

Rating Action: Moody's rates A1 Banco Estado's \$750 million senior US dollar notes

06 Jan 2020

New York, January 06, 2020 -- Moody's Investors Service ("Moody's") has today assigned an A1 global foreign currency debt rating to Banco del Estado de Chile's (Banco Estado) \$750 million fixed-rate five-year senior unsecured notes. The rating has a stable outlook.

The following rating was assigned to Banco Estado's \$750 million fixed-rate five-year senior unsecured notes:

Long-term foreign currency senior unsecured debt rating: A1, stable outlook.

RATINGS RATIONALE

Banco Estado's A1 long-term debt rating is in line with Chile's A1 sovereign bond rating. The rating incorporates Moody's assessment of a very high probability of government support in a situation of financial stress, which results in five notches of uplift from Banco Estado's baa3 baseline credit assessment (BCA), to reflect the bank's systemic importance. Banco Estado, 100% owned by the Government of Chile (A1 stable), benefits from full backing from the sovereign even though its obligations do not benefit from an explicit government guarantee.

Banco Estado is the country's largest deposit-taking institution and second-largest mortgage lender. The bank plays a significant public policy role with an explicit mandate to promote home ownership and national savings among low-income individuals, to finance small and medium-sized enterprises (SMEs), and foster financial inclusion by servicing rural areas.

Banco Estado's baa3 BCA benefits from the bank's superior access to stable core deposit funding and low reliance on confidence sensitive market funding, supported by ample holdings of high-quality liquid assets. The bank's BCA nevertheless is constrained by the low capitalization ratio, which Moody's calculates as tangible common equity as a percentage of risk weighted assets, and which reflects the high levels of deferred tax assets (DTAs) and modest after-tax earnings relative to its large bank peers in Chile.

Although Banco Estado's asset quality has deteriorated since 2017, it will continue to be supported by substantial government guarantees that the bank has on its most vulnerable portfolios of SME financing and residential mortgages, as well as by its ample reserve coverage. The bank's nonperforming loan (NPL) ratio increased to 3.7% as of November 2019, from 3.5% as of September 2019, following a slowdown in activity triggered by unrests in Chile. In 2020-21, we expect asset quality could be further strained by modest economic growth.

Banco Estado's low profitability reflects its large branch network, its business mix focused on low yielding loans in line with its social policy mandate, and a higher tax burden. Nevertheless, Banco Estado's net income improved to 0.41% of assets as of November 2019, from 0.35% in 2017, because of a focus on cost controls and higher margin lending. For 2020, Moody's has lowered Chile's GDP growth estimate to 2.3%, from 3.2%; weaker economic activity will likely hurt Banco Estado's profitability.

Banco Estado's total regulatory capital ratio of 10.7% as of September 2019 remains comfortably above current regulatory minima, but it is among the lowest in the Chilean banking system. Tangible core capital is just 6.6% of reported risk-weighted assets and could be even lower if Banco Estado's deferred-tax assets (DTAs), which represent about 50% of common equity, were capped at 10% of capital as is done under Basel III norms and under Moody's methodology.

Moody's believes Banco Estado's exposure to environmental risks is low, consistent with its general assessment for the global banking sector. Banco Estado's exposure to social risks is moderate, consistent with Moody's general assessment for the global banking sector. Governance risks are largely internal rather than externally driven. Moody's does not have any particular concerns with Banco Estado's governance.

RATING OUTLOOK

Banco Estado's A1 rating has a stable outlook, in line with the sovereign rating outlook, because the bank's ratings are at the same level of Chile's sovereign rating. The bank's ratings benefit from five notches of uplift owing to the very high probability of government support.

WHAT COULD CHANGE THE RATING UP OR DOWN

Barring a sovereign upgrade, Banco Estado's senior debt rating is unlikely to face upward pressure even if the bank's fundamentals improve, given that the rating is already at the same level as the sovereign bond rating.

The rating could face downward pressure if Chile's government bond rating is downgraded. Material deterioration in Banco Estado's credit fundamentals could lead to a downgrade of its BCA, but its debt rating is unlikely to be affected because of Moody's assessment of the very high probability of government support.

The principal methodology used in this rating was Banks Methodology published in November 2019. Please see the Rating Methodologies page on www.moody.com for a copy of this methodology.

Headquartered in Santiago, Chile, Banco Estado reported consolidated assets of CLP41 trillion (\$57 billion), CLP25 trillion in gross loans, CLP26 trillion in deposits, shareholders' equity of CLP1.7 trillion, and net income of CLP157 billion, as of September 2019.

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