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1. Global economy: incipient and heterogeneous signs of recovery amidst elevated uncertainty

The progress of the world economy continues to be determined by the development of the Covid-19 pandemic and the containment measures necessary to protect lives and livelihood. After historic drops in economic activity at the beginning of the second quarter, the gradual reopening of a significant group of countries has given way to an incipient rebound in global activity. Despite new outbreaks, authorities have tried to avoid returning to the strictest confinements, drawing on the gained experience in controlling spread its worst consequences instead. The evolution of the pandemic across countries has been heterogeneous. Latin America keeps a high number of infections relative to other regions, but dynamics across countries in the region differ significantly. The learning curve for authorities and the population has been steep, which may influence future dynamics.

Although with varying intensity, the pandemic weakened labor markets in many countries. Taking into consideration idiosyncratic factors, such as the coverage and strength of the social safety net, and the scope and effectiveness of the measures taken by their authorities, the labor market has been significantly affected by lockdowns and restrictions on economic activities involving social contact. According to the *International Labor Organization*, hours worked fell 14 percent globally—equivalent to 400 million full-time jobs—in the second quarter and will remain below pre-pandemic records during the year. The decline has been led by South America (-20.6 percent), where inactivity has grown substantially, in part because of larger informality and weaker social safety nets. This drop falls disproportionally in women and younger cohorts, risking increases in inequality. Were this situation to last, it could have long-term consequences in poverty and negatively impact potential output.

Central Bank actions continue to focus on supporting financial stability and the functioning of credit systems, in a context in which global inflation rates remain subdued. In addition to massive asset purchase programs in advanced economies, a novel development was the deployment of these measures in emerging market economies, which, together with other unconventional measures, helped reduce market stress. Coupled with fiscal and financial regulators measures, such as government guarantees, temporary measures to free bank capital, and macroprudential measures, they have been effective in maintaining and increasing the flow of credit to firms decreasing liquidity pressures and mitigating solvency risks. Several economies—including Chile—have experienced an acceleration of credit, reaching a large share of firms hit the hardest by the pandemic. Still, scarring effects could be sizable, compromising the recovery in some sectors and even the potential capacity to grow.

For small open economies and commodity exporters, the recovery of commodity prices may help mitigate the pandemic shock. In line with the recent rebound in financial markets, commodity prices have risen. Copper and metals in general led the increases, in large part, due to the improvement in investment in China. Thus, the price of copper rose 18 percent between the second and third quarters, hovering around USD 3 per pound. Meanwhile, the price of oil (Brent-WTI average) rose 15 percent, to around USD 45 a barrel. The outlook for Chile's exports has improved in the margin, with a 2.2 percent contraction in 2020, and a larger increase in 2021 (5.0 percent). The risks to this outlook remain closely linked to the wounds that the pandemic will leave on the world economy.

2. Despite being hardly hit, Chile is deploying its firepower thanks to previously built buffers

The economic impact of the pandemic has been very deep, as expected for a small open economy facing multiple external shocks. During the second quarter of the year, Chile posted the worst contraction in several decades (-14.1%), and the outlook for 2020 is for real GDP growth to fall between 5.5 to 4.5 percent. Yet this reflects an upward revision from the June outlook, in line with the global signs of bottoming out. The new 2020 projections assume a more dynamic recovery during the second half of the year, on the back of stable terms of trade, growing exports, a gradual rolling back of sanitary constraints, a recovery of consumption, a resumption of suspended investment projects, and a large impulse from fiscal and monetary policy. The labor market was badly hit by economic contraction in the second quarter, compromising 1.8 million jobs, out of a labor force close to 10 million. Inflation remains at 2.5 percent, below the 3 percent medium-term target, to which it is expected to converge by 2022. Expectations remain well anchored on the policy horizon.

Massive and timely policy measures have been implemented on the fiscal, monetary, and financial fronts, owing to buffers built in good times. Chile has experienced several decades of strong macro-financial policies within a sound policy framework based on a structural fiscal balance rule, an inflation-targeting monetary policy regime, a floating exchange rate, and a sound financial system. As a result, fiscal, external, and bank-capital buffers provided an adequate basis for the policy responses to the Covid-19 shock. Fiscal stimulus amounted to 7.7 percent of GDP and monetary impulse 19 percent of GDP. In addition, external markets remained open at favorable conditions, and sovereign wealth funds readily available for drawdowns. In addition, the Central Bank of Chile (CBC) secured in May additional external liquidity with a two-year *Flexible Credit Line* for $24 billion granted by the IMF, supplemented by swap and repo facilities with bilateral partners. Special liquidity measures, government loan guarantees, and regulatory forbearance, combined with the solvency of the banking system, have pushed bank lending to firms to grow at more than 10% in real terms, contrasting with its pro-cyclical behavior in previous crises. Close to a quarter million loans have been channeled to SMEs, combined with 1.5 million rollover operations for commercial, consumption, and mortgage loans. This access to credit has sustained the operational continuity of businesses and helped mitigate the drop in investment.

3. Caution in the recovery, with an eye on medium-term policy priorities

Signs of stabilization in the contagion dynamics, combined with mixed economic signals point to continuing monetary accommodation to support recovery in 2021. Resilience in the corporate sector combines with positive health developments as contagion dynamics dropped significantly since mid-July. The authorities set in motion a gradual and evidence-based territorial deconfinement process. This 5-stage process contemplates backtracking in territories with worsening health indicators. As of September, it is estimated that 21 percent of the population is still affected by quarantines. As the health crisis abates, economic measures will be reassessed while minimizing the risk of a premature withdrawal. In fact, many of the fiscal and monetary extraordinary measures in place extend well beyond the immediate emergency and are likely to foster economic recovery once containment measures begin to roll back. Monetary policy will keep rates at their effective lower bound for an extended period and may intensify through non-conventional measures if required. Thus, while Chile's GDP contraction in 2020 will be about half that of the rest of Latin America, the output gap opened in the first half of the year may take until 2022 to close, while per capita income would return to its pre-crisis levels only by 2023.

Enhancing Chile's policy framework. The CBC has voluntarily requested the Fund to run a Financial Assessment under the *Financial Stability Assessment Program* (FSAP) led by joint teams from the IMF and the WBG. The scope of this work has already been agreed and will be resumed shortly. The last FSAP was conducted in 2011, and since then Chile made significant progress, including in adopting international standards through legal changes enacted in 2019. The new General Banking Law introduces modernizations in three fundamental dimensions: (i) supervisory institutions; (ii) bank solvency standards; and (iii) management of critical situations. A new financial regulator was established, the Commission for the Financial Market (CMF)—that brought together the superintendencies in charge of regulating and surveillance of the financial market—which is autonomous and led by five Board Members nominated similarly to the CBC Board of Governors.

The CBC looks forward to continuously reaffirming its commitment to transparency and good practices. In 2019 the CBC Board of Governors voluntarily appointed a Panel of Experts composed by renowned central bankers and academics, to independently assess the implementation of the core mandate of the CBC. The Panel highlighted the high standards followed by the CBC to conduct monetary policy and safeguard financial stability, the key role that the rooted credibility plays in anchoring expectations, and the swift and transparent communication strategy of the Board of Governor's decisions to the public, among others. More recently, the CBC volunteered to be assessed under the pilot country assessment that will follow the recently approved *Central Bank Transparency Code* at the Fund. The CBC celebrates the update of the Code, considering the broadening of central banks' mandate, functions, and powers since the *Global Financial Crisis*, and evidenced during the Covid-19 crisis.

4. The CBC believes the World Bank Group and the Fund must continue being key players in supporting a sustainable and equitable recovery.

The financial response from the WBG and the Fund during the Covid-19 crisis has been paramount. The CBC welcomes and appreciates the coordinated initiative to alleviate Debt Service for LICs, endorsed by the G20 (DSSI), that was a success, though still, the lack of participation of private creditors remains a concern, and we hope the envisioned enhancements will incentivize their involvement. In addition, the membership has responded to the call and pledged sizable resources to complement this initiative by replenishing the *Catastrophe and Containment Trust* and allow for additional concessional financing adding resources to the *Poverty Reduction and Growth Trust*. As a result, the IMF has approved close to 80 requests for emergency financing, even modifying the debt limits to better serve the member's immediate needs. Being an emerging market economy, Chile is well aware that some economies will face debt overhang problems. In this regard, the new program for Ecuador, and the ongoing conversations with Argentina, are a positive step to avoid a default that would cause greater GDP losses. Finally, the CBC appreciates that the Fund recognizes that under this extreme uncertainty even strong economies needed insurance, and thus access to precautionary resources. Overall, the combined toolkit of the WBG and the Fund, is an asset that should be preserved and enhanced as needed in order to prevent future Balance of Payment crises and minimize the cost for the world's financial stability. Along the way, we echo the WBG and the Fund's continued efforts to encourage debt transparency, and debt management, as well as enhanced levels of disclosure by debtors and creditors.

Looking forward, the WBG and the Fund should continue supporting their members to return to a sustainable and inclusive growth path. Besides the key tasks of surveillance, technical assistance, and support for rebuilding infrastructure, it is Chile's opinion that restoring human capital and boosting market development will be of the essence. Low income countries will need more than ever, the support from the international community. For the first time, poverty reverted its decreasing trend, a regrettable consequence of the crisis which will require stronger deployment of efforts, as the accomplishment of the *Sustainable Development Goals* is at greater risk. In addition, scarring could be larger in these countries, and hence, the challenges to bolster productivity will be sizable. Apart from challenges, in the eyes of the CBC, many opportunities will come out of the crisis at the world level but could be led by advanced economies, including fostering green investment, digitalization and tackling gender issues. Financial assistance from the international community has played a central role in the current juncture, and should continue doing so, while supporting countries in need to improve debt management or even debt restructuring.

We concur that the WBG and the Fund, as well as the international community, will be at the center of the recovery. To successfully achieve the recently mentioned goals, both institutions need to be adequately funded, and the WBG is one step ahead. Chile has been an active part in strengthening the second and third lines of defense of resources at the Fund. We were part of the first set of countries to renew the bilateral loan agreement for the next three years, and already approved the doubling of our creditor position at the *New Arrangements to Borrow* (NAB). Nevertheless, as we have often said in the past, we are convinced that the Fund should remain a quota-based institution, with sufficient resources to provide full confidence that it can adequately support its membership, and remain at the center of the global financial safety net. In this regard, Chile is committed towards the prompt completion of the *16th General Review of Quotas*, considering a quota increase, and the needed realignment that will improve governance, while protecting the quota share of the poorest and smaller members of the Fund.