MNI Chile Central Bank Preview: May 2022

Monetary policy decision and release of statement: 2300BST/1800ET - Thursday, May 05, 2022.

MNI Point of View: Pace of Hikes to Slow

The BCCh are widely expected to continue their tightening cycle at the May meeting, albeit with a smaller hike relative to the last meeting. Consensus points toward the monetary policy committee hiking the overnight rate by 100bps to 8.00%. However, opposing forces of more dovish prior rhetoric and accelerating inflation dynamics indicate a wider range of potential outcomes for the May meeting.

President Costa Notes March Inflation Surprise

At the March meeting, the BCCh delivered a below-consensus hike of 150bps and clearly signalled that there would be a reduction in the pace of future hikes. The messaging was clearly dovish relative to market expectations prompting a dramatic relief rally in the front end of the Camara swaps curve.

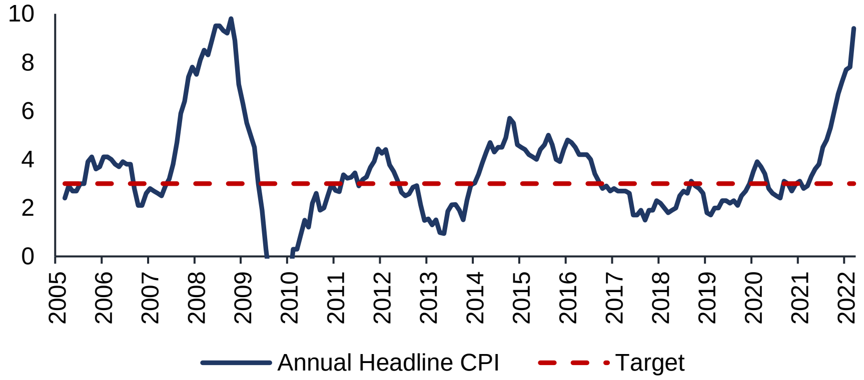
The relatively dovish rhetoric seemed to be confirmed by President Costa following the decision, as she reiterated that inflation would keep on increasing over the next few months before CPI starts a downward trend in the second half of the year. However, following the release of the March CPI figures, President Costa described the data as a 'significant surprise' and that the BCCh would be analysing the figures with caution.

Annual headline CPI Approaches Double Digits

March CPI printed 1.9% M/m prompting the annual rate to surge to 9.4%, ahead of the median expectation of 8.7% Y/y. Data for April will not be released until May 06, however, early estimates point toward the yearly reading for consumer prices breaching 10.00%.

Additionally, in the latest central bank survey of economists, 2022 year-end inflation forecasts were revised up to 7.8% from 5.8%. Furthermore, 2023 year-end predictions rose to 4.2% from 4.0%, highlighting the continued contamination of medium-term expectations. While inflationary pressures add credence to the BCCh maintaining their 150bp tightening pace, both the latest BCCh economist and traders surveys expect rates to be raised by 100bp to 8.00% on Thursday.

Figure 1: Headline Annual CPI Rises To 9.4% Y/y



Source: MNI/Bloomberg

Analysts Remain Divided Over Decision and Terminal Rate Predictions

While the median expectation sits in line with these BCCh survey estimates for a 100bp hike, the large survey range points toward disagreement among sell side forecasters. Barclays point out that recent growth figures (March economic activity: +7.2% y/y vs. Exp. +6.2%) support a not so steep reduction of the pace of hikes. Indeed, SocGen believe the possibility remains substantial that the central bank maintains its recent pace of tightening in May amid worsening inflation expectations and the bank now sees scope for a higher terminal rate of 9.5%.

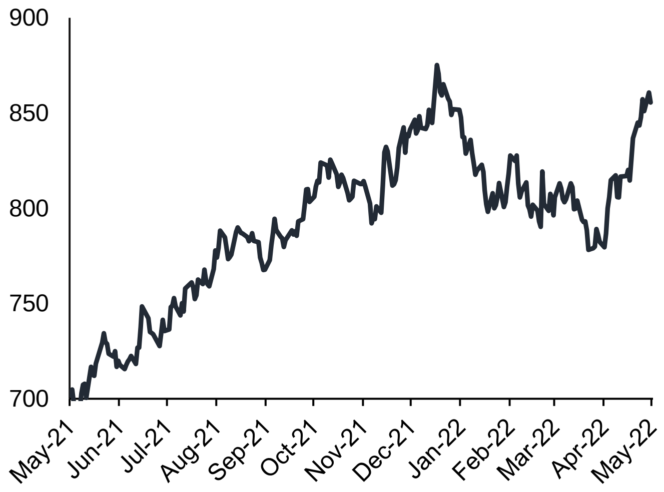
CLP Weakness May Add Pressure On Committee

Over recent weeks, the Chilean peso has come under renewed pressure amid waning risk sentiment across global markets, a more hawkish Fed and renewed domestic uncertainty. The ongoing constitutional re-write continues to act as a strong headwind for the local currency, with additional pressures stemming from the rapid decline of the newly elected President's approval rating.

Figure 2: Boric's net approval slides alongside waning consumer confidence

Source: Morning Consult

Figure 3: USDCLP Sharp Move Higher Since March



Source: MNI/Bloomberg

While the currency depreciation adds pressure to the BCCh, a hawkish surprise may only offer a short-term reprieve for CLP as the nation marches toward the September 4 deadline. It's then that the new constitution is due to be put to a referendum. On the other hand, further relative dovishness could exacerbate the renewed upward trajectory for USDCLP.

Technically, USDCLP maintains a firmer tone. Recent gains resulted in a break of resistance at 823.72, Apr 11 high, and this confirmed an extension of the current bull cycle that started Mar 29. Potential is seen for a climb above the 860.00 handle, which has been probed, to open 876.15, the Dec 20 high. Firm support has been defined at 799.53, the Apr 13 low. Initial support lies at 823.72.

Central Bank Watch - Chile

MNI Chile Data Watch List											
Inflation		**Current**	**3m ago**	**3m Chg**	**6m ago**	**6m Chg**	**2Y History**	**Hit / Miss**	**Vs Trend**	**Surprise Index**	**Z-Score**
CPI	% m/m	1.9	0.8	↑	1.2	↑					2.76
CPI	% y/y	9.4	7.2	↑	5.3	↑					1.70
Oil Price (WTI Active)	$	103.23	83.85	↑	75.42	↑					1.56
Economic Activity		**Current**	**3m ago**	**3m Chg**	**6m ago**	**6m Chg**	**2Y History**	**Hit / Miss**	**Vs Trend**	**Surprise Index**	**Z-Score**
Manufacturing Production	% y/y	3.3	2.3	↑	4.6	↓					0.25
GDP	% y/y	12.0	0.0	↑	-14.7	↑					0.74
Industrial Man Prod	% y/y	0.9	1.7	↓	-0.6	↑					0.00
Economic Activity	% y/y	7.20	10.12	↓	14.75	↓					-1.10
Trade Analysis		**Current**	**3m ago**	**3m Chg**	**6m ago**	**6m Chg**	**2Y History**	**Hit / Miss**	**Vs Trend**	**Surprise Index**	**Z-Score**
Trade Balance	$ (M)	1263.9	416.9	↑	286.9	↑					0.09
Exports Total	$ (M)	9481.4	8984.3	↑	7619.6	↑					1.75
Copper Exports	$ (M)	4945.8	4931.4	↑	4345.7	↑					1.00
Consumer / Labour Market		**Current**	**3m ago**	**3m Chg**	**6m ago**	**6m Chg**	**2Y History**	**Hit / Miss**	**Vs Trend**	**Surprise Index**	**Z-Score**
Retail Sales	% y/y	11.2	14.2	↓	19.3	↓					0.28
ICME Business Confidence	Index	47.5	53.4	↓	58.2	↓					-0.81
Unemployment Rate	%	7.8	7.2	↑	8.4	↓					0.03
Nominal Wage Increase	% y/y	7.7	5.9	↑	6.4	↑					1.48
Markets		**Current**	**3m ago**	**3m Chg**	**6m ago**	**6m Chg**	**2Y History**	**Hit / Miss**	**Vs Trend**	**Surprise Index**	**Z-Score**
IPSA Index	Index	4,776	4,548	↑	4,092	↑					1.05
Local 10-Year Swap Rate	%	6.29	5.54	↑	5.60	↑					1.80

Note: For quarterly data the 3m ago column will display the previous data point and the 6m ago column will display the data point prior to that.
Source: MNI, Bloomberg

Analyst Views (Alphabetical Order)

The median expectation is for the BCCh to raise rates by 100bps to 8.00% with 9/13 analysts forecasting this scenario. From the Bloomberg survey, three analysts expect less aggressive action, with two calling for a 50bp hike and one for a 75bp increase. One surveyed analyst, combined with a preview included below are both expecting the BCCh to maintain their most recent 150bp hiking pace on Thursday.

Barclays: BCCh Getting Closer To The ‘Terminal Rate’ Of 8.5%, Likely To Be Achieved In June

- Barclays expect Chile to continue to hike but at a lower pace. They now expect the pace to be lower than the 125bp they expected previously and vis-à-vis what the central bank has done in the past two meetings (+150bp in January and March).
- Barclays call is for the BCCh to lift the reference rate by 100bp to 8%, along the same lines as analysts’ consensus.
- Inflation has continued to surprise on the upside, but we will not know the next CPI figure until next week on Friday, a day after the meeting. As a result, Barclays are basing their monetary policy meeting forecast on central bank communication, including the recent comments by two board members that participated in various events within the IMF/WB Spring meetings that took place last week in Washington DC.
  In this context, while they highlighted their inflationary concerns, in Barclays view, they emphasized four issues that favour a less ‘hawkish’ stance looking forward:
- (1) The tightening that the central bank has already conducted in this cycle (+650bp); (2) recent slowdown of economic activity; (3) more stringent financial conditions due to the past pension fund withdrawals, with more money in banks, rather than financial markets, with a lower duration and higher cost of funds; and (4) the fact that the recent initiative for a sixth pension funds withdrawal was rejected.
- All in all, considering these growth and financial tightening circumstances, Barclays continue to believe that the BCCh is getting closer to the so-called ‘terminal rate’ of 8.5%, which will probably be achieved in June.

- This week, a Commission in the Constitutional Assembly voted to approve the full-fledged autonomy of the central bank. They also approved three relevant changes: (1) The board will now have seven members, instead of five; (2) the term of the chairman will last three years, instead of five; and (3) the board will have to incorporate financial stability, foreign exchange volatility, employment conditions and environmental criteria as foundations in their decision making process, although not as part of the central bank targets or responsibilities.
- This still has to face a plenary vote, but in Barclays' view, is good news in terms of the much needed institutional strength of the central bank.

Goldman Sachs: MPC To Drive Policy Rate To 8.50% In 2022 With No Cuts During The Year

- In general, inflation remains high, and prints have continued to surprise to the upside (e.g., the 1.9% mom in March was above the central bank's forecast in the March IPoM) with upward pressures from both demand (the output gap remains positive) and costs (high commodity prices, high producer prices (24.9% yoy) and significant nominal wage growth (7.7% yoy)).
- In addition, in Goldman Sachs' assessment, the deteriorating inflation expectations, the somewhat uncertain policy environment due to the ongoing drafting of a new constitution, and a more hawkish Fed all support the case for the MPC to drive the policy rate towards a more restrictive stance.
- All in all, GS expect the MPC to hike the policy rate by 100bp to 8.00%.
- The March IPoM confirmed the central bank's dovish tone following the March meeting. The report showed that if the economy's trajectory conforms to the baseline scenario (1% to 2% growth in 2022, and inflation approaching 10% in Q2-Q3, but moderating visibly during 4Q2022 to end 2022 at 5.6%), future increases in the monetary policy rate would be smaller than those made in recent quarters. Furthermore, the mid-point level of the policy rate corridor contained in the March IPoM peaks at 7.53% in 3Q2022 (period average) and declines after that, suggesting that the MPC expected to begin to cut rates by the end of this year.
- Overall, GS view the 5.6% end-2022 forecast for headline inflation following the report as optimistic, and the very high and higher-than-expected 1.9% M/m March inflation print reaffirmed this view.
- Goldman Sachs expect inflation to peak close to 10.8% and end 2022 at 7.9% Y/y. Besides, GS expect monetary policy to remain restrictive over the relevant policy horizon, with the MPC driving the monetary policy rate further up in 2022 to 8.50% with no cuts during the year.

LarrainVial: BCCh To Hike Its Key Rate By 150bps To 8.5%

- Bloomberg reported that the head of research at LarrainVial expects Chile's central bank to hike its key rate by 150bps to 8.5% this week, more than expected by most analysts.
- BCCh may pause its cycle of rate hikes in June if domestic demand shows signs of slowing in May.
- MPR at 8.5% could make it attractive for consumers to leave their money in deposit accounts, which would help to reduce the liquidity available for spending
- A substantial drop in domestic demand this year should rein in inflation in 2023. Domestic demand to contract 3% in 2023, GDP should contract 0.6% that year.
- Q1 marked the inflection point between the deterioration and the recovery of fiscal accounts. Chile's fiscal deficit should narrow to 2% of GDP in 2022 from 7.6% in 2021. A lower fiscal deficit in 2022 should allow govt to deploy countercyclical policies in 2023 to face GDP contraction.
- Central bank should cut its policy rate to ~2.5% next year.
- They expect the Chilean peso to continue depreciating, potentially reaching ~900/USD by the end of the year. Long-term bond yields are close to peaking; BTP-2030 yield shouldn't breach 7.0%.

RBC: CLP Back At Pre-Dec Election Levels Means BCCh Must Be More Careful With Messaging

- This week we expect the BCCh to hike rates by 100bps to 8%, signaling a more gradual normalization of rates moving forward as they move into restrictive territory.
- The previous monetary policy message was a more cautious approach as domestic demand softens and they don't foresee increasing pressure on price formation.

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- With currency back to the pre-Dec election levels the CB will have to be more careful with the message this week.
- Despite the fact that current levels are looking attractive to sell USDCLP, RBC prefer to remain on the sidelines waiting for 1/ Hacienda to resume the dollar selling operations and/or 2/ more clarity around the 5th pension fund withdrawal.

Scotiabank: BCCh Could Move Faster After Upward Surprise In March Inflation

- March CPI data surprised upward both market expectations and Scotiabank forecasts. The CPI increased 1.9% m/m (9.4% y/y), reflecting a general increase in prices across volatile items, such as food and energy as well as at the core level.
- The March outcome, which we consider may be a “one-off” surprise to the central bank’s baseline scenario, could motivate the BCCh to accelerate the pace at which it moves the monetary policy rate to the centre of its desired policy rate corridor. This would allow the BCCh to wait for more information and possible changes to its forward guidance at the June meeting.
- Accordingly, Scotiabank have revised up their expectation of the monetary policy rate hike in May, from 25 bps to 50 bps. At the same time, they now consider the March Monetary Policy Report projection of annual inflation of 5.6% out of range, while Scotiabank forecast of 6.6% is more likely.
- They expect the benchmark rate will not exceed 7.50% in this tightening cycle, with rate cuts beginning in December 2022.

SocGen: High Possibility Of Interest Rates Peaking At 9.5% In 3Q22

- At its last policy meeting, the central bank forward guidance suggested it was prepared to reduce the pace of tightening in the next meeting, and accordingly SocGen expect BCCh to raise the overnight rate by 100bp to 8.0% in May.
- With headline and core inflation at 9.4% yoy and 7.6% respectively in March, and the near- and medium-term inflation expectations deteriorating further, the possibility remains substantial that the central bank maintains its recent pace of tightening in May (i.e., raising rates by 150bp) followed by moderation in the next meeting.
- Inflation is likely to stay around current levels in the coming month while core inflation will rise further before moderating in 2H22 onwards. Consumption demand and the economy have begun to slow, as the impact of withdrawals from pension funds is fading and the high inflation affects demand.
- However, with the inflation outlook nowhere close to BCCh’s target (3.0%, +/- 1.0pp), growth will not enter the central bank’s monetary policy calculations anytime soon.
- SocGen see a substantial possibility of rate hikes being implemented in 3Q22 (with some upside risk of the tightening cycle getting extended into 4Q22). The overnight rate is more likely to peak around 9.5% (in 3Q22) vs their earlier forecast of 8.5%.

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