

Chile Watch

BCCh cut rates 75bp. Policy report: neutral rate up to 4%.**BCCh cut rates 75bp to 8.25%**

The Chile central bank (BCCh) cut the policy rate by 75bp to 8.25%, faster than the 50bp of the previous meeting, as expected by Bloomberg consensus (BofA -50bp). The move seems to be mostly based on the reversal of global financial tightening and a domestic macro scenario in line with BCCh's expectations. It is mostly a dovish statement, downplaying recent inflation upside surprise. BCCh also increased the neutral rate to 4% (from 3.75%) in the monetary policy report.

Dovish: Global conditions and domestic inflation

BCCh argued that global financial conditions have evolved favorably in recent weeks, reversing the significant tightening observed during last October's meeting. The dollar has depreciated globally. Oil prices have fallen to \$75/barrel, and copper prices have bounced to \$3.8/pound. BCCh noted that headline inflation has declined to 4.8% and underlying inflation to 6%. It expects core inflation to converge to 3% in 1H24, faster than headline convergence (end of 2024), and believes that further rate cuts are needed. Investment remains weak, and job creation remains slow (8.9% unemployment rate). Sentiment remains pessimistic.

Hawkish: wages and activity recovery

BCCh acknowledged that activity is recovering at the margin (non-mining Imacec up 0.2% in 3Q and 0.5% momsa in October). Private consumption has shown an incipient increase. Real wages are up 3.5% yoy. BCCh expects stronger global growth.

Our view: lingering risks could lead to slower cuts

Underlying inflation has declined significantly to 6% from 9.1% in June, and the economy is stagnant, so more cuts are justified. However, we see some risks going forward that could lead to slower cuts of 50bp clips. The economy has been resilient recently (non-mining Imacec +1% yoy). Expansionary fiscal policy, GDP recovery in 2024 and minimum wage hike pose inflation risks. Also, while the global situation has improved markedly for Chile (higher copper prices, lower oil prices and low US rates), it remains very volatile. BCCh is increasingly sensitive to global financial conditions (see inside) and the CLP, so some reversal in the externals could lead to a more cautious rate path.

Strategy: keep 5y breakeven, 3y2y forward; close 10y payer

From a strategy viewpoint, we keep the 5y inflation breakeven (2.95% current) and 3y2y forward rate (4.28% current) payers (see our report, [Chile: Two new trades based on our higher inflation and policy rate views](#)). The central bank's shift to dovishness will likely put upward pressure on inflation: we forecast headline inflation at 3.9% in 2024 relative to market consensus at 3.3%. The local curve is also pricing too aggressive an easing cycle, in our view, with benchmark rates reaching 3.5% in 2025, while we expect a terminal rate of 5.25%. Sharp disinflation and lower global yields are risks to the trades.

We close our more than year old 10-year spread payer trade (see our report, [Chile: 10y Camara vs US spread payer 2 December 2023](#)). The trade was opened 2022 at a 190bp spread, and we close it at 125bp. Carry for the duration of the trade was -75bp.

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momsa: month over month
seasonally adjusted

For a complete list of our open trades and trades closed over the past 12 months, see our latest Global Emerging Markets Weekly (see [Global Emerging Markets Weekly: 1,000 investors – no consensus 08 December 2023](#))

Other comments: inflation to converge in 2h24

BCCh argued that inflation exceeded expectations in November, mainly due to the behavior of some volatile prices, which it considers less informative about inflationary trends. 2-year inflation expectations remain at 3%. The episodes of tension in the global and local financial markets in previous meetings have dissipated.

BCCh stated that In line with the central scenario of the December IPOM, the convergence of inflation requires further rate cuts. Its magnitude will consider the evolution of the macro scenario.

Policy report: Neutral rate up to 4%

In the monetary policy report (IPOM) released today, BCCh increased the neutral rate to 4% (from 3.75%), of which 1% is a real component, while 3% is the inflation target. BCCh also reduced its trend growth estimate to 1.9% from 2.2% previously, mostly due to the change in the 10-year period rolling window. BCCh argues that the output gap already closed in 3Q23.

Forward guidance: The corridor (IPOM) point to a policy rate by the end of 2024 at between 5.0% and 5.5%, according to our estimates (depending on whether the broad corridor or the 66% interval is used). This can be done with a mix of 50bp cuts and 25bp cuts next year.

We forecast a 50bp cut in next meeting and the policy rate at 6% by the end of 2024 (down from 6.25%), as we expect a bit more GDP growth than the BCCh scenario, and we see some inflation risks to the upside (expansionary fiscal policy and minimum wage hikes, plus volatile external environment). We forecast inflation down to 3.6% in 2024, from 4.7% this year.

Corridor extremes: BCCh said that slower cuts (top of the corridor) would reflect slower inflation convergence, for example if the external impulse is stronger than anticipated. The bottom of the corridor reflects a faster inflation decline if, for example, past high interest rates have a stronger delayed impact on activity.

Risks mostly external? In the summary of the IPOM, BCCh argued that the external backdrop is subject to significant uncertainty (including China real estate, US fiscal issues).

Other macro forecasts: BCCh did not change macro forecasts substantially in the IPOM; it just made marginal increases in growth in some demand components and expects headline inflation to converge in 2H24 (though it expects underlying inflation to converge a bit faster in 1H24). BCCh expects 1.25-2.25% GDP growth in 2024 (from about 0% this year) and 2-3% in 2025. BCCh sees inflation at 2.9% in 2024, down from 4.8% this year. it sees the current account deficit up to 4% of GDP in 2024 (from 3.3% in 2023).

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