Macro scenario - Chile

May 16, 2025

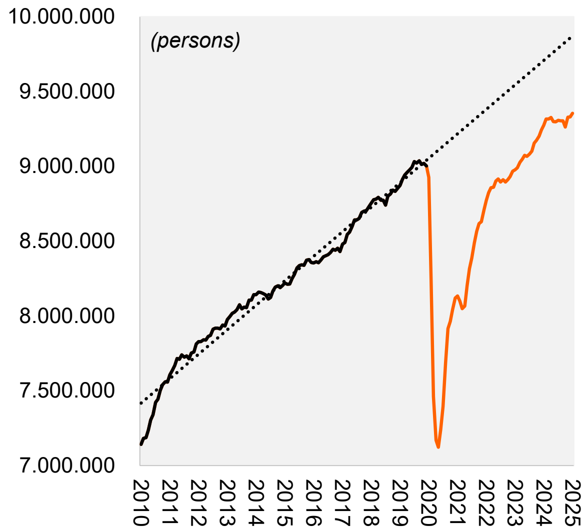
Rate cuts are coming

- Sequential core inflation readings are well-behaved. Medium-term inflation expectations are retreating towards the 3% target. Labor market slack has persisted, and credit dynamics remain soft. The effect of trade tensions on global demand has yet to materialize but will likely consolidate lower price pressures. The scenario outlined in the March IPoM of lower rates over the policy horizon is consolidating. We see room for two 25-bp cuts to 4.5% before year-end and to 4.0% in early 2026, with risks tilting to a frontloading of the cycle.

Labor market slack is still there

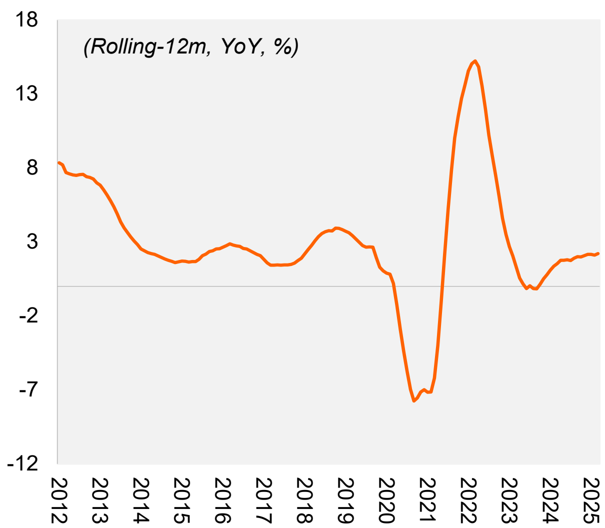
The unemployment rate (SA) has hovered around 8.5%, the upper bound of the estimated NAIRU, for several quarters. Labor demand proxies have remained subdued following a significant increase in labor costs. Since April 2022, the minimum wage has increased by slightly less than 50% in nominal terms, well above the 20% rise in CPI during the period; a sizable share of the labor force earns wages close to the minimum wage (roughly 940k job posts, 18% of total formal posts), as evidenced by administrative data. Employment levels compared to the pre-COVID trend show a gap of around 0.5 million. Despite labor slack, high copper prices and lower domestic policy uncertainty are supporting a recovery in mining investment. Imports of capital goods continue to increase at a double-digit annual pace, and the multi-year investment pipeline continued to edge up prior to "Liberation Day". However, elevated global policy uncertainty poses a risk to future investment dynamics. Beyond mining, the economy is growing at around its potential. The rolling 12-month growth rate for non-mining activity has hovered around 2% for the last six months. Since early in the second half of 2024, non-mining activity has received an external boost from consumer tourism, particularly from Argentina. The marginal effect of tourism will diminish as base effects become more demanding.

Low employment levels



Source: INE, Itaú

Non-mining growth near potential



Source: BCCh, Itaú

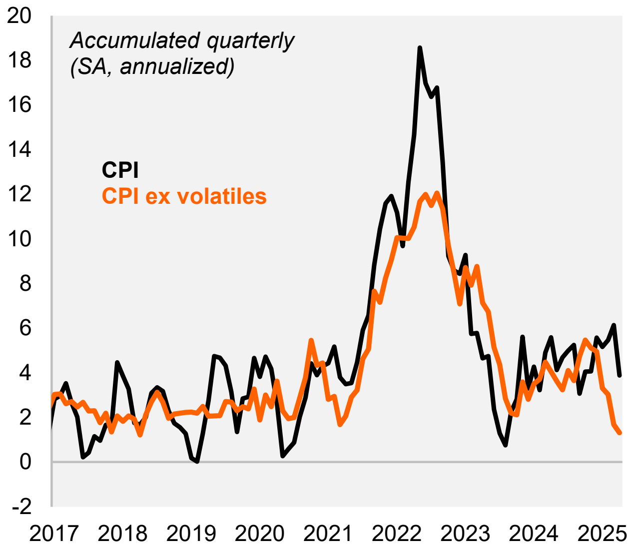
Copper still supporting the trade surplus

The rolling 12-month trade balance in April neared a whopping surplus close to 7% of GDP. Copper exports increased by 8.2% YoY in April (8.8% in 1Q25). Chile's year-to-date goods exports to the US account for roughly 17% of total exports, up from 11% during the same period in 2024, likely indicating a frontloading of goods, particularly copper, before the implementation of tariffs. The anticipated global economic slowdown will likely reduce export demand and gradually decrease the elevated trade surplus. Nevertheless, with a current account deficit at 1.5% of GDP, the economy is much more balanced compared to the near double-digit deficit recorded in 2022.

Core inflation dipping fast

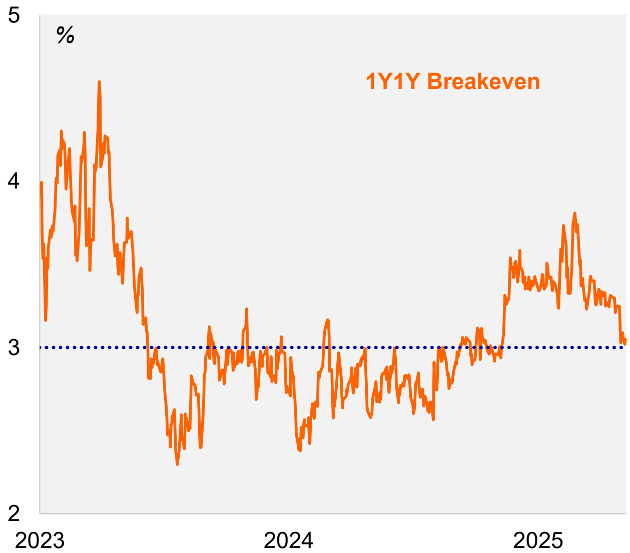
Second-round effects from previous electricity adjustments remain contained. Headline inflation reached 4.5% in April, down from the 4.8% average in 1Q25. Core inflation decreased to 3.5% from the 3.9% average in 1Q25, marking the lowest rate since July last year. Over the past year, core service inflation has adjusted down by 100 basis points to 4.2%, which is near the 2011-2019 average of 4%. Core goods inflation is at 2.7%, slightly above historical rates. Volatile inflation remains elevated at 6.1%, compared to around 3% during 2011-2019, affected by the sizable electricity price adjustments since June 2024. However, annualized headline inflation accumulated over the last quarter reached 3.9%, the lowest since 3Q24, while core pressures came in at a low 1.3%, down from a recent peak of 5.5% in the October 2024 quarter. Although uncertainty lingers regarding an electricity price adjustment towards the end of the year, limited demand-side pressure, low global oil prices, and base effects should contribute to lower inflation going forward.

Falling inflation



Source: INE, Itaú

Inflation expectations dip



Source: BCCh, Itaú

Rate cuts to be all about timing

In April, the central bank unanimously held the policy rate at 5%, as expected, while maintaining a neutral forward guidance. The Board noted that the uncertain environment still favors a cautious approach. The communiqué highlighted that changes in global trade policy have worsened the outlook for global growth and increased uncertainty. The magnitude and timing of these effects on the local economy remain unclear. Regarding inflation, although it will remain high in the immediate future, its recent performance and main determinants reaffirm the prospects for convergence outlined in the March Report. The real ex ante rate, which is the current MPR (5.0%) minus the one-year inflation expectation according to analysts (3.6%), is at 1.4%, close to the upper bound of the BCCh's neutral real range (0.5-1.5%). While the communiqué held a neutral tone, the minutes incorporated a dovish twist. At the meeting, the option to already cut by 25bps was considered. The publication of the June IPoM (18) will consolidate the convergence path of inflation and the rate path towards the 4% nominal neutral rate. Market pricing of inflation is correcting downward swiftly. The 1Y1Y breakeven is now back to the 3% target, after nearing 4% at the start of the year.

Fiscal revenues gradually improve

Fiscal data through 1Q25 reveal an expected improvement in revenues and some signs of spending restraint. This year's fiscal consolidation forecast relies on additional spending restraint and continued revenue improvement; now, all eyes are on April's projected revenue jump. The fiscal balance through 1Q25 reached a deficit of 0.7% of GDP, the same as in 2024. We still believe that the recently announced watered-down structural deficit target seems challenging. The Ministry of Finance (MoF) forecasts this year's spending growth at 2.3% (3.3% as of 1Q25), significantly below previous election years. We forecast a nominal deficit of 2.2% of GDP this year. Low levels of liquid assets should lead the MoF to continue with its debt-financing plan.

Adjusting the scenario following the trade truce

Activity has been holding up well. While the influx of tourists is expected to remain at elevated levels, its marginal effect on growth will diminish as the base of comparison becomes more demanding. April's business and consumer survey results indicate a slightly more pessimistic outlook for activity, mainly due to global developments. We anticipate growth of 2.2% for this year, with the effects of slower global activity dynamics in the second half and a more demanding base of comparison leading to a domestic slowdown. The less detrimental trade scenario leads us to now expect a milder GDP growth slowdown to 2.0% in 2026 (+0.2pp).

Recent dynamics suggest that fears of further inflationary persistence, due to potential second-round effects and other factors, are easing. Looking ahead, an anticipated 7% increase in electricity prices in July may slow the disinflation process before a pronounced decline toward the end of the year, driven by base effects and low global oil prices. We forecast year-end inflation at 4% (BCCh: 3.8%) and 3.0% next year (+0.1pp). The balance of risks tilts to the downside, especially if more favorable CLP dynamics persist. We anticipate a year-end CLP rate of 970 per dollar, above the current spot rate of 935, based on a narrower interest rate differential with the US and the expectation that copper prices are overshooting ahead of weaker global demand.

We expect that as the pace of the inflation decline accelerates during the second half of 2025 and the global economy shows signs of slowing, the central bank will resume cutting rates by 2x25bps to 4.5%. We anticipate the cycle ending at 4% in early 2026. Our updated scenario of only one 25bp rate cut by the Fed late this year (down from two) may prevent the Board from acting in the short run. Starting to cut in September is our base scenario, but we acknowledge that risks tilt an earlier start.

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Chile | Forecasts and Data

	2020	2021	2022	2023	2024	2025F		2026F	
						Current	Previous	Current	Previous
Economic Activity									
Real GDP growth - %	-6.1	11.3	2.2	0.5	2.6	**2.2**	2.2	**2.0**	1.8
Nominal GDP - USD bn	254	311	302	332	324	**332**	332	**363**	362
Population (millions)	19.5	19.7	19.8	20.0	20.1	**20.2**	20.2	**20.3**	20.3
Per Capita GDP - USD	13,068	15,801	15,249	16,616	16,115	**16,448**	16,448	**17,852**	17,817
Unemployment Rate - year avg	10.8	8.9	7.9	8.7	8.5	**8.5**	8.5	**8.4**	8.4
Inflation									
CPI - %	3.0	7.2	12.8	3.9	4.5	**4.0**	4.0	**3.0**	2.9
Interest Rate									
Monetary Policy Rate - eop - %	0.50	4.00	11.25	8.25	5.00	**4.50**	4.50	**4.00**	4.00
Balance of Payments									
CLP / USD - eop	711	851	851	879	996	**970**	970	**940**	940
Trade Balance - USD bn	18.9	10.3	3.6	13.8	21.0	**19.0**	19.0	**16.0**	16.0
Current Account - % GDP	-1.9	-7.4	-8.8	-3.2	-1.5	**-2.0**	-2.0	**-2.5**	-2.5
Foreign Direct Investment - % GDP	4.5	4.9	6.2	5.5	3.9	**4.1**	4.1	**4.1**	4.1
International Reserves - USD bn	39.2	51.3	39.2	46.3	44.4	**46.0**	46.0	**48.0**	48.0
Public Finances									
Primary Balance - % GDP	-6.3	-6.9	2.1	-1.6	-1.7	**-1.1**	-1.1	**0.0**	0.0
Nominal Balance - % GDP	-7.3	-7.7	1.1	-2.4	-2.8	**-2.2**	-2.2	**-1.2**	-1.2
Gross Public Debt - % GDP	32.4	36.4	37.9	39.4	**41.7**	**43.0**	43.0	**43.5**	43.5
Net Public Debt - % GDP	13.3	20.2	20.5	23.2	**25.8**	**26.5**	26.5	**27.0**	27.0

Source: IMF, Bloomberg, BCCh, INE, Haver and Itaú

Macro Research – Itaú

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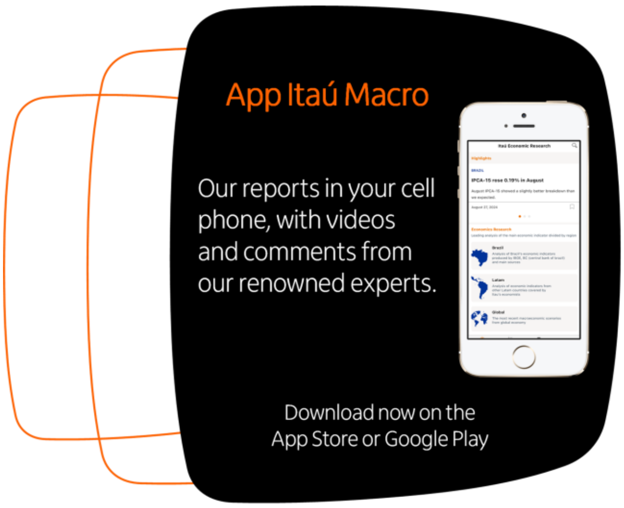

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