Chile Central Bank Review: August 2021

Links:

September monetary policy report: https://www.bcentral.cl/en/web/banco-central/areas/monetary-politics/monetary-policy-report-ipom

MNI Point of View: BCCh takes the hawkish route

The Chilean central bank took the hawkish route at Tuesday's rate decision, hiking rates by 75bps to 1.50% from 0.75% previously. The bank's statement flagged that economic growth and consumption has strengthened, implying faster pipeline inflation. The larger-than-expected rate hike is likely a one-off to get ahead of any de-anchoring of inflation expectations and may not signal the start of a tightening cycle comprised of several rate hikes of the same magnitude.

In the unanimous decision, the board cited fuel prices, 'extraordinary' dynamism in consumption, the soon-to-turn positive output gap and liquidity injections as fuelling inflation - a sign that many on the sell-side have interpreted as leading to a faster tightening cycle in Chile.

The day following the decision, Chile released their September Monetary Policy Report, detailing more of the thinking behind the Tuesday rate decision. In the release, the bank upgraded their GDP and inflation forecasts for 2021, with markets focussing on the sizeable upgrade to 2021 inflation projections.

The BCCh now see year-end GDP growth of 10.5-11.5%, slowing to 1.5-2.5% in 2022 and 1.0-2.0% in 2023. This is a sizeable upgrade from the last report, with the BCCh pinning the upward revision on private consumption growth (seen rising 18% Y/Y) and a larger contribution from government spending, with associated health expenses feeding directly into growth.

These assumptions feed directly into the bank's inflation forecasts, which are upgraded to 5.7% at year-end, up from the 4.4% forecast made in June. This is close to double the bank's mandate and will likely have been a key catalyst behind the decision to hike rates at a more expedited pace this month. The Bank see higher private consumption as making a 0.5ppt contribution to the forecast upgrade, but notably FX passthrough is a key contributor, making up 0.4ppts of the upgrade.

Nonetheless, the bank's quarterly forecasts suggest the bank board see pressures on consumption, inflation and growth as temporary and driven by exogenous factors. The most notable being the "strong dynamism of consumption" driven by pension withdrawals, currency weakness and government spending. The BCCh see this effects fading through the end of 2021 and into 2022, thereby moderating inflation and bring price levels back toward target. This suggests that August's 75bps hike is a strong start to the tightening cycle, but the pace of rate rises may not be maintained going forward, with 25bps – and possibly 50bps – hikes more likely at upcoming meetings.

Analyst Views (Alphabetical Order)

Goldman Sachs: Strong commitment to guide inflation back to target

- Goldman Sachs see the bank as sending a strong signal of its commitment to guide inflation to the target and anchor inflation expectations. The MPC have now reduced the risk of having to deliver an interest rate shock later on to re-anchor inflation to the target.
- The forward guidance suggests additional rate hikes to come, with economic fundamentals reducing the need for accommodative monetary policy. The unsettled political and policy backdrop and loose fiscal policy also supports a conservative calibration of monetary policy. GS now expect the policy rate to reach 2.75% by end-2021, and further up to 4.00%-4.25% by end-2022, i.e., modestly above-neutral.

JPMorgan: The message is clear – BCCh will not fall behind

- The move was more aggressive than they'd expected, with the message clear: the BCCh will not fall behind the curve against a lack of fiscal anchor and risk of additional pension fund withdrawals.
- The decision breaks the dovish aura at recent decisions, and JPM await today's policy report before fine tuning their base case. They see the policy rate reaching 3.50% by H2 2022.

Scotiabank: No adjustments of this magnitude likely in October

- Scotiabank's preliminary assessment is that no adjustments of this magnitude will come in October, especially if we have a reduction in inflationary expectations and should Congress reject the 4th withdrawal of pension funds.
- - Their view is that the BCCH would be concerned about an inflationary acceleration due to the permanence of high logistics costs, the absence of disinflationary pressures from the exchange rate and the increase in gasoline prices.
- - They consider this 75bps rise as a sharp, decisive signal to appease short- and medium-term inflationary expectations that were markedly above historical averages. If this objective is achieved, they expect the Central Bank to reduce the intensity of the withdrawal of the monetary stimulus, with an increase of 50 bp at the October meeting and a further 25 bp in the December meeting, which would leave the MPR at 2.25% by December 2021. The normalization path would reduce its intensity over 2022.

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