October 8, 2020

Chile: September Inflation Surprise

- **September CPI rose 0.6% m/m, strongly surprising the market and leaving annual inflation at 3.1% y/y.**
- **This print moves us to raise our end-2020 inflation forecast from 2.2% y/y to 2.4% y/y, identical to the BCCh's own forecast.**
- **The BCCh should look through this print as it's in line with its baseline scenario. We expect the Board to keep the monetary policy rate on hold at -0.5% into 2021.**

SEPTEMBER CPI ROSE 0.6% M/M, STRONGLY SURPRISING THE MARKET AND LEAVING ANNUAL INFLATION AT 3.1% Y/Y

At 07:00 ET this morning, INE published September's CPI data, which showed an expectations-busting 0.6% m/m increase in the headline index (chart 1), up from 0.1% m/m in August and well above the 0.3% m/m rate expected in the Bloomberg consensus. The print moved annual inflation up from 2.4% y/y in August to 3.1% y/y in September, versus an expectation of 2.8% y/y (chart 2).

FORECAST REVISION

Although our baseline scenario already included a higher path for inflation than anticipated in the market consensus, September's inflation surprise drives us to raise our forecast for end-2020 from the 2.2% y/y published in our October 4 *Latam Weekly* to 2.4% y/y. This aligns our outlook with the latest forecasts published by the BCCh, the central bank, in its September *Monetary Policy Report*. Although September's surprise was generated mainly by food prices, other gains were sufficiently widely distributed across goods and services to merit this revision in our outlook. The CPI appears to be responding to the following factors:

1. The ongoing re-opening of the economy in a context where distributors and retailers do not have much financial flexibility to allow price reductions;
2. A strong demand shock from recent liquidity injections, including the withdrawal of up to 10% from pension accounts and the middle-class bonus, but where supply has not been able to respond. Retailers have reported sellouts of some durable goods, such as electronics and white goods, among others; and
3. Slight increases in costs derived from the depreciation of the CLP.

BCCh TO LOOK THROUGH THIS PRINT

Nevertheless, we hope that the BCCh will not read the September inflation print with undue concern, for the following reasons:

1. September's upside surprise was driven by a transitory consumer demand shock underpinned by the liquidity injections from the withdrawal of pension account funds and fiscal aid—not a solid increase in wage bills;

CONTACTS

Brett House, VP & Deputy Chief Economist
416.863.7463
Scotiabank Economics
brett.house@scotiabank.com

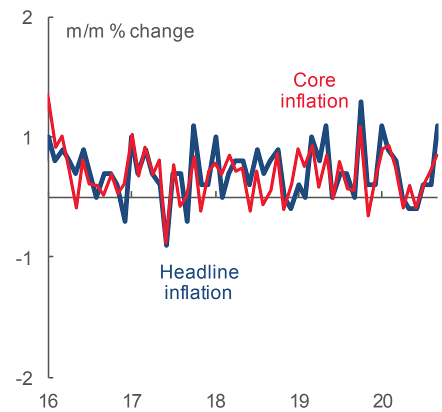
Jorge Selaive
56.2.2939.1092 (Chile)
Scotiabank Chile
jorge.selaive@scotiabank.cl

Carlos Muñoz
56.2.2619.6848 (Chile)
Scotiabank Chile
carlos.munoz@scotiabank.cl

Waldo Riveras
56.2.2619.5465 (Chile)
Scotiabank Chile
waldo.riveras@scotiabank.cl

Chart 1

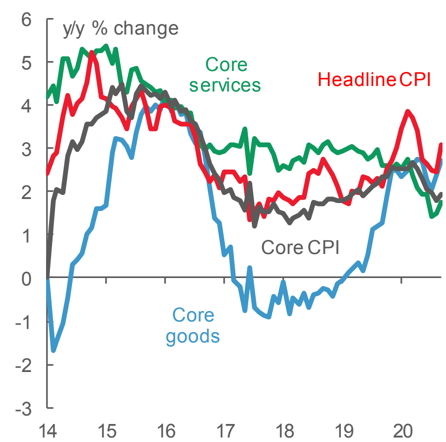
Chile: Headline & Core Inflation



Sources: Scotiabank Economics, INE.

Chart 2

Chile: Headline & Core CPI



Sources: Scotiabank Economics, INE.

2. Economic activity indicators for August disappointed, mainly owing to the slow recovery of investment, which is the main determinant of employment; and

3. The September print is still consistent with the central bank's baseline scenario that foresees annual inflation ending 2020 at 2.4% y/y.

IN THE DETAILS: BROAD BASE FOR SEPTEMBER SURPRISE

September's monthly CPI inflation rate of 0.6% m/m (3.1% y/y) was mainly explained by increases in food prices (with a contribution of 0.37 ppts) and a rebound in core inflation, especially in goods (chart 3). Core inflation increased 0.3% m/m (2.2% y/y), which was mainly explained by goods price inflation of 0.6% m/m (3.1% y/y) and to a lesser extent by incipient inflationary pressures coming from services prices (0.2% m/m; 1.7% y/y), which continue to be affected by data that have been missing since the beginning of the pandemic and are simply imputed.

Our inflationary diffusion indicator (i.e., the percentage of products with positive monthly inflation) showed that 54.8% of the products in the CPI basket saw price increases in September, higher than the historical average of 51.5% for the month. The diffusion of goods prices was 55.8%, also higher than its historical average (chart 4), while that of services was 45%, rebounding strongly with respect to recent readings earlier this year (chart 5)—consistent with the demand shock we noted above.

END TO IMPUTATION POSES NEW VOLATILITY AHEAD

For the next few months, it will be key monitor when and how the INE goes back to collecting price data in a manner closer to its usual practices as this could inject new volatility into upcoming inflation prints. It is not yet clear whether the disinflationary effects of the high output gap or the inflationary pressures emanating from constrained supply in the face of stimulated demand will dominate. For now, in its technical note, the INE observed that in September the imputation methods applied in the previous months of the lockdown were maintained for cases where actual prices could not be collected. This included an assumption of zero monthly price inflation in items such as tourist packages, air transportation, and other services. The extent of imputation has been rising—not falling—as the economy has re-opened and hit 28.2% in September, the highest value since last May. The INE advises that it will be constantly re -evaluating its imputation practices over the coming months with a view to re-incorporating actual prices as they become available.

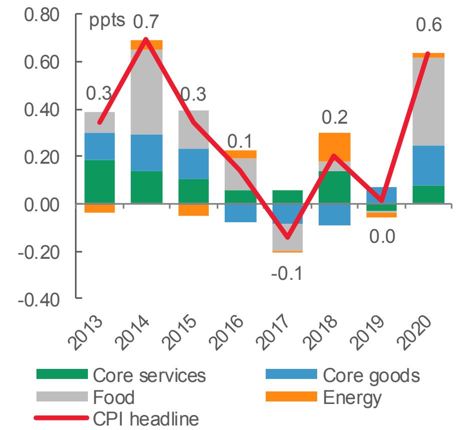
LOOKING AHEAD TO OCTOBER'S INFLATION PRINT

On a preliminary basis, we expect headline inflation in October to land between 0.2% m/m and 0.3% m/m. On the downside, October prices should not see a significant inflationary contribution coming from fuels; also, food prices will be left with a high monthly base from September, which leads us to anticipate slightly less inflationary pressure from this segment. **On the upside,** we should see a positive impact on prices from the reinstatement of the stamp tax, which could contribute 0.06 ppts to the headline sequential inflation rate. **Finally, we expect that in October the INE will begin collecting actual prices for air travel and tourist packages**, which would inject an additional element of uncertainty into the monthly projection. Historical data imply that during May–October both items would have seen increases in their prices.

—Jorge Selaive, Carlos Muñoz & Waldo Riveras

Chart 3

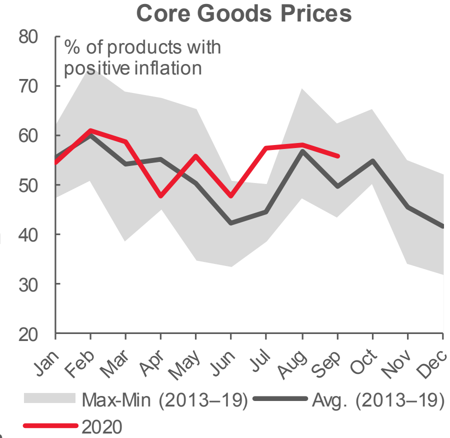
Chile: Contributions to Inflation



Sources: Scotiabank Economics, INE.

Chart 4

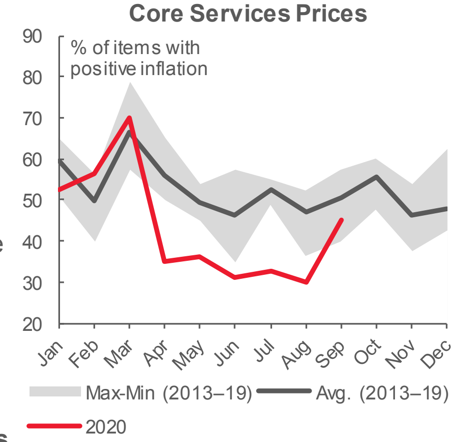
Chile: Inflationary Diffusion of Core Goods Prices



Sources: Scotiabank Economics, INE.

Chart 5

Chile: Inflationary Diffusion of Core Services Prices



Sources: Scotiabank Economics, INE.