

THE CHILEAN ECONOMY IN 2002

During the year 2002, the Chilean economy exhibited a lower growth rate than that recorded in the previous two years. The moderate Gross Domestic Product (GDP) expansion, estimated at about 1.9 percent for the year 2002, was influenced by both domestic and foreign factors.

In the international context, the year 2002 was characterized by uncertainty and market volatility, mainly stemming from a slowdown in the world economy and, particularly, in the United States economy, which entered a recessive phase in the first half of 2002. The lower growth rate in the leading world economy and the likelihood of a war in the Persian Gulf translated into further deterioration in the terms of exchange for the Chilean economy, evidenced in lower revenues from our main export goods and higher costs of import goods.

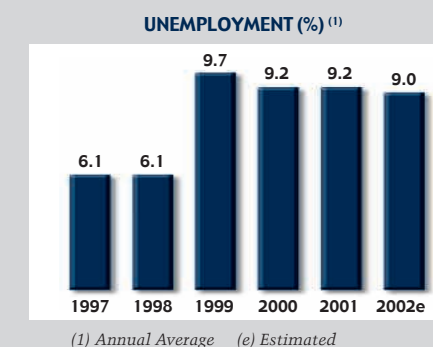
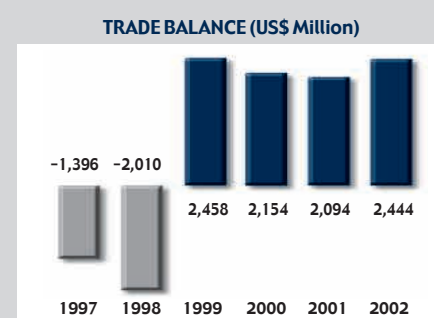
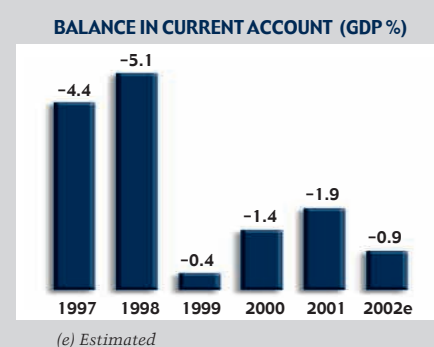
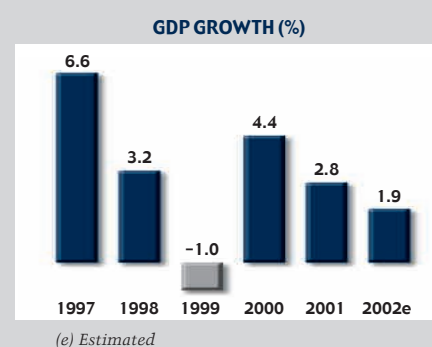
Notable at regional level was the profound financial and political crisis in Argentina, added to the uncertainty arising from presidential elections in Brazil. Also important were the crisis in Uruguay, the political problems in Venezuela and Peru, and the ongoing conflict in Colombia.

In this context, international and also local interest rates fell to historical low levels in the absence of inflationary pressures. Notwithstanding this expansive monetary policy scenario, consumer and investor confidence has not been recovered, affecting private investment and consumption, and inflows of fresh capital into Chile.

The difficult global and regional conditions encountered by our economy in 2002, added to some internal factors, such as uncertainty associated with labor and tax reforms, explain to a large extent the evolution of the main macro-economic data. Unemployment remained high, at around 9 percent average; the investment rate fell as compared to 2001; and the observed exchange rate reached historical highs in the third quarter of 2002. On the other hand, inflation was kept under control at 2.8 percent, while the current account deficit decreased to 0.9 percent of Gross Domestic Product.

The Chilean economy is expected to show some signs of recovery in terms of growth and domestic expenditure in 2003. Growth forecasts for 2003 stand at 3.0 percent, with an inflation rate that is to be kept under control. This improvement would be based on the recovery of the U.S. economy and increased international demand. We should note the free-trade agreements that Chile concluded with the United States of America, the European Union, and Korea during 2002, which lend added stability to the Chilean economy as direct benefits thereof should be realized in the mid to long term, particularly those arising from tariff phase-outs. In spite of the expectations for world and domestic economic recovery, there prevails the uncertainty associated with regional instability and the likelihood of belligerence in the Middle East, which could carry contractionary and inflationary consequences for the Chilean economy.

COUNTRY DATA



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THE BANKING INDUSTRY

The Chilean banking industry has experienced strong competition over the last years with the entry of new market actors, increased de-intermediation and the creation of large banking institutions.

In spite of this higher level of competition and the scenario of depressed economic growth and greater international uncertainty that prevailed over the last periods, results obtained by the Chilean banking industry have shown a favorable evolution, both in terms of performance and activity levels. During the year 2002 in particular, the Financial System was able to generate significant earnings, with an increase in Net Operating Results of 5.0 percent in real terms as compared to 2001, which partially offset higher portfolio-related expenses. Said evolution is based on both the positive effect of successive reductions in nominal rates and on the management capacity of the different institutions.

Today, the Financial System is comprised of 26 institutions, among which are Banco del Estado, eleven Chilean private sector banks and fourteen foreign banks.

Business Volume

Total lending in the Financial System showed a recovery during the second half of 2002, thus reaching a year-on-year increase of Ch\$ 1,404,153 million at December 2002, representing a 1.6 percent increase in real

terms. Analyzing the main components of total lending operations, we may appreciate that the largest growth rate was recorded in mortgage loans with a 2.2 percent increase in real terms for the period, followed by consumer credits with a 12.0 percent increase in real terms. It should be noted that higher exchange rates and its impact on dollar-denominated loans account for a significant part of the growth rate in foreign trade loans.

On the other hand, the annual average balance in current account recorded a growth of 7.4 percent in real terms for the period 2001-2002, which is mainly explained by lower nominal interest rates during this period and commercial efforts made by the banking sector to expand this source of funding.

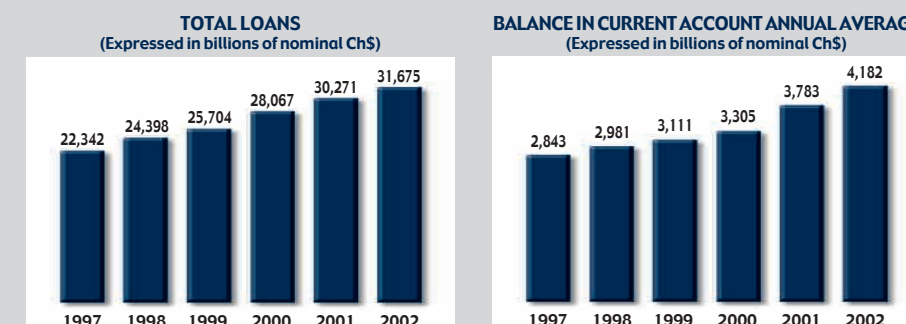
Asset Quality

The quality of the Financial System's loan portfolio has deteriorated as a result of the economic slowdown in the country and worldwide instability, which has had an impact on the financial standing of borrowers, consequently implying higher provisions for loan losses. Thus, the ratio of total allowances for loan losses to average total loans increased from 1.0 percent at December 2001 to 1.1 percent at December 2002, while the ratio of past due loans to total loans increased from 1.6 to 1.8 percent over the same period. However, the coverage ratio of allowances to past due loans reached 128 percent, which, although lower than the



Soundness and innovation in the Chilean Banking Industry have and shall be fundamental building blocks in our country's development.

FINANCIAL SYSTEM INDICATORS



146 percent recorded in December 2001, gives ample space for the Financial System to cover eventual deterioration in the loan portfolio.

Income

As of December 2002, the Financial System accumulated a net income of \$ 511,870 million, down 12.5 percent in real terms from net income posted in 2001. Consistently, the return on average shareholders' equity fell from 17.3 percent to 14.8 percent over the same period. This year's lower income is mainly explained by an increase in provisions and charge-offs and by higher operating expenses associated mainly with the merger processes verified during the year.

In the event of a slight recovery in economic activity, as expected for the second half of 2003, the domestic banking industry forecasts stronger competition and a moderate growth in business volumes. On the other hand, in terms of asset quality, expenses related to provisions and write-offs are expected to achieve stability, at the levels observed in 2001. The consolidation of the merger process initiated in 2002, will have a particular impact on the industry's results, allowing the sector to achieve a better performance based on higher operating efficiencies.

FINANCIAL SYSTEM
(expressed in billions of nominal Ch\$)

	Dec. 2001	Dec. 2002	Real Variation
Total Loans	30,271	31,675	1.6%
Commercial	12,931	12,935	-2.8%
Foreign Trade	2,552	2,680	2.0%
Consumer	2,327	2,683	12.0%
Mortgage	7,755	8,156	2.2%
Contingent	1,892	2,017	3.5%
Other	2,814	3,204	10.6%
Balance in Current Account Annual Average	3,783	4,182	7.4%
Total Assets	44,827	46,966	1.8%
Shareholders' Equity	3,781	4,070	4.5%
Net Income	568	512	-12.5%
Branches (number)	1,429	1,446 *	-1.7%
Employees (number)	38,587	37,483 *	-5.7%

* Number of branches and employees as of September 2002.
Source: Superintendency of Banks and Financial Institutions (SBFI)

STATEMENT OF INCOME
(expressed in billions of nominal Ch\$)

	Dec. 2001	Dec. 2002	Real Variation
Gross Operating Results	2,095	2,216	2,7%
Operating Expenses	1,208	1,257	1,1%
Net Operating Results	887	958	5,0%
Net Charges Against Assets at Risk*	297	334	8,9%
Subsidiaries and Foreign Branches	80	89	7,5%
Voluntary Allowances	-18	27	-
Net Income	568	512	-12,5%
Gross Operating Results/ Average Productive Assets	5.8%	5.7%	-
Efficiency	57.7%	56.7%	-
Charge Against Allowances* / Average Net Loans	1.0%	1.1%	-
Net Income / Average Capital and Reserves	17.3%	14.8%	-
Net Income / Average Total Assets	1.2%	1.0%	-

* Excludes voluntary allowances

FINANCIAL SYSTEM INDICATORS



Permanent incorporation of new technologies has allowed the banking industry to offer customers more and better services, thus providing for improved efficiency at industry's level.

