Annual Report
2007

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BANCO CENTRAL DE CHILE

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Senior authorities of the Central Bank of Chile

As of 31 December 2007

Board

José De Gregorio Rebeco
Governor

Jorge Desormeaux Jiménez
Deputy Governor

José Manuel Marfán Lewis
Board Member

Enrique Marshall Rivera
Board Member

Sebastián Claro Edwards
Board Member

GENERAL MANAGER
Alejandro Zurbuchen Silva

DEPUTY GENERAL MANAGER
Leonardo Hernández Tagle

GENERAL COUNSEL
Miguel Ángel Nacrur Gazali

GENERAL AUDITOR
Silvia Quintard Flehan

DIVISION DIRECTORS

Kevin Cowan Logan
Financial policy

Pablo García Silva
Research

Luis González Bannura
Management and Corporate Services

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Financial Operations

MANAGERS

Luis Álvarez Vallejos
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Mabel Cabezas Bullemore
Logistical Services

Rodrigo Cifuentes Santander
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Economic Research

Mario Ulloa López
Chief Auditor

Claudia Varela Lertora
Corporate Affairs

Ricardo Vicuña Poblete
Statistical Research and Information

Jorge Zúñiga Mayorga
Security

Central Bank of Chile Employee Profile

AS OF 31 DECEMBER 2007

Number of employees	626
By gender	
Women	209
Men	417
By age (years)	
Under 25	13
26 to 35	165
36 to 45	139
46 to 55	177
56 to 65	129
Over 66	3
By educational level	
Doctorate	30
Professional	382
Administrative	214
Average years of service	15
Annual turnover	7.8

BANCO CENTRAL
DE CHILE

Santiago, 28 April 2008

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 this institution's *Annual Report, 2007*.

Yours sincerely,

José De Gregorio R.
Governor

BANCO CENTRAL
DE CHILE

Santiago, 28 April 2008

Mr. Adolfo Zaldívar L.
President
The Senate
VALPARAÍSO

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 this institution's *Annual Report, 2007*.

Yours sincerely,

José De Gregorio R.
Governor


BANCO CENTRAL DE CHILE

I. Financial management and policies of the Central Bank of Chile in 2007

A. Economic overview

Macroeconomic conditions changed substantially during 2007. The year began with Chile's economy continuing to weaken, as it had since mid-2006, although inflationary pressures remained well under control. Toward the middle of the first half, the prospects for both inflation and activity were showing signs of relevant shifts. The economy was picking up significantly, with growth bouncing back to around 6%, and inflation was also climbing.

Toward the second half of the year, the macroeconomic outlook changed further. The economy slowed somewhat, with annual growth reaching 5.1% by year's end, while annual inflation continued to rise, reaching levels well above the inflation target tolerance range. This reflected the combined effects of several supply shocks, above all a substantial rise in some food prices (reflecting increases in their equivalents abroad and/or external inputs), the effects of frost damage to fruit and vegetable prices, a new rise in fuel costs, and the combined impact of these higher fuel costs and a natural gas shortage on electric power rates. As the subprime mortgage crisis in the U.S. evolved, international markets grew increasingly turbulent. Although in late 2007, it was impossible to clearly discern the impact of these events on the Chilean economy, prospects for 2008 dimmed, while the relaxation of monetary policy in several developed economies pointed in the same direction. The main consequences for domestic financial markets were highly volatile share prices and marked peso appreciation, largely in response to the dollar's decline on world markets.

B. Monetary policy

To remain consistent with the macroeconomic outlook, monetary policy shifted significantly during the year. In early 2007, as indicated, the macroeconomic scenario suggested that inflation would remain under 3% for some time and the output gap would close more slowly than previously thought. In this context, and to ensure compliance with the inflation target, the Board cut the monetary policy rate (MPR) by 25 basis points during its January meeting. At its meetings in February, March and April, it kept the MPR at 5.0% annually, with the prospects of a new cut gradually fading.

By May, information to date revealed that inflation was higher than estimated in the January *Monetary Policy Report*, so the Board decided that the only option was to keep the MPR at 5.0% annually. From the June meeting onward, policy options included raising the rate. By then, the outlook for inflation had changed substantially, and the Board raised the MPR by 25 basis points in July, August, September and December, until it reached 6.0% annually by the end of 2007.

C. Financial policy

C.1 The payment system and financial infrastructure

As part of its financial market regulation modernization program, in January 2007, a new regulatory framework governing financial intermediation and deposits for banking firms in Chile was approved, as part of Chapter III.B.1 of the *Compendium of Financial Regulations*. The main changes involved modernization of regulations governing interest rates and currencies in which term deposits can be contracted, flexibilization of regulations covering prepayments of deposits and short-term intermediation; homologation of minimum deadlines for repo sales; and replacement of the regulations governing short selling with one regulating securities lending operations. Another important element that formed part of these new regulations was a requirement that banks have policies, procedures and systems in place for the suitable management and control of risk arising from repo sales and securities lending operations. Banking companies were given a grace period to adapt their risk policies, procedures and management and control systems to the new regulation, which came into effect on 2 April 2007.

In July, the Central Bank of Chile raised the ceiling on pension fund investment in foreign securities to 35%. It also increased the ceiling on investment in unhedged foreign exchange for each type of fund, as per its authority under Article 45, Decree Law 3500 (1980), modified by Law 20,210. In November, the Central Bank again increased the ceiling on pension fund investment in foreign securities, this time to 40%, in line with the gradual procedure established in the transitional articles of this law. This new ceiling came into effect on 18 December 2007. Similarly, the ceiling on investment in unhedged foreign exchange for each type of fund rose too: to 45% for type A fund; 31% for type B; 24% for type C, and 19% for type D. These new ceilings came into effect on 12 February 2008, given the six-month requirement established by the law for changing these limits, and the previous increase.

Also in November, the Central Bank expanded the list of easily liquidated financial instruments available for investment by the small business guarantee fund (*Fondo de Garantía para Pequeños Empresarios*, Fogape). This regulatory change was also in line with changes introduced by Law 20,202 to allow Fogape to diversify and boost its profitability. Similarly, Fogape was required to apply a cautious investment policy to manage fund resources appropriately, starting on 19 January 2008.

Macroeconomic conditions changed substantially during 2007

C.2 Foreign exchange regulations

The Central Bank created a specific foreign exchange regime applicable to special contracts between foreign investors and the Chilean Government, and dealing with explorations, operations or reception of benefits from hydrocarbons, as per Article 19, N° 24 of Chile's National Constitution, granting the right to remit abroad any payments or income in foreign or domestic currency, received by the contractor under said contract.

Also, as per Section 83 of its Basic Constitutional Act, the Central Bank interpreted Chapter XXVI, Title I, *Compendium of Foreign Exchange Regulations*, repealed in April 2001, ruling that in the event of capital increases by the receiving body, in the form of a share issue, the foreign exchange provisions contained in the repealed regulation would not be applicable.

Moreover, it suppressed the information requirement for credits obtained by persons domiciled in and resident abroad, serving as branches, agencies or subsidiaries of legally recognized bodies in Chile, and the requirement applicable to guarantees in foreign exchange provided by or in favor of bodies domiciled in or resident in Chile.

D. Financial management

D.1 Foreign exchange and monetary management

Through its monetary management, the Central Bank supports monetary policy implementation and provides liquidity to the market in an efficient manner. This requires ongoing monitoring of the interbank interest rate (*tasa de interés interbancaria*, TIB) to keep it around the MPR and control the credit risk assumed by the Central Bank in its own operations.

To fulfill this objective, monetary management schedules are updated monthly and market liquidity projections monitored daily, allowing the bank to carry out the necessary monetary fine-tuning to keep the MPR and TIB lined up. In 2007, the two rates remained within seven basis points of each other.

In 2007, the Central Bank used traditional instruments regularly, introducing some flexibility during the second half to facilitate the work of financial system agents, given market liquidity needs arising from the highly volatile international conditions and the technical reserve regulation coming into effect. This made a gradual reduction in the technical reserve possible through January 2008 and, essentially involved increasing the calculation base (from base capital to effective equity), exclusion of time deposits within ten days of their maturity from the calculation base, and expansion of the set of eligible instruments (consisting of promissory notes and bonds issued by the Central Bank of Chile and the General Treasury within bank portfolios), thanks to the lifting of a minimum 90-day residual maturity previously required for these instruments. Thus, repo operations mainly covered one- to seven-day periods, with decisions made case by case, according to daily liquidity projections. In the third quarter, the Bank added auctions of Central Bank Discountable Promissory Notes (PDBC), maturing in 180 days to one year, to those involving notes maturing in 30 and 90 days, and the liquidity deposit was used more often.

Also in the first half, the Bank carried out swaps to improve liquidity in domestic currency.

In terms of foreign exchange management, in 2007 the Central Bank carried out no buy or sell operations in foreign exchange on the domestic exchange market.

D.2 Management of foreign exchange reserves

The purpose of foreign exchange reserve management is to provide efficient and secure access to international liquidity and to safeguard the Central Bank's financial equity. This management is based on the legal framework defined by the Bank's Basic Constitutional Act and a series of internal policies and practices in line with recommendations from international bodies.

In 2007, the bank maintained sufficient foreign exchange reserves to deal with potential and foreseeable foreign exchange liquidity needs. As of 31 December, the investment portfolio, which includes short- and long-term assets to deal with contingencies and long-term requirements, stood at US$15.355 billion. The liquidity portfolio, which includes short-term assets for covering requirements foreseeable in the short term, stood at US$1.340 billion. At the aggregate level, total foreign exchange reserves reached US$16.910 billion.

Compared to the closing date last year, reserves were down by US$2.519 billion. This reflected a decline in balances held for financial institutions in the Central Bank, due to lower technical reserve requirements, and the withdrawal of some government funds from Central Bank deposits. The latter were initially part of the fiscal agency program for managing government resources (the Economic and Social Stabilization Fund and the Pension Reserve Fund), beginning in March. These declines were partly offset by capital payments that the General Treasury made to the Central Bank, worth 0.5% of GDP (US$736 million) and prepayments of the last dollar debt payments that it held in the Central Bank, worth US$1.108 billion.

Reserve liquidity was guaranteed through management of a short-term deposit portfolio in international commercial banks and fixed income instruments trading on highly liquid secondary markets. As of 31 December 2007, current account and time deposits accounted for 42.5% of foreign exchange reserves, short-term papers 24.7%, bonds 31.5% and other assets 1.3%.

To safeguard Central Bank equity, investment resources are administered according to policies and controls approved by the Board and designed to limit operating and financial risks. Investment credit risk was controlled through limits on issuers, instruments, intermediaries and custodians. As of 31 December, 47% of reserves were invested in AAA-rated instruments, issued by banks, sovereigns, supranational or U.S. financial agencies. The remaining 53% was invested in A to AA+ rated instruments, mainly in the banking sector. Market risk was controlled by diversifying investment currencies, instruments and maturities and taking into consideration the impact of decisions regarding these parameters on the Central Bank's balance sheet. At year's end, 62.3% of reserves were held in dollar instruments, 36.7% in euros and 0.9% in other currencies, while portfolio duration averaged 12.1 months. Operating risk was controlled through the separation of functions and responsibilities and the application of internal and external controls.

In January 2007, a new long-term general mandate for the external administration of part of the bank's foreign exchange reserves began. The number of external administrators involved was reduced from three to two and US$250 million was handed over to each for administration. The risk evaluation method was also changed, to move from management based on established limits to one based on a risk budget, with administrators authorized to take a maximum risk of no more than 100 basis points of tracking error against the respective basis for comparison or benchmark. The mandate specializing in Mortgage Backed-Securities (MBS) remained unchanged. The project to modernize computer information systems used to administer foreign exchange reserves also went ahead, with the supplier being chosen and the respective contracts signed, followed by the beginning of system implementation.

In 2007, the total return on foreign exchange reserve management reached 4.81%, measured in foreign currencies (the investment portfolio currency reference basket) and 1.99%, measured in pesos, thereby revealing the depreciation of the foreign currencies in which reserves were invested against the peso. The differential return against the benchmark used to guide and evaluate investment performance was three basis points higher, amounting to an additional return of US$5.1 million. The total operating costs involved in managing Central Bank foreign exchange reserves was three basis points of the total reserves under management, for this fiscal year.

In line with the Board's usual practice of obtaining external evaluations, the International Monetary Fund (IMF) was asked to send a technical assistance mission to independently evaluate the bank's foreign reserve management. The main conclusion from this evaluation, which took place in April, was that the Central Bank met all recommendations from this multilateral body in managing its foreign exchange reserves and, moreover, had the appropriate skills for fulfilling its role as fiscal agent.

As per bank policy, appendix III provides a more detailed report on the foreign exchange reserve management, described in this section.

Through its monetary management, the Central Bank supports monetary policy implementation and provides liquidity to the market in an efficient manner.

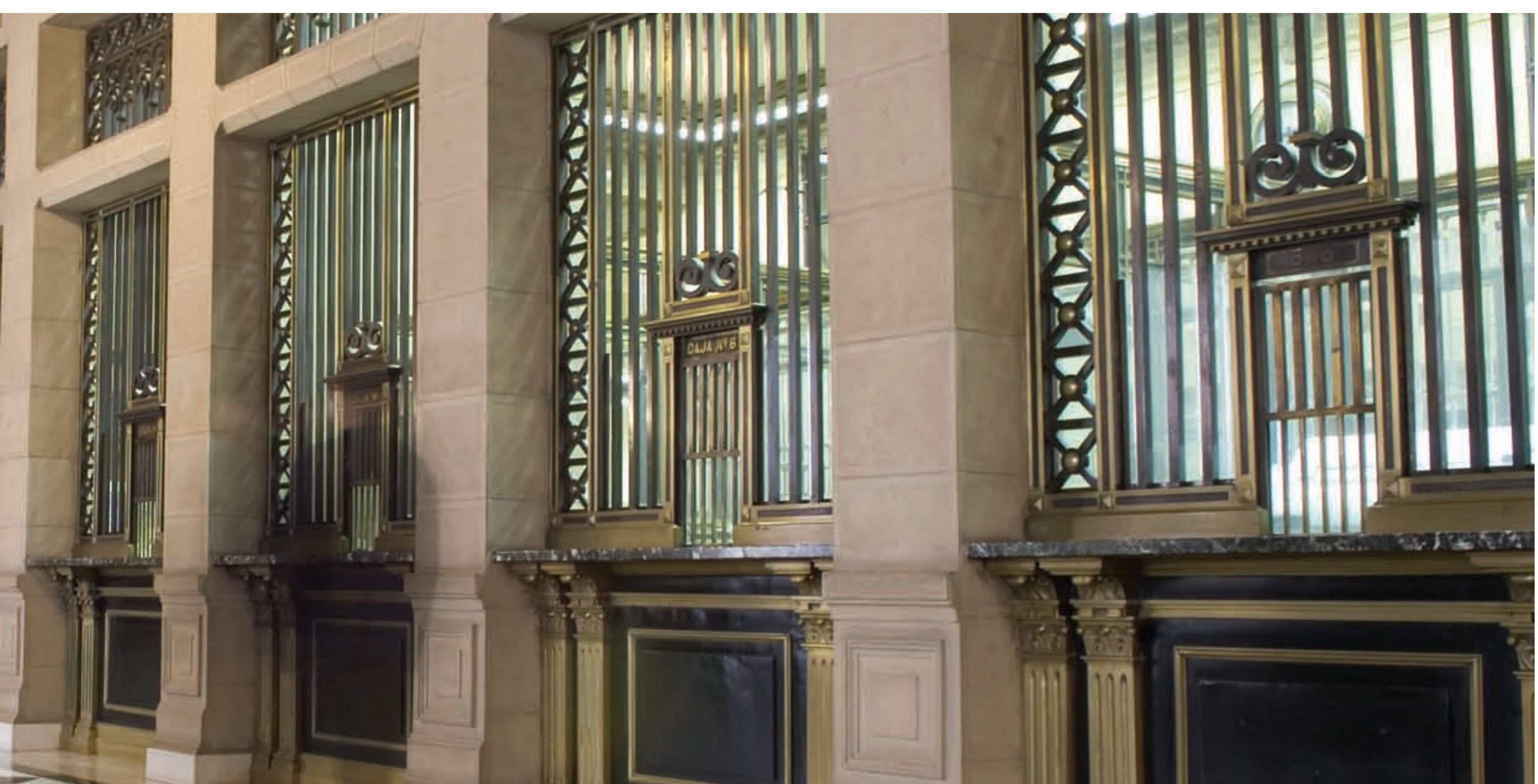
D.3 Debt management

Central Bank debt policy aims to minimize financing costs within the limits defined for financial risk. It also seeks to contribute to the development of a long-term securities market, providing a benchmark for the private sector.

For the second year running, and continuing with its transparency policy and international standards in this field, as the year began, the Board once again announced its 2007 annual schedule of bond auctions, to provide the public and the market with information enough in advance to facilitate decision making over a stable and defined period of time. The Finance Ministry also communicated its interest in the Central Bank playing the role of fiscal agent in placing General Treasury debt instruments, during 2007.

As in the previous year, the schedule included only monthly auctions of instruments, thus making debt placement more efficient. During the year, monthly securities auctions involved its own, peso-denominated instruments, maturing in two and five years (BCP-2 and 5), and UF-indexed instruments maturing in five and ten years (BCU-5 and 10). Similarly, for the January reserve period only and in order to complete the benchmark, peso-denominated bonds maturing in ten years (BCP-10) were auctioned off.

In mid-January, the Board accepted the role of fiscal agency assigned to the Central Bank through a Supreme Decree issued by the Finance Ministry, for placing General Treasury bonds on the local capital market and servicing them as per their corresponding maturity dates,



Central Bank debt policy aims to minimize financing costs within the limits defined for financial risk.

during 2007. It was decided to issue UF-denominated General Treasury bonds maturing in 20 years (BTU-20) and peso-denominated General Treasury bonds maturing in 10 years (BTP-10).

During the year, peso-dominated securities (BCP-02 and BCP-05), UF-denominated securities (indexed using the inflation-indexed accounting unit, *Unidades de Fomento*, BCU-05), and securities expressed in foreign exchange payable in pesos (BCD-05) came due, with a remainder falling due in January 2008.

In December 2006, the Central Bank reported the criteria that would be used to manage dollar-denominated instruments in 2007. These sought to maintain suitable liquidity, continue to reduce Central Bank financing costs, and control risk to the balance sheet. In particular, the bank indicated that it had no intention of using these policies to influence the exchange rate and that it did not expect to swap these securities for bonds payable in dollars or to renew them in the form of new foreign-currency-denominated securities as they expire during the year.

D.4 High-value payment service provision

The Central Bank complies with its ongoing policy of providing high-value fund transfer services and intraday liquidity facilities to the financial system, which meet high standards of quality, reliability and operating security. Similarly, it provides these services according to international principles for delivery versus payment (DVP), and its incentives allow financial actors to understand the risks involved and take suitable provisions.

In 2007, the Real Time Gross Settlement system (RTGS) worked well, with amounts traded rising 20% by volume and 35% by value, as the number of users rose (appendix IV). The intraday liquidity facility (ILF) also rose by value, by almost 25%.

During 2007, the bank improved its technology, moving to the production environment of the new version of the CAS 3.40 software used to run the RTGS, updating the hardware platform and adjusting its SWIFT planning in preparation for migrating to SWIFTNet Phase 2.

Also in 2007, work on operating continuity strengthened, in close cooperation with those operating the settlement and securities payment systems (the central securities deposit or *Depósito Central de Valores, ComBanc, Sinacofi* and the Central Bank). Thus, the bank progressed according to the agenda prepared early in the year, with each participant presenting procedures for dealing with different scenarios involving service interruption that would keep business operating as usual.

Similarly, and given a strong rise in the volume of payment system transactions faced by the Central Bank in August, with authorization of higher investment abroad by pension funds, in the fourth quarter a major effort was made to increase coordination, focusing on the evaluation of courses of action for the suitable management of the payments system and settlements at times when security transaction volumes or payment settlements could rise significantly higher than normal. In response, payment system and security system operators focused on initiatives that would boost their capacity and processing speeds.

D.5 Management of government resources

In early 2007, through Supreme Decree 1383 (agency decree) and under Law 20,128 on Fiscal Responsibility, the Ministry of Finance requested that the Central Bank act as its fiscal agent in the administration of all or part of the resources held in the Economic and Social Stabilization Fund, ESSF (*Fondo de Estabilización Económica y Social*) and the Pension Reserve Fund, PRF (*Fondo de Reserva de Pensiones*).

Given its constitutional framework and the economies of scale and sphere that the Central Bank could contribute to the management of these fiscal resources, the Board accepted and empowered the Director of Financial Operations Division to establish the internal procedures necessary to perform these functions as a managerial agent, according to the guidelines in article 4 of the agency decree and the guidelines for execution.

In 2007, the Central Bank administered these resources with its goals focusing on preserving capital and adding value, within the risk standards defined by the Finance Ministry in its execution guidelines (*Directrices de ejecución*) and accepted by the Central Bank. On behalf of the government and at the government's cost, it hired a general custodian for measuring administrative performance, risk and compliance with regard to the resources provided to the Central Bank according to the agendas and parameters included in the execution guidelines.

During the same year, the Central Bank received US$13.1 billion in ESSF for administrative purposes, for a market value, as of 31 December, of US$14.0326 billion. It also received pension reserve funds worth US$1.34885 billion, whose market value reached US$1.46635 billion, bringing the total administered by the Central Bank as fiscal agent to US$15.49896 billion at year's end.

The resources under Central Bank administration were invested according to policies and controls agreed upon with the Finance Ministry and designed to limit operating and financial risks, according to standards equivalent to those used to manage foreign exchange reserves.

Credit risk was controlled through limitations on issuers, instruments, intermediaries and custodians, defined in the above mentioned guidelines. As of 31 December, 62.65% of these resources were invested in AAA-rated instruments, while 37.35% were in instruments rated from A- to AA+. Market risk was controlled through diversification of instruments, currencies and maturities. At year's end, 66.22% of funds were invested in sovereign issues, 30.04% in bank securities and 3.74% in U.S. agencies. In terms of currency composition, 50.07% of funds were in U.S. dollar instruments, 39.76% in euros and 10.17% in yens, while average portfolio maturity was 30 months.

From March to December, ESSF funds delivered to the Central Bank for administration generated an absolute return of 9.55%, measured in dollars, one basis point away from the benchmark, when both are measured using the Times Weighted Rate of Return (TWRR) method. During the same period and using the same methodology, pension fund resources administered by the Central Bank generated an absolute return, measured in dollars, of 8.68%, 28 basis points below the benchmark[1]/.

Moreover, since the Central Bank began to serve as fiscal agent, it has delivered daily, monthly and quarterly reports to the Finance Ministry and the General Treasury, using measures for performance, risk and compliance with benchmarks for the resources managed by the fiscal agent, as per agreements.

[1]/ Although the reference benchmark for both portfolios is the same, each portfolio performed differently against it, because management began on different dates in March 2007.

For its services managing the funds transferred to it by the Government in 2007, the Central Bank received the equivalent of 0.48 basis point annually[2]/.

Finally, note that the April IMF assessment of compliance with the guidelines for foreign exchange management concluded that the Central Bank has the appropriate capacity for carrying out its roles in foreign exchange reserve management and as fiscal agent.

In line with institutional policy for reporting and requirements in the agency decree, appendix V provides a more detailed report on the administration of fiscal resources.

E. Miscellaneous

E.1 Technical Secretariat for the Distortions Commission

The national commission in charge of investigating price distortions affecting imported merchandise is a technical body consisting of representatives of public institutions involved in the economic sector. Its function is to advise the President of Chile on the application of anti-dumping measures, compensatory duties and safeguards. The Commission functions independently from the Central Bank. Nonetheless, the law has located its technical secretariat, which is responsible for collecting information regarding investigations, preparing technical reports, carrying out communications between parties and providing the necessary notifications, in the Central Bank.

In 2007, the Technical Secretariat supported the Distortions Commission, which met on ten occasions, starting two and finishing three investigations. At year's end, an anti-dumping duty on wheat flour imports from Argentina was in effect.

E.2 Chilean Copper Commission (Cochilco)

In 2007, the Board had two representatives on the Chilean Copper Commission (Cochilco): Beltrán De Ramón Acevedo and Felipe Hernán Jaque Sarro. Both were appointed in 2006 and will remain until 20 April 2008, in the case of Mr. De Ramón, and 20 July 2008, in the case of Mr. Jaque.

E.3 Free Competition Defense Tribunal

In Resolution 1365E, passed at a special session on 17 October 2007, the Board appointed Joaquín Gustavo Morales Godoy as alternate presiding lawyer (*Ministro Suplente Abogado*) of the Free Competition Defense Tribunal, until 12 May 2012. Mr. Morales' appointment was the result of the voluntary resignation of the lawyer Blanca María Palumbo Ossa.

[2]/ Based on the average total portfolio maintained from March to December 2007.

F. The balance sheet

F.1 Balance sheet levels and structure

The main components of the Central Bank balance sheet reflect the behavior of the economy and policies applied in recent decades. Its capital deficit is primarily due to the financial crisis in the early 1980s. Foreign exchange reserve levels mainly reflect foreign exchange policy and the strengthening of the balance of payments that followed that crisis. Finally, debt issued to finance both the capital deficit and the accumulation of foreign exchange reserves (promissory notes) reflect the Central Bank's firm commitment to price stability (table I.1).

TABLE I.1

Central Bank of Chile Balance Sheet

(balance in Ch$ billion and as percentage of GDP, as of 31 December of each year)

					Implicit profitability rate (2) %			
	2006		2007		2006		2007	
	Balance	% of GDP	Balance	% of GDP	Interest	△Value	Interest	△Value
Assets (1)	**13.829**	**17.9**	**10.940**	**12.6**	**4.1**	**2.4**	**4.6**	**-1.5**
Net foreign exchange reserves	10.383	13.4	8.384	9.7	4.1	7.2	4.3	-2.6
General Treasury promissory notes	678	0.9	69	0.1	6.8	5.2	14.1	-5.5
Other public sector assets	698	0.9	772	0.9	4.2	1.2	6.3	4.1
Subordinate debt	933	1.2	957	1.1	5.1	1.9	5.1	6.7
Monetary policy instruments (3)	939	1.2	564	0.7	1.3	0.0	3.8	0.0
Other	197	0.3	194	0.2	2.0	3.3	2.9	-3.3
Liabilities (1)	**15.973**	**20.7**	**13.118**	**15.1**	**3.5**	**2.0**	**3.4**	**1.7**
Monetary base	3.406	4.4	3.672	4.2	0.0	0.0	1.0	0.0
Monetary policy promissory notes (4)	8.601	11.1	7.758	9.0	4.9	1.6	4.9	3.6
Other monetary policy liabilities (5)	2.166	2.8	1.163	1.3	1.4	4.5	2.8	-2.0
Current accounts and reserves in foreign currencies	524	0.7	116	0.1	0.0	2.7	0.0	-3.5
General Treasury and other public sector deposits	1.068	1.4	207	0.2	4.3	5.3	2.1	0.0
Other	207	0.3	202	0.2	10.3	7.3	2.0	0.7
Capital (1)	**-2.144**	**-2.77**	**-2.177**	**-2.51**				
Revalued starting capital	-2.475		-2.281					
Nominal starting capital	-2.424		-2.144					
Revalued own capital	-51		-137					
Net result	8		-283					
Non-financial results (6)	-44		-52					
Net interest (6)	-8		70					
Changes in value (7)	10		-438					
Less: revalued own capital	51		137					
Capital contributions	323		387					

(1) Equity evaluated is equivalent to the accounting measure; however, total assets and liabilities are different, mainly reflecting the different treatment of provisions, temporary assets and liabilities.

(2) Implicit rates are calculated based on average balances and losses/gains due to interest or value changes. The resulting rates may be distorted if end-of-the-month balances, used to estimate average balances, are not representative.

(3) Includes credits to banks guaranteed using foreign exchange deposits (foreign exchange swaps) or risk-free documents (repos), and liquidity lines in pesos and foreign currencies.

(4) Includes PDBC, BCP, PRC, CERO UF, BCU, and BCD.

(5) Short-term remunerated bank deposits in pesos and foreign exchange. Foreign exchange deposits, except daily ones, guarantee credits in domestic currency (note 3).

(6) The foreign exchange component of these items is converted to pesos using the average exchange rate.

(7) Includes corrections in pesos and the effect of changes in the exchange rate on foreign-currency-denominated assets and liabilities. In 2006, this also included writing off deferred losses.

Source: Central Bank of Chile.

Changes in foreign exchange reserves in recent years were mainly offset by interest and valuation changes, and shifts in domestic rights and obligations in foreign exchange, mainly due to the General Treasury and banks. In 2006 and 2007, capital contributions by the government were added. The Central Bank's participation in the foreign exchange market has been limited to servicing BCDs with Chilean pesos and to very minor foreign exchange operations arising from administrative processes.

In 2007, foreign exchange reserves fell from US$19.429 billion to US$16.91 billion. Of this change, US$1.446 billion reflected interest and dollar portfolio revaluation. US$23 million (six billion pesos) was offset by exchange operations with the General Treasury and banks. The remaining drop of US$3.988 billion was partly offset by a US$244 million rise in other foreign exchange operations with the government, a US$4.194 billion decline in bank operations and a US$38 million decline in other operations. More details on operations with the General Treasury and banks follow.

The US$244 million rise in foreign exchange reserves due to operations with the General Treasury involved:

i) A US$1.123 billion prepayment for the total of capital and interest accruing on General Treasury promissory notes in dollars in favor of the Central Bank. Given the terms under which these promissory notes were subscribed, the balance outstanding, which had already been reduced by prepayments in recent years, included capital falling due again only from 2013 onward.

ii) A -US$1.615 billion withdrawal of fiscal deposits in foreign exchange held in the Central Bank.

iii) A US$736 million rise due to the capital contribution from the General Treasury, mentioned above, made in 2007. The government withdrew deposits in foreign exchange to finance this capital contribution and to invest in line with the fiscal responsibility law (*Ley de Responsabilidad Fiscal*, 2006).

The US$4.194 billion decline in foreign exchange reserves in operations with the banking system were the result of changes in the technical reserve required under Law 20,190 on Capital Market Modernization (5 June 2007). These changes reduced the demand for liquidity in pesos among banks and brought a substantial reduction in bank deposits in foreign exchange and their counterparts in foreign exchange reserves. This decline breaks down as follows:

i) US$3.444 billion in withdrawals of remunerated bank deposits in dollars, used as collateral on credits in pesos that the Central Bank provided to banks.

ii) US$750 million in bank current account withdrawals in foreign exchange from the Central Bank, as technical reserves were gradually reduced, reflecting regulatory changes. This process concluded early in 2008.

The monetary base rose Ch$266 billion in 2007. Of this rise, Ch$36 billion was from interest paid on the technical reserve (MPR minus 100 basis points) and the reserve requirement in pesos required on time deposits in pesos (50% of the change in UF) and Ch$6 billion withdrawn to finance the foreign exchange operations mentioned above. The balance, Ch$224 billion, was somewhat offset by changes in other rights and obligations payable in pesos. Of these last, increased flows include: Ch$230 billion to pay off BCD; and Ch$1.3 billion to

service promissory notes denominated and payable in pesos. These flows were partly offset by bank operations worth Ch$1.199 billion and other operations worth Ch$106 billion. The net decline with banks included Ch$410 billion due to the recovery of short-term loans and Ch$789 billion due to the increase in liquidity deposits in pesos. The Ch$106 billion involved in the decline in other net flows include: General Treasury servicing of promissory notes in UF (Ch$67 billion), bank shareholders' servicing of subordinated debt owed the Central Bank (Ch$84 billion) and a remaining net rise of Ch$45 billion, mainly from non-financial results in pesos.

The real increase in the monetary base, whose components include deposits in pesos for the technical reserve, was lower than GDP growth, because of the law on capital market modernization, which reduced the technical reserve requirement. Despite this, the monetary base's share of total liabilities rose from 21.3% at the end of 2006 to 28% by the end of 2007. When the monetary base accounts for a larger share of financing, the balance sheet's profitability improves, because its financial cost is negative in real terms and is certainly less than the real positive costs of most of the remaining liabilities. In the medium term, once the momentary effects of recent changes to banking laws and MPR increases have been absorbed, the monetary base should resume growth rates similar to those of the GDP.

Along with these flows, which are balancing items for changes in the monetary base and foreign exchange reserves, the remaining assets and liabilities in the balance sheet fluctuate due to accrued interest and value changes. Together, these factors explain changes in table I.1. In general, assets and liabilities in the balance sheet fell both proportionately and nominally against GDP. The drop in liabilities with banks and government came with a similar decline in foreign exchange reserves, on the asset side, but did not significantly affect the total balance sheet because interest rates accruing on these deposits were similar to the yield on foreign exchange reserves. Meanwhile, the replacement of technical reserve deposits by liquidity deposits reduced profitability to the Bank, given that the first are subject to a 75-basis-point write-off compared to the latter.

F.2 Trends in asset profitability, liability costs and equity

In 2007, the Central Bank's financial statements posted a loss of Ch$283 billion. If the General Treasury's capital contribution during the year, worth Ch$387 billion, is added in, the bank earned a Ch$104 billion profit, which explains the real change in equity between its revalued starting value, -Ch$2.281 billion, and its closing value, -Ch$2.177 billion. The capital contribution was deposited directly into equity, bringing an equivalent rise in the Central Bank's balance of assets minus liabilities in foreign exchange.

As usual, the main factor behind these accounting results were shifts in exchange rates. From the end of 2006 to the end of 2007, the US dollar's value against the peso fell by 7.2%, special drawing rights (SDR) by 2.7%, and the yen 3.1%. The euro rate, meanwhile, rose 3.2%. To measure the impact of exchange rate fluctuations on results, we use foreign exchange-denominated assets minus liabilities. At the end of 2006, this figure stood at Ch$6.998 billion (US$13.095 billion), while at the end of 2007 it had reached Ch$7.770 billion (US$15.672 billion), about 9% of GDP. Given the breakdown of foreign exchange-denominated assets and liabilities and the nominal change in their peso value, the net result of different foreign exchange rates was about -3%.

Shifts in the exchange rates, which have the most effect on assets, and in the UF, which primarily affects liabilities, produced an unfavorable shortfall of -3.2% for the rates implicit in the changed value of assets and liabilities (compared to +0.4% in 2006). The gap between the average interest rate on assets minus the average interest rate on liabilities was 1.2% (compared to 0.6% in 2006). The average interest rate accruing on foreign exchange reserves was 4.3%, while that for monetary policy promissory notes reached 4.9%. In practice, the cost of maintaining foreign exchange reserves was temporarily lower than in the past.

Favorable interest rate trends in recent years could turn around in the short term, at least partially, given recent drops in international interest rates. These will mainly affect assets, while the increases in domestic interest rates will mostly affect liabilities.

Note that negative equity means that earnings due to asset yields are lower than spending on increased liabilities. Hence, the importance of capital contributions authorized by the fiscal responsibility law (*Ley de Responsabilidad Fiscal*).

The net balance of interest earnings minus losses was Ch$70 billion. The net outcome of profits minus losses due to value changes was negative, -Ch$438 billion. As noted, this was mainly due to changes in exchange rates. To the net loss of -Ch$368 billion due to interest and value changes, we added profits from devaluation (by inflation) of negative starting capital, Ch$137 billion, then subtracted Ch$52 billion in non-financial costs, for a final accounting result of -Ch$283 billion.

There are some signs of future improvements in results within the changes in balance sheet financial results, which are subject to enormous volatility due to shifting exchange rates. First, the narrowing of the gap between domestic and external interest rates in recent years is at least partly due to Chile's solid public finance. Secondly, the balance outstanding has grown smaller thanks to the General Treasury's prepayments in pesos and the repurchasing of promissory notes in dollars using foreign exchange. Finally, the government's capital contribution has improved the profitability of the balance sheet, since it makes it possible to cover a larger proportion of liability costs using returns on assets.

In the recent past, the average cost of liabilities has also fallen, thanks to growth in the monetary base at real rates that are higher than those for output. This behavior could contain a permanent component of greater bank demand for liquidity to run the interbank payment system through the RTGS mechanism, which in turn is associated with less risk to the Central Bank as the system's guarantor. Nonetheless, these increases could turn around, given the recent rise in the MPR and legal changes to improve capital market functioning, which allow banks to meet technical reserve requirements using Central Bank papers with any maturity.

Non-financial costs rose from Ch$44 billion in 2006 to Ch$52 billion in 2007 (table I.2).

Most of this rise reflected costs associated with providing the public with coins and banknotes, which is mainly the result of the rise in average commodity prices.

In short, the drop in exchange rates brought negative results, despite favorable changes in domestic and external rates. For the Central Bank's equity situation and future profitability of its balance sheet, prospects are positive over the long term, for several reasons: capital contributions from the General Treasury; a reduction in the relative size of assets and liabilities; the narrowing of the gap between domestic and external interest rates; and the changing composition of liabilities, which has cut their average costs.

TABLE 1.2
Central Bank Net Non-Financial Losses
(Ch$ billion, for each year)

	2006	2007	Nominal change
Costs of banknotes and coins	17.5	23.1	5.6
Personnel expenditures	18.0	20.5	2.5
Administrative expenditures	7.4	9.4	2.0
Other	1.5	-0.9	-2.4
Total	**44.4**	**52.1**	**7.7**

Source: Central Bank of Chile.

F.3 Balance sheet positions

To visualize the changes in the balance sheet that have resulted from Central Bank policies, this section provides two tables which distinguish between nominal changes in asset and liability balances arising from exchanges and those produced by nominal losses and gains and capital contributions (tables I.3a and I.3b). Central Bank losses and gains are the result of interest, readjustments and other value changes in its assets and liabilities and, to a

lesser degree, to its non-financial profits and losses. Exchanges bring modifications in the composition of its capital, without altering its level, and most closely reflect the policies seeking or achieving this effect. As part of controlling for and squaring results, we verify that the net result, minus revaluation of own capital, plus capital contributions (table I.1) is equal to the nominal change in equity (table I.3a).

To clearly identify the Central Bank's participation in the foreign exchange market, tables I.3a and I.3b group accounts according to currency positions (assets minus liabilities), distinguishing among the following: i) Position denominated and payable in pesos; ii) Position payable in pesos, but denominated in foreign exchange; and iii) Position payable and denominated in foreign exchange. Since these measures add assets and subtract liabilities, the resulting signs for balances and flows should be directly interpreted as increasing or decreasing equity. To isolate the effect of shifts in the U.S. dollar against the peso on foreign exchange reserves measured in pesos, table I.3b presents positions denominated in foreign exchange, whether payable in pesos or foreign exchange, measured in U.S. dollars. Details for components of the position denominated and payable in pesos and that payable in foreign exchange reveal the nature of operations that affect changes in the monetary base and foreign exchange reserves, respectively.

Since the monetary base is a negative component (liability) within equity, a rise appears negatively signed in table I.3a and vice versa, and changes due to exchanges among the remaining items offset shifts in the base. In contrast, given that foreign exchange reserves are a positive component (asset) within equity, positive flows increase the balance and negative flows push it downward. Exchange flows for the remaining items, with signs opposite to the table, offset changes resulting from shifts in the foreign exchange reserve balance. This analytical framework describes Central Bank operations in pesos and foreign exchange and their impact on the composition of its balance sheet.

TABLE 1.3A

Central Bank Balance Sheet Positions

(balances outstanding as of 31 December of each year and annual flows in Ch$ billion)

	Balances in 2006	Flows in 2007 (4) Exchanges (5)	Profits and △capital (6)	Balances in 2007
Denominated and payable in pesos (1)	**-9,142**	**-236**	**-570**	**-9,948**
Monetary base (2)	-3,406	-230	-36	-3,672
Central Bank promissory notes	-8,169	1,300	-690	-7,560
Banks	753	-1,199	10	-435
Other	1,680	-106	146	1,719
Denominated in foreign exchange and payable in pesos (1)	**-432**	**230**	**4**	**-198**
Denominated and payable in pesos (1)	**7,431**	**6**	**532**	**7,969**
Equity (1)	**-2,144**	**0**	**-34**	**-2,177**

TABLE 1.3B

Positions denominated in foreign exchange in the Central Bank balance sheet

(balances outstanding as of 31 December of each year and annual flows in US$ million)

	Balances in 2006	Flows in 2007 (4) Exchanges (5)	Profits and △capital (6)	Balances in 2007
Denominated in foreign exchange and payable in pesos	**-809**	**444**	**-36**	**-400**
Denominated and payable in foreign exchange	**13,904**	**23**	**2,144**	**16,071**
Foreign exchange reserves (3)	19,429	-3,965	1,446	16,910
Central Government (net)	-886	-244	811	-319
Banks (net)	-4,599	4,194	-58	-463
Central Bank bonds and promissory notes	0	0	0	0
Other (net)	-41	38	-55	-57
TOTAL	**13,095**	**468**	**2,109**	**15,672**

(1) Positions are defined as assets minus liabilities, so their sum equals equity. Given that assets are added and liabilities subtracted, the resulting signs for balances and flows should be considered positive or negative contributions to equity, according to the sign.

(2) Since monetary base is a negative component of the position denominated and payable in domestic currency, its negative flows (due to exchanges or net profit) improve and positive flows reduce this position. Exchange flows between other items offset the rise or decline due to exchanges.

(3) Since foreign exchange reserves are a positive component within the position denominated and payable in foreign currencies, its flows reflect, with the same sign, the direction of changes. Exchange flows of other items, but with opposite signs, offset increases or declines due to exchanges.

(4) Flows in general are the result of operations or imputations that translate into changes in balances.

(5) Exchange flows occur when an asset or liability changes as the consequence of an opposite change in another asset or liability. In aggregate terms, exchanges do not in themselves change equity.

(6) Includes interest, readjustments and other value changes, profits minus non-financial losses, and capital contributions.

The rise, in 2007, in the position denominated and payable in foreign exchange almost solely reflected net profits in foreign exchange and General Treasury capital contributions. Of the US$2.167 billion rise in this position, US$1.408 billion came from net profits in capital in foreign currencies, if measured in U.S. dollars, and US$736 million from capital increases arising from General Treasury capital contributions. Only Ch$6 billion (US$23 million) of this increase was financed using pesos (exchanges).

Of greater importance were the Ch$236.2 billion (US$444 million) that the Central Bank paid out in pesos to service its own promissory notes expressed in US dollars, but payable in pesos (BCD). This payment is presented as an increase (decline in liabilities) in the foreign exchange-denominated position payable in pesos. A Board resolution ruled that from October 2006 onward, servicing these documents would not be offset by issuing peso-denominated documents payable in dollars upon falling due (BCX), as had previously been the practice. The purpose of this resolution was to mitigate pressure toward a stronger peso arising from the current balance of payments. Note that in January 2008 amortization using pesos of all BCDs was completed.

F.4 Central Bank capitalization

Law 20,128, governing fiscal responsibility, empowers the General Treasury to make up to five capital contributions to the Central Bank, each in foreign exchange and worth up to 0.5% of the previous year's GDP. Accordingly, the government made a second capital contribution to the Central Bank, charged to the actual national surplus (2006), last June, worth Ch$387 billion (US$736 million). In 2006, this contribution was Ch$323 billion (US$606 million).

On specific contributions by the Genreal Treasury to the Central Bank, Board Resolution 1312-07 (28 December 2006) expressly assigned these funds to the Central Bank's foreign exchange reserves, as long as slack remains in external accounts and macroeconomic conditions remain stable.

F.5 Prepayments by the General Treasury

In 2007, the corresponding Board Resolutions accepted prepayment of the last General Treasury promissory notes issued in foreign exchange, as per Article 75 of Law 18,768. These payments, plus normal servicing of interest reached US$1.123 billion and were made in June (US$10.3 million), September (US$551.5 million) and December (US$561.7 million), thereby completely paying off this debt.

II. Institutional management and governance

A. Organization and functions

A.1 The Board

The Board has five Members, one of whom chairs it and serves as the Central Bank's Governor. The Board is responsible for the senior management of the Central Bank of Chile, as an institution of constitutional rank under public law.

Board Members are appointed by the President of Chile through a Supreme Decree issued by the Ministry of Finance, after approval from the Senate. Appointments last ten years, Members can be reappointed, and one position is renewed every two years[1]/.

The President of Chile appoints the Central Bank's Governor from among Board Members. The Governor holds this post for five years or until his appointment as Board Member expires, whichever comes first, with reappointment allowed. Along with chairing the Board, the Governor is responsible for representing the Central Bank on non-judicial matters and directing institutional relations with public authorities, financial institutions and international bodies, among other functions. Vittorio Corbo Lioi was appointed to the Board and simultaneously designated Governor from May 2003 to 6 December 2007, on which date he was replaced by José De Gregorio Rebeco, who will remain until his appointment to the Board ends.

The Board itself appoints the Deputy Governor for the period it determines. The Deputy Governor replaces the Governor and exercises other functions, as required. José De Gregorio Rebeco was appointed Board Member in June 2001 and served as Deputy Governor until 6 December 2007. Board Member Jorge Desormeaux Jiménez,

[1]/ Title II of the Central Bank's Basic Constitutional Act, as per Articles 108 and 109 of the Chilean Constitution, includes the regulations governing the Board and the legal regime specific to Board Members in terms of their appointment, remuneration, incompatibilities, impeachment, conflict of interest, causes of impeachment and other legal obligations. The last amendment to this legal body was Article 7, Law 20,088, regarding declarations of personal equity.

appointed in December 1999, became Deputy Governor on 13 December 2007, and his term will expire on 7 December 2009.

The other Board Members are Manuel Marfán Lewis (appointed in December 2003), Enrique Marshall Rivera (appointed in December 2005) and Sebastián Claro Edwards (December 2007). All were appointed for 10-year terms.

In general terms, the Board is responsible for exercising the authority and fulfilling the functions legally assigned to the Central Bank to comply with its mandate: ensuring monetary stability and the normal functioning of domestic and external payments. The Board therefore determines general Central Bank policies, issues regulations governing its operations, supervises and enforces practice in the upper levels of the Central Bank. It also conducts ongoing evaluations of compliance with general rules and policies it has established and the development of institutional activities.

Rules applied to Board sessions and resolutions

The Central Bank operates essentially through resolutions and other agreements passed by the Board according to the organizational statute to which it is subject.

The Board must hold regular sessions at least once a week, and special meetings when these are called by the Governor, of his own accord or in response to a written request from two or more Board Members. Resolutions passed must be included in the minutes from the respective meeting.

To be legally binding, Board resolutions require a minimum quorum of three Members in attendance and the majority of those present must approve, except where the law requires a special quorum, as it does for specific resolutions of particular importance[2]/. The Board Member chairing the session will cast the deciding vote in the event of a tie. The Board normally meets in its offices in Santiago, but is nonetheless empowered to meet and pass legal resolutions, regulations or otherwise make decisions elsewhere in Chile.

A.2 Mechanisms for coordination and transparency included within the institutional governance of the Central Bank of Chile

The Central Bank's Basic Constitutional Act establishes the relationships necessary for the Central Bank to fulfill its functions in coordination with the Executive and other governmental bodies, which guarantee suitable controls with regard to its actions. Provisions in this sense include:

i) Section 6, paragraph two of the Basic Constitutional Act, which defines coordination between the Board and the government, states that "on passing resolutions, the Board will keep in mind the general orientation of the government's economic policy."

ii) Before 30 April of each year, the Central Bank must submit to the Minister of Finance and the Senate a report on its activities the previous year, including policies and programs carried out during that period. The *Annual Report* must include financial statements with their respective notes and the opinion of an external auditor.

[2]/ Among other reasons, special quorum is required to approve internal regulations governing Board operation; reconsider and approve a resolution that has been suspended or vetoed by the Finance Minister; adopt, renew or terminate ahead of schedule foreign exchange restrictions; receive deposits from the General Treasury (*fisco*) or other governmental bodies; and to give up individual immunity from prosecution arising from economic and financial contracts signed by the Central Bank.

iii) In terms of information about policies adopted and annual programs, the law also requires that the Central Bank report to both the Minister of Finance and the Senate, no later than 30 September of each year.

iv) It is the Bank's duty to report to the President of Chile and the Senate regarding general rules and policies approved as part of exercising its attributes and advising the Executive, when this is requested, and in all matters having to do with its own functions.

v) The Minister of Finance can attend Board meetings, with speaking right and can propose the passing of certain resolutions. For this purpose, all invitations to Board meetings and agendas must be duly delivered in advance and in writing.

vi) The Minister of Finance can suspend any Board agreement or resolution for no more than 15 days, unless all Board Members unanimously insist on its application, in which case this suspension will not take effect.

vii) The Minister of Finance has the right to veto Board resolutions involving the imposition, lifting or amendments to foreign exchange restrictions referred to in Section 49 of the Basic Constitutional Act. In the event of a veto, the corresponding restriction can only be adopted through unanimous vote of all Board Members.

These last two indications aim to promote dialogue with the Executive before the passing of very important resolutions. This should prevent their possible suspension or veto, and thus overcome the differences in criteria that may arise with regard to economic measures, giving priority in all cases to the Central Bank's autonomy and technical nature.

Aside from these legal regulations, the Board has established different norms to keep both the authorities and the general public informed in an ongoing manner about any measures it approves, as part of ensuring the transparency of its actions, and keeping in mind that its decisions play a crucial role in the public's and the market's perceptions of Central Bank policies and their impact on the economy.

These measures include providing advance notice of the dates of monetary policy meetings and publication of the minutes from same, along with references to resolutions regarding monetary, credit, financial or foreign exchange regulations. Moreover, special consideration is due to Board Resolution 1289-01 (31 August 2006), on policy for providing information to the public. This defines how information will be released to the authorities and the public in terms of both its format and its periodicity. Its purpose is to contribute effectively to the regular and timely publication of measures adopted in terms of monetary, foreign exchange and capital market policies, and the fundamentals on which they are based.

In the same context, the Bank presents its *Monetary Policy Report* to the Senate and publishes it three times a year (in January, May and September). As of 2004, it publishes a *Financial Stability Report* twice a year (June and January). It also reports regularly on foreign exchange reserve management, covered in this *Annual Report* and in the Report on the Balance Sheet, included in its *Monthly Bulletin* (*Boletín Mensual*).

A.3 Board regulations

The current regulation on the Board's functioning involves general rules applied to meetings. These refer to how the meeting is called, how the agenda is prepared, how participation and debate take place, how minutes are prepared and how information on the matters

dealt with is released to the public. Special rules govern monetary policy meetings, dealing primarily with their frequency, participants, ordering of matters and debate, minutes, summary of discussion, and release of resolutions through a public news release, sent out once the respective meeting ends.

Given its importance and to make it as widely available as possible, this regulation was published in the *Official Gazette* and is on the Central Bank's website, *www.bcentral.cl*

A.4 Appointment of the new Governor and Board Member

Through Supreme Decree 1550 (2007) issued by the Ministry of Finance and published in the *Official Gazette* on 29 December 2007, the President of Chile appointed José De Gregorio Rebeco to the post of Governor of the Central Bank of Chile, as of 7 December 2007 and for the period remaining to him as Board Member (until 9 December 2011). Similarly, Supreme Decree 1557 (2007) issued by the Ministry of Finance and published in the *Official Gazette* on the same date, appointed Sebastián Claro Edwards to the Board, for a ten-year term beginning on 7 December 2007.

A.5 General management, General Counsel and Audits

Sections 24, 25 and 26 in the Basic Constitutional Act indicate that the General Manager will manage and supervise the Central Bank on a daily basis, according to instructions and faculties provided by the Board. The General Counsel must ensure the Bank's legal structures are respected and control legal risk associated with Central Bank actions. The Bank's General

Auditor is responsible for inspecting and enforcing internal regulations regarding accounts, operations and administrative rules.

Since 7 August 2006, Alejandro Zurbuchen Silva has served as General Manager, and Leonardo Hernández Tagle as Deputy General Manager. Miguel Angel Nacrur Gazali has served as General Counsel and Certifying Officer since 1997. Silvia Quintard Flehan has served as General Auditor since 1 January 2007.

A.6 Appointment of the Audit and Compliance Committee

Board resolutions 1330-01-070419 created the Audit and Compliance Committee and approved its terms of reference. As an advisory body to the Board, this Committee fulfils its roll by performing tasks that involve reporting on the effectiveness of internal control systems and procedures; assessing and reporting on the implications for bank capital and reputation of complying with its obligations; assessing confidentiality, integrity and delivery of information forming part of financial statements; coordination with the Central Bank's General Auditor in terms of the roles assigned by the Basic Constitutional Act; and proposing the hiring of external auditors.

The Committee, which enjoys due independence in the performance of its functions, is covered by a special statute approved by the Board, which establishes that its members will serve three-year periods that are renewable for partial periods of one each year. This statute also requires ordinary Committee meetings be held at least four times a year, notwithstanding the special sessions that the Committee itself may decide to hold.

The purpose of creating the Audit and Compliance Committee and appointing independent professionals to sit on it was to increase efficiency in Board compliance with its role, as per the Basic Constitutional Act governing the Central Bank. Current members are Luis Bates H., University of Chile lawyer and Doctor of Law from the *Universidad Complutense*, chair; Vivian Clarke L., Bachelor of Commerce from the Catholic University of Chile, specializing in corporate administration, General Accountant and Chartered Accountant; and Francisco Mobarec A., Bachelor of Commerce, University of Chile, with a mention in Administration and Chartered Accountant.


Alejandro Zurbuchen Silva
General Manager

B. Internal administration

B.1 Strategic planning

In 2007, the Bank continued to apply the medium-term measures defined in its strategic plan for 2006–2008, introducing the necessary adjustments for the successful short- and medium-term implementation of this plan. Thus the mission, vision, values and strategic objectives remain its central pillar and the foundation of the strategic plan 2008, approved by the Board in December 2007. The areas registering the most progress in 2007 were human resources, informatics, management, corporate governance, communications and transparency.

B.2 Internal organization, restructuring and the appointment of executives

In 2007, the Bank implemented some changes in its internal structure to boost the efficiency of its management. Thus, in January it eliminated the Department of Information and Surveys (under the Information and Statistical Research management area), moving all its functions to the Foreign Exchange and Trade Policy management area. As a result, this last unit became the Foreign Exchange and Statistics management area, with corresponding changes in the names of its departments, to suitably reflect their new functions. To the same end, in February functions were reassigned within the Informatics management area, which also brought changes to the names of some of its departments. Finally, and to prepare the Central Bank for future challenges in the field of currency management, in December a department for researching and developing currency (*Departamento de Investigación y Desarrollo de Circulante*) was set up within the Treasury management area. This change came into effect on 1 January 2008.

Together with these measures and as a result of the search for greater efficiency, in December the Bank replaced the positions of Chief Counsel (*Abogado Jefe*) and Senior Counsel (*Abogado Primero*), with those of Chief Counsel of Corporate Legal Services (*Abogado Jefe de Servicios Legales*) and Normative Legal Services (*Abogado Jefe Normativo*), both at the managerial level. Appointed to these posts were Juan Esteban Laval Zaldívar and Pablo Mattar Oyarzún, respectively. Finally, the retirement of some executives led to new appointments in December: Pablo García Silva became manager of the Research Division (replacing Rodrigo Valdés Pulido), Kevin Cowan Logan took over as manager of the Financial Policy Division (replacing Pablo García Silva) and Beltrán De Ramón Acevedo took over as manager of the Financial Operations Division (replacing Esteban Jadresic Marinovic). This last appointment took effect in January 2008.

B.3 Human resource management

In 2007, human resource management focused on continuing strategic projects begun in recent years, dealing with policies for managing individuals and the organizational climate. Similarly, 2007 was important to labor relations, since a new collective bargaining process was completed with the union. The main progress in this area included the following.

Individual management policies

At the last Board session chaired by Vittorio Corbo Lioi, the Board approved individual management policies prepared by a work team led by the General Manager. These policies offer a general framework based on workers' labor cycle within the Bank, organized according to ethical principles, mission, vision and institutional values.

As part of the continuation of this project, as of publication of this *Annual Report*, the Bank was preparing the respective operating regulations for the different human resources subsystems (hiring and retirement of personnel, posts and compensations, training and development, career development and performance management). This was entering final stages with implementation expected in 2008.

Training

As part of the modernization process begun in 2004, ongoing skills development for executives and directors was considered necessary. In this context, a second version of the program on leadership skills and strategic development (*Programa de Habilidades Directivas* *y Desarrollo Estratégico*), was carried out with participation from the remaining 50% of managers and directors not trained in 2006. As in the previous year, this program dealt with high-yield team development, leadership, strategic planning, effective communication, team work, network management, innovation, negotiation and conflict resolution, among the main subjects. Similarly, to strengthen critical skills and know-how, in 2007 a series of workshops were held to deepen relevant knowledge about leadership, communications, team work, self-management, among others, especially for managers and department chiefs participating in the 2006 version of this program.

During the year, training continued both internally and outside the Bank. Thus, 28 courses were delivered within the Central Bank, mostly by using internal instructors.

Competencies

To continue to progress in personnel management policy initiatives, in late 2007 implementation of a competency based management model began, similar to that applied in other central banks, considered reference points in terms of human resources.

The first activity involved training human resource management area staff. Later, profiles of the competencies needed were developed for the three groups of directors within the bank, specifically division directors, area managers and department chiefs. A series of benefits come with the competency management model, mainly with regard to guiding the behavior

of Central Bank professionals in terms of achieving targets and remaining consistent with institutional values, promoting excellence, and improving professional development, and personnel selection processes.

Performance evaluation and target-setting

In March 2007, the new performance evaluation (redesigned in 2006) was applied to all Central Bank employees, including chiefs and directors. This form not only measures compliance with goals or functions, but also aspects of how personnel perform in terms of their consistency with institutional conduct and values. In the case of chiefs, the instruments also included variables for leadership skills.

In March, also for the first time, a formal process for setting goals for all Bank professionals occurred, using a cascading methodology from the most senior managers on down.

Organizational environment

In May 2007, a second survey for measuring the organizational climate was applied, in management areas not studied in 2006. The survey evaluated several factors and results were reported to the Board, the Central Bank in general, and each of the units under evaluation. Then each unit set up working groups to deal with the most critical variables identified by

the study. Thus, practically every management area prepared action plans to improve the variables with the largest gaps. The Central Bank decided to give this element an ongoing and integral treatment, with frequent measures (every two years) starting in 2009.

Collective bargaining

In 2007, the Bank signed a new collective contract with its union, which will last for four years. The whole process took place within the legally defined periods for negotiations and was signed on 29 June 2007.

B.4 Controls management

The Comptroller's activities focus on helping the Board and management to fulfill their duties, through an independent, objective and systematic evaluation of the design and effectiveness of risk management, internal controls and corporate governance. It also does some consulting that, combined with the above, adds value and helps it to meet its own institutional objectives.

In 2007, the main challenges involved implementing the Audit and Compliance Committee and advancing its activities; and developing a quality management system based on ISO 9001:2000, achieving certification of its audit process, thereby contributing to improvements by apply international best practices and standards, to provide quality service, add value to its functions, and meet its strategic goals.

B.5 Main contracts and consultancies

In line with rules in the Bank's constitution on regular reporting to the public by the Central Bank, the main contracts for purchasing goods and services are presented below. To improve transparency, we provide the main contracts signed in 2007, worth more than Ch$100 million. Their purpose is to provide goods and services necessary to the normal functioning of the Bank (tables II.1 and II.2). On the issuing of banknotes and coins, section D.6 on providers and money-related security provides general information on contracts as per the 2007 schedule.

TABLE II.1

Contracts signed in 2007

(amounts higher than Ch$100 million for the time they are in effect)

Supplier	Purpose	Starting date	Ending date
PROD. GRÁFICA ANDROS LTDA.	PUBLICATION PRINTING SERVICE	01/01/2007	01/01/2010
TECH ONE GROUP S.A.	INFORMATICS AND TECHNOLOGY SERVICES	01/01/2007	01/01/2010
WILSHIRE ASSOCIATTES INCORPORATE	INFORMATION SERVICES	19/01/2007	Indefinido
PATRIMONIO CONSULTORES ASOCIADOS LTDA.	CONSULTING AND IMPLEMENTATION OF THE "CLOSE-UP ON THE ECONOMY" PROGRAM	26/03/2007	26/03/2010
AGENCIA VIAJES FORUM LTDA.	TRAVEL AGENT AGREEMENT	01/05/2007	01/05/2010
TRAVEL SECURITY S.A.	TRAVEL AGENT AGREEMENT	01/05/2007	01/05/2010
EQUANT CHILE S.A.	INFORMATICS AND TECHNOLOGY SERVICES	12/05/2007	12/05/2010
AQUILES GÓMEZ Y CÍA. LTDA	SPORTS STADIUM ACTIVITIES SERVICE	15/06/2007	15/06/2010
DEMARCO S.A.	CLEANING SERVICES	01/10/2007	01/10/2012
PROVEEDORES INTEGRALES PRISA S.A.	OFFICE SUPPLIES SERVICE	01/10/2007	01/10/2010
UNIVERSIDAD DE CHILE	PROVISION OF STATISTICAL PRODUCTS	01/10/2007	31/01/2008
SUNGARD REFERENCE DATA SOLUTIONS	STATISTICS GENERATION SERVICE	10/10/2007	10/10/2010
WALL STREET SYSTEMS SWEDEN AB	INFORMATICS AND TECHNOLOGY SERVICES	10/10/2007	10/10/2012
DELOITTE & TOUCHE SOCIEDAD DE AUDITORES CONSULTORES LTDA.	CONSULTING FOR EVALUATION AND SELECTION OF AN INTEGRATED SYSTEM (ENTERPRISE RESOURCE PLANNING, ERP)	24/10/2007	24/11/2008
EMC CHILE S.A.	INFORMATICS AND TECHNOLOGY SERVICES	30/11/2007	30/11/2008
ING. Y ASESORÍAS EN COMPUTACIÓN Y COMUNICACIÓN NEOSECURE S.A.	INFORMATICS AND TECHNOLOGY SERVICES	15/12/2007	15/12/2010
CONSTRUCTORA BIGGEMANN Y DATTWYLER LTDA.	CONSTRUCTION SERVICES	27/12/2007	27/06/2008

Source: Central Bank of Chile.

TABLE II.2

Expenditures on consultants, surveys, studies and seminars (*)

(Ch$ million of 2007)

	2003	2004	2005	2006	2007
Consultants	609.6	466.2	406.4	467.3	1,529.4
Surveys and studies	388.6	630.9	428.4	249.4	280.3
Seminars	129.9	148.9	123.8	134.4	211.5

(*) Average CPI was used to update figures from previous years to 2007 pesos.
Source: Central Bank of Chile.

C. Operating expenses

Operating expenses include staff wages and benefits, the use and consumption of goods and services, and other associated expenditures necessary for carrying out Central Bank activities (table II.3). In the financial statements, they are broken down as follows: i) personnel; ii) administration; iii) depreciation, amortization and write-offs; and iv) taxes, contributions and others. Of total operating expenses, personnel accounts for 63%; administration, 29%; depreciation, amortization and write-offs, 7%; and taxes, contributions and others, 1%.

Personnel expenditures

From 2003–2007, personnel expenditures rose a real 22.2% for this five-year period, from Ch$16.786 billion in 2003 to Ch$20.505 billion in 2007. This reflects a gradual shift in the job structure, characterized by professionalization of the Central Bank and a decline in administrative, secretarial and service personnel. From December 2003 to 2007, employees rose 4.3%, from 600 to 626 staff. Professionals, along with executives and senior management accounted for 48% of total staff in 2003, rising to 66% in December 2007. For the future, this trend toward more professionals is expected to continue. The real increase, 8.9%, in personnel expenditures in 2007 over 2006 mainly reflected a rise in spending on wages given a larger staff and the payment of a bonus to celebrate completion of collective bargaining.

Administrative expenditures

Administrative expenditures rose a real 3.1% from 2003 to 2007, going from Ch$9.112 billion to Ch$9.392 billion. The rise mainly reflects more spending on general services and consultants, surveys, studies and seminars. The real 21% rise in administrative expenditures in 2007 over 2006 reflects more spending on consultants and professional services.

TABLE II.3

Main operating expenses

(Ch$ million 2007)*

	2003	2004	2005	2006	2007
Operating expenses					
Personnel	16,786.3	17,928.9	18,004.7	18,834.4	20,505.0
Administration	9.111.5	7,785.3	7,090.9	7,762.9	9,391.6
Depreciation. amortization and write-offs	1,449.3	1.730.5	1,735.6	1,487.6	2,215.2
Taxes, contributions and others	568.1	527.8	502.4	481.9	447.3
Total	**27,915.2**	**27,972.5**	**27,333.6**	**28,566.8**	**32,559.1**
A. Personnel expenditures					
Wages and other employer contributions	13,600.4	14,470.3	14,397.1	15,048.5	16,880.0
Staff welfare	1,888.7	1,936.3	1,998.1	2,063.0	2,104.2
Training	211.6	303.5	449.8	642.2	628.2
Provision for severance pay (years of service)	1,085.6	1,218.8	1,159.7	1,080.7	892.6
Total	**16,786.3**	**17,928.9**	**18,004.7**	**18,834.4**	**20,505.0**
B. Administrative expenditures					
Basic utilities	613.4	634.8	639.6	635.3	737.6
General services	2,283.8	2,690.6	2,800.9	2,878.5	3,014.2
Maintenance of fixed asset goods	954.8	1,012.0	427.5	881.2	681.9
Expenditures on computers and technological development	4,131.3	2,201.9	2,264.3	2,516.8	2,936.7
Consulting, surveys. studies and seminars	1,128.2	1,246.0	958.6	851.1	2,021.2
Total	**9,111.5**	**7,785.3**	**7,090.9**	**7,762.9**	**9,391.6**

* The average CPI was used to update figures in pesos from prior to 2007.

Source: Central Bank of Chile.

D. Communications and diffusion

D.1 Main publications

Throughout 2007, the main purpose behind the Central Bank's publications policy was to increase transparency in the delivery of economic information, improve its timeliness, and provide the public with information on key economic issues. The main publications for this purpose remained the *Monetary Policy Report* and the *Financial Stability Report.* The first, published in January, May and September of each year, analyzes economic and financial conditions, explains the fundamentals behind policies and offers the main prospects for short- and medium-term scenarios. The second offers a relevant analysis of the macroeconomic and financial environment in Chile and abroad, as it relates to financial system stability. It also includes an analysis of trends in borrowing and credit users' ability to pay, conditions facing non-bank financial intermediaries, the impact of these indicators on the banking system, and the Chilean economy's international financial position. This publication also includes different articles summarizing recent Central Bank research on issues affecting financial stability.

In January 2007, the document *The Central Bank of Chile's Monetary Policy Framework*, *Based on Inflation Targeting*, was published. This presents the institutional context in which monetary policy is developed and applied, the Board's view of the policy framework, including its objectives, transmission of monetary policy, leadership and operations, and the role played by transparency and communications. Its purpose is to facilitate comprehension of the reasons guiding monetary policy decisions among the public and economic agents. This document, published in English and Spanish, replaced the publication *Monetary Policy of the Central Bank: Objectives and Transmission* (May 2000).

In March 2007, the Bank's economic research area published volume 11, *Monetary Policy under Inflation Targeting*, of the series *Central Banking, Economic Policies and Analysis*. This series focuses on issues and policy regarding economic leadership in developing countries. The collection has become a major point of reference for economic research in many countries, especially Latin America. This last volume in particular offers papers presented to the Central Bank of Chile's Ninth Annual Conference, held in October 2005.

The Central Bank's economic research also saw publication in the periodical *Economía Chilena*. Eleven papers and eight research summaries were included in the April, August and December 2007 editions. The subject matter mainly involved the Chilean economy, from an empirical perspective or in terms of economic policy leadership.

During 2007, four issues of the economic policy document series, *Documentos de Política Económica*, were published, offering the thinking of Bank authorities on relevant economic and monetary policy issues. These included the challenges and opportunities facing Latin American economies involved in globalization, Chile's economic growth from a long-term perspective, policy lessons from the Chilean banking system's experience with implementing Basel II agreements, and monetary policy in Chile within the inflation-targeting scheme of the past 16 years.

Similarly, Bank researchers published 47 working papers (*Documentos de Trabajo*). This series has become one of the most important internationally in the field of specialized economics, given the number of Internet consultations, whose purpose is primarily to facilitate the exchange of ideas and make preliminary economic research results better known, for discussion and commentaries.

The Bank also published eight new papers within the economics statistics series, *Estudios Económicos Estadísticos.* The purpose of these publications is to provide information on empirical research in the field. These papers generally are final by nature, in the sense that they are not published again in other media. The new papers published in this series covered overlapping GDP and expenditure components, for annual and quarterly series (1986-2002) with 2003 as the base year, and a paper published in December dealing with the characterization of turbulence and its effects on portfolio investment in emerging economies.

In October, the Bank published the bilingual document *Publicaciones Académicas/Academic Publications 2005-2006*, a catalogue of academic publications and working papers by Central Bank and associated external researchers (2005-2006). The publications highlighted in this catalogue represent the final product of much of the research that the Central Bank has carried out or fostered.

In July, the Bank published a methodological paper called *Producto Interno Bruto Regional 2003-2005, base 2003*, on its website, along with a set of statistics in Excel, which included the results of regionalizing GDP by economic sector as per the 2003 reference.

Moreover, and in line with Section 53 of its Basic Constitutional Act, in terms of providing information on the main domestic macroeconomic statistics, the Central Bank carried out its annual periodical publications program, publishing a series of daily, monthly and other publications including key indicators and analysis, among them, its *Informativo Diario, Boletín Mensual, Indicadores de Comercio Exterior, Indicadores Macroeconómicos y de Coyuntura,* and the yearbooks *National Accounts/Cuentas Nacionales, Balanza de Pagos, Chilean External Debt/Deuda Externa de Chile, Síntesis Monetaria y Financiera, and Statistical Synthesis of Chile/Síntesis Estadística de Chile.*

D.2 Visits to the Senate

As per the provisions in the Basic Constitutional Act regarding the requirement to report on policies and regulations issued, the Board presented its *Monetary Policy Report* for January and May to the Senate Finance Commission and the September *Report* to the plenary of the Senate. Similarly, in June it presented its *Financial Stability Report* (first half 2007), to the same Commission for the first time.

D.3 Seminars and conferences

From 16-19 March, the Bank organized its Ninth Workshop on International Finance and Economics (*IX Taller de Economía y Finanzas Internacionales*), in cooperation with the Torcuato Di Tella University (Argentina), the World Bank and Inter-American Bank (IDB). Distinguished Chilean and foreign economists met to analyze papers, selected for their theoretical and empirical contribution to the debate on macroeconomics and finance, by authors from major universities and world institutions. Presenters included the then Governor of the Central Bank of Chile, Vittorio Corbo; an economist formerly with Cieplán, Mario Marcel; the World Bank's former chief economist for Latin America and the Caribbean, Guillermo Perry; and a professor of economics and international and public affairs from the University of Columbia, Guillermo Calvo.

On 30 March, economists with different regional universities, the National Statistics Bureau (*Instituto Nacional de Estadísticas*, INE) and the Central Bank participated in a workshop on regional economic research, with presentations on data and background of current regional

conditions, an inventory of regional research and international comparisons, and a discussion of different issues involved in economic research in regions.

In April, distinguished Chilean and foreign economists participated in a seminar on the effects of China in Latin America (*Los Efectos de China en América Latina*), analyzing that country's strong growth, its soaring participation in international markets and how this will affect the region.

In June, a seminar on unobservable variables in macroeconomics (*Variables Inobservables en Macroeconomía*) offered an opportunity for academics and professionals in general to examine the results of a research agenda focused on developing alternative models for estimating and projecting for unobservable variables, specifically: the neutral interest rate, potential product, the real equilibrium exchange rate and the natural unemployment rate.

On 13 July, executives responsible for managing financial operations at the main central banks in Latin America met at the Americas Meeting, to discuss issues of common interest.

In August, the Central Bank, the School of Public Administration at Chile's Catholic University, and the business and economics section (*Economía y Negocios*) of the newspaper *El Mercurio*, held a joint seminar on economics and finance specifically for journalists, to bring them up to scratch and improve their understanding of the economy, to improve information reported to the market. For this same reason, training seminars were held for regional journalists as part of meetings held in May and September in Antofagasta and Puerto Montt to provide more information on the *Monetary Policy* and *Financial Stability Reports.*

On 4-5 October, representatives from the Americas, Europe and Asia met during the Third Meeting of Central Bank Security Chiefs, co-organized with the Centro de *Estudios Monetarios* Latinoamericanos, Cemla. The meeting aimed to deepen understanding of the activities involved in banking security and how these can be included in banks' internal processes in each country, integrating best practices in strategic planning and risk management directly into the management of security.

From 8-10 October, the congress, *II Congreso Internacional de XBRL en Iberoamérica,* organized together with the *Banco de España*, internal revenue service (*Servicio de Impuestos Internos*) and the Superintendencies of Banks and Financial Institutions, Pension Fund Managers, and Securities and Insurance, to promote interest in the XBRL standard throughout the region, as part of reviewing regional initiatives in this sense and providing more information on Spain's experience.

On 14 November, the Bank participated in the second summit on central banks and inflation targeting (*Segunda Reunión Cumbre de Bancos Centrales sobre Metas de Inflación*), to exchange opinions and experience on monetary policy management in countries using the inflation-targeting approach. On this occasion, the governors, directors and chief economists of 24 of the world's central banks using inflation targeting or in the process of adopting this system, participated, along with representatives from international bodies and academics from foreign universities.

On 15-16 November, the Bank held its 11th annual conference (*Undécima Conferencia Annual del Banco Central de Chile*), focusing on monetary policy during times of uncertainty and learning. The purpose of the meeting was to improve policy-makers' understanding of the implications of uncertainty for monetary policy, and to develop tools, frameworks and models that incorporate an analysis of uncertainty into policy and private sector decisions. This also required focusing on how expectations are shaped and the role that learning (for both central banks and market agents) plays in their own behavior and its effects on macroeconomic performance. The conference brought together academics, central bank researchers and monetary policy makers who have developed pioneering research (both theoretical and empirical) on the implications of uncertainty for data and models, and the role of learning in applying monetary policy. Speakers included Stanley Fisher, current Governor of the Central Bank of Israel, and Thomas Sargent, a New York University professor.

In 2007, the Bank continued to hold its seminars on macroeconomics and finance, which involved 28 talks during the year. These focused on generating exchanges about theoretical and applied work among researchers, university professors, students and Central Bank staff. Speakers included researchers from central banks, foreign institutions and universities, and some of the issues dealt with included China's impact on the world economy, a comparative analysis of Asian and Latin American markets and economies, inflationary impacts of an oil price shock, macrofinancial risk, volatility, employment and income distribution.

D.4 "Economics for the Majority" program

As part of its diffusion program, "Economics for the Majority", the Central Bank continued to organize guided tours, a program begun in 2004, which involves visits to its main premises. During the year, more than 4,500 people visited its headquarters, most of them students.

For the third year running, the bank organized its competition *La economía + cerca* (Close-up on the economy). This initiative, designed to bring economics closer to students and foster greater awareness of the Central Bank's role and functions, is organized by the Bank and sponsored by the Ministry of Education. Third- and fourth-year high school students from all over the country work in groups under the guidance of a professor on a project that,

For the third year running, the bank organized its competition *La economía + cerca.*

from a down-to-earth perspective, deals with the impact that Central Bank decisions have on the country, their region, municipal area or household.

This year, the Bank received 493 essays from 286 public, private and subsidized private schools, all over Chile. The winning group came from Temuco's *Colegio Pumahue*, with its essay *Niveles de conocimiento y confianza manifestados en el Central Bank y su autonomía por un grupo de agentes económicos de la comuna de Temuco.* In second place, La Serena's Trinity School presented its paper *Estado de shock: la desestabilización de los precios y su impacto comparativo en el bienestar de la población*, while in third place, a group from Concepción's *Colegio de la Santísima Trinidad* presented its essay, *La revolución del plástico.*

In November, the Bank launched an educational video on price stability and its importance to viewers, *La estabilidad de precios: ¿por qué es importante para ti?* Using cartoons and in around seven minutes, it explains the importance of price stability and controlling inflation. The video is an authorized adaptation of a similar film prepared by the European Central Bank and during its first phase was distributed to more than 2,000 schools all over Chile. By the end of 2008, all schools should have a copy.

D.5 Visits to regions

To foster learning and familiarity with Bank objectives, policies, instruments and projections among the population at large and thereby achieve greater and better understanding of its actions and policy impacts, the Central Bank continued to present its main reports (*Monetary Policy Report, Financial Stability Report*) as part of its regional meetings program.

These meetings, which coincide with publication of the *Monetary Policy Report* every four months, and the *Financial Stability Report*, twice yearly, are complemented by other talks on Central Bank policies and instruments and a panel on development perspectives for the region visited. In 2007, sessions took place in Antofagasta, Arica, Copiapó, Puerto Montt, Temuco and Valparaíso, and were chaired by Board Members.

The Bank organizes these meetings in association with a university or regional business group, and they offer a valuable opportunity for bringing together the community, business people and regional authorities, offering direct and fluid dialogue to foster greater mutual awareness between the Bank and different economic sectors in each region. Attendance ranges from 75 to 350 people.

Board Members and other senior management also made several presentations outside Santiago, in response to invitations from academic bodies, associations, or the media.

The Central Bank opened its sixth annual exposition, called BordeMar-AltaMar.

D.6 Cultural diffusion

For the fourth year running, on Sunday 27 May the Central Bank participated in Chile's national heritage day, organized by the government and involving the participation of more than 50 heritage buildings. The Governor and other authorities received almost 2,000 people, explaining the Bank's role and main functions.

In early November, to offer the public the opportunity to enjoy its valuable collection of paintings, the Central Bank opened its sixth annual exposition, called *BordeMar-AltaMar*. The show included 18 paintings, all with an ocean-related theme and was visited by around 2,000 people, from 6 November to 28 December. It was free and included a specialized guide, expert in art history, and a video in which the director of Chile's national fine arts museum and curator of this show, Milan Ivelic, explained in detail each of the works on exhibition.

E. Miscellaneous

E.1 Technological change

The year 2007 saw the consolidation of a multi-year plan started in mid-2004 to improve the technological infrastructure, informatics services and support systems. It focused on reaching market standards in information technologies, their security, and communications, and including best practices in terms of technological management. For this purpose, the Central Bank constantly compares itself to other central banks and similar institutions and has committed to international standards such as COBIT, for information technology governance; ITIL for managing informatics infrastructure and processes; PMI for project management; and BS-7799 for informatics technology security.

The main activities in 2007 with regard to infrastructure included completion of the renewal of users' work stations, migration from the Novell network to the Microsoft network, inclusion of cooperative working tools (which have been quickly adopted by the different units in their daily processes), data base technology consolidation and renewal, and the start of centralized back-up and storage systems renewal.

In the field of informatics technology security, the Banks has focused on mechanisms for protecting against and detecting intrusions, both at the main site and alternative processing sites, inclusion of protective mechanisms at the application level (application firewall), and the start-up of a process to include protection at the individual work station level (personal firewall).

Finally, in 2007 the Bank consolidated its application quality control service (QA), focusing on strategic projects and services critical to its work, implementing a projects office for monitoring and controlling project execution (PMO). Moreover, state-of-the-art technological tools were added for some business areas, such as the international investment management area, which manages external asset portfolios, and the Risk Assessment and Management Department, which monitors and controls compliance (middle-office).

E.2 Independent auditors appointed

Paragraph two of Section 76 of the Basic Constitutional Act establishes that financial statements must be approved by external auditors appointed by the Board from among those registered with the Superintendency of Banks and Financial Institutions. As a result, through Resolution 1341-01-070628, the Board renewed its contract with *Ernst & Young Servicios Profesionales de Auditoría Ltda.*, to audit its financial statements through 31 December 2007.

E.3 Sale of *Banco de Chile* shares

As part of the capital increase agreed upon with the shareholders meeting of *Banco de Chile* and as per Article 30 of Law 19,396, in July 2007, the Central Bank set a market price for selling off its preferential subscriber rights to *Banco de Chile* shares, owned by the *Sociedad Administradora de la Obligación Subordinada* (SAOS S.A.) and which were subject to a lien on behalf of the Central Bank, as part of a guarantee of payment of its subordinated debt.

In October, the Board agreed to auction off the subscription rights not purchased during the special preferential offer period in the stock market. In November 2007, this sale was suspended, given conditions on international financial markets, which had affected the price structure and offers received. Because of all this, the Central Bank instructed SAOS S.A. to inform the general public that these preferential subscription rights would be sold on the stock market at prices and in conditions to be determined by the Board before the 5 March 2008 deadline.

E.4 Banknotes and coins

In 2007, the Central Bank continued its training program to help the community get to know its banknotes and ways of ensuring their authenticity. During the year, it trained 1,511 commercial bank tellers and staff responsible for 826 teller machines in Santiago and regions. The Bank also distributed more than 19,000 leaflets and 1,000 posters to banks, stores and public institutions, and the information on the website continues to serve people handling cash.

By the end of 2007, the number of banknotes in circulation stood at 448.73 million, up 13.8% over late 2006 (394.16 million). Total coins were up 6.85%, to 7.93433 billion. To satisfy growing public demand, during the year banknote and coin supply contracts were signed with local and international suppliers, for a total of 598.8 million banknotes and 975.6 million coins, as follows: 50.9 million 20,000-peso banknotes; 160.2 million 10,000-peso banknotes; 75.2 million 5,000-peso banknotes; 30 million 2,000-peso banknotes; 282.5 million 1,000-peso banknotes; 25 million 500-peso coins; 60 million 100-peso coins; 29.6 million 50-peso coins; 313.2 million 10-peso coins; 199.2 million 5-peso coins, and 348.6 million 1-peso coins. Banknotes and coins issued in 2007 were produced in Australia, Canada, Chile, France and England.

At year's end, the Central Bank started to update the designs on Chilean banknotes, in preparation for the celebration of Chile's 200th Independence anniversary. It considers the bicentennial an appropriate moment to renew artistic design and reinforce banknotes security, so it will require more technological capacity from its suppliers of legal currency, thereby providing citizens with safer, easier to recognize means of payment.

E.5 International relations and activities

In 2007, the Central Bank continued to promote Chile's integration into the world, through its regular activities as well as an intense agenda of special initiatives. The former included participation of its authorities and senior executives in bi-monthly and annual BIS meetings, the spring IIF and IMF meetings, annual IDB and IIF meetings, the joint annual IMF and World Bank meeting, the Mercosur and associated countries central bank president meeting, Cemla governors meeting, along with visits to other central banks. During the year, the Bank also received missions from the International Monetary Fund (5), the World Bank, and eleven groups of MBA students from foreign universities.

Special activities included international seminars held in Santiago, already mentioned, and visits from senior authorities and technical personnel from other central banks. These included visits from the Governor of France's Central Bank (February), the Governor of the Federal Reserve Bank of Atlanta (February), the Director of the Bundesbank (March), the Assistant Governor of China's People's Bank (May), the Governor of the Central Bank of India (June), the President of the New York office of the Central Bank of Indonesia (June), the then candidate and currently Managing Director of the International Monetary Fund (August), the Governor of the Central Bank of Greece (October), the Executive Director of Norges Bank Investment Management (October) and the Governor of the *Banco de España* (November). Also in 2007, the Bank received technical and staff visits from the central banks of Paraguay (February), Ecuador (April), Argentina (April), Spain (May/June) and Colombia (June), and held two working seminars in the context of IMF missions received in May and December.


BANCO CENTRAL DE CHILE

Appendix I: Monetary policy meeting press releases, 2007

11 January

At its monthly monetary policy meeting, the Board of the Central Bank of Chile decided to reduce the annual monetary policy interest rate (MPR) from 5.25% to 5%.

The information accumulating in recent months points to a low-inflation scenario for coming quarters, which justifies this cut to the interest rate, to keep inflation around the 3% target over a policy horizon of around two years.

The external scenario relevant to the Chilean economy remains favorable. Despite the U.S. economic deceleration, global growth is strong, while international financial conditions remain favorable. Oil and copper prices have dropped in recent weeks, suggesting a faster than expected return to normal.

Information available suggests that, although domestic activity recovered some dynamism, gaps arising from an unforeseen dip in growth last year will persist for several quarters, despite vigorous domestic demand, especially in consumption, increased salaried employment and reduced unemployment. Domestic financial conditions remain favorable.

Headline and core inflation are between 2% and 3%, considerably below earlier projections. Aside from the drop in oil prices, these measures have been influenced by wider output gaps and reduced cost pressures. Other trend inflation indicators are still low, although some show early signs of a reversal, explained by seemingly one-off factors. In the short term, inflation is projected to approach 3% for a while, because of the basis of comparison, before falling closer to 2% for a few quarters and then approaching 3% in about two years.

The Board reaffirms its commitment to conducting monetary policy to keep projected inflation around 3% over the policy horizon. Future changes in the MPR to achieve this goal will depend on new information and its implications for inflation projections.

8 February

At its monthly monetary policy meeting, the Board of the Central Bank of Chile agreed to keep the monetary policy interest rate at 5% annually.

The external scenario relevant to the Chilean economy remains favorable. Global growth remains strong, while international financial conditions are still positive. The copper price has fallen further, although more gradually than in recent months, while the oil price has rebounded. Both movements are consistent with the baseline scenario in the last *Monetary Policy Report*.

The information available shows that domestic activity recovered some dynamism during the fourth quarter of 2006, in line with estimates in the last *Report*. Salaried employment continues to rise. Domestic financial conditions remain favorable, and the nominal yield curve has declined.

Headline inflation evolved according to forecasts in the last *Monetary Policy Report*. Core CPIX and CPIX1 measures (which exclude fuels and perishables, and some regulated utilities, respectively), increased somewhat more than anticipated, although these increases do not warrant a change in the baseline scenario. Labor costs are still contained, and medium- and long-term inflation expectations remain anchored around 3%.

The Board reaffirms its commitment to conducting monetary policy to keep projected inflation around 3% over the policy horizon. Future changes in the MPR to achieve this goal will depend on new information and its implications for inflation projections.

15 March

At its monthly monetary policy meeting, the Board of the Central Bank of Chile agreed to keep the monetary policy interest rate at 5% annually.

The external scenario relevant to the Chilean economy remains favorable, despite increased volatility and price adjustments affecting some assets in international financial markets. The latter has had mild consequences in the domestic financial market. Global growth remains strong, the copper price has strengthened, exceeding estimates in the latest *Monetary Policy Report's* baseline scenario, and the oil price is somewhat above earlier projections.

Information available is consistent with a gradual increase in internal output dynamism, in line with forecasts in the last *Report*. Recently announced government measures support this scenario. Salaried employment continues to grow, although somewhat less intensely than in recent months. Internal financial conditions look more favorable than they have in recent months.

Beyond changes in prices as a result of the implementation of *Plan Transantiago*, annual measures for CPI and CPIX (which exclude fuels and perishables) are evolving as forecast in the last *Report*. Meanwhile, annual CPIX1 inflation (which also excludes some regulated utilities and other goods), has been higher than projected, but more moderate in the past month. Alternative measures for trend inflation show mixed paths. Although labor costs remain contained and long-term inflation expectations anchored around 3%, some wage indicators show increased growth.

The Board reaffirms its commitment to conducting monetary policy to keep projected inflation around 3% over the policy horizon. This means that, should inflationary risk fade amidst consolidation of the baseline scenario in the last *Monetary Policy Report*, a somewhat greater monetary impulse could be necessary in coming months.

12 April

At its monthly monetary policy meeting, the Board of the Central Bank of Chile agreed to keep the monetary policy interest rate at 5% annually.

The external scenario relevant to the Chilean economy remains favorable. World growth is still high. The copper price has increased strongly and is now considerably above baseline projections in the last *Monetary Policy Report*. Oil and derivative prices, especially for gasoline, have risen beyond projections and other commodity prices have also increased.

Information available continues to reflect increased dynamism of domestic output, in line with forecasts in the last *Report*. Salaried employment is still on the rise and domestic financial conditions remain favorable.

CPI inflation is somewhat below 3%, as projected. This is the result of changes in the price level due to the startup of *Plan Transantiago*, increased fuel prices with respect to January and core CPIX1 inflation (which excludes fuels, perishables and some regulated utilities) that is slightly higher than projected, partly influenced, in the latter's case, by the higher international price of some grains. Alternative measures of trend inflation show no material changes. Labor costs remain contained and inflation expectations are around 3%. Overall, the new information suggests that annual inflation will decline in the coming months with less intensity than was projected in the last *Report.*

The Board reaffirms its commitment to conducting monetary policy to keep projected inflation around 3% over the policy horizon. Future changes in the MPR to achieve this goal will depend on new information and its implications for inflation projections.

10 May

At its monthly monetary policy meeting, the Board of the Central Bank of Chile agreed to keep the monetary policy interest rate at 5% annually.

The external scenario relevant to the Chilean economy remains favorable. World economic activity is expanding strongly, the copper price is still high and financial conditions remain positive. Prices for oil and derivatives, especially gasoline, and some foods have remained high.

Information available confirms stronger growth in domestic output in the first quarter of 2007, somewhat above earlier projections. Consumption is still robust, while both investment and exports have bounced back. Salaried employment continues to grow, and domestic financial conditions are good.

CPI inflation has fallen below 3%, although it is slightly higher than projected last January. Most recently, it has been affected by higher-than-expected fuel prices and core CPIX1 inflation (which excludes fuels, perishables and some regulated utilities), especially due to higher food prices. Alternative measures for trend inflation show no significant change. Most recently, growth in labor costs has picked up from relatively low rates. Medium- and long-term inflation expectations remain well anchored around 3%.

The Board reaffirms its commitment to conducting monetary policy to keep projected inflation around 3% over the policy horizon. Future changes in the MPR to achieve this goal will depend on new information and its implications for inflation projections.

14 June

At its monthly monetary policy meeting, the Board of the Central Bank of Chile agreed to keep the monetary policy interest rate at 5% annually.

The external scenario relevant to the Chilean economy remains favorable. World economic activity confirms its dynamism, with better prospects for developed economies, which has pushed medium- and long-term interest rates up. Copper, oil and derivate prices, especially for gasoline, and some foods, remain high.

Information available on domestic output and expenditure show both are performing more strongly than projected, suggesting higher growth than that contemplated in the last *Monetary Policy Report's* baseline scenario. Private consumption, investment and exports are all performing particularly strongly. Salaried employment continues to rise and, despite recent increases in market interest rates, domestic financial conditions remain favorable.

CPI inflation is slightly below 3% and continues to be influenced by fuel prices and a rebound in core CPIX1 inflation (excluding fuels, perishables and some regulated utilities), which has been particularly affected by higher prices of foods and some health-related products. Beyond the increases of these specific prices, alternative measures of trend inflation have risen, while inflation expectations for the medium and long term remain well anchored around 3%.

The Board reaffirms its commitment to conducting monetary policy to keep projected inflation around 3% over the policy horizon. This means that, should a scenario involving inflation that is higher than projected in the last *Monetary Policy Report* materialize, it will be necessary to reduce monetary impulse.

12 July

At its monthly monetary policy meeting, the Board of the Central Bank of Chile agreed to increase the monetary policy interest rate by 25 basis points to 5.25% annually.

This decision is consistent with less slack than foreseen in the last *Monetary Policy Report*, and is necessary to ensure that inflation projections for two years hence will remain at 3%.

The external scenario relevant to the Chilean economy remains favorable. World economic activity is expanding strongly, financial conditions are still good and the copper price has increased once again, but so have the prices of oil and its derivatives. The prices of several foods remain high and some have increased even further.

Beyond the performance of some specific sectors, information available on domestic output and expenditure continues to show significant dynamism in the second quarter, above early projections. Salaried employment continues to rise and domestic financial conditions are favorable.

CPI inflation is slightly above 3%, exceeding forecasts in the last *Monetary Policy Report*, and continues to be influenced by fuel prices and by the higher price of foods: The latter have also raised core CPIX1 inflation (excluding fuels, perishables and some regulated utilities). Beyond the increases in these specific prices, alternative measures of trend inflation stand at, or somewhat above, 3%, while labor costs remain well contained. Although, because of a supply shock, short-term expectations for inflation have risen in this higher inflation scenario, long-term expectations remain well anchored around 3%.

The Board believes that, in the most likely scenario, it will be necessary to reduce monetary stimulus in coming months to keep projected inflation around 3% over the policy horizon. As usual, changes in the MPR will depend on new information as it becomes available and its implications for inflation projections.

9 August

At its monthly monetary policy meeting, the Board of the Central Bank of Chile agreed to increase the monetary policy interest rate by 25 basis points to 5.5% annually.

This decision is necessary to keep projected inflation two years hence at around 3%.

Although the external scenario relevant to the Chilean economy remains positive and world economic activity is still strong, risk premiums have increased, international financial markets are more volatile and credit conditions have tightened somewhat. Copper and oil prices remain high, while gasoline prices have fallen. Prices for several foods also remain high.

Beyond the performance of some specific sectors, output data available confirms an important dynamism in the second quarter, above earlier projections and above trend. Domestic demand seems to have exceeded forecasts, salaried employment continues to rise and domestic financial conditions remain favorable.

CPI inflation has risen to almost 4%, well above projections in May's *Monetary Policy Report.* Increases in the prices of some non-perishable foods and fuels have deepened, in combination with abnormal rises in the prices of some perishables, which are expected to be largely temporary. The higher prices of non-perishable foods have also driven up core CPIX1 inflation (excluding fuels, perishables and some regulated utilities). Alternative measures for trend inflation stand slightly above 3%, while labor costs remain well contained. In this setting of higher inflation due to various supply shocks, short-term inflation expectations have increased significantly, although for the longer-term they remain around 3%.

The Board believes that, in the most likely scenario, it will be necessary to continue to increase the MPR in coming months to keep projected inflation around 3% over the policy horizon. As usual, changes in the MPR will depend on new information as it becomes available and its implications for inflation projections. The possibility of specific strong price shocks requires special monitoring, both to check their propagation to other prices and in terms of their impact on medium- and long-term inflation expectations.

13 September

At its monthly monetary policy meeting, the Board of the Central Bank of Chile agreed to increase the monetary policy interest rate by 25 basis points, to 5.75% annually.

This decision is necessary to ensure that the recent rise in annual inflation be temporary, thus keeping projected inflation two years' hence at around 3%.

Although overall the external scenario relevant for the Chilean economy remains positive, downside risks have increased. In fact, in recent weeks problems in international financial markets have worsened. Meanwhile, the copper price remains high, the oil price continues to rise, and several food prices remain high.

Domestically, beyond the performance of some specific sectors, the information available suggests that output is still dynamic. Imports growth indicates that domestic demand should continue to expand relatively strongly in the third quarter. Salaried employment continues to rise and domestic financial conditions remain favorable.

Annual CPI inflation has risen above 4%, affected by unusual price increases in some foods, both perishable and non-perishable. The latter have also pushed up core CPIX1 inflation (excluding fuels, perishables and some regulated utilities). Alternative measures for trend inflation stand above 3% and the growth rate of labor costs has increased. Inflation expectations reveal an outlook comparable to that in the last *Monetary Policy Report*, with high levels for the short term, and near 3% further ahead.

The Board considers it timely to underline that the future path of the MPR will depend on new information as it comes in and its implications for inflation projections. Developments internationally, the possible propagation of recent inflationary shocks to other prices, and changes in output gaps will be closely watched.

11 October

At its monthly monetary policy meeting, the Board of the Central Bank of Chile agreed to keep the monetary policy interest rate at 5.75% annually.

In recent weeks, liquidity problems in international financial markets have moderated, while the U.S. dollar has depreciated against most global currencies. Meanwhile, industrial economies are expected to perform less dynamically. The copper price has risen again, while oil and several food prices also remain high, above forecasts. This all points to a positive external scenario for the Chilean economy, although the risk of adverse international scenarios persists.

Domestically, the information available suggests that output in the third quarter was lower than projected in the last *Monetary Policy Report,* and appears to go beyond the performance of a few specific sectors. How long this will persist remains uncertain. On domestic demand, indicators suggest that investment has remained dynamic while has dropped slightly. Salaried employment keeps rising and domestic financial conditions remain favorable.

Annual CPI inflation has risen to over 5% and is expected to rise above projections in the last *Monetary Policy Report* in the coming months. The unusual increases in some food prices, both perishable and non-perishable, have not only persisted, but intensified. Non-perishables have also contributed to increasing core CPIX1 inflation (which excludes fuels, perishables and some regulated utilities). Alternative measures for trend inflation stand above 3% annually. Notwithstanding, wages have not accelerated further recently, while peso/dollar parity has dropped in recent weeks. Inflation expectations for the medium and long term remain anchored around 3% annually, consistent with the view that inflation increases are temporary.

The Board considers it timely to underline that the future path of the MPR will depend on new information as it comes in and its implications for inflation projections. Developments internationally, the possible propagation of recent inflationary shocks to other prices (and

especially wages), medium-term expectations for inflation and changes in output gaps will be closely watched.

13 November

At its monthly monetary policy meeting, the Board of the Central Bank of Chile agreed to keep the monetary policy interest rate at 5.75% annually.

In recent weeks, world financial markets' perceptions of problems arising from the subprime lending crisis have deteriorated, and the U.S. dollar has depreciated further against most currencies. Industrialized economies are expected to perform less strongly. Oil prices are up considerably, while copper and some food prices also remain high, above projections. Altogether, this suggest an external scenario relevant to the Chilean economy that, while positive, now poses a larger risk of adverse international conditions.

Domestically, the information available suggests that output in the third quarter was lower than projected in the last *Monetary Policy Report*, and appears to go beyond the performance of a few specific sectors. How long this will persist remains uncertain. On domestic demand, indicators suggest that investment remains stable, while consumption has dropped. Salaried employment continues to rise and domestic financial conditions are somewhat less favorable.

Annual CPI inflation stands above 6% and is projected to remain high for several months before falling toward target. The prices of some foods, both perishable and non-perishable, are showing early signs of reversal. The drop in the prices of other relatively volatile products also contributed to the low monthly IPCX1 inflation rate (which excludes fuels, perishables and some regulated utilities). Medium- and long-term inflation expectations continue to be well anchored around 3% annually, consistent with a temporary rise in inflation.

The future path of the monetary policy interest rate will depend on incoming information and its implications on projected inflation. Of particular importance will be the developments in the international scenario, the potential propagation of recent inflationary shocks to other prices —especially the path of wages—, medium-term inflation expectations and the evolution of the output gap.

The Board considers it timely to underline that the future path of the MPR will depend on new information as it comes in and its implications for inflation projections. Developments internationally will be particularly important, along with the possible propagation of recent inflationary shocks to other prices (especially wages), medium-term expectations for inflation, and changes in the output gap.

13 December

At its monthly monetary policy meeting, the Board of the Central Bank of Chile agreed to increase the monetary policy interest rate by 25 basis points, to 6% annually.

This decision, necessary to reduce the risks of current high inflation, affects both costs and expectations, thereby ensuring annual inflation returns to 3% over the policy horizon.

Internationally, problems and risks associated with the subprime crisis have intensified, and industrialized economies are expected to perform less well. The oil price, although still high, fell from high levels a month ago, while copper and several food prices remain high, above projections. This has kept the external scenario relevant to the Chilean economy positive, but the risk of more adverse conditions has increased.

Domestically, the information available points to output growth in the second half falling short of projections in the latest *Monetary Policy Report*, a situation that goes beyond the performance of some specific sectors. On the demand side, however, both consumption and investment remain dynamic. Salaried employment continues to grow, albeit at lower rates, and internal financial conditions show no significant changes.

Annual CPI inflation has continued to increase and now stands above 7%. Annual figures are projected to remain high for several months, before falling toward the target. In the past month, the CPI was affected particularly by sudden, large price increases in electric power and fuels, widening the gap with CPIX1 inflation (which excludes fuels, perishables and some regulated utilities). The price increases of some foods, particularly perishables, have begun to revert. Medium- and long-term inflation expectations remain anchored around 3% per annum.

The Board considers it timely to underline that the future path of the MPR will depend on new information as it comes in and its implications for inflation projections. Developments internationally will be particularly important, along with changes in the output gap and the possible propagation of recent inflationary shocks to other prices.

Appendix II: Main Central Bank of Chile measures in 2007

January

03 The Central Bank of Chile presented its schedule for tendering open market securities in 2007. For the purpose of tendering these debt instruments, the schedule continued with the practice of carrying out one auction per month, begun in 2006, for both Central Bank of Chile peso-denominated bonds (BCP) maturing in two and five years and those denominated in *Unidades de Fomento* (BCU) maturing in five and ten years.

Moreover, the Bank received notice of the Ministry of Finance's request that the Bank act as fiscal agent in the placement and administration of debt instruments issued by Chile's General Treasury in 2007, as per the respective legal authorization for borrowing, contained in the national budget law (*Ley de Presupuestos*).

11 At its monthly monetary policy meeting, the Board of the Central Bank of Chile decided to cut the monetary policy interest rate from 5.25 to 5% annually.

23 Making use of Section 35, No. 1 in its Basic Constitutional Act, the Central Bank's Board replaced the regulation on financial intermediation and deposits applicable to banks in Chile. The new regulation is organized on the basis of fundamental criteria that aim to modernize, reinforce and simplify regulatory norms. In this sense, new instruments for holding the deposits of the general public were included, the application of standards promoted, recommendations and accepted international practices applicable to these operations were included, and regulations were organized according to principles or categories. The main changes involved modernization of rules governing interest rates and currencies for time deposits and short-term financial intermediation; the inclusion of structured notes as time deposit instruments for category A solvency banks; regularization of minimum maturities for repo sales; and replacing the regulations governing selling short with one that regulates securities lending.

Other rules were also changed to coordinate and facilitate the application of the new regulations and in this sense, the Bank authorized an indexation system using parities for foreign currencies generally accepted in international markets for banking operations.

To ensure that banking firms have sufficient time to adapt their policies, procedures, management systems and risk monitoring to the new regulation, it was scheduled to come into effect on 2 April 2007.

February

22 Through Resolution 1321-01-070222, the Board of the Central Bank accepted the fiscal agency entrusted to it through Ministry of Finance Supreme Decree 1383, published in the *Official Gazette* on 17 February 2007, as per Law 20,128 on Fiscal Responsibility, for managing and investing resources held in the economic and social stabilization fund (*Fondo de Estabilización Económico y Social*) and the pension reserve fund (*Fondo de Reserva de Pensiones*).

28 Through Resolution 1322-01-070228, the Central Bank's Board accepted the fiscal agency for the placement of bonds issued by the General Treasury in the Chilean capital market, including servicing these securities as they fall due.

March

22 The Board decided to change regulations applicable to operations involving Central Bank debt instruments issue in the primary market and involving institutional investors. This measure came into effect on 2 April 2007.

26 Through Resolution 1326E-070326, passed in a special session, and with reference to Resolutions by the Bank of Chile's shareholders referring to capitalization of profits and the issuing of shares free of the 30% payment requirement applicable to revenues from the 2006 fiscal year, and keeping in mind the option granted to it under Law 19,396, article 31, on Subordinated Debt, the Central Bank's Board decided that all profits accruing to it as creditor of said obligation should be paid to it in cash.

29 Through Resolution 1327-01-070329, the Central Bank's Board established a foreign exchange regime applicable to contracts for exploring and operating or benefiting from hydrocarbons, signed by foreign investors and the State of Chile, as per Article 19 N°24 in the Chilean Constitution, and with regard to Decree Law 1089 (1975) and its amendments, whose reorganized text was set as DFL 2 issued by the Ministry of Mining (1986).

April

19 Through Resolution 1330-01-070419, and in line with its policy on institutional transparency, the Central Bank's Board established the Audit and Compliance Committee, whose function will be to advise it on compliance with institutional objectives in this sense within its own corporate governance, as the body responsible for the Bank's senior-level management.

Similarly, this session approved the statute that will govern this Committee, charging it with reporting to the Board on the effectiveness of internal control systems; the impact on equity and reputation arising from compliance with Bank obligations; and the evaluation of confidentiality, integrity and timeliness of financial statements.

At its 31 May session, the Central Bank's Board appointed independent professionals with distinguished careers to this Committee.

May

10 Through a Resolution passed at Session 1333-01-070510, the Central Bank's Board interpreted the former Chapter XXVI of Title I of its *Compendium of Foreign Exchange Regulations* covering foreign exchange agreements between the Bank and investors, limiting its application and establishing that this special regulation, adopted under Section 47 of its Basic Constitutional Act, is not applicable to payments of shares arising from capital increases made by receiving institutions after the repeal of this chapter.

Notwithstanding, to avoid affecting potential investors' rights, the option was provided, for one time only, to accept the foreign exchange charters (*Convenciones Cambiarias*) in effect payments arising from capital increases with receiving institutions up to 31 August 2007, subscribed and paid for through 31 August 2008.

June

21 Through Resolution 1340-01-070621, the Central Bank's Board approved an integrated security policy for the Central Bank (*Política de Seguridad Integral del Banco Central de Chile*) to help meet institutional objectives and ensure the continuity of Bank operations, providing suitable protection to individuals as well as safeguarding confidentiality, integrity and the availability of information, as per current legislation.

Through Resolution 1340-02-070621, the Central Bank's Board authorized *Cajas de Compensación de Asignación Familiar* to invest in company shares covered by Article 183-C of the Labor Code and its regulations, where the sole objective is to certify the amount and contractors' compliance with employees, including potential legal indemnities for severance of an employment contract. In any case, and to avoid conflicts of interest, investment in these financial instruments was limited by the condition that the *Caja de Compensación de Asignación Familiar* that subscribes or purchases these shares do not become a controller of the company issuing them.

July

12 At its monthly monetary policy meeting the Central Bank's Board agreed to increase the monetary policy interest rate by 25 basis points, to 5.25% annually.

30 The Central Bank's Board decided to establish the market price for the subscription of options on capital increase payment shares in the *Banco de Chile*, for the preferential offering to respective shareholders, in terms established under letter b) Article 30 of Law 19,396 on Subordinated Debt.

31 The Central Bank's Board raised the ceiling on pension fund investment in foreign securities to 35%. Moreover, it increased the ceilings on investment in foreign exchange with no foreign exchange coverage for each type of pension fund, specifically, 43% for type A; 28% for type B; 22% for type C; and 17% for type D. The new ceilings on investment came into effect on 9 August 2007.

August

09 At its monthly monetary policy meeting, the Central Bank's Board agreed to increase the monetary policy interest rate by 25 basis points, to 5.5% annually.

Through Resolution 1350-01-070809, the Board opened the process and approved the terms of reference for the public competition to appoint a replacement representative on the Free Competition Defense Tribunal, given the voluntary resignation from this post of Blanca Palumbo Ossa.

September

13 At its monthly monetary policy meeting the Central Bank's Board agreed to increase the monetary policy interest rate by 25 basis points, to 5.75% annually.

27 Through Resolution 1360-01-070927, the Central Bank's Board accepted a prepayment from the General Treasury for the sum of US$523.9 million, on promissory notes in U.S. dollars issued under Article 75 of Law 18,768.

October

11 The Central Bank's Board established internal regulations applicable to contractors and sub-contractors, to ensure compliance with labor law requirements and occupational health and safety issues, and it also included rules governing privacy (information security) in terms set by the Central Bank's integral security policy, previously approved by the Board.

17 The Central Bank's Board appointed lawyer Joaquín Gustavo Morales Godoy as the alternative lawyer on the Tribunal for Defense of Free Competition, for the period ending 12 May 2012, as per the public competition carried out for this purpose.

29 The Central Bank's Board established the conditions for selling off the remainder of subscription options corresponding to the *Banco de Chile's* capital increase, not sold during the preferential offering phase, through the Santiago stock exchange (*Bolsa de Comercio de Santiago S.A. Bolsa de Valores*).

November

14 The Central Bank's Board set the minimum reserve price applicable to the sale of *Banco de Chile* share subscription options.

15 The Central Bank's Board set the ceiling for investment abroad by insurance and reinsurance, general and life insurance firms at 20% of its technical reserves and risk equity, maintaining the previous margin, which is the legally allowed maximum. This ceiling will remain in effect until 31 December 2008.

In the same session, the Central Bank's Board extended the list of easily liquidated financial instruments in which the small business guarantee fund (*Fondo de Garantía para Pequeños Empresarios*, Fogape) can invest. This regulatory amendment was in line with Law 20,202, which increased the government's contribution to this fund. It extended the type of operations that can be covered by the guarantee and empowered Fogape to hire mechanisms for refinancing insurance covering current or future guarantees, allowing Fogape to further diversify and improve its profitability. It was also ruled that the Fogape manager must adopt an investment policy to safeguard and suitably manage fund resources, establishing its start-up date as 19 January 2008.

20 The Central Bank's Board instructed the firm administering subordinate debt, *Sociedad Administradora de la Obligación Subordinada* SAOS S.A., to suspend the sale of any share subscription options registered for sale, corresponding to the *Banco de Chile*'s capital increase, not sold within the preferential sale period referred to in letter b) Article 30 of Law 19,396.

This decision reflected price structures and offers received for these options, at a time when recent events in financial markets led to an unsuitable level of interest and demand for these options in the market. The Central Bank suspended the sale of share subscription options because turbulence on financial markets led to fewer than normal offers and those received were unattractive.

Similarly, the Central Bank of Chile instructed SAOS S.A. to inform the public that these options would be put on sale on the stock exchange, at prices and under conditions duly determined by the Board, before the deadline of 5 March 2008.

29 The Board increased to 40% the ceiling on pension fund investment in foreign securities, as per the gradual process established by transitory Articles in Law 20,210. This new ceiling came into effect on 18 December 2007. It also increased the ceiling on investment in unhedged foreign exchange for each type of fund, to 45% for type A; 31% for type B; 24% for type C, and 19% for type D. These new ceilings came into effect on 12 February 2008, as per the respective legal dispositions.

December

13 Through Resolution 1379-01-071213, Board Member Jorge Desormeaux Jiménez became Vice-Governor of the Board and of the Central Bank of Chile.

At its monthly monetary policy meeting, the Central Bank's Board decided to increase the monetary policy interest rate by 25 basis points, to 6% annually.

20 Through a Resolution approved at Session 1381-01-071220, the Board issued a favorable preliminary report on the proposed merger between *Banco de Chile* and Citibank Chile, as per article 25 of Law 19,396 on Subordinate Debt, subject to passing of the requisite resolutions by the boards of both banks and by the respective special shareholders' meetings, to meet the conditions established in this Resolution, and safeguard compliance with subordinate debt.

It should be noted that through Resolution 1371 (8 November 2007), the Board hired the foreign investment bank, Merrill Lynch & Co., to advise it in the preparation of this *Report*.

27 Through Resolution 1382-07-071227, the Central Bank's Board accepted a prepayment from the General Treasury worth US$524.2 million, corresponding to the last two payments of General Treasury debt under article 75 of Law 18,768, scheduled to fall due in June and December 2014.

Through same Resolution the Central Bank's Board also decided, in essence, to suppress reporting requirements included in Chapters VIII, X and XIII of the *Compendium of Foreign Exchange Regulations*, referring to: i) Credits obtained by people domiciled and resident abroad, be these branches, agencies or subsidiaries of legally entities established in Chile, and ii) Guarantees in foreign exchange, for or in favor of individuals domiciled or resident in Chile.

28 The regulation governing the real time payment system (RTGS) was amended, specifically in the section "tariffs", to accommodate these charges to higher costs to the Central Bank of Chile involved in the respective operations carried out through this payment system. These tariffs will remain in effect up to and including 30 June 2008.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Appendix III: Foreign exchange reserve management

A. Introduction

The Central Bank of Chile maintains foreign exchange reserves, liquid assets in foreign currency, to support its monetary and foreign exchange policies. These reserves are one of the instruments available to the Bank to meet its objective of safeguarding currency stability and the normal functioning of domestic and external payment systems.

The current floating exchange rate, combined with inflation targeting, solid fiscal policies, prudent financial regulations and supervision, and full financial integration abroad, constitute a coherent framework that helps to maintain essential macroeconomic balances and deal with the different shocks facing the economy, reducing their impact. Notwithstanding, the Central Bank reserves the right to intervene in the foreign exchange market under exceptional and special circumstances.

As is consistent with the function of foreign exchange reserves and their benefits and costs, the purpose of their management is to guarantee secure, efficient access to foreign exchange liquidity and safeguard Central Bank financial equity. To achieve this, the Bank acts according to the legal framework outlined in Section 38 of its Basic Constitutional Act, which specifically empowers it to manage, maintain and dispose of its foreign exchange reserves, abroad.

In line with its transparency policies[1]/, the Bank reports on foreign exchange management in 2007 in this *Annual Report* [2]/. The next section reports on investment policies and the reference structure applied to their management. The third section reports on the results of external reserve management and the development of new informatics system for their administration. The fourth section summarizes the risk management policies and the results of the foreign exchange reserve management. Finally, this report refers to the International Monetary Fund (IMF) and its assessment of Central Bank foreign exchange management.

[1]/ Board Resolution 1289-01-060831 (29 August 2006).

[2]/ A detailed analysis of foreign exchange reserve management is provided in the paper, "Management of Foreign Currency Reserves at the Central Bank of Chile," http://www.bcentral.cl/eng/financial-operations/pdf/Reservemanagement.pdf."

B. Investment policy and reference structure

The foreign exchange reserve investment policy covers liquid financial assets meeting the legal requirements for their management and was designed in terms of their impact on Central Bank balance sheet results and risks and the potential need for liquidity in foreign exchange, seeking essentially to preserve capital in the face of possible market fluctuations.

B.1 Investment portfolio and liquidity portfolio

In 2007, foreign exchange reserve investments were grouped mainly in two portfolios: the investment portfolio and the liquidity portfolio.

The investment portfolio included short- and long-term foreign exchange assets. The short-term component acted as a buffer to deal with shifts in foreign exchange liquidity needs. This subportfolio's investments were held in bank deposits and monetary market instruments maturing in up to one year. Similarly, the long-term subportfolio included investment in nominal and indexed bonds[3]/ maturing mainly in from one to ten years. This subportfolio was designed to deal with unforeseeable contingencies and long-term requirements.

At the same time, part of the investment portfolio was managed externally, as both a long-term portfolio and an MBS[4]/ portfolio, as detailed in section C of this appendix.

The liquidity portfolio was designed to cover financing needs foreseeable in the short term and represented the preferred source for dealing with daily requirements arising from withdrawals from foreign exchange accounts that the public sector and commercial banks held in the Central Bank. These consisted mainly of bank deposits (overnight, weekend and time) and monetary market instruments.

As of 31 December, the Central Bank of Chile's foreign exchange reserves stood at US$16.91 billion, with US$15.355 billion in the investment portfolio and US$1.34 billion in the liquidity portfolio. Of total reserves, 62.3% were invested in dollars, 36.7% in euros and 0.9% in other currencies (table B.1).

[3]/ Refers to indexed bonds in U.S. dollars referred to as TIPS, Treasury Inflation-Protected Securities.

[4]/ Mortgage-backed securities, that is, debt securities guaranteed using mortgages.

TABLE B.1
Foreign exchange reserves
(US$ million)

Portfolio type	Currency	2006 Dec.	2006 %	2007 Dec.	2007 %
I. Investment portfolio		**11,997.2**	**61.7**	**15,355.0**	**90.8**
Currencies and deposits	U.S. dollar	3,654.5	18.8	3,338.9	19.7
	Euro	439.9	2.3	2,504.7	14.8
	Other	1.8	0.0	0.4	0.0
Securities	U.S. dollar	3,551.1	18.3	5,791.5	34.2
	Euro	4,349.8	22.4	3,707.7	21.9
	Other	0.0	0.0	11.8	0.1
Total	U.S. dollar	7,205.6	37.1	9,130.4	54.0
	Euro	4,789.7	24.7	6,212.4	36.7
	Other	1.8	0.0	12.2	0.1
II. Liquidity portfolio		**7,227.8**	**37.2**	**1,340.3**	**7.9**
Currencies and deposits	U.S. dollar	5,893.1	30.3	1,340.3	7.9
	Euro	0.0	0.0		
	Other	782.8	4.0	0.0	0.0
Securities	U.S. dollar	551.8	2.8		
Total	U.S. dollar	6,445.0	33.2	1,340.3	7.9
	Euro	0.0	0.0	0.0	0.0
	Other	782.8	4.0	0.0	0.0
III. Other assets		**204.0**	**1.1**	**214.9**	**1.3**
Monetary gold	Other	4.3	0.0	5.4	0.0
IMF SDR	Other	54.6	0.3	53.4	0.3
IMF reserve position	Other	113.2	0.6	88.4	0.5
Reciprocal credit agreements	U.S. dollar	31.9	0.2	67.6	0.4
Foreign exchange reserves (I+II+III)		**19,428.9**	**100.0**	**16,910.1**	**100.0**
	U.S. dollar	13,682.5	70.4	10,538.3	62.3
	Euro	4,789.7	24.7	6,212.4	36.7
	Other	956.7	4.9	159.5	0.9

Source: Central Bank of Chile.

In 2007, foreign exchange reserves fell by US$2.519 billion, reflecting a drop in balances held by financial institutions in the Central Bank, thanks to lower requirements for the technical reserve and the withdrawal of some General Treasury funds. The latter were part of an initial contribution under the fiscal agency program to manage fiscal resources, which started up in March 2007[5]/ (*Fondo Estabilización Económica y Social* and *Fondo de Reserva de Pensiones*). These reductions were partly offset by General Treasury capital contributions to the Central Bank, worth 0.5% of GDP (US$736 million) and prepayments of the last dollar debt owed to the Central Bank, worth US$1.108 billion.

B.2 Investment portfolio reference structure

The investment portfolio reference structure establishes the basic parameters guiding the composition of currencies, maturities, distribution of credit risk by type of risk and instrument, and the respective benchmarks for comparison.

[5]/ See appendix V.

The reference structure called for 60% of assets to be held in dollars and 40% in euros, allowing for a ±5% deviation from the main values, corrected for hedging requirements for a predetermined amount of liquidity in foreign exchange.

For the long-term investment portfolio, the reference duration was 31 months, with a range of from zero to eight months permitted over and above the reference maturity of this portfolio. For the short-term investment portfolio, the reference maturity was three months. Overall, the reference duration for the investment was 11.3 months, with a minimum maturity of zero months and a maximum deviation of six months allowed for the reference value.

Table B.2 shows the composition of the investment portfolio managed internally by the Central Bank as of December 2007, broken down by maturity, risk and currency. For the long-term external managers, a reference structure analogous to a long-term portfolio, presented in the table, was used. The MBS portfolio, meanwhile, was completely in dollars and used the corresponding Lehman Brothers index as its benchmark (table B.3).

TABLA B.2

Internal administration investment portfolio o reference structure

(percent)

Instrument	Share	Share by currency	
		U.S. dollar	Euro
Short-term portfolio	70.0	41.3	28.7
Bank short-term	37.0	21.8	15.2
Sovereign short-term	33.0	19.5	13.5
Long-term portfolio	30.0	17.7	12.3
Bonds	27.0	14.7	12.3
Indexed bonds	3.0	3.0	-
Total	**100.0**	**59.0**	**41.0**

Source: Central Bank of Chile.

Finally, and based on the composition indicated in table B.2, benchmarks were established for each investment portfolio component.

TABLE B.3

Investment portfolio benchmarks

Benchmark	Instrument	
	U.S. dollar	Euro
I. Short-term portfolio		
Bank short-term	U.S.$ Libid rate to six months	EUR Libid rate to six months
Sovereign short-term	U.S.$ Fixbis rate to six months	EUR Fixbis rate to six months
II. Long-term portfolio		
Bonds	JP Morgan index 1-10 years	JP Morgan index 1-10 years
Indexed bonds	Barclays indexed bonds index	
Mortgage-backed securities (MBS)	Lehman Brothers MSB index	

Source: Central Bank of Chile.

B.3 Liquidity portfolio reference structure

This portfolio's investments matched upcoming disbursements in the Central Bank's balance sheet in terms of both currency and maturity. The Bank defined the reference structure for liquidity portfolio currency according to the actual currency composition required by scheduled disbursements and bank and public sector deposits and withdrawals. It used the overnight, weekend and time interest rates, covering the disbursement schedule for currencies making up liquidity portfolio investments, to calculate the interest benchmark.

C. External management program and system modernization project

C.1 External portfolio management programs

In 2007, the Central Bank maintained two external portfolio management programs. The first involved a long-term general mandate, with selection of managers completed in 2006, and the program scheduled to come into effect in January 2007. This new mandate focused on a portfolio similar to the long-term investment portfolio managed internally, except that external managers are allowed to invest in mortgage-backed securities (MBS). The purpose of this program remains three-fold: to add value to the foreign exchange portfolio; to obtain transfers of know-how and technologies; and to create an active benchmark for the Central Bank portfolio. Unlike the previous mandate, the new program calls for two rather than three external managers, each handling US$250 million. Moreover, the risk assessment method changed, allowing managers a maximum 100-basis point tracking error (deviation from the benchmark).

The second program involved a specialized MBS mandate, maintained in 2007. Its main objective was to add value to the portfolio and achieve a knowledge transfer through dialogue between Central Bank staff and managers. This program had one external manager in 2007, handling a US$370 million portfolio as of 31 December.

Measurements for performance, risk assessment and compliance with benchmarks for both programs was carried out externally by a custodian bank.

C.2 Development of the new information technology for managing reserves

In 2007, modernization of informatics system used to manage foreign exchange reserves continued under the leadership of the International Investment Management area, with support from an external consultant. All phases for selecting a supplier and signing the corresponding contracts were completed, thus starting the system implementation.

D. Risk management and the results of foreign exchange reserve management

D.1 Risk management within foreign exchange reserve management

When managing foreign exchange reserves, the Bank applies the criteria necessary to limit liquidity, credit, market and operating risks.

To reduce liquidity risk, the portfolio consists solely of short-term deposits with diverse maturities in international commercial banks, and fixed income instruments trading on very deep and liquid secondary markets. Credit risk management involved limits on external financial institution, supranational, sovereign and bank risk, and on any counterparts used. Table D.1 presents the breakdown of foreign exchange reserves by type of credit risk and credit rating, as of 31 December.

TABLE D.1
Breakdown of foreign exchange reserves by credit risk (1) (2) (3)
(percent)

Type of credit risk	Credit rating						
	AAA	AA+	AA	AA-	A+	A	Total
Agency	8.5	0.0	0.0	0.0	0.0	0.0	8.5
Bank	1.6	5.8	6.2	13.1	10.3	4.6	41.7
Sovereign	34.6	2.0	10.6	0.3	0.0	0.0	47.5
Supranational	2.3	0.0	0.0	0.0	0.0	0.0	2.3
Total	**47.0**	**7.8**	**16.8**	**13.4**	**10.3**	**4.7**	**100.0**

(1) Data as of 31 December 2007.

(2) Bank risk is that arising from investment in bank financial instruments (deposits, forex-spot/forward-, Pfandbriefes). Sovereign risk arises from investment in sovereign state instruments (deposits, bills, floating rate notes, nominal and indexed bonds). Agency risk arises from investment in U.S. government agencies (bills, nominal bonds, mortgage-backed securities). Supranational risk is associated with investment in an official multilateral body (deposits, bills, floating rate notes, nominal bonds).

(3) The credit rating is the average of ratings obtained from the agencies Fitch, Moody's and Standard & Poor's.

Source: Central Bank of Chile.

Market risk was controlled by diversifying investment currencies, instruments and maturities, and measuring and controlling the limits of exposure to currency and maturity risk, as noted above.

For operating risk, the Bank appropriate separates responsibilities and functions at the institutional and hierarchical levels. Efficiently applied controls mitigate the risks associated with reserve management. Computer applications also help in the application of market quality standards. The Bank also improved operating continuity standards by appointing alternates to fulfill critical functions and creating a contingency operating unit to ensure operations remain ongoing in the case of both foreign exchange reserves and fiscal resources, notwithstanding any problems affecting its physical or technological infrastructure. This, combined with audits and assessments, has ensured that decision-making processes and management evaluation within the institution remain clearly defined.

D.2 Returns on foreign exchange reserve management

In 2007, the total return from foreign exchange reserve management was 4.8%, measured in foreign exchange (a reference basket of currencies used in the investment portfolio). Measured in pesos, the return was 2.0%, revealing shifts in parities against the Chilean peso. The difference from the reference structure was 0.03%, meaning that foreign exchange reserve management generated an additional yield of US$5.1 million over and above the benchmark. For 2000-2007, the average annual return, measured in foreign exchange was 4.0%, for a 21 basis point difference over the benchmark (table D.2).

TABLE D.2
Absolute returns on foreign exchange reserves (FER) and benchmarks (BMK) (1) (2)

	Currencies		Pesos		U.S. dollars		Euros		Difference	
Year	FER %	BMK %	FER %	BMK %	FER %	BMK %	FER %	BMK %	%	US$ billion
2007	4.81	4.78	1.99	1.96	8.86	8.83	-1.16	-1.19	0.03	5.113596
2006	2.45	2.39	10.93	10.87	6.84	6.78	-3.95	-4.01	0.06	10.635972
2005	2.90	2.85	-9.92	-9.97	-1.72	-1.77	11.72	11.67	0.05	7.094786
2004	1.84	1.95	-2.36	-2.25	4.08	4.20	-3.50	-3.39	-0.11	-17.240565
2003	2.31	1.78	-12.84	-13.37	6.64	6.12	-11.26	-11.79	0.53	81.486123
2002	5.25	4.69	17.89	17.32	9.34	8.78	-7.19	-7.76	0.57	81.421354
2001	5.57	5.27	18.08	17.78	3.90	3.60	9.28	8.98	0.30	42.988824
2000	6.88	6.65	12.92	12.70	4.84	4.61	11.64	11.41	0.22	30.860148

(1) Continuously compounded returns.
(2) Average annual amount of foreign exchange reserves (FER), multiplied by return differentials.
Source: Central Bank of Chile.

D.3 Operating costs

In 2007, total operating costs involved in managing the Central Bank's foreign exchange reserves amounted to about 3.0 basis points of the total portfolio.

E. International Monetary Fund assessment

In early 2007, the Central Bank requested a technical assistance mission from the International Monetary Fund (IMF) to independently assess its foreign exchange reserve management. This was the first time the Central Bank requested an initiative of this nature from the IMF, but formed part of the Central Bank Board's regular practice of requesting external assessments of its foreign exchange reserve management.

An expert from the IMF's Monetary and Capital Markets Department carried out this assessment from 17 to 24 April, reviewing compliance with the IMF's Guidelines for Foreign Exchange Reserve Management (2001). The areas assessed included reserve management objectives; its scope and coordination; transparency and accountability; institutional framework; the risk management framework; and the role of efficient markets.

The IMF mission concluded that the Central Bank has followed all its recommendations for foreign exchange reserve management and is suitably equipped to fulfill out its role as fiscal agent. Moreover, the IMF considered Central Bank practices in the fields of reserve management transparency and accountability an example for other central banks.

A summary of the IMF assessment results follows[6]/ (table E.1).

[6]/ The results are available in Spanish at www.bcentral.cl/prensa/notas-prensa/pdf/02082007.pdf.

TABLE E.1
IMF Assessment Results

IMF assessment results, by topic	IMF comments
Reserve management objectives are clear and supported by a solid regulatory framework.	Chile's Central Bank considers reserve adequacy appropriately, based on a cost/benefit approach to holding reserves. Its operational framework is well developed and ensures that liquidity, market risk, and credit risk are prudently controlled, paying careful attention to the relationship between Central Bank assets and liabilities.
Measures with regard to transparency and accountability to the public meet standards and in several aspects are an example worthy of imitation by other central banks.	It is satisfactory to note that the Central Bank aims to establish similarly high standards of transparency for its management of public funds as the Government's fiscal agent.
The Central Bank's internal governance structure, based on a strong control framework with clear allocation of authority and an appropriate level of management reporting, is sound.	Although functions in the Central Bank are clearly defined, it could be useful to review front, middle and back office operating dependencies and/or middle office functional responsibilities to ensure efficient policy formulation and separation in operating dependencies.
It also has a well developed risk management framework, backed by adequate systems and human resources.	The level of information provided to the Board is suitable and the strategic profile of investment is suitably evaluated, monitored and reviewed. Operating compliance with investment policies is constantly monitored and the procedures applied are solid and professional, both with regard to internal investment activities and those of external managers.
Assets are invested in deep, liquid markets and there is ongoing monitoring to guarantee compliance with the Board's investment strategy.	This ensures that foreign exchange reserves are effectively available as per the reserve management policy objectives. At the same time, over the years the Central Bank has been able to generate reasonable profits within the restrictions to ensure liquidity and limit overall financial risk.

Source: Central Bank of Chile.

APPENDIX 1

Financial institutions with deposits as of 31 December 2007

1	ALLIANCE AND LEICESTER PLC, LEICESTER	25	ERSTE BANK DER OESTERR. SPARKASSEN AG, VIENA
2	ALLIED IRISH BANKS, DUBLIN	26	FEDERAL RESERVE BANK OF NEW YORK, NEW YORK
3	BANCA MONTE DEI PASCHI DI S., LONDON	27	FORTIS BANK SA/NV, BRUSSELS
4	BANCO BILBAO VIZCAYA ARG. SA, MADRID	28	HSH NORDBANK AG, KIEL
5	BANCO ESPIRITO SANTO SA, LISBON	29	ING BANK NV, AMSTERDAM
6	BANCO ESPIRITO SANTO SA, LONDON	30	LANDESBANK BADEN-WÜRTTEMBERG, STUTTGART
7	BANCO SANTANDER CENTRAL HISPANO SA, N.YORK	31	LANDESBANK HESSEN-THÜRINGEN GIROZENTRALE, FRANKFURT
8	BANK AUSTRIA CREDITANSTALT AG, VIENNA	32	LANDESBANK RHEINLAND-PFALZ GIROZENTRALE, MAINZ
9	BANK OF MONTREAL, LONDON	33	MIZUHO CORPORATE BANK LTD., LONDON
10	BARCLAYS BANK PLC, LONDON	34	NATIONAL AUSTRALIA BANK LTD, LONDON
11	BAYERISCHE HYPO-UND VEREINSBANK AG, MUNICH	35	NATIXIS, PARIS
12	BAYERISCHE LANDESBANK, MUNICH	36	NORDDEUTSCHE LANDESBANK GIROZENTRALE, LONDON
13	CAIXA GERAL DE DEPOSITOS SA, N.YORK	37	NORDEA BANK FINLAND PLC, N.YORK
14	CAJA DE AH. and MONTE DE PIEDAD DE MADRID, MADRID	38	NV BANK NEDERLANDSE GEMEENTEN, THE HAGUE
15	CAJA DE AHORROS and PENSIONES DE BARCELONA, BARCELONA	39	SKANDINAVISKA ENSK.BANKEN AB (PUBL)(SEB), STOCKHOLM
16	COMMERZBANK A.G., FRANKFURT	40	SOCIETE GENERALE, PARIS
17	CREDIT INDUSTRIEL ET COMMERCIAL (CIC), LONDON	41	SUMITOMO MITSUI BANKING CORPORATION, N.YORK
18	DEKABANK DEUTSCHE GIROZENTRALE, FRANKFURT	42	SVENSKA HANDELSBANKEN AB (PUBL), STOCKHOLM
19	DEPFA BANK PLC, DUBLIN	43	THE NORINCHUKIN BANK, LONDON
20	DEUTSCHE BANK AG, LONDON	44	THE ROYAL BANK OF SCOTLAND PLC, LONDON
21	DEXIA CREDIT LOCAL SA, N.YORK	45	THE TORONTO DOMINION BANK, TORONTO
22	DNB NOR BANK ASA, OSLO	46	UBS AG, ZURICH
23	DRESDNER BANK AG, FRANKFURT	47	UNICREDITO ITALIANO SPA, LONDON
24	DZ BANK AG DEUTSCHE ZENTRAL-GENOSS., FRANKFURT		

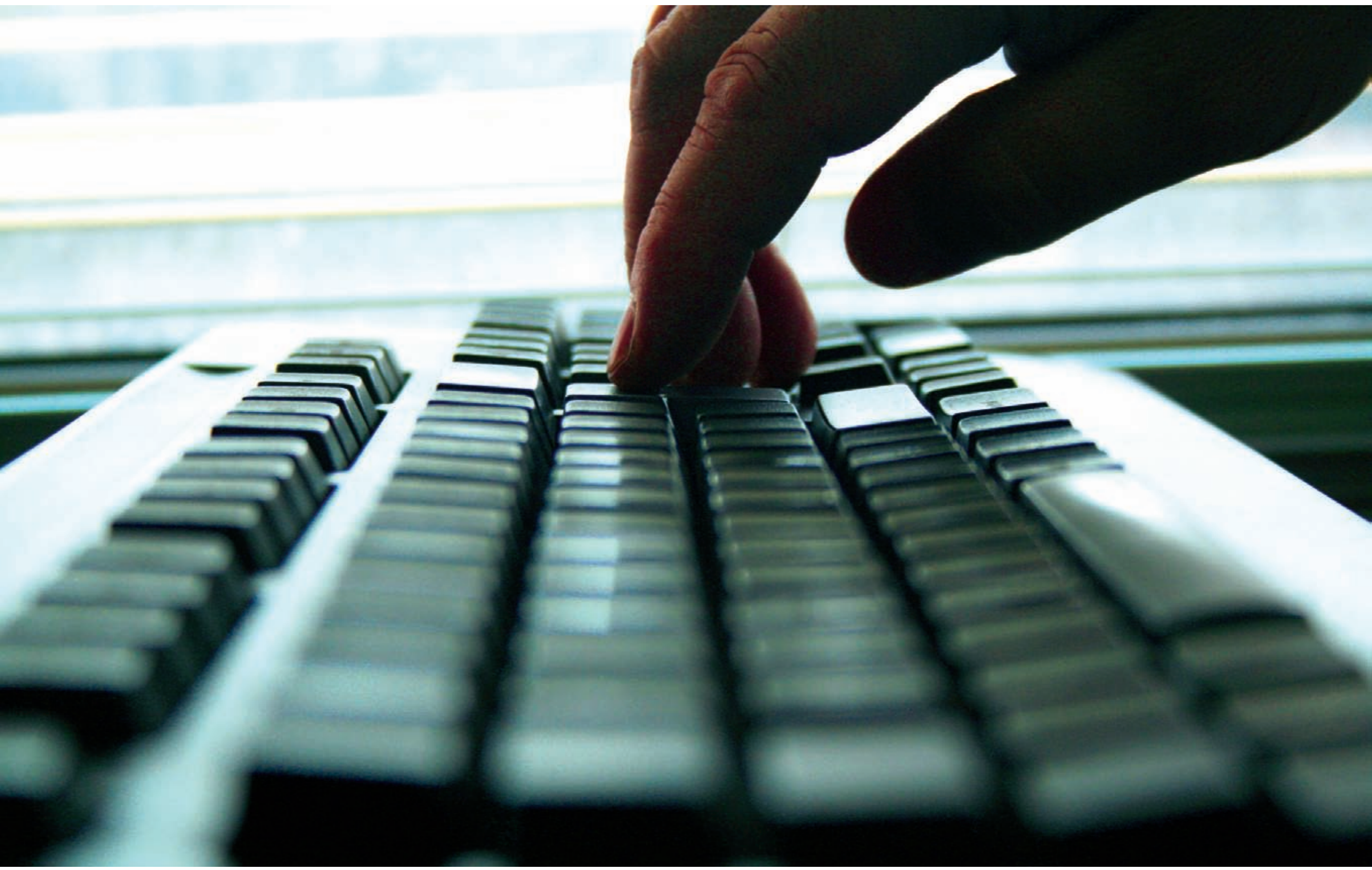
Source: Central Bank of Chile.

APPENDIX 2

Intermediaries used in 2007

1	BANK OF AMERICA SEC. LLC, USA	19	GOLDMAN, SACHS & CO., USA
2	BANK FOR INTERNATIONAL SETTLEMENTS, BASLE	20	GREENWICH CAPITAL MARKETS, INC., USA
3	BARCLAYS CAPITAL INC., USA	21	HSBC BANK PLC, LONDON
4	BAYERISCHE HYPO-UND VEREINSBANK AG, MUNICH	22	HSBC SECURITIES (USA) INC., USA
5	BNP PARIBAS SA, LONDON	23	IXIS CIB, FRANCE
6	BNP PARIBAS SECURITIES CORP.	24	J.P. MORGAN SEC. LTD., U. KINGDOM
7	CALYON CORPORATE AND INVESTMENT BANK	25	J.P.MORGAN SECURITIES, INC., USA
8	CITIGROUP GLOBAL MARKETS INC., USA	26	LANDESBANK BADEN-WÜRTTEMBERG, STUTTGART
9	CITIGROUP GLOBAL MK. LTD., U. KINGDOM	27	LEHMAN BROTHERS INC., USA
10	COMMERZBANK A.G., FRANKFURT	28	MERRILL LYNCH GOV. SEC. INC., USA
11	CREDIT SUISSE SECURITIES	29	MIZUHO SECURITIES USA INC., USA
12	CREDIT SUISSE SECURITIES (USA) LLC, USA	30	MORGAN STANLEY & CO. INC., USA
13	DEUTSCHE BANK AG (LONDON BRANCH), U. KINGDOM	31	NATIXIS, FRANCE
14	DEUTSCHE BANK AG, FRANKFURT	32	NOMURA SECURITIES INTERNATIONAL INC.
15	DEUTSCHE BANK SECURITIES INC., USA	33	SOCIÉTÉ GÉNÉRALE, FRANCE
16	DRESDNER BANK AG, FRANKFURT	34	THE ROYAL BANK OF SCOTLAND PLC, LONDON
17	DZ BANK AG DEUTSCHE ZENTRAL-GENOSS., FRANKFURT	35	UBS LIMITED, U. KINGDOM
18	FORTIS BANK SA/NV, BRUSSELS	36	UBS SECURITIES LLC, USA

Source: Central Bank of Chile.



Appendix IV: Real Time Gross Settlement system (RTGS/CAS)

A. Introduction

Payment systems include a set of instruments, banking procedures and interbank systems for transferring funds that ensure money circulates. To comply with this, participants and the system operator, usually the central bank itself, reach agreements, and funds are transferred using the appropriate technical infrastructure. Banks, meanwhile, serve their customers by distributing payments among the accounts they maintain and those defined as payment beneficiaries, through bilateral agreements between banks and the holders of accounts.

For its own operations a central bank requires an efficient, secure payment system. This ensures the harmonious transfer of monetary policy stimulus and a stable transmission process as soon as liquidity and interest rate policy is applied in the interbank market. Because of this, an efficient high-value payment system must be able to process large volumes in a short period and distribute them to all participants who, in turn, must be able to carry out the operations necessary to manage their balance in the interbank market immediately.

As per Section 3 of its Basic Constitutional Act, the Central Bank of Chile's objectives include ensuring the normal functioning of domestic payments, which is directly related to administer and operating a Real Time Gross Settlement system (RTGS). To do so, it enjoys a series of regulatory and supervisory powers over payment systems and also promotes standards of efficiency and security approaching those applied internationally and consistent with best practices in this field.

B. The RTGS system

As a result of the modernization of Chile's high-value payment system, led by the Central Bank, in April 2004 the RTGS system started up, run by the Central Bank itself. All the country's banks participate in this system, which processes and completes gross settlements resulting from transfer instructions in pesos as they occur, that is, in real time. Since this is a gross settlement system, transfers are individually settled, that is without netting debits and credits, with the sole consideration being whether the issuing bank has enough of a balance in its account. Once settled, using money from the Central Bank, the transfer is final and irrevocable.

When the issuing bank has insufficient funds in its Central Bank account, transfer instructions go into a centralized wait list. In this case, the transfers pending are settled once additional funds become available. Participants access administrative tools to make transfers in the wait list and can change their order or eliminate them.

The RTGS system liquidates transfers of funds in pesos as per instructions from banks on their own initiative or on their customers' behalf, but acting always in their own name, and also transfers net results from clearing houses used by banks (checks, automatic tellers and high-value). All operations between the Central Bank and participants for which settlement requires debiting or crediting peso accounts held in the Central Bank are settled by this system.

Although settlement of high-value payments through the RTGS system eliminates settlement risk for these transactions, it can potentially create liquidity pressures among participants, so suitable measures for providing liquidity are also necessary. To meet this need, the Central Bank also developed an electronic platform for carrying out security purchasing operations with buyback clauses (repos). This intraday liquidity facility (ILF) is totally collateralized by the actual transfer of eligible securities to Central Bank position accounts in the securities deposit, which are reversed on request or automatically by day's end.

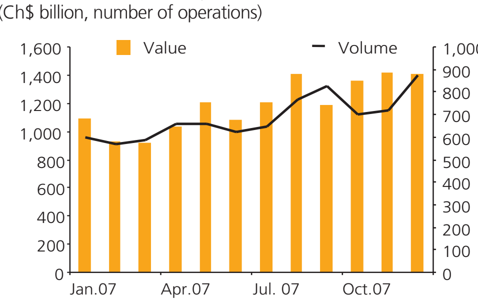
C. Initiatives

In 2007, continuity plans expanded to additional low probability/high impact scenarios. One line of work established an external contingency room that would provide services in the event of some barrier to accessing central facilities. Moreover, the Bank also took measures to reinforce operation (duplicate components) should some event affect the RTGS system, preventing normal recovery measures. Under these circumstances, one priority would be quick recovery of participants' balances just prior to failure and manual start-up. A tool was developed for this purpose, based on the SWIFT messaging system. These measures should become fully operative in 2008.

As part of modernizing financial infrastructure, the Central Bank met with industry representatives (Santiago stock exchange, *ComBanc*, Central Securities Deposit and the association of banks and financial institutions) to more closely examine financial infrastructure capacity to continue providing a specific service in the event of another operator's failure. Similarly, it coordinated efforts to evaluate suitable management of payment and settlement systems, in the event of an unusual surge in security or settlement transactions.

Figure D.1

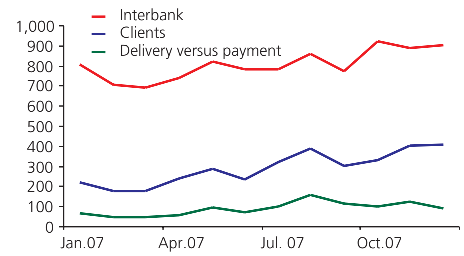
FTIs settled in the RTGS system (*)
(Ch$ billion, number of operations)



(*) Daily average each month.
Source: Central Bank of Chile.

Figure D.2

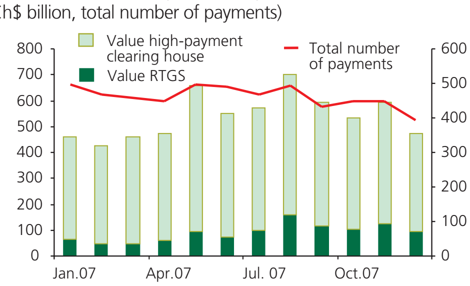
Value of FTIs settled in the RTGS system by type (*)
(Ch$ billion)



(*) Daily average each month.
Source: Central Bank of Chile.

Figure D.3

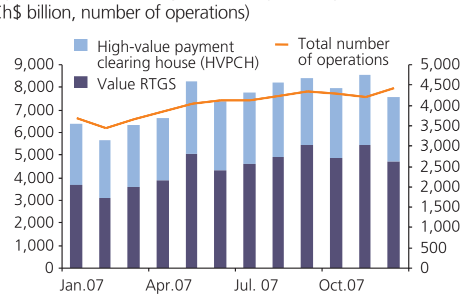
Settlements of delivery versus payment (DVP) operations (*)
(Ch$ billion, total number of payments)



(*) Daily average each month.
Sources: ComBanc and Central Bank of Chile.

Figure D.4

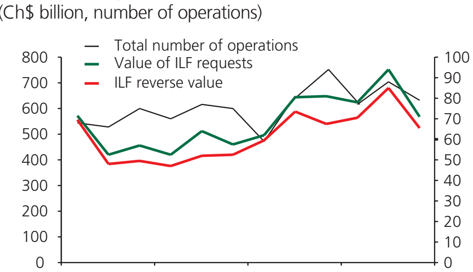
Payments settled in High-Value Payment Systems (*)
(Ch$ billion, number of operations)



(*) Daily average each month.
Source: ComBanc, Central Bank of Chile.

Figure D.5

Intraday facility operations
(Ch$ billion, number of operations)



(*) Daily average each month.
Source: Central Bank of Chile.

Finally, in the first half of 2007, the Central Bank began upgrading its LCSS/CAS software, which forms the basis of its RTGS system, from the previous 3.30 to the current 3.40 version. The new version resolves many problems and improves both security and operating capacity.

From the technological perspective, one of the Bank's constant concerns has been to keep its automatic payment platform up to date by constantly upgrading system components. In 2007, it improved both hardware and software components, to keep technology up to date and improve information security. It also reinforced internal procedures for managing payment system services, according to best practices in this market.

D. Statistics

In 2007, the number of settlements and their value rose steadily, with 167,902 fund transfer instructions (FTIs) processed worth Ch$292.49 trillion, for a daily average of 686 transfers worth Ch$1.19 trillion, up 20.7% over 2006, by volume, and 36.7% by value. The average value of each settlement in 2007 reached Ch$1.742 billion (figure D.1).

The RTGS system processes interbank FTIs associated with payments between financial institutions, on clients' behalf (when the final beneficiary is not a banking firm), and synchronizes payments with the transfer of securities in the Central Securities Deposit. Figure D.2 reveals changes in average daily payments settled in the RTGS system by payment type. Figures show interbank payments predominate, accounting for 67.9% of the total value in 2007. Payments on clients' behalf follow, at 24.5%, followed by delivery versus payment (DVP), at 7.6%. Interbank payments have fallen in importance from 76.9% in 2006, while clients' payments have increased thanks to growth in real time transfer services.

In Chile, two high-value payment systems (HVPS) operate: the Central Bank's RTGS system, and the high-value payment clearing house (*Cámara de Compensación de Pagos de Alto Valor,* HVPCH), managed and run by *ComBanc* S.A. as a supporting company in operation since December 2005. Unlike the RTGS system, in which transfers are settled on a gross level, the HVPCH is a deferred net settlement (DNS) system, in which payments are offset in a multilateral fashion using risk control mechanisms based on bilateral and multilateral ceilings, along with a guarantee system that ensures final net settlement.

Implementation of both HVP systems made it possible to implement delivery versus payment models (DVP) in settling securities, thereby reducing participants' risk and improving efficiency as per international recommendations and standards in this field. Daily payments for DVP settled within the HVP systems in 2007 reached Ch$541 billion, up 35% over the previous year. The average daily number of payments was 462, similar to the previous year. In numbers, Ch$90 billion was processed in the RTGS system, corresponding to 35 daily payments (figure D.3).

The total value of operations settled using the HVPS rose steadily in 2007, averaging 4,036 payments daily. Of these, around 75% used the high-value clearing house, because of the reduction in reserve balance needs. The total daily average value of operations reached Ch$7.43 trillion. Of this figure, Ch$4.46 trillion was settled in the RTGS system, while Ch$2.97 trillion was processed in the high-value clearing house (figure D.4). The Central Bank carries out monetary policy operations, including debt security placements, payment of coupons falling due, repos, and permanent deposit facilities, among others, within the RTGS system.

To avoid participants' facing liquidity constraints that hamper ongoing settlement of transfers, the Central Bank provides the system with an intraday facility available on request and based on buying securities with a buy-back clause within the same day (repos) at no intraday cost. Toward the end of the day, funds are returned and securities sold back automatically. If funds are insufficient, the difference not covered becomes a Permanent Liquidity Facility (PLF) maturing in one working day, with the corresponding interest charge.

In 2007, daily operations averaged 76, of which 37 were requested, while resales were the rest. The average daily value of the facility provided was Ch$547 billion, while the average reverse value was Ch$493 billion (figure D.5). The average value of each individual request (Intraday Liquidity Facility, ILF) stood at Ch$14.823 billion.

Figure D.6 presents the intraday distribution for the value of FTIs settled in the RTGS system. These concentrate particularly as business hours begin (9:00 am) and reflect transfers by banks to fulfill guarantee requirements to start operating within the high-value payment clearing house (HVPCH). In general, amounts settled are spread more evenly throughout the day, except for 10:45 to 11:15 am, when settlements are made on Santiago stock exchange operations, due to interbank loans falling due, or the buying and selling of foreign currency. During the afternoon, from 4:30 to 5:00 pm, payments mainly reflect transfers to clients, interbank loans, mutual fund operations, and the closing time for settling payments associated with DVP security market operations.

The intraday liquidity pattern including ILF operations is presented in figure D.7. RTGS system participants quickly increase their liquidity after opening for business, completing around 50% of requests before 9:30 am. For the rest of the day, liquidity rises steadily, peaking between 2:00 and 3:00 pm, and then falling (through buy-backs on request of participants) around 4:45 pm. 70% of ILF buybacks are automatic and have been relatively constant over the past two years.

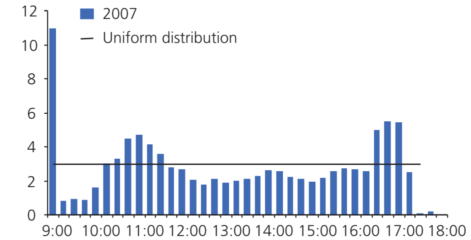
Systems based on determining net multilateral positions accumulate commitments at a given moment, usually every 24 hours, and participants transfer their net positions vis-à-vis other participants. Netting systems significantly reduce the number of transactions, especially in the case of checks and withdrawals from automatic telling machines, since these generate an enormous number of transactions for relatively low amounts. This also reduces balances needed, given the offsetting effect, which is particularly important in the HVPCH, where amounts settled on average in 2007 were 16 times higher than those settled in the RTGS system.

In 2007, the average daily amount settled in checks was Ch$47 billion, automatic tellers Ch$8 billion, and the HVPCH, Ch$186 billion (figure D.8).

For the overall system, the liquidity available daily to the RTGS includes all balances maintained as account settlement closes, returns associated with use of the permanent deposit facility, and ILF requests. The level of aggregate balances maintained after closing is determined by the Central Bank through its open market operations, which are designed to ensure that the aggregate supply of funds meets aggregate demand from banks at the target interest rate. Liquidity estimates by banks early in the morning determine the level of ILF requests. During the day, participants' payments can also be financed using incoming payments or interbank loans. The RTGS system enjoys enormous liquidity, since in general there is a one on one proportion involved in the value of funds transferred daily through the system (figure D.9).

Figure D.6

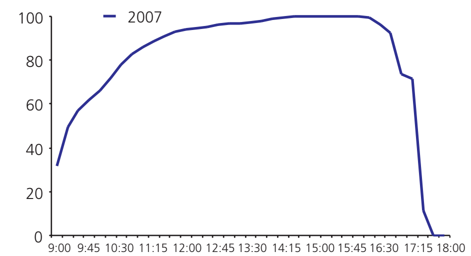
Intraday pattern for FTI settlement (*)
(percent, every 15 minutes)



(*) Annual daily average.
Source: Central Bank of Chile.

Figure D.7

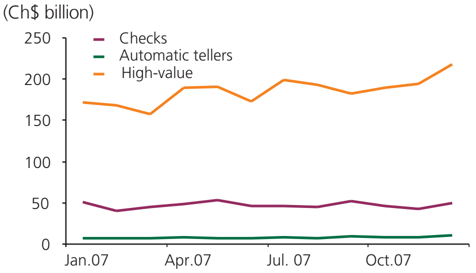
Intraday liquidity value pattern ILF (*)
(percent, every 15 minutes)



(*) Percent of total liquidity requested. Annual daily average.
Source: Central Bank of Chile.

Figure D.8

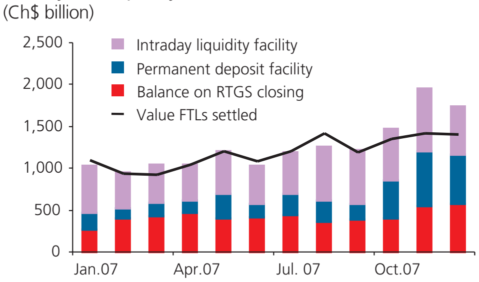
Clearing house amounts settled (*)
(Ch$ billion)



(*) Daily average each month.
Source: Central Bank of Chile.

Figure D.9

RTGS system liquidity (*)
(Ch$ billion)



(*) Daily average each month.
Source: Central Bank of Chile.

Appendix V: Management of General Treasury resources

A. Introduction

As fiscal agent, the Central Bank manages resources for the General Treasury. These form part of the Economic and Social Stabilization Fund (ESSF) and the Pension Reserve Fund (PRF).

The following sections provide details on the institutional context that shapes the functions of this fiscal agency. Moreover, they also report on investment policy, fund structure, reporting system, management results, and costs associated with managing these resources.

B. Institutional framework

In September 2006, Law 20,128, on Fiscal Responsibility, created the ESSF and the PRF. Under that law, the Ministry of Finance issued Supreme Decree 1383, assigning the task of investing all or part of these resources to the Central Bank, upon the Bank's formal acceptance of this role, as per its Basic Constitutional Act.

Board Resolution 1321-01 (22 February 2007) formally accepted this responsibility, including the guidelines for its implementation, and the mandate to act as fiscal agent.

Moreover, this Board Resolution also empowered the Director of the Financial Operations Division (FOD) to establish the internal procedures necessary to regulate fulfillment of these functions, as per the relevant decree and guidelines.

The operational management of this fiscal agency lies in the international investment management area (IIMA) under the FOD. All procedures used in foreign exchange reserve management were considered and applied to management of fiscal resources. This has ensured equivalent quality standards in portfolio management and processes for controlling financial and operating risk. This was possible thanks to economies of scale within the Financial Operations Division and synergies arising from procedures that have ensured the solid functioning of the IIMA.

C. Investment objectives and policies

The investment policy objectives for each fund (fiscal portfolios) and the risk-return profile associated with each reflects Finance Ministry decisions. Once it has accepted them, the Central Bank must manage resources according to the relevant decrees and guidelines.

Implementation guidelines primarily contain investment agendas, which in turn define a referential benchmark and restrictions applied to managing fiscal portfolios. The benchmark structure implicitly includes return-risk objectives established by the Finance Ministry. Fiscal agency results are evaluated against this benchmark portfolio.

Among other elements, investment agendas determine and limit the different risks facing fiscal portfolios, such as foreign exchange, interest rate and credit risk. To limit foreign exchange risk, the benchmark requires that funds be distributed as follows: 50% in U.S. dollars, 40% in euros and 10% in yens, with ±5% maximum deviation. Moreover, these guidelines also consider another nine eligible currencies[1]/. Notwithstanding, investment in secondary currencies depends on the existence of a core asset and hedging in one of the main currencies.

On interest rate risk, investment guidelines establish that the reference portfolio duration is 30 months and that fiscal portfolios cannot mature in under zero months, with maximum deviation from these standards being five months over the reference portfolio duration.

Credit risk exposure is controlled by limiting the issuers. Thus, the system allows investment in sovereign risk (up to 100% of the portfolio), supranational risk (60% ceiling), bank risk (50% ceiling) and U.S. agencies (30% ceiling). Moreover, the universe of eligible instruments allows balances to be held in current accounts, overnight deposits, time deposits, certificates, bank acceptances, commercial papers, bills, notes, discount notes, bonds (bullets and callables) and floating rate notes.

Investment guidelines establish other criteria and restrictions as complementary measures to minimize risk: eligibility criteria for issuers, maximum exposure to each type of risk, eligible operations, treatment of derivatives and eligible intermediaries.

The reference portfolio established in the investment guidelines consists of short- (30%) and long-term (70%) portfolios. The benchmark for short-term portfolio bank risk is the six-month Libid, lagged by three months. A portion of the short-term sovereign risk portfolio is benchmarked against government six-month Treasury bill rates, also lagged by three months.

The nominal long-term portfolio is benchmarked against total return indices provided by JP Morgan Chase (Government Global Bond Index for different maturity tranches). The long-term portfolio composed of U.S. Treasury Inflation-Protected securities is benchmarked against the total return index provided by Barclay's Capital (1-10 year U.S. TIPS).

[1]/ Pound sterling, Canadian dollar, Norwegian krone, Australian dollar, Swedish krona, Danish krone, Swiss franc, New Zealand dollar and Singapore dollar.

D. Constitution and structure of fiscal portfolios

The management mandate officially began in March 2007, with the reception of US$7.1 billion in ESSF funds and US$612.5 million in PRF.

Altogether, in 2007, the Central Bank received and managed US$13.1 billion in ESSF funds and US$1.34885 billion in PRF. As of 31 December, the market value of these resources stood at US$15.49896 billion, of which US$14.03260 billion was from the ESSF and US$1.46635 billion from the PRF, reflecting a US$1.05011 billion rise in the market value of the resources delivered for management (table D.1).

TABLA D.1

Summary of ESSF and PRF as of 31 December 2007

(US$ million)

Sector	Market value (U.S.$)		Total value	% of market value
	PRF	ESSF		
U.S. agency	**46.7**	**533.1**	**579.8**	**3.7**
U.S. dollar	46.7	533.1	579.8	
Bank risk	**439.5**	**4,216.3**	**4,655.8**	**30.0**
U.S. dollar	222.0	2,097.3	2,319.2	
Euro	175.0	1,672.4	1,847.5	
Yen	42.5	446.6	489.2	
Sovereign risk	**980.1**	**9,283.2**	**10,263.3**	**66.2**
U.S. dollar	470.1	4,390.7	4,860.8	
Euro	408.3	3,907.3	4,315.6	
Yen	101.8	985.2	1,086.9	
Total	**1,466.4**	**14,032.6**	**15,499.0**	**100.0**

Currency	Market value (U.S.$)		Total value	% of market value
	PRF	ESSF		
U.S. dollar	738.7	7,021.1	7,759.8	50.1
Euro	583.4	5,579.7	6,163.1	39.8
Yen	144.3	1,431.8	1,576.1	10.2
Total	**1,466.4**	**14,032.6**	**15,499.0**	**100.0**

Currency	Duration (years)	
	PRF	ESSF
U.S. dollar	2.51	2.51
Euro	2.46	2.46
Yen	2.65	2.66
Total	**2.49**	**2.50**

Source: JP Morgan.

E. Reports

Supreme Decree 1383 and the implementation guidelines define the contents and frequency of reports that the Central Bank must deliver to the Ministry of Finance and Chile's General Treasury. The basic principle is that the custodian bank, in its middle office role, must provide the information necessary to prepare reports and the fiscal agent must report daily, monthly, quarterly and annually on the status of the resources under administration.

Daily reports offer information on the market value and duration of each portfolio, under items grouped by currency and risk type. Monthly, quarterly and annual reports offer more detailed information on portfolios, specifically, a description of changes in financial markets, compliance with investment ceilings, the market value of each fund, and the absolute returns and differences with benchmarks.

To complement the custodian bank's compliance with investment guidelines and performance measures, the Central Bank also monitors and evaluates the information it provides, for use in its own calculations based on systematically recorded information.

In addition, the fiscal agent must annually report to the Ministry of Finance and the General Treasury on the performance of the custodian bank.

F. Management results

Since investment operations began in March 2007 and through year's end, both ESSF and PRF resources posted positive returns. For the period, ESSF resources managed by the Central Bank generated an absolute return measured in U.S. dollars of 9.55%, one basis point higher than the benchmark when both were measured using the Time Weighted Rate of Return (TWRR)[2]/ method. Using the same method, PRF resources managed by the Central Bank generated an absolute return measured in U.S. dollars of 8.68%, 28 basis points lower than the benchmark (table F.1).

TABLA F.1

***Time-Weighted Rate of Return* (TWRR) (1)**

(percent, March - December 2007)

	Currency (2)	U.S. dollar
ESSF (3)	4.38	9.55
PRF (4)	4.16	8.68

(1) Figures calculated by JP Morgan N.A.

(2) Reference basket of currencies relevant to the portfolio (50% U.S. dollar, 40% euro and 10% yen).

(3) Fund started up on 6 March 2007 with reception of the first amount.

(4) Fund started up on 28 March 2007, with reception of the first amount.

Source: JP Morgan N.A.

While the benchmark for both portfolios is the same, performance against each varied, given that the management of each portfolio started up on different dates in March 2007.

[2]/ This method generates a rate of return adjusted to occasional capital contributions and withdrawals, isolating the administrator's management result from the impact of exogenous changes in the portfolio size on funds returns. Moreover this methodology allows to compare the portfolio administrator's management against the reference benchmark performance.

G. Retribution to the fiscal agent

As per the reference framework in article 9, letter a) of Supreme Decree 1383, the fiscal agent has the right to charge an annual fee for direct expenditures and costs incurred in fulfilling its duties. For March 2007 to February 2008, this amount was set at US$515,000 per year in the custodial guidelines, an amount consistent with the Basic Constitutional Act that indicates that the Central Bank cannot provide the State with financing. At the end of 2007, this amounted to 0.48 basis point annually[3]/ over total resources under its management.

APPENDIX 1

Financial institutions with deposits in effect as of 31.12.2007

1	*ALLIANCE AND LEICESTER PLC, LEICESTER*	13	*HSH NORDBANK AG, KIEL*
2	*ALLIED IRISH BANKS, DUBLIN*	14	*ING BANK NV, AMSTERDAM*
3	*BANCA MONTE DEI PASCHI DI S., LONDON*	15	*LANDESBANK BADEN-WÜRTTEMBERG, STUTTGART*
4	*BANCO ESPIRITO SANTO SA, LONDON*	16	*LANDESBANK HESSEN-THÜRINGEN GIROZENTRALE, FRANKFURT*
5	*BARCLAYS BANK PLC, LONDON*	17	*LANDESBANK RHEINLAND-PFALZ GIROZENTRALE, MAINZ*
6	*CALYON CORPORATE AND INVESTMENT BANK, LONDON*	18	*MIZUHO CORPORATE BANK LTD., LONDON*
7	*DEPFA BANK PLC, DUBLIN*	19	*NATIXIS, PARIS*
8	*DEXIA BANK BELGIUM SA, BRUSSELS*	20	*NORDDEUTSCHE LANDESBANK GIROZENTRALE, LONDON*
9	*DNB NOR BANK ASA, OSLO*	21	*SOCIETE GENERALE, PARIS*
10	*DRESDNER BANK AG, FRANKFURT*	22	*THE ROYAL BANK OF SCOTLAND PLC, LONDON*
11	*DZ BANK AG DEUTSCHE ZENTRAL-GENOSS., FRANKFURT*	23	*UNICREDITO ITALIANO SPA, LONDON*
12	*ERSTE BANK DER OESTERR. SPARKASSEN AG, VIENA*		

Source: Central Bank of Chile.

APPENDIX 2

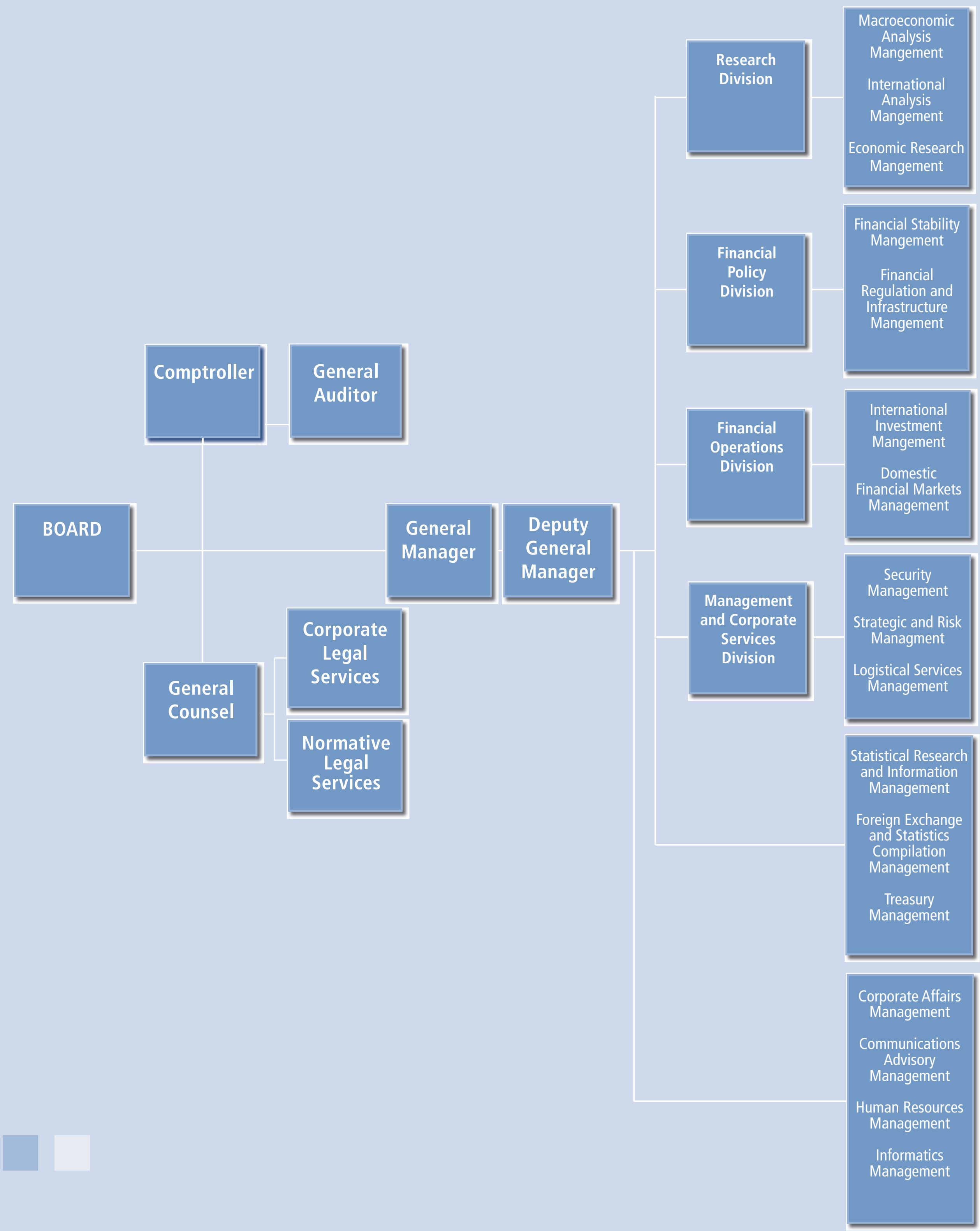
Intermediaries used in 2007

1	*BANK OF AMERICA SEC. LLC, USA*	16	*IXIS CIB, FRANCE*
2	*BARCLAYS CAPITAL INC., USA*	17	*J.P. MORGAN SEC. LTD., U. KINGDOM*
3	*BAYERISCHE HYPO-UND VEREINSBANK AG, MUNICH*	18	*J.P. MORGAN SECURITIES, INC., USA*
4	*BNP PARIBAS SA, LONDON*	19	*LANDESBANK BADEN-WÜRTTEMBERG, STUTTGART*
5	*BNP PARIBAS SECURITIES CORP., USA*	20	*LEHMAN BROTHERS INC., USA*
6	*COMMERZBANK AG., FRANKFURT*	21	*MERRILL LYNCH GOV. SEC. INC., USA*
7	*DEUTSCHE BANK AG, FRANKFURT*	22	*MIZUHO SECURITIES USA INC., USA*
8	*DEUTSCHE BANK SECURITIES INC., USA*	23	*MORGAN STANLEY & CO. INC., USA*
9	*DRESDNER BANK AG, FRANKFURT*	24	*NOMURA SEC. INTL., INC., USA*
10	*DZ BANK AG DEUTSCHE ZENTRAL-GENOSS., FRANKFURT*	25	*ROYAL BANK OF SCOTLAND, U. KINGDOM*
11	*FORTIS BANK SA/NV, BRUSSELS*	26	*SOCIÉTÉ GÉNÉRALE, FRANCE*
12	*GOLDMAN, SACHS & CO., USA*	27	*HE ROYAL BANK OF SCOTLAND PLC, LONDON*
13	*GREENWICH CAPITAL MARKETS, INC., USA*	28	*UBS LIMITED, U. KINGDOM*
14	*HSBC BANK PLC, LONDON*	29	*UBS SECURITIES LLC, USA*
15	*HSBC SECURITIES (USA) INC., USA*		

Source: Central Bank of Chile.

[3]/ The calculation uses the average total portfolio maintained from March to December 2007.

Organizational structure



III. Financial Statements of Central Bank of Chile

Balance Sheets as of 31 December 2007 and 2006

(Ch$ million)

ASSETS	Note	2007	2006
Foreign assets		8,508,562.6	11,293,851.1
Reserve assets	3	8,384,368.1	11,151,783.3
Monetary gold		2,688.2	2,479.3
Special drawing rights (SDR)		26,483.5	31,346.2
Reserve position in the IMF	4	43,830.6	64,981.5
Foreign currencies	3	8,277,839.8	11,034,682.3
Other assets		33,526.0	18,294.0
Other foreign assets		124,194.5	142,067.8
Shares and contributions to the IDB		91,281.3	105,754.3
Bank for International Settlements (BIS) shares		32,913.2	36,313.5
Domestic assets		2,412,778.4	3,236,066.7
Domestic loans		2,412,778.4	3,236,066.7
Loans to state-owned companies	5	1,033.5	1,323.2
Loans to *Banco del Estado de Chile*		-	120,436.6
Loans to commercial banks	6	569,927.7	592,957.6
Loans to other institutions	7	592,539.4	566,448.0
Treasury transfers (Laws 18,267, 18,401 and 18,768)	8	292,389.3	952,741.6
Loans for subordinated obligations of financial institutions (Laws 18,401 and 19,396)	9	956,888.5	1,002,159.7
Other assets		19,123.1	322,818.4
Bank premises and equipment, net	10	15,223.1	14,987.1
Other securities		3,900.0	3,747.6
United States dollars purchased with resell agreement		-	304,083.7
Total Assets		10,940,464.1	14,852,736.2

The accompanying notes 1 to 28 are an integral part of these financial statements.

Balance Sheets as of 31 December 2007 and 2006

(Ch$ million)

(From previous page)

LIABILITIES	Note	2007	2006
Foreign liabilities		179,264.8	202,329.1
Reciprocal loan agreements		6,313.2	7,819.8
Loans		-	93.4
Accounts with international organizations		76,961.9	88,423.2
Special drawing rights (SDR) allocations		95,989.7	105,992.7
Domestic liabilities		12,865,125.0	16,569,622.3
Monetary base		3,672,153.3	3,657,626.4
Banknotes and coins in circulation	11	3,315,835.6	3,031,980.5
Deposits from financial institutions (domestic currency)		326,317.7	194,971.9
Deposits for technical reserves		30,000.0	430,674.0
Deposits and obligations	12	1,499,301.4	3,744,931.6
Deposits and obligations with the Treasury		206,352.3	1,146,848.9
Other deposits and obligations		1,292,949.1	2,598,082.7
Instruments issued by Central Bank of Chile	13	7,693,670.3	9,167,064.3
Central Bank bonds in UF (BCU)		2,556,394.6	2,099,836.1
Central Bank bonds in Chilean pesos (BCP)		1,935,120.0	1,918,403.0
Indexed promissory notes payable in coupons (PRC)		1,488,343.9	2,055,701.3
Central Bank discountable promissory notes (PDBC)		852,300.0	1,853,187.0
Indexed coupons (CERO) in UF		663,313.5	776,513.3
Central Bank bonds expressed in US dollars (BCD)		198,177.2	462,802.3
Other		21.1	621.3
Other liabilities		72,900.8	383,109.9
Provisions		7,887.3	7,643.4
Other securities		995.0	201.6
Temporary liabilities		64,018.5	71,221.0
Creditors on foreign currency purchased with resale agreements		-	304,043.9
Capital and reserves	14	(2,176,826.5)	(2,302,325.1)
Capital		(1,894,368.8)	(2,311,321.5)
Surplus (deficit) for the year		(282,457.7)	8,996.4
Total Liabilities		**10,940,464.1**	**14,852,736.2**

The accompanying notes 1 to 28 are an integral part of these financial statements.

Statements of Income for the years ended as of 31 December 2007 and 2006

(Ch$ million)

OPERATING RESULTS	Note	2007	2006
Operating income		992,762.1	1,403,345.4
Interest received and accrued	15	610,185.2	596,280.4
Readjustments received and accrued	16	101,478.2	32,274.9
Income on price differences	17	79,977.2	89,105.6
Exchange earnings	18	199,526.4	684,877.1
Other operating income		1,595.1	807.4
Operating expenses		(1,382,323.6)	(984,605.1)
Interest paid and accrued	19	564,949.5	680,626.0
Indexation paid and accrued	20	293,555.2	127,822.4
Loss due to price differences	21	31,748.1	37,722.5
Exchange losses	18	468,866.3	118,151.9
Other operating expenses		23,204.5	20,282.3
Gross margin		(389,561.5)	418,740.3
Other operating expenses		(32,559.1)	(29,387.6)
Personnel expenses		20,505.0	19,375.6
Administrative expenses		9,391.6	7,985.9
Depreciation, amortization and write-offs	10	2,215.2	1,530.3
Taxes and contributions		447.3	495.8
Income before provisions and write-offs		(422,120.6)	389,352.7
Provisions and write-offs		-	(446,331.7)
Net margin (total operating results)		(422,120.6)	(56,979.0)
Non-operating results		609.7	(549.4)
Non-operating income		706.3	651.4
Non-operating expenses		(96.6)	(1,200.8)
Results before price-level restatement		(421,510.9)	(57,528.4)
Price-level restatement		139,053.2	66,524.8
Surplus (deficit) for the year		**(282,457.7)**	**8,996.4**

The accompanying notes 1 to 28 are an integral part of these financial statements.

Notes to the Financial Statements as of 31 December 2007 and 2006

Note 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 of a technical nature, with full legal capacity, its own assets and indefinite duration, created in accordance with Sections 108 and 109 of the Political Constitutions of Chile and ruled by its Basic Constitutional Act contained in Article One of Law 18,840 and its modifications.

The Bank's objective is to ensure stability of both the currency and the normal operations 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, as well as, dictating regulations on monetary, credit, financial and foreign exchange matters. Additionally, the Bank is exclusively empowered to issue banknotes and to mint coins.

Note 2 Summary of significant accounting policies

a) Basis of preparation of the financial statements

The financial statements have been prepared in conformity with 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 and generally accepted accounting principles in Chile ("Chilean GAAP"). Should there be any discrepancies, the regulations dictated by the Board of the Central Bank of Chile shall prevail.

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 creditor position. For this reason the economic concepts of international reserves and monetary base are shown under the captions Reserve Assets and Liabilities and Monetary Base, 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 22) are disclosed.

For comparative purposes, the 2006 figures have been restated according to changes in the Chilean consumer price index for the period between 30 November 2006 and 30 November 2007, amounting to 7.4%.

b) Assets and liabilities in 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 expressed in Chilean sealed gold pesos are valued at the average London morning quotation of the "Gold Fixing" rate (U.S. dollars per fine troy ounce) for all business days in the prior quarter, less 10%.

Settlement of foreign currencies other than U.S. 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 U.S. dollar" rate.

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

	2007	2006
	Ch$	Ch$
United States dollar (Observed exchange rate)	495.82	534.43
Pound sterling	989.46	1,049.34
Euro	725.73	703.38
Special drawing rights (SDR)	782.64	804.00

c) Shares and contributions to the Interamerican Development Bank (IDB) and contributions to the International Monetary Fund (IMF)

Shares issued by and contributions made to the IDB, and to the IMF, on behalf of the Chilean General 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 Decree Law 2943 dated 1979, published in the *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 Bank's accounting purposes as investments with a charge to its own resources.

Shares and contributions to IDB are shown under "Other Foreign Assets". Contributions to the IMF are recorded under "Reserve position in the IMF" in "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 2007, the Bank received a dividend for US$1.2 million (US$1.1 million in 2006).

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 foreign governments, institutions and banks, which are valued at the lower of cost or market value.

f) Loans and obligations

Non-adjustable loans receivable and obligations are stated at their original value or the value of the last renewal. 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 as of year-end on transactions with foreign residents are included under "Other Foreign Assets" and "Other Foreign Liabilities" and those related to operations with residents in Chile are included in Domestic assets and Domestic liabilities, respectively.

Interest paid and not accrued from obligations, and interest received 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

In accordance with Law 19.396, loans for subordinate obligations included under "Domestic assets" (note 9) include restated balances as of each year-end and accumulated increases recorded and credited to income on an accrual basis.

During 2006, the Bank provisioned Ch$446,318.9 million, which was applied in its entirety to cover the balance of the deferred loss as of year-end.

h) Loan provisions

The Bank has not made any loan provisions during 2007 and 2006 since it deems that there is no risk of uncollectability. As of 31 December 2007 and 2006, no provisions are maintained for this concept.

i) Bank premises and equipment

Bank premises and equipment as of 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 2007 is Ch$6,621.3 million (Ch$6,415.8 million in 2006).

k) Vacation accrual

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

l) Price-level restatement

Equity, Bank premises and equipment and other assets and liabilities have been price-level restated in accordance with changes in the consumer price index (CPI), which was 7.4% in 2007 (2.1% in 2006). Income statement account balances in local currency, except for depreciation and price-level restatement, have not been restated for inflation. Price-level restatement produced a net credit to income of Ch$139,053.2 million in 2007 (Ch$66,524.8 million in 2006).

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.

Note 3 Reserve assets

Reserve assets include international reserves held by the Bank at each year-end, detailed as follows:

	(US$ million)	
	2007	2006
Monetary gold	5.4	4.3
Special drawing rights (SDR)	53.4	54.6
Reserve position in the IMF	88.4	113.2
Foreign currencies:		
Foreign currencies-coins and deposits	7,184.2	10,772.2
Bonds issued by foreign governments, organizations and banks	5,331.8	4,522.6
Euro notes	1,190.9	-
Commercial papers	653.5	557.6
Foreign government treasury bills	1,189.1	2,224.1
Notes for discount	1,145.8	1,148.5
Other assets:		
Reciprocal loan agreements	67.6	31.8
Total reserve assets	16,910.1	19,428.9

As of 31 December 2007, monetary gold amounted to US$5.4 million (US$4.3 million in 2006) equivalent to 7,940 fine gold troy ounces valued at US$682.85 per ounce (US$544.03 in 2006). In respect to 2006, there was no variation in the amount of troy ounces.

The decrease observed as of 31 December 2007 of reserve assets of US$2,518.8 million, compared to 2006, is mainly explained by the decrease in overnight, weekend and other deposits in the amount of US$3,640.3 million and time deposits made by the General Treasury in the amount of US$1,630.7 million, that were offset by increases due to advanced payments received from the General Treasury for the concept of Fiscal Transfer Law 18,768 in the amount of US$1,107.9 million, of the specific contribution to equity made by the General

Treasury in the amount of US$736.0 million and the effect of the variation in parity, income from the investment portfolio and other operations in the amount of US$908.3 million.

The distribution of reserve assets according to investment currency is the following as of each year-end:

	(US$ million)	
	2007	2006
United States dollars	10,538.2	13,682.5
Euro	6,212.4	4,789.7
Other currencies	159.5	956.7
Total	16,910.1	19,428.9

Note 4 Reserve position in the International Monetary Fund (IMF)

As of each year-end, the balance of the reserve position in the IMF is as follows:

	(Ch$ million)	
	2007	2006
Subscription installment, contribution	670,020.8	739,239.3
Loan, account Nº. 1	74.0	226.6
Deposits	(626,264.2)	(674,484.4)
Total IMF position	43,830.6	64,981.5

Note 5 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, to be assigned as shares of the corresponding financial institutions. As of 31 December 2007 accounts receivable from Corfo amount to Ch$974.4 million (Ch$1,007.0 million in 2006), and are 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 General Treasury through future transfers (note 8), which as of 31 December 2007 amounted to Ch$223,603.9 million, equivalent to UF11.4 million (Ch$224,408.5 million in 2006, 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 a preliminary report to the Superintendency of Banks and Financial Institutions in order to materialize the corresponding government transfer of UF697,630.81, referring to the shares of *Banco Internacional* and UF4,435,114.95, referring to the shares of the former *Banco Concepción*, that were alienated in accordance with the aforementioned law.

Note 6 Loans to commercial banks

Loans to commercial banks mainly include the following operations:

	(Ch$ million)	
	2007	2006
Credit line on debt restructuring	5,931.4	8,498.0
Purchase of promissory notes issued by the Central Bank of Chile with resale agreements	563,996.3	584,459.6
Total	569,927.7	592,957.6

Note 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 3 of the law established that the *Caja* being liquidated will cease operations, whether or not it has completed the liquidations entrusted to it in this law, which will include an inventory of all its rights, obligations and equity and those of the *Asociación*. This account will be submitted to the consideration of the President of the Republic through the Ministry of Finance. Likewise, this article provides for the account to be approved by the President of the Republic through a supreme decree issued through the Ministry of Finance, which must be published in the *Official Gazette*.

Article 5 of the aforementioned law establishes that the General 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 1263 dated 1975.

As of 31 December 2007, the amount payable to the Bank from the liquidation of these institutions, including accrued interest as of such date, was Ch$592,539.4 million, of which Ch$544,433.8 million relate to direct loans granted by the Bank and Ch$48,105.6 million with credit lines for international organizations programs (Ch$566,448.0 million in 2006, of which Ch$520,820.4 million relate to direct credits granted by Central Bank of Chile and Ch$45,627.6 million to credit lines for international organizations programs) and is shown under "Loans to other institutions".

Note 8 General Treasury transfers

General Treasury transfers, included under Domestic Loans, are detailed as follows:

	(Ch$ million) 2007	2006
General Treasury promissory notes Law 18,267	68,785.4	136,698.8
General Treasury transfers Law 18,401	223,603.9	224,408.5
General Treasury promissory notes Law 18,768	-	591,634.3
Total	292,389.3	952,741.6

a) General Treasury promissory notes Law 18,267

In conformity with Law 18,267, the General 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) General 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.

Also in conformity with this law, General 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. In this respect, to date, the amounts corresponding to the *Banco Internacional* and former *Banco Concepción* have been determined, as indicated in note 5.

c) General Treasury promissory notes Law 18,768

This item relates to promissory notes denominated and payable in U.S. dollars, accruing on an annual interest of Libor plus 0.5 point, of which 2% is payable semiannually and the balance is capitalized. The last installment expires on 15 December 2014. However, this year the General Treasury made advance payments for the total remaining principal owed in the amount of US$1,058.1 million, and interest payments of US$49.8 million, which were credited to income (in 2006 US$1,500.7 million principal and interest of US$58.4 million). The detail of the advance payments made during 2007 by the General Treasury, is as follows:

	(US$ million) Principal	Interest
28 September	523.9	27.5
28 December	534.2	22.3
Total	1,058.1	49.8

Note 9 Subordinated obligation

The loan for the subordinated obligation represents balances at the end of each year owed to the Central Bank of Chile as a result of the agreement for the modification of payment conditions entered into with the Central Bank of Chile on 8 November 1996, in conformity with Law 19,396. On that date, the parent company, *Sociedad Matriz del Banco de Chile*, previously referred to as *Banco de Chile*, agreed to, in accordance with that indicated in paragraphs three and five of the aforementioned Law 19,396, the transfer of this agreement to *Sociedad Administradora de la Obligación Subordinada* SAOS S.A. Consequently, the obligation must be paid in 40 annual, consecutive and equal installments beginning in April 1997.

During 2007, the Bank received UF4,478,870.6697 from *Sociedad Administradora de la Obligación Subordinada* SAOS S.A, of which UF2,481,528.8982 was to pay interest on the debt and UF1,997,341.7715 for amortization of the loan for subordinated obligation (in 2006 UF4,302,361.2779 of which UF2,582,394.0184 was for interest and UF1,719,967.2595 amortization).

Likewise, an extraordinary payment was received on 14 September 2007 in the amount of Ch$1,373,921,952, (equivalent to UF72,056.2234), in conformity with Article 30 of Law 19,396, for the concept of the alienation price of the cash share subscription options corresponding to the capital increase of *Banco de Chile* agreed upon in May 2007, which were sold during the period of preferential offer to the shareholders under the terms indicated in that legal body. That extraordinary payment was imputed to the payment of the fixed annual installment that becomes due on 30 April 2008, leaving a balance of Ch$956,888.5 million in 2007 (Ch$1,002,159.7 million in 2006).

Note 10 Bank premises and equipment

As of each year-end, the Bank's premises and equipment mainly includes the following:

	(Ch$ million)	
	2007	2006
Properties and facilities	7,742.5	8,103.9
Furniture and equipment	3,957.6	3,464.2
Other immovable property	3,523.0	3,419.0
Total	15,223.1	14,987.1

The charge to income for depreciation for the year amounted to Ch$2,215.2 million (Ch$1,530.3 million in 2006).

During 2006, the Bank sold the building located at 1175 *Huérfanos*, which was valued at Ch$4,829.5 million, and had an accumulated depreciation of Ch$1,569.5 million.

Note 11 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 of each year is as follows:

Denomination	2007	(Ch$ million) 2006
Ch$ 20,000	772,983.8	693,826.6
Ch$ 10,000	1,909,115.1	1,739,771.2
Ch$ 5,000	278,945.7	252,093.8
Ch$ 2,000	83,500.4	77,543.9
Ch$ 1,000	112,008.7	115,042.2
Ch$ 500	4,810.3	5,211.2
Coins	154,471.6	148,491.6
Total	3,315,835.6	3,031,980.5

Note 12 Deposits and obligations

a) Deposits and obligations with the General Treasury include the following:

	2007	(Ch$ million) 2006
General Treasury current accounts	157,248.2	156,168.3
Other	49,104.1	48,617.8
Time deposits	-	942,062.8
Total	206,352.3	1,146,848.9

b) Other deposits and loan obligations include the following items:

	2007	(Ch$ million) 2006
Liquidity deposits from financial institutions	1,050,015.4	250,090.9
Foreign currency current accounts	116,032.5	563,331.7
Short-term deposits from bank institutions	113,598.2	1,772,000.4
Other	13,303.0	12,659.7
Total	1,292,949.1	2,598,082.7

Note 13 Instruments issued by Central Bank of Chile

As of 31 December 2007 and 2006, the expiration dates of these documents are as follows:

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 2007	Total 2006
				(Ch$ million)			
Central Bank bonds in UF (BCU)	296,315.7	5,042.8	260,000.2	466,038.2	1,528,997.7	2,556,394.6	2,099,836.1
Central Bank bonds in Chilean pesos (BCP)	42,149.4	186,620.6	320,000.0	711,550.0	674,800.0	1,935,120.0	1,918,403.0
Indexed promissory notes payable in coupons (PRC)	141,213.5	120,973.1	202,735.1	536,198.4	487,223.8	1,488,343.9	2,055,701.3
Central Bank discountable promissory notes (PDBC)	772,300.0	40,000.0	40,000.0	-	-	852,300.0	1,853,187.0
Indexed coupons (CERO) in UF	13,408.0	17,361.6	42,039.0	140,204.0	450,300.9	663,313.5	776,513.3
Central Bank bonds expressed in U.S. dollars (BCD)	198,177.2	-	-	-	-	198,177.2	462,802.3
Exchange differential promissory notes	21.1	-	-	-	-	21.1	22.7
Deposit certificates expressed in U.S. dollars, Resolution 1649	-	-	-	-	-	-	598.6
Total as of 31 December 2007	1,463,584.9	369,998.1	864,774.3	1,853,990.6	3,141,322.4	7,693,670.3	-
Total as of 31 December 2006	2,126,132.0	331,685.2	1,080,173.0	2,687,124.6	2,941,949.5	-	9,167,064,3

Balances include interest and adjustments accrued as of 31 December 2007 and 2006.

Transitory liabilities include net discounts granted but not accrued, net of price differences received but not accrued, generated by instruments issued for Ch$64,096.7 million (Ch$71,294.7 million in 2006).

Note 14 Capital and reserves

Changes in capital and reserves during 2007 and 2006 were as follows:

	Capital	Results for the year	Total
		(Ch$ million)	
Balances as of 1 January 2006	(1,285,535.1)	(1,138,376.8)	(2,423,911.9)
Distribution of 2005 deficit	(1,138,376.8)	1,138,376.8	-
General Treasury contribution			
1st installment	322,745.7	-	322,745.7
Price-level restatement on equity	(50,902.2)	-	(50,902.2)
Surplus for the year	-	8,376.5	8,376.5
Balances as of 31 December 2006	(2,152,068.4)	8,376.5	(2,143,691.9)
Balances as of 31 December 2006 restated for comparison purposes	(2,311,321.5)	8,996.4	(2,302,325.1)
Balances as of 1 January 2007	(2,152,068.4)	8,376.5	(2,143,691.9)
Distribution of 2006 surplus	8,376.5	(8,376.5)	-
General Treasury contribution			
2nd installment	386,688.5	-	386,688.5
Revaluation of beginning capital	(158,633.2)	-	(158,633.2)
Revaluation of General Treasury contribution (5.5%)	21,267.8	-	21,267.8
Deficit for the year	-	(282,457.7)	(282,457.7)
Balances as of 31 December 2007	(1,894,368.8)	(282,457.7)	(2,176,826.5)

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$1,819,763.3 million restated as of 31 December 2007), to be paid according to Transitory 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 2007, the Bank has an equity deficit of Ch$2,176,826.5 million (Ch$2,302,325.1 million as of 31 December 2006), which is mainly generated as a result of the accumulated effects from this and prior years of decreases generated in exchange gains or losses of assets in foreign currency.

Article 11 of Law 20,128 published in the *Official Gazette* on 20 September 2006 established that the General Treasury, through the Ministry of Finance will be able to make capital contributions to the Central Bank of Chile under the conditions established in the aforementioned law.

On 28 May 2007, the Ministry of Finance made a capital contribution to the Bank of Ch$386,688.5 million (Ch$346,628.9 million on 27 December 2006) which was formalized in its equivalent sum in United States dollars US$736.0 million (US$605.9 million in 2006), in conformity with Supreme Decree 698 issued by the Ministry of Finance, published in the *Official Gazette* on 22 June 2007. This amount became part of the Bank's international reserves.

The amount of the contribution made by the General Treasury in June 2007, restated as of 31 December 2007 amounted to Ch$407,956.3 million.

Note 15 Interest received and accrued

As of each year-end, income from interest received and accrued is as follows:

	(Ch$ million) 2007	2006
Investments abroad	444,216.7	423,574.8
Other institutions	49,574.8	33,079.3
General Treasury transfers (Laws 18,768 and 18,267)	47,097.1	76,500.7
Subordinated obligation	46,728.8	49,425.4
Commercial banks	20,975.3	12,988.4
Reciprocal loan agreements	1,592.5	711.8
Total	610,185.2	596,280.4

Note 16 Indexation received and accrued

As of 31 December 2007 and 2006, income from indexation received and accrued is as follows:

	(Ch$ million) 2007	2006
Subordinated obligation	60,896.5	19,146.8
General Treasury transfers (Laws 18,401 and 18,267)	21,633.2	8,095.7
Caja Central and *Asociación Nacional de Ahorro y Préstamo*	14,625.3	4,415.3
Other	4,323.2	617.1
Total	101,478.2	32,274.9

Note 17 Income from price differences

As of 31 December 2007 and 2006, income from price differences is as follows:

	(Ch$ million) 2007	2006
Central Bank bonds in UF (BCU)	37,271.0	32,695.0
Central Bank bonds in Chilean pesos (BCP)	33,451.8	41,405.9
Central Bank indexed promissory notes (PRC)	7,964.6	10,418.9
Central Bank bonds expressed in U.S. dollars (BCD)	1,289.8	1,585.8
Central Bank bonds in U.S. dollars (BCX)	-	2,999.9
Indexed promissory notes in U.S. dollars (PRD)	-	0.1
Total	79,977.2	89,105.6

Note 18 Net exchange rate income (loss)

As of 31 December 2007 and 2006, net foreign currency exchange rate income and loss are as follows:

	(Ch$ million) 2007	2006
Foreign exchange rate income	199,526.4	684,877.1
Foreign exchange rate losses	(468,866.3)	(118,151.9)
Net foreign exchange rate income (loss)	(269,339.9)	566,725.2

This net foreign exchange rate income (loss) is mainly generated by exchange variations in assets in foreign currency, according to the following detail:

	(Ch$ million) 2007	2006
U.S. dollar	(353,779.4)	178,181.0
Euro	85,430.3	367,708.7
Pound sterling	1,487.7	16,349.2
Other currencies	2,290.7	700.6
IMF special drawing rights (SDR)	(3,235.2)	11,320.0
Subtotal net foreign exchange rate income (loss)	(267,805.9)	574,259.5
Arbitrage and others	(1,534.0)	(7,534.3)
Total net foreign exchange rate income (loss)	(269,339.9)	566,725.2

Note 19 Interest paid and accrued

As of 31 December 2007 and 2006, income from interest paid and accrued is as follows:

	(Ch$ million) 2007	2006
Central Bank bonds in Chilean pesos (BCP)	142,400.1	142,673.2
Central Bank bonds in UF (BCU)	111,221.0	94,633.1
Indexed promissory notes payable in coupons (PRC)	107,298.9	150,320.3
Other notes issued	92,632.1	84,146.2
Central Bank discountable promissory notes (PDBC)	63,704.1	91,109.1
Foreign operations	30,413.6	61,527.0
Central Bank bonds expressed in U.S. dollars (BCD)	17,053.4	22,721.0
Reciprocal loan agreements	226.3	306.3
Central Bank bonds in U.S. dollars (BCX)	-	32,217.5
Indexed promissory notes in U.S. dollars (PRD)	-	972.3
Total	564,949.5	680,626.0

Note 20 Indexation paid and accrued

As of 31 December 2007 and 2006, income from indexation paid and accrued is as follows:

	(Ch$ million) 2007	2006
Central Bank bonds in UF (BCU)	160,157.7	37,350.6
Indexed promissory notes payable in coupons (PRC)	106,187.8	46,238.6
Optional indexed coupons (CERO) in UF	45,793.5	16,901.6
Other notes	946.1	9,031.2
Central Bank bonds expressed in U.S. dollars (BCD)	(19,529.9)	17,155.9
Indexed promissory notes in U.S. dollars (PRD)	-	1,144.5
Total	293,555.2	127,822.4

Note 21 Losses from price differences

As of 31 December 2007 and 2006, income from price differences is as follows:

	(Ch$ million) 2007	2006
Redemption to CERO promissory notes in UF	29,492.2	34,052.8
Indexed promissory notes payable in coupons (PRC)	1,873.4	2,812.7
Other	382.5	853.6
Indexed promissory notes in U.S. dollars (PRD)	-	3.4
Total	31,748.1	37,722.5

Note 22 Monetary base and international reserve asset variations

According 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 payment imbalances, indirectly regulating such imbalances through exchange market intervention and/or for other purposes.

Variations in the monetary base		
	(Ch$ million)	
	2007	2006
Beginning Balance	3,657,626.4	3,210,867.2
Increase		
Operations with international organizations	1,485.0	4,110.2
Domestic loans	-	236,041.2
Other assets	3,506.7	-
Notes issued	1,018,553.3	456,022.4
Interest and indexation paid	1,210,951.0	1,628,800.4
Technical reserve	-	142,412.4
Currency exchange operations	5,739.5	-
Other operating expenses	26,357.8	27,002.2
Total increase	2,266,593.3	2,494,388.8
Decrease		
Domestic loans	(97,307.7)	-
Deposits and obligations	(795,179.1)	(253,561.9)
Foreign currency forward sales receivables	(283,114.8)	(479,061.1)
Other liabilities	(23.7)	(200.7)
Other assets	-	(2,564.8)
Interest and indexation received for domestic loans	(824,425.9)	(1,078,548.3)
Currency exchange operations	-	(167,651.5)
Total decrease	(2,000,051.2)	(1,981,588.3)
Change in monetary base for the period	266,542.1	512,800.5
Effect of price-level restatement on beginning balance of monetary base	(252,015.2)	(66,041.3)
Ending Balance	3,672,153.3	3,657,626.4

Variations in international reserve assets		
	(US$ million)	
	2007	2006
Beginning Balance	**19,428.9**	**16,963.4**
Increase		
Domestic loans	1,048.0	1,205.2
Deposits and obligations	-	2,851.4
Capitalization of General Treasury contribution		
Interest received for deposits and other	735.9	605.9
investment instruments abroad	1,038.5	790.7
Total increase	2,822.4	5,453.2
Decrease		
Notes issued	(1.0)	(2,400.0)
Foreign currency forward sales receivables	(529.6)	(886.5)
Deposits and obligations	(5,223.3)	-
Other liabilities	(0.2)	(0.3)
Other assets	(0.1)	(0.2)
Interest paid for foreign liabilities	(172.3)	(121.4)
Currency exchange operations, net (1)	11.2	0.5
Total decrease	(5,915.3)	(3,407.9)
Change in reserves during the year	(3,092.9)	2,045.3
Effect of exchange rate	574.1	420.2
Ending Balance	16,910.1	19,428.9
(1) Currency exchange operations, net, are as follows:		
Currency exchange operations	11.2	(297.6)
Less: Currency exchange operations that do not generate cash flows		
- Treasury transfers	-	248.1
- BCX tender	-	50.0
Total currency exchange operations, net	11.2	0.5

Note 23 Balance in foreign currency

Rights and obligations payable in foreign currency included in the balance sheet as of 31 December 2007 and 2006 are as follows:

	(US$ million)	
	2007	2006
Assets		
Foreign assets	17,381,1	19,857.9
Reserves	17,130.6	19,610.4
Other foreign assets	250.5	247.5
Domestic assets	-	1,030.8
Domestic loans	-	1,030.8
Other assets	2.9	2.2
Total assets	17,384.0	20,890.9
Liabilities		
Foreign liabilities	296.3	288.5
Other foreign liabilities	102.7	103.8
Special drawing rights (SDR) allocations	193.6	184.7
Domestic liabilities	793.5	5,987.5
Deposits and obligations with the General Treasury	318.5	1,916.5
Other deposits and obligations	475.0	4,070.0
Notes issued	-	1.0
Total liabilities	1,089.8	6,276.0
Net assets	16,294.2	14,614.9

Note 24 Contingencies and commitments

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

Note 25 Income tax

Pursuant to Article 7 of Decree Law 3345 dated 1980, the Bank's income is tax exempt.

Note 26 Relevant events

By Supreme Decree 1550 issued by the Ministry of Finance on 4 December 2007, published in the *Official Gazette* on the 29th of the same month and year, the President of the Republic, Ms. Michelle Bachelet Jeria appointed Mr. José De Gregorio Rebeco as Chairman of the Board of the Central Bank of Chile, as of 7 December 2007 and for the remaining time he has as Board Member to the same Body.

By Supreme Decree 1557 issued by the Ministry of Finance on 7 December 2007, published in the *Official Gazette* on the 29th of the same month and year, Mr. Sebastián Claro Edwards was appointed to the position of Board Member of the Central Bank of Chile, for a term of 10 years, beginning on 7 December 2007.

Likewise, by Resolution 1379E-01-071213, dated 13 December 2007, the Board of the Central Bank of Chile decided to appoint Board Member Jorge Desormeaux Jiménez as Deputy Governor of the Central Bank of Chile, beginning on 13 December 2007 until 7 December 2009, inclusive. That Resolution was published in the *Official Gazette* on 13 December 2007.

Note 27 Subsequent events

Between 31 December 2007 and the date of issuance of these financial statements, the exchange rate of the observed dollar applied at the closing of the mentioned statements has decreased from Ch$495.82 to Ch$478.28 per dollar. This variation would represent a negative effect on income, due to change of value in the amount of Ch$265,405.5 million in the Bank's exchange position as of 31 December 2007.

Note 28 Fiscal Agency

Law 20,128 on Fiscal Responsibility was published in the *Official Gazette* on 30 September 2006, thereby creating the Economic and Social Stabilization Fund (FEES) *"Fondo de Estabilización Económica y Social"* and the Pension Funds Reserve (FRP) *"Fondo de Reserva de Pensiones"*. In conformity with the mentioned law, by Supreme Decree 1383 of 11 December 2006, the Minister of Finance designated the Central Bank of Chile as Fiscal Agency for the administration of the resources in reference to those funds, in accordance with the procedures, conditions, modalities and other standards established in the aforementioned Supreme Decree.

In accordance with Article 5 of the aforementioned Supreme Decree 1383, investments of Government Resources Administrated by the Bank, as a Fiscal Agency, have been performed in accordance with the guidelines established for that purpose by the Minister of Finance. These investments are recorded in accounts outside the Bank's Balance Sheets.

In accordance with Board Resolution 1341 of 28 June 2007, Ernst & Young Ltda. was engaged to audit the *"Fondo de Estabilización Económica y Social"* (FEES) and the *"Fondo de Reserva de Pensiones"* (FRP).

ALEJANDRO ZURBUCHEN SILVA
General Manager

CÉSAR CARO BROWN
General Accountant

SILVIA QUINTARD FLEHAN
General Auditor

Report of Independent Auditors

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 December 31, 2007 and 2006, and the related statements of income for the years then ended. These financial statements are the responsibility of the management of Central Bank of Chile. Our responsibility is to express an opinion on these financial statements based on 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 charge to net income for 2006 of Ch$446,318.9 million due to the amortization of all accounting losses 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 December 31, 2007 and 2006 and the results of its operations for the years then ended, in conformity with the accounting policies described in note 2.

5. As indicated in note 14 to the financial statements, as of December 31, 2007, the Central Bank of Chile has a deficit in equity of Ch$2,176,826.5 million (Ch$2,302,325.1 million in 2006), which is mainly generated by decreases in variations of exchange rates of foreign currencies.

6. As indicated in Article 11 of Law 20.128, during 2007, the Chilean Government through the Ministry of Finance made a capital contribution to the Bank of Ch$407,956.3 million (Ch$346,628.9 million in 2006), in conformity with the Fiscal Responsibility Law.

7. As indicated in note 27 to these financial statements, the observed exchange rate for United States dollars has decreased at the date of issuance of these financial statements.

Enrique Aceituno A. ERNST & YOUNG LTDA.

Santiago, Chile, 17 January 2008

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