LATIN AMERICA ECONOMICS UPDATE

Chile's central bank tries to rein in rate cut bets

- **The more cautious tone of the *Monetary Policy Report* released by Chile's central bank today supports our view that, once the large falls in inflation are behind us in early 2024 and the economy recovers, the easing cycle is likely to shift down a gear. We think that the policy rate will be lowered to 5.25% next year, which is less easing than the consensus and markets expect.**
- At its meeting yesterday, Chile's central bank (BCCh) slowed the pace of easing with a 75bp rate cut (to 9.50%), a smaller move than the 100bp cut delivered in July that marked the start of the easing cycle. It seems like, having surprised the markets with a larger-than-expected cut in July, which led to a marked downward shift in market expectations for the path for interest rates, the central bank wanted to avoid sending an overly dovish message at this meeting.
- **Indeed, the language in the accompanying statement sounded more cautious.** Policymakers highlighted the recent fall in the peso – the currency is down by around 5% against the dollar since the last meeting. And, in contrast to July's statement which stated that inflation had "fallen faster than forecast", the communications to yesterday's meeting flagged that headline and core inflation "remain at high levels".
- **This view was also reflected in the quarterly *Monetary Policy Report* released today**. While inflation projections remained broadly unchanged, the *Report* flagged that services inflation has "fallen more slowly" and that it expects the easing in services inflation to "be slow due to the impact of the indexation processes of salaries and rates".
- **To be clear, this does not mean that the central bank won't continue to ease monetary policy.** In fact, policymakers gave clear forward guidance that the policy rate will be lowered to 7.75%-8.00% by the end of this year. We think that two more 75bp cuts at each of the remaining meetings this year, to 8.00%, are most likely.
- **That said, the overall tone of the central bank's communications suggest that investors and the analyst consensus may have got ahead of themselves in expecting aggressive monetary easing to continue well into next year.**
- We think that, by early 2024 the large falls in inflation will have happened and the disinflation is likely to enter a slower phase. (See Chart 1.) This, alongside a rebound in the economy, are likely to prompt the central bank to slow the pace of easing in 2024. **Overall, we expect a cumulative of 275bp of cuts, taking the policy rate to 5.25% next year.** This still implies more aggressive monetary easing than in most other EMs, but it's a bit less easing than most other analysts expect and that is implied by market pricing.

Chart 1: Consumer Prices (% y/y)

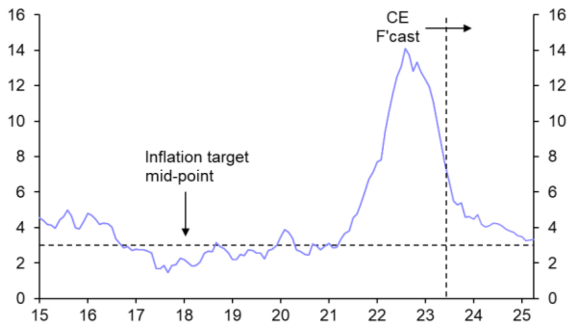
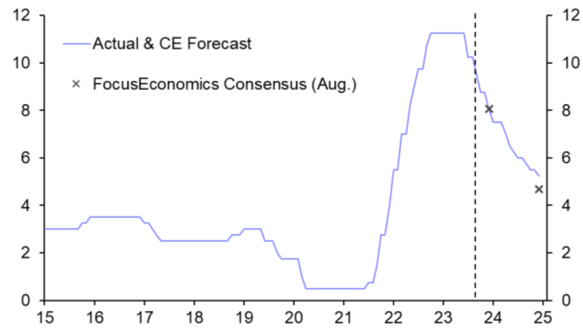


Chart 2: Policy Rate (%)



Sources: Refinitiv, Central Bank of Chile, Capital Economics

Kimberley Sperrfechter, Latin America Economist, kimberley.sperrfechter@capitaleconomics.com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