Macro scenario - Chile

June 13, 2025

An earlier restart to the easing cycle

- The recovery in activity has been swifter than expected, partly due to transitory factors. The labor market and credit dynamics remain weak. Meanwhile, disinflation of core indices has unfolded more quickly, and medium-term inflation expectations are anchored. With the net result of the global trade conflict expected to be growth-negative and deflationary, the central bank is anticipated to move monetary policy closer to the center of its neutral rate range. We now expect the cutting cycle to resume earlier, in July rather than September, with a year-end rate of 4.25% (-25 bps). We still foresee the cycle concluding at 4% early next year.

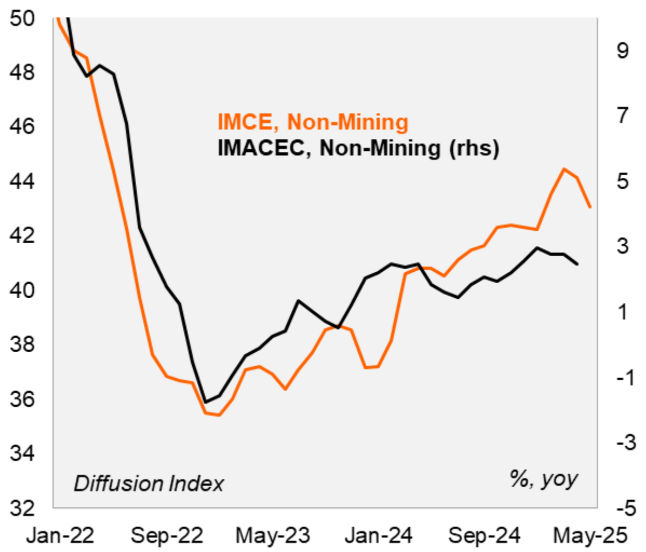
Nearing the political business end

The wide-ranging coalition from the political left will hold its primary election on June 29. Carolina Toha, a center-left politician and former interior minister, along with Jeanette Jara, a former labor minister and member of the Communist Party, are the frontrunners according to several polls. The focus has been on public safety and economic growth, a significant shift from the previous cycle which took place in the context of a constitutional rewrite. The left coalition will participate in the November 16 presidential and congressional elections as a single pact, consolidating its vote share. Meanwhile, the political right may have at least three candidates in the presidential first round, and several congressional lists.

Better-than-expected activity, but weak labor demand

The 1Q25 GDP data showed that the economy grew by 2.3% YoY, 30 basis points above the monthly GDP proxy estimate. April activity continued to demonstrate positive dynamics. The carryover for 2025, assuming activity remains at April levels for the rest of the year, is at 1.7%. Early in the year, the economy was bolstered by the external sector, with government spending and a temporary boost from tourism consumption also playing significant roles. Sequentially, the economy has grown for the last three quarters (+0.7% QoQ/SA in 1Q25). With capital goods imports remaining strong during 2Q25 and global trade tensions appearing to have eased, the economic recovery is expected to progress. Business sentiment experienced only a slight dip during the peak of the global trade conflict, while the five-year investment pipeline continues to be revised upward. Meanwhile, the Corporation of Capital Goods' (CBC in Spanish) 1Q25 survey, a leading investment indicator closely monitored by economic authorities and analysts, showed that this year's private investment forecast was revised up by 12.7% compared to the previous survey. This upward revision was primarily driven by mining and energy sectors, which could eventually reverse the long-standing decline in construction. The BCCh's May "beige book" also indicated another marginal increase in private investment plans for 2025.

Private sentiment dynamics still favorable for growth



Source: Icare, BCCh, Itaú

Nevertheless, labor demand remains limited amid rising costs. The favorable economic recovery has been accompanied by stagnant employment levels and elevated unemployment rates. The minimum wage is set to increase again this year by a total of 5.6%, well above inflation. This rise follows significant increases since April 2022, with the minimum wage having increased by a total of 46% in nominal terms, while inflation has risen by 20% during the same period.

Better positioned to face global shocks

At its semi-annual financial policy meeting, the Central Bank of Chile unanimously maintained the countercyclical capital requirement at 0.5% of RWA, in line with expectations. The release of the Financial Stability Report showed that despite the magnitude of the trade shock, global financial markets, including Chile's, have been able to accommodate these movements and function without major disruptions. In Chile, the imbalances of previous years have been corrected, and the financial situation of credit users—households and businesses—has been improving over the last few quarters. At the same time, the banking sector has liquidity and capital levels that would allow it to withstand adverse events. This puts the economy in a better position to face a significant deterioration in the global scenario. As previously highlighted, the Central Bank of Chile will assess whether it is appropriate to converge to the neutral level of the countercyclical capital requirement (1% of RWA) in May 2026, which would take at least one year to build up.

The rolling 4Q current account balance showed a moderate deficit of 1.6% as of March (1.5% in 2024). This was driven by a substantial trade surplus in goods (USD 6.9 billion), with exports rising by 6% YoY and a gradual recovery in domestic demand leading to an 8.4% YoY improvement in imports. Part of the surplus was offset by a growing income deficit (USD 4.6 billion) as high copper prices boosted FDI investment results. The annual current account deficit (CAD) is comfortably financed by foreign direct investment (FDI). Net FDI into Chile, around 2% of GDP, vs a 1.6% CAD. The low CAD reflects a well-balanced economy, likely supporting a more favorable external view of the CLP. Despite narrow interest rate differentials with the US, this leads to lower FX volatility compared to previous episodes of global market stress, and to other regional currencies. Non-residents' CLP derivative positions have been balanced out for several weeks.

Limited sequential inflation pressures

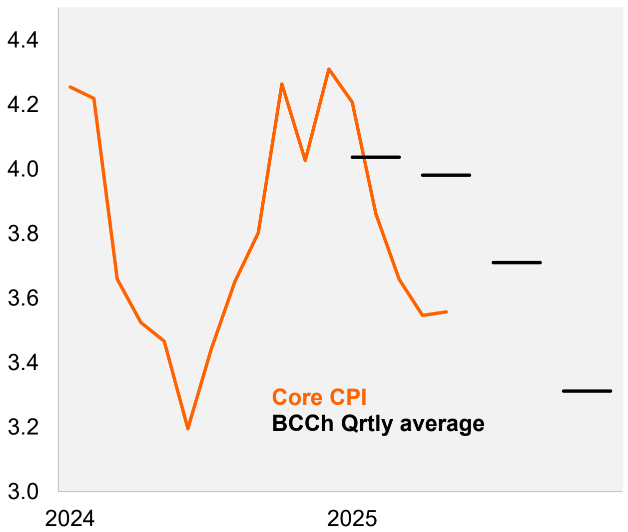
Sequential price dynamics align with annual inflation being near or below the 3% target. In annual terms, headline inflation remained steady at 4.5% in May. Annual inflation has exceeded the 3% target since early 2021. Core inflation is lower at 3.6%. Core goods and services inflation increased by 2.7% and 4.2%, respectively. Sequentially, the annualized headline inflation accumulated over the last quarter reached 3.0% (the lowest since 3Q23). Importantly, core pressures were below target at 2.0%. We expect consumer prices to fall by 0.2% in June, driven primarily by the effects of Cyber Day. For July, we estimate a 7.3% increase in electricity prices (2.2% of the basket), resulting in a total CPI of around 0.6%. Annual inflation should decline more rapidly during the final quarter of the year due to more demanding base effects.

Timing of rate cuts down to strategic preference

The baseline policy rate path outlined in the March IPoM signaled cuts in September and December. Since then, the domestic activity recovery has been somewhat swifter, but labor market slack has persisted, and commercial credit and non-mining investment dynamics remain weak. Despite the global trade shock, local financial market indicators have performed better than expected, in line with other EMs. The IPoM considered two rate cuts by the Fed this year, similar to current market pricing. On the inflation front, the evolution of the core disinflation process has been swift, likely 30 basis points lower during 2Q compared to the IPoM estimate. Meanwhile, relevant medium-term inflation expectations are once again anchored to the 3% target after a spike at the start of the year. The ex-ante real rate in Chile is around the upper bound of the central bank's neutral range (0.5%-1.5%). As mentioned, we believe the Chilean economy is better positioned to face new shocks, which is consistent with a monetary policy scenario closer to the center of the neutral rate range, over time. The central bank expects higher global tariffs to negatively impact Chilean growth, along with lower inflationary pressures, factors that further favor lower rates ahead. The policy rate has been stable at 5% since December, yet the April meeting already discussed a 25-basis-point cut.

With a swifter disinflation path underway and deflationary pressures ahead, cutting rates this month cannot be ruled out, however we believe the Board will rather use the June IPoM to guide the market into anticipating a cut at the next meeting in July. Board members have adopted a tone of caution, emphasizing significant uncertainties and a preference to accumulate more information before embarking on a cycle of cuts. Market pricing and survey results do not point to a rate cut as early as June. While domestic conditions provide the space to cut, a surprise move in June may generate market expectations for an extended cutting cycle, placing greater pressure on the CLP and demand more communication from the Board to steer expectations. Given that monetary policy in Chile is not restrictive, we believe there is less urgency to deliver the final cuts at the tail end of the cycle. By using the June meeting to guide the market towards a July cut, financial market volatility can be contained.

Swifter core disinflation



Source: BCCh, INE, Itaú

Lower inflation leads to earlier cutting cycle

The better-than-expected start to the year and the still upbeat export dynamics in 2Q have built a firm foundation for overall growth this year. We now project the economy to grow by 2.6%, an increase of 40 basis points from our previous scenario. This scenario considers a significant sequential slowdown during the second half of 2025 as the effects of tighter global trade conditions begin to materialize, and transitory factors that boosted activity in the first semester fade. We expect the economy to grow by a lower 2% next year amid a weaker net export pull.

The evolution of international oil prices, favorable exchange rate dynamics, and the apparent absence of second-round effects from the previous electricity price increase raise the odds of a swifter disinflation path. We have revised our year-end inflation forecast down by 20 bps to 3.8%. We now project a year-end USDCLP rate of 940 (down from 970), due to a weaker global dollar.

Amid reduced inflation pressures and renewed anchoring of inflation expectations, along with a deflationary global scenario, we expect the central bank to proceed with a lower interest rate environment. We now anticipate the cycle to resume in July (previously September), with the year-end rate reaching 4.25% (a decrease of 25 bps from our previous scenario). We still foresee the cycle concluding at 4% early in 2026. We cannot rule out the possibility that the cycle is fully completed this year, especially if CLP dynamics remain stable despite the interest rate trends in the US.

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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	**2.6**	2.2	**2.0**	2.0
Nominal GDP - USD bn	254	311	302	332	324	**347**	332	**376**	363
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	**17,169**	16,448	**18,503**	17,852
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	**3.8**	4.0	**3.0**	3.0
Interest Rate									
Monetary Policy Rate - eop - %	0.50	4.00	11.25	8.25	5.00	**4.25**	4.50	**4.00**	4.00
Balance of Payments									
CLP / USD - eop	711	851	851	879	996	**940**	970	**910**	940
Trade Balance - USD bn	18.9	10.3	3.6	13.8	21.0	**20.0**	19.0	**17.0**	16.0
Current Account - % GDP	-1.9	-7.4	-8.8	-3.2	-1.5	**-1.9**	-2.0	**-2.4**	-2.5
Foreign Direct Investment - % GDP	4.5	4.9	6.2	5.5	3.9	**4.0**	4.1	**4.0**	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	**-0.9**	-1.1	**0.0**	0.0
Nominal Balance - % GDP	-7.3	-7.7	1.1	-2.4	-2.8	**-2.0**	-2.2	**-1.2**	-1.2
Gross Public Debt - % GDP	32.4	36.4	37.8	39.4	41.7	**42.4**	43.0	**42.9**	43.5
Net Public Debt - % GDP	13.3	20.2	20.4	23.2	26.0	**27.0**	26.5	**27.5**	27.0

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

Macro Research – Itaú

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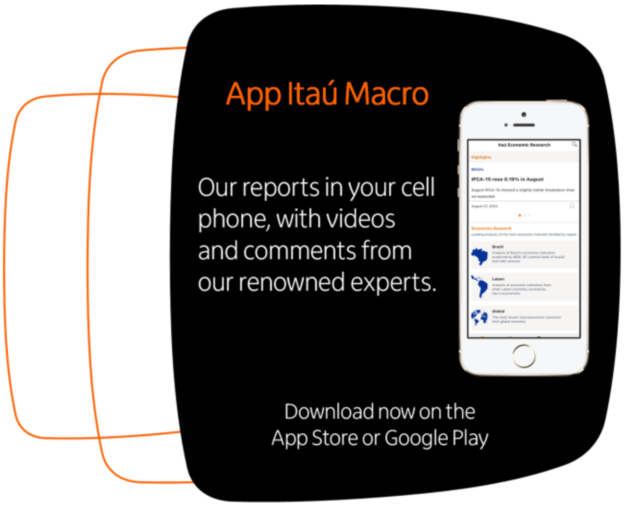

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