Q4 2022 Earnings Call

Company Participants

- Daniel Galarce, Head of Financial Control & Capital
- Pablo Mejia, Head of Investor Relations
- Rodrigo Aravena, Chief Economist and Senior Vice President, Investor Relations

Other Participants

- Andres Soto, Analyst
- Carlos Gomez-Lopez, Analyst
- Juan Recalde, Analyst
- Tito Labarta, Analyst
- Yuri Fernandes, Analyst

Presentation

Operator

Good afternoon, everyone, and welcome to Banco de Chile's Fourth Quarter 2022 Results Conference Call. If you need a copy of the management financial review, it is available on the company's website.

Today with us we have Mr. Rodrigo Aravena, the Chief Economist and Institutional Relations Officer; Mr. Pablo Mejia, Head of Investor Relations; and Daniel Galarce, Head of Financial Control and Capital; and Natalia Villela, Investor Relations Specialist.

Before we begin, I would like to remind you that this call is being recorded and that the information discussed today may include forward-looking statements regarding the company's financial and operating performance. All the projections are subject to risks and uncertainties and actual results may differ materially. Please refer to the detailed note in the company's press release regarding forward-looking statements.

I'll now turn the call over to Mr. Rodrigo Aravena. Please go ahead, sir. The floor is yours.

Rodrigo Aravena {BIO 15086260 <GO>}

Good afternoon. Thank you very much for attending this conference call, where we will review the main accomplishments achieved by our bank during the fourth quarter and the full year of 2022. In this call, we will also share our business analysis and guidance for 2023.

Before reviewing the economic environment, I'd like to share with you some of our main achievements during the last year. Please go to slide number two. 2022 was an outstanding year for Banco de Chile, when we undoubtedly reaffirmed our leadership in the Chilean banking industry, not only financial performance but also in many other key strategic aspects when compared to our competitors.

Even though we will go over our main accomplishments through this presentation, I'd like to briefly highlight some of them. On the financial side, we achieved historical bottom line of CLP1,409 billion, equivalent to an ROAE of 31.4%, well above the industry average. After adjusting the bottom line by the transitory and non-recurrent effects of higher inflation rate in the equity value, ROAE would have been 19%, well above the rest of the peers, but more in line with our historical figures.

Our growth in operating income was accompanied by a historical efficiency ratio of 52% and robust asset quality figures also positioning us better than our peers. 2022 was also a year where we strengthened our capital position even more by reaching a Basel ratio of 18%, well above both the regulatory threshold and our main competitors. Moreover, we increased our additional provisions to an unprecedented amount of CLP700 billion, achieving a coverage ratio of 3.7 times our non-performing loans, allowing us to be even more prepared to face negative cycles.

Additionally, we took important steps in our sustainability pillars. Apart from permanent activity supporting the community, we made numerous environmental, social, and governance improvements, which allow us to be the best bank in ESG risk rating in Chile, according to Sustainalytics, and received several recognitions.

Finally, we made important advances in our digital transformation process, which has been a critical piece to maintaining the best rate of customer service, improving productivity, and strongly contributing to promoting financial inclusion in Chile. As I mentioned, we will develop these and other activities during this presentation. But before that, I'd like to share our view for the Chilean economy.

Please move to slide number four. The Chilean growth has continued to weaken as the chart on the top left clearly shows. Generally, this trend is attributable to three main factors. First, the removal of several temporary stimuli implemented during the pandemic, such as the 32% rise in fiscal spending and the withdrawal of more than $50 billion from pension funds. Consequently, the absence of further fiscal and liquidity measures in 2022 contributed to reducing disposable income and domestic demand. A second factor has been the lagged effects of the tightening in the monetary policy rate, which rose by 1,075 basis points between July 2021 and November last year. Finally, some local factors, especially those related to political uncertainty, have also reduced economic growth.

In this environment, the GDP fell by 1.6% year-on-year in the fourth quarter, posting the first negative annual figure since the second quarter 2020 as the other left chart shows. This slowdown has been explained by the fall in commerce and industry sectors (technical difficulty) fell by 8.4% year-on-year and 5.5% year-on-year, respectively. Other cyclical sectors, such as construction, have also been negatively affected. On the other hand, services have steadily risen in line with greater levels of mobility due to the ease in sanitary condition since last year. On a sequential basis, as can be seen in the chart of the other right, the slowdown has been also evident. In fact, the activity level posted in December of 2022, for instance, was 1% below the figure posted one year ago, reflecting that the economy didn't grow last year. The IMACEC, which is the monthly GDP figure breakdown, shows that all sectors declined sequentially during the year.

Despite the average unemployment rate in 2022 was 7.9%, a 130 basis points below the figure posted one year ago, it's important to be aware of the deterioration in the labor market. For instance, the weak expansion of the labor force has reduced the number of unemployed people. Therefore, the lower unemployment rate when compared to 2021 is a consequence of demographic changes rather than a greater dynamism in the economy. Additionally, real wages continue to fall, minus 2.3% year-on-year in November, due to the higher growth in CPI compared to the expansion in nominal wages.

Finally, the formality rate has remained around 26% above the level observed some years ago, suggesting a potential deterioration in the quality of jobs. However, the subdued growth is contributing to reducing the macroeconomic imbalances that widened during the pandemic. Specifically, as the chart of the bottom right displays, the trade balance has been improving, led by higher export and lower imports, anticipating a lower deficit in the current account in the short term. This trend should anticipate a normalization in external accounts, which is a fundamental pillar for macro sustainability. These adjustments in the business cycle have been accompanied by changes in different prices as we will see in the next slide, number five.

Following the global trend, the CPI had an impressive rise last year, particularly, in 2022, the inflation ended the year at 12.8%, achieving the highest figure since 1991. The trend, as observed in the chart located on the top left, was a consequence of three main drivers. First, the higher global inflation, a factor that is particularly relevant for an open economy as Chile, where tradable goods represent more than 60% of the total CPI basket. A second factor was the depreciation of the Chilean peso, especially in the first half of last year, as you can see in the bottom-right chart. Finally, the substantial increase in domestic demand due to the stimuli implemented during the pandemic played a critical role in non-tradable pressures. Additionally, it's also important to be aware of the high indexation in Chile since several prices are set in UF, which could add further persistence to the CPI.

The upward trend in domestic prices led to an important adjustment in local interest rates, especially during the first half of the year. Part of the explanation behind the trend was a material adjustment in the overnight rate, which rose from only 0.5% in July 2021 to a record figure of 11.25% November last year, as the bottom-left chart reflects. In fact, the monetary policy in Chile has been one of the most tightened in the world in this cycle. Nevertheless, the long-term rates have been falling, anticipating a weaker growth this year, as well as a potential easing cycle in monetary policy over the next quarters. Despite the weaker cycle, the Chilean peso has strengthened during the last months. Some of external factors, such as better copper prices and the weakening of dollar globally, in addition to local factors such as the slight improvement in some risks, have contributed to strengthening the Chilean peso.

Among the factors that have reduced uncertainty is a mechanism defined for the incoming constitutional process to be held this year, which will consider the participation of both elected people and constitutional experts in elaborating the proposal. This mechanism, coupled with some borders defined for the discussion, such as a strong separation of powers, reduce the possibility of institutional weakening in the country. It is well known that an appropriate design of counterweight can make the difference in the long term.

Now, I'd like to move to our forecast for this year. Please move to slide number six. We expect the Chilean GDP this year to fall by 1.4% after a 2.7% expansion in 2022. This figure results from a U-shaped trend in the activity, with negative annual expansion rates between fourth quarter 2022 and second quarter of this year as a result of the normalization of temporary factors that increased the growth, as I mentioned previously. This forecast consequently is consistent with a gradual recovery in activity since the second half of this year. This slowdown and the recent strengthening (technical difficulty) currency should contribute to reducing pressures on prices.

In our baseline scenario, the overall inflation will fall from 12.8% last year to 4.8% this year, with a potential convergence to the 3% policy target only by 2024. Given these figures, we see room for lower monetary policy interest rate in the near future. Despite a neutral bias that the central bank has adopted in the last monetary policy meeting, we believe that the conjunction of lower growth and inflation will leave room to reduce the interest rate to nearly 6% by the end of this year. All these forecasts are subject to risks.

In addition to global uncertainties, where Chinese dynamism is a key driver for Chile and geopolitical conflicts in Eastern Europe could produce some noises in international prices, we have to pay attention to the evolution of some local factors as well, especially those related to political and institutional aspects. Some of them include the evolution of some reforms that are currently under discussion in Chile, such as the tax and pension bills, as well as the ongoing constitutional process. The evolution of these factors will be critical to the length and deepness of the recession that we currently face.

Before moving to Banco de Chile discussion, I'd like to briefly discuss the evolution of local banking industry. Please flip to slide number seven. 2022 was a profitable period for the banking industry, posting stronger nominal results than the prior year. However, inflation was the main driver for this result and, as you will see later in the presentation, the true profitability adjusted by the loss of purchasing power due to the high level of CPI, which Chile has experienced, is substantially lower than the 21% for the banking industry in 2022.

The cost of higher CPI is also reflected in asset quality, where, for the last four quarters in a row, the industry has seen an upward trend in loan loss provisions, as shown on the chart on the bottom right. Loan growth in real term has also weakened, as shown by the chart on the bottom left. Inflation and several sources of uncertainty have impacted demand. For 2023, we expect a weak real growth of around 1%, driven by mortgage and consumer loans.

Now, I'd like to pass the call to Pablo, who will go into more detail about Banco de Chile strategy and financial performance.

Pablo Mejia {BIO 21990305 <GO>}

Thanks, Rodrigo. Please go to slide number nine. The strong results that we have consistently achieved have been the product of our sound strategic pillars based on customer centricity, productivity, and sustainability. To reach our mid-term targets, we have established six core priorities. In the next slides, we will review some of these advances that we have been making.

Please move to slide number 10, where I'll highlight some of our digital banking initiatives. Our strategic ambition at Banco de Chile is to deliver the best customer experience and to provide the best digital banking platforms to clients in Chile. During 2022, we strengthened existing platforms and continued implementing innovative digital solutions. We are proud to highlight that Cuenta FAN accounts has reached over 1 million clients as of December 31, 2022 by adding approximately 350,000 customers in this period. Another relevant aspect is that despite the quick growth of this product, we grew our customers by almost 50% this year without affecting our customer satisfaction levels.

Among other advances in 2022, we launched three new digital products to promote customer onboarding and financial inclusion. Digital current account, FAN Clan, and FAN Emprende. The new digital current account was launched in the first half of the year and is a full bank account with the possibility to open other products, such as lines of credit and credit cards. FAN Clan is a free digital account for teenagers between 14 and 17 years old with a purpose to build strong relationships early in the customers' lifecycle. And FAN Emprende is a digital account for SMEs that has no entrance or maintenance fees and gives access to exclusive benefits for small businesses.

All of these products are in line with our aspirations of growing our clients and also promoting financial inclusion. Furthermore, among other initiatives, we released several upgrades and innovations in our apps. As shown on the right side of the slide, we launched an improved investment app that allows our clients to invest easily worldwide, and we made an alliance with other important institutions to facilitate the monetary transactions between clients of these two banks using telephone numbers and QR codes.

In addition, we made important upgrades in our main app, Mi Banco, such as withdrawing funds from ATMs without the need of a physical card, providing online loan simulations, and also approving these consumer loans online. Likewise, we added new functionalities in our app for enterprises called Mi Banconexion. Finally, we are honored that our advances in digital banking, together with our permanent focus on providing the best customer experience, led us to be recognized by The European as the most Innovative Digital Bank in Chile and by the digital newspaper focused on the financial industry and Chilean consumers called Chocale as having the Best Digital Banking Solution in the country.

Please move to Slide 11. We continued implementing changes and initiatives to reduce expenses and improve our operations in line with our efficiency and productivity objectives. We introduced a new purchase model, which uses an electronic auction in tender processes to increased competition among potential providers, while ensuring transparency and cycle times. Additionally, we made several negotiations to fulfill all banking functions proactively through the annual purchase plan, which generated savings of approximately $20 million. And finally, regarding our cost reduction process, we have developed optimization projects that cover diverse aspects, such as our branch footprint analysis, savings in energy costs, while optimizing and consolidating service purchases at the corporate level.

On the productivity side, through the Retail Sales Excellence Plan, we (technical difficulty) loan originations by 45% year-on-year, while maintaining our account managers headcount flat. This impressive figure was the fruit of a set of improvements, such as the standardization of commercial processes, the digitalization of sale, and refocusing intelligence of commercial campaigns. Due to the successful implementation of the productivity projects on our retail business, the bank decided to extend and adapt these initiatives to the SME banking segment that promptly achieved good results as the increase of 25% in originations per account manager. Thanks to these and other actions previously implemented, we ended the year with the best efficiency ratio amongst our peers in Chile.

We also accomplished important advances in ESG as we'll discuss in the next slide, number 12. During 2022, we had taken important steps towards strengthening our sustainability strategy. We have proactively been reinforcing the development of social, environmental, and governance initiatives, some of which are presented on this slide. We developed a Sustainability Financing Framework to issue ESG-related bonds and to finance projects with positive impacts. In addition, we created a Sustainability Committee, led by the CEO, to boost our ESG strategy and launched the Blue Commitment program to promote our green products.

Last year, we also continued boosting our social and environmental initiatives, such as our financial education courses, tournaments to promote entrepreneurship, volunteer programs to support social organizations, care and support for elderly, and reforestation. Those programs directly benefited over 44,000 people. It's also worth mentioning that we have the largest corporate volunteering program in Chile, in which almost 10,000 employees participated as volunteers at the Teleton event in 2022.

Finally, our permanent focus on improving diverse ESG aspects of our business. We were recognized as the best bank for financial inclusion by The European and the third best company ESG in Chile, according to the corporate reputation business monitoring company called Merco, based in Spain, among other recognitions. In addition, we are very proud to have received tremendous upgrade in our ESG risk ratings by Sustainalytics that went from a medium risk to a low risk, placing us first amongst banks in Chile. This recognition demonstrates that we are advancing in the right direction as a responsible institution that contributes to the development of the country and its people.

Please turn to Slide 14 to go into detail about Banco de Chile's financial performance. 2022 has proven exceptionally profitable for the banking industry in nominal terms, as evidenced by the chart to the left, where we led the sector with over 30% nominal ROAE. Our competitive advantages, consistent strategy, and strong governance practices have been key for our success. Accordingly, we took the proper actions during the pandemic that translated into record results we are witnessing today in this environment of high inflation, interest rates, and liquidity.

However, it's important to be aware of the transitory impact generated by the high level of inflation on profitability. Since 2009, the nominal effect of inflation under Chilean GAAP, similar to IFRS, does not take into consideration the full impact of inflation on income or the balance sheet. When we consider the effect of inflation on equity to recognize the loss in purchasing power, profitability becomes much more aligned with our long-term figures. The chart on the right demonstrates the inflation adjusted ROAE from the main Chilean banks, considering the impact of inflation on equity, by deducting the effect of price-level restatement of capital in the income statement.

In our view, this measure provides a clearer perspective of real profitability, as it shows the full economic value that is generated by maintaining the real value of equity after considering the negative impact of inflation on its nominal value. Even after this approach, our adjusted return on average equity was far greater than those of our competitors and surpassed our pre-pandemic track record, showing an impressive competitive edge and consistent long-term strategy.

Please turn to Slide 15. Our financial performance in the fourth quarter of 2022 and over the course of the entire year was exceptional. As shown on the chart to the left, net income reached CLP347 billion in the fourth quarter of 2022, 21% higher than the same period last year; and for the full year, we grew 78% over 2021. This bottom line surpassed all of our main competitors in both absolute figures, as well as growth, as shown on the chart on the right. This strong bottom line was composed of both, temporary and core factors, driven by our sound and consistent strategy.

Our balance sheet positioning and superior competitive advantages permitted us to greatly benefit from the non-recurring rise and inflation as a result of our UF GAP position. Higher nominal interest rates also played a major role in this result due to the higher contribution of demand deposits. Other core factors that supported the bottom line came from higher loan origination and the dynamic fee business, all being boosted even more by the persistent strong levels of asset quality.

Please turn to Slide 16 on operating revenues, where we will go into more detail. Our operating revenues experienced a rise of 15% when comparing the fourth quarter to the same period last year and grew 42% year-on-year. The latter grew 74% in non-customer income and 28% in customer income. In terms of non-customer income, we generated greater revenues from our UF structural GAP position due to the high level of inflation we experienced this year and, to a lesser extent, higher income from our management of our trading and debt securities portfolio, given the positive changes in both interest rates and inflation. The rise in customer income was the result of stronger demand deposit contribution, given a scenario of high local and foreign interest rates and, to a lower degree, by a moderate increase in average balances. Likewise, lower liquidity among individuals also resulted in the reactivation of higher margin lending products, such as consumer loans.

Putting aside the temporary revenues that we generated in 2022, the charts to the right shows how our overall operating income compared to our competitors. As you can see on the right of the slide, we have outperformed our peers in net interest margin, fees, and total operating margin. We believe that part of this better performance responds to our consistent approach to risks, which is supported by prudent corporate governance standards.

Please turn to Slide 17. Total loans grew by 7.2% as compared to the previous year and 1.7% versus the third quarter of 2022. A large portion of this expansion is attributable to market factors, as inflation had a significant uptick this year, particularly since 100% of mortgage and 37% of commercial loans are denominated in UF. The difference in nominal versus real growth becomes clear in the charts to the right. Nevertheless, consumer loans continued to exhibit higher dynamism by growing 17.5% year-on-year and an impressive 6% quarter-over-quarter. This positive outcome is primarily due to strong loan origination figures, which were driven by effective marketing strategies and solid value proposition.

We have also seen an important improvement in originations by account manager as a consequence of our successful Retail Banking Sales Excellence program. This has been implementing best practices across the organization, boosting productivity levels through four key pillars.

First, improving the effectiveness of risk models to increase pre-approved loans and adjusting risk attributions at the branch level to boost efficiency. Second, leveraging digital tools to enhance analytics. Third, expanding our business intelligence and building new propensity models, which is a set of approaches to building predictive models to forecast behavior of a target audience by analyzing their past behaviors. And finally, developing commercial discipline through the implementation of management and training procedures, branch per branch.

Through this program, we have been able to increase not only our originations of consumer loans that grew 45% year-on-year, but also our market share in this product that grew 76 basis points to reach 17.4%. A similar program has been implemented in the SME segment, and we are already seeing strong improvements in originations, with a rise of 25% this quarter when compared to the same quarter in 2021.

For 2023, we expect that loans in the industry should grow in line with expectations for inflation and that loan growth should be driven by consumer and mortgage loans. We expect that commercial loans will continue growing below inflation due to the low business confidence, political uncertainties, and the recession we are currently experiencing. As for our loan portfolio, this should follow a similar trend of moderate growth.

Please turn to Slide 18. We have adjusted our balance sheet structure accordingly for the changes we are expecting with regards to falling interest rates and inflation. Consequently, this led to a change in our funding strategy by proactively placing UF bonds in the local market and increasing the source of funding 8% year-on-year and 5% in the quarter. This increase in the duration of our liabilities reduced the price risk in the banking book by decreasing our exposure to inflation, as shown on the chart on the bottom right, and refinance scheduled amortization of outstanding bonds.

The timing of the issuances was especially relevant, given the expectations that the local bond market may become very active in debt placements in light of the financing needs from the scheduled amortization of the FCIC financing beginning 2024 and the expected behavior of demand deposits, among others. With regards to demand deposits we continued to see a normalization in this quarter in terms of the source of funding, decreasing by 6.4% during this quarter and 27% year-on-year from the unsustainably high levels of 2021 due to the pension fund withdrawals and relief programs.

As can be seen on the chart on the upper right, the relationship of demand deposits to time deposits has been moving quickly to a more normal level, given the extraordinary high levels of short-term interest rates implemented to control inflation and normalized liquidity levels in the economy. Nevertheless, we expect that our current level of demand deposits equal to 36.5% of total loans is relatively in line with our long-term levels from this source of funding. We expect that DDAs will remain relatively flat throughout 2023 when compared to 2022. We are also confident that our premium customer base should continue to support our strong funding mix.

Additionally, during 2023, we'll keep on assessing funding alternatives, depending on the market dynamics, evolution of time deposits and demand deposits and loan growth. Likewise, we can't rule out that we'll continue to reduce price risk exposures in the banking book, for instance, in terms of the inflation gap, all of which will determine the steps we will take to finance our balance sheet.

Please turn to Slide 19 to discuss our superior capital levels versus our peers. As shown on the slide, our profitability track record has consistently outperformed our peers, including return on average equity, despite our larger capital base. We finished the year with a Basel ratio of 18%, significantly higher than our peers, as shown on the chart on the top left, and the positive direction of our CET1 ratio over the past few years has meaningfully surpassed both of our main competitors, as shown on the chart on the bottom left.

This position of high return, high net income, and high CET1 is truly unique, as shown on the chart to the right. We have achieved this through our customer-centric business strategy and the appropriate balance between risk and return. This has allowed us to grow our portfolio and bottom line sustainably. Additionally, we have been able to continue providing an attractive dividend without affecting this leadership position, all the while maintaining the largest gap of our capital over the regulatory limit to easily comply with Basal III regulations.

Please turn to Slide 20. Undoubtedly, core expected credit losses are in a process of normalization. This quarter, expected credit losses reached CLP123 billion, down from CLP138 billion posted one year ago, with a lower amount of additional provisions established. For the full year, we recorded CLP435 billion of expected credit losses, up 22% from one year ago. This rise is attributable to the normalization of asset quality after a period of high liquidity that maintained risk indicators transitorily low.

As shown on the chart on the bottom left, NPLs rose from a very low level of 0.85% in the fourth quarter of 2021 to a still lower than pre-pandemic level of 1.08% this quarter, a rise that was significantly lower than those posted by our main peers. Excluding the decrease of CLP65 billion of additional provisions, the Retail Banking segment contributed the most expected credit losses, with an annual increase of CLP31 billion, while the Wholesale Banking segment rose CLP13 billion due to the high inflation and weaker economy that is affecting individuals and businesses alike.

Nevertheless, the quality of our portfolio and the risk management culture is evident when we compare to our peers, as you can see on the charts on this slide. Not only do we have the soundest portfolio, we also have the highest coverage ratio of 3.7 times and the most additional provisions, amounting to CLP700 billion, as shown on the charts to the right. This clearly positions us better than our peers if the economy worsens beyond our baseline scenario.

Lastly, it's important to stress the relevance that controlling risk has on our bottom line. This is truly a competitive advantage, where we have demonstrated a superior track record to our peers, as shown on the chart on the bottom right. Since 2021, we have continued to widen the gap with our peers despite our significantly larger coverage ratio, demonstrating our excellence in managing our business.

Please turn to Slide 21. Expenses have grown this quarter 19% nominal over the same period last year and 14% nominal in 2022 over 2021. This rise is primarily due to the high inflation that reached 12.8%, which has an impact on most of expense line items, including salaries, advisory services, and IT expenses, that are indexed to CPI. We also recorded higher variable compensation due to the strong results during 2022. Nevertheless, the annual rise in real terms reduced significantly to only 2.8% as a consequence of our cost control efforts bearing fruit.

In terms of efficiency ratio, we reached a ratio of 33.1% this quarter and 31.9% for the full year, both significantly below the levels recorded in 2021. When compared to our peers, we continue to lead and widen the gap in efficiency, as shown on the chart to the right. We are confident that through our firm focus of strengthening cost controls, boosting productivity, and using technology to improve how we manage our business should continue to allow us to post strong normalized efficiency levels that are better than what we recorded in the past. Nevertheless, it's fair to mention that our current level of efficiency has clearly been driven by market factors, such as inflation and interest rates, that transitorily increased operating revenues. However, we are confident that we will continue to reach sustainable levels below 45% in the medium term.

Please turn to Slide 22. The last few years have been turbulent. Despite this, we have managed the bank well throughout the cycle, posting historic results in 2022 that are well above all our competition. We outperformed in total profitability measured by ROE and ROA and, at the same time, in capitalization. We posted the highest net interest margin, the highest fee margin, and the highest operating margin. We recorded the best asset quality indicators and set the highest level of coverage to face possible uncertainties that could have occurred or that may lay ahead. Not only that, we also posted the best efficiency ratio in the industry, taking away this recognition that has historically been held (technical difficulty) main competitor.

Overall, we believe that through our superior customer-centric strategy, together with our uncompromising approach to manage risks are the main pillars of our solid track record. This is especially relevant, as we are currently in a recession. We expect that the recovery should begin in the second half of 2023, and we are well positioned to take greater advantage of this environment than our peers.

Our short-term guidance is NIM decreasing from the unsustainably high rates to a level of around 4.3%; cost of risk should normalize this year to around 1.2%; and efficiency should reach a level of around 40%. As for ROAE, this should converge to a range around 18%, while also maintaining a solid capital base.

Thank you for listening. And if you have any questions, we would be happy to answer them.

Questions And Answers

Operator

Thank you very much for the presentation. We will now be moving to the Q&A part of the call. (Operator Instructions) Our first question comes from Mr. Tito Labarta from Goldman Sachs. Please go ahead, sir. Your line is open.

Q - Tito Labarta {BIO 20837559 <GO>}

Hi, good morning, Rodrigo and Pablo. Thanks for the call and taking my question. Couple of questions. I guess, just on your expense outlook, I notice [ph] efficiency deteriorating a bit as margins kind of normalize. But how do you think about expense growth from here? And I know inflation has been high, as inflation comes down, but you're still growing a bit above inflation. Is that what we should expect, slightly above inflation, or is there room where you can improve efficiency on the cost side?

And then a second question on your capital ratio, very strong at 13.7%. Just help us, what's -- what do you think is the right level of capital where you feel comfortable operating and what could that mean for your dividend payout? Thank you.

A - Pablo Mejia {BIO 21990305 <GO>}

Hi, Tito. Yeah. So, in terms of efficiency, what we're seeing is that the strong growth of 2022 inflation has a important effect in terms of the variation of costs in 2023. So, we'll probably start seeing a level of around a couple of points above inflation in terms of cost, because most of us are indexed to inflation, right?

So we have some things that we've been doing throughout the year and prior years, like digital transformation. We've been improving everything related to our digital products, the services and tools that we provide online, the onboarding that we're giving customers. We had a reduction in our branch level. We optimized the branches across Chile. Today, we have 266 branches. Half of those branches are located in Chile, half of those -- the other half is -- sorry, half of those branches are located in Santiago and the other half are located in regions outside Santiago. In regions outside Santiago, there's only one or two branches in those cities and towns. So there's not much room for improvement there or improvement in the footprint.

On Santiago, all depends on the evolution in terms of growth and how many customers use the branches. But today, the level that we have of the branch network is -- we feel is optimal as of today. And we've also been implementing improvements in efficiency through the -- our efficiency program, where we've seen different improvements across the company in terms of how we purchase goods within the bank, implementing new tools and to auction all purchases to get better deals and also, on how we are doing trainings within the branches in order to improve productivity and increase originations per account manager.

So basically, in summary, for 2023, one of the main drivers for us is the effects of inflation through 2022, which is affecting the comparison base. So in the medium term, we should think that Banco de Chile will grow in line or slightly below inflation. But with 2023, the main driver is 2022 inflation.

And for capital, Daniel Galarce will respond to your question.

A - Daniel Galarce

Hi, everybody. Regarding capital ratios, in fact, we feel pretty confident with -- and pretty comfortable with the levels we have today, particularly in terms of CET1. And in terms of the dividend payout, as you probably know, the Board has decided to propose a 100% payout ratio for 2023 over the net distributable income now, which in fact is an effective payout ratio of 68% approximately.

It's important to consider that we -- every year, we retain the effect of inflation on the shareholders' equity, of course. So, we normally distribute the -- over the rest of the earnings. In this case, distributable earnings. So basically, we will continue to reinforce our capital base. And in the future, we will probably come back to the same payout ratio that we normally have every year, which is approximately 60% of the net distributable income.

Q - Tito Labarta {BIO 20837559 <GO>}

Thanks. That's very helpful. Just in terms of the --

A - Pablo Mejia {BIO 21990305 <GO>}

Sorry, but one --

A - Daniel Galarce

Just one -- just a correction. The effective payout ratio is 62% of our net distributable over the total net income. The last year, 2022, was 68%.

Q - Tito Labarta {BIO 20837559 <GO>}

Great. Thanks, Daniel. And just in terms of, like, what the optimal level of capital is, where you -- where we think you should be operating?

A - Daniel Galarce

Yeah. Will depend on n the balance sheet growth, of course. But we feel pretty comfortable with the level we have today. Probably, we will use some capital in the -- over the next three years, but basically, will depend on how the (technical difficulty) will expand in the mid term. Today, we have room to grow in terms of the balance sheet, of course, and probably levels of CET1 of 12%, 12.5% is something that is reasonable for us.

Q - Tito Labarta {BIO 20837559 <GO>}

Perfect. Great. Thank you very much.

Operator

Thank you very much. Our next question comes from Mr. Andres Soto from Santander. Please go ahead, sir. Your line is open.

Q - Andres Soto {BIO 15822388 <GO>}

Welcome, everyone, and thank you for taking my question. My question is related to your NIM sensitivity and your outlook for Chile's inflation and interest rates. Can you please remind us what is the sensitivity that we have, both ARPU and NIM -- ARPU growth rate and inflation? And besides that, I would like to understand what changed in your expectations. When I compare this guidance that you are providing with the one that you provided three months ago, I see that both for NIM and -- you consider [ph] -- you are guiding now to the upper end of that range that you guided before and now -- lower end, I meant, sorry. And for cost of risk, you are guiding for the upper end. So I would like to understand what changed your view of Chile over the past few months to provide this more cautious guidance. Thank you.

A - Pablo Mejia {BIO 21990305 <GO>}

Yeah. Sorry, it's very low, the volume. Could you repeat the question, sorry, again?

Q - Andres Soto {BIO 15822388 <GO>}

Sure, Pablo. Basically, I would like to understand your updated sensitivity to interest rates and margins.

A - Pablo Mejia {BIO 21990305 <GO>}

Okay. So, the -- in terms of our net interest margin -- you can hear, me right?

Q - Andres Soto {BIO 15822388 <GO>}

Yes.

A - Pablo Mejia {BIO 21990305 <GO>}

Okay. So in terms of net interest margin, what we're seeing today is a level that goes somewhere around 4.3% for 2023. And the main driver there is really, for us, the evolution of inflation. So depending on the evolution of inflation will be the main driver in the short term for where that level finishes for the end of the year. What we're seeing the -- some other drivers, but less of an impact, is how we're growing the retail base loans. So, the evolution of the growth in loans that we're seeing, we see that the retail is a little bit healthier than the wholesale. But still, it's not significant as inflation.

So, for every 100 basis point change of inflation it's about CLP60 billion change in net interest income, or more or less in NIM around 13 basis points, with the gap that we have on the balance sheet today. And if we look at the sensitivity to the overnight rate, once everything reprices after three years, a 100 basis point change in the overnight rate is about a 30 basis point change in net interest margins. So, that would be the main driver for 2023 for net interest margin, is inflation. And the -- there is some positive effects on growth in terms of loans, but what we're seeing is what -- it is relatively flat in total with a slightly higher growth in terms of retail loans above inflation.

Q - Andres Soto {BIO 15822388 <GO>}

Thank you. Thank you, Pablo. And regarding your additional provisions, this -- connecting this with the updated model for -- the (inaudible) model for provisioning consumer loans, do you have any updated estimate of how much of your excess provisions are going to be used for these updated model? If I assume it's not the full amount, will you consider to release some of those provisions in case the cost of risk this year at some point exceeds the 1.2% that you are forecasting now?

A - Pablo Mejia {BIO 21990305 <GO>}

Well, today, we have the highest level of additional provisions, which is CLP700 billion. It's a very strong coverage ratio of 3.7 times. In the last -- if you look to the -- if you see in the presentation, in the last quarters, we've been provisioning -- the provisions that have been flowing through the income statement is more based on models and additional provisions. So we only set CLP15 billion of additional provisions in the last quarter.

Now, with respect to why we place these provisions or why we have these additional provisions, they're for the evolution of the economy and how that can affect our portfolio, but not for model changes. What we're expecting is somewhere around 1.2% for cost of risk for the next year and that's in line with our base scenario. Now, we haven't mentioned the effect of the new provisioning model. But for us, it's not so material. But there's not a clear guideline on how this will be implemented or also, the rule of the provisioning model, how it will end up in -- at the end, because it's -- it just finished in the consultation period and we started to find out the final draft.

A - Rodrigo Aravena {BIO 15086260 <GO>}

So, let me add. Hi, this is Rodrigo Aravena. Can you hear me well, sorry? Yep?

Q - Andres Soto {BIO 15822388 <GO>}

Yes, Rodrigo.

A - Rodrigo Aravena {BIO 15086260 <GO>}

Okay, thanks. So, it's very important to keep in mind that there are some sources of uncertainty that still remain for the country -- for Chile. It's not clear, for example, what will be the long-term impact from the different measures that were adopted during the last year, for example, the long-term impact from the withdrawal from pension funds, the lower exchange rate, et cetera. So, there are some doubts related to the long-term GDP growth for Chile. It's not clear how will be, for example, the long-term level of the monetary policy rate as well.

So at the end of the day, it's very important, especially this year, to be aware of different source of uncertainty, especially considering some discussions that we're going to have in 2023, including, for example, different discussions from the taxes, the pension reform, the constitutional process that -- it will be held this year as well. So, the evolution of these sources of risks are very important in terms of (technical difficulty) in the future. And also, it's extremely important to pay attention to the evolution of the exchange rate in Chile, because it has a critical impact in terms of inflation. Yet to have an idea, a 10% change in the exchange rate, it change the overall inflation in one year of around 150 basis points. So, that's why there are some sources of uncertainty that it's very important to pay special attention to this year.

Q - Andres Soto {BIO 15822388 <GO>}

Thank you so much, Rodrigo and Pablo, for your answers.

Operator

Thank you very much. Our next question comes from Mr. Juan Recalde from Scotiabank. Please go ahead, sir. Your line is open.

Q - Juan Recalde {BIO 21032747 <GO>}

Hi, Pablo, Rodrigo. Thank you for taking my question, and congratulations on the strong results. My question is related to the guidance, and I wanted to understand what are the -- what's the upside risk that you see. What are the main sources for upside risk to your guidance and what would be the main ones for the downside risks as well? Thank you.

A - Pablo Mejia {BIO 21990305 <GO>}

So, I think the main upside risks that we're seeing today is -- in recent economic figures, is better than expected results of the economy and maybe how that will transfer into 2023 with a stronger GDP growth that would be positive. Also, the evolution of the unemployment rate is also a positive factor that can continue benefit in different line items in the balance sheet. For example, stronger growth in the portfolio, in more higher-margin products. We also have the benefit of lower cost of risk than could be expected if the economy is stronger. And we continue to see a very good payment behavior from our customers.

I think those are the main upside. But the main downside also fall in the same line, I would say, as well. If the economy grows slower, there's more uncertainty, the business confidence levels are weaker, that can have an effect in the balance sheet in terms of growth of the portfolio and also, in the evolution of risk. But it's important also to mention that we have a huge amount of additional provisions. So, if something escapes, it's a little bit more higher NPLs in our baseline scenario, or it gets very difficult in 2023, we still have a large amount of additional provisions, which the Board takes into consideration on a monthly basis on the evolution of those provisions and how they should be used. Rodrigo?

A - Rodrigo Aravena {BIO 15086260 <GO>}

Yeah. Yeah, so, in other words, the key sources of potential changes in our bottom line are related with macro drivers. So we are not especially concerned, for example, any fears or special factor related to the -- in the sector, especially for Banco de Chile. So, at the end of the day, the upside risk or downward risk related to the bottom line mainly are related with economic growth, with the evolution of interest rate, the CPI, as Pablo mentioned, the unemployment rate, especially considering the material impact in risks. So, the potential gap between our guidance today and final results for the next -- for this -- for the end of this year will be closely related with the evolution of macro factors rather than specific aspects of our bank or the financial industry.

Q - Juan Recalde {BIO 21032747 <GO>}

Understood. So, the changes in interest rates wouldn't have a direct impact on your guidance. It will be more indirect, through economic growth expectations and inflation. Is -- could that be correct?

A - Pablo Mejia {BIO 21990305 <GO>}

Our baseline scenario for interest rates is -- they're relatively, on average, similar, 2022 and 2023. The evolution of that changes or the evolution of inflation changes, that would have an effect on our net interest margins.

A - Rodrigo Aravena {BIO 15086260 <GO>}

So, at the end of day, the key figures to monitor this year is the inflation, the evolution of CPI, because that is the variable where we have more uncertainty. In fact, we now let [ph] some downward risk today in the evolution of the CPI. Yet to have an idea, for instance, our forecast of 4.8% [ph] of inflation for this year is consistent with an exchange rate of around CLP860, CLP850. So, if the exchange rates didn't, for example, hover in the current level, there would be a potential downward risk in terms of the inflation and, consequently, in the bottom line.

So, at the end of the day, the most relevant figure for this year in terms of the evolution of the bottom line will be inflation.

Q - Juan Recalde {BIO 21032747 <GO>}

Got it. Thank you for the comments, Rodrigo and Pablo.

A - Rodrigo Aravena {BIO 15086260 <GO>}

Perfect. Thanks.

A - Pablo Mejia {BIO 21990305 <GO>}

Thanks.

Operator

Thank you very much. Our next question comes from Mr. Yuri Fernandes from JP Morgan. Please go ahead.

Q - Yuri Fernandes

Hi, guys. Hi, Rodrigo, Pablo, congrats on this incredible year. I have a question regarding fees. If you can provide some outlook? I guess, the year was growing, like, 9% to 10% [ph]. And with lower inflation, not sure if this line should be slightly weaker in 2023 or if all those new initiatives, we should see a normal supportive figure [ph] for 2023. And also regarding the NPLs, you have in the guidance, 1.2, 1.3. That is some 20 bps increase versus 2022. But in the release, you mention that maybe during the year, you could see some peak on, like, higher NPLs during the year. What do you mean by that? Like, are you waiting for some kind of corporate cases, just like a more cautious macro environment by half of the year and as the charge-offs to NPL comes down? So, basically trying to understand the curve of NPL, right, like, should we start to see the peak in June -- 3Q, and then gradually improve in the 4Q? What is the message here? Thank you.

A - Pablo Mejia {BIO 21990305 <GO>}

So, thanks for the question. So, in terms of our expectations for fees grow, historically, similar to -- well, the main driver of fees is customer growth. So, if we look at the last 10, last five years, customers, depending on how you calculate it, if you look at the current account customers, we're growing on average over those periods similar around 6%, 7% in the last periods. If we look in a shorter time frame, it's slightly above that because of all these new products that we've been implementing, where we've been growing very strongly in terms of new current account openings, all these digital onboarding platforms.

So, one of the main drivers is the -- is customer growth, the sustainable drivers. Obviously, inflation has an effect of -- on fees, because most fees are indexed to inflation. But in the long term, expecting a level of 3%, 3.5% for inflation. We should think that -- plus, customer growth in current accounts, 7%, somewhere around there, maybe hovering around there. That's the average -- more or less the average in the past. We should get to the high-single digit level of fee growth. There is cross-selling there. And for 2023, the main drivers that we're seeing is we have a very good ATM business based in very good locations that have a very high usage rates. That's a good driver. Credit cards, mutual funds -- the mutual fund business as well, current account administration fees, all of those are the main drivers for 2023.

In terms of the question of NPL, I think I mentioned it should hover around 9% or high-single digits for 2023 and beyond. It's a reasonable level to expect. Most fees are generated from the retail segment and transactional. In terms of NPLs, the NPLs should be around these levels. But if we look at it by segment, we see NPLs in the corporate book relatively similar to what we've had in the past. But if we look in terms of the mortgage or more retail NPLs from the retail book, there's still a little bit of change that can occur there. We're still seeing very good behavior, a very high quality book, and we think that this should continue normalizing in line with the normalizing of liquidity.

So, during 2023, the evolution of that really will be more macro, so how the evolution of unemployment and how that passes through into the retail book could occur and also, the activity in terms of the wholesale. We don't see -- today, we have a very high quality book in all sectors. If we look at the real estate companies, they're are strong. We haven't had material problems there. If we look at the retail sector where we're a bank that's focused on more upper-income individuals, so we've had good payment behavior across the board. But it's still normalizing. The levels that we have today, overall, are still lower than a normal level. So, changes is more macro.

Q - Yuri Fernandes

Perfect, Pablo. That was very clear. And to just correct myself, I guess, you grew like 14%, 15% in your fees, not like 9% to 10% [ph]. It was more mid-single --

A - Pablo Mejia {BIO 21990305 <GO>}

Yeah.

Q - Yuri Fernandes

Mid-teens than the high-teens. Thank you.

A - Pablo Mejia {BIO 21990305 <GO>}

Yeah. So that's -- that -- those fees is -- customer growth, but one of the important factor there is inflation.

Q - Yuri Fernandes

Perfect. Thanks very much.

A - Pablo Mejia {BIO 21990305 <GO>}

So, that's unsustainably high.

Operator

Thank you very much. Our final question today comes from Mr. Carlos Gomez from HSBC. Please go ahead, sir.

Q - Carlos Gomez-Lopez {BIO 18107094 <GO>}

Thank you for taking my questions. I have a question also on fees. I think you referred to placement regulation, you don't refer to competition. Do you think that with the new open banking environment and more competition from digital banks, you might have pressure in the future, or you think it will not fundamentally change the structure of the market? And then going forward, in terms of the Group and -- would you kind of -- you still see yourself strictly constrained to Chile, or would you consider international opportunities, or perhaps going into the pension fund business, if that opens up? Thank you.

A - Pablo Mejia {BIO 21990305 <GO>}

So, I think in Chile, in general, the banking industry is a highly competitive environment. We have 18 banks in Chile that operate here, local banks and International banks. And there's a lot of regulations that have been set, which maintain fees low. So, for example, no -- current account, a huge pay [ph] anything for your current account as a customer, includes all the fees regarding transactions, for example, all transfers -- electronic transfers are -- have no fees. You can transfer $0.50 equivalent or a $100 equivalent. There is no fee associated to that.

If we look at the ATMs, customers don't get charged to use other banking -- other bank ATMs. So, there's less customer loyalty to your ATMs. The banks charge each other. So there's -- a lot the fees are very low already. There's areas that, of what we've seen through competition, have been decreasing. For example, mutual fund administration fees, those have come down over the years. But significant changes in the fee structure, we don't see a relative change to what we've seen in the past. The fee structure is relatively -- well, we see a lot of competition from all of these banks that I've mentioned there, local and international banks.

In terms of the second question, rationalization [ph] of Banco de Chile, so for Banco de Chile, we are a bank that's focused in Chile. Obviously, any new deals or business opportunities are all evaluated. But today, the focus has been to be in Chile and to continue operating in Chile and grow with our customers and help Chile grow. There is no news today of any changes of that. But obviously, if there's any opportunities that appear, it would be something that we would evaluate at that time.

Q - Carlos Gomez-Lopez {BIO 18107094 <GO>}

And the pension funds, if that opens up?

A - Pablo Mejia {BIO 21990305 <GO>}

It's also something that would be evaluated. If any deals occur, pension funds, any -- anything related to the financial institution that we can operate in, it would be something that would be evaluated at that point of time. And if it's an interesting and appropriate business and the cost structure makes sense, it would be evaluated at the Board level to see how we would enter or not into that opportunity, taking a good -- always taking care of having a good relationship between risk and return.

Q - Carlos Gomez-Lopez {BIO 18107094 <GO>}

Thank you, Pablo.

Operator

Thank you very much. Looks like we have no further questions. We'll pass the line back to Banco de Chile team for concluding remarks.

A - Pablo Mejia {BIO 21990305 <GO>}

Thank you for listening,and we look forward to speaking with you on our first quarter results for 2023.

Operator

Thank you very much. This concludes today's call. We'll now be closing all the lines. Thank you very much.