



The Chilean Banking System in a Global Environment*

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* Based on Betancour, De Gregorio and Jara (2005), "Improving the Banking System: The Chilean Experience", prepared for the BIS Meeting on "The Banking System in Emerging Economies: How much progress has been made?", Basel, December 2005.



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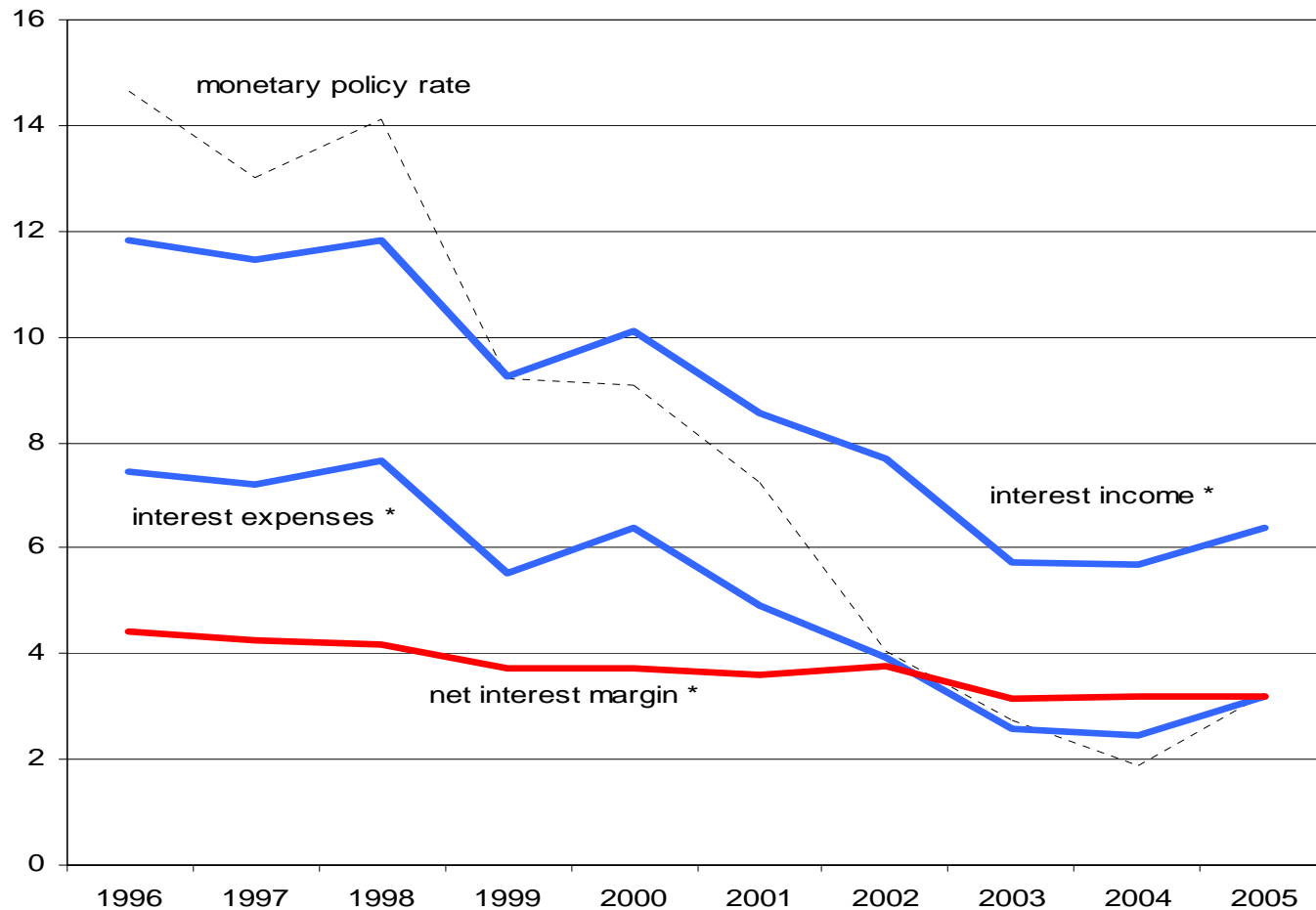
Structure of the Chilean Banking System

| | Number | | % total loans | | % total deposits | |
|----------------------------|--------|------|---------------|------|------------------|------|
| | 1990 | 2005 | 1990 | 2005 | 1990 | 2005 |
| Foreign banks | 22 | 12 | 15.2 | 39.0 | 16.3 | 39.4 |
| Local private banks | 17 | 13 | 66.5 | 47.7 | 64.1 | 44.2 |
| State-own bank | 1 | 1 | 18.2 | 13.2 | 19.6 | 16.3 |

Source: Superintendence of Banks and Financial Institutions



Monetary policy rate and bank's interest margin



Source: Superintendence of Banks and Financial Institutions



Performance of banks

| | Domestic | | | | Foreign | |
|---|----------|---------|-------------|---------|---------|---------|
| | Private | | State-owned | | | |
| | 1990-99 | 2000-05 | 1990-99 | 2000-05 | 1990-99 | 2000-05 |
| Net interest margin (% total assets) | 5.0 | 3.9 | 4.6 | 3.3 | 4.1 | 3.7 |
| Overhead cost (% of total assets) | 3.2 | 2.6 | 3.2 | 2.9 | 3.0 | 2.6 |
| Overhead cost (% of net operational income) | 55.2 | 52.8 | 62.3 | 65.8 | 62.0 | 51.5 |
| Loan-loss provisions (% of total assets) | 0.9 | 1.1 | 1.0 | 0.6 | 0.7 | 0.9 |
| ROA | 1.8 | 1.3 | 0.6 | 0.5 | 0.9 | 1.6 |
| ROE | 25.5 | 17.6 | 10.2 | 9.4 | 7.6 | 16.7 |
| Capital adequacy ratio | | 12.2 | | 12.2 | | 16.0 |
| Assets structure | | | | | | |
| % Loans to total assets | 72.8 | 76.1 | 58.2 | 32.5 | 60.3 | 68.3 |
| % Household credit to total loans | 17.8 | 20.7 | 36.5 | 45.5 | 18.4 | 27.0 |
| % Consumer to total loans | 7.5 | 8.4 | 4.0 | 7.1 | 8.0 | 9.6 |
| % Mortgage to total loans | 9.8 | 12.4 | 32.5 | 38.5 | 10.5 | 17.4 |

Source: Superintendence of Banks and Financial Institutions



International Comparison

| | Private Credit/GDP | Stock market capitalization/GDP | Turnover ratio | Private Bonds/GDP | Financial Strength Index |
|----------------------|-----------------------|------------------------------------|-------------------|----------------------|-----------------------------|
| Latin America | | | | | |
| Argentina | 12 | 62 | 6 | 10 | 0 |
| Brazil | 33 | 36 | 32 | 10 | 24 |
| Chile | 75 | 86 | 10 | 19 | 58 |
| Mexico | 18 | 18 | 21 | 3 | 42 |
| Colombia | 23 | 15 | 3 | 0 | 24 |
| USA | 174 | 118 | 121 | 113 | 77 |
| Europe | | | | | |
| Italy | 83 | 37 | 121 | 44 | 63 |
| France | 88 | 67 | 85 | 42 | 73 |
| Germany | 117 | 37 | 129 | 43 | 47 |
| Spain | 111 | 71 | 157 | 24 | 77 |
| Czech Rep | 30 | 18 | 52 | 7 | 41 |
| Poland | 28 | 15 | 27 | n/a | 31 |
| Asia | | | | | |
| Japan | 105 | 60 | 87 | 44 | 21 |
| Korea | 120 | 48 | 235 | 50 | 18 |
| Malaysia | 132 | 141 | 34 | 53 | 35 |
| Philippines | 35 | 40 | 9 | 0 | 19 |

Source: World Bank, Moody's



New Forms of Risk

1. Contagion through the payment system
2. Increased uses of derivatives
3. Risks transfers
4. Managing liquidity risk



Impact of Basel II: Capital Requirements

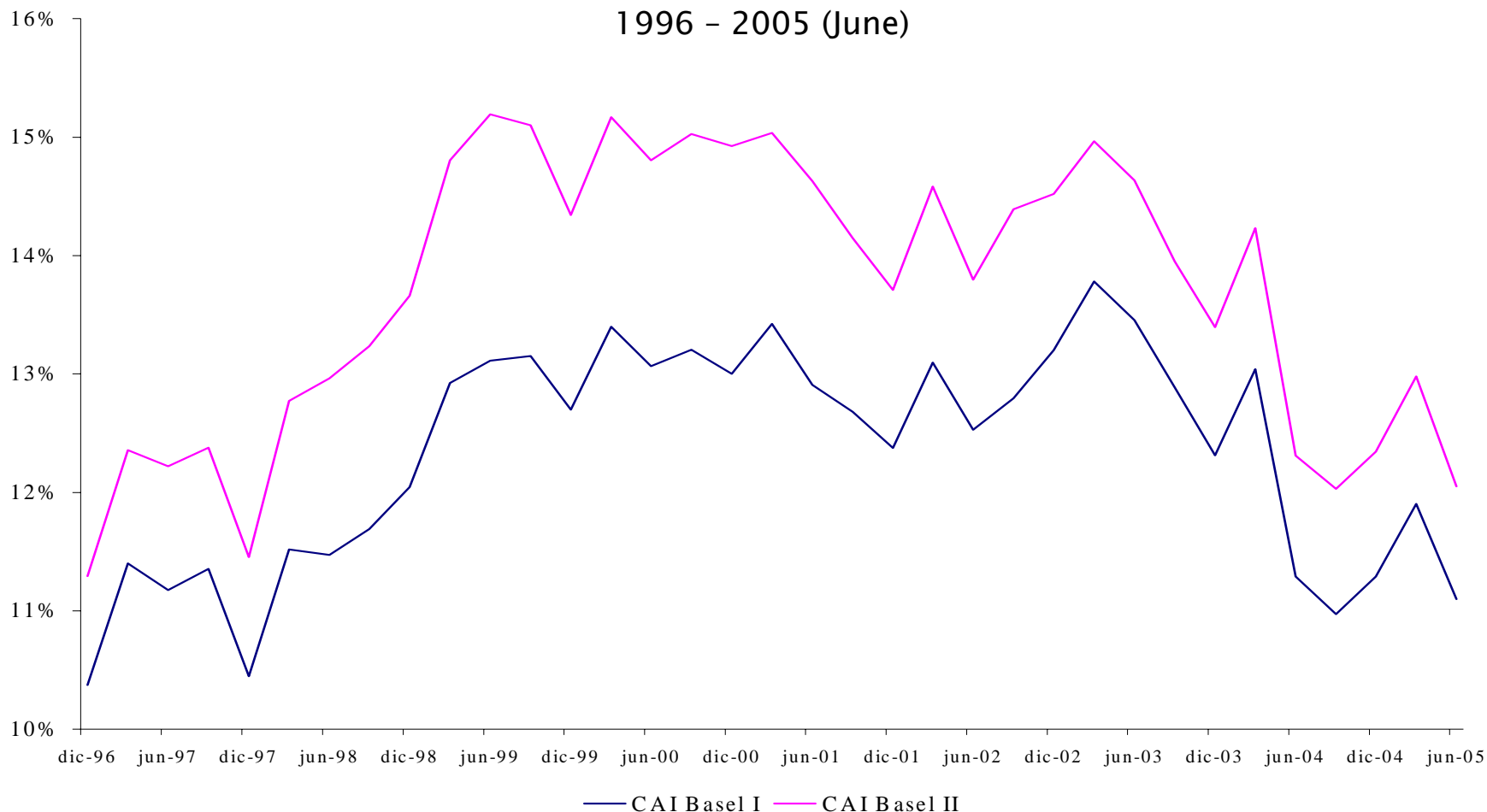
- Capital requirements depend on:
 - New weights for the different types of credit
 - Structure of assets
 - Operational risk charges



Impact of Basel II: Capital Requirements

Capital Adequacy Index

1996 - 2005 (June)





Impact of Basel II: Capital Requirements

| | LRM* | Credit Risk Impact (%) | Operational Risk Impact (%) | Global Impact (%) |
|-----------------------------|-------------|-----------------------------------|--|------------------------------|
| Established banks in Chile | 7 | -13.4 | 10.2 | -3.2 |
| Foreign banks' branches | - | -11.6 | 12.6 | 1.0 |
| Total banking system | 7 | -13.3 | 10.3 | -2.9 |

* Lending risks mitigators

Source: Held et al. (2004)



Impact of Basel II: Capital Requirements

Special considerations for implementing the new accord in LA countries

- Rating business is less developed
- Lack of adequate information to the banks
- Need to strengthen regulation



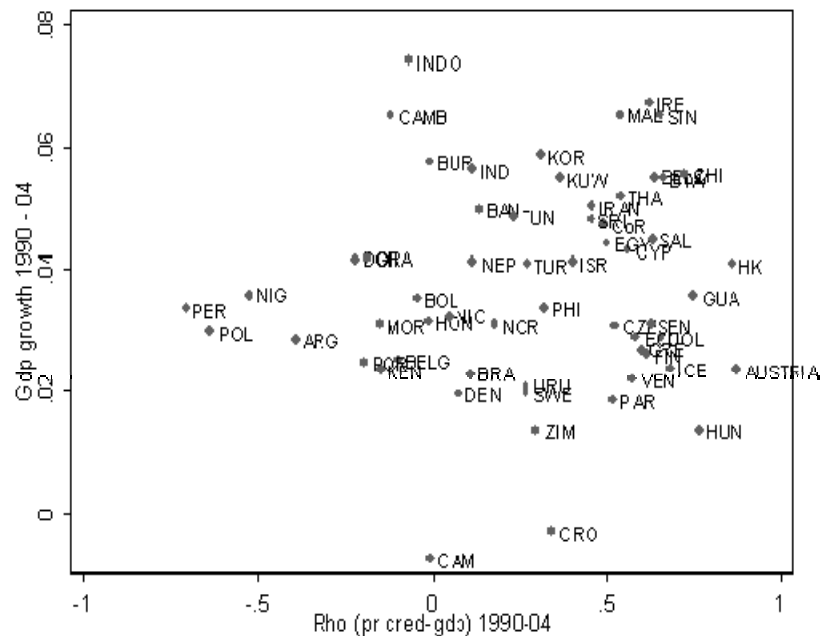
Impact of Basel II: Procyclicality

- Credit market affects procyclicality because loans are reduced during recessions
- There is low correlation between procyclicality and economic performance
- If any, there is a correlation with deepness of the banking system

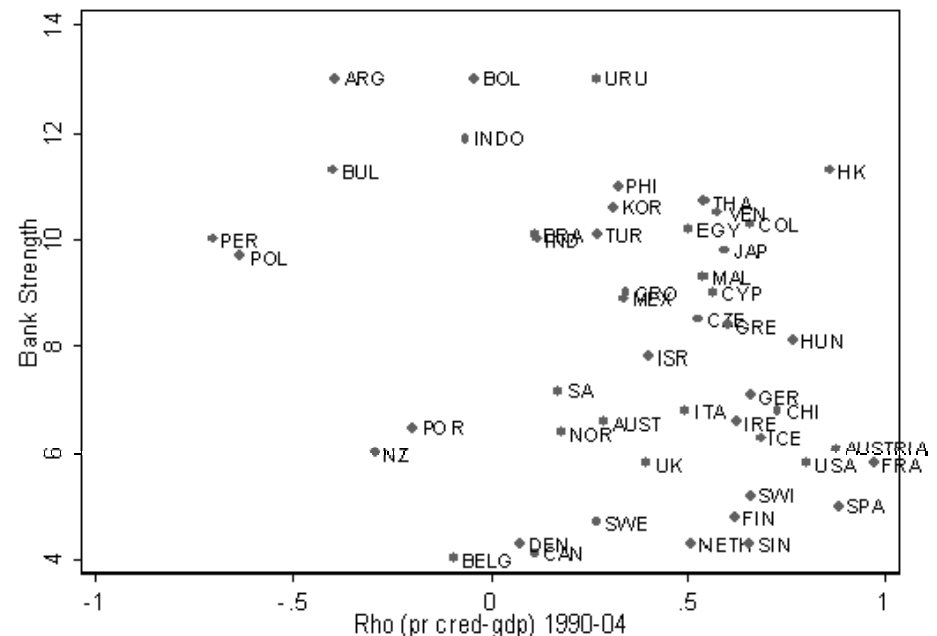


Impact of Basel II: Procyclicality

Procyclicality and Growth



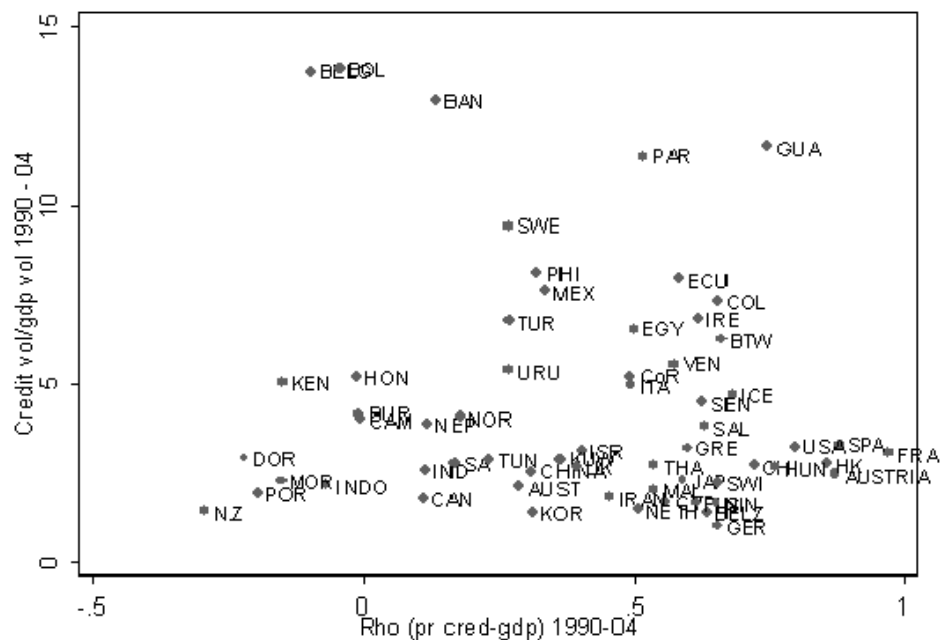
Procyclicality and Bank Strength



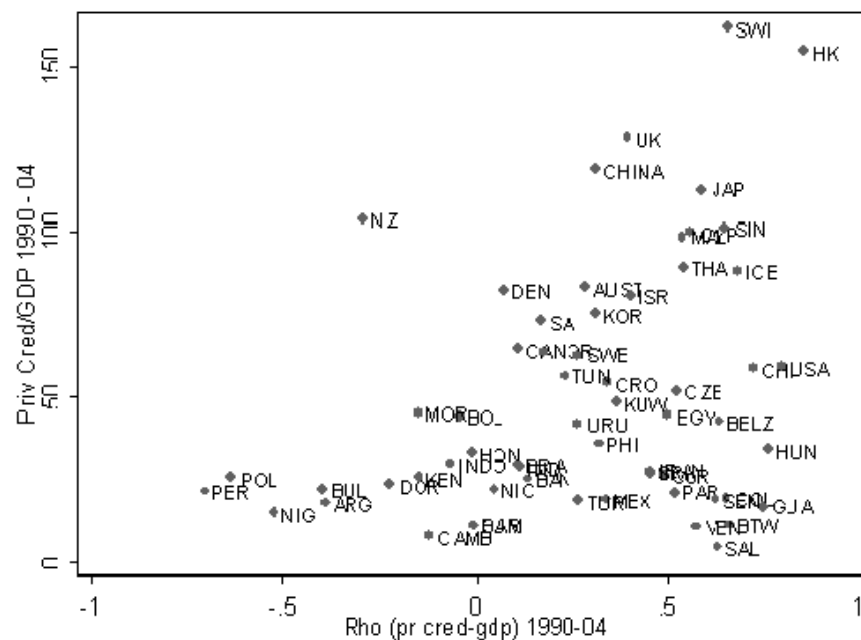


Impact of Basel II: Procyclicality

Volatility and Procyclicality in the Credit Market



Procyclicality and Deepness of the Banking System





Concluding Remarks

- Capital requirements are reduced under Basel II.
- Consequently, it is not clear that procyclicality should increase if capital requirements are binding.
- Chilean Banking System is on a solid ground to follow a gradual implementation of Basel II.



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