Latam Daily: Chile Pension Reform; Colombia Financing Plan 2021: Peru Pensions Update

- **Chile: Government announced plan to reform the pension system, total costs could reach USD 4 bn**
- **Colombia: Traditional exports remained weak in January; Financing Plan 2021 clarifies public accounts**
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CHILE: GOVERNMENT ANNOUNCED PLAN TO REFORM THE PENSION SYSTEM, TOTAL COSTS COULD REACH USD 4 BN

On the evening of Wednesday, March 3, President Piñera announced the central aspects of his administration's proposals for pension reforms that are currently under discussion in the Senate. After more than 10 months of negotiations with the Opposition, which did not produce an agreement, the President affirmed on a nationwide broadcast that his plan would significantly enhance the pensions of 2.1 million Chileans, especially women, the middle class, and the most vulnerable groups. It would also reduce the pension gap between men and women and between people at different income levels through, amongst other things, guarantees of pensions that would sustain recipients above the poverty line combined with improvements to future pensions.

We summarize below the key elements of President Piñera's plan.

Broad overview. The President's initiative would raise individuals' pension contributions out of pre-tax gross income from the current 10% level to 16%. The Piñera administration initially considered a move 18%, but this was viewed as too ambitious in the current labour market. Within the proposed additional contributions, 3 ppts of income would go into individuals' retirement savings accounts and the other 3 ppts would go into a collective "solidarity" pool to finance minimum pensions for low-wage workers.

Costs of pension reform. The combined cost to the government of the pension reform bill already under discussion in Congress and the President's new proposals would add up to 1.5% of GDP, or USD 4 bn, over the long term.

Package of measures and their key features:

1. **Expansion of the pension system's Solidarity Pillar:** The Solidarity Pillar's coverage would rise from 60% of the population to 80%, which would add 480k people to the pension system who do not currently have recourse to public support. As a result, the Solidarity Pillar would end up benefiting some 2 million pensioners. The Pillar benefits two types of Chileans: first, older adults who receive a Basic Solidarity Pension, i.e., people who did not contribute to the system during their lifetimes and, hence, receive only minimal retirement support; and second, retirees who receive the Solidarity

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Pension Contribution, i.e., people who did contribute to the pension system during their working lives, but not enough to qualify for retirement payouts beyond the Basic Solidarity Pension.

2. **Increasing the Basic Solidarity Pension to ensure it's consistent with the national poverty line.** The goal is to ensure that all pensions maintain recipients above the national poverty line of about USD 230 per month. This move would apply to more than 580k people who receive the Basic Solidarity Pension and would improve the Solidarity Pension Contribution top-up for about 1.5 million others.

3. **A new one-off adjustment to the Solidarity Pillar.** Scheduled for January 1, 2022, this increase in the Basic Solidarity Pension would benefit retirees between the ages of 65 and 74.

4. **Strengthening the pension system's Contributory Pillar:** The proposal strengthens the Contributory Pillar of the pension system by gradually raising the employer's contribution to workers' retirement savings by 6 ppts. Half of this increase would go directly to an individual Pension Savings Account for each worker whose balance would be added to their respective AFP accounts on retirement. These new accounts would be managed by a public agency called the Social Security Administration Council (CASS in Spanish). These additional contributions should lift workers' eventual pensions by 30%. The other half of this increase in employer contributions would go to a new Collective and Solidarity Savings Program (PACS) to finance the following additional benefits:

    - **A larger rise in women's pensions than men's pensions.** An immediate increase of UF 2.7 per month (UF is the inflation-adjusted "unidad de fomento; this amounts to about USD 110) would be provided for current female pensioners over 65 years of age who contributed to the system over at least 8 years;

    - **For men, pension would be enhanced by only UF 2 per month** (about USD 81 per month) for retirees over 65 years of age who contributed to the system over at least 12 years. The increase would be extended to future pensioners over 65 years of age; and

    - **Minimum pensions.** All new pensioners with 30 years of contributions to the system and at least 10 years of contributions to the PACS would be guaranteed a pension equal to or greater than the current minimum salary, that is, UF 11.1 per month, equivalent today to USD 452.

5. **Reform of the pension funds:** Non-profit funds would be created and their administrators would be empowered to distribute any profits to their members.

6. **Sanction on underperforming funds:** The reform would establish that pension administrators that produce negative returns and returns lower than their fund's reference benchmark portfolio would be required to return 20% of their fees to their account holders.

Opposition Senators criticized the President's proposals because, in line with the Chamber of Deputies' bill, the proposed changes maintained the split that directs half of new contributions to individual pension accounts and half to common funds. The Opposition would prefer to see all of the additional contributions directed to solidarity funds.

Still, Opposition Senators indicated that they would make themselves available to approve parts of the proposal that would: direct more resources to retirees; extend the Solidarity Pillar to the middle class (which would increase its coverage from 60% of the most vulnerable to 80%): ensure that the Basic Solidarity Pension is above the poverty line; and that anyone who has contributed to the retirement system for 30 years or more could not have a pension income lower than the minimum wage. "We will certainly support these new things, those that serve for better pensions," said Socialist Juan Pablo Letelier, President of the Labour Commission.

Opposition parliamentarians indicated on Wednesday night that the President's proposals also fell short of what they believe would be required to end so-called "excessive" profits in the pension-fund industry.

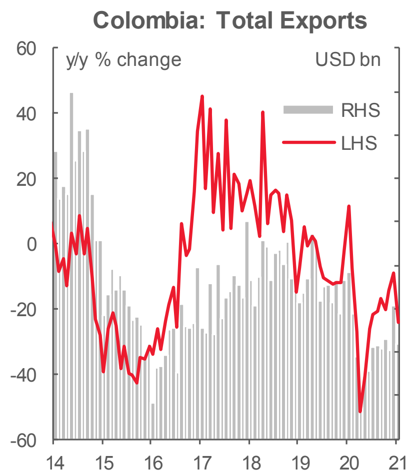
—Jorge Selaive, Carlos Muñoz, & Waldo Riveras

COLOMBIA: TRADITIONAL EXPORTS REMAINED WEAK IN JANUARY; *FINANCING PLAN 2021* CLARIFIES PUBLIC ACCOUNTS

I. January exports remained weak owing to the oil and mining sector, while non-traditional exports stayed strong

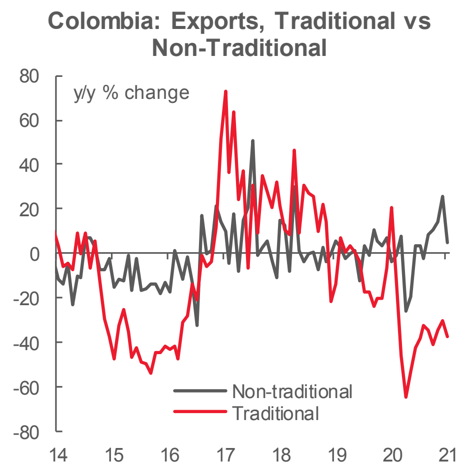
According to DANE's release on Thursday, March 4, January's monthly exports stood at USD 2.59 bn (-24.1% y/y, chart 1), and below December's figure (USD 3.03 bn). Non-traditional exports remained at their best level since 2013, broadly led by gold exports, while traditional exports stayed close to their lowest numbers in four years, amid weak oil and mining exports. In fact, these goods exports were down -42.2% y/y in January. Agricultural exports were down a milder -2.5% y/y while manufacturing exports were almost flat (-0.7% y/y) on an annual basis.

Chart 1



Sources: Scotiabank Economics, DANE.

Chart 2



Sources: Scotiabank Economics, DANE.

Traditional exports as a whole were down by -37.8% y/y in January (chart 2) and their absolute levels were low compared with recent years. Oil-related exports represented 35% of total exports, closer to the average of 40% in 2019, and better than the 28% share for all of 2020. Lower production remained a challenge, however, that would be more pointed if international prices come down. Coal exports contracted by -69.62% y/y owning to a reduction of -72.32% y/y in volumes exported. We expect coal to continue exerting a drag on exports in 2021. In contrast, coffee exports increased by 2.31% y/y in January due to better prices.

Non-traditional exports amounted to USD 1.15 bn in January, an increase of 4.9% y/y compared with a year ago (chart 2 again). Significantly expanded exports of gold (up 67.4% y/y), agricultural products such as flowers (up 33% y/y), and cattle (a 147.3% y/y gain) drove the overall rise in non-traditional goods exports.

All in all, January's export numbers showed similar trends to those observed in 2020—and imply that these trends could continue through 2021. Growth in coal exports should continue moderating, while the drag from oil should wane as international prices continue increasing. We see room for further improvements in non-traditional exports as the world gets the pandemic under control and consolidates its recovery path. However, although exports should keep improving in 2021, imports could rise even more as domestic demand improves: we expect a current account deficit of about -3.8% of GDP or wider in 2021, beyond the -3.3% deficit observed in 2020.

II. *Financing Plan 2021* clarifies public accounts; fiscal reform is the next milestone

On Thursday, March 4, the Ministry of Finance (MoF) released the *Financing Plan 2021* and fiscal results for 2020. The publication was overdue and its delay had created a lot of uncertainty since its release was initially scheduled for the end of January. In the event, the MoF presented a picture in which 2020's public deficit was a positive surprise since it came in at -7.8% of GDP versus the -8.2% of GDP that had been anticipated in the *Medium Term Fiscal Framework* for 2020 (MTFF-2020). On the other hand, in 2021, a higher deficit of -8.6% of GDP is now the MoF's base case scenario and debt issuances will remain high. With the publication of the *Plan*, the MoF reduced uncertainty about its likely activities over the next year and reinforced its commitment to present a comprehensive set of fiscal reforms. In fact, the *Plan* anticipates that this reform package would generate savings and extra income equivalent to around 1.5% of GDP next year. The next milestone in this process will be the release of recommendations from the experts' committee on changes to the Colombian tax code. These recommendations should trigger a more explicit discussion on fiscal reform measures. The Fiscal Rule Committee's deliberations will be also important, especially for the debate about the resumption of compliance with the fiscal rule.

Macro assumptions

- The government expects GDP growth of 5.0% y/y in 2021 (table 1), a more moderate pace than the 6.6% y/y that had been forecast in the MTFF-2020 and more aligned with market consensus and our projection of 5.0% y/y.
- For 2021, the government expects USDCOP to average around 3,466 pesos, which for now looks feasible. Brent oil prices are expected to average 53 USD/bbl, which looks like a reasonable assumption.

Table 1
Colombia: Macroeconomic projections

Variable	2020	2021 MTFF-2020 forecast	2021 Current forecast
USDCOP, avg.	3,694	3,747	3,466
Brent prices, USD/bbl avg.	43.3	50.2	53.0
CPI inflation, y/y % change eop	1.6	3.0	2.4
Real GDP, y/y % change	-6.8	6.6	5.0
Nominal GDP, y/y % change	-5.5	11.8	9.3

Sources: Scotiabank Economics, Ministry of Finance Colombia.

Fiscal results in 2020

Fiscal deficit for 2020 stood at -7.8% of GDP (table 2), narrower than the -8.2% of GDP expected in the MTFF-2020, and below the Fiscal Rule Committee's estimate of -8.9% of GDP. A positive surprise came from lower execution of spending from the Emergency Fund equivalent to 0.8% of GDP and lower interest payments equal to 0.4% of GDP. These developments offset a negative surprise in net tax collection amounting to 0.3% of GDP and extra expenditures for the public pension fund that tallied up to 0.5% of GDP.

Table 2
Colombia: Fiscal balance, 2020 vs 2021

% of GDP	2020	2021 MTFF-2020 projection	2021 Financing plan projection
Income	15.1	15.6	15.7
Taxes	13.0	13.5	13.5
Others	2.0	2.1	2.2
Total expenditures	22.8	20.7	24.3
Interest payments	2.8	3.2	3.4
Operating & investment expenses	20.0	17.5	21.0
Operating expenses	16.3	15.8	16.1
Investment	2.0	1.7	3.1
Emergency expenses	1.7	0.0	1.7
Primary balance	-4.9	-1.9	-5.3
Fiscal deficit	-7.8	-5.1	-8.6

Sources: Scotiabank Economics, Ministry of Finance Colombia.

Financing Plan for 2021—above the line

- **For 2021, the expected fiscal deficit was revised to -8.6% of GDP, much wider than the -5.1% of GDP projected in the MTFF-2020 and more substantial than the Fiscal Rule Committee's estimate of -7.6% of GDP.** Nevertheless, the new fiscal deficit projection complies with existing law since Colombia's fiscal rule remains suspended in 2021. It is worth noting that a higher deficit for 2021 responds to expected higher expenditures related to the pandemic, under-executed budget in 2020, additional spending for the vaccination program, and a higher investment budget for the economic recovery.
- **Assets sale assumptions are projected to deliver COP 12 tn.** In Thursday's press conference, Minister Carrasquilla underscored that, for now, the main transaction would be the sale of ISA to Ecopetrol and that, compared with previous years, there is better confidence that this transaction will be executed. Note that current IMF standards would consider asset sales revenue as exceptional financing below the line.
- **Our take is that the revision of the fiscal deficit projected for 2021 is neutral since the positive surprises from 2020 appear to have been transferred to enable a higher deficit in 2021.** Moreover, the fiscal rule remains suspended and the revisions are still broadly in line with the Fiscal Rule Committee's recommendations. The government is expected to resume compliance with Colombia's fiscal rule in 2022, but even the IMF has suggested an extension of the rule's suspension.

Financing Plan for 2021—below the line

Total financing needs for 2021 remained high in the *Plan*, at around COP 132 tn compared with COP 137 tn in 2020 (table 3). Major financing needs include the fiscal deficit at COP 94.6 tn, debt amortizations of COP 18.7 tn, and COP 8.6 tn in other obligations such as lawsuits. Amortizations are set to come down from 2020 owing to a reduction in the stock of COLTES 2021 paper outstanding through debt swaps. Final cash availability is expected to pass from COP 32.7 tn to COP 10.2 bn by end-2021 as a result of greater budget execution this year.

On the financing side, about two thirds are expected to come from local debt, while one third would come from external sources.

- **Local sources are expected to provide COP 55.3 tn in financing.** Debt auctions are pencilled in to garner COP 40 tn and COP 2 tn of additional issuance will be allocated to green bonds. Local issuance remains high since Colombia is still facing the fallout from the pandemic crisis. However, it may prove challenging to execute this scale of local issuance in an international environment where rates are starting to rise and the Colombian authorities may encounter some volatility in rolling out this debt.

Table 3

Colombia: Financing plan 2021, sources & uses

	MTFF 2020	FP 2021		MTFF 2020	FP 2021
Sources, COP tn	**104.9**	**132.1**	**Uses, COP tn**	**104.9**	**132.1**
Disbursements	64.2	90.5	Fiscal Deficit	57.8	94.6
Foreign sources (USD 6.5 bn; USD 10.11 bn)	24.4	35.2	Local interest	25.5	26.3
Local sources	39.8	55.3	External interest (USD 2.9 bn)	10.7	10.5
Auctions and syndications	32.0	40.0	Amortizations	29.2	18.7
Green bonds		2.0	External (USD 3.9 bn)	14.5	10.4
			Local	14.7	8.3
Other	18.6	8.9	Payment of other obligations	8.2	8.6
Initial availability	**22.1**	**32.7**	**Final availability**	**9.8**	**10.2**

Sources: Scotiabank Economics, Ministry of Finance Colombia.

- **New local debt syndications are in the pipeline.** However, there will be increased flexibility regarding potential tenors: previously, there was an expectation of a 25-year benchmark, but 20-year and 10-year maturities are all possible, subject to market conditions.

- **Additionally, the Treasury announced that auctions of UVRs are projected to increase from COP 300 bn to COP 350 bn.**

- **External sources are expected to provide USD 10.1 bn, above the projection in the MTFF-2020 of USD 6.5 bn.** The MoF expects 70% of this total to come through bonds and 30% from multilaterals. It is worth noting that up to today, around USD 1.6 bn of bonds have been issued. During 2021, amortizations of around USD 3 bn are expected, which implies that some further monetizations of existing debt are expected.

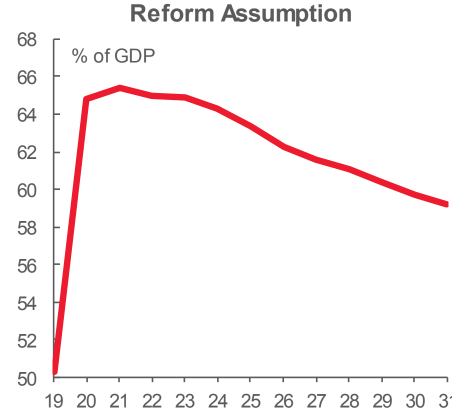
Debt dynamics and implications for the sovereign rating

The debt to GDP ratio for the central government is projected to increase from 64.8% in 2020 to 65.4% in 2021 (chart 3). Despite a significant increase in the deficit, the debt ratio would rise proportionately less because: (1) Colombia is projected to grow 5% y/y in real terms and 9.3% y/y in nominal terms in 2021; and (2) on average, the COP is expected to appreciate by 6.1% versus the USD. In the coming years, the debt to GDP ratio is expected to continue decreasing if a reasonable fiscal reform package is approved.

Altogether, the new *Financing Plan* should be received with a neutral tone by the credit-rating agencies. The new *Plan*'s revisions use 2020's positive surprised to underpin the deficit goals for 2021; in the end, the impact on Colombia's debt ratios should be moderate. The rating agencies are likely to pay more attention to progress on controlling the pandemic and furthering the economic recovery. The key thing to watch for in the coming weeks will be expert-committee recommendations on tax code exemptions, which should kick off in earnest discussions on fiscal reform to maintain Colombia's sustainable debt trajectory.

Chart 3

Colombia: Central Government Gross Debt Ratio Under Fiscal Reform Assumption



Sources: Scotiabank Economics, Min. of Finance.

—Sergio Olarte & Jackeline Piraján

PERU: RETURN TO THE INTERNATIONAL BOND MARKET; MORE PENSION WITHDRAWALS UNDER DISCUSSION

I. Peruvian sovereign issues USD 4 bn in new global bonds

The Peruvian sovereign returned to fixed-income markets on Wednesday, March 3, with the issue of USD 4 bn in global bonds to secure financing for part of its USD 11 bn in fiscal requirements for 2021. This matches the USD 4 bn the authorities issued in November 2020. The new borrowing included the re-opening of the 2031 global bond (10 years) for USD 1.75 bn with a yield of 2.734% and a spread over US Treasurys of 125 bps. This represented a mild 25 bps widening compared with the spread obtained in November 2020 (100 bps at 12 years). Two new benchmarks were also issued: a 20-year bond for USD 1.25 bn with a yield of 3.30% and a spread of 140 bps over USTs, and a 30-year bond for a total of USD 1 bn, with a yield of 3.55% and a spread of 145 bps over USTs. The bid to cover ratio was 2.5x, a positive sign that reflects investors' still-firm appetite for Peruvian paper.

With this issuance, much of the public financing needs for 2021 have been met. A further placement of sovereign bonds may still be pending, however. Recently, the Minister of Finance stated that he anticipated that 40% of the fiscal requirements would be financed with sovereign bonds. This would equate to as much as USD 4.5 bn, of which only USD 0.6 bn had been issued prior to Wednesday. Overall, this is in line with an expansion in public debt from 35.5% of GDP at end-2020 to 37% of GDP this year.

II. Another round of pension withdrawals could be forthcoming as new safety-net payments approved

A key Congressional committee has approved proposals for new withdrawals from the private pension funds, the AFPs. One possibility would allow for withdrawals of up to 2% of each AFP member’s total funds under management, while another would increase this amount to 10%. Both initiatives are set to be taken to the Congressional floor for debate. The BCRP has advised that 45% of individual pension accounts have been depleted, largely due to previous Congressionally-enabled withdrawals. Congress is also preparing a bill that would allow individuals to access worker compensation funds (i.e., the CTS-Compensación por Tiempo de Servicio) which in Peru serve as a form of unemployment insurance. In both cases—the AFP withdrawals and access to the CTS—Congress would be changing the legal nature of the funds and creating long-term sustainability issues. However, both innovations would, if approved, have a positive short-term impact on consumption.

In the same vein, the Cabinet has approved stimulus and household safety-net measures amounting to PEN 800 mn, according to Finance Minister Waldo Mendoza. The measures include monies for the Trabaja Perú temporary jobs program, as well as an expansion of transfers to households in regions under extreme risk.

—Guillermo Arbe & Mario Guerrero