Banco Santander Chile

CONFERENCE CALL ON BANCO SANTANDER CHILE'S RESULTS FOR THE 2Q OF 2023

Operator:

Hello and welcome to Banco Santander Chile's second quarter 2023 results conference call. We are joined today by the CFO Emiliano Muratore, Chief Strategic Planning and Head of IR Cristian Vicuna, and Chief Economist Claudio Soto. I'll now hand the line over to Emiliano to begin the presentation. Please go ahead, sir.

Emiliano Muratore:

Good morning, everyone. Welcome to Banco Santander Chile's second quarter 2023 results webcast and conference call. This is Emiliano Muratore, CFO, and I'm joined today by Cristian Vicuna, Chief of Strategic Planning and Investor Relations, and Claudio Soto, Chief Economist. Thank you for attending today's conference call. Today we will be discussing the trends and results of the second quarter. I am pleased to share that our digital strategy and customer-centric product offerings have been instrumental in driving robust results across all business segments, particularly witnessing exceptional growth in non-NII revenues. In addition to this success, our relentless focus on cost discipline has allowed us to partially offset the NII pressures arising from the non-client's NIM during this period of lower inflation and high rates. Looking ahead, we are optimistic about the benefits our well-positioned balance sheet will reap from the Chilean central bank easing cycle of interest rates, which commenced last week. This shift is anticipated to trigger a significant recovery in our NIMs, and we expect this positive impact to manifest in the final months of this year. To begin, 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, economic activity contracted significantly due to continued tight financial conditions and less favorable external conditions for the country. Also a poor mining performance affected by the delay of large investment projects had an impact on activity. In the coming months, we will continue to see a weak economy, with consumption falling at significant rates and low investment. Based on the information available, we have revised downward our activity estimate for this year from minus 0.75 percent to minus 1 percent. However, next year the economy should rebound and grow at around 2 percent. The contraction of GDP has generated a significant slack in the economy. This, together with an appreciated peso, the normalization of raw material prices, and a reduction in international logistic costs, have caused inflation to drop rapidly. Thus, the CPA, after closing 2022 with an annual variation of 12.8 percent, today stands at 7.6 percent. In this context, the Central Bank of Chile began the process of monetary easing, with a sharp cut of 100 basis points in the monetary policy rate at its July meeting. The rate drop was somehow higher than expected by the market. Because of that, there were adjustments in some financial prices. The peso tended to depreciate, and swap rates fell significantly, indicating that the next rate cuts would be more intense than expected until a few weeks ago. In recent days, the peso has continued to depreciate due to global factors associated with greater risk aversion after the downgrade of the U.S. sovereign note. Looking ahead, we estimate that despite the recent depreciation of the peso, inflation will continue to drop rapidly and will close 2023 at around 4 percent, to then reach the target of 3 percent during the second quarter of 2024. This will give room for the Central Bank to continue cutting the monetary policy rate at least 100 basis points in each of the following meetings during the year, with which the NPR will close at around 7.25 percent. In the second part of 2024, the rate will reach its neutral level, which we estimate at 4.25 percent. On page 6, we give an update on proposed regulations. At the political level, after the rejection of the tax reform in Congress last March, the government has announced a fiscal pact. The idea is to implement measures against tax evasion and to boost growth with the aim of increasing fiscal revenues, and thus financing a series of expenses in the areas of health, pensions, and public security. Next March, there will be a new bill with a proper tax reform, although details are still unknown. On the other hand, the government has summoned various actors to unlock the pension reform, which has failed to advance in Congress. In financial matters, the Central Bank of Chile decided to activate the countercyclical capital requirement, setting it at 0.5 percent of risk-weighted assets. This is a precautionary measure against financial risk from the external scenario. Banks have until May 2024 to constitute that requirement.

Cristian Vicuna:

Thank you, Claudio. I would like to start by reminding you of our Chile First strategy on page 8, where we are aiming to become the best bank for our customers, employees, communities, and shareholders. We want to achieve this plan through the four pillars of our strategy. First, to become a digital bank with branches, a digital bank with work cafes, to reach customers with state-of-the-art technology and the best level of service. Second, with specialized and value-added services for our corporate, middle market, and private banking businesses that focus on value-added transactional, trade, ethics, and advisory products and services. Third, searching for growth opportunities. We want to break paradigms in the banking sectors, finding new business opportunities and leading the sustainable transformation of our clients. And finally, a key enabler, an organization that is agile, collaborative, and high-performing in which a diverse culture with exceptional people can advance based on merit. To elaborate on our first strategic pillar of a digital bank with work cafes, we highlight the success of our digital products, such as the Santander Life Accounts, which has over 1 million clients with access to a simple current account and the opportunity to buy other products such as time deposits, mutual funds, and access credit lines and loans when they meet the bank's risk requirements. We also offer our Mas Lucas, our new site and savings account that was launched in March this year and is gaining traction every day. The onboarding process is 100% digital. There are no passwords, only facial recognition. This account has no fixed or variable costs and accepts deposits for up to 5 million pesos.

Thanks to these successful initiatives, we have around 2 million digital clients who are able to carry out their banking needs through the website or phone app. The advances in our digital strategy have allowed us to deepen our branch innovation. Many of you have had the opportunity to experience our work cafe branches, our digital branches with a co-working space, and we have reinforced our branch network with the Work Cafe Expresso branches, a format that aims to consolidate cash operations in a transaction hub with a work cafe look and feel and a state-of-the-art technology behind the scenes to offer our customers an efficient and more secure experience. We have opened four Work Cafe Expresso centers in Viña, Rancagua, Santiago Center, and Las Condes, and we are looking for further expanding the model in other dense areas in Chile. On page 10, we can see the results in the advancements on our digitalization and simplification in the reduction of our branch footprint. As of June, our total network reached 260 branches, down 16% from June 2022. 31% of our branches currently are cashless, meaning that there is no back office and that the branch is a business center oriented towards advisory, new business, and customer experience. At the same time, our productivity is rising, with loan and deposit volumes per branch increasing 22% year over year, and in the same indicator, per employee, rising 6.8% in the same period. Moving on to page 11, we can see how our SME footprint is growing strongly with the joint offer with GetNet. Firstly, our digital life accounts for SMEs continue to drive a 17% year over year increase in total clients of that segment, reaching more than 300,000 SMEs, and a 13% year over year increase in active SME clients. Furthermore, if we consider current accounts for businesses, as reported by the CMF, we have increased our business accounts by 31%, representing 33.5% of the market share as of April 2023. GetNet, our acquiring business, also continues to contribute to the success of attracting more SME clients. GetNet continues to focus on the development of companies of different sizes and improving customer experiences through the integrated payment solutions to business. In total, GetNet has now deployed more than 219,000 POSs across the country, with over 157,000 SMEs GetNet clients, which have been growing 83% year over year. In the first six months of the year, GetNet has generated fees of 21 billion pesos. Some results on how productivity is being achieved through a committed and talented workforce are shown in page 12.

We can see how our strategy is leading to a cost structure where it costs us less to serve our clients compared to our competitors. In terms of recurrence, our fees generated by our customers now cover almost 60% of our expenses, compared to an average of 43% in the industry. Our costs represent only 1.1% of our assets, compared to 1.5% in the industry, and the operating cost to serve our loans is 2.3%. Our cost per branch is 3,144 million pesos, compared to over 4,000 million average per branch in the system. The cost per current account is 0.35 million per account, less than half the industry average of 0.8 million per account. These indicators show how the organization is transforming to be more agile, collaborative, and high performance. On page 13, in terms of NPS, we continue to lead our peers in service quality with 56 points. Over the last year, we have seen a slight dip in results due to ongoing improvements in cybersecurity for our 2 million digital clients. Our live clients continue to surpass our other clients in satisfaction with the bank, with an NPS of 72 points, demonstrating the strength of our digital channels and our website and app, both score highly with 70 and 69 points respectively. Furthermore, Euromoney have recognized us as the best bank in Chile, demonstrating the impressive results of our strategy compared to our local peers. Another point to highlight was the progress made in our commitment to our responsible banking objectives. Our progress to meet our goals, such as diversity and inclusion, are well on track. We have a market-leading range of sustainable products that help care for climate change with Santander Verde, and in 2022, we managed to support numerous customers with sustainable operations in our businesses and corporate banking businesses. So far, in 2023, we have disbursed $140 million for green finance in the first half of the year. We believe that this will be one of the fastest-growing areas in the coming years. This has resulted in being ranked first in the main sustainability indices, such as Sustainalytics and MSCI. We are also the only Chilean bank included in the Dow Jones Sustainability Index for global emerging companies. Now let's talk about the trends in our results and balance sheet. On page 17, we show our results for the quarter. Our operating segments that exclude the corporate centers and ALM continue to perform well, with a 38.8 percent year-over-year increase in their net contribution, an important expansion in income lines, and fees with cost and risk under control, demonstrating the results of our strategy across the segments. The accumulated net income as of June 2023 totaled 263 billion pesos, decreasing 50 percent year-over-year. On the other hand, the book value of our equity increased 16 percent year-over-year, with our TNAPs per share and dividends per share growing 23 percent. With those two effects of net income and equity, the accumulated ROE reached 12.9 percent in the first six months of 2023. Moving on to page 18, the results of Santander CIB, Corporate Investment Banking, have continued to be impressive, increasing 84.5 percent year-over-year. Net contribution from the middle market of corporates increased 38 percent year-over-year. Both of these commercial segments experienced an important rise in deposit stress, as well as high growth of fees and treasury income. The focus of these segments continues to be on non-lending activities driving profitability. On slide 19, we can see that retail banking results increased 21 percent year-over-year, driven by the greater client base and more activity by our clients.

Our active individual clients increased 4.2 percent year-over-year, and digital clients increased 1.3 percent, while our active SME clients have grown 13 percent compared to June last year. The margin increased 18.5 percent year-on-year, due to a better mix of funding and loan growth. Fees in this segment increased strongly, by 29 percent year-over-year, driven by card fees, due to greater usage and the increase in the client base, as well as the fees generated by GetNet. Provision increased 57 percent year-over-year, due to the normalization of the liquidity of our clients in recent periods. Operating costs increased in a controlled manner, by 4.5 percent year-over-year, as the bank continues its digital transformation, generating greater operating efficiencies. In terms of loan growth, in the second quarter, loan growth remained subdued, as the economy continued to feel the effects of the high interest rates. During the quarter, the CID segment decreased 1.4 percent quarter-over-quarter, as the short-term loan operation carried out in 2022 came due. The middle market segment's loan portfolio slightly increased 0.2 percent quarter-over-quarter, mainly driven by positive translation gains on U.S.-denominated loans. Earlier this year, we launched specialized attention models for the agro-, automotive- and multilatina sectors, that will enhance loan and income growth in this sector in the coming quarters. Federal banking loans grew 1.3 percent Q-on-Q, led by a 2.4 percent quarter-on-quarter growth in mortgage loans, and a 1.3 percent in consumer loans. Origination of new mortgage loans has remained subdued, due to higher interest rates and the impact of the inflation on the value of the unidad de fomento. Including consumer loans, between the end of 2019 and 2021, these loans decreased 7 percent, as clients reduced large purchases, such as travel and a hotel, which fuels credit card loans. At the same time, many clients paid off credit card debt with the liquidity obtained from government transfer and pension fund withdrawals. At the end of 2022, as household liquidity levels returned to normal and holiday travel resumed, credit card loans began to grow again, increasing total balance compared to pre-pandemic levels. As for SMEs, the demand for new loans continues to remain subdued, as clients continue to pay back their forgotten loans disbursed in 2020 and 2021. Overall, loans have grown 3 percent year over year, and we maintain our guidance of year over year loan growth of mid-single digits.

Slide 21. Liquidity levels remain strong in the quarter. The bank's total deposit increased 0.3 percent QonQ and 2.2 percent year over year. The increase was driven by time deposits that increased 4.4 percent quarter on quarter and 25 percent year over year, as the high interest rates continue to attract clients. While our demand deposits have decreased 15.6 percent year on year, our market share in demand deposits has increased from 19.9 percent to 21.7 percent. Bonds issued increased 7 percent and 2.6 percent the last quarter. During the year, the bank has issued bonds for 1.7 million U.S. and 383 thousand million pesos, 30 million dollars, and 17.5 billion Japanese yen, taking advantage of attractive opportunities in the various fixed income markets locally and abroad. The bank's liquidity coverage ratio, LCR, which measures the percentage of liquid assets over net cash outflows as of June 30, 2023, was 175 percent, well above the minimum. At the same date, the bank's net stable funding ratio, NSFR, which measures the percentage of illiquid assets financed through stable funding sources, reached 109.4 percent, also well above the current legal minimum set for this ratio. In terms of margins, the bank's NIM in the quarter reached 2.2 percent. The variation of the UF continued to decelerate while short-term interest rates remained high. Both of these factors continued to weigh on the bank's NIM. As shown on this slide, this is mainly a phenomenon that affects our non-client NIM, or the net interest margin from our ALM activities, including the UF gap and our liquidity. The client NIM, which is defined as NII from our business segments over interest-earning assets, has increased as deposits and loan spreads have risen. The bank is well-positioned for a fall in real rates. The sensitivities to inflation and interest rates remain stable through the first quarter, with 100 basis points dropping inflation will pressure down our NIMs by 15 basis points and 100 basis points dropped in the average interest rates will increase our NIM by 30 basis points. Given the negative UF variation in July and the recent 100 basis points dropped in the monetary policy rates, we expect a UF variation of 4.3 and an average monetary policy rate of 10.3 percent for 2023, with our NIMs showing signs of a solid recovery in the fourth quarter to reach an estimated total NIM of 2.3 percent for 2023. Moving on to asset quality on slide 23, NPL ratio rose to 2.1 percent, gradually returning to pre-pandemic levels as household liquidity levels returned to normal and the economy feels the squeeze from high interest rates. The coverage of NPLs of June 2023 reached 165 percent and there has been no reversal of the voluntary provisions. As we can see on slide 24, these overall positive asset quality indicators led to our cost of credit of 1.19 percent in 2023, in line with our guidance for this year. On slide 25, we move on to non-net interest income revenue sources, which continue showing exceptional growth trends. Income from fees and treasury rose 61 percent compared to a second quarter of 22 and 6.6 percent quarter on quarter, driven by higher usage of products in all segments. We expect these trends to continue in 23. The gradual implementation of the new interchange fee regulation will start by year end and we estimate a negative impact in fees in 24 of 25 billion pesos and 47 billion pesos in 2025.

As shown on slide 26, we also can see the bank's effort to continue increasing productivity and to control costs. Operating expenses decreased 7.5 percent year over year and increased 2.2 percent quarter on quarter. The bank continues ahead with its 260 million dollar in technology investment plan for the years 23 to 25. And because of these investments, we are expecting costs to fall in absolute terms in 2023. Moving on to slide 27, we observe a positive evolution of our capital ratios. At the end of the second quarter of 23, the bank reported a core equity ratio of 11 percent and a BIS ratio of 17.5 percent after distribution of the annual dividend that amounted to 60 percent of the 2022 earnings. In May, the regulator announced that from next year, the Chilean banks will need to include a counter cyclical buffer of 0.5 percent. This, together with the conservation buffer of 2.5 percent and the systemic buffer for Santander of 1.5 percent means that our minimum fully loaded seat one will be 9.0 percent in December 2025. Below, on the right, we summarize the requirement levels by our regulator including the potential buffer requirements and additional capital. On slide 29, we conclude with some guidance. Our strategy of a digital bank with WorkFS will continue to provide us with a greater digital client base and solid fee growth and impressive operating efficiencies. Our updated macro scenario for 2023 is now a GDP contraction of 1 percent, a UF variation of 4.3 percent, and an average interest rate of 10.3 percent for the year. In terms of loan growth, we expect mid-single digit growth with a focus on all segments. As mentioned, the bank is well positioned for a fall in real rates and so, with further cuts in rates expected and a UF variation of 4.3 percent for the year, we expect NIMS of 2.3 percent for the full year with solid client NIMS and with the upward trends to continue into the next year. Non-NII growth should surface 20 percent this year on the back of strong client acquisition and usage figures. Growth control will be a major focus and we expect a decrease of low single digits in our total cost base. Asset quality has now almost normalized and the cost of risk should remain at a manageable level of 1.1 to 1.2 percent for the rest of the year. In summary, due to our updated inflation expectations, we expect ROE to be in the neighborhood of 15 percent for the full year and our long-term ROE expectations remain unaltered at 17 to 19 percent. With this, I finish the presentation and now we will gladly answer any question you may have. I'll hand over the word to our moderator.

Operator:
Thank you very much for the presentation. We will now be moving to the Q&A part of the call. We already acknowledged the questions that came in. However, if you have any questions, please press star two on the keypad. That's star two on the keypad for any voice questions and wait for your name to be called. You may also ask a voice or a text question if you are dialed in via the web. Okay, thank you very much. Our first question comes from Mr. Juan Recalde from Scotiabank. Please go ahead, sir.

Juan Recalde:
Hi. Good morning, Emiliano, Cristian, Claudio, and thanks for the opportunity to ask questions. I have two questions. I will ask the first one and then the second. So the first one is in terms of NIEM. The NIEM projection for 2023 is expected now to be around 2.3 percent. And in the past, it was mentioned that in 2024, it could rebound to 3.3 or 3.5 percent. So under the current macro outlook, how do you see NIEM in 2024?

Emiliano Muratore:
Hello, Juan. Thank you for your question. I mean, I think that what you mentioned still holds. I mean, like we expect the NIEM for this year to close around – I mean, by the fourth quarter, I mean, by the end of the year, to be around three. And for the next year, according to the real rates, we are anticipating for next year, I mean, combining rates to trajectory with the inflation slowdown to be in the 3.5 area for the full year 2024.

Juan Recalde:
Thank you. And my second question is related to this, because – so next year, the FCIC facilities expected to be repaid, and my understanding is that also some derivatives will expire next year in the first half of the year. So I was wondering if you can talk about the expected impact of these two factors, the FCIC facility being repaid and some derivatives expiring.

Emiliano Muratore:
Yeah, absolutely. So in our case, I mean, the FCIC was mainly floated. I mean, for us, it's like a floating rate liability. That is in part what has been affecting our NIEMs during the last two years, because of interest rates, short-term interest rates being as high as they are and they were. But the good part of this thing is that for us, the maturity or the expiration of the FCIC will be like non-relevant for our NIE. That number of the NIE will improve, because let's say we'll have a significant part of the balance sheet like the leveraging and falling with a low NIEM, and that will make the overall NIEM of the bank to improve, but going to your question, in our case, the expiration of the FCIC will be non-material for the NIE of the bank.

Juan Ericalde:
Thank you for the comment.

Operator:
Okay, thank you very much. Our next question comes from Mr. Ernesto Gabilondo from Bank of America. Please go ahead, sir.

Ernesto Gabilondo:
Thank you. Hi, good morning, Emiliano, Claudio, and Cristian. Thanks for the opportunity to ask questions. So my first question is on your ROE guidance. And remember, you were guiding before between 15 to 17, so now you're expecting the low part of the range, because of the expectation of lower inflation levels. So just wondering, how should we think about the ROE next year and in 2025? Just wanted to understand how we'd be approaching to your 17, 19

long-term target. Then my second question is on your reserve coverage ratio of 175%. Given your strategy to expand into the mid- to high-income segment in the consumer segment, what would be the level you'll be comfortable to maintain for the next years? And then my final question is on your effective tax rate. We have seen it has benefited because of high inflation, but now thinking that we're going into a lower level of inflation, how should we think the effective tax rate should be normalizing? Thank you.

Emiliano Muratore:
Okay. Thank you, Ernesto. Thank you for your question. I'll take the first one and I'll leave the other two to Cristian. In terms of the ROE path going forward, I mean, we expect to be next year in the long-term range that we are mentioning, I mean, from 17 to 19. And what part of that range will be basically will depend on the path of rates. I mean, as I mentioned before with the name for the year being around 3.5 according to our expectation of real rates next year being around like 2 to 2.2% for the full year. That will take us maybe closer to the higher part of that range. And I mean, looking forward to 2025, which is really long-term, we still hold our long-term ROE range and we think that we will stay there.

Cristian Vicuna:
Hi, Ernesto. This is Christian. Regarding your credit risk question, we are seeing the portfolio behaving at the 1 to 1 to 1.2 cost of credit levels and with the anticipated that we expected that the lower velocity of the economy is also increasing a little our NPLs to levels pre-pandemic. So we expect this situation to continue in this area. We are not seeing the portfolio deteriorating further. So we're comfortable with the 1.1 to 1.2 levels. Regarding the tax rate, the effective tax rate, well, you know, Chilean banks, because of this inflation exposition, get their credit book in terms of the taxes readjusted by inflation. So a lower inflation will make our effective tax rates increasing in the coming quarters. And we expect it to get back to the levels we've seen when inflation is usually lower, so closer to 20, 23 percent.

Ernesto Gabilondo:
Thank you very much, Emiliano. Christian, just to follow up in terms of the – you were mentioning cost of risk, but in terms of your reserve coverage ratio, so you feel comfortable to maintain these levels?

Cristian Vicuna:
We – well, that's a board decision, but we haven't made any decisions in order to take use of our additional provisions, so coverage will remain in the same area.

Ernesto Gabilondo:
Okay, perfect. Thank you very much.

Operator:
Okay, thank you. Thank you very much for that. The next question comes from Tito Labarta from Goldman Sachs. Please go ahead, sir.

Tito Labarta:
Hi. Good morning. Thank you for the call. I'll take my question also. I have a question just on your fee income, the non-NII, which is growing around 20 percent this year. Just to think about how that can continue to evolve in 2024 and 2025, how should we think about that non-NII growth going forward? Thank you.

Cristian Vicuna:

Hi, Tito. This is Christian. Well, we are having a very good year on non-NII figures. So we're growing higher than 20 percent, so that's very good news for us. And we expect – the reason this is happening is because we're increasing our customer base and now we're reaping the profits of that growth. So we expect this trend to continue further, but to lower down a little. So we're looking at 10 percent-ish figures for the 2024 and 2025.

Emiliano Muratore:
Factoring in the headwind from the interchange fees going down in the next two years, so factoring in that, we think that we can be in the low double-digit growth in terms of fees.

Tito Labarta:
Okay. Perfect. Thank you.

Operator
Okay. Thank you very much for the question. Next question comes from Mr. Yuri Fernandes from JP Morgan. Please go ahead, sir.

Yuri Fernandes:
Hey, guys. Thank you very much. I have two questions, one on US GAP and the other on cost. Let's start with the US GAP. I saw that this quarter your GAP moved up. Just would like to understand the rationale here, because given inflation is moving lower and you have been reducing your GAP over the past quarters, I just would like to understand a little bit why the GAP is higher now. Not sure if the cost of derivatives is moving up. It has been more costly to hedge this asset on US, and this explains the higher GAP. But that's the first one. And regarding the cost, I would like to check your investment plan, right? You put out in the presentation the $260 million plan. This is not new, right? We knew about it. But how much of the plan has been implemented this year? Because your operating expenses are super tracking, super good, right? I think it's the other line, also no surprise. But given you have such a big investment plan, my concern is that you may need to accelerate the execution of this plan for 2024, 2025. And these with higher taxes eventually may pressure your bottom line and your R&D target. So trying to understand how much you're asking about the investment plan to understand how your operating expenses may evolve in the near future. Thank you.

Emiliano Muratore:
Hello, Yuri. Thank you for your question. So regarding the US GAP, as you mentioned, I mean, we in the second quarter increased. I mean, basically, that's because of derivatives that were expiring. I mean, like, let's say we had inflation locked in at high levels, and those derivatives expired. That produced like a net increase in the mismatch. The reason why, let's say, we didn't keep it down is basically because we saw that the inflation implied in the derivatives going forward, it's like in line with what we are expecting and considering the latest evolution of the FX rate. We even think that we can have some, let's say, upward pressure in headline inflation for the rest of the year. So basically, the decision is if we lock in what the market has today, which is around like 3%, depending on the tenor, but it's an inflation of 3%, we can, let's say, lock in that and reduce the gap. And in that case, the readjustment will be lower, but the margin will be higher, or what we can expect from that 3%, which is implied, and we don't see a clear call of the inflation being far away from what the derivatives are discounted. And that connects to your point about the cost, that basically when we hedge and when we operate in the derivatives market, we don't do it at mid-prices, and basically, trying to lock in the 3% would imply to leave some basis point of inflation on the table when you hedge, and that's why we are, let's say, comfortable. Not because we don't feel that we are not growing the risk, but the level of the price that we could hedge, it's reasonable for us, and that's why we don't expect to grow the gap

further. It will stay around where we were in the second quarter, but that's the reason why you saw the jump from first quarter to second quarter. And regarding cost going forward, I mean, our investment plan keeps the same, and basically, our efforts are making room in OPEX general to make room for investment, especially in all the digitalization and all the transformation of the branches network, and we keep our long-term target and ambition to have all-in costs growing below inflation, and that holds for next year too, where we plan to have all-in expenses growing below inflation, with inflation expectations being around 3% for next year.

Yuri Fernandes:
No, super clear. So cost below inflation for the next year, and the U.S. gap will remain around those like $7 trillion kind of level, right? Those are the takes. Thank you very much.

Operator:
Thank you very much. Our next question comes from Daniel Mora Ardila from Credit Core Capital. Please go ahead, Daniel. Your line is open.

Daniel Mora Ardila:
Hi. Good morning, and thank you for the presentation. I have just two questions. The first one is a follow-up regarding the NIM. I would like to understand that negative part that is impacting currently the NIM related to the swap of interest rates, how it's going to evolve with the decrease in interest rates expected for the rest of 2023 and also beginning of 2024, and what could be the impact of the expiration of the FSEC related to these swap of interest rates, just to understand what will be the process there. And the second question is regarding to NPLs. We have seen in recent quarters that the commercial NPL has been above peers and also above the industry level. I would like to understand if you are seeing any risk in any company or any economic sector that should have explained this performance, and what would be the expectations going forward. Thank you so much.

Emiliano Muratore:
Hello, Daniel. Thank you for your questions. I'll take the first one, and I'll leave the second one for Cristiano. Regarding the NIM path and the non-clients, I mean, that negative will, let's say, rebound to positive territory in the coming quarters. I mean, we basically expect that to be more closer to the 0.5 percent negative during the next year in order to have the clients' NIMs around 4 percent and the non-clients in the minus 0.5, and that adds up to the 3.5 percent we were talking before. I mean, basically, the main driver of the non-clients NIM improving is the fell in interest rates, short-term interest rates, combined with the process of getting the curve steeper from where we are now. I mean, we have a very steep curve on the negative slope territory, and going forward we'll have that going more to flat at the beginning and gaining some positive slope by the end of next year, and that will help the non-clients NIM because of the positive slope of the curve. And connecting that with the FCIC, basically, in that case, considering that we have that liability floated, we will benefit in the next quarter to the reduction of the interest rate that will reduce the cost of that, and that the maturity will be kind of neutral for us because, basically, we have short-term assets to pay that off, and, basically, we have, if you want, a monetary policy rate asset falling together with a liability that for us is also floated to the monetary policy rate, so it will be kind of neutral and not much relevant for our NII going forward because an asset and a liability with a similar yield will, let's say, go away with the expiration of that.

Cristian Vicuna:
So – hi, Daniel. This is Cristian. Regarding your NPL question in the commercial portfolio, actually, the commercial NPL has increased from 2.5% to 2.9% in the first six months of the

year, and our impaired loan ratio has increased from 7% to 7.6% in the first six months of the year. So all in all, we are seeing a slight deterioration in the SMEs portfolio, but it's nothing to be really concerned on the higher lending names. We haven't seen the middle market or the CIB portfolio actually being very stressed, and I will say that the sectors that we are seeing are agro and some construction, but those are very, very – a small part of our total portfolio. There is some further details on page 38 of the management commentary.

Daniel Mora Ardila:
Okay. Thank you so much for the answers.

Operator:
Okay. Thank you very much. The next question comes from Ms. Isabelle Irish from Bering Asset Management. Please go ahead, ma'am. Your line is open.

Isabelle Irish:
Hello. My question is actually on NIMS, which was partially answered before, but an extension to that is on the funding cost. I see the switch as you would get as interest rates are high, you switch from demand to time deposits. How sticky is that? Does that persist for a long time, and how quickly does that shift back? Thank you.

Emiliano Muratore:
Well, thank you, Isabel, for your question. So, well, what we are seeing is the reasonable economic decision of a person that has money in their account, and it's moving them to time deposits to attain the benefits of a higher interest rate. Demand deposits are paying zero in Chile, and time deposits are paying about 1 percent per month for the last 12 months. So, we are seeing a trend of re-portfoliation of our deposits that we expect to start reversing once the interest rate in the monetary policy rate in the coming months starts further decreasing. So, we don't have sensitivities yet of how this effect will evolve, but definitely we are going to see further reduced movement from demand to time deposits.

Isabelle Irish:
Thank you.

Operator:
Thank you very much. Our next question comes from Neha Agarwala from HSBC Global Research. Please go ahead, ma'am.

Neha Agarwala:
Hi. Thank you for taking my question. Just one quick question. How should we think about the asset quality trend and cost of risk for next year? This year, we are seeing some normalization, but should we see some stability in 2024? And any other headwinds in terms of going back to normalized levels of ROE for 2024 that we should watch out for? Any reason why the ROE for 2024 should deviate from the normalized ROE level? Thank you so much.

Emiliano Muratore:
I mean, in terms of asset quality, I mean, well, remember that cost of risk for next year, I mean, we still hold a significant amount of voluntary provisions that will, let's say, serve as a kind of backstop in case that the behavior or the asset quality deteriorates. So, we feel comfortable to be around the 1.1%, 1.2%. We are, in terms of cost of risk, I mean, having the possibility of tapping the voluntary provisions in case the situation goes worse. In terms of the risk for the path to normal ROE next year, basically, I would say that it goes to, again, to the NIEM part,

because as I just mentioned, the asset quality part, we feel comfortable to stay around there. In terms of NIEMs, we'll depend on how this reduction of real rates goes going forward. Chile already started the cycle, I mean, Brazil followed, and we have the developed economies still in the tightening part of the cycle. So, going forward, by the end of next year, we see nominal rates in the 4.5% by the end of next year, and that implicitly has also the Fed and the developed countries starting easing cycles by the second half of next year. And if you put yourself in a scenario where that doesn't happen and inflation internationally stays up and developed economies don't start their easing cycles, you can argue that the floor for the rate in Chile would be maybe higher than that 4% to 5%, and that will create some pressure on the NIEM normalization for us. And that might be one of the things that could deviate the path to normal ROEs. But apart from that, I don't see – I don't know, Cristian, if you see any other –

Cristian Vicuna:
Well, not really. I will reinforce Emiliano's point. So, well, actually, the rate path and the inflation are probably the main effects to be monitoring, and we are seeing asset quality stable from what we are looking at now. So, and we are confident that we can deliver on our cost figures and fees. Well, we already mentioned what we expect, so I will say all in all, we feel that we are going back into our regular profitability levels of the pre-pandemic. Yep.

Neha Agarwala:
Thank you so much.

Operator:
Okay. Thank you very much. Our final question comes from Mr. Ewald Stark-Bittencourt from BC Investiones. Please go ahead, sir. Your line is open.

Ewald Stark-Bittencourt:
Hello. Thanks for taking my question. You mentioned earlier in the presentation that Fogape loans will reactivate S&E trade growth. So, I was wondering what's the expected margin on these Fogape loans, and how do they compare to normal margins on S&E loans?

Emiliano Muratore:
Yeah. So, thank you for your question. Yes. I mean, basically, in the S&E portfolio, we have like two forces. I mean, first, we have like the maturity of the initial Fogape loans that were granted in 2020, 2021. Those, let's say, are maturing and going away. Those were set with very low rates, because we are the prevailing rates at that moment. So, those were really low yielding and low spread loans, and those are going away. The new ones, the new Fogape loans, where the program itself was set in this new rate environment. So, actually, the spread is not as low as it was at the beginning, and it's in line or slightly higher than the average spread for S&E. So, your question regarding if you want the average spread of the portfolio, the dynamic of the old ones going away and the new ones entering at average or slightly higher than the average spread for the portfolio, it's a tailwind for the average spread of the S&Es going forward. And the program is still there, and it's a significant part of the new origination in S&Es, and it's different to the original one, where in terms of pricing was kind of a sacrifice for us. In this case, it's more in line with the rest of the portfolio.

Ewald Stark-Bittencourt:
Okay, perfect. Thanks.

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:
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:
Okay, thank you very much. This concludes today's conference call. We'll now be closing all the lines. Thank you, and goodbye.