ANNUAL REPORT 1986



BANCO CENTRAL DE CHILE

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1986



AUTHORITIES OF BANCO CENTRAL DE CHILE

As of December 31, 1986

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BANCO CENTRAL DE CHILE

SANTIAGO, APRIL 30, 1987

To
Guillermo Ramírez Vilardell
Superintendent of Banks
and Financial Institutions
Santiago

Pursuant to article 53 of the Organic Law of the Monetary Council and Central Bank of Chile, we are submitting herewith the Annual Report of this Institution for 1986.

ENRIQUE SEGUEL MOREL
President

JORGE AUGUSTO CORREA GATICA
General Manager

ALFONSO SERRANO SPOERER
Vice-President



I
REPORT

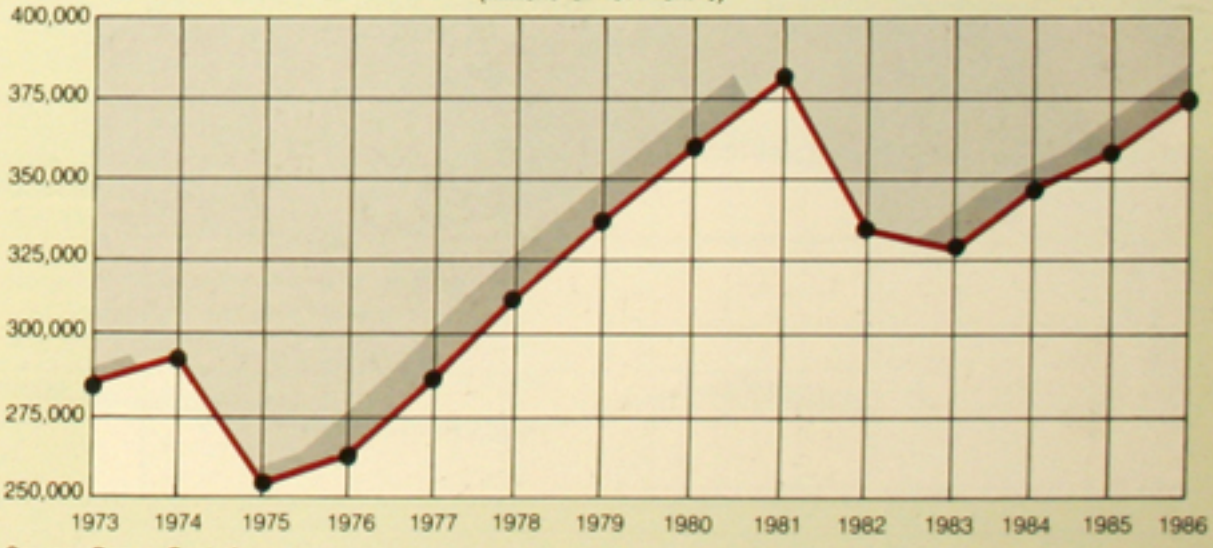
BEHAVIOR OF THE CHILEAN ECONOMY IN 1986

The performance of the main economic variables in 1986 shows that the behavior of the Chilean economy in that period was satisfactory. According to provisional estimates, gross domestic product grew at 5.7% per annum. The down trend in unemployment and inflation continued. External accounts performed more favorably than expected, while the adoption of an effective policy for normalizing and strengthening the financial system, together with fiscal policy tending to raise public sector contribution to domestic savings and a flexible monetary policy, led to significant reduction in real interest rates. The exchange policy ensured adequate international competitiveness for Chile. The fiscal policy aims to reduce the public sector deficit in accordance with programmed guidelines. Lastly, the reduction of medium– and long-term foreign debt may be traced, to a considerable extent, to the implementation in mid-1985 of novel mechanisms for converting foreign debt instruments. The behavior of main macroeconomic variables in 1986 is discussed in detail below.

Graph N° 1

GROSS DOMESTIC PRODUCT

(Millions of 1977 Ch. $)



Source: Banco Central

Production

From the latest available estimates, the Gross Domestic Product (GDP) would have grown in 1986 at an annual rate of 5.7%, considerably higher than the top level of the growth range programmed for the period (3%-5%). This means that the Chilean economy has now expanded for three years in succession; since the drop in activity observed in the 1982-83 period, growth averaged 4.8% yearly. The GDP level of 1986 is only slightly lower than in 1981, when the economy reached its peak point in the present decade.

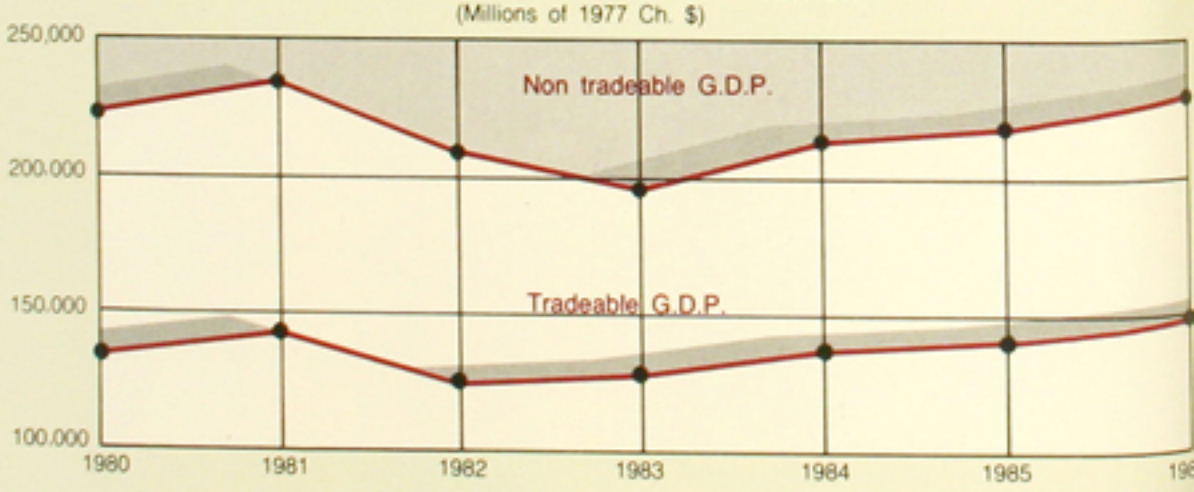
The 1986 reactivation, reflecting the results of the ongoing structural adjustment program, was headed by export and efficient import substitution operations. The sectors showing greatest expansion included Agriculture (8.7%) and Industry (8.0%), in addition to closely related sectors such as Transport and Communications (8.1%), and production of Electric Power, Gas, and Water (6.5%).

As stated above, many of the productive sectors equalled, even exceeded, the levels of 1981, highest in the previous expansive cycle. The 1986 levels of Agriculture, Fisheries, Mining, and Utilities were more than 10% higher than in 1981. The 1986 figure for Transport and Communications was 5% higher than in 1981. Industry and Miscellaneous Services, however, are still lower than in 1981, though their recent behavior points to full recovery of such levels by early 1987. Lastly, Construction and Commerce are more backward than the other sectors and although fairly dynamic in the last quarter of 1986, are likely to take longer to reach the high levels of 1981.

Graph N° 2

GROSS DOMESTIC PRODUCT COMPOSITION

(Millions of 1977 Ch. $)



Source: Banco Central

Labor

One of the most critical issues of the crisis that affected Chile in the period 1982-83 was unemployment; conversely, one of the salient features of the economic recovery of the past three years was the abrupt drop in unemployment figures. At its worst, in 1982, unemployment was as high as 19.6% nationwide, according to a survey conducted by Instituto Nacional de Estadísticas (INE). Since then, the rate of unemployment dropped steadily to 8.8% in the moving quarter ending in December 1986.

The reduction in unemployment is due primarily to increased job supply. According to the INE survey, jobs nationwide grew by 6.9% per annum between December 1983 and December 1986. This growth rate, higher even than GDP growth, eloquently reflects the structural adjustment of the economy and the flexibility and efficiency of prevailing labor legislation. The sectors contributing most to increase employment are those connected with exports and import substitution, such as Agriculture, Forestry, and Industry. It is worth noting that employment rose despite marked reduction in the number of persons in the emergency PEM and POJH programs.

The progress made in the field of employment required a degree of wage discipline in both public and private sectors. This was achieved thanks to an austere public wage policy and flexible labor legislation. In future, the imperative need to continue reducing unemployment and preserving a strong competitive position for domestic production will require keeping up moderate expectations of higher purchasing power for remunerations.



Graph N° 3



Source: Instituto Nacional de Estadísticas

Behavior of Inflation

The inflation rate for 1986, measured by variations in the Consumer Price Index, amounted to 17.4%, well within the range of 15-20% specified in the economic program for the year. In addition to the substantial contribution of economic policy to the significant drop in inflation in 1986, it should be recognized that the above favorable result was aided by the decrease in international oil prices. The rate of inflation observed in 1986 is the lowest in the past two decades, except for 1981, when inflation amounted to only 9.5%. Slowing the pace of inflation is an ongoing concern of Chilean economic policy, while the fact of facing adjustment followed by reactivation in a context of moderate and diminishing inflation, is undoubtedly a major achievement. The consolidation of advances made in this field and further progress along the same lines make up a most significant task that lies ahead for 1987 and subsequent years.



Graph N° 4

INFLATION RATE



Source: Instituto Nacional de Estadísticas

Balance of Payments

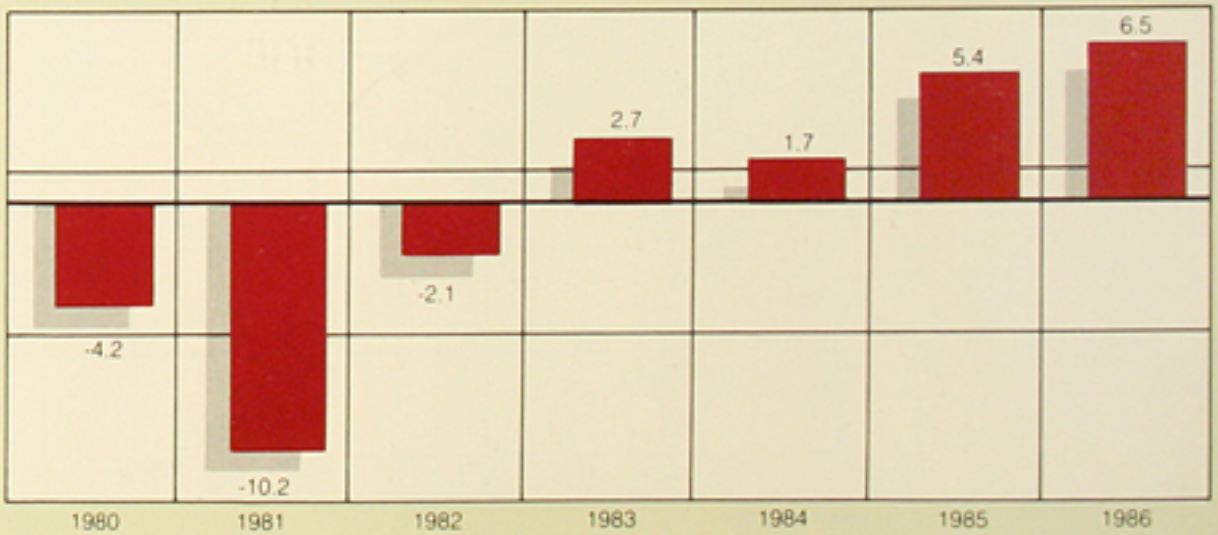
One major objective of the 1986 macroeconomic program was to keep up a current account deficit on the order of US$ 1.3 billion, with a trade balance surplus of about US$ 835 million. Preliminary estimates suggest that both goals were amply met. The trade balance surplus is estimated at US$ 1.1 billion, or 20% higher than planned. This is partly the result of export efforts by the public and the private sectors. Copper exports are estimated to have risen by 1.8% in 1986, while non-copper exports are estimated to have grown by 12.3% over 1985. The most notable contributions to this result were made by sawn lumber, raw pulp, fruit (particularly pears and apples) and iron ore pellets. The behavior of export prices was not the same for all items. The price of copper fell from 1985 levels to 62 US cents per pound, or 6 cents below schedule, whereas other export prices rose by 8.0%.

The value of total imports increased by 6.0% in 1986. This variation was favorably affected by the drastic 53% fall in the international price of crude petroleum, which was only partly offset by increased fuel volume owing to inventory replenishment and lower domestic production. The volume of other imports is estimated to have grown by about 6%, while the associated prices rose by about 4%, though behavior was different in each case.

Graph N° 5

TRADE BALANCE IN GOODS AND SERVICES

(As % over G.D.P.)



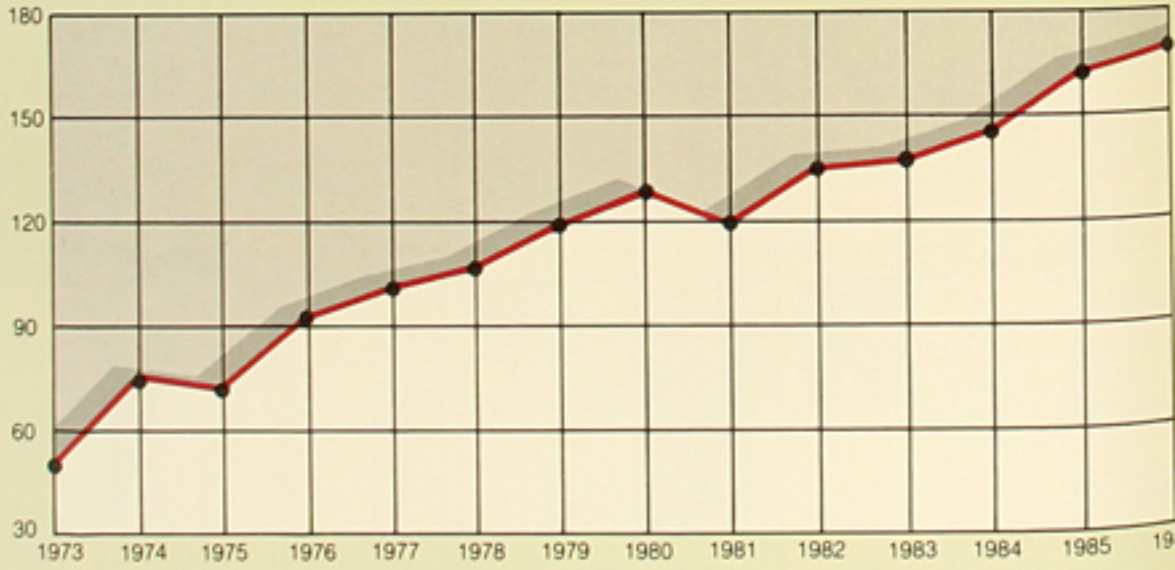
The trade balance behavior described above explains to some extent the improvement in the current account deficit of the balance of payments, to approximately US$ 1.2 billion. This result was also affected by the reduction in international interest rates, although the operation of the respective credit agreements will make the bulk of the benefit felt in the first quarter of 1987, and by the savings in interest payments derived from redeeming foreign debt instruments. The deficit was financed by direct foreign investment in the form of foreign currency, loans from multilateral institutions and supplier credits, drawings on financing agreed with international banking creditors and the World Bank during 1985, and repatriation of private sector funds.



Graph N° 6

EXPORT QUANTITY INDICES (FOB)

(1977 = 100)



Source: Banco Central

Exchange and Trade Policy

The exchange policy adressed to keeping up a real rate of exchange consistent with the objective of supporting a strong competitive position for domestic products, in both foreign and domestic markets, continued during 1986. This policy provides for daily devaluation of the reference rate of exchange, geared to the difference between domestic inflation in the previous month and international inflation relevant to Chile. The foregoing rule further establishes a margin equal to ± 2% in respect of the reference value, applicable to foreign currency transactions by Banco Central; this determines a limited float of the exchange rate observed in the market. In this policy framework, the average real rate of exchange increased by about 9% over the 1985 average. This result is explained by the abrupt fall of the US dollar in international markets.

In addition to keeping up the above exchange policy, the goal of export promotion and efficient import substitution is further aided by a free trade policy, which provides for a virtually uniform tariff of 20% –with temporary surcharges in instances of proved unfair competition– and contains no quantitative restrictions whatsoever. Export promotion basically comprises mechanisms for expeditious reimbursement of tariffs and taxes, with a view to neutralizing certain export disincentives, and support from ProChile.



The Foreign Debt Policy

The high figures of foreign debt in Latin American countries undeniably check these countries' development. Indeed, debt service requires transferring abroad considerable amounts of funds, limits normal access to additional foreign financing, and, because of official credit negotiations, arouses uncertainty as to the country's ability to face its balance of payment requirements. Chile has therefore adopted a realistic debt policy, which allows it to meet its obligations without sacrificing the prospects of sustained development based on export promotion and efficient import substitution. This decision led, first of all, to drawing up a macroeconomic program –in the framework of negotiations with the IMF and World Bank– consistent with sustained product growth, satisfaction of certain levels of consumption, and necessary increase of investment in production. Next, financing was obtained from banking and official creditors, in addition to the flow of foreign currency from foreign investment, supplier and other credit, to help finance the balance of payments.

In this context, mention should be made of the successful operation of mechanisms for converting foreign debt into foreign investment of domestic debt instrument. As of December 31, 1986, the reductions from the various mechanisms available since mid-1985 amounted to US$ 1.4 billion, of which US$ 968.5 million pertained to operations performed in 1986. The establishment of these foreign debt conversion mechanisms arose in response to growing interest shown by both domestic and foreign investors, in taking part in the relatively developed market for such paper, which is currently transacted at a discount of close to 30%.

The potential benefits for Chile to be derived from these operations include reduction or slower growth of foreign debt; operation of a fairly simple technique for capital remittances; incentive to foreign investment; and, lastly, a means to aid the financial restructuring of domestic debtors.

Finally, reference should be made to the favorable foreign debt renegotiation agreements for the 1987-88 period reached by the Chilean authorities and the Banking Advisory Committee for Chile, which represents Chile's creditor banks. The main agreements reached include retiming interest payments from semi-annual to annual, starting on January 1, 1988, which will mean an estimated saving of US$ 447 million in interest in 1988; secondly, reductions in interest rates applicable to the foreign debt, with an estimated saving of US$ 63 million in the period 1987-88, and US$ 606 million for the duration of the loans involved; thirdly, credit restructuring for US$ 12.5 billion, meaning that all credits and all new money agreements negotiated after 1983 will not mature until 1991; lastly, the availability of short-term trade-related facilities for a minimum of US$ 1.7 billion was extended until the end of 1989. Chile has thus obtained necessary financing for the 1987-88 macroeconomic program without increasing debt levels. It is therefore possible to look forward to a sustained increase in production and employment, together with gradual reduction of foreign obligations.

Monetary Policy and Interest Rates

The substantial reduction experienced by interest rates in 1986 was one of the year's characteristic features and continued the trend that began in 1985. In particular, the rate of interest on 90 –to 365– day indexed loans fell from 8.87% in December 1985 to 6.61% twelve months later. The equivalent borrowing rate dropped from 6.20% to 3.47% in the same period. Furthermore, as a result of weaker expectations of inflation, nominal interest rates followed a similar pattern.

The moderate interest rates prevailing in the course of 1986, though positive in real terms and competitive in international terms, are unprecedented since 1975, when all prevailing interest rate controls were lifted. This recent solution of the critical problem posed by high cost of credit, which characterized the decade 1975-84, shows that a free capitals market is in fact capable of generating rates of interest compatible with debtors' payment capability. This, however, requires careful handling of exchange, fiscal, and monetary policies. It should be pointed out, moreover, that the behavior of real interest rates is to a considerable extent the result of growing confidence in the stability of such policies.

Moderation in exchange rate expectations, fiscal adjustment as described above, plus application of a monetary policy geared to transient changes in liquidity conditions prevailing in the credit market, have indeed allowed the rates of interest to operate in a balanced range.

Traditional monetary aggregates increased significantly in 1986. Such is the case of money circulation and private money. Following an abrupt fall in 1984 and a slight recovery in 1985, the real increase between December 1985 and December 1986 was about 17.3% for money in circulation and 22.7% for M1, letting these aggregates reach levels comparable to those of mid-1984. The behavior of monetary aggregates as described above is fully compatible with recovery of productive activity, reduction of real interest rates, and substantial lowering of inflation expectations. Regarding broader monetary aggregates, the increases of 1986 are slightly less than those of 1985; in real terms, 6.2% for M2 and 14.3% for M7. A major factor responsible for such increase is the behavior of pension funds, which currently account for about 27% of total financial savings, with an estimated real increase of 26% in the present year.

Fiscal Policy

Management of the public sector budget has aimed to enhance the state's contribution to the task of raising capital formation and domestic savings. Public savings, defined as the current account surplus in the consolidated budget of the non-financial public sector, grew by 21% in real terms, from 3.8% of GDP in 1985 to 4.4% of GDP in 1986. Public investment, in turn, is estimated to have increased by 15% in real terms in the same period, from 7% to 7.6% of GDP. In the same context, the public sector deficit is estimated to have fallen to 2.2% in 1986. This fiscal adjustment is consistent with that applied to external accounts and allows releasing funds to the private sector, thus relieving the pressure on interest rates in the domestic market.

Fiscal adjustment has been achieved without losing sight of the objectives of increasing public investment and savings. The former has been growing steadily and is currently at its highest level in the past ten years. As for the latter, it is worth noting that growth is this case has taken place in a context of depressed fiscal revenues owing to the drop in international copper and oil prices, with adverse effects on the two major public concerns. Furthermore, the increase in public savings has not been offset by significant tax hikes, in keeping with the ongoing tax reform, which is designed to encourage individual as well as corporate savings. One exception in the matter of taxes was the fuel tax amendment introduced in April 1986, with a view to buffering the effect on the treasury of violent swings in world oil prices.

Fiscal efforts have thus focused on slowing down current expenditure, perfecting tax control (tax collection increased by 4% in real terms during the year), and improving management of public concerns; the latter, in spite of the unfavorable behavior of international copper and oil prices, have kept up a contribution of about 4% to public savings.

The slowing down of current expenditure has been conducted without affecting the upkeep of a significant effort in social spending.

Lastly, significant progress was made this year in the task of privatizing and spreading the ownership of concerns up to now directly or indirectly under government control. In the past two years the number of stockholders in the main productive industries increased by about 14,000 individuals; by about 20,000 in larger banks, and by 14,134 in Pension Funds. This process, in which workers in the businesses concerned have participated actively, is intended to strengthen and spread out the right to property. On the other hand, the sale of packages of shares in State-owned concerns has made it possible to undertake major investment projects that would otherwise have been limited by the objective restrictions affecting the public sector. Furthermore, the funds obtained from such sales help to increase public investment in areas of high economic and social priority.

SUMMARY

In 1986 the Chilean economy experienced substantial recovery in production and employment, inflation was kept at a moderate and declining rate, and solid progress was made in consolidating the balance of payments position. These are the results of a coherent and realistic macroeconomic program. The tasks ahead for 1987 and subsequent years may be summarized as follows: one, to make sure that improvement in the domestic economic environment materializes in accelerated expansion of exports and gross capital formation, preventing unwarranted expectations from drawing off funds towards non-essential consumption and/or speculation; and two, to consolidate and intensify structural adjustment of the size and composition of the public sector, with a view to maximizing its contribution to savings and investment as well as adapting it to the needs of a dynamic private economy.



TABLE 1

RATES OF GROWTH OF GROSS DOMESTIC PRODUCT BY SECTOR

(Rate of real annual variation)

SECTOR / YEAR	1980	1981	1982	1983	1984	1985	1986 (*)
Agriculture	3.6	2.7	–2.1	–3.6	7.1	5.6	8.7
Fisheries	7.5	18.1	9.4	8.8	11.5	5.6	10.0
Mining	5.2	7.7	5.7	–1.9	4.4	2.2	1.5
Industry	6.2	2.6	–21.0	3.1	9.8	1.2	8.0
Electricity-Gas-Water	5.0	2.1	0.1	4.3	7.0	3.5	6.5
Construction	23.9	21.1	–23.8	–5.0	4.2	16.1	1.3
Commerce	12.4	4.3	–17.3	–3.5	5.0	1.7	5.5
Transport and Communications	11.1	1.8	–11.8	–1.6	6.0	5.5	8.1
Other 1/	5.3	6.5	–15.0	–0.1	5.4	0.0	4.7
TOTAL	7.8	5.5	–14.1	–0.7	6.3	2.4	5.7

1/ Includes financial services, personal services, housing ownership, civil service, import taxes, and banking service associated costs.
(*) Estimated.

Source: National Accounts, Banco Central de Chile.

TABLE 2

EMPLOYMENT AND UNEMPLOYMENT

Total Country

YEAR	LABOR FORCE		EMPLOYED				UNEMPLOYMENT RATE
			FISCAL PROGRAMS		BALANCE		
	Thousand persons	% Variation previous year	Thousand persons	% Variation previous year	Thousand persons	% Variation previous year	(% unemployed rate labor force)
1980 1/	3,635.5	4.5	207.2	36.1	3,049.9	7.0	10.4
1981 1/	3,688.0	1.4	171.4	–17.3	3,099.5	1.6	11.3
1982 2/	3,660.7	–0.7	385.8	125.1	2,557.3	–17.5	19.6
1983 1/	3,767.7	2.9	500.1	29.6	2,715.7	6.2	14.6
1984 1/	3,890.7	3.3	363.3	–27.4	2,986.1	10.0	14.0
1985 1/	4,018.7	3.3	283.1	–22.1	3,254.3	9.0	11.9
1986 1/	4,270.0	6.3	192.6	–32.0	3,703.1	13.8	8.8

1/ Moving quarters ending in December.
2/ Two-month period October-November.

Source: Instituto Nacional de Estadísticas.

TABLE 3

GENERAL INDEX OF SALARIES AND WAGES

(Base 1982 = 100)

YEAR	NOMINAL		REAL 1/	
	Level 2/	% Variation previous year	Level 2/	% Variation previous year
1980	70.0	47.0	92.0	8.9
1981	91.2	30.3	101.8	10.5
1982	100.0	9.6	100.0	–1.8
1983	113.7	13.7	89.3	–10.7
1984	136.4	20.0	89.4	0.1
1985	170.6	25.1	85.6	–4.3
1986	208.1	22.0	87.4	2.1

1/ Deflated by CPI variation.
2/ Monthly average.

Source: Instituto Nacional de Estadísticas.

TABLE 4

CONSUMER PRICE INDEX (CPI) AND WHOLESALE PRICE INDEX (WPI)

PERIOD	CPI		WPI	
	Index (1978 = 100)	Variation same month previous year	Index (1974 = 100)	Variation same month previous year
Dec. 1980	182.29	31.2	5,973.90	28.1
Dec. 1981	199.68	9.5	5,739.54	–3.9
Dec. 1982	241.08	20.7	8,011.72	39.6
Dec. 1983	296.75	23.1	10,029.65	25.2
Dec. 1984	365.12	23.0	13,685.64	36.5
Dec. 1985	461.57	26.4	17,825.57	30.3
Dec. 1986	541.68	17.4	21,077.17	18.2

Source: Instituto Nacional de Estadísticas.



TABLE 5

NOMINAL AND REAL RATE OF EXCHANGE

PERIOD	NOMINAL 1/		REAL 2/	
	$/US$	Variation same month previous year	Index (1978 = 100)	Variation same month previous year
Dec. 1980	39.00	0.0	81.87	–14.1
Dec. 1981	39.00	0.0	73.35	–10.6
Dec. 1982	72.40	85.6	107.97	47.2
Dec. 1983	87.07	20.3	103.78	–3.9
Dec. 1984	126.23	45.0	120.33	15.9
Dec. 1985	182.48	44.6	144.19	19.8
Dec. 1986	203.67	11.6	145.32	0.8

1/ Average observed rate of exchange.
2/ Actual real rate of exchange measuring the weighted average of relevant international price indexes relevant to Chilean foreign trade, in pesos, in relation to domestic CPI. Wholesale price indexes of Chile's major trading partners are used, converted by the exchange rates of the respective countries, weighted by the fraction of Chilean imports from those countries.

Source: Banco Central de Chile.



TABLE 6

BALANCE OF PAYMENTS

(Million US$)

SPECIFICATION	1980	1981	1982	1983	1984 1/	1985 1/	1986 1/
I. CURRENT ACCOUNT	–1,971	–4,733	–2,304	–1,117	–2,060	–1,329	–1,091
1. Trade Balance	–764	–2,677	63	986	293	849	1,100
Exports	4,705	3,836	3,706	3,831	3,650	3,804	4,199
– Copper	2,125	1,738	1.685	1,875	1,604	1,789	1,757
– Other	2,580	2,098	2,021	1,956	2,046	2,015	2,442
Imports	–5,469	–6,513	–3,643	–2,845	–3,357	–2,955	–3,099
2. Non-financial Serv.	–390	–701	–555	–452	–434	–338	–388
3. Financial Services	–930	–1,463	–1,921	–1,748	–2,018	–1,901 5/	–1,887
4. Transfers	113	108	109	97	99	61	84
II. CAPITAL ACCOUNT 2/	3,215	4,800	939	476	1,897	1,385	1,188
1. Foreign Inv. 6/	170	362	384	132	67	112	319
2. Amortizations 3/ 7/	–1,438	–1,819	–1,259	–895	–488	–625	–719
3. Disbursements medium –and long– – term credit	3,541	5,090	2,609	1,934	1,620	1,471	1.219
Foreign bank credit 4/	(–)	(–)	(–)	(1,300)	(780)	(714)	(370)
– Other	(3,541)	(5,090)	(2,609)	(634)	(840)	(757)	(849)
4. Other 7/	942	1,167	–795	–695	698	427	369
III. BALANCE OF PAYMENTS BALANCE (I + II) 8/	1,244	67	–1,365	–641	–163	56	97

1/ Provisional figures.
2/ Excludes variation of Banco Central short-term debt and includes "errors" and "omissions".
3/ Total amortizations, net of refinancing.
4/ "New Money" from the foreign banking community. In 1986, includes IBRD cofinancing.
5/ Net of saving on interest paid, owing to retiming in 1985 of interest payments on restructured debt.
6/ Includes capitalization of credit and, as from 1985, investment with foreign debt notes (Chap. XIX).
7/ Includes operations under Chap. XVIII in 1985 only.
8/ These figures include Central Bank short term indebtedness

TABLE 7

GROSS FOREIGN DEBT 1/

(million US$)

SPECIFICATION	1980	1981	1982	1983	1984	1985	1986 2/
I. TOTAL FOREIGN DEBT (II + III)	11,084	15,542	17,153	17,431	18,877	19,318	19,342
Public Sector 3/	5,063	5,465	6,660	8,394	12,343	13,725	14,334
Private Sector	6,021	10,077	10,493	9,037	6,534	5,593	5,008
II. MEDIUM –AND LONG–TERM FOREIGN DEBT	9,413	12,553	13,815	14,832	16,963	17,650	17,768
Public Sector 3/	4,720	4,415	5,157	6,689	10,601	12,161	12,949
Private Sector	4,693	8,138	8,658	8,143	6,362	5,489	4,819
III. SHORT-TERM FOREIGN DEBT	1,671	2,989	3,338	2,599	1,914	1,668	1,574
Public Sector 3/	343	1,050	1,503	1,705	1,742	1,564	1,385
Private Sector	1,328	1,939	1,835	894	172	104	189

1/ Balances as of December 31 of each year, referred to net utilizations. Excludes debt to IMF and direct trade-related debt associated with foreign trade (collections from and credits to, exporters).

2/ Estimated.

3/ Includes private sector with public guaranty





TABLE 8

PRIVATE MONETARY AGGREGATES

(Average in million $ of 1977) 1/

DATE	C		M1		M2		M7	
	Amount	% Variation year (*)	Amount	% Variation year (*)	Amount	% Variation year (*)	Amount	% Variation year (*)
Dec. 1980	10,421	15.0	24,290	21.4	69,998	(–)	90,933	(–)
Dec. 1981	11,474	10.1	24,093	–0.8	89,852	40.4	124,050	36.4
Dec. 1982	8,926	–22.2	18,150	–24.7	77,493	–13.8	117,311	–5.4
Dec. 1983	9,176	2.8	18,701	3.0	56,926	–26.5	113,099	–3.6
Dec. 1984	8,746	–4.7	16,348	–12.6	60,780	6.8	120,710	6.7
Dec. 1985	8,926	2.1	16.596	1.5	66.397	9.2	143.690	19.0
Dec. 1986 2/	10,470	17.3	20,363	22.7	70,514	6.2	164,238	14.3

(–) Not available.
1/ Deflated by official CPI.
2/ Provisional figures
(*) Variation December-December.

Ratios: C = Money in circulation.
M1 = C + Private sector current accounts.
M2 = M1 + Time deposits.
M7 = M2 + call and time savings + Banco Central paper + Treasury notes + Credit bills + Private sector deposits in foreign currency.

TABLE 9

RATES OF INTEREST (%)

Banking System Average

PERIOD	NON-INDEXABLE SHORT-TERM RATES 1/				INDEXABLE 90-365 DAYS	
	BORROWING 30-89 DAYS		LOANS 30-89 DAYS		SHORT-TERM RATES 3/	
	Nominal	Real 2/	Nominal	Real 2/	Borrowing	Loans
1980 (December)	2.98	1.06	3.38	1.45	6.33	13.28
1981 (December)	3.28	2.77	4.22	3.70	7.36	15.95
1982 (December)	4.59	3.35	5.47	4.22	5.90	10.36
1983 (December)	1.82	1.21	2.60	1.99	6.06	8.20
1984 (December)	2.90	1.48	4.16	2.72	14.68	10.43
1985 (December)	1.91	0.60	2.33	1.01	6.20	8.87
1986 (December)	1.61	0.11	2.03	0.52	3.47	6.63

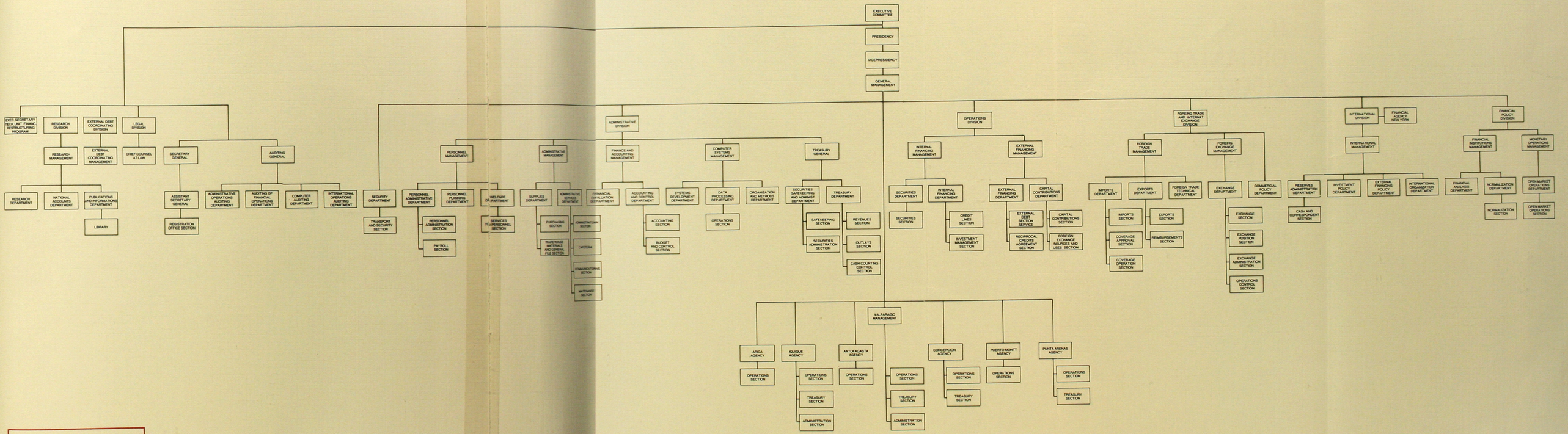
1/ Weighted average monthly rate on operations in the month.
2/ Nominal rate deflated by CPI variation in the month.
3/ Weighted average annual rate on operations in the month.



II
ORGANIZATION CHART

BANCO CENTRAL DE CHILE

As of
December
31, 1986



SUMMARY OF HEAD POSITIONS		
EXECUTIVE COMMITTEE	:	3
DIRECTORS	:	10
MANAGEMENTS	:	18
CHIEFS OF DEPARTMENTS	:	37
AGENTS	:	6
CHIEFS OF SECTION	:	51
TOTAL	:	125

PLACES : 1.184

III
BALANCE SHEET

BANCO CENTRAL DE CHILE

As of
December
31, 1986

BALANCE SHEET

AS OF DECEMBER 31, 1986

(in millions of Chilean pesos)

Chilean Currency and F/C equiv.
(US$ 1 = $ 201.46)
(Gold $ 1 = $ 441.33)

(A free translation from the original in Spanish prepared in accordance with the norms and instructions of the Chilean Superintendency of Banks and Financial Institutions)

ASSETS

ASSETS OVERSEAS		817,172.2
ASSET RESERVE	771,560.1	
Gold and foreign currencies	267,579.5	
Special drawing rights holdings	187.4	
IMF subscription	108,284.0	
Bonds, certificates of deposit and others	340,577.8	
Mutual loan agreements	54,843.5	
Others	87.9	
OTHER ASSETS	45,612.1	
Contributions made to other international organizations	37,118.6	
Interest receivable	4,317.9	
Others	4,175.6	
DOMESTIC ASSETS		2,469,359.4
DOMESTIC LOANS	2,404,628.9	
Fiscal loans	250,931.2	
Loans to public entities	135,519.8	
Loans to Banco del Estado	235,561.7	
Loans to commercial banks	1,504,388.4	
Loans to other institutions	278,227.8	
OTHER DOMESTIC ASSETS	64,730.5	
OTHER ASSET ACCOUNTS		1,821,226.7
TOTAL ASSETS		5,107,758.3

LIABILITIES AND SHAREHOLDERS' EQUITY

OVERSEAS LIABILITIES		1,429,069.4
RESERVE LIABILITIES	413,291.4	
IMF loans	267,515.6	
Mutual credit agreements	37,491.5	
IMF deposits	108,284.3	
OTHER OVERSEAS LIABILITIES	985,806.8	
Loans and other liabilities	891,758.7	
Accounts with other international organizations	58,517.4	
Interest payable	35,530.7	
ALLOCATION OF SPECIAL DRAWING RIGHTS	29,971.2	
DOMESTIC LIABILITIES		2,588,482.9
ISSUES OF:	145,914.7	
Notes and coins in circulation	130,384.0	
Financial institutions' deposits	15,530.7	
OTHER DEPOSITS AND COMMITMENTS	934,572.6	
Deposits and commitments with the Treasury	120,505.4	
Others	814,067.2	
NOTES ISSUED BY BANCO CENTRAL DE CHILE	1,434,989.9	
OTHER DOMESTIC LIABILITIES	73,005.7	
OTHER LIABILITY ACCOUNTS		856,452.3
SHAREHOLDERS' EQUITY		233,398.4
Capital	50.0	
Fluctuation reserve	184,594.2	
Contingency reserve	48,754.2	
SURPLUS FOR THE YEAR		355.3
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY		5,107,758.3

STATEMENT OF INCOME

for the year ended December 31, 1986

(in millions of Chilean pesos)

	PARTIAL	TOTAL
OPERATING RESULTS		
OPERATING INCOME		
Interest earned	145,229.6	
Restatement gains on loans	470,370.5	
Commissions earned	0.1	
Profit on sale of assets	20,540.9	
Profit on exchange	93,341.6	
Other income	10,061.0	
Total operating income		739,543.7
OPERATING EXPENSES		
Interest expense	304,741.8	
Restatement losses on loans	134,840.9	
Commission expense	2,180.9	
Loss on sale of assets	25,119.8	
Loss on exchange	276,211.4	
Other expenses	26,577.7	
Total operating expenses		(769,672.5)
GROSS OPERATING LOSS		(30,128.8)
OTHER EXPENSES		
Personnel expenses	2,491.6	
Administrative expenses	1,404.4	
Depreciation, amortization and write-offs	331.3	
Taxes	685.2	
Total other expenses		(4,912.5)
Operating results		(35,041.3)
Write-offs and provisions for possible loan losses		(65,884.6)
NET OPERATING LOSS		(100,925.9)
NON OPERATING RESULTS		
Non Operating Income	134,481.7	
Non Operating Expenses	(6.6)	
Total of non operating results		134,475.1
Income before price-level restatements		33,549.2
PRICE LEVEL RESTATEMENTS (loss)		(33,193.9)
NET INCOME FOR THE YEAR		355.3

The accompanying notes 1 to 17 are an integral part of these financial statements.

NOTES TO THE FINANCIAL STATEMENTS

1. Summary of Significant Accounting Policies:

(a) Principles applied:

The financial statements as of December 31, 1986 have been prepared in accordance with generally accepted accounting principles, with the norms and instructions of the Superintendencia de Bancos e Instituciones Financieras (the Superintendency), and with the provisions of the statutes of the Banco Central de Chile (Decree Law 1,078). The norms and instructions of the above mentioned Superintendency are in agreement with generally accepted accounting principles except for provisions for possible loan losses.

(b) Exchange rates:

Assets and liabilities in foreign currencies have been translated into Chilean pesos at the year-end exchange rates set by the Superintendency.
In accordance with the Superintendency's regulations, those assets and liabilities expressed in minted Chilean gold coins are valued on the basis of the average London morning quotation of the "Gold Fixing" rate (U.S. dollars per ounce troy) for all business days in the preceding quarter, less 10%. Likewise, foreign currency was converted at the agreed dollar rate (Ch$ 201.46 per US$ 1), stated in the Compendium of International Exchange Norms in its Chapter I, N° 7, which is the same as that reported by the Superintendency. The exchange rate used in the prior year represented the average exchange rate used for the transactions carried out on the last day of operations, that is, the day before the closing date.

The main rates used at year-end are as follows:

	$
Minted Chilean gold coins	441.330
U.S. dollar	201.460
Pound sterling	293.673
Deutsche mark	102.576
Special drawing rights (SDR)	245.819

(c) Loans receivable and payable:

Non readjustable loans are shown at their original value or at their latest renewal value, with the exception of commercial instruments and discounted notes which are expressed at their maturity value. Readjustable loans are shown with their corresponding accrued restatements at the balance sheet date, and loans expressed in foreign currency include their respective exchange adjustments.

Accrued interest on loans receivable and payable at the balance sheet date is shown for residents abroad under Other Overseas Assets and Other Overseas Liabilities, respectively. Operations concerning domestic residents are included under Other Domestic Assets and Other Domestic Liabilities.

Prepaid interest on borrowings is included under Other Asset Accounts. Interest received in advance on loans is included under Other Liability Accounts.

(d) Past due loans receivable:

These are shown under Other Assets and include all those loans receivable which are overdue for more than 90 days from their maturity date. Foreign loans are translated into Chilean pesos at the rate of exchange prevailing at the Balance Sheet date. Interest receivable on these loans and restatements, if applicable, were accounted for up to their maturity dates.

(e) Financial investments:

Overseas financial investments are shown under Asset Reserve as bonds, certificates of deposits and others, and include mainly government, overseas institutions and bank bonds and commercial instruments valued at their investment cost. Interest receivable is shown under Other Overseas Assets.

(f) Property, premises, and equipment:

These are shown under Other Asset Accounts and are stated at cost plus price-level restatements, net of accumulated depreciation. Depreciation has been computed by the straight-line method over the estimated useful lives of the assets, see Note 3.

(g) Employees severance compensation:

A provision for accrued severance compensation payable by the Bank as an acquired right of its staff for past services, in case of retirement or dismissal, has been set-up each year based on the present value of the accrued cost, discounted at an 8% annual interest rate. This amounts to $ 305.6 million at December 31, 1986 and is included under Other Liability Accounts.

(h) Provision for possible loan losses:

Pursuant to Resolution N° 1,775, dated December 30, 1986, of the Bank's Executive Committee, the Bank has set up a provision for overdue loans and doubtful debts. These provisions are included under Other Liability Accounts, and the charge to income is detailed in Note 9.

(i) Inter American Development Bank (IDB) shares and contributions, and International Monetary Fund (IMF) contributions:

Shares and contributions made by the Chilean Treasury to the Inter American Development Bank and contributions to the International Monetary Fund are carried at acquisition costs, and contributions at restatement value, when applicable.

IDB shares and contributions are shown under Other Assets Overseas, as Contributions made to other International Organizations.

Contributions to the IMF in domestic and foreign currencies are shown under Asset Reserve Overseas as an IMF susbscription. Shares and contributions made to the IDB and contributions to the IMF are considered investments, pursuant to Decree Law 2,943, of November 8, 1979.

(j) Gold and foreign currency reserves:

In accordance with article 41 of the Bank's statutes (Decree Law 1.078), a mandatory cash reserve must be kept either in gold, foreign currency, or both.

Gold and foreign currencies shown under Asset Reserve include 210.7 million of Chilean gold pesos which correspond to the mandatory gold reserve.

(k) Revenue and expense accounts:

Revenues and expenses are accounted for on an accrual basis. Revenue and expense accounts, expressed in domestic currency, with the exception of depreciation, represent accumulations of amounts registered at the date the transactions were performed.

(l) Price-level restatements:

In order to show the effect of price-level changes on the financial position and results of operations, and in accordance with the Superintendency's regulations, nonmonetary assets, liabilities and equity have been adjusted to changes in the consumer price index during the year. The net result of price-level restatements is shown in the Statement of Income (see Note 8). Likewise, exchange differences in assets and liabilities expressed in foreign currencies, and restatement of loans, are included under operating results.

2. Financial Statements Presentation Policies:

The balance sheet presentation approved by the Superintendency follows an economic-accounting pattern which aims to show the institution's accounting and financial position, at the same time assisting the economic analyses of the Bank's operations by clearly distinguishing whether they are performed by domestic or overseas agents. In this manner the Bank's participation in the domestic supply of monetary assets and credit policy may be assessed together with their effect over the Bank's gearing position abroad. The economic concepts of international reserves and issues are thus shown as Assets and Liabilities, under Asset Reserve and Issues, respectively.

3. Property, Premises, and Equipment:

These assets at December 31, 1986 were composed as follows:

In millions of Chilean pesos

	Prior value (net) Dec. 31, 85	Net changes during 1986	Resta-tements	1986 depre-ciation	Net book value Dec. 31, 86
Real estate	3,009.4	94.7	609.2	(179.0)	3,534.3
Furniture and fixtures	468.9	166.4	126.7	(135.4)	626.6
Vehicles	36.3	32.7	13.8	(17.0)	65.8
Works of art	91.0	12.9	15.6	–.–	119.5
Medals and collection of notes and coins	59.8	(0.3)	11.4	–.–	70.9
Total	3,665.4	306.4	776.7	(331.4)	4,417.1

4. Domestic Assets:

Domestic assets comprise the following:

(a) Domestic loans:

This caption includes mainly credit lines in respect of renegotiation of debts amounting to Ch$ 526,657.0 million; credit lines in respect of deposits under agreement N° 1.686 for Ch$ 477,812.3 millions; and portfolio purchased with obligation to resell under Agreement 1.555 for an amount of Ch$ 390,505.7 million.

(b) Other domestic assets:

Correspond to interest and commissions receivable on domestic assets amounting to $ 64,730.5 million.

5. Other Asset Accounts:

Other asset accounts mainly include: tangible fixed assets amounting to $ 4,417.1 million; purchase of U.S. dollars with obligation to resell for $ 414,281.0 million; overdue loans for $ 25,047.5 million; loan portfolios acquired from financial institutions for $ 225,431.6 million; Treasury notes for $ 1.144,298.1 million; and interest paid in advance on sale of readjustable promissory notes of the Banco Central for Ch$ 4,154.6 million.

6. Domestic Liabilities:

The following are included under this caption:

(a) Other deposits and commitments:

The caption "Others" includes the following: mandatory deposits on foreign credits for $ 874.7 million; public sector time deposits for $ 112,095.0 million; Agreement N° 1,470 deposits (peso current accounts expressed in U.S. dollars) for $ 8,735.1 million; differential in exchange payable for $ 12,758.6 million; Banco del Estado de Chile deposits for $ 78,597.4 million; foreign currency accounts for $ 6,105.8 million; outstanding balance on promissory notes acquired from Banco del Estado for $ 35,943.9 million; deposits on import operations for advance sales of foreign currencies for $ 13,402.7 million; short-term loans for $ 6,533.3 million; and Agreements N° 1,657 and 1,686 deposits in foreign currency for $ 529,627.4 million.

(b) Notes issued by Banco Central de Chile:

Includes mainly promissory notes for renegotiation of debts for $ 357,383.2 million; non-transferable deposit certificate stated in U.S. dollars as per Agreement 1,649 for $ 244,867.8 million; readjustable promissory notes issued by Banco Central for $ 140,972.9 million; promissory notes on purchase of portfolio under Agreement 1,555 for $ 117,593.9 million; promissory notes stated in U.S. dollars for $ 142,874.5 million; and promissory notes in respect of exchange differential for $ 167,713.7 million.

7. Other Liability Accounts:

These include mainly provisions for $ 176,426.0 million; funds for reimbursement of reciprocal credit agreements for $ 11,412.8 million; foreign currency to be sold for purchase of U.S. dollars amounting to $ 441,031.4 million; and bills of exchange for purchase of portfolios from financial institutions for $ 225,431.6 million.

8. Price-level Restatements:

The price-level restatements as indicated in Note 1 (1) resulted in a net charge to income of $ 33,193.9 million, as follows:

	In millions of Chilean pesos	
	Debits	Credits
Shareholders' equity	34,120.0	
Property, premises, and equipment		776.7
Other assets		149.4
Net effect on the results for the year		33,193.9
Total	34,120.0	34,120.0

The change in the consumer price index applied for the year amounted to 17.1%

9. Provision for Possible Loan Losses:

Write-offs and provisions for possible loan losses during the year are summarized as follows:

	(In millions of) Chilean pesos) $
Balance brought forward 1-1-86	119,356.4
Write-off against provisions	(616.1)
Specific provisions for the year	65,891.9
Recovery of prior years' provisions	(7.3)
Write-off against prior years' provisions	(8,504.5)
Balance at 12-31-86	176,120.4

The charge to income of the year arising from provisions set up amounting to $ 65,884.6 million is included under Depreciation, Write-offs, and Provisions in the Statement of Income, net of recovery of prior years' provisions.

10. Shareholders' Equity:

Increases and decreases in equity during 1986 are summarized as follows:

(In millions of Chilean pesos)

	Capital $	Reserve for contingencies $	Fluctuation reserve $	Restatement of equity reserve $	Surplus $	Totals $
Balance at January 1, 1986	50.0	41,589.0	157,639.4	–.–	2,896.5	202,174.9
Distribution of 1985 surplus and repayment of loans to Treasury	–.–	–.–	–.–	–.–	(2,896.5)	(2,896.5)
Price-level restatement of shareholders' equity	–.–	–.–	–.–	34,120.0	–.–	34,120.0
Distribution of restatement of shareholders' equity reserve	–.–	7,165.2	26,954.8	(34,120.0)	–.–	–.–
Surplus for the year	–.–	–.–	–.–	–.–	355.3	355.3
Balance at December 31, 1986	50.0	48,754.2	184,594.2	–.–	355.3	233,753.7

11. Income Taxes:

Pursuant to Decree Law N° 3,345 of April 24, 1980, Banco Central de Chile is exempt from income taxes.

12. Preferential U.S. Dollars:

Resolutions N°s. 1,466, 1,484 and 1,556 of the Bank's Executive Committee, provided that certain commitments in foreign currencies or stipulated to be restated in foreign currency before August 6, 1982 may be repayed at a preferential exchange rate, the Banco Central bearing the difference between this exchange rate and the prevailing rate at the dates of repayment.

On June 27, 1985 the Executive Committee replaced Resolutions N°s. 1,466, 1,484 and 1,556 by Resolution N° 1,657 and established a new system dealing with preferential rates of exchange for commitments amounting to or exceeding US$ 50,000 contained in Chapter XIII of "Compendio de Normas de Cambios Internacionales". For debts of up to US$ 50,000 the amount payable by the Bank will be the difference between the exchange rate prevailing on the settlement date and the equivalent of 0.0399 U.F. in Chilean pesos on the same date.

In respect of debts exceeding US$ 50,000 the amount payable by the Bank will be the difference between the exchange rate prevailing on the settlement date and a variable factor which at June 30, 1985 was 0.39908 and which will be reduced by 0.0007256 daily until it reaches zero value by December 31, 1986.

The preferential exchange rate is recognized on an accrual basis, the cost for this concept during the year amounted to $ 58,406.1 million.

13. Portfolio Acquired from Financial Institutions:

Pursuant to Agreement N° 1,555 of the Executive Committee and its corresponding amendments, Banco Central de Chile purchased portfolio from financial institutions by issuing special agreements whereby those institutions have committed themselves to repurchase the portfolio. The amount to be repurchased annually will depend on the recuperability of the portfolio sold and on the financial institutions' yearly surplus.

Considering that so far the financial institutions have met their obligations to repurchase the portfolio, allocating their surpluses for this purpose, and assuming that this situation will be maintained in the coming years, the Bank has not deemed it necessary to set up a provision for this purpose.

The amount recorded by the financial institutions as a portfolio with obligation to repurchase is affected by the change experimented by the Unidad de Fomento, plus a surcharge of 5% on the portfolio which was paid for in cash.

14. Treasury Funds Transferred to Banco Central de Chile:

Pursuant to the updated text of Law N° 18,358 of November 19, 1984, the Treasury transferred to Banco Central de Chile during the current year, 41 million of "Unidades de Fomento" (restated domestic currency to account for the changes in the consumer price index), by issuing Treasury promissory notes with a 28 year maturity term. The amount transferred has been recorded as an extraordinary item and is shown under Other Income, while the Treasury promissory notes are included under Other Asset Accounts.

15. Balances in Foreign Currencies and Gold:

	(Amounts expressed in millions of US$
ASSETS	
ASSETS OVERSEAS	3,483.0
Reserve	3,404.2
Other assets overseas	78.8
DOMESTIC ASSETS	1,891.0
Domestic loans	1,873.4
Other domestic loans	17.6
OTHER ASSET ACCOUNTS	15.5
Total assets	5,389.5
LIABILITIES	
OVERSEAS LIABILITIES	4,976.0
Reserve	186.1
Other overseas liabilities	4,641.1
SDR allocations	148.8
DOMESTIC LIABILITIES	7,755.8
Other deposits and commitments	4,390.8
Notes issued by Banco Central de Chile	3,347.0
Other domestic liabilities	18.0
OTHER LIABILITY ACCOUNTS	(7,342.3)
Total liabilities	5,389.5

16. Contingencies, Commitments and Obligations:

(a) Memorandum Accounts:
The following are outstanding at December 31, 1986.

	$ Million
Treasury operations	8,168.3
Domestic loan operations	297.2
Exchange operations and overseas loan operations	7.4
Safekeeping and securities in guarantee operations	395,772.7
Total	404,245.6

(b) Input V.A.T. on gold purchased through agents:
A request to the Internal Revenue Service has been presented regarding input V.A.T. claimed on gold purchased through agents. The amount disputed is for Th 594.4 U.T.M. There are good reasons to believe that the outcome of this dispute will be favorable.

17. Surplus for the Year:

In accordance with the Bank's statutes, the Executive Committee agreed to allocate the surplus for the year, once the provisions and write-offs agreed by them have been covered, as follows:

To create reserves to cover the risk of portfolio and exchange operations or of any other event, they will be equivalent to a percentage to be agreed by the Executive Committee.

Any remaining surplus will be allocated to pay off outstanding debts owed by the Treasury to the Bank.

Mr. Jorge Correa Gatica
General Manager

Mr. Francisco García Letelier
Finance Accounting Manager

Mr. Vicente Montan Ugarte
General Auditor

INDEPENDENT AUDITORS' REPORT

To the President and
Members of the Executive Committee of
the Banco Central de Chile

We have examined the balance sheet of the Banco Central de Chile as of December 31, 1986 and the related statement of income for the year then ended. Our examination was made in accordance with generally accepted auditing standards and, accordingly, included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

As described in Note 1 (a) to the financial statements, the Banco Central de Chile prepares and presents its financial statements in accordance with accounting norms and instructions established by the Superintendencia de Bancos e Instituciones Financieras (a government supervisory agency).

In our opinion, the financial statements referred to above have been prepared in accordance with the accounting norms and instructions established by the Superintendencia de Bancos e Instituciones Financieras and the provisions of its statutes, as described in the notes to the financial statements.

Vivian Clarke L.

LANGTON CLARKE
COOPERS & LYBRAND

Santiago, Chile
January 16, 1987