Macro scenario - Chile

October 4, 2024

Room to keep going

- While domestic activity has improved sequentially in 3Q24, leading indicators still suggest private investment is unlikely to swing back in the near term. Meanwhile, global factors have contributed to higher copper prices and a stronger CLP. The easing of global financial conditions and lower CPI risks from exchange-rate dynamics, amid anchored inflation expectations, give the Board space to take the policy rate to its estimated nominal neutral rate of 4% during 2025 (down from our prior 4.5% estimate).

Signs of improving activity

After a soft second quarter, activity is improving... Mining is driving activity, and non-mining activity is also improving. Year-to-date mining growth sits at 6.1% yoy, recovering from prior years of weakness. Commercial activity increased by 6.4% yoy during the quarter ending in August (-2.5% in 2Q24). Separately, industrial production rose 8.4% in the quarter (1.2% in 2Q24). Overall, IMACEC rose by 2.2% yoy in the quarter ending in August, above the 1.6% seen in 2Q24. Non-mining rose by 1.5% (0.6% contraction in 2Q24). At the margin, activity increased 1.8% qoq/saar, after the 2.2% decline in 2Q24. Nevertheless, leading indicators have yet to signal an activity rebound that goes much beyond the potential (around 2%). Commercial credit dynamics remain contractionary and investment-related capital imports continue to decline, while overall private sentiment remains below pre-pandemic levels.

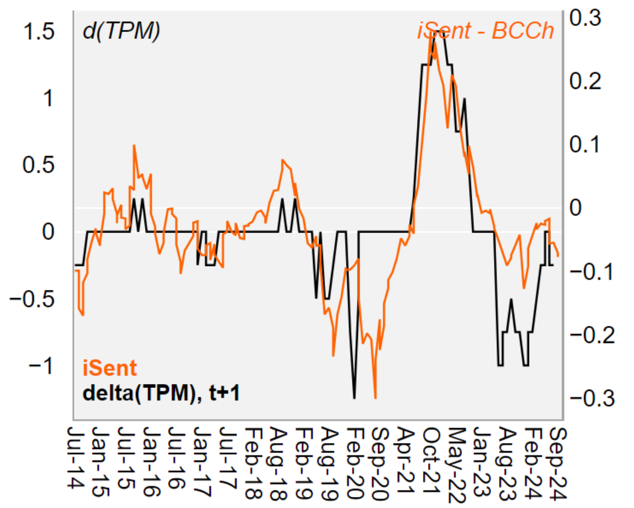
… but the labor market is still weakening. At the margin, employment levels have been broadly stable, resulting in the seasonally adjusted unemployment rate rising by 0.2 pp from the previous rolling quarter, to 8.7%, the highest level since February 2024. Looking at flows in the labor market, the BCCh's labor-demand proxy for the month of August fell by 24.41% yoy (-17.88% in July), remaining well below pre-pandemic levels, while administrative data on job destruction point to significant annual gains. In this context, the informality rate reached 27.6% in August, increasing 0.9 pp over the last year, indicating a gradual deterioration of formal job creation.

Anchored inflation expectations support additional cuts

In the lead-up to the September inflation release, market expectations continue to reflect anchored medium-term expectations. The central bank's monthly analyst survey showed that while the one-year-ahead inflation expectations remained unchanged at 3.8%, the two-year measure was anchored at 3% (the target) for the nineteenth consecutive month. The traders' survey showed that the one-year CPI outlook dropped 20 bps to 3.5%, while the key two-year view remained at the 3% target. We expect CPI to rise by 0.3% in September, leading to an annual decline of 40 bps, to 4.2%. A large 15% electricity price hike expected for October could be offset by Cyber Day-related sales. With headline inflation boosted by supply shocks, the market has incorporated the transitory nature of the current CPI pressures by maintaining medium-term inflation expectations at the BCCh's target, opening the door for further cuts to neutral.

In September, the board discussed faster (50-bp) easing, hinting at more cuts ahead. The BCCh's board unanimously voted to cut the policy rate by 25 bps, to 5.50%, and signaled that they would continue to take the policy rate toward neutral (3.5%-4.5%) through 2Q25 (an easing pace swifter than previously signaled in June). In contrast to the July policy meeting, when the BCCh paused at 5.75%, in September the Board discussed cutting the policy rate by 25 or 50 bps. The latter option was swiftly dismissed, while the communicational advantages of the former option were highlighted. We believe the Board's assessment of the 50-bp option surprised the market, especially considering July's pause. We think that the bank's trying experience with quick pace changes, early in the cycle, argues against changing gears. Still, lower global rates, weaker domestic demand in 2Q24, and anchored inflation expectations support additional easing, albeit at a sedate rhythm.

A dovish tilt



Source: BCCh, Itaú

A challenging fiscal scenario

2025 budget bill to ramp up fiscal spending by 2.7% yoy, above market estimates. Fiscal expenditures are projected to rise by 2.7% yoy in real terms in 2025, above the roughly 2% that market participants were expecting. GDP growth next year is seen at 2.7% (above our 2.1% call), with revenues projected to increase by 8.5% yoy. Official forecasts point to a 1% nominal fiscal deficit in 2025, although risks tilt toward a slower fiscal consolidation. In line with Chile's institutional framework, Congress may not raise spending further during the legislative discussion. The budget must be approved in 60 days. This is the last budget that the Boric administration will fully implement, with legislative and presidential elections scheduled for November 2025.

The combination of persistently weak revenues and strong spending has led to a cumulative nominal fiscal deficit through August of 2.2% of GDP, above the MoF's 2.0% forecast. The deficit normally ramps up significantly during the final quarter of the year, suggesting an even wider deficit by year-end. As such, the MoF is set to miss this year's structural deficit target of 1.9% of GDP, further eroding the credibility of the fiscal institutional framework. Our nominal deficit forecast of 2.3% of GDP for this year is biased to the upside.

Lower terminal rate

Activity data in Chile has been especially noisy this year, affected by several transitory shocks, but data for 3Q24 has shown favorable dynamics. Recently announced stimulus measures in China, Chile's main trading partner, and a swift easing cycle in the U.S. could consolidate a soft-landing scenario for the global economy. We continue to expect GDP growth of 2.5% this year and 2.1% for 2025, as prior downside risks to the scenario have faded.

Lower global oil prices, anchored inflation expectations, and the lagged effect of a still-contractionary monetary policy will support the disinflation process. We continue to see inflation of 4.5% this year, as upside electricity risks and past CLP depreciation pressures are offset by widespread retail sales events and lower oil prices. We expect inflation to fall to 3.3% next year.

Policy stimulus in China has contributed to boost copper prices and the CLP in the short term (year-end estimate of CLP 910/USD; CLP 930 previously). Yet, our call for the BCCh to conclude the cycle 50 bps lower than previously signaled will result in a year-end 2025 exchange rate of CLP 870/USD (from CLP 850 previously).

We expect the BCCh to cut by 25 bps in each of the remaining meetings this year, taking the policy rate to 5.0% by year-end. We now see rates reaching 4%, the center of the BCCh's neutral range, during 2Q25 (50 bps lower than our previous scenario), as global developments and anchored domestic inflation expectations support additional cuts.

We expect the nominal fiscal deficit for 2024 to come in at 2.3% of GDP, above the administration's 2% estimate, as revenue dynamics continue to underwhelm. For 2025, we expect some consolidation to 1.5%, above the administration's estimate (1%), as risks of persistent revenue weakness still linger, we have a lower GDP growth forecast, and uncertainty prevails on the boost from anti-tax evasion measures.

Andrés Pérez M.
Vittorio Peretti
Andrea Tellechea Garcia

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	**2.5**	2.5	**2.1**	2.1
Nominal GDP - USD bn	273	254	311	303	332	**323**	314	**356**	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	**16,078**	15,657	**17,639**	17,639
Unemployment Rate - year avg	7.2	10.8	8.9	7.9	8.7	**8.6**	8.6	**8.4**	8.4
Inflation									
CPI - %	3.0	3.0	7.2	12.8	3.9	**4.5**	4.5	**3.3**	3.3
Interest Rate									
Monetary Policy Rate - eop - %	1.75	0.50	4.00	11.25	8.25	**5.00**	5.00	**4.00**	4.50
Balance of Payments									
CLP / USD - eop	753	711	851	851	879	**910**	930	**870**	850
Trade Balance - USD bn	3.0	18.9	10.3	3.7	15.3	**21.0**	21.0	**19.0**	17.0
Current Account - % GDP	-5.3	-1.9	-7.4	-8.6	-3.6	**-2.5**	-2.5	**-2.6**	-2.8
Foreign Direct Investment - % GDP	5.0	4.5	4.9	6.0	6.6	**6.5**	6.7	**6.5**	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	**-1.6**	-1.6	**-0.7**	-1.2
Nominal Balance - % GDP	-2.9	-7.3	-7.7	1.1	-2.4	**-2.3**	-2.3	**-1.5**	-2.0
Net Public Debt - % GDP	7.9	13.4	20.2	20.4	23.1	**24.8**	24.4	**25.6**	26.0

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

Macro Research – Itaú
Mario Mesquita – Chief Economist

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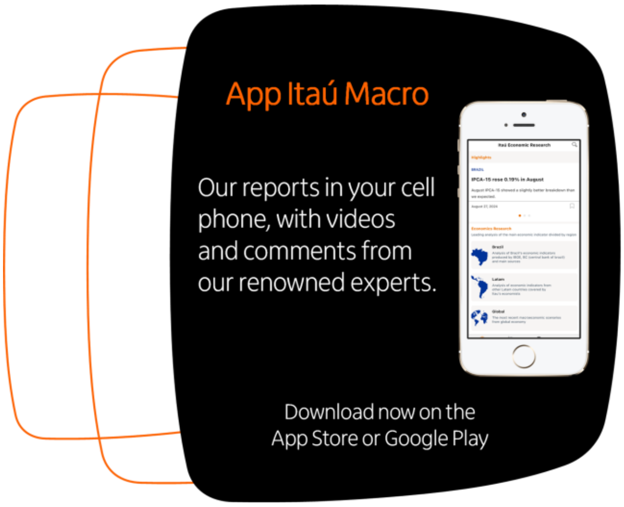

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