Santander Chile

Q1 2023 EARNINGS CALL

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Participants:

- Emiliano Muratore, Chief Financial Officer
- Cristian Vicuna, Head of Strategic Planning
- Robert Moreno, Head of Investor Relations
- Claudio Soto, Chief Economist

Moderator:

Good afternoon and welcome to Banco Santander Chile's first quarter 2023 results conference call. We are joined by Emiliano Muratore, Claudio Soto, Cristian Vicuna and Robert Moreno. I will hand over to Emiliano to begin the presentation.

Emiliano Muratore:

Good morning everyone. Welcome to Banco Santander Chile's first quarter 2023 results webcast and conference call. This is Emilio Muratore, CFO and I'm joined today by Robert Moreno, Head of Investor Relations, Cristian Vicuna, Head of Strategic Planning and Claudio Soto, Chief Economist. Thank you for attending today's conference call. Today we will be discussing the trends and results seen in the first quarter. While tight monetary policy continues to squeeze margins, our successful digital strategy and customer-oriented product offering continues to drive strong results from our business segments. To begin, I invite Claudio Soto to give us an update on the macro scenario beginning on slide three.

Claudio Soto:

Thank you Emiliano. The economy continues its adjustment process after the overheating of 2021. GDP grew 2.4 percent in 2022 and contracted 2.5% in the first quarter of this year in response to tight financial conditions and a contracted fiscal policy. High interest rates have drained away excess liquidity from past pension fund withdrawals. The liberal market remains relatively weak with low employment growth and an increasing unemployment. Real wages have contracted due to high inflation. Political uncertainty fell after the referendum that rejected the constitutional proposal of the constitutional convention last year. However, it remains relatively high as compared with the historic levels. In this context, we expect that GDP will have a mild contraction this year of around minus 0.25% before returning to trend next year. Domestic demand will remain subdued while the external sector will benefit from the reopening of China. Overall, the outlook for activity is better than what were previously estimated.

With domestic demand and better terms of trade, will help recovering the external accounts. During the first quarter, the trade balance reached 7.5 billion surplus, an historical record. For the year we expect a current account deficit of 4% of GDP down from the 9% of GDP deficit of last year. High copper prices, lower political uncertainty and the global depreciation of the dollar has strengthened the Chilean currency. Inflation, although it remains elevated, has begun to fall in line with our past forecast. More CPI increased 11.1% year/year and during the second quarter CPI, annual changes should reach a single digit. The slightness of the economy, the acquisition of the currency and the fall of fuel prices will keep pushing down inflation, which we expect will be running at 5.1 US variation by the year's end. The central bank has kept its monetary policy rate at 11.25%.

Although the last inflation report had a relatively hawkish tone, we expect that the condition for an issued cycle will be met at the beginning of the third quarter as the fall in core inflation becomes entrenched. Given the high level of the monetary policy rate, once the board begin cutting, they will proceed at a fast pace. As a result, we expect the monetary policy rate to finish the year between 7.5 and 8%, above our previous estimate. Our baseline scenario assumes that the proposal for a new pension fund withdrawal that is currently being discussed in Congress is not approved.

On page five, we have some of the reforms that are in the agenda of the government. One of the most important ones, the tax reform was rejected in Congress last March. Currently, the government is trying to build an agreement for a new tax proposal. In the meantime, the discussion for increasing the mining royalty has advanced. The pension reform is still pending and should be announced during the second semester. The reduction in the number of weekly hours from 45 to 40 was approved during March. The new regulation introduces some more flexibility in the labor market and contemplates a five-year transition for the hours reduction. This week, the new interchange fee for credit and debit cards was officially published. The transition from the current fees to the new ones will be gradual and will start in six months time.

Also this year the government has launched the Fogape scheme for SMEs and a Fogape scheme offering state warranties for the first time mortgage buyers. Last week the government announced a new national strategy for lithium involving the participation of both public and private companies, the use of greener technologies and looking for apps to add more value added in the production process. Finally, the constitutional process has continued as scheduled. The expert commission is preparing a preliminary draft for a new constitution that should be sent to the Constitutional Council in June. The members of this council will be elected on May 7th. The final text will be subject to a referendum with mandatory participation on December 17th, 2023.

Cristian Vicuna:

Thank you, Claudio. In my presentation in stage five, six, I would like to start first by reviewing an update on the bank's strategy. Our purpose, like the rest of Grupo Santander is to help people and business prosper with the mission of being the best financial services company, acting responsibly and gaining the loyalty of our clients, shareholders, collaborators, and communities. Our style of doing business is simple, personal and fair, and our day-to-day behavior with all the stakeholders is summarized by the team's acronym. And where do we envision ourself by 2026? We see ourselves as the leading financial services company in Chile for our clients, collaborators, communities, and shareholders. We will focus on being obsessed for our clients, their progress and their experiences. For our collaborators, we seek to maintain a committed and high performance team. For the community, we expect to be leaders in social and sustainable finance. And finally, for shareholders, we seek attractive and predictable returns and to be the leading bank in terms of profitability, efficiency and recurring risk-free revenues in Chile.

We want to achieve this plan through four pillars of our strategy under the Chile First. First to be a digital bank with branches, a digital bank with work office 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 and wealth management businesses that focuses on value added transactional trade and advisory product and services. Third, always searching for unexplored growth opportunities. We want to break paradigms in the banking sector, finding new business opportunities and leading the sustainable transformation of our clients. And finally, a key enabler, an organization that is agile, collaborative and with a high performance and diverse cultures where exceptional people can advance based on merit. As we can see on page nine, we are also fully committed to diversity. For example, as of April, we are the Chilean company with the highest percentage of women among the board, among all firms included in the IPSA index.

Moreover, 56% of the bank's total employees are women and the percentage of women in the top managerial position has increased from 18% in 2019 to currently 32%. Another key innovation launch in the first quarter of 2023 was the Work/Cafe Expresso. In this newly fully transactional branches, it takes on average less than five minutes to perform a transaction with the highest level of security for our customers and the state-of-the-art technology with facial recognition and digital totems. All of this combined with the great service experience of our Work/Cafe Santander style, we have opened four Work/Cafe Expresso centers in Vina, Rancagua, Santiago centro, Las Condes where we serve over 50,000 people weekly. The MPS of these branches is an eye-opening 96. The Work/Cafe Expresso, it allows us to keep updating our branch network while improving waiting times on NPS.

At the same time, other traditional branches surrounding the work of espresso will be a hundred percent dedicated to value added services. Currently, 28% of Santander Chile's branches do not perform transactional services and are completely paperless, improving efficiency and productivity. Loan and deposit volumes increase 22% year over year and in the same indicator per employee rose 9.3% in the same period. On page 12, we show how life continues to shine with clients growing 17% year over year and total revenues generated by life increasing by 40%. Moving on to page 13, we show how life success has permitted the bank in a short period to achieve a market share of approximately 25% of checking account balances in Chile. Now our aim is set on the large pocket of site and saving account deposits. This market in Chile totals 24 billion dollars in deposits in which we only have a 1.8% share of savings accounts and a 7.7% share of the site account market.

In order to capture a greater share of this market in the first quarter of 2023, we launched Mas Lucas. This is a hundred percent digital product that includes an interest bearing site account plus a saving account. The onboarding process is a hundred percent digital and there are no password, only facial recognitions and the account number is very easy to remember. Chile's country code, 66, plus your national ID number. This account has no fixed or variable cost and accepts deposit for up to 5 million pesos.

Moving on to page 15, we show how the success of GET Net continues. Our acquirer has sold more than 177,000 POS's with a 17% market share in points of sales and a 7% in total purchases, according to our estimates. Fee totaled more than 10 billion pesos in the quarter and are growing more than 200%. In the first quarter, we also introduce a new specialized attention modeling in our middle market segment for the agriculture, automatic and Multi-Latina sector, which encompasses Chilean middle market corporations seeking to internationalize. This new specialized attention models seek to enhance our growth and market share in this highly attractive sectors of the Chilean economy, which are intense not only in lending but also non-lending products as well.

Another point to highlight was the progress made in our commitment to the objectives of sustainable finance and environment. We have a market leading range of sustainable products that help care for climate change with Santander Verde. In 2022, we managed to support numerous customers with sustainable operations in our business and corporate banking businesses. In total in 2022, we used best sustainable trades, both social and environmental for an amount of 230 million dollars, 390% more than in 2021, making us the leader in these products in Chile. We believe that this will be one of the fastest growing areas in the coming years.

The success in sustainable finance has also been achieved in all of our responsible banking objectives has shown on the next slide. We achieved our goals in gender, environmental, social, and educational targets. This has resulted on being ranked as the number one in the main sustainability indexes such as Sustain Analytics and MSCI. We are also the only Chilean bank included in the Dow and Jones Sustainability Index for global emerging markets. In terms of MPS, we continue to have an indicator above the average of our main peers. In the first quarter of 23, we did see a slight dip in our results. This was due to the ongoing changes in our app to improve cyber security. We are fully committed to return to the number one spot. The work of Espresso should be key as the improvements of these models in terms of MPS at the branch level are substantial. Now I will turn it to Robert who will discuss our results.

Robert Moreno:

Thank you Cristian. Moving on to page 22, net income in the first quarter totaled 136 billion, decreasing 42% year over year and increasing 33% quarter on quarter. In the quarter, the bank's margins continue to be negatively affected by the high interest rate environment. The bank's ROE in the quarter reached 13%. On the other hand, our business segments continue to show solid growth with an important expansion in net interest income and fees with cost and risk under control. The net contribution from our business segments that excludes the corporate center and ALM increased 30% year over year. The results of Santander Corporate and Investment Banking or CIB have remained impressive increasing 76.7% year-over-year net. Contribution from the middle market of corporate increased 31% year over year. Both of these commercial segments experienced an important rise in deposit spreads as well as high growth of fees and treasury income.

The results from retail banking rose 110.5% year over year, also driven by rising deposit spread and greater fee income coupled with higher productivity levels. In terms of loan growth in the first quarter, loan growth accelerated as the economy feels the effects of tight monetary policy slowing inflation rates and depreciation of the peso. During the quarter, the CIB segment decreased 1.2% Q and Q influenced by translation gains or translation losses caused by the 6.5% appreciation are the best on the quarter. This also explains the 1.0% Q and Q decrease in loans in our middle market segment. As mentioned during the quarter, we launched specialized attention models for the agriculture, automotive, and multi Latina sectors to enhance loan and income growth in the sector. Retail banking loans grew 1.1% Q and Q led by consumer loans which in turn were driven by good demand for credit card and auto loans.

Origination of new mortgage loans has decelerated with the slowdown of inflation and high interest rates. As for SME, the demand for new loans remains subdued as clients continue to pay back their Fogape loans dispersed in 2020 and 2021. A new Fogape/Fogaes program was launched by the government in April to support mortgage growth to households and lending to SMEs. We maintain our guidance of year over year loan growth of five to 6%. Liquidity levels remain strong in the quarter. The bank's total deposits increased 3.7% Q and Q. The increase was driven by time deposits that increased 9.9% Q over Q. Bonds issued increased 17% year over year and 2.3% for the quarter. During the first quarter the bank has issued various bonds in the local bond market in order to take advantage of the inverted yield curve, to control funding costs. The bank's liquidity coverage ratio which measures the percentage of liquid assets over net cash outflows at the end of the quarter was 182%, well above the minimum.

At the same day, the bank's net stable funding ratio, which measures the percentage of illiquid assets financed through stable funding sources reached 113%. Also well above the current legal minimum set for this ratio. In terms of margins, the bank's NIM in the quarter remains stable, Q over Q at 2.2%. The variation of UF continued to decelerate while short-term interest rates remained high. Both of these factors continue 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 deposit and loan spreads have risen. On slide 27, we give further insights into our margins for the rest of 2023. For every a hundred basis points declining in inflation, our NIM falls on average by 15 to 20 basis points and for every a hundred basis points rise in the average monetary policy rate, our NIM falls by around 30 basis points.

We have updated our base case scenario for 2023 with our latest internal forecast by increasing the expected average monetary policy rate from 9.2% to 10.4% this year and the UF inflation of 5.1. Under this base case scenario, the bank's NIM in 2023 should reach 2.4%. Moving on to asset quality on slide 28, the rise in the NPL ratio to 1.9% is gradually returning to pre-pandemic levels as household liquidity. Gradual returns to normal and the economy feels the squeeze from high interest rates. The coverage of NPLS as of March, 2023 reached 186% and there has been no reversal of the voluntary provisions. As we can see on slide 29, these overall positive asset quality indicators led to a cost of credit of 1.2% in 2023 in line with our guidance for this year. On slide 30, we move on to non-net interest income revenue sources which continues showing exceptional growth trends. Income from fees and treasury rows 33.8% year over year and 20% Q and Q driven by higher usage of products in all segments. We expect these trends to continue for the rest of the year.

As shown on slide 31, we can see the bank's efforts to continue increasing productivity and to control costs. Operating expenses decreased 1.2% year over year and 8% Q over Q. The bank continues ahead with its 260 million technology investment plan for the years 2023 to 2025 and because of these investments, we're expecting costs to fall in absolute terms in 2023. Moving on to slide 32, we also observed a positive evolution of our capital ratios. At the end of the first quarter, the bank reported a core equity ratio of 10.5. It is important to point out that in March, 2023 the bank changed its policy for provisioning its dividends. In March, the bank provisioned the full dividend which was paid out in April, 2023, equivalent to 60% of 2022 earnings following the board's approval of said dividend. Last year, the full impact of the dividend was recognized in April.

Therefore, the two equity bases are not entirely comparable. As a result, value added for our shareholder measured as a growth and book value plus dividends dispersed increased 23.7% year over year. On slide 33, we will conclude with some guidance. Despite 2023 being a somewhat more challenging year on the macro fund, we believe our strong client activities will continue to expand. Coupled with this, we will continue with our investment program which focus on the digitalization and automatization. We also expect client growth to remain robust led by Santander Life, Getnet and now Mas Lucas.

In terms of loan growth, we expect mid-single digit growth but they focus on all segments. NIM should contract to 2.4% with solid client names. As the monetary policy rate comes down, we expect NIMS to rebound. Non NII growth should surpass 20% this year on the back of strong client acquisition and usage figures. Cost control will be a major focus and we expect a decrease of low single digits in our total cost base. Asset quality should deteriorate somewhat but the cost of risk will remain at a manageable level of 1.1, 1.2%.

In summary, we start the year with ROEs in the low teens. As the year progresses, ROEs should improve for the full year and for the full year we are guiding an ROE of 15 to 17% lower than the initial guidance. This is mainly due to higher average short-term interest rates partially offset by strong client profitability numbers. Our long-term ROE expectations remain unaltered at 17% to 19%. With this I finished my presentation and I will gladly answer any questions you may have.

Moderator:

Thank you. We will now move to the question and answer section. If you would like to ask a question, please press star two on your phone and wait to be prompted. So our first question comes from Juan Recalde at Scotiabank. Your line is open. Please go ahead.

Juan Recalde:

Hi, thank you for taking my question. My question is related to the NIM. So the name expectation has declined and now you are dying for around 2.4% NIM for 2023. I was wondering what kind of NIM can we expect for 2024? I'm just trying to get a sense of what a more normalized level of NIM can be. Thank you.

Emiliano Muratore:

Yes, hello Juan. Thank you for your question. A more normalized NIM would be like around like 4%. That's on monetary policy. It's like on a normal level. We don't see that happening before 2025 maybe. So in 2024 it would be like in the middle from where we are this year at around 2.4 to 0.5. So next year being around 2.3, 3.3, 3.5, all depending on the pace and the path of the monetary policy rate. But that would be like the trend going forward.

Juan Recalde:

That's helpful. Thank you for your comment.

Moderator:

Thank you. So our next question comes from Neha Agarwala from HSBC. Please go ahead.

Neha Agarwala:

Hi, thank you for taking my question. Could you please explain once again what led you to reduce your guidance for ROE for this year? Is it just the interest rates which are higher than expected previously or is it something else? Regarding the NIM from the market, when do you think that'll normalize, be close to zero if nothing else, by early 2024 it seems by now? Could you please confirm? Thank you.

Emiliano Muratore:

Yes. Hello Neha. Thank you. Thank you for your question. So the adjustment in NIM guidance basically is if you look at the heat map, the way we call that chart on the previous call, basically what we did is we moved to the new average monetary policy rate and the new inflation. So let's say that it's just related to the delay in the interest rate cuts that we were expecting before and now we are expecting a bit later. So there is not more than a date in to the new macro scenario we're expecting now. And so in terms of the non-clients NIM going to neutral, again will depend on the level of interest rates and according to the pace we are respective for the central bank to cut rates, that should be more around the second half of next year.

Neha Agarwala:

Perfect. And are there any regulatory changes that we should expect this year or next year that could impact the bank? Thank you so much.

Emiliano Muratore:

There is nothing in agenda. Now we have the interchange fees already known and the transitioning period announced. So there are no regulatory issues being discussed at this moment that we envision that could affect us in the coming months.

Neha Agarwala:

Thank you so much.

Moderator:

Thank you. We have a question from Tito Labarta from Goldman Sachs. Please go ahead.

Tito Labarta:

Hi, good morning. Thank you for the call and taking my questions. A couple questions. Just to understand a little bit, the ROE evaluation and the timing of when you expect the rates to come down because as long as rates remain high, the ROE should be relatively low just given the guidance. So should we expect first half of the year you'll be below that ROE guidance of 15 to 17% and then maybe three Q and four Q, you start to go above that? And then could you clarify when do you expect rates to start to come down in Chile? And then my second question is on your fee income, which very, very strong. Is that growth that we're seeing sustainable? How long can you continue to grow the fee income at that pace? Thank you.

Emiliano Muratore:

Hello Tito. Thank you for your question. Regarding the timing for interest rate cuts, our best case scenario is assuming a cut in July. A small cut but the cutting cycle starting in the third quarter and then continuing during the year. So with that path, the trajectory of ROE will be the one you mentioned.

Basically first half below the average for the year and third quarter starting to rebound together with the NIM when the central bank starts the relaxing cycle and keep going up during the first fourth quarter as the additional cuts are made.

Cristian Vicuna:

So and Tito, this is Cristian. Regarding the fee question, of course this year it's spectacular for us with more than 20% growth or over 15 to 20% growth. So it's looking really good. This is very linked to our customer growth base and the performance of our GET Net initiatives and life initiatives. So for the upcoming years we of course expect to grow strongly, hopefully better than the market, but I'll say that 20% figures for the long run are not what we expect normally. So we'll say larger than 10% but, no, not 20.

Tito Labarta:

Okay, that's helpful. Thank you so much.

Moderator:

Thank you. Our next question comes from Carlos Gomez from HSBC. Please go ahead.

Carlos Gomez:

My question's actually answered. Thank you.

Moderator:

Okay, thank you. So our next question then comes from Daniel Mora at Credicorp. Please go ahead.

Daniel Mora:

Hi, good morning and thank you for the presentation. I have a couple of questions. The first one is regarding the NIM. You already explained the decrease in the guidance, but I would like to understand what will be the strategy of the derivatives that are currently impacting the net interest income. I mean the hedge of interest rates. Are you waiting for them to decrease? The decrease of rates will improve the position of the derivatives or are you going to wait for the expiration date of these assets? What is the strategy there? And the second one is regarding fees, very strong performance in the first quarter and without considering the effect of the new regulation of interchange phase, do you expect this to continue in the coming years? The current pace of growth? And I would like to understand what is in the ord fees in the first quarter because we observe a strong increase in order fees. Thank you so much.

Emiliano Muratore:

Thank you Daniel for your question. Regarding the derivatives strategy, definitely that portfolio will have the margin improving when interest rates start to fall. Today, as you saw, our expectation for monetary policy average for the year is like 10.4. When you look at what the market is pricing, it's slightly higher than that, like 10.6 or so. So that's why we are not logging in that or fixing that level because we do expect that the trajectory will be slightly lower and faster than what the market is imply. And that's why the strategy basically is to wait to rates to fall and to follow our path, which is now slightly lower than what the market was expecting. Late last November, the market was on the opposite side. Was implying a more dog-ish trajectory to our view. And in that moment we closed part of that sensitivity securing a more dog-ish path. But today we don't see that opportunity because our scenario, it's on the lower part compared to what the market is expecting on the fees. I will leave it to Cristian to comment.

Cristian Vicuna:

Hi. So regarding the fees, similar to our previous question, we expect a very strong 2023 and then to grow a little slower but better than the market. So probably something a little higher than 10, but not the same 20 that we expected for the year. And regarding your question of on the other fees, it's mostly related to corporate investment bank advisory fees on MNA and structuring.

Daniel Mora:

Perfect. Thank you so much.

Moderator:

Thank you. Our next comes from Olavo Arthuzo at UBS. Please go ahead.

Olavo Arthuzo:

Yes, thank you guys for taking my question. Actually, I just have one related to the paid expenses because the bank revised downwards the guidance for this year with the expectations for a negative growth in costs. So could you please just clarify a little bit more on the drivers behind this performance and if you could add to it, if we could expect a drop of 1% to 2% or maybe 5% of the credit expenses, that would be helpful. Thank you.

Emiliano Muratore:

Hello, Olavo. Thank you for your question. No it is not like minus 5%. It's more on the low single digit fall that we are expecting and the drivers are a combination of things. First all, the fraud control that we are doing, all the fraud expenses that we have on the bank are in the other operating expenses and that's something that we have been making good progress and that number has improved and is going to help the loan growth or the loan, the cost fall for this year. And then all the work we are doing in the branch networks optimization and also the transformation, you saw the work of the Espresso initiative, which is also apart from driving MPS, the app because clients are also happy. It's a very efficient way to deal with the transactionality coming for clients and in general terms, all the digitalization of the bank, all the Mas Lucas and all the live initiatives we are doing are taking productivity up by having new client growth, new client acquisition and client revenues and having cost under control. And Cristian, if you want to add on that.

Cristian Vicuna:

I'll say that we expect these new initiatives to keep us from allowing us to update the branch network as a whole and we see further improvements in how we will deploy our study. Yeah.

Olavo Arthuzo:

Okay, thank you very much guys.

Moderator:

Thank you. Our next question comes from Yuri Fernandes at JP Morgan. Please go ahead.

Yuri Fernandes:

Thank you guys. I have a first one regarding expenses. It has been very good and have been delivering on these closing branches, reducing a little bit the head count, but we are seeing a super strong growth on fees and I think part of that fees, some administrative expense, they should be somewhat related like technology, software. I don't know. My question is how sustainable is for you to keep such a good level of G&E growth? I understand the guidance is negative for this year, but my question is should we see more investments in 2024? How comfortable are you that this year is not a one-off because you kind of built some provisions on costs last year and we should see a pickup in the coming years? That's the first one.

I have a follow-up regarding the margins. Just a curiosity on the FCC instrument. I think the FCC, they explain part of your margins, part of your strategy on asset liability management and when your FCC instrument they should mature? I don't know, I think there are different material dates depending on the program. So not sure if March, not sure if this is July, 2024. So just trying to understand when should we start to see your FCC instrument getting paid? Thank you.

Emiliano Muratore:

Okay, thank you Yuri for your question. Regarding expenses, definitely you should not expect cost fully in the following years. In that sense, this year is going to be a one-off. Our usual target and what we have done basically every year, I would say in the latest period, is to have costs growing below inflation. That is the starting point for our strategies. So inflation will be in the mid to low single digits going forward and that's where we want cost to be. The composition of that cost will be shifting to what you mentioned. More on amortization of technology investments and digital initiatives and taking advantage of the improvements in the footprint of the branch network because we would be having less square meters. All this strategy of Work/Cafe Expresso will help us to reduce the square feet of branches and that will help in that cost. And also all the digitalization will increase the productivity per employee. And so yes, in that sense it's a one-off.

The performance in cost for this year, it's part of the discipline we think we need to have with the revenue pressure we are having coming from margins. So this is going to be a tight tier on that and we are delivering on that. And going forward we should expect to go back to a more normalized pace of cost growth slightly below inflation. And regarding the FCC, the FCC basically matures half of it in April and half of it in July next year. And as you said, considering our strategy that basically has that liability floated, the maturity itself won't have a significant impact for us because basically we are already paying the floating cost of that so that we will be benefiting from interest rate going down starting the same day that the interest rates start to fall.

And so when the maturity happened, considering that we are already floated at the level of rates that will be at that moment. I don't know, let's say six, seven or whatever percent we have in mid next year for us, it won't have an impact because we are already with the liability at that level. I don't know if I explained the situation.

Yuri Fernandes:

If I understood, the liability is floating, but your assets, they are not floating for that, right? You bought, I don't know, fixed rate instruments on that. So like the materials, and correct me if I'm wrong, but maybe the maturity of that fee should be a tailwind for your margins. No?

Emiliano Muratore:

No, it's not going to be a significant tailwind because we already have, as you said, we are talking on the liability side then we have the assets repricing in this context and we are already seeing repricing on the asset side that will help us. But yeah.

Robert Moreno:

It's Robert. It's a tailwind in the sense that rates come down, it's a tailwind. Okay? And when it expires it should be a tailwind depending where rates are. Okay? But in a itself today it's not. You see, it'll be a tailwind when rates start to go down. Okay?

Yuri Fernandes:

Okay. No, perfect guys, thank you. If I may a third one just touching on asset quality, if you can provide some color for us, like the trends we are seeing, some worsening on consumers. So just like your overall view on asset quality. Thank you.

Emiliano Muratore:

Asset quality as you saw on the slide, basically we are normalizing in terms of NPLs and impaired loans. Impaired loans is still below pre-pandemic levels and that's what we see for the year. This 1.1 - 1.2% cost of risk for the year is consistent with having a similar to pre-pandemic levels of asset quality. We are confident that we can be there. We still have the voluntary provisions as a way to cope with a more deteriorated scenario in case that happens. But as you saw, first quarter cost and risk was at 1.2. And we think that we can keep at that level for the rest of the year, which is a definitely higher level of cost to risks to the one we had this last couple of years, but consistent with a more normalized scenario that in a certain sense is a bit of the flip side of the slower pace of rate, high of rate cuts that we are seeing consistent with a not so weak economic scenario that is also, let's say reflected in the asset quality which is normalizing to pre-pandemic, but not in a extreme or harder way.

One thing that has been clarified to us regarding asset quality this year is that the adjustment in the consumer portfolio of the new regulation that was being discussed, it's been delayed. So we don't expect this happening in 2023.

Emiliano Muratore:

At least not be before late this year. Maybe next year.

Yuri Fernandes:

No, no, that's good news, guys. Thank you and congrats on the cost control.

Emiliano Muratore:

Okay, thank you.

Moderator:

Thank you. Our next question comes from Ewald Stark from BICE Inversiones, please go ahead.

Ewald Stark:

Hello everyone. Thanks for the presentation. I have two questions. The first one is related to NIMs and given the monetary policy is expected to stay higher than people expected, how do you expect NIMs to behave in 2024, a year from now? In a scenario of a normalized yield curve, a NIM with an upward slope and some level of repricing of the portfolio. Because NIM seems affected in the previous months and going forward, one will expect that the NIMs should recover as the portfolio in prices and we have to monitor the policy rate.

Robert Moreno:

Okay. So yeah, so would you say this is correct? We have some tightness in the NIM because of the high rates, but effectively, effectively, and you can see some of this already in the client NIM. The client NIM is hard to forecast. But you can see that our client NIM, which is basically the net interest margin of our business segments is rising because they're repricing their assets. Okay? So we're getting hurt more by the increasing cost of deposits, but assets are slowly beginning to reprice, spreads are rising, even though long growth isn't helping too much for that repricing, you need quicker loan growth. But there has been definitely an increase in loan spreads and also deposit spreads.

Okay, this is important that every money we get in the checking account, the spread rises with rates so those are both a tailwinds to our margin. So effectively next year, a little bit what Emiliano said before, as rates go down, probably our funding base will get cheaper, the assets will be still repricing and then obviously you still have the headwind of lower inflation. But all in effectively NIMS should bottom out if everything goes as we expect in the second or third quarter and then slowly begin to recover next year as Emiliano said, 3.5 around there. And then in 2025 probably we reach equilibrium rate and inflation, should we go back to our historical levels of around four.

Ewald Stark:

Okay, perfect. And the second question, it's about operating expense. It's said previously that expect that stronger for operating specs or operating expense, maybe growing at 0% or even negative. But in the first quarter, operating expense nearby 13%. So how do you arrive to the consolidated figure if the remaining quarters are here?

Emiliano Muratore:

Yeah, so I think that when we talk about total expenses, we are including other operating expenses. When you factor that in, that total number fell like 1.2% in the first quarter. And I think that is the line that you have to factor in. And that's why we talk about total expenses, including other operating expenses.

Robert Moreno:

So it's personnel administration and others. Okay?

Emiliano Muratore:

And in the first quarter, that number fell 1.2%.

Ewald Stark:

Sorry, what line of operating expense?

Robert Moreno:

Okay, so that when we talk about our operating expenses, we're signing it just as they show up in the financials now, which is personnel, administrative, depreciation and modernization and other operating expenses. The big item that's falling is other operating expenses, which has a lot to do with the improvements we have made in cybersecurity and the lower cost of our cyber fraud insurance. And there's also an interesting reduction in personnel. Okay?

Ewald Stark:

Ok perfect yeah. I'm okay. Thanks.

Emiliano Muratore:

Thank you.

Moderator:

Thank you. And we have a question from Ernesto Gabilondo from Bank of America, please go ahead.

Ernesto Gabilondo:

Thank you. Hi, good morning Emiliano and Robert. Most of my questions have been answered, so just have a couple of questions. The first one is a follow-up in your net income guidance or your ROE guidance when we incorporate the ROE of 15 - 17%. This implies earnings contraction between 15 to 25% this year. So I just wanted to double check if that sounds reasonable and I believe last time you were expecting a modest earnings contraction. So as you have explained it, the delay in lower interest rates has mainly been the key reason for lowering the guidance.

And then my second question is on your effective tax rate. We have seen the banks have benefiting from high inflation before having lower effective tax rates. But now that we are thinking of a more normalized inflation level, how should we be thinking about the effective tax rate in the next years?

Emiliano Muratore:

So yes, thank you for your question, Ernesto. Your assumption, I call it reasonable, but it's consistent with ROE guidance to be around like 15% fall in net income. And yes, basically the biggest driver to our adjustment in guidance of NIMs and ROE has to do with the monetary cycle normalizing later than what we were expecting. And so we see this as the process of normalization of NIMs and are we taking longer than we were expecting and that's in term for 2023 will have, let's say an impact for one or two quarters of that delay. And in the third quarter, starting the normalizing process and going forward and also being closer to normal in 2024 and definitely in 2025. And the second was?

Robert Moreno:

Tax.

Emiliano Muratore:

Ah, tax.

Robert Moreno:

Long-term effect.

Emiliano Muratore:

Yeah, Bob?

Robert Moreno:

Yeah. So there, effectively as rates and inflation go back to normal, the tax rate should rise. Okay? The ROE should also rise. And so today we're paying like 12, 13% effective tax rate. There's different effects. Inflation is still high. The lower net income also lowers the tax. But effectively by next year, if inflation is back to more lower single digit levels, we should be going by 20, I would say 2024, we should be roughly close to the 18% effective tax rate, 2025, probably around 21, 22. And it should stay around there.

Sorry. And one quick thing regarding your first question. It's true that the net income falls, but we do see a slight rise in book value. I think that's a key point to make that we try to explain it a bit in one of the slides. But book value, given the way rates and inflation are moving, which might have a negative impact on NIM, but in capital it's been positive. So our book value is growing and I think that means we're still creating value.

Ernesto Gabilondo:

Perfect. Thank you very much, Emiliano and Robert.

Moderator:

Thank you. I'm not seeing any more questions, so perhaps I can hand back to Emiliano for closing remarks.

Emiliano Muratore:

Yeah, so Robert, the floor.

Robert Moreno:

Okay, thank you everyone. Just as a final note. Note, after 30 great years, today is my last day at Santander Chile. I decided to move on to other projects. I would like to thank the investor and analyst community for your support. Cristian Vicuna along with Rowena and Claudia will keep you guys covered. For me, it has been an honor to be your IR guy. Please feel free to keep in touch and I'll be sending an email soon with my details. Thanks. Thank you everyone. Bye.

Emiliano Muratore:

And I want to publicly thank Bob for his commitment and his terrific job during this 30 years. Without any doubt, he made a huge positive impact on Santander Chile and the Chilean banking sector as whole. He will be deeply missed. I wish him the best of luck in his new stage. And on this emotional note, I thank you everyone for joining us today and we look forward to speaking with you soon again.

Robert Moreno:

All right.

Moderator:

Thank you. That concludes the call for today. Thank you and have a nice day.