



Financial Stability Reporting in Chile: Issues and Communication Channels

Carmen G. Silva
Financial Stability Area



Central Bank and financial stability

- As established in its Basic Constitutional Act, the Central Bank of Chile must “safeguard the stability of the currency and **the normal operation of internal and external payments.**”
- The normal operation of internal and external payments is closely related with the macro-financial developments and with the soundness of the financial system as a whole.
- To carry out these tasks, the Central Bank of Chile is vested with diverse legal powers, such as extending emergency credit, determining regulations in matters affecting the financial system and international trade operations.
- In this context, the Financial Stability report (FSR) is the main tool for the Bank’s sharing of its assessment about the functioning and risks of the financial system.



Financial Stability Report



Objective

- Provide information on recent macroeconomic and financial events, both internal and external, that could affect the financial stability of the Chilean economy.
- Propose and discuss the policies and measures that support the normal operation of the internal and external payment system.
- Share the vision of the Board about financial regulations and promote general knowledge and public debate.
- Key role: identify and communicate risks



Characteristics

- Audience: domestic and international financial institutions, Congress, academics, supervisors/regulators.
- Analysis at system level (not specific institutions) of interconnection between financial agents and market.
- The Central Bank's tracking of financial stability is complementary to that undertaken by the specialized supervisory entities.
- Growing coordination among institutions:
 - Supervisors and Minister of Finance: Council of Financial Stability (CEF)
 - FSB: Assessment Group of Vulnerabilities (AGV)
 - IMF (FSAP)



Periodicity and structure

- FSR is published twice a year from 2004.I.
- Currently FSR has the following chapters:
 - I. External environment and financial risks
 - II. Local financial markets
 - III. Credit users
 - IV. Banking system
 - V. Financial regulation
 - VI. Payment systems (once a year)
- Also includes:
 - Executive summary
 - Boxes: 4 to 6 per issue.



Main contents: example of last FSR

I. External environment and financial risks

- Process of US monetary policy normalization and its impact on financial volatility.
- Slowdown in emerging economies and capital flows
- External liquidity and solvency indicators

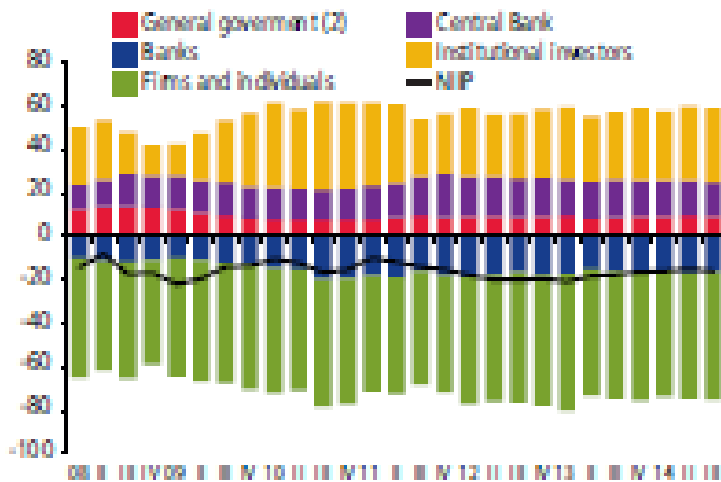
II. Local financial markets

- An increase in the cost of international funding and its impact on local long-term interest rates.
- Analysis of level and volatility of financial markets that are relevant for banks: money market and currency market
- Institutional investor's portfolio: PF, MF, ICo.



Main contents: example of last FSR

Net international investment position
(percent of GDP) (1)

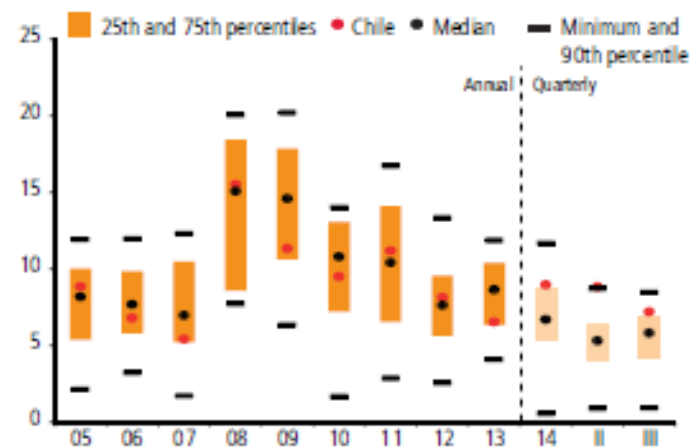


(1) GDP at a constant real exchange rate (fixed-base index September 2014 = 100).

(2) Central Government and municipalities.

Source: Central Bank of Chile.

Exchange rate volatility (*)
(annualized percent)



(*) Monthly average volatility calculated as the standard deviation in a 20-day moving window of the daily change in the exchange rate. Includes: Australia, Brazil, Canada, Chile, China, Colombia, Czech Rep., England, Eurozone, Hungary, India, Indonesia, Japan, South Korea, Malaysia, Mexico, New Zealand, Norway, Peru, Philippines, Poland, South Africa, Turkey and Vietnam.

Source: Central Bank of Chile, based on data from Bloomberg.



Main contents: example of last FSR

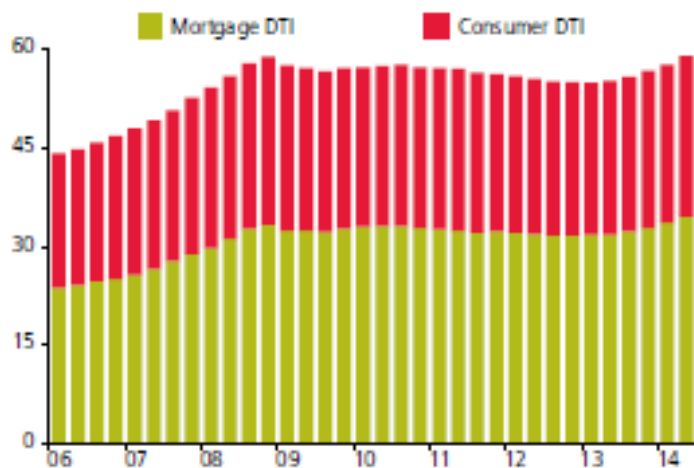
III. Credit users

- Financial position of the corporate sector: leverage, profitability, currency mismatch and non-performing indicators.
- Households: indebtedness, financial burden, impact of regulation on the ceiling interest rate, and delinquency rates.
- Real estate market: housing prices and sales, office supply and absorption, vacancy rate, credit standards (LTV, DTI).
- This chapter uses individual data (when is possible) and concentrates on sectors which banks have a significant exposure.



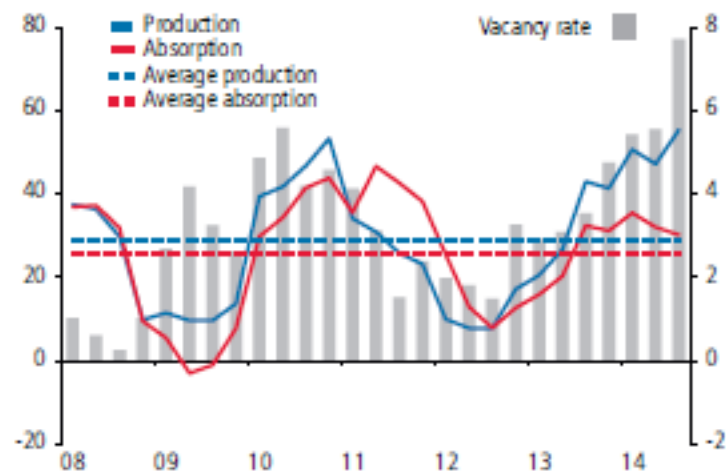
Main contents: example of last FSR

Household indebtedness
(percent of disposable income)



Source: Central Bank of Chile, based on data from SBIF, SuSeSo and SVS.

Class A/A+ offices market
(times, percentage)



Source: Central Bank of Chile, based on data from Global Property Solutions.



Main contents: example of last FSR

IV. Banking system

- Central part of the FSR: it summarizes the impact of risk factors from pervious chapters
 - External environment → external funding cost for banks
 - Domestic financial markets → domestic funding cost and market risk (asset prices)
 - Credit users → credit risk
- Financial indicators: loans dynamics, credit risk (delinquency rates, write-offs, provisions), profitability.
- Sources of financing: bond issuance, wholesale deposits
- Stress tests results on capital adequacy and profitability.

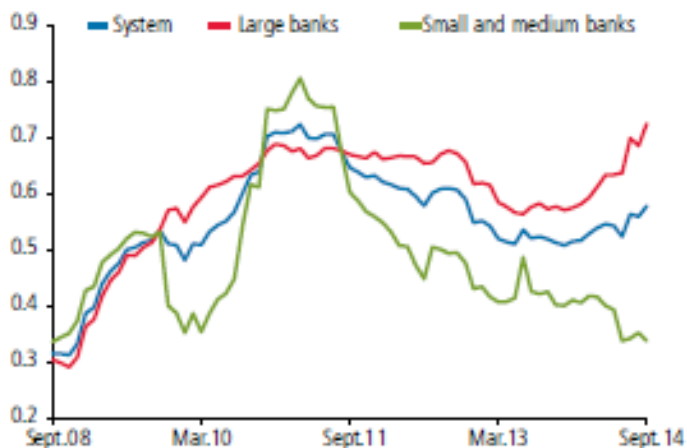
V. and VI. Financial regulation and Payment systems (once a year)

- Domestic and international regulations: for ex. Implementation of the Basel Committee standards
- Payment systems: large-value systems, retail payment system, and financial infrastructure.



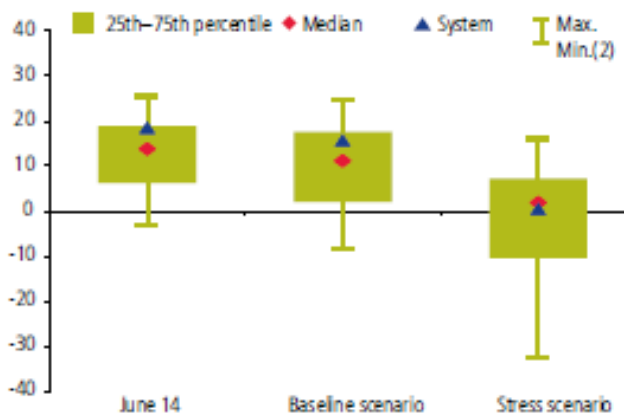
Main contents: example of last FSR

Commercial portfolio write-offs by bank size
(percent of loans, 12-month moving sum)



Source: Central Bank of Chile, based on data from SBIF.

Impact of different scenarios on ROE (1)
(earnings over core capital)



(1) Data weighted by the core capital of each institution.

(2) Minimums correspond to the 1st percentile.

Source: Central Bank of Chile, based on data from SBIF.



Main contents: example of last FSR

Boxes

- The Board decides 4 to 6 boxes for each FSR on the basis of a broader proposal.
- The aim of these boxes is to give a deeper analysis on selected issues.
- Last FSR's boxes were:
 - Global factors and the sovereign credit spread (EMBI)
 - Investment portfolio analysis of life insurance companies:
 - Currency mismatch in the nonfinancial corporate sector
 - Dynamics of the Loan-to-value ratio
 - Status of implementation of Basel III standards
 - Compliance with the principles for market infrastructures and cross-border derivatives transactions



The process

- The preparation time for the FSR is 3 months approx.
- Human resources: 20 people of the Financial Policy Division (FPD) working almost full-time. They are organized in 5 working groups, similar to the chapter structure.
- The FSR schedule involves the following steps:
 - Step 1: Internal meetings
 - Step 2: Presentations to the Board and division directors
 - Step 3: Draft for comments
 - Step 4: Board's approval
 - Step 5: Publication



Communication

- The FSR is presented to:
 - The Congress (Finance Commission) together with the Monetary Policy Report by the Governor.
 - Journalists (press conference) by the Governor and director.
 - Entrepreneurs by the Governor.
 - Bank Directors by the Governor (once a year).
 - Market analysts by the Director.
 - Financial Stability Council by the Director.
 - Real sector and financial analyst outside the Metropolitan Area by Board members.



Challenges and solutions



Main challenges

- Risk identification
 - Systemic risk culture
 - Risks not identified or identify unreal risks \Rightarrow CB loses credibility \Rightarrow no-role for FSR
- Robust analysis
 - Disaggregated dataset, methodologies, market information
 - Close work with prudential regulators (CEF)



Main challenges

- Internal coordination
 - Interaction between internal areas.
 - Since 2009, Chilean FSR and Monetary Policy Report's publication date is the same.
- External communication
 - Accurate, direct, simple, effective.
 - Audience segmentation: journalist, analyst, Congress, etc.
 - Transparency: Chile discloses underlying data of Figures and Tables, and the English version.



Learning in-situ

- We have hosted the following international regulators/supervisors that wanted to learn about Chilean experience:
 - Central Bank of Dominican Republic
 - Central Bank of Uruguay
 - Superintendence of banks Ecuador
- You´re welcome.



Financial Stability Reporting in Chile: Issues and Communication Channels

Carmen G. Silva
Financial Stability Area