LATIN AMERICA ECONOMICS UPDATE

Chile's central bank paves the way for July rate cut

- **The *Monetary Policy Report* released by Chile's central bank today alongside the communications to yesterday's policy meeting have reinforced our view that the easing cycle will commence in July. We expect a cumulative of 200bp of cuts, to 9.25%, this year. But the central bank's surprisingly dovish tone means that the risks to our forecasts, in the near-term, are skewed towards more aggressive easing.**
- At its meeting yesterday, Chile's central bank (BCCh) kept its policy rate unchanged at 11.25% for a fifth consecutive meeting as expected. **But, in contrast to previous – very hawkish – communications, there was a significant dovish shift this time.**
- For one thing, while the central bank's decision to keep rates on hold at its last meeting in May was unanimous, this time two of the five Board members surprisingly voted for a 50bp *cut*. Apart from Stephany Griffith-Jones, who has tended to be a dove, Vice-Governor Pablo García voted for a cut too. García appears to be one of the more hawkish members of the MPC. He was the only member who voted for a *larger* 125bp hike at the central bank's meeting last September (when rates were raised by 100bp).
- **There was also a substantial change in the language in the accompanying statement.** The central bank highlighted that two-year ahead inflation expectations had fallen to 3% (the mid-point of its inflation target range) and that inflationary risks "have been balancing out". Policymakers also stated that the adjustment process was going "in the required direction", which, if continued, would pave the way for a "downward process [in the policy rate] in the short term".
- This view was also reflected in the quarterly *Monetary Policy Report* released today. The end-2023 inflation forecast was lowered to 4.2% (from 4.6% in the previous report, published in March). And the central bank's latest interest rate corridor – which is used as forward guidance – is now consistent with a more aggressive loosening cycle compared to the guidance given in the March report.
- It's not surprising that the tone in Chile has started to shift. After all, interest rates were hiked aggressively (and well into restrictive territory) and with the economy showing clear signs of adjusting, balance of payments risks easing and inflation falling (see Chart 1), we had been expecting Chile's central bank to be one of the first EM (and Latin American) central banks to start easing monetary policy in early Q3.
- **Policymakers' latest communications have reinforced our view that the first cut will come in July, but the surprisingly dovish tone has prompted us to pencil in a larger initial cut (of 50bp compared to 25bp previously)**. We are sticking with view that the policy rate will be lowered to 9.25% by the end of this year (see Chart 2), although risks are tilted towards more aggressive easing this year than we currently anticipate. That all being said, with inflation set to only fall back within the central bank's target range around Q2 next year, policy is likely to remain in restrictive territory for some time to come.

Chart 1: Consumer Prices (% y/y)

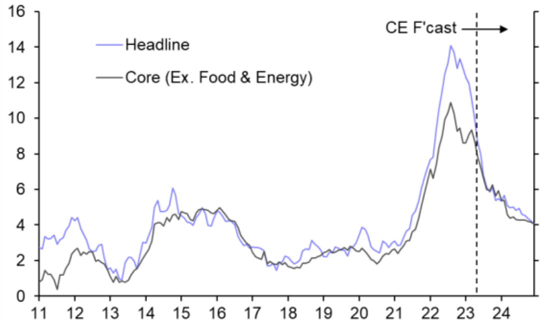
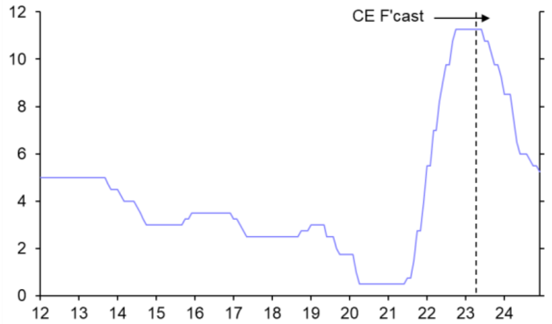


Chart 2: Policy Rate (%)



Sources: Refinitiv, Central Bank of Chile, Capital Economics

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