



# Credit Trends in LA: The Chilean Experience

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# Contents

1. Credit growth and booms: characteristics
2. Credit trends in LA
3. Credit trends in Chile
4. Concluding remarks



# Credit growth and booms: characteristics

Credit can grow rapidly for three reasons:

- financial deepening (trend)
- normal cyclical upturns
- excessive cyclical movements (“credit booms”)



# Credit growth and booms: characteristics

## What do credit booms look like?

Credit booms in emerging market countries have five key characteristics (WEO, April 2004):

- They are much less common than episodes of rapid credit growth
- They are synchronized across countries
- They are somewhat asymmetric
- There is almost a 70 percent probability that a credit boom coincides with either a consumption or investment boom
- They are often associated with banking and currency crises



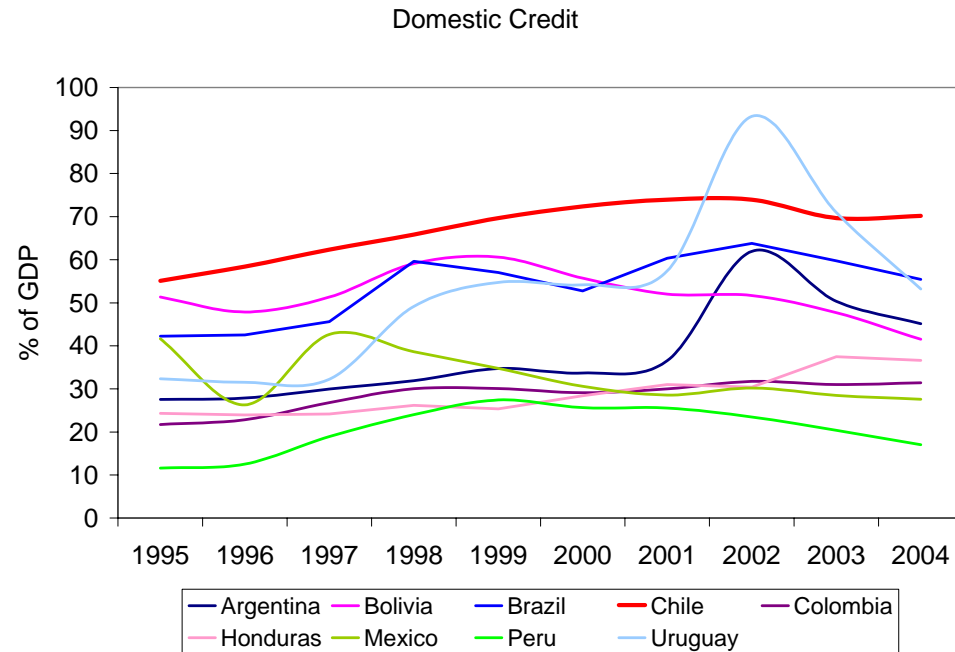
# Credit growth and booms: characteristics

- What do credit booms look like?
  - Credit booms are associated with macroeconomic fluctuations as follows:
    - Credit booms are associated with a cyclical upturn, followed by a sharp downturn, in economic activity and private absorption
    - Credit booms are associated with a rapid increase, and subsequent fall, in the price of nontradables relative to tradables
    - Credit booms are accompanied by an increase in real stock prices and a subsequent dramatic drop
    - Credit booms do not have a major effect on inflation



# Credit trends in LA

- Domestic credit in LA has showed an increasing trend in the last decade
- A key question is whether strong credit growth is part of the ongoing process of "financial deepening" or whether some countries are now experiencing a credit boom, a situation where credit is expanding at an unsustainable pace

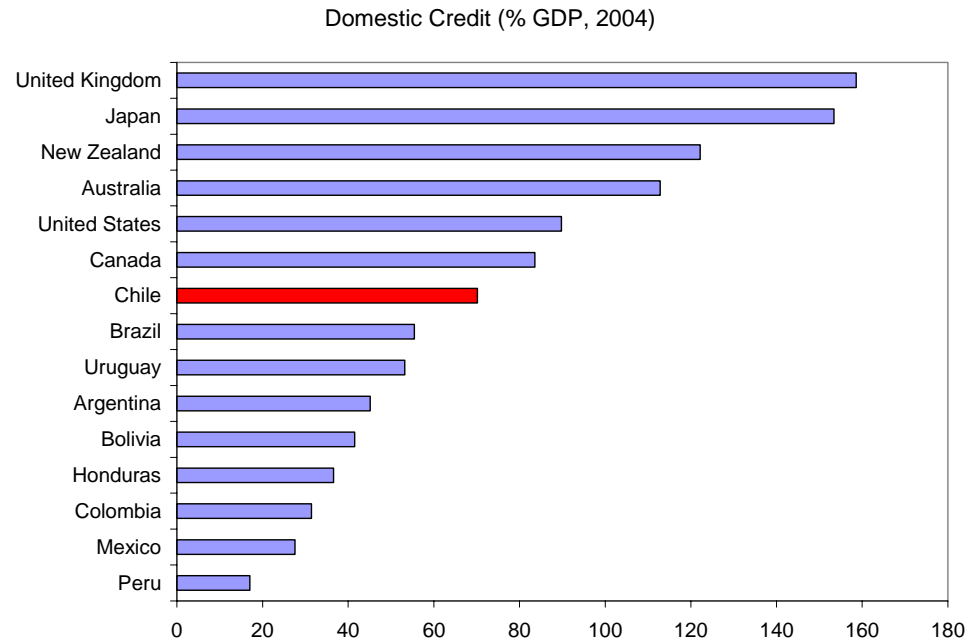


Source: IFS.



# Credit trends in LA

- Financial deepening is still relatively low in LA vis-à-vis industrialized economies (and even other groups of developing economies: East Asia, Middle East, and North Africa)
- Small and open industrialized economies such as Australia, Canada and New Zealand have much higher levels of domestic credit than the average LA country
- Japan, UK and the US also show credit-to-GDP ratios relatively high

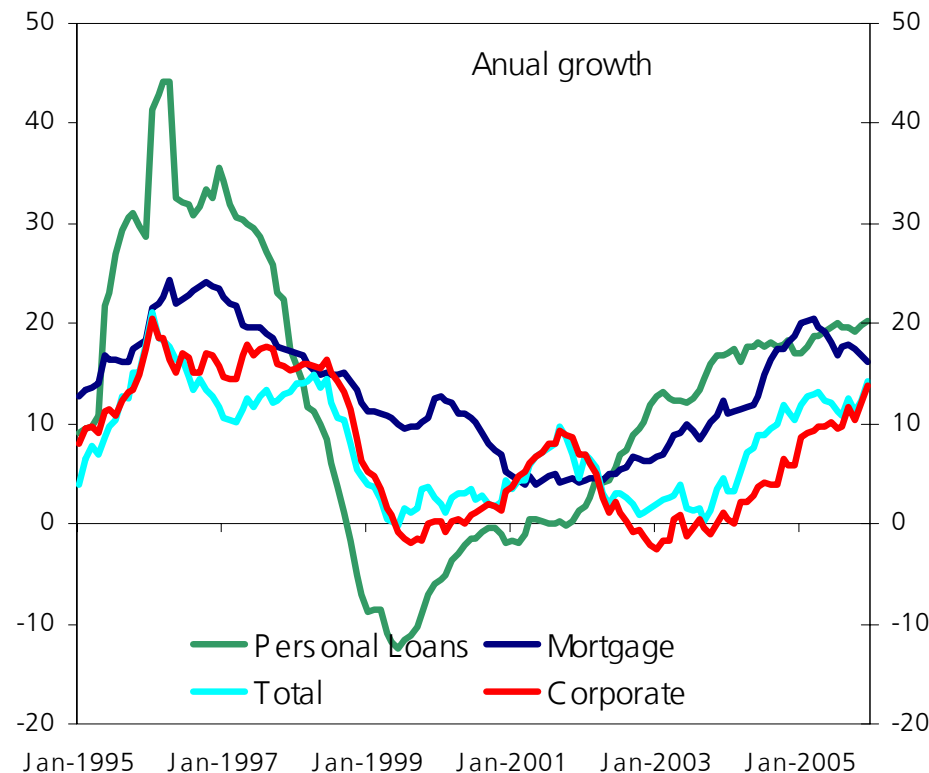


Source: IFS.



# Credit trends in Chile

- In the recent cycle, credit has increased significantly in all sectors
- But, rapid credit growth has been particularly strong in the retail and housing sectors



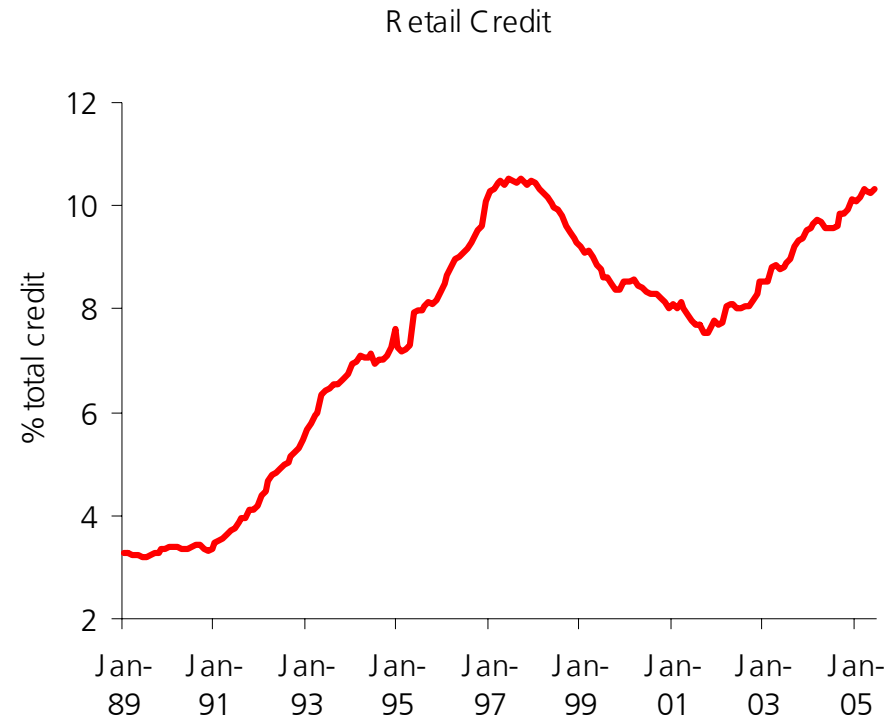
Source: SBIF.





# Credit trends in Chile

- However, the increasing trend is more associated to recovery from the last recession rather than continuous growth in credit

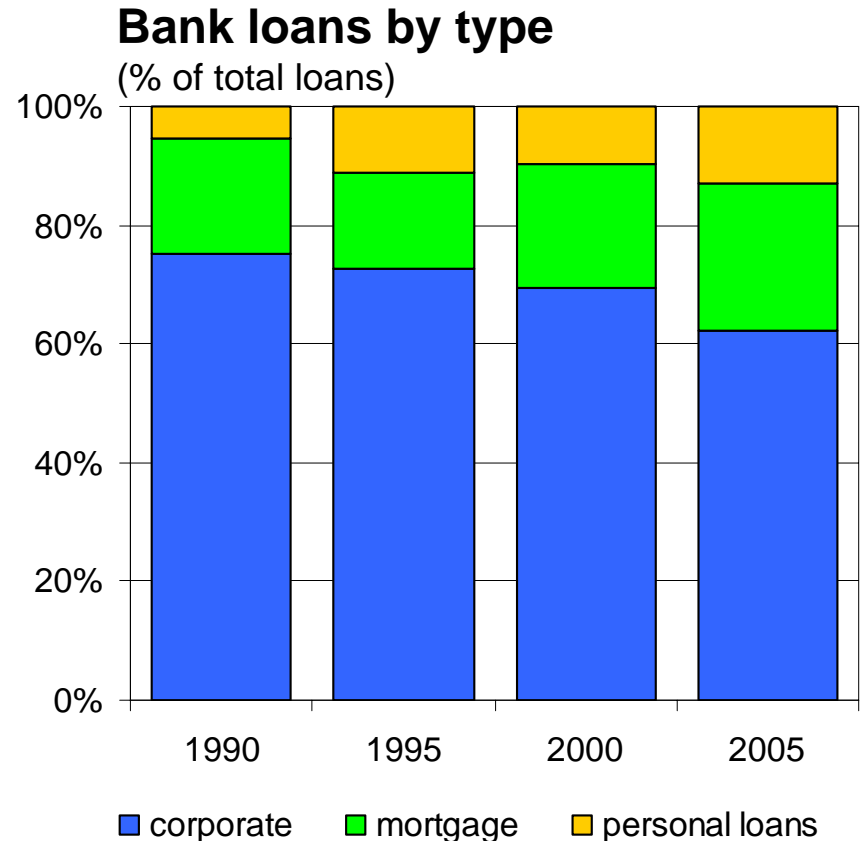


Source: SBIF.



# Credit trends in Chile

- Household credit (retail and housing) has increased its participation in recent years
- Commercial loans remain the most important source of risk

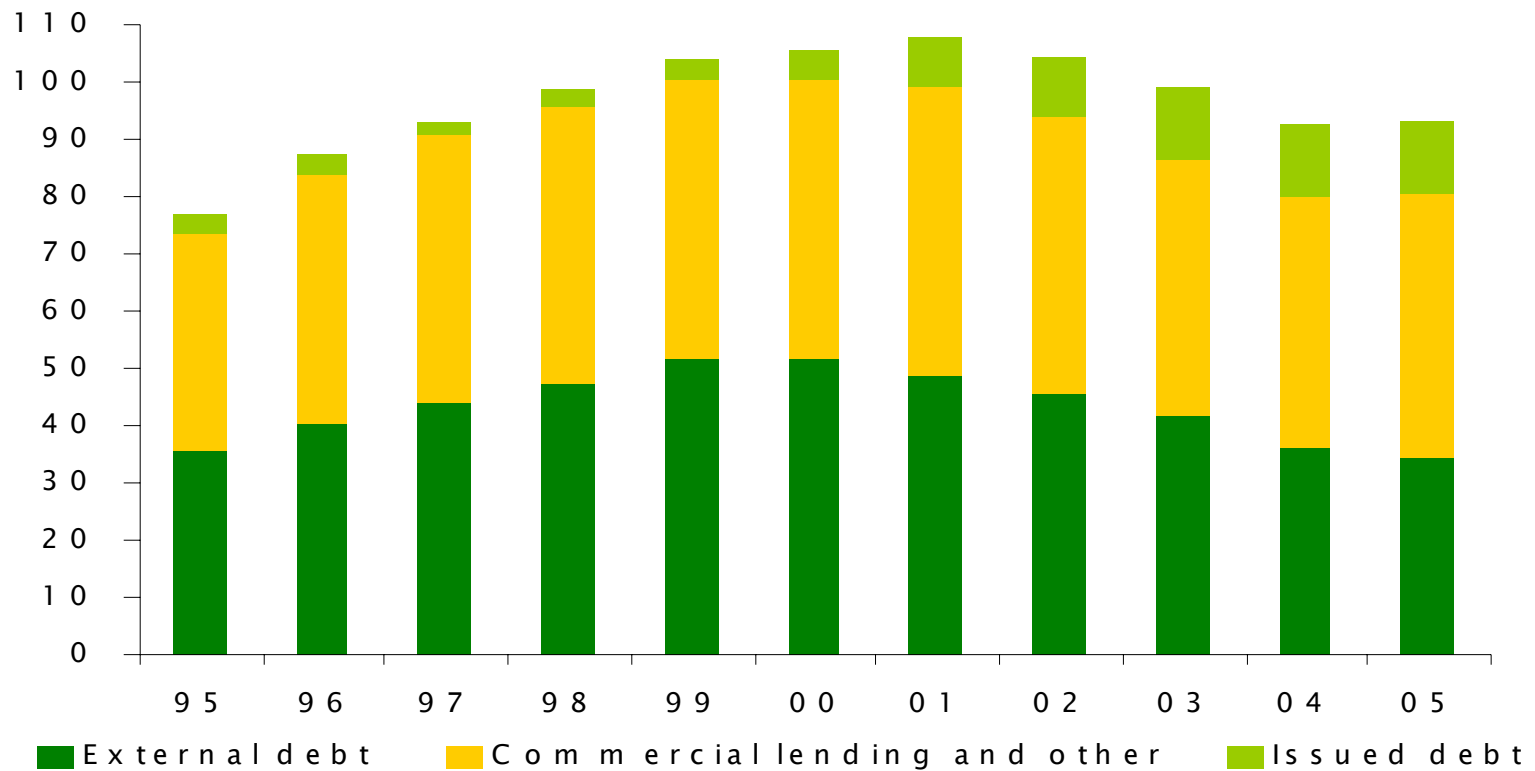


Source: SBIF.



# Credit trends in Chile

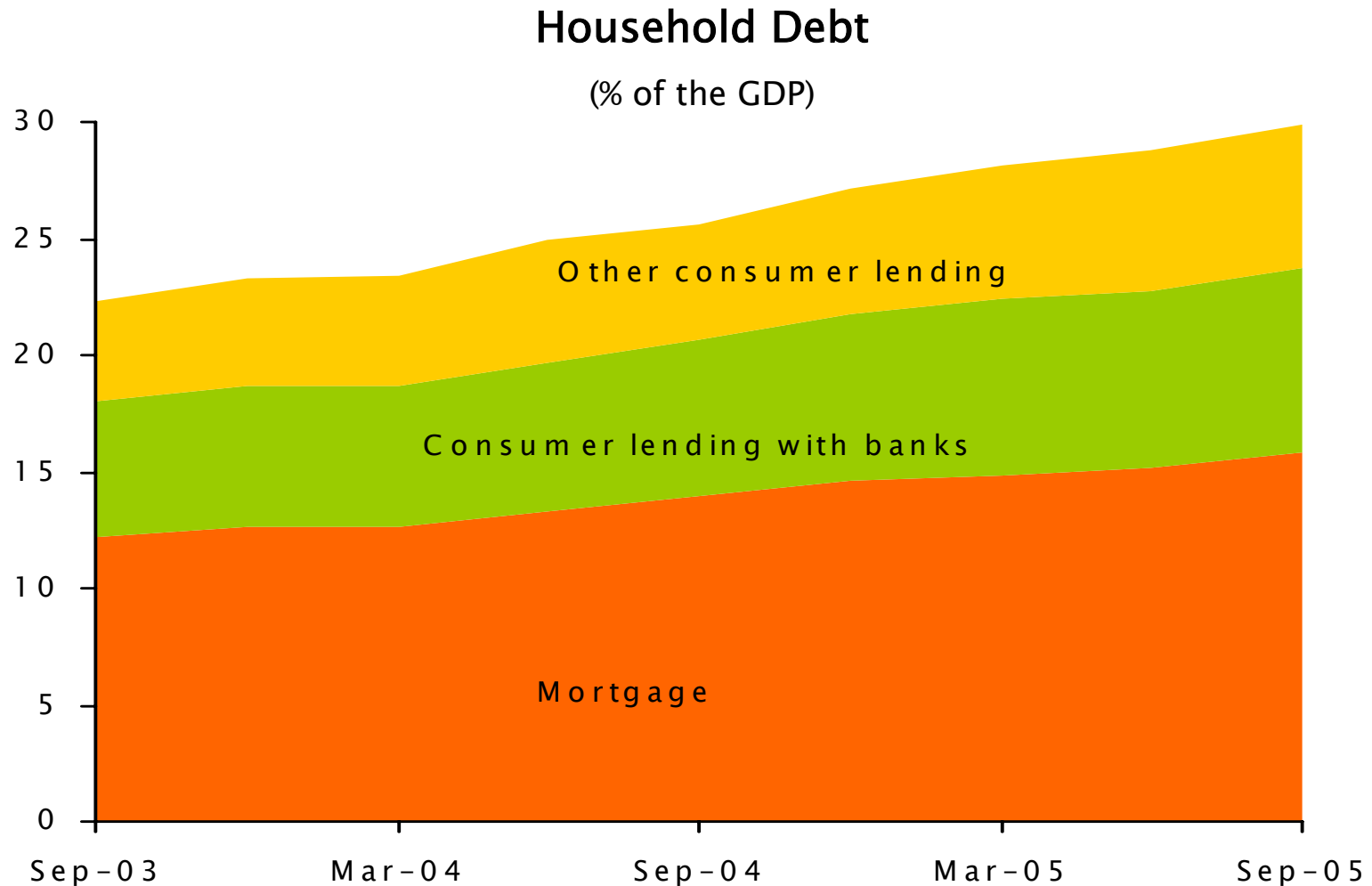
## Corporate Total Debt (% of the GDP)



Source: Calculations based on SVS, SBIF and ACHEF information



# Credit trends in Chile

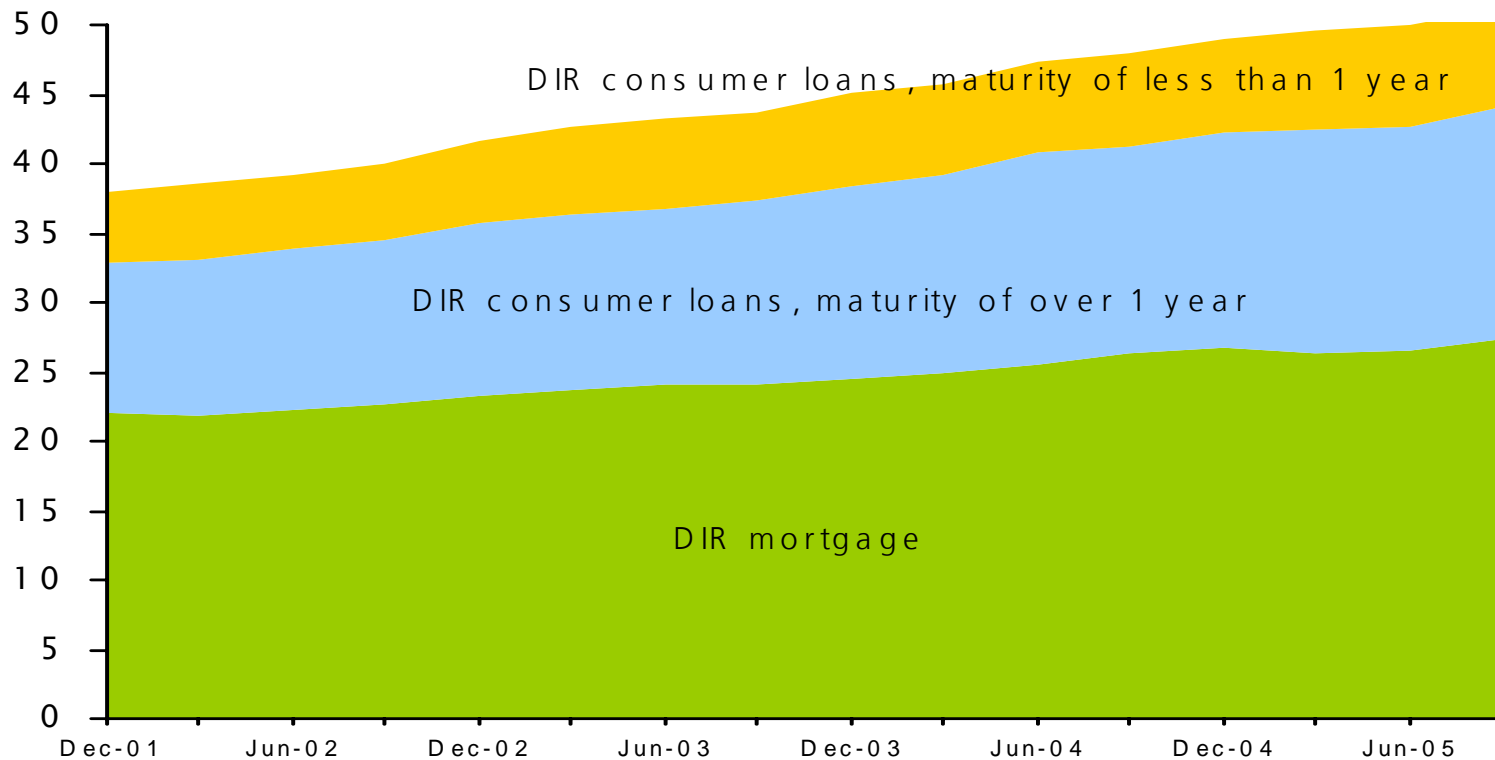


Source: SBIF, SVS, SuSeSo, Central Bank of Chile



# Credit trends in Chile

## Debt – Disposable Income Ratios (DIR) (%)

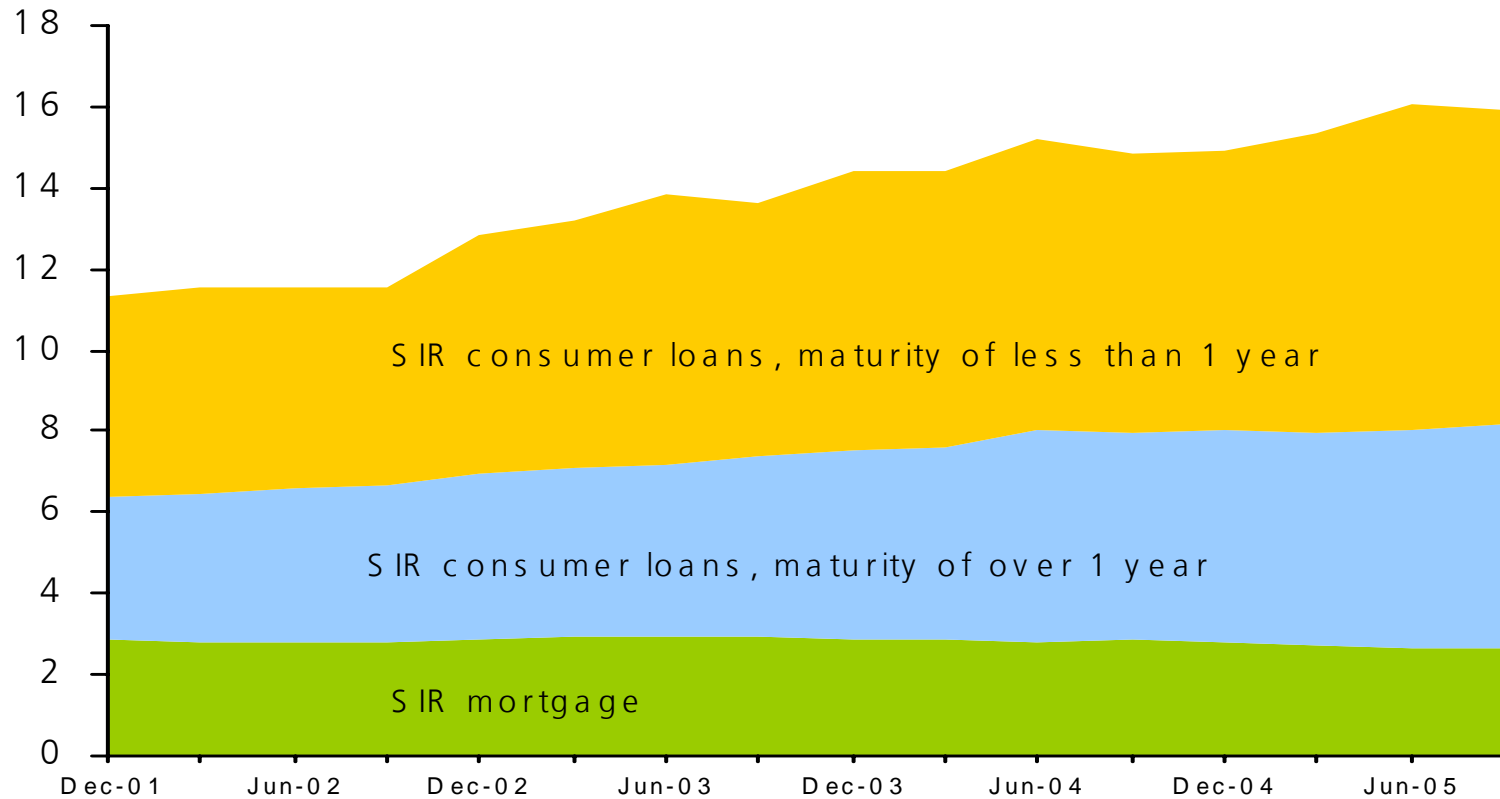


Source: SBIF, SVS, SuSeSo, Central Bank of Chile



# Credit trends in Chile

## Debt Service – Disposable Income Ratios (SIR) (%)



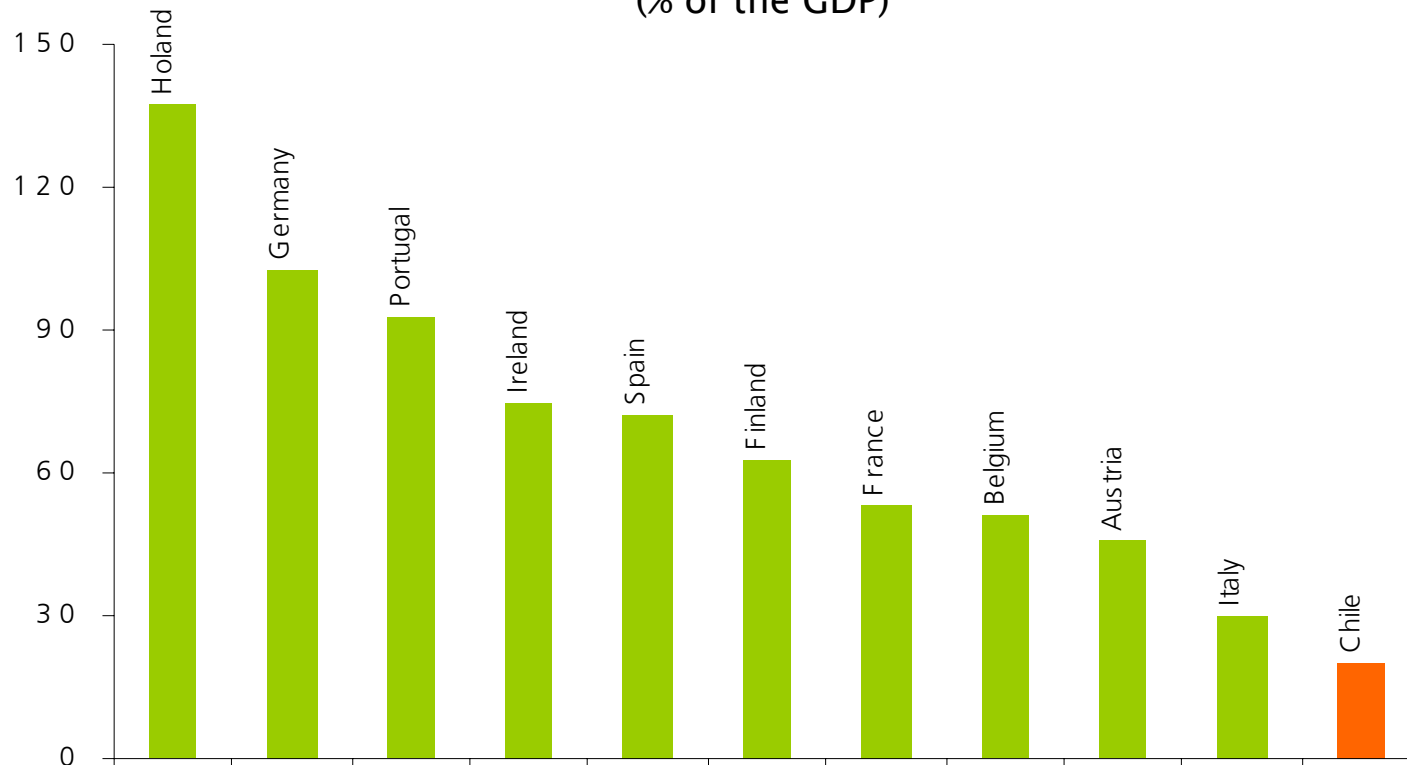
Source: SBIF, SVS, SuSeSo, Central Bank of Chile



# Credit trends in Chile

## Household Lending\*: International Comparison

(% of the GDP)



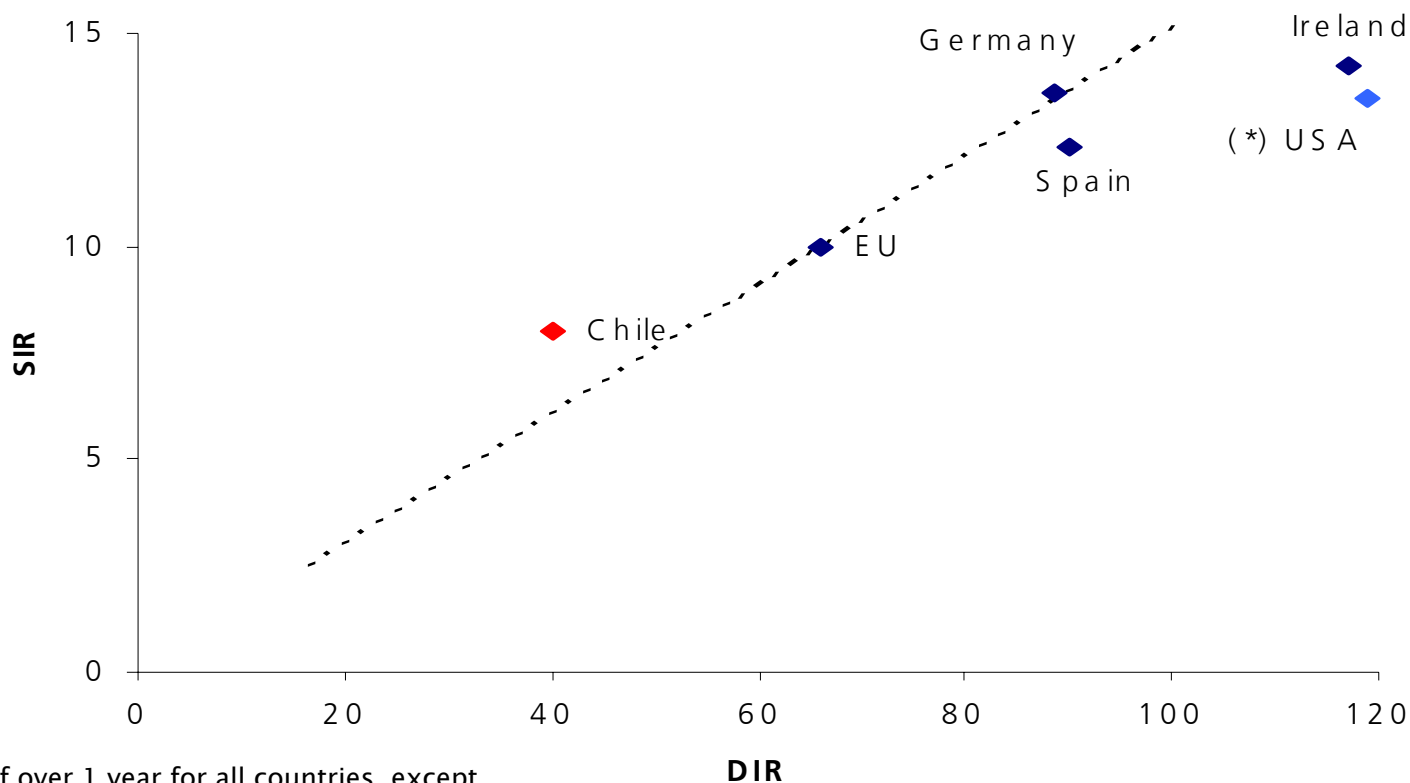
(\*) Total household lending (retail and mortgage) for period 1999–2001, except for Chile, which corresponds to October 2004.

Source: ECB, Central Bank of Chile, own countries central banks



# Credit trends in Chile

## Consumer Loans Indicators (SIR and DIR): International Comparison



(\*) Maturity of over 1 year for all countries, except for USA. Total SIR and total DIR for USA

Source: Central Bank of Chile





# Credit trends in Chile

Although a matter of concern, the rapid growth in Chile has been positive:

- Driven by domestic demand, it has boosted consumption, while low real interest rates are providing a stimulus to investment
- Against this background, inflationary pressures have not picked up and the current account deficit has remained reduced



# Concluding remarks

- Credit booms are not easy to identify, calling for policymakers to make difficult judgments
- The effects of the increasing domestic credit in LA are not clear
- The signs accompanying credit expansion should be a matter of concern: growing macroeconomic, financial and corporate imbalances



# Concluding remarks

Measures are needed to reduce the risks that are associated with strong credit growth:

- Improving surveillance of the banking system
- Increasing scrutiny of corporate borrowing
- Tightening macroeconomic conditions
- Better inform borrowers about the risks they face and how exchange and interest rate movements could affect their debt-servicing costs



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