MACROECONOMIC ANALYSIS

Slow fiscal execution creates a risk that projections for public spending over the year will not be met

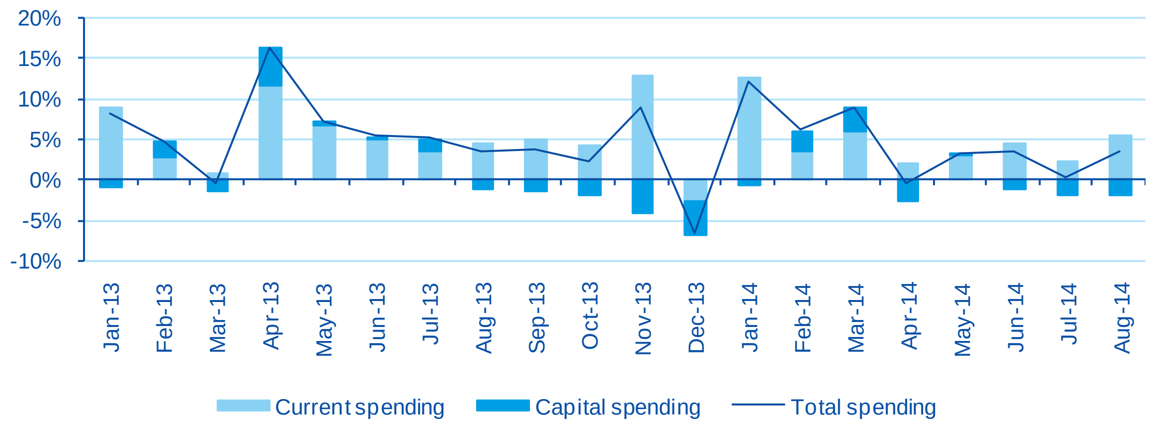
Chile Unit

- During the first eight months of the year, the rate of execution of fiscal expenditures has not differed significantly from the same period in 2013. Expenditure in public-sector investment fell again in August, and is contributing to the severe reduction in total investment so far this year
- In order to meet the Ministry of Finance's target for this year, spending will have to grow by an annual real average of 10% in the last four months, putting a 2% floor on GDP growth
- Meeting these targets will also put pressure on the CLP to appreciate

To August, the rate of execution has not differed significantly from the same period in 2013. The execution of expenditure in August was 7.8% of the budget, accumulating so far this year to 61.4%. During this month in 2013, 7.6% was executed, accumulating to 59.8%.

Spending on public-sector investment dropped again in August and, so far this year, will add to (instead of offsetting) the severe fall-back in private investment. Public-sector investment is contributing to the fall-back in total investment. The August figures continue to show that the rate of public spending execution is a hindrance as far as the recovery of economic momentum goes, particularly when it comes to investment. Central government spending in total grew by 3.5% in August, accumulating a real annual increase of 4.4% in the first eight months of the year. The increase in spending is fully accounted for by current spending, which grew 6.4% in real annual terms in August, a cumulative 5.7% so far this year (Figure 1). **However, public-sector investment (investment after capital transfers) dropped again by a real 12.3% YoY, an accumulated reverse of 2.7% for the year to date.**

Figure 1
Monthly rates of current spending growth and of capital in the total (% real var. YoY)

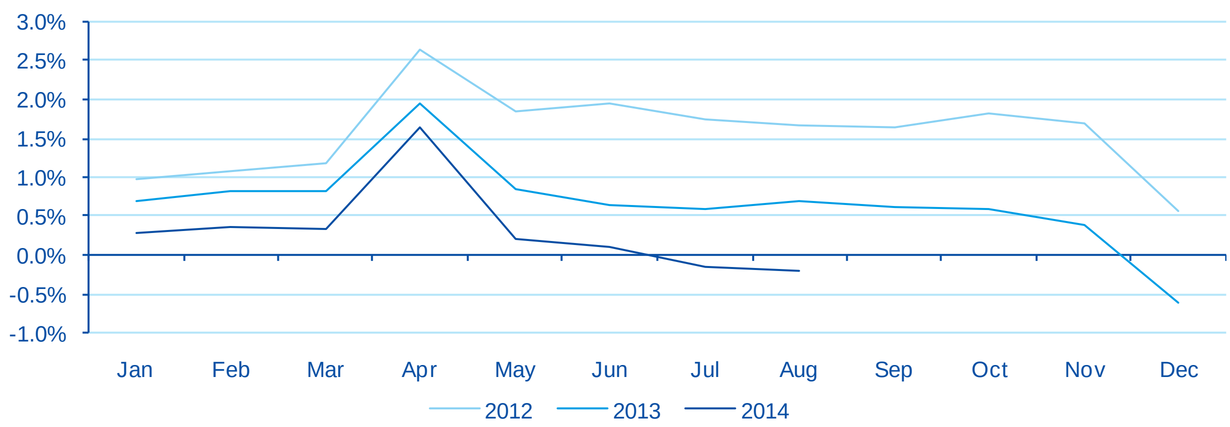


Source: Budget Office, BBVA Research

To meet the Ministry of Finance's targets for this year, spending would have to grow in the last four months by an annual real average of 10%, putting a 2% floor on GDP growth. If the rate of execution can be accelerated and the forecast made by the authorities is met, we will see a powerful fiscal stimulus from this month onwards, which will contribute to better activity data in the last four months of the year. Given the weight of public spending in GDP, in fact, average growth of 10% would put a growth floor of 2% for the last four months of the year, always provided the sums committed to are executed. Given the estimate figures for execution, with every month that goes by the government is less likely to fulfil with the spending commitment it announced in July.

The accumulated fiscal effective deficit to August is 0.2% of GDP, upholding our forecast of a deficit slightly higher than 2% of GDP (Figure 2)**.**

Figure 2
Accumulated fiscal deficit as % of GDP



Source: Budget Office, BBVA Research

Meeting these targets will also put pressure on the CLP to appreciate. We repeat that if forecast spending for this year actually happens, it would require the Ministry to liquidate assets to the tune of USD3bn, given that the indebtedness limit (USD6bn) will not be enough to finance the estimated deficit for this year. We have been making this call for some time now *(see report)*.

Fiscal revenues have already accumulated a 2.3% reduction YoY to August, and only the higher revenues resulting from the tax reform are capable of halting the fall. While mining revenues are showing a slight uptick, in particular thanks to the tax revenues from private-sector mining, the fall in tax revenues from other contributors is accentuating, accumulating a reduction of 0.9% YoY. These figures, affected by the slowdown in the economy across the board are significantly different from the moderate 0.4% drop for the entire year announced to Congress in July. The report accompanying the 2015 Budget law to be presented next week to Congress, which contains an update for 2014 forecasts, will include the resources from the Tax Reform (TR) for this year, calculated at 0.3% of GDP, so it will not cover such a pronounced annual fall in income as the accumulated drop in execution.

However, we estimate that, not counting TR resources, total income this year will be USD900mn less than the amount announced three months ago, which supports our view of an asset liquidation over the rest of the year. So, given the importance of greater TR revenues in order to underpin fiscal income this year, we repeat that there are risks associated with the estimate given by the Ministry of Finance, in particular the fact that half of this amount is associated with earnings resulting from less tax evasion.

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