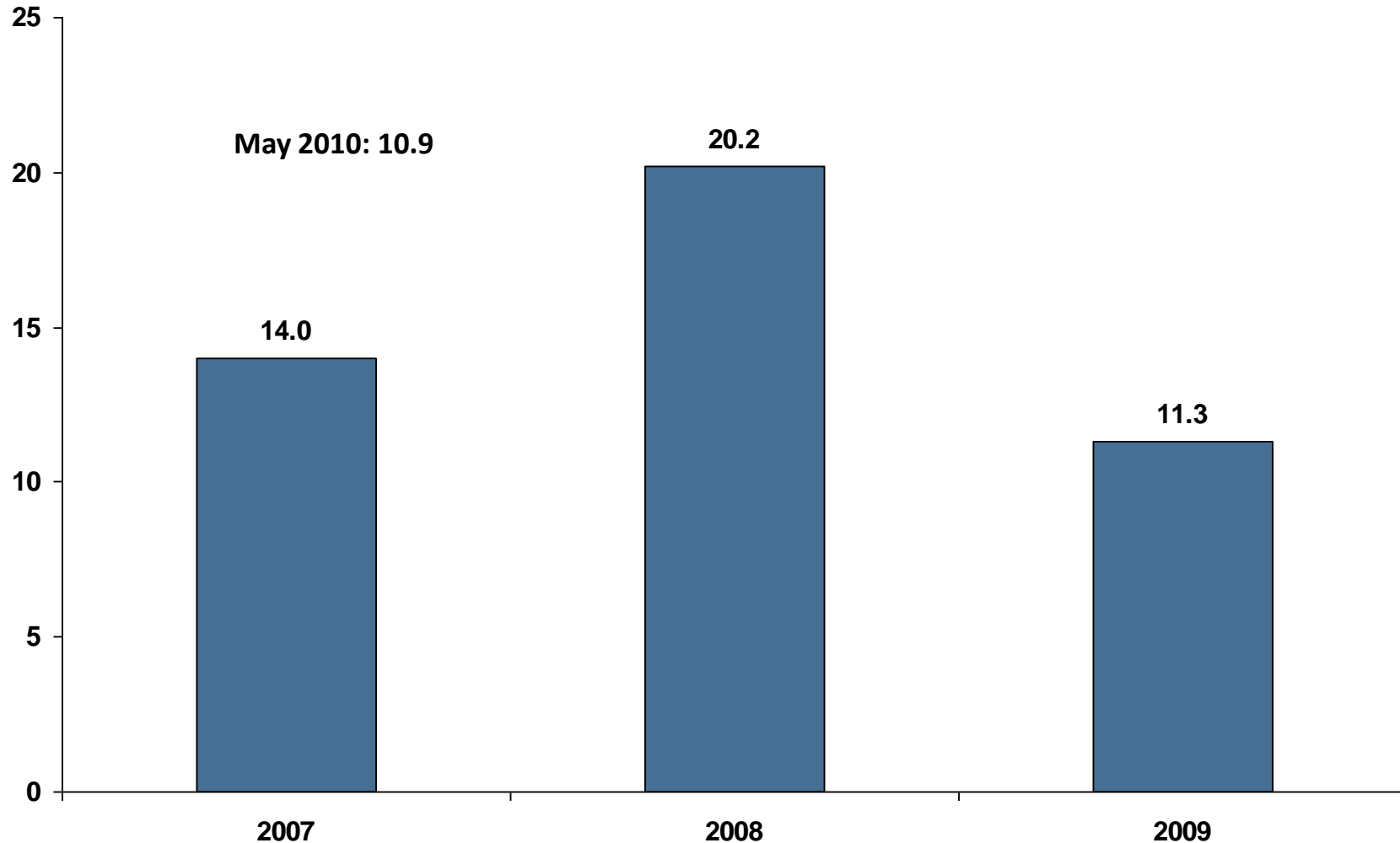
- The SBR isolates the impact of the economic cycle on public finances
- The SBR commits to a balanced budget (zero deficit) when
  - The economy grows at its potential rate
  - Copper price is at its long-term level
- In practice, this means
  - Saving during economic booms, when extraordinary revenues are received
  - Disaving in downturns, when fiscal revenue drops

# Central Government Balance 1987-2009



# Chile's Economic and Social Stabilization Fund (Sovereign Fund)

(billion dollars)

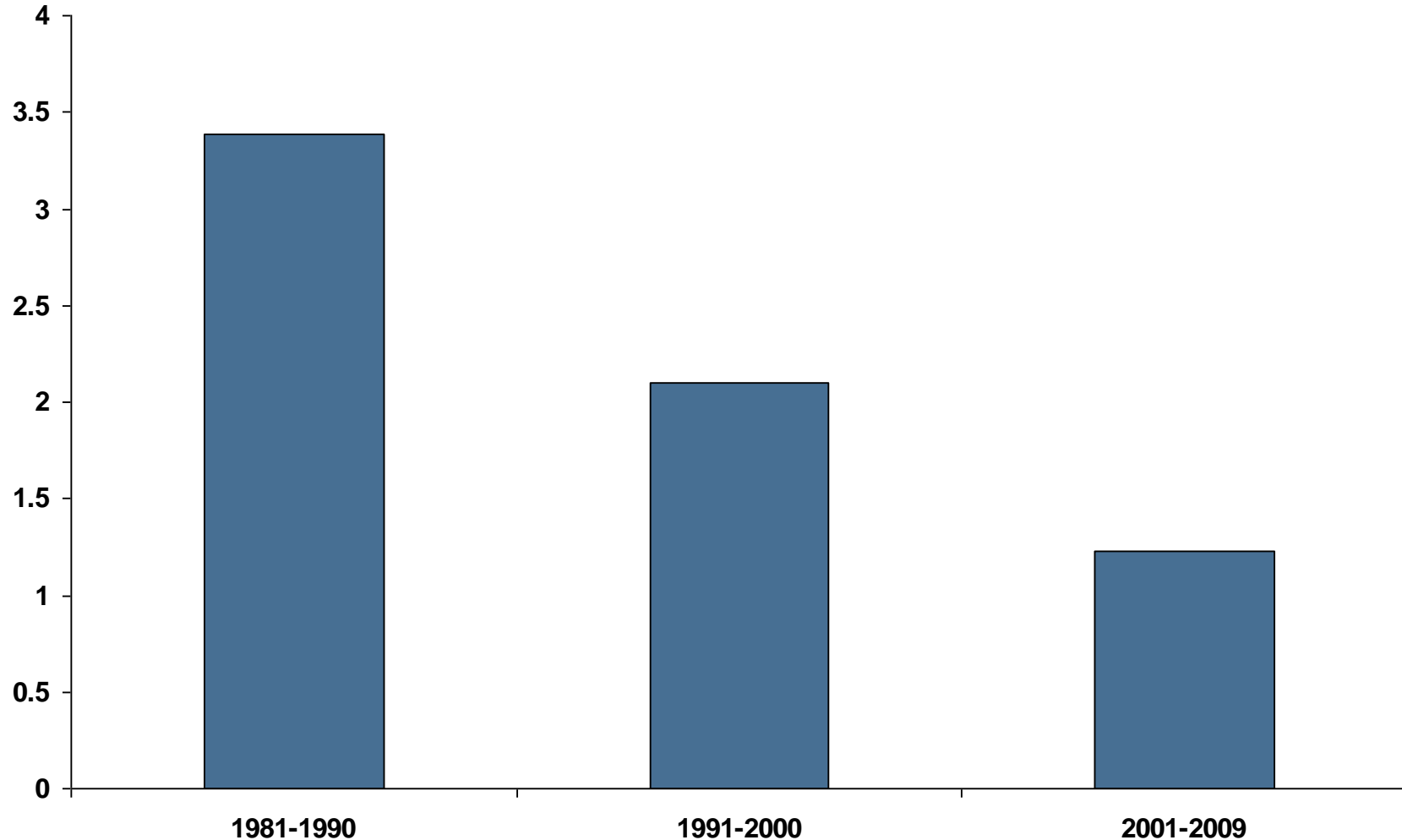


Source: DIPRES



# Chile's Declining Macroeconomic Volatility

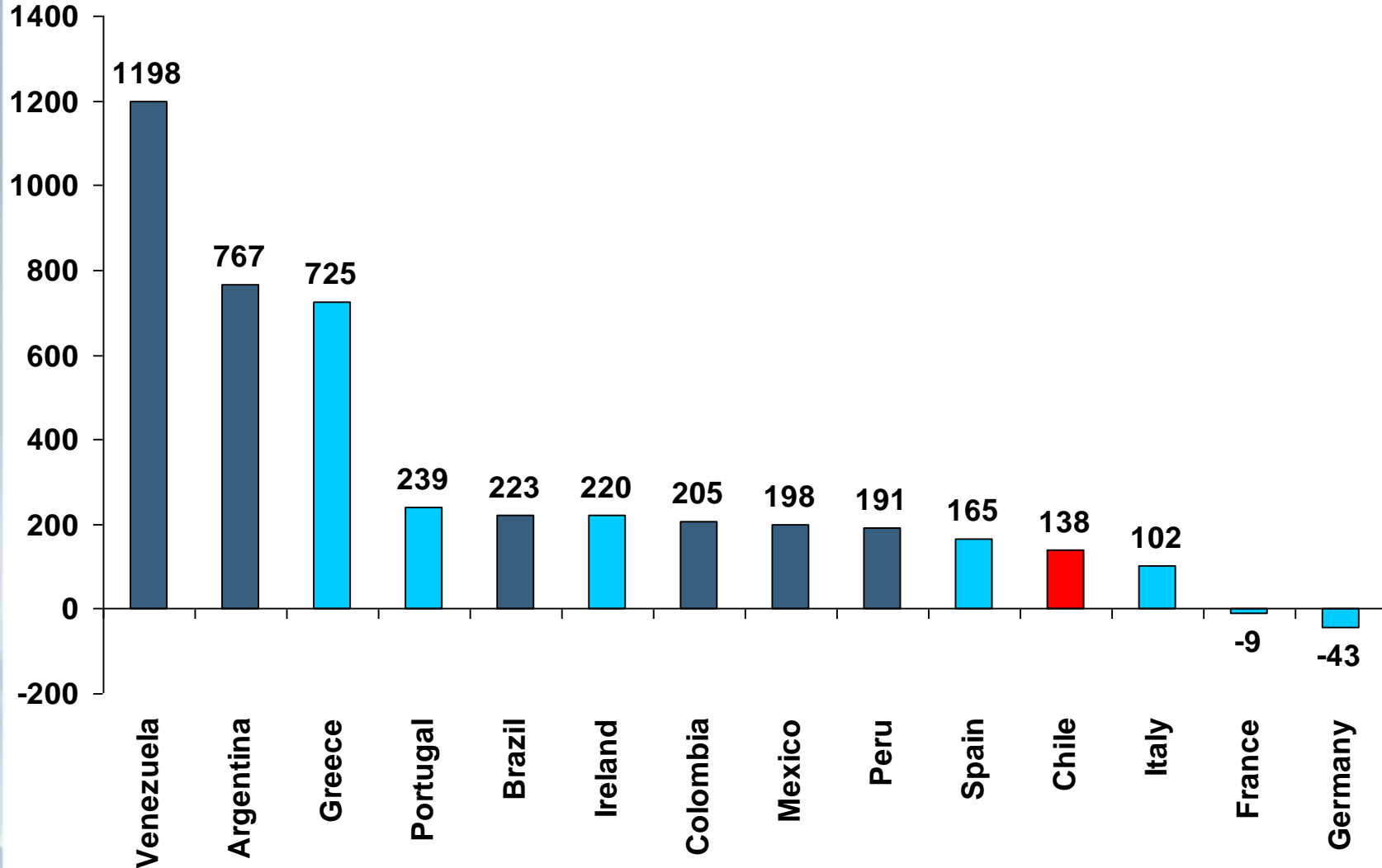
(average of four-quarter trailing standard deviation of GDP growth)



Source: Own elaboration based on Central Bank of Chile

# Chile's Very Favorable International Credit Conditions

(Sovereign spread, July 12)



Source: JP Morgan and Bloomberg

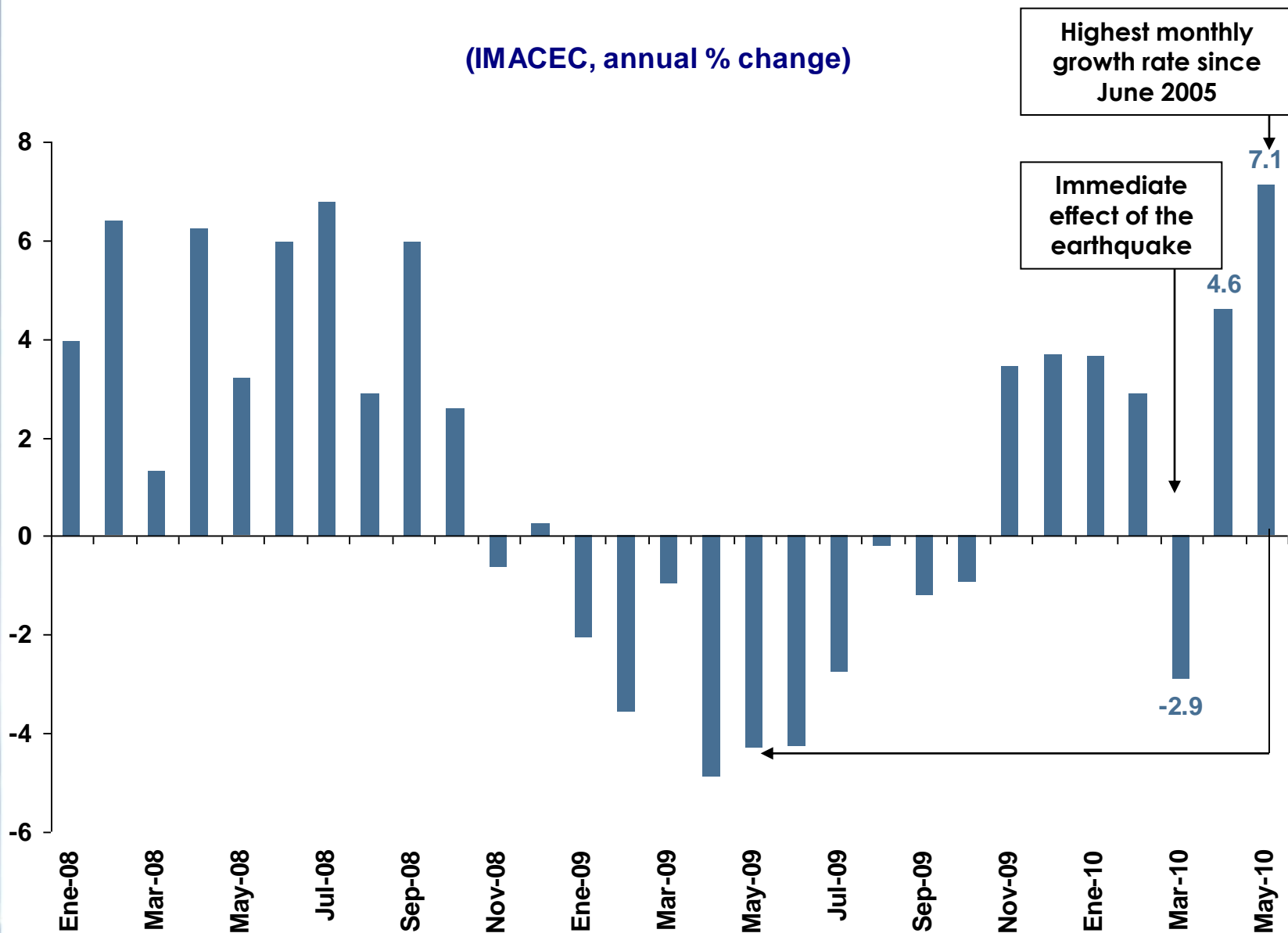




# CHILE: FROM RECESSION TO RECOVERY

# Monthly Economic Activity: Highly Dynamic

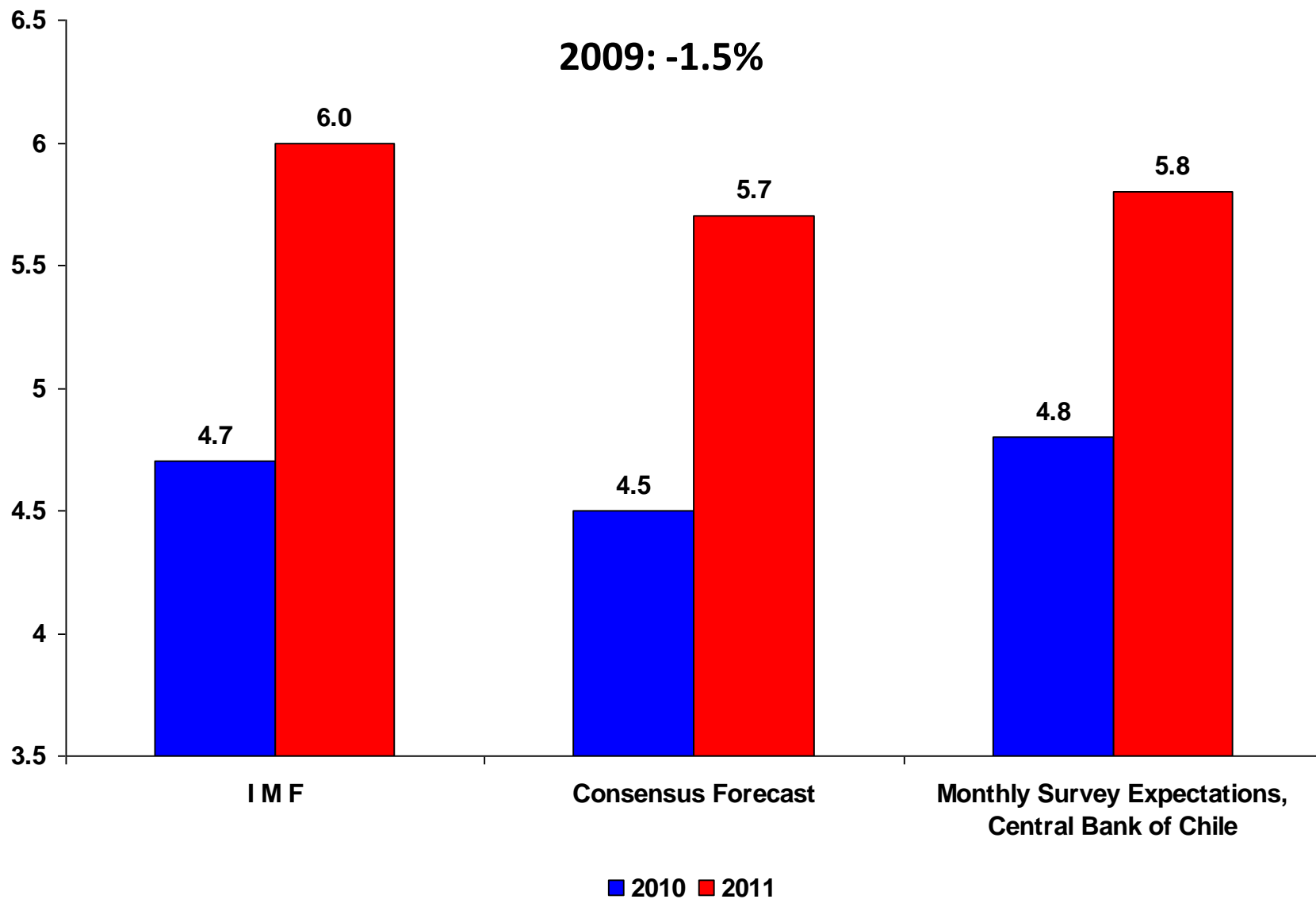
(IMACEC, annual % change)



Source: Central Bank of Chile



# High Economic Growth Expected in 2011

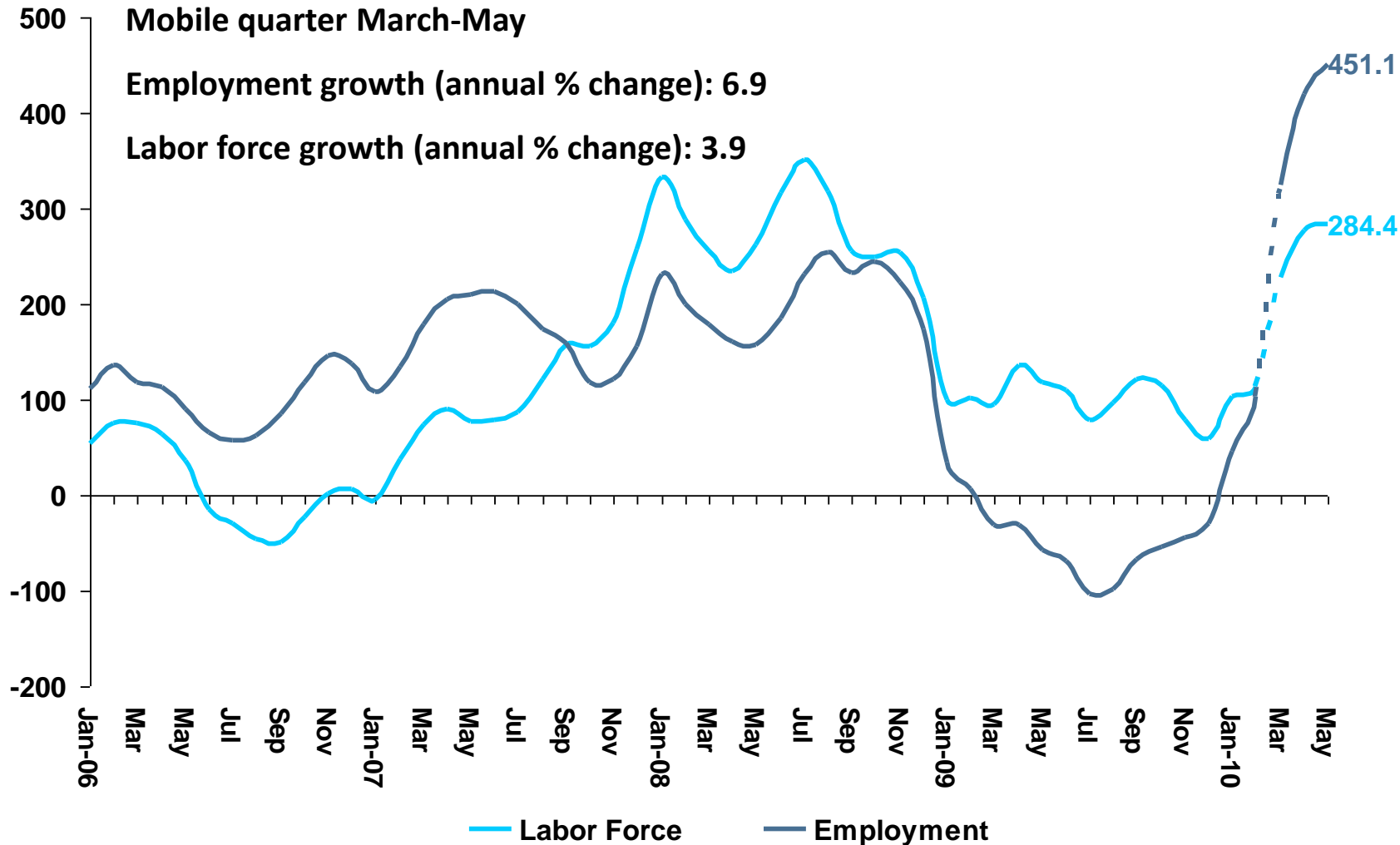


Source: IMF, Consensus Forecast and Central Bank of Chile



# Strong Employment Creation

(annual employment growth, thousands, mobile quarters, March-May 2010)

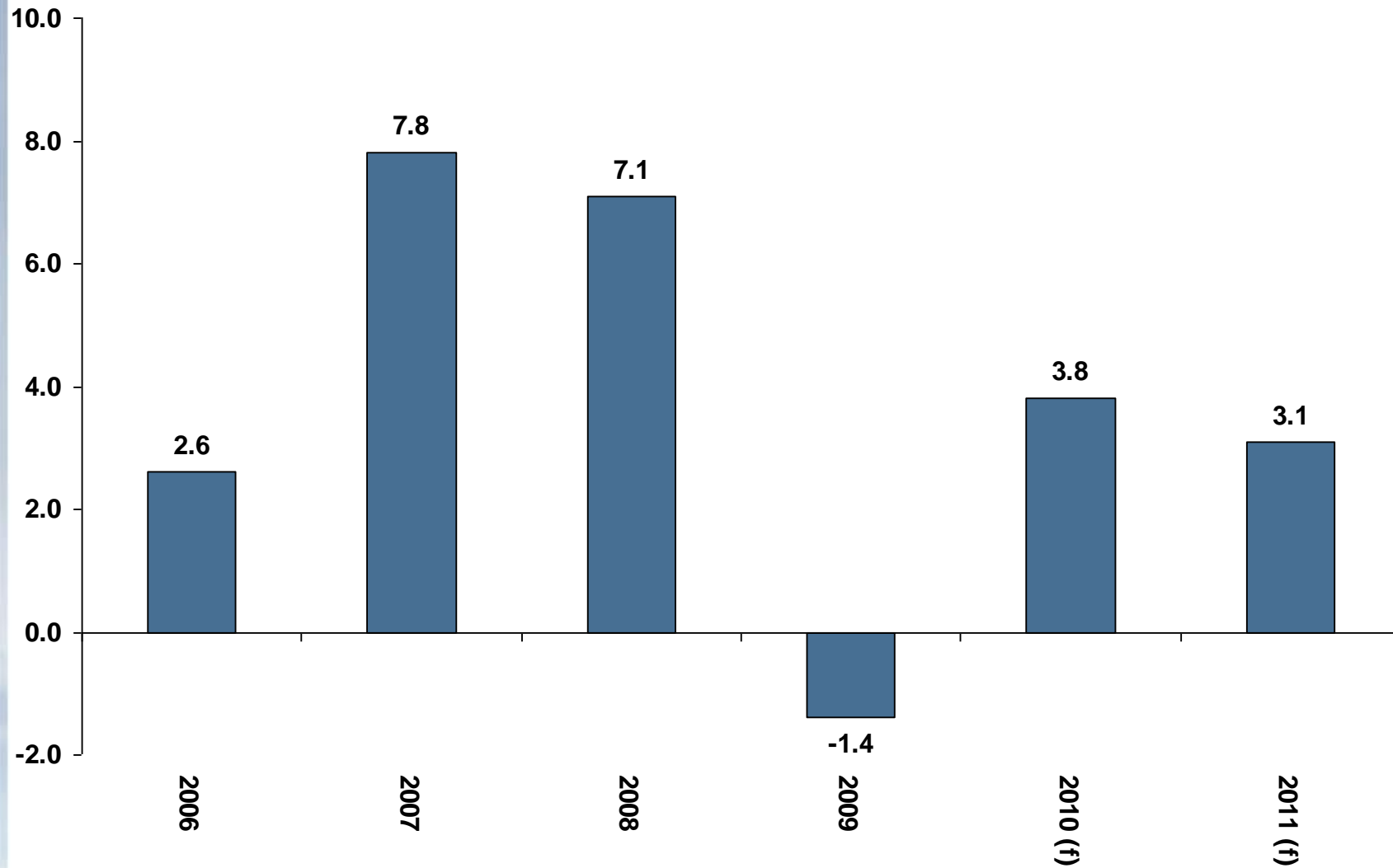


Since mobile quarter January-March 2010 data are based on the New National Employment Survey. Due to the conceptual differences between the new survey and the older one, data can not be spliced.

Source: INE

# Inflation

(% change dec/dec)



Source: Central Bank of Chile, Monetary Policy Report, June 2010

# CHILE'S EARTHQUAKE: COSTS AND EFFECTS



# Chile Had One of the Strongest Earthquakes On Record

Location	Date	Magnitude
Chile	22/05/1960	9.5
Alaska	28/03/1964	9.2
Northern Sumatra	26/12/2004	9.1
Kamchatka	11/04/1952	9.0
Chile	27/02/2010	8.8
Ecuador	31/01/1906	8.8
Alaska	02/04/1965	8.7
Indonesia	28/03/2005	8.6
Assam - Tibet	15/08/1950	8.6
Alaska	03/09/1957	8.6

# Economic Damages of the Earthquake and the Tsunami

	US\$ bn	% of GDP
Total losses	29.7	14.9
Infrastructure losses	20.9	10.5
Public infrastructure losses:		
• Total	10.6	5.3
• Net of insurance payments	9.3	4.7
• Reconstruction costs (including efficiency gains)	8.4	4.2

# Macroeconomic Effects of the Earthquake

- The earthquake reduced economic growth in the first half of 2010
- Reconstruction efforts will give a strong boost to the economy later on
- Most relevant investment projects underway in the second half of 2010 and in 2011-12
- Inflationary effects have not been significant



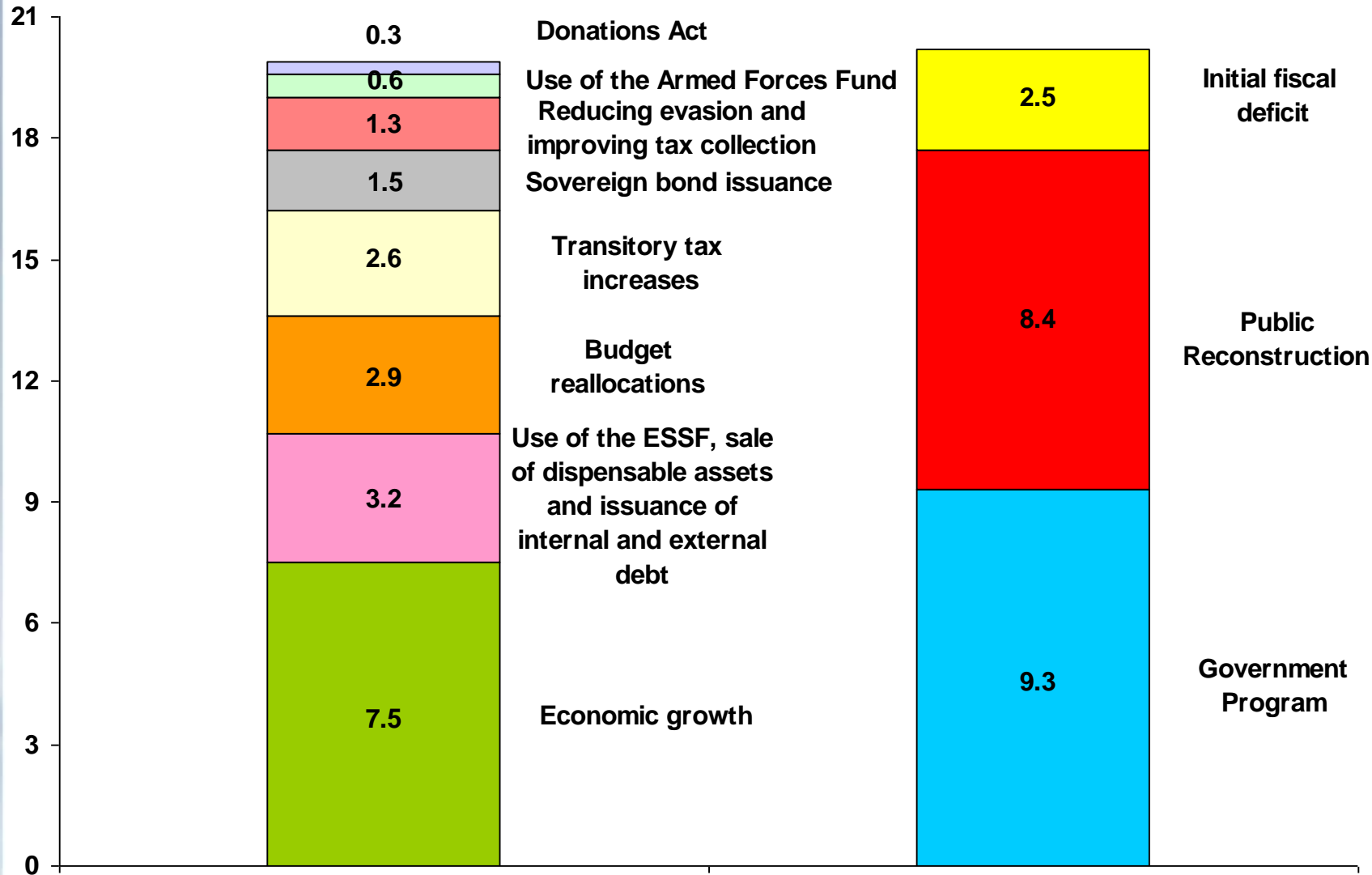
# **FINANCING RECONSTRUCTION AND THE GOVERNMENT PROGRAM**

# Multiple Financing Sources

- Faster economic growth will increase revenue
- Austerity and budget reallocations total US\$2.9 bn
- Donations Act
- A (mostly) transitory tax component:
  - Corporate Tax (business)
  - Tobacco tax
  - Real estate tax
  - Reducing evasion
- Sale of dispensable public assets
- Issuance of internal and external debt
- Use of the Economic and Social Stabilization Fund (ESSF) and of the Armed Forces Fund



# Sources and Uses



# Importance of Balanced Financing

- Balanced financing of the reconstruction effort is the key to avoid undesirable macroeconomic effects
- This was recognized when Moody's upgraded Chile's government bond ratings from A1 to Aa3 :

*“Fiscal saving by themselves would be enough to cover the government's estimated \$8.4 bn in post-earthquake financing needs, but the new center-right administration has chosen to rely mainly on a combination of taxation and new debt issuance, and keep most of the fiscal savings for future use”*

Moody's Statement, June 16, 2010

# **BICENTENNIAL CAPITAL MARKETS AGENDA (MKB) AND NEW FUNDS LAW**



# MKB

- The capital market has played a decisive role in Chile's economic growth and development.
- Chile has carried out a continual process of reforms that have allowed its capital market to develop: acquiring increasing liquidity and depth and gaining experience in managing significant financial resources.
- But we have greater aspirations. Some of the main goals are:
  - greater financial integration with global markets
  - more transparency
  - greater liquidity
  - higher safety standards for transactions
- We will provide a new legal framework to improve regulation for investment instruments.
- Our target is a competitive capital market both domestically and internationally.



# A New Law for Financial Funds

- The Chilean law recognizes 5 main different types of funds (investment funds, mutual funds, funds for the investment of foreign capital, funds for the investment of foreign venture capital and funds for home savings purposes), each of them regulated by different laws:

Investment Vehicle	Regulation (Legal Framework)	Number of Funds (Dec' 09)	Managed Assets - US\$MM (Dec' 09)
<b>Mutual Funds</b>	Law 1.328 / Bylaw	455	34,613
<b>Investment Funds</b>	Law 18.815 / Bylaw	164	6,442
<b>Foreign Capital Funds / Foreign Risk Capital Funds</b>	Law 18.657	9	384
<b>Funds for Home Savings</b>	Law 19.281 / Bylaw	8	226

Source: Chilean Superintendency of Securities and Insurance (Superintendencia de Valores y Seguros, SVS)

- Additionally, the Securities Market Law regulates fund managers, supervised by the SVS.
- Although these instruments are functionally similar and may face comparable problems, the legal frameworks applicable to each of them establish several differences, many of them without any technical justification (i.e.: existence of series of quotas, tax treatment, number of quota holders, etc) generating confusion among investors, unjustified discrimination among industries and allowing regulatory arbitrage.

# New Funds Law: General Proposal

- The project seeks the creation of a new legal framework, simplified and symmetric, to be applicable to all types of funds:
  - Standardize the regulatory framework
  - Define a reasonable and equitable tax treatment for the funds industry
  - Specify restrictions and requirements among the funds considering the type and number of investors and the liquidity of the underlying assets and the quota
  - Promote foreign investment in Chile
  - Require certification for traders and investment advisers
  - Make the operation and fund management much simpler and at a lower cost (i.e.: quota holders assemblies, summons requirements, proxies, etc)
- For these purposes, the Ministry of Finance will call representatives from the private sector, the SVS and SII in order to hear them and prepare the final project to be delivered to Congress during the first semester of 2011



# BEYOND THE EARTHQUAKE: OUR MAIN GOALS

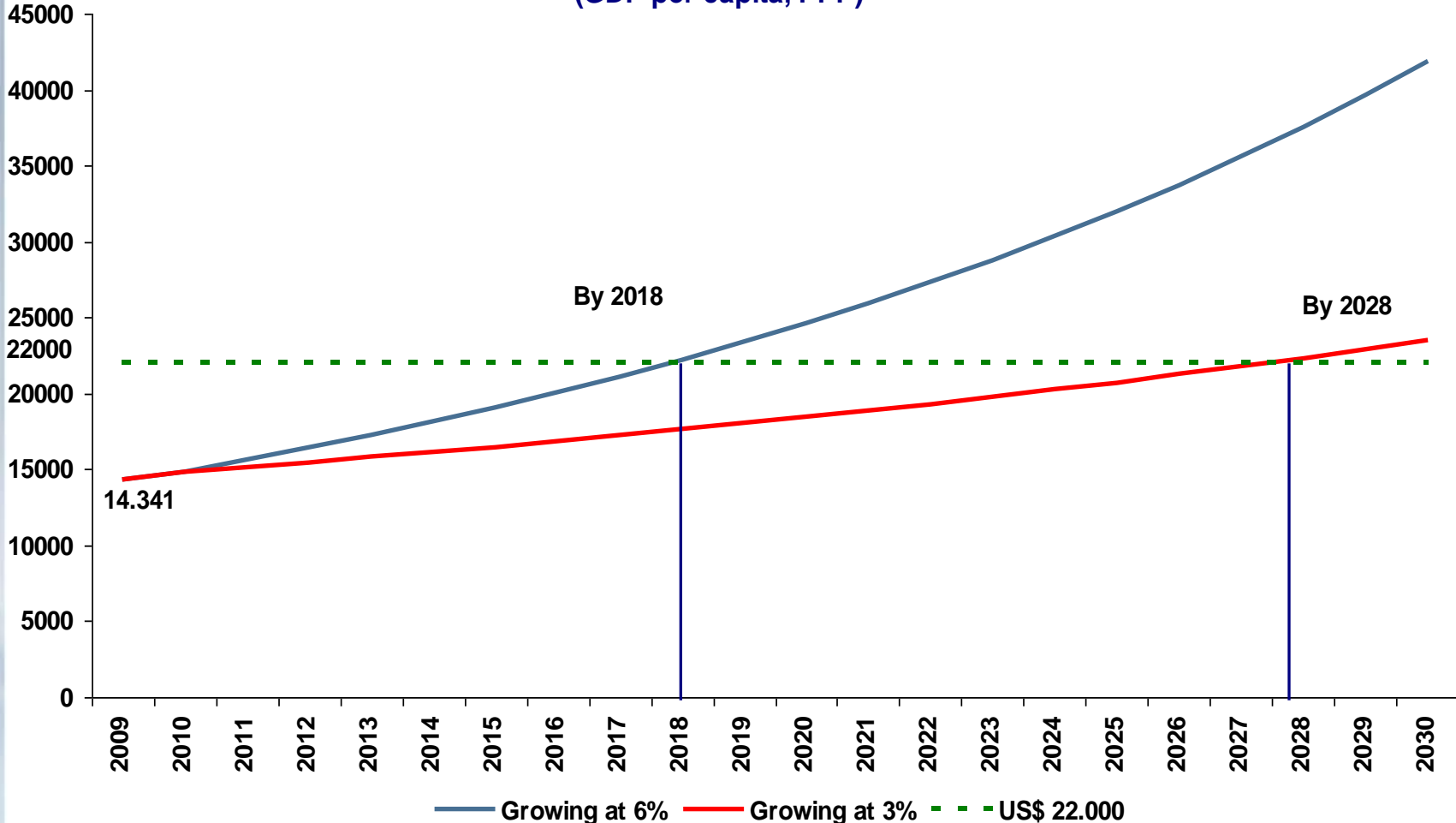
# Despite the Difficulties We Maintain Our Main Goals

- Grow at 6% average annual rate
- Create 200.000 jobs annually (2010-2014)
- Increase investment (Gross Fixed Capital Formation) from 22% of GDP (2009) to 28% of GDP in 2014
- Eliminate extreme poverty by 2014
- Lay the ground to become a developed country by 2018



# Chile's Road to Development by 2018

(GDP per capita, PPP)





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