Scotiabank

GLOBAL ECONOMICS

LATAM FLASH

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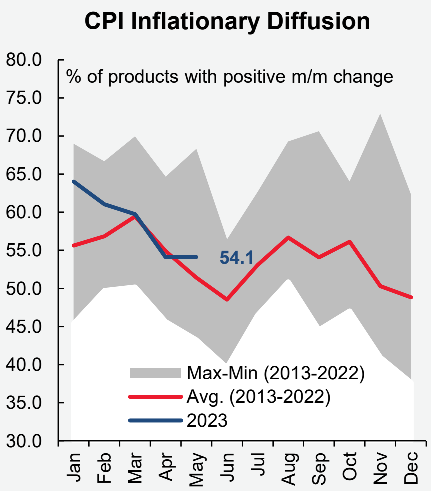
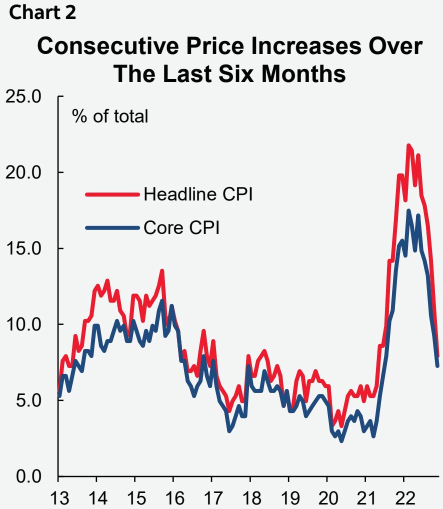
Chart 1



Sources: Scotiabank Economics, INE.

Chart 2



Sources: Scotiabank Economics, INE.

Chile—Important Downside Surprise in May Inflation: 0.1% m/m and 8.7% y/y

- **We see a risk of a zero or negative inflation print in June. CLP appreciation continues to do its job**

A clear headline surprise for the BCCh and market expectations. May CPI rose 0.11% m/m (8.7% y/y), below survey expectations (BCCh economists survey: 0.4%; BCCh traders survey: 0.3%), forward markets (0.3%) and the Bloomberg consensus (0.3%), but closer to our 0.19% m/m projection (see latest Latam Weekly).

Core CPI (excluding volatiles) rose 0.5% m/m (9.9% y/y), which should not have been a significant surprise for the Central Bank's (CB) baseline scenario. However, at the headline level, the March Monetary Policy Report (MPR) had assumed a cumulative inflation of between 0.5 and 0.6% across May and June, which becomes difficult to achieve considering May's 0.1% reading. With this result, we believe that the BCCh should lower its inflation projection in the MPR to be unveiled on June 20 (which in March saw 4.6% y/y in December 2023) closer to our 3.7% projection.

The basket clearly evidenced lower price pressures in the month, but also lower inflationary persistence. Total CPI diffusion remained at 54.1% (chart 1), around normal levels for the month. In the ex volatiles basket, diffusion continues to decrease, albeit more gradually. On the one hand, services breadth continues to show somewhat greater persistence, still at the high end of the historical range, while goods diffusion has normalized since the beginning of the year. On the other hand, there has been a significant drop in the percentage of products in the basket that have registered consecutive price increases in the last 6 months (chart 2). With the May data, this measure is below its historical averages, both for the total basket and core CPI.

What happened at the core level, the BCCh's preferred measure?

- Half of the 0.5% m/m increase in core prices was explained by 6 products, where 4 of them were services. The increase in the price of bread is the main impact on non-volatile goods. From a historical standpoint, the monthly gain was again within the range of variations of the last 10 years for the second consecutive month.
- Diffusion fell to 58% at core level, close to historical averages.
- Inflationary persistence is being left behind. In the core basket, the percentage of products with consecutive price increases in the last three and six months was below their historical averages.
- Year-on-year core inflation returned to single-digits after 10 months (9.9% y/y).

While May's print should not have been surprising for the CB—which assumes a cumulative core inflation of 0.9% between May and June—we still think that the path to meet this projection faces some headwinds. Preliminarily, we project that the declines in tradable goods that did not occur in May could be captured in June, so we now see a higher risk of zero or negative inflation for the current month.

With these data, market expectations and surveys used by the Central Bank will probably show a new downward adjustment in expected inflation in coming months, where a definitive anchoring of 1 and 2-year expectations looks very likely. Since March of this year, 2-year inflation expectations have already anchored at 3% according to the median of the Economists Survey, while in the Traders Survey this sits already at 3.2%. Given the expectation contained in these surveys for May of 0.4% and 0.3% respectively, inflation of 0.1% represents a genuine surprise of at least 0.2ppts. Asset prices will also reflect a surprise of at least 0.2ppts which should bring a further downward adjustment in break-even inflation by year-end.