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LATAM FLASH

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Chile—Inflation Data Reinforces Q1 Cut Forecast

- **October CPI of 0.5% m/m: a true disinflationary surprise.**
- **We reiterate our view of a benchmark rate cut of between 100 and 200bps in January 2023.**

Today, the statistical agency (INE) published CPI data for October, showing a 0.5% m/m increase (12.8% y/y; chart 1), below both the market and our expectations. **Volatile items increased 1.2% m/m, while excluding volatile items, the CPI rose 0.1% m/m.** The diffusion of inflation (percentage of products with price increases m/m) fell back to historical averages. Excluding volatile goods, it is located at the bottom of the range for the month of October (53.3%), while excluding volatile services it falls to 52.2%.

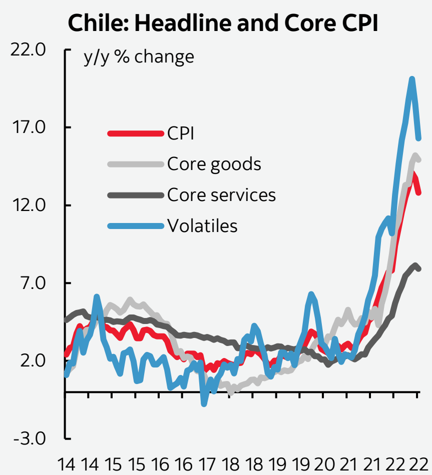
Monetary policy implication: aggressive 100–200bps cut no later than January 2023 meeting. We expect the market to align with our view very quickly with significant falls in nominal rates. The recent disinflationary surprise of the CPI for October is not explained by specific products, but by a basket of prices that “suddenly” disappears. Emblematic products have fallen due to weak demand, high inventories and the null multilateral depreciation of the CLP in recent months.

For the central bank, the monetary policy strategy to deal with the success of slowing down inflation in the short term can take two paths, taking into account that the battle against inflation cannot yet be considered complete and a consecutive easing of monetary policy is not a valid strategy.

The first option is to wait for the confirmation of the inflation turnaround with the November CPI release on December 7, which will not be known before the December 6 BCCh meeting. Under this strategy, it would be prudent to tip-off markets of the need for an adjustment to the reference rate level, which would take place at the January 26, 2023 meeting after verifying that the inflation data for November and December reinforce that which was observed in the October release. Regarding economic activity, the news will not be good, which would support an aggressive cut to the reference rate. Given that the second meeting of 2023 will be in April, monetary policy guidance would be moderately stimulative but conditional on inflation.

Alternatively, BCCh can bring forward the cut in the reference rate to the December meeting, explaining the reasons in the *Monetary Policy Report* (December 7) that will be published almost simultaneously with the monetary policy decision (December 6). In this case, although economic activity figures and indicators that determine inflation would support an aggressive cut in the reference rate, the central bank could have reduced freedom to determine the appropriate adjustment in the policy rate. Additionally, if it brings forward the increase, it faces the risk of an inflationary surprise in December, though this risk could be assessed based on the traditional determinants of inflation. The December cut would be with a neutral bias for the target rate.

Chart 1



Sources: Scotiabank Economics, INE.