Chile

Budget 2025 bets on revenue-led fiscal consolidation again despite 2024 fiasco

- **Budget assumes deficit falls to 1.0% of GDP in 2025 from 2.0% in 2024, gross debt stabilizes**
- **Govt fails to acknowledge big 2024 fiscal deviation, deficit likely to be much higher than 2.0%**
- **Govt again expects consolidation from revenues rising to record in terms of GDP after missing 2024 forecast by at least 1.2% of GDP**
- **Revenues would grow on higher copper prices and output, tax compliance, and stronger domestic demand**
- **GDP growth forecast of 2.7% is above 2.0%-2.2% consensus**
- **Revenue optimism allows expenditures to rise 0.5% of GDP, govt at least allocates spending growth to easy-to-cut categories**
- **Gross financing needs set at USD 16.0bn, net financing needs would be USD 9.9bn (2.6% of GDP)**
- **Gross debt would steady at 41.3% of GDP assuming optimistic-looking assumptions hold**

The government's 2025 Budget Bill proposes to continue the fiscal consolidation path under terms similar to the ones originally laid out by the Boric administration in 2022, which would allow for gross central government debt to stabilize below a prudent level of 45% of GDP, and steady net debt below 40%. The projected deficit and debt levels were raised for the budget bill compared to the last set of fiscal projections from July, but again, the numbers remain in line with the original debt stabilization plan put forward in 2022, so the government going for a slightly higher deficit than expected in 2025 is not a big concern in itself.

There are other reasons for concern though, mainly tied to a big fiscal underperformance in 2024 that the government is not acknowledging, the 2025 budget assuming a big step up in revenues after doing the same in the 2024 budget backfired, a growing below-the-line deficit that keeps gross borrowing needs high, and a GDP growth forecast that is above consensus.

Fiscal balance and debt projections, % of GDP

	October 2024 estimate				
	2024	2025	2026	2027	2028
Income	22.9	24.3	23.9	23.4	22.9
Spending	24.8	25.3	24.2	23.6	22.9
Balance	-2.0	-1.0	-0.3	-0.3	0.0
Treasury assets	3.7	3.3	3.4	3.4	3.3
Gross debt	41.2	41.3	41.4	40.9	40.4

Net debt	37.5	38.1	38.0	37.5	37.0
	July 2024 estimate				
	2024	2025	2026	2027	2028
Income	22.9	23.7	22.8	22.2	21.7
Spending	24.8	23.9	22.6	22.0	21.6
Balance	-1.9	-0.2	0.2	0.1	0.2
Treasury assets	4.0	3.7	3.5	3.4	3.5
Gross debt	40.1	41.0	41.0	40.8	40.8
Net debt	36.2	37.3	37.5	37.5	37.3

Source: Budget Office

Fiscal targets, May 2022

		2019	2020	2021	2022	2023	2024	2025	2026
Budget balance	% of GDP	-2.9	-7.3	-7.7	-1.7	-1.9	-1.5	-1.1	-0.5
Structural balance	% of GDP	-1.7	-2.2	-10.8	-3.3	-2.6	-1.8	-1.1	-0.3
Gross debt	% of GDP	28.3	32.5	36.3	38.8	41.6	42.9	43.9	43.9
Net debt	% of GDP	18.6	24.2	31.0	33.2	36.2	37.8	38.9	39.2
Assumptions									
GDP growth	%	0.8	-6.0	11.7	1.5	0.4	3.0	3.0	3.0
Revenue	% of GDP	21.7	20.0	23.9	21.7	22.8	23.2	23.5	23.5
Expenditure	% of GDP	24.5	27.3	31.5	23.4	24.7	24.7	24.6	24.0

Source: Finance Ministry

The big picture: the 2024 starting point and credibility

We believe it's important to look at the big picture before diving into the details of the 2025 budget proposal, and this look needs to start with the 2024 fiscal performance.

The 2024 Budget Law projected a fiscal deficit of 1.9% of GDP for this year. As of end-August, the 12-month rolling deficit is 3.8% of GDP and the cumulative deficit in 2024 is already 2.2% of GDP. With what we know so far, the fiscal deficit appears likely to end 2024 at about 3.5%-4.0% of GDP.

The government currently assumes the 2024 deficit will be 2.0% of GDP. This would require an unprecedented turnaround in the fiscal performance, particularly on the side of revenues, which need to rise a near record 8.9% of GDP in Sep-Dec (the usual is 7.3%-7.8%) to meet the government's latest projections. The government seems to expect a surge in income tax payments, lithium-related proceeds, and transfers from state companies, including Codelco. Perhaps there is a chance of the deficit ending at 3.0% of GDP, but this would require the government taking money from public companies to mask the results. The implications for the 2024 gross borrowing program are not clear, since the government isn't even acknowledging that it is likely to end with a significantly larger deficit than budgeted.

We start by focusing a lot on the 2024 fiscal performance because it really puts into question the credibility of the government's fiscal projections. Chile has fiscal space to absorb a big fiscal deviation of one year and still stabilize gross debt below the designated prudent level of 45% of GDP, so there is no immediate crisis here. However, 2024 will represent a step back in the fiscal consolidation process that is still in its first steps, at least if looking at the deficit level. Moreover, our look at the 2025 budget suggests the same practices that explain this fiscal deviation in 2024 are repeated, since the fiscal consolidation next year is projected entirely based on revenue growth from hard-to-estimate sources.

The big picture: budget 2025 basics and fiscal consolidation path

For 2025, the government projects a deficit of 1.0%. To get there, the government assumes revenues rise 1.5% of GDP. That is from an expected revenue performance for 2024 that at this point seems too optimistic, and discounting the impact of a GDP growth forecast that is also optimistic. Even though there are some revenue growth drivers (discussed in detail in the following section), these are from volatile and uncertain sources. It's particularly hard to have confidence in these revenue growth forecasts when the government is in line to miss its budgeted revenue forecast for 2024 by about 2.0% of GDP.

Expenditures would rise by 0.5% of GDP in 2025, and by 3.9% y/y in inflation-adjusted terms, meaning the fiscal consolidation efforts would take place exclusively on the side of revenues next year. That was also the plan for 2024, but the big miss in the revenue forecast will force the government to spend less than budgeted.

Thus, in a first broad look, the projected fiscal consolidation for 2025 is based on fairly optimistic assumptions for revenues and GDP (more details on the macro assumptions in a section below). Gross and net debt are projected to stabilize starting in 2025 at relatively low levels, but again, this is contingent on the government meeting deficit targets based on optimistic assumptions.

Fiscal balance and debt projections, % of GDP

	October 2024 estimate				
	2024	2025	2026	2027	2028
Income	22.9	24.3	23.9	23.4	22.9
Spending	24.8	25.3	24.2	23.6	22.9
Balance	-2.0	-1.0	-0.3	-0.3	0.0
Treasury assets	3.7	3.3	3.4	3.4	3.3
Gross debt	41.2	41.3	41.4	40.9	40.4
Net debt	37.5	38.1	38.0	37.5	37.0

Source: Budget Office

Budget 2025 expenditures and revenues breakdown

Revenues

For the second year in a row, the government is projecting a decline in the fiscal deficit based on revenues rising to a record in terms of GDP (excluding 2022, when revenues were massively inflated by the unique effect of the post-Covid GDP rebound). Revenues would rise by 1.5% of GDP or more (we believe the 2024 revenue projection will not be met). The drivers for this would be stronger economic growth in 2024-25 underpinning income tax and VAT payments, higher copper prices and their impact on collection from the new mining royalty and regular income tax payments, the impact of the Tax Compliance Law approved recently, and the first effects of the Codelco-SQM association in Chile's largest lithium venture.

Before a deeper look at the numbers, it is worth noting that these are all fairly volatile sources of revenue. The government's income tax revenue projections missed by huge margins for three years in a row now. VAT proceeds are projected to rise in part due to a domestic demand growth forecast that seems a bit optimistic. Revenues tied to copper and lithium are always volatile due to the nature of the prices of the metals.

The new Tax Compliance Law deserves its own paragraph. The implementation of the law is expected to contribute 0.37% of GDP to revenues in 2025. This is much lower than the 0.73% projected by the budget office when the reform was in Congress, but it still looks high. The law contains measures against aggressive tax planning that should have a material impact on tax payments, but outside of that, it's hard to believe administrative changes can have such a big and quick impact. The budget assumes income tax collection grows 0.23% of GDP in 2025 due to the new law, VAT revenues grow 0.05%, and there would be another 0.09% in revenues from sources that were not detailed.

Income tax payments coming from mining companies are projected to jump to 1.6% of GDP next year from 1.0%. We can't say with confidence if the projection is overly optimistic, but there are drivers for a jump. Copper output is going through a strong recovery after two down years, copper prices have also been considerably higher for several months, and the new mining royalty is supposed to increase tax collection even more in periods of high prices.

Income tax payments from the non-mining sector are set to rise by about 0.8% of GDP or more according to the budget projections. This is a riskier forecast in our view, as it includes the uncertain impact of the Tax Compliance Law, and the expected effect from the acceleration of GDP growth. As a reference, the government projected non-mining income tax collection at 18.7% of GDP in the 2024 budget law, but this has been corrected down by 0.9pps to 17.6%.

The Codelco-SQM deal would grant the government extra revenues because the state miner will be receiving a share of profits, which then get transferred to the state. The Finance Ministry said these will be part of the property rents category. Property rents are projected to rise 9.6% y/y in inflation-adjusted terms, but would stay at 0.8% of GDP.

Expenditures

The increase in projected revenues would enable expenditures to grow by 0.5% of GDP while still being consistent with the fiscal consolidation goal. We see downside risks to revenues that make this budgeted spending hike risky as well, but there is a mitigating factor.

The budget assumes the spending growth will be largely allocated to capital spending, subsidies, and goods and services. These are three categories of spending over which the government has a fair degree of flexibility to under-execute in a pinch, in contrast with more inflexible spending obligations on social security, wages, and interest. When the government was at risk of missing the 2023 fiscal target, it slashed capital spending and subsidies. This year the government is already planning to slash capital outlays and spending on goods and services.

Outside of that, spending would remain fairly steady compared to the latest projections for 2024. The government says it will spend more on security, public healthcare, and education, to reflect Chileans' spending priorities, but there are no big changes in above-the-line spending.

One point worth considering is that the pension reform proposal being treated in Congress, which could be headed for approval in 2025, contains an increase in the universal pension stipend. The financing for this was tied to the approval of the Tax Compliance Law, but the fiscal impact of the Tax Compliance Law seems already accounted for in the budget.

Fiscal balance breakdown

	Budget 2024		Expected 2024		Budget 2025	
	% of GDP	% y/y	% of GDP	% y/y	% of GDP	% y/y
Revenue	**24.0**	**5.7**	**22.8**	**5.3**	**24.3**	**8.5**
Taxes	19.7	9.3	18.6	10.6	20.0	9.7
Mining income tax	1.0	6.1	1.0	23.5	1.6	68.6
Non-mining taxes	18.7	9.5	17.6	9.9	18.4	6.4
Income	9.0	18.0	7.9	14.6	8.7	13.4
VAT	8.7	3.1	8.9	9.4	9.2	4.9
Excise	1.3	-10.8	1.2	-1.9	1.2	2.8
Codelco	0.4	-6.6	0.6	51.6	0.5	-8.4
Social security	1.1	0.5	1.2	12.3	1.3	6.3
Donations	0.1	35.7	0.1	81.3	0.0	-10.1
Property rents	1.2	-18.7	0.8	-53.6	0.8	9.6
Lithium leases	-	-	0.2	-	0.3	10.7
Operational income	0.5	12.4	0.5	9.1	0.5	0.2
Others	1.1	-13.0	1.1	-13.3	1.1	3.6
Expenditure	**25.9**	**3.7**	**24.8**	**2.3**	**25.3**	**3.9**
Current	21.8	3.5	21.0	2.9	21.3	3.1
Wages	4.9	6.2	5.0	11.5	4.9	0.6
Goods and services	1.9	4.3	1.7	-1.8	1.8	9.3
Interest	1.1	16.8	1.2	29.0	1.2	-1.0
Subsidies	9.2	2.3	8.6	-1.5	8.8	4.1
Pensions	4.7	1.2	4.5	0.1	4.5	2.5
Other	0.0	-71.9	0.0	-72.0	0.0	4.6
Capital spending	4.1	4.7	3.8	-0.6	4.0	8.8
Overall balance	**-1.9**	-	**-2.0**	-	**-1.0**	-
Primary balance	**-0.8**	-	**-0.8**	-	**0.2**	-

Note: y/y change adjusted for inflation
Source: Budget Office

Gross borrowing plan, debt, and the hidden deficit

The government requested a gross borrowing ceiling of USD 17.5bn for 2025, of which USD 16.0bn would be for the regular gross borrowing plan, and USD 1.5bn in space would be reserved for precautionary reasons. The number looks high when the fiscal deficit is projected at USD 3.8bn and when gross debt is expected to remain almost unchanged in terms of GDP, but we delved into the numbers and they do seem to add up.

Aside from the fiscal deficit, the government has below-the-line financing needs we estimate at USD 6.1bn, or 1.6% of GDP. These would grow from a projected 1.3% of GDP in 2024. The only breakdown of these financing needs offered so far by the government is in the first table at the end of this section.

By adding up the financing needs from the above- and below-the-line deficits, we arrive to net financing needs of approximately USD 9.9bn for 2025. In addition to this, there are some USD 6.2bn in bond maturities the government will look to roll, pushing gross financing needs to about 16.0bn.

Debt in terms of GDP would grow to 41.3% of GDP, up only 0.1pps y/y. Net financing needs of 2.6% of GDP would be slightly below the 2.7% real GDP growth forecast. However, nominal debt growth would exceed nominal GDP growth due to valuation changes.

Looking beyond 2025, the government is projecting gross debt to remain steady through 2026 before declining through 2029. This hinges not only on the continuation of the above-the-line fiscal consolidation, but also on a decline in the below-the-line financing needs. We don't have enough elements to comment on whether the projected decline in below-the-line financing needs is realistic, but this would go against the trend of recent years, including projections for 2025.

Gross borrowing plan and debt

	2024	2025
	USDbn	USDbn
Gross borrowing plan	17.0	16.0
Gross financing needs estimate	15.3	16.1
Fiscal deficit	7.0	3.8
Financial transactions (below the line)	4.5	6.1
Public firms capitalization	1.0	1.1
Other capitalization mandated by law	1.9	2.1
IFI contributions	0.1	0.1
Loans	1.2	2.7
Recognition bonds	0.2	0.1
Bond maturities	3.8	6.2
Gross debt projection	140.6	156.1
Gross debt change	-	15.5
from net financing needs	-	9.9

from valuation changes (mainly CLP appreciation)	-	5.6
	% of GDP	% of GDP
Gross debt projection	41.2	41.3

Source: EmergingMarketWatch

Net financing needs projection, USD bn

	2024	2025	2026	2027	2028
Net financing needs	11.5	9.9	7.4	6.0	4.9
Fiscal deficit	7.0	3.8	1.6	1.0	-0.1
Below the line	4.5	6.1	5.8	5.0	5.0
Gross debt	140.6	156.1	165.0	170.7	177.0
Valuation effect	-	5.6	1.5	-0.3	1.4
Net financing needs % of GDP	3.4	2.6	1.9	1.5	1.2
Gross debt % of GDP	41.2	41.3	41.4	40.9	40.4

Source: EmergingMarketWatch

Macro assumptions

The budget assumes GDP growth that is above consensus for 2024 and 2025, a change in the GDP growth composition into domestic demand-led growth instead of the export-led growth seen in 2024, exchange rate appreciation, and higher copper prices.

For us, the above-consensus GDP growth forecast is a relatively minor cause for concern. This is in part because the deviation isn't massive, but also because the Finance Ministry's out-of-consensus GDP forecasts have been pretty good under Finance Minister Mario Marcel.

Macro assumptions

		2024	2025	2026
GDP	% y/y	2.6	2.7	2.3
Domestic demand	% y/y	1.5	3.4	2.7
Consumption	% y/y	2.0	3.1	2.7
Investment	% y/y	0.0	5.9	3.0
Exports	% y/y	5.9	4.1	3.0
Imports	% y/y	2.1	6.5	4.3
GDP mining	% y/y	6.0	3.5	3.0
GDP non-mining	% y/y	2.2	2.5	2.2
CPI	% y/y avg	3.9	4.2	3.1
FX rate avg	USD/CLP	928	887	866
Copper price	USD/Lbs	415	430	430

Oil WTI	USD/bbl	78	81	81
CA balance	% of GDP	-2.5	-2.3	-2.7

Source: Budget Office

Legislative process

We don't expect the budget bill to be challenged by the opposition. Marcel could be questioned about the big fiscal underperformance this year, but it would be surprising if this leads to the proposed budget getting cut. The usual is for the opposition to request more spending authorization for areas of interest and cuts on programs they don't like, but spending caps rarely get changed.

Last year was atypical in that the opposition pushed for the borrowing ceiling to be cut, and there was an agreement to do it. The same could potentially happen this year given that below-the-line financing needs are high, but with debt projected to stabilize in terms of GDP, the opposition may not feel the need to pursue that battle.

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