FINANCIAL STABILITY REPORT

FIRST HALF 2025

100 pesos, Central Bank of Chile,1926

On 14 October 1925, Decree Law 606 established the type of currency that our country would adopt: the "peso", which was to be made up of 0.1830057 grams of fine gold. In turn, ten units of weight would constitute one "condor". It is because of this law that the coin was engraved with the legend "Cien Pesos" (One Hundred Pesos) in the upper margin and, in the lower margin, it reads "Diez Cóndores" (Ten Condors).

This circular coin features on its obverse side a female face illustrated by Louis-Oscar Roty, a prominent French engraver of coins and medals. The reverse shows the Chilean coat -of-arms with the rampant condor and huemul and a star in the center.

Next to the representation of the condor, the mint mark of the Chilean Mint is distinguished. The S mark with a halo on the coins and medals produced by this institution is the oldest in the country. The symbol represents the Apostle Santiago, who was the patron saint of Chile's capital city.

Financial Stability Report

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Financial policy of the Central Bank of Chile (BCCh)

The Central Bank of Chile has as its purpose to ensure the stability of the currency and the normal functioning of internal and external payments. To fulfill this second objective, it must safeguard the stability of the financial system within the perimeter of its legal powers, implemented from a macro-financial perspective. The decisions and actions derived from its powers are part of its financial policy framework. In this context, financial stability is considered to exist when the system performs its functions normally or without significant disruptions, even in the face of adverse temporary situations. Identifying potential risk events, vulnerabilities and mitigators, together with assessing their impact on the financial system, are at the core of the Central Bank of Chile's financial policy analysis.

Financial policy conduct and implementation

The BCCh conducts its financial policy seeking to contribute, within its scope of competence, to the stability of the financial system. This has been deepening and gaining stability in recent decades due, in part, to the development of financial policy tools and their adequate application, which in turn has contributed to monetary policy effectiveness and increased the economy's resilience to disruptive events.

The Bank implements its financial policy through rigorous decision-making processes, in joint and coordinated actions with the supervisor and regulator. In particular, the BCCh issues and administers financial regulations, decides on the activation and deactivation of the countercyclical capital buffer, prepares reports and issues opinions on the impact of potential legal or regulatory changes on which it is consulted. In addition to these measures, it may exercise the role of lender of last resort for banking companies and other liquidity management tools.

Information disclosure and transparency

The Financial Stability Report (FSR) is one of the BCCh's main financial policy and communication instruments. In view of its mandate, the FSR delivers the Board's view on the main risks, vulnerabilities and mitigators affecting financial stability.

The FSR is published twice a year, in May and November. In line with international best practices, it is produced by specialized professionals and is led by the Financial Policy Division. Its contents are disseminated through various channels. In this way, the Central Bank communicates its analysis and implements its financial policy in a transparent and active manner.

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*/ This is a translation of a document originally written in Spanish. In case of discrepancy, the original version prevails. The statistical cutoff date for this Financial Stability Report is May 5th, except where noted otherwise. Financial data considers the moving average value of the last 10 days.

SUMMARY

The tariffs announced by the United States in early April —and subsequent developments— have considerably heightened uncertainty around the world. The unexpected magnitude of the announcements caused significant movements in financial asset prices and a substantial increase in volatility. Global financial markets have operated without major disruptions; however, risks to financial stability have increased markedly. At home, financial assets have also shown greater volatility, with trends that mirror those of other emerging economies. The Chilean economy has fixed the imbalances of previous years and the financial situation of borrowers —households and firms— has improved with respect to the previous report. Banks, in turn, have liquidity and capital levels that would allow them to withstand negative events. Thus, the deterioration of the global scenario finds the Chilean economy on a better position. A worsening of geopolitical and trade tensions represents the main risk for local financial stability, due to its impact on economic growth and deteriorating global financing conditions. Although the Chilean economy is not immune to these challenges, it has macroeconomic soundness and robust financial regulation and supervision standards in place, which provide adjustment mechanisms and buffers to mitigate the effects of adverse shocks.

EVOLUTION OF FINANCIAL MARKETS

Global economic uncertainty has increased considerably in the past few months. Since the publication of the previous Financial Stability Report (FSR) in November last year, there have been a series of developments in the political and commercial scene. The high point came at the beginning of April, when the US government announced much higher than expected tariffs on a broad set of countries. Additionally, the response from some of them was added. As a result, the index measuring trade uncertainty (TPU) almost doubled, hitting in April its highest in its recorded history, while financial volatility (measured by the VIX) rose to levels comparable to those at the outbreak of the pandemic. In addition, the string of announcements and counter-announcements have raised doubts about the magnitude and duration of the measures. Most recently, there have been some moves that have led to a better mood in the financial markets, but the scenario remains highly uncertain.

So far, the financial markets have been able to absorb these events smoothly enough, although the risks to global financial stability have increased significantly. The increased uncertainty has shaken the prices of financial assets and increased volatility around the world. It should be noted that the U.S. financial assets —long-term rates and the dollar— has not behaved as it used to in the face of events of global uncertainty, in which they tend to offer a safe haven. Trade tensions have increased in a context where other global vulnerabilities are still present. These include a high level of public and private debt in the world, doubts about the performance some Chinese industries and the unfolding of various geopolitical conflicts. This scenario has led to downward revisions in activity forecasts for various economies.

In emerging economies —Chile included—, financial markets have shown a favorable evolution compared to past stressful episodes. Although sovereign spreads rose in April, these rises were of a lesser magnitude than in past stress episodes, while sovereign interest rates have declined slightly, currencies have appreciated against the dollar and stock markets have yielded positive returns. The increase in volatility of long-term rates and the Chilean stock market has been lower than the average of the emerging world. By contrast, the peso/dollar parity has been more volatile, which is to be expected given its role as an adjustment variable during stressed periods.

SITUATION OF BORROWERS AND LENDERS

The Chilean economy has adjusted its macroeconomic imbalances of previous years. The current account deficit continued to narrow in recent quarters, in line with a recovery in domestic saving. This higher saving owes mainly to improved household and corporate income resulting from the better performance of domestic activity. Despite still high levels of inflation, its recent evolution and that of its main determinants reaffirm the convergence outlook contained in our March Monetary Policy Report (MPR).

The downturn in the global scenario finds individuals and businesses in a financial position that has been improving for the last few quarters, which mitigates the risks to the system. This assessment is made in a context where the increase in income and savings, along with the reduction of short- and long-term rates, have improved the indicators of indebtedness and financial burdens. Consumer credit defaults have fallen and mortgage defaults have stabilized. Commercial delinquency remains high by historical standards, even though it has been decreasing across the board in the different economic sectors. Larger companies —which report to the Financial Market Commission (FMC)— show an increase in operating cash flow and liquidity close to their historical average. On an aggregate level, the firms' indebtedness stood at 112% of GDP at the end of 2024, down somewhat from the figure reported at mid last year. This result came from a higher level of output, which more than offset the increase in external debt in nominal terms, given the increase in the issuance of instruments abroad and the depreciation of the exchange rate.

Despite the favorable evolution of overall financial conditions, vulnerabilities persist in some specific groups. Bigger companies show a stronger recovery of their financial indicators (i.e., indebtedness, margins, and financial burden) in contrast to the persistent lag of smaller firms, those that received Fogape loans during the pandemic, and those in the construction and real estate sectors.

The weakness in the residential real estate sector has persisted. The main factors that have affected this sector have remained, including the level of mortgage rates, low demand, and a high stock of finished homes. Thus, the slack provided by a stock of unfinished homes, which helped the companies to cope with the drop in sales, has been running out. Housing prices have shown a slight increase. As noted in previous Reports, a significant downward adjustment continues to be a risk factor. However, in the face of a stress scenario, such as an abrupt adjustment in valued collateral, banks have sufficient mitigators in terms of debt-to-collateral ratios and conservative collateral valuation criteria (Box II.1, FSR second half 2024). In any case, at the margin, the sector has seen incipient positive signs, such as a good performance in the stock market valuation; lower commercial lending rates; and stabilized default rates among the firms, albeit at high levels.

The persistence of structural deficits for several years has been eroding fiscal slack and has increased public debt. Official projections indicate that in the short term, public debt would be slightly below the 45% of GDP limit defined as prudent by the authority. However, as noted in previous reports, there are risks that could lead to the debt exceeding this level in the coming years. Sustaining the debt below the defined threshold requires a strict set of measures and agreements. This poses an important challenge in which all stakeholders must compete. Maintaining prudent fiscal accounts through sustainable sovereign indebtedness is essential for the economy's ability to mitigate the impact of future shocks and improve the financing situation of households and businesses.

The banking system is further adapting to the full implementation of Basel III and appears to be well prepared to face a more negative scenario. The banks have built up sufficient provisions and collateral to cover the level of default in their portfolios and show slack in their liquidity indicators. The banking sector has continued to strengthen its capital base and its solvency indicators have grown in line with the process of convergence to Basel III standards. Since our last FSR, this has been done mainly through new issues of perpetual bonds. Its profitability has remained above historical averages.

Since the previous report, lending activity presents no big changes, associated with still sluggish demand and stable supply conditions, as shown by our first-quarter Bank Lending Survey. Consistently, the firms surveyed in the May Business Perceptions Survey report an easing of lending conditions, but with prospects that are still low in terms of their own demand for financing. Credit interest rates have continued to evolve in line with their benchmarks.

MAIN RISKS

The biggest risk for domestic financial stability stems from the external scenario, particularly a new resurgence of trade and geopolitical tensions. In a context where the valuation of external financial assets remains elevated, the risk of further price repricing is still present. An abrupt adjustment in global risk appetite could generate a correction in asset prices, thus worsening financial conditions for emerging economies. In such a scenario, a significant increase in sovereign spreads and sudden capital outflows could be observed, with consequences for agents' liquidity, borrowing capacity, and solvency. This is especially relevant in emerging economies with weaker fiscal and external buffers (GFSR, April 2025). Locally, the shallower financial market as compared with previous episodes could erode the country's capacity to cushion the effects on financial variables of abrupt changes in portfolios.

International tensions may have a negative local impact on both economic activity and the payment capacity of households and firms. Although certain positive developments have been observed in recent weeks, the magnitude of the effects that trade tensions and increased uncertainty will have on the Chilean economy remains unclear. Thus, scenarios where these effects are significant cannot be ruled out, negatively impacting activity, the labor market and wealth, affecting the payment capacity of households and firms. These repercussions may be greater if commercial and geopolitical tensions intensify.

The Chilean economy has adjusted its imbalances of previous years, allowing households and firms to better deal with a deteriorated economic scenario. Compared to the previous FSR, under stress scenarios, debt-at-risk decreases in firms, mainly due to the better initial default situation of the trade sector. For individuals, debt-at-risk is mostly unchanged compared to the previous exercise. Incoming data suggests that the debt-at-risk of credit users continued to decline this year to date.

Stress tests yield that the local banking industry remains solvent to face a severe shock. In such a scenario, where activity contracts abruptly, funding costs escalate and financial conditions deteriorate, the banking system's capital level would allow it to absorb the potential losses. The availability of additional capital buffers, to which the issuance of perpetual bonds and the construction of regulatory buffers have contributed, has strengthened its capacity to absorb shocks in times of financial stress. In such scenarios, considering the most stringent capital metric (CET1), the banking system also remains solvent, with some banks of varying sizes making partial use of the regulatory buffer established for these purposes.

Despite having mitigators in place, the local financial system is not immune to the effects of a global shock. A deep capital market allows mitigating the effects of exposure to global markets, especially in the face of sudden reversals in financial prices. For this reason, it is necessary to continue efforts to deepen the local financial market. The pension reform will contribute to increasing household savings. However, it will take a long period for its effects to be reflected in a deeper capital market. Along the same lines, restoring fiscal slack will help generate fiscal slack to address shocks and strengthen the financial position of local agents, through access to lower-cost domestic and external funding.

The institutional framework that governs the Chilean economy, which includes macroeconomic soundness and robust financial regulation and supervision standards, allows having the necessary buffers and tools to mitigate the effects of adverse shocks. Our robust banking regulation and supervision framework, in line with international standards, stands out. This makes it possible for banks to have solid liquidity and capital positions, with adjustment mechanisms and buffers to face adverse shocks. In addition, the institutional framework contemplates a series of tools to be used in exceptional situations —which have been complemented with new powers incorporated in the Resilience Law— and coordination instances between the branches of government, the regulators, and the supervisors.

FINANCIAL POLICY DEVELOPMENTS

The implementation of macro prudential policies, such as the Countercyclical Capital Buffer activated in May 2023, reinforces the resilience of the banking industry and helps safeguard the stability of the overall financial system by supporting the provision of credit. The Board has decided to maintain the Countercyclical Capital Buffer (CCyB) at its current level of 0.5% of risk-weighted assets (RWA), consistent with the macrofinancial conditions and risks faced by the financial system, as described in this Report. This risk environment highlights the importance of having a pre-established capital buffer by the banks, which increases their capacity to withstand shocks and can be released in the event of a financial stress event, helping to mitigate its impacts on the provision of credit to households and businesses. As communicated in November 2024, the first Financial Policy Meeting of 2026 will evaluate the start of the convergence towards the neutral level of 1% of RWA, as long as macrofinancial conditions allow, and considering a period of at least one year for its construction.

With respect to the Central Bank's financial regulation agenda, this report outlines the priority initiatives for 2025, which focus on the implementation of the Resilience Law. During the first half of this year, a new regulation will be published for consultation that will allow the recognition of framework agreements and special conditions for Repo transactions. This initiative should contribute to the development of this market and thereby support the liquidity provision and management of financial institutions. For the second half of the year, priority will be given to initiatives related to the liquidity management of Central Counterparties, and to the access of certain non-bank entities to the RTGS system.

Among other financial policy developments, it is worth noting the changes associated with the implementation of the pension reform. Considering the volume of pension funds (roughly 60% of GDP), an important challenge is to enforce the new regulatory framework while avoiding undesired effects on the valuation and volatility of financial assets. In this sense, the implementation process of the following innovations is worth mentioning: biannual bids for affiliates; the entry of new players to the industry; and the replacement of the current Multifunds by Generational Funds. However, the approved legal framework contemplates a gradual transition to allow for the necessary adaptations.

I. FINANCIAL MARKETS' TRENDS

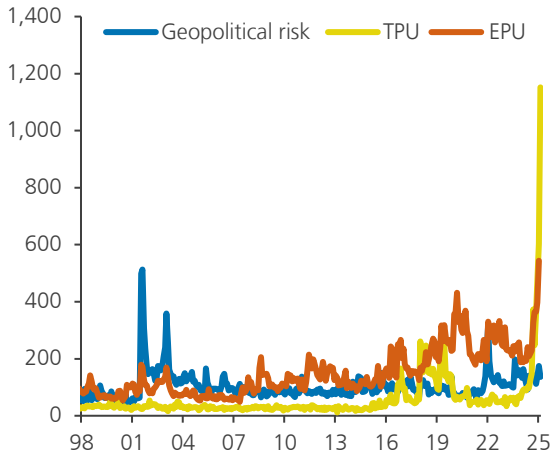
Since the previous Report, following the announcement of tariffs imposed by the United States and the responses from the main economies involved, uncertainty has risen significantly. Financial markets have absorbed these events without major disruptions; however, risks to financial stability have increased. The unexpected magnitude of the announcements magnified the volatility of financial assets and impacted their valuations, leading to price adjustments. These have been particularly intense in the U.S., while emerging countries' financial markets have performed relatively well compared to past stress episodes. In addition, previously identified external risk factors remain, such as persistently high long-term interest rates, substantial global debt levels, and vulnerabilities in the Chinese economy. Concerns about high valuations of external financial assets also persist, keeping alive the risk of abrupt corrections in these assets. Local financial market developments have aligned with those of their emerging peers. Overall, a deterioration in financial conditions due to escalating geopolitical and trade tensions remains the main risk to local financial stability. In this context, continued efforts to deepen the local financial market are needed.

INTERNATIONAL FINANCIAL CONDITIONS

The implementation of protectionist trade policies has heightened uncertainty and financial market volatility in recent months. Nevertheless, no significant disruptions in the functioning of financial markets have been observed. Since the last Report—particularly after the tariffs announced by the U.S. in early April and subsequent developments—global uncertainty has increased and risk appetite has declined. Thus, indexes of political, economic, and trade uncertainty have reached all-time highs (Figure I.1), and volatility indicators in equity and bond markets have risen considerably (Figure I.2). In this context, financial systems have functioned normally, with no significant global liquidity constraints (Bank of Canada, May 2025). Notably, recent signs of a more friendly tone have improved financial market sentiment.

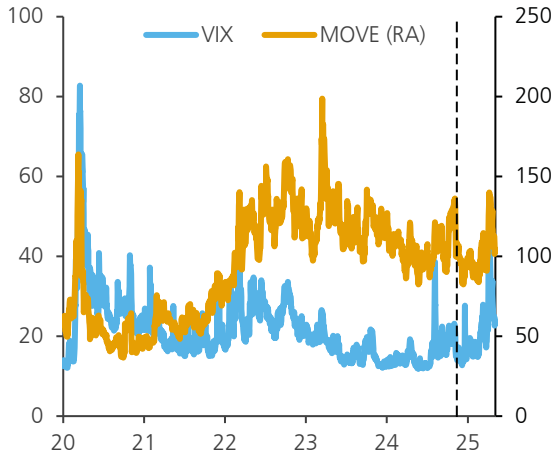
The macro-financial repercussions of trade tensions have triggered an unusual risk-off scenario originating from the U.S., prompting a search for safe-haven assets. Since the tariff announcements, the S&P 500 has dropped nearly 2.6%, a larger decline than observed in other equity markets (Figure I.3), while long-term interest rates and the U.S. dollar have behaved differently from past stress episodes. In particular, long-term interest rates have risen, and the dollar has depreciated by 4.6% since April 2. Still, there is significant risk of further corrections in these asset prices, given their historically high valuations relative to other countries. In this scenario, there has been a substantial increase in flows to money market funds in search of more liquid assets, and a preference for other safe-havens such as gold, which has appreciated by 27% since the end of last year.

FIGURE I.1 GEOPOLITICAL RISK, TRADE POLICY UNCERTAINTY AND ECONOMIC POLICY UNCERTAINTY INDICATORS (*)
(indexes)



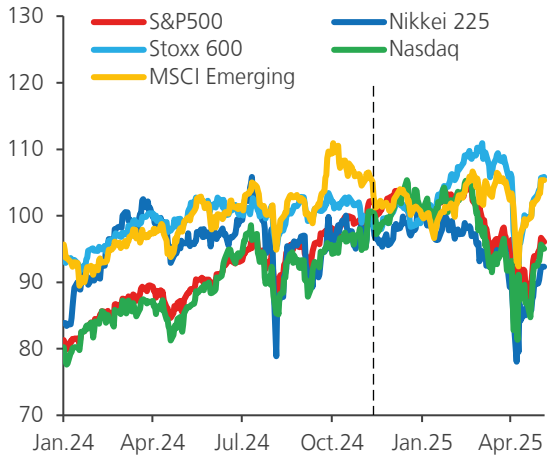
(*) Monthly data.
Source: Central Bank of Chile based on Davis (2016); Caldara et al. (2020); Caldara and Iacovello (2022).

FIGURE I.2 IMPLICIT VOLATILITY INDEXES (*)
(index, percent)



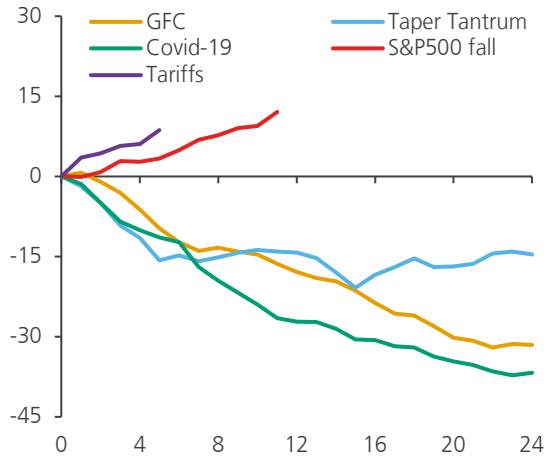
(*) Dashed vertical line marks cutoff date of previous FSR. VIX: volatility implicit in one-month options over S&P500. MOVE: Implicit volatility index on one-month options on 2-, 5-, 10- and 30-year U.S. Treasury bills.
Source: Central Bank of Chile based on Bloomberg data.

FIGURE I.3 STOCK MARKETS' EVOLUTION (*)
(index, December 31st, 2024=100)



(*) Dashed vertical line marks cutoff date of previous FSR.
Source: Central Bank of Chile based on Bloomberg data.

FIGURE I.4 EQUITY INVESTMENT FLOWS OF NON RESIDENTS IN EMERGING ECONOMIES (EXCLUDES CHINA) (*)
(billion of dollars, weeks)



(*) Cumulative weekly flows since the onset of respective event: GFC (Global Financial Crisis, June 2008); Taper Tantrum (May 2013); Covid-19 (March 2020); S&P500 fall (all-time highs of the stock index on February 19); Tariffs (April 2, the day of US tariff announcement).
Source: Central Bank of Chile based on data from Emerging Portfolio Fund Research (EPFR).

In this highly uncertain context, the risk of a significant deterioration in emerging markets' financial conditions persists. In recent months, due to increased risk in the U.S. economy, equity investment flows to emerging markets have increased, in contrast to other financial stress episodes (Figure I.4). Currencies have appreciated against the dollar (Figure I.5). However, a reversal of these trends cannot be ruled out, given the high levels of political uncertainty and financial assets' volatility. Trade conflicts could also affect economic growth prospects and equity prices (GFSR, April 2025), which combined may worsen financial conditions in emerging markets.

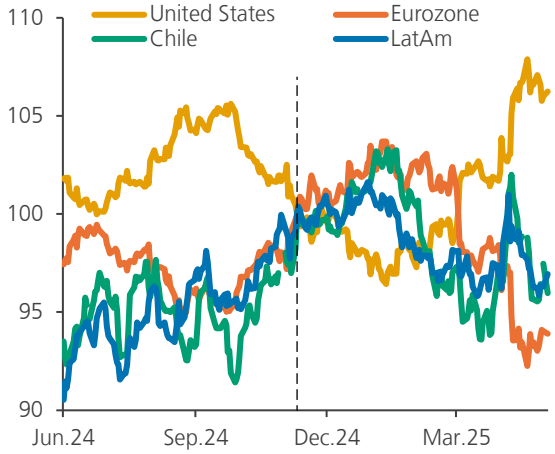
High levels of public and private debt (Figure I.6), coupled with a complex global fiscal outlook, contribute to persistently elevated long-term interest rates (Figure I.7). The resurgence of trade protectionism and rising geopolitical tensions have led the European Union and Germany to announce massive fiscal packages focused on defense and infrastructure. Additionally, there is ongoing pressure from the existing debt stock that will need to be rolled over at higher interest rates in the future, along with greater spending related to climate change and sustainable development (FSR, first half 2024). The fiscal deficits of the major economies' are still substantial, requiring historically high adjustments to stabilize debt levels (Fiscal Monitor, April 2025).

Structural vulnerabilities in the Chinese economy persist, which added to the tariffs imposed by the U.S. could pose additional risks to emerging economies. Although China's first-quarter economic activity data exceeded market expectations, structural vulnerabilities remain. A slow adjustment in the real estate sector and local government debt continue to impact demand and depress both consumer confidence and the stock market—potentially worsened by tighter global financial conditions due to the trade conflict. In the long run, China faces demographic challenges due to rapid population aging, which could adversely affect productivity and demand (WEO, April 2025). Along these lines, the measures adopted by the Chinese government since last September have focused on supporting the residential housing sector and local governments, but it remains uncertain whether further efforts will be needed to boost economic activity amid limited fiscal slack (Fiscal Monitor, April 2025). Overall, China's uncertain economic outlook poses additional risks for emerging economies, particularly its trading partners and commodity-exporting countries.

While the U.S. sovereign bond market has operated without major disruptions, liquidity conditions remain tight and warrant monitoring due to their implications for long-term rates. Although the U.S. Treasury market liquidity has improved over the past year, it remains below the decade average (Figure I.8). This coincides with increased volatility in mid- and long-term Treasury markets (Figure I.2) and a recent widening of swap spreads, alongside a slight uptick in repo funding costs in the U.S. market. In this context, the growing size of the Treasury market in the past few years has complicated the absorption of large movements, at times pressuring primary dealers to provide liquidity (GFSR, April 2025). Despite this, no major disruptions have been observed. However, low liquidity combined with high volatility could lead to an increase in risk premiums and requires close monitoring.

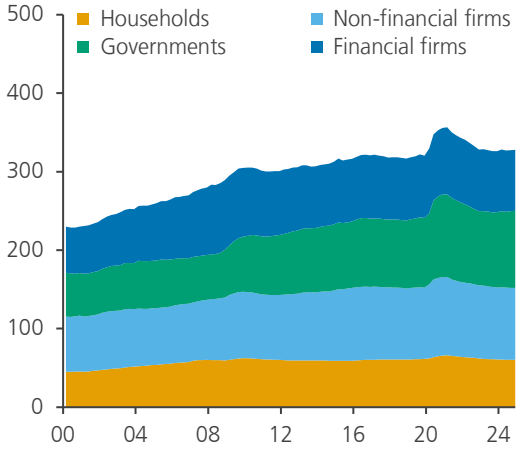
The regional banking sector' outlook in the U.S. remains a concern. Additionally, the growing presence of non-bank financial intermediaries (NBFIs) in the credit market could exacerbate existing financial vulnerabilities. U.S. and European bank stock valuations have declined since the beginning of the year (Figure I.9), with U.S. regional banks still showing a poor performance compared to early 2023. Meanwhile, the U.S. NBFI sector continues to expand and has grown consistently in recent years. There is also growing interconnectedness with the banking sector; for example, through funding provided by these institutions to investment funds (GFSR, April 2025). Notably, private credit funds tend to have concentrated exposure in a few economic sectors, and other NBFIs have increased leverage (BIS Quarterly Review, March 2025). This makes the sector vulnerable to high-volatility episodes, and monitoring its ties with the banking sector becomes increasingly important.

FIGURE I.5 CURRENCIES (*)
(index, previous FSR's statistical close =100)



(*) Dashed vertical line marks statistical cutoff date of previous FSR. For LatAm, simple average of indexes of Brazil, Colombia, Mexico, and Peru are considered. A higher index denotes a currency depreciation and vice versa. For the United States, the inverse of the multilateral exchange rate is used to make it comparable with the other currencies.
Source: Central Bank of Chile based on Bloomberg data.

FIGURE I.6 GLOBAL DEBT (*)
(percent of global GDP)

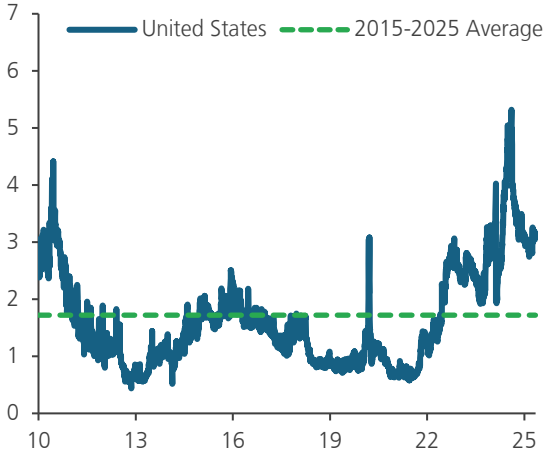


(*) Includes cross-border loans and bonds (deposits are not included).
Source: Central Bank of Chile based on Global Debt Monitor data.

FIGURE I.7 TEN-YEAR SOVEREIGN INTEREST RATES (*)
(percent)

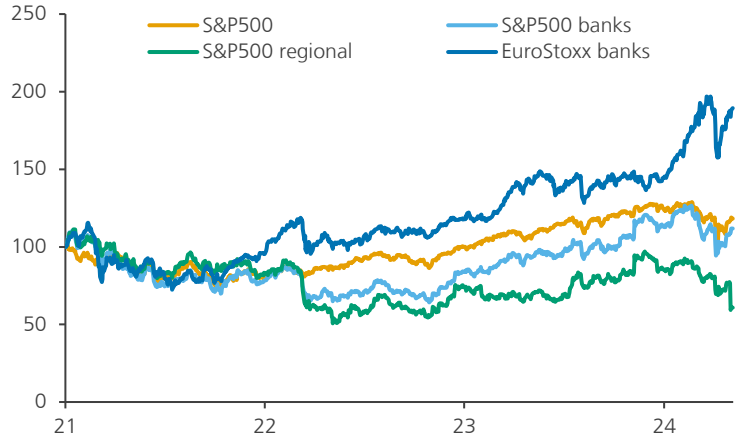
(*) Dashed vertical line marks statistical close of previous FSR. Developed countries include: Australia, Canada, Denmark, Eurozone (minus Portugal and Greece), Korea, Norway, Singapore, Sweden, United Kingdom, and United States. Emerging countries include: Brazil, Chile, Colombia, Hungary, India, Indonesia, Mexico, Peru, Poland, South Africa, Thailand, and Türkiye.
Source: Central Bank of Chile based on Bloomberg data.

FIGURE I.8 LIQUIDITY CONDITIONS IN THE U.S. SOVEREIGN DEBT MARKET (*)
(basis points)



(*) Average projection error of the yield curve for maturities equal to or greater than 1 year. Thus, when liquidity conditions are favorable (tight), the average projection error is smaller (bigger).
Source: Central Bank of Chile based on Bloomberg data.

FIGURE I.9 STOCK INDEXES OF INTERNATIONAL BANKS
(index; December 31st, 2021=100)



Source: Central Bank of Chile based on Bloomberg data.

LOCAL FINANCIAL SITUATION

Local financial conditions have improved since the last Report, despite increased asset price volatility due to recent external developments. The Chilean peso has been the primary adjustment variable in response to high external uncertainty, fluctuating more than other currencies (Figure I.10), though without disrupting market functioning. Overall, since the last Report, the local currency has appreciated 2.0%, close to $940 pesos per U.S. dollar. Meanwhile, the local stock market has posted positive returns year-to-date (Figure I.11), with increased volatility in line with its peers since the previous Report (Figure I.12). Sovereign spreads have risen across emerging economies, especially in recent months. Specifically, Chile's 5-year CDS spread has increased by 24bp since the last FSR—less than in other stress episodes and lower than in other Latin American economies, remaining below its 20-year average.

Local long-term interest rates have followed external trends, showing declines since the last Report. Long-term sovereign interest rates have dropped by about 7bp (Figure I.13), in a context of increased rate volatility (Figure I.14). The spread between Chile's 10-year sovereign interest rate and its U.S. counterpart is around 140bp—an all-time low but consistent with other emerging markets. Long-term UF-indexed bank and corporate bond interest rates remain elevated by historical standards, reflecting still-restrictive long-term financial conditions (Figure I.15).

Pension funds have seen limited transfers to funds with higher fixed-income allocation. There has been an increase in transfers to Fund E, consistent with higher global risk aversion, although the transfers between funds have been relatively modest compared to previous years (Figure I.16). In this context pension fund performance has been volatile and heterogeneous (Figure I.17). Riskier funds have increased investments in foreign fixed income and local equities, while more conservative funds have increased exposure to both local and foreign fixed income—these latter showing better returns, likely linked to the evolution of long-term local interest rates.

Mutual funds have increased their demand for bonds in the domestic market, with redemptions remaining contained. Mutual fund investments have increased steadily in recent years (Figure I.18), particularly in short-term (Type 2) and medium/long-term (Type 3) debt funds, whose assets grew by 14.7% and 16.8%, respectively—driving increased demand for bank and sovereign bonds in both primary and secondary markets. The assets of free-investment funds (Type 6) also grew by 16.8%, gaining a larger share of the sector and showing high interconnection with other funds. The industry's growth has been driven mainly by increased contributions to leading funds, with redemptions staying moderate.

FIGURE I.10 NOMINAL EXCHANGE RATE VOLATILITY IN EMERGING ECONOMIES (1)
(percent)

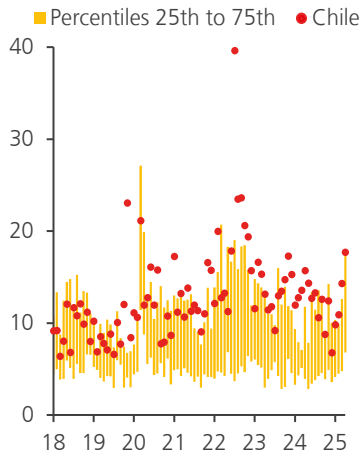


FIGURE I.11 LOCAL STOCK EXCHANGES IN EMERGING ECONOMIES (2)
(index; statistical close of previous FSR =100)

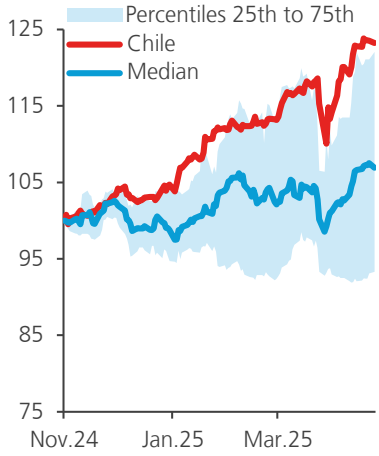


FIGURE I.12 VOLATILITY OF LOCAL STOCK EXCHANGES IN EMERGING ECONOMIES (1)
(percent)

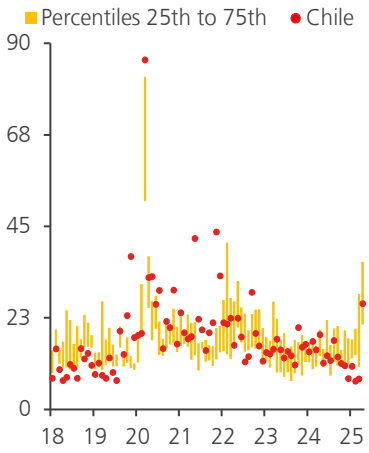


FIGURE I.13 TEN-YEAR NOMINAL SOVEREIGN RATES IN EMERGING ECONOMIES (2)
(basis points, cumulative variation since previous FSR)

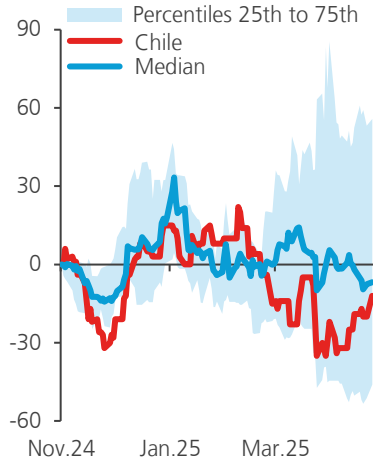


FIGURE I.14 VOLATILITY OF 10-YEAR SOVEREIGN INTEREST RATES IN EMERGING ECONOMIES (1)
(basis points)

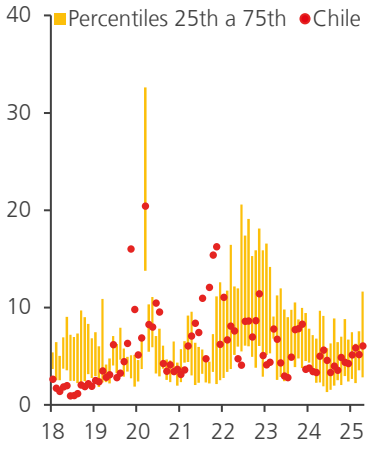
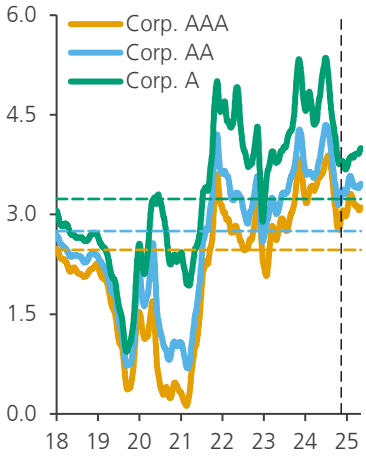


FIGURE I.15 INTEREST RATES ON 10-YEAR UF-INDEXED CORPORATE BONDS (3)
(percent, moving 30-day mean)



(1) Bars show the difference in volatility between the 25th and 75th percentiles of a set of emerging economies that includes: Brazil, China, Colombia, Hungary, India, Indonesia, Malaysia, Mexico, Peru, Poland, Russia and Türkiye. Annualized standard deviation of the daily return during each month (Figures I.10 and I.12) and daily change during each month (Figure I.14). (2) Shaded area shows the difference between the 25th and 75th percentile of the distribution of cumulative changes since the last FSR for a set of emerging economies that includes: Brazil, Chile, Colombia, Hungary, India, Indonesia, Mexico, Peru, Poland, South Africa, Thailand and Türkiye. (3) Dashed vertical line marks statistical cutoff date of previous FSR. Horizontal lines show average between 2013 and 2019. The figure shows RiskAmerica's generic bond rates.
Source: Central Bank of Chile based on Bloomberg data and RiskAmerica.

Local monetary policy transmission to market interest rates has continued to operate normally, and the cost of dollar funding has shown no significant changes in recent months. Short-term interest rates have remained relatively stable for some months (Figure I.19), aligned with recent domestic monetary policy developments. In turn, the cost of dollar funding in the local market—measured by the on-shore spread—continues to hover around historical patterns (Figure I.20), with no major disruptions in dollar liquidity in the market.

Local bank and corporate bond issuances have mainly aimed at refinancing maturities, with issuance spreads above pre-pandemic levels and shorter recent terms. In 2025, bank and corporate bond issuances have been subdued (Figure I.21), mainly due to lower bank bond placements despite a modest rebound in April. Issuance spreads remain high relative to pre-pandemic levels (Figure I.22), with maturities enabling marginal funding diversification. Both banking and corporate bond markets show a high concentration of maturities over the next two years, indicating greater refinancing needs.

Market depth indicators remain historically low, limiting the economy's ability to cushion external shocks. Although some depth indicators have improved in recent quarters, overall, they still reflect a shallower market compared to the pre-pandemic period. Pension fund assets as a share of GDP stand at 60.3%, about 20 percentage points below pre-withdrawal levels (Figure I.23). Transactions in the UF-denominated fixed income securities reveal a shallow market, amounting to only 73% of 2019 levels.

THREATS TO FINANCIAL STABILITY

A deterioration in financial conditions due to heightened geopolitical and trade tensions remains the primary risk to local financial stability. Although markets have reacted favorably in recent days following the U.S. government's temporary tariff postponement toward some economies[1]/, uncertainty over the outcome remains high. The scope and scale of the tariff measures are still unknown, posing a threat to financial stability. Specifically, rising uncertainty and risk aversion have significantly increased financial market volatility, thus affecting asset prices. While recent equity flows to emerging markets and currency appreciation have risen, renewed risk aversion could trigger capital outflows from these economies leading to tighter financial conditions (FSR, second half 2024). Notwithstanding, the local economy could be affected by weaker export demand from other economies impacted by trade conflicts (real channel) and an overall decline in international trade flows (trade channel)[2]/.

A sudden shift in risk appetite could lead to a correction in asset prices, worsening financial conditions in emerging markets. A resurgence of trade tensions and greater uncertainty over future protectionist measures have triggered considerable asset price corrections, which nonetheless remain elevated. Notably, emerging markets have continued to attract net equity flows since the beginning of the year. Risky asset prices have shown resilience during this period. However, a deterioration in relative growth expectations in this group of economies could reverse these flows, affecting local financial asset prices.

Elevated public and private debt levels around the world—alongside large fiscal deficits—remain a concern for long-term financing. Since the last Report, rising uncertainty and trade tensions have further challenged fiscal sustainability in several economies. Given already high debt and fiscal deficits (FSR, second half 2024), the situation is now more complex, as governments face difficult choices between fiscal consolidation to improve their fiscal position, building buffers against adverse shocks, and addressing rising geopolitical-related spending pressures (Fiscal Monitor, April 2025). These elements, along with rising inflation expectations, suggest that long-term interest rates will likely remain elevated.

[1]/ Data received after the statistical cutoff of this report.

[2]/ For details, see Box I.1, FSR second half 2024.

FIGURE I.16 PENSION FUND TRANSFERS TO FUND E
(millions of dollars, moving 3-month sum)

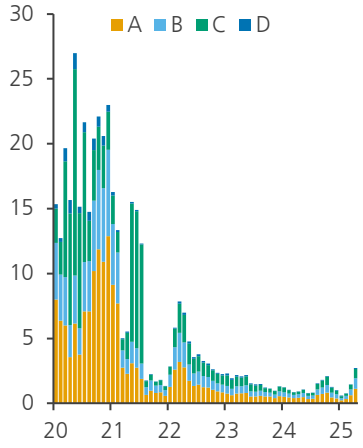


FIGURE I.17 PENSION FUND INVESTMENT BY TYPE OF FUND
(index, statistical close of previous FSR =100)

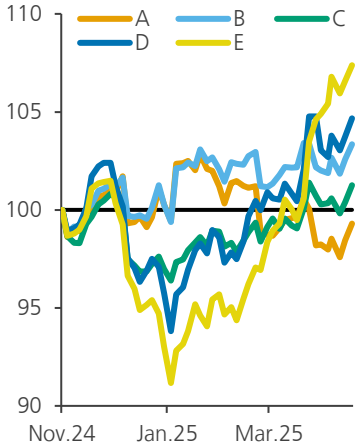
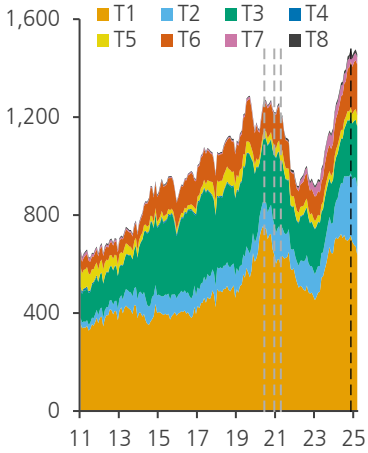


FIGURE I.18 MUTUAL FUNDS' INVESTMENTS BY TYPE (*)
(millions of UFs)



(*) Series adjusted to discount the mutual funds' investments in other mutual funds to avoid duplication. Light colored dashed vertical lines indicate pension fund withdrawals. Black dashed vertical line marks statistical close of previous FSR.
Source: Central Bank of Chile based on information from the Pension Superintendency and Financial Market Commission.

FIGURE I.19 MONETARY POLICY RATE, DEPOSITS AND SHORT-TERM OVERNIGHT INDEX SWAP (1)
(percent)

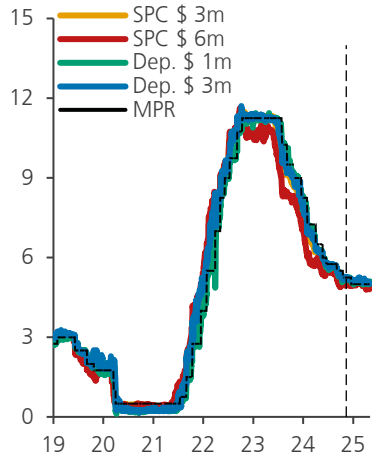


FIGURE I.20 SPREAD ON SHORE AT 30 DAYS (2)
(percent)

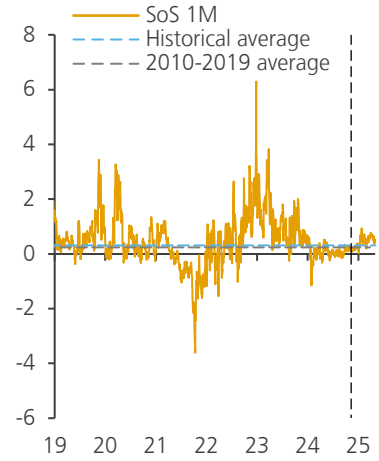
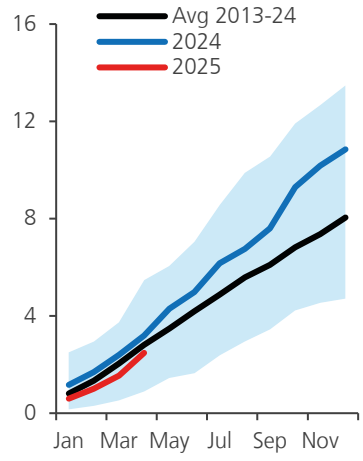


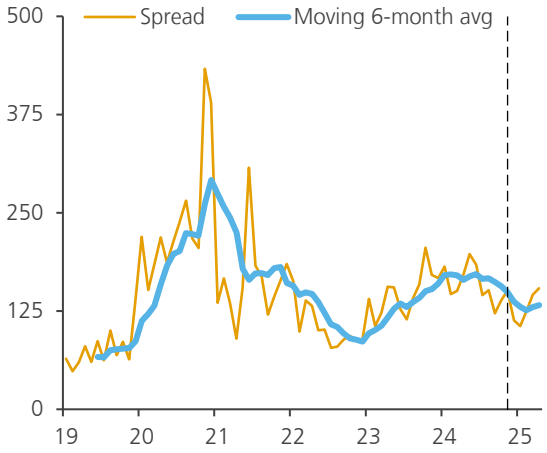
FIGURE I.21 BANK AND CORPORATE BONDS ISSUED IN THE LOCAL MARKET (3)
(billions of dollars)



(1) Dashed vertical line marks statistical close of previous FSR. (2) "Historical average" covers from years 2010 to 2025. (3) Includes bank and corporate bonds issued in pesos and UFs. Amounts converted to dollars using prices on the day of issuance. Shaded area represents the range of the distribution between 2013 and 2024.
Source: Central Bank of Chile based on BCS, DCV, FMC, and RiskAmerica information.

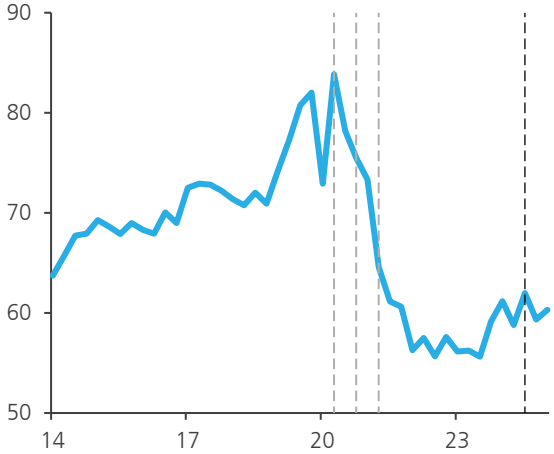
A deterioration in external macro-financial conditions could have significant impacts locally, especially considering limited market depth. This implies a reduced capacity for the local market to absorb shocks coming from abroad. Continuous policy development to deepen the local financial market is therefore essential, as it will take long for such efforts to translate into a deeper capital market.

FIGURE I.22 SPREADS OF UF-INDEXED BANK AND CORPORATE BONDS ISSUED IN LOCAL MARKET (*)
(basis points)



(*) Dashed vertical line marks statistical close of previous FSR. Data aggregated by using monthly weighted averages. Spreads calculated over OIS denominated in UFs.
Source: Central Bank of Chile based on BCS, DCV, and RiskAmerica information.

FIGURE I.23 ASSETS IN PENSION FUNDS (*)
(percent of GDP)



(*) Quarterly GDP data at current prices are used, accumulating four moving quarters and monthly data of total assets of the pension fund system, considering the last month of each quarter. First quarter 2025 GDP calculated based on April 2025 Economic Expectations Survey. Gray vertical lines indicate pension fund withdrawals. Black vertical line indicates the quarter of the statistical close of the previous FSR.
Source: Central Bank of Chile based on information from the Pension Superintendency.

II. BORROWERS

Credit borrowers show a better risk balance compared to the previous Report. The evolution of local macroeconomic conditions improved household income and corporate sales. In line with the MPR adjustments, commercial and consumer credit rates were reduced across the board, while mortgage loan rates have dropped in line with their benchmarks. The various measures of corporate and household bank defaults have also shown some improvement, although commercial portfolio default levels remain high. Aggregate corporate indebtedness over GDP declined while the bigger companies' financial indicators have improved. Nonetheless, vulnerabilities persist among small-sized firms, construction and real estate firms, and those that obtained Fogape loans during the pandemic. Households recorded an increase in their saving rate and a reduction in their financial burden, while debt-to-income remained stable. In this context, the main risk facing households and companies continues to be a deterioration in the already uncertain external scenario, which, if passed on to the local economy, would affect their repayment capacity. Overall, the stress tests point to a positive evolution of debt-at-risk with respect to the previous Report, explained by the better initial payment situation, financial burden, and activity. However, the most vulnerable households and firms could see their repayment capacity affected in case of a deeper and more protracted deterioration in global financial conditions.

FIRMS

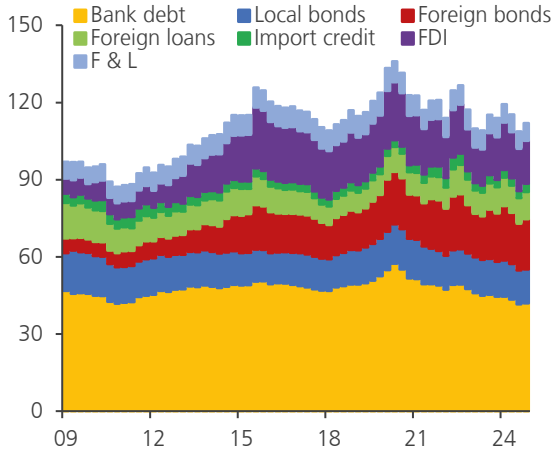
The firms' financial vulnerability has subsided, but they are still facing a more challenging global scenario. The positive evolution of activity in recent quarters, lower indebtedness and a reduced financial burden among the bigger companies puts them in a better position than in the previous Report. A further deterioration of external conditions that would worsen the local economic environment and affect their ability to pay poses the most important risk for this segment.

Aggregate corporate indebtedness declined from the previous Report. With information from the end of 2024, the aggregate debt of non-bank firms was 112% of GDP, a decline explained mainly by the economic recovery (Figure II.1) and the contraction of commercial bank credit (Chapter III).

The firms' external debt grew; however, their limited exchange rate mismatch would allow them to absorb significant fluctuations of the peso. The external debt grew during 2024, due to greater issuance of international corporate bonds and also driven by the valuation effect associated with the depreciation of the exchange rate (Figure II.1). The forex risks associated with bond issuance are low, since most of the issuing firms receive their revenues in dollars, which protects them from exchange rate fluctuations (MPR, September 2018; FSR, first half of 2019). Meanwhile, the portion of foreign debt associated with FDI corresponds mostly to debt between subsidiary and parent company, which is less enforceable (FSR, second half 2019). The companies that report their financial statements to the Financial Markets Commission (FMC) and are indebted abroad and their revenues are mainly in pesos, showed a net creditor position of about 2.5% of their assets[1]/. In turn, the share of assets of firms with a greater than 10% mismatch has remained contained.

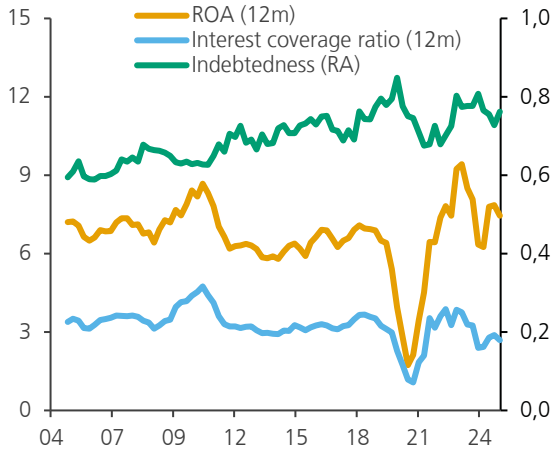
[1]/ As a proportion of assets, the net creditor position is composed of roughly 10% of foreign currency liabilities, 9% of foreign currency assets, and a net derivative asset position representing 3%.

FIGURE II.1 DEBT OF NON-BANKING FIRMS (*)
(percent of GDP, 2024.Q4)



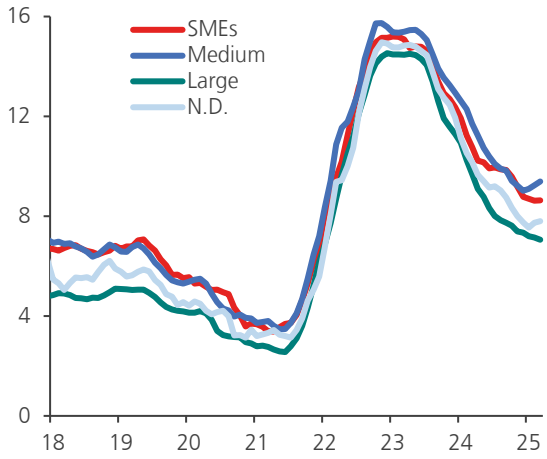
(*) Based on firm-level information with the exception of non-bank factoring, leasing and others, securitized bonds and bills of exchange. Bank debt corresponds to local bank debt. F & L: Factoring and leasing. Does not include commercial college debt. Quarterly data.
Source: Central Bank of Chile based on Achef and FMC data.

FIGURE II.2 FINANCIAL INDICATORS (*)
(percent of total assets; times financial expenses; times equity)



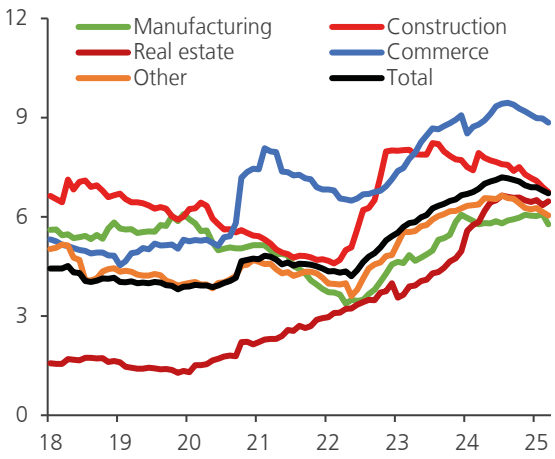
(*) Return on assets corresponds to cumulative twelve-month profit before financial expenses and taxes on total assets. Interest coverage ratio defined as twelve-month profit before taxes and financial expenses over annualized financial expenses. Indebtedness stands for debt-to-equity ratio. Consolidated data. Does not consider state-owned enterprises nor those classified in Financial Services or Mining sectors.
Source: Central Bank of Chile based on FMC data.

FIGURE II.3 INTEREST RATE ON COMMERCIAL LOANS UNDER ONE YEAR
(percent, weighted average)



(*) Considers only installment credits of locally financed firms; does not consider persons. Rates calculated as weighted average by bracket, smoothed using moving quarterly average. Sales brackets defined as of December 2022: Small enterprise (2,400 UF>sales<25.000 UF a year); Medium-sized (25,000 UF>sales<100,000 UF a year); Big (sales>100,000 UF a year).
Source: Central Bank of Chile based on FMC and SII information.

FIGURE II.4 PORTFOLIO IN DEFAULT (*)
(percent of debt)



(*) Locally financed enterprises. Portfolio in default corresponds to C or group portfolio non-compliance. Other includes other economic sectors such as: Agriculture, Mining, Financial services, Transport & telecommunications, Natural resources and unclassified. Preliminary information for March 2025. More information in Box II.1, FSR first half 2024.
Source: Central Bank of Chile based on FMC and SII information.

The financial situation of big companies has remained stable since the previous FSR, with an increase in profitability. With information at the fourth quarter of 2024, the situation of the companies that report to the Financial Market Commission (FMC) did not vary much with respect to the previous FSR. Profitability remains high, in line with improved operating cash flows. The debt and interest coverage indicators remained near their historical averages (Figure II.2). Likewise, liquidity remained stable at average values, with increased cash, which enhances the firms' capacity to deal with potential short-term difficulties.

The firms financed with local bank loans saw an improvement in their financial indicators, driven by the bigger ones. During 2024, various factors put pressure on corporate margins (MPR, March 2025). However, in line with the reduction in commercial credit interest rates (Figure II.3) and the improvement in economic activity, the financial burden and indebtedness decreased, particularly in larger firms. By sector, it is worth mentioning the reduction in the financial burden in Manufacturing and the decrease in indebtedness in Construction, while Commerce showed a positive evolution in both indicators. Meanwhile, companies that participated in support programs during the pandemic, such as Fogape-Covid loans, stabilized their default rate after a long period of increases, and have seen improvements in their financial position. Meanwhile, smaller firms' financial indicators have not fully recovered after the pandemic, which leaves them more vulnerable in a scenario of high uncertainty like the present one, in which risks of higher long rates or contraction in activity could materialize.

The improvement in the firms' financial situation reflected a reduction in commercial loan defaults, although they remain high by historical standards. In March 2025, default reached 6.7% of commercial loans, which compares positively with the 7.2% peak observed in July 2024, but is still above its pre-pandemic levels (Figure II.4)[2]/. More recently, the improvement in the Trade and Construction sectors and the stabilization in the Real estate sector stand out. Other default indicators showed a similar performance. Thus, in March 2025, the Unpaid Installment Index (ICI) reached 2.1%, which compares positively with the peak of 2.5% recorded in September last year[3]/. Commercial loan default presented a similar behavior (Chapter III)

Interest rates on banks' commercial loans have continued their downward trend, which, combined with the improvement in activity, has eased the financial burden on the firms. Interest rates on commercial loans have fallen by nearly 40bp since the close of the previous FSR. This drop was transversal by risk rating and sales bracket (Figure II.3). Lower short-term rates facilitate access to refinancing and help alleviate the financial burden. Meanwhile, up to the first quarter of this year, credit supply conditions, both for SMEs and large companies, showed no significant changes with respect to the end of 2024 (Bank Lending Survey and Chapter III).

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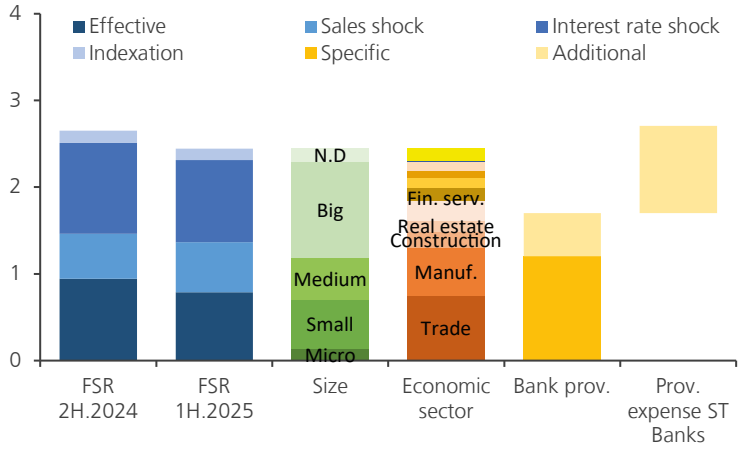
[2]/ The non-performing portfolio includes "debtors and their loans for which recovery is considered remote because they show a deteriorated or null payment capacity" (FMC). In other words, in addition to the debtors in default, those that have required restructuring or that have stopped or are expected to stop repaying their lenders are also considered. For more information see Box II.1 in FSR, first half 2024.

[3]/ The Unpaid Installment Index (ICI) comes from the "Debtors System" file of the FMC and is calculated as the arrears between 90 days and three years divided by the sum of the current debt and arrears up to three years. (Fernández and Vásquez, 2019).

A STRESS TEST FOR FIRMS[4]/

In the stress scenario, the debt-at-risk is lower than in the previous test due to the better initial situation of the firms. Facing the materialization of a severe scenario, the debt at risk reaches 2.4% of GDP according to information at December, i.e., lower than the 2.7% of the test in the previous Report with data up to June. This difference (-0.3% of GDP) is largely explained by a better initial situation of effective default (-0.2% of GDP), where the decrease is mainly explained by the favorable evolution of the Trade sector (Figure II.4). Under stress, the impact of the interest rate shock is 0.1% smaller than in the previous test, expressed as debt-at-risk (Figure II.5)[5]/. Since December, marginal data indicates that the financial position of the firms continued to improve, trade defaults declined, sales continued to grow, and the financial burden dropped, most sharply in larger firms and in the Trade and Manufacturing sectors. This suggests that the debt-at-risk has continued to adjust downward so far this year.

FIGURE II.5 COMMERCIAL DEBT AT RISK (*)
(percent of GDP, 2024)



(*) Enterprises financed with local bank credit. Does not consider loans to persons. Corresponds to amount owed by each firm weighted by individual probability of default in one year. Last column shows additional expenditure in provisions derived from the bank stress test (Chapter III).
Source: Central Bank of Chile based on FMC and SII information.

REAL ESTATE

Weakness in the residential property sector has been prolonged, with sales still depressed and high inventories of finished homes. According to the Chilean Chamber of Construction (CChC), in 2024 housing sales in the Santiago Metropolitan Region fell by 8% from the year before, while in the first quarter of this year sales matched those observed at the beginning of 2024. In March 2025, the stock of finished housing reached 57% of total units for sale, up from 52% in the first quarter of 2024 (Figure II.6). Thus, the number of months required to use up the finished stock is close to two years, the longest in recorded history. The slack that used to be provided by unfinished stock, and which allowed the firms to cover the drop in sales, has been running out, leaving them in a tight situation, which could pressure them to liquidate inventories, reducing the prices of new homes.

[4]/The test is based on Córdova et al. (2021). It has a one-year horizon and assumes the occurrence of three shocks: i) a severe scenario of falling sales for activity, consistent with the one presented in the banking stress test (Chapter III); ii) an increase of 600 bp in commercial interest rates; and iii) a 4pp rise in inflation in one year.

[5] / This test considers increases in inflation that directly affect the payment of UF-denominated debt. It does not consider all additional general equilibrium effects associated with inflationary shocks.

FIGURE II.6 STOCK OF NEW HOMES FOR SALE (1)
(thousands of units)

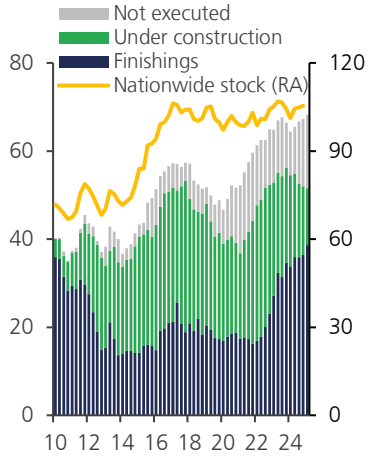


FIGURE II.7 HOUSING PRICE INDEX (IPV)
(index, 2015.Q1=100)

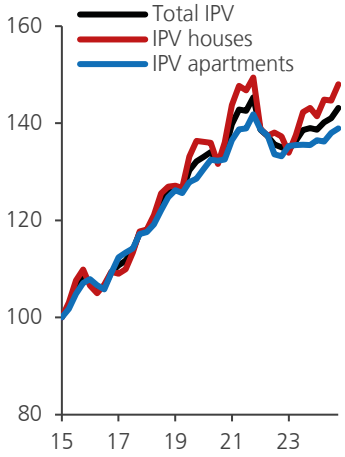
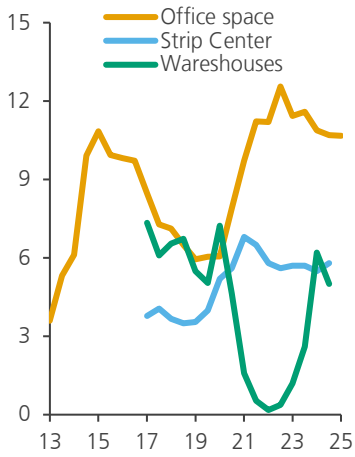


FIGURE II.8 VACANCIES IN NON-RESIDENTIAL LEASE MARKET (2)
(percent)



(1) The bars represent the stock in the Metropolitan Region. (2) Six-month data. Preliminary information for Office space up to 1Q.2025.
Source: Central Bank of Chile based on CChC, SII, CBRE, Colliers, and GPS.

Although mortgage interest rates have declined, they are still high. Since the previous Report, bank mortgage rates decreased, standing around 4.4% in real terms in March 2025. This is mostly explained by the influence of long-term external rates on the local economy. This level is still high compared to pre-pandemic ones; thus, between 2015 and 2019, the average mortgage rate reached 3.3% in real terms[6]/. Accordingly, demand for housing loans in the first quarter of 2025 was perceived to be weaker than in the previous quarter (Bank Lending Survey, BLS).

Housing prices have shown some rebound in recent quarters, although, as noted in previous reports, the sector remains exposed to the risk of a significant downward adjustment. Housing prices rose 3% in real annual terms in the fourth quarter of 2024, with across-the-board increases among the different types of units (Figure II.7). As of the first quarter of 2025, rental prices have remained stable in real terms in houses and apartments, compared to the same quarter of the previous year. Meanwhile, the gross profitability of buy-to-let, as well as the share of borrowers with more than one loan, did not present major variations in the second half of the year. However, a significant adjustment in housing prices persists as a risk factor, due to the accumulation of finished housing stock and the liquidity pressures that firms in the sector could face.

In this context, some positive signs were observed, such as lower interest rates on commercial loans, stabilized default, and a good performance of the stock market valuation of the firms in the sector. In particular, lending interest rates have fallen, which has eased the financial burden on real estate and construction firms. Along these lines, default indicators have stabilized (Figure II.4). In turn, the stock market value of the main real estate and construction companies in the sector accumulated gains with respect to the close of 2024, registering returns even above the IPSA, which suggests an improvement in how the sector is perceived. Meanwhile, personal income has also risen.

[6]/ For more information, see Statistical Data Base.

In the non-residential sector, vacancy rates showed no significant variation in the last numbers. Office space vacancies have remained stable, closing 2024 at 10.7% (Figure II.8). In the case of warehouses, the rate stood at 5%, after the acceleration observed between 2022 and early 2024 (Figure II.8)[7]/.

Overall, in the face of a stress scenario and an abrupt adjustment in collateral value, banks have sufficient mitigators based on prudential regulation (Box II.1 in FSR second half 2024). Specifically, these relate to the debt to collateral ratio and conservative collateral valuation criteria. Thus, a substantial drop in collateral valuation would not compromise the solvency of the banking system, given its current capital levels and regulatory requirements. Along these lines, as of the fourth quarter of 2024, it is estimated that 85% of the mortgage debt stock corresponds to loans that have financed an amount of less than 80% of the value of the home. However, the degree of interconnection of this sector with the real economy and the financial sector makes it vulnerable to external shocks that could jeopardize the recovery of our economy.

HOUSEHOLDS

Since the previous Report, households continued to normalize their financial position. Thus, there was a recovery in savings, while net financial wealth remained stable and the labor market continued to show limited slack. At the end of 2024, the saving rate as a percent of GDP stood at 5.6%, which implies a slight increase over the previous year, due to an expansion of income higher than that of consumption (CNSI, fourth quarter 2024)[8]/. Higher savings is a positive sign, as it allows households to be more resilient in the face of a potential loss of income in the future. Consistent with this, net financial wealth remained near 120.4% of GDP[9]/ while the annual growth of real wages continued to exceed the average of the last decade, with an expansion of 3.8% in February (INE). Regarding the labor market, the unemployment rate stood at 8.7% in the January-March moving quarter (INE), a trend that is also observed in the administrative data[10]/.

Following the MPR adjustments, interest rates on consumer loans decreased across the board, while those on mortgage loans declined in line with their benchmarks. Beyond seasonal fluctuations and the effects of participation by type of product (i.e., installments, cards, or overdrafts) interest rates on consumer loans have evolved in line with the MPR trajectory, reaching 23.4% as of March, a decrease of 265bp in one year. This fall has been widespread among debtors of different income levels and credit risk. Meanwhile, mortgage interest rates were down from the last FSR, in line with their benchmark rates (4.4% as of March). However, from a longer perspective, long-term rates are still high, influenced by both external market conditions and the reduced depth of the local capital market (Chapter I).

The fall in rates, together with increased income, has helped reduce the financial burden of households. Thus, a drop in debt service was observed among lower-income households, particularly in the burden associated with housing loans, while in the rest of the households it remained similar to that of the previous Report (Figure II.9). On aggregate, indebtedness remained fairly stable, standing at 47% of GDP at the end of 2024 (CNSI, 2024Q.IV). In line with the aggregate data, indebtedness decreased in lower-income households driven by the consumption component (Figure II.10), in a context where, in the first quarter of 2025, consumer and mortgage credit granting standards did not vary significantly from the previous quarter. In the same period, banks perceived weaker demand in both segments (Bank Lending Survey and Chapter III).

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[7]/ The price of office rent remained flat in real terms, while that of warehouses was down 6.5% in 2024 with respect to 2023.

[8]/ Income expansion was driven by the 4.7pp contribution of production income, associated to wages and self-employed income, and by the 4.1pp contribution of property income (income withdrawals).

[9]/ In the previous FSR, with information at the end of the second quarter of 2024, the net financial wealth of households stood at 120.6% of GDP. Compared to 2023, households ended the year with a 0.8pp lower net financial wealth, mainly explained by lower balances held in cash and deposits.

[10]/ Data collected from pension fund (AFPs) contributors.

FIGURE II.9 FINANCIAL BURDEN TO INCOME RATIO (1)
(percent of monthly income, median)

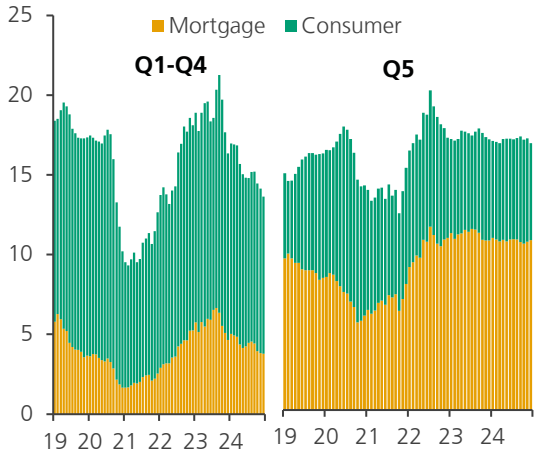


FIGURE II.10 BANK DEBT TO INCOME RATIO (1)
(times monthly rent, median)

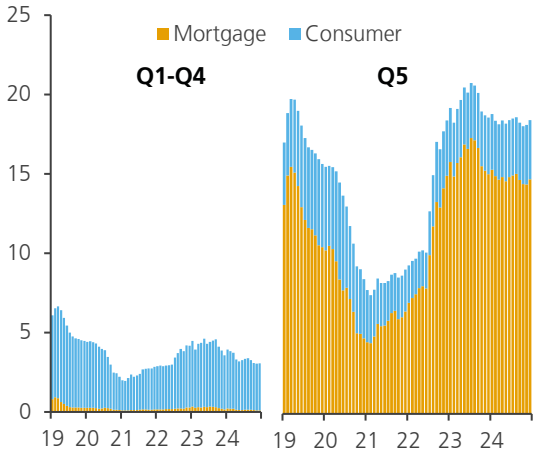


FIGURE II.11 MORTGAGE AND CONSUMER CREDIT DEFAULT RATE (1)
(percent of debtors of each group)

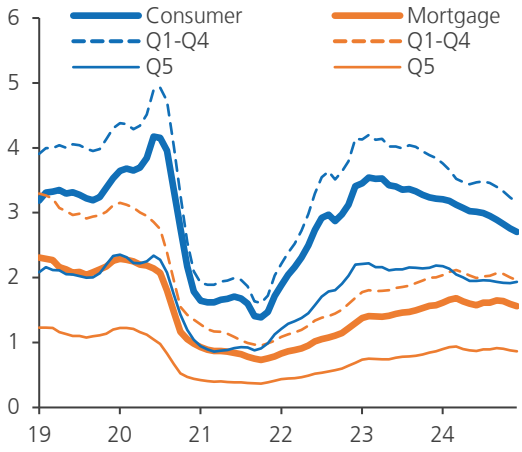
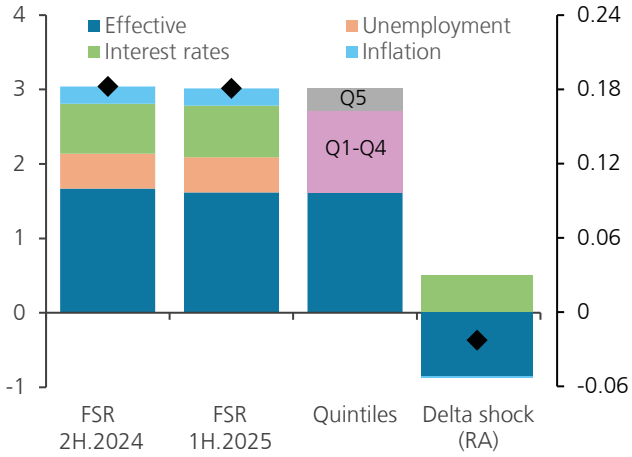


FIGURE II.12 DEBT AT RISK (1) (2)
(percent of GDP)



(1) Moving three-month average. Quintiles 1st to 4th, up to C$1,365,000: Fifth quintile up to C$5,200,000. Fifth quintile truncated in taxable cap. (2) Debt at risk represents the individual debt multiplied by the probability of default of each debtor by portfolio. Differences with previous versions of the Report are due to modifications in the estimation models used.
Source: Central Bank of Chile based on information from FMC and Social Security Superintendency (SUSESO).

Non-payment indicators declined for consumer loans and stabilized in the mortgage portfolio. With granular information at December, there was a decrease both in debt and in the proportion of debtors in default on consumer loans (Figure II.11). This development is in line with the accounting indicators of bank delinquency (Chapter III), with the different measures at levels near those before the pandemic. In turn, both the proportion of delinquent debtors and mortgage debt in default stabilized, after increasing steadily in the last three years. This would correspond to a normalization, returning to historical patterns in terms of the profile of debtors, the composition of the different payment states and the macroeconomic determinants of default (Box II.1).

A STRESS TEST FOR HOUSEHOLDS[11]/

The balance of household risks is similar to that of the previous Report, with positive signs at the margin. Effective debt-at-risk remained at 3% of GDP between the two years (Figure II.12). Notwithstanding the persistence of the result with information as of December 2024, the better financial conditions observed since then in terms of a lighter financial burden, lower effective default in consumption and a stabilization in housing, indicate that the debt at risk of individuals would have decreased this year to date. Under the stress scenario, debt-at-risk is concentrated in the lower income quintiles and the impact of the unemployment shock maintains an important share, similar to that of the previous Report. Meanwhile, the interest rate shock, being the one with the highest share, mainly affects the mortgage component. Finally, the indexation shock is the smallest and is unchanged with respect to the previous test.

In the current global scenario of high uncertainty, the main risk for households is a deterioration of activity causing a weakening of the labor market. A reduction in people's income increases the probability of not meeting their debt repayments on time. This is a risk that has increased its probability of occurrence, given the worsening of trade and geopolitical tensions, and their potential effects on local economic activity (Chapter I). The banks maintain an adequate level of provisions and the stress tests reveal their resilience to a possible worsening of financial conditions, such as a slowdown in economic activity and employment, and rising interest rates (Chapter III).

THE CENTRAL GOVERNMENT

The persistence of structural deficits for several years has been eroding fiscal buffers and increasing public debt. At year-end 2024, central government gross debt reached 41.7% of GDP, which represented an increase of 2.2pp from the previous year. The actual deficit reached 2.8% and the structural deficit 3.3% of GDP, exceeding the Cyclically Adjusted Balance target of 1.9%. If this trend continues, the debt could exceed the limit of 45% of GDP defined as prudent by the authority for the coming years. In this context, the government announced an adjustment plan that includes administrative actions, bills of law, and a postponement of the convergence of the structural balance. For the next few years, the Budget Bureau projects that the debt will remain below its prudent limit of 45% of GDP (Figure II.13) (Public Finances Institute IFP, 2025.QI)[12]/. The increase in debt over the last few years has been mainly explained by the continuous fiscal deficits and the higher share of financial expenditures, such as recognition bonds, purchase of the State-sponsored loans and the capitalization of public enterprises, among others. The current level of indebtedness and a demanding path of future committed expenditures —which could make it difficult to meet the structural balance target— have narrowed the space to contain the effects of external shocks. Sustaining debt below the defined threshold requires a demanding set of measures and agreements. This is a major challenge in which all stakeholders must take part.

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[11]/ Stress tests evaluate the potential effect of shocks in extreme, low-probability, high-impact stress scenarios. These exercises are partial in nature, as they do not model the reactions of agents and do not constitute projections. Further details can be found in Box V.1 in FSR, first half 2023 and Córdova and Toledo (2023). Three shocks are considered, in line with the severe scenario considered for the bank stress exercise (Chapter III). The first one consists of an increase in the unemployment rate of 7pp in one year. The second considers a 680bp increase in consumer credit interest rates and a 350bp increase in mortgage rates. The third and last assumes an indexation shock of an additional 4pp in one year.

[12]/ Within the framework of Law 20.128 (on Fiscal Responsibility) and through Decree 755, the current government administration establishes the basis for fiscal policy for the period 2022-2026. In this context, a prudent debt level of 45% of GDP is defined.

Increased fiscal indebtedness, together with the rise in long-term interest rates, has increased the cost of rolling over central government debt. The official projection of interest expenditure for the period 2026-2029 averaged 1.2% as a percentage of GDP, which contrasts with the 0.8% average recorded between 2015-2019 (Figure II.14). In the current scenario of high uncertainty, it cannot be ruled out that long-term international interest rates will further rise, worsening renewal conditions and increasing interest expenses (Chapter I). Along these lines, during 2024, bonds were issued, and swap programs were implemented to shorten debt maturities in 2025 and 2026, thus reducing the risk of short-term refinancing. However, foreign currency debt has gained greater participation in recent years, which could represent a risk in the gross debt projection.

Maintaining prudent fiscal accounts, through sustainable sovereign borrowing, enhances the economy's ability to mitigate the impact of future shocks and improves the perception of risks threatening the local economy.

FIGURE II.13 CENTRAL GOVERNMENT GROSS DEBT (*)
(percent of GDP)

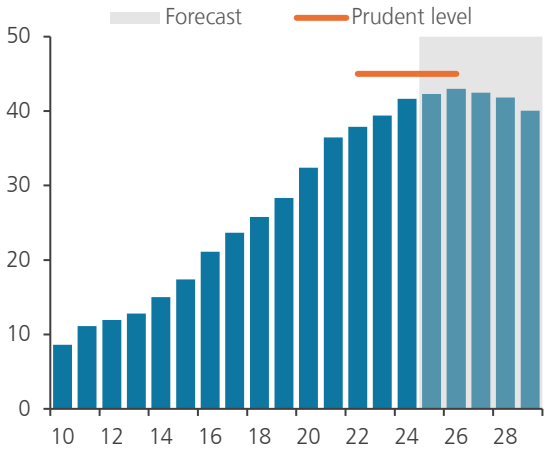
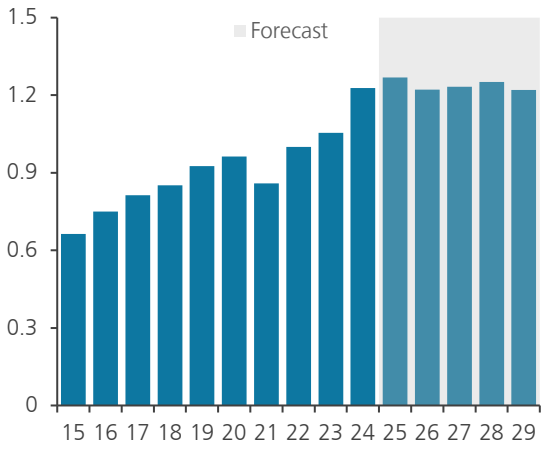


FIGURE II.14 INTEREST EXPENSE EVOLUTION (*)
(percent of GDP)



(*) Gray area shows forecast in Public Finance Report, first quarter 2025, DIPRES.
Source: Central Bank of Chile based on information from Autonomous Fiscal Council and Finance Ministry Budget Bureau, DIPRES.

BOX II.1:

Payment situation of the banks' mortgage portfolio

The analysis and monitoring of the determinants of people's payment decisions is paramount for financial stability. In particular, in the case of housing debts, this importance lies in the size of this portfolio in the banks' assets (35% of bank loans and 41% of GDP) and in the fact that the repayment behavior of these loans is a reflection of the financial health of those who have such obligations (close to 1.2 million people as of March 2025).

Mortgage non-performing loans is now near pre-pandemic levels after three years on a rising trend from record lows. Between 2017 and 2019 the delinquency indicator averaged 2.4% of mortgage loans. In March 2022 it stood at 1%, its all-time low, which coincides with a period of high liquidity and changes in the balance sheet of individuals (Thematic Chapter in FSR, first half 2023). Since then, a sustained upward trend began, reaching 2.3% in March of this year (Chapter III).

The increase in bank mortgage non-performing of recent years has been widespread among debtors. Administrative data allows analyzing repayment behavior as a function of individuals' demographic variables, their financial situation, the characteristics of their loans, and macroeconomic conditions. Thus, there are no significant differences in the rate of increase of mortgage default after controlling for these observables. One exception is found when disaggregating borrowers by the type of interest rate on their loan. The increase in default since 2023 occurred across the board among those with fixed rates, the dominant group that accounts for 65% of delinquent debt. In contrast, among those with variable or mixed-rate loans —that is, where the rate is fixed at the beginning of the loan and then variable— there was a convergence, from low levels, towards the level of default of the total, going well above its pre-pandemic value (Figure II.15). This group is relatively smaller in size, accounting for 11% of nonperforming debt. It is possible that due to the varying nature of their mortgage loans, there was an increase in the monthly value of their dividends, and eventually default, given the higher long-term rates (FSR, first half 2022).

The increase in mortgage defaults corresponds to a normalization toward historical patterns, aligned with macroeconomic fundamentals. The granular model used for the household stress test[1]/ —based on Gerardi et al. (2018), where individuals with a heavy financial burden are more prone to default face of unexpected variations in income or expenses— indicates that, between 2021 and 2023, bank mortgage default was systematically below that implicit in the individual and aggregate fundamentals, probably due to the high liquidity available at that time. Since 2024, the gap between actual and expected defaults has been closing, which also suggests that the increase in non-performing loans corresponds to a normalization towards historical patterns. (Figure II.16).

[1]/ This analysis is based on the individual mortgage default model, which is the one used in the households' stress test (Chapter II). The specification includes debtors' characteristics, employment, and outstanding bank loans. The model does not consider direct transfers nor other non-labor earning sources perceived by the persons. For details, see Box V.1 in FSR, first half 2023.

GRÁFICO II.15 MORTGAGE DEBT IN OVERDUE PAYMENT OVER 90 DAYS (1)
(percent of bank mortgage debt)

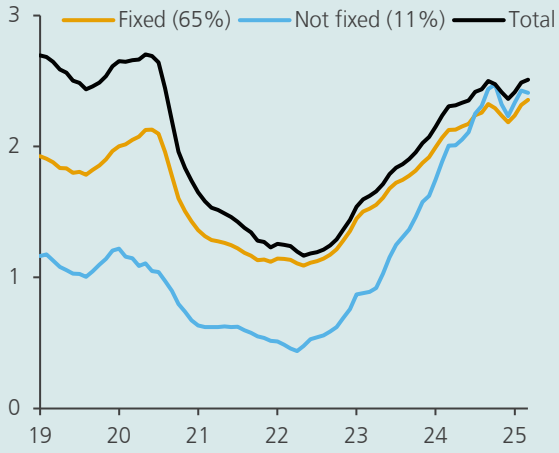
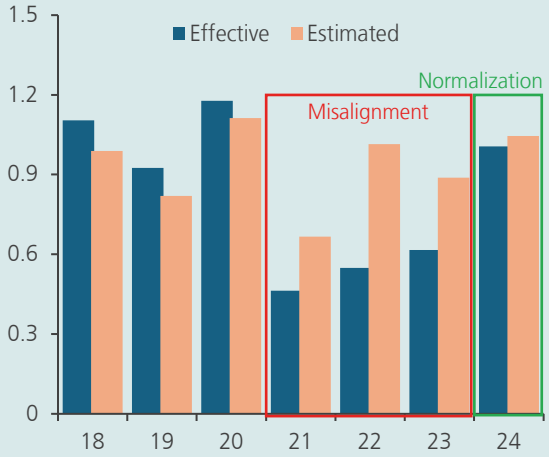


GRÁFICO II.16 MORTGAGE DEFAULT RATE OVER 90 DAYS (2)
(percent of bank mortgage debtors)



(1) Moving quarter average. Percentage in legends indicates share of each group in non-performing debt; 24% of non-performing debt corresponds to debtors who cannot be assigned a category. Fixed: Debtor with only fixed rate loans. Non-fixed: Debtor with at least one non-fixed rate loan (mixed or variable). (2) The default rate is defined as the proportion of individuals in default with respect to the total number of bank mortgagors in a sub-sample for which individual characteristics are available. More details of the model in Box V.1 in IEF, first half 2023
Source: Central Bank of Chile based on CMF, AFC and SUSESO information.

III. CREDIT LENDERS

The banking system has continued to strengthen its capital base according to line with its convergence to Basel III standards, by issuing instruments, while its profitability has remained above historical averages. Meanwhile, it maintains adequate levels of liquidity and stable long-term funding; however, the cost of long-term funding remains high. Bank credit continues to decelerate, mainly due to weak demand, in an environment where lending interest rates continue to evolve in line with their respective benchmark rates. Credit risk indicators have decreased for the consumer and commercial portfolios and have stabilized for mortgages. Banks have sufficient provisions and guarantees to cover the level of default in their portfolios. In this context, stress tests indicate that banks have sufficient capital levels to remain solvent in stressful scenarios.

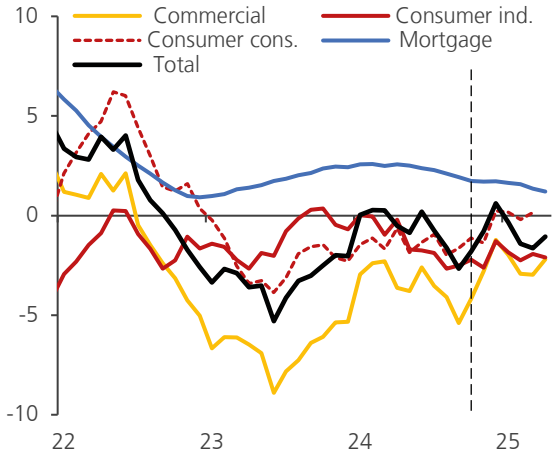
LENDERS' SITUATION

Compared with the last FSR, lending activity shows no major changes relating to a still weak demand. Total loans show negative growth rates associated with sluggish demand, which is attributed to lower funding needs for investment according to the Business Perceptions Survey (EPN) and Bank Lending Survey (ECB) (figures III.1 and III.2). Thus, stock growth of the commercial portfolio remains negative, while flows of new loans show a positive trend although, on average, at shorter terms than before the outbreak of the pandemic. Meanwhile, the banks' consumer segment shows an annual drop in installment credits of around 3%, which has been offset by a greater use of credit cards. The latter have maintained an annual growth of close to 3% in recent months, driven by the business support entities (SAG), whose stock of card transactions represents nearly half of the total. Mortgages averaged a real annual growth rate of 1.4% in the first months of the year, lower than before the pandemic. Meanwhile, the flow of new mortgage operations has remained relatively stable (Figure III.3). This occurs in a context where short-term interest rates for commercial and consumer loans have been adjusted downward, in line with the evolution of the MPR. Despite a recent decrease, the mortgage interest rate remains high, following the dynamics of long-term rates (Figure III.4).

Credit delinquency indicators have improved but remain at high levels. The coverage of loan loss provisions and guarantees would allow banks to address a greater deterioration in repayment behavior. The overall non-performing loans of the system decreased from the previous FSR, with a noteworthy reduction in the commercial segment, which stood at 2.6% in March. Consumer non-performing loans continued to decline, reaching 2.4%. On the other hand, mortgage non-performing loans has been close to pre-pandemic levels in recent months (Figure III.5). Loan loss provision expenses have decreased and are around their historical averages, which would indicate a normalization of the risk of new loans in all portfolios[1]/ In particular, in the commercial segment, the share of loans classified in higher risk categories (substandard and non-performing), which have a high collateral coverage, has been stable, while the exposure of Chilean banks to businesses affected by tariff changes in the U.S. is relatively low (Box III.1).

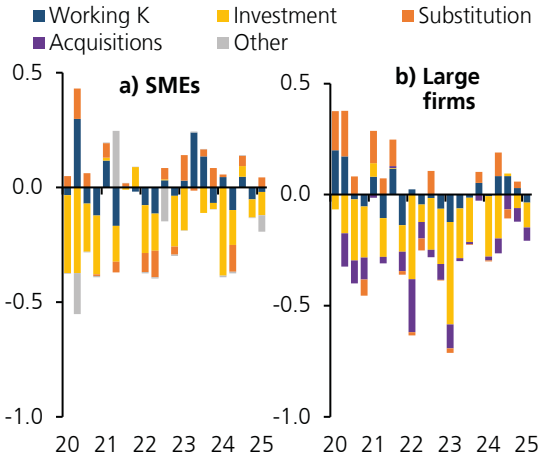
[1]/ The entry into force of the standardized model for consumer provisions generated an increase in expenses on specific provisions, which were generally managed through additional provisions.

FIGURE III.1 CREDIT GROWTH (*)
(real annual change, percent)



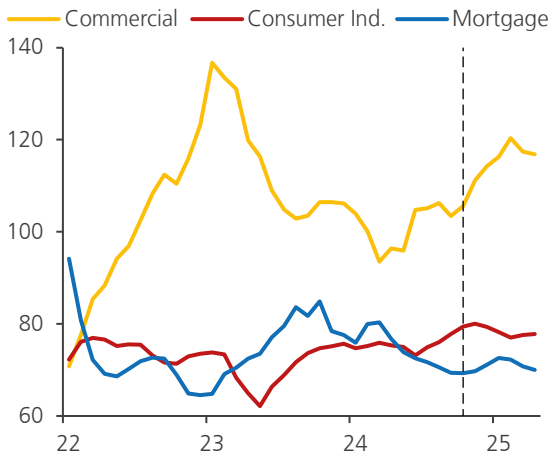
(*) Based on individual financial statements, excep for consolidated local consumer loans, which includes business support entities. Figures as of April according to regulatory information. Ind: Indivdual, Cons: Consolidated. Dashed vertical line marks statistical close of previous FSR.
Source: Central Bank of Chile based on FMC data.

FIGURE III.2 CAUSES OF FIRMS' DEMAND FOR CREDIT (*)
(index)



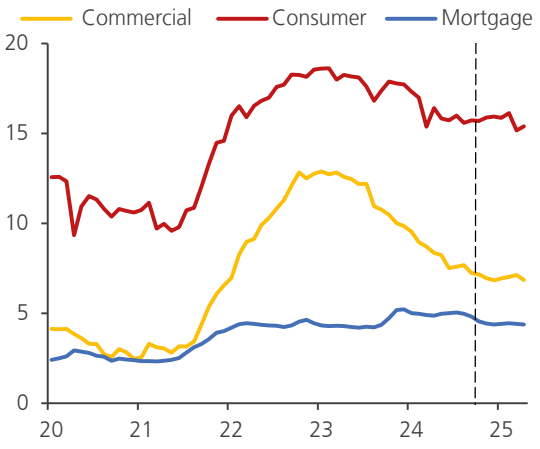
(*) The indicator denotes net value of responses weighted by the bank's share of the commercial portfolio. Negative (positive) values indicate greater weakness (strength) compared to the previous survey. Regarding causes, working capital refers to clients' needs for this purpose; investment refers to funding requirements for this purpose; acquisitions includes client financing for acquisitions or mergers with other companies; substitution refers to financing from other bank or non-bank sources (bonds, commercial paper, own resources).
Source: Central Bank of Chile.

FIGURE III.3 MONTHLY FLOW OF INSTALLMENT LOANS (*)
(index, 2018 = 100)



(*) 3-month moving average. Includes loans denominated in CLP for commercial and consumer purposes, and in UF for housing loans, covering only the Metropolitan Region. Excludes restructured loans due to credit deterioration. Flows seasonally adjusted using CENSUS X-12, national calendar, and adjusted for outliers. The dashed vertical line indicates the statistical cutoff of the previous FSR.
Source: Central Bank of Chile based on FMC data.

FIGURE III.4 INTEREST RATES ON INSTALLMENT LOANS (*)
(percent)



(*) Rates in CLP for commercial and consumer loans, UF-indexed for housing, covers only the Metropolitan Region. Dashed vertical line marks statistical close of previous FSR.
Source: Central Bank of Chile based on FMC data.

The funding structure of the banking system remains stable, while spreads on new debt issuance showing a decrease from their still high levels. Both demand and time deposits continue to dominate the composition of liabilities after the withdrawals of pension funds. Retail deposits show a stable dynamic, and interest rates on time deposits have decreased in line with short-term rates. At the level of institutional investors, the participation of Mutual Funds in the holdings of time deposits prevails and shows no significant changes, unlike the pension funds, whose share was low since by the withdrawals. Meanwhile, bond issues have materialized with spreads somewhat lower than those of previous months (Chapter I), indicating a slight improvement in the availability of long-term funding for banks. Thus, the structure of bank liabilities stabilized with a duration that returned to pre-pandemic levels.

Banks' liquidity and long-term funding indicators remain significantly above their required levels. The current levels of liquidity indicators of the banking system (LCR and NSFR) show adequate liquidity management and allow them to face a scenario of higher exchange rate volatility (statistical annex and Chapter I). In particular, the NSFR is around 113%, which exceeds the 100% required in full implementation of the regulations as of January 2026. This buffer of required stable funding is equivalent to about 10% of the stock of loans, which would allow banks to cover a potential increase in the demand for short-term credit.

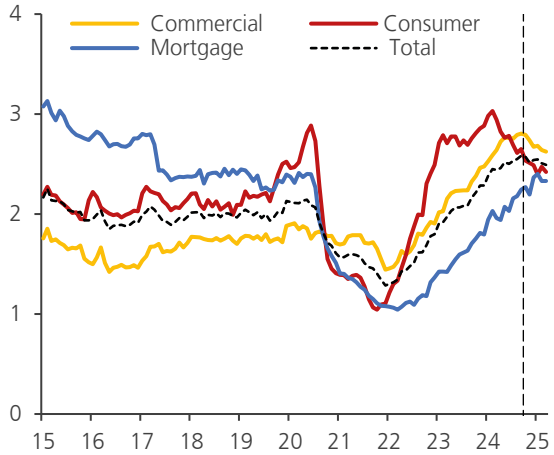
The banking system's profitability remains above its historical average, showing a recovery of the incidence of net interest incomes. At the close of this Report, the annualized return on assets and equity of the banking system stood at 1.3% and 15.2%, respectively, somewhat above their historical averages (see statistical appendix), with an increase in net interest income and a decrease in loan loss provision expenses. Higher profitability contributes to strengthening, in an organic manner, the banks' capital adequacy, inasmuch as the institutions capitalize a larger fraction of their profits. This is particularly relevant given the convergence to the new capital requirement standard and the challenges in facing more unfavorable conditions.

Banks' capital indicators have been strengthened, following the Basel III implementation process, increasing their resources to preserve the supply of credit. Since the last Report, banks have further strengthened their capital base, mainly through perpetual bonds issues. Thus, as of March 2025, the system's capital adequacy ratio (CAR) reached 16.8% and CET1, 11.9% (Figure III.6). Upcoming challenges include preparing for full convergence to Basel III standards and managing a heightened credit risk, so that banks can reinforce their capacity to face additional risks while simultaneously sustaining normal credit supply. This is even more relevant for those banks whose capital headroom are somewhat tighter.

Meanwhile non-bank financial institutions (NBFIs)[2]/ have given signs of recovery of consumer loans and moderating risk indicators, while their profitability remains stable. Consumer lending by both Savings & Loans, Cooperatives and Family compensation funds show greater activity as of the end of 2024. On the other hand, auto loans have moderated their annual contraction. In addition, non-performing loans continue to show a downward trend across the board.

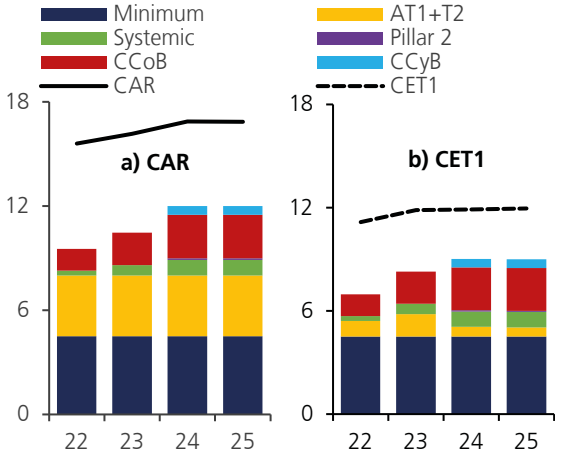
[2]/ These include banking support entities, department stores, family allowance and clearing houses, savings & loans cooperatives, and entities that finance automobile purchases.

FIGURE III.5 BANKING NON-PERFORMING LOANS (*)
(percent of loans by portfolio)



(*) Default refers to payment delayed 90 days or more.
Source: Central Bank of Chile based on FMC data.

FIGURE III.6 BANKING SYSTEM'S CAPITAL REQUIREMENTS (*)
(percent of risk-weight assets)



(*) The information for 2025 is current as of March. Capital requirements are calculated as the weighted average of the particular limits of each bank. The deficit of AT1 and T2 is calculated as the portion of the requirement that is not covered by the respective capital level and that must be covered with CET1.
Source: Central Bank of Chile based on FMC data.

EVALUATION OF STRESS SCENARIOS[3]/

The stress tests show that the materialization of macro-financial shocks would not threaten the solvency and liquidity of the banking system. This tool uses accounting data for the banking system and the market as of December 2024 and considers an adverse and a severe stress scenario (statistical appendix). The adverse scenario assumes a slow and persistent slowdown, while the severe scenario assumes an abrupt contraction of activity, accompanied by an increase in funding costs and a decrease in investment. In both scenarios, the fall in external demand and the deterioration of financial conditions have an effect on funding costs and the exchange rate. Due to recent international events (Chapter I), and as in the previous Report, we consider a more adverse shock than in previous years on long-term interest rates of 200bp and 300bp on short-term interest rates, a 16% volatility and a 30% depreciation of the exchange rate, up from the usual assumption of 20%.

Losses due to credit risk remained stable from the previous year, where the lower lending activity has reduced the banks' exposure to this risk, but also their capacity to generate profits. The lower exposure of banks to credit risk due to the contraction of both commercial and consumer loans has mitigated the impact of stress scenarios on capital. Meanwhile, due to the sensitivity of the commercial portfolio to the exchange rate, a depreciation has a greater negative effect on this portfolio. Consequently, in the severe scenario, this risk is estimated to lead to a potential loss of 15.8% of the system's capital, similar to the previous exercise, and 13.9% in the adverse scenario (Figure III.7).

The impact of market risks remains contained. The banking system remains with a small maturity mismatch compared to its situation before the pandemic, which keeps its exposure to repricing risk low[4]/, while its valuation risk[5]/ is limited thanks to its lower exposure to financial instruments (Figure III.7). Currency risk is stable, given the low mismatch maintained by the banking system. In addition, liquidity stress exercises indicate that the banks would have adequate levels to face deposit outflows, currency depreciation, and interest rate increases.

[3]/ Based on the methodology described in the FSR of the second half of 2013 and in Martínez et al. (2017). Both the analysis and its results are routinely reported to the CMF. Given their nature, they should not be considered as forecasting exercises.
[4]/ The repricing risk refers to potential losses due to changes in interest rates, which affect the interest income and expense of assets and liabilities.
[5]/ Valuation risk refers to the potential loss of the present value of trading and available-for-sale instruments registered in the Trading Book, due to an increase in interest rates.

Banks remain solvent under a severe stress scenario, showing some improvement with respect to the previous FSR in the total capital levels considered in the exercise. The difference between the capital adequacy ratio (CAR) recorded in December 2024 and the one obtained under the severe scenario is 2.5pp, less than that of the previous Report (Figure III.8). Thus, stress tests show that the current level of capital, measured through the CAR, allows banks to remain solvent, face severe stress scenarios, and cover the new requirements in the convergence process towards Basel III[6]/ (Figure III.9a).

Similarly, solvency measured in terms of higher-quality capital (CET1), would allow them to absorb the losses caused by severe macro-financial shocks. The decrease between the observed initial capital and that resulting from the severe scenario amounts to 2.2pp, measured in terms of CET1 (Figure III.9b). Therefore, banks would be above the minimum regulatory requirements in these stress events, considering a release of the Countercyclical Capital Buffer (CCyB) by the authority and the availability of the conservation buffer, both contemplated to be used in such circumstances. Banks have improved their capital position with AT1 issuance, which has allowed them to maintain capital headrooms. However, as in the previous Report, the proximity to the minimum requirements would imply the use of the conservation buffer under a stress scenario by some banks, which could further affect lending activity.

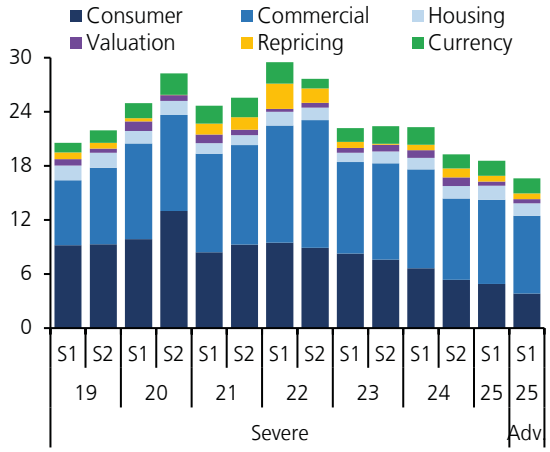
RISK FACTORS

A worsening of the external scenario, which significantly impacts the banks' funding conditions in a context of a shallow local market, would put pressure on the banks' costs and their capacity to generate profits. Although banks have the resources to continue providing credit, a deterioration in external conditions would increase funding costs for banks, with less room to obtain funds locally. Meanwhile, this scenario could have adverse effects on the debtors' repayment capacity and on the demand for new loans. Thus, the credit market would shrink, reducing the sector's profit generation and limiting the organic generation of capital.

A sudden correction of property prices would affect the collateral coverage of bank loans and the value of collateral available for new loans. A sizable portion of bank loans is covered by collateral, mainly real collateral. In the case of commercial loans, firms classified in the highest risk categories lately show stable collateral coverage, but dependence on this mitigator is high in relation to their historical patterns. Mortgages, on the other hand, are mostly covered by the value of the property. Thus, despite having a low probability of occurrence, the materialization of a stress scenario could generate a massive foreclosure of collateral and, therefore, significant adjustments in recovery values (Box II.1 in FSR, second half 2024). In such conditions, debtors could have difficulties in complying with the collateral conditions required in credit applications. Considering the above, it is important for banks to maintain an adequate balance of credit risk mitigators to face this type of scenarios.

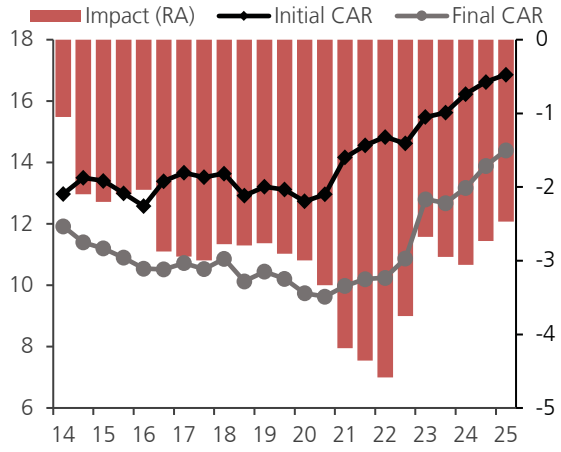
[6]/ The traditional objective of stress tests has been to analyze the evolution of risks and evaluate the capacity and solvency position of the bank in the event of a severe scenario. To face such a scenario, the bank has at its disposal both its core or better-quality capital or loss absorption capacity and other instruments included in the CAR, which play a role in case the bank goes into resolution (e.g., subordinated bonds).

FIGURE III.7 BANKING SYSTEM'S CREDIT AND MARKET RISK (*)
(percent of core capital)



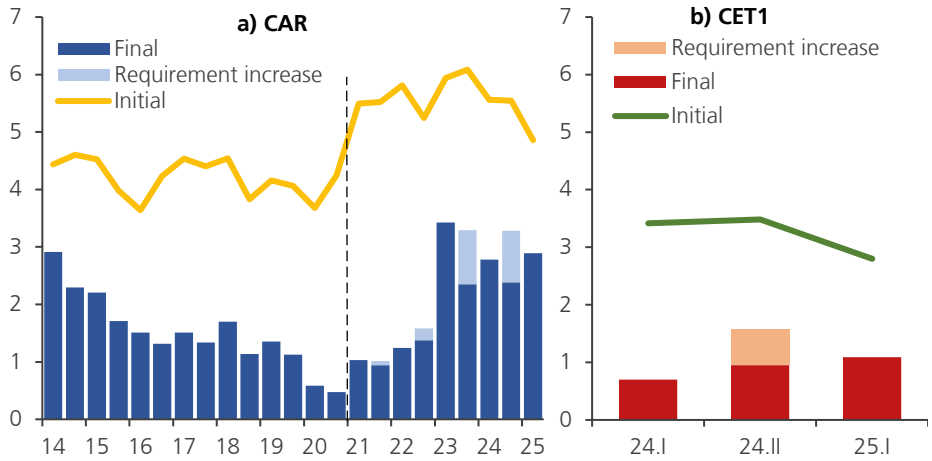
(*) As from 2021, only the consumer business support entities are considered in credit risk. Only the results under adverse scenario of the latest test are shown.
Source: Central Bank of Chile.

FIGURE III.8 IMPACT OF STRESS SCENARIO ON CAPITAL ADEQUACY RATIO (*)
(percent of risk-weighted assets)



(*) Considers profit reinvestment.
Source: Central Bank of Chile based on FMC data.

FIGURE III.9 CAPITAL BUFFER UNDER SEVERE STRESS SCENARIO (*)
(percent of risk-weighted assets)



(*) Excess of effective equity over regulatory minimum, which includes Pillar 2, and buffers. Does not include CCyB in stressed buffer (final CAR). Considers the particular limits of each bank. Dashed vertical line marks the start of the Basel III implementation schedule. For the tests in FSR of the second half of 2021, 2022, 2023 and 2024, the blue bar shows the final buffer with the limits in effect in December of each year, according to the Basel III phased-in implementation schedule, while the light blue bars use the limits in effect as of June.
Source: Central Bank of Chile based on FMC data.

BOX III.1:

Exposure of local banks to foreign trade

This box presents a measure of Chilean banks' exposure to its export sector. This tool seeks to contribute to the monitoring of the potential impact of trade tensions on local financial stability. The results show that the loans granted to the sectors affected by the tariffs announced by the United States are a low fraction of the commercial banking portfolio, so that the risks due to direct exposure are limited. However, operations with all exporters and their suppliers have a significant weight in Chilean banking, so the evolution of the conflict and its implications should continue to be monitored with the tools described in this box.

The definition of firms potentially affected by tariffs includes exporters and their suppliers. The former participate directly in the international market, while the latter could be affected indirectly by the decrease in trade. For this exercise, an exporter is defined as a firm that exports more than 25% of its annual sales. An exporter's supplier is defined as a firm that sells to an exporter more than 25% of its annual sales[1/2/].

Considering only shipments to the United States, the amount of the commercial portfolio potentially exposed to the announced measures is low, but rises if all exports are considered. By using the methodology described above, it is estimated that the debt of exposed exporters will reach 9.3% of the trade portfolio at the end of 2024[3/], while the debt of suppliers to these exporters amounts to 7.8% (Figure III.10). If the analysis is limited to exports to the U.S. and copper and wood products are excluded, the exposure of exporters changes to 1.6% and that of suppliers, to 1.1% of the banks' trade portfolio. It should be kept in mind that in this exercise there are groups of firms that have access to other sources of financing apart from local bank debt (Figure II.1).

Heterogeneity is observed when differentiating bank exposure by economic sector[4/]. Sectors producing tradables, like mining or natural resources[5/], present high exposure to exporters (Figure III.11. In sectors such as agriculture, manufacturing and wholesale trade, there is significant participation of both exporters and suppliers. In some sectors, exposure is only at the supplier level, as in the case of EGW (electricity, gas, and water) and civil works. Finally, there are sectors with almost no exposure at all, such as real estate[6/].

CONCLUSIONS

Banks show a significant exposure to exporting firms, with high variability by economic sector. Given the magnitude of the potentially affected commercial portfolio, the impact of possible restrictions in the international market and their consequences in the local market need to be closely monitored. It is worth noting that the distribution by sectors seems consistent with the aggregate information available on foreign currency debt provided by local banks.

[1/] For total sales and exports, sales data from Form 29 (SII) and Customs information was used. Invoices were used to determine sales across firms Alternative sales limits (20% - 30%) were used, with results similar to those presented in this box.
[2/] In both cases sales/exports are associated with debt at the firm level, so the possible effect of credits within an economic group is not considered.
[3/] If Customs data is used instead of F29 export data, the total drops to 8.8%.
[4/] The sectors reported correspond to the Economic Activity Classification (CAE) revised to year 2022 used by the Central Bank of Chile and which is compatible with the International Standard Industrial Classification (ISIC).
[5/] This includes fishing industry, forestry, and forest products, among other activities related to this sector.
[6/] This sector is classified under "Other."

FIGURE III.10 BANKING SYSTEM'S EXPOSURE TO EXPORTERS AND SUPPLIERS (1)(2)
(percent of commercial debt)

FIGURE III.11 BANKIN SYSTEM EXPOSURE TO EXPORTER AND SUPPLIER FIRMS BY ECONOMIC SECTOR (1)
(percent of sectors' commercial debt)

(1) Preliminary data subject to revision. An exposed exporter is defined as a firm that exports more than 25% of its sales. An exposed supplier is defined as a firm that invoices an exposed exporter for more than 25% of its sales. Export and sales data for the full year, debt data as of December. In the case of buildings and real estate, the number of exposed exporters is lower than the limit allowed by statistical confidentiality. The crossover does not include possible debts of subsidiaries or parent companies or other firms of a corporate group.(2) In the case of the U.S., copper and wood products are excluded.
Source: Central Bank of Chile based on CMF, SII and Customs data.

IV. FINANCIAL POLICY DEVELOPMENTS

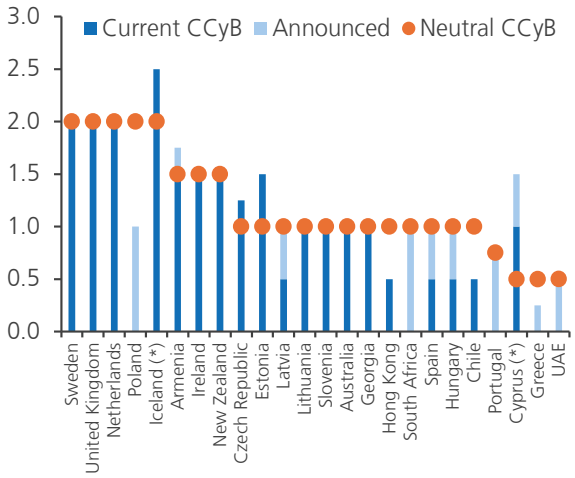
At the Financial Policy Meeting (FPM) of the first half of 2025, the Board of the Central Bank of Chile decided to maintain the Countercyclical Capital Buffer (CCyB) at 0.5% of risk-weighted assets (RWA), considering the current risk scenario discussed in previous chapters. This decision takes into account both the update to the policy framework announced in November 2024 and the full convergence with the Basel III capital buffers during this year. The Central Bank of Chile (BCCh)'s financial regulation agenda this year focuses on initiatives related to the implementation of the Resilience Law, particularly emphasizing in this chapter the exercise of the Central Bank's new powers over the private repo market. It also reports progress in other policy development initiatives linked to the securitization market and the internationalization of the peso. Finally, the approval of the pension reform is highlighted as the main legislative development since the last Report from a financial stability perspective, which poses various implementation challenges, especially given the weight of pension funds in the local financial system.

COUNTERCYCLICAL CAPITAL BUFFER DECISION

At the Financial Policy Meeting of the first half of 2025, the Board of the Central Bank of Chile decided to maintain the Countercyclical Capital Buffer (CCyB) at 0.5% of risk-weighted assets (RWAs). It was considered that this level of CCyB was consistent with the macro-financial and risk conditions faced by the financial system, as described in this Report. This risk environment underscores the importance of having a pre-constituted capital buffer within the banking system, enhancing its capacity to absorb shocks' and allowing its release in the event of financial stress, thus helping mitigate impacts on credit provision to households and businesses. The decision is part of the macroprudential planning toolkit announced in the November 2024 meeting, where, alongside the issuance of the new CCyB policy framework (BCCh, 2024), a phased approach towards the neutral level of 1% of RWAs was established (BCCh, 2025). It was announced then that this level would be adopted starting from the first financial policy meeting of 2026, depending on macro-financial conditions' and allowing for at least one year of gradual build-up. Additionally, this decision of the Board aligns the Central Bank's objectives of resilience and financial stability with the full convergence to the global Basel III capital buffers during this year.

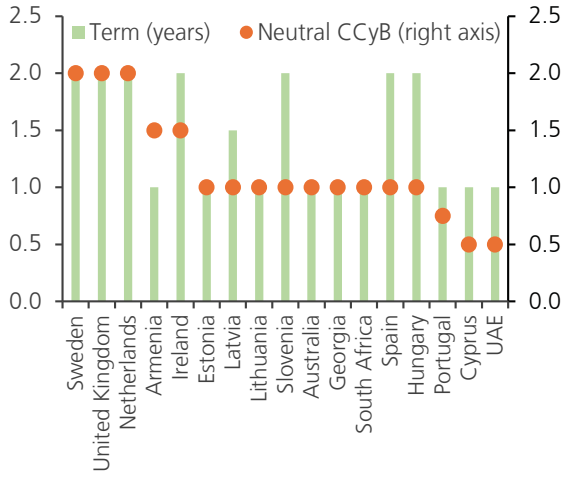
Internationally, the adoption of a positive neutral level (PNL) for the Countercyclical Capital Buffer has gained prevalence as a resilience factor for financial stability. The process of building up the CCyB to a PNL level has been implemented gradually in a growing number of jurisdictions, allowing banks to adapt progressively. The goal is to provide financial institutions with more time to adjust to the requirements and to promote the use of retained earnings over eventual adjustments in RWAs through lower leverage (BIS, 2024). Currently, the ranges defined for the PNL by these jurisdictions stand between 0.5% and 2% of RWAs, with 1% being the most common level among countries applying a PNL for the CCyB (IMF, 2025) (Figures IV.1 and IV.2).

FIGURE IV.1 INTERNATIONAL EVIDENCE ON THE APPLICATION OF RESILIENCE-FOCUSED CCYB
(percent of RWA)



(*) Iceland and Cyprus set a minimum CCyB PN rate of 2% and 0.5%, respectively.
Source: Central Bank of Chile based on information from BIS, ESRB, CMF and websites of CCyB authorities in respective jurisdiction.

FIGURE IV.2 INTERNATIONAL EVIDENCE ON THE APPLICATION OF RESILIENCE-FOCUSED CCYB
(years, percent of RWA)



Source: Central Bank of Chile based on information from BIS, ESRB, CMF and websites of CCyB authorities in respective jurisdiction.

The Central Bank of Chile joins financial authorities that have adopted a positive neutral level (PNL) for the CCyB. Last November, the Board updated the CCyB implementation framework, reinforcing its resilience-oriented approach and setting a PNL of 1% of risk-weighted assets. This neutral level, which will prevail most of the time, allows for the availability of a capital buffer that can be released in a timely manner during macro-financial stress. The transition to this neutral level will begin once Basel III capital requirements are fully implemented by December 2025 and will consider an appropriate time frame for its gradual build-up[1]/.

Communication by authorities regarding the pace of PNL accumulation for the CCyB plays a key role in banks' capital planning. Communication strategies vary across jurisdictions depending on whether the implementation strategy emphasizes predictability for banks or flexibility for economic-specific conditions (BIS, 2024). A convergence strategy to the PNL with detailed timelines and charges can offer clarity and predictability for capital planning. However, such a strategy may lack flexibility if the financial system's conditions change significantly during the accumulation period. In this case, a communication strategy that allows adjustments based on macro-financial conditions is more malleable to changing conditions.

The introduction of the PNL for the CCyB has increased the aggregate capital requirement for banks in most jurisdictions where it has been implemented. Cross-country experience has it that, consistent with the risk-based nature of the CCyB, most jurisdictions did not reduce other capital requirements when implementing the PNL, except to avoid overlap of risks already covered by other capital buffers (European Central Bank, 2025). This was mostly observed in Europe, where a few jurisdictions reduced their Systemic Risk Buffers (SyRB) to maintain the CCyB as the sole macroprudential tool.

[1]/ Web section with implementation timeline and other reference documents (link).

Since the last Report, the Financial Market Commission (CMF) agreed to adjust Pillar 2 capital buffer and defined the timeline for their implementation. Pillar 2 capital charges are determined by the CMF through the supervisory review process for each bank individually. This process incorporates assessing risks not covered by Pillar 1, for which there is no metric standard, such as banking book market risk and credit concentration risk[2]/. It also includes bank-submitted inputs like the Internal Effective Equity Self-Assessment Report, which determines the internal equity target needed to cover material risks over a horizon of three years or more. In this second round, the CMF maintained the requirements for the same institutions as the previous round, requiring 50% completion by June 2025. This represents an aggregate charge of 0.16% of the system's RWA, 56.3% of which must be met with core capital. Under the CMF's gradual implementation, 75% must be constituted by 2026 to reach 100% completion by 2027 of the requirement.

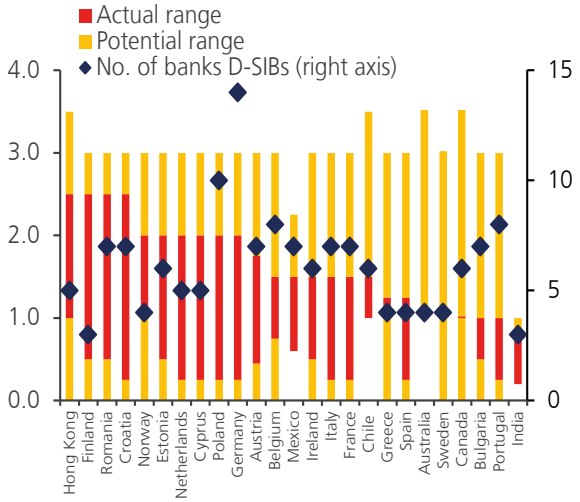
Systemic capital surcharges will reach 100% implementation by December 2025. Last April, the CMF announced the annual designation of systemically important banks, maintaining the same six banks designated in the previous review period. Thus, the additional core capital charges also remain the same, except for one bank whose surcharge was reduced from 1.75% to 1.5% of RWAs. Thus, the surcharge now falls within the 1%–1.5% RWA range, representing approximately 1% of the overall banking system RWAs. These systemic capital requirements established for the financial system in Chile are within ranges frequently observed globally (Figure IV.3).

The timeline for the gradual implementation of the Basel liquidity standards defined by the BCCh continues, including the Internal Liquidity Adequacy Assessment Process (ILAAP). As per the gradual adoption defined in Chapter III.B.2.1 of the CNF and Chapter 12-20 of the Updated Compilation of Banking Regulations (RAN), ILAAP became fully effective in April 2025, allowing the CMF to demand greater High-Quality Liquid Assets (HQLA) for banks with significant deficiencies in their assessment process. This additional requirement may reach up to 20% of the HQLA stock managed by the bank for short-term liquidity. In turn, the Net Stable Funding Ratio (NSFR) continues its implementation, to be completed by 1 December 2026. These elements, together with other policy developments that form part of the BCCh's regulatory agenda, seek to provide the supervisor with tools that enable it to urge banks to improve their liquidity management in the face of market stress (Box IV.1).

As from December 2025, most capital and liquidity charges under Basel III will be fully effective in Chile. Minimum capital requirements and Systemic Charges must be 100% met by then, as stipulated in the General Banking Law and CMF regulations[3]/. The banking system has gradually adapted, partly through issuing additional capital and hybrid instruments —especially in the case of systemic banks (Figure IV.4)— while maintaining buffers above the core capital and effective equity requirements. These buffers are more pronounced for non-systemic banks (Figure IV.5), although historical buffers have also been used (Figure IV.6). Full implementation ensures that banks maintain high-quality capital levels, improve risk management, and strengthen their resilience upon financial stress.

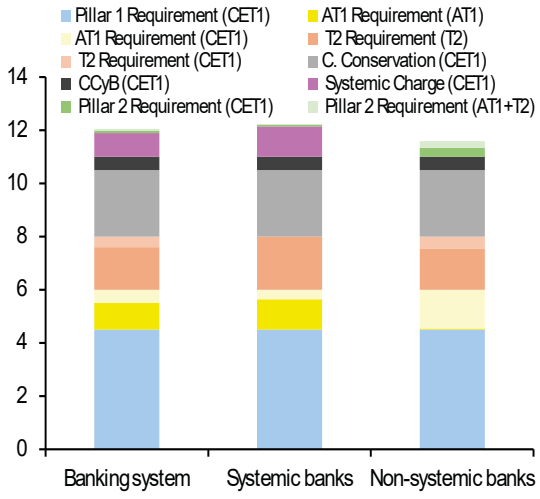
[2]/ Market risk in the banking book (MRBB) refers to the possibility of losses in a bank's financial positions due to adverse movements in market prices, such as interest rates, exchange rates, or asset prices. The Financial Market Commission (CMF) regulates the measurement and management of these risks, including how financial institutions should calculate their capital requirements to cover these risks, in accordance with Basel III standards.
[3]/ See Implementation Timeline for Basel III Standards in Chile.

FIGURE IV.3 COMPARATIVE ANALYSIS OF CAPITAL CHARGES FOR SYSTEMIC BANKS
(percent of RWA, number of banks)



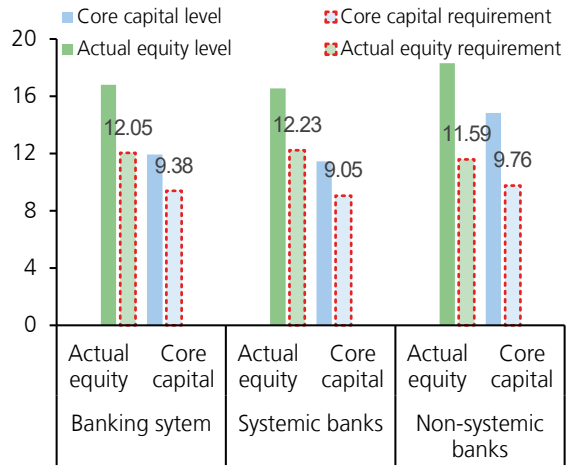
Source: Central Bank of Chile based on information from BIS, ESRB, CMF and websites of CCyB authorities in respective jurisdiction.

FIGURE IV.4 CAPITAL REQUIREMENTS OF DOMESTIC BANKING SYSTEM (*)
(percent of RWA)



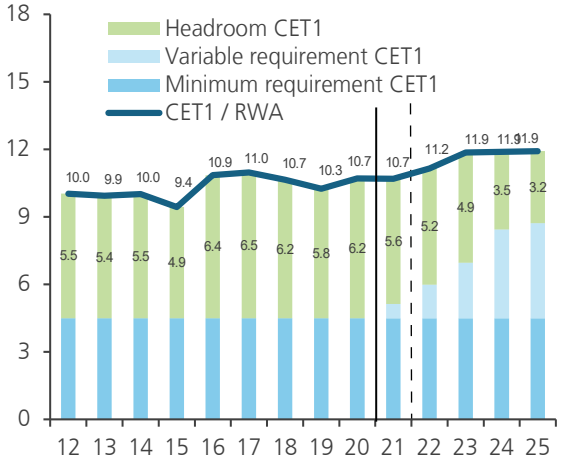
(*) In case AT1 or T2 instruments are unavailable to complete the respective requirements, institutions must complete such requirements with Core Capital (CET 1).
Source: Central Bank of Chile based on CMF data.

FIGURE IV.5 CORE CAPITAL HEADROOM AND ACTUAL EQUITY OF LOCAL BANKING SYSTEM
(percent of RWA)



Source: Central Bank of Chile based on CMF data at January 2025.

FIGURE IV.6 EVOLUTION OF CORE CAPITAL HEADROOM IN DOMESTIC BANKING SYSTEM (*)
(percent of RWA)



(*) Data as of January 2025 with expected requirements for December 2025 composed of Minimum CET1, and Variable CET1 composed of Pillar 2, Systemic, Conservation Cushion and CCyB requirements. Dashed vertical line marks the beginning of the Basel III implementation timeline.
Source: Central Bank of Chile based on CMF data.

The convergence in the implementation of every component of Basel III opens opportunities for Chilean banks to develop Internal Models (IM). In many jurisdictions, banks use IMs to define credit risk weightings below those in the "standardized models" an innovation introduced by Basel II. This allows Risk-Weighted Assets (RWA) for Credit Risk to represent a smaller portion of total assets, enabling capital savings. In Chile, this was not previously possible since risk weightings were fixed in the General Banking Law until 2019, following Basel I standards. This delay has the advantage of allowing lessons learned from the application of these internal models in the rest of the world to be incorporated, mainly related to the difficulty of supervising and evaluating each of the models applied. In fact, Basel III increased the requirements for the application of internal models by establishing a maximum reduction in RWA output floor density of 72.5%)[4]/.

The CMF is currently working with banks to address challenges in adopting Internal Models, aiming to facilitate their adoption and use. This opens opportunities for banks to reduce RWA density (measured as RWA/TA), which has historically remained near 70%[5]/. With the RWA structure of the local banking system, a 5pp reduction in RWA density through the application of IM to the treatment of CRWA translates into capital savings equivalent to roughly 1pp in the CET-1-to-CRrA ratio. The impact of the application of IM on the capital ratio is not only due to the reduction in the capital requirement for risk exposure, but also to the reduction in the capital requirement for liquidity risk.

THE BCCH'S REGULATORY AGENDA AND DEVELOPMENT OF THE REPO MARKET

The BCCh is in the process of implementing the Law Strengthening the Resilience of the Financial System and its Infrastructure (Law 21,641), particularly with regard to the development of repurchase agreement (repo) transactions. In accordance with the new powers conferred on the BCCh by this legislation, regulatory frameworks are currently being developed that will expand access to certain financial services provided by the BCCh, implement new liquidity management mechanisms for Central Counterparty Entities, and develop the private repo market. This chapter focuses on the latter initiative, while the remaining measures, being more directly related to the functioning of Financial Market Infrastructures (FMIs), will be analyzed in the next Payment Systems Report.

A repurchase agreement (repo) is a transaction in which one party sells a security to another party, with the agreement to repurchase it in the future at a predetermined price and date. Although a security, typically a fixed-income instrument, is sold at the beginning of the repo, the commitment to repurchase it in the future means that the buyer only has a temporary right to the asset, and the seller only has temporary access to the cash obtained from the initial sale. Therefore, although the repo is structured as a purchase and sale of securities, it behaves economically as a collateralized loan. The difference between the price paid by the buyer at the start of the repo and the price received at the end constitutes the return on this collateralized loan, corresponding to an implicit interest rate.

[4]/ The Basel I standard historically applied in Chile, being a conservative model in its calculation of RWA for Credit Risk, resulted in a high RWA density on Total Assets (TA) compared to that observed in jurisdictions that implemented the possibility of using internal models with Basel II. By allowing the use of IM for the calculation of RWA for Credit Risk in Chile, through the implementation of the Basel III standard, banks now have the possibility of reducing their RWA density on TA, while the implementation of the "output floor" or "minimum floor" by those jurisdictions moving towards Basel III from the internal models of Basel II would see the opposite effect, i.e., an increase in their RWA density on TA.

[5]/ Currently, CMF regulation (RAN 21-6) establishes a minimum floor of 72.5% of the total that would have been obtained using standard methodologies for the determination of credit risk-weighted assets using internal models.

The development of the repo market in Chile lags behind that of advanced and emerging markets, and generally in relation to the local financial market. The local interbank market operates mainly unsecured and is dominated by operations and transactions involving the purchase and sale of certificates of deposit (Box IV.2 IEF first half 2023). Meanwhile, among non-bank financial intermediaries (NBFIs), only broker-dealers show a use of repos comparable to that observed in the money markets of other jurisdictions (figures IV.7, IV.8, and IV.9).

A robust repo market will support the functioning of the financial market as a whole. In general terms, the benefits of further development of the repo market are related to gains in market efficiency, liquidity, and risk management. Indeed, repos have various uses that improve price formation in the underlying asset markets (typically fixed-income instruments) by generating greater demand for securities used as collateral, facilitating arbitrage, position taking and hedging, monetization of assets to meet short-term cash needs, etc. In particular, a higher degree of collateralization in the money market makes it more resistant to potential liquidity shocks, which reduces dependence on central bank liquidity tools while increasing its transmission capacity (IMF, 2022).

The balance of benefits versus risks favors the former, especially considering the current limited development of this market domestically. As with all financial intermediation activities, there are also risks associated with repo transactions, such as increased leverage and procyclicality in the value of collateral. International experience during the Global Financial Crisis has shown that the materialization of these risks is more related to the use of less traditional instruments as collateral or to excessive maturity mismatches. However, the low degree of development of this market in Chile, together with a robust local regulatory framework that has incorporated the main lessons of the 2008 Global Financial Crisis, indicates that there is room to exploit the significant benefits of further developing this market while keeping risk levels under control.

FIGURE IV.7 BANKING SYSTEM REPOS (*)
(percent of assets or liabilities)

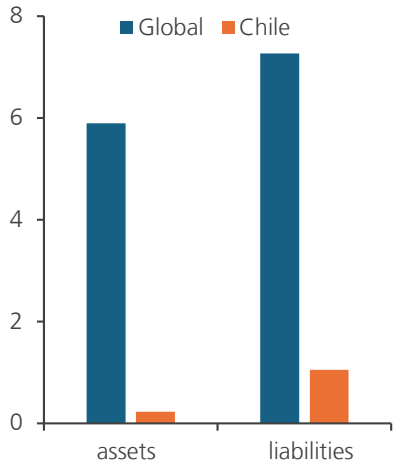


FIGURE IV.8 BROKER-DEALER REPOS (*)
(percent of assets or liabilities)

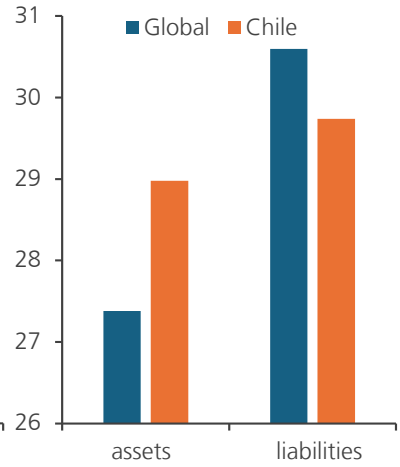
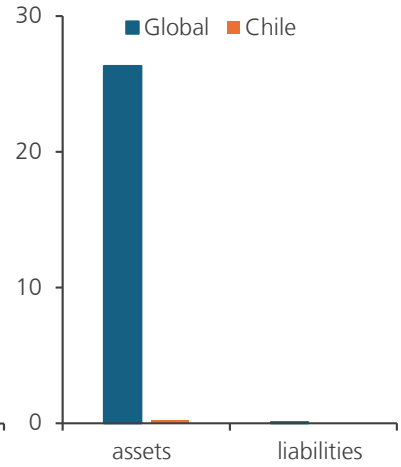


FIGURE IV.9 MONETARY MUTUAL FUNDS REPOS (*)
(percent of assets or liabilities)



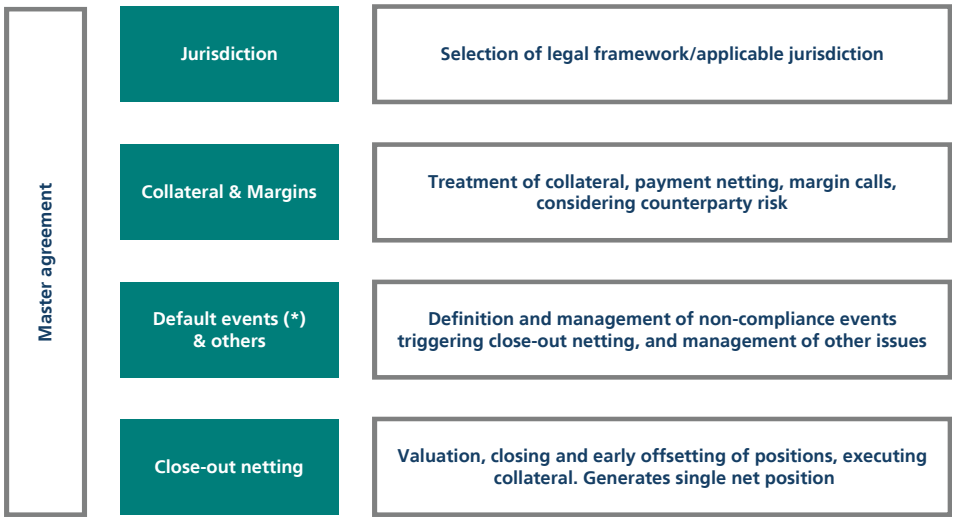
(*) Corresponds to the 2019-2023 average at the end of December of each year. Global sample corresponds to jurisdictions participating in the FSB's NBFI exercise: Argentina, Australia, Belgium, Brazil, Canada, Cayman Islands, Chile, China, France, Germany, Hong Kong, Indonesia, Ireland, India, Italy, Japan, South Korea, Luxembourg, Mexico, Netherlands, Russia, Saudi Arabia, Singapore, South Africa, Spain, Switzerland, Turkey, United Kingdom, and United States.
Source: Central Bank of Chile based on information from NBFI Annual Monitoring Report, FSB (2024), and CMF.

The fundamental objective of the new regulation that the BCCh will publish shortly is to provide legal certainty in the event of non-compliance by one of the counterparties. The main risk management tool for parties to a repo transaction is the use of Master Agreements, which were specially developed for the proper documentation and administration of such transactions. Of particular importance is the use of master agreements in cross-border transactions, considering that they are typically used by large international financial institutions. It is in the Master Agreements that the general terms and conditions are established, including the treatment of events of default, processes in which the possibility of compensation, collateral enforcement, and close-out netting of the positions that the parties hold between themselves due to the agreed repos is particularly important (Illustration IV.1).

Specifically, the BCCh is empowered to grant recognition of framework agreements and regulate the conditions for early termination and global settlement of the corresponding positions resulting from repos agreed under such agreements. Considering that the use of collateral is at the core of a repo transaction, its treatment in such cases of default is of particular importance. For this reason, master repurchase agreements typically used in more developed markets contain specific and detailed clauses on how to proceed with regard to instruments used as collateral in different cases of default (Illustration IV.2). Therefore, the recognition of Master Agreements in BCCh regulation is crucial for the proper functioning of this market.

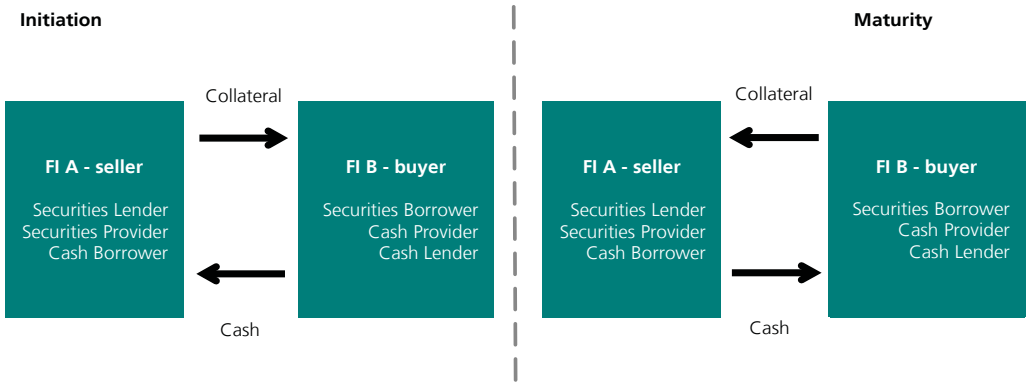
However, during the analysis stage, several gaps have been identified that require regulatory advances in different areas of competence of other authorities. Although the regulation that the BCCh proposes to implement is expected to have a positive effect, there are a number of factors that need to be addressed, which have been identified in various instances in which the BCCh has gathered views from the private sector and authorities on regulatory issues that could be hindering the development of this market. In this regard, the Technical Assistance on systemic liquidity management that the IMF carried out last year and whose report was recently published (Box IV.1) has been particularly useful. In general terms, the other gaps identified relate to the treatment of repos in prudential banking regulation and the need for greater certainty or clarity regarding their tax and accounting treatment. It is worth noting here the CMF's proposal to apply risk weights of less than 20% to repos in the banking industry in the case of transactions agreed on under a framework agreement recognized by the BCCh, in the context of its recent publication for consultation on adjustments to chapters 21-6 and 8-40 of its Updated Compilation of Banking Regulations (RAN) and General Regulations No. 303 and No. 451, which aim to eliminate obstacles affecting the development of the repo, securitization, insurance, and credit derivatives markets.

ILLUSTRATION IV.1 BASIC ELEMENTS OF A REPO MASTER AGREEMENT (*)



(*) Default events are predefined in the Master Agreements and are negotiated by the parties as part of the general terms governing the transactions. In particular, the parties may agree that failure to deliver collateral constitutes a default event or not.
Source: Central Bank of Chile.

ILLUSTRATION IV.2 DIAGRAM OF REPO CONTRACT AND POTENTIAL NON-COMPLIANCE (*)



(*) If the financial institution (FI) A is intervened, becomes insolvent or falls into any serious default, predefined in the Master Agreements as "events of default" during the term of the repo, the legal and regulatory framework should ensure the possibility of exercising the netting clauses, execution of collateral and close-out netting.
Source: Central Bank of Chile.

FOLLOW-UP ON PREVIOUS INITIATIVES

Frictions are being cleared to implement the internationalization process of the peso promoted by the BCCh since 2020. To facilitate greater participation of non-residents in domestic currency or local financial instrument markets, the Bank initiated in December 2020 a process to eliminate restrictions on the cross-border use of the peso[6]/. As extensively documented in previous reports and other Bank presentations[7]/, this policy seeks to promote greater international use of the peso, which in turn would contribute to financial stability by alleviating liquidity concerns during crisis episodes, reducing counterparty risks, offering new ways to manage exchange rate risk, and lowering financing costs for local agents.

Recent initiatives by the SII and the CMF remove the last regulatory frictions for the materialization of the peso's internationalization. The SII issued a regulation to allow simplified RUT access to financial institutions opening correspondent accounts in financial institutions established in Chile, a power granted to it under the so-called Resilience Law. In turn, the CMF enabled the substitution of the promissory note required for the subscription of agreed overdrafts in checking accounts when the beneficiary has neither residence nor domicile in the country. These measures —adding to others previously taken by the BCCh and the CMF— aim to facilitate the provision of correspondent banking services in the country, an essential element for non-residents to conduct financial operations in the country with the local currency, as well as for the potential incorporation of the peso into CLS.

The BCCh will soon define the financial conditions for accepting self-securitized bonds issued by the banking industry as collateral. In July 2024, the BCCh defined in Chapter III.B.4 of its Compendium of Financial Regulations the terms and conditions applicable to the structuring of auto-securitized bonds by banks, so that they may be accepted as collateral; for example, in terms of their risk rating and underlying credits[8]/. An additional step for enabling these instruments is the definition of specific financial conditions that will apply to these instruments, such as haircuts and valuation conditions.

THE PENSION REFORM: MAIN LEGISLATIVE DEVELOPMENT FOR THE FINANCIAL SYSTEM SINCE THE LAST FINANCIAL STABILITY REPORT (IEF)

Pension funds (PFs) currently at roughly 60% of GDP and play a key role in the development and depth of the local financial system. Given their long-term investment horizon, PFs constitute a structural demand factor for long-term financial instruments, which has favored the development of the local fixed income market. Additionally, in the context of highly diversified portfolios, PFs invest approximately half of their resources in international markets, which has fostered the development of the forex derivatives market as a source of risk hedging. With an investment volume of close to US$200 billion, even after the significant reduction following the fund withdrawals approved during the Covid-19 pandemic, pension funds in Chile remain the most important segment of the local financial system after banks (Figure IV.10).

The incidence of pension funds on the financial system poses significant challenges for the implementation of the various innovations included in the Reform. The creation of the new target date funds (TDF), the incorporation of portfolio bidding processes every two years, among others, have the potential to generate temporary distortions that impact the prices of financial assets and the valuations of the PFs' own portfolios. Avoiding undesired effects on the main variables that describe the performance of pension fund portfolios is essential, especially considering their weight in the financial system. Relevant mitigating factors for these risks are the incorporation in the new legislation of a comprehensive gradual implementation program, lasting 61 months, and progressive increases in flows destined for individual capitalization.

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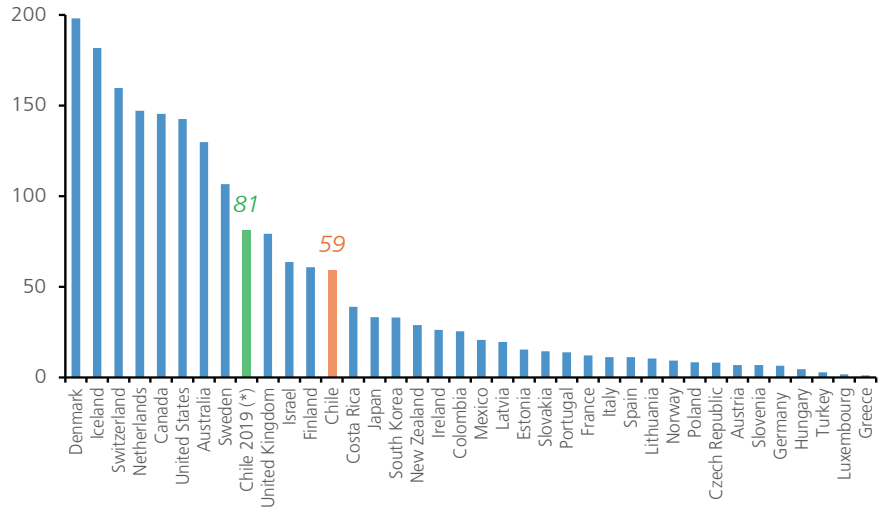
[6]/ Central Bank authorizes the use of the Chilean peso in cross-border transactions (press release, December 29, 2020).
[7]/ See Box VI.1 in IEF 2H.19, Box V.1 in IEF 2H.20, Box IV.1 in IEF 2H.21 y Box IV.1 in IEF 2H.23.
[8]/ "Central Bank of Chile publishes new regulation on securitized bonds" (press release, 9 July 2024).

FIGURE IV.10 CROSS-COUNTRY COMPARISON OF PENSION SYSTEMS
(assets as percent of GDP at December 2023)



(*) Green bar shows Chile at December 2019.
Sources: OECD (2024), Pension Markets in Focus 2024 and Superintendency of Pensions (2020), Social Security Statistical File No. 86 for Chile at December 2019.

The adoption of a new TDF scheme with benchmark portfolios that will replace Multifondos involves a reconfiguration of the Pension Fund portfolios. The current Multifondos model, which is subject to investment limits, is being replaced by a TDF scheme that must follow a "benchmark portfolio" subject to a system of rewards and penalties based on relative performance. According to this model, members are assigned to a specific TDF according to their pension horizon, in order to keep their savings in it throughout their accumulation phase. Each TDF follows an asset allocation that evolves over time, from a composition with greater exposure to risky instruments to an increasingly conservative one as participants approach retirement age. The objective of this change is to reduce the funds' need for short-term liquidity and maintain a long-term return target, in order to align the level of risk exposure of a person's savings with their pension horizon, for the purpose of generating income during the contributors' retirement.

In this context, the main element that must be defined by the Superintendency of Pensions is the benchmark portfolio framework for the TDFs, which will largely determine the structure of the portfolios. The transition from the current scheme to (at least) ten TDFs will require the reallocation of members' savings according to their age, as the current distribution in the Multifondos is not in line with the risk profile associated with age. The magnitude of this portfolio reorganization and its potential effect on the market will depend on the new benchmark portfolios, the investment regime and limits defined for the generational funds, and the adjustment period considered. Australia, Mexico, and the United Kingdom have incorporated TDFs into their pension systems with different portfolio composition strategies: in Mexico, fixed-income instruments and local investments dominate; in the United Kingdom, there are administrators with portfolios heavily oriented toward variable income in comparison, Australia tends to assign greater weight to investments in alternative assets. These international experiences can be considered, both in terms of elements that have worked well and potential frictions that should be avoided, which would help guide their implementation and adaptation to the Chilean pension system. However, the new investment regime to be defined may lead to a different demand for instruments in the capital market.

With the objective of reducing commission costs for members, the reform considers a tender for 10% of the member accounts every two years. The Superintendency of Pensions will conduct public bidding processes to award the administration of the individual capitalization accounts of 10% of the total number of members of the system who are not retired, selected at random, in accordance with the provisions of a general regulation of the Superintendency of Pensions. The Superintendency of Pensions shall also formally approve the bidding terms and conditions, which, among other elements detailed in the law, must contain historical statistics on members and contributors and the aggregate composition of investment portfolios. In each tender, the service will be awarded to the administrator that charges the lowest commission, in addition to meeting the corresponding requirements, including having less than 25% of the system's affiliates. Members will have the right to opt out from the tender or change administrators.

A new public institutional framework is envisaged through the creation of the Autonomous Pension Protection Fund (FAPP in Spanish) and new functions assigned to the Pension Normalization Institute (IPS). The FAPP was created to finance the benefits of the Social Security Pension Insurance and will be managed by an autonomous, technical entity, which will report to the President of the Republic through the Ministry of Finance. Meanwhile, the IPS will be allowed to provide account management services to Pension Fund Administrators (AFPs).

The range of entities authorized to function as Pension Fund Administrators is expanded. The reform allows General Fund Administrators (AGF) that are not subsidiaries of a banking institution, Savings & Loans Cooperatives (CAC) supervised by the CMF, Family Allowance Institutions (CCAF), and others that meet the accreditation requirements and those of the Superintendency of Pensions, to participate in the incorporation of an AFP. To do so, they must have prior authorization from the CMF or the Superintendency of Social Security (SUSESO), as applicable, and from the Superintendency of Pensions. The possibility that any of these entities —or existing AFPs— may contract account management services with the IPS, focusing on investments, is in itself a dimension that reconfigures the organization of the pension industry.

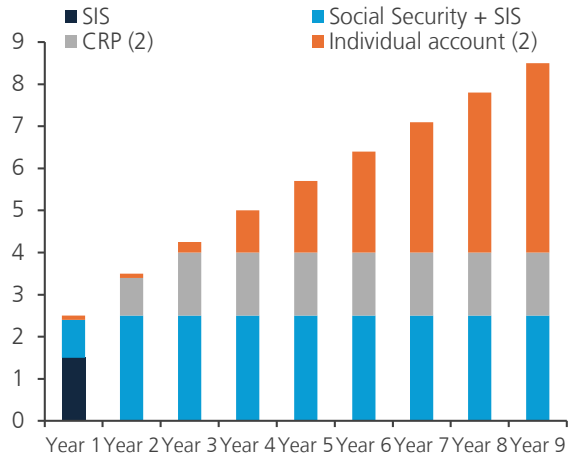
Considering the increase in the contribution rate, the legal change enlarge the flow of long-term savings and contributes to the recovery of the local financial market after the persistent impact of fund withdrawals approved during the pandemic. The increase in the contribution rate will be gradually incorporated over a period of nine years, reaching a total of 8.5 percentage points of taxable income at the end of the transition period. Of this contribution flow, 4.5 pp will be allocated to the Individual Capitalization Accounts (C.I.) of each contributor; 1.5 pp correspond to the Protected Return Contribution (CRP), which should contribute to the financing of the benefit for years contributed through the FAPP; and 2.5 pp will be allocated to the FAPP to finance compensation for differences in life expectancy and death & disability insurance. During the transition, the maximum levels for social security and CRP will be reached in the third year, while the additional contribution for C.I. will reach one pp in the fourth year, reaching the maximum defined in year nine (Figure IV.11).

Consequently, implementing the reform poses a significant challenge in terms of defining the system's regulations. The transition from a system subject to investment limits, prescribed in detail in the legal and regulatory framework, to a more flexible system and a new investment regime based on benchmark portfolios requires safeguards and checks and balances, robust investment and supervisory institutions, and a new regulatory framework to be developed. In this implementation, the bidding processes for member portfolios and the possibilities for the AFPs to transfer or liquidate assets must be considered. Thus, risk-based supervision and adequate coordination and monitoring by the various authorities involved will be key elements for proper implementation, given the scale of this reform.

Overall, the approved legal framework provides for an extended transition period to address these challenges and considers mechanisms to mitigate the market effects of portfolio adjustments. To this end, the reform provides for transition periods, temporary investment limits, and mechanisms that allow the transfer of ownership of financial instruments without the need to liquidate them on the market, among other mitigation measures. This transition process will be coordinated according to the instructions of the Superintendency of Pensions, with a maximum transition period of up to five years (Figure IV.12).

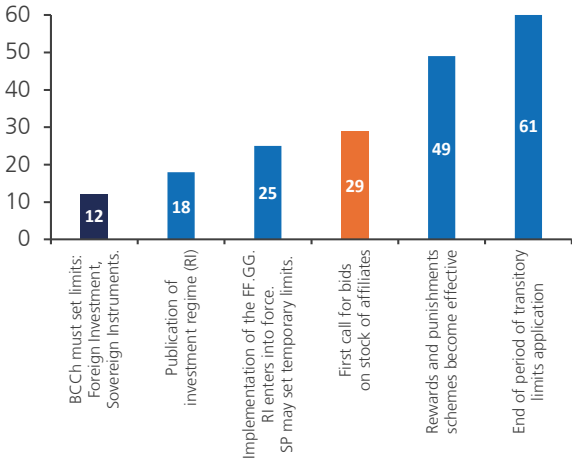
In turn, the BCCh maintains a limited set of powers to set structural limits in line with its institutional objectives, relating to foreign investments and sovereign instruments. The BCCh's decisions must be adopted in the initial stages of the process (Figure IV.12), which will require close coordination with the Superintendency of Pensions. At this point, it should be noted that the BCCh's main considerations in exercising these powers have focused on possible macroeconomic and financial stability impacts, incorporating the background information and expert judgment of the Superintendency of Pensions, in transparent processes through public consultations. Finally, it is important to maintain caution and prudence during the implementation process, as well as to monitor possible market effects.

FIGURE IV.11 INCREASE IN CONTRIBUTION RATE (1)
(percent of taxable income)



(1) According to the provisions of Law 21,735, the terms are counted as from the date of publication of the law, i.e., 26 March 2025. (2) CRP: "contribution with protected return"; C.I.: "individual account".
Source: Central Bank of Chile based on "Bill that creates a new mixed pension system and social insurance in the contributory pillar, improves the Universal Guaranteed Pension and establishes benefits and regulatory amendments indicated." Presentation of the Ministry of Finance before the Senate's Finance Committee, 21 January 2025 and information from Law 21,735.

FIGURE IV.12 TIMELINE OF PENSION REFORM IMPLEMENTATION (*)
(months)



(*) Number of months the law grants for the corresponding implementation milestone. According to the provisions of Law 21,735, the terms are counted from the date of publication of the law, that is, 26 March 2025.
Source: Central Bank of Chile based on information from Law 21,735.

BOX IV.1:

Technical Assistance of the International Monetary Fund for Strengthening Systemic Liquidity Management

Recent experiences of central banks offer lessons for the design of future market liquidity support programs at systemic level, aiming to enhance their efficiency and minimizing risks. Systemic liquidity support measures are actions implemented by central banks at the market or market segment level to ensure that the financial system has sufficient liquidity, especially during periods of economic or financial stress. During the 2023 banking turmoil episode in the United States and Switzerland, the respective central banks acted quickly to contain contagion by expanding liquidity lines and strengthening coordination among authorities. These responses helped stabilize markets and underscored the importance of having flexible and well-designed tools to address system-wide liquidity stress.

In this regard, the International Monetary Fund (IMF) provided technical assistance (TA) in 2024, at the request of the BCCh. The main objective of this assessment was to continue strengthening the BCCh's management and exceptional liquidity provision capabilities in stress situations and the coordination of measures with other relevant authorities under formal collaboration arrangements. This TA began with the deployment of a mission of experts appointed by the IMF, who met with financial authorities and private sector participants.

The final report, published by the IMF in May 2025, presents its main findings at the regulatory and operational levels, highlighting the BCCh's coordinated actions with other financial authorities in recent situations of stress. The main results of the analysis led to a series of recommendations on systemic liquidity management capabilities, including cases of liquidity provision in stressful situations, for consideration by the local financial sector and the BCCh, which are detailed in the TA report published by the IMF on its website (Table IV.1)[1]/. This report underscores the available capabilities and proactive role of the BCCh in managing exceptional measures implemented to address disruptions in the local market during the social unrest of late 2019 and subsequent Covid-19 pandemic, as well as the coordinated action of the financial authorities. These measures included actions in the forex market, implementation of system-wide liquidity support programs, repo programs, and expansion of eligible collateral for operations with the BCCh, among others. The IMF also noted positively the progress made in our jurisdiction's institutional framework for effective crisis response, through initiatives such as Law 21,641, which strengthens the resilience of the financial system and its infrastructure (Resilience Law), currently ongoing implementation.

Measures are also proposed that essentially seek to identify opportunities for strengthening systemic liquidity management tools. Specifically, the TA focused on four key areas: (i) strengthening the collateral framework for BCCh financial operations; (ii) improving the BCCh's systemic liquidity provision tools and programs, both in normal times and in exceptional cases, (iii) identifying extreme scenarios, conditions, and decision variables that would justify the eventual provision of emergency liquidity assistance (ELA), and (iv) the possibility of further developing the private repo market (Illustration IV.3).

[1]/ IMF (2025). Chile: Technical Assistance Report-Strengthening Systemic Liquidity Management. IMF, May 2025.

TABLE IV.I SUMMARY OF MAIN TECHNICAL ASSISTANCE RECOMMENDATIONS

TA area	Subject	Objective/Main recommendations
Provision of systemic liquidity	Collateral framework	• Systematize eligibility criteria, valuation methodologies, and risk mitigation safeguards in the collateral framework.
	Systemic liquidity	• Reinforce, in the design and implementation of future programs, mechanisms aimed at promoting participation and facilitating exit, in accordance with balance sheet risk management. • Maintain transparency mechanisms, which contribute to disclosing and evaluating the objectives of the measures.
	ELA	• Continue strengthening internal procedures and coordination between authorities of the financial safety net.
Market development	Private repo market	• Implement a comprehensive medium-term market development strategy, addressing regulatory matters involving the BCCh and other authorities such as CMF and SP, as well as tax and accounting issues.

Source: Central Bank of Chile based on Technical Assistance report.

Regarding the BCCh's collateral framework, the TA proposes recommendations aimed at systematizing the criteria applied to better achieve an appropriate balance between the objectives of the tools and financial risk management. It proposes to systematize the fundamental criteria applied by the BCCh in relation to: (i) eligibility; (ii) valuation procedures; and (iii) risk mitigation measures. The Bank is currently working on these recommendations, seeking to calibrate acceptance criteria based on both technical aspects related to the instruments and the state of the local financial system. In the short term, the BCCh has adopted measures to expand the range of eligible collateral, under appropriate safeguards, facilitating the issuance of self-securitized instruments. The latter project involved a regulatory amendment published in 2024 and operational adjustments to be implemented during 2025[2]/.

As of emergency liquidity assistance (ELA) mechanisms, the Report highlights their importance as a fundamental tool for financial stability. In accordance with its Organic Constitutional Law (LOC), in its role as lender of last resort, the BCCh is empowered to provide emergency liquidity, on an exceptional basis, to banks and other eligible financial institutions experiencing problems arising from a temporary liquidity shortage, provided the other conditions established in the LOC are met[3]/. The aim is to maintain the stability of the financial system and protect depositors. The TA report proposes recommendations to strengthen the operationalization of this mandate, which will reinforce internal procedures and deepen the agreements formalized between the BCCh, the CMF, and the Ministry of Finance, considering measures for transparency and communication.

[2]/ Central Bank of Chile publishes new regulation on securitized bonds - Central Bank of Chile.

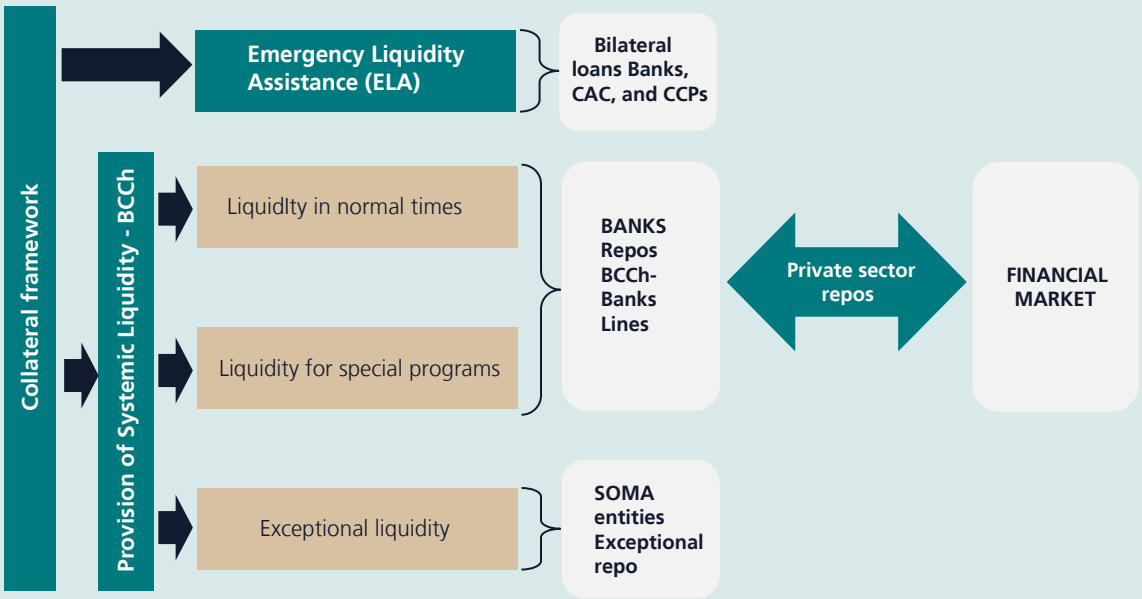
[3]/ As established in the LOC, in these cases the BCCh may make this type of loan conditional on the applicant's compliance with certain financial management standards.

Finally, with regard to opportunities for the development of the repo market, a wide range of actions involving the capacities of various authorities has been identified. The BCCh has identified the development of the repo market as a strategic priority within its regulatory agenda, given its contribution to financial stability by providing a stable source of financing, especially in times of stress and market volatility. The TA report highlights the potential of the close-out netting regulation of these transactions, which will be issued shortly by the BCCh in accordance with new powers granted by the Resilience Law. In addition, other fundamental factors for deepening the private repo market are identified, for which a cross-cutting strategy and strengthening of the monitoring of market liquidity conditions, among other measures, are suggested.

The work and recommendations of the TA are part of the current legal and regulatory development that the BCCh has been conducting in conjunction with the CMF and the Ministry of Finance. The financial authorities are currently making progress in incorporating the main international standards for strengthening the local financial safety net, seeking to align themselves with the requirements and institutional design that more advanced jurisdictions have implemented to protect financial stability, in line with the findings of the TA and previous reports such as the Financial Sector Assessment Program (FSAP)[4]/.

ILLUSTRATION IV.3 SCOPE OF TECHNICAL ASSISTANCE ANALYSIS

Matters addressed by the IMF's Technical Assistance.



Source: Central Bank of Chile.

[4]/ IMF (2021). "Chile Financial System Stability Assessment". IMF, December 2021. Box V.1 Chilean Financial Sector Assessment Program (FSAP) 2021.

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