Macro scenario - Chile

February 17, 2025

Upward revisions to growth and inflation

- Inflation is expected to remain near the 5% mark during 1H25, boosted by supply shocks and indexation pressure, before retreating to 4.1% at YE25 (10-bp upward revision). Activity has exceeded expectations recently, leading to the upward revision of our 2025 GDP growth forecast to 2.3% (from 1.9% previously). The slightly negative output gap is probably narrower than indicated in the December IPoM, and the inflation path somewhat higher. We believe that keeping interest rates at the current 5% for the remainder of the year will offset these developments. While the rates curve incorporates hikes throughout the year, we expect the policy rate to remain unchanged for now.

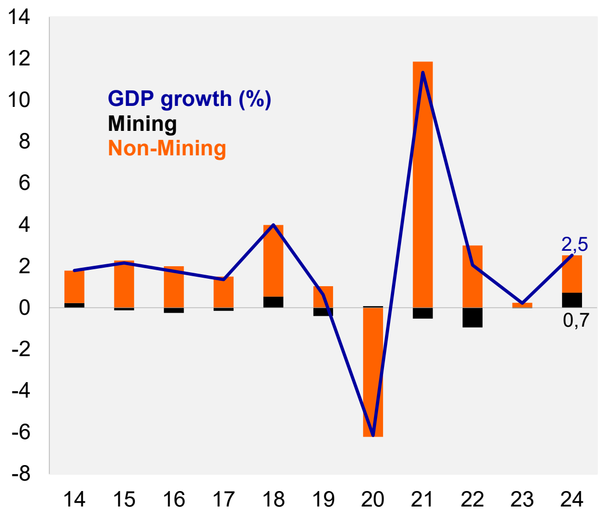
End of pension chapter

A positive reform on net. Higher pensions have been at the top of the policy priority list for some time, as expectations of elevated replacement rates have yet to be met. This is mostly a result of issues in the labor market (low participation, spells of unemployment, slowing wage growth, informality), demographics (unchanged retirement age, longer life expectancy), capital markets (gradual decline in returns), and the effects of the pension fund withdrawals. The approved reform, while far from a "first best", is net positive because it reflects the potential to achieve a broad consensus on structural reforms in Congress and validates individual savings accounts as the main pillar of the pension system. That said, there are risks to a broad-based change in the pension system, which include fiscal costs, negative effects on a cyclically-weak labor market, and implementation challenges. We provide a more in-depth analysis in this report.

Mining boosts returns

A mining production surge in December and a sharp uptick in commerce led to an above-consensus growth in 2024. The economy grew 2.5% in 2024 (0.2% in 2023), as mining rose 6.2%, reaping the benefits of prior investment in the sector to recuperate output levels (for details see our report here), while the flow of consumer tourism (mainly from Argentina) has boosted retail dynamics amid soft domestic fundamentals. Commerce increased by 3.8% in 2024, despite a broadly flat real domestic wage bill, as above-average real wage growth (in response to minimum wage hikes) was met with job destruction during 2H24.

Mining no longer a drag



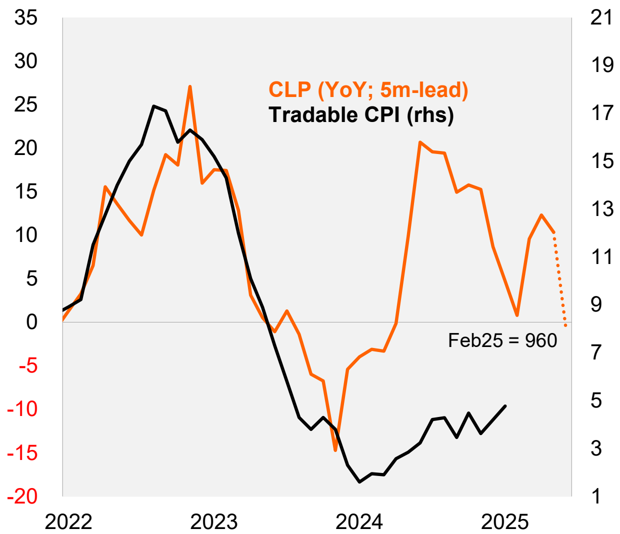
Source: BCCh, Itaú

Above-expectation year-end activity raised the carryover for 2025 by around 20 bps. Still-high copper prices, despite trade war rumblings, and upbeat capital goods imports suggest that the recovery of investment this year (after two years of decline) could exceed our prior estimate. While strong tourism-spending from Argentina is likely to persist this year, domestic spending is expected to remain subdued amid lower projected real wage growth and weak job demand, with consumer loan-borrowing rates unlikely to drop from the current high levels.

Kicking off 2025 with strong inflation

Payback from sales events in December and the last expected double-digit electricity hike resulted in a 1.1% MoM CPI gain in January. In annual terms, headline inflation rose from 4.5% to 4.9%, remaining above the 3% target since early 2021. Core inflation, however, posted a slight decline from 4.3% to a still-high 4.2%. Core goods dropped by 0.3 pp to 3.1% YoY, while core services were stable at 5% (roughly the case since June of last year). Volatile items rose by 1.8% MoM, leading to an annual increase of 6.1%. Annualized headline inflation posted a downtick in 4Q24, to 4.8%, while core pressures dipped to 3.8% (from a peak of 5.6% in the quarter ended in October 2024). With the bulk of indexation pressures expected to materialize during 1H25, inflation will likely hover around 5% before entering on a downward trajectory, due to a high comparison base (electricity prices) and the effect of soft domestic labor dynamics on consumption. While business surveys have signaled a desire to pass through a greater share of prior FX pressures to final prices, the recent rally of the CLP and falling employment levels may keep it at bay.

CLP rally may ease passthrough pressures ahead



Source: INE, BCCh

Large fiscal miss

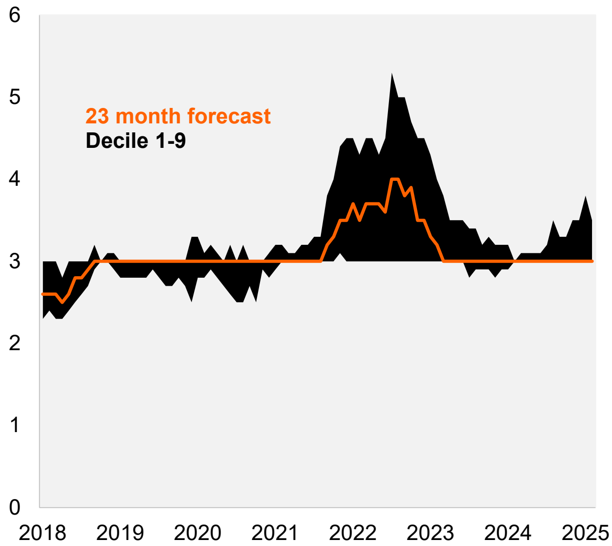
The structural fiscal deficit in 2024 ballooned to 3.2% of GDP, well above the official target of 1.9% and the 2.7% reported for 2023. The miss was primarily driven by weaker-than-expected revenues, given that expenditures were essentially in line with the MoF's adjusted forecasts. The 2025 nominal deficit forecast was revised up to 1.7% of GDP, from 1% in the October forecast and 0.3% in February 2024. The MoF estimates that gross public debt peaked at 42.3% of GDP at the end of 2024 and will remain at a similar level this year (42.1%), before gradually edging down to 40.6% in 2029. In the near term, exchange-rate dynamics and deficit financing are likely to lead to even more debt. We expect the MoF to announce an additional spending adjustment of at least 0.5% of GDP in the near term, in an effort to meet the 2025 structural deficit target of 1.1% of GDP. In our view, the fiscal target misses in recent years suggest that Chile should target a structural surplus sooner rather than later, which would require a significant fiscal adjustment on the spending side.

Central bank on hold

With higher short-term upside inflation risks, the Board paused its easing cycle at 5% in January and shifted the forward guidance to neutral, in line with our view of a prolonged period of stable rates as further data is accumulated. The pause followed a 25-bp cut in December. The real ex-ante rate – i.e., discounting the one-year inflation expectation according to analysts in January (3.8%) from the current policy rate (5.0%) – remained at 1.2%, within the BCCh's neutral range (0.5%-1.5%). In contrast with the previous statement, the Board eliminated the signaling of further cuts, consistent with the higher short-term inflation risks and the rise in medium-term inflation expectations.

While the rates curve has priced in one to two hikes for this year, we believe that the move may be premature for now. Breakeven CPI measures for the two-year horizon are above the 3% target, but the Board has continued to signal that inflationary pressures are attributable to transitory supply shocks. The non-mining output gap remains slightly negative. This coupled with global protectionist measures that would hurt Chile's small, open economy means that the demand-side balance of risks for inflation continue to be tilted to the downside. The approval of the pension reform, while positive for capital markets, will raise the cost of labor further and likely result in real wage growth beneath historical rates. The swift appreciation of the CLP in recent weeks may be playing a role in containing the rise in survey- and market-based inflation expectations. The March IPoM is likely to signal a near-term rate pause before a resumption of cuts in 2026 toward neutral nominal levels (3.5%-4.5%). Still, authorities should bear in mind that the failure to achieve the target for so many years raises the risk of a persistent shift in inflation expectations.

Analysts cool inflation outlook at the margin



Source: BCCh, Itaú

Slightly more growth and higher inflation

The higher carryover from activity and consolidating signs of an investment recovery this year support the upward revision of our GDP call by 40 bps to 2.3%. The evolution of the consumer-tourism wave will keep the balance of risks tilted to the upside.

A modest upside inflation surprise in January and the revision of our growth scenario add to the inflation risks. On the other hand, the ongoing CLP rally (CLP 960/USD), which was not our base-case scenario (annual average of CLP 990/USD), will offset some of the pressures previously priced in. On a net basis, we are raising our year-end call by 10 bps to 4.1%, with the risks still tilted to the upside.

The fiscal update by authorities and the associated macroeconomic scenario support the upward revision of our nominal fiscal deficit by 20 bps to 2%.

For now, we expect the market and the central bank to consolidate the view of a prolonged period of stable rates at 5%. Given the global and domestic volatility, as well as the considerable uncertainties, maintaining a more cautious path (vs. the signaling in the December meeting) is the most efficient way to consolidate an inflation convergence path toward the 3% target within the policy horizon.

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Chile | Forecasts and Data

	2020	2021	2022	2023	2024F		2025F		2026F	
					Current	Previous	Current	Previous	Current	Previous
Economic Activity										
Real GDP growth - %	-6.1	11.3	2.1	0.2	**2.5**	2.2	**2.3**	1.9	**2.0**	2.0
Nominal GDP - USD bn	254	311	303	332	**312**	311	**321**	319	**355**	352
Population (millions)	19.5	19.7	19.8	20.0	**20.1**	20.1	**20.2**	20.2	**20.3**	20.3
Per Capita GDP - USD	13,068	15,810	15,294	16,617	**15,523**	15,490	**15,891**	15,795	**17,450**	17,331
Unemployment Rate - year avg	10.8	8.9	7.9	8.7	8.5	-	**8.5**	8.5	**8.2**	8.2
Inflation										
CPI - %	3.0	7.2	12.8	3.9	4.5	-	**4.1**	4.0	**3.0**	3.0
Interest Rate										
Monetary Policy Rate - eop - %	0.50	4.00	11.25	8.25	5.00	-	**5.00**	5.00	**4.50**	4.50
Balance of Payments										
CLP / USD - eop	711	851	851	879	996	-	**955**	955	**930**	930
Trade Balance - USD bn	18.9	10.3	3.7	15.3	22.1	-	**22.5**	21.0	**18.0**	18.0
Current Account - % GDP	-1.9	-7.4	-8.6	-3.6	**-2.3**	-2.5	**-2.4**	-2.6	**-2.9**	-2.9
Foreign Direct Investment - % GDP	4.5	4.9	6.0	6.6	**4.9**	5.3	**4.8**	4.9	**4.8**	4.8
International Reserves - USD bn	39.2	51.3	39.2	46.3	44.4	-	**50.0**	50.0	**58.0**	58.0
Public Finances										
Primary Balance - % GDP	-6.3	-6.9	-1.6	-0.9	**-1.8**	-1.9	**-0.9**	-0.7	**0.2**	0.2
Nominal Balance - % GDP	-7.3	-7.7	1.1	-2.4	**-2.9**	-3.0	**-2.0**	-1.8	**-1.0**	-1.0
Net Public Debt - % GDP	13.4	20.2	20.4	23.1	**26.0**	26.6	**27.3**	27.5	**27.5**	27.5

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

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