CHILE: INFLATION PERSPECTIVES

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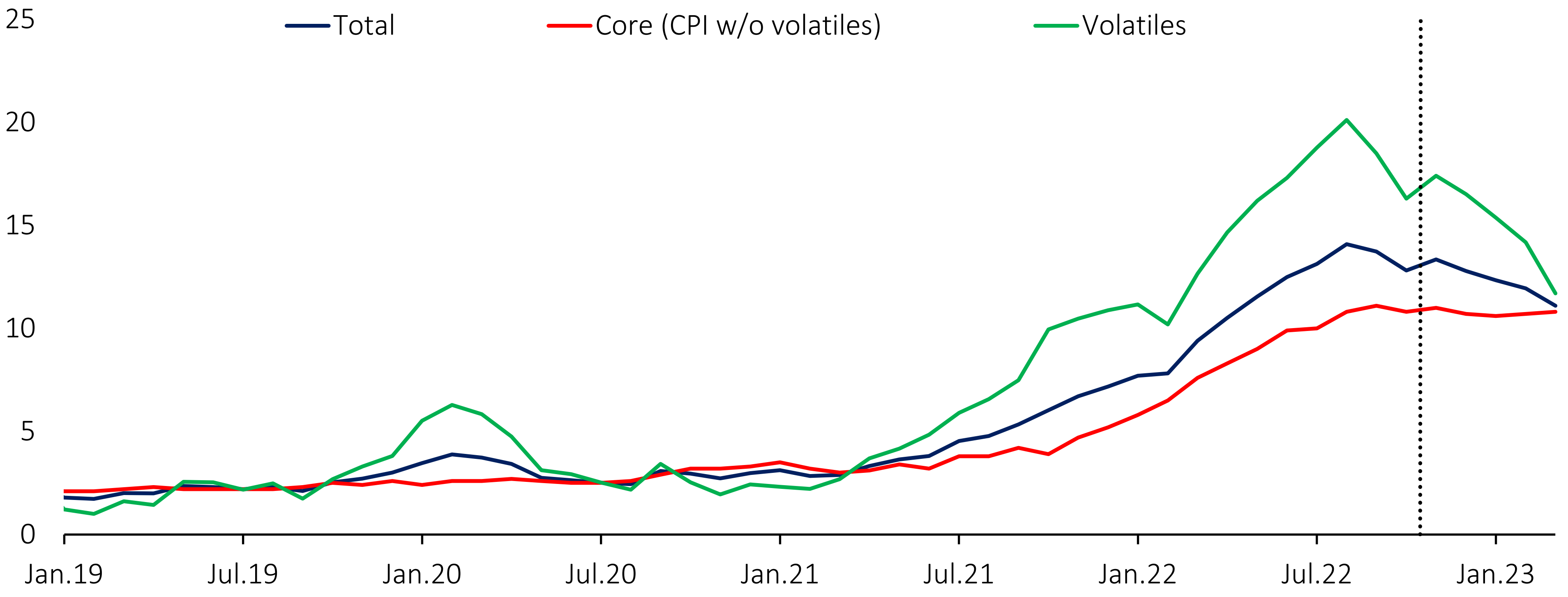
Región de Los Lagos

Inflation remains very high. Latest figures (March) shows a decline of total CPI related to maximum levels of 2022. But core inflation remains around 11.5% from several months.

Inflation indicators (1)(2)

(annual change, percent)



(1) Dotted vertical line marks statistical cut-off of December 2022 MP Report. (2) For details on groupings and their shares in total CPI basket, see box IV.1 in December 2019 MP Report, Carlomagno and Sansone (2019), and Economic Glossary. Sources: Central Bank of Chile and National Statistics Institute.

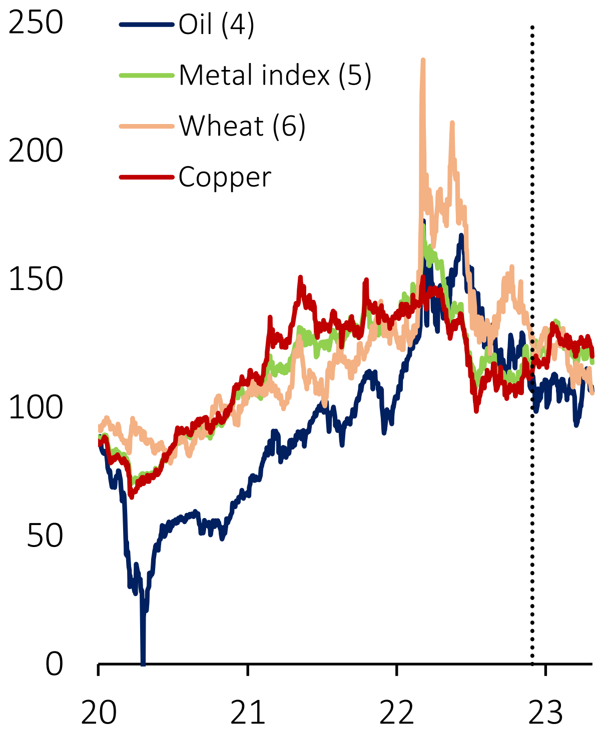
Several inflation fundamentals shows an improve over the last months, such as an exchange rate appreciation, declining commodity prices, and eased logistic problems.

Real exchange rate (RER) (1)(2)

(index, 1986 average=100)

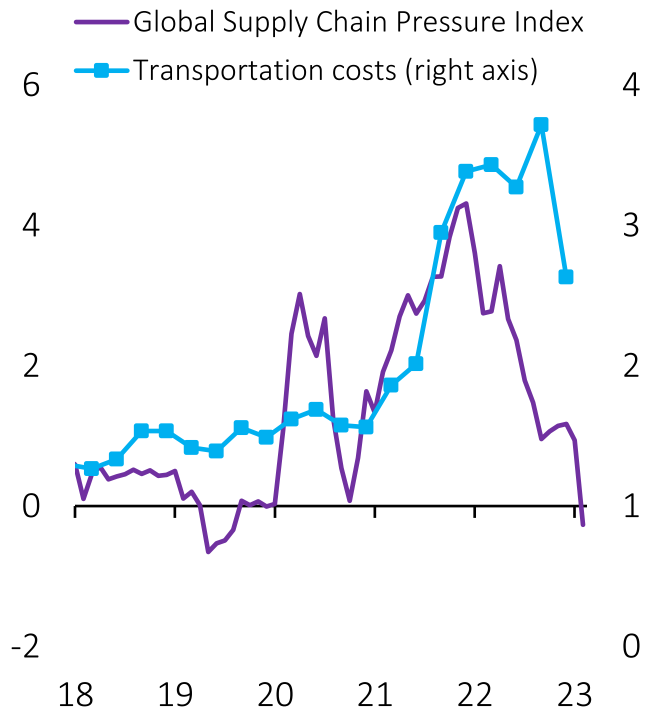
Commodity prices (3)

(index, 2010-2023 average=100)



Cost factors evolution (7)

(percent of GDP, quarterly; st. deviation of historic average, monthly)

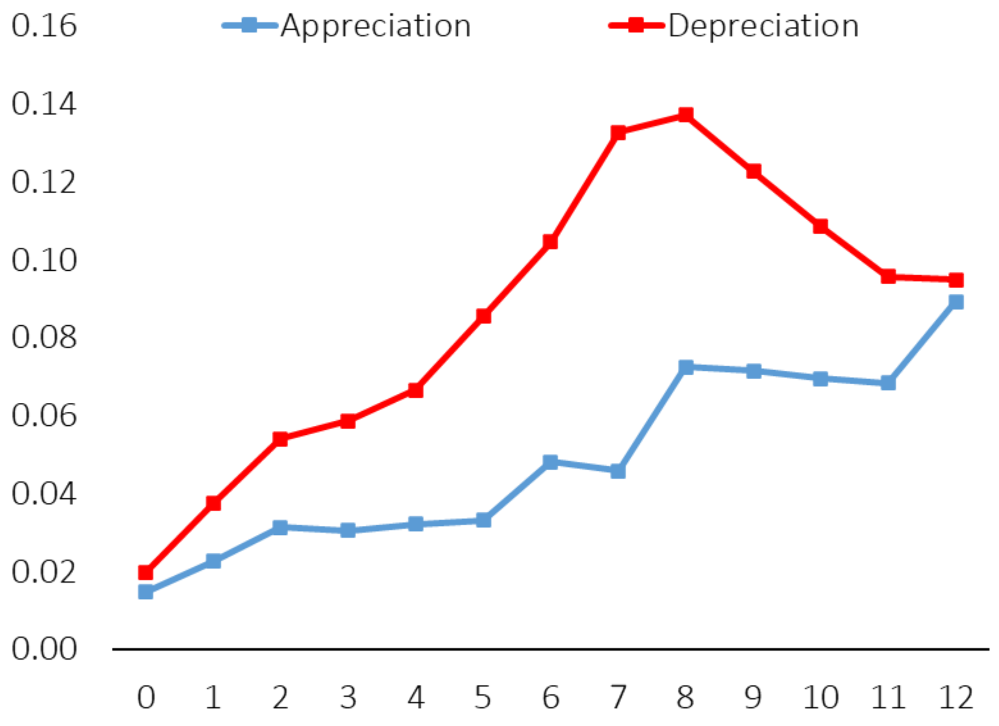


(1) March 2023 figure is preliminary average of the month. (2) Average of the last 15 years covers the period Apr.2008-Mar.2023 (3) Dotted vertical line marks statistical cut-off of December 2022 MP Report. (4) WTI-Brent average. (5) S&P GSCI Industrial Metals. (6) One-month futures price. (7) Transportation cost is calculated as the difference between CIF and FOB imports. Sources: Central Bank of Chile, Bloomberg, and New York Federal Reserve.

Nonetheless, the transmission to inflation has been slower than projected. In part, this could be the result of the slower transmission speed of an ER appreciation and the situation of firms’ margins.

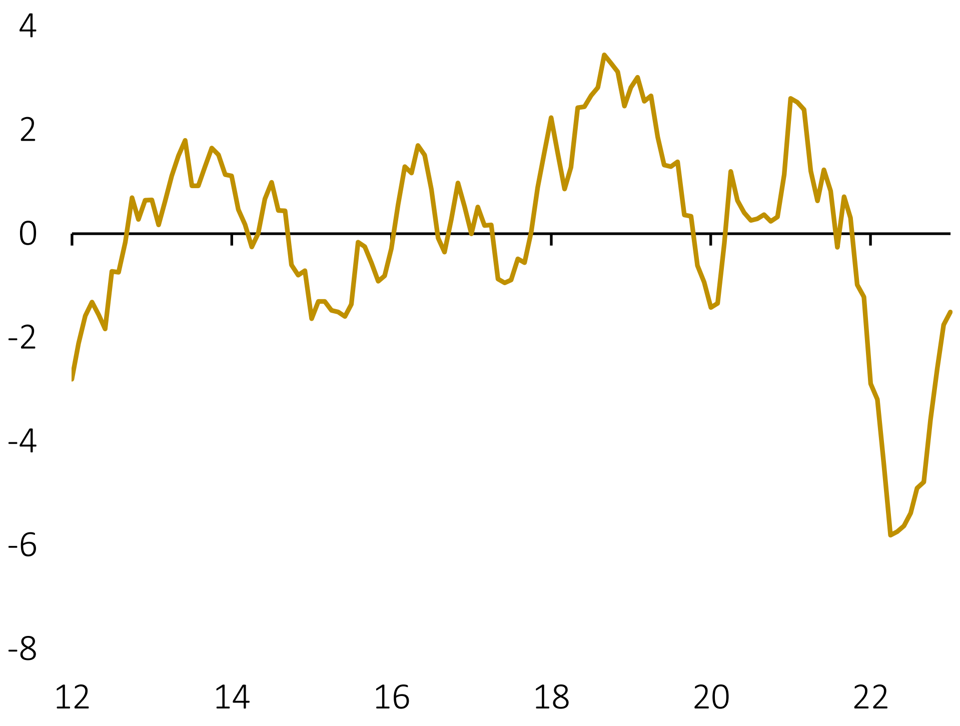
Estimates of exchange-rate pass-through coefficient based on micro-data

(percent change in prices of +/-1% ER)



Cyclical component of aggregate margins

(moving three-month average, percent)

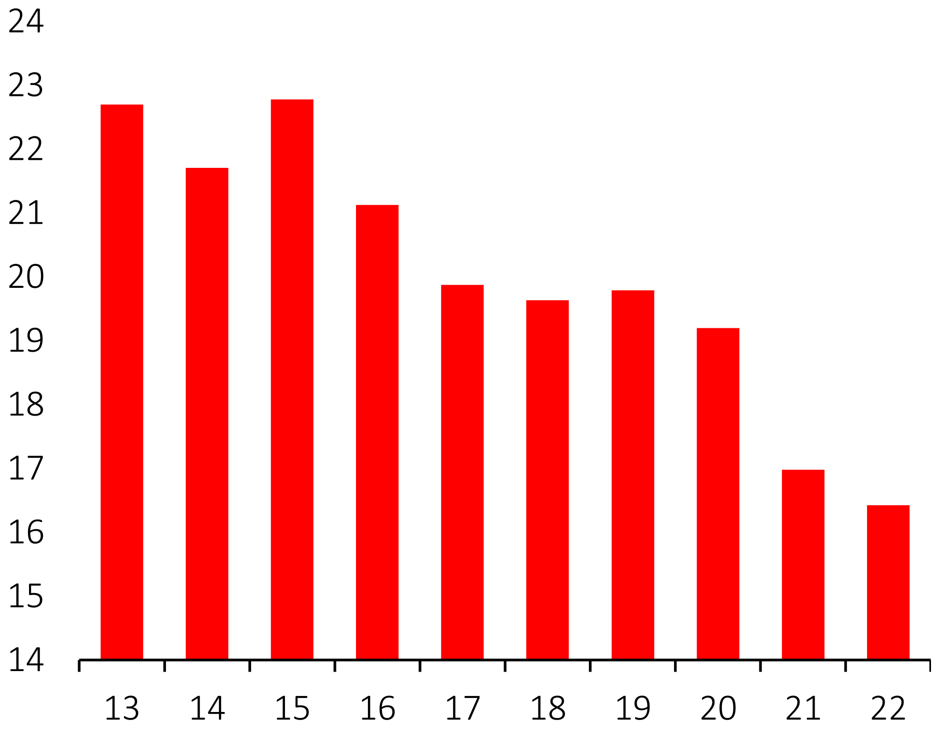


Sources: Arenas *et al*. (2023) and Acevedo *et al*. (2023)

On the other hand, the economy has not yet managed to reverse the effects of the imbalances that accumulated in previous years. Savings fell sharply and external accounts deteriorated significantly, used more to finance consumption than investment.

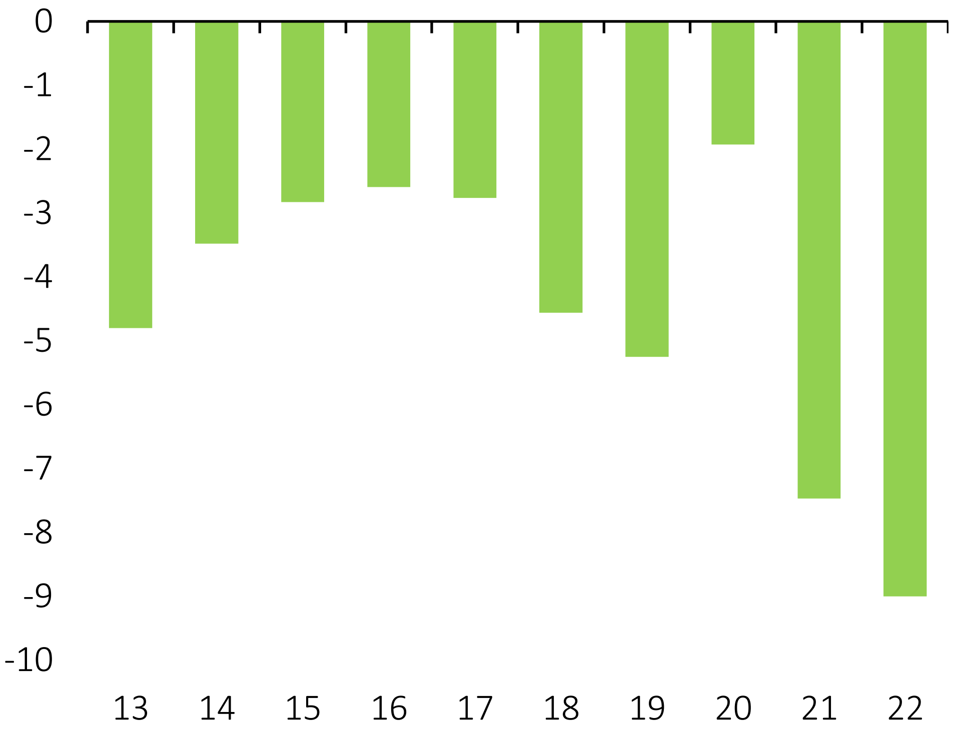
Gross National Saving

(percentage of GDP)



Current Account

(percentage of GDP)

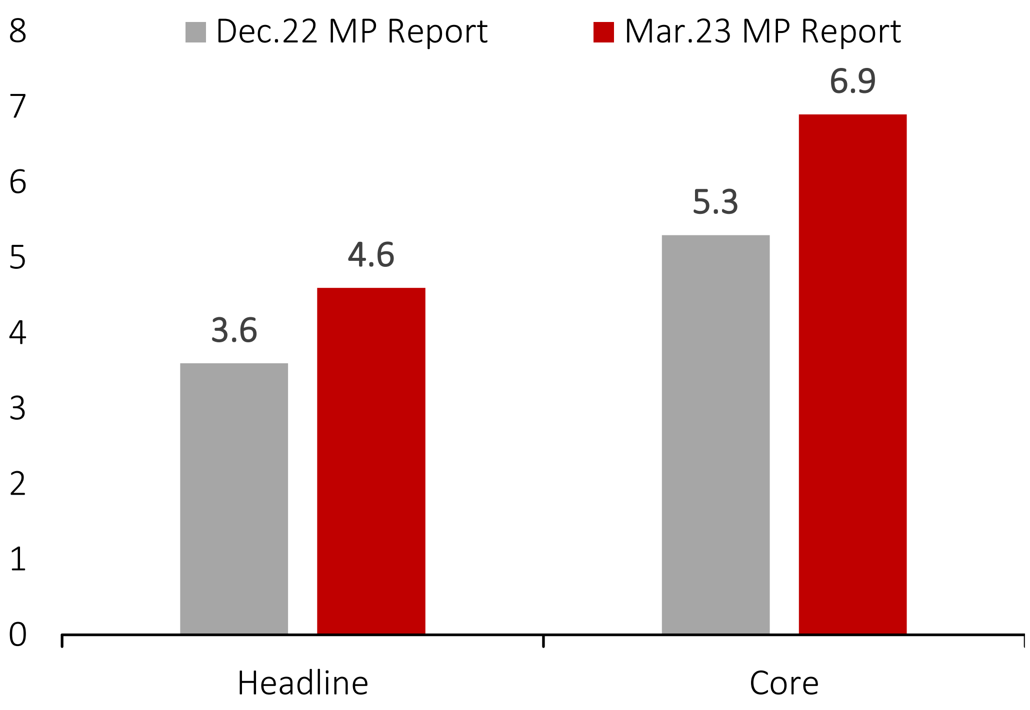


Source: Central Bank of Chile.

In the central scenario, inflation trajectory will be higher than expected in December MP Report. Headline inflation will reach the 3% target in the latter part of 2024, while core inflation will do so by the end of the MP horizon.

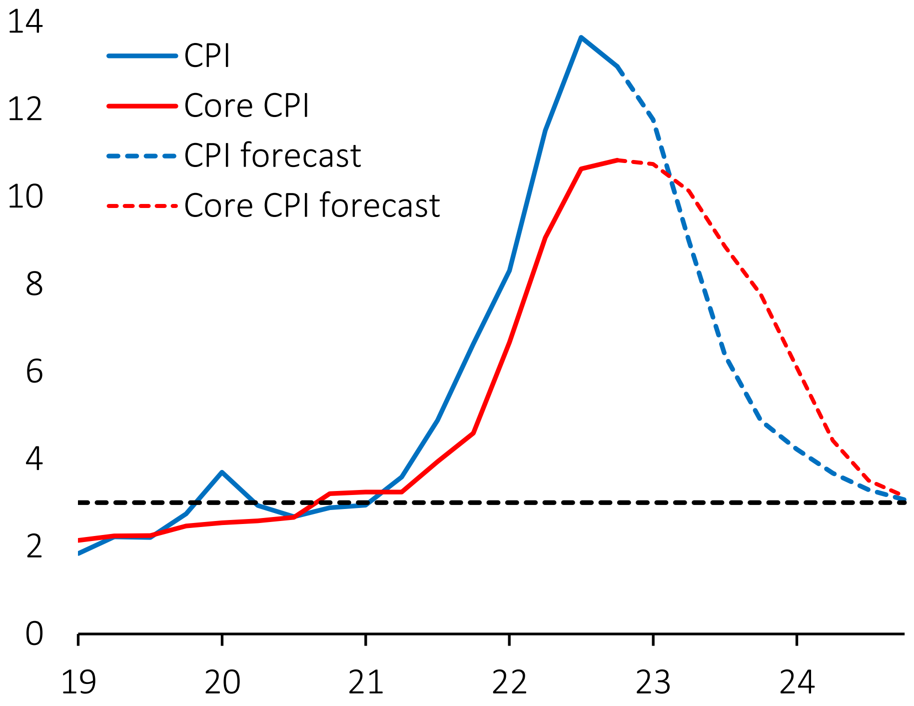
Inflation forecast: December 2023

(annual change, percent)



Inflation forecast: two years MP horizon (*)

(annual change, percent)

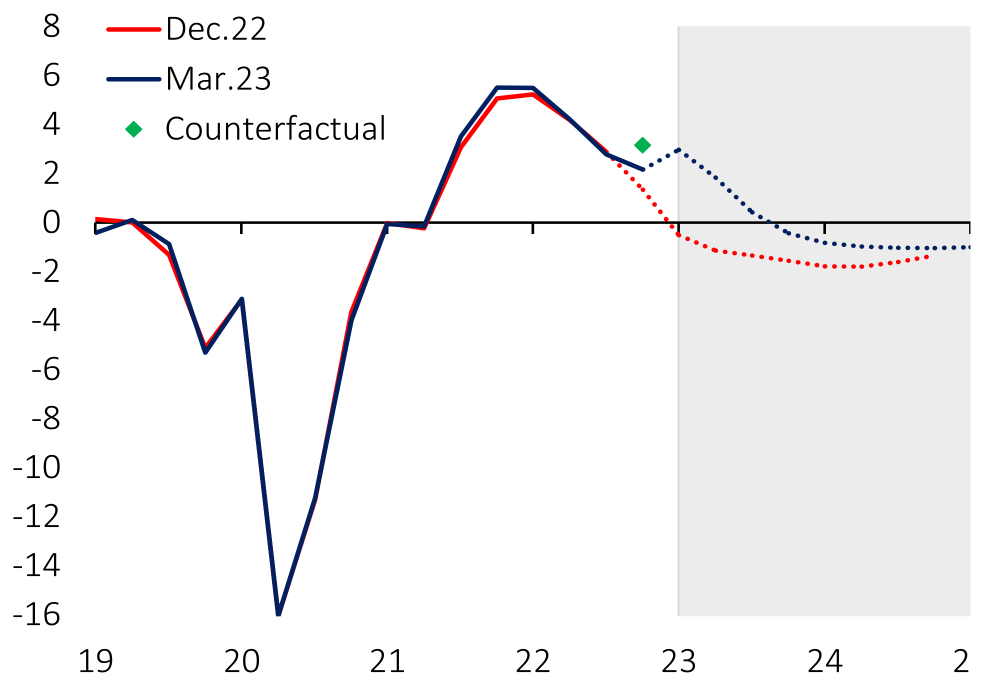


(*) As from the first quarter of 2023, slashed lines shows forecast in March 2023 MP Report.
Sources: Central Bank of Chile and National Statistics Institute.

The adjustment of the local economy is still one of the key assumptions behind the convergence of inflation. This implies a negative output gap for several quarters and a relevant improve in current account deficit.

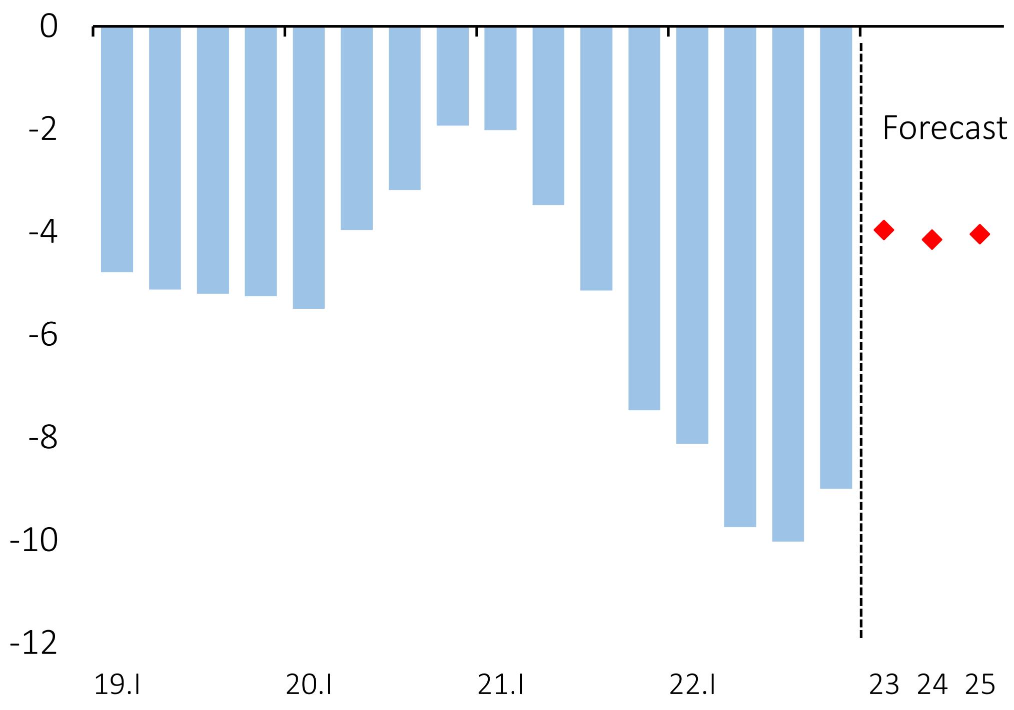
Activity gap (1) (2) (3)

(level, percentage points)



Current account (4)

(percent of GDP, last twelve months)

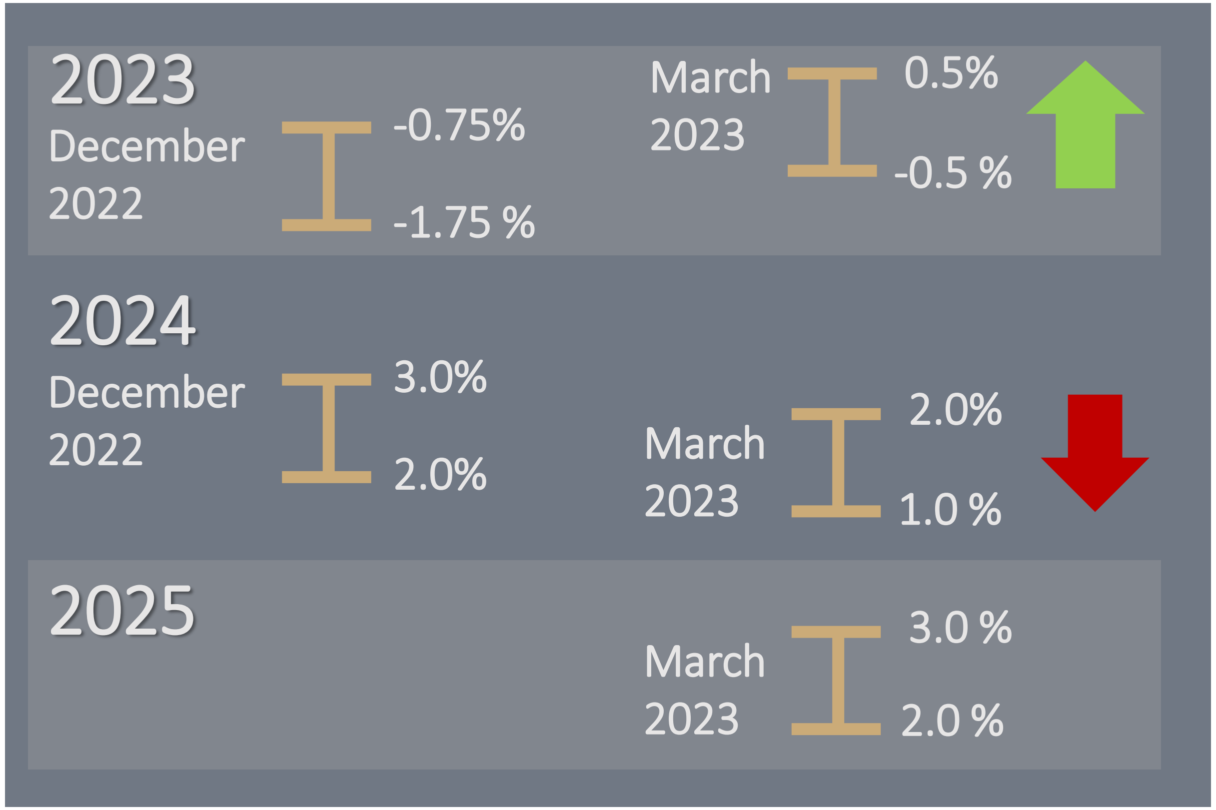


(1) Constructed using seasonally adjusted data. Dotted lines show forecasts. (2) Projection uses structural parameters updated in the December 2022 MP Report (trend) with methodological revision of potential GDP. (3) Counterfactual for 2022.Q4 estimated assuming that the value added measure of the Transport sector remains at its level of 2022.Q3, which is equivalent to zero velocity. All other non-mining sectors use published velocities. For the fourth quarter, both the effective and counterfactual gaps are calculated using the same potential GDP. (4) Quarterly effective data. Red diamonds show forecasts for respective years. Source: Central Bank of Chile.

Projections consider that activity will drop in the coming quarters and will accumulate growth around 1.5% between 2023 and 2024, similar to what was foreseen in the last MP Report.

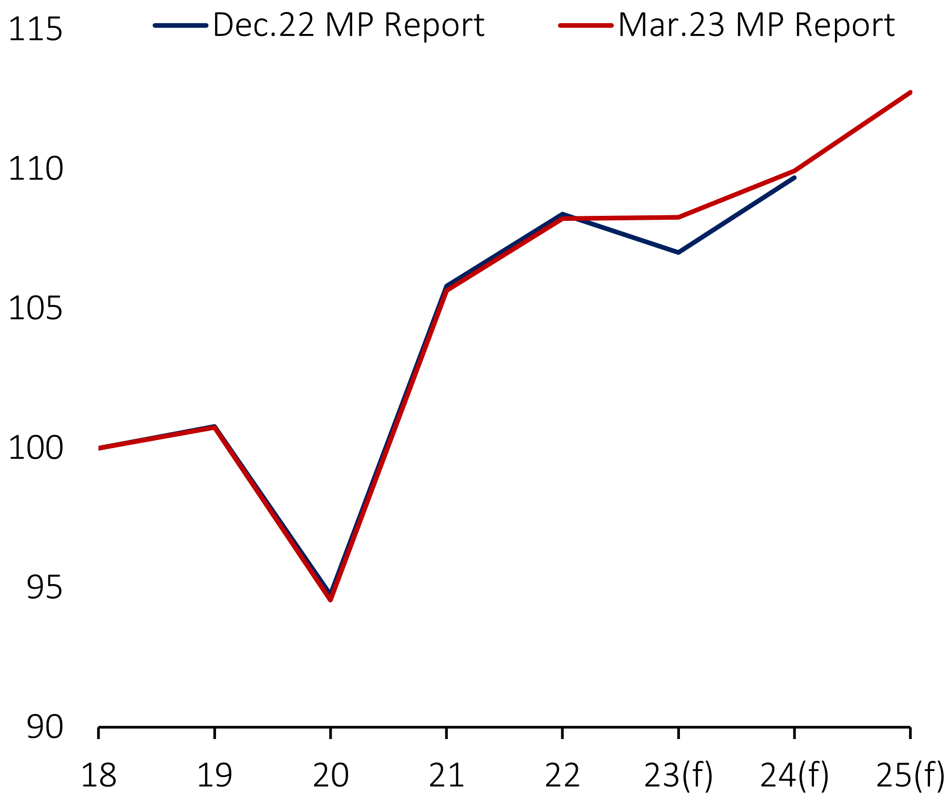
GDP growth forecasts (1)

(annual change, percent)



GDP forecasts (2)

(index, 2018=100)



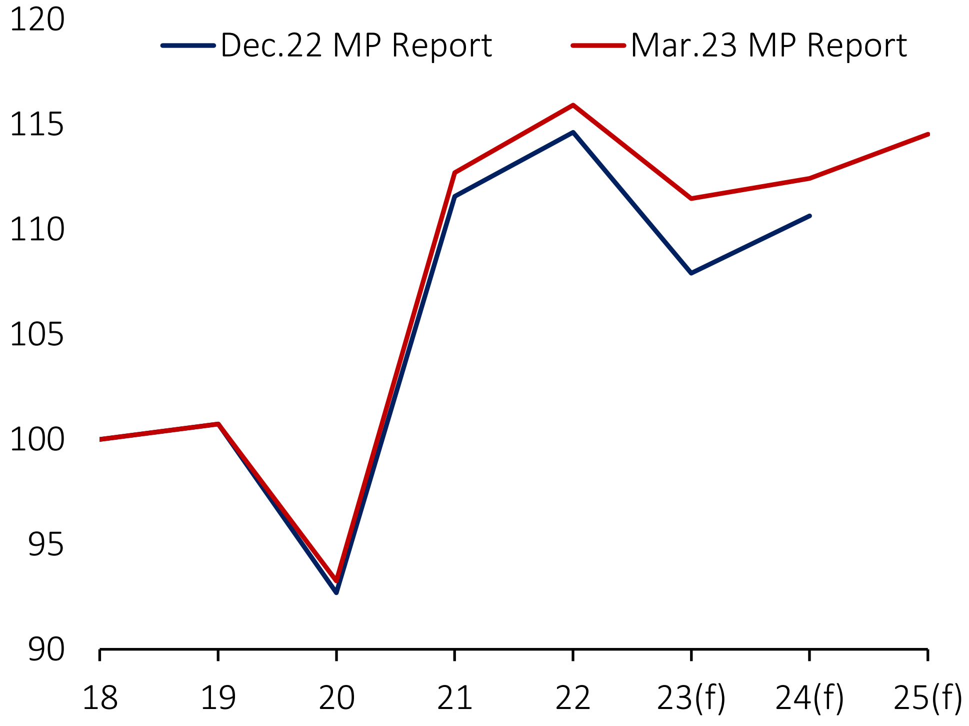
(1) Forecasts contained in respective MP Report. Arrows indicate change from December 2022 forecast. (2) Forecasts consider the midpoint of the growth ranges published in March Report. (f) Forecast.

Source: Central Bank of Chile.

The main components of domestic demand will decline this year, although less than expected in December, transferring a lower dynamism relative to what was previously projected in 2024.

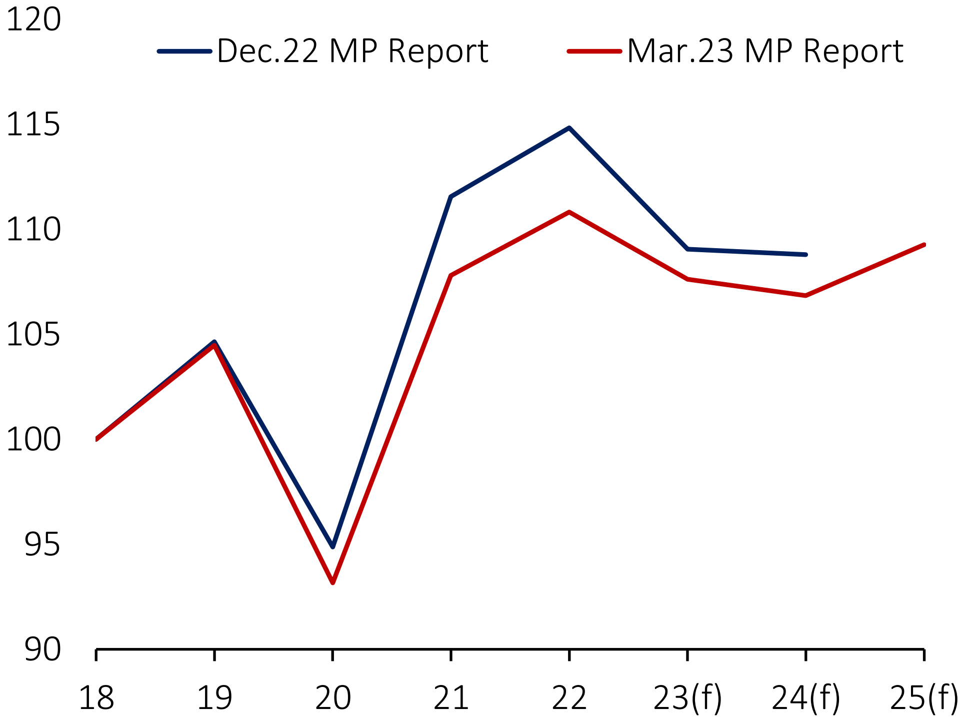
Private consumption

(index, 2018=100)



Gross fixed capital formation (GFCF)

(index, 2018=100)

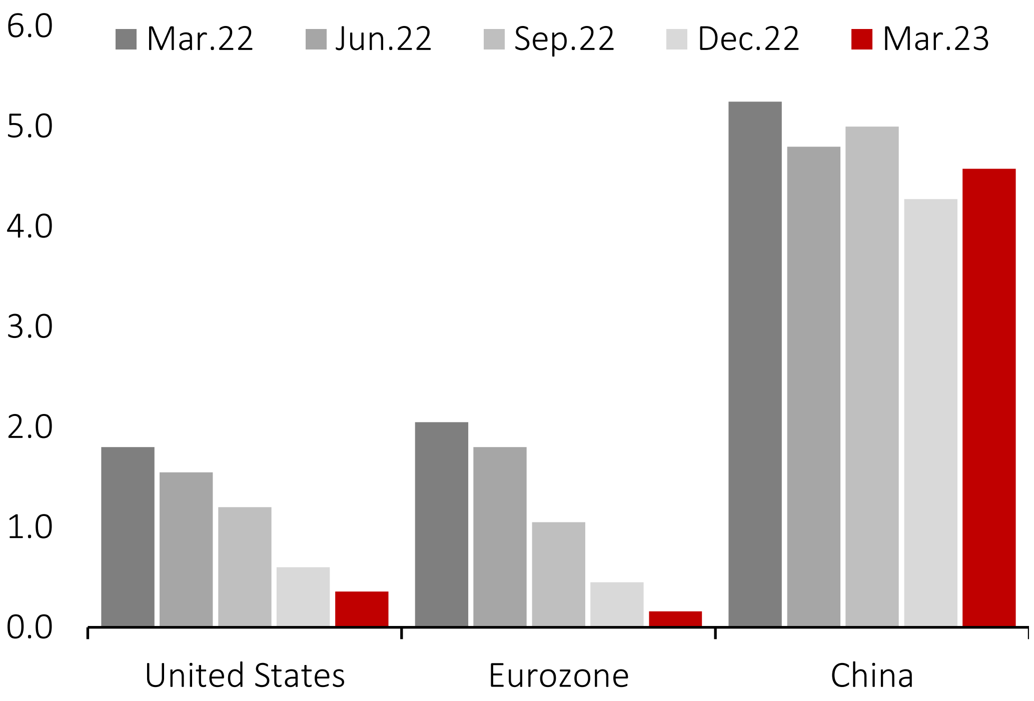


(f) Forecast.
Sources: Central Bank of Chile and Consensus Forecasts.

In the external side, we consider a more deteriorated economic and financial external scenario. For China, the boost from the lifting of sanitary restrictions is expected to dominate.

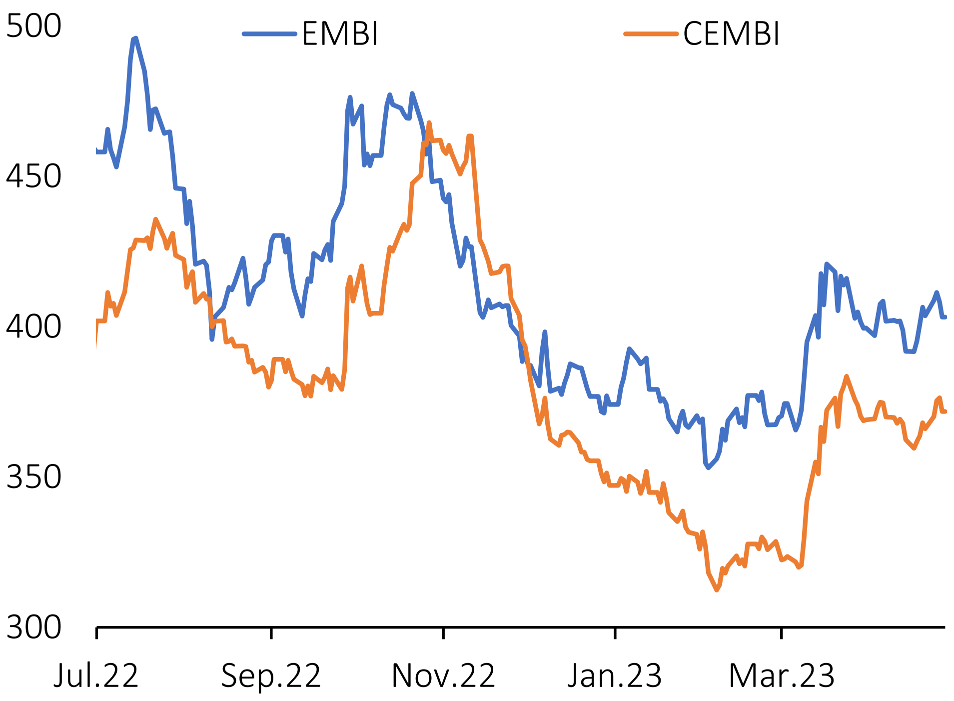
World growth forecasts for 2023-2024 (*)

(annual change, percent)



Global risk premiums

(basis points)

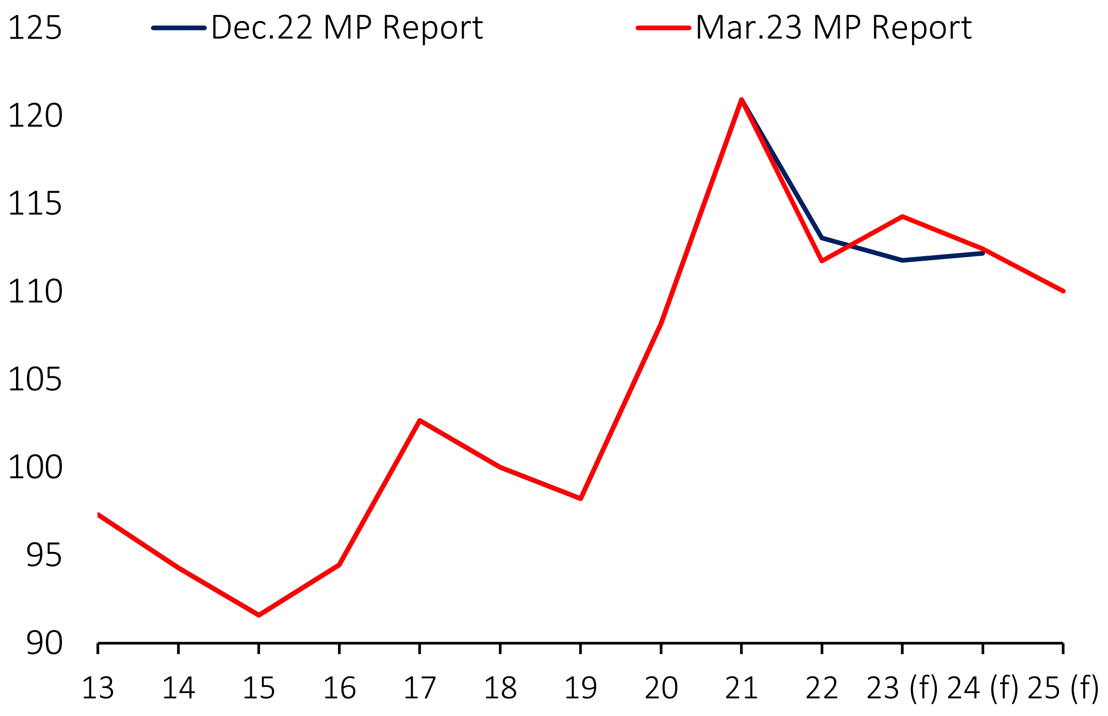


(*) Average of both years.
Sources: Central Bank of Chile and Bloomberg.

This drives the outlook for copper prices and terms of trade upward. Other commodity prices are revised downward.

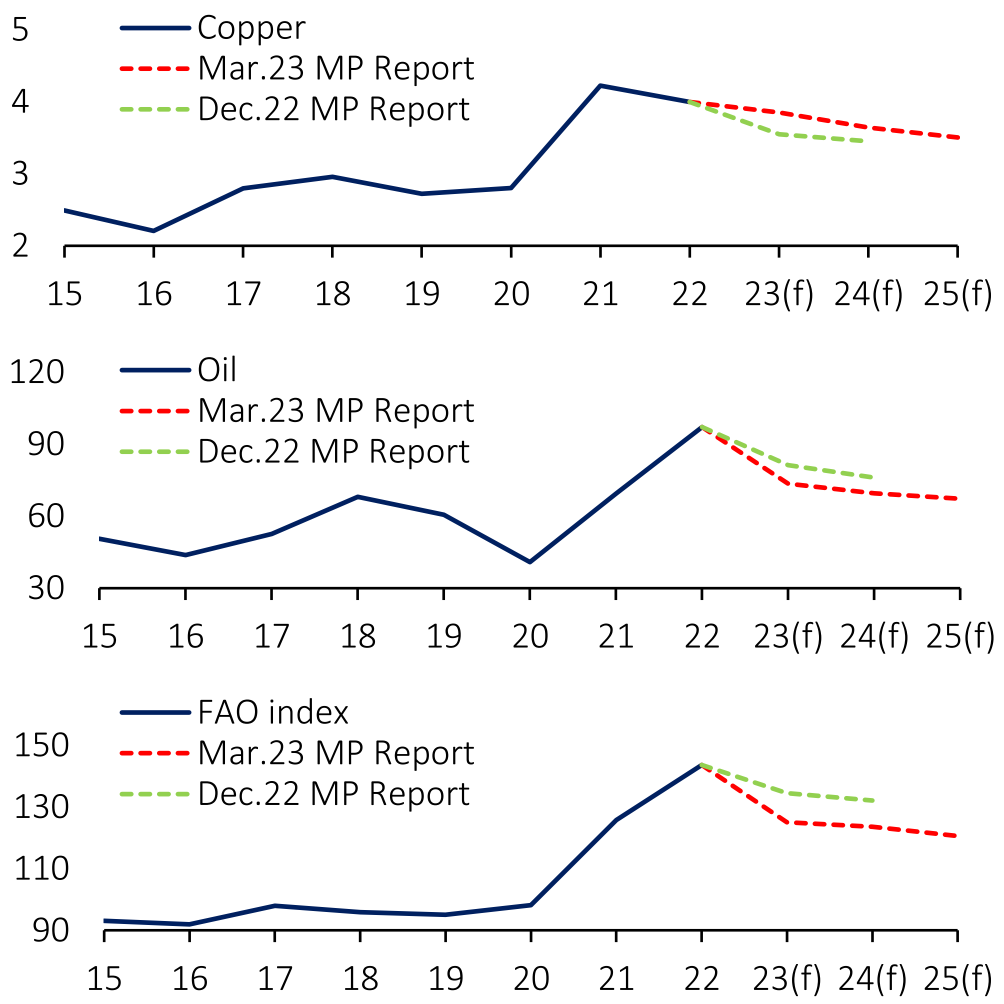
Terms of trade

(level, 2018=100)



Actual and projected prices (1) (2)

(dollars per pound; dollars per barrel; index)

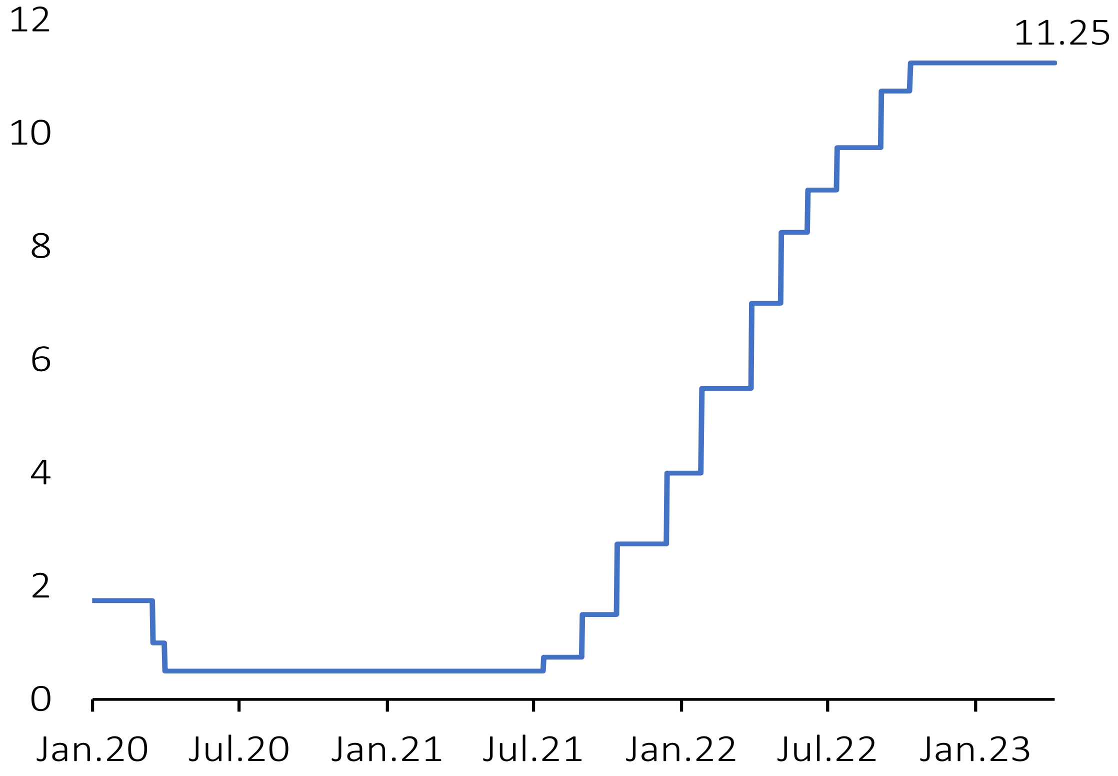


(f) Forecast. (1) For oil it is the average price between the WTI and Brent barrels. For foods is the FAO index. (2) Effective price/index is average for each year. Dotted lines represent the 2023-2025 projections contained in respective MP Report. Sources: Central Bank of Chile, Bloomberg and FAO.

The CBCh Board considers that it will be necessary to keep the MPR at 11.25% until macroeconomic conditions indicate that the process of inflation convergence to the 3% target has been consolidated.

Monetary policy interest rate (MPR)

(percent)



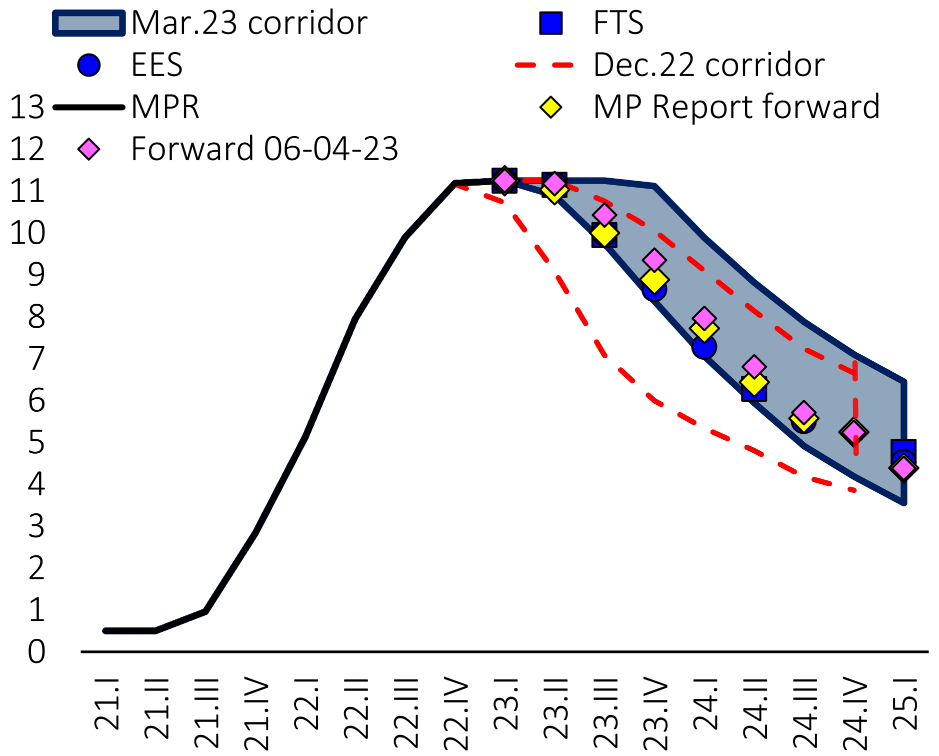
Source: Central Bank of Chile.

- The economy is adjusting more slowly than expected and inflation is taking longer to come down.
- In this context, the Board considers that it will be necessary to keep the MPR at 11.25% until macroeconomic conditions indicate that the process of inflation convergence to the 3% target has been consolidated.
- As described in the central scenario of the March MP Report, this process will take longer than expected in December.
- The Board reaffirms its commitment to act with flexibility in case any of the internal or external risks materializes and macroeconomic conditions so require.

The borders of the MPR corridor reflect scenarios where the pace at which inflation will return to the target is somewhat different, which would lead to earlier or later interest rate adjustments than those considered in the central scenario.

MPR corridor (*)

(quarterly average, percent)



(*) The corridor is constructed following the methodology of box V.1 of the March 2020 MP Report and box V.3 of the March 2022 MP Report. For details, see methodological note (figure II.1, chapter II, March 2023 Monetary Policy Report). Source: Central Bank of Chile.

Inflation persistence: particularly significant will be the occurrence and sign of new inflation surprises, the evolution of consumption and the unfolding of external conditions.

- Depending on how these variables behave, this could lead to a sooner- or later-than-expected reduction in the MPR.

Upper bound: MPR is kept at its current level for longer than anticipated in the central scenario.

- High inflation is prolonged
- Slow adjustment of consumption
- Better than projected external scenario

Lower bound: Faster adjustment of the local economy and earlier reduction of inflation and the MPR.

- Worse than expected external scenario
- Higher global risk
- Strong impact on global activity and commodity prices