BOX I.1:

Global spending on defense

The fiscal situation in the main economies has deteriorated steadily over the past few years, and the outlook does not point to an improvement, which is generating upward pressure on long-term interest rates. These conditions are intensified by the new geopolitical environment, which has led to commitments of significant increases in defense spending in the coming years. This dynamic has two important consequences for global financial markets: on the one hand, it increases the already high upward pressure on long-term interest rates; on the other, it supports the price of strategic commodities used in the military industry, such as copper.

Defense spending has entered a new phase of expansion around the world, particularly in developed countries. In Europe, for example, after four decades of decline or stagnation, several European Union members once again exceeded the 2% of GDP threshold in 2024 (Figure I.21). Similarly, at their meeting in June this year, NATO countries agreed to increase their defense spending to 5% of annual GDP by 2035, divided into 3.5% for basic defense spending and 1.5% for related spending, up from the current level of 2.6%. Japan, for its part, announced that it would double its military budget over a five-year period, altering its policy that has been in place since the end of World War II. Considering all the increases in spending observed and announced for the next decade, Álvarez et al. (2025) estimate that, in the period 2024-2035, global defense spending would increase by between 57% and 80% in real terms. This would mean that such spending would rise from around 2.5% of global GDP to between 3% and 3.5% (Figure I.22)[1]/.

Spending increases of this magnitude, in a fiscal context with little room for maneuver, are particularly challenging. This is especially true because, for the moment, there are no signs that the increased spending will be accompanied by financing or compensation measures in other spending categories. The case of the European Union stands out, as it announced a relaxation of fiscal rules to accommodate increased spending through deficits and additional debt. Álvarez et al. (2025) estimate that the announcement of the ReArm Europe plan—which would imply a permanent increase in spending of 1.5 percentage points (pp) of GDP per year and allow the 3.5% target for basic spending to be reached—led to an increase of around 25 basis points (bp) in the 10-year rates of the countries involved (Figure I.23). It is conceivable that, as the higher deficits materialize, additional pressure on rates will be observed.

The higher defense spending also has implications for the demand for commodities. Copper, which is essential for the military industry, is becoming increasingly important due to its use in advanced technologies such as guided weapons and drones[2]/. Álvarez et al. (2025) estimate that a 1pp increase in US military spending increases demand for refined copper by around 5% (Figure I.24). Based on this result, and considering global spending announcements, the authors calculate that the demand for copper generated by defense spending could grow by around 485,000 tons over the next decade. This represents just over 1.8% of current global consumption and is roughly equivalent to half of the annual production of Escondida (the world's largest producer of copper cathodes and concentrate).

[1]/ For the US, the forecasts included in the 2026 budget and the OBBBA guidelines are used, with convergence expected from 3.4% of GDP to closer to 4.0% in 2035. These figures are in line with the historical evidence presented by Albagli et al. (2024), who conclude that, in periods of severe geopolitical tensions without large-scale conflicts, military spending increases by around 1 pp of global GDP.

[2]/ Hackett J. et al. (2025). Critical Raw Materials and European Defence. The International Institute for Strategic Studies.

In a context of constrained supply and demand that is relatively insensitive to price—mainly due to the low elasticity of demand for data centers and the energy transition—this increase in demand for copper could put significant pressure on prices. Assuming that supply does not react in the short term, Álvarez et al. (2025) estimate an impact of between 3% and 6% on prices. Along the same lines, the semi-structural decomposition proposed by Zelpo et al. (2024)—and described in Box I.2 of the June 2024 IPoM—highlights that, since the beginning of this year, geopolitical factors have been among the main determinants of copper price movements, accounting for almost half of the observed increase (Figure I.25). This factor includes not only the direct effect of increased arms production, but also higher demand due to the need to secure the supply of strategic inputs.

Conclusion

The fiscal deterioration in developed economies is putting upward pressure on long-term interest rates. The new geopolitical environment and its consequences for defense spending add a new source of pressure, which tends to negatively affect financial conditions globally, especially in emerging economies. However, higher defense spending also improves the outlook for prices of strategic inputs such as copper and related investments. Chile is therefore in a more favorable position than other emerging economies, because although higher long-term interest rates would prevail, their contractionary effect is offset by higher copper prices and better investment prospects, consistent with the upward revisions to GFCF contemplated in the central scenario of this IPoM.

FIGURE I.21
Evolution of defense expenditure (1)
(percent of GDP)

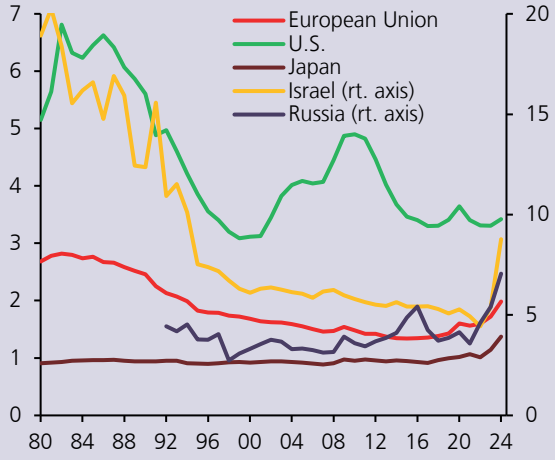
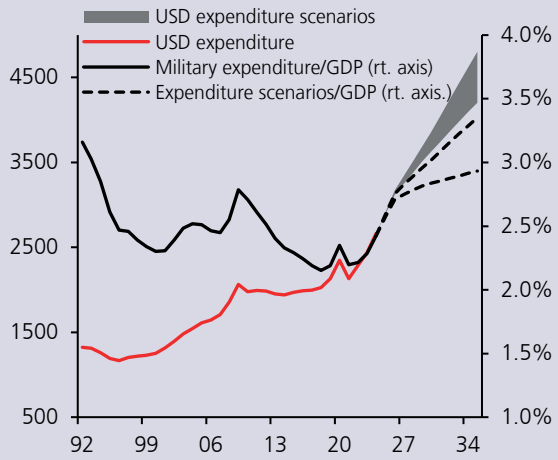


FIGURE I.22
Forecast of defense expenditure (2)
(real USD billion, 2024 prices; percent of global GDP)



(1) For the EU, the chart shows the weighted average (based on GDP at purchasing power parity) of defense spending as a percentage of GDP. (2) The lower spending scenario was built based on the minimum commitments made by states and military alliances, while the higher spending scenario was built based on the full adoption of those commitments.
Source: Álvarez et al. (2025) and SIPRI.

FIGURE I.23
10-year rate increase in EU countries respect to control group (1)
(cumulative change since 03.Mar.25, basis points)

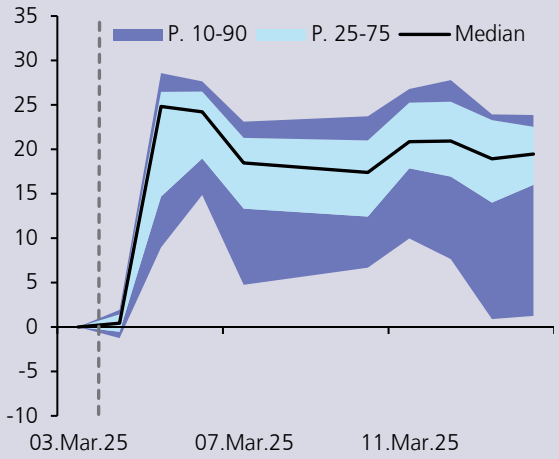
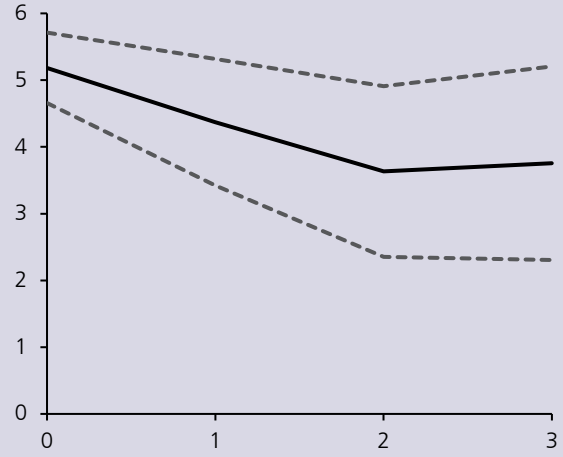
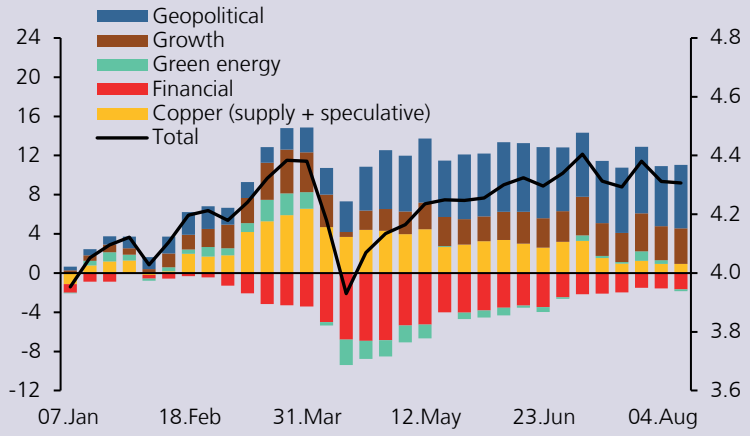


FIGURE I.24
Causal effect of U.S. military spending shock on copper demand (2)
(1 pp. shock to military expenditure/GDP ratio to copper consumption)



(1) Difference-in-differences analysis of the evolution of 10-year interest rates. The treated group includes countries within the European Union; the control group consists of countries aligned with the Western bloc but not EU members (Australia, Japan, South Korea, Norway). (2) Cumulative IRF. The exercise is based on annual data for the U.S. starting in 1940. The estimation is conducted using a Local Projections approach (Jorda, 2005) with instrumental variables, where the narrative military spending shock from Ramey and Zubairy (2018) is used as an instrument for military expenditure. Confidence intervals are set at 66%.
Source: Álvarez et al. (2025).

FIGURE I.25
Decomposition of copper price (1)
(percent, cumulative change; USD/pound)



(1) Bayesian VAR with sign restrictions at weekly frequency based on Zelpo et al. (2024).
Source: Álvarez et al. (2025).