BANCO SANTANDER CHILE

CONFERENCE CALL DEDICATED TO BANCO SANTANDER CHILE FINANCIAL RESULTS 2Q 2022

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Participants:

- Emiliano Muratore, Chief Financial Officer
- Robert Moreno, Managing Director and Head of Investor Relations
- Claudio Soto, Chief Economist

Operator:

Ladies and gentlemen, thank you for standing by. And I would like to welcome you to Banco Santander-Chile results conference call on the 29th of July 2022. At this time, all participant lines are on listen only mode. The format of today's call will be a presentation by the management team, followed by a question and answer session. So without further ado, I would now like to pass the line to Mr. Emiliano Muratore, the CFO of the company. Please go ahead, sir.

Emiliano Muratore:

Good morning, everyone. Welcome to Banco Santander Chile second quarter 2022 results webcast and conference call. This is Emiliano Muratore, CFO. And I'm joined today by Robert Moreno, Managing Director and Head of Investor Relations. And Claudio Soto, Chief Economist. Thank you for attending today's conference call. The bank has continued with strong results in the second quarter of this year, with all time highs ROE and solid financial performance. Our successful digital strategy and consumer oriented product offerings continues to attract new clients indicating great growth opportunity going forward. Before we start the presentation, let me start with some important news. Santander-Chile's results in recent years have consolidated its leading position in the Chile market. Not only in terms of loans, profitability, and efficiency, but in client growth and digital innovations. This performance has been achieved with the contribution of all the teams under the leadership of Claudio Melandri and Miguel Mata.

Emiliano Muratore:

Leadership in the corporate world has always been dynamic and changes are the norm. After more than 30 years working for the bank, our current CEO Miguel Mata will be leaving this position to take new challenges, and he will continue to contribute to the group. Claudio Melandri will remain as chairman of the board in Chile. On August the 1st, Roman Blanco will take over as country head and CEO of the bank. Roman has 18 years of experience in the group, which he joined in 2004 as vice president of Banco Santander Banespa in Sao Paulo, Brazil, where he was assigned the task of strengthening the group's presence in this market. In 2007, he was appointed as president and CEO of Santander in Columbia, whose strategy led to significant value creation for Santander in that country. In 2012, he assumed the same responsibilities in Puerto Rico and later was appointed as CEO of Santander Bank NA and Santander Holdings in Boston United States.

Emiliano Muratore:

He was currently responsible for Santander Group operations in the Andean region and Uruguay. He's also a member of the board of directors of Santander Uruguay, Santander Peru and Santander Columbia. We would like to stand a warm welcome to Roman Blanco whose leadership will continue strengthening Santander's strong market position in Chile. Now I invite Claudio Soto to give us an update on the macro scenario beginning on slide five.

Claudio Soto:

Thank you Emiliano. During the second quarter, the economy has continued slowing down. Gradual returning back to trend. Consumption has remained resilient, while investment is contracting. High interest rates have helped to normalize liquidity levels. Business confidence has decreased and the growing concern of a global recession has led to significant fall in the copper price. The labor market continues subdued] with employment still running below pre pandemic levels. The economy will keep decelerating throughout the year. We estimate GDP will contract Q on Q, in the third and fourth quarter.

Claudio Soto:

As a result, annual growth will be negative in the second semester. We keep our GDP growth forecast for this year at 1.5%, as seen on slide six. Inflation has continued increasing, the consumer price index CPI rose 12.5% year on year in June. And it will reach more than 13% in August and September. Behind that, there are the still high commodity prices with currency and second round effects from past price increases. In the last quarter of the year it should begin slowing down as global prices soften and local activity moderates. All in all CPI inflation should close the year at around 12%. The Central Bank has tightened its monetary policy even further by raising the monetary policy rate by 225 basis points since March, reaching 9.75%. We expect the monetary authority will increase its policy rate in the next two meetings, finishing the heightened cycle with an MPR at around 10.5%.

Claudio Soto:

After that, they should keep the rate on hold and begin cutting at the beginning of next year as inflation and activity slow down. There are a few weeks ahead before the constitutional referendum, which will take place on September 4th. The result is highly uncertain and most likely it will be tight. In any case, there is broad consensus that indicate the approved option wins amendments to the new tax will be necessary. In case the reject option win, a deeper reform to the current constitution will take place because of that, there will be still a considerable period of uncertainty ahead.

Robert Moreno:

Thank you, Claudio. We will now move on to slide eight, to focus on the evolution of our various client and digital initiatives this year. A key theme of the quarter is the ongoing strong client growth driven by these platforms. On slide nine, we begin with our most successful initiative Santander Life.

Robert Moreno:

This platform reached in the second quarter, the important milestone of surpassing 1 million clients. As can be seen from the graph, we started a life program in 2018 and this platform really gained traction once we launched the Cuenta Life in June, 2020. A full blown digital checking account that clearly differentiated us from our competitors, who focused on offering a digital prepaid debit card. In 2022 Santander Life also began offering clients the ability to open a US dollar checking account online for an additional fee. Life clients are growing 42% year-over-year and 86% of our Life clients are new to the bank. Life active clients, defined as those in which Santander is their main bank increased 30% year-over-year. And loyal clients, which are those that are active and profitable and profitably use a majority of Life products rose 46%. Furthermore, our Life clients have a net promoter score of 68 highlighting their satisfaction with this platform.

Robert Moreno:

Santander Life's clients are also rapidly being monetized with gross income of $63 million in the first half of 2022, a 68% increase compared to the same period of last year. Demand deposits remaining high at 950 million, surpassing by many, many times the amounts clients have deposited in similar competing platforms. On the loan side, Life clients had a total of 316 million in consumer loans, increasing by 56% in consumer credit and 118% year-over-year in credit cards alone. These clients are also beginning to purchase other products such as mutual funds and time deposits, which have grown 44% year-over-year and 203% respectively. On slide 10, we showcase our two most recent digital initiatives that are piggybacking on the Life's platform to expand our presence among micro entrepreneurs, Prospera and Cuenta PYME Life. These are two projects in the incubation stage. Prosper is for the owner operated microbusinesses, which need a current account. With a small monthly fee and a one time payment for the mobile POS these clients can access a current account with free and unlimited transfers and no limits to their monthly balance.

Robert Moreno:

Cuenta PYME Life has a slightly different focus targeting companies with tax records that need a current account. The government has a program called Tu Empresa en un Día in which approximately 365 companies are created each day online. Through this same platform, companies have the option through Cuenta PYME Life to open a checking account online without previous history nor minimum sales. Cuenta PYME Life builds on the same successful platform we had created for individuals focusing mainly on transactionality, as well as responsible lending opportunities in the future. The success of Getnet continues, as shown on slide 11. Getnet has sold over 111,000 POS's. Also in the second quarter, Getnet began rolling out it's eCommerce solution. 94% of Getnet's clients are SMEs, our target clients. And 99% of the POS's are sold to the bank's distribution channels. Getnet already has a market share greater than 14% in POS's with around 318 billion in monthly sales flowing through these POS's. This product has been quick to monetize, generating 9 billion in pesos and fees in the first half increasing 800% year-over-year.

Robert Moreno:

And in the second quarter, Getnet has also started to break even after just over one year of operations. On slide 12, we show how Superdigital continues to expand. Superdigital is a prepaid digital product aimed at the unbanked who seek a low cost bank account. Superdigital clients have grown 84% year-over-year, reaching over 334,000 clients. This growth has been held by alliances with companies such as Cornershop and Uber as a way of attracting new clients. As can be seen on slide 13, we continue to lead our main competitors in NPS. And then in 2022, our NPS has dipped slightly as the bank has accelerated the monetization and digitization of customer channels and incorporated tighter cybersecurity protection, which has led to some client disruptions in the short term. But that will allow us to give a better service and heightened cybersecurity in the medium term.

Robert Moreno:

On slide 14, we show how all these efforts are translating into record client growth led by our most important product, checking accounts. Clients with checking accounts increased 29.6% year-over-year compared to June of last year. With this success and attracting new current account clients, we have gained over seven percentage points since April, 2019, reaching a market share of 29.1%. With the new US dollar checking account offer through Life, we have seen a sustained increase in our market share in this product, which reached an impressive 34.5% in April of 2022. As shown on slide 15, the bank accelerated the branch transformation process, focusing on the work of a model and closing less productive branches. In the last 12 months, we have closed 10% of our branch network and in the same period, we have opened nine more work cafes. As a result of these initiatives, coupled with our digital strategy, productivity is rising significantly with volumes per point of sale increasing 13.9% year-over-year, and volumes per employee increasing 10.2% year-over-year.

Robert Moreno:

Moving forward to slide 16, we want to highlight the most relevant progress in our responsible banking commitment. Since 2019, we have financially empowered over two million people, mainly through our Life, Getnet and Superdigital platform. This puts us well on track to reach our goal of financially empowering four million people by 2025. Another milestone was reached in our environmental goal in the quarter. As many of you may remember from our ESG talk last year, the bank announced that it will start to generate its own energy through six solar plants. We are pleased to comment that our first solar plant will begin operations in September and the further three plants will be operational by the end of the year. Each plant generates 300 kilowatts of energy, with these solar plants, we should reach our goal to be carbon neutral in our own operations by 2025.

Robert Moreno:

Beginning on slide 18, we will now take a look at our financial results, our net income to shareholders in the second quarter, reach a new quarterly record of 285 billion pesos. Increasing 41% year-over-year and 21% Q over Q. With this, our quarterly return on equity also reached a new high of 31.7%. With this strong quarterly result our net income in the first half totaled 521 billion pesos increased increasing 40.9%. And our ROE reached an impressive 28.7% in the first half of this year. As we will analyze an upcoming slides, the high inflation rate was clearly a key factor behind these solid results, but as we can observe on slide 19, the contribution from our client segments, which excludes the impact of inflation, continue to grow steadily. As of June, the net contribution of our business segments increased 17.6% year-over-year. Results from retail banking, which includes individuals and SMEs increased 10% year-over-year, mainly driven by higher margins and higher fees due to client growth and greater product usage.

Robert Moreno:

Our middle market segment grew 20% year-over-year driven by a higher loan spread. Additionally commissions increased 36% in line with the greater activity of clients and cash management and foreign trade businesses. The results of Santander Corporate and Investment Banking, or SCIB, grew an impressive 39% year of year due to the increase in loans, higher loan spreads, and an increase in fees driven by our investment banking unit and greater client treasury income. On slide 20, we review our loan book, which grew 3.8% Q over Q, and 10% year-over-year. Loans to individuals increased 11.8% year-over-year and 3.3% Q over Q. With loan growth in this segment being driven by high yielding outer loans, which grew 5.2% Q over Q and 51% year-over-year. Our credit card loan book also started to accelerate growing 7.4% as household consumer behavior patterns have begun to normalize. Mortgage loans increased 13.5% year-over-year and 4% quarter over quarter. Growth in this product was mainly driven by the higher UF inflation rate that resulted in a positive translation impact on mortgage loans.

Robert Moreno:

During the quarter loans in our SCID segment group 12.8% Q over Q, while loans to our middle market increased 4.7% in the same period, as economy continued to grow and large corporate sought funding in the form of corporate loans as the bond market remained illiquid, this growth was also affected by translation gains from the depreciation of the peso and the high UF and variation in the quarter. On slide 21, we show the evolution of our funding mix. Total deposits decreased 6.3% year-over-year and increased 2.1 Q over Q. After a strong increase in non-interest bearing deposits in the last two years, we have started to see clients shifting their money to time deposits as rates rise. As a result, time deposits increase 17.1% Q over Q. With this shift, we expect average funding costs to continue to rise as the monetary policy rate continues to go up. These higher rates will be eventually transferred to our loan book, but given that our interest bearing liabilities have a shorter duration than our assets funding costs will go up first.

Robert Moreno:

Moving on to slide 22, we can see how the movement of volumes rates and inflation have been affecting our margins in the quarter, the variation of the UF in the second quarter reached 4.3% compared to 2.4 in the first quarter of this year, and 1.1 in the second quarter of last year. This led to a strong increase in our net interest income from readjustments, which grew 11.7% year-over-year and 24% Q over Q, and led to an increase in the quarterly [NIMs 00:18:14] to 4.5% compared to 3.7% in the first quarter of this year. However, this has been partially offset by the rise in funding cost due to the increase in the monetary policy rate by the Central Bank and the subsequent shift of funds from non-interest bearing demand deposits to time deposits.

Robert Moreno:

Going forward, we expect rates to continue to rise and for inflation to gradually start to slow down. This will put a downward pressure on our NIMs in the second half. Therefore we maintain our guidance for NIMs for 2022 at a level between 3.5% and 3.7%. On slide 23, we can see the evolution of asset quality over a long period where it is clear that the asset quality of the bank remains at historically low levels as measured both by the NPL and impaired loan ratio, while coverage also remains at all time highs. As household liquidity levels normalized we expect asset quality levels to gradually return to pre pandemic levels. As shown on slide 24, this process was visible in the quarter with NPLs increasing to 1.5% of loans. However, it is important to note that the impaired loan ratio, that is the ratio of NPLs plus restructured loans did not show the same trend. Reflecting that new impaired loan creation did not accelerate in the quarter. The coverage of NPLs as of June, 2022, reached 228%, and there has been no reversal of the voluntary provisions we recognized in 2020 and 2021.

Robert Moreno:

As we can see on slide 25, these positive asset quality indicators led to a cost of credit of 1% for the second quarter of 2022 and 0.9% during the first half of the year. In line with our guidance for this year, which remains unchanged. On slide 26, we moved to non net interest income revenue sources, which expanded 15.3% year-over-year in the second quarter. Fee income increased 17% year-over-year driven by higher client activity and the growth of our client base as previously described. Compared to the first quarter fees decreased 2.5%, mainly due to the effect the new interchange fee caps that started in April this year that reduced the income the bank makes under card transactions.

Robert Moreno:

As shown on slide 27, operating expenses in the second quarter, increased 8.5% year-over-year and 15.8% Q over Q. The QOQ rise in cost is mainly due to seasonality effects and inflation. Compared to the second quarter 2021, the rising cost was mainly fueled by the impacts of inflation on personnel expenses and some administrative costs, the depreciation of the peso, which increased some administrative expenses denominated in US dollars, mainly IT related. And finally hire other operating expenses due to the recognition of greater provisions for non-credit related contingencies, mainly related to future severance payments. Furthermore, as Santander consumer, our outer lending subsidiary, sales and results have increased significantly. We also incur greater expenses related to the joint venture with our main dealership partner, which is recognized in this line. Finally, the bank continues ahead with its $260 million technology investment plan for the year's 2022, 2024.

Robert Moreno:

Despite this rise in cost, the being sufficiency ratio in the first half reached 37.9% to compare to 40% in the same period of 2021. Moving on to slide 28, we now analyze our capital ratios. At the end of second quarter 22, the bank reported a core equity ratio of 9.6% and a total BIS ratio of 16.2. During the second quarter, the bank paid its annual dividend representing 60% of 2021 net income with an attractive dividend yield of 5.5%. This led to a decrease of 60 basis points on our core capital. Our fully loaded ratio was 10.1% core capital. And we recorded a total BIS ratio of 16.77% at the same date. We are on track to finish the year with a core capital ratio above 10%. And we are maintaining our guidance of a dividend payment of 50 to 60% of 2022 earnings. Finally, on slide 29, we present our outlook for the rest of 2022.

Robert Moreno:

We expect our business segments to continue performing well, thanks to our digital platforms and growing client base. This will be the basis for long term growth and profitability in the coming years. The macroeconomic situation is also a key factor on our results. And as Claudio mentioned, we now expect the GDP of around 0.5% this year with inflation reaching around 12% on the monetary policy rate with further increases and probably finishing the year at around 10.5. With this, we expect long growth of eight to 10%, and a net interest margin for the full year of 3.5 to 3.7. Non NII should grow this year by at least 15% driven by client growth and greater product usage. Our guidance for the cost of credit remains unchanged at 0.91%. Given our efforts with our digital strategy, we expect cost to grow below inflation at around 7% for the year, and at a much slower pace than observed in the second quarter. All in, we expect an ROE of 21 to 22% for 2022. With this, I finished my presentation and now we will gladly answer any questions you may have.

Operator:

Thank you very much for the presentation. We'll now be moving to the Q&A part of the call. If you have any questions, please press star two on your keypad. That's star two on your keypad. You may also ask a voice question if you are dialed in via the web, the text questions are disabled for this call. Our first question comes from Mr. Jason Mollin from Scotiabank. Please go ahead, sir. Line is open.

Jason Mollin:

Thank you very much. Thanks for the presentation gentlemen. My thought, my first question, I guess, is on the path for inflation in the third and fourth quarter, given the higher policy rates. If you can talk about that path to get to the inflation rate for the full year. And I'm imagining that sensitivity for NIM to inflation is why you're maintaining the NIM guidance at three and a half to 3.7. And why the ROE for the full year is so much lower than the first half. If you can provide some color, that would be great. And my second question is really on the outlook for the regulatory environment in Chile. We've seen some news on a potential FinTech law. If you can talk about that and if you expect competition to heat up. Thank you.

Emiliano Muratore:

Okay. Hello. Thank you for your question, Jason. I mean, I'll take the first and I leave Claudio for the first one. I mean, regarding the path for let's say inflation rates and NIM, as basically our expectation for inflation for the year in slide, basically having in the second half, the same inflation or almost the same inflation we had in the first half. So that's, let's say so it would be flat semester versus semester, but the policy rates for the second half is going to be significantly lower. And that's why even though, in the first half, we were able to sustain the NIM above four, for the second half that number will trail downwards, according to our expectation for inflation and rates. And that will, let's say average 3.5 to 3.7 for the year.

Emiliano Muratore:

It's true that the reaction function for the Central Bank in the sense of how sticky high inflation will be and how they will react to that. And when they will start, the easing cycle is going to be a crucial element going forward for our NIM, but for the second half, basically that's the equation. I mean, a similar level of inflation with a higher short term rates and that's implying lower NIM for the second half averaging 3.5, 3.7 for the year.

Claudio Soto:

Well in term of the regulatory environment, one of the main regulation that is in Congress right now is the fintech regulation that also includes open banking, regulating open banking in Chile. In term of a FinTech, basically our reviews that it regulate activities that are currently being developed by certain companies. So it basically put them under the umbrella of the CMF, which is a good thing to do. In terms of banking, the key point there is basically data protection. There is also a law in Congress right now that is pursuing to protect personal data. And the important thing here is that both laws talk to each other, that they are coherent.

Claudio Soto:

So the important thing in the case of open banking is to have a good regulation in term of a personal data. Also, it is advancing in Congress, an old bill that consolidate that information, that has been very important in order to have a better data and information to evaluate risk, and because this regulation on FinTech and on open banking that has opened the door to re-discuss this bill on consolidated debt. And would have a positive view on that regulation.

Jason Mollin:

Is there any comment on timing? When do you think open banking rules or the FinTech law could be implemented?

Claudio Soto:

We think that at least during this year, it will be on the discussion in Congress. And then there is a transition for implementation that might take place during next year. Probably the political agenda in the second semester this year will be very much focused on the constitutional process. And that will take a lot of political energy in Congress. So it might be the case that this discussion will stall a little bit, but it might be finished by the end of this year. And then next year starting its implementation, that would be the shortest period of implementation.

Jason Mollin:

Thank you. Appreciate it.

Operator:

Thank you very much. The next question comes from Mr. Tito Labarta from Goldman Sachs. Please go ahead, Sir. Your line is open.

Tito Labarta:

Hi, good morning, Emiliano and Robert, thank you for the call, taking my question. A bit of a follow up to Jason's first question on the guidance for the year. I guess, I mean, do you think that the guidance is sort of conservative at this point? Can there be some upside risk? Because to get to 21, 22% ROE for the year, that means you probably have to be below 20% in the second half of the year, just to get how much conservativeness may be baked in to that guidance? And then kind of similarly, could you remind us the sensitivity of your margin to the higher rates? So if inflation will be the same in the second half as the first half, how much will your margin fall because of the higher rates or just if you can remind us of the sensitivity of that. Thank you.

Emiliano Muratore:

Yeah. So hello, Tito, thank you for your question. I mean, I would call it like neutral, I mean, or balanced the different risk to the guidance. I mean, basically it will depend on the combination of inflation and monetary policy rate. So with our expectation of inflation around 12 and the rates picking at 10.5, that's the number basically we have seen. And from that basically the risk or the moment from that base case scenario would be the higher the inflation, the better and the opposite, right? I mean, considering that we are already in July, the effect of the rate for this year tends to be lower for the calendar year and will be affecting more next year. So with our macro expectations, I would call it, like balanced and without, let's say, I wouldn't call it conservative, according to that assumption. So inflation at 12 and rate speaking at 10.5 by the end of the year. And in terms of sensitivity, probably-

Robert Moreno:

Yeah. So basically we have around like 30 basis points, sensitivity to inflation, okay. For every a hundred basis points, it's around 30 basis points in NIM, and here it's really informative, and Emiliano said, it's over like the sequential. So even inflation's going to remain high, we had like more or less 6% inflation UF, and the first app, we more or less have six in the second. Sequentially, we're not gaining any more NIM because of inflation. Okay. So that's why it's a little tricky because inflation is still high, but we're not gaining any more from that. On the other hand, we have the sensitivity, the short term interest rates, as you know, we have this kind of natural hedge where we have our long inflation, and we're obviously repriced our liabilities okay, faster than the more sensitive to monetary policy rates.

Robert Moreno:

So today the sensitivity of more or less, a hundred percent rise in rates, short term rates is around 25, 30 basis point. So in the first quarter, I think the average monetary policy rate must have been around four, the second quarter, seven. But in the third and fourth quarter, the average monetary policy rate is going to be roughly around 10%. Okay. So you're not gaining anymore NIM, unless inflation continues to surprise on the upside, but now you're going to see the bulk of the effect of the rise of rates. Okay. So with those sensitivities, you more or less get that, an interest margin for the year of 3.7.

Robert Moreno:

And where could this change? Is if inflation goes higher and rates don't change. So if inflation ends up at 13, let's say, and rates still stay 10, we get another 30 basis points more of NIM. Okay. So that is kind of the equation we're looking for, for the second half of this year.

Emiliano Muratore:

Remember that also inflation has an impact on the effective tax rate.

Robert Moreno:

Yeah.

Emiliano Muratore:

So that's amplifies the effect. I mean, let's say the higher the inflation from our base case will imply a lower, effective tax rate on the opposite. So that's, but as we see now, and when you look at market prices and service and the different scenario, inflation around 12 looks like balance view.

Tito Labarta:

Great. Thanks, Robert. Thanks Emiliano. That's helpful, but it just sorry, to follow up on this, but I think your economist mentioned inflation reaching 13% in August and September, right? So already for 3Q, you're probably running ahead of that expectation to some extent. So you would expect some kind of decline in inflation probably for the fourth quarter. So-

Emiliano Muratore:

Yeah, yeah. On a year basis, remember that inflation has started to pick up late last year. So that's why the sequential year-over-year tends to go down from where we are now, because last quarter of last year was already high. So we, that-

Claudio Soto:

Yeah-

Emiliano Muratore:

Go ahead.

Claudio Soto:

From July until October, we see prints that are on average one percentage point increase from a monthly basis. And then November and December, we see much softer monthly CBIs, about 0.4% on average.

Tito Labarta:

Okay. Perfect. Thank you.

Operator:

Thank you very much. The next question comes from Yuri Fernandez from JP Morgan. Please go ahead, sir. Your line is open.

Yuri Fernandes:

Thank you everybody. I have a question regarding asset quality. We saw an increase on NPLs this quarter, or slightly higher new NPO formations than you using little bit your coverage ratio. My question is what should we see going forward? Like should NPLs keep deteriorating now that economy is slowing down, we have much higher inflation? And if any NPLs are supposed to keep deteriorating, where should they land? Is this a normalization to pre COVID levels? Are you concerned that this may go higher? What is the message overall for asset quality going forward? Thank you very much.

Robert Moreno:

Okay. Yeah. You're correct. So the NPLs went up in the quarter, not so much impaired loans. So what does that mean basically is that people who were already impaired meaning that they were restructured or they were more than one day overdue, they floated down to NPL status. So that's a good thing in the sense that given that more people are not really entering impaired and people who are impaired are entering NPLs. It basically means that it's good for the cost of credit because we already have a high coverage. Meaning that people who are impaired or are going to NPL already have a deteriorated expected loss and therefore the provision taken. Okay. So that's why we should continue seeing some NPL deterioration going forward and should eventually by the end of next year, I would say, or sometime next year reach pre pandemic levels, which I believe was an NPL ratio over around 1.8%.

Robert Moreno:

Okay. Remember, we're coming off of all time lows. So I think that's going to be a normal process. Also we are expecting, I said the economy was going to grow like 0.5. This year, the economy is going to grow like 1.5, what Claudio said, but next year it could actually have a recession. It could actually be negative. Okay. So all in, we expect the cost of credit, we're not changing that. We still think it's there, because of the high coverage, it should remain at 0.91%, the cost of credit, but NPL should slowly, gradually return to pre pandemic levels of around 1.8%. And also a coverage level should go down further. Okay. And this is without taking into account any reversal yet of the voluntary addition of provisions we have taken.

Okay. There are also some accounting, for example, in the first quarter you saw mortgages fall very, a lot in NPL, but we did a lot of coverage.

Robert Moreno:

So we knew there was going to be a shift in the NPLs and in mortgage. Okay. Because we saw that in early non-performance, so that's good because in the first quarter we ready took the necessary provisions to cover the mortgage. So I don't see mortgage NPLs rising very much going forward. And the coverage ratio basically went back to where it was at the beginning of this year. So I think there's, we did a very good move in the first quarter of anticipating that increase in NPLs. So that's basically the summary. I don't know if that was clear.

Yuri Fernandes:

No, that was super clear, Robert. Thank you very much. And if I may just a second question regarding the deposits, right. And I guess this is totally expected. We are seeing demand deposit decreasing. There is a cost of opportunity given higher rates. But my question is, how do you see these movements, right? Is this in the same pace as you're expecting, is this faster than you expect? So basically, what is this view for demand deposits versus total deposits going forward? You know, should this normalize in 2023, do you believe you can keep a buffer helping your margins? Because I guess we discuss in the previous questions a lot about inflation and rates, but I guess on the liability side, you also have the pressure, right? Like your funding costs should go up because of the mix, right?

Emiliano Muratore:

Yeah. I mean, we think that the fall in demand deposit will start to slow down. And basically, because what we are seeing is that the fall is mainly concentrated on individuals. I mean, basically people spending the money they got from the pension fund withdrawals and from the fiscal stimulus through COVID. Spending, or let's say taking advantage of the higher level of rates, I mean, or let's say reacting to the higher opportunity cost of the rates, so that process is finished. I mean, let's say is not, let's say unlimited, but that amount money, so that will be slowing down. We think that maybe by the end of the year, that process should like normalize and we can start to have like a normal pace of growth, because the effect of the opportunity cost of rates basically will be already there, I mean that will be, that the shifting should kind of finish and starting forward from there, we should have like a more normal pace of growth of deposits, time and demand deposits, and the shifting basically waning by the end of the year, beginning of the next year. I don't know about-

Robert Moreno:

Yeah. So we talked about the sensitivity to rates and that also includes the shift. So another reason the NIMs are a little tighter and the second half is because of this shift. Okay. So I guess that's a really good point you're making, where it's not only the sensitivity is what it is, but also you have a lot of people flowing to time deposit, we haven't seen this rate of markets here in Chile stock and everything. There's kind of still a lot of risk aversion. And you can take a 10, 12% time deposit and that's an assured profitability for the clients. So, yeah, that's included basically in our NIMs outlook, it includes the shift.

Emiliano Muratore:

And also there is an effect on the same direction related to the asset side, in the sense that people still have liquidity. So basically they are not borrowing much. And that's why you see origination and volumes in the consumer side falling flat to fall in. But when they basically spent the money, or they don't have more money, they will also, I mean, the demand deposit will stop falling. And also there will be more, let's say tailwind to consumer credit. So we will start to originate assets at higher rates. So at the end, that process happening by the end of the year, beginning of next year will have like that double positive effect that the negative effects will stop.

Robert Moreno:

Yeah. So just the last thing it's kind of hard to see this because there's a lot of translation gain and long growth. Okay. But let's say if you eliminate that apart from auto loans, the finally credit card loans started to grow in the quarter. Okay. Remember credit card and auto loans are nominal peso. So in terms of real origination, we saw, honestly, in two products auto loans and credit card, which is basically people returning to more normal. So basically in line with Emiliano, you should see, and those are coming out at good spreads, but you'll see the impact of that on NIMs next year. Okay.

Yuri Fernandes:

No. Perfect. Thank you, Emiliano. Thank you Robert.

Operator:

... very much. Our next question comes from Mr. Ernesto Gabilondo from Bank of America. Please go ahead, Sir. Your line is open.

Ernesto Gabilondo:

Hi, good morning, Emiliano, Claudio, Robert, and good morning everyone. My first question is on your long road. Just want to hear your expectations considering the higher rates and the potential economic recession in Chile. So wondering more about the long road for next year, I would like to hear like your first impressions for next year. And which do you think will be the segments that could suffer the most, and which would be the ones that could be more resilient. And then my second question is on asset quality, also considering the economic recession, the challenges of a new tax reform, a new pension reform, the economic risk that you pointed out on the ongoing constitutional process, even if it's approved or not, the lower copper prices that you mentioned, and that you are no longer having the excess liquidity from pension withdrawals. How should we think about the asset quality for next year? Thank you.

Robert Moreno:

Okay. So long growth, obviously this year, it's growing a lot of it influenced now by the depreciation of the peso on inflation. And then originations are, if originations lead to a lower actual long growth. Okay. So next year with economy flat or negative growth, okay. We should see long growth probably in the mid to low single digits. Okay. The good news there. And linking this to your question about resilience. I would say that a lot of loans that were very subdued growth because the excess liquidity in households should drive growth next year, mainly consumer growth. Okay. I think there's... And also, even though there might be a slight recession, unemployment should then continue to improve, our average client in terms of depth servicing ratio, in terms of household depth overall, is still much better than it was actually even before 2018.

Robert Moreno:

Okay. So the average health of our client without being very aggressive in loan growth, there should be room to grow the retail loan book. SMEs have been, basically, they grew a lot 2020, 2021 because of the

Fogape. This year, there's been more of actually the SMEs normalizing their balance sheet situation, paying off some of these loans. So I think there should be some moderate SME growth next year. And mortgages, if rates start to come down and inflation starts to come down, there could be real origination growth. This year, originations are down, it's basically inflation. So basically I think there will be growth in the retail loan growth, but basically overall with low single digit loan growth.

Robert Moreno:

And in terms of asset quality, yeah. As you said, on the one hand, there's going to be lower growth, but on the other hand, as I said, we still have, our average client still has very good asset quality indicators. Okay. In terms of paying, remember some people spent their excess liquidity, a lot of our clients paid off their debt or saved their money. Okay. So I think that in this recessionary cycle, there will be, as I mentioned before, an uptake in NOLs. NPLs going back to pre pandemic levels, but we still currently, even with our GDP guideline, we're still seeing the cost of credit 0.91%. Okay. And on top of that we still have our addition of voluntary provisions, which are there, and we're not thinking of using them, but they're still available.

Ernesto Gabilondo:

Perfect. Thank you very much, Robert. And I just want to double check if you continue to see a medium term ROE between 17 and 19%?

Emiliano Muratore:

Yeah. Yeah. Basically we maintain that view on long term ROE.

Ernesto Gabilondo:

Perfect. Thank you very much.

Operator:

Okay. Thank you very much. Our next question comes from Mr. Alonso Garcia from Credit Suisse. Your line is open, sir. Please go ahead.

Alonso Garcia:

Hi, good morning. Thank you for taking my question. It's just a follow-up on a asset quality. I don't know if you could comment on your exposure to certain industry where you see particular risks. I mean, the current macro environment, I mean, have in mind the real estate industry, given higher interest rates and the health insurance industry, given all the noise that we have been seeing with the Isapres. So those are the ones I have in mind, but I don't know if you could comment on this or any other sector where you could see particularly higher risks in this environment for your commercial portfolio? Thank you.

Robert Moreno:

Okay. So regarding our exposure first of all, in the health industry, it's really low. We have a 10% market share in Isapres, and it's not significant. I mean, it probably require, maybe require more provisions, but I would say nothing that jeopardizes our outlook. And in real estate and in construction, I would say it's around five, 6% of our loan book. And there, the good news is that the companies we deal with, first of all, the NPLs are still ridiculously low. And second of all, the companies we deal with in those sectors still have very strong balance sheets. And we tend to deal with well-established a real estate and construction firms that have good balance sheets. So I would say construction in Chile has been slowing down. I would say that's a little bit more of the tricky sector.

Robert Moreno:

There will probably be an increase in provisions, maybe mainly among small construction businesses, but overall, those are a big part of our loan book. Okay. But the large construction companies, I think have very solid balance sheets. We probably won't be growing, but we don't see a major threat there. And then the real estate developers, our client mix, there is actually very good and they manage very well. The cycle, like selling, getting rid of inventory, having good cash. So overall there will be an increase in risk in those sectors. But I would say nothing that jeopardizes our cost of credit outlook. Also remember during the pandemic in 2020, '21, we set a lot of provisions in the corporate area. So any weakness we saw in the loan book, any, and more than a sector on a client basis, we kind of cleaned up during the pandemic.

Robert Moreno:

So any weaker client that we saw that either wasn't going to make it through the pandemic or was going to have difficulty in a recession, we increased a provision. So that's why I think even during this downturn, we're entering it with, I think a very healthy corporate loan book, which is in the end where you always try to avoid big surprises. And on the retail side, you can manage it in terms of the scoring models, but the problems come when a larger company has problems. But there, I think we are very, very confident that we're entering the cycle with very, very good coverage of that loan book.

Alonso Garcia:

Thank you. And so I may follow-up, I mean, what is needed for you to decide using some, at least of additional provisions that you have created since 2020? I mean, what kind of NPL ratio or contraction in GDP you would need to see to make use of those additional provisions that I think that's so far you are guiding that you won't be using, correct?

Emiliano Muratore:

Yeah. I mean, I would say that the base scenario is not using them. Basically that's a board decision, there hasn't been set a specific target of NPL or cost of risk, as you were asking. I could say that the idea of those provisions basically was to prepare for really high levels of risk coming out of the pandemic from the macro situation. So I wouldn't expect the usage of those provision unless we are significantly high in terms of customer risk, meaning significantly high, definitely above pre pandemic levels. And let's say, and using that voluntary provision as a way to smooth, or to absorb that extraordinary high level of risk, that, that's why it was created. But as I said, I mean, so far the base cases that we are not planning to reverse any of that and basically will be decision from the board when to use it. But the spirit is basically that, I mean, to use it as a way to absorb extraordinarily high levels of cost of risk.

Alonso Garcia:

Very clear. Thank you very much.

Operator:

Okay. Thank you very much. Our final question comes from Neha Agarwala from HSBC. Please go ahead.

Neha Agarwala:

Hi. Congratulations with the results. And thank you for taking my question. Just very quickly about the outlook for 2023. So this year, the earnings have benefited a lot from higher inflation. Next year, as inflation eases off, is there anything that the bank can do to offset the impact on margins from more moderate levels of inflation? Maybe higher fee income growth, loans, what you said would be around, in low single digit, but is there anything that you can do? How do you see the earnings evolution for 2023? Thank you so much.

Emiliano Muratore:

Hello, Neha. Thank you for your question. I mean, talking about 2023, we think that it's still a bit early to talk much about the guidance for next year, basically, because as you were saying, inflation and rates are going to be key drivers for revenue, for margin, and for basically bottom line evolution. When you say what the bank can do, I can add that what the Center Bank can do. I mean, in the sense that in that scenario of inflation, basically going down from, let's say, low double digital, low teens, if you want to mid-single digits or something like that, we would expect the Central Bank to start cutting rates. And that's going to be the counterbalancing effect on our margins. I mean, the big question is, say the pace and the rhythm and how aggressive the falling inflation is and how aggressive the Central Bank is reacting to that.

Emiliano Muratore:

So, but basically, I would like to wait some more months, I mean, maybe next call to discuss more 2023 in that sense, because at the end it will be the combination of that, how fast and how low the inflation goes down and how the Central Bank reacts to that. That from let's say the pure financial sensitivity point of view, as you said, all the non NII revenues are doing really well. I mean, expect also to be growing healthy on the different lines in fees as we are doing now. And also from our market transaction, you saw the numbers in checking accounts, special checking accounts, dollar checking accounts, that, that's doing really well. So from the non NII point of view, we are, let's say confident and positive on the outlook for next year, because our commercial activity is with clients is doing really well. And all the initiatives we are doing in the digital front are helping to sustain that.

Emiliano Muratore:

And from the more NII financial point of view, I would like to wait a bit more visibility on that let's say, easing cycle or the dovish cycle that it should happen anytime in the future, depending on local and international conditions.

Robert Moreno:

Okay. No, just real quickly, also costs, I mean, obviously there's the inflation, but as you saw in the second quarter, we sped up, we've already closed 10% of our branches. There's a lot of efficiencies that we're working on as well. So productivity should rise as Emiliano said, our client business is doing really well. You know, we're adding, I believe like 60,000 clients a month or so, and a new client. So there's a lot of room there in terms of cross selling. And another thing that's important is that in the second quarter, obviously inflation was a big deal, but when you exclude that the growth of non credit related income has been very strong. Okay. So I think that's really going to sustain our results next year.

Neha Agarwala:

Very helpful. Thank you so much.

Operator:

Okay. Thank you very much. It looks like we have no further questions at this point. I'll pass the line back to the management team for the concluding remarks.

Emiliano Muratore:

So thank you, Miguel. And thank you all very much for taking the time to participate in today's call. We look forward to speaking with you again soon.

Operator:

Thank you very much. This concludes today's call. We'll now be closing all the line. Thank you, and have a good day. Goodbye.

Emiliano Muratore:

Bye-Bye.