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## Latam Daily: BCCh Opts for Larger Cut, MPR Today

**CHILE: CENTRAL BANK CUTS BENCHMARK RATE BY 75BPS, TO 8.25%; MPR AT 7ET**

- **Back to the (minimum) necessary dose of cuts, but still behind the curve**

Yesterday, the Central Bank of Chile (BCCh) cut the benchmark rate by 75 bps, returning to the minimum required dose of rate cuts. The decision was in line with consensus and swap rates but above what was expected by surveys (Economics Expectations Survey and Financial Traders Survey).

Continuing to cut the benchmark rate by 75bps until the end of the first quarter of 2024 would eventually leave the real benchmark rate at a level similar to the current one. In this scenario, monetary policy would not be withdrawing the restriction, but rather maintaining it, which is misaligned with the weakness of domestic demand, the reduction of political uncertainty, the rapid inflationary convergence and the new external interest rate scenario.

We do not rule out an increase in the size of the rate cuts if our early warning of negative inflation in December is confirmed, followed by muted inflationary prints in January and February. This would be conditional on the Chilean peso (CLP) maintaining or adding to its recent strength as the BCCh has linked monetary policy to the evolution of the exchange rate.

External conditions have been less restrictive than expected and economic momentum abroad has fared better. In its statement, the BCCh acknowledges less tight financial conditions, including a relatively dovish message from the Fed, lower long-term international interest rates (-100bps), a global depreciation of the dollar (DXY almost 4%) and a drop in oil prices (close to 12%). All this would lead the BCCh to revise downwards its assumption for the Fed Funds Rate in 2024 (September IPoM: 4.9% average). At the same time, it highlights the better projections for GDP growth in China and the US, which would provide a greater boost from global growth.

For the BCCh, activity would be showing signs of stabilization and mixed signals within domestic demand, consumption with some recovery, but weak investment. On the labour market and expectations side, the diagnosis remains unchanged: weakness and pessimism. We agree with the BCCh and, along the same lines, we expect guidance of less restrictive monetary policy once inflation slips to 3% or below by the end of the first quarter. At that point, it will be difficult to lift inflation again without a monetary policy that places the benchmark rate much closer to its (new) neutral level, which will probably be reflected by the new corridor to be revealed in the December IPoM (due today, at 7ET).

It is worth noting the scarce reference to the exchange rate in this statement, which only states that “the peso has appreciated” and is a far cry from the concern shown in the previous meeting, when the peso depreciated. The truth is that the peso appreciated 8% since the previous meeting, being the currency that gained the most value among emerging countries and the fourth most appreciated worldwide. At the previous meeting, the BCCh showed extreme concern about the exchange rate level and its possible impact on inflation convergence, which materialized in a cut of only 50 bps (lower than market expectations) and the end of the international reserve accumulation program, among other measures. At that time, the RER stood at 106 points, precisely at the high end of the range estimated by the Central Bank as long-term. Today, our estimate for the spot RER is 97 points (base index 100=1996), close to the low end of the new equilibrium range revealed in the December 2022 IPoM (between 93 and 106 points). The above continues to evidence the strong link that the BCCh has established between monetary policy and the evolution of the exchange rate.

December 20, 2023

An important addition by the BCCh, that aligns to our view, comes in core inflation (ex-volatiles) that it now sees reaching 3% during the first half of 2024. Although in the November CPI we saw part of the exchange rate pass-through, for December we anticipate a partial reversal of those effects. Market prices anticipate a negative print for the current month and surveys assign a high probability to it, echoing our early estimate some weeks ago. According to our projection, reversals could be seen in those services highly influenced by the depreciation of the peso, in addition to the fact that the demand for goods (especially durable goods) remains depressed, so that those emblematic imported products would show further declines in their prices in the face of the recent appreciation. At Scotiabank, we maintain our inflation projection at or below 3% in the first part of 2023.

We expect the upward revision in the neutral interest rate to be between 25 and 50 bps in the December IPoM. This revision corresponds to a process that the Central Bank performs once a year and that was announced a few weeks ago by the Board. Our estimate is that the estimated level of 3.75% (between 3.5 and 4%) will again reflect the increase in neutral rates observed in other economies. With this, the neutral benchmark rate would increase to a level between 4 and 4.25%, which will very slightly raise the rate projected by the Central Bank for the end of 2025, a scenario that we incorporated in Scotiabank some weeks ago.

With this cut, the real benchmark rate remains one of the highest (and most contractionary) in the world. Our estimate for the December (ex-post) real rate is 3.75%, one of the five highest in the world. In fact, if compared to the neutral real rate, Chile is almost 4 times above that level, which keeps it as the most contractionary in Latin America and one of the most contractionary worldwide.

—Jorge Selaive, Aníbal Alarcón & Waldo Riveras

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