FINANCIAL STABILITY REPORT

PRESENTATION BEFORE THE

FINANCE COMMITTEE OF THE

HONORABLE SENATE OF THE REPUBLIC*

Rosanna Costa

Governor

Central Bank of Chile

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*The Financial Stability Report for the second half of 2025 can be found at http://www.bcentral.cl.

Introduction

Madam President of the Finance Commission, senators members of this Commission,

As has become customary every May and November, we appear before this Committee to present the Board of the Central Bank of Chile's view on recent developments in the financial sector and their implications for financial stability, which are detailed in the Financial Stability Report (IEF) published this morning.

On Monday and Tuesday this week, we held our Financial Policy Meeting, at which the Board decided to maintain the Countercyclical Capital Buffer (CCyB) for the banking system at 0.5% of risk-weighted assets. This buffer is a precautionary macroprudential measure whose main objective is to strengthen the resilience of the banking system.

As we usually note at the beginning of this presentation, the Financial Stability Report falls within the mandate granted to us by law to ensure the normal functioning of internal and external payments. Its purpose is to analyze the vulnerabilities, potential risks, and mitigating factors of our financial system as well as its capacity to absorb severe shocks. Unlike the Monetary Policy Report, this report does not present forecast scenarios; rather, it focuses on risk scenarios that, while less likely, could materialize.

This focus on risks —which has an inherent negative bias and a tone of caution— may give the unaccustomed reader the impression of a complex outlook. We want to make it clear that this is not our goal, but rather to explain how the Chilean economy in general, and the financial system in particular, are facing possible adverse scenarios.

Turning to the contents of this IEF, as has been the trend for some time now, we highlight that the main risks to Chilean financial stability are brewing abroad.

Our economy faces these risks from a position that has improved over time. Credit borrowers' vulnerability indicators have declined in recent years, reflecting improving financial conditions, an economy that has resumed growth rates in line with its trend, and, in general, no macroeconomic imbalances.

Local banks have been adapting to advances in the implementation of Basel III standards, by strengthening their capital structure with the aim of enhancing the system's resilience. According to stress tests, nowadays the banking system holds capital levels that would enable it to remain solvent in a severe stress scenario.

As always, it is important to bear in mind that the Chilean economy is not immune to potential global shocks, especially if they are significant in magnitude. However, we have the tools to mitigate their adverse effects, while we relentlessly work to strengthen these capabilities.

Let me now turn to the details of this new IEF's contents.

Evolution of global financial markets

On the external front, the first fact worth noting is that financial vulnerabilities have continued to deepen, in a context where the markets' risk appetite has increased despite persistent uncertainty. Thus, risk premiums have continued to decline in developed economies, with increases in the prices of equities, corporate bonds, and other risky assets, especially in the United States.

This development, along with the reduction in the implied volatility indices for US stock and Treasury bond prices (VIX and MOVE), reflects the high level of risk appetite in financial markets. As I mentioned, this contrasts with the high uncertainty associated with the current scenario of trade, geopolitical, and institutional tensions (Figure 1).

This surge in risk appetite has occurred against a backdrop where the fiscal outlook is more complex for developed economies. On the one hand, sovereign debt has increased following the post-pandemic adjustment. On the other hand, market agents expect more persistent fiscal deficits in the future, following the greater fiscal stimulus approved in the United States and announcements of higher defense spending by NATO countries. This trajectory of deficits could compromise the fiscal sustainability of some economies and exert pressure on the functioning of sovereign debt markets, affecting demand for these securities and their interest rates (Figure 2).

In turn, similar reports issued by a group of international institutions underscore the greater role of non-bank financial intermediaries (NBFIs) in developed economies. This could be a factor contributing to amplifying the transmission of shocks, given their greater involvement in private and sovereign debt markets and their interconnection with the rest of the financial system (Figure 3).

Evolution of domestic financial markets

At home, financial conditions have improved slightly over the course of the year. Long-term interest rates have fallen, settling around their three-year average. Spreads on sovereign and corporate bonds have also declined, and corporate bond issuance has recently gained momentum (Figure 4).

Meanwhile, in line with other emerging economies, stock prices have risen in the local market and capital inflows into Chile have been increasing in recent months. Likewise, exchange rate and long-term interest rate volatility has also declined (Figure 5).

Situation of credit lenders and borrowers

As I noted at the beginning, the vulnerabilities of local credit users have decreased in recent years. In the shorter term—compared to what we described in the previous IEF—these vulnerabilities have remained low among households. Indebtedness showed a slight reduction, while the financial burden relative to income and bank defaults remained mostly unchanged. In this context, debt at risk remains below the levels seen a couple of years ago, as I mentioned, with no major changes compared to the exercise we presented in our Financial Stability Report for the first half (Figure 6).

For firms, there has been a decrease in their debt, financial burden, and default indicators, reflecting lower financial vulnerability. The reduction in debt has been more pronounced in the trade and manufacturing sectors, supported by increased sales. Something similar was observed in the financial burden-to- sales ratio, which also declined as a result of lower commercial interest rates (Figure 7).

There are differences across sectors. In some industries, such as construction, financial services, and commerce, the portfolio in default has been declining. In others, however, such as real estate, it has not changed (Figure 8). By size, the smaller firms and a fraction of those that obtained Fogape loans during the pandemic continue to show high levels of default, but still lower than those reported in the previous IEF.

Macro-financial developments enable businesses to better withstand a potential deterioration in economic conditions. The respective stress tests show a reduction in debt at risk compared to the previous test. This is due to the initial situation of lower defaults—except in the real estate sector—together with higher sales and wider margins (Figure 9).

The residential real estate sector remains weak, although some improvements have been observed. Default indicators remain high, and the stock of finished homes remains at record highs. However, interest rates on commercial loans for companies in the sector have fallen and sales have recently shown some improvement, reflecting the impact of the government's guarantee and subsidy program. Against this backdrop, the share price of the leading real estate and construction companies has accumulated gains this year (Figure 10).

On the fiscal front, as noted in previous reports, persistent structural deficits over several years have reduced fiscal headroom and swelled public debt. Official projections indicate that in the coming years, public debt will remain below the levels defined as prudent by the authorities. Maintaining caution in fiscal accounts, through sustainable sovereign debt, is a fundamental task in preserving adequate financing conditions for households and businesses, and also in ensuring the economy's capacity to mitigate the impact of future shocks.

About other local developments, domestic non-bank financial intermediaries have increased their exposure to long-term interest rates. In mutual funds, this has taken place through growth in the assets under their management, especially in those that invest in long-term and free investment assets. Pension funds, meanwhile, have extended the duration of their portfolios through investments in dollar-denominated interest rate derivatives.

Banks maintain capital and liquidity levels that would allow them to remain solvent under a severe stress scenario. Additional capital from perpetual bonds and regulatory buffers has strengthened their ability to absorb financial shocks (Figure 11).

As is normal in this report, a relevant exercise is to assess how banks' capital would perform in a scenario where economic activity shrinks sharply and funding costs rise significantly. This exercise shows that banks maintain the capacity to absorb a shock under the most demanding Common Equity Tier 1 (CET1) capital metric. In this case, some institutions would draw on part of their regulatory capital buffers, which are intended for these purposes (Figure 12).

Main risks

As I just mentioned, the IEF is a report that identifies low probability / high impact risk scenarios that have the potential to cause severe economic damage both locally and globally. Having already described how we assess external and internal financial vulnerabilities, in this part of my presentation I will outline the main sources of risk that we must monitor. This, of course, does not prevent the global scenario from constantly undergoing changes, which may transform these risks and vulnerabilities or lead to the development of mitigating factors.

In this IEF we highlight that the main risk to local financial stability continues to be an abrupt tightening of financing conditions resulting from a deterioration of the external scenario. In an environment of elevated global financial assets valuation, which I described at the beginning, there are several factors that might reduce investors' risk appetite. This would cause a global decompression of spreads, triggering a fall in financial asset prices in international markets.

Among the factors that could trigger this change in risk aversion, the evolution of trade, geopolitical, or institutional tensions stands out, either because they intensify or because their impact on global activity or inflation is greater than expected.

Another factor that could alter risk appetite is scenarios where markets change their perception of the benefits of new technologies. Such an event could reduce the valuations of firms in the sector and negatively affect global growth expectations. In the last couple of weeks, we have seen fluctuations in the share prices of these companies.

There could also be a more negative assessment of the sustainability of sovereign debt in the developed world, given its sustained increase. Such an event could raise benchmark interest rates in the international financial system. Moreover, these increases could be amplified and transmitted through the interconnections between banks and nonbank financial intermediaries, given the growing role of the latter.

Domestically, the materialization of these risk scenarios, or similar ones, could trigger capital outflows, interest rate hikes, sharp corrections in sovereign bond prices, and exchange rate movements. All these developments could interact with the financial vulnerabilities of local credit users and providers.

Although the Chilean economy is not immune to a significant deterioration in the global scenario, it is macroeconomically sound and has robust financial regulation and supervision standards in place, which provide adjustment mechanisms and leeway to mitigate the effects of adverse shocks.

Concluding thoughts

Dear Senators, over the past decade, the global economic landscape has posed a series of challenges for economic and financial policymakers.

When we presented the Financial Stability Report for the first half of the year last May, we depicted a scenario of high uncertainty, dominated by external events, particularly the significant changes in tariffs announced by the US government. This event also took place amid various sources of global geopolitical tension, which had been escalating for some time, reflected not only in armed conflicts but also in the increased willingness of several developed economies to spend on defense.

As the months went by, the world and the financial markets gradually adapted to the new trade policy . In fact, as I said, we have seen greater risk appetite, which has pushed up the prices of global financial assets. This development contrasts with a backdrop that presents several potential sources of uncertainty, any of which could lead to sudden changes in risk appetite.

An episode of this kind could lead to significant changes in global financial conditions. For example, an increase in risk premiums could cause long-term rates to rise sharply, which would be transmitted to emerging economies through various channels.

We could see episodes of capital outflows, volatility, rising interest rates, and widespread declines in financial asset prices. In such circumstances, particularly when adjustments are abrupt, it is critical for emerging economies to have a sound economy, a solvent and resilient banking system, and a financial system with robust supervision.

The global environment is changing in different ways, which demands that we adapt while maintaining or even enhancing our strengths and working on areas where there is room for improvement.

Chile has been working precisely along these lines and has mitigating measures in place to address these challenges, although it is certainly not immune. Every step we take in this direction is valuable.

In recent years, we have resolved the macroeconomic imbalances of previous periods, which was a tremendous challenge as we had current account deficits of 10% of GDP. In addition, we estimate that inflation will converge to the target in the third quarter of 2026 and the economy will grow at around its trend rate. We continue to work to maintain these balances and keep inflation at 3% annually.

These advances in restoring macroeconomic balances have allowed for lower interest rates and higher income for households and businesses, which has helped reduce their financial vulnerability.

At the same time, in recent years the banking system has strengthened both the quality and quantity of its capital in response to the implementation of Basel III. These capital requirements function as an integrated system that combines minimum or structural requirements with other contingent ones. Their aim is to ensure the solvency of individual institutions (micro-prudential dimension) and strengthen the resilience of the overall banking system in the face of severe stress scenarios resulting from the materialization of systemic risks in a macro-prudential dimension. Basel III will come into force at the end of the year, beyond certain scope for learning, complement, and improve.

One of the requirements included in the Basel III regulations is the Countercyclical Capital Buffer (CCyB), which, given its macroprudential nature, has been assigned to our Central Bank.

As we have explained before to this Commission, the main objective of the CCyB is to enhance the resilience of the banking system in the face of scenarios of severe financial stress, mitigating the impact of systemic shocks on the supply of credit and other financial services essential to the functioning of the economy.

A year ago, we announced that the Bank had established a neutral level for the CCyB equal to 1% of risk-weighted assets (RWAs), which remains valid even in the absence of evident signs of stress. On the same occasion, the Board decided to maintain the buffer at its current level of 0.5% of RWAs, consistent with the macro-financial and risk conditions facing the financial system. For its part, and as indicated in the Financial Policy Framework, updated in November 2024, starting with the first Financial Policy Meeting of 2026, we will evaluate the beginning of convergence toward the neutral level of 1% of RWAs, as macro-financial conditions permit, and considering a period of at least one year for its construction.

In addition to the elements mentioned above, we have also made progress in building additional capabilities. As we have previously noted in this Commission, the approval of the Financial Resilience Law improves the capacity to respond to economic and financial crises. This is achieved by expanding the tools available to address stressful situations and ensuring the continuity of payments and liquidity.

During this year, the Bank launched a public consultation on a proposed regulation that will allow for the recognition of framework agreements for the signing of repurchase agreements, establishing conditions for their acceleration and clearing in the event of default by any counterparty.

In addition, a proposal to strengthen liquidity management of Central Counterparty Institutions was published for consultation. This measure equates the treatment of cash funds held at the BCCh with that of other liquidity deposits. Thus, in situations of stress, the speed of fund availability increases, improving the system's operating efficiency and resilience.

In the second half of this year, we will publish for consultation a proposal for a regulatory framework that will allow expanded access to the Real-Time Gross Settlement System for certain non-bank entities, including financial intermediaries and market infrastructures. These initiatives are part of the strategy to modernize the critical infrastructures of the Chilean financial system, which are aimed at boosting its resilience and safeguarding its stability.

Another initiative that the Bank has been promoting is to encourage the use of the Chilean peso in cross-border transactions, which has become known as the “internationalization of the peso.” This initiative stems from a regulation issued by the Bank to authorize certain transactions with non-residents denominated in Chilean pesos (i.e., opening of correspondent accounts, credit transactions, derivative transactions with physical settlement in pesos). This has several objectives, including making the local financial market more competitive, increasing its liquidity levels, and deepening it.

Also, with a view to strengthening our capacity to mitigate external shocks, last August we launched a reserve purchase program, a measure that is embedded in a financial policy strategy aimed at gradually replacing part of our existing credit lines with our own international reserves. This, while not altering the Bank's current total level of international liquidity, which stands at roughly 20% of GDP and is considered adequate for the size and degree of openness of the Chilean economy.

The purchase program began on August 8 and is designed to accumulate reserves of up to US$25 million per day for three years. As expected, the announcement of this measure had a very limited impact on market prices, with the peso depreciating by about 1%, an effect that dissipated within two days.

None of this means we are immune. It is important to work on building resilience on different fronts and with different actors. An economy like ours needs to draw on its strengths and have the capacity to face challenges which, as I said, although with low probability, can have significant effects.

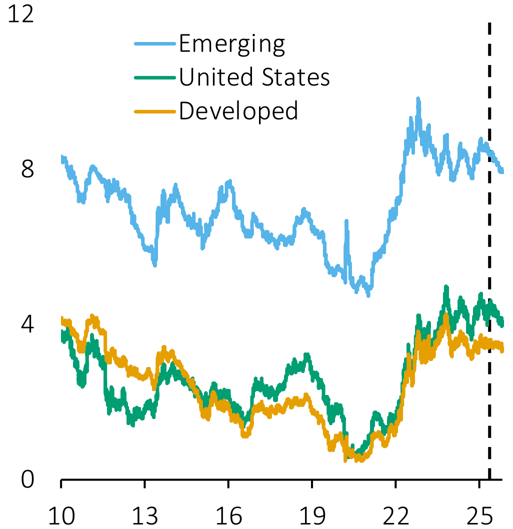
Dear Senators, our economy has made significant progress in strengthening its ability to cope with external shocks. But it must continue to build its capacity to adapt when circumstances change. This is an ongoing task. Our efforts, and those of all public policy makers, must be focused on building capacity. Experience has taught us how important it is to have tools that can mitigate these impacts.

Thank you.

Figure 1

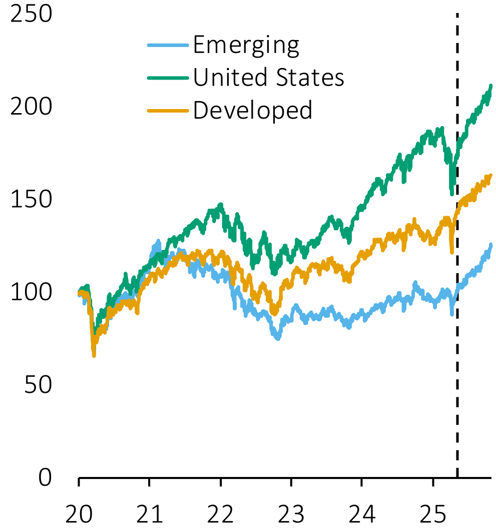
Ten-year sovereign rates (1)(2)

(percent)



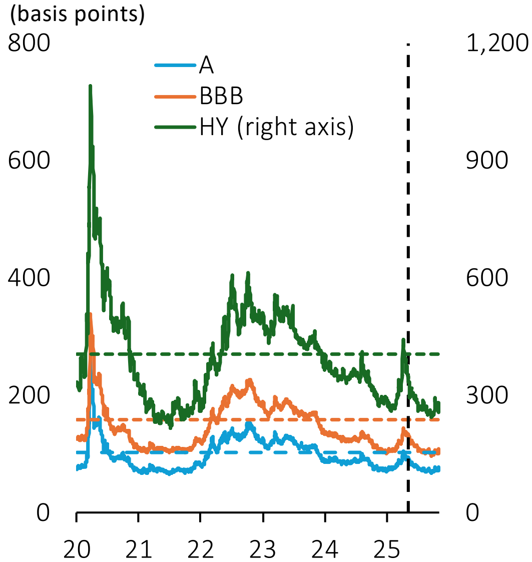
Yield of world stock exchanges (1)(3)

(base 100 = 02.Jan.2020)



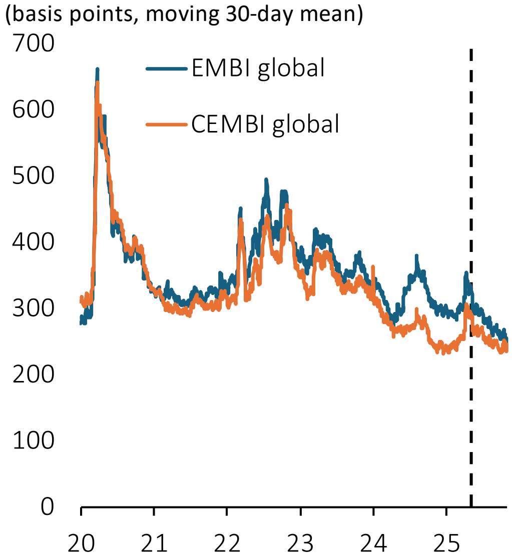
US corporate spreads (1)(4)

(basis points)



Emerging countries' spreads (1)(5)

(basis points, moving 30-day mean)



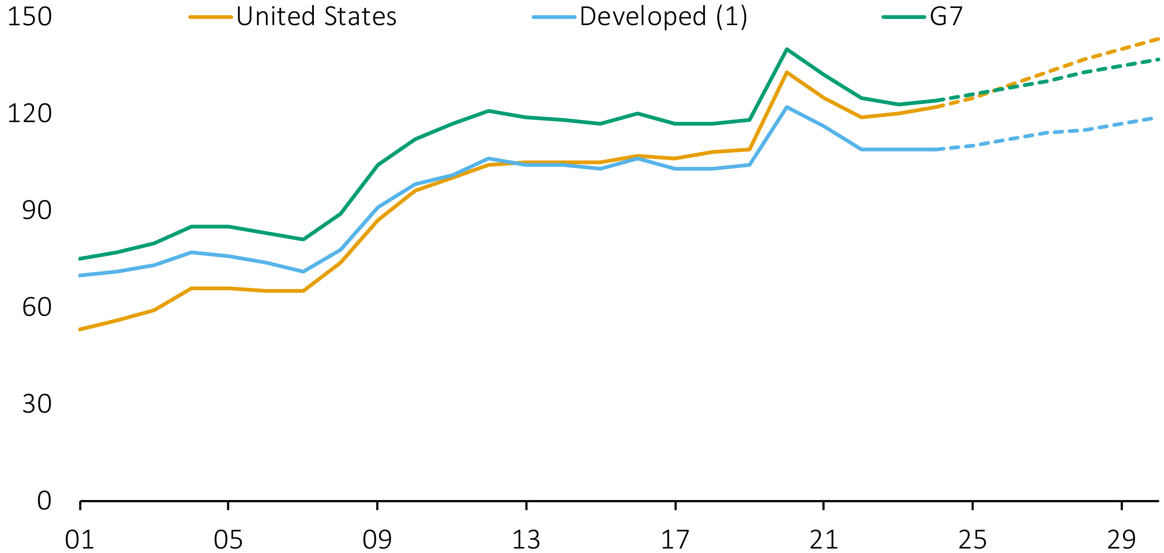
(1) Black vertical lines mark statistical close of the previous IEF. (2) Developed countries include: Australia, Canada, Germany, Italy, Korea, New Zealand, Norway, Singapore, Spain, Sweden, the United Kingdom, and the United States. Emerging markets include: Brazil, Chile, Colombia, Hungary, India, Indonesia, Mexico, Peru, Poland, South Africa, Thailand, and Turkey. (2) Performance in local currencies. The US corresponds to the S&P 500, Developed means the MSCI World ex USA Index, which considers the 22 developed markets other than the US; for Chile it is the IPSA, and Emerging stands for the MSCI emerging markets Index, which considers 24 emerging economies. (3) Dotted lines represent averages for the period 2013-2023. (4) The EMBI reflects the spread between emerging market sovereign bonds and US Treasuries, according to J.P. Morgan's EMBI Global methodology. The global CEMBI represents the yield spread between emerging market corporate bonds and US Treasuries, according to J.P. Morgan's CEMBI Broad Diversified Core index methodology.

Source: Central Bank of Chile based on Bloomberg and RiskAmerica information.

Figure 2

Sovereign debt

(percent of GDP)

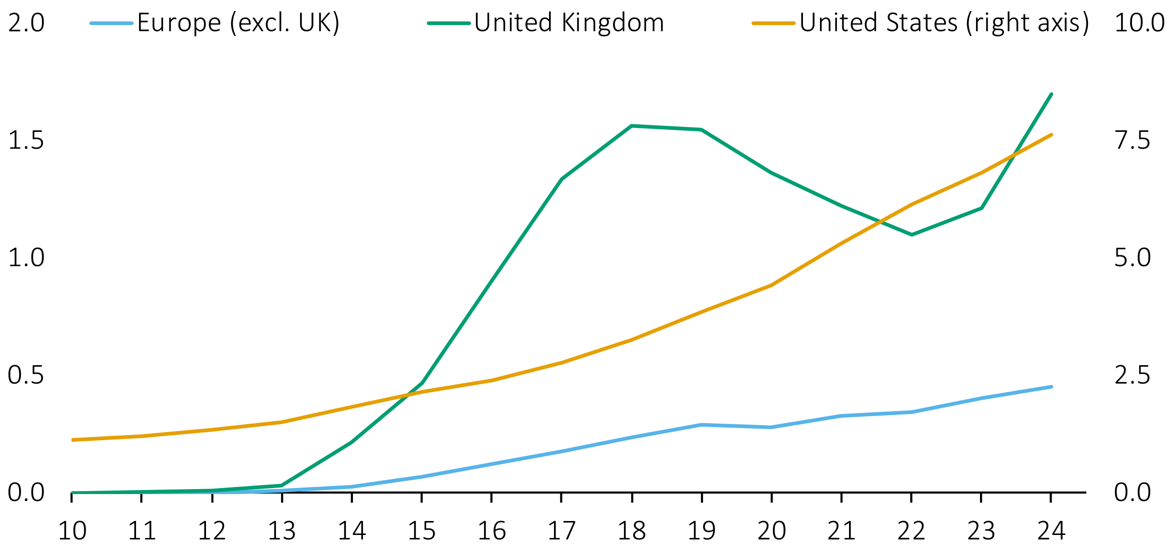


(1) Considers a set of developed economies as defined by the International Monetary Fund (IMF).
Source: Central Bank of Chile based on October 2025 IMF's World Economic Outlook information.

Figure 3

Private credit market (1)

(percent of total credit)

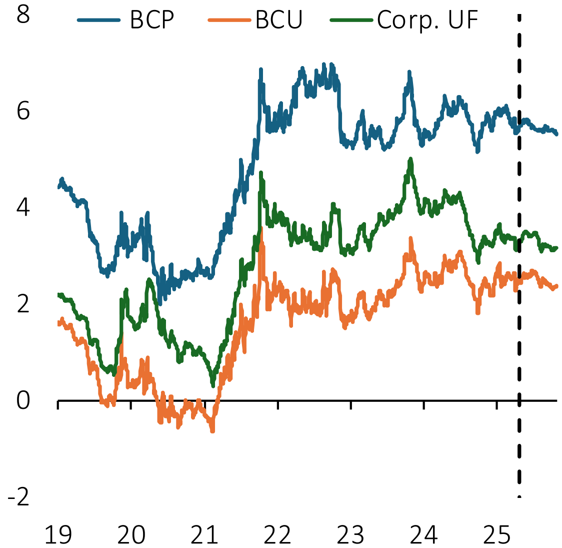


(1) Private credit is shown as a percentage of total credit, defined as the sum of private credit plus bank credit granted to the non-financial private sector, by borrower's region. Private credit is the total volume of direct and asset-backed loans. Data as of December 2024.

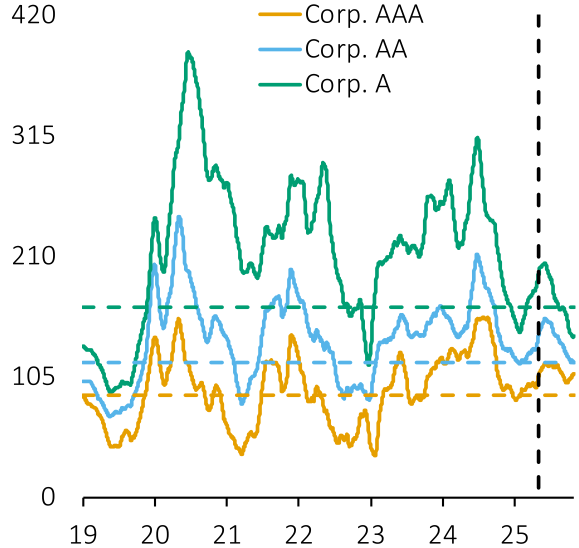
Source: Central Bank of Chile based on BIS information.

Figure 4

Ten-year rates of sovereign and UF-denominated corporate bonds (1)(2)
(percent)



Ten-year spread of UF-denominated corporate bonds (1)(3)
(basis points, moving 30-day mean)

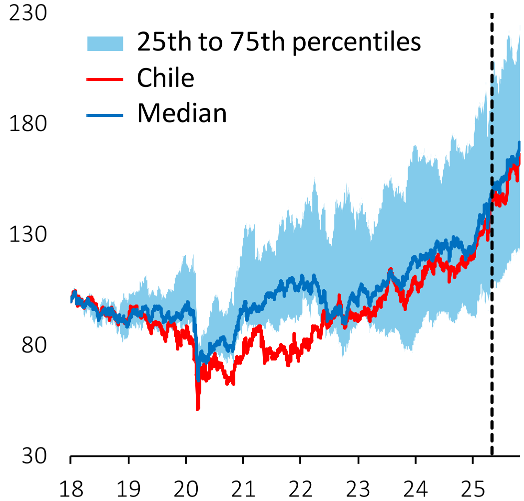


(1) Black vertical line marks statistical close of previous IEF. (2) Corporate bond rates generated considering bond transactions with residual maturities between eight and 13 years, considering risk ratings AAA, AA+, AA, AA-, A+, A, and A-. (3) Horizontal lines represent the averages for each series from 2013 to 2019. Spreads calculated on SPC UF.

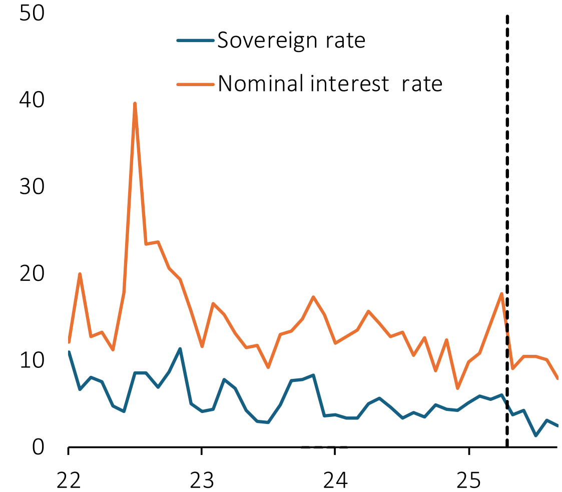
Source: Central Bank of Chile based on RiskAmerica data, using generic bond rates.

Figure 5

Local emerging countries' stock markets (1) (2)
(index, 03.Jan.18=100)



NER volatility and sovereign rates in pesos at 10 years (3)
(basis points)



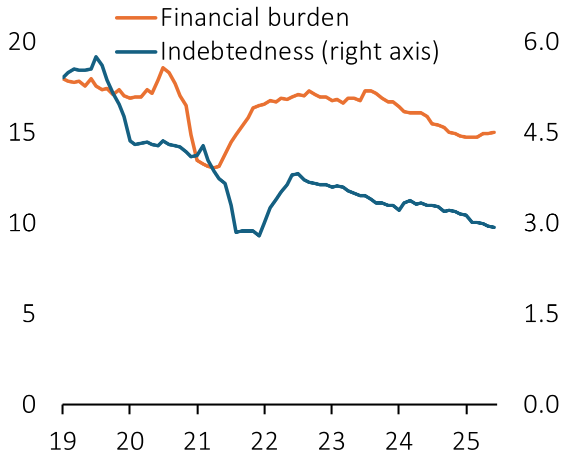
(1) Vertical lines mark statistical close of the previous IEF. (2) Colored area shows difference between 25th and 75th percentiles of the distribution of cumulative variations since the last IEF for a group of emerging economies. These are: Brazil, Chile, Colombia, Hungary, India, Indonesia, Mexico, Peru, Poland, South Africa, Thailand, and Turkey. (3) Annualized standard deviation of the daily change in the 10-year sovereign rate in pesos and the daily return on the nominal exchange rate. Vertical lines indicate the latest data included in the previous IEF.

Source: Central Bank of Chile based on Bloomberg information.

Figure 6

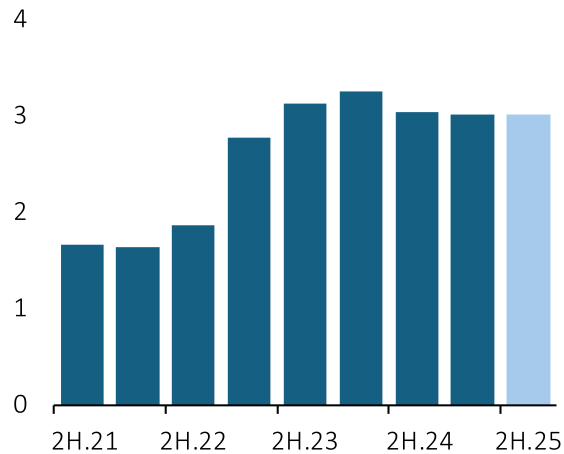
Households: financial burden and bank debt (1)

(percent of income; times of income)



Households: debt at risk (2)

(percent of GDP)

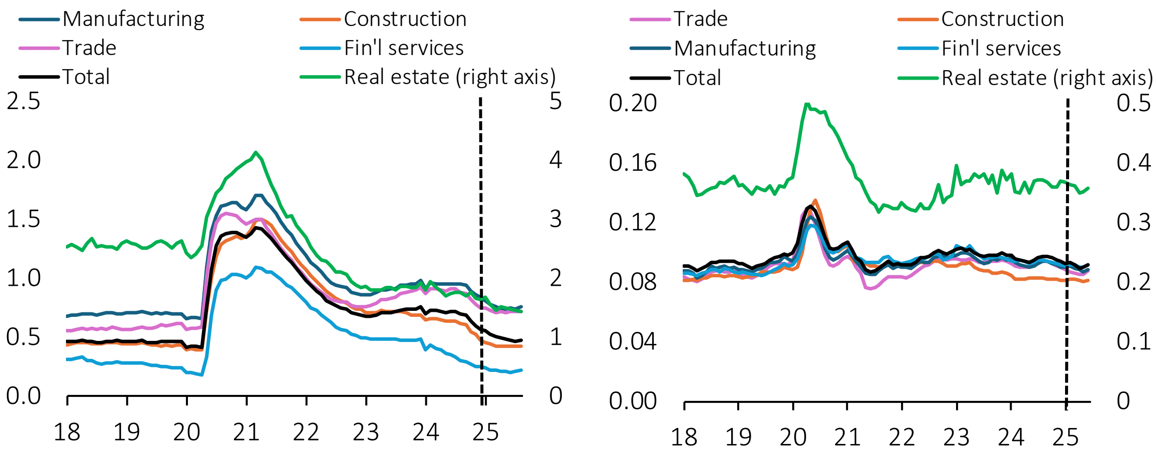


(1) Median. Moving six-month average. (2) Individual debt multiplied by the probability of default for each debtor in the portfolio. Differences with previous versions of the Report are due to changes in the estimation models used.

Source: Central Bank of Chile based on AFC, CMF, and SUSESO information.

Figure 7

Firms: debt to sales ratio (1) (2) | **Firms: Financial burden over sales (1) (3)**
(times of monthly sales)

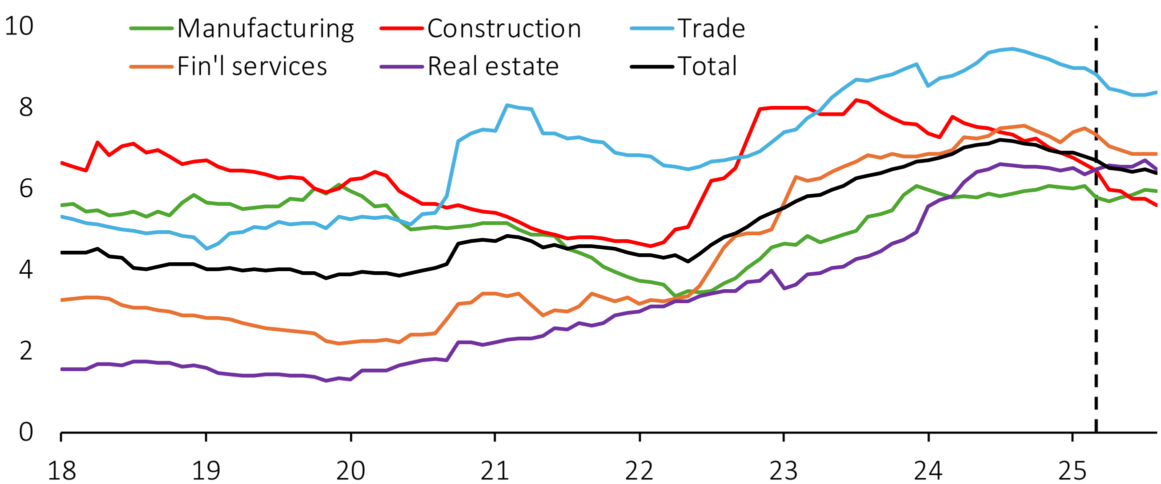


(1) Vertical lines mark statistical close of previous IEF. Firms financed with local bank credit. Does not include individuals. (2) Median. Moving quarterly average. (3) Median. Deseasonalized series. Financial burden and sales are denoted by moving quarterly sums.

Source: Central Bank of Chile based on CMF and SII information.

Figure 8

Portfolio in default (1)
(percent of debt outstanding)



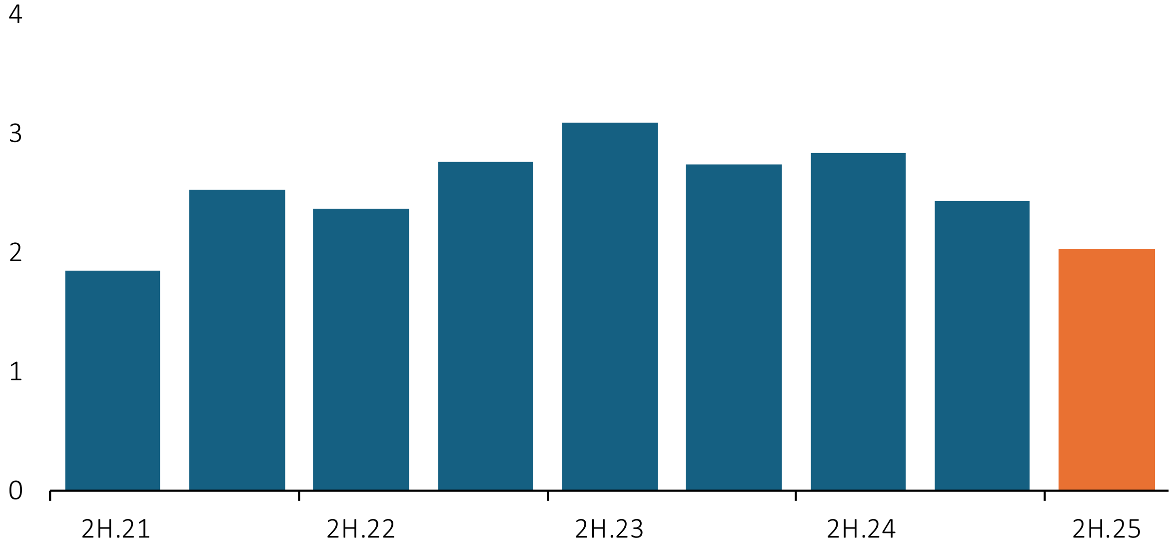
(1) Vertical line marks statistical close of previous IEF. Firms financed with local bank credit. Portfolio in default corresponds to portfolio C or group default. The remainder is composed of other economic sectors such as: Agriculture, Mining, Financial services, Transportation & telecommunications, Natural resources, and unclassified.

Source: Central Bank of Chile based on CMF and SII information.

Figure 9

Commercial debt at risk (1)

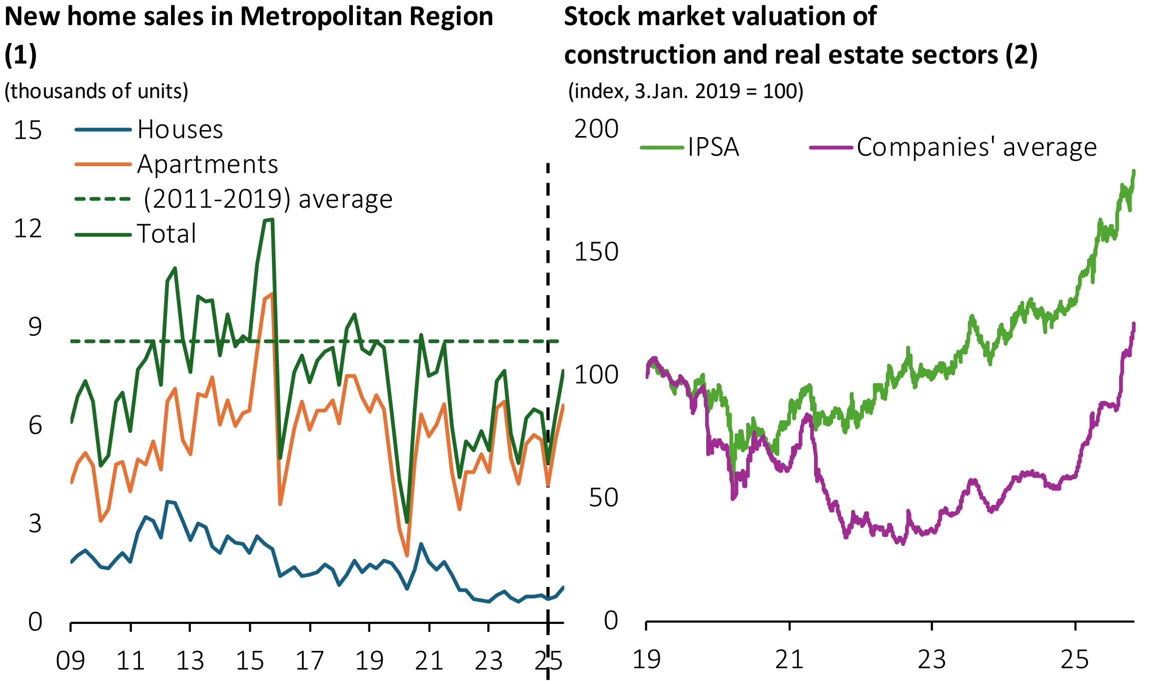
(percent of GDP, 2024)



(1) Firms financed with local bank credit. Does not include loans to individuals. Shows the amount owed by each firm weighted by its individual probability of default within one year.

Source: Central Bank of Chile based onf CMF and SII information.

Figure 10



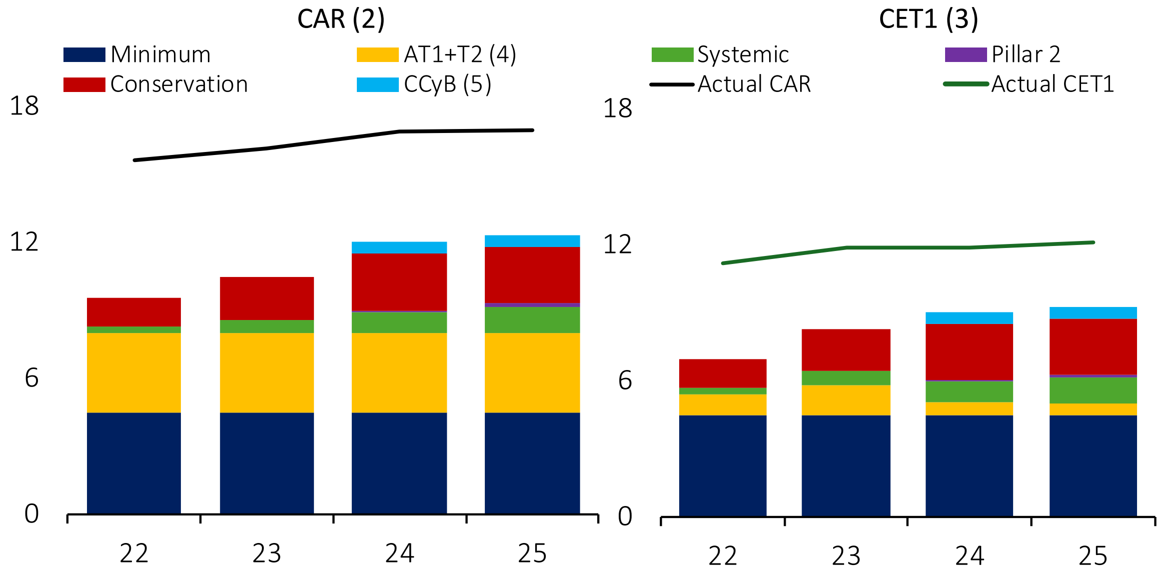
(1) Vertical line marks statistical close of previous IEF. (2) Includes companies Besalco, Echeverría Izquierdo, Ingevec, Salfacorp, and Socovesa.

Source: Central Bank of Chile based on Chilean Chamber of Construction (CChC) and Bloomberg information.

Figure 11

Banking system's capital requirements (1)

(percent of risk-weighted assets)



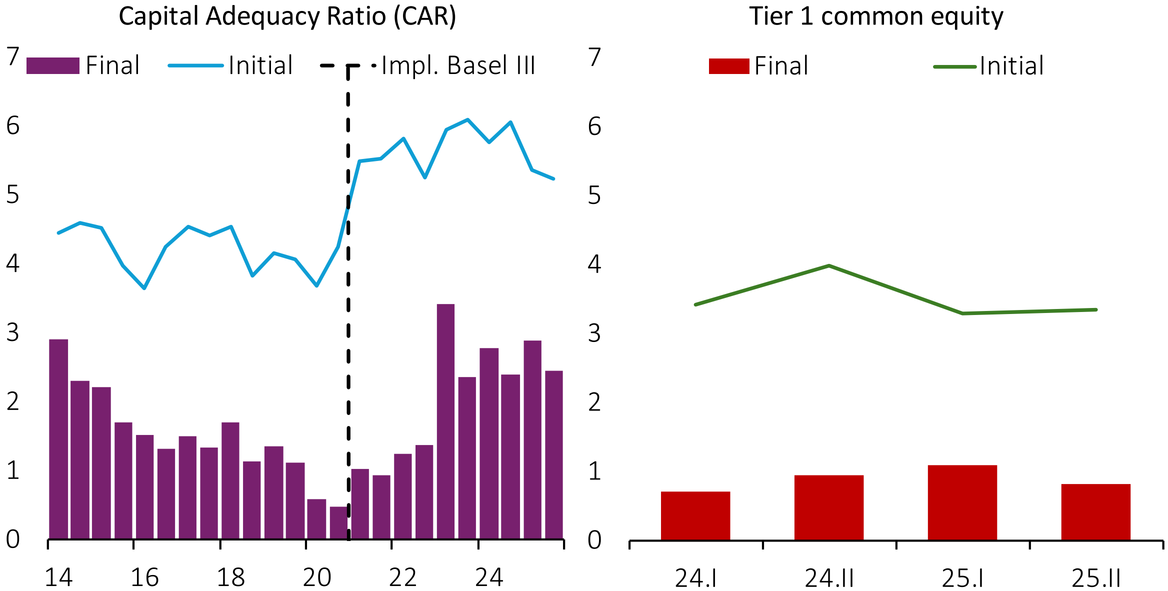
(1) Information at December of each year. Actual capital data as of August 2025. Figures for requirements as of December 2025 consider the Basel III convergence calendar. (2) Capital adequacy ratio. (3) Common Equity Tier 1 capital. (4) Additional Tier 1 capital and Tier 2 capital. (5) Countercyclical capital buffer.

Source: Central Bank of Chile based on CMF information.

Figure 12

Capital buffers under severe stress scenarios (1)

(percent of risk-weighted assets)



(1) Excess of effective capital over the regulatory minimum, including Pillar 2 and buffers. Does not include the CCyB in the stressed (final) margin nor in the initial margin. Considers the specific limits of each bank. For the IEF stress tests for the second half of 2021, 2022, 2023, and 2024, the solid bar shows the final buffer with the limits in force as of December of each year, in accordance with the Basel III phased implementation schedule. The vertical line marks the start of the Basel III implementation schedule.

Source: Central Bank of Chile based on CMF information.