Contributors

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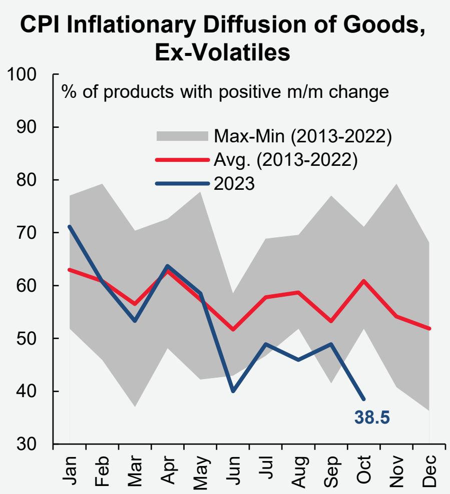
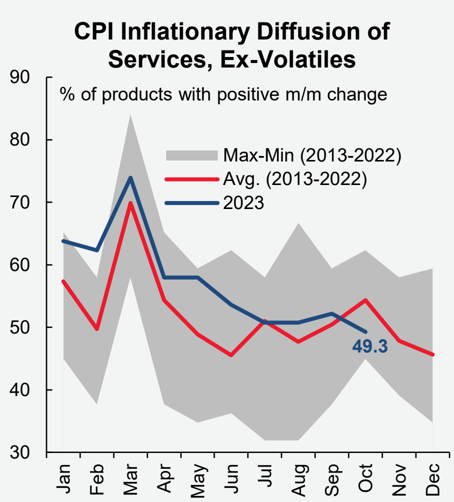
Chart 1



Sources: Scotiabank Economics, INE.

Chart 2



Sources: Scotiabank Economics, INE.

Chile—October CPI of 0.4% m/m (5% y/y) with Diffusion at Record Lows

- **Annual inflation decelerates faster than expected by the central bank and consensus: four products explain 90% of the monthly rise. Some of them could see price reversals in the near term.**
- **November CPI is expected to be around 0% m/m. We reaffirm our inflation projection of 3.7% y/y in December, reaching sub-3% in March 2024. Watch out for the new CPI basket base 2023=100.**
- **After the November CPI data, we expect the BCCh to resume rate decreases at a pace of no less than 75 bps.**

This morning, the statistical agency (INE) released October CPI data, showing a prices rise of 0.4% m/m, surprising the most inflationary expectations that anticipated a generalized exchange rate pass-through. In our view, this did not occur for two reasons. (1) the exchange rate pass-through is asymmetric to the economic cycle not to its direction, as the central bank (BCCh) highlighted and which explained the delay in the process of rate cuts, consequently placing Chile's rate among the highest in the world. Excess inventories in commerce and the weakness of the labour market have been sufficient to contain exchange rate pass-throughs. (2) A large part of the depreciation of the CLP has been bilateral with respect to the dollar. That is to say, the CLP has not depreciated sharply with respect to its other trading partners, which implies exchange rate pass-throughs of no more than 10%.

The inflation reading of 0.4% m/m in October (5.0% y/y) is exclusively explained by increases in volatile products, especially food and energy, since inflation ex-volatiles had a 0.0% monthly variation. As a result, inflation ex-volatiles decelerated again in y/y terms, standing at 6.5%. In fact, only four products explained 90% of the m/m inflation increase: gasoline, tourism packages, wine, and soft drinks. The increases in tourism packages and gasoline are mainly explained by the depreciation of the CLP, which should reverse in the coming months.

The inflationary diffusion of the total CPI stood at 43.9% (the share of goods with m/m price increases), the lowest value for an October reading on record (at least since 2009), showing that the downward adjustment of inflation is still strong and is even accentuated at the margin, especially at the level of the core basket. The low level of the indicator is due not only to the low diffusion of goods (38.5%), which also recorded its minimum for the month, but also to the fact that the diffusion of services (49.3%) was at the low end of its range for the first time this year (charts 1 and 2).

Some considerations for monetary policy:

- The exchange rate pass-through of the recent CLP depreciation is very low and limited to some specific products, such as tourism packages and fuels. Contrary to the BCCh's estimates, the exchange rate pass-through is not being asymmetric with respect to the ups and downs of the exchange rate, but rather the asymmetry is due to the cyclical phase of the economy. CLP depreciations are less inflationary at times of weak domestic demand, while peso appreciations put more downward pressure on prices at times of economic weakness.
- The central bank projected inflation of 4.3% y/y for December, which would be achieved by accumulating 0.6 ppts of inflation between November and December. The BCCh acknowledged a surprise in the August CPI and, certainly, this October CPI should be a surprise for its base projections. Moreover, history shows us that between 2014 and 2020, CPI has not accumulated more than 0.2 ppts in both months.

- Regarding the CPI ex-volatiles, the BCCh projected inflation of 6.3% y/y for December, which would be achieved by accumulating 1.1 ppts of inflation between November and December. As in the case of the total CPI, history shows us that between 2013 and 2020, both months have not accumulated inflation above 0.3 ppts.
- Inflation would return to the 3% target (or below) in March 2024. March monthly inflation will also be lower thanks to the new CPI basket. As we pointed out in a previous note regarding the new CPI basket base 2023=100, the March CPI could show a lower incidence of the Education division given the lower participation (of at least 2.5 ppts) in the expenditure captured by the Household Budget Survey, which should be reflected in the new CPI (effect of the free university education). This is important given that historically about 70% of the March CPI is explained by Education.
- We raise the risk of negative inflation in November and/or December. Some emblematic volatile products that injected inflation in the last couple of months are likely to subtract inflation in the last part of the year (gasoline, some vegetables and tourist package). Additionally, the price of new automobiles could resume declines in November considering the low level of sales and the discounts applied to all events in the last few days.