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Latam Daily: Chile CPI Preview, BCCh FX Program

- **Chile: We forecast July CPI at 0.57% m/m (3.9% y/y)**; **BCCh announced International Reserve accumulation of USD 18.5 bn in three years**

CHILE: WE FORECAST JULY CPI AT 0.57% M/M (3.9% Y/Y)

- **Annual inflation would be below 4% again after one year**

On Friday, Chile's INE will publish July CPI data that we forecast will show a 0.57% m/m (3.9% y/y) rise in prices, which, if realized, would push year-over-year inflation below 4% for the first time in a year. While our forecast is in line with the median of the surveys, it is also slightly below the forward inflation forecast (0.66% m/m). Meanwhile, we forecast inflation excluding volatiles at 0.4% m/m (3.7% y/y), with the largest impact on overall CPI coming from goods (+0.16 ppts) followed by services (+0.07 ppts). Regarding volatile items, we forecast a 0.33 ppts impact on headline CPI, highlighting a further increase in electricity tariffs. Our projection assumes a rebound in the level of inflationary diffusion similar to that seen in July 2024, although accompanied by somewhat more limited price increases than last year.

A 7% increase in electricity rates has been confirmed by distribution companies. Following the publication of the Decree modifying tariffs for energy and power components, some distribution companies immediately published new tariffs confirming the 7% average increase nationwide. However, given the lack of updated information from major distribution companies, doubts arose about the magnitude of the increase that the INE would report in this CPI release. Finally, based on electricity bills issued to date by companies that had not published the updated tariffs on their websites, it is possible to confirm that the 7% rate increase has materialized and should be fully captured by the INE. With this, we project a 0.23 ppts impact on headline CPI from electricity tariffs.

We project price reversals in goods following the June Cyber sale. This effect would be especially concentrated in the clothing and footwear, household equipment, and miscellaneous goods and services divisions, returning much of the negative impact they contributed last month. With this, we assume that the inflationary diffusion in the total CPI would reach the maximum levels seen in July, as well as for the core CPI.

The food and beverage division is expected to resume price increases, albeit on a limited basis (table 1). Based on our price data, the increases would be driven primarily by meat, eggs, and some non-perishable products, while on average fresh fruits and vegetables would have a negative impact on the overall CPI, only partially offsetting the aforementioned price increases.

Table 1: Chile - July CPI Projections, by Division (m/m)

Division	Contribution (%)
Food and non-alcoholic beverages	0.04
Alcoholic beverages and tobacco	0.01
Clothing and footwear	0.03
Housing, water, electricity, gas and others	0.30
Household equipment and maintenance	0.08
Health	0.03
Transport	0.03
Communication	-0.02
Recreation and culture	0.02
Education	0.00
Restaurants and hotels	0.02
Insurance and financial services	0.00
Miscellaneous goods and services	0.03
CPI	0.57
CPI (rounded)	0.6

Source: Scotiabank Economics.

BCCH ANNOUNCED INTERNATIONAL RESERVE ACCUMULATION OF USD 18.5 BN IN THREE YEARS

- **We estimate limited impact (no more than CLP 10 per USD) on the exchange rate given the modality, timing and optionality of the process**

On Tuesday August 5th, the central bank announced it will launch a program to accumulate International Reserves (IR), purchasing up to USD 25 million daily for three years. The program will begin on August 8th, one year before the renewal of the IMF's Flexible Credit Line (FCL), which was for US $13.8 billion on August 27th, 2024. On that occasion, a line corresponding to 600% of the quota was approved with the commitment that the Chilean authorities would reduce access in the future (see **IMF Executive Board Approves New Two-Year Flexible Credit Line Arrangement with Chile**). This renewal carried out in 2024 was for 600% of the quota, significantly less than the 1,000% of the August 2022 quota. We believe that the central bank also anticipated, like us, a smaller renewal of the FCL in August 2026, probably with a line no higher than 400% of the quota. In this context, this accumulation of reserves will allow it to maintain the liquidity buffer (IR + FCL) relatively stable. Indeed, by August 2026, the central bank will have accumulated US $6.5 bn in own international reserves and would have a renewal of the FCL for something around US $6.977 bn (400% of Chile's quota in the IMF).

In our view, it seems quite clear that the central bank opted to stop stating that the level of international reserves was entirely adequate given the expected reduction in the FCL. We agree that the highly volatile external environment, subject to continuous expectations adjustment, made it advisable to maintain a robust level of own reserves, complemented by the FCL. Recall that the reserve level stood at around 13.7% of GDP, at the bottom of a broad group of economies. Of greater concern is the distance from Brazil, Peru, and Colombia, which maintain reserves-to-GDP ratios between 2 and 13 ppts of GDP above Chile.

PREVIOUS INTERNATIONAL RESERVE ACCUMULATION PROGRAMS

The first period of reserve accumulation began in 2008, following a sharp appreciation of the peso in a context of international financial tensions. The decision was made to begin a reserve accumulation process of 5 ppts of GDP, which was concluded ahead of schedule due to exchange rate pressures on the peso following the collapse of *Lehman Brothers*. The implementation of the international liquidity accumulation program would have allowed for an increase of approximately 50% in the level of international reserves relative to the *stock* as of March 2008, after they had shown a significant decline between 2003 and 2005 compared to indicators such as GDP and imports. Reserves reached over 20% of GDP in 2003 but were around 10% by 2007.

The second phase was announced on January 3rd, 2011, at which point reserves as a percentage of GDP had also declined given strong GDP growth. The goal was to bring reserves to 17% of GDP through sterilized accumulation throughout 2011. This accumulation program was fully completed and sterilized by BCP 2, 5, and 10, and BCU 2, 5, 10, 20, and 30.

The third round of reserve accumulation began in January 2021. This program, which began with purchases on January 18th, ended early in October of that year, with a total of US $7.44 bn, equivalent to 62% of the announced amount. At the start of the purchases, the exchange rate was around $700/USD, while at the early end, it reached around $950/USD. The program's objective was to reach 18% of GDP by the end of the program. It seems quite clear that the sharp depreciation of the peso was a factor that led to the decision to finish the accumulation process early. The fourth round of accumulation began on June 13th, 2023, for an announced amount of US $10 bn, but was quickly suspended at the end of October of that year due to growing tensions in global financial markets, completing only 37% of the announced amount.

The central bank has consistently pursued its goal of holding around 18% of GDP in international reserves, characterizing this level as close to "optimal" in the face of financial stress scenarios that could affect foreign currency liquidity.

WHY DO WE EXPECT LIMITED EFFECTS ON THE EXCHANGE RATE?

USD liquidity has remained at adequate levels across all maturities in recent weeks, despite the recent global dollar appreciation and uncertainty and volatility stemming from the external environment. Indeed, the on-shore spread across all maturities was around 50 bps, marking further declines from the levels reached during the first week of July (around 75 bps) following the announcement of 50% tariffs on copper by the US. It is also worth noting that the on-shore spread is significantly below the average levels reached at the time of the suspension of the reserve accumulation program initiated in June 2023 (around 140 bps). Consequently, the Chilean economy is not facing a liquidity shock that would prevent the central bank from adequately absorbing US dollars.

For now, the Ministry of Finance, playing the opposite game, would help further mitigate the exchange rate impacts. Indeed, they recently announced the sale of US dollars to finance spending amounting to USD 300 million per week (between July and September). While this has disappointed, with sales of only 63% of what was announced this year, dollar sales total nearly US $5 bn in 2025.

The purchase method and amount are crucial to anticipate limited effects on the exchange rate. Indeed, the central bank will open a US $25 million window prior to the market opening, which will be settled at that day's observed dollar rate published in the afternoon. Market participants may be interested in "raising" the observed dollar rate (calculated as the weighted average of all daily transactions). However, this is unlikely given that the US $25 million purchase is insignificant compared to the daily traded amount, which exceeds US $1 bn on a day of moderate transactions. What the central bank should strive for is to generate market appetite to participate in the window, assuming the observed dollar risk. It is difficult for market participants to "sell blindly". However, we believe that, given the limited purchase amount and the fragmentation of market participants, this risk will be assumed by several interested parties. The operations will be spot, with minimum bids of US $5 million, and independent of the NDF program, which currently renews US $2.7 bn.

The option of suspension is another important factor in expecting very limited impacts. While the central bank suspended the program in previous accumulation sessions, this time it explicitly stated that it will review the program (eventual suspension) every six months. This generates a probability distribution that favours limited impacts on the exchange rate, as the market will assign a higher probability than it would have had this semi-annual review not been explicitly stated, especially if the exchange rate experiences depreciations greater than those compatible with fundamentals.

On the other hand, the impact of reserve accumulations on parity has steadily decreased over time according to our estimates. This can be attributed to a greater depth of the foreign exchange market, as well as to an improvement in the way the central bank makes, announces, and implements these accumulation announcements. The stance of monetary policy in terms of the monetary policy rate level has been different in recent announcements, as well as in subsequent steps. Despite these differences in monetary policy stance, the impacts on the CLP have been reduced.

However, we estimate an impact of no more than CLP 0.5 for each USD bn purchased, which leads us to expect an impact of no more than CLP 10 on the exchange rate as a result of this reserve accumulation program, which would be diluted over the course of the accumulation due to the rise in nominal short rates given the sterilization program.

Finally, we see no reasons linked to Chile's presidential elections next November. The central bank would not be improving the composition of US dollar liquidity in anticipation of liquidity stress, given that the timing of this accumulation coincides with the reduction of the FCL program next August, allowing for adequate replacement with own reserves.

—Aníbal Alarcón