Annual Report

CENTRAL BANK OF CHILE

2005

Annual Report 2005*

CENTRAL BANK OF CHILE

*This is a translation of a document originally written in Spanish. In case of discrepancy or difference in interpretation, the Spanish original prevails. Both versions are available at www.bcentral.cl.

Table of contents

Senior authorities of the Central Bank of Chile

AS OF 31 DECEMBER 2005

BOARD

VITTORIO CORBO LIOI,
Governor

JOSÉ DE GREGORIO REBECO,
Vice-governor

JORGE DESORMEAUX JIMÉNEZ,
Board Member

JOSÉ MANUEL MARFÁN LEWIS,
Board Member

ENRIQUE MARSHALL RIVERA,
Board Member

LEONARDO HERNÁNDEZ TAGLE,
General Manager (I) and Deputy General Manager

MIGUEL ÁNGEL NACRUR GAZALI,
General Counsel

ALEJANDRO ZURBUCHEN SILVA,
General Auditor

DIVISION MANAGERS

LUIS GONZÁLEZ BANNURA,
Management and Development

LUIS ÓSCAR HERRERA BARRIGA,
Financial Policy

ESTEBAN JADRESIC MARINOVIC,
International Affairs

RODRIGO VALDÉS PULIDO,
Research

MANAGERS

EDUARDO ARRIAGADA CARDINI,
Communications

MABEL CABEZAS BULLEMORE,
Logistics and Security

BELTRÁN DE RAMÓN ACEVEDO,
Financial Markets

CECILIA FELIÚ CARRIZO,
Human Resources

OSVALDO GARAY HIDALGO,
Strategic and Risk Management

JERÓNIMO GARCÍA CAÑETE,
Information Systems

PABLO GARCÍA SILVA,
Macroeconomic Analysis

JOSÉ MANUEL GARRIDO BOUZO,
Financial Analysis

JUAN ESTEBAN LAVAL ZALDÍVAR,
Chief Counsel

SERGIO LEHMANN BERESI,
International Analysis

IVÁN EDUARDO MONTOYA LARA,
Treasury Manager

GLORIA PEÑA TAPIA,
Foreign Exchange and Trade Policy

CRISTIÁN SALINAS CERDA,
International Investment

KLAUS SCHMIDT-HEBBEL DUNKER,
Economic Research

MARIO ULLOA LÓPEZ,
Chief Auditor

RICARDO VICUÑA POBLETE,
Statistical Information and Research

BANCO CENTRAL
DE CHILE

Santiago, 24 April 2006

Mr. Andrés Velasco B.
Minister of Finance
SANTIAGO

Pursuant to Sections 78 and 79 of the Basic Constitutional Act of the Central Bank of Chile, contained in Article One of Law 18,840, I hereby submit the *Annual Report* of this institution, for the year 2005.

Yours sincerely,

Vittorio Corbo L.
Governor

BANCO CENTRAL
DE CHILE

Santiago, 24 April 2006

Mr. Eduardo Frei R-T.
President
The Senate
Valparaiso

Pursuant to Sections 78 and 79 of the Basic Constitutional Act of the Central Bank of Chile, contained in Article One of Law 18,840, I hereby submit to the Senate the *Annual Report* of this institution, for the year 2005.

Yours sincerely,

Vittorio Corbo L.
Governor

I. Financial policies and management of the Central Bank of Chile in 2005

A. Overview of the economic environment

In 2005, the Chilean economy continued to face very favorable external conditions. Strong world growth slowed only very marginally compared to an extraordinary performance in 2004, with the main thrust continuing to come from the US and China. The Japanese economy recovered and the Euro area's performance picked up, especially toward the second half, with the pattern for world growth tending toward a balance. The copper price rose significantly during the year, performing well beyond expectations from early 2005, as demand rose amidst a sluggish response from supply. Something similar occurred with the prices for oil and its derivatives, which soared, particularly during the first half.

This global environment did not cause inflation worldwide to bounce back significantly since rising fuel prices in the main economies did not significantly affect price trends or inflation expectations over longer horizons. The gradual return to normal, less expansionary monetary conditions in the US occurred without generating any turbulence in international financial markets, while the dollar appreciated against the main currencies. Emerging countries' currencies tended to strengthen against the dollar, amidst high commodity prices, global liquidity and strong performances from their economies. External financial conditions remained favorable, bringing additional cuts to sovereign risk premiums, which somewhat cushioned higher international interest rates.

Domestically, economic activity rose 6.3%, more than in 2004. In 2005, non-tradable sectors, among them construction and wholesale and retail, grew significantly over 2004. Manufacturing rose somewhat less than the previous year, and mining reflected problems specific to that sector and the fact that it was operating at full capacity. Domestic demand rose 11.4%, led by gross fixed capital formation, for which the rate of investment reached a new, all-time high, and consumption, particularly of durable goods, which were not affected by higher fuel prices.

Strong domestic expenditure produced no tension within the macroeconomy. Good external conditions and a significant rise in public saving, the result of the structural surplus policy, prevented significant deficits in any of the economy's general external accounts. Likewise, demand's large imported component headed off tension between domestic productive capacity and prices. Higher investment also boosted growth in productive capacity. In the labor market, idle capacity was gradually absorbed and, despite rising participation, unemployment fell steadily, reaching levels not seen since the previous decade.

Core inflation remained in line with expectations early in the year. The annual change in CPIX1[1] went from around 1% in late 2004 to 2.6% in late 2005. CPI inflation rose more noticeably, reflecting the higher price of fuels and some perishables. These had a temporary effect on inflation expectations and financial asset prices. After remaining low for some time, in the second half long-term interest rates rose substantially. As the risk of an inflationary outbreak due to higher fuel prices declined, so did nominal interest rates.

The favorable external and domestic macroeconomic context came with significant peso appreciation, both real and nominal. Although qualitatively this strength was consistent with the year's macroeconomic trends, toward late 2005 the real exchange rate was considered to be slightly lower than its long-term values, given the fundamentals that influence it, particularly the copper price.

B. Monetary policy

The process of normalizing monetary policy, begun in September 2004, continued in 2005, reflecting specific shifts in the economy and potential risks.

During the first half, monetary policy rate (MPR) increases remained gradual. Overall, the preferred option at monetary policy meetings was to keep the MPR at its current level or increase it by 25 basis points. The accumulated rise of 100 basis points over six months, with increases in January, February, April and May, reflected the conclusion that as idle capacity fell, monetary stimulus should be reduced. Inflation, which behaved as forecast, made gradual progress possible.

In the second half, the rising price of oil in international markets and strong turbulence in the gasoline market due to hurricanes in the Gulf of Mexico significantly boosted domestic fuel prices. Uncertainty about the persistence of higher international fuel prices and their impact on domestic prices rose significantly. This was apparent as virtually all measures for inflation expectations were up over the longer term.

This higher risk scenario, at a time when monetary policy was clearly expansionary, led to MPR increases of 25 basis points at five consecutive meetings. This pace of normalization, which was faster than in previous periods, reflected the Board's risk evaluation in the second half of 2005.

In December, the greater normalcy prevailing on international fuel markets and inflation measures approaching 3% reduced the risk of expectations taking off. Moreover, activity slowed during the third and fourth quarters and peso appreciation dampened medium-term inflation expectations. In this context, the Board considered a return to a more gradual pace for normalizing monetary policy the best option. In the most likely scenario this will continue.

[1] CPI minus fresh fruit, vegetable, fuels, meat and fish, public utilities, financial services and indexed prices. Around 70% of the basket.

C. Financial policy

C.1 Payments system and financial infrastructure

Payments system modernization, begun in late 2000, was completed in 2005. In June, the Bank authorized the creation of a High-Value Payments Clearing House in Chilean currency (*Cámara de Compensación de Pagos de Alto Valor*). This is managed by a company offering support services to banks, *Combanc S.A.*, which started up in December 2005. Likewise, an electronic "delivery versus payment" system came into effect, providing real-time transfers of securities held in the central deposit (*Depósito Central de Valores*) through the high-value payments system, RTGS system and *Combanc*.

In terms of low-value payments, the Central Bank and the Superintendency of Banks and Financial Institutions (*Superintendencia de Bancos e Instituciones Financieras, SBIF*) proposed changes to regulations governing issuing and operating with credit cards, taking into account recent developments in the industry. The purpose of these regulations is to provide suitable management and control of credit, financial and operational risks associated with the issue of non-bank credit cards. These regulations establish the prudent minimums required of those issuing and operating with these credit cards, commensurate with their importance as a means of payment and the risks inherent to affiliates. In particular, with reference to issuers other than SBIF-supervised banks and savings and credit cooperatives, cards used to effect payments and other transactions with bodies unrelated to the issuer for one million *unidades de fomento* (an inflation-indexed accounting unit) or more, are considered significant. Similarly, special requirements are imposed on issuers reaching agreements with commercial establishments for the payment of services over periods longer than three banking days from the date of the transaction. This new regulation, which received the benefits of comments from the industry, was approved in February 2006 and came into effect on 30 April 2006.

C.2 Financial regulations

The Bank continued to modernize financial regulations, publishing a new regulatory framework in January 2005 on market risk (currencies and interest rates). The purpose of the new system was to encourage suitable management and monitoring of financial risk, according to the Basel Committee's recommendations, made in 1996[2]/ and 2004[3]/. The main characteristics include: i) a requirement that financial institutions' boards establish and apply a "Market Risk Management Policy" (*Política de Administración de Riesgos de Mercado*), appropriate to the scale and complexity of their operations and SBIF management and solvency rules; ii) the inclusion of quantitative limits on exposure to transaction book interest rate and currency risk throughout the balance sheet, according to actual equity minus exposure to credit risk; iii) the inclusion of a basic or standardized methodology for measuring and monitoring market risk exposure, to be applied in all financial institutions, and the possibility that institutions with a category A solvency rating and authorization from the SBIF can apply their own or internal models for this purpose, and iv) a requirement to carry out tension tests on all activities generating market risk exposure, using scenarios appropriate to the structure of the balance and the scale and complexity operations. To allow time to adapt existing market risk management and monitoring systems to the new requirements, they came into effect on 4 July 2005.

As of September 2005, banks received authorization to offer options on currencies, indices and interest rates. This initiative made it possible to expand the local supply of instruments for covering financial risk.

C.3 Foreign exchange regulations

In line with the current policy of a free-floating foreign exchange rate, investments abroad by persons domiciled or living in Chile may take the form of shares or other corporate rights in companies set up in the country, and capital contributions and investment made in Chile by persons domiciled or resident abroad can take the form of shares or other rights in companies set up abroad. The first type of investment is regulated by Chapter XII and the second treated as capital contributions or investments regulated under Chapter XIV, both in the *Compendium of Foreign Exchange Regulations* (*Compendio de Normas de Cambios Internacionales*). This amendment expanded the concept of investment and capital contribution made abroad or coming from abroad, authorizing materialization through a non-currency payment medium.

Moreover, several requirements in the *Manual of Procedures and Forms* (*Manual de Procedimientos y Formularios*) of the *Compendium of Foreign Exchange Regulations* were simplified. The main changes i) reduced the information required for financial operations; ii) reduced the information required from foreign investors; iii) streamlined information from bodies reporting directly, using the Internet, and iv) reduced the frequency of reporting, from every two weeks to once a month.

[2]/ Originally as per the Basel I Capital Accord, 1988, followed by subsequent amendments.

[3]/ Guidelines for managing and supervising interest rate risk, based on Pillar II of the new Basel II Capital Accord, and taking into account conditions specific to the domestic financial system.

D. Financial management

D.1 Foreign exchange and monetary management

The main objective of monetary management is the efficient provision of market liquidity, which involves ensuring that the interbank interest rate and the structure of short-term interest rates move with the MPR, thus minimizing credit risk to the Bank arising from its operations. For this purpose the Bank has a set of instruments, such as PDBCs, repos (buy-back operations, *Compras con Pacto de Retroventa*) and Antirepos, which were used regularly in 2005. Combined with management of long-term debt, these make it possible to increase or reduce liquidity according to the economic agents' needs.

Moreover, the Bank has an ongoing commitment to modernizing its financial instruments to ensure that it has effective, efficient and secure policy implementation procedures. In early 2005, the permanent liquidity facility in Chilean currency (*Facilidad Permanente de Liquidez en Moneda Nacional, FPL*) was set up, to allow banks to obtain liquidity from the Central Bank for one day through security purchase operations with buy-back clauses, at a single interest rate equivalent to the MPR+25 basis points. Operating aspects of the "Liquidity Deposit" (*Depósito de Liquidez*), were changed and it became the permanent liquidity deposit in Chilean currency (*Facilidad Permanente de Depósito de Liquidez en moneda nacional, FDP*), operating with interest rates set at MPR-25 basis points. The MPR±25 basis point band has made it possible to combine stable interbank interest rates with incentives for the prudent management of financial institutions' liquidity and the development of a market in interbank loans.[4]/

Aside from the usual overnight repo operations, in 2005 two-week repo operations were regularly scheduled, complemented by swaps over the same period. Swaps made liquidity provision more efficient, by using the US dollar as collateral, thereby resolving situations where there were insufficient securities eligible for repos. Likewise, the matching requirement regulation was simplified to facilitate compliance and financial institutions' liquidity management.

In 2005, the Bank did not buy or sell foreign currency on Chile's foreign exchange market.

[4]/ A more detailed explanation of these instruments is available in the *Monetary Policy Report* January 2005, pp. 37-38.

D.2 International reserve management

To ensure a stable currency and the normal functioning of domestic and external payments, the Bank held international reserves to deal with potential, exceptional foreign currency liquidity needs. As of December 2005, reserves stood at US$16.963 billion, 1.17 times the amount of residual foreign debt falling due or scheduled for short-term amortization.

The Bank manages its reserves according to regulations established by its Basic Constitutional Act (*Ley Orgánica Constitucional, LOC*), for secure, efficient access to international liquidity, thereby safeguarding the Bank's financial equity.

This liquidity objective was met by using a portfolio of short-term deposits in international commercial banks and fixed yield instruments in highly liquid secondary markets. As of 31 December 2005, current account and term deposits in its own investment portfolio accounted for 41.29% of the Bank's international reserves, short-term papers, 31.62%, and bonds, 27.09%.

Market and operating credit risk management policies guided the administration of investments. The former were monitored by maintaining limits on issuers, instruments, intermediaries and custodians. Eligible countries and institutions were required to have a long-term rating of from "AAA" to "A-", from the main international risk rating agencies. Market risk was limited by diversifying investment currencies, instruments and maturities, and measured in terms of portfolio duration and values at risk (VaR), which as of December 2005 stood at 13.8 months and 0.23% of the value of international reserves,[5]/ respectively. Operating risk was managed through the separation of functions and responsibilities and internal and external controls.

[5]/ Confidence level 95% and decay factor 0.94.

In September, the Bank published the main aspects of its investment policy for international reserves, including a description of the main characteristics of a referential portfolio, used to guide investment decisions.[6]/

D.3 Debt management

The Bank's debt management aims to minimize financing costs within the limits defined by financial risk and, where possible, promote the development of capital markets. In 2005, the Bank continued to publish calendars scheduling the auctions of long-term debt instruments, including weekly auctions of its own peso-denominated securities (BCP-2, 5 and 10), those indexed to *unidades de fomento* (BCU-5 and 10), and Treasury instruments, as requested by the Ministry of Finance.

In September 2005, the Finance Ministry's request to the Bank to serve as its fiscal agent was accepted. This involved an agreement to issue 10- and 20-year BTU bonds. To offset their monetary effect, the policy for issuing and placing the Bank's own instruments was adjusted by reducing BCP-2, BCU-10 and BCP-10 issue.

During the year, the Government scheduled and prepaid debt to the Central Bank. For monetary sterilization, regular auctions of BCPs and PRCs were held, within the usual monthly calendar. Moreover, the policy of renewing dollar-denominated instruments falling due (PRDs, ZEROs and BCDs) was extended, to keep the market's net position in foreign currency stable and thus continue to apply a neutral foreign exchange policy, consistent with the free-floating currency regime.

Progress was made, moreover, in debt design, auction frequency and other measures to improve efficiency, as per similar practices of other central banks. A new auction calendar was scheduled for implementation in January 2006.

D.4 Provision of high-value payment services

The Bank provides high-value payment services and liquidity facilities to the financial system, to ensure high standards of quality, reliability and operating security. It also seeks to ensure that payment systems are fully interconnected with systemically important settlement systems.

The Real-Time Gross Settlement (RTGS) system, administered by the Central Bank, with participation from all banks in the country, is a system for transferring funds in Chilean pesos. Settlement takes place on an individual, ongoing basis, as the bank issuing the instruction for the corresponding transfer must have sufficient resources available in its Chilean peso current account in the Central Bank.

The RTGS system and liquidity facilities worked flawlessly in 2005, making it possible to settle payments quickly and securely, offering modernization through improved efficiency.

The computer program on which the RTGS system depends was completely updated with the CAS 3.30 version, which added new functions to facilitate the management and settlement of participants' payments.

Moreover, the process of connecting the Central Securities Deposit (*Depósito Central de Valores*) to implement a delivery versus payment system and begin shifting securities market operations to the new platform also advanced. This way the seller frees the securities once payment is received and the buyer liberates the funds upon receiving the securities, thus eliminating the risk of principal loss.

[6]/ Appendix C: International Reserve Management, *Monetary Policy Report*, September 2005, pp. 83-93.

The RTGS system has also been connected to the High-Value Payments Clearing House in Chilean currency (*Cámara de Compensación de Pagos de Alto Valor*), operated by *Combanc S.A.*, since December 2005. This expanded the range of possibilities open to participants for liquidating high-value transactions, including a mechanism for ensuring their settlement even when the participant with the larger balance owing does not have a sufficient balance.[7]/

E. Changes in the balance sheet

E.1 Levels and structure of the balance

The amount of assets and liabilities in the Bank's balance continued to fall in 2005, reflecting operating flows and the decline in the price of the US dollar. Nominally, assets fell 6 percentage points, going from 26% of GDP in late 2004 to 21% by the end of 2005, while liabilities fell 1%, from 28% of GDP in late 2004 to 25% one year later. The general structure of assets and liabilities within the Central Bank's balance sheets remained the same in 2005. The main asset components were international reserves and Treasury promissory notes. The main liabilities were monetary policy promissory notes, other monetary policy liabilities, and the monetary base.

The total balance of international reserves, measured in pesos, fell due to the exchange rate. Measured in dollars, reserve amounts rose. The balance outstanding on Treasury promissory notes in pesos fell substantially thanks to prepayments made by the Government using the fiscal surplus and the lower price of the dollar, since these are calculated in that currency. On the liability side, monetary policy promissory notes fell substantially, since the Bank used resources from Government prepayments to withdraw part of its debt. In contrast, liabilities in the financial system, especially those denominated in dollars, rose because banks deposited dollars to meet technical reserve requirements and primarily to provide guarantees for liquidity loans (table I.1).

International reserves measured in dollars rose from US$16.016 billion in late 2004 to US$16.963 billion in late 2005. Aside from interest worth US$482 million and devaluations worth US$769 million, this change included a rise in foreign currency debt with banks worth US$3.95 billion, consisting mainly of foreign currency reserves, overnight deposits and deposits guaranteeing peso loans. These increases more than offset the US$2.7 billion decline in international reserves, the result of the Bank's policy of replacing promissory notes indexed to the exchange rate with those indexed to dollars, whose matured was not extended. In short, changes in international reserves mainly reflected changes in bank portfolios and the buy-back, using dollars, of promissory notes indexed to the foreign exchange rate.

The balance of Treasury promissory notes in favor of the Central Bank fell by Ch$1.24 trillion. This reflected servicing of these instruments, worth Ch$1.2 trillion, accrued interest worth Ch$82 billion and the negative accrual of corrections, due to the decline in the exchange rate, worth Ch$114 billion. The amount serviced by the Government during the year took the form of prepayments.

Monetary policy promissory notes fell by Ch$1.8 trillion, reflecting servicing and buy-backs worth Ch$2.3 trillion, accrued interest worth Ch$511 billion, and a negative accrual of corrections, due to the decline in the exchange rate, worth Ch$6 billion. The buy-back included Ch$1.4 trillion financed using international reserves and Ch$878 billion in Chilean pesos.

7/ In interbank settlement systems, a member's incompliance with a payment obligation can produce a chain of incompliance among participants. The new system ensures that the final result in net positions can be settled even if the participant with the largest balance due does not have sufficient funds in the RTGS system account.

TABLE I.1

Central Bank Balance Sheet

(billions of Chilean pesos, as of 31 December of each year)

			Structure of assets and liabilities (%)		
	2004	2005	2004	2005	Average 2005 (2)
Assets (1)	**14,891**	**13,535**	**100.0**	**100.0**	**100,0**
Net international reserves	8,966	8,722	60.2	64.4	63,3
Treasury promissory notes	2,705	1,464	18.2	10.8	15,3
Other assets with the public sector	619	662	4.2	4.9	4,5
Subordinated debt (shares and credit)	934	947	6.3	7.0	6,5
Deferred losses	393	407	2.6	3.0	2,8
Liquidity credit line and repos	1,021	397	6.9	2.9	3,6
Other monetary policy assets (3)	0	729	0.0	5.4	2,5
Other	252	206	1.7	1.5	1,6
Liabilities (1)	**16,131**	**15,959**	**100.0**	**100.0**	**100,0**
Monetary policy promissory notes (4)	12,060	10,245	74.8	64.2	73,1
Other monetary policy liabilities (5)	174	1,862	1.1	11.7	4,5
Current accounts and foreign exchange reserve fund	77	374	0.5	2.3	1,4
Treasury and other public sector deposits	205	140	1.3	0.9	1,2
Other, except monetary base	1,286	410	8.0	2.6	4,1
Monetary base	2,329	2,928	14.4	18.3	15,7
Equity (1)	**-1,241**	**-2,424**			
Revalued starting capital	-558	-1,286			
Nominal starting capital	-545	-1,241			
Revalued own capital	-14	-45			
Net result	-682	-1,138			
Non-financial result	-27	-27			
Net interest (6)	-216	-104			
Net corrections and other value changes (7)	-452	-1,052			
Less: revalued own capital	14	45			

(1) The equity evaluated is equivalent to an accounting measure; however, total assets and liabilities vary, essentially reflecting the different treatment of temporary assets and liabilities and provisions.

(2) Average balances at month's end, December 2004 and December 2005, inclusive.

(3) Credits in Chilean pesos to banks guaranteed using deposits in foreign currency (currency swaps).

(4) Includes PDBC, BCP, PRC, CERO-UF, BCU, PRBC, PRD, ZERO-US$, BCD, PCX, XERO-US$ and BCX.

(5) Short-term remunerated bank deposits: to guarantee credits in Chilean currency (note 3), and others to one day.

(6) Interest and profits in foreign currency are converted to Chilean pesos using average exchange rates.

(7) Includes corrections in Chilean pesos and the effect of foreign exchange fluctuations on assets and liabilities in foreign currency.

Source: Central Bank of Chile.

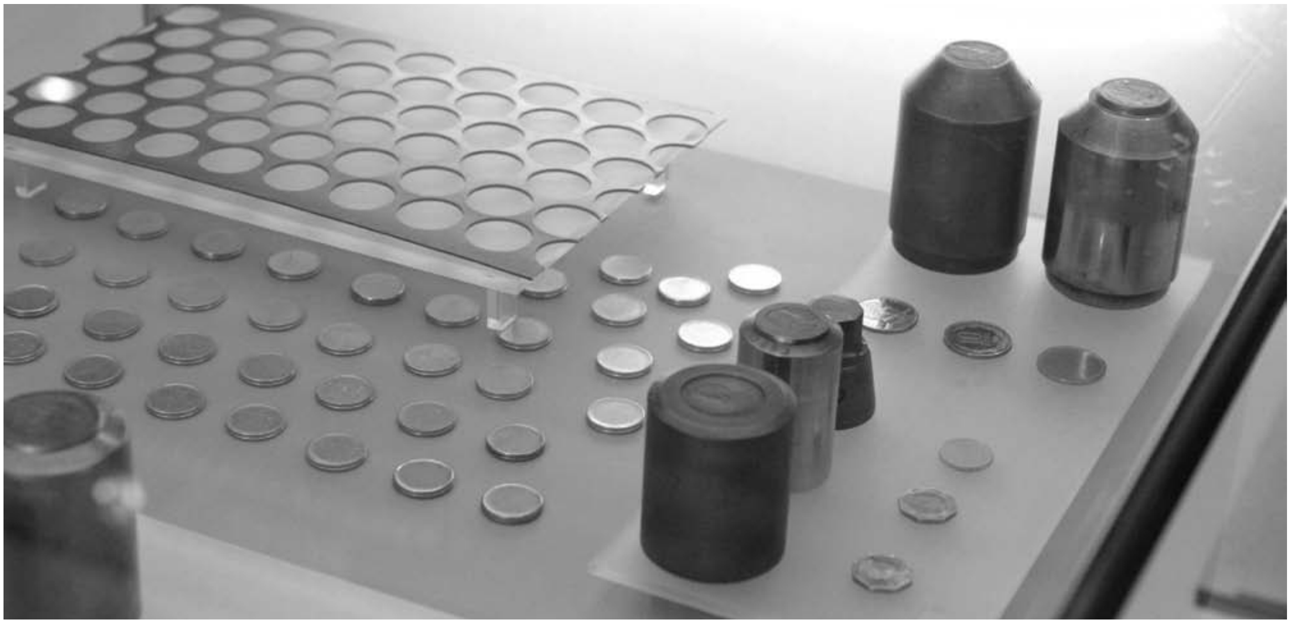
The monetary base rose Ch$599 billion pesos. Net expansionary flows included net operating flows involving monetary policy assets (ChP$1.4 billion), the payment of capital and interest in Chilean pesos on monetary policy promissory notes (Ch$878 billion) and a decline in bank liquidity deposits (Ch$834 billion). Net declines in flows included servicing of Treasury promissory notes (Ch$1.2 billion) in pesos owed to the Central Bank and subordinated debt (Ch$67.1 billion). Other less important operations, whether expansionary or contractive, were behind the remainder.

On the composition of assets and liabilities, international reserves over total assets rose from 60.2% in 2004 to 64.4% in 2005. Treasury promissory notes, in contrast, fell from 18.2% to 10.2%. Monetary policy assets rose from 6.9% to 8.3%, while for liabilities, the share held by monetary policy promissory notes fell from 74.8% to 64.2% of the total.

Equity in foreign currency, that is the difference between dollar-denominated or dollar-indexed assets and liabilities, measured in US dollars, fell from US$13.87 billion to US$11.555 billion, reflecting virtually zero sales of foreign currency, US$412 million in earnings due to interest, a loss of US$658 million through devaluation in terms of the US dollar, and a decline in dollar-denominated Treasury promissory notes worth US$2.065 billion, which was covered using domestic currency. The foreign exchange mismatch, while smaller than in the past, continues to make the balance and accounting results extremely sensitive to fluctuations in the foreign exchange rate.

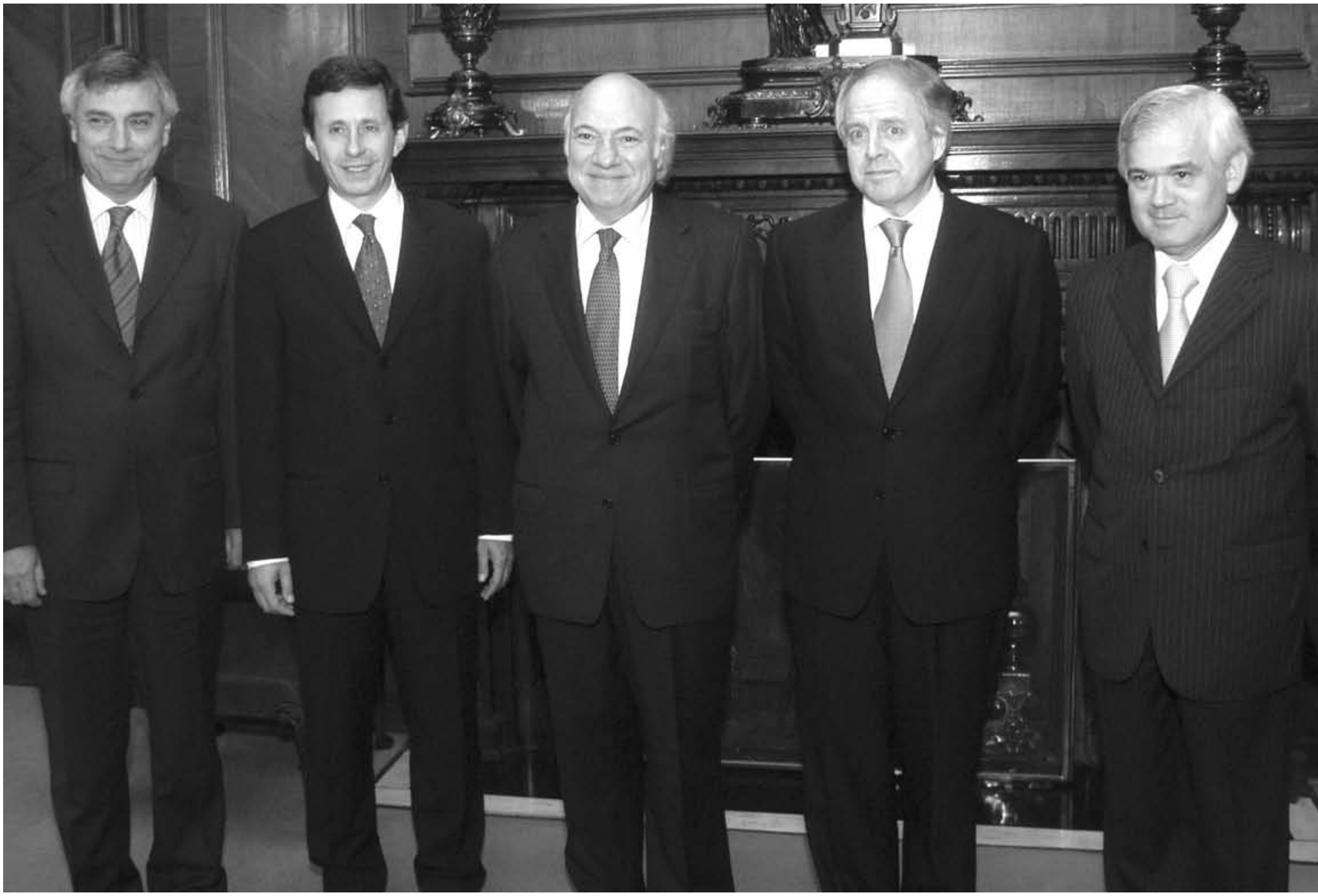
E.2 Asset profitability, liability costs and changes in equity

Given the peso's strength and the weakness of the yen and the euro against the US dollar, international reserves fell 12.2% for the year. The dollar's decline (8.1% annually) also affected the value of dollar-denominated Treasury promissory notes owed to the Central Bank. Notwithstanding, the presence of other non-indexed assets or those indexed to domestic inflation, brought the average correction to assets to -8.3%. The average correction to liabilities, which to a lesser degree were also affected by the exchange rate, reached -1.1%. Thus, for the third year running, corrections and price changes brought a negative result.



The recovery of international interest rates and the inertia affecting the financial cost of Central Bank papers reduced the interest rate gap within the balance sheet. Profitability due to interest went from 2.3% annually in 2004 to 3.2% annually in 2005. The average cost of interest on liabilities fell from 3.6% annually in 2004 to 3.5% annually in 2005. Thus, the negative gap due to interest fell from 1.3% in 2004 to 0.3% in 2005.

Net losses due to corrections and price changes totaled Ch$1.05 trillion in 2005 (1.6% of GDP), mainly due to the foreign exchange losses mentioned above. Net losses in interest worth Ch$104 billion (0.2% of GDP) and non-financial results worth Ch$27 billion were also involved. A 45-billion peso profit must also be subtracted due to inflation's erosion of initial negative capital. In short, book losses in 2005 reached Ch$1.13 trillion (1.8% of GDP). Thus, equity reached -Ch$2.424 billion (-3.8% of GDP), down from the minimum registered in 1998 (-2.6% of GDP).



II. Institutional management and governance

A. Organization and functions

A.1 The Board

The five-member Board is chaired by one of its Members, designated the Governor of the Central Bank. The Board is responsible for directing and handling the senior management of the Central Bank of Chile, in its role as a public institution of constitutional rank.

The President of the Republic Chile appoints Board Members through an executive decree issued by the Ministry of Finance, following agreement in the Senate. They hold their posts for ten years, and may be reappointed. Every two years, a Board Member is replaced.[1]/

The President of Chile also appoints the Bank Governor, who holds the post for the time left in her or his term or five years, whichever is less. The Governor may be reappointed. The Governor chairs Board meetings, represents the Bank extrajudicially out of court, and conducts institutional relations with public authorities, financial institutions and international bodies. Vittorio Corbo Lioi has been Governor since his appointment to the Board in May 2003.

The Vice-Governor is appointed by the Board for as long as it determines and must replace the Governor and exercise all other functions entrusted to him or her. José de Gregorio Rebeco was appointed to the Board in June 2001 and has held the post of Vice-Governor since December 2003.

The other Members are Jorge Desormeaux Jiménez, appointed in December 1999; Manuel Marfán Lewis, appointed in December 2003, and Enrique Marshall Rivera, appointed in December 2005. María Elena Ovalle Molina was a Member until December 2005.

In general terms, the Board is responsible for exercising the attributes and complying with the functions that the law entrusts to the Bank to fulfill its mandate: specifically ensuring the stability of the currency and the normal functioning of domestic and external payments. As a result, the Board determines the Bank's general policies, decides the rules governing its operations, and supervises

[1]/ Title II of the Bank's Basic Constitutional Act (*Ley Orgánica Constitucional)* as per Articles 108 and 109 of the Chilean Constitution, includes the regulations governing the Board and the legal regime applicable to its Members in terms of appointments, wages, incompatibilities, ineligibility, conflicts of interest, reasons for removal, and other legal obligations to which they are subject during their appointment.

and enforces Bank regulations. To do so, it permanently evaluates compliance with the general regulations and policies it has established and the development of institutional activities.

Regulations applicable to sessions and resolutions

The Bank's actions are ruled by the resolutions and other decisions adopted by the Board according to the Basic Constitutional Act governing the Central Bank.

The Board holds ordinary meetings no less than once a week and extraordinary sessions upon receiving a special request from its Governor, on its own decision, or as the result of a written petition from two or more of its Members. The resolutions approved must be included in the minute of the respective session.

Board resolutions require a minimum attendance of three Members and a favorable vote from the majority of those present, unless the law requires a special quorum, given the importance and impact of a specific subject.[2]/ The Board Member chairing the session has the casting vote in the case of a tie. Normally Board meetings take place in its Santiago domicile; nonetheless, it is empowered to hold sessions and adopt valid resolutions, regulations or decisions elsewhere, provided these occur within Chile's borders.

A.2 Mechanisms for coordination and transparency

The Bank's Basic Constitutional Act (*Ley Orgánica Constitucional, LOC*) establishes how the Bank will fulfill its role in concordance with the Executive and other governmental bodies, to guarantee suitable control of its actions. Among the relevant sections:

i) Article 6, second clause (*LOC*) establishes there will be coordination between the Board and the Government, stating that "when making decisions, the Board must take into consideration the general orientation of the Government's economic policy";

ii) Prior to 30 April each year, the Bank must present to the Minister of Finance and the Senate, an *Annual Report* summarizing its activities during the previous year, reporting on policies and programs applied during that period. The report must include the Bank's financial statements, with their respective notes and the opinion of external auditors;

iii) In terms of information on policies adopted by the Bank and its annual programs, the law requires it to inform both the Minister of Finance and the Senate of same, prior to 30 September of each year;

iv) The Board also has the duty of reporting to the President of the Republic all general regulations and policies decreed while exercising its attributes and advising him or her, upon request, on all issues related to its functions;

v) The Minister of Finance can attend Board meetings, with a right to voice and to propose specific resolutions. To do so, the Minister is informed of all Board meetings and the agenda to be discussed in advance and in writing;

vi) The Minister is empowered to suspend any Board resolution or desicion, for up to 15 days, unless all Board Members unanimously insist on its application, in which case the resolution will go into effect;

[2]/Special quorums are required to approve the internal regulations governing the Board and the Bank; to insist on the approval of a resolution that has been suspended or vetoed by the Finance Minister; to approve, renew or end foreign exchange restrictions ahead of time; to receive deposits from the Government or other state bodies or institutions; and to renounce judicial immunity and execution of international contracts signed by the Bank on financial or economic matters.

vii) The Minister's can veto Board resolutions if they impose, lift or modify foreign exchange restrictions referred to in Article 49 of the *LOC*. In the case of a veto, the corresponding restriction can only be adopted if it is supported by a unanimous vote of all Board Members.

The last two points aim to promote a dialogue with the Executive prior to making major resolutions. This should avoid their suspension or a veto, and thus overcome differences in criteria over economic measures, giving priority in every sense to the Board's autonomy and technical nature.

Aside from these legal provisions, the Board has established many regulations for keeping both the authorities and the general public informed on an ongoing basis of the measures that it adopts. This is important to ensure the transparency of its actions, keeping in mind that the decisions it makes are crucial to the market and the general public's perception of Bank policies and their effects on the economy. These measures include advance notice of monetary policy meetings and publication of the minutes, along with decisions regarding monetary, credit, financial or foreign exchange regulations.

In the same context, three times a year (in January, May and September) the *Monetary Policy Report* is delivered to the Senate and published. It analyzes economic and financial conditions, the fundamentals behind policies applied, and the main prospects for short- and medium-term scenarios.

Likewise, starting in 2004, twice a year, in June and December, a *Report on Financial Stability* is published. It analyzes the macroeconomic and financial environment in Chile and abroad, from the perspective of financial system stability. It also examines borrowing trends and credit users' capacity for payment, the status of non-bank financial intermediaries, the impact of these indicators on the banking system, and the profile of the Chilean economy within international finance.

A.3 Board regulations

Current regulations governing the Board[3]/ include general rules of order applicable during sessions. These govern how meetings are called, the agenda, participation and debate, preparation of minutes, and announcements to the public on the issues discussed, using the respective documents. Special rules govern monetary policy meetings, covering primarily their regularity, participants, the order of materials and debate, minutes, summary of debate, and publication of the resolutions adopted in a news release, delivered once the session has ended.

Because of its importance, this regulation was published in the *Diario Oficial* (Chile's official gazette) and is available on the Bank's website: www.bcentral.cl.

A.4 Appointment of a new Board Member

Board resolution N° 1237E-01, 22 December 2005, accepted the resignation of Enrique Marshall Rivera in his post as General Manager of the Central Bank of Chile, in light of his appointment to the Board as of 23 December 2005, as per the executive decree confirming his appointment, issued by the Ministry of Finance.

Enrique Marshall holds the equivalentof a Bachelor of Commerce (*Ingeniero comercial*) is a business administrator from the University of Chile, along with holding a master's degree and a doctorate from the University of Notre Dame, United States. His experience is vast and widely respected throughout the financial sector and capital markets, as he had held the post of General Manager of the Central Bank of Chile, since September 2005, after serving as Superintendent of Banks and Financial Institutions (2000-2005); International Manager of the *Banco O'Higgins* (1994) and the *Banco de Santiago* (1994-2000); General Manager of the Central Bank of Chile (1991-1994), and Superintendent of Banks and Financial Institutions (1990-1991).

A.5 The General Manager and the General Counsel

Under Sections 24 and 25 of the Basic Constitutional Act, the General Manager is responsible for directly managing and monitoring Bank affairs, according to the faculties conferred and instructions provided by the Board. The General Counsel, meanwhile, is the sole guarantor and evaluator of institutional legality and legal risk associated with Bank actions.

[3]/ Approved by Resolution 818, 27 January 2000.

Through August 2005, Camilo Carrasco Alfonso was General Manager of the Bank. From September to December, this post was held by Enrique Marshall Rivera, who was appointed to the Board as of 23 December. Since then, Leonardo Hernández Tagle has held this post on a temporary basis.

Miguel Ángel Nacrur Gazali has held the post of General Counsel and certifying official (*Ministro de Fe*) of the Bank since 1997.

B. Internal administration

B.1 Organizational structure and internal restructuring

In recent decades, the Chilean economy has undergone a significant structural change. It has moved away from strict state control, with important price distortions and subject to fierce restrictions on its international transactions, becoming highly integrated into the world economy, in terms of trade in goods and services and financial operations.

In line with these shifts, monetary policy and foreign exchange policies have changed, with the fixed exchange rate regime of the 1970s moving to an exchange rate band with some restrictions (reserve requirement) on capital flows during the 1990s, and finally becoming a floating exchange rate accompanied by inflation targeting since 1999.

These changes have meant that at different stages in its history, the Central Bank has had different objectives, and it has had to adapt its organizational structure accordingly. In the 1970s, offices responsible for foreign trade were reinforced to effectively monitor the restrictions in place at the time. During the 1990s, more analytical functions were emphasized, particularly those involved in the analyses that sustain monetary policy in an inflation-targeting regime.

More recently, since price stability was achieved, the Bank has focused on keeping inflation within the target range, promoting the development of stable capital markets, and achieving greater financial integration with the rest of the world, all of which have required enormous technical capacity.

Internally, the Bank has made an effort to increase its efficiency in the use of resources and, moreover, to meet the growing need for transparency and accountability required by its autonomy. This last was reflected, for example, in the creation of the Communications management area in 2003, and the strengthening of the General Auditor's office the following year. Likewise, in 2004, the Risk and Strategic Management area was created, and its first task was to develop a policy and to implement a program for integrated risk management inside the Bank.

In line with the above, during the last four months of 2005, the Deputy General Manager's office was created, with Communications, Information Systems, Human Resources and International Relations reporting directly to it. These structural changes reflected the importance the Board assigned to the transformation and modernization processes being carried out by these areas.

The International Division area was eliminated, moreover, and the Financial Operations Division created, thus bringing the Bank into step with the new policy framework involved in the floating exchange rate and complete openness of the capital account, along with the greater emphasis the Bank wished to place on capital markets. The Financial Operations Division is responsible for interactions with domestic and international financial markets, that is, open market operations to implement monetary policy and administer international reserves.

Today the Research Division and the Financial Policy Division focus solely on analysis in the macroeconomic and financial fields, respectively. To further strengthen analytical work with relevant to ensuring the stability of domestic and external payments, within the Financial Policy Division a Financial Stability Management area was created.

To further separate analytical from operational areas, such as the provision of statistics and banknotes and coins, Statistical Information and Research was moved from the Treasury and Foreign Exchange and Trade Policy, to report directly to the General Manager.

Appointments of executives and creation of committees

These organizational changes follow the best practices observed in other central banks around the world, reflecting the need to achieve the highest standards of excellence in the medium term. They also require adjusting executives' skills, to ensure they have the knowledge and know-how necessary to meet these objectives.

Aware of this, in mid-2004, the Bank started an executive search both internally and externally. New managers were appointed (Institutional Services and Management Division, Security and Logistical Services, Human Resources, Information Services and Treasury). This continued in 2005, with the appointment of the General Manager, Deputy General Manager, General Auditor, Risk and Strategic Management manager, and manager of Domestic Financial Markets.

The Bank has also incorporated best practices in corporate governance into its internal management, through the creation of different committees over time. These have become instances for coordination, communication and consultation, which support the decisions made by the Bank's senior management. They include:

Management Committee, created in mid-2005 to develop medium-term strategic planning for the Bank from 2006-2008. It also allows coordination of strategic and operating issues involved in managing, evaluating and handling risks facing the Institution and the Bank's internal administration. On a weekly basis, the General Manager chairs a meeting that includes the General Auditor, the General Counsel, the Deputy General Manager, Division managers, Human Resource, and Risk and Strategic Management managers.

Technology Committee, created in mid-2005 to evaluate the use of new technologies and the associated risks, ensuring that these add value and respond to the needs of the Bank's strategic plans. These monthly meetings are chaired by the General Manager and include the Deputy General Manager, the Manager of Information Systems and other managers.

Security Committee, created in late 2005 for the integrated management of the security of Bank individuals, information, assets and equity. The Deputy General Manager chairs the monthly meeting, which also includes the Manager of the Institutional Services and Management Division, the managers of Treasury, Human Resources, Security and Logistical Services, and the heads of the Security, Planning and Information System Security, and Risk and Strategic Management departments.

The RTGS System Supervisory Committee, created in 2004 to supervise the progress of the Real-Time Gross Settlement System (RTGS). The General Manager chairs the monthly meetings, which include the managers of the Financial Operations and Financial Policy Divisions, a representative from the General Auditor's office, the managers of Domestic Financial Markets, Infrastructure and Financial Regulation, Information Systems and the head of the Department of Payments and Securities.

Investment Committee, created prior to 2004 to facilitate coordination between the units responsible for managing international reserves and analyzing the world economy. This committee meets weekly, is chaired by the Financial Operations Division manager and includes the managers of International Investment and International Analysis, and the heads of the International Counter and Risk and Management Evaluation departments.

Committee for Monitoring the Balance Sheet, created in late 2005 to examine proposals regarding strategic aspects of policies governing Bank assets and liabilities. Starting in 2006, it will meet on invitation, be chaired by the General Manager, and include the Deputy General Manager, division managers, the managers of International Investment, Domestic Financial Markets and Risk and Strategic Management, and the head of the Department of Risk and Management Evaluation.

Statistics Committee, created in late 2005, after the organization was restructured, to coordinate the management of statistical information within and outside of the Bank. Its meetings take place according to need. It is chaired by the Research Division Manager, and involves the managers of the Financial Policy and Financial Operations divisions, along with those from the Statistical Information and Research, Foreign Exchange and Trade Policy, Economic Research, Macroeconomic Analysis, International Analysis and Communications management areas.

Grants Committee, created prior to 2004, to establish the criteria for assigning scholarships and policies regarding professional development programs. This committee meets twice a year, in May and October, is chaired by the Bank Governor and includes the Vice-Governor, a Board Member, the Human Resources Manager, and a guest external academic.

In the human resources area, several special committees have been set up to resolve issues regarding qualifications, performance awards and other outstanding values.

B.2 Strategic planning

As mentioned, the Board ordered the creation of a Managers' Committee in mid-2005, to prepare a strategic plan for 2006-2008. This involved defining strategic objectives for the Bank as a whole, its divisions and main areas, which also shaped the budget for this three-year period. Based on these guidelines, an activities plan and budget for spending and investment, 2006, was prepared and approved by the Board in December 2005.

B.3 Human resource management

One of the main foundations for the process of institutional modernization is human resource development. Bank policy has been to promote the integral development of human capital through staff training and support for professional career advancement within the Bank.

Career development

In 2005, efforts focused on updating the Bank's structure of senior positions, which dated from 1984. Although over the past 20 years the Bank has experienced many changes in the processes, functions, responsibilities and profiles of its employees (during the past decade, for example, the number of professionals has risen by 43%), this was not reflected in the structure and job descriptions. Starting in the second half of 2004 and early 2005, a new structure was implemented, reducing these from 120 to 60, [4]/ a process scheduled for completion during the first four months of 2006.

This process sought to clarify career options for staff and facilitate the design of an integrated approach to human resource policies, bringing together hiring, training, performance evaluation, wages and bonuses, among other elements.

[4]/ The Hay Guide Chart-Profile Method is used to evaluate positions.

Training

In 2004, training policies and regulations were reviewed. New programs were set up, particularly those focusing on upgrading the staff knowledge necessary for a solid job performance and promoting the development and further training of individuals.

The new regulation and training policies were implemented in 2005, with priority given to internal training through courses and talks provided by the Bank's own professionals and through external suppliers. In 2005, 391 staff members, 66% of the total, received training.

In mid-2005, training needs were examined to identify the specific programs necessary to improve performance in the years to come. All this became part of the strategic plan, 2006-2008. The analysis and processing of this information formed the basis for preparing an Annual Training Plan, 2006, recently approved by the Board.

Key training sessions to be held in 2006 include a Management Skills and Strategic Development program, designed for area chiefs, along with visits and fellowships in other central banks.

Institutional orientation

In 2005, an orientation program for new staff began. Its purpose was to facilitate integration of new staff members. It included talks on the Bank's history, legal regulations, vision, values, main functions and organizational structure, provided by the professionals in charge of different areas within the Bank.

Structure of the human resource management area

The purpose of this management area is to "attract, develop and retain Bank staff, keeping them motivated and committed to excellence and the achievement of institutional values and goals, within a balanced work and personal environment." To meet this goal and assume its strategic role within the Bank, in late 2004 the Human Resource Development Department was created, to provide consistent advice to all Bank units on issues regarding human resource management.

Main changes in personnel regulations

Labor relations between Bank workers and the Bank itself are conducted according to the Basic Constitutional Act, the personnel regulations adopted by the Board, and the Labor Code. The Bank's internal regulations are based on these legal obligations, requiring that changes or amendments must be approved by the Board.

The main changes to internal regulations introduced in 2005 included:

i) Changes to the Basic Constitutional Act (*LOC*), arising from Law 20,000, which punishes illegal trafficking in drugs and other illegal psychotropic substances.

The new law required amendments to articles 14bis and 81bis of the *LOC*, to make anyone dependent on illegal drugs, psychotropics or other substances ineligible for a senior management post or equivalent, unless consumption formed part of medical treatment.

Regulations governing staff in this sense specify that senior management or equivalent refers to any staff member holding executive positions through to department chief. Likewise, regulations were included to prevent undue consumption of illegal psychotropics, mind-altering drugs or substances, along with random monitoring of consumption, administered under strict privacy controls, to respect individuals' dignity and intimacy.

ii) Sexual harassment law

Given publication in the *Official Gazette* (*Diario Oficial*) of Law 20,005, which amended the Labor Code and defined and established punishment for sexual harassment, the necessary norms were included in Bank regulations for investigating and punishing sexual harassment.

iii) Amendments to regulations governing upward evaluations

Another aspect that progressed in 2005 was the reorganization of the upward evaluation process. The purpose of this effort was to discover staff perceptions about their immediate chiefs and implement programs for developing any skills requiring improvement. In 2005 division managers (senior administrators) were evaluated, as were different levels of management, for aspects such as work organization, leadership, communication, technical knowledge and values.

B.4 Internal control and monitoring

The activities of the General Auditor aim to provide a wide range of services and types of audit affecting processes, account reviews, meeting of objectives, projects and research.

In 2005, one of the main tasks of the General Auditor was to develop and implement a proactive approach and methodology to generate added value in the areas of risk management, internal monitoring and corporate governance. Tasks focused on defining the statutes governing audits, implementing an auditing approach based on risks and processes, and defining the methods to be used and standards to be met. At the same time, tasks for attracting, retaining and developing the own staff of the General Auditor were also carried out, so this unit can comply with its mission and standards.

C. Operating expenses

Operating expenses include staff wages and benefits, the use and consumption of goods and services, and other expenditures necessary for carrying out Bank activities. They are broken down into personnel expenditures, administrative expenditures, depreciation, amortization and write-offs, taxes, contributions and others (tables II.1 and II.2).

Of total operating expenses, personnel account for 66%; administration, 26%; depreciation, amortization and write-offs, 6%, and taxes, contributions and others, 2%.

Personnel expenditures

Personnel expenditures grew 13.4% in real terms in the past five years, from Ch$14.717 billion in 2001 to Ch$16.687 billion in 2005. From December 2001 to 2005, the number of employees rose 0.9%, from 557 to 562. The structure shifted toward the growing professionalization of the Bank, with a decline in administrative staff, secretaries and service personnel. Professionals, who along with executives and chiefs accounted for 48% of employees in 2001, reached 60% in December 2005. This trend is expected to continue.

Personnel expenditures rose a real 0.4% in 2005 over 2004, mainly reflecting higher spending on training and staff welfare. This was partly offset by the fact that new professionals were hired at different points in the year.

TABLE II.1
Operating expenses
(as of 31 December of each year)

	2001	2002	2003	2004	2005
Operating expenses (1)					
Personnel expenditures	13.4153	13.2239	14.9344	16.1231	16.6865
Administrative expenditures	5.0692	7.1566	8.1063	7.0012	6.5717
Depreciation, amortization and write-offs	1.3621	1.4436	1.2894	1.5562	1.6085
Taxes, benefits and others	0.4832	0.4742	0.5055	0.4746	4656
Total	20.3298	22.2983	24.8356	25.1551	25.3323
Operating expenses (2)					
Personnel expenditures	14.7166	14.1628	15.5467	16.6229	16.6865
Administrative expenditures	5.5610	7.6646	8.4386	7.2182	6.5717
Depreciation, amortization and write-offs	1.4942	1.5461	1.3423	1.6044	1.6085
Taxes, contributions and others	0.5301	0.5079	0.5262	0.4893	0.4656
Total	22.3019	23.8814	25.8538	25.9348	25.3323

(1) In billions of pesos of each year.
(2) In billions of 2005 pesos. To update figures from previous years, the average CPI of each year was used.
Source: Central Bank of Chile.

TABLE II.2
Main operating expenses (*)
(as of 31 December of each year)

	2001	2002	2003	2004	2005
Personnel expenditures					
Wages and other employer contributions	11.4418	11.9493	12.5961	13.4164	13.3430
Staff welfare	1.7704	1.7342	1.7493	1.7952	1.8518
Training	0.1426	0.1697	0.1960	0.2814	0.4169
Provision for severance pay (years of service)	1.3618	0.3096	1.0053	1.1299	1.0748
Total	14.7166	14.1628	15.5467	16.6229	16.6865
Administrative expenditures					
Basic services	0.5457	0.5929	0.5681	0.5886	0.5928
General services	2.1484	2.2402	2.1151	2.494,6	2.5958
Maintenance of fixed asset goods	0.5607	0.6637	0.8843	0.9383	0.3962
Expenditures on computers and technological development	1.5500	1.8299	3.8263	2.0415	2.0985
Consulting, surveys, studies and seminars	0.7562	2.3379	1.0448	1.1552	0.8884
Total	5.5610	7.6646	8.4386	7.2182	6.5717

(*) In billions of 2005 pesos. To update figures from previous years, the average CPI of each year was used.
Source: Central Bank of Chile.

Administrative expenditures

Administrative expenditures rose a real 18.2% in 2005 over 2001, going from Ch$5.561 billion to Ch$6.572 billion. The increase basically reflected spending on maintaining a suitable level of operations in support of the Bank's essential functions. This involved adding appropriate technologies for better meeting institutional objectives and achieving the highest quality standards in administrative services. This included spending on computers and technological development, general services, fixed asset maintenance, consultants, surveys, studies and seminars, and basic services.

Between 2004 and 2005, administrative expenditures fell a real 9%. This mainly reflected less spending in remodeling buildings, since the offices in the Plaza Constitución building [5]/ were completed in 2004. Consultants' fees, professional services, surveys and studies also required fewer resources, especially compared to the base year 2003 (*Programa Año Base 2003*).[6]/

D. Communications and diffusion

D.1 Main publications

Through its publications, the Central Bank offers timely information about its policies, to promote the development of and debate about economic research, contribute to the expansion of information about issues related to its activities, and provide essential economic and financial statistics.

The main vehicles for policy information are the *Monetary Policy Report* (*Informe de Política Monetaria*) and the *Financial Stability Report (Informe de Estabilidad Financiera)*. The first, published three times yearly (January, May and September), analyzes recent trends and provides forecasts for the economy and inflation, and their implications for formulating monetary policy in the medium term. The latter (June and December) analyzes the development of those aspects of the economic environment relevant to financial system stability.

These publications are complemented by three issues in the series *Documentos de Política Económica (Economic Policy Documents)*, whose purpose is to provide information about the thinking of Bank authorities about the Chilean economy and the conduction of monetary policy.

In the first quarter, volumes 8 and 9 of the series *Central Banking, Analysis and Economic Policies (Banca Central, Análisis y Políticas Económicas)*, were also published: *General Equilibrium Models for the Chilean Economy* (*Modelos de Equilibrio General para la Economía Chilena*) and *Labor Markets and Institutions* (*Mercado Laboral e Institucional*). Both works include research presented at the Bank's annual conferences. These are attended by distinguished Chilean and foreign economists, who analyze and discuss unpublished work about central banking and policies regarding the economic management of developing countries. This collection has become an essential point of reference for economic research in many countries, particularly in Latin America.

Another important aspect of the Bank's economic research was reflected in the periodical, *Economía Chilena*, published in April, August and December. The 2005 issues focused on nine studies and six research reports, all dealing with analyzing and providing information on issues relevant to the Chilean economy and the management of economic policy.

[5]/ The Bank rented floors 1, 2 and 3 in a building located at Morandé 115, requiring renovations and furnishing for use by International Exchange and Trade Policy, Communications, Statistical Research and Studies, The General Auditor`s Office and an auditorium.

[6]/ This formed part of the Bank's usual statistical policy review, which involved developing a new set of references for macroeconomic aggregates included in Chile's national accounts. Thus, 2003 became the reference point for national accounts, the base year for new annual and quarterly estimates for 2003-2008, and the basis for the 2003 input-output matrix.

In 2005, 50 *Documentos de Trabajo* (*Working Papers)* were published, to facilitate the exchange of ideas and information about preliminary research. Five issues of the series *Estudios Económicos* (*Economic Studies*) were also published, on studies involving more empirical data.

In December, the book *Características de los Instrumentos del Mercado Financiero Nacional* was published. As its name indicates, it summarized the general and specific characteristics of the main securities trading on Chile's capital markets.

The Bank provides economic and financial statistics, as per Section 53 of its Basic Constitutional Act, in its regular publications including the: *Informativo Diario, Boletín Mensual, Síntesis Monetaria y Financiera, Indicadores de Comercio Exterior*, and its *Cuentas Nacionales* (*National Accounts*), *Balanza de Pagos* (*Balance of Payments*) and *Deuda Externa de Chile* (*Foreign Debt*) *yearbooks*.

D.2 Seminars and conferences

In 2005, the Bank held its ninth annual conference. The main subject was the conduction of monetary policy in countries using inflation targeting, and impacts on the world and Chile. The purpose of this gathering was to promote and discuss progress in economic research of interest to central banks.

The meeting, held from 20 to 21 October, brought together academics, experts from foreign financial institutions and central banks, and authorities from international bodies. The keynote speaker was the International Monetary Fund's First Deputy Manager, Anne Krueger, who spoke on "A prize worth having: the IMF and price stability".

The meeting was closely associated with a central bank summit on inflation targeting, held 19 October, attended by governors and authorities from 26 central banks using inflation targeting or in the process of implementing this approach. Participants, who included distinguished foreign academics, exchanged opinions and experiences with monetary policy management in their respective countries.

The presentation of the *Financial Stability Report (IEF)* for the first half of 2005 framed the seminar *Desarrollo de los sistemas financieros en Latinoamérica* (Development of financial systems in Latin America), offering a more complete overview of progress on these issues within the region. On 24 June, distinguished economists from the World Bank and the Inter-American Development Bank (IDB) presented a report on credit and capital market prospects and delinkages to more than 100 executives from Chile's financial sector. The seminar culminated in an analysis of the economies of Latin America, by Guillermo Calvo, chief economist with the IDB.

On 19 July, the first vice-president and operations manager of the Federal Reserve Bank of Atlanta, Patrick Barron, visited Santiago to speak on payments systems in the United States. The meeting was organized by the Central Bank and the Superintendency of Banks and Financial Institutions, and more than 100 economists and executives attended.

The 10th Central Bank Communications Meeting, organized by the Centre for Latin American Monetary Studies (*Centro de Estudios Monetarios Latinoamericanos, Cemla*) and the Bank, was held in Santiago 2 - 4 November. Its purpose was to encourage analysis and debate of the relationship between communications and monetary policy, transparency and ways of managing or releasing sensitive information to markets.

On 17 - 18 November, the first workshop on Monetary Policy Research in Latin America and the Caribbean, organized by the Central Bank of Chile and the Bank of England's Centre for Central Bank Studies, took place. Entitled "Monetary policy response to supply and asset price shocks," the workshop brought together researchers and experts from central banks in Latin America, England and Canada to discuss recent theoretical and empirical studies and works in progress, focusing on the effects of supply and asset price shocks, to help central banks understand and model these shocks to project inflation and make decisions.

From 14 to 25 November the course "Balance of Payments Methodology" was provided by two experts with Cemla. This attracted Bank employees and foreign guests. Its purpose was to teach the fundamentals involved in registering the balance of payments and the international investment position, according to the International Monetary Fund's *Balance of Payments Manual*.

In 2005, seminars on Central Bank macroeconomics and finance continued, involving 24 presentations. These focused on delivering information about theoretical and applied research to researchers, university professors, students and Bank employees. Researchers from foreign bodies such as MIT, the Dallas and New York Federal Reserve banks attended. Issues dealt with included the relationship between economic growth, credits to small and medium-sized firms, monetary policy, money and inflation targeting, capital flows and volatility, and the Chilean pension system.

D.3 "Economics for the Majority" Program

In 2005, the Bank also took a great leap forward in its diffusion program for working more closely with the community, "Economics for the Majority".[7]/ Guided tours for primary, secondary and higher education continued, with more than 6,000 students visiting Bank headquarters to learn about its main functions, during the year.

The "Economics for the Majority" program also involved presentations from Board Members outside of Santiago. On 19 May, Manuel Marfán, spoke to teachers in Puerto Montt, and the following day Jorge Desormeaux did likewise in Copiapó.

[7]/ This program included among its activities the publication of texts on the economy, such as the paper *Economía para todos* (Economics for everyone) by former Bank Governor Carlos Massad, launched in October 2004.

The program's most important event was the successful completion of its first competition *La economía + cerca* (bringing the economy closer), whose main purpose was to bring secondary students into contact with economic information and the Bank's functions.

The purpose of the competition, sponsored by the Education Ministry, was to invite third- and fourth-year high school students all-over the country to participate in groups of three to five, under a teacher's guidance, and prepare an essay, from the perspective of daily life, on the importance and impacts of Bank decisions on the country, their region, municipal area or household.

Four hundred twenty four papers came in from 227 schools, including public schools, publicly subsidized private and private schools throughout the country.

The winning group came from the Arturo Alessandri Palma high school, in Providencia (Santiago), with their paper "Impact of the Interest Rate on Family Spending". Second place went to the team from the Carlos Cousiño Goyenechea high school in the southern town of Lota, with their essay "Interest versus reito (from "rédito", surcharge on private loans)". Third place went to a group from the Anglo Maipú high school, which presented the paper "A Youthful Conceptual Proposal: the Student's Basket".

In May, for the second year running, the Bank opened its doors one Sunday to celebrate the "Day of Cultural Patrimony". More than 3,000 people visited the main rooms in the Agustinas street building, to appreciate its architectural and historical heritage.

D.4 Regional meetings

For the past three years, in tandem with publication of the *Monetary Policy Report*, regional meetings or *"Encuentros"* have been organized in different cities along the country.

These gatherings offer the Bank a chance for free-flowing dialogue with the community, increasing its knowledge of the concerns of different sectors in the country and talking about what it does to achieve its goals in the best way possible. The Bank organizes these meetings in association with some regional business group or university and they typically involve presentations on financial and monetary issues, such as those included in the *Financial Stability Report*.

In 2005, from 100 to 300 people participated in meetings in Iquique, with Bank Governor Vittorio Corbo; in Copiapó, with Board Member Jorge Desormeaux; and in Talca, with Board Member Manuel Marfán.

Board Members also made presentations outside Santiago, in response to invitations from academic institutions, business organizations or the media. On 27 July, the Governor gave a keynote speech at the University of Los Lagos in Puerto Montt, on Chile's Economic Prospects. Board Member Jorge Desormeaux presented the September *Monetary Policy Report* at the University of *Concepción*, while Board Member Manuel Marfán spoke at the regional business meeting (*Encuentro Regional de la Empresa 2005, Erede*), on 15 November, also in Concepción.

D.5 Cultural difussion

For the fourth year running, a show of pieces from the Bank's valuable art collection was on display in the main salon at the entrance of its headquarters. The 2005 show exhibited 29 paintings by two distinguished Chilean artists: Juan Francisco González and Arturo Gordon. On the suggestion of the curator and director of Chile's national fine arts museum, Milan Ivelic, the show was called "*Convergencias*" (Convergences). This reflected the closeness of both artists, who formed part of the landmark, "Generation of Thirteen", in Chilean painting. More than 1,600 people visited the exhibition, which was open from 26 October to 23 December at no cost, and included specialized guides and a video in which Milan Ivelic explained each work.

In 2005, the Pedro Lira and Herrera Guevara salons in Bank headquarters were officially inaugurated. They constitute a tribute to two distinguished masters of Chilean painting, and include an important selection of their works, all from the Bank's collection.

D.6 Communication campaign on banknotes security

One of the Bank's objectives is to provide efficient and secure means of payment, providing high quality banknotes and coins and manufactured to the highest international security standards. One ongoing concern is ensuring the public's familiarity with banknotes and coins, which helps to maintain confidence in our means of payment.

As part of initiatives to celebrate the Bank's 80th anniversary, in August 2005 a campaign to help the community become more familiar with banknotes and therefore ensure their authenticity was launched.

To raise awareness of the importance of ensuring the security of banknotes, 40,000 flyers and 9,000 posters were distributed to the media, schools, banks, post offices, the Chamber of Commerce, means of transportation and police institutions. Moreover, the Bank's website information on this subject was updated, and an interactive and educational section was added.

D.7 Activities to celebrate the bank's 80th anniversary

In August 2005, the Bank turned 80. To celebrate, a series of events and activities were held throughout the year, among them a formal dinner in the *Patio Inglés*, on 18 August, attended by distinguished players in Chile's economic and political spheres, headed by the President of Chile and the Governor of the Central Bank of Chile. Senior authorities from the central banks of Mercosur (Argentina, Brazil, Paraguay and Uruguay) and associated countries (Bolivia, Chile and Peru) also attended.

The Bank launched a book, *La Emisión del Dinero en Chile: Colección de Monedas y Billetes del Banco Central de Chile*, highlighting the collection of Chilean banknotes and coins from the colonial period to date, which forms part of Chile's cultural heritage and is stored in the Bank's vaults.

It also sponsored the exhibition "Coins and banknotes: 80 years of the Central Bank", in the central hall of the national fine arts museum (*Museo Nacional de Bellas Artes*). The show, which opened on 2 August, showed the public the coin collection stored in the Bank's vault, which is one of the most complete collections of Chilean banknotes and coins, with elements produced by the *Casa de Moneda* since 1749, along with banknotes from the entire history of Chile. Material from the national history museum (*Museo Histórico Nacional*) and the national mint, the *Casa de Moneda de Chile* was also included. More than 15,000 people, offering an educational and attractive view of the details, codes, images and symbols contained on both sides of the country's coins and banknotes.

E. Other

E.1 External portfolio administration program

In line with its commitment to the efficient management of its international reserves, for the past ten years the Bank has developed an external program for managing part of its portfolio.

Program characteristics

In 2005, the Bank ran two external portfolio management programs for its international reserves. The first, which began in 1995, consisted of hiring foreign specialists (3) in this field. On behalf of the Bank, they handled a percentage of its foreign currency assets, according to a previously approved mandate, which currently focuses on a general long-term investment portfolio. The purpose of this approach is threefold: i) to constitute an active standard of comparison for the Bank portfolio; ii) to achieve a transfer of knowledge and technology, and iii) to add economic value to the foreign currency portfolio. The program is structured into two- to three-year periods, which begin with a process of selecting administrators and end with an evaluation and decision on continuing the mandate. In 2005, three external administrators were in charge of a portfolio that, as of 31 December, stood at US$572 million.

The second program consists of a specialized mandate in Mortgage-backed Securities (MBS). This began in 2003, to add value to the portfolio and achieve a transfer of knowledge through dialogue between Bank staff and the managers. In 2005, an external manager handled a portfolio that, as of 31 December, stood at US$327 million.

As programmed, in 2005 the Bank evaluated it external portfolio management programs. For the long-term portfolio a new selection process was scheduled for 2006. For the MBS program, the current manager was ratified, with some technical corrections to its mandate.

Selection and evaluation processes for external managers

The process for selecting external managers involves two stages. In the first, a “request for information” is sent to all institutions that have expressed an interest in participating in the selection process. These may be commercial banks, investment banks, or companies dedicated to managing portfolios. The information requested from these institutions is then subjected to a pre-evaluation, according to three basic criteria: seniority of the institution and experience with similar portfolios, allocation of personnel to the Bank portfolio, and other characteristics such as costs, previous performance, investment philosophy and financial solidity. This stage of the evaluation involves scoring each of these variables. A small number of institutions are then pre-selected to carry on to the next stage.

The second stage aims to generate a definitive ranking of the pre-selected institutions according to the external portfolio management program. An external specialist assists in this process. The resulting ranking is presented to the Board, which is the final instance for selection of external managers.

The external managers’ performance evaluation is based on their results and a comparison with those of the Bank’s internal management team. The evaluation also considers the market risk assumed by the external managers and the costs, penalties for transgressions and other factors, such as the transfer of knowledge.

E.2. Suppliers of banknotes and coins

As per Section 28 and the following of its Basic Constitutional Act, the Bank has sole authority to issue banknotes and coins for their circulation in the country. For this purpose, it hires the services of a group of specialized firms through national and international auctions. Banknotes and coins placed in circulation in 2005 were manufactured in Chile and Australia using high quality raw materials, as per the Bank's institutional policies in this area.

In 2005, the Bank ordered the production of 215.5 million banknotes and 331 million coins, in the following denominations: Ch$10,000; Ch$5,000; Ch$1,000; Ch$100; Ch$50; Ch$10; Ch$5, and Ch$1. Moreover, the policy for supplying banknotes and coins was amended to permit the production in 2006-2007 of a total of 711 million banknotes and 715 million coins. This policy gives priority to economic efficiency in the granting of national and international auctions and forms part of the institutional modernization being implemented to reinforce the management of risk by expanding the Bank's reserves of banknotes and coins to satisfy the growing demand from the public.

E.3 Appointment of external auditors

Section two of Section 76 of its Basic Constitutional Act, establishes that financial statements must be approved by external auditors appointed by the Board from those registered with the Superintendency of Banks and Financial Institutions.

As a result, through resolution N°1200-02-050609, the Board renewed a one-year service provision contract with *Ernst & Young Servicios Profesionales de Auditoría Ltda.*, under which this firm audited the Bank's financial statements and credits corresponding to international bodies requiring the opinion of independent auditors, through 31 December 2005 and, with the renewal, through 31 December 2006.

Appendix 1
News releases from monetary policy meetings in 2005

11 January

At its monthly monetary policy meeting, the Board of the Central Bank unanimously increased the monetary policy interest rate by 25 basis points to 2.5% per annum.

The information available revealed that the main trends from recent months were continuing: inflation was under control and activity increasingly strong. In an international environment that remained favorable amidst markedly expansionary conditions, activity and domestic expenditure continued to grow apace. Investment and exports continued to enjoy rapid growth, employment continued to consolidate as did the labor force, and private expectations were optimistic. The inflationary pressures arising from this scenario, in which idle capacity was being absorbed, made it necessary to continue to bring monetary impulse back to normal.

Beyond the fluctuations in fuel prices, inflation measures have risen slowly, particularly underlying indicators (which exclude some goods whose prices are more volatile). Costs had continued to post weak growth, particularly labor costs, thus keeping inflation down. This made the continued gradual reduction to monetary stimulus advisable.

The Board reiterated that, in the most likely scenario, it would continue to gradually reduce the markedly expansionary monetary stance to keep inflation within the target range of 3% over the usual 12- to 24-month policy horizon.

10 February

At its monthly monetary policy meeting, the Board of the Central Bank unanimously increased the monetary policy interest rate by 25 basis points to 2.75% per annum.

The information available to date indicated that the economy continued to grow apace, in December somewhat more than forecast in the previous *Monetary Policy Report*. This took place in a favorable international environment, in which the copper price remained high, and monetary conditions in Chile were still markedly expansionary. Investment continued to grow well, employment and the labor force had risen at high rates for five months, and private expectations were more optimistic.

The most recent price information, meanwhile, including the January CPI, remained in line with a scenario involving limited inflation for the present year, as forecast in the previous *Monetary Policy Report*. Likewise, different measures for trend inflation continued to rise gradually. This, along with the steady reduction in idle capacity and the marked monetary stimulus at present made it advisable to increase the policy interest rate. This correction was consistent with the strategy of gradually normalizing monetary impulse, reducing the risk of sudden corrections in future and reflected the solid prospects of the Chilean economy.

The Board believed that in the most likely scenario this strategy would keep inflation at around 3% per annum over the usual 12- to 24-month policy horizon, despite the likelihood that 12-month inflation could be lower for part of 2005.

10 March

At its monthly monetary policy meeting, the Board of the Central Bank unanimously decided to keep the monetary policy interest rate at 2.75% per annum.

The information available indicated that inflation and growth in activity were performing in line with the forecast in the previous *Monetary Policy Report*. Solid economic growth was based on a favorable international environment and monetary conditions in Chile that remained clearly expansionary. Investment continued to grow extremely robustly, employment and the labor force remained dynamic, and private expectations remained optimistic.

The latest price information, meanwhile, indicated that aside from some fluctuation due to changes in regulated rates, the different measures for trend inflation continued their gradual rise, in line with projections in the latest *Monetary Policy Report*. This was consistent with a steady decline in idle capacity. Monthly inflation was expected to show some short-term volatility because of the strong influence from shifts in fuel prices. Nonetheless, the 12-month inflation projection remained low for part of 2005, at under 2% for some months.

The decision to keep the monetary policy rate the same at this time did not change the general plan for gradually reducing monetary impulse. The Board considered this the strategy that would, in the most likely scenario, keep inflation at around 3% per annum over the usual 12- to 24-month policy horizon.

7 April

At its monthly monetary policy meeting, the Board of the Central Bank unanimously increased the monetary policy interest rate by 25 basis points to 3% per annum.

The information available indicated that expenditure continued to post robust growth, while growth in activity remained solid, although somewhat less intense than in previous quarters. This scenario was supported by monetary conditions in Chile that remained clearly expansionary and a favorable international outlook, although some risks had increased.

The latest price information suggested that the different measures for trend inflation were continuing their gradual rise, in line with projections from the latest *Monetary Policy Report*. Monthly inflation had posted some volatility, reflecting the direct effects of the rising international oil price and its impact on regulated rates, a situation that was expected to continue in the short term.

The trend in inflation and monetary stimulus made it advisable to increase the policy interest rate. This correction reduced the risk of sharp movements in future and was consistent with the process of normalizing monetary policy and solid prospects for the Chilean economy.

The Board reiterated its commitment to correcting monetary policy to keep inflation at around 3% per annum over the usual 12- to 24-month policy horizon. In the most likely scenario, this should involve gradual increases to the policy rate.

12 May

At its monthly monetary policy meeting, the Board of the Central Bank unanimously increased the monetary policy interest rate by 25 basis points to 3.25% per annum.

Information available indicated that activity was on the rise, although more slowly than in previous quarters, but still above trend. Investment, consumption and employment continued to grow, supported by clearly expansionary domestic monetary conditions and a favorable international outlook, but risks nonetheless remained high.

The latest price information indicated that aside from some unusual movements in specific prices and the direct impact of the rising oil price, trend inflation continued to increase gradually, in line with forecasts. Despite the hourly wage increase in recent months, unit labor costs remained stable.

This interest rate increase was consistent with the gradual pace of normalization begun last September. It reflected the solid prospects of the Chilean economy and reduced the risk of sharp movements in future. The Board reiterated its commitment to conducting monetary policy in a way consistent with keeping inflation at around 3% per annum over the usual 12- to 24-month policy horizon.

9 June

At its monthly monetary policy meeting, the Board of the Central Bank unanimously decided to keep the monetary policy interest rate at 3.25% per annum.

The information available indicated that inflation and economic activity were behaving in line with the forecast in the previous *Monetary Policy Report*. Output growth remained above trend, driven by the favorable international outlook and monetary conditions in Chile that remained clearly expansionary.

In line with forecasts, trend inflation continued its gradual rise, despite some bouncing around due to the effects of higher fuel prices and some regulated rates on CPI and CPIX inflation (which excludes fuels and perishables). Unit labor costs remained under control, despite a larger hourly wage increase.

The decision to keep the monetary policy rate unchanged at this time signaled no change in plans to gradually reduce monetary impulse. The Board considered that this strategy would, in the most likely scenario, keep inflation at around 3% per annum over the usual 12- to 24-month policy horizon.

12 July

At its monthly monetary policy meeting, the Board of the Central Bank increased the monetary policy interest rate by 25 basis points, to 3.5% per annum.

The information available indicated that activity continued to grow above trend, supported by monetary conditions in Chile that remained clearly expansionary and a favorable international outlook, despite high oil prices. Investment continued to grow with unexpected strength, while employment had risen substantially, thereby boosting consumption.

Monthly CPI inflation had been higher than projected in the previous *Monetary Policy Report*, reflecting higher prices for fuels, regulated rates and some perishable prices. Nonetheless, inflation continued to rise gradually, as per forecasts.

The Board reiterated its commitment to conduct monetary policy in a way consistent with keeping inflation at around 3% per annum over the usual 12- to 24-month policy horizon.

11 August

At its monthly monetary policy meeting, the Board of the Central Bank increased the monetary policy interest rate by 25 basis points, to 3.75% per annum.

The information available indicated that activity continued to grow above trend and domestic expenditure was still posting strong growth. The international environment remained favorable, despite the oil price's continued rising. Domestically, monetary conditions remained clearly expansionary and investment continued to post vigorous growth. Employment was rising at high rates, thus encouraging consumption.

CPI inflation had reached over 3% before forecast, mainly reflecting rises in fuel prices and some regulated rates. Aside from these, the different measures for inflation trends continued their return to normal, leaving behind the unusually low rates of recent quarters.

The Board considered that, in the most likely scenario, it would continue to reduce monetary stimulus, to keep inflation at around 3% per annum over the usual policy horizon.

8 September

At its monthly monetary policy meeting, the Board of the Central Bank increased the monetary policy interest rate by 25 basis points to 4% per annum.

Despite the fact that the oil price had remained high, the international environment was still favorable. World growth remained strong, the copper price high, and financial conditions advantageous. The effects of hurricane Katrina, which were considered to be low in terms of world activity, brought with them an additional shock to fuel prices and had a somewhat weaker impact on international interest rates.

In July, domestic activity growth slowed somewhat compared to previous months, reflecting specific, probably temporary, factors. Domestic expenditure continued to soar amidst monetary conditions that remained clearly expansionary. Optimism fanned by continued vigorous growth in investment and high growth in private employment encouraged consumption.

Annual CPI inflation and other measures for inflation remained within the target range of 2% to 4%. Private expectations regarding inflation had risen, especially for the next year or less, lining up with the temporary increase projected in the previous *Monetary Policy Report*.

The Board considered that, in the most likely scenario, it would continue to reduce monetary stimulus, to keep inflation at around 3% per annum over the usual 12- to 24-month policy horizon.

11 October

At its monthly monetary policy meeting, the Board of the Central Bank increased the monetary policy interest rate by 25 basis points to 4.25% per annum.

Activity continued to grow above trend, although recent information suggested it was rising less than forecast. Domestic demand remained strong, particularly investment rather than consumption. Employment was still rising at high rates and monetary conditions in Chile remained clearly expansionary. Despite high oil prices and more risk posed by international inflation, the external environment was still favorable, with the high copper price, advantageous financial conditions, and the prospects for high world growth continuing.

In September, inflation was surprisingly high, reflecting specific prices, particularly fuels and some perishables, taking annual CPI inflation to almost 4% sooner than projected. In contrast, the core inflation measures, the CPIX and CPIX1 (which exclude fuels, perishables and some regulated utility rates, among others) continued to rise in line with forecasts. Measures for inflation expectations, over the next two or more years, remained at around 3%. This outlook was consistent with a temporary rise in inflation and a tendency for inflation to move toward the center of the target range, as forecast in the previous *Monetary Policy Report*.

The Board considered that, in the most likely scenario, it would continue to reduce monetary stimulus, to keep inflation at around 3% per annum over the usual 12- to 24-month policy horizon.

10 November

At its monthly monetary policy meeting, the Board of the Central Bank increased the monetary policy interest rate by 25 basis points to 4.5% per annum.

Activity growth in the third quarter was somewhat lower than forecast in the previous *Monetary Policy Report*, although it remained above trend. Investment continued its strong performance and employment was still growing robustly. Interest rates on different instruments rose in previous weeks, but financial conditions in Chile remained expansionary. Despite the fact that inflation and interest rates in developed countries have also risen, the external environment was still favorable, with the copper price remaining high, and good prospects for strong world growth, although with some increased risk.

October inflation was higher than forecast, reflecting perishable prices. This took annual CPI inflation to over 4% and it was expected to remain above the target range during the first months of 2006. The core inflation measures, CPIX and CPIX1 (which exclude fuels, perishables and some regulated utility rates, among others) remained well under control, as were inflation expectations, which for one year hence stood at around 3%. This was consistent with a temporary rise in annual inflation followed by a shift toward the center of the target range, as forecast in the previous *Monetary Policy Report*.

The Board considered it appropriate to reaffirm its commitment to price stability and reducing the current monetary stimulus at the pace necessary to keep inflation at around 3% per annum over the usual 12- to 24-month policy horizon.

13 December

At its monthly monetary policy meeting, the Board of the Central Bank of Chile decided to keep the monetary policy interest rate at 4.5% per annum.

The external environment relevant to the Chilean economy was still very favorable and some of the risks identified in previous months had faded. The copper price had risen yet again and international financial conditions remained favorable.

In Chile, financial conditions remained expansionary. Recent growth in activity was less than in previous months, but in annual terms remained around trend. Domestic demand continued to grow strongly and although job creation had slowed, the unemployment rate continued to drop.

Annual CPI inflation and its short-term projection had fallen, influenced by the rapid return to normal of fuel prices and significant peso appreciation. Core inflation measures, the CPIX and CPIX1 (which exclude fuels, perishables and some regulated utility rates, among others) remained under 3%. Other indicators for inflation trends and different measures for inflation expectations remained well anchored.

Recent news on activity, the exchange rate, prices and their implications for future inflation justified keeping the current monetary policy rate unchanged. This pause was consistent with the strategy of gradual normalization of monetary impulse, to keep inflation at around 3% per annum over the usual 12- to 24-month policy horizon.

Appendix 2

Main Central Bank of Chile measures in 2005

January

6 The Board of the Central Bank of Chile amended regulations governing banking firm' financing systems in the *Compendium of Financial Regulations*, to incorporate the Permanent Liquidity Facility (*Facilidad permanente de depósito de liquidez*) in domestic currency. This financing system, which is permanently available, operates on an information system platform and allows banks to obtain liquidity in domestic currency from the Central Bank of Chile for one or more days, by purchasing credit securities using a buy-back clause (repos), provided the credit payment is duly guaranteed. Moreover, some operating aspects of the Liquidity Deposit, currently referred to as the Permanent Liquidity Deposit Facility in domestic currency were modified to make it possible to receive banks' regulatory deposits. As a result, the current Liquidity Credit Line to banks can only be used under exceptional circumstances and with express authorization from the Central Bank of Chile.

This financing system started to operate on 24 January 2005 through an electronic platform for transactions provided by the Open Market Operating System (*Sistema de operaciones de mercado abierto*), with on-line communication, connected to the Central Bank's Real-Time Gross Settlement System (RTGS) and the central securities deposit (*Depósito central de valores*), for the purpose of transferring funds and securities corresponding to the respective operations using similar procedures to those used for the Intraday Liquidity Facility established in 2004. The incorporation of this financing system represents enormous progress in this area as per international standards and brings with it important benefits for financial institutions and the Central Bank of Chile, in terms of operating efficiency and security. Moreover, the reliability of purchases and sales of securities improved with the link to the securities deposit, as payment settlement occurs at the same time as the transfer of the respective securities, through the "delivery versus payment system".

11 At its monthly monetary policy meeting, the Board of the Central Bank of Chile increased the monetary policy rate (MPR) by 25 basis points, to 2.5% per annum.

13 As per its faculties under its Basic Constitutional Act to issue regulations and define limitations on the relationship between financial institutions' asset and liability operations to ensure compliance with their obligations, the Board of the Central Bank of Chile decided to modernize regulations governing the market risk associated with interest rates and currencies that may be assumed by these institutions.

This new regulatory framework includes established international recommendations and standards in this area, such as the 1996 Amendment to the 1988 Basel Committee Capital Agreement and 2004 recommendations on managing and supervising interest rate risk included in Pillar 2 of the New Basel Accord, referred to as Basel II.

The main characteristics of these new regulations include:

* The role of financial institutions' boards in developing a Market Risk Management Policy, appropriate to the scale and complexity of operations and in line with solvency and management criteria established by the Superintendency of Banks and Financial Institutions. In this sense, the financial institution board must constantly monitor information on market risk exposure incurred by the respective institution and compliance with its policies.
* The inclusion of quantitative limits to interest rate risk exposure in the negotiation book and to currency risk throughout the balance sheet, as part of calculating actual equity minus credit risk exposure.
* The inclusion of a basic method for measuring and controlling market risk exposure applicable to all financial institutions. Notwithstanding, these new regulations allow institutions with an A solvency rating and prior authorization from the Superintendency of Banks and Financial Institutions to apply their own internal methods, which can also be used to measure and control market risk exposure.
* The requirement that financial institutions periodically review all activities that may lead to market risk exposure, taking into consideration relevant scenarios according to the structure of the balance sheet, the scale and complexity of institutional operations.

These regulations came into effect on 4 July 2005.

14 The Bank decided to continue with policy to date on renewal of dollar-denominated securities (PRD, ZERO and BCD) falling due. This policy seeks to maintain a stable net position in foreign currency for the Central Bank of Chile's balance sheet as compared to the market.

To renew Central Bank dollar-denominated promissory notes and bonds, the Bank established a calendar with quotas for the monthly auctions, including dollar-denominated bonds maturing in one year (BCX), along with the amounts to be issued, according to the average maturity of dollar-denominated securities.

February

10 At its monthly monetary policy meeting, the Board of the Central Bank of Chile increased the MPR by 25 basis points, to 2.75% per annum.

March

10 The Board of the Central Bank of Chile decided to extend from 8 April to 7 December 2005, the period during which the check clearing house (*Cámara de cheques*) can daily and separately swap, compensate or cash chits and other demand documents, or whose payment is due on demand, in Chilean pesos, presented to it and whose individual value is Ch$50 million or more.

Moreover, it decided that until 8 September 2005, the amounts corresponding to chits and other demand documents worth Ch$50 million or more presented for cashing to the clearing house may be paid out by the respective debtor institution through the RTGS system.

This amendment formed part of the gradual and orderly migration of high-value payments to the new systems, to significantly reduce credit and liquidation risk for payments of systemic importance to Chile, as per international recommendations in this field.

April

7 At its monthly monetary policy meeting, the Board of the Central Bank of Chile increased the MPR by 25 basis points, to 3% per annum.

May

12 At its monthly monetary policy meeting, the Board of the Central Bank of Chile increased the MPR by 25 basis points, to 3.25% per annum.

26 The interest rate payable on deposits in the Technical Reserve Deposit Account (*Cuenta de depósito de reserva técnica*) –Article 65 of the General Banking Law– was changed, so that as of 9 June 2005, this rate will be the MPR set by the Central Bank's Board, less 100 basis points.

Likewise, upon request from the Central Bank of Chile, the Superintendency of Banks and Financial Institutions informed financial institutions that the deposits they make in Chilean pesos in the Central Bank of Chile to constitute the technical reserve must be made solely in the Technical Reserve Deposit Account, to ensure the effectiveness of the guarantee, as per the relevant law.

26 In line with its free floating exchange rate policy, established by the Central Bank of Chile in April 2001, the Bank authorized, as from 2 June 2005, the use of shares or other corporate rights on companies in Chile or abroad for the purposes of capital and investment abroad or in Chile as the case may be. Regulations to date in Chapters XII and XIV of the *Compendium of Foreign Exchange Regulations* only allowed these operations to be carried out using foreign currency.

To complement this measure and continue to simplify the delivery of foreign exchange information to the Central Bank, as well as improving the quality, coverage and efficiency of this reporting process, in August 2005 Chapters XII and XIV of the *Manual of Information Forms and Procedures* (*Manual de procedimientos y formularios de información*) in the *Compendium of Foreign Exchange Regulations* were replaced. The main changes involved: i) eliminating requirements for information from pension fund managers and others carrying out operations using foreign securities or CDV; ii) reducing information requirements applied for foreign investors; iii) streamlining the delivery of information by allowing direct reports via the Internet, and iv) requiring monthly rather than bi-weekly reports to the Central Bank of Chile from non-bank agents.

June

2 The Board of the Central Bank of Chile authorized the creation of the High-Value Payments Clearing House in domestic currency, managed by a banking support firm, known as *Sociedad Operadora de la Cámara de Compensación de Pagos de Alto Valor S.A.* (*Combanc*). This firm will play an important role in the functioning of the payment system in Chile.

23 The Bank allowed financial institutions to freely transfer through endorsement promissory notes covered by Law 19,980 (*Bonos de reparación*) and authorized buy-back operations involving these securities among individuals and non-financial legal entities for up to four banking days and, in the case of financial institutions monitored by the Superintendency of Banks and Financial Institutions, for from one banking day, thereby increasing the liquidity of these securities.

23 In the context of modernizing its financial regulations, the Central Bank's Board decided to allow financial institutions to offer buy and sell options on foreign currencies, price indices and interest rates, making the necessary changes in Chapter III.D.1 of the *Compendium of Financial Regulations*.

Given the nature of these operations and the risk involved, the respective resolution required that financial institutions issuing options must have A solvency ratings, as per Article 61 of the General Banking Law. Likewise, to ensure appropriate management and control of the associated market risk, these bodies must use models authorized by the Superintendency of Banks and Financial Institutions to calculate the corresponding sensitivity and volatility factors.

The authorization allowing financial institutions to operate in the options market according to these requirements came into effect on 5 September 2005.

30 The Bank authorized the purchase of credit securities using buy-back agreements (repos) between the Central Bank of Chile and financial institutions at variable interest rates, based on the average value of the MPR during the period the operation is in effect. This measure should deepen the market for these securities.

July

12 At its monthly monetary policy meeting, the Central Bank's Board increased the MPR by 25 basis points, to 3.5% per annum.

August

11 At its monthly monetary policy meeting, the Central Bank's Board increased the MPR by 25 basis points, to 3.75% per annum.

11 The list of operations requiring reporting to the Central Bank of Chile was amended to include options contracts carried out by bodies in the Formal Foreign Exchange Market with people domiciled or resident in Chile.

22 The Central Bank announced a change to its policy of issuing its own securities, to offset the monetary effect of bond issues in indexed units of account (*Unidades de fomento, UF*) maturing in 10 and 20 years (BTU-10 and BTU-20) from the Treasury as of September. The amendments were as follows:

* Peso-denominated bond maturing in two years (BCP-2): This bond will no longer be issued and offered between September 2005 and March 2006, inclusive.
* Bond in indexed units of account (*Unidades de fomento, UF*) maturing in ten years (BCU-10): This bond will no longer be issued between September and December 2005, inclusive.
* Peso-denominated bond maturing in ten years (BCP-10): The monthly issue was cut from Ch$17.5 billion to Ch$8 billion, extending the period of the current series to May 2007.

September

1 The Board accepted the Fiscal Agency entrusted to the Central Bank of Chile through executive decree 967 issued by the Ministry of Finance (17 August 2005), to represent and act on behalf of the Trasury in issuing and managing bonds issued by the Chilean Treasury expressed in indexed units of account (*Unidades de fomento, UF*) and payable in pesos, as per the terms and conditions established therein.

In fulfillment of its role as Fiscal Agency, the Central Bank of Chile agreed to place, through auctions or over-the-counter sales, two issues of Treasury bonds, expressed in UFs, maturing in ten and 20 years (BTU-10 and BTU-20), for no more than UF11 million each, and to buy back and pay said bonds, upon maturity, using funds deposited for this purpose by the Treasury, no later than the banking day prior to the date scheduled for the respective payment, in the special current account in the Central Bank of Chile.

1 The Central Bank's Board decided to extend from 7 December 2005 to 3 March 2006, the period during which the Clearing House for Checks and Other Securities in domestic currency can daily and separately process, through swaps, compensation or cashing, chits and other demand documents, in Chilean pesos, presented to it and whose individual value is Ch$50 million or more.

In addition, the Bank authorized until 9 December 2005, the individual payment of the corresponding amounts by the respective debtor institution of chits and other demand documents worth Ch$50 million or more presented to the clearing house, through the RTGS system.

8 At its monthly monetary policy meeting, the Central Bank's Board increased the MPR by 25 basis points, to 4% per annum.

22 The form of payment for debt instruments issued by the Central Bank of Chile, payable in Chilean pesos and deposited in the central securities deposit (*Depósito central de valores, DCV*), whose beneficiaries were non-bank entities, was replaced. The new payment method involves deposits in the Bank's current account that refer to the DCV for this purpose, through transfers carried out by the Central Bank of Chile in the RTGS. Thus, the system became more uniform and payments can be made more quickly and securely.

October

11 At its monthly monetary policy meeting, the Central Bank's Board increased the MPR by 25 basis points, to 4.25% per annum.

13 The Central Bank of Chile and the Superintendency of Banks and Financial Institutions announced proposed regulations on the issue of and operations with non-bank credit cards and invited those interested to send their comments through the means established on the Central Bank website, before 14 November 2005. This proposal arose as part of the review of current regulations on the issue of and operation with credit cards, considering recent developments in terms of payment means. Their use has increased in recent years with the arrival of new issuers and more affiliates.

20 Matching regulations governing banks, financial firms and savings and credit cooperatives were changed, to simplify requirements, make compliance more flexible and facilitate their liquidity management. These changes, in effect since the matching period that began on 9 November 2005, consisted of: i) changing the matching requirement, by calculating it using a difference of one month, that is, applying the matching requirement on average deposits, loans and obligations from the previous month to the matching month, instead of using the average for the same monthly period, and ii) the elimination of the requirement to have on hand from the 9 to 23 of each month, inclusive, an average reserve no less than 90% of the amount required for this same period.

November

3 The Bank empowered financial institutions to operate with local market derivatives based on Chilean Treasury bonds, making the corresponding changes to Chapter III.D.1 in the *Compendium of Financial Regulations*.

10 At its monthly monetary policy meeting, the Central Bank's Board increased the MPR by 25 basis points, to 4.5% per annum.

24 Regulations governing the interbank operations clearing house in Chilean pesos were amended to specify that from then on, this system will function as a support system to the management of operating contingencies that may eventually arise from any of the other interbank payment systems. As an exceptional procedure, a resolution from the General Manager of the Central Bank of Chile is required to make use of this possibility.

28 The General Manager approved the operating regulation for special deposit accounts for the extraordinary settlement of high-value payment clearing houses (*Reglamento operativo de las cuentas especiales de depósito para la liquidación extraordinaria de las cámaras de compensación de pagos de alto valor*) containing operating instructions for constituting and maintaining funds available to ensure the final settlement of the net results of the high-value clearing house operated by *Combanc* within the RTGS system.

December

2 The General Manager authorized implementation of the interbank operations clearing house (*Cámara de compensación de operaciones interfinancieras*) in domestic currency, as a support

system to cover contingencies, during the period from 9 December 2005 to 3 March 2006, inclusive. Moreover, he defined the times at which the clearing house must settle the net results of its operating cycles in the RTGS system.

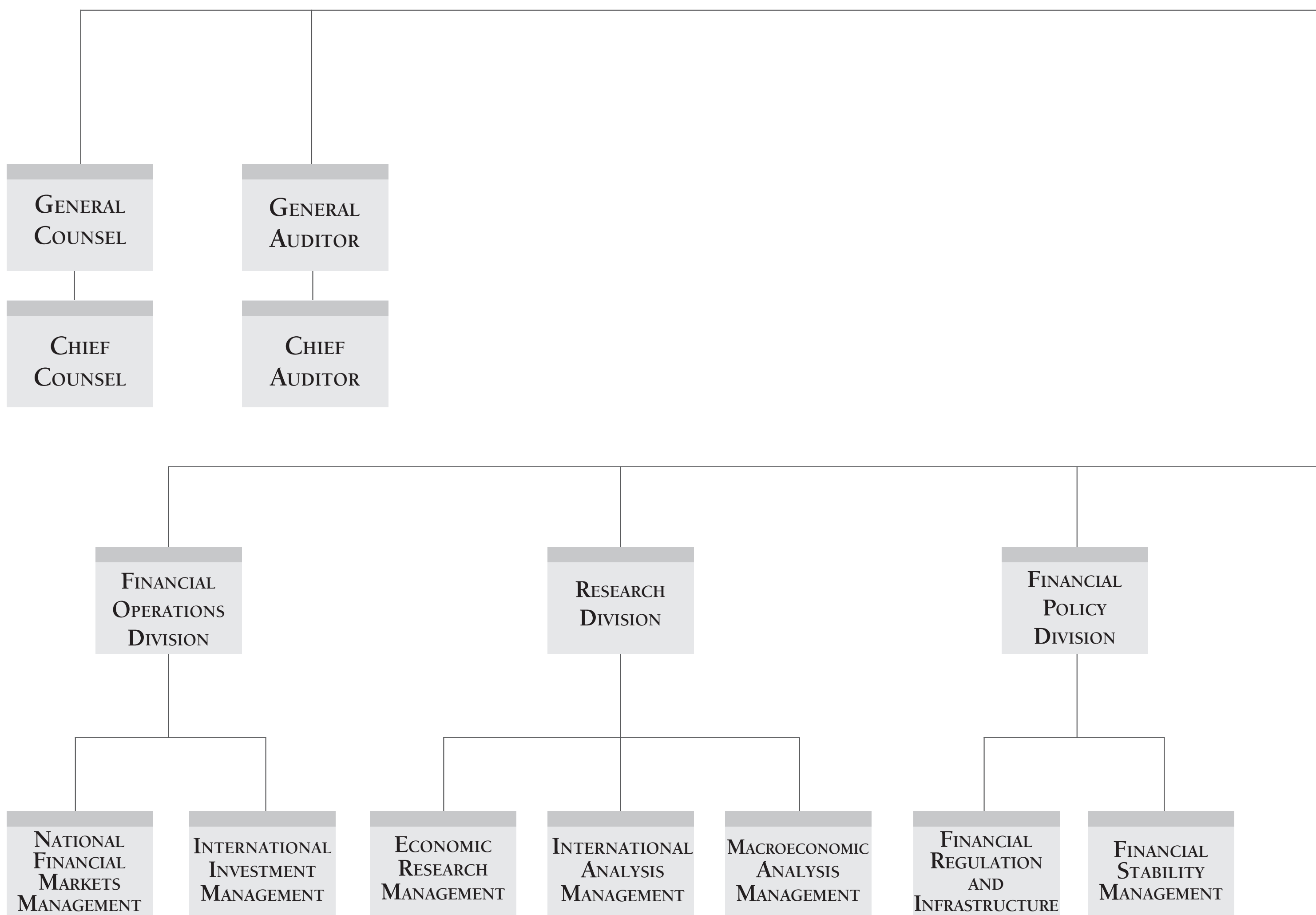
20 The Central Bank's Board set the limit on investment abroad that applies to insurance and reinsurance, general and life insurance companies, at 20% of technical reserves and risk equity, thereby maintaining the previous margin, which is the maximum allowed under current legislation. This will be in effect until 31 December 2006.

Moreover, the Board changed the Appendix in Chapter I of the *Compendium of Foreign Exchange Regulations*, to establish the annual correction factor applicable to the reference currency basket used to calculate the "reference dollar", for the period from 10 January 2006 to 9 January 2007, inclusive.

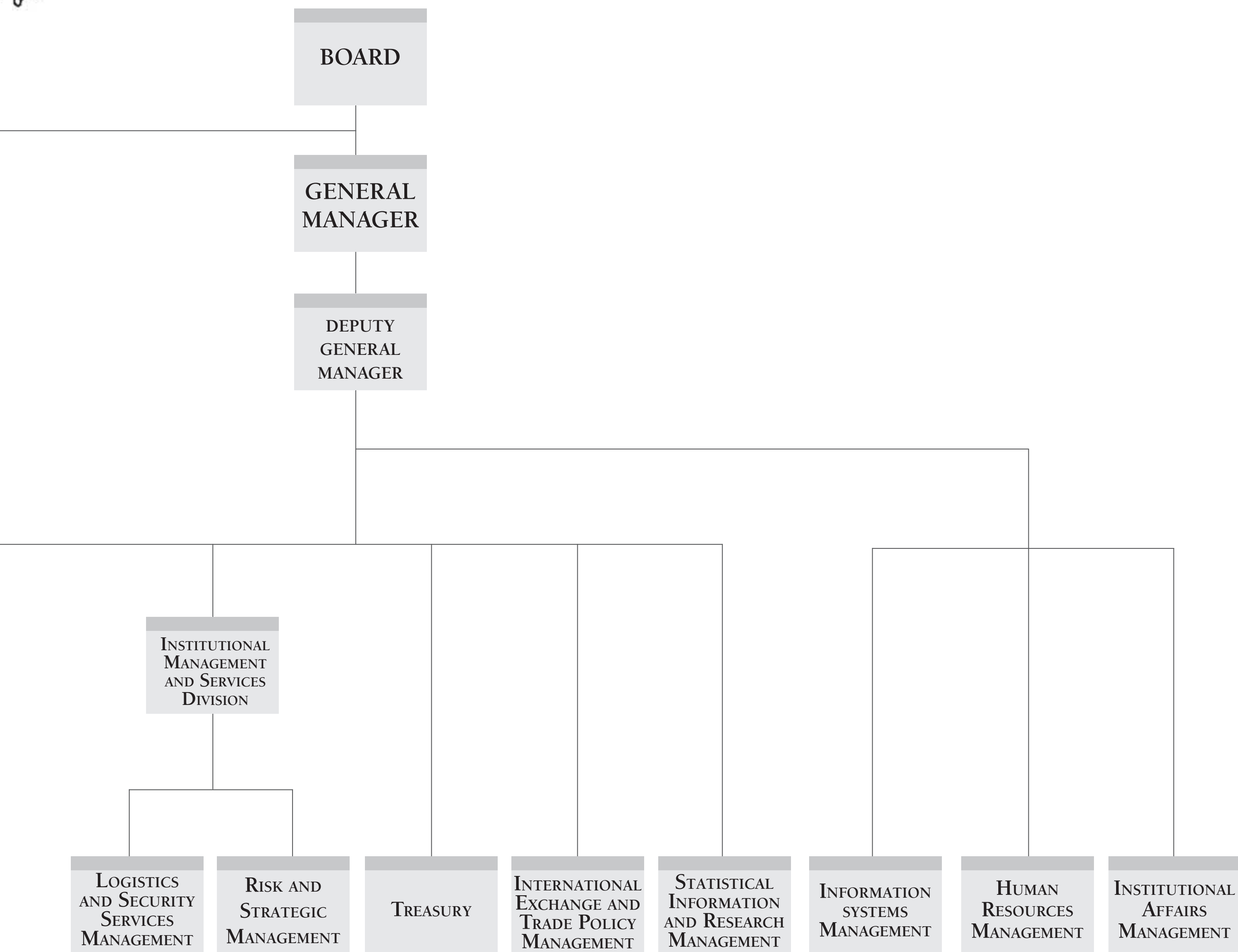
29 The General Manager changed the operating regulations for the RTGS system (*Chapter III.H.4.1, Compendium of Financial Regulations*), to change the requirements for the daily operating cycle in line with the authorization to function granted to the interbank operations clearing house (*Cámara de compensación de operaciones interfinancieras*) in domestic currency, and to establish the tariffs applicable to RTGS system participants in 2006.

Glossary

Foreign debt with a short-term residual maturity:	Payments and amortization of foreign debt due in the next 12 months.
AntiREPO:	PDBC sale within the period of monetary contraction (normally one day). To drain liquidity from banks in short-term liquidity correction operations.
BCD:	Central Bank of Chile bonds expressed in US dollars.
BCP:	Central Bank of Chile bonds in pesos.
BCU:	Central Bank of Chile bonds in indexed units of account, UFs.
CERO-UF:	Optional indexed coupons expressed in indexed units of account, UFs.
CERO-US$:	Optional indexed coupons expressed in US dollars.
PDBC:	Discountable promissory notes of the Central Bank of Chile.
PRC:	Central Bank of Chile indexed promissory notes payable in coupons.
PRD:	Central Bank of Chile indexed promissory notes in US dollars.
REPO:	Purchase of credit securities using a buy-back agreement to provide banks with collateralized liquidity.
SWAP:	Purchase of foreign currency using a buy-back agreement, to inject liquidity in Chilean pesos into the banking system, guaranteed by this currency.
Unidad de Fomento (UF):	An inflation-indexed unit of account.
ZERO:	The stock code for CERO-US$.



III. Organizational structure


BOARD
GENERAL MANAGER
DEPUTY GENERAL MANAGER
INSTITUTIONAL MANAGEMENT AND SERVICES DIVISION
LOGISTICS AND SECURITY SERVICES MANAGEMENT
RISK AND STRATEGIC MANAGEMENT
TREASURY
INTERNATIONAL EXCHANGE AND TRADE POLICY MANAGEMENT
STATISTICAL INFORMATION AND RESEARCH MANAGEMENT
INFORMATION SYSTEMS MANAGEMENT
HUMAN RESOURCES MANAGEMENT
INSTITUTIONAL AFFAIRS MANAGEMENT

IV. Financial statements of the Central Bank of Chile

Balance sheets as of 31 December 2005 and 2004

(Millions of Chilean pesos)

Assets	2005	2004
Foreign assets	**8,848,388.7**	**9,433,654.1**
Reserve assets	**8,722,739.3**	**9,289,040.3**
Monetary gold	1,714.3	1,743.8
Special drawing rights (SDR)	27,051.8	30,525.0
Reserve position in the IMF	97,078.7	258,457.4
Foreign currencies	8,581,670.9	8,987,063.9
Other assets	15,223.6	11,250.2
Other foreign assets	**125,649,4**	**144,613.8**
Shares and contributions to the IDB	94,742.2	106,860.9
Bank for International Settlements (BIS) shares	30,907.2	37.752.9
Domestic assets	**3,530,016.7**	**5,536,736.6**
Domestic loans	3,530,016.7	5,536,736.6
Loans to state-owned companies	1,963.5	3,553.9
Loans to *Banco del Estado de Chile*	4,667.4	386,772.8
Loans to commercial banks	415,371.1	710,143.3
Loans to other institutions	492,279.9	468,013.4
Treasury transfers (Laws 18,267, 18,401 and 18,768)	1,669,061.1	3,000,444.0
Loan for subordinated obligations of financial institutions (Laws 18,401 and 19,396)	946,673.7	967,809.2
Other assets	**1,156,730.4**	**439,657.7**
Bank premises and equipment, net	16,691.5	17,317.5
Other securities	410,853.3	422,340.2
Foreign currency purchased with resell agreement	729,185.6	-
Total assets	**13,535,135.8**	**15,410,048.4**

The accompanying notes 1 to 19 are an integral part of these financial statements.

Liabilities	2005	2004
Foreign liabilities	**183,423.0**	**222,723.1**
Reciprocal loan agreements	8,493.4	9,211.6
Loans	251.3	472.1
Accounts with international organizations	84,624.5	103,186.3
Special drawing rights (SDR) allocations	90,053.8	109,853.1
Domestic liabilities	**14,985,115.1**	**16,408,820.7**
Monetary base	2,928,143.3	2,413,040.6
Banknotes and coins in circulation	2,466,319.2	2,220,533.4
Deposits from financial institutions (domestic currency)	193,424.1	192,507.2
Deposits for technical reserves	268,400.0	-
Deposits and obligations	**1,785,163.1**	**1,472,353.2**
Deposits and obligations with the Treasury	139,436.5	205,758.5
Other deposits and obligations	1,645,726.6	1,266,594.7
Instruments issued by Central Bank of Chile	**10,271,808.7**	**12,523,426.9**
Indexed promissory notes payable in coupons (PRC)	2,508,826.1	3,268,057.9
Central Bank discountable promissory notes (PDBC)	1,937,600.0	1,693,860.0
Central Bank bonds in Chilean pesos (BCP)	1,677,283.0	1,988,195.6
Central Bank bonds in UF (BCU)	1,609,467.4	1,313,389.6
Central Bank bonds in US dollars (BCX)	1,225,687.4	1,472,511.3
Indexed coupons (CERO) in UF	756,676.3	852,229.7
Central Bank bonds expressed in US dollars (BCD)	414,611.1	1,320,436.9
Commercial notes from redenomination of foreign debt securities	81,624.5	82,895.5
Promissory notes indexed in US dollars (PRD)	58,949.7	409,342.6
Other	1,083.2	1,802.5
Indexed coupons (CERO) in US dollars	-	120,705.3
Other liabilities	790,509.6	64,039.7
Provisions	6,869.4	8,353.4
Other securities	129.9	190.3
Temporary liabilities	55,259.4	55,496.0
Creditors on foreign currency purchased with resale agreement	728,250.9	-
Capital and reserves	**(2,423,911.9)**	**(1,285,535.1)**
Capital	(1,285,535.1)	(578,474.0)
Deficit for the year	(1,138,376.8)	(707,061.1)
Total liabilities	**13,535,135.8**	**15,410,048.4**

The accompanying notes 1 to 19 are an integral part of these financial statements.

Statements of income for the years ended as of 31 December 2005 and 2004

(Millions of Chilean pesos)

Operating results	2005	2004
Operating income	**889,131.6**	**956,821.7**
Interest received and accrued	463,602.1	431,538.3
Readjustments received and accrued	58,028.9	38,431.4
Income on price differences	149,545.3	143,110.3
Foreign exchange rate income	217,383.5	343,416.8
Other operating income	571.8	324.9
Operating expenses	**(2,064,811.9)**	**(1,666,682.5)**
Interest paid and accrued	682,221.2	732,998.7
Indexation paid and accrued	149,720.4	54,538.4
Loss due to price differences	70,101.3	60,246.2
Foreign exchange rate losses	1,156,287.8	811,962.8
Other operating expenses	6,481.2	6,936.4
Gross margin	(1,175,680.3)	(709,860.8)
Other operating expenses	**(25,332.3)**	**(26,060.7)**
Personnel expenses	16,686.5	16,703.5
Administrative expenses	6,571.7	7,253.2
Depreciation, amortization and write-offs	1,608.5	1,612.2
Taxes and contributions	465.6	491.8
Income before provisions and write-offs	(1,201,012.6)	(735,921.5)
Provisions and write-offs	-	60.5
Net margin (Total operating results)	(1,201,012.6)	(735,861.0)
Non-operating results	**920.7**	**761.6**
Non-operating income	920.8	787.3
Non-operating expenses	(0.1)	(25.7)
Income before price-level restatement	(1,200,091.9)	(735,099.4)
Price-level restatement	**61,715.1**	**28,038.3**
Deficit for the year	**(1,138,376.8)**	**(707,061.1)**

The accompanying notes 1 to 19 are an integral part of these financial statements.

Notes to the Financial Statements

1. Description of business

The Central Bank of Chile was established on 21 August 1925 by Decree Law 486. The Bank is an autonomous organization entity of technical nature, full legal capacity, its own assets and indefinite duration, created in accordance with Sections 108 and 109 of the Political Constitution of Chile and ruled by the Basic Constitutional Act contained in Article One of Law 18,840 and its modifications.

The Bank's objective is to look after stability of the currency and the normal functioning of domestic and foreign payments.

In order to meet its objectives, the Bank regulates the amount of money and credit in circulation and executes credit operations and international exchange, such as, dictating regulations on monetary credit, and financial and international exchange matters. Additionally, the Bank is exclusively empowered to issue banknotes and to mint coins.

2. Summary of significant accounting policies

a) Basis of preparation of the financial statements

The financial statements have been prepared in conformity with generally accepted accounting principles in Chile ("Chilean GAAP") and regulations issued by the Board of the Central Bank of Chile, upon approval by the Chilean Superintendency of Banks and Financial Institutions, as established in Section 75 of the Basic Constitutional Act of the Central Bank of Chile. These policies are consistent with Chilean GAAP, except for the method used in recording losses on subordinated loan obligations, which is explained in letter g) below.

The presentation of these financial statements is within an economic and accounting framework that provides an understanding of the financial and accounting position of the Bank and, at the same time, contributes to the economic analysis of the Bank's operations by clearly identifying whether they are undertaken by domestic or foreign agents. From this information it is possible to determine the Bank's share in the domestic supply of monetary assets and credit and the related effects on the Bank's foreign indebtedness position. For this reason the economic concepts of international reserves and currency issuance are shown under the captions Reserve Assets and Liabilities and Currency Issuance, respectively. Therefore, and especially considering the unique operating features of the Bank, the statement of cash flows is not presented. Instead, notes to the financial statements containing the Monetary Base Change and another detailing the International Asset Reserve Change (note 14) are disclosed.

For comparative purposes, the 2004 figures have been restated according to changes in the Chilean consumer price index for the period between 30 November 2004 and 30 November 2005, amounting to 3.6%.

b) Assets and liabilities and foreign currency

Assets and liabilities denominated in foreign currency are translated to Chilean pesos at the "observed US dollar" exchange rate pursuant to Section 44 of the Basic Constitutional Act, that governs the Bank, referred to under No. 6 of Chapter I in the "General Provisions" of the *Compendium of Foreign Exchange Regulations* (*Compendio de Normas de Cambios Internacionales*).

Assets and liabilities stated in minted Chilean gold, are valued at the average London morning quotation of the "Gold Fixing" rate (US dollars per fine troy ounce), for all business days in the preceding quarter, less 10%.

Settlement of foreign currencies other than US dollars is made at the exchange rates published daily by Central Bank of Chile, in the *Official Gazette*, which are always based upon the "observed US dollar" rate.

The principal exchange rates used as of each year-end are as follows:

	2005 Ch$	2004 Ch$
United States dollar (Observed exchange rate)	514.21	559.83
Pound Sterling	886.26	1,072.88
Euro	608.60	759.71
Special Drawing Rights (SDR)	734.94	866.53

c) Shares and contributions to the Inter-American Development Bank (IDB) and contributions to the International Monetary Fund (IMF).

Shares issued by and contributions made to the IDB, and contributions to the IMF, on behalf of the Chilean Treasury, are valued at acquisition or contribution cost plus restatements, where applicable.

The accounting treatment of the previously mentioned shares and contributions is in conformity with Article 3 of DL 2,943 dated 1979, published in *Official Gazette* on 16 November of the same year, according to which such shares and contributions, as well as the documents evidencing them, must be recorded for the accounting purposes of the Central Bank of Chile as investments with a charge to own resources.

Shares and contributions to IDB are shown under Other Foreign Assets. Contributions to the IMF are recorded under Foreign Reserve Assets.

d) Bank for International Settlements (BIS) Shares

During 2003, Board resolutions 1073-04-030710 and 1084-02-030916, authorized the incorporation of the Central Bank of Chile as a member of the Bank for International Settlements (BIS). On 26 September 2003, in accordance with these resolutions, the Central Bank of Chile acquired 3,000 shares of the BIS for SDR 42,054,000, which are valued at acquisition cost and are shown under Other Foreign (Assets. During the year dividends were received in the amount of US$1.0 million (US$0.5 million in 2004).

e) Financial investments

Foreign financial investments including interest receivable are shown under Foreign Currency in Reserve Assets and mainly include bonds and securities issued by governments, foreign institutions and banks, which are valued at the lower of cost and market value.

f) Loans receivable and obligations

Non-indexed loans receivable and obligations are shown at original value or at their latest renewal value, except for commercial instruments purchased and discounted notes, which are shown at nominal value upon maturity. Indexed balances include accrued indexation adjustments as of the balance sheet date, and balances denominated in foreign currency include the related exchange rate adjustments.

Interest accrued at year-end on transactions with foreign residents are included under Other Foreign Assets and Other Foreign Liabilities. Interest on transactions with domestic residents are included in Domestic Assets and Domestic Liabilities, accordingly.

Interest paid and not accrued from obligations, and interest earned and not accrued from loans are shown as Transitory Assets under Other Assets or as Transitory Liabilities under Other Liabilities, according to the net balance.

g) Subordinated obligations of financial institutions

Loans for subordinate obligations included under Domestic Assets (note 9), includes restated balances as of each year-end and accumulated increases recorded and credited to income on an accrual basis, according to Law 19.396.

Accounting losses arising from changes in payment terms of the subordinated debt from the banks *BHIF, Internacional, Concepción* and *Santiago*, have been deferred in conformity with Article 19 of Law 19,396 which states: "Any losses incurred by the Central Bank of Chile in its capacity as creditor of a subordinated obligation may be deferred and absorbed by any surpluses generated in future periods. To this effect, the Central Bank of Chile is entitled to allocate such surplus to set up provisions to absorb any such losses ".

As of 31 December 2005, deferred losses amounted to Ch$407,019.5 million (Ch$407,01.5 million in 2004) and are shown under "Other securities" in "Other Asset Accounts". During 2005 and 2004 no provisions have been made for this concept.

h) Loan provisions

The Bank has not established any loan provisions in 2005 and 2004. As of 31 December 2005 no provisions have been recorded for this concept, whereas in 2004 the balance of these provisions amounted to Ch$9,702.5 million and is disclosed deducting the related assets.

During 2005, write-offs were made with a charge to provisions established in 1989 in the amount of Ch$8,602.1 million (Ch$8.1 million in write-offs and Ch$60.5 million of recovery in 2004).

i) Bank premises and equipment

Bank premises and equipment at each year-end are shown at cost plus price-level restatement, net of accumulated depreciation under "Other Assets". Depreciation has been calculated using the straight-line method based on the estimated useful lives of assets.

j) Staff severance indemnities

Staff severance indemnities have been determined using the present value method (accrued cost of the benefit), with an annual interest rate of 6%. The total amount of the provision as of year-end is Ch$5,836.3 million (Ch$7,330.1 million in 2004).

k) Vacation accrual

The annual cost of employee vacations is recognized in the financial statements on an accrual basis.

l) Price-level restatement

Capital, Bank premises and equipment and other assets and liabilities have been price-level restated in accordance with changes in the Chilean Consumer Price Index (CPI). Income statement account balances in local currency, except for depreciation and price-level restatement, have not been restated for inflation. The effect of the application of price-level restatement originated a net credit to income of Ch$61,715.1 million in 2005 (Ch$28,038.3 million in 2004).

The effect of foreign currency translation on assets and liabilities denominated in foreign currencies and indexation on loans and liabilities is included under Operating results, separate from price-level restatement.

3. Relevant events

As stated in resolution 1211E-01-050812, the Board of the Central Bank of Chile accepted the resignation of the General Manager Mr. Camilo Carrasco Alfonso, effective 31 August 2005. Mr. Camilo Carrasco was assigned to this position through resolution 328-02-931223, on 1 February 1994. In his replacement, through resolution 1211E-02-050812, the Board assigned Mr. Enrique Marshall Rivera, who assumed the position on 1 September 2005.

Through resolution of the Board 1237E-01-051222, the Bank's Board accepted the resignation of Mr. Enrique Marshall Rivera from the position of General Manager, due to his assignment by executive decree 1,534 (Ministry of Finance), dated 22 December 2005, to the position of Board Member of the Central Bank of Chile, as of 23 December 2005, taking over for Ms. María Elena Ovalle Molina, whose assignment as Board Member expired on 6 December 2005.

Taking over for Mr. Enrique Marshall Rivera, through resolution 1237E-01-051222, the Board assigned Mr. Leonardo Hernández Tagle, as the Interim General Manager, as of 23 December 2005.

4. Reserve assets

Reserve assets include international reserves held by the Bank, detailed as follows:

	(US$ million)	
	2005	2004
Monetary gold	3.3	3.0
Special drawing rights (SDR)	52.6	52.6
Reserve position in the IMF	188.8	445.6
Foreign currencies:		
Coins and deposits	8,900.4	7,604.1
Bonds issued by governments, organizations and foreign banks	4,105.6	5,824.0
Commercial papers	-	972.4
Foreign government treasury bills	3,042.2	712.7
Floating rate bills	640.9	282.0
Other foreign investment instruments	-	100.2
Other assets:		
Reciprocal loan agreements	29.6	19.4
Total reserve assets	**16,963.4**	**16,016.0**

5. Domestic loans to banks, financial institutions and other institutions or companies

Domestic loans to banks, financial institutions and other institutions or companies, which amounted to Ch$914,281.9 million (Ch$1,568,483.4 million in 2004), mainly include the following :

	(Millions of Ch$) 2005	2004
Receivables from *Corfo* (note 6)	1,124.7	1,329.9
Credit line on debt restructuring	11,946.2	17,897.6
Liquidity credit lines	-	39,373.0
Credit lines to finance the sale of mortgage portfolio of former *Anap*	10,593.8	20,548.6
Credit lines for programs of international organizations	838.8	2,017.3
Credit lines for deposits, Resolution 1,686	-	239.0
Former *Caja Central de Ahorros y Préstamos* and former *Anap* (note 7)	492,279.9	468,013.4
Purchase of Central Bank of Chile promissory notes with resale agreement	397,498.5	1,018,857.6
Other	-	207.0
Total	914,281.9	1,568,483.4

6. Accounts receivable from *Corporación de Fomento de la Producción*

Balances receivable from *Corporación de Fomento de la Producción (Corfo)*, in accordance with Law 18,401 dated 1985 and its modifications, and Law 18,577 dated 1986, relate to loans granted to financial institutions that were sold by the Central Bank of Chile to *Corfo* in order to finance the acquisition, on behalf of third parties, of shares of these financial institutions.

Corfo amortizes its debt by transferring securities that it recovers from shareholders, for the assignment of shares of the corresponding financial institutions. As of 31 December 2005, accounts receivable from *Corfo* amount to Ch$1,124.7 million (Ch$1,329.9 million in 2004), and is included under Loans to state-owned companies.

In accordance with Article 13 of Law 18,401, differences produced in the recovery, as a result of discounts granted to shareholders of up to UF15 million, will be covered by the Treasury through future transfers (note 8) which as of 31 December 2005 amounted to Ch$204,826.3 million, equivalent to UF11.4 million (Ch$204,434.9 million in 2004, equivalent to UF11.4 million). Based on the available information, the maximum transfer amount established by law is deemed adequate to absorb the discounts.

Likewise, the Central Bank of Chile in conformity with Article 13 of Law 18,401, requested to the Superintendency of Banks and Financial Institutions the previous report mentioned in that legal provision, for the purpose of the corresponding government transfer in the amount of UF697,630.81, referring to the shares of *Banco Internacional* that were disposed in accordance with above mentioned law.

7. *Caja Central de Ahorros y Préstamos and Asociación Nacional de Ahorro y Préstamo*

In accordance with Law 18,900 dated 16 January 1990, *Caja Central de Ahorros y Préstamos ("CCAP")* and *Asociación Nacional de Ahorro y Préstamo ("Anap")* ceased to exist and a procedure was established through which the respective equity would be liquidated and used to pay shareholders and the obligations of the institutions.

Article 5 of the aforementioned law establishes that the Treasury shall be responsible for any obligations of the *CCAP* and the *Anap* that are not covered upon liquidating shareholders' equity, the funds for which should be requested from the national budget, in conformity with Article 21 of the Decree Law 1,263 of 1975.

As of 31 December 2005, the amount payable to the Bank from the liquidation of these institutions, including accrued interest as of such date, was Ch$492,279.9 million, of which Ch$452,857.5 million relate to direct loans granted by the Bank and Ch$39,422.4 million with credit lines for international organizations programs (Ch$468,013.4 million in 2004, of which Ch$430,734.8 million relate to direct credits granted by Central Bank of Chile and Ch$37,278.6 million to credit lines for international organizations programs) and is shown under "Loans to other institutions".

8. Treasury transfers

Treasury transfers, included under Domestic Loans, are the following:

	(Millions of Ch$)	
	2005	2004
Treasury promissory notes Law 18,267	185,302.5	244,156.3
Treasury promissory notes Law 18,768	1,278,932.3	2,551,852.8
Treasury transfers Law 18,401	204,826.3	204,434.9
Total	**1,669,061.1**	**3,000,444.0**

a) Treasury promissory notes Law 18,267

In conformity with Law 18,267, the Treasury transferred Ch$100,000 million to the Bank by issuing 40 Treasury promissory notes over a 25-year term, denominated in UF with an annual interest rate of 1%, capitalized and amortized on a semiannual basis with a five-year grace period. The last installment matures on 15 December 2008.

b) Treasury promissory notes Law 18,768

This item relates to promissory notes denominated and payable in US dollars, accruing on an annual interest of Libor plus 0.5 points, of which 2% is payable semiannually and the balance is capitalized. The last installment expires on 15 December 2014. During the current year, the Bank received principal prepayments of US$1,957.1 million, and interest of US$43.1 million, which were credited to income (in 2004 US$488.2 million for principal and US$12.1 million for interest).

Law 20,083 on public sector budgets for 2006 was published in the *Official Gazette* on 29 November 2005. Article 18 of this law states:

"Article 18°. The President of the Republic is authorized to substitute the promissory notes issued by virtue of Article 75 of Law 18,768, through one or more executive decrees from the Ministry of Finance, for other documents or bonds issued by the Treasury, the expiration period of which will be equal to or less than the expiration of debt referred to in Law 18,358. The substitution procedure, interest rate, and other characteristics, conditions and types of those instruments will be determined in the respective decree.

Upon substitution of those promissory notes indicated in the preceding subparagraph or upon assumption of obligations with the purpose of prepaying debt indicated in Law 18,358 and its modifications, interest rate or foreign currency exchange contracts may be entered into for the resulting liabilities. The sum of amounts involved in exchange contracts cannot exceed the total amount of related liabilities.

c) Treasury transfer Law 18,401

The balance of this account relates to discounts of up to UF15 million, as indicated in Article 13 of Law 18,401, that have been granted to shareholders who are subject to the aforementioned law, as explained in note 6.

Also in conformity with this law, Treasury transfers will be completed in a period not exceeding 30 years, with a 10-year grace period, beginning on the date of final determination of the total amount.

9. Subordinated obligation

The balances as of each year-end represent a subordinated obligation of *Banco de Chile* with the Bank as established in the agreement amending payment terms dated 8 November 1996, in accordance with the provisions of Law 19,396. On that date, the parent company of *Banco de Chile*, formerly Banco de Chile, agreed to transfer the obligation to *Saos S.A.* (*Sociedad Administradora de la Obligación Subordinada*), based on paragraphs three and five of the aforementioned law. Consequently, the obligation must be paid in 40 annual, consecutive and equal installments beginning in April 1997.

10. Banknotes and coins in circulation

Banknotes and coins in circulation are recorded at face value. The costs of printing and coining are recorded as operating expenses.

The distribution of banknotes and coins in circulation as of 31 December is as follows:

	(Millions of Ch$)	
Denomination	2005	2004
20,000	540,620.1	467,951.4
10,000	1,417,782.3	1,266,635.0
5,000	214,358.3	202,667.7
2,000	71,059.3	66,894.0
1,000	95,083.2	94,595.3
500	4,910.8	5,226.6
Coins	122,505.2	116,563.4
Total	**2,466,319.2**	**2,220,533.4**

11. Deposits and loan obligations

Other deposits and loan obligations include the following items:

	(Millions of Ch$) 2005	2004
Foreign currency current accounts	374,477.6	79,754.7
Deposits in foreign currency, Resolutions 1,657 and 1,686	1.2	133.1
Short-term deposits	1,271,070.1	1,186,467.9
Current accounts in domestic currency	177.7	239.0
Total	**1,645,726.6**	**1,266,594.7**

12. Maturities of instruments issued by the Central Bank of Chile, as of 31 December 2005 and 2004

(Millions of Ch$)

Type of document	Up to 90 days	91 to 180 days	181 days to 1 year	over 1 year to 3 years	Over 3 years	Total 2005	Total 2004
Indexed promissory notes payable in coupons (PRC)	190,970.1	161,900.5	283,958.6	913,572.8	958,424.1	2,508,826.1	3,268,057.9
Central Bank discountable promissory notes (PDBC)	1,937,600.0	-	-	-	-	1,937,600.0	1,693,860.0
Central Bank bonds in Chilean pesos (BCP)	33,803.5	178,379.5	164,970.0	680,780.0	619,350.0	1,677,283.0	1,988,195.6
Central Bank bonds in indexed units UF (BCU)	22,927.3	1,620.2	-	731,116.4	853,803.5	1,609,467.4	1,313,389.6
Central Bank bonds in US dollars (BCX)	320,867.0	313,478.9	591,341.5	-	-	1,225,687.4	1,472,511.3
Indexed coupons (CERO) in UF	25,674.1	22,986.3	36,968.0	154,083.7	516,964.2	756,676.3	852,229.7
Central Bank bonds expressed in US dollars (BCD)	8,385.2	-	-	406,225.9	-	414,611.1	1,320,436.9
Commercial notes from redenomination of foreign debt securities	-	4.5	81,620.0	-	-	81,624.5	82,895.5
Promissory notes indexed in US dollars (PRD)	27,952.0	30,997.7	-	-	-	58,949.7	409,342.6
Deposit certificates expressed in US dollars, Resolution 1649	19.5	-	521.3	521.3	-	1,062.1	1,780.7
Exchange differential promissory notes	21.1	-	-	-	-	21.1	21.8
Indexed coupons (CERO) in US dollars	-	-	-	-	-	-	120,705.3
Total as of 31 December 2005	2,568,219.8	709,367.6	1,159,379.4	2,886,300.1	2,948,541.8	10,271,808.7	
Total as of 31 December 2004	2.473.037,0	836.433,9	2.629.748,6	2.794.040,8	3.790.166,6		12.523.426,9

Balances include interest and adjustments accrued as of 31 December 2005 and 2004.

Transitory liabilities include net discounts granted but not accrued, net of price differences received but not accrued, generated by notes issued for Ch$55,487.7 million (Ch$55,571.3 million in 2004).

13. Capital and reserves

Changes in capital and reserve during 2005 and 2004 were as follows:

	Capital	(Millions of Ch$) Results for the year	Total
Balances as of 01 January 2004	885,786.5	(1,430,540.3)	(544,753.8)
Distribution of the 2003 deficit	(1,430,540.3)	1,430,540.3	-
Price-level restatement on equity	(13,618.8)	-	(13,618.8)
Deficit for the year	-	(682,491.4)	(682,491.4)
Balances as of 31 December 2004	(558,372.6)	(682,491.4)	(1,240,864.0)
Balances as of 31 December 2004 restated for comparison purposes	(578,474.0)	(707,061.1)	(1,285,535.1)
Balances as of 01 January 2005	(558,372.6)	(682,491.4)	(1,240,864.0)
Distribution of the 2004 deficit	(682,491.4)	682,491.4	-
Price-level restatement on equity	(44,671.1)	-	(44,671.1)
Deficit for the year	-	(1,138,376.8)	(1,138,376.8)
Balances as of 31 December 2005	(1,285,535.1)	(1,138,376.8)	(2,423,911.9)

Section 5 of the Basic Constitutional Act of the Central Bank of Chile established a start-up capital for the Bank at Ch$500,000 million (Ch$1,659,529.1 million restated as of 31 December 2005), to be paid according to Interim Article 2 of Law 18,840.

In accordance with Section 77 of the Basic Constitutional Act of the Central Bank of Chile, the deficit produced in any year will be absorbed with a charge to constituted reserves.

When there are no reserves or they are insufficient, the deficit produced in any certain period will be absorbed with a charge to paid-in capital.

As of 31 December 2005, the Bank has a capital deficit of Ch$2,423,911.9 million (deficit of Ch$1,285,535.1 million in 2004).

The negative variation in equity resulted mainly from the effects of exchange rate variations on assets in foreign currency.

14. Monetary base and international reserve asset variations

Acording to note 2 a) and in consideration of the Bank's unique operations, beginning in 2001, instead of a Statement of Cash Flows, the Bank discloses a Statement of Variations in Monetary Base and a Statement of Variations in International Reserves, further defined as follows:

Monetary Base: Bank liabilities that form part of money, or otherwise contribute to the formation of monetary aggregates including freely circulating banknotes, coins and checks issued by the Bank, plus deposits made by the financial system in the Bank.

International Reserves: Foreign assets that are readily available and controlled by monetary authorities for directly financing unbalances, indirectly regulating such unbalances through exchange market intervention and/or for other purposes.

Variations In the monetary base (Millions of Ch$)	2005	2004
Beginning balance monetary base		
increase of monetary base	2,413,040.6	2,224,061.2
Operations with international organizations	10,570.8	13,403.0
Foreign currency forward sales receivables	729,185.6	-
Domestic loans	-	336,327.2
Deposits and obligations	567,713.6	-
Notes issued	1,875,484.2	1,511,956.8
Interest and indexation paid	358,056.4	507,816.0
Technical reserve	268,400.0	-
Other assets	-	11,670.1
Operating support expenses	23,330.3	23,569.9
Total increase	3,832,740.9	2,404,743.0
Decrease of monetary base		
Domestic loans	(651,775.9)	-
Deposits and obligations	-	(220,519.1)
Other assets	(10,641.2)	-
Interest and indexation received for domestic loans	(132,289.4)	(89,771.6)
Currency exchange operations, net (1)	(2,439,080.8)	(1,851,227.6)
Total decrease	(3.233.787.3)	(2,161,518.3)
Change in monetary base	598,953.6	243,224.7
Effect of price-level restatement on		
beginning balance of monetary base	(83,850.9)	(54,245.3)
Ending balance monetary base	2,928,143.3	2,413,040.6
Currency exchange operations, net are comprised of:		
Currency exchange operations	*(2,439,080.8)*	*(2,682,809.2)*
Currency exchange operations that do not generate cash flows	*-*	*831,581.6*
Currency exchange operations, net	*(2,439,080.8)*	*(1,851,227.6)*

Variations in international reserve assets (US$ million)	2005	2004
Beginning reserves balance	16,016.0	15,851.2
Reserve increase		
Domestic loans	17.1	0.7
Deposits and obligations	2,412.9	479.5
Other obligations	1,416.3	-
Interest received for deposits and other		
investment instruments abroad	681.6	559.1
Total increase	4,527.9	1,039.3
Reserve decrease		
Notes issued	(2,510.8)	(1,001.4)
Other liabilities	(0.3)	(0.3)
Interest paid for foreign liabilities	(119.5)	(0.7)
Currency exchange operations, net (2)	(95.5)	(130.3)
Total decreases	(2,726.1)	(1,132.7)
Change in reserves during the year	1,801.8	(93.4)
Effect of exchange rate	(854.4)	258.2
Final asset reserve balance	16,963.4	16,016.0
(2) Currency exchange operations, net are as follows:		
Currency exchange transactions	*(4,357.7)*	*(4,282.3)*
Less: Currency exchange operations that do not generate cash flows		
Treasury transfers	*1,912.2*	*966.7*
BCX tender	*2,350.0*	*1,874.0*
Promissory notes exchange	*-*	*1,311.3*
Total currency exchange operations, net	*(95.5)*	*(130.3)*

15. Balances in foreign currency

Rights and obligations paid in foreign currency included in the balance sheet as of 31 December 2005 and 2004, are as follows:

	(US$ million)	
	2005	2004
Assets		
Foreign assets	17,299.5	16,123.8
Reserves	17,055.1	15,874.5
Other foreign assets	244.4	249.3
Domestic assets	2,487.2	4,400.2
Domestic loans	2,487.2	4,400.2
Other assets	2.6	12.5
Total assets	**19,789.3**	**20,536.5**
Liabilities		
Foreign liabilities	282.1	296.1
Reserves	16.5	15.9
Other foreign liabilities	90.5	90.8
Special drawing rights (SDR) allocations	175.1	189.4
Domestic liabilities	5,513.3	3,274.6
Deposits and Treasury obligations	192.5	282.5
Other deposits and obligations	2,935.1	450.2
Notes issued	2,385.7	2,541.9
Total liabilities	**5,795.4**	**3,570.7**
Net assets	**13,993.9**	**16,965.8**

16. Contingencies and commitments

There are lawsuits currently in process against Central Bank of Chile, whose outcomes according to the law department will have no material effect on equity.

17. Income taxes

Pursuant to Article 7 of Decree Law 3,345 dated 1980, the Bank's income is tax exempt.

18. Income from interest, indexation and price differences

Income generated by interest, indexation and price-differences, as of 31 December 2005 and 2004, is as follows:

	(Millions of Ch$) 2005	2004
Interest received and accrued originated from:		
Investments abroad	292,841.0	286,327.5
Treasury transfers (Laws 18,768 and 18,267)	76,585.8	66,211.5
Subordinate obligations	46,093.3	47,253.6
Other institutions	32,725.8	28,012.1
Commercial banks	14,599.6	2,680.9
Banco del Estado de Chile	499.2	912.4
Reciprocal loan agreements	257.4	140.3
Total	**463,602.1**	**431,538.3**
Indexation received and accrued related to:		
Subordinated obligations	33,452.5	21,423.0
Treasury transfers (Laws 18,401 and 18,267)	15,634.0	10,993.7
Caja Central and *Asociación Nacional de Ahorro y Préstamo*	7,478.9	4,677.1
Other	1,463.5	1,337.6
Total	**58,028.9**	**38,431.4**
Income on price differences originated from:		
Central Bank bonds in Chilean pesos (BCP)	84,654.2	71,460.7
Central Bank bonds in UF (BCU)	26,186.6	18,722.2
Central Bank bonds in US dollars (BCX)	20,306.3	9,463.1
Central Bank indexed promissory notes (PRC)	11,544.7	13,353.7
Central Bank bonds expressed in US dollars (BCD)	6,076.8	28,320.6
Indexed promissory notes in US dollars (PRD)	776.7	1,728.3
Redemption to CERO promissory notes in US dollars	-	61.7
Total	**149,545.3**	**143,110.3**

	(Millions of Ch$) 2005	2004
Interest paid and accrued from:		
Indexed promissory notes payable in coupons (PRC)	179,479.9	229,417.4
Central Bank bonds in Chilean pesos (BCP)	158,721.8	160,058.7
Central Bank bonds in US dollars (BCX)	71,486.3	23,380.5
Central Bank bonds in UF (BCU)	71,243.9	55,874.7
Foreign operations	62,723.0	61,900.4
Central Bank discountable promissory notes (PDBC)	52,627.3	45,145.0
Central Bank bonds expressed in US dollars (BCD)	34,388.1	95,031.6
Other notes issued	32,758.0	21,806.6
Indexed promissory notes in US dollars (PRD)	18,604.9	40,289.5
Reciprocal loan agreements	188.0	94.3
Total	682,221.2	732,998.7
Indexation paid and accrued from:		
Indexed promissory notes payable in coupons (PRC)	98,113.0	77,918.5
Central Bank bonds in UF (BCU)	55,185.8	27,551.0
Optional indexed coupons (CERO) in UF	28,715.4	21,006.4
Optional indexed coupons (CERO) in US dollars	(4,678.2)	6,123.6
Other notes	5,589.2	4,436.9
Central Bank bonds expressed in US dollars (BCD)	(12,493.2)	(69,915.0)
Indexed promissory notes in US dollars (PRD)	(20,711.6)	(12,583.0)
Total	149,720.4	54,538.4
Loss due to price differences corresponds to:		
Redemption to CERO promissory notes in UF	35,115.8	40,707.5
Central Bank bonds in pesos (BCP)	23,312.8	-
Indexed promissory notes payable in coupons (PRC)	6,683.7	4,566.3
Redemption to CERO promissory notes in US dollars	4,607.3	13,683.5
Other	220.4	693.3
Indexed promissory notes in US dollars (PRD)	161.3	595.6
Total	70,101.3	60,246.2

19. Subsequent events

Between 31 December 2005, and the date of issuance of these financial statements there have been no significant subsequent events that may affect them.

LEONARDO HERNÁNDEZ TAGLE
Interim General Manager

CÉSAR CARO BROWN
General Accountant

ALEJANDRO ZURBUCHEN SILVA
General Auditor

Report of independent auditors

(Translation of a report originally issued in Spanish – see note 2 a)

To the Governor and Board Members of
Central Bank of Chile:

1. We have audited the accompanying balance sheets of Central Bank of Chile (the "Bank") as of 31 December 2005 and 2004, and the related statements of income for the years then ended. These financial statements (including the related notes) are the responsibility of the management of Central Bank of Chile. Our responsibility is to express an opinion on these financial statements based upon our audits.
2. We conducted our audits in accordance with generally accepted auditing standards in Chile. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by the Bank's management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.
3. The Bank prepares its financial statements in accordance with accounting policies established by its Board with prior approval from the Chilean Superintendency of Banks and Financial Institutions (Law 18,840). These policies are in accordance with generally accepted accounting principles in Chile, except for the deferral of accounting losses of Ch$407,019.5 million in 2005 (Ch$407,019.5 million in 2004), arising from amendments to the subordinated loan obligation payment agreements of certain banks, in accordance with Law 19,396 (notes 2 g) and 9).
4. In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Central Bank of Chile as of 31 December 2005 and 2004 and the results of its operations for the years then ended, in conformity with the accounting policies described in note 2.
5. As of 31 December 2005, the Bank recorded a deficit in equity of Ch$2,423,911.9 million (Ch$1,285,535.1 million as of 31 December 2004). As in the prior year, the negative variation in equity as of 31 December 2005 is a consequence of the deficit for the year of Ch$1,138,376.8 million (Ch$707,061.1 million in 2004), which is mainly explained by the decrease in the observed exchange rate of the United States dollar and euro in 2005, and by the decrease in the observed exchange rate of the United States dollar and by variations in the exchange rates of other foreign currencies during 2004, which unfavorably affected the foreign currency asset position of the Bank.
6. As explained in note 2 g), during 2005 and 2004, the Bank did not amortize accounting losses generated by the modification of the payment conditions of the subordinated loan obligation due to the Bank had a deficit in both periods.

Enrique Aceituno A. — ERNST & YOUNG LTDA.

Santiago, Chile 16 January 2006

BANCO CENTRAL DE CHILE
Agustinas 1180, Santiago, Chile • P.O. Box 967, Santiago, Chile
Zip code 834-0454 Santiago
Tel: 56-2-670 2000 • Fax: 56-2-670 2231 • www.bcentral.cl • bcch@bcentral.cl

Photographs from Central Bank of Chile's file