BANCO CENTRAL DE CHILE

ANNUAL REPORT 1985



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REPORT
PUBLISHED BY THE
STATISTICAL INFORMATION AND
PUBLICATIONS DEPARTMENT
CENTRAL BANK OF CHILE

ISSN 0716-2901

60th ANNUAL REPORT

SUBMITTED
TO THE SUPERINTENDENCY
OF BANKS AND FINANCIAL
INSTITUTIONS
1985

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As of December 31, 1985

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BANCO CENTRAL DE CHILE

Santiago, June 30, 1986

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 1985.

ENRIQUE SEGUEL MOREL
President

JORGE AUGUSTO CORREA GATICA
General Manager

ALFONSO SERRANO SPOERER
Vice-President

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I
REPORT

Introduction

This Annual Report contains the General Balance, the Financial Statements, the Organization Chart of Banco Central de Chile, and an examination of the financial and economic performance of the country.

Concerning the Balance Sheet and Financial Statements, their presentation is framed within an economic and accounting scheme. This allows not only to know the accounting and financial position of the Institution, but also to evaluate its significance in economic affairs, thus providing an adequate outlook of the role performed by Banco Central de Chile in the period under discussion.

Chilean Economy Evolution during 1985

A. INTRODUCTION

The problems recently faced by the Chilean economy are basically due to the marked and persistent deterioration suffered by the purchasing power of its exports observed during the last ten years. In fact, the terms of trade of Chile –according to ECLA calculations– have experienced the following evolution, taking as a basis a value index equal to 100 for the 1965-1974 period.

1965-1974	:	100
1975-1984	:	51
1985	:	41

The answer of the economic policy in view of this situation has been a wide program of structural adjustment which, in spite of the sacrifices it involves, assures the upturn of the Chilean economy. A similar process was experienced since 1975, when the terms of trade suffered a first and meaningful unfavourable change. Thus, in the 1975-1980 period, exports were promoted by means of a realistic exchange policy and a loosening of the foreign trade, the fiscal deficit was eliminated by restraining the public spending, and regulating and privatizing the government-owned companies; the private sector was furthered through market freeing, tax burden reduction and flexibility of labour legislation; at the same time, inflation was opposed by a considerate and stable monetary policy. The private sector reacted fast and efficiently in front of the incentives of the economic program: the economic activity raised swiftly –G.D.P. grew at an annual average rate of 7.5%, between 1976 and 1980– promoted by non copper exports, which grew in the period at an annual rate of 18%. Inflation gradually decreased from 340% in 1975 to 31% in 1980, and the balance of payments showed a steady surplus, allowing between 1975 and 1980 a reduction of 23% in the net external debt, in real terms.

Towards 1980-1981, the adjustment effort lost intensity in the presence of an abundant supply of external credits very favourable in terms of interest rates. Between 1980 and 1982, the macroeconomic policy allowed an important flow of external credits to the private sector, which financed an important increase in the residential and productive investment, as well as in the per capita consumption, with the subse-

quent growth in real wages. As a counterpart of it, internal savings decreased and exports showed less dynamism.

The external setting suffered a new unfavourable change since 1981. On the one hand, the terms of trade, from their already low 1980 level began a new and speedy fall which has continued during 1985. On the other hand, the external debt cost increased abruptly in 1981 and since then has gradually decreased, while private credit supply to Latin America ceased almost completely. Chilean economy, facing an additional fall in its exports prices and not able to obtain the required external funding, had then to initiate a severe process of adjustment, which has inevitably imposed heavy sacrifices to the population. During 1985, the Government has carried on a program of structural reform that gathers experiences accumulated since 1975 and that, step by step, is giving solution to the severe problems produced by the 1982-1983 crisis, while establishing the foundation of a growth under austerity.

B. CHILEAN ECONOMY DURING 1985

The economic program under application may be synthesized in four great tasks: to conquer the export markets, to drive national effort towards savings and investment to reduce unemployment, and to strengthen a competitive and efficient system of private enterprise, total and sectorial policies applied during the year being inserted, within one or more of the already mentioned tasks.

The performance of the economy during 1985, is examined below with an emphasis on aspects related to the progress of the economic program above stated.

B.1. Productive activity

During 1985, gross domestic product growth rate suffered a deceleration with respect to the previous year. In fact, according to the last available estimates, G.D.P. grew by 2.4%, which rate is compared with an originally programmed range of 2% to 4% and with an estimated rate of 6.3% for 1984. The lower growth is mainly explained by the additional fall of the terms of trade that took place in 1985, what made the country lose an income of about US$ 300 million; this represents 1.9% of G.D.P., approximately.

However, the fact that in 1985 Chilean economy was able to avoid a recession and obtained a moderate growth is remarkable, considering the severe adjustment carried out in its external accounts –a decrease of US$ 720 million in the current account deficit of the balance of payments, as will be shown further on– and in the presence of the already mentioned fall of terms of trade.

On closing the second year since the beginning of the upturn, G.D.P. has grown at an annual rate of 4.3% during the 1984-1985 period. The structural adjustment under way has meant that sectors producing goods (agriculture, fishing, mining, and construction and industry) have grown at an annual rate of 5.8%, within the period, while sectors producing services have increased at an average annual rate of only 3.3%. Such behaviour fully agrees with a growth strategy based on exports and on the effective substitution of imports, supported by the maintenance of a proper real rate of exchange.

As a consequence of the 1984-1985 growth, domestic economy has raised a good deal from the fall experienced in the 1982-1983 period. In fact, the sectors of agriculture, fishing, mining and public utilities already show production levels significatively higher than those of 1981, peak year of the previous expansive cycle.

The manufacturing activity –influenced by the subsectors producing consumer durables, transport and construction material– still shows an inferior level to that of 1981, but sectors manufacturing ordinary consumer goods and intermediate products for the industry have already overcome the marks recorded prior to the crisis. In turn, construction, trade, and miscellaneous services still show the effects of the recession.

B.2. **Labour situation**

The increase in the unemployment rate is a consequence of the past economic recession. In fact, in the 1982 most critical moments unemployment was about 20% of the labour force, while the emergency programs of employment –Minimum Employment Program (PEM) and Employment Program for Heads of Households (POJH)– reached less than 9% of what is observed in the labour force. Therefore, it should be mentioned that as a result of the upturn observed in the economic activity, an important increase in employment has taken place, which is reflected in an unemployment rate that according to the results of the survey carried out by the National Bureau of

Statistics (INE) was of 11.9% in December, 1985 –while government programs represented 7% of the labour force.

The improvement experienced by the employment situation comes mainly from the employment growth suffered by the productive sectors –an annual average of about 10%– during 24 months ended in December, 1985. Such growth rate, which largely exceeds the G.D.P. increase, has been translated into the creation of six hundred and eleven thousand new productive and stable employments. On the other hand, the Government has made changes to PEM and POJH so as not to obstruct the labour force job rotation from these programs to more productive employments. This policy, although it prevents that the productive employment growth be reflected in a sharp fall of the unemployment rate, at last it definitively facilitates unemployment absorption, releasing at the same time fiscal resources assigned to other social purposes.

It should be mentioned that the more dynamic sectors within the employment growth are those dedicated to exports and to the effective substitution of imports, besides construction, which activity has been promoted by the public investment in the area.

Employment growth reflects that the strategy of structural adjustment under application offers an effective and lasting solution to that urgent social and economic problem which is unemployment.

Naturally, the progress achieved in the employment field would have not been possible if there were not a flexible and modern labour legislation in force, which has made possible that remunerations be quickly adapted to the present conditions. In fact, given that the deterioration of the Chilean export prices has reduced the value of the productivity of our labour force, real wages have dropped, thus making possible the already mentioned employment recovery. This has taken place in a relatively paralell way in all productive sectors and employment categories, including public and private sectors, those who bargain collectively and those who do it individually. In fact, a similar phenomenon –with even higher dimensions in some countries– has been observed all over Latin America.

The Government has tried to ease the most critical consequences of the adjustment, giving the lowest remunerations adjustments similar to the inflation. The remunerations of the public sector have been recently adjusted according to the expected

inflation, which reflects the authority's estimation in the sense that real remunerations have struck bottom and should soon begin a gradual recovery.

B.3. Inflation behaviour

The moderate price level growth rate has been one of the most noticeable achievements of the economic policy during the last years. In fact, while an important part of the continent lives a violent inflationary explosion, Chilean economy –in spite of having devaluated the Chilean peso more than 360%, in nominal terms, since about the middle of 1982 up to date– has shown since then annual rates of inflation of only 20% to 25%.

During 1985 inflation reached a 26.4% rate, being affected by the acceleration in price growth that took place during the first semester of the year due to the late effects of the rises in the exchange rate at the end of the year 1984. Thus, while during the first semester the monthly average inflation rate was of 36.8% annual equivalent, during the second semester this reached 16.8% annual equivalent.

B.4. Balance of Payments

The 1985 macroeconomic program had as one of its main objectives the sharp reduction in the balance of payments current account deficit from US$ 2,060 million in 1984 to US$ 1,380 million in 1985, in order to reduce the Chilean economic dependence with respect to the external credit. Such goal has been fully achieved, reaching an estimated current account deficit of US$ 1,307 million for the present year.

The components of the current account have changed, although differently to what was programmed. Trade balance –according to preliminary estimates– registered a surplus of US$ 788,0 million, which figure, though more than twice higher than the one of 1984, is lower than the programmed one. This difference is wholly explained by the aforementioned fall in export prices, especially in the non copper minerals, forestry products, and fishmeal. Such behaviour has shadowed the important achievement of having increased in 1985 the output of the main non copper exports in an estimated 13% with regard to 1984. However, non traditional exports increased considerably over the average of our exports. This is how shipments –having the 10%

during the second semester of 1985– represented around US$ 150 million as an average during the 1983-1984 period; in 1985 represented US$ 209 million, approximately. On the other hand, copper exports and imports have developed –approximately– as programmed, the latter registering an estimated fall that reached 12% with respect to the year 1984.

The reduction observed in the deficit of the balance of services, which was favoured by the lower imports of non financial services, the indemnity income corresponding to reinsurances of goods being damaged by the earthquake of March 3, an external interest rate reduction, and the change in the schedule of interest payments of some credits, agreed in the negotiations with the international banking. This reduction was of a great help in the achievement of the current account adjustment.

B.5. External debt renegotiation

The elaboration of the macroeconomic program previously demanded to engage with the international financial community the necessary credits to settle the needs of the country. Within this process –which started in March with the amounts to be asked for and finished at the end of the year with the inflow of the first installments– the following was obtained: the 12 year term refunding with 6 years of grace of a total of US$ 5,900 million of amortization due for payment during the 1985-1987 period; the extension of the availability of commercial credit service for an amount of US$ 1,700 million till 1987, and new credits and other fundings for an amount equivalent to US$ 1,955 million, which amount is enough to settle the 1985 and 1986 balance of payments.

The credit amounts and terms obtained are favourable. In the negotiations, the option of granting the State guaranteee to the re-scheduled debt of the private financial system, was established engaging –as a counterpart– the payment of a commission on behalf of the National Treasury by the secured creditors and debtors.

During the external debt negotiations, Chile was actively supported by the International Monetary Fund, the World Bank, and certain governmental credit agencies. An Extended Credit Agreement of SDR 750 million is in force with the IMF for the 1985-1987 period. Such agreement is based on a medium term macroeconomic program which gathers the external debt goals of growth and dependence reduction already

mentioned, translating them into a set of objectives and goals. The World Bank participates with US$ 300 million in a cofunding and guarantee program with the foreign banking, in addition to a structural adjustment loan (SAL) for US$ 250 million, which backs up a long term program consistent with the national goals in this respect and which is also traslated into a set of specific agreements. Finally, certain agencies of foreign governments facilitated the debt service re-scheduling of their loans services maturing in 1985 and 1986.

B.6. **Fiscal policy**

The management of the public sector budget has been directed to fulfill the public savings and investment goals designed in the economic program. It has been translated into a reduction of the public sector deficit consolidated from 4.2% of G.D.P. in 1984 to around 3% in 1985. This fiscal adjustment is in agreement with the one carried out in the external account, and it has allowed to free resources to the private sector, thus reducing the pressure upon the interest rate in the domestic market.

The public sector consolidated savings changes from 0.6% of G.D.P. in 1984 to 3.4% in 1985. This significant increase of savings has been achieved thanks to an austere fiscal program that reduces tax evasion, and organizes and moderates recurrent expenditures. In fact, the General Government's recurrent expenditures decreased, as a percentage of G.D.P. from 30.7% in 1984 to 29.8% in 1985. The restraint of expenditures has been concentrated on the purchase of consumer goods and services, which has been reduced by a real 5%, and it has been facilitated by the financial and administrative decentralization process of the State. It should be noted that the fiscal expenditure programs directed to the extreme poverty, have been kept unchanged. On the other hand, tax receipts have been affected by two important modifications: tax reform and tariff reduction. Both measures –one rewarding the reinvestment of the enterprise profits and people's savings, and the other favouring exports– are important factors in the above stated structural adjustment.

As it has been pointed out, the public sector investment experienced an important growth, from 6.4% of G.D.P. in 1984 to 7.1% in 1985, that is to say 15% of real growth. From the total amount of investments –which amounts to the equivalent of US$ 1,139 million– 55% corresponded to projects of the public enterprises, while the remaining 45% was mainly assigned to housing and public works.

In the 1985 public investment –and also in the next years– the imperative effort of reconstruction motivated by the earthquake of March 3, 1985, is being reflected. Damages have been estimated in the equivalent to US$ 1,000 million. The public sector is efficiently contributing so as to repair and replace damages assets, the private sector contribution to this effort has been a very significant one.

Thus, fiscal policy has been oriented towards two simultaneous objectives. First, the evolution of expenditure is consistent with the Government's purpose to gradually reduce the relative size of the public sector. Second, an important change in the structure of expenditure has been carried out. The restraint on recurrent expenditures has had as a counterpart the increase in public savings, which finances a higher investment as well as it allows the fiscal deficit to decrease gradually.

B.7. Monetary policy and interest rates

The 1985 macroeconomic program intended to achieve –through a monetary policy considering the liquidity needs of the market– an important discount in the interest rates, consistent with the forecast fiscal and exchange policies. The interest rate for short term indexed deposits –which represents a free rate, agreed in real terms– decreased from 14% in December 1984, to something more than 6% twelve months later. The average rate of the long term instruments traded at the Stock Exchange decreased in like period from a value of 11.2% to 7.7%, approximately. Real lending rates followed a similar trend too. After long periods of high and fluctuating interest rates, their stable and decreasing trajectory is a noticeable achievement.

Monetary policy management was carried out through open market operations and medium term credit lines of a non preferential character. The handling of the monetary policy has acquired higher flexibility as credit subsidy programs have been reduced, such as the preferential dollar and dollar sale mechanism under repurchase agreement.

Monetary aggregates have had a disimilar evolution. Private money –which includes currency and demand deposits– showed a growth lower than expected, apparently affected by a reduction in its demand.

The widest definition of money showed, in turn, important increases in real terms. Within said growth, pension funds associated to the new previsional system are a determining element, which grew by 35% in real terms along the year, reaching 24% of

total financial assets (M_7). The presence of these and other institutional investors is a factor of dynamism and stability in the domestic capital market.

C. SYNTHESIS

During 1985, the economic policy was focused on the task of keeping the recovery process of the activity level began towards the end of 1983, and at the same time of achieving an important adjustment in its external accounts, this being expressed in a significant reduction of the current account deficit of the balance of payments. To obtain the above mentioned goals meant a challenge to the extent that the contraction of the external expenditure level required by the external account adjustment could negatively affect the level of activity. In addition, the work of the economic policy was impaired by the new fall of the terms of trade occurring during 1985, what according to ECLA's preliminary estimates reached 4%.

Given the complexity of the goals and the unfavourable context in which the economic policy had to evolve, the results obtained are actually an important achievement. In fact, the attainment of a growth of the product, together with a significant reduction in the current account deficit, all this accompanied by a moderate price growth has allowed to carry out a structural adjustment of the Chilean economy within a frame of growth and stability.

The consolidation of a significant stage of the structural adjustment the economic policy had intended is shown not only in the management of the external account but also especially in the creation of a favourable frame for the development of the export and import substitution sectors, as well as in an incentive for savings and investment factors, determining the possibilities of sustaining a growth process in the medium term. Given the objectives, there is no doubt that the results achieved during 1985 are an important step within the economic policy applied. Thus, having already made a substantial adjustment in the internal expenditure level, the future work should be basically concentrated in the development of favourable conditions to increase savings and investment, in order to maintain a stable growth process which may gradually allow an important rise in the standard of living of the population, especially of the poorest sectors.

D. STATISTICAL ANNEX

TABLE N^{O} 1

GDP GROWTH RATES PER SECTOR
(Annual real rate of variation)

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

1/ Includes financial services, personal services, housing ownership, public administration, tax on imports and imputed costs of banking services.

(*) Estimates.

SOURCE: National Accounts, Banco Central de Chile.

TABLE N^{O} 2

EMPLOYMENT AND UNEMPLOYMENT
Total Country

YEAR	LABOUR FORCE		EMPLOYED				UNEMPLOYMENT RATE
			Fiscal Programs		Rest		
	Thousands of persons	% variation previous year	Thousands of persons	% variation previous year	Thousands of persons	% variation previous year	(% over labour force)
1980 1/	3,635.5	4.5	207.2	36.1	2,935.6	1.5	13.6
1981 1/	3,688.0	1.4	171.4	−17.3	3,073.5	4.7	12.0
1982 2/	3,660.7	−0.7	315.8	84.2	2,628.1	−14.5	19.6
1983 1/	3,687.6	0.7	500.1	58.4	2,649.4	0.8	14.6
1984 1/	3,798.4	3.0	363.3	−27.4	2,904.7	9.6	14.0
1985 1/	4,018.7	5.8	283.1	−22.1	3,254.3	12.0	12.0

1/ Three-month moving monthly averages ended in December.
2/ Bimester corresponding to the October-November period.

SOURCE: National Bureau of Statistics.

TABLE N^{O} 3

GENERAL INDEX OF REMUNERATIONS
(Base 1982 = 100)

YEAR	NOMINAL		REAL 2/	
	Level	% Variation Previous Year	Level	% Variation Previous Year
1980	70.0	47.0	92.0	8.7
1981	91.2	30.3	100.2	8.9
1982	100.0	9.6	100.0	−0.2
1983	113.7	13.7	89.3	−10.7
1984	136.5	20.1	89.5	0.2
1985 1/	170.8	25.1	85.4	−4.6

1/ Includes the January-September period.
2/ Deflated by the Consumer Price Index variation.

SOURCE: National Bureau of Statistics.

TABLE Nº 4

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

DATE	CPI		WPI	
	Index (1978 = 100)	Variation with respect to like month of the previous year	Index (1974 = 100)	Variation with respect to like month of the previous year
December 1980	182.29	31.2	5,973.90	28.1
December 1981	199.68	9.5	5,739.54	–3.9
December 1982	241.08	20.7	8,011.72	39.6
December 1983	296.75	23.1	10,029.65	25.2
December 1984	365.12	23.0	13,685.64	36.5
December 1985	461.57	26.4	17,825.60	30.3

SOURCE: National Bureau of Statistics.

TABLE Nº 5

NOMINAL AND REAL EXCHANGE RATE

YEAR	NOMINAL 1/		REAL 2/	
	Ch. $/US$	% variation with respect to like month of the previous year	Index (1978 = 100)	% variation with respect to like month of the previous year
1980	39.00	0.0	81.99	–14.0
1981	39.00	0.0	73.32	–10.6
1982	72.40	85.6	108.03	47.3
1983	87.07	20.3	103.86	–3.9
1984	126.23	45.0	120.42	15.9
1985	182.48	44.6	141.10	17.2

1/ Data as at December of each year for the average exchange rate observed.

2/ Real effective exchange rate, which measures the weighted average of the price indexes relevant to our foreign trade with respect to domestic CPI. Wholesale Price Indexes of the main trading partners of the country are used, translated through the rates of exchange of the respective countries, weighted by the fraction of Chilean imports proceeding from such countries.

TABLE Nº 6

BALANCE OF PAYMENTS
(Millions of US$)

SPECIFICATION	1980	1981	1982	1983 1/	1984 1/	1985 2/
I. CURRENT ACCOUNT	**–1,971**	**–4,733**	**–2,304**	**–1,073**	**–2,060**	**–1,307**
1. Trade Balance	–764	–2,677	63	1,009	293	788
Exports	4,705	3,836	3,706	3,827	3,650	3,743
Copper	2,125	1,738	1,685	1,871	1,604	1,770
Other	2,580	2,098	2,021	1,956	2,046	1,973
Imports	–5,469	–6,513	–3,643	–2,818	–3,357	–2,955
2. Non Financial Services	–390	–701	–555	–471	–497	–255
3. Financial Services	–930	–1,463	–1,921	–1,703	–1,955	–1,901
4. Transfers	113	108	109	92	99	61
II. CAPITAL ACCOUNT 3/	**3,215**	**4,800**	**939**	**432**	**1,897**	**1,364**
1. Foreign Investment	170	362	384	148	67	112
2. Amortizations 4/	–1,438	–1,819	–1,259	–683	–488	–625
3. Disbursements, Long and Medium Term Credits	3,541	5,090	2,609	1,946	1,620	1,471
External Banking Credit 5/	(–)	(–)	(–)	(1,300)	(780)	(714)
Other	(3,541)	(5,090)	(2,609)	(646)	(840)	(757)
4. Other	942	1,167	–795	–979	698	406
III. BALANCE OF PAYMENTS BALANCE (I + II)	**1,244**	**67**	**–1,365**	**–641**	**–163**	**57**

1/ Provisional figures.
2/ Estimates.
3/ Excludes Banco Central's short term variation and includes the entry "errors" and "omissions".
4/ Total amortizations, net of refunding.
5/ "New Money" from the foreign banking.

TABLE Nº 7

GROSS EXTERNAL DEBT 1/
(Millions of US$)

SPECIFICATION	1980	1981	1982	1983	1984	1985 2/
I. TOTAL EXTERNAL DEBT (II + III)	**11,084**	**15,542**	**17,153**	**17,431**	**18,877**	**19,757**
Public Sector	5,063	5,465	6,660	8,394	12,343	13,823
Private Sector	6,021	10,077	10,493	9,037	6,534	5,934
II. LONG AND MEDIUM TERM EXTERNAL DEBT	**9,413**	**12,553**	**13,815**	**14,832**	**16,963**	**18,089**
Public Sector	4,720	4,415	5,157	6,689	10,601	12,259
Private Sector	4,693	8,138	8,658	8,143	6,362	5,830
III. SHORT TERM EXTERNAL DEBT	**1,671**	**2,989**	**3,338**	**2,599**	**1,914**	**1,668**
Public Sector	343	1,050	1,503	1,705	1,742	1,564
Private Sector	1,328	1,939	1,835	894	172	104

1/ Balances as of December 31 of each year, referred to net applications.
2/ Estimates.

TABLE N° 8

MONETARY AGGREGATES
(Monthly averages in thousands of millions of Ch. $)

DATE	M_1		M_2		M_7	
	Amount	Year % variation (*)	Amount	Year % variation (*)	Amount	Year % variation (*)
December 1980	75.94	59.4	200.09	53.9	284.30	(–)
December 1981	82.51	8.7	307.72	53.8	424.84	49.4
December 1982	75.05	–9.0	320.42	4.1	485.06	14.2
December 1983	95.18	26.8	289.73	–9.6	575.63	18.7
December 1984	102.37	7.6	380.62	31.4	755.91	31.3
December 1985	131.38	28.3	525.63	38.1	1,134.48	50.1

RELATIONS
C = Currency.
M_1 = C + Private Sector Current Accounts.
M_2 = M_1 + Time Deposits.
M_7 = M_2 + At Sight and Time Savings + Central Bank Instruments + Treasury Promissory Notes + Credit Instruments + Private Sector Deposits in Foreign Currency.

(–) Not available.
(*) December to December % variation.

TABLE N° 9

INTEREST RATES (%)
Average of the Banking System

DATE	NON-INDEXED SHORT TERM RATES				INTEREST RATES INDEXED	
	Deposits at 30-89 days		Loans at 30-89 days		At 90-365 days	
	Nominal 1/	Real 2/	Nominal 1/	Real 2/	Deposits	Loans 1/
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)	1.92	0.62	2.34	1.04	6.22	8.87

1/ The above mentioned rates correspond to the weighted average rate of all the operations carried out during the month.
2/ Correspond to the nominal rate deflated by the Consumer Price Index variation of the month.

Administrative Issues

During the year, the organic structure of the Institution suffered several modifications reflecting a reassignment of its functions among the different managements, due to the more active role the Banco Central is performing as a supporting and revitalizing element of the National Financial System.

In this respect, the creation of the Managements of External and Internal Financing should be mentioned, these replaced the Management of Financial Administration considering the higher importance acquired by the supervision and control of foreign currency operations, and management of credit lines granted to banking institutions.

On the other hand, and as an acknowledgement of the growing importance of informatics within the different activities performed by the Bank, the Management of Systems was created, a unit which is for the computer assisted systems development and the elaboration of administrative procedures. At present, there are two very large computer configurations with 143 terminals, 31 printing terminals, 5 high speed printers, and a data communication system permitting the connection with the main branches along the country. This significant investment has allowed to give an effective support to foreign trade, international exchange, finance and accounting, international and financing, among other areas, thus optimizing the operating management of the units involved.

Finally, the agreements achieved with the World Bank implied the formation of the Technical Unit of Financial Rescheduling, whose Executive Secretariat is in charge of the revision and analysis submitted by enterprises applying for credits to be financed with resources of the Financial Rescheduling Program of the Private Sector, in coordination with the participant banks.

The permanent concern shown by the Bank's authorities regarding the evolution of the A.F.P. Security Self-Keeping System (Administradoras de Fondos de Pensiones = Pension Fund Associations), should also be mentioned. The sharp growth experienced by Pension Funds and Cash Position has meant that, as of December 31, 1985, 448 thousand financial instruments for a total value amounting to Ch $ 262 thousand million were kept in custody, representing an increase of 28% in the number of securities deposited with respect to the previous year.

Some of the measures taken reflecting the above mentioned concern are the following: the elaboration –together with the different Superintendencies and General Treasury– of regulations related to the issuance of species valued by agreed common criteria intending to avoid forgery and/or adulteration of securities, strengthen provisions on security, cash balances, and audits, make the service to A.F.P.'s more expeditious, and a statistical system that should permit having a complete and suitable vision about securities deposited.

Nevertheless, in view of expected future growth of Pension Funds, the impostponable need to carry out deep changes in the medium term system incorporating the alternatives the computer technology offers in the intermediation of financial instruments, gathering the experience of other countries and of the national reality itself, is foreseen.

Publications

Banco Central de Chile's information policy continued during 1985 with traditional publications such as "Monthly Bulletin", "Foreign Trade Indicators", "Monetary and Financial Synthesis", and others. Likewise, "Annual Report", "Economic Report of Chile", "Economic and Financial Report", and "Statistical Synthesis of Chile" were published, both in Spanish and English. Also, bilingual editions of "Foreign Debt of Chile" and the updated edition of "Foreign Investment Statute (D.L. 600)" were issued.

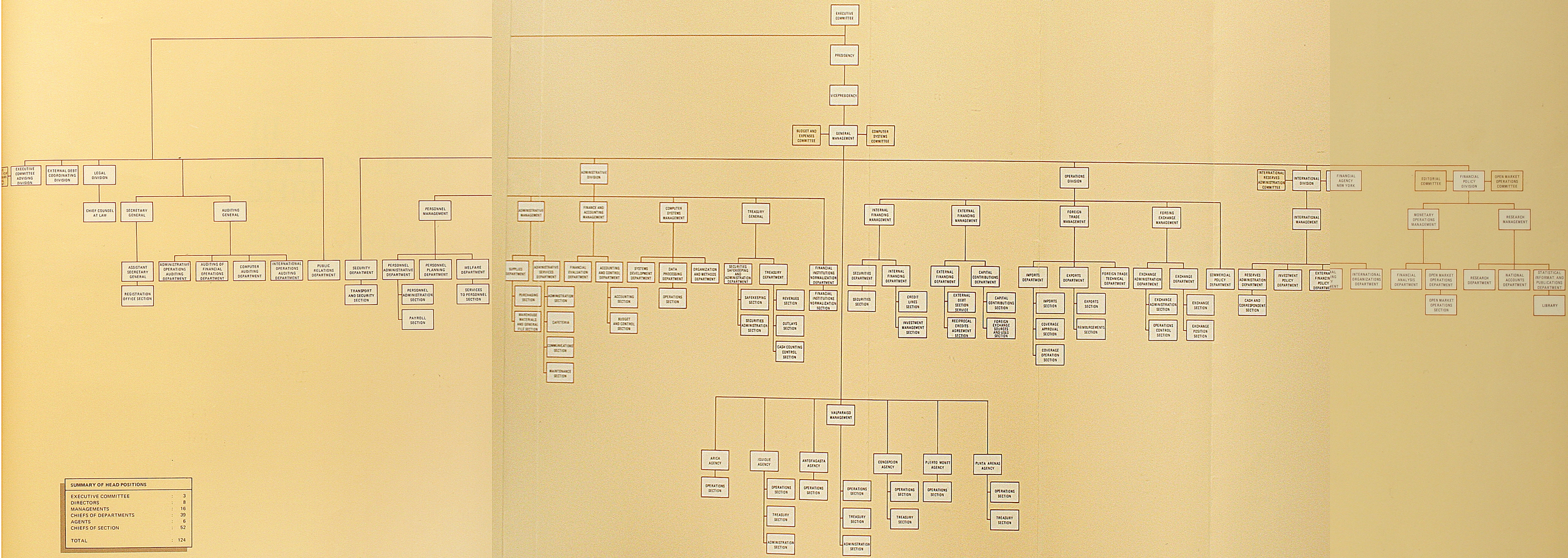
On the other hand, the publications of the Series of Monetary Studies, with Volume IX entitled "Chronological and legal history of the Chilean monetary issues since the Independence" and of the Series of Economic Studies, with issues 24 and 25 corresponding to the "Real cost of credit in 1984" and "Exchange rate and real wages: about the Chilean case", were restarted.

Finally, the Library acquired –during the period– an important amount of specialized bibliographical material, thus allowing to increase its collection and updating the level of the same, with the subsequent benefit for the employees of the Bank and the public in general.

II
ORGANIZATION CHART

BANCO CENTRAL DE CHILE

As of
December
31, 1985



SUMMARY OF HEAD POSITIONS		
EXECUTIVE COMMITTEE	:	3
DIRECTORS	:	8
MANAGEMENTS	:	16
CHIEFS OF DEPARTMENTS	:	39
AGENTS	:	6
CHIEFS OF SECTION	:	52
TOTAL	:	124

III
BALANCE SHEET

BANCO CENTRAL DE CHILE

As of
December
31, 1985

BALANCE - SHEET

As of December 31, 1985
(million pesos)

Chilean Currency
and F/C equiv.
(US$ 1= $ 180.22)
(Gold $ 1= $ 310.77)

ASSETS

EXTERNAL ASSETS		700,643.5
RESERVE	657,004.3	
Gold and Foreign Currency	339,453.6	
Holdings of Special Drawing Rights	54.9	
IMF Subscription Payments	86,995.1	
Bonds, Certificates of Deposit & Other	195,258.1	
Reciprocal Credit Agreements	35,027.6	
Other Securities	215.0	
OTHER EXTERNAL ASSETS	43,639.2	
Contributions to Other International Organizations	33,194.9	
Interest Receivable	7,800.3	
Other Securities	2,644.0	
DOMESTIC ASSETS		2,156,773.2
DOMESTIC CREDIT	2,117,252.9	
Credits to the Treasury	208,049.5	
Credits to State-Owned Enterprises	60,051.2	
Credits to Banco del Estado	222,146.1	
Credits to Commercial Banks	1,365,947.9	
Credits to Other Institutions	261,058.2	
OTHER DOMESTIC ASSETS	39,520.3	
OTHER ASSET ACCOUNTS		1,447,750.7
TOTAL ASSETS		4,305,167.4

LIABILITIES

EXTERNAL LIABILITIES		1,224,847.1
RESERVE	320,598.2	
IMF Credits	195,635.4	
Reciprocal Credit Agreements	37,967.3	
IMF Deposits	86,995.5	
OTHER EXTERNAL LIABILITIES	880,170.0	
Loans and Other Obligations	793,858.6	
Accounts with Other International Organizations	50,471.9	
Interests payable	35,839.5	
SDR ALLOCATIONS	24,078.9	
DOMESTIC LIABILITIES		2,127,313.4
ISSUANCE	110,791.5	
Bills and Coins in Circulation	99,989.3	
Deposits of Financial Institutions (D/C)	10,802.2	
OTHER DEPOSITS AND OBLIGATIONS	881,921.5	
Deposits & Obligations with the Treasury	79,564.1	
Other	802,357.4	
DOCUMENTS ISSUED BY THE CENTRAL BANK	1,100,316.9	
OTHER DOMESTIC LIABILITIES	34,283.5	
OTHER LIABILITY ACCOUNTS		750,832.0
CAPITAL AND RESERVES		199,278.4
Capital	50.0	
Buffer Fund	157,639.4	
Contingency Fund	41,589.0	
SURPLUS		2,896.5
TOTAL LIABILITIES		4,305,167.4

INCOME STATEMENT

(For the period from January 1 to December 31, 1985)
(million pesos)

	Partial	Total
OPERATING RESULTS		
OPERATING INCOME		
Received and accrued interests	137,835.0	
Received and accrued adjustments	339,719.4	
Received and accrued commissions	0.4	
Profits due to price differences	974,6	
Exchange profits	133,518.6	
Other operating income	1,440.0	
TOTAL OPERATING INCOME	613,488.0	
OPERATING EXPENSES		
Paid and accrued interests	260,720.6	
Paid and accrued adjustments	123,705.0	
Paid and accrued commissions	1,883.6	
Losses due to price differences	4,885.5	
Exchange losses	675,531.4	
Other operating expenses	3,788.8	
TOTAL OPERATING EXPENSES	1,070,514.9	
GROSS MARGIN		(457,026.9)
OPERATING SUPPORT EXPENSES		
Personnel expenses	1,847.7	
Administrative expenses	1,171.1	
Depreciation, amortization and write-off	285.0	
Taxes and contributions	582.3	
TOTAL OPERATING SUPPORT EXPENSES	3,886.1	(3,886.1)
OPERATING RESULTS		(460,913.0)
Less: Provisions and write-offs for risky assets		(43,620,0)
NET MARGIN		(504,533.0)
NON-OPERATING RESULTS		
NON-OPERATING INCOME		548,009.8
Results before monetary correction		43,476.8
MONETARY CORRECTION		(40,580.3)
SURPLUS		2,896.5

MEMORANDUM ACCOUNTS

	Domestic Currency (million pesos)
TREASURY OPERATIONS	6,062.4
DOMESTIC CREDIT OPERATIONS	16,734.5
EXCHANGE & EXTERNAL CREDIT OPERATIONS	7.5
SAFEKEEPING & SECURITY OPERATIONS	261,649.1
TOTAL	284,453.5

Notes 1 to 16 below are an integral part of the above Financial Statements.

NOTES TO FINANCIAL STATEMENTS

1. SUMMARY OF ACCOUNTING CRITERIA APPLIED

(a) PRINCIPLES

The financial statements as of December 31, 1985 were prepared according to generally accepted accounting principles, rules issued by the Superintendency of Banks and Financial Institutions where applicable, and provisions of the Organic Law of the Central Bank of Chile (DL 1,078). The standards of the said Superintendency are different from the generally accepted accounting principles as regards provisions for deposits and recording of price differences resulting from the Agreement on Sale of Deposit Certificates in US$, which have not been recognized on an accrued basis.

(b) PARITIES

Assets and liabilities in foreign currencies are shown in pesos at the rates of exchange for each currency at year-end, as set by the Superintendency of Banks and Financial Institutions.

Under instructions from the Superintendency of Banks and Financial Institutions, assets and liabilities denominated in Chilean gold bullion pesos were valued at the average London morning Gold Fixing rate (US dollars per ounce troy fine) for all business days in the preceding quarter, less 10 per cent.

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

	$
Chilean gold bullion	310,770
US Dollar	180,220
Pound Sterling	257,090
Deutsche Mark	72,059
Special Drawing Rights (SDR)	197,491

(c) LOANS AND OBLIGATIONS

Non-indexed loans and obligations are shown at original value or value at latest renewal, except for purchased commercial paper or discounted documents, which are shown at nominal value at maturity. Indexed balances include adjustments earned by the date of the balance-sheet and balances in foreign currency include the respective exchange adjustments.

Interest accrued as of the end of the year is included under Other External Assets and Other External Liabilities when in respect of operations with residents abroad, and under Investments and Other Assets and under Other Domestic Liabilities when in respect of operations with residents in Chile. Interest paid and not accrued from obligations is included under Other Asset Accounts. Interest received and not accrued from loans is included under Other Liability Accounts.

(d) NOTES DUE:

Under this item, included in Other Accounts of Assets, all those deposits due within a maximum term of 90 days as from their maturity date are recorded. Since these are deposits in foreign currency, they are included in the balance sheet according to the closing exchange rate. Interest to be collected on these deposits and adjustments, if applicable, are calculated and recorded only until maturity.

(e) FINANCIAL INVESTMENTS

External financial investments, which are shown under Reserve Assets broken down into bonds, certificates of deposit, and other, basically include bonds and instruments issued by Governments, foreign institutions, and banks, valued at investment cost. Interest receivable is shown under Other External Assets.

(f) TANGIBLE FIXED ASSETS
Tangible fixed assets are included under Other Asset Accounts and are shown at cost plus legal revaluations, net of cumulative depreciation. Depreciation was calculated by the linear method, considering years of useful life of the goods. Breakdown is given in note 3.

(g) COMPENSATION FOR YEARS OF SERVICE
Compensation for years of service is payable by the Bank as an acquired right of Bank staff; it was calculated on the basis of present value (accrued cost) plus interest at 8 per cent per annum. The balance of the obligation as of December 31, 1985 amounts to $ 148.1 million and is included under Other Liability Accounts.

(h) PROVISIONS ON LOANS
In 1984, pursuant to the powers of the Executive Committee, the Bank allowed for provisions on non-performed loans and individual provisions on loans considered likely to prove irrecoverable, according to the Executive Committee Agreement Nº 1,699 of December 1985. These provisions are included under Other Liability Accounts and the associated charge to the profit-and-loss account is shown in note 9.

(i) SHARES IN AND CONTRIBUTIONS TO, THE INTER AMERICAN DEVELOPMENT BANK (IDB) AND CONTRIBUTIONS TO THE INTERNATIONAL MONETARY FUND (IMF)
Shares and contributions from Chile to the Inter American Development Bank and the International Monetary Fund are valued at acquisition cost and at value of contribution plus adjustments where appropriate.
Shares in and contributions to, the IDB are shown under Other External Assets as Contributions to Other International Organizations.
Contributions to the IMF in both domestic and foreign currency are shown under Reserve Assets as IMF Subscription Payments. Shares in and contributions to, the IDB and contributions to the IMF, as expressly provided under DL 2,943 of November 8, 1979, are considered investments.

(j) GOLD AND FOREIGN CURRENCY RESERVES
Pursuant to article 41 of DL 1,078 (Organic Law of the Central Bank), the Bank is bound to keep a reserve fund in gold, foreign currency, or both.
Under Reserve Assets the item Gold and Foreign Currency includes 210.7 million gold pesos which correspond to the Gold Reserve Fund.

(k) INCOME AND EXPENDITURE ACCOUNTS
Financial income and expenditure are entered on the basis of accrued value.
Profit-and-loss balances in domestic currency, except for depreciations, account for cumulative values corresponding to peso amounts entered at the time of the transactions involved.

(l) MONETARY CORRECTION:
In this fiscal year, the effect of applying the monetary correction standards on the financial equity capital, fixed assets and other assets and liabilities, taking into account the variation of Consumer Price Index with a one-month time-lag, is presented in the Profit and Loss Statement, under the caption Monetary Correction. Likewise, the variation of exchange rate for assets and liabilities in foreign currency, as well as the adjustments of deposits and obligations, are included in the operating expenses. In the previous fiscal year, the above mentioned effect was shown in the accounts correspondig to Capital and Reserves.

2. CRITERIA FOR PRESENTING FINANCIAL STATEMENTS

Balance-sheet presentation, as approved by the Superintendency of Banks and Financial Institutions, is framed in an economic-accounting scheme that reveals the accounting and financial position of the Bank while simultaneously aiding economic analysis of Central Bank operations by clearly distinguishing whether they are conducted with domestic or external agents. In this way Central Bank participation in the domestic supply of monetary assets and credit may be assessed together with its effect on the Bank's external creditor position.
The economic concepts of international and issue reserves are thus shown respectively under Reserve and Issue Assets and Liabilities.

3. TANGIBLE FIXED ASSETS

The following is a breakdown of tangible fixed assets as of December 31, 1985.

(Million chilean pesos)

	Previous value (Net) Dec. 31, '84	Year's variation	Year's revaluation	Year's depreciation	Net book value Dec. 31, '85
Real estate	2,419.4	26.7	727.2	(163.9)	3,009.4
Furniture and fixtures	315.4	134.4	122.9	(103.8)	468.9
Vehicles	22.6	14.6	13.7	(14.6)	36.3
Works of art	71.9	–	19.1	–	91.0
Collections of bills, coins, medals, etc.	43.9	3.4	12.5	–	59.8
Total Fixed Assets	2,873.2	179.1	895.4	(282.3)	3,665.4

4. OTHER ASSETS

Includes interest and commisions receivable on Domestic Assets amounting to $ 39,520.3 million.

5. OTHER ASSET ACCOUNT

Mainly includes tangible fixed assets for $ 3,665.4 millions, purchase of US dollars with repurchase agreement for $ 353,302.7 million, past-due credits for $ 15,403.9 million, assets acquired from Banco Continental, Law 18,430, amounting to Ch $ 41,308.1 million, portfolio purchased from financial institutions for $ 163,347.3 million, and Treasury notes for $ 860,528.2 million.

6. OTHER DEPOSITS AND OBLIGATIONS

"Other" mainly includes mandatory deposits on foreign credits for $ 6,158.5 million, public sector time deposits for $ 93,704.7 million, deposits under Resolution 1,470 (peso current accounts denominated in US dollars) for $ 7,902.7 million, payable exchange differential for Ch $ 22,972.0 million, Banco del Estado deposits for $ 86,438.9 million, and foreign currency current accounts for $ 5,212.3 million, debit balance of $ 38,000.5 million originated by purchase of promissory notes to the State Bank, $ 13,910.2 million in advanced import payment deposits, $ 14,676.6 million in short-terms deposits, and $ 506,050.7 million in deposits in accordance Nº 1,657.

7. OTHER LIABILITY ACCOUNTS

Mainly includes provisions for $ 119,381.8 million, reimbursement funds under reciprocal credit agreements for $ 6,099.5 million, foreign currency to be sold for purchase of US dollars for $ 382,403.0 million, liabilities coming from Banco Continental, Law 18,430, for Ch $ 41,916.6 million and bills of exchange for purchase of portfolio from financial institutions for $ 163,347.3 million.

8. MONETARY CORRECTION

The monetary correction applied to the criterion described under 1), Note 1, gave rise to a net charge on results of Ch $ 40,580.3 million as follows:

(Million of Chilean pesos)

	Charges	Credits
Equity capital	41,758.4	
Tangible fixed assets		895.4
Other assets		282.7
Net effect on result		40,580.3
Total	41,758.4	41,758.4

The CPI variation for the year was 26.5%.

9. PROVISIONS AND WRITE-OFFS

Provisions and write-offs about loan portfolio the year moved as follows:

	(Million of Chilean $)
–Provision balance as of December 31, 1984	80,910.1
–Write-offs charged to provisions	(407.0)
–Provisions set up during the year	43,615.2
–Recovery of previous year provisions	(0.4)
–Use of previous year provisions	(4,884.2)
–Provision balance as of December 31, 1985	119,233.7

The charge to the year's results arising from provisions set up amounting to Chilean $ 43,615.2 million, is included under "Provisions and Write-Offs for Risky Assets" in the Profit and Loss Statement. During the year the Bank carried out loan write-offs, charged to results amounting to Ch $ 4.8 million.

10. CAPITAL AND RESERVES

Capital and reserves accounts moved in 1985 as shown below:

(Million Chilean pesos)

	Capital	Contingency Fund	Buffer Fund	Equity cap. revaluation reserve	Surplus 1985	Total
Balance as of January 1, 1985	50.0	32,819.7	124,650.3	–	914.1	158,434.1
Distribution 1984 surplus & repayment of credits to Treasury (fiscal remainder)					(914.1)	(914.1)
Equity capital revaluation				41,758.4		41,758.4
Equity capital revaluation reserve distribution		8,769.3	32,989.1	(41,758.4)		–
Surplus for the year					2,896.5	2,896.5
Balance as of December 31, 1985	50.0	41,589.0	157,639.4	–	2,896.5	202,174.9

11. INCOME TAX

Pursuant to DL 3,345 of April 24, 1980, the Central Bank is exempt from income tax.

12. PREFERENTIAL DOLLAR (EXCHANGE DIFFERENTIAL)

The Central Bank, through agreements of the Executive Committee Nº 1,466, 1,484, and 1,556 set forth that debtors of certain obligations assumed in foreign currency or agreed upon with adjustability in foreign currency before August 6, 1982, could access to an exchange differential, this being chargeable to the Bank.

As from June 27, 1985, through the agreement 1,657, the Executive Committee repealed the agreements number 1,466, 1,484, and 1,556 and set forth a new system to determine and pay the exchange differential, whether it corresponds to obligations of debtors up to US$ 50,000 or over US$ 50,000, which is included in Chapter XIII of the Compendium of Standards for the International Exchange Rate. In the case of debtors up to US$ 50,000, the exchange rate corresponds to the difference between the exchange rate at the date of obligation payment and the equivalent in pesos of 0.0399 UF at the same date.

In the remaining cases, the bank differential corresponds to the difference between the exchange rate at the date of obligation payment and a variable factor that, as at June 30, 1985, was 0.39908 and which is daily reduced from that date on in 0.0007256 until reaching the zero value as at December 31, 1986. The exchange differential is recognized as long as the users use this procedure and during 1985, it reached the amount of Ch $ 150,015.9 millions.

13. TRANSFER OF NATIONAL TREASURY FUNDS TO BANCO CENTRAL DE CHILE

According to the updated text of Law 18,358 as of November 19, 1984, the National Treasury transferred during this year to the Banco Central the amount of 196 millions of Unidades de Fomento through delivering notes of the Treasury General of the

Republic at a 29-year term. The amount transferred has been recorded as extraordinary incomes of the year and it is presented under "Other Income", while the above mentioned notes are included under "Other Asset Accounts".

14. BALANCES IN FOREIGN CURRENCIES AND GOLD

ASSETS

	(Million US$) 1985
EXTERNAL ASSETS	3,357.9
Reserve	3,263.3
Other external assets	94.6
DOMESTIC ASSETS	1,858.6
Domestic credit	1,779.8
Other domestic assets	78.8
OTHER ASSET ACCOUNTS	18.4
Total Assets	5,234.9

LIABILITIES

EXTERNAL LIABILITIES	4,986.7
Reserve	210.6
Other external liabilities	4,642.5
SDR allocations	133.6
DOMESTIC LIABILITIES	8,134.2
Other deposits and obligations	4,656.7
Documents issued by Central Bank	3,431.2
Other domestic liabilities	46.3
OTHER LIABILITY ACCOUNTS	(7,886.0)
Total liabilities	5,234.9

15. MEMORANDA ACCOUNTS

The balances of memoranda accounts as of December 31, 1985 were the following:

	(Millions of Chilean pesos)
Treasury Operations	6,062.4
Domestic Credit Operations	16,734.5
Exchange and External Credit Operations	7.5
Safekeeping and Security Operations	261,649.1
Total	284,453.5

16. SURPLUS OF THE YEAR

According to the Organic Law of the Bank, the Executive Committee in a Session held on January 22, 1986, agreed to assign the surplus of the year to pay the outstanding debts the National Treasury had with the Bank.

JOSE LUIS ARBILDUA ARAMBURU
Finance and Accounting Manager

JORGE COURT MOOCK
General Manager

VICENTE MONTAN UGARTE
Auditor-General Manager

AUDITORS' REPORT

To the Chairman and Members of the
Executive Committee of the Central Bank of Chile:

We have examined the balance-sheet of the Central Bank of Chile as of December 31, 1985 and the associated income statement for the twelve-month period ending on that date. Our examination was performed in accordance with generally accepted accounting principles; accordingly, it included selective accounting entry tests and other auditing procedures to the extent we judged them necessary under the circumstances.

As pointed out in note 1 (a), the Central Bank of Chile prepares and submits its financial statements based on rules and accounting practices issued by the Superintendency of Banks and Financial Institutions.

In our opinion, the above financial statements have been prepared pursuant to the rules and accounting practices issued by the Superintendency of Banks and Financial Institutions and to the provisions of its own Organic Law described in the notes appended to such statements.

LANGTON CLARKE
COOPERS AND LYBRAND

VIVIAN CLARKE LEVI

Santiago, January 22, 1986.

Issue of 900 copies
July 1986
Printed by
ALFABETA IMPRESORES
Lira 140, Santiago