

Banco del Estado de Chile

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Table Of Contents

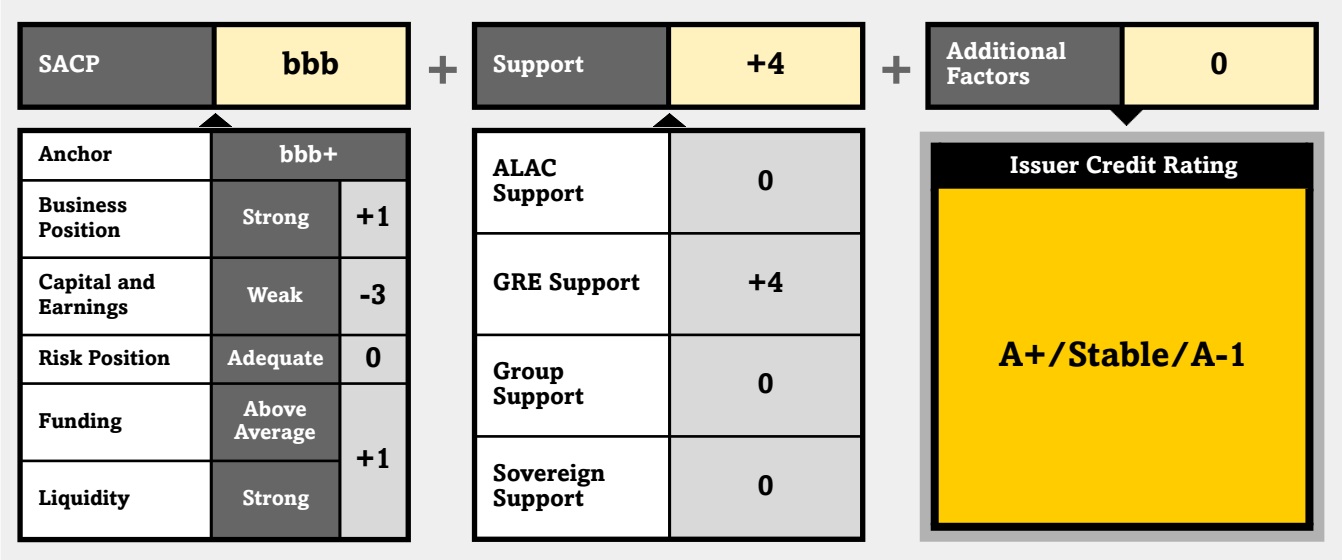
Major Rating Factors

Outlook

Rationale

Related Criteria

Banco del Estado de Chile



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Major Rating Factors

Strengths:	Weaknesses:
<ul style="list-style-type: none"> Extremely high likelihood of extraordinary support from the solvent Chilean government; Strong business position as the third-largest bank in Chile; and Above-average and diversified funding, given its access to a large and stable deposit base. 	<ul style="list-style-type: none"> Weak capital position based on our risk-adjusted capital (RAC) framework; and Weaker-than-average profitability (including the effect of a higher tax burden compared to other peers).

Outlook: Stable

The stable outlook on Banco Estado for the next 24 months reflects that on the sovereign, and our expectation that the bank will maintain its strong market position and public policy role. Given that we expect an extremely high likelihood of government support, our ratings on Banco Estado will move in tandem with those on the sovereign, as long as the bank maintains its SACP at 'bb-' or above (the SACP is currently at 'bbb').

Downside scenario

We could lower the ratings on the bank in the next 24 months if we downgrade the sovereign.

Upside scenario

We could raise the ratings on Banco Estado in the next 24 months if we take a similar action on the sovereign.

Rationale

The ratings on Banco del Estado de Chile (Banco Estado) reflect its sound business position as the country's only state-owned bank and business scale and stability stemming from the status as the country's third-largest bank in terms of total loans and largest in terms of deposits. The weak capital and earnings profile is a credit weakness for the bank. In our capital assessment, we're using our RAC, which incorporates the effect of the deduction from the bank's capital of deferred tax assets. We consider Banco Estado to have an adequate risk position with plain vanilla operations focused in lending and asset quality metrics and business mix that fit with its public bank role and mandate of expanding banking services to the lower-income slice of the population. We consider Banco Estado to have an above-average funding profile thanks to a high share of stable deposits, and a strong liquidity.

The ratings also incorporate our view that there's an extremely high likelihood that Chile (foreign currency: A+/Stable/A-1; local currency: AA-/Stable/A-1+) would provide extraordinary and timely support to the bank in the event of financial distress. As a result of this support, the long-term issuer credit rating on the bank is four notches higher than the stand-alone credit profile (SACP), which is currently 'bbb'.

According to our criteria for government-related entities (GREs), we base our view of this support on our assessment of Banco Estado's very important role as a vehicle in promoting the low-income population's use of banking products and access to home ownership. We also account for the bank's integral link with the Chilean state, which fully owns the bank. Banco Estado and the government are integrally linked in terms of management, strategic and financial monitoring, coordination of debt issuance, and in fulfilling a public policy role. Because of these factors, we believe that there's an extremely high likelihood of support from Chile.

Anchor:'bbb+' for banks operating in Chile.

Table 1

Banco del Estado de Chile Key Figures					
--Year-ended Dec. 31--					
(Mil. CLP)	2018*	2017	2016	2015	2014
Adjusted assets	37,572,721.0	37,722,252.0	34,651,509.0	32,415,778.0	28,018,079.0
Customer loans (gross)	23,078,504.0	22,531,470.0	20,745,293.0	19,071,559.0	16,614,586.0
Adjusted common equity	831,685.4	821,322.2	879,258.8	955,272.0	696,409.9
Operating revenues	702,109.0	1,278,285.0	1,243,492.0	1,116,889.0	1,090,497.0
Noninterest expenses	410,883.0	815,822.0	763,759.0	709,181.0	636,049.0
Core earnings	82,962.0	132,497.0	159,977.0	122,915.0	175,263.0

*Data as of June 30.

Our bank criteria use our Banking Industry Country Risk Assessment's economic risk and industry risk scores to determine a bank's anchor, the starting point in assigning an issuer credit rating. The anchor for banks operating only in Chile, where Banco Estado operates, is 'bbb+' (For more information see "Outlook On 10 Chilean Financial Institutions Revised To Stable From Negative On Lower Risk Of Credit-Fueled Asset Bubble," published on Aug. 22, 2018.)

Chile's resilient economy reflects many years of sound and consistent economic policies, such as strong fiscal performance, low inflation, and a healthy financial system. However, the country's GDP per capita is still lower than those of more developed countries and its BICRA peers. But at about \$15,400 at the end of 2017, it's among the highest in the region and gradually rising. In this sense, better global copper prices than in 2016 and renewed business confidence after the 2017 national elections have boosted GDP growth prospects to about 4.0% in 2018 and 3.3% in 2019 from 1.6% in 2017. In addition, we're seeing more moderate growth in credit and real estate prices than historical levels, which stave off pressure on the sovereign's slightly weaker capacity to face external shock, while reducing the risks of cyclical credit-fueled asset bubbles. We expect the Chilean banking industry's asset quality to remain adequate and in line with those of its peers amid better economic and business prospects.

In terms of industry risk, we believe that Chile has a sound and comprehensive regulatory framework. The banking sector has generated adequate profitability for the past five years, and the absence of significant market distortions results in healthy competitive dynamics. We also believe that Chile's financial system has an adequate funding mix consisting of deposits, domestically issued debt, and external debt (banks and capital markets). However, institutional deposits have historically played a significant role, especially for mid-size and smaller banks. In June 2017, the government submitted a draft of a banking law that aims to align the country with Basel III standards for capital and to introduce tools such as an early regularization plan. At this point, we don't see an impact on potential government support to banks, but we'll monitor changes in the resolution framework.

Business position: The only state-owned bank; with a sound market presence and in segments relevant for the government

Table 2

Banco del Estado de Chile Business Position					
	--Year-ended Dec. 31--				
(%)	2018*	2017	2016	2015	2014
Loan market share in country of domicile	15.1	15.5	14.9	14.5	13.3
Deposit market share in country of domicile	20.2	22.0	20.3	20.1	18.3
Return on average common equity (%)	10.0	8.3	10.5	9.0	15.1

*Data as of June 30.

We assess Banco Estado to have a sound business profile given its position as the only state-owned bank and as the country's third-largest bank in terms of total loans and largest in terms of deposits, with market shares of about 15% and 20%, respectively, as of the end of June 2018. Its scale of operations and broad customer base give Banco Estado significant business stability, making operations less vulnerable to adverse operating conditions than the industry risk score indicates.

Banco Estado follows the government's guidelines for facilitating access to banking products, including transactional accounts, for the low-income segment population. To comply with the guidelines, Banco Estado has a large presence in the country, with 512 branches and ServiEstado (service centers) and 23,651 remote service centers (Caja Vecina) and 2,441 ATMs as of June 2018. Additionally, as of the same date, about 10.7 million customers use the bank's CuentaRut card, a debit card that cardholders can use for money transfers or for retail purchases. As a result, Banco Estado controls 47% of the debit card market, a significant achievement in offering banking services to Chile's wider population. Retail banking represents about half of the bank's loan portfolio, consisting of mortgages, consumer loans, and credit cards. Commercial banking represents the other half and includes middle-market companies, with gains in market share in 2014-2017 due to the bank's countercyclical role.

We expect Banco Estado to continue facilitating credit access for the low-income population while expanding its mortgage and small- and middle-market company lending.

Market Shares In Terms Of Loans

(Mil. CLPs as of June 2018)

	Institutions	Loans	
1	Santander Chile	29,233,928	18.7%
2	Banco de Chile	26,919,118	17.2%
3	Banco Estado	23,665,630	15.1%
4	BCI	22,196,330	14.2%
5	Itaú Corpbanca	16,320,001	10.4%
6	Scotiabank Chile	11,289,854	7.2%
7	BBVA Chile	9,908,479	6.3%
8	Banco Bice	5,072,151	3.2%
9	Banco Security	5,070,827	3.2%
10	Banco Consorcio	2,275,566	1.5%
11	Banco Falabella	1,692,189	1.1%
12	Banco Internacional	1,362,158	0.9%

Market Shares In Terms Of Loans (cont.)**(Mil. CLPs as of June 2018)**

	Institutions	Loans	
13	Banco Ripley	850,562	0.5%
14	BTG Pactual Chile	367,090	0.2%
15	HSBC Bank Chile	163,610	0.1%
16	China Construction Bank, Agencia en Chile	123,552	0.1%
17	Banco do Brasil	41,374	0.0%
18	MUFG Bank	22,136	0.0%
19	Banco de la Nación Argentina	6,410	0.0%
20	JP Morgan Chase Bank	0	0.0%
	Domestic banking system	156,580,965	100%

Market Shares In terms Of Deposits**(Mil. CLP as of June 2018)**

	Institutions	Deposits	
1	Banco Estado	24,546,924	20.2%
2	Santander Chile	20,809,352	17.1%
3	Banco de Chile	19,772,671	16.2%
4	BCI	16,810,688	13.8%
5	Itaú Corpbanca	9,928,888	8.2%
6	Scotiabank Chile	7,871,220	6.5%
7	BBVA Chile	6,932,977	5.7%
8	Banco Bice	4,144,174	3.4%
9	Banco Security	3,582,290	2.9%
10	Banco Consorcio	2,182,871	1.8%
11	Banco Falabella	1,839,773	1.5%
12	Banco Internacional	1,472,397	1.2%
13	HSBC Bank Chile	779,022	0.6%
14	Banco Ripley	489,408	0.4%
15	BTG Pactual Chile	385,916	0.3%
16	MUFG Bank	85,465	0.1%
17	China Construction Bank, Agencia en Chile	34,559	0.0%
18	JP Morgan Chase Bank	18,677	0.0%
19	Banco do Brasil	16,995	0.0%
20	Banco de la Nación Argentina	99	0.0%
	Domestic banking system	121,704,366	100%

Capital and earnings: capitalization metrics negatively impacted by deferred tax assets

Table 3

Banco del Estado de Chile Capital And Earnings					
	--Year-ended Dec. 31--				
(%)	2018*	2017	2016	2015	2014
Tier 1 capital ratio	6.9	7.0	7.0	7.3	6.9
Adjusted common equity/total adjusted capital	100.0	100.0	100.0	100.0	100.0
Net interest income/operating revenues	68.3	69.3	67.1	68.2	67.8
Fee income/operating revenues	21.1	20.4	19.1	17.7	17.2
Market-sensitive income/operating revenues	9.8	9.4	12.7	12.9	14.1
Noninterest expenses/operating revenues	58.5	63.8	61.4	63.5	58.3
Preprovision operating income/average assets	1.5	1.3	1.4	1.3	1.7
Core earnings/average managed assets	0.4	0.4	0.5	0.4	0.7

*Data as of June 30.

The bank's capitalization levels is one of the weaknesses. This is because the calculation of capitalization metrics (RAC, according to our methodology that's aligned with Basel III principles) incorporates the impact of high deferred tax assets. This is due to the bank's high tax burden (as a government-owned entity, it pays 40% in addition to the regular tax rate that other banks pay) and because it can't discount the loan-loss provisions of the tax payment until the loan is written off amid a high share of mortgages that have low charge-offs.

Therefore, our projected RAC ratio before diversification is about 3.3% for the next 18 months. This forecast incorporates:

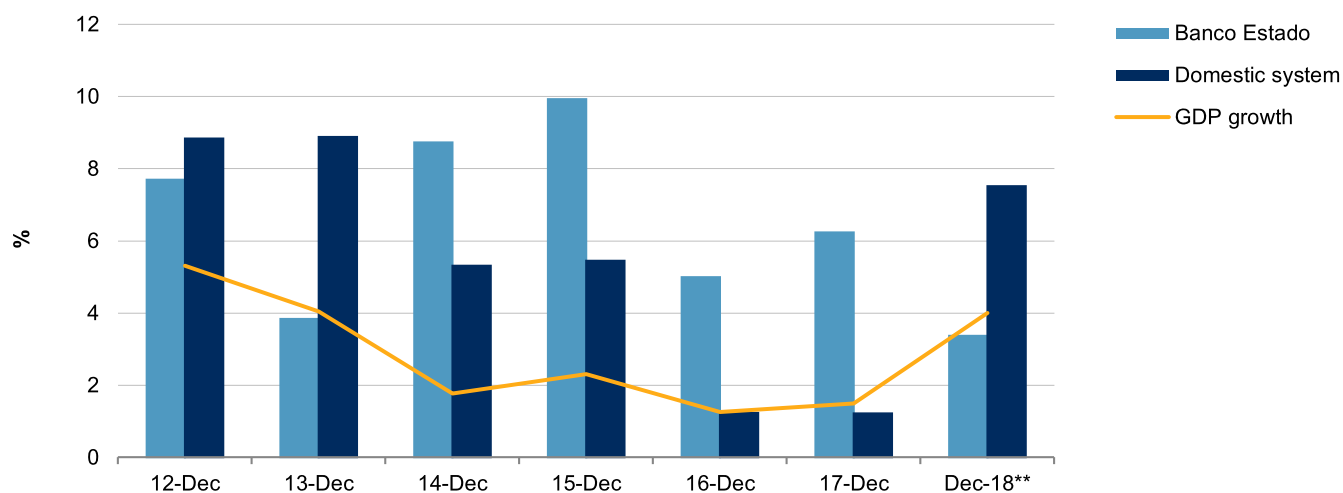
- GDP growth in Chile of 4.0% in 2018 and 3.3% in 2019;
- Growth in the loan portfolio of about 7.5% in 2018 and 8% in 2019 (on nominal basis);
- Slightly higher margins given an increase in inflation to about 3.0% in 2018 and 3.2% in 2019 from 2.3% in 2017, which benefits Chilean banks given their higher exposure to indexed currency assets;
- Increasing policy rates; and
- Weaker asset quality metrics than in 2017 until the employment rate and quality rises given better economic prospects.

Capitalization of dividends and potential capital injections into the bank depend on the government's economic policy plans and future actions such the approval of a new banking law. Our base-case scenario currently incorporates dividend payout ratios of 50% (with capitalization of the remaining half of results) and no additional capital infusions. We don't include the future implementation of a new banking law.

Banco Estado's quality of capital suffers from the high share of deferred tax assets that account for 56% of total adjusted common equity as of June 2018. On the other hand, earnings, although modest partly due to the high tax burden, have been steady amid adequate diversification. Net interest income represented 68% of earnings in the first half of 2018, followed by fee income (21%) and market-sensitive income (11%). We expect profitability to remain modest because the bank focuses on increasing the lower-income segment's access to banking products rather than on boosting its profitability.

Chart 1

Real Credit Growth Versus GDP Growth*



*Domestic system excludes Banco Estado. **Forecast. Source: S&P Global Ratings. Copyright © 2018 by Standard & Poor's Financial Services LLC. All rights reserved.

Risk position: Focus in lending, with the portfolio diversified by economic sector, business segment, and single-name exposures.

Table 4

Banco del Estado de Chile Risk Position

(%)	--Year-ended Dec. 31--				
	2018*	2017	2016	2015	2014
Growth in customer loans	4.9	8.6	8.8	14.8	12.4
Total managed assets/adjusted common equity (x)	45.4	46.1	39.6	34.1	40.4
New loan loss provisions/average customer loans	1.2	0.9	1.1	0.8	1.5
Net charge-offs/average customer loans	0.8	0.6	0.4	0.3	0.4
Gross nonperforming assets/customer loans + other real estate owned	3.3	3.1	3.4	3.1	3.3
Loan loss reserves/gross nonperforming assets	92.0	98.1	88.0	90.8	81.1

*Data as of June 30.

We consider Banco Estado to have a satisfactory risk profile thanks to focus on lending, given the bank's countercyclical role and a diversified loan portfolio among economic sectors, business segments, and single-name exposures. We expect Banco Estado to continue focusing on segments where it has expertise, with no significant changes in its lending composition.

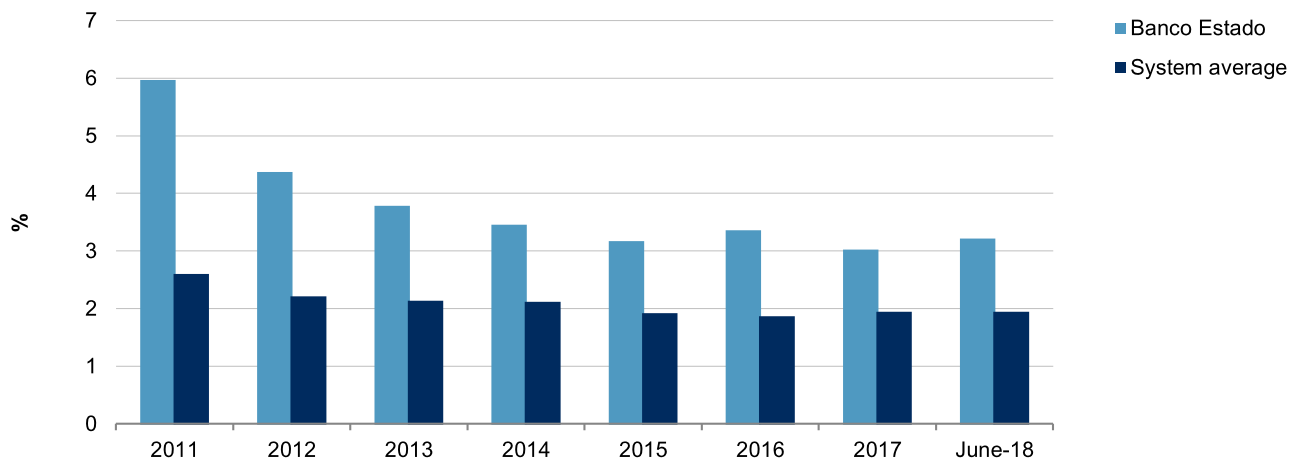
The bank's asset quality has been weaker than the industry average given that it's exposed to the low-income residential mortgage segment. However, its asset quality performance has improved over the last few years. This is partly because the bank shifted its focus to the middle-income segment for its mortgages (as of June 2018, about 24% of mortgages are guaranteed by the government, down from 36% in December 2012). In addition, the government has

offered incentives to borrowers that repay loans on time. As of June 2018, 90-day overdue loans were 3.28% of Banco Estado's total loans, compared with the industry average of 1.95%. We expect metrics to strengthen as the unemployment rate falls.

Banco Estado also has one of the highest levels of additional provisions among its domestic peers; higher than the regulatory requirement. If we add these provisions to the required provisions, the coverage for the 90-day overdue loans is 154% as of June 2018.

Chart 2

NPL Trends At Banco Estado Versus Banking System

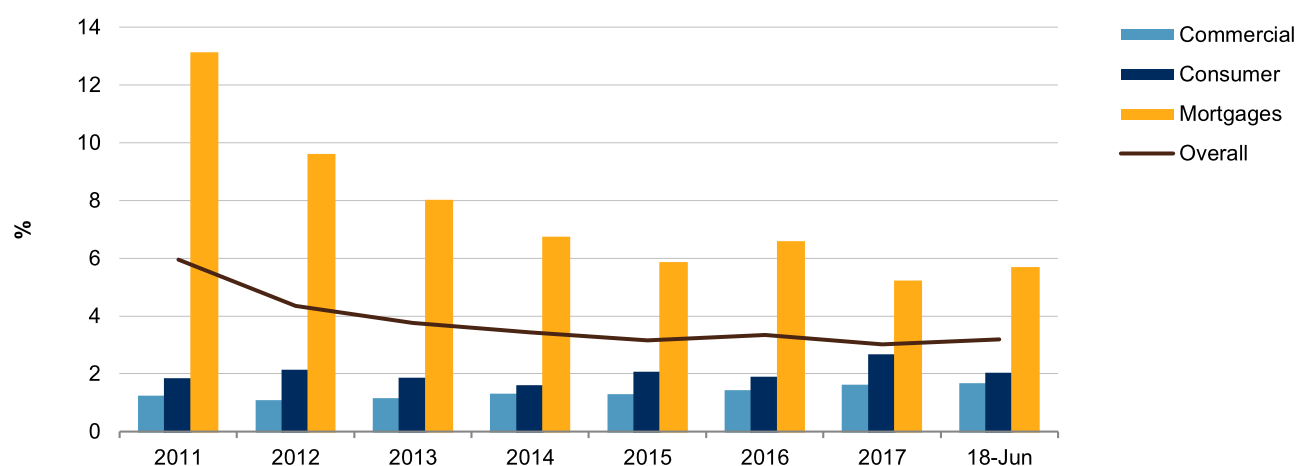


Source: S&P Global Ratings.

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Chart 3

NPLs By Lending Segments



Source: S&P Global Ratings.

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Funding and liquidity: Above average and strong.

Table 5

Banco del Estado de Chile Funding And Liquidity

(%)	--Year-ended Dec. 31--				
	2018*	2017	2016	2015	2014
Core deposits/funding base	72.5	76.1	75.0	75.9	77.0
Customer loans (net)/customer deposits	91.2	83.9	86.3	83.2	83.8
Long term funding ratio	92.4	93.0	92.0	94.5	95.1
Stable funding ratio	112.8	121.0	115.6	120.6	120.6
Short-term wholesale funding/funding base	7.9	7.3	8.3	5.7	5.1
Broad liquid assets/short-term wholesale funding (x)	2.9	3.9	3.2	4.7	5.5
Net broad liquid assets/short-term customer deposits	21.4	32.2	32.7	37.9	40.3
Short-term wholesale funding/total wholesale funding	28.8	30.4	33.3	23.7	22.3
Narrow liquid assets/3-month wholesale funding (x)	3.5	8.9	5.6	8.6	7.4

*Data as of June 30.

We view Banco Estado's funding as above average. The bank's nationwide distribution network and strong market position result in one of the largest deposit bases in Chile: a competitive advantage given this funding's stability and its lower cost than other funding sources. As of June 2018, Banco Estado had 20% of the system's total deposits, and customer deposits represented about 73% of the bank's funding base. As of the same date, Banco Estado's stable funding ratio was 112%, and has averaged 119% for the past three years. Additionally, the bank sources about 17% of total liabilities from the government either as payment of government employee salaries or as payment to government service providers. The other main funding source is the issuance of bonds (senior and subordinated) and bank loans,

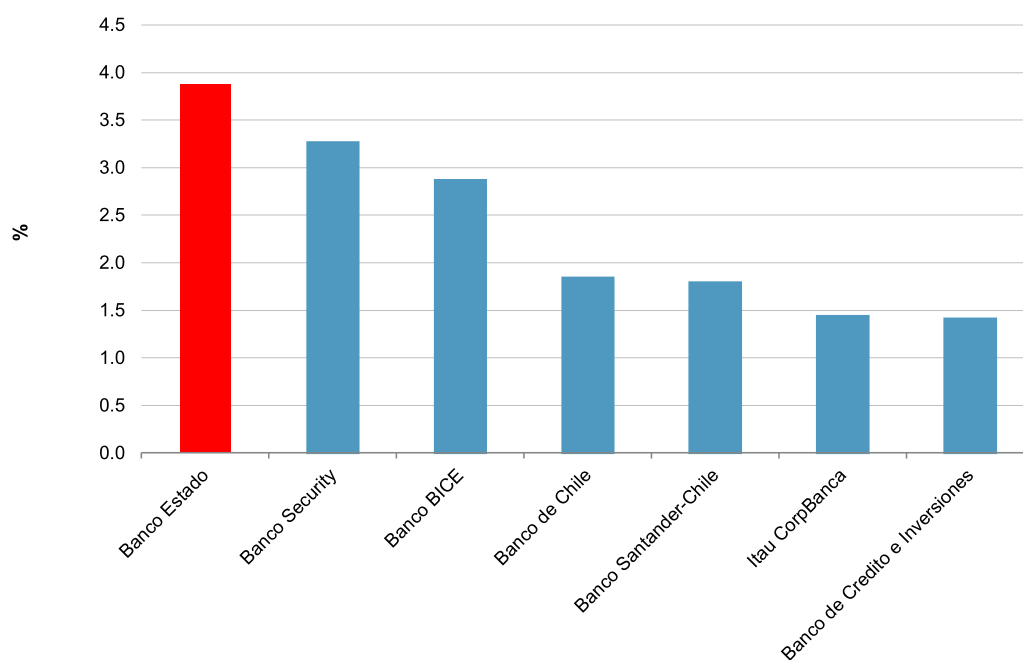
which account for about 25% of the bank's funding base. Repos make up the remaining 2%. Banco Estado has access to the domestic and international capital markets and has access to the central bank's funding if needed.

Banco Estado enjoys high levels of liquidity, as seen in its large portfolio of liquid assets, which include mainly cash and securities from domestic banks and the central bank. The bank's broad liquid assets to short-term wholesale funding ratio is high at almost 3x as of June 2018, compared with the average of 3.9x for the past three years. Its average is better than that of the Chilean banking system.

Chart 4

Broad Liquid Assets To Short-Term Wholesale Funding

As of June 2018



Source: S&P Global Ratings.

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Related Criteria

- Criteria - Financial Institutions - General: Risk-Adjusted Capital Framework Methodology, July 20, 2017
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings, April 7, 2017
- General Criteria: Rating Government-Related Entities: Methodology And Assumptions, March 25, 2015
- General Criteria: Group Rating Methodology, Nov. 19, 2013
- Criteria - Financial Institutions - Banks: Assessing Bank Branch Creditworthiness, Oct. 14, 2013

- Criteria - Financial Institutions - Banks: Quantitative Metrics For Rating Banks Globally: Methodology And Assumptions, July 17, 2013
- Criteria - Financial Institutions - Banks: Banks: Rating Methodology And Assumptions, Nov. 9, 2011
- Criteria - Financial Institutions - Banks: Banking Industry Country Risk Assessment Methodology And Assumptions, Nov. 9, 2011
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009
- Criteria - Financial Institutions - Banks: Commercial Paper I: Banks, March 23, 2004

Anchor Matrix										
Industry Risk	Economic Risk									
	1	2	3	4	5	6	7	8	9	10
1	a	a	a-	bbb+	bbb+	bbb	-	-	-	-
2	a	a-	a-	bbb+	bbb	bbb	bbb-	-	-	-
3	a-	a-	bbb+	bbb+	bbb	bbb-	bbb-	bb+	-	-
4	bbb+	bbb+	bbb+	bbb	bbb	bbb-	bb+	bb	bb	-
5	bbb+	bbb	bbb	bbb	bbb-	bbb-	bb+	bb	bb-	b+
6	bbb	bbb	bbb-	bbb-	bbb-	bb+	bb	bb	bb-	b+
7	-	bbb-	bbb-	bb+	bb+	bb	bb	bb-	b+	b+
8	-	-	bb+	bb	bb	bb	bb-	bb-	b+	b
9	-	-	-	bb	bb-	bb-	b+	b+	b+	b
10	-	-	-	-	b+	b+	b+	b	b	b-

Ratings Detail (As Of September 28, 2018)	
Banco del Estado de Chile	
Issuer Credit Rating	A+/Stable/A-1
Senior Unsecured	A+
Issuer Credit Ratings History	
14-Jul-2017	<i>Foreign Currency</i> A+/Stable/A-1
27-Jan-2017	AA-/Negative/A-1+
27-Dec-2012	AA-/Stable/A-1+
14-Jul-2017	<i>Local Currency</i> A+/Stable/A-1
27-Jan-2017	AA-/Negative/A-1+
06-Aug-2015	AA-/Stable/A-1+
Sovereign Rating	
Chile	
<i>Foreign Currency</i>	A+/Stable/A-1
<i>Local Currency</i>	AA-/Stable/A-1+
Related Entities	
Banco del Estado de Chile Sucursal New York	
Issuer Credit Rating	A+/Stable/A-1
Short-Term Debt	A-1

Ratings Detail (As Of September 28, 2018) (cont.)

*Unless otherwise noted, all ratings in this report are global scale ratings. S&P Global Ratings' credit ratings on the global scale are comparable across countries. S&P Global Ratings' credit ratings on a national scale are relative to obligors or obligations within that specific country. Issue and debt ratings could include debt guaranteed by another entity, and rated debt that an entity guarantees.

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