

THE CHILEAN FINANCIAL SYSTEM



The soundness and strength of the Chilean economy along with a stringent regulatory system have sustained the consolidation of a modern and competitive financial system, characterized by strong expansion during the past decade, an attractive profitability, and a great diversity in the products offered, all within an environment of high domestic and international confidence. This development has supported banking penetration levels largely above those observed throughout the rest of the region, with total loans equivalent to more than 70 percent of GDP.

Note should be taken that a large part of the consolidation of the banking industry is associated with foreign capital inflow. In fact, in December 1995, 22.4 percent of total capital and reserves in the financial system was controlled by foreign banks whereas, as of December 2003, the share had risen to 49.5 percent.

An additional element that has sustained this development has been the sector's high capital base, reflected by a 14.1 percent Basle ratio as of November 2003, above the 8 percent required by current Chilean regulations. Moreover, as of November 2003, 21 institutions exhibited an indicator above 12 percent, which leaves space for both future industry expansion and a favorable position

to face regulatory changes regarding minimum capital levels required. Finally, risk rating agencies have confirmed the soundness of the domestic banking industry, assigning favorable risk ratings to most participating institutions.

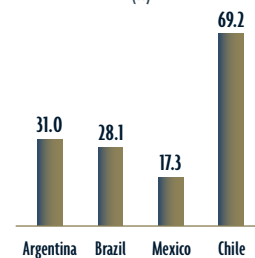
At present, the financial system is comprised of 26 institutions: one state-owned bank, 12 domestic private banks, and 13 foreign private banks.

THE FINANCIAL SYSTEM IN 2003

In spite of the complex regional and international economic environment, particularly during the first semester of the year, the domestic banking industry attained record highs in terms of results, business volume, and number of customers during fiscal year 2003, as a consequence of low interest rates and a high confidence level on the part of customers and the public in general. Additionally, the entry of new institutions, especially within the consumer credit segment, has contributed to favorable loan evolution.

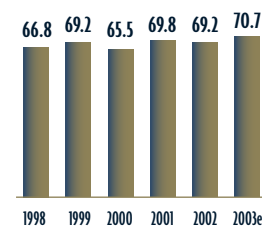
Total loans recorded a 5.7 percent nominal growth in December 2003 as compared to December 2002, reaching Ch\$ 33,480 billion. This increase was mainly accounted for by mortgage and consumer loans. It is worth recalling that the latter had fallen systematically during recent years only resuming their growth trend by the end of 2001,

**LOANS / GDP
LATIN AMERICA**
(Dec. 2002)
(%)

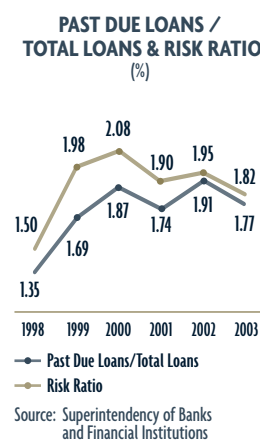
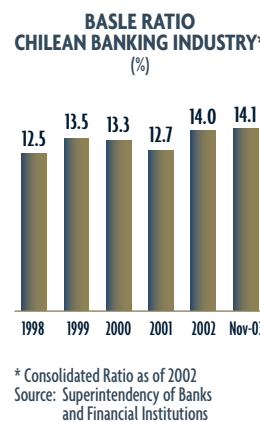
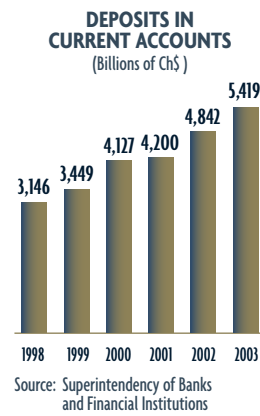


Source: Central Banks of Argentina, Brazil, Mexico and Chile, respectively.

**LOANS / GDP
CHILE**
(%)



(e): Estimated
Source: Chilean Central Bank



fostered by lower interest rates and the attractive promotions offered by the banking sector.

Commercial loans, for their part, have shown a stable behavior mainly due to a delay in investment projects associated with the uncertainty existing during the first semester of the year and the lack of clear-cut signals pointing to an upturn in domestic economy. Added to the above was wider diversification of corporate financing through the substitution of bank loans with direct financing generated in the securities market by means of bond issues, negotiable instruments, and securitizations.

The balance deposited in current accounts has shown continuous growth during the past years, reaching Ch\$ 5,419 billion as of December 2003, which represents an 11.9 percent growth with respect to December 2002. The number of current accounts showed a 1.5 percent increase in the same period, equivalent to approximately 23,000 additional accounts. This evolution was mainly associated with both the significant efforts made by the sector to attract new customers by means of better and more efficient services and the change in banks' cost structures, enabling them to offer bank accounts to lower income people. Particularly noteworthy was ongoing innovation through new technological channels. This is reflected by the increase in Internet-based transactions, which,

during the first semester of 2003, reached more than 30 million, a level ten times higher than the one recorded in the same period in 2000.

ASSET QUALITY

The recovery of economic activity and improved short and long term expectations have had direct bearing on corporate results, and consequently, on the quality of banks' portfolios. Past due loan and risk ratios have stabilized after the increase recorded at the beginning of 2000. In fact, the banking sector showed the lowest risk ratio over the last four years with 1.82 percent as of October 2003. Notwithstanding the above, these ratios are higher than those recorded before the economic crisis, so they could continue to improve in line with better economic perspectives.

RESULTS

The net income for the financial system as of December 2003 was Ch\$ 617.6 billion, which is equivalent to a 20.7 percent growth with respect to the previous period. Consequently, average return on capital and reserves improved from 14.7 percent in 2002 to 16.2 percent in 2003, a level exceeding the average obtained over the last ten years.

The industry's income increase during 2003 was mainly accounted for by the lower net expense on loan losses and the reduction in operating expenses, the latter associated with the consolidation of the

mergers that took place during previous periods and the banking sector's ongoing effort aimed at efficiency level improvement. Note should be taken that, during recent years, the Chilean banking

FINANCIAL SYSTEM
(Billions of nominal Ch\$)

	Dec. 2001	Dec. 2002	Dec. 2003	Nominal Variation Dec. 03/Dec. 02
Total Loans	30,271	31,675	33,481	5.7 %
Commercial	12,931	12,935	13,261	2.5 %
Foreign Trade	2,552	2,680	2,507	(6.5)%
Consumer	2,327	2,683	3,167	18.0 %
Mortgage	7,755	8,156	8,734	7.1 %
Contingent	1,892	2,017	2,287	13.4 %
Others ⁽¹⁾	2,814	3,204	3,525	10.0 %
Deposits in Current Accounts	4,200	4,842	5,419	11.9 %
Total Assets	44,827	46,966	49,175	4.7 %
Shareholders' Equity	3,781	4,070	4,344	6.7 %
Branches (No.)	1,429	1,434	1,468 ⁽²⁾	2.4 %
Employees (No.)	38,587	36,701	39,474 ⁽²⁾	7.6 %

(1) Including interbank loans.
(2) Number of branches and employees as of September 2003.
Source: Superintendency of Banks and Financial Institutions.

Statement of Income
(Billions of nominal Ch\$)

	Dec. 2001	Dec. 2002	Dec. 2003	Nominal Variation Dec. 03/Dec. 02
Gross Operating Income	2,095	2,216	2,131	(3.8) %
Operating Expenses	(1,208)	(1,257)	(1,224)	(2.6) %
Provisions for Loan Losses ⁽¹⁾	(297)	(334)	(241)	(27.7) %
Subsidiaries and Foreign Branches	80	89	111	24.5 %
Voluntary Provisions	(18)	27	10	(61.7) %
Net Income	568	512	618	20.7 %
Gross Operating Income/Average Interest-Earning Assets	5.7 %	5.6 %	5.1 %	
Efficiency	57.7 %	56.7 %	57.4 %	
Provisions for Loan Losses ⁽¹⁾ /Average Net Loans	1.0 %	1.1 %	0.7 %	
Net Income/Average Capital and Reserves	17.2 %	14.7 %	16.2 %	

(1) Net of recoveries and excluding voluntary provisions.
Source: Superintendency of Banks and Financial Institutions.

industry has consolidated an operating efficiency level consistent with the levels exhibited by developed countries. Thus, the industry's efficiency level has stood near 57 percent during the last year.

Gross operating income as of December 2003 dropped by 3.8 percent with respect to the previous year, when the successive nominal interest rate decreases recorded in 2002 undoubtedly produced higher benefits for the industry throughout that period. In spite of the above mentioned decrease, there was a remarkable 24.4 percent increase in net fees, attesting to the success of the banking sector's efforts in diversifying sources of revenue, particularly those associated with transaction pricing. Also noteworthy in this area were the results obtained by bank subsidiaries, which contributed 16.3 percent to the financial system's results as of December 2003.

Forecasts for 2004 are for the sector's business volumes to expand further, which, along with better economic expectations, should enable attainment of profitability levels similar to those recorded during fiscal year 2003. Notwithstanding, a significant competition increment is expected as a result of newcomers into the industry, which are putting pressure on trading spreads. The above will require furthering the efforts to achieve higher levels of efficiency, innovation, and diversification of both, products and sources of revenue.

