Macro scenario - Chile

April 12, 2024

Upside pressures

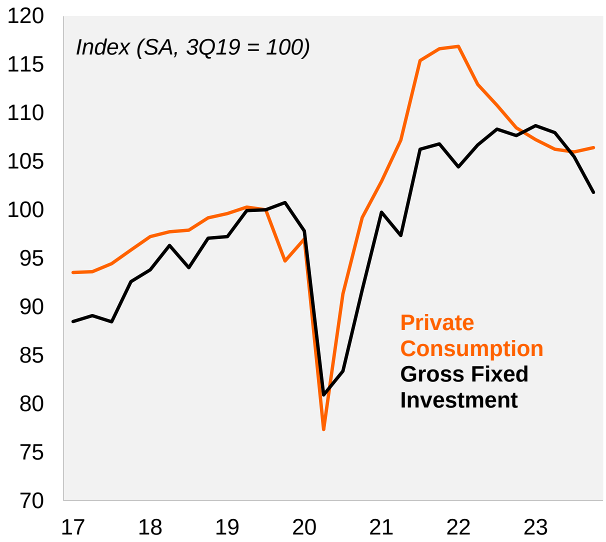
- The activity rebound this year will be lifted by private consumption, while mining production is set to improve. Revised national accounts and a better-than-expected start to the year have led us to upgrade our 2024 GDP growth call up by 70bps to 2.4% (0.2% in 2023). Higher growth is curtailed by upward revisions to our inflation, interest rates and CLP path. While we still believe the Chilean peso will remain under pressure in the short term due to narrowing interest rate differentials, the CLP should gradually appreciate from its current levels through our forecast horizon as monetary policy paths across the globe converge. Nevertheless, given the higher CLP path expected during the year, a large upside CPI surprise during 1Q24, and the incorporation of electricity price increases, we now see 2024 yearend inflation at 4.1% (0.6pp up from our previous scenario). Inflation above the target, and a more cautious Fed stance lead us to expect cuts of 50 and 25bps from here on until the policy rate reaches 5.25% (+50bps above our March scenario and above the 3.5-4.5% neutral range.

A swifter activity recovery

The monthly GDP proxy (IMACEC) increased 2.0% (SA) from December to January, and a further 0.8% to February (SA), leading to an average annual growth of 3.4% YoY. The annual rise was boosted by the leap-year effect (estimated at +1pp). Sequential gains have been widespread across sectors. IMACEC increased 4.3% qoq/saar (0.6% in 4Q), lifted by mining and the 4.4% non-mining rise (2.5% in 4Q) as commerce and services advance. Fiscal spending has also supported activity in the year. The central government's real expenditures rose by 15.1% YoY in February, rising materially for the second consecutive month (7.5% in January). Current expenditures rose by 9% YoY, primarily due to subsidies and donations, as well as base effects of state-financed pension payouts. Capital expenditures had a rise of 86.3% YoY, which were driven by 146.9% YoY increase in public investment and a 66.7% YoY rise in capital transfers to regions. In our view, the large expenditure increases reflect a payback from the lower spending of December 2023, which were an effort to comply with the 2023 fiscal targets amid low liquid assets. Expenditures in the year have increased by 11.2% YoY through February, well above the MoF's 2024 projected 5.6% YoY rise. Leading indicators continue to point to an activity recovery. Think-tank ICARE's business sentiment improved at the margin in March, rising for the third consecutive month, yet is still in pessimistic territory. Business confidence rose to 46.3 points (50 = neutral; 44.9 in February), with the non-mining index at 42.2 (40.8 in February). Imports of consumer goods are growing during 1Q (but capital goods imports are weak). Real bank credit's annual growth remained slightly positive for the second consecutive month in February, while upbeat sequential employment growth and rising wages have led to an improving real wage bill. The strong activity start to the year follows a better-than-expected 2023. Sequentially, the economy rose 0.1% from 3Q23 to 4Q23, building on the 0.8% increase in the previous quarter. As a result, the economy increased 0.2% YoY, above the -0.2% expectation derived from the monthly GDP proxy series.

The current account deficit (CAD) posted a significant adjustment last year as domestic demand fell by 4.2%. The 3.6% of GDP CAD in 2023 was well below the 8.7% seen in 2022, reflecting a more balanced economy and lower vulnerability to external shocks. During the year, the trade balance of goods was broadly stable from 2022, while the services deficit narrowed notably. The income deficit continued to tick up as copper prices remained elevated. The financing breakdown of the CAD continued to improve with the bulk derived from long-term FDI.

Consumption & investment dynamics diverge



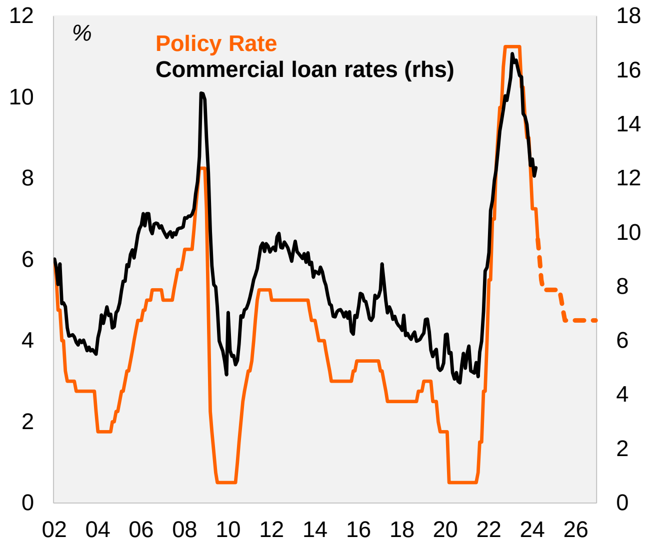
Source: BCCh, Itaú.

Inflation rebounding

Inflation last year was well below expectations but prints during 2024 surprised to the upside. Consumer prices increased by a whopping 0.7% from December to January (asset prices 0.35%) and a further 0.6% to February (asset prices 0.14%), before underwhelming with 0.4% (asset prices 0.6%) in March due to volatile food items. Tradable prices (0.9% MoM) drove headline inflation in January, while services were key drivers in February (0.9% MoM) and March (0.7%). Annual inflation of the spliced series sits at 3.7% (3.9% in 2023). At the margin, we estimate that inflation accumulated in the quarter was 5.2% (SA, annualized; from 3.2% in 4Q23). Meanwhile, core inflation reached 4.1% (SA, annualized, 2.6% in 4Q23). The CLP dynamics this year (roughly 8% depreciation YTD) will likely translate into further tradable price pressure in coming months, especially considering the new CPI basket gives goods greater weight. Meanwhile, sequential employment growth along with nominal wage growth that has averaged 7.1% YoY in the last quarter pose upside risks to service inflation dynamics.

The central bank reduced the pace of the easing cycle, while signaling a more gradual rate cut path ahead. Macro developments during the two-month break between the first two monetary policy meetings of 2024 led the BCCh to step down the pace of cuts from 100bps to 75bps. At the end of January, the central bank cut the policy rate by 100 bps to 7.25% and signaled that with inflation falling faster than expected (prior to the January and February prints), the board expected to fast-track the easing cycle explicitly stating that the policy rate would reach neutral (3.5%-4.5%) during 2H24. Along these lines, the Board assessed cuts that were even larger than 100 bps (up to 150bps) in January. However, the April IPoM incorporated the effects of large inflation surprises, the new CPI basket, the CLP's depreciation, revised national accounts, higher global costs, and the changing Fed scenario on the policy strategy. The BCCh's updated rate path still signals more rate cuts as the macroeconomic imbalances have corrected, but with a less aggressive signaling compared to January. The policy rate is seen averaging 5% in 4Q24, above the neutral range, and gradually falling during 2025.

Policy rate transmission unfolding



Source: BCCh, Itaú.

Challenging reform outlook

On the political front, reforms are progressing slowly. The Lower House Floor approved the administration's anti-tax evasion bill that plans on raising revenue by 1.5% of GDP per year once fully phased-in, according to the Ministry of Finance's estimates. The additional revenue would finance additional spending, rather than accelerate the fiscal consolidation process. While the government has yet to formally present a new tax reform to Congress, it has begun adjusting certain measures to look for support in the Lower House. The press reports that the Ministry of Finance would send a tax reform to Congress that would propose raising the marginal personal income tax rates for workers earning monthly wages starting at CLP4.5 million (roughly USD4,600), increasing the highest marginal tax rate from 40% to 43%, and reducing the income threshold to pay higher taxes. In contrast, experts and international organizations have called for a broadening of the base for personal income taxes. The opposition is calling for pro-growth measures, including lower taxes, expenditure reviews, and spending cuts. The administration still has a minority in the Lower House and the Senate, and hence its reform proposals are likely to face a challenging scenario.

Revising up

The activity rebound this year will be lifted by private consumption, while mining output is set to improve. Despite falling interest rates, investment is likely to remain weak as private sentiment is still downbeat, rates are still high, and policy uncertainty regarding the approval times associated to investment projects. Strong fiscal spending at the start of the year will likely need to be reeled in during the latter part of 2024 to meet fiscal targets. Revised national accounts and the swift activity start to the year have led us to revise our 2024 GDP growth call up by 70bps to 2.4% (0.2% in 2023). A larger upside revision is prevented by our higher inflation and interest rate paths. All in all, the volatility of monthly data will continue in March, given the rare occurrence of Easter unfolding during the month, followed by a favorable calendar effect in April.

The CLP depreciation has exceeded the weakening of peer currencies, driven by narrowing interest rate differentials. With the BCCh swiftly narrowing interest rate differentials with the U.S. by a total of 475-bps in this easing cycle, the currency has felt the pressure, which should filter through to consumer prices, even if demand-side pressures remain subdued. We expect the Chilean peso to gradually recover from its current levels as monetary policy paths across the globe converge later this year and in 2025. However, the expectation of fewer cuts by the Fed ahead led us to revise our CLP estimate to 850 by the end of 2025 (830 previously). In the short term we expect the CLP to remain under pressure. Given the CLP's higher average path (already filtering through to gasoline prices), large upside CPI surprises in 1Q24, greater growth, and the incorporation of electricity price adjustments, we now see inflation of 4.1% this year (0.6pp up from our previous scenario).

Smaller rate cuts expected ahead and a higher terminal rate for 2024. Inflation above the target, and a more cautious Fed stance led us to expect cuts of 50 and 25bps from here on until the policy rate reaches 5.25% (+50 bps from our previous scenario). As the Fed advances with the easing cycle next year, we see further cuts to 4.5% (the upper end of the 3.5-4.5% neutral range).

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Chile | Forecasts and Data

	2019	2020	2021	2022	2023	2024F		2025F	
						Current	Previous	Current	Previous
Economic Activity									
Real GDP growth - %	0.7	-6.1	11.3	2.1	0.2	**2.4**	1.7	**2.0**	2.2
Nominal GDP - USD bn	274	254	311	303	332	**315**	318	**355**	364
Population (millions)	19.1	19.5	19.7	19.8	20.0	**20.1**	20.1	**20.2**	20.2
Per Capita GDP - USD	14,329	13,068	15,810	15,294	16,617	**15,679**	15,826	**17,584**	17,995
Unemployment Rate - year avg	7.2	10.8	8.9	7.9	8.7	**8.6**	8.6	**8.4**	8.3
Inflation									
CPI - %	3.0	3.0	7.2	12.8	3.9	**4.1**	3.5	**3.1**	3.0
Interest Rate									
Monetary Policy Rate - eop - %	1.75	0.50	4.00	11.25	8.25	**5.25**	4.75	**4.50**	4.50
Balance of Payments									
CLP / USD - eop	753	711	851	851	879	**920**	890	**850**	830
Trade Balance - USD bn	3.0	18.9	10.5	3.8	15.5	**12.0**	9.0	**7.5**	6.5
Current Account - % GDP	-5.3	-1.9	-7.4	-8.6	-3.6	**-3.8**	-3.7	**-4.0**	-4.0
Foreign Direct Investment - % GDP	5.0	4.5	4.9	6.0	6.6	**5.7**	5.3	**5.1**	4.7
International Reserves - USD bn	40.7	39.2	51.3	39.2	46.3	**46.0**	46.0	**50.0**	50.0
Public Finances									
Nominal Balance - % GDP	-2.9	-7.3	-7.7	1.1	-2.4	**-2.3**	-2.3	**-2.0**	-2.0
Net Public Debt - % GDP	7.9	13.4	20.2	20.4	23.1	**24.5**	23.8	**26.0**	26.0

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

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