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Dinner Speech

From Financial Weakness to Financial Strength:

The Chilean Case

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FROM FINANCIAL WEAKNESS TO FINANCIAL STRENGTH: THE CHILEAN CASE

ENRIQUE MARSHALL

SUPERINTENDENT OF BANKS AND
FINANCIAL INSTITUTIONS

THE FINANCIAL CRISIS OF THE 80s

- Financial liberalization with weak regulation
- Abnormal growth of credit
- Adverse macroeconomic conditions
- Bad loans reached 30% of total loans or 3 times the system’s capital
- Programs to reestablish the solvency of viable banks and debtors
- Non-viable banks intervened and wound up
- Fiscal costs of solvency-recovery programs: 42% of GDP

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BANK REFORMS

- Bank reform of 1986: a turning point as regards prudent regulation and effective supervision
- Bank reform of 1997: modernization of the legal framework and expansion of bank activities
- Financial liberalization fully in place during this period

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MAIN COMPONENTS OF THE PRUDENT REGULATORY FRAMEWORK

- Industry entry requirements
- Limits on lending to related parties
- Capital adequacy in line with Basel standards
- Preventive and self-correcting safeguards
- A limited State guarantee on deposits
- Financial disclosure requirements
- Corporate governance

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CAPITAL MARKET REFORMS

- Pension reform: privately administered system based on individual capitalization accounts
- Additional reforms covering: insurance companies, securities and stock exchanges, mutual funds and the corporate sector
- Recent reforms to strengthen corporate governance and transparency
- Measures to promote private equity and venture capital currently before Congress

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INSTITUTIONAL CHANGES AND MACROECONOMIC STABILITY

- Central Bank
  - Autonomous since 1989
  - Target inflation range: 2%-4% per year
  - Current inflation rate: below 2%
- Fiscal Policy
  - Anchored to a structural surplus of 1% since 2001
  - Allows for a deficit during the downside of the economic cycle
  - A surplus is expected in 2004

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FINANCIAL DEVELOPMENT AND ECONOMIC GROWTH: CURRENT INDICATORS (1)

- Continuous growth of financial activities
- Solid banking system: well capitalized and managed
- High banking penetration. Total assets: US$ 80 billion (103% of GDP)
- Pension funds: US$ 50 billion under management (60% of GDP)
- Main institutional investors managing assets worth US$ 71 billion (84% of GDP)

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FINANCIAL DEVELOPMENT AND ECONOMIC GROWTH: CURRENT INDICATORS (2)

- Bond market: outstanding liabilities of US$ 12 billion (14% of GDP)
- Relatively high market capitalization: US$ 86 billion (103% of GDP)
- Sovereign rating: A; sovereign spread: 80 basis points
- Significant contribution to economic growth

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CONCLUDING REMARKS

- Chile went from financial weakness to financial strength over the last two decades.
- Four main factors contributed to this process:
  - Macroeconomic stability
  - Adequate financial infrastructure
  - Market reforms and policies
  - A sound regulatory and supervisory framework.

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