

CHILE – The last inflation mile

- ▶ The risk of higher domestic demand in Chile— driven by a swifter investment-related recovery, as well as resilient private consumption— has raised questions regarding the output gap and the pace of inflation convergence to the target. In this context, we assess the inflation outlook using Phillips Curve models.
- ▶ Our baseline scenario foresees inflation ending 2025 at 3.9% converging to the 3% target by Q2 2026. In our risk scenarios with activity outperforming, inflation convergence is more gradual, warranting a cautious path in the final stages of the BCC's cutting cycle.

Quo vadis short-term inflation? We estimate a Phillips Curve model for Chile that posits a positive relationship between economic activity and inflation expectations. Our model considers annual headline inflation as the dependent variable, with explanatory variables including the average of one-year-ahead inflation expectations from the Central Bank's analyst survey and inflation-linked swaps, as well as our output gap estimate as a proxy for economic activity. The table below presents the estimated coefficients, confirming the positive link between activity and inflation, as well as the role of expectations¹.

Phillips Curve Estimation					
	Estimate	Std. Error	t-value	Pr(> t)	
(Intercept)	1.4072	0.1572	8.25	.000	***
CPI (-1)	0.5474	0.0440	12.44	.000	***
Output Gap	0.1486	0.0542	2.74	.008	**
1-year Inflation Expectations minus target	1.3193	0.1554	8.49	.000	***
Residual standard error: 0.682 on 82 degrees of freedom					
Multiple R-squared: 0.945, Adjusted R-squared: 0.943					
Wald test: 451 on 3 and 82 DF, p-value: <2.2e-16					
Diagnostic tests:	df1	df2	Statistic	p-value	
Weak instruments	2	81	37,83	2.2e-13***	
Wu-Hausman	1	81	1,03	0,31	
Sargan	1	NA	0.26	0.61	
--- Signif. codes: 0 '***' 0.001 '**' 0.01 '*' 0.05 '.' 0.1 ' ' 1					

Note: Estimated using quarterly data starting in 2002, where economic activity is measured by the output gap—estimated using the HP filter.

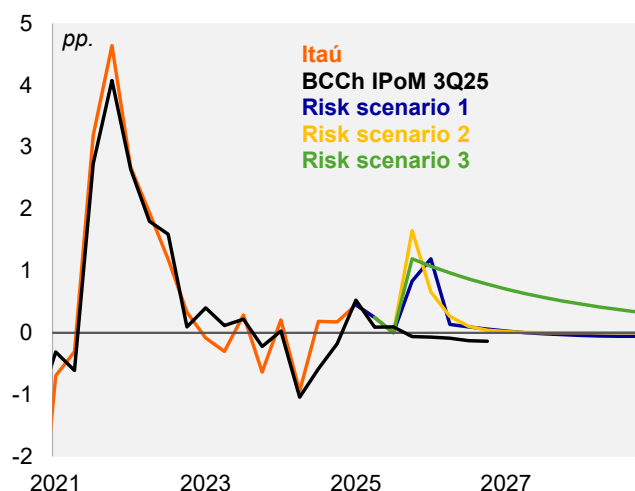
We then explore three upside risk scenarios related to the output gap and its impact on inflation dynamics.

The risk scenario considers the alternative domestic economic activity scenarios presented in the Central Bank's 3Q25 Monetary Policy Report that considers upbeat domestic demand reinforcing agents' expectations, hence adding an additional boost to spending, in a context in which nominal wages continue to grow above historical averages.

¹ Following Medel (2016), we address the simultaneity issue between inflation and expectations by estimating the model using Generalized Method of Moments (GMM), instrumenting expectations with their two lagged values. Consistent with Medel's findings, we observe no significant differences between the GMM and OLS estimates.

Each scenario differs in the intensity and persistence of inflationary pressures to assess potential paths for convergence. The first scenario simulates a positive shock to the output gap of around 0.9 and 1.2pp peaking between 4Q25 and 1Q26 and partially 2Q26. With this, 2025 and 2026 GDP growth would reach 2.9% and 2.4%, respectively (Itaú's forecast: 2.5% and 2.2%)². The second and third scenarios introduce a positive output gap shock in 4Q25 that decays at a constant rate. The second assumes a shock of 1.2pp (highest peak of the first risk scenario), and a decay consistent with an AR(1) process with a coefficient of 0.4, following the calibration used in the Central Bank's MSEP model. The third scenario uses the peak output gap increase from the first scenario but assumes a more persistent shock, with an AR(1) coefficient of 0.9. These scenarios help illustrate the sensitivity of inflation convergence to varying degrees of intensity and persistence of the economic activity shocks.

Output gap shocks



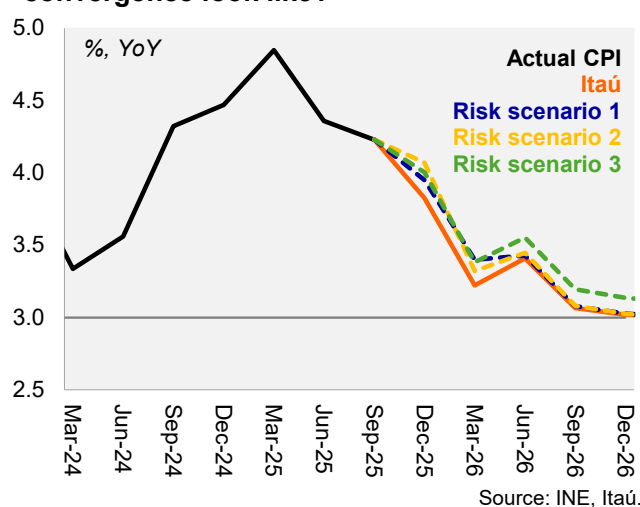
Source: BCCh, Itaú

The results reveal markedly different speeds of inflation convergence across the risk scenarios³. All scenarios show a downward trend in CPI, indicating a general expectation of inflation deceleration. However, the pace of convergence toward the target and the accumulated inflation resulting from each path differ. The graph and table below show how the convergence path and accumulated inflation from 3Q25 to 4Q26 would play out. First, Itaú's baseline scenario predicts that annual inflation would reach 3% around 2Q26. Risk Scenarios 1 (black) and 2 (blue) show a relatively slower decline, in line with the increase of the output gap. In these scenarios, inflation would still reach 3% in late 2026, but with a higher price level. Risk Scenario 3 (yellow) shows inflation not reaching the 3% goal by 2026 with the consequent higher accumulated inflation.

² The shock is calibrated to be consistent with the 70% bound of the GDP growth confidence interval published by the Central Bank in its September 2025 IPoM.

³ Is important to mention that we assume stand-alone shocks to cleanly isolate the Phillips curve mechanism.

What will the final stretch of inflation convergence look like?



Accumulated inflation 3Q25 - 4Q26

	%
Itaú baseline scenario	3.87%
Risk scenario 1	4.01%
Risk scenario 2	4.12%
Risk scenario 3	4.17%

The last mile of the disinflation process is in sight, yet uncertainty prevails. Our baseline forecast foresees inflation at 3.9% by end-2025, reaching the 3% target by 2Q26, supported by a stronger CLP, favorable base effects, and a balanced economy (see our inflation forecast table of October scenario below). However, our exercises suggest that risk scenarios in which the output gap drifts considerably higher could delay the disinflation process. The Central Bank's caution is warranted: aggressive easing could threaten credibility if inflation persistence endures, while excessive restraint could weigh on activity. We expect the policy rate to decline gradually to 4.5% by end-2025 and 4.25% by during 2026, contingent on the speed of convergence.

Itaú inflation forecast YoY

Quarter	%, eop
4Q25	3.82%
1Q26	3.22%
2Q26	3.41%
3Q26	3.07%
4Q26	3.00%

*Growth rate calculated as quarterly average

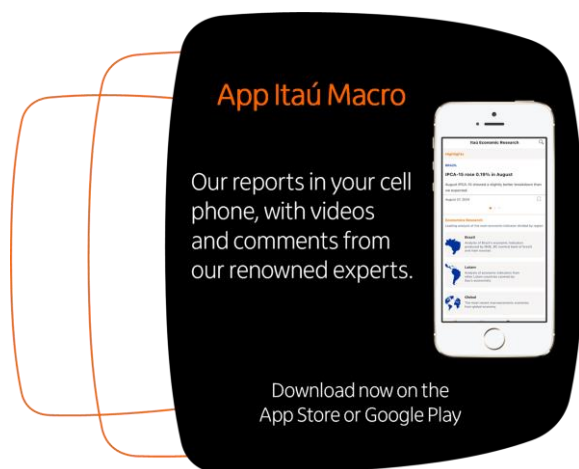
Andrés Pérez M.
 Marcus Cobb
 Andrea Tellechea Garcia
 Ignacio Martínez

Macro Research – Itaú

Mario Mesquita – Chief Economist

To access our reports and forecast visit our website:

<https://www.itaub.com.br/itaubba-pt/macroeconomic-analysis>



Relevant Information

1. This report has been prepared and released by the Macro Research Department of Itaú Unibanco S.A. ("Itaú Unibanco"). This report is not a product of the Equity Research Department of Itaú Unibanco or Itaú Corretora de Valores S.A. and shall not be construed as a research report ("relatório de análise") for the purposes of Article 1 of the CVM Instruction NR. 20, dated 2021.
2. The exclusive purpose of this report is to provide macroeconomics information and it does not constitute and shall not be construed as an offer to buy or sell or a solicitation of an offer to buy or sell any financial product, or to participate in any particular trading strategy in any jurisdiction. The information herein is believed to be reliable as of the date on which this report was released and it has been obtained from public sources believed to be reliable. However, Itaú Unibanco does not make any explicit or implied representation or warranty as to the completeness, reliability or accuracy of such information, nor does this report intend to be a complete statement or summary of the markets or developments referred to herein. Itaú Unibanco has no obligation whatsoever to update, modify or amend this report and inform the reader accordingly.
3. The opinions contained herein reflect exclusively the personal views of the analyst responsible for this report and were prepared independently and autonomously, including in relation to Itaú Unibanco, Itaú Corretora de Valores S.A. and any other companies within their economic group.
4. This report may not be reproduced or redistributed to any other person, in whole or in part, for any purpose, without the prior written consent of Itaú Unibanco. Additional information on the financial products mentioned in this report may be available upon request. Itaú Unibanco and/or any other company within its economic group is not and shall not be liable for any investment decisions (or otherwise) based on the information provided herein.
5. This report may include sections generated with the support of artificial intelligence tools. All content has been reviewed and validated by the authors to ensure the accuracy and integrity of the information presented.

Additional Note: This material does not take into consideration the objectives, financial situation or specific needs of any particular client. Clients must obtain financial, tax, legal, accounting, economic, credit and market advice on an individual basis, based on their personal characteristics and objectives, prior to making any decision based on the information contained herein. By accessing the material, you represent and confirm that you understand the risks related to the financial instruments described in this material and the laws in your jurisdiction relating to the provision and sale of financial service products. You acknowledge that this material contains proprietary information and you agree to keep this information confidential for your exclusive use.

SAC Itaú: For inquiries, suggestions, complaints, criticisms and compliments, talk to Itaú's CSCC: 0800 728 0728. Or contact us through our portal <https://www.itaub.com.br/atendimento-itaub-para-voce/>. If you are not satisfied with the proposed solution, please contact the Itaú Corporate Ombudsman: 0800 570 0011 (on weekdays from 9 AM to 6 PM) or our PO Box 67.600, São Paulo-SP, Zip Code 03162-971. Hearing impaired, every day, 24h, 0800 722 1722.