REPUBLIC OF CHILE
Ministry of Finance

ECONOMIC AND SOCIAL STABILIZATION FUND

Fourth Quarter, 2008

CONTENTS

I. INTRODUCTION

As of December 31, 2008, the Economic and Social Stabilization Fund (ESSF) had a market value of US$20,210.7 million. The net change in capital and interest income over the quarter amounted to US$942.4 million. This represented an Internal Rate of Return (IRR) in US dollars[1] of 4.89% for the quarter.[2] No contributions were made into the fund during this period.

The quarter was dominated by the development of the international financial crisis. The US Federal Reserve's announcement of the intervention of the country's main mortgage agencies (Fannie Mae and Freddie Mac) and the bankruptcy of Lehman Brothers in mid-September marked the start of a chain of events that eventually affected other institutions including investment banks, commercial banks and insurance companies.

The ESSF's value in dollars in the last quarter reflected international financial volatility and, principally, variations in the currencies and rates into which the fund has diversified its portfolio. In the case of currencies, the dollar appreciated against the euro by 1.04% but depreciated against the yen by 17.12% while the euro weakened by 15.50% against the yen. It should be noted that the ESSF's IRR in local currency for the quarter was 3.46%.

The present report is divided into two parts. The first section provides information about the ESSF's performance during the last quarter and the composition of its portfolio by currency and type of risk while the second part consists of an explanation, prepared by the Fiscal Agent, of the behavior of the markets that affected the ESSF's investments during the period.

[1] Henceforth, referred to simply as dollars.
[2] Unless otherwise indicated, the rate given is the non-annualized rate for the period in question.

II. MARKET VALUE AND PERFORMANCE OF THE ESSF

The Economic and Social Stabilization Fund (ESSF) was established on March 6, 2007 and its management was entrusted to the Central Bank of Chile (CBC) which acts as Fiscal Agent. However, formal monitoring of its performance did not begin until April 1, 2007, after the implementation of its investment policy. The starting date for all comparisons with the benchmark is, therefore, March 31, 2007.

II.1. Market Value of the ESSF

As of December 31, the ESSF held assets worth US$20,210.7 million. The variations in its market value are set out in the table below:

Table 1: Market Value of ESSF

Market Value (US$ million)	2007	2008						Summary 2008
		Q1	Q2	Q3	Q4			
					October	November	December	
Starting value	-	14,032.6	17,192.0	18,770.4	19,268.3	18,791.5	19,164.2	14,032.6
Contributions	13,100.0	2,100.0	1,900.0	1,000.0	-	-	-	5,000.0
Change in value	932.6	1,059.4	-321.6	-502.1	-476.8	372.8	1,046.4	1,178.1
Final value	14,032.6	17,192.0	18,770.4	19,268.3	18,791.5	19,164.2	20,210.7	20,210.7

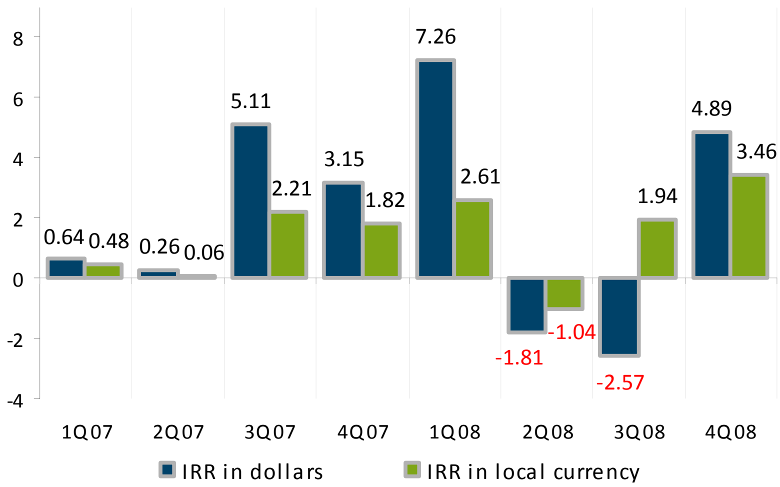
Source: JP Morgan

In the last quarter of 2008, the ESSF's market value increased by US$942.4 million, representing an IRR for the period of 4.89% while, over the whole year, the increase reached US$1,178.1 million, equivalent to an annualized IRR of 6.81%.

Since its inception, the value of the ESSF at market prices has shown a net increase in capital and interest income of US$2,110.7 million, equivalent to an annualized IRR in dollars of 8.62%.

The figure below shows the fund's quarterly IRR in dollars and in local currency.

Figure 1: Quarterly IRR in Dollars and Local Currency[3]
(percentage points)

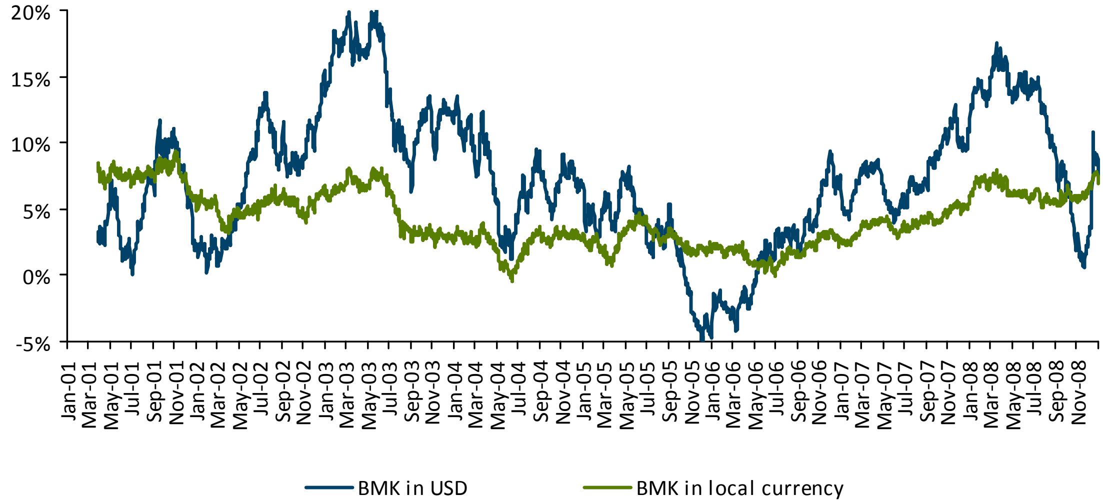


Source: Dipres based on data provided by JP Morgan and Bloomberg

Analysis of the historic performance of the benchmark portfolio shows that the return in dollars during the first quarter of 2008 and subsequent adjustments in the second and third quarters are similar to those seen between 2001 and mid-2004 during the US Federal Reserve's last expansive monetary-policy cycle. As shown in Figure 2, the benchmark registered higher annual returns -measured in dollars- for almost two years as from mid-2002 before entering a two-year cycle of decreasing returns.

[3] Annualized compound rate. The fund started regular operations on April 1, 2007.

Figure 2: Moving Annual Return on the Benchmark in Dollars and in Local Currency



Source: Dipres based on data provided by JP Morgan and Bloomberg

In the last quarter, the composition of the ESSF by type of risk and currency, expressed in dollars,[4] was as follows:

Table 2: Composition of the ESSF by Asset Class, Currency and Duration

Assets	Original Currency	4th quarter 2008 (US$ million)		
		October	November	December
Sovereign	USD	7,666.7	8,211.3	8,568.7
	EUR	6,291.3	6,480.3	6,614.9
	JPY	1,268.3	1,310.2	1,433.6
Agencies	USD	337.1	-	-
	EUR	-	-	-
	JPY	-	-	-
Bank	USD	1,413.2	1,541.9	1,718.2
	EUR	1,211.8	997.1	1,264.7
	JPY	603.1	623.4	610.6
Total		*18,791.5*	*19,164.2*	*20,210.7*

Source: JP Morgan

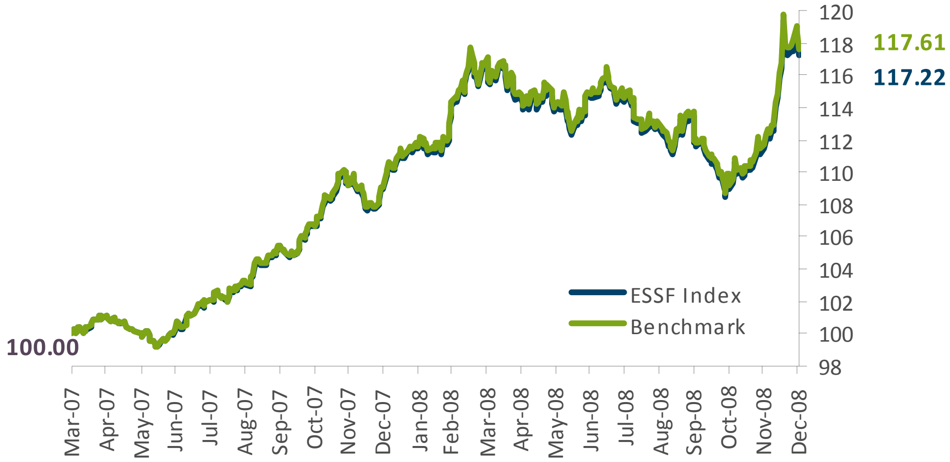
[4] According to JP Morgan, the exchange rates used at the close of the month were:
October 31 : 0.7886 EUR/USD and 98.3500 JPY/USD
November 30 : 0.7881 EUR/USD and 95.2450 JPY/USD
December 31 : 0.7194 EUR/USD and 90.6500 JPY/USD

II.2. Performance of the ESSF

II.2.1 Performance of Financial Investments

Figure 3 sets out the performance of the ESSF measured using an index[5] that shows daily variations in the market value of its portfolio expressed in dollars. The base value is 100 as of March 31, 2007.

Figure 3: ESSF Index vs. Benchmark
(March 31, 2007 = 100)



Source: Dipres based on data provided by JP Morgan, CBC and Bloomberg.

In the last quarter, the index showed a return of 4.89% in comparison to 5.03% for the benchmark. As from March 31, 2007, the index registered an annualized return of 9.81% while the equivalent figure for the benchmark was 10.03%.

[5] Unlike the IRR, this indicator excludes the effect of net cash flows (contributions minus withdrawals) on the fund's return.

The table below provides a summary of the return of both the index and the benchmark in dollars and in local currency:

Table 3: Returns on the ESSF
(In dollars and local currency)

	Return	Q4	Accumulated since March 31, 2007 (annualized)
Dollars	ESSF Index	4.89%	9.81%
	Benchmark	5.03%	10.03%
	Return differential	-0.14%	-0.21%
Local currency	ESSF Index	3.47%	6.70%
	Benchmark	3.61%	6.90%
	Return differential	-0.14%	-0.20%

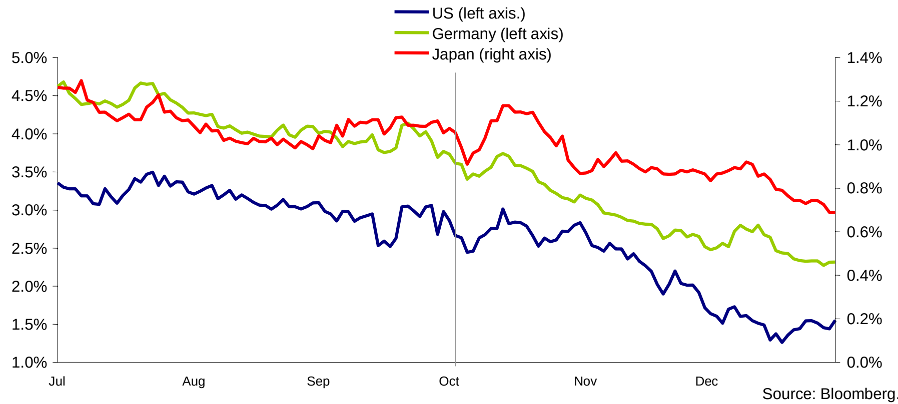
Source: Dipres

III. BEHAVIOR OF RELEVANT MARKETS IN THE FOURTH QUARTER

The adjustments produced in the world's main economies as a result of the international financial crisis are apparent in macroeconomic indicators for the fourth quarter and, particularly, in a moderation of price growth, due principally to a drop in commodity prices, and an increase in unemployment rates. Figures for activity in the last quarter led to a reduction in growth projections for the year and for 2009.

In this context, the main central banks (US Federal Reserve, European Central Bank, Bank of England and the monetary authorities of Switzerland, Canada and Sweden) took coordinated action on October 8, reducing their respective monetary-policy interest rates by a half point. In the face of expectations of further rate cuts, the yield on fixed-income sovereign securities subsequently continued to drop (Figure 4), also reinforcing concern about the length and depth of the crisis.

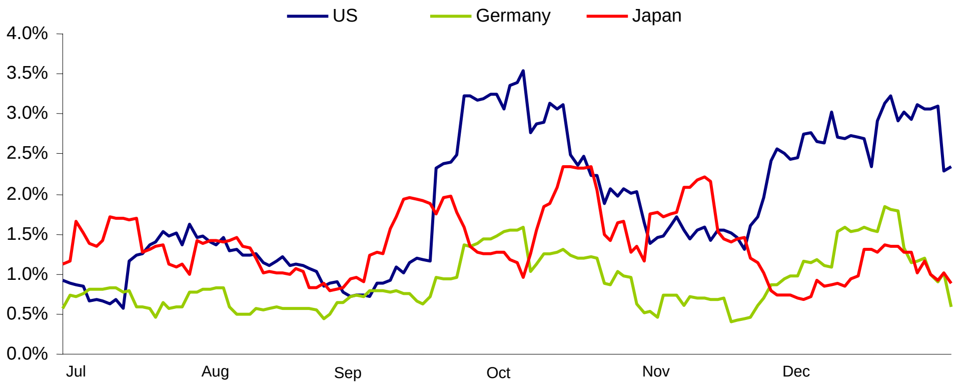
Figure 4: Interest Rates on 5-Year Bonds



Source: Bloomberg.

During the fourth quarter, there was an increase in the volatility of fixed-income sovereign securities, particularly in the US. For example, the volatility of 5-year Treasury bills almost doubled on the previous quarter (Figure 5).

Figure 5: Risk Level of 5-Year Bonds[6]



Source: Bloomberg.

III.1. Main Economic Trends

In the **United States**, activity and private consumer spending fell in the last quarter and retail sales also deteriorated. During the quarter, the Federal Open Market Committee (FOMC) reduced the monetary-policy interest rate by 175 basis points. The first cut of 50 basis points was announced on October 8 after an extraordinary meeting of the FOMC and was coordinated with other central banks. This was followed by cuts of 50 and 75 basis points in meetings scheduled on 29 October and 16 December, respectively, taking the rate to a range of 0%-0.25%.

Unemployment continued to increase and closed the year at 7.1%, up from 6.0% at the end of the previous quarter. At the same time, a significant drop in commodity prices, particularly fuels, helped reduce inflation from an annual rate of 4.9% at the end of the third quarter to 0.1% at the end of the year while core inflation dropped from 2.5% to 1.8%. In the real estate sector, inventories increased indicating the weakness of this sector.

In the **Euro Zone**, the European Central Bank introduced three cuts in its monetary-policy interest rate, taking it from 4.25% to 2.50% while reductions were also made by non-euro European countries, particularly England (300 basis points), Norway (275 basis points), Sweden (275 basis points) and Switzerland (225 basis points). Inflation dropped, closing the year at an annual rate of 1.6%, down from 3.6% at the beginning of the last

[6] The standard deviation of the daily logarithmic variation of the price of a generic 5-year bond in a moving 10-day period was used as an approximate measure of risk.

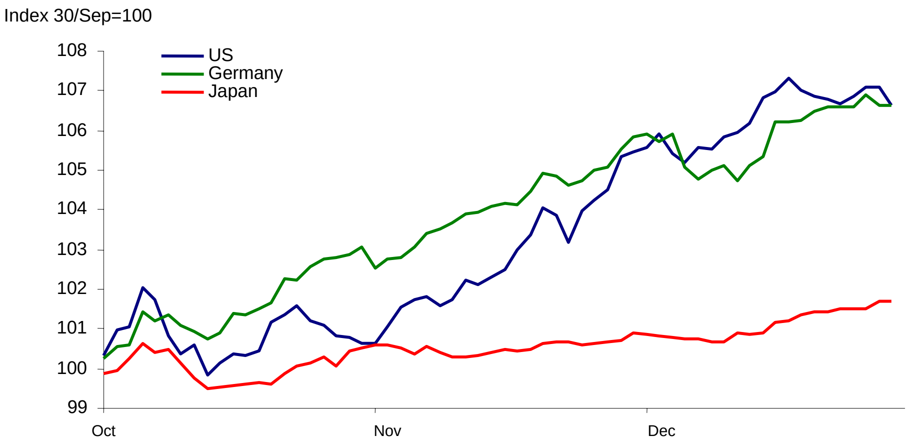
quarter. However, core inflation remained virtually unchanged, closing the year at an annual 1.8%. There was a slight increase in unemployment, which reached 7.8% up from 7.6% in the previous quarter.

In **Japan**, the Bank of Japan made two cuts to its monetary-policy interest rate, reducing it from 0.5% to 0.1% in response to weak domestic demand and concern about the economic performance of the country's trading partners. As in Europe and the United States, inflation dropped, closing the year at an annual rate of 1.0%, down from 2.1% in the previous quarter, while core inflation closed the year at 0.0% as compared to 0.2% at the end of the previous quarter. Unemployment dropped marginally from 4.0% to 3.9%.

III.1.1 Fixed-Income Market

Due to the general drop in the level of interest rates, fixed-income sovereign securities performed positively in terms of total returns during the last quarter (Figure 6).

Figure 6: Index of Total Returns, 1-10 Year Sovereign Bonds[7]



Source: JP Morgan.

III.1.2 Main Spreads on Portfolio Securities

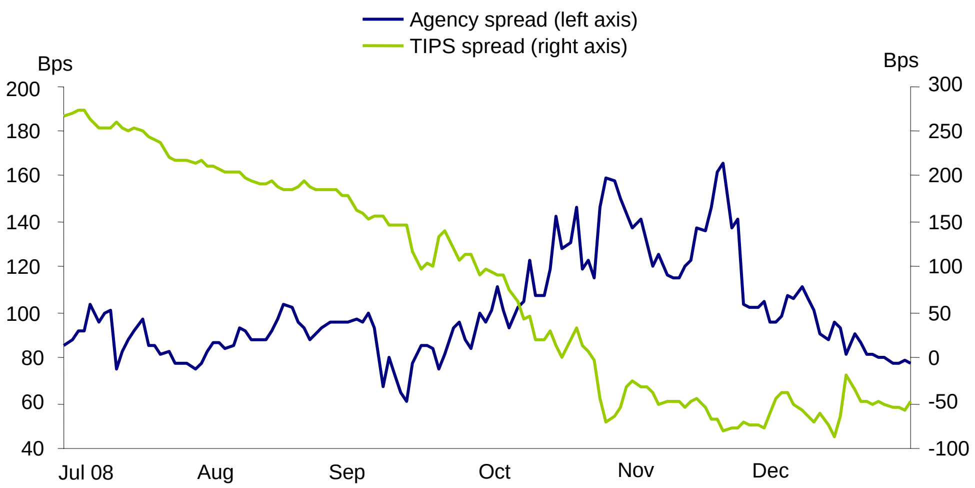
The spread on 5-year agency bonds dropped approximately 18 basis points during the quarter (Figure 7). However, given the behavior of the spread during the period, their yield was virtually the same as on the equivalent Treasury bill. It should be noted that,

[7] Total return expressed in local currency.

during the quarter, the spread on agency securities reached a record level of 166 basis points in the case of 5-year bonds.

US Inflation-Linked Bonds (TIPS) yielded significantly less than (nominal) Treasury bills with the same maturity. For example, 5-year TIPS yielded approximately 12% less during the period and this was reflected in the spread on TIPS which narrowed by 150 basis points in response to lower inflation expectations.

Figure 7: Agency and TIPS Spread on 5-Year Bonds



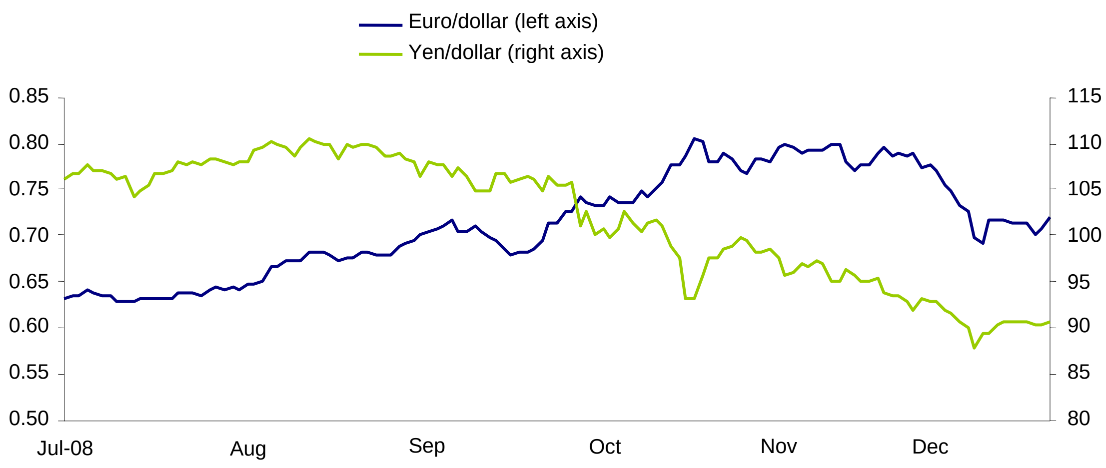
Source: Bloomberg.

III.1.3 <u>Exchange Rates</u>

In the fourth quarter of 2008, the euro-dollar exchange rate was very volatile. However, the depreciation of the euro between the start and close of the period was only a marginal 1.04%.

However, the yen appreciated by 17.12% against the dollar due to increased risk aversion and a drop in the differential between US and Japanese interest rates, which reduced the incentives for carry trade (Figure 8). This meant that the euro weakened by 15.50% against the yen during the quarter.

Figure 8: Euro/Dollar and Yen/Dollar Exchange Rates



Source: JP Morgan.

IV. APPENDIX 1: POSITIONS WITH SOVEREIGN ISSUERS AND FINANCIAL INSTITUTIONS

The Fiscal Agency has investments in **Sovereign Bonds** of the United States, Germany, France and Japan.

ESSF and PRF
Banks with Deposits, December 31, 2008

1	ABN AMRO BANK NV, AMSTERDAM
2	ALLIANCE AND LEICESTER PLC, LEICESTER
3	ALLIED IRISH BANKS, DUBLIN
4	BANCO BILBAO VIZCAYA ARG. SA, N. YORK
5	BANCO SANTANDER CENTRAL HISPANO SA, N.YORK
6	BANCO OF IRELAND, DUBLIN
7	BARCLAYS BANK PLC, LONDON
8	BAYERISCHE HYPO-UND VEREINSBANK AG, MUNICH
9	BAYERISCHE LANDESBANK, MUNICH
10	BNP PARIBAS SA, PARIS
11	CAIXA GERAL DE DEPOSITOS SA, N.YORK
12	CALYON CORPORATE AND INVESTMENT BANK, LONDON
13	CREDIT INDUSTRIEL ET COMMERCIAL (CIC), LONDON
14	DANSKE BANK AKTIESELSKAB, COPENHAGEN
15	DEXIA BANK BELGIUM SA, BRUSSELS
16	DEXIA CREDIT LOCAL SA, PARIS
17	DNB NOR BANK ASA, OSLO
18	ING BANK NV, AMSTERDAM
19	ING BELGIUM SA/NV, BRUSSELS
20	KBC BANK NV, BRUSSELS
21	MIZUHO CORPORATE BANK LTD., LONDON
22	SVENSKA HANDELSBANKEN AB (PUBL), N. YORK
23	SVENSKA HANDELSBANKEN AB (PUBL), STOCKHOLM
24	THE BANK OF NOVA SCOTIA, LONDON

V. APPENDIX 2: FINANCIAL INTERMEDIARIES USED BY THE FISCAL AGENT

ESSF and PRF
Intermediaries used between October and December 2008

1	BANK OF AMERICA SEC. LLC, USA
2	BARCLAYS CAPITAL INC., USA
3	BARCLAYS CAPITAL, U.KINGDOM
4	BAYERISCHE HYPO-UND VEREINSBANK AG, MUNICH
5	BNP PARIBAS SA, PARIS
6	CREDIT SUISSE SECURITIES (USA) LLC, USA
7	CREDIT SUISSE SECURITIES(EUROPE) LIMITED, U.KINGDO
8	DEUTSCHE BANK AG, FRANKFURT
9	DEUTSCHE BANK SECURITIES INC., USA
10	DRESDNER BANK AG, FRANKFURT
11	DZ BANK AG DEUTSCHE ZENTRAL-GENOSS., FRANKFURT
12	GOLDMAN, SACHS & CO., USA
13	GREENWICH CAPITAL MARKETS, INC., USA
14	HSBC SECURITIES (USA) INC., USA
15	J.P. MORGAN SEC. LTD., U.KINGDOM
16	J.P.MORGAN SECURITIES, INC., USA
17	MERRILL LYNCH GOV. SEC. INC., USA
18	MERRILL LYNCH INTL., U.KINGDOM
19	MIZUHO SECURITIES USA INC., USA
20	MORGAN STANLEY & CO. INC., USA
21	SOCIÉTÉ GÉNÉRALE, FRANCE
22	THE ROYAL BANK OF SCOTLAND PLC, LONDON
23	UBS LIMITED, U.KINGDOM
24	UBS SECURITIES LLC, USA

VI. Investment Limits

A. Credit Risk

The ESSF's investments must fulfill the following credit-risk conditions and requirements:

The eligible issuers are:

Asset Class (Risk)	Upper Limit
Sovereigns	100%
Multilaterals	60%
Banks	50%
Agencies	30%

A.1 Sovereign Risk

The eligible countries are those, other than Chile, that over the previous 24 months have held a long-term risk classification equivalent to **A-** or higher issued at least by two of the following international credit rating agencies: Fitch, Moody's and Standard & Poor's.

Investment limits for eligible sovereign risk (between **AAA** and **A-**) are:

Risk Classification	Upper Limit
AAA	100%
AA+ AA AA-	90%
A+ A A-	30%

A.2 Supranational or Multilateral Risk

The eligible international organizations are those with a long-term risk classification equivalent to **AA-** or higher issued at least by two of the following international credit rating agencies: Fitch, Moody's and Standard & Poor's.

Investment limits for eligible multilateral risk (between **AAA** and **AA-**) are:

Risk Classification	Upper Limit (US$ million)
AAA Aaa	800
AA+ Aa1 AA Aa2 AA- Aa3	600

A.3 Bank Risk

The methodology for selecting banking institutions and assigning limits is based on international risk classifications and the size of the institutions.

Eligible institutions are those that have a long-term risk classification of **A-** or higher issued at least by two of the following international credit rating agencies: Fitch, Moody's and Standard & Poor's, and a minimum shareholders' equity equivalent to **US$1,000 million**.

Investment limits by institution are expressed in discrete intervals according to the table below:

Risk Classification	Upper Limit (US$ million)
AAA Aaa	600
AA+ Aa1 AA Aa2 AA- Aa3	400
A+ A1 A A2 A- A3	300

A.4 Agency Risk

The eligible agencies are those in the United States with a long-term risk classification equivalent to **AAA** issued at least by two of the following international credit rating agencies: Fitch, Moody's and Standard & Poor's, and a minimum shareholders' equity equivalent to **US$1,000 million**. Investment in any one agency may not exceed **US$800 million**.