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Chile—Central Bank Policy Rate Preview

- We expect the BCCh to hike its key reference rate 50 bps, to 7.5%, though we do not rule out a possible 75 bps increase.
- Either outcome would be less than what is priced in interest rate swaps and the expectations of most market analysts, both of which may be over-estimating the BCCh's hawkishness.

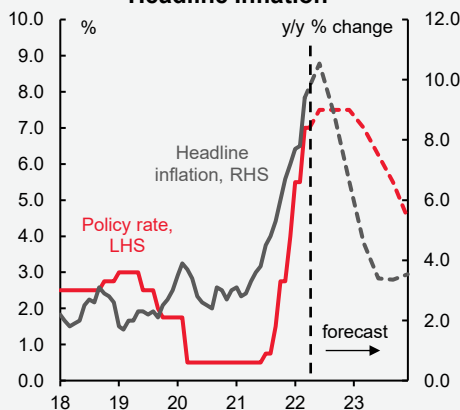
On Thursday, May 5, the central bank (BCCh) will announce its monetary policy rate decision, which we think will entail a 50 bps hike in the reference rate, to 7.5% (chart 1). Most economic analysts and market participants expect an increase of 100 basis points (bps), to 8%. We do not entirely rule out an intermediate move of 75 bps, raising the benchmark rate to 7.75%. This would be higher than what we expect, but still below market expectations.

In our view, interest rate swaps and expectations surveys are over-estimating the hawkishness of the BCCh. The following arguments explain why:

- **Despite the expansion in March monthly GDP expansion, the economy is already in a slowdown phase**, especially with respect to private consumption, which has been mentioned by the central bank as the main driver of recent high inflation.
- **Fiscal policy is doing its job**, managing to contain the pressures emanating from Congress, with government spending remaining within the budget law.
- **The CPI surprise in March was mainly limited to volatile items**. There was no relevant surprise on core inflation relative to the baseline scenario the last *Monetary Policy Report*.
- While the de-anchoring of inflation expectations is a widespread phenomenon in the world, idiosyncratic factors driving price pressures may be receding. In this environment, **an excessively aggressive withdrawal of monetary stimulus would not restore inflation expectations but could trigger a strong deceleration in domestic demand**. In this respect, a significant part of the de-anchoring of inflation expectations is explained by a lagging normalization of monetary policy in developed economies.
- Since the last monetary policy meeting, **the terms of trade have deteriorated further. Moreover, multilateral organizations have revised down their forecasts of global GDP growth for 2022 and 2023**. These factors generate a decrease in the external demand for Chile, suggesting a less hawkish forward guidance.
- Finally, the CB is likely to report a drop in the price of metals and stability in food and energy prices since the last monetary policy meeting, while freight costs have decreased amid the lockdown in the Chinese economy.

Chart 1

Chile: Policy Rate vs Headline Inflation



Sources: Scotiabank Economics, BCCh, INE.

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