Macro scenario - Chile

November 18, 2024

Growing headwinds

- Domestic demand remains weak. An upward unemployment rate trend indicates growing slack. Leading indicators suggest the bulk of the investment adjustment has materialized, but as the administration's final year approaches and global uncertainty rises, a meaningful investment rebound appears unlikely. Supply shocks continue to push inflation, while the weaker CLP will lead to a further wave of tradable price pressure. The central bank will continue to lower the policy rate, but our revised scenario of a higher FFR and slower inflation convergence process lead us to increase our terminal rate call by 50bps to 4.5%.

Global challenges rise

Protectionist US trade policies would be negative for Chile. As a small, open economy (trade openness exceeding 50% of GDP), policies that raise barriers to trade and hinder growth prospects of key partners would pose headwinds to Chile's recovery path. With more than 40% of exports sent to China, a hark back to a 2018-19 styled trade war would weaken global growth, lower commodity prices and lead to further weakening of the CLP. While Chile currently has a small current account deficit (2.4% estimate; 2010-19 average: 3.5%), low levels of central bank reserves (13% of GDP), higher public debt (gross debt nearly 20pp higher than in 2017); lower assets in the Stabilization Fund (USD 3.8 billion; USD 14.7 billion in 2017) and a shallower local capital market following several pension fund withdrawals, leave the economy more vulnerable to global shocks relative to the 2018-2019 trade war.

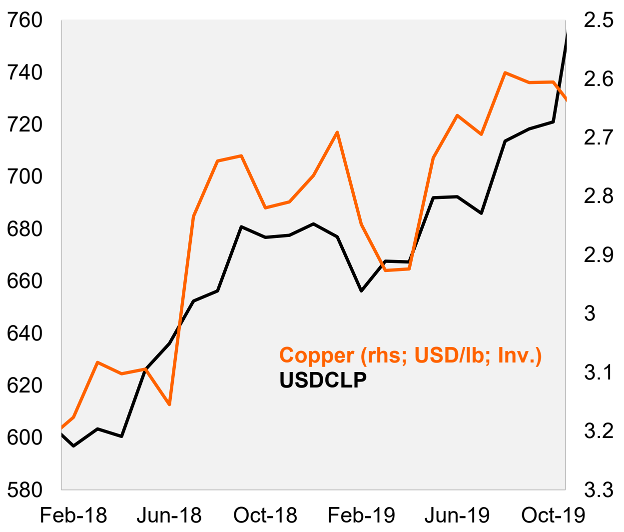
Activity ended 3Q on a weak footing

After a one-off rebound in July, led by the education sector, lifted growth at the start of 3Q24, activity underwhelmed in August and September. Employment growth dynamics have been muted over the last five months, as private consumption is projected to rise by less than 2% this year, and at a similar rate in 2025. Imports of capital goods and business survey results suggest that the two-year investment decline may have concluded, but the combination of internal and global dynamics will likely keep non-mining businesses in a wait-and-see mode. While copper prices may be capped versus a pre-Trump scenario, they remain high amid supply shortages and a global transition into greening economies, supporting sector-specific investment. We expect gross fixed investment to contract between 1 and 2% this year (down 5.3% in 2023) and grow by between 3 and 4% next year.

CLP whiplash

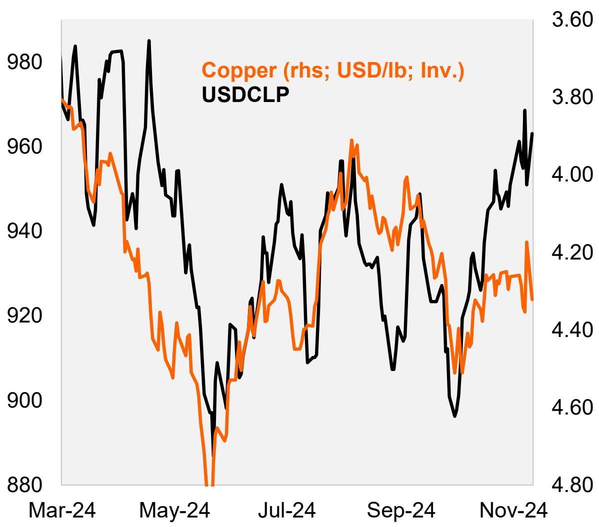
At the time of writing our October scenario the Chilean peso was trading at around 900 pesos per dollar, responding to expectations of a swifter easing cycle by the Fed and the announcement of Chinese stimulus measures. Subsequently, stronger US data at the margin cooled expectations of a fast-easing cycle, while electoral results in the US raised financial volatility and cooled sentiment toward EM. The CLP is around 10% weaker than at the close of September. While copper has only fallen 4% during the same period, a reversion of risk sentiment toward EM is evident in the rise in non-residents' shorting of the CLP.

Copper and CLP evolvement during '18-19 trade war



Source: Central Bank of Chile, Itaú

Current CLP overshooting



Source: Central Bank of Chile, Itaú

Higher short-term inflation pressures

As anticipated, electricity prices rose by around 19% MoM in October. The adjustment followed the 7% and 12% hikes in June and July, respectively, as the normalization process advanced following several years of frozen prices. Nevertheless, food price pressures came in well above our expectations, supporting a 1% monthly increase in October. The YTD price accumulation sits at 4.5%. At the margin, rising pressures come from goods, with services broadly stable. Short-term inflation expectations have increased following the recent surprise and CLP dynamics, but the key two-year outlook remains anchored to the 3% target, signaling that the market still deems pressures as transitory, with domestic demand too weak to sustain above-target inflation.

Rate cuts to continue, for now.

The central bank's board was unanimous in its decision to cut the policy rate by 25bps to 5.25% at its October meeting. The meeting minutes show 25bps was the only plausible option. At the time of the meeting, the central bank signaled that both inflation and activity were broadly in line with its baseline scenario. The current guidance remains taking the policy rate to neutral (3.5-4.5% nominal rate range), but global tensions have been highlighted as a risk to monitor.

The fiscal battle

The cumulative fiscal deficit widened in September to 2.5% of GDP, exceeding the MoF's 2.0% year-end nominal deficit forecast and last year's annual deficit (2.4%). Cumulative revenue growth in the year improved at the margin to -2.9% YoY in September (-4.4% in August), but is still well below the MoF's annual revenue growth forecast (+5.3%). On the spending side, current expenditure growth slowed again in September, leading to cumulative expenditure growth in the year reaching 5.5% (5.9% through August), implying a material spending constraint would have to be implemented through year-end to comply with the MoF's spending growth forecast of 3.5%. With fiscal revenues underperforming, the government has faced resistance in Congress to approve the 2025 Budget leading to unprecedented concessions towards lower spending. Risks also tilt towards a greater fiscal deficit in 2025, as revenue assumptions seem hard to achieve.

Lower growth, higher inflation and rates

Activity data in Chile continues to be volatile amid several transitory shocks and calendar effects, but data at the backend of 3Q24 lost steam. We have revised growth down 30bps to 2.2%. Weaker carryover (-10pp to 0.7%), lower China growth (-50bps to 4%), and higher average interest rates and inflation support a downward revision of 20bps to 1.9%.

Underwhelming policy stimulus measures in China, along with an EM risk-off sentiment has seen the CLP depreciate significantly. While we reckon there is some overshooting in the latest figures, the global scenario is coherent with a weaker currency path. Chile is one of the economies most exposed to a global slowdown. We now see a year-end 2025 exchange rate of CLP 940/USD (from CLP 870 previously).

The large upside CPI surprise in October and a higher CLP path result in a higher average inflation scenario. We now see inflation of 4.7% this year (+20bps from our last scenario). We expect inflation to fall to 3.5% next year (3.3% previously). Lower global oil prices and softer domestic demand will limit the impact of higher inflation pressures stemming from the weaker CLP.

We expect the nominal fiscal deficit for 2024 to come in at 3% of GDP (+70bps), incorporating the prior upside risks outlined as revenue dynamics have not improved sufficiently. For 2025, we expect some consolidation to 1.8% (+30bps), above the administration's estimate (1%), as the less benign global scenario will likely materialize into another revenue overestimation.

A slower inflation convergence path towards the 3% target, and higher global rates scenario are consistent with fewer rate cuts going forward in Chile. We expect the central bank to cut by another 25bps to 5% next month but signal a higher rate path in its IPoM compared to September (4.2% average during 4Q25). We now see the Board taking rates to 4.5% (+50bps from our October scenario). We do not rule out pauses during the final run-in given elevated global volatility.

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Chile | Forecasts and Data

	2019	2020	2021	2022	2023	2024F		2025F	
						Current	Previous	Current	Previous
Economic Activity									
Real GDP growth - %	0.6	-6.1	11.3	2.1	0.2	**2.2**	2.5	**1.9**	2.1
Nominal GDP - USD bn	273	254	311	303	332	**317**	323	**336**	356
Population (millions)	19.1	19.5	19.7	19.8	20.0	**20.1**	20.1	**20.2**	20.2
Per Capita GDP - USD	14,312	13,068	15,810	15,294	16,617	**15,777**	16,078	**16,619**	17,639
Unemployment Rate - year avg	7.2	10.8	8.9	7.9	8.7	**8.5**	8.6	**8.5**	8.4
Inflation									
CPI - %	3.0	3.0	7.2	12.8	3.9	**4.7**	4.5	**3.5**	3.3
Interest Rate									
Monetary Policy Rate - eop - %	1.75	0.50	4.00	11.25	8.25	**5.00**	5.00	**4.50**	4.00
Balance of Payments									
CLP / USD - eop	753	711	851	851	879	**940**	910	**940**	870
Trade Balance - USD bn	3.0	18.9	10.3	3.7	15.3	**22.0**	21.0	**21.0**	19.0
Current Account - % GDP	-5.3	-1.9	-7.4	-8.6	-3.6	**-2.4**	-2.5	**-2.3**	-2.6
Foreign Direct Investment - % GDP	5.0	4.5	4.9	6.0	6.6	**6.6**	6.5	**6.8**	6.5
International Reserves - USD bn	40.7	39.2	51.3	39.2	46.3	**46.0**	46.0	**50.0**	50.0
Public Finances									
Primary Balance - % GDP	-1.9	-6.3	-6.9	-1.6	-0.7	**-1.9**	-1.6	**-0.7**	-0.7
Nominal Balance - % GDP	-2.9	-7.3	-7.7	1.1	-2.4	**-3.0**	-2.3	**-1.8**	-1.5
Net Public Debt - % GDP	7.9	13.4	20.2	20.4	23.1	**25.0**	24.8	**26.2**	25.6

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

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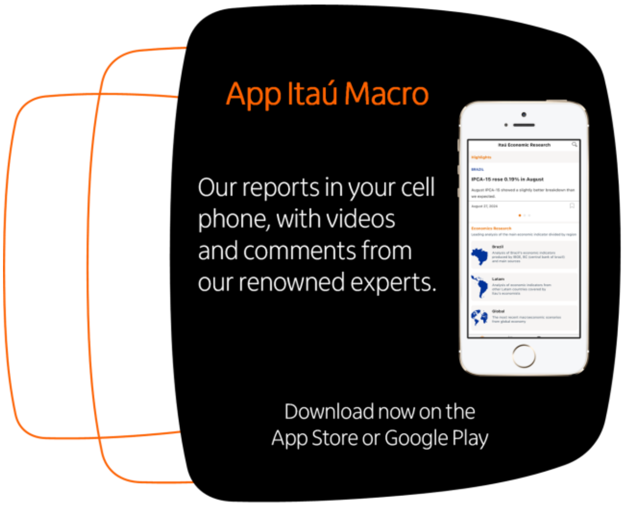

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