BCCh Review: May 2022

Executive Summary:

- **BCCh surprise markets, raising rates by 125bps vs. Exp. Hike of 100bps**
- **Statement shows a board clearly concerned with external inflation environment**
- **Hawkish statement puts policy closer to bank's 'worst case' scenario**

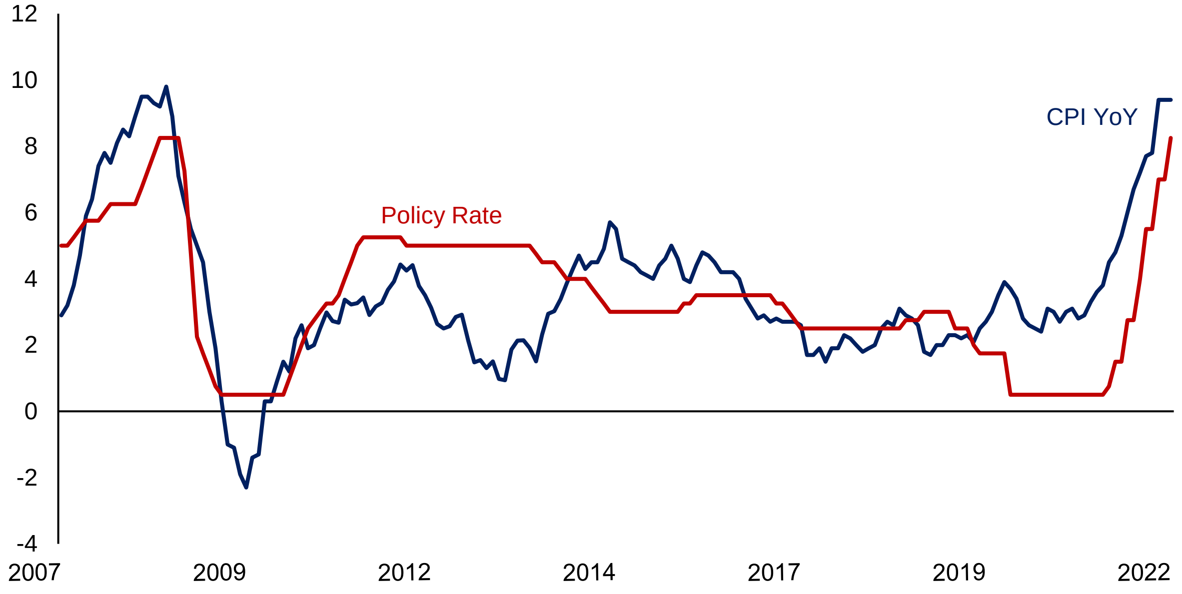
Policy statement here: **https://www.bcentral.cl/en/content/-/details/monetary-policy-meeting-may-2022**

MNI Point of View

The BCCh took markets by surprise in May, raising rates by 125bps against expectations for a 100bps rate rise. This ran against markets primed for the BCCh to slow the pace of tightening more aggressively and extends the bank's tightening cycle to a total of 775bps. The accompanying statement showed a board that remains of the view that the inflation outlook is a cause for concern, and that view has intensified since the prior meeting. As such, additional rate rises later this year are likely, and this week's more activist approach could prompt markets to revise higher their terminal rate forecasts.

The external inflation environment is clearly a concern among the board, and a major driver behind the bank's decision to go for an above-consensus hike this month. The vote itself was unanimous, citing pressure on global supply chains, confinements in China and the persistent uncertainty surrounding the Russian invasion of Ukraine.

Figure 1: BCCh tightening now totals 775bps



Source: MNI/Bloomberg

The board retained their strong language on domestic economic conditions, stressing that inflation in March was "significantly" higher than assumed, with currency weakness, energy prices and hampered supply chains driving the price rises. As such, inflation expectations remain above 3% across the two-year time horizon, keeping the onus on the board to tighten policy further.

This week's policy move puts rates near their previous 'worse case' scenario of 8.50% - meaning markets may be forced to reprice expectations for the terminal rate further ahead of the early June monetary policy report.

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Analyst Views (Alphabetical Order)

Morgan Stanley: A Hawkish U-Turn

- The decision surprised consensus and ourselves (both expecting +100bp) and underscores that policymakers' attempt to execute a dovish shift – per the latest IPoM and the latest decision's outcome – is over.
- The front-loading work done so far amounts to 775bp of hikes since July 2021, the strongest tightening cycle in Chile's monetary policy history. Accompanying this, the statement was decidedly hawkish. Policymakers flagged several hawkish developments since the last decision.
- The decision presents important upside risks to our terminal rate call. With external conditions deteriorating and policymakers reacting by abandoning the attempt to do a dovish shift, we see important upside risks to our 8.50% terminal rate call by June.
- First, global commodity prices have not shown signs of inflecting at the margin, thus suggesting that policymakers' baseline inflation scenario is very unlikely to materialize, in our view. Moreover, with the currency's renewed weakness, their upper scenario for inflation (which has inflation averaging 10.3% throughout 3Q22) is looking increasingly likely and clearly increases the odds of taking rates above the upper bound of the current rates corridor (8.50% terminal).
- Finally, policymakers refrained from making remarks that the end of the cycle was near, in contrast with the guidance from the latest IPoM.

Santander Chile: Likely another hike in June, but smaller rate rise than May

- The rate increase was more aggressive than expected. It is likely that at the next meeting in June there will be a significant rise again, but less than the current one.
- With this increase, the rate is at the ceiling of the corridor recently published in the March Report. Since this report, inflation and activity have surprised to the upside and inflationary risks have risen, both due to the new disruptions in global chains due to the confinements in China, and due to the global appreciation of the dollar.
- The Board did not state a clear bias regarding the future evolution of the rate, but rather indicated that it would re-evaluate its future trajectory in the next Report to be presented in early June.
- All in all, even though the March Imacec was above expectations, the risks of a deeper slowdown in the economy are latent.
- We estimate that at the next meeting we could see a new rise in the rate of between 50 and 75bps, with which the cycle could end with an MPR of around 9%.