December 3rd, 2019
Ministry of Finance of Chile
Investor Relations Office

The Ministry of Finance announces a Pro-Employment & Economic Recovery Plan of USD5.5 billion

The events that have taken place in recent weeks have had a significant negative impact on the Chilean economy which is expected to persist into 2020. In order to support households, especially the most vulnerable, the Ministry of Finance (MoF) has prepared a Pro-Employment & Economic Recovery Plan that considers exceptional measures for a total of USD5.5 billion.

This note summarizes the MoF's downward revision to the growth outlook for the Chilean economy for 2019 & 2020, briefly outlines the measures of the policy package, announces an updated fiscal policy path based on the structural balance, and provides information on the government's sources of financing for the Pro-Employment & Economic Recovery Plan.

1. Changes in the Ministry of Finance's Macroeconomic Outlook for 2019-2020

In light of recent data, the MoF has revised down its growth forecasts for the Chilean economy for 2019 and 2020. The monthly activity indicator (IMACEC) for October revealed that the events that have taken place in recent weeks throughout the country are having a greater than expected negative impact on the economy. As a matter of fact, the contraction in economic activity in October is consistent with those witnessed during years of economic crises with recessions. Even though unemployment data thus far has not reflected the recent decline in economic activity, it is worth noting that during the 2009 recession, the national unemployment rate peaked above 11%. As a result, policy measures must be taken with urgency to mitigate negative effects this shock may have on employment prospects and families, especially the most vulnerable.

In addition, the significant deterioration in expectations, more restrictive domestic financial conditions, greater risk in several industries, higher uncertainty on different fronts, vandalism, and violence have weighed on activity and growth prospects. As a result, the MoF's baseline scenario for the Chilean economy considers an annual expansion of 1.4% in real terms in 2019 and between 1.0% and 1.5% (centered in 1.3%) in 2020.

In this context, the government has prioritized the implementation of an agenda that places employment at the forefront by boosting job creation prospects with greater public investment and reconstruction efforts, supporting thousands of jobs that are currently at risk, and strengthening existing financial mechanisms for those that lose their jobs. In addition, considering the damages that many firms suffered, especially smaller-sized ones, the agenda includes several measures that will ease their financial strains by enhancing their working capital and ensuring access to credit.

2. Policy Measures that will Support the Economic Recovery

The Chilean economy requires a robust set of counter-cyclical policy measures. The policy agenda described herein protects jobs, supports the economic recovery, rebuilds public infrastructure, and supports Micro, Small, and Medium-sized Enterprises (SMEs).

This agenda considers new measures for USD 4.8 billion, which in addition to the capitalization of Banco Estado and other credit measures to support SMEs, reach a total of USD 5.5 billion.

This total is distributed in greater public expenditures of roughly USD3 billion, measures that support SMEs for USD 1.95 billion, and other measures for USD 525 million. 1 These measures are mostly transitory and focus directly and/or indirectly on creating jobs by boosting public investment, in addition to supporting SMEs. These USD 525 million include concessions and the reconstruction of Metro.

These measures are expected to generate at least 100,000 new jobs next year.

2.1 Measures that Support Employment & Household Incomes:

- Employment protection: For firms that have been negatively affected by events since October 18th, employers and dependent employees affiliated to the unemployment insurance system may agree on a reduction of regular work hours with a supplement to be paid out of the unemployment insurance's solidarity fund. A bill will be sent to Congress to move forward on this initiative.
- Transitory Adjustments to the Unemployment Insurance System: Greater Monthly Payouts, Wider Eligibility, and an Extension in the Duration of Payouts
    a) A ten percentage point increase in payouts in the first three monthly payouts for open-ended contracts and in the first two payouts for fixed-term contracts;
    b) Under the current legislation, when the national unemployment rate surpasses exceeds the average of the previous four years by one percentage point, beneficiaries are entitled to two additional monthly payouts from the solidarity fund. However, for the following year, these two payouts from the solidarity fund will be extended regardless of the unemployment rate;
    c) In order to increase access of resources in individual unemployment insurance accounts, the minimum amount of monthly contributions will be reduced from 12 to 10 for open-ended employees, and from 6 to 5 contributions for fixed-term workers;
    d) Complementing the previous point, the minimum requirements to use the unemployment insurance's solidarity fund are reduced from 12 to 10 monthly contributions since the employee's affiliation to the unemployment insurance system or since the last payout, in the previous 24 months since the end of the termination of the job contract.

    A bill will be sent to Congress to move forward with these initiatives.

- Accelerating the Transition of Pension Payouts from the Solidarity Pillar: Public resources will be destined to accelerate the transition of payouts from the Solidarity Pillar, once the law has been approved, at a total annual cost of USD 400 million for two years.

2.2 Further Boosting Public Investment

The Pro-Employment and Economic Recovery Plan considers an important boost to public investment and reconstruction. The list below describes the different initiatives that include rebuilding public infrastructure across the nation at the regional and municipal levels, supporting housing and urban investment projects, improving transport, and increasing investment in infrastructure for pre-schools, among others.

- Reconstruction of public infrastructure excluding Metro: USD 921 million
- Regional investment projects: USD 480 million
- Housing, subsidies, and urban improvement projects: USD 350 million
- Frontloading investment in local equipment: USD 218 million
- Infrastructure for local markets nationwide: USD 20 million
- Train from Santiago to Melipilla, at a total cost of USD 1.5 billion in five years, and USD 200 million per year over the next two years
- Drinking water public works: USD 200 million
- Fund for the Support of Public Education for equipment and infrastructure: USD 46 million
- Contribution to the Common Municipal Fund: USD 50 million
- Incentives for donations towards public infrastructure of up to USD 75 million
- Funds to support investment in municipalities: USD 100 million
- Improvement of infrastructure for pre-schools: USD 65 million

2.3 Support for SMEs

- SMEs that experienced a decline in their sales during October 2019 relative to their average sales over the past twelve months will be supported by the following measures:
    - Early tax refunds: early refund of 20-75% of the average provisional monthly payments paid between this year and refunds received in the last two years. This measure is expected to inject resources up to USD536 million and will benefit over 500,000 SMEs nationwide.
    - Easing VAT payment schedules: VAT payments for the months of October, November, and December of 2019 are postponed to February of 2020. Starting in February 2020, VAT payments for these three months may be paid out in 12 monthly installments with a real interest rate of zero. This measure is expected to free up resources of up to USD564 million.

- Special tax treatment for donations for SMEs: For the following 18 months, donations that favor SMEs that suffered material losses or a significant decline in their productivity or sales, will have a special tax treatment. These donations must finance new SMEs or support the financial sustainability of an SME. The following incentives should support these donations:
    - Gift tax exemption and any other tax;
    - Released from a prior judicial approval;
    - The donor may deduct the donation as a tax expense.

As a result, these concrete incentives should attract support from civil society to be channelled through donations that support SMEs.

A bill that includes these three measures will be presented to Congress this week under immediate discussion.

- Capitalization of Banco Estado, FOGAIN, and FOGAPE: Resources for a total of USD 800 million will facilitate credit access for small-sized firms. In addition to the recent capitalizations of Banco Estado, the state-owned commercial bank, and FOGAIN, a state credit-guarantee facility, for USD 500 million and USD 200 million respectively, USD 100 million will now be destined to FOGAPE, another state credit-guarantee facility. A bill to inject these resources to FOGAPE will be sent this week under immediate discussion, which after legislative approval will allow for up to USD 1.5 billion in loans to SMEs. In total, these three measures will free up lending capital for a total of USD 9 billion for SMEs.

- Support of Entrepreneurship and tourism via SERCOTEC: A total of USD 50 million will be destined to CORFO, the state's development agency, and SERCOTEC, which in turn, will subsidize SMEs that were negatively affected by the events that began on October 18th. Each beneficiary will receive an amount of up to CLP 4 million, which will be calculated based on the requirements to restart the sales process, the purchase of fixed assets, and the purchase of infrastructure and/or working capital. This measure will benefit 20,000 SMEs considering an average subsidy of CLP 2 million.
- Faster payments to suppliers of the State: The central government has recently integrated several platforms that allow for centralized payments of electronic invoices issued by different institutions to the government. As a result, the purchase and payment processes will be entirely digital, which should facilitate timely payments to suppliers of the central government. The pilot plan of this initiative is in development and is expected to be completely operational in 2020.

3. New Medium-Term Fiscal Trajectory

According to the Republic of Chile's fiscal institutional framework, every new administration issues a decree within the first ninety days formalizing its commitment to a structural balance target at a four-year horizon, thereby providing guidance on fiscal policy in the medium-term.

In June 2018, the Ministry of Finance announced a fiscal consolidation path based on the structural balance of approximately 0.2% of GDP per year, starting from a deficit of 2% in 2017 and projected towards a deficit of 1% of GDP by end-2022.

Although the MoF is firmly committed to significantly improving the efficiency and effectiveness of government spending, and reallocating fiscal resources whenever possible, the new economic scenario requires an adjustment of the current fiscal structural consolidation path.

For 2020, the structural deficit target has been revised up from 1.6% to 3.0% of GDP, with a reduction of 0.5% of GDP per year thereafter, reaching 2% of GDP by end-2022. In other words, the structural deficit target has been revised up transitorily, to give space to the economic stimulus package, but will thereafter gradually converge back towards structural balance.

In this scenario, relative to the 2019 Budget Law, public expenditure in 2020 will increase by 9.8% in real terms. This is the largest projected increase in public expenditures since 2009. The headline fiscal deficit forecast has been revised up to 4.4% of GDP in 2020, similar to the deficit of 4.3% of GDP recorded in 2009.

4. Sources of Government Financing

Considering deficit financing and other commitments, government financing needs for 2020 are estimated at approximately USD 16.6 billion, which will be fulfilled by a combination of debt issuance of USD 9 billion, recently approved in the 2020 Budget Law, and the use of approximately USD 7.6 billion of the Republic's assets, primarily invested abroad.

As a result of current domestic and international financial conditions, the Republic intends to increase the issuance share of foreign currency denominated Treasury bonds relative to local currency denominated Treasury bonds during 2020. During recent years, local currency denominated bonds concentrated roughly 80% of the issuances every year, with US dollar and Euro denominated bonds accounting for the remaining 20%. In 2020, 40% of the Treasury bonds issued by the Republic will be denominated in foreign currency, approximately equivalent to USD 3.6 billion, and 60% in local currency (both nominal and inflation-linked).

In sum, over USD 11 billion of financing needs for 2020 will be met by assets and debt issuance in foreign currency.

Considering a combination of debt and assets as sources of financing for the following years, and given the fiscal policy's structural balance commitment, gross public debt as a share of GDP is projected to stabilize at roughly 38% of GDP towards the end of 2024.

In line with Chile's current fiscal institutional framework, updated medium-term public debt projections that consider different sources of financing will be released in January 2020 in the next quarterly macro-fiscal report (*Informe de Finanzas Públicas*).

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Table 1. Pro Employment & Economic Recovery Plan Measures in 2020

USD Millions

Public Expenditure	**3,025**
Transitory	**2,875**
Reconstruction of public infrastructure excluding Metro	921
Accelerating the transition of Pension Payouts from the Solidarity Pillar	400
Regional investments projects	480
Infrastructure for local markets	20
Housing, subsidies, and urban improvement projects	350
Frontloading investment in local equipment	218
Fund for the support of public education	46
Improvement of infrastructure for pre-schools	65
Funds to support investment in municipalities	100
Incentives for donations towards public infrastructure	75
Public works related drinking water	200
Permanent	**150**
Train between Santiago-Melipilla	100
Common Municipal Fund	50
Support for SMEs	**1,950**
Capitalization of Banco Estado	500
Capitalization of Fogape	100
Capitalization of Fogain	200
Early tax refunds	536
Easing VAT payment schedules	564
Support of Entrepreneurship and tourism via SERCOTEC	50
Other Reconstruction Efforts	**525**
Metro	380
Concessions	145
TOTAL	**5,500**

Source: Ministry of Finance