banco central Chile

MONETARY POLICY REPORT

DECEMBER 2024

ZORZAL
Región de Coquimbo

MONETARY POLICY REPORT

DECEMBER 2024

The Central Bank of Chile's Monetary Policy

Money plays a fundamental role in the proper functioning of any economy. To preserve such role, the monetary policy of the Central Bank of Chile (CBCh) must protect the value of the national currency —the peso—, in its quest to keep inflation low and stable. Achieving this fosters the population's wellbeing by safeguarding their income's purchasing power and making the economy function better. When inflation is low and stable, monetary policy can also moderate fluctuations in employment and production.

The inflation target and the monetary policy interest rate (MPR)

The Bank conducts its monetary policy seeking that, irrespective of the current level of inflation, its forecast for a two-year horizon will be 3%. This is similar to the practice of other countries in the world that have, as does Chile, a floating exchange rate; this is the so-called inflation targeting scheme.

The MPR is the main instrument used by the Bank to achieve the inflation target. Its level is decided at the Monetary Policy Meeting, which is held eight times a year. In practice, the MPR is a reference interest rate to determine the cost of money and other financial prices, such as the exchange rate, and longer-term interest rates, among others. In turn, these variables affect the demand for goods and services and, thereby, prices and inflation. Monetary policy decisions take several quarters to be fully reflected in the economy, which warrants that monetary policy be made from a forward-looking point of view, having as its primary focus the inflation projection two years ahead, and not just today's inflation.

Communication, transparency and the Monetary Policy Report

Since the Central Bank makes its monetary policy decisions autonomously, it must constantly account for them and their results to the general public. This is so not only because it is a government agency within a democratic society, but also because a credible monetary policy, understood by the people, helps to keep inflation low and stable. Through the Monetary Policy Report (MP Report), the Bank communicates to the general public its view of the recent evolution of the economy, its projections for the coming years and the way in which, in this context, it will conduct monetary policy in order to meet the inflation target.

The MP Report is published four times a year (every March, June, September, and December) and is put together by a team of around 60 persons.

Cover picture: ZORZAL - Región de Coquimbo

Luis Oscar Herrera Barriga / Legal Representative
Corporate Affairs Division
CENTRAL BANK OF CHILE
Agustinas 1180, Santiago, Chile

Tel.: 56-22670 2000
www.bcentral.cl
bcch@bcentral.cl
ISSN: 0716-2219

CONTENTS*/

*/ For the central scenario construction purposes, the statistical cut-off date is 11 December. This document was originally written in Spanish. In case of discrepancy or difference in interpretation, the Spanish version prevails.

SUMMARY

Inflation is above forecasts of a few months ago. The annual change in the CPI stood at 4.2% in November and is expected to close the year at 4.8%, to then fluctuate around 5% during the first half of 2025. This higher inflationary trajectory in the short term responds to a mix of cost factors. On the one hand, there is the global appreciation of the dollar —which has raised the exchange rate—, caused by increased uncertainty in the world. On the other hand, there is the rise in domestic labor costs. These shocks have occurred simultaneously, which has contributed to the narrowing of firms' operating margins and leads to a pass-through to final prices higher than previously anticipated. In the medium term, cost pressures will tend to ease, and the evolution of inflation will be determined by the behavior of domestic demand, particularly by a lower performance of household consumption. This remained rather flat in the second and third quarters of the year, amid the low dynamism in job creation, the real depreciation of the peso and still pessimistic expectations. The convergence of inflation to the target will not be very different from what was previously estimated, with forecasts for activity that do not have major changes, but with consumption that will grow less than what was considered in September. The risk balance for inflation is biased upward in the short term, so caution is most needed. This means that the Board will steadily accumulate information regarding the progress of the economy in order to assess the timing for monetary policy report (MPR) cuts in the coming quarters.

As of November, the annual variation of total and core (non-volatile) CPI stood at 4.2% and 4.0%, respectively. These figures exceeded the forecasts in the last IPoM, especially in the core components of both goods and services. Recent inflationary dynamics have been influenced by the combined increase of several cost factors, among which the depreciation of the peso, higher labor costs and increases in electricity rates stand out. Short-term inflation expectations have risen, while in the two-year term they remain around the 3% target.

The depreciation of the peso from the previous IPoM is mainly due to a global strengthening of the dollar, within a more uncertain external scenario. The sources of uncertainty have to do with ongoing war tensions, fears about the world's fiscal and sovereign debt situation, and the impact of a possible reconfiguration of international trade, in a context of doubts regarding the policies that the new United States administration will adopt. For its part, the Federal Reserve began cutting its interest rate in September, mitigating a risk that had been significant until recently, although uncertainty persists as to the speed and point of arrival of this process. In this scenario, long-term interest rates remain high globally and it is estimated that this set of elements will continue to influence international financing conditions (Box I.1).

Wage indicators have shown significant expansion rates, despite the weakness in the evolution of employment. The increase in wages is explained by a number of factors, such as the recovery of real wages after the high inflation of previous years and the readjustment of the minimum wage. Measured in real terms, the annual increase in the Labor Cost Index (INE) has outperformed its historical averages in recent months. In turn, indicators obtained from administrative records (AFC) show that the real annual change in wages has remained high over the last year, directly affecting some CPI items, which adds to the already mentioned cost pressures in the firms.

Although third-quarter activity was in line with forecasts in the September IPoM, domestic demand grew less than expected. By sectors, the favorable results of copper mining and industry stood out, in contrast to the poor performance of financial and entrepreneurial services, adding to the prolonged weakness of construction. Partial information for the fourth quarter, particularly the Imacec for October, shows a rise in activity. This result includes the impact of transitory supply elements in some sectors, factors whose recurrence has added a certain degree of volatility to the figures throughout the year. Meanwhile, the lower dynamism of spending is explained by weaker private consumption, which had as a counterpart higher public consumption. At the same time, the economy has received a greater boost from external demand, as reflected by the evolution of exports of goods and services.

The lower growth in private consumption occurs in a context of weak job creation. Information from surveys and administrative data shows a decline or stagnation in several dimensions, such as formal employment (AFC), job creation in some sectors (INE) and also in less schooled groups (INE). The slow pace of job creation would be associated with sluggish investment in non-mining industries over the last several quarters, the evolution of activity in the most job-demanding sectors (e.g., construction) and the rise in wage costs. The real wage bill has tended to moderate its recovery, thus affecting income disposable for consumption.

The performance of gross fixed capital formation (GFCF) has been in line with September projections and remains marked by dissimilar behavior between components and sectors. Machinery and equipment remains dynamic in the face of stagnant construction and works for several quarters now. By activities, dynamic mining investment again contrasts with other sectors lagging behind.

Credit remains weak, evidencing a still limited demand for financing, in a context where short-term lending rates continue to reflect the MPR cuts. After their recent peaks, these have retreated about 550 and 750 basis points (bps) in the consumer and commercial portfolios, respectively. Long-term interest rates (BTP10) were at levels close to 10bps lower at the statistical cut-off of this Report compared to September.

Projections

In the short term, the main adjustment to the central scenario of this IPoM is that it incorporates higher cost pressures. The projection also considers a greater pass-through of costs to prices in the coming months compared to previous estimates, given the simultaneity with which the various cost shocks have occurred and the firms' squeezed operating margins. Core inflation leads the revisions, with average inflation in 2025 to be 0.5 percentage points higher than forecast in September. For headline inflation, that is partially offset by downward corrections in the external prices of some products, particularly fuels.

Into the medium term, inflationary pressures will be dominated by a weaker outlook for domestic demand and easing cost pressures, including the gradual reduction of the real exchange rate (RER). This, even though the reduction in the financial burden on individuals and in short-term interest rates will sustain the recovery of consumption in the foreseeable future (Box I.2).

In the central scenario, annual inflation will rise in the coming months, fluctuating around 5% during the first half of 2025. It will then begin to decline, ending the year at 3,6% and converging to the 3% target in the early months of 2026.

GFCF forecasts also decrease, while confirming differences across sectors. The Capital Goods Corporation survey continues to foresee stronger mining investment in 2025 compared with other activities, a divergence that is also reported in the Business Perception Report and confirmed by high-frequency tax information sources. The main factor behind the adjustment of the projection is the tightening of external financial conditions —in the context of high global uncertainty— via greater persistence of long-term interest rates at high levels and a depreciation of the peso.

The GDP growth ranges forecast for 2025 and 2026 remain at 1.5%-2.5%. This factors in a higher public spending and a greater boost from the external sector, that are offset by the lesser stimulus foreseen for household and business demand. This also affects the estimate of 2.3% growth for this year, at the lower end of the range forecast in September (2.25-2.75%).

Compared to what was considered in September, the activity gap is now expected to be somewhat more negative until the end of 2025, which will contribute to mitigate inflationary pressures. Thereafter, the gap will return to its equilibrium as the economy continues to grow around its trend, demand recovers and the MPR cuts continue. The assessment regarding the level of the activity gap is consistent with an estimated narrow labor market gap (Box II.1).

Projections include a real expansion of public spending that matches the one portrayed in the recently approved budget law. As a working assumption, the process of consolidating public finances is still expected to continue. All in all, the coming years present a challenging situation for complying with the fiscal rule.

Estimates for the current account deficit in the next two years are slightly reduced. This assumes a greater dynamism in exports of goods and services associated with the depreciation of the peso, including consumption derived from tourism and greater volumes shipped. Imports will also expand less, considering the evolution of domestic demand.

Regarding the world economy, projections reiterate near 3% growth for trading partners for the 2025-2026 period. This estimate recognizes the increased likelihood of a more moderate slowdown than previously anticipated for the United States, whose recent data have surprised positively. Furthermore, the outlook continues to show slower growth in China over the next two years. In this context, the average copper price will approach values around US$4.3 throughout the projection horizon.

Monetary policy

The short-term inflationary outlook has become more challenging due to increased cost pressures. These will lead inflation to fluctuate around 5% during the first half of 2025 according to the central scenario of this IPoM. All things considered, in the medium term, the weaker domestic demand would mitigate inflationary pressures. Thus, if the assumptions in the central scenario materialize, the MPR will follow a descending trajectory over the policy horizon.

The risk balance for inflation is biased upward in the short term, so caution is most needed. This means that the Board will steadily accumulate information regarding the progress of the economy in order to assess the timing for MPR cuts in the coming quarters.

In this IPoM, the sensitivity scenario that defines the upper bound of the MPR corridor is associated with a stronger impact from cost pressures. Should these intensify and/or the passthrough to final prices increase, higher inflation scenarios would be triggered, which in turn would increase both second-round effects and the possibility of observing greater persistence. Short-term risks in these scenarios are higher, considering the global uncertainty and the levels where inflation will stand in the central projection scenario. If such a scenario were to materialize, a more contractionary monetary policy strategy than the central scenario would be called for.

The lower bound is related to the effects of the higher uncertainty and weakness of the international scenario in the evolution of domestic spending. A sharper tightening of global financing conditions, associated with a worsening of the current sources of uncertainty, would further dampen agents' spending, especially in investment. This could be compounded by a scenario in which employment deteriorates more than expected. This would lead to capacity gaps that would be discordant with the convergence of inflation to the 3% target, requiring more significant reductions of the MPR.

The risk scenarios are linked to global conditions, particularly financial ones, but with more severe consequences that could drive the MPR to movements outside the corridor. More extreme developments on the trade front, the ongoing war conflicts or the fiscal situation in several economies do not allow to rule out more complex episodes of risk aversion in financial markets. This could lead to a more pronounced exchange rate depreciation or a greater contraction of activity, considering that long rates have played a weaker buffering role in the face of negative shocks, particularly in the United States (Box I.1).

TABLE 1: INFLATION (1)(2)
(annual change, percent)

	2022	2023	2024 (f)		2025 (f)		2026 (f)	
			Sep.24 IPoM	Dec.24 IPoM	Sep.24 IPoM	Dec.24 IPoM	Sep.24 IPoM	Dec.24 IPoM
Average CPI	11.6	7.3	3.9	3.9	4.3	4.6	3.0	3.1
December CPI	12.8	3.4	4.5	4.8	3.6	3.6	3.0	3.0
CPI in around 2 years (3)							3.0	3.0
Average core CPI	9.0	7.5	3.7	3.8	3.4	3.9	3.1	3.1
December core CPI	10.0	4.7	3.9	4.5	3.2	3.3	3.1	3.0
Core CPI around 2 years (3)							3.1	3.0

(1) Core inflation is measured using the CPI without volatiles. (2) Figures consider the 2023 CPI reference basket and the splice made by the Central Bank of Chile. (3) For September 2024 IPoM corresponds to inflation forecast for the third quarter of 2026, for December 2024 IPoM to inflation forecast for the fourth quarter of 2026. (f) Forecast.
Sources: Central Bank of Chile and National Statistics Institute (INE).

TABLE 2: INTERNATIONAL SCENARIO

	2022	2023	2024 (f)		2025 (f)		2026 (f)	
			Sep.24 IPoM	Dec.24 IPoM	Sep.24 IPoM	Dec.24 IPoM	Sep.24 IPoM	Dec.24 IPoM
					(annual change, percent)			
Terms of trade	-6.8	2.4	0.5	0.9	-0.6	-0.5	0.5	1.0
Trading partners	3.0	3.4	3.0	3.2	2.9	2.9	2.9	2.8
World GDP at PPP	3.6	3.5	3.2	3.3	3.0	3.0	3.1	3.0
Developed GDP at PPP	3.0	1.7	1.4	1.6	1.4	1.6	1.8	1.7
Emerging GDP at PPP	3.9	4.6	4.2	4.4	4.0	3.9	3.9	3.8
					(levels)			
LME copper price (US$cent/pound)	400	385	415	415	425	420	430	430
Oil price, average WTI-Brent (US$/barrel)	97	80	81	78	76	71	72	69

(f) Forecast.
Source: Central Bank of Chile.

TABLE 3: INTERNAL SCENARIO
(annual change, percent)

	2022	2023	2024 (f)		2025 (f)		2026 (f)	
			Sep.24 IPoM	Dec.24 IPoM	Sep.24 IPoM	Dec.24 IPoM	Sep.24 IPoM	Dec.24 IPoM
GDP	2.1	0.2	2.25 - 2.75	2.3	1.5 - 2.5	1.5 - 2.5	1.5- 2.5	1.5 - 2.5
Domestic demand	2.3	-4.2	1.3	1.1	2.5	1.9	2.4	2.1
Domestic demand (w/o inventory)	2.9	-3.2	1.3	0.9	2.5	2.2	2.2	2.3
Gross fixed capital form	3.9	-1.1	-0.8	-1.3	5.1	3.6	2.5	2.2
Total consumption	2.6	-3.9	2.0	1.5	1.7	1.8	2.1	2.4
Private consumption	1.6	-5.2	1.7	1.1	1.9	1.6	2.2	2.0
Goods and services exports	0.8	-0.3	6.1	5.6	3.2	3.8	2.2	2.8
Goods and services imports	1.5	-12.0	2.9	1.7	4.5	4.2	3.3	3.1
Current account (% of GDP)	-8.7	-3.6	-2.1	-2.4	-2.4	-2.3	-2.5	-2.3
Gross national saving (% of GDP)	16.9	19.4	20.0	20.4	19.7	19.7	19.7	20.0
Gross fixed capital formation (% of nominal GDP)	25.3	23.8	23.1	23.6	23.1	23.1	23.0	23.6

(f) Forecast.
Source: Central Bank of Chile.

I. RECENT EVOLUTION OF THE MACROECONOMIC SCENARIO

In general, world activity has been in line with forecasts in our September IPoM, albeit with differences in its composition. The United States has been more dynamic than expected, while the Chinese economy has decelerated further, as predicted. Global inflation has continued to decline while monetary policy has been eased in an important group of countries, where the U.S. Federal Reserve (Fed) stands out as it started lowering its benchmark interest rate. However, these developments have taken place against the backdrop of a more uncertain global scenario, with uncertainty coming from different sources, notably the ongoing war tensions, fears about the global fiscal situation and the impact of a possible reconfiguration of international trade. On the domestic front, annual and core inflation stood at 4.2% and 4.0% in November, respectively. These figures exceeded the projections of the last IPoM, especially the core components of both goods and services. Third quarter activity was in line with expectations, driven mainly by exports, in contrast with the slower recovery of domestic demand. In particular, the lower dynamism of household consumption stands out, in a context of slow job creation as informed by different sources. This compares with a greater boost in government consumption, while heterogeneities persist in investment across sectors and components. The performance of banking credit remains weak, especially the commercial portfolio, in a context where short-term loans interest rates continue to reflect the cuts in the Monetary Policy Rate (MPR).

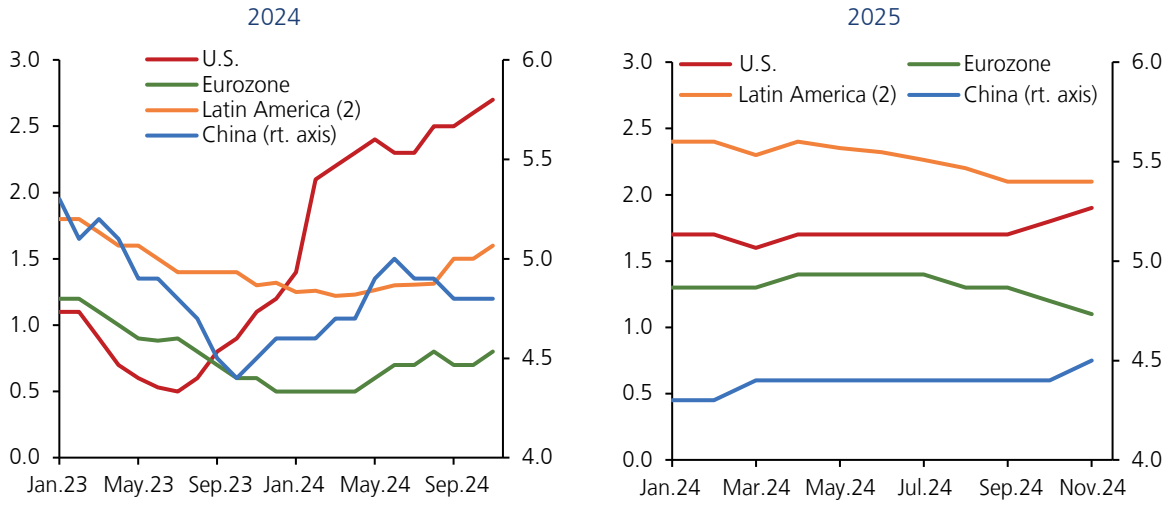
THE INTERNATIONAL SCENARIO

United States economic activity exceeded forecasts in the last IPoM. Market expectations have revised growth upwards for this and next year (Figure I.1). Beyond some volatility in the figures, labor market indicators show that the gaps have been closing, while the unemployment rate remains low from a historical perspective. Incoming data show that in the third quarter, the performance of private consumption of goods and services stood out again, along with a reduction in the saving rate and an increase in households' real disposable income. Investment slowed down, due to a new drop in the residential component. Meanwhile, government spending rose, with a considerable increase in defense.

In China, despite a marginal improvement in some indicators, the economy continues to show signs of fragility. Third-quarter growth was in line with forecasts for the September IPoM. In that period, the slowdown in manufacturing contrasted with advances in the services sector. Some short-term figures have shown some rebound recently, including sales and real estate sentiment indicators, possibly associated with the stimulus measures that the authorities have implemented in recent months. However, several of the announcements have failed to fully convince the market, as they have resulted in no significant changes to their expectations for the country's growth (Figure I.1).

Regarding our other trade partners' activity, the Eurozone maintained a moderate performance, whereas Latin America grew above expectations. Within the European bloc, heterogeneity among countries and sectors is observed, while the general outlook remains weak (Figure I.1). Among the main economies, Spain's growth stood out during the third quarter, while Germany lagged. Meanwhile, market projections for Latin America have improved for this year, considering the positive surprises in several economies' figures. The sustained improvement of the Brazilian economy stands out, favored by the expansion of household consumption, the fiscal impulse and the services sector during the third quarter, in a context of strong labor market dynamism.

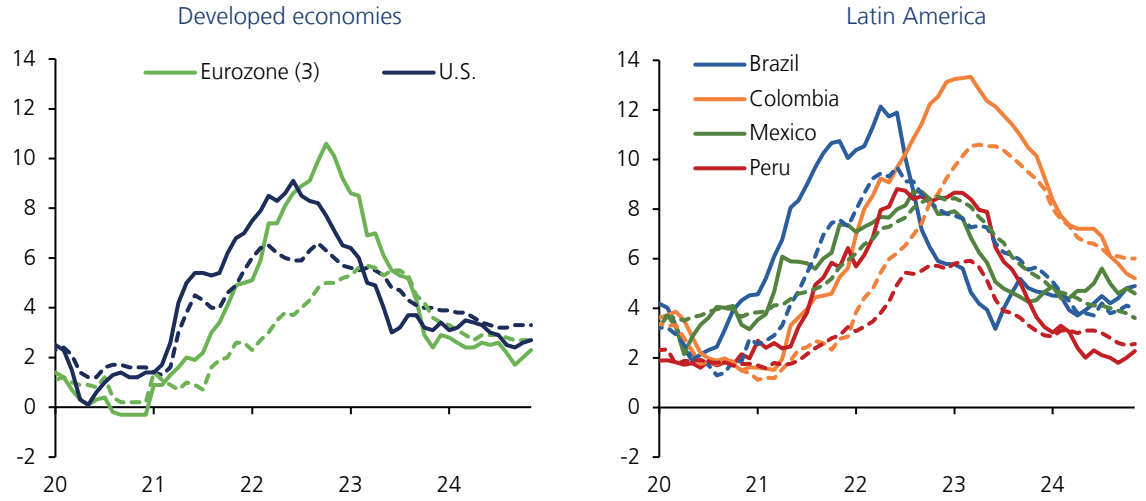
FIGURE I.1 CONSENSUS GROWTH FORECAST (1)
(percent)



(1) The latest information available at the closing of this IPoM refers to the month of November 2024. (2) Considers Brazil, Argentina, Peru, Colombia and Mexico. PPP-weighted growth; shares of each economy according to WEO (IMF).
Sources: Consensus Forecasts and International Monetary Fund (IMF).

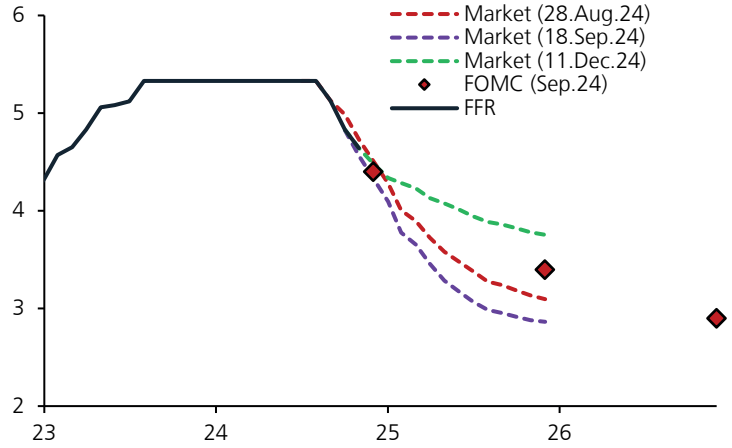
World inflation has continued to decline, and monetary policy has advanced in its easing process in an important group of economies, especially with the start of the Fed's rate-lowering cycle (figures I.2 and I.3). The decline in global inflation has been mainly supported by the components of goods and volatile prices, while services inflation has remained high. In the United States, the Fed has accumulated declines of 75 basis points (bp) in its benchmark rate in the last two meetings. In any case, its authorities have reinforced their messages of caution in the conduct of monetary policy. The market's outlook for the path of the Fed Funds rate has become less expansionary, in a scenario in which inflation had evolved somewhat above forecasts in the September FOMC, where the more pessimistic labor market scenarios have become less likely to occur, and there is a considerable degree of uncertainty about the inflationary effects to be expected of the commercial and economic policies the incoming administration will adopt. In the Eurozone, after a pause in July, the ECB resumed lowering rates in recent months. Latin America's main central banks have also continued to reduce their benchmark rates. The most important exception has been Brazil, whose monetary authority accumulated an increase of 175bp in its last meetings. Brazilian inflation has accelerated and expectations have de-anchored from their target, in a context of strong activity, a tight labor market and an expansionary fiscal policy.

FIGURE I.2 WORLD INFLATION (1) (2)
(annual change, percent)



(1) Dashed lines correspond to core inflation. (2) Core figures exclude foods and energy. (3) For November, it considers preliminary estimate.
Source: Bloomberg.

FIGURE I.3 FED FUNDS RATE (*)
(percent)



(*) FOMC projections correspond to the mid-range of the fed funds rate presented in September 2024; market projections are for the mid-range of the fed funds rate of futures at the statistical closing of the September IPoM (28.Aug.24), September FOMC (18. Sep.24) and at the statistical closing of this IPoM (11.Dec.24).
Sources: U.S. Federal Reserve and Bloomberg.

The international outlook has been marked by high degrees of uncertainty coming from different fronts. Broadly speaking, these are related to the ongoing war tensions, fears about the fiscal and sovereign debt situation in the world —aggravated by a possible increase in defense spending in several countries— and the impact of a potential reconfiguration of international trade, in a scenario where uncertainty persists regarding the Fed's upcoming actions.

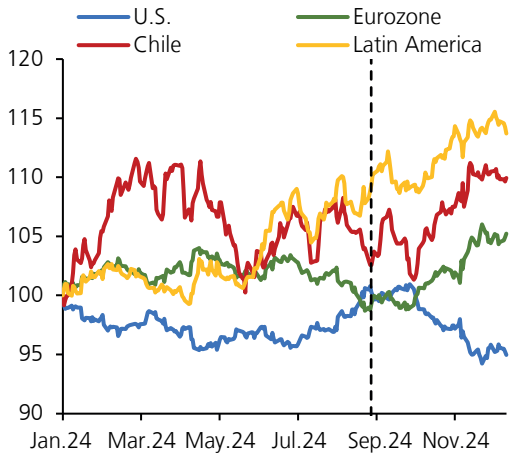
In this context, long-term interest rates have risen in various economies, especially in the United States, amid markets still highly sensitive to several news (Figure I.4). In the American economy, long rates regained similar levels to those of mid-year, but, unlike then, the uncertainty elements have played an important role in this rise. Added to this is an improvement in the outlook for growth in the United States, an increase in risk appetite derived from election results and uncertainty on the terminal Fed Funds rate (Box I.1).. As for other variables, since the last IPoM, short-term interest rates have evolved heterogeneously across countries and the dollar has appreciated against most currencies. Meanwhile, risk premiums and stock markets have shown mixed movements, with the United States stock prices rising the most.

In general, the local financial market has performed in line with its international peers (Figure I.4). After declining in September, nominal long-term interest rates rose during October and November, and were partially reversed in recent weeks. At the close of this IPoM, they were somewhat below their level at the close of the September Report. In turn, short-term rates reversed the downward trend they showed in September, and in the two-year term they are around the level of the September statistical close. The IPSA, with ups and downs, accumulated limited gains since the September IPoM.

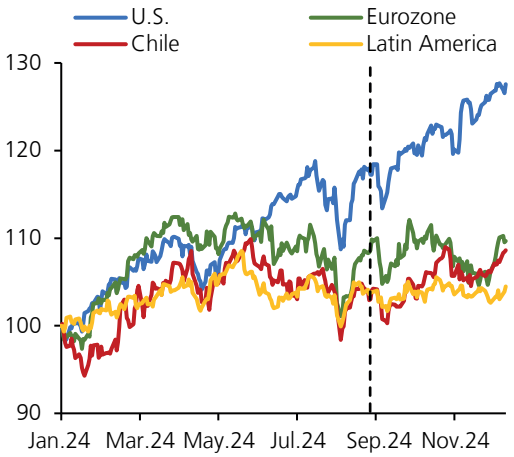
Commodity prices have accumulated mixed changes since the September IPoM (Figure I.5). The oil price has shown greater volatility, given the dissimilar behavior of its determinants. On the one hand, there are the opposing effects on supply resulting from the ongoing war conflicts and some favorable news regarding world supplies. On the other hand, there are prospects of a fall in global demand. Considering the 10-day average prior to the statistical close of this IPoM and the September Report, the price of a barrel of oil (WTI-Brent average) had fallen by around 9%, standing at around US$71. The price of copper has also fluctuated. The pound of copper was trading near US$4.1 at the statistical close of this Report, similar to the close of the September IPoM. Its evolution has been mainly influenced by the news coming from the Chinese economy, a lower impulse associated with the demand for its use in the energy transition and by the strengthened dollar. However, the medium-term outlook for its price has not changed. On the other side, food prices have risen, pressured mainly by lower supply resulting from the impact of climatic factors. The FAO index for November accumulated an increase of 5.5% with respect to July (the last data known at the close of the September IPoM), driven mainly by the sharp rise in vegetable oils.

FIGURE I.4 FINANCIAL CONDITIONS

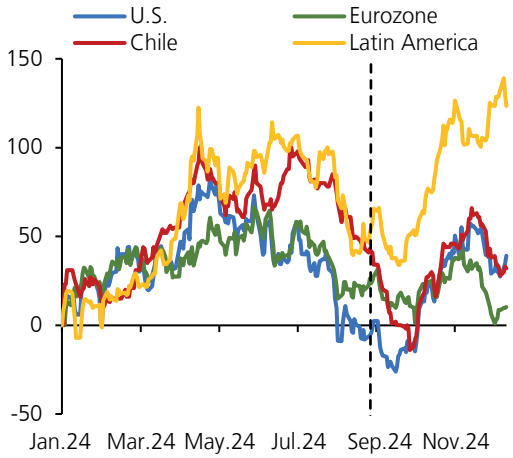
a) Currencies (1) (2) (3)
(index 1.Jan.24=100)



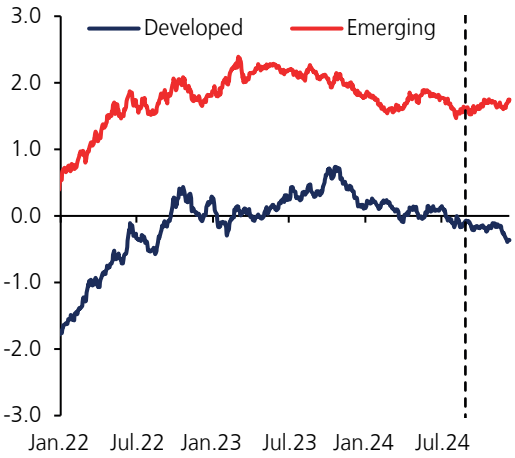
b) Stock markets (1) (2)
(index 1.Jan.24=100)



c) Interest rates on nominal 10-year bonds (1) (2)
(difference with respect to 1.Jan.24, basis points)

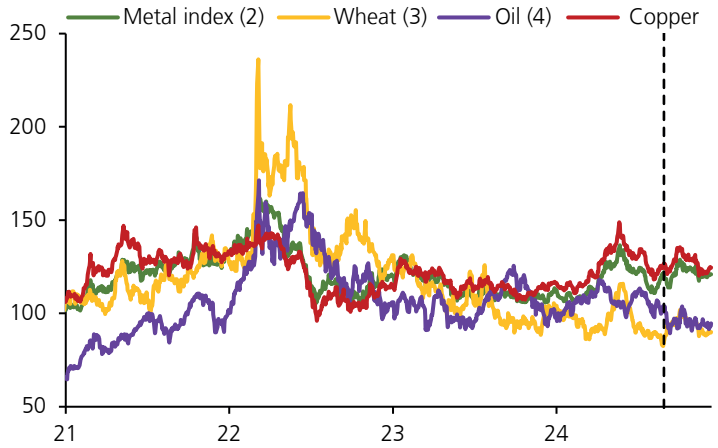


d) Goldman Sachs financial conditions index (1) (4)
(standard deviations)



(1) Dashed vertical line marks statistical closing of September IPoM. (2) For Latin America, considers the simple average of Brazil, Mexico, Colombia and Peru. (3) An increase in the index indicates a currency depreciation, and vice versa. For the U.S., uses multilateral exchange rate. (4) Standardized with mean and standard deviation between 2010 and 2019. For developed countries, simple average of U.S., Eurozone, U.K., Canada, Australia, New Zealand, Norway and Sweden. For Emerging markets, simple average of Thailand, Indonesia, Czech Republic, Brazil, Mexico and Chile.
Sources: Central Bank of Chile, Bloomberg and Goldman Sachs.

FIGURE I.5 COMMODITY PRICES (1)
(index, 2010-2024 average=100)



(1) Dashed vertical line marks statistical closing of June IPoM. (2) S&P GSCI Industrial Metals. (3) Prices of futures one-month ahead. (4) WTI-Brent average.
Source: Bloomberg.

THE DOMESTIC SCENARIO

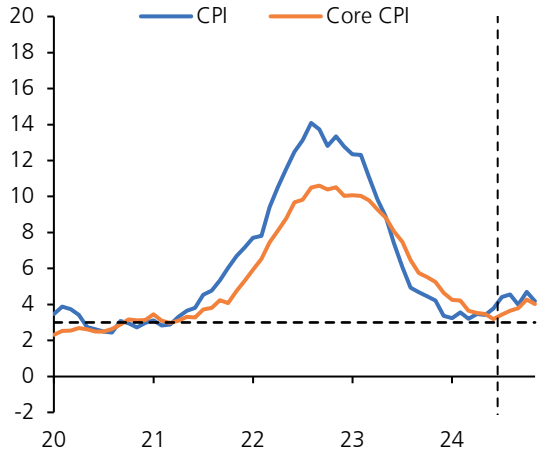
November's annual inflation stood at 4.2% (4.4% in July, latest data known at the close of the September IPoM, while core inflation —the non-volatile CPI— was 4.0% (3.4% in July) (Figure I.6).[1]/ The evolution of the core part was mainly influenced by the increase in goods inflation, which also considers a somewhat greater contribution of foods (Figure I.7). Inflation of services has stopped falling in annual terms, with the administered and indexed components remaining stable, while all other services have seen some rebound. As for the volatile CPI items, the rise in electricity during October played a part, continuing with the rate adjustment process. Also noteworthy were the marked fluctuations in the prices of some foods, such as meats and potatoes, and the decline in other vegetables. Fuel prices have fallen in recent months, affected by the decrease in global oil prices. In turn, volatile goods and services prices rose, particularly those sensitive to the exchange rate.

Cumulative August to November inflation exceeded the September IPoM forecast, the difference being mainly due to its core component. Since the last IPoM, the inflation of goods —excluding foods— and core services exceeded expectations and explain in equal parts the difference with respect to projections. For volatile items, on aggregate, there were no significant differences.

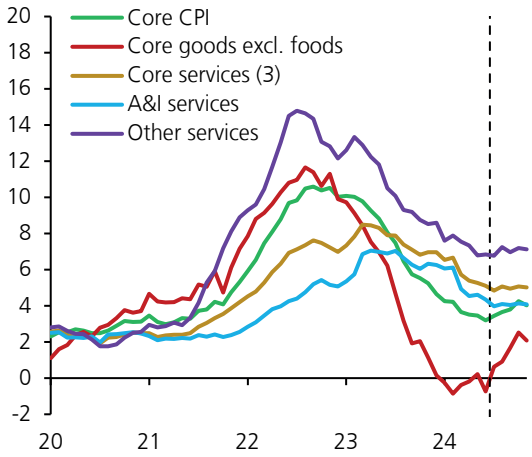
[1]/ The figures consider the 2023 benchmark CPI basket and the splicing done by the Central Bank of Chile.

FIGURE I.6

Headline and core inflation (1) (2)
(annual change, percent)

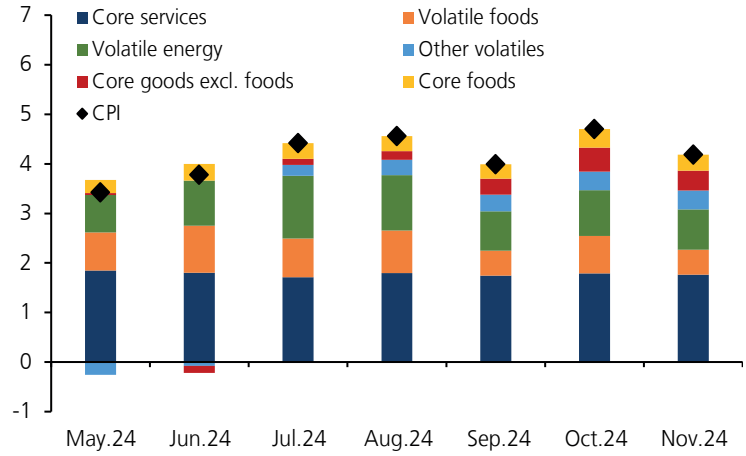


Core inflation (1) (2)
(annual change, percent)



(1) Series consider the 2023 CPI reference basket with the BCCh splice. (2) Dashed vertical line marks statistical closing of June IPoM. (3) Considers the sum of administered and indexed services (A&I) and Other services.
Sources: Central Bank of Chile and National Statistics Institute (INE).

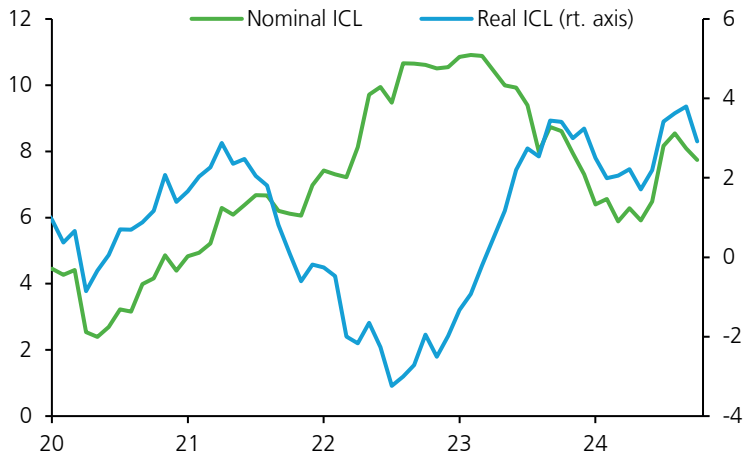
FIGURE I.7 CONTRIBUTIONS TO ANNUAL CPI
(contributions, percentage points)



Sources: Central Bank of Chile and National Statistics Institute (INE).

Recent inflationary dynamics have been influenced by the combined increase of several cost factors. The exchange rate has risen in the past few months, affected by the global strengthening of the dollar, concerns regarding the Chinese economy and the fluctuations of the copper price, to name a few (Figure I.4). Considering the average of the 10 days leading up to the close of this IPoM and the previous one, the peso has depreciated close to 6% against the dollar and slightly more than 2% in multilateral terms. Furthermore, labor costs have risen recently, due to different regulatory changes, including the upward adjustment of the minimum wage (Figure I.8), all this in the context of increased electricity rates. This situation is endorsed in the November Business Perceptions Report (IPN), where interviewees highlight the cost pressures coming from these fronts. At the same time, there is the increase in some international prices, such as foodstuffs.

FIGURE I.8 LABOR COSTS INDEX (ICL) (*)
(annual change, percent)

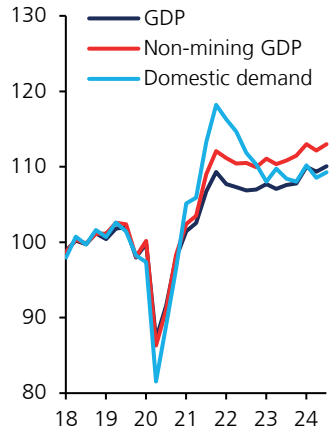


(*) Splicing of original series is used.
Source: National Statistics Institute (INE).

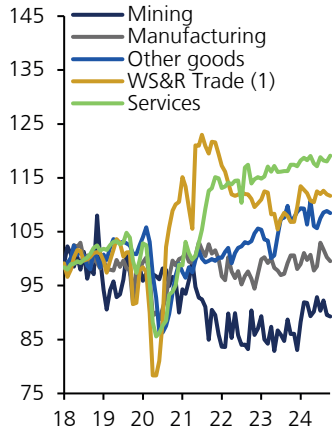
Third quarter activity was in line with expectations, driven mainly by the external sector (Figure I.9). In this period, the seasonally adjusted series of total and non-mining GDP increased 0.7% compared to the previous quarter (q/q) (2.3% and 2.0% annually, respectively), which was largely determined by the good performance of exports. In the non-mining sectors, manufacturing performed better, particularly foodstuff production—benefited by the greater availability of fishing inputs—while entrepreneurial services decreased. On the other hand, copper mining made significant progress. Preliminary data for the fourth quarter confirms the volatility that the figures have shown throughout the year, mostly influenced by one-off supply elements (Figure I.9). The seasonally adjusted October Imacec grew 0.4% month-on-month, with contractions in the mining and manufacturing sectors, along with a rebound in services, particularly entrepreneurial ones.

FIGURE I.9

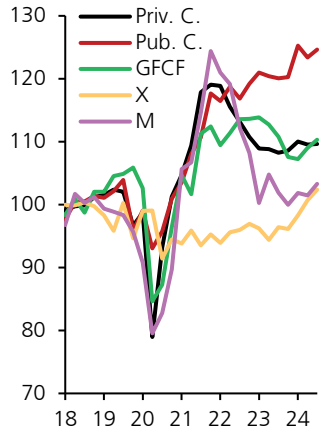
a) Activity and demand
(index, 2018 average=100, real seasonally-adjusted series)



b) Imacec by sectors
(index, 2018 average=100, real seasonally-adjusted series)



c) Expenditure components (2)
(index, 2018 average=100, real seasonally-adjusted series)



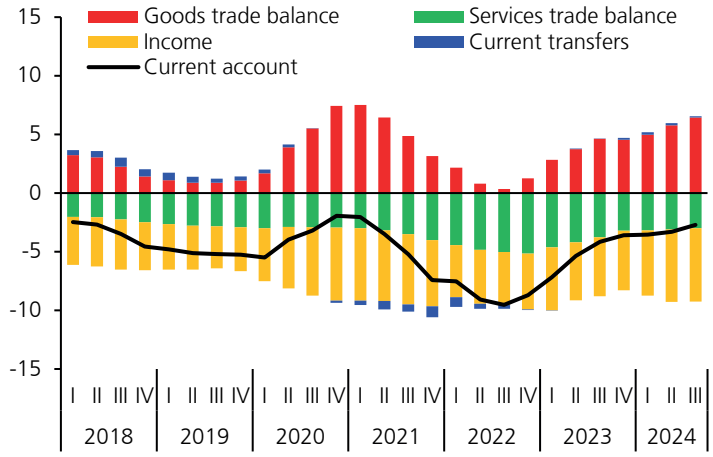
(1) "WS&R Trade" = Wholesale and retail trade. (2) "Priv. C." = Private consumption, "Pub. C." = Public consumption; "X" = Exports; "M" = Imports.

Source: Central Bank of Chile.

The factors that supported the export sector allowed the third quarter current account deficit to reach its lowest level in almost four years (2.7% of GDP in the cumulative annual sum) (Figure I.10). In goods exports, the main positive developments were related to mining and agriculture. Regarding exported services, the increase in those related to travel—including inbound tourism—and air transportation stood out. Investment income remitted abroad only partially offset these increases. At the same time, some import lines—especially consumer goods—remain weak, in line with the evolution of domestic spending. As a result, national savings have continued to recover and reached, in the cumulative annual sum, 19.5% of GDP in the second quarter (18.7% in the same period of the previous year), led by the increase in private savings.

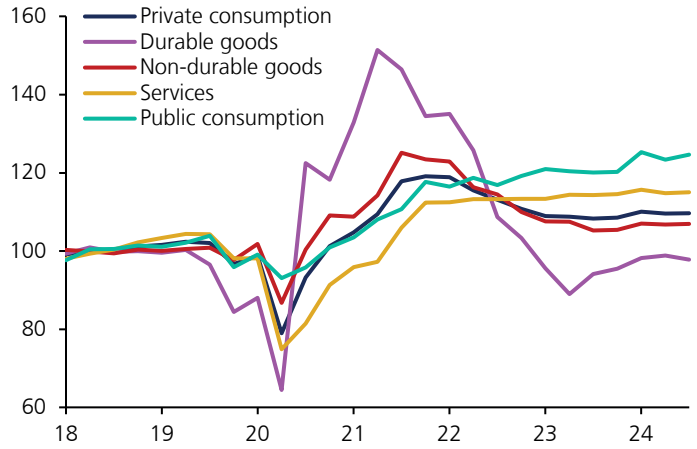
The recovery of domestic demand has been slower than expected, especially due to the private consumption (Figure I.11). In the third quarter, its seasonally adjusted quarterly change was close to zero (1.0% annually), below what was considered in the September IPoM. The q/q contraction of the durable goods component stood out. High-frequency indicators linked to households' consumption—such as digital payment methods, automobile sales (ANAC) and consumer imports—anticipate limited dynamism at the beginning of the fourth quarter. The slower growth in private consumption was partly offset by higher government consumption.

FIGURE I.10 CURRENT ACCOUNT, CONTRIBUTIONS BY COMPONENT
(percent of GDP, cumulative annual sum)



Source: Central Bank of Chile.

FIGURE I.11 CONSUMPTION BY COMPONENTS
(index, 2018 average=100, real seasonally-adjusted series)



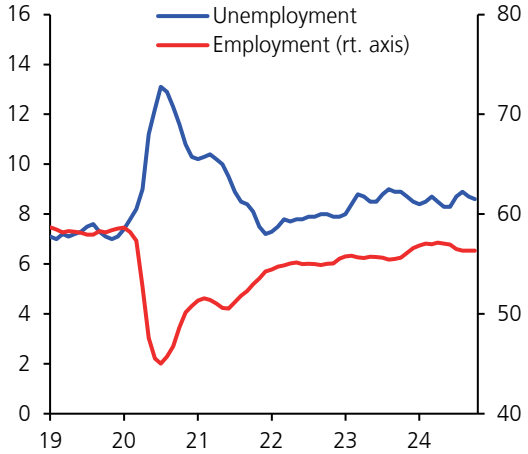
Source: Central Bank of Chile.

Job creation has shown low dynamism (Figure I.12). Data obtained from surveys and administrative records suggest stagnation or decline in various dimensions, such as formal employment (AFC and AFP), in some economic sectors or in groups with lower levels of education (INE). In 2024, the unemployment rate has averaged 8.6%, which is slightly above the range that would be obtained for the reference unemployment rate—which considers the absence of cyclical pressures on inflation—using different methodologies. This would be consistent with the existence of limited slack in the labor market (Box II.1).

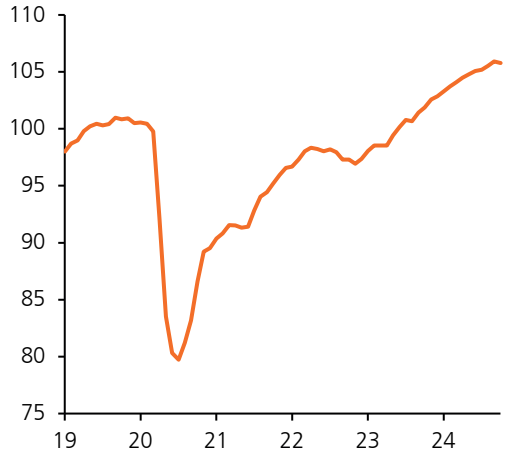
Other private consumption fundamentals have not had major variations in recent months (Figure I.12). Growth of the real wage bill remains close to historical averages, although its composition has changed at the margin, with a lower incidence of employment and a higher incidence of earnings. The financial burden of households remains below its 2023 peaks and has continued with its decreasing trend, despite a slight increase in the last figure. Notwithstanding all this, the expectations of wholesale and retail trade-related firms (sectoral IMCE) and consumers (IPEC) have gone several months without significant changes and remain in pessimistic territory.

FIGURE I.12

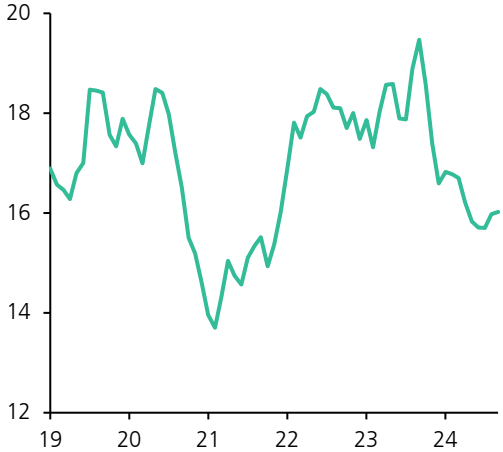
a) Unemployment and employment rate
(percent)



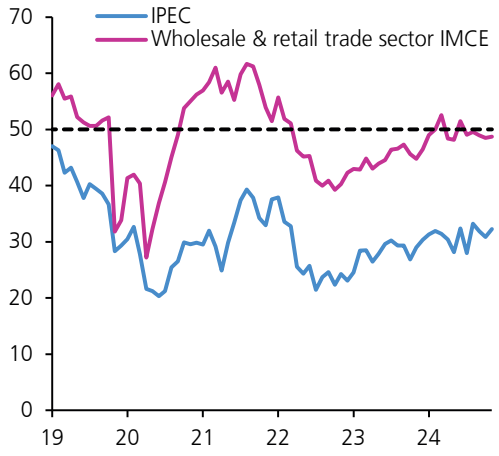
b) Real wage bill (1)
(index 2019=100, seasonally-adjusted)



c) Financial burden to income ratio
(percent, quarterly moving average)



d) IPEC and Wholesale & retail trade sector IMCE (2)
(diffusion index)



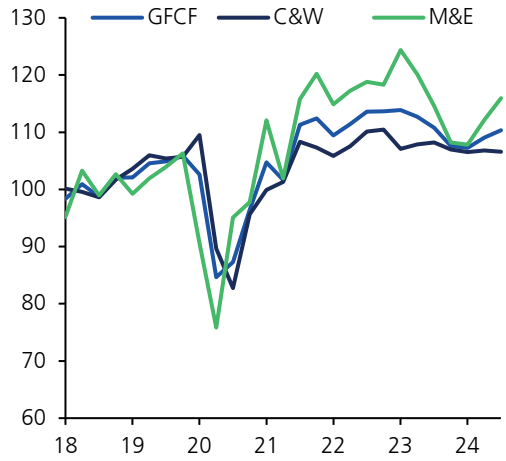
(1) Calculated using seasonally-adjusted series of the real ICL, hours worked and occupation. (2) Value above (below) 50 indicates optimism (pessimism).

Sources: National Statistics Institute (INE), Central Bank of Chile, ICARE/UAI and GfK Adimark.

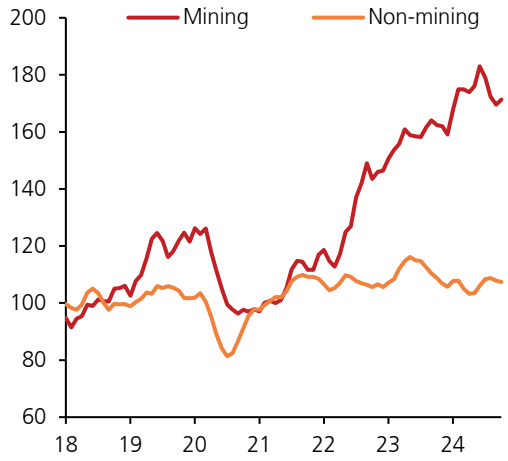
Gross fixed capital formation continues to recover as expected (Figure I.13). This was again explained by the quarterly expansion shown by the machinery and equipment component, which contrasts with the stagnation of the construction and other works component. At the sectoral level, the heterogeneity in investment reported in the previous IPoM persists, characterized by a strong impulse in the mining sector and a lag in all other sectors (Figure I.13). As reported in the third quarter survey of the Capital Goods Corporation (CBC), this discrepancy is expected to persist in the short term. This is confirmed by interviewees from the northern part of the country in the November Business Perception Report (IPN), who expect mining-related projects in the pipeline to be started next year, unlike other sectors whose investment expectations remain limited. However, it is acknowledge that the magnitude of the impact of such projects would be less than in recent episodes, such as the previous mining boom (see Box I.1 in September 2024 IPoM).

FIGURE I.13

a) Gross fixed capital formation by components (index, 2018 average=100, real seasonally-adjusted series)



b) Sectoral GFCF: mining and non-mining sectors (*) (2018=100, quarterly moving average, real seasonally-adjusted series)



(*) Methodological details are found in the Minute of Boxes of the September 2024 Report.

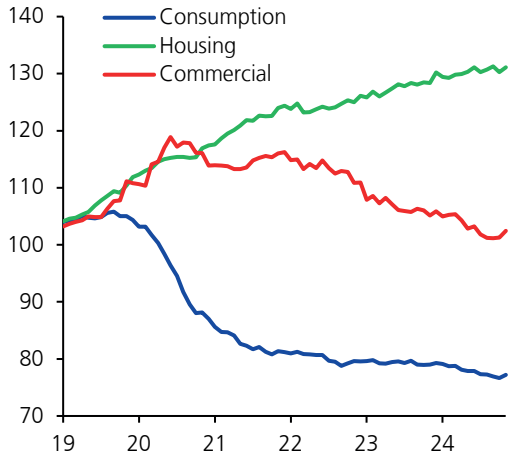
Sources: Internal Revenue Service (SII), Customs and Central Bank of Chile.

Bank lending remains weak, especially its commercial component (Figure I.14). According to the latest Banking Credit Survey (ECB) and the Financial Stability Report (IEF) for the second half of this year, lending standards remain broadly unchanged from the previous quarter. This coincides with the November IPN interviewees, who still state that they face restrictions in access to bank financing. On the other hand, the ECB survey also points out that the demand for credit—especially if associated with real estate and construction firms—continues weak, but the consumer portfolio is perceived to be somewhat more dynamic than in previous records. In this context, the stock of consumer and commercial loans maintains negative real annual variation rates (Figure I.14). The housing portfolio continues to grow at a slow pace, while long-term interest rates are still high compared to previous years.

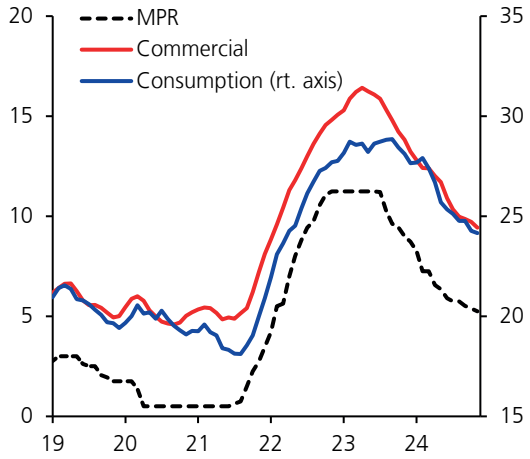
Interest rates on short-term loans have continued to reflect the pass-through of the cuts in the MPR (Figure I.14). The Board has lowered the MPR by 625bp since July 2023, when the cuts cycle began. Meanwhile, consumer and commercial lending rates have fallen by around 600bp and 700bp, respectively, since their recent peaks. In the November Business Perceptions Survey (EPN), of the total number of respondents who acknowledge an improvement in credit conditions, a significant proportion considers that this can be explained by the decline in short-term interest rates.

FIGURE I.14

a) Real loan stock (1)
(index, 2018=100)



b) Lending interest rates and MPR (2)(3)
(percent)



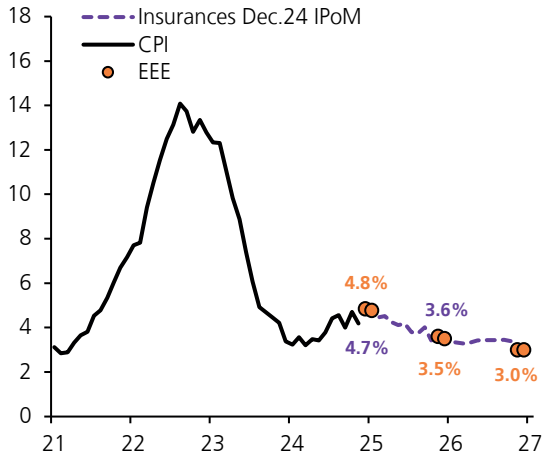
(1) Series adjusted by CPI, using the 2023 reference basket with the BCCh splice, considering its most recent revision. (2) For commercial and consumption rate, weighted average rates of all transactions in Chilean pesos performed each month in the Metropolitan Region (3) For commercial and consumption rates, the quarterly moving average is used; for the MPR, the annual average is used.

Source: Central Bank of Chile.

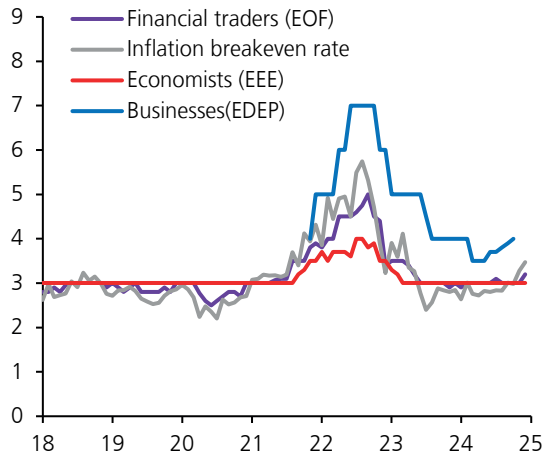
Experts' inflation expectations remain around the 3% target over the two-year monetary policy projection horizon (Figure I.15). Looking ahead, prospects derived from the Economic Expectations Survey (EEE) and from inflation insurances point to an inflation of 4.8% and 4.7%, respectively, at the end of 2024. One year ahead, both the survey and inflation insurances expect inflation to be close to 3.5%. Also, according to the November EPN, the percentage of firms expecting 12-month inflation to be near its normal level has increased. Meanwhile, the latest versions of the EEE and the Financial Traders Survey (EOF) expect inflation to be around 3% in two years' time.

FIGURE I.15

a) Actual and expected annual inflation (1)
(annual change, percent)



b) Two-year inflation expectations (2)(3)(4)
(annual change, percent)



(1) Series consider the 2023 CPI reference basket. Insurance considers average prices of the last ten days as of 11 December. (2) For surveys, median of responses are shown. (3) EOF considers the survey of the first half of each month until January 2018. From February 2018 onwards, it considers the last survey published in the month, including the one prior to the December 2024 Meeting. In months with no survey published, the latest available one is considered. (4) Breakeven inflation considers averaged prices of the last ten days of each month. For December 2024 it uses the average of the last ten days as of 11 December.

Source: Central Bank of Chile.

Market growth expectations for this and next year show no major changes compared to what was reported in the September IPoM. The November EEE expects growth of 2.2% for 2024 (2.3% in the August survey), while Consensus Forecasts projects it at 2.3% (2.4% in the last IPoM). Forecasts for 2025 have not changed much either: the EEE foresees a growth of 2.0% for that year, while Consensus Forecasts expects an expansion of 2.2% (2.2% and 2.3% respectively in the September IPoM). For 2026, the EEE foresees an expansion of 2.0%.

Expectations for the MPR continue to account for the gradual normalization process of the monetary policy that is still underway. One year ahead, the outlooks contained in the EEE and the EOF foresee that the interest rate will stand at 4.5% (4.75% and 4.5% in the previous IPoM, respectively), while the expectations implicit in the overnight index swap (OIS) rates suggest that it will reach 4.75%. In the monetary policy horizon (two years), the EEE, the EOF and the OIS rates expect a monetary policy rate of 4.0%, 4.5% and 4.75%, respectively).

BOX I.1:

Evolution of long-term interest rates

Evolution of long-term interest rates in recent decades

After a sustained decline in the first two decades of this century, long-term interest rates have risen sharply in recent years. This has been particularly evident in the rate of 10-year U.S. Treasury bonds, which in recent weeks reached around 250 basis points (bp) above the 2012-2021 average.

Due to the significance of this situation both for the conduct of monetary policy and for the functioning of the economy, the XXVII Annual Conference of the Central Bank of Chile, held on 4-5 November, had as its main topic the medium- and long-term evolution of interest rates. The Conference was attended by renowned international experts in this literature who, together with researchers from the Central Bank of Chile, presented a series of papers specially prepared for the event.

The participants at the Conference discussed the various forces behind these rate changes. Among the factors that could have been behind the fall in interest rates in the 2000-2020 period were the excess of savings over global investment (savings glut), demographic changes —including longer life expectancy—, low productivity growth, greater risk aversion and increased inequality. Other factors that would explain the most recent increase in interest rates include the rise in productivity resulting from the development of artificial intelligence, investments related to climate change and defense spending, which, if not accompanied by reductions in spending on other items, will result in larger fiscal deficits.

The Conference featured a panel discussion on the future outlook for rates and their importance for emerging economies. Differences in the determinants of long rates between developed and emerging economies were noted, including that in the latter, external shocks and exchange rate movements tend to play a greater role. Moreover, in general, emerging economies have less developed financial markets, which makes it difficult for structural fundamentals to be reflected in the level of rates and may generate greater volatility. For these and other considerations, long rates in emerging economies include risk premiums of various kinds, and this raises financing costs.

Recent dynamics of long rates

Beyond the structural elements analyzed at the Conference, several factors have clarified the dynamics of United States long-term rates in recent quarters. These include the change in the business cycle and the resulting monetary policy reaction, the strength of the United States economy and a significant increase in risk appetite. In addition, there is greater uncertainty regarding the neutral level of the federal funds rate (FFR), which would be causing a greater sensitivity of long rates to changes in the short-term monetary policy outlook (Reszczynski et al., 2024).

Compared to the September IPoM, the U.S. 10-year rate has risen by around 40bp. Part of this could be related to the improved growth outlook. The outcome of the elections and the deregulation agenda of the new administration may also be generating some preference for equities over fixed income, favoring the increase in long rates.

Another important factor in the evolution of interest rates is the increase in term premiums (Figure I.16). This may be influenced by factors such as uncertainty about the neutral rate, doubts about public finances in a context of already high debt levels and a complicated global geopolitical context that would have implications for defense spending. Added to this are the possible inflationary consequences of the new global trade environment[1]/.

The increase in international rates erodes external financing conditions for emerging economies and reduces commodity prices, which in turn tends to depreciate currencies and worsen local financing conditions. These effects are particularly strong when the reason for the increase in global rates is a higher risk premium (Figure I.17) —see also Reszczynski et al. (2024). Actually, since the September IPoM, most of the exchange rate depreciation in Chile and other emerging economies is explained by the higher global risk premiums (Figure I.18).

What can be expected from risk premiums and the evolution of long-term rates?

Although the risk premium component is highly volatile and could reverse in a few weeks, some background information suggests that part of the recent increase could prove to be persistent. Of particular note is the unusual reaction of the U.S. 10-year rate to the escalation of geopolitical tensions. Instead of falling, as is usual in risk-off events, since Russia's invasion of Ukraine it has tended to rise (Figure I.19). Calculations based on empirical semi-structural models indicate that the current level of the rate includes a geopolitical premium in the order of 30-40bp (Reszczynski et al., 2024). This uncommon behavior could be due to two elements. On the one hand, the perception of a lasting change in geopolitical balances, with clearer bloc formations and a higher probability of extreme events, which will limit some of the mechanisms that contributed to reducing rates in the past (for example, the increase in global demand for U.S. bonds). On the other hand, this change in the global geopolitical scenario occurs while public finances are already in a delicate position, so pressures for higher defense spending will also tend to push rates upwards[2]/.

Conclusions

For emerging economies, international financial conditions appear to be a significant source of medium-term risks. The uncertainty surrounding the fiscal outlook in the developed world, the geopolitical situation and the unfolding of trade conflicts have tended to increase the likelihood of scenarios that just a few months ago were only tail risks or were not even part of the universe of possibilities. Given the difficulty of properly factoring these scenarios into asset prices, seemingly small developments are causing disproportionate reactions in market prices. The most likely scenario is that this uncertainty —and its associated volatility— will remain present in the coming months, which would keep pressure on long rates globally and, therefore, on asset prices in the emerging world.

[1]/ The relevance of the fiscal outlook on the increase in long rates is also observed by analyzing the markets' reaction to fiscal announcements in other developed and emerging economies and by applying the Ferreira and Shousha (2023) decomposition for U.S. rates (Reszczynski et al., 2024).

[2]/ Albagli, E., S. Bauducco, G. Carlomagno, L. Gonzales and J. Wlasiuk, "Climate change, wars, and the natural rate of interest." Pre-sen¬ted at the BCCh's 2024 Conference.

FIGURE I.16

U.S. 10-year rate decomposition (1)
(accumulated since 28.Aug.24, basis points)

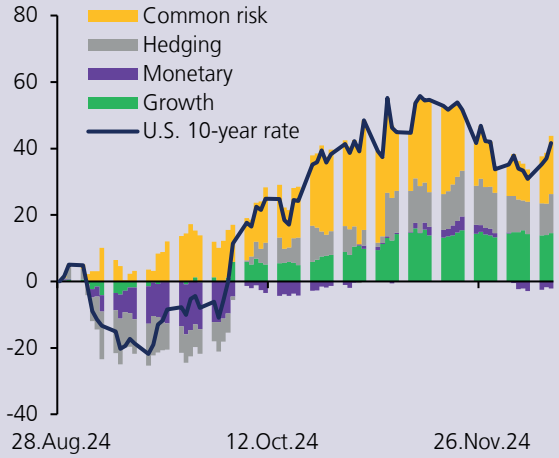
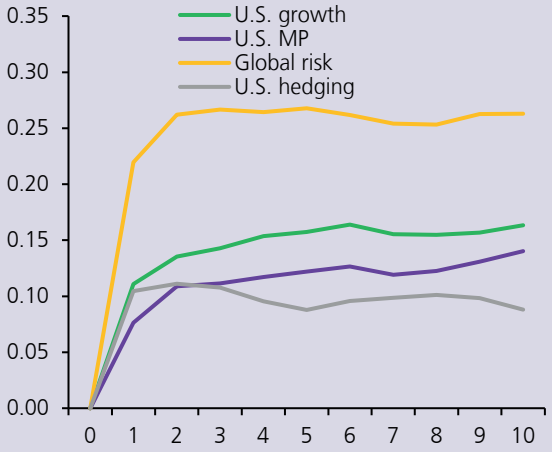


FIGURE I.17

IRFs: Emerging NER to global shocks (2)
(percent)



(1) Decomposition based on Cieslak & Pang (2021). (2) IRFs obtained through local projection methodology using daily frequency data. Structural shocks identified through bayesian SVAR with blocs of emerging and developed countries, U.S. and commodities. IRFs correspond to the variables response to a one standard deviation shock. For further details, see Reszczynski et al. (2024).
Sources: Reszczynski et al. (2024) based on data from Bloomberg.

FIGURE I.18

NER decomposition (1)
(accumulated since 28.Aug.24, percent)

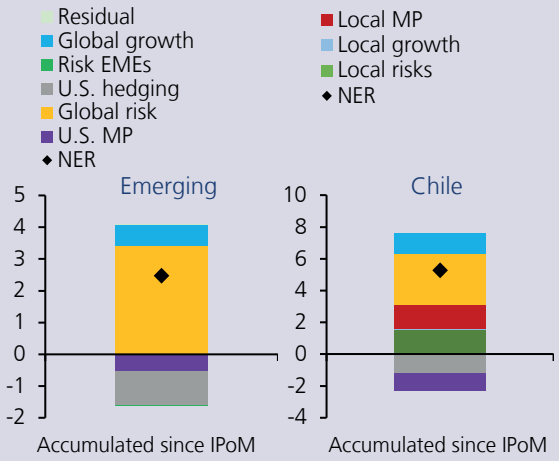
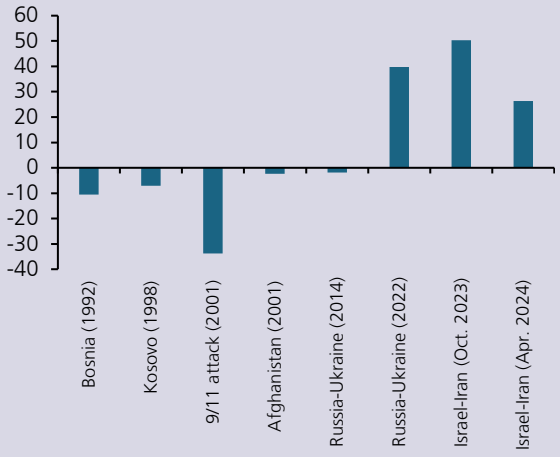


FIGURE I.19

U.S. 10-year rate response to war conflicts (2)
(basis points)



(1) Structural shocks identified through bayesian SVAR with blocs of emerging and developed countries, U.S. and commodities. Net accumulated change respect to average since 2010. For further details, see Reszczynski et al. (2024). (2) 10-year rate change of 30-day event centered average. Results for real rates are similar, with the exception of 2022 Russia-Ukraine war, in which the increase of real rate is near to zero.
Sources: Reszczynski et al. (2024) based on data from Bloomberg.

BOX I.2:

Recent evolution of consumption and its determinants

Household consumption has performed weaker than expected in recent quarters. After a significant normalization process between 2022 and early 2023, in the latter part of last year and the first quarter of this year it showed positive rates. However, in the last two quarters it has shown less dynamism, falling below expectations (Figure I.20). This has implied that, in this and the previous IPoM, one important change in macroeconomic projections has been the lower expansion expected for private consumption. Thus, while in June and September a cumulative growth of around 7% and 6% was projected between 2024 and 2026, the current central scenario considers a figure of around 5%.

This Box describes the evolution of some factors that could be explaining the weaker performance of consumption and its implications for the macroeconomic scenario.

Evolution of consumption fundamentals

One of the main determinants of household spending is labor income, the evolution of which depends on the dynamics of employment and wages. In recent quarters, both have behaved in opposite directions. On the one hand, there was a significant increase in wages—especially in the middle of the year—and, on the other, a weak performance of employment. However, the real wage bill has continued to expand annually, albeit at a lower rate at the margin. The same is observed in the income from production in the national accounts by institutional sector. Although these have a longer lag, they include other sources of household income.[1]/ Information for the second quarter of 2024 showed positive annual growth rates, but lower than those of the wage bill.

Regarding employment, different sources report stagnation in recent months. For example, there has been no q/q increase in total employment (INE), while formal salaried employment has tended to stabilize after a significant drop in previous quarters (Figure I.21, Panel a), according to administrative records of dependent affiliates (AFP).[2]/ This further weakening of job creation is attributed to various factors. Most notable is the delay in the recovery of some labor-intensive sectors, especially construction (Figure I.21, Panel b). Moreover, non-mining investment was sluggish, and labor costs increased following different regulatory changes.

In terms of labor costs, Albagli *et al.* (2024) carry out an exercise based on the administrative records of unemployment insurers AFC, separating companies into two groups according to the fraction of workers subject to the minimum wage. The results show that, in relative terms, the most recent increases in the minimum wage have been reflected in an increase in labor costs[3]/ and a negative impact on the level of employment of firms

[1]/ In the national accounts by institutional sector, income from production is an important component of gross disposable income. In the household sector, in particular, income from production includes compensation of employees (formal and informal) and mixed income (income from production generated by unincorporated units). Gross operating surplus is also included.

[2]/ Seasonally adjusted series.

[3]/ Compared to March 2023, the average wage of firms with more workers subject to the minimum wage increased 4.3% more than the average wage of the rest of the firms. For details, see Albagli *et al.* (2024).

with more workers subject to it (Figure I.22, Panel a).[4]/ This differential effect is consistent with the evolution of face-to-face retail sales, which shows a greater deterioration in lower-income municipalities (Figure I.22, Panel b). It should be noted that the econometric exercise does not allow assessing the impact of the minimum wage on total formal employment, since it is not possible to infer the impact on the employment of firms with fewer workers subject to the minimum wage or on those firms created after the May 2023 minimum wage increase.

Another element that could be affecting the evolution of consumption is expectations. IPEC figures show an economic perception below the average of recent years. Despite their improvement between 2022 and 2023, they slowed down their recovery in 2024. This could be associated with the increase in inflation[5]/ and the stagnation of employment (Figure I.23). It is worth noting that a deterioration of employment could affect expectations and consumption via two channels: lower households' disposable income and increased households' precautionary behavior.

Financial conditions could also be playing a role. Although local conditions, related to monetary policy, have relaxed since last year, external conditions remain tight, in line with still high long-term interest rates and an appreciated dollar. The latter could explain, at least in part, the worse recent performance of goods consumption (more affected by the depreciation of the Chilean peso) compared to the services.

An econometric exercise[6]/ aimed at estimating the relevance of each factor on consumption highlights the slowdown in household income and expectations that remain in negative territory. Less restrictive local financial conditions would have partially counterbalanced this, although external developments continue to tone down the boost from consumption (Figure I.24).

Consumption outlook and implications

In the central projection scenario, given the deterioration of several of its fundamentals and the lower-than-expected dynamism in the third quarter, private consumption will expand less than estimated in the previous IPoM. The recent weakening of employment plays an important role in this, although other factors—such as external financial conditions and expectations—would also be contributing negatively. This lower consumption impulse will determine lower inflationary pressures in the medium term, contributing to the convergence of inflation to the 3% target within two years. In any case, it is still considered that the easing of individuals' financial burden and short-term domestic interest rates will support the recovery of private consumption in the near future.

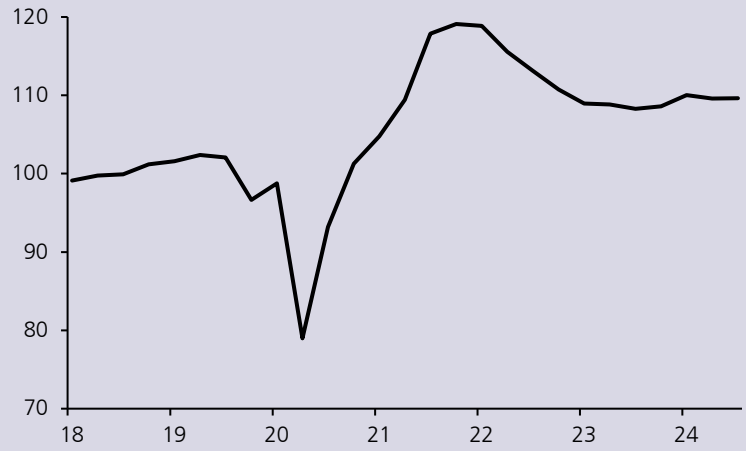
---

[4]/ In Figure I.22 each red dot represents the percentage change in the average employment of firms with more workers subject to the minimum wage than the rest of the firms. Blue bars delimit the confidence intervals. Changes in employment are always relative to March 2023. The dotted lines indicate the months prior to increases in the minimum wage. For details, see Albagli *et al.* (2024).

[5]/ By replicating the Burn-Murdoch (2023) estimates for the United States, the IPEC was modeled with data between 2002 and 2019 based on different macroeconomic fundamentals, including contemporary inflation, unemployment, real wages, interest rate and other controls. The results show that a 1% increase in inflation is associated with a decrease in IPEC between 3% and 11%. In addition, over the course of 2024, a sentiment gap persists between the IPEC and model predictions that would be associated with a persistent effect of past inflationary shocks on expectations, which would take up to two years to dissipate once occurred (Cummings & Mahoney, 2023).

[6]/ A semi-structural decomposition of consumption with a VAR based on external global factors, expectations and local variables is used. The latter include gross disposable income, consumer credit interest rates and the Central Bank's Banking Credit Survey. For details on the methodology, see Albagli *et al.* (2019).

FIGURE I.20 PRIVATE CONSUMPTION
(index 2018 = 100, seasonally adjusted series)

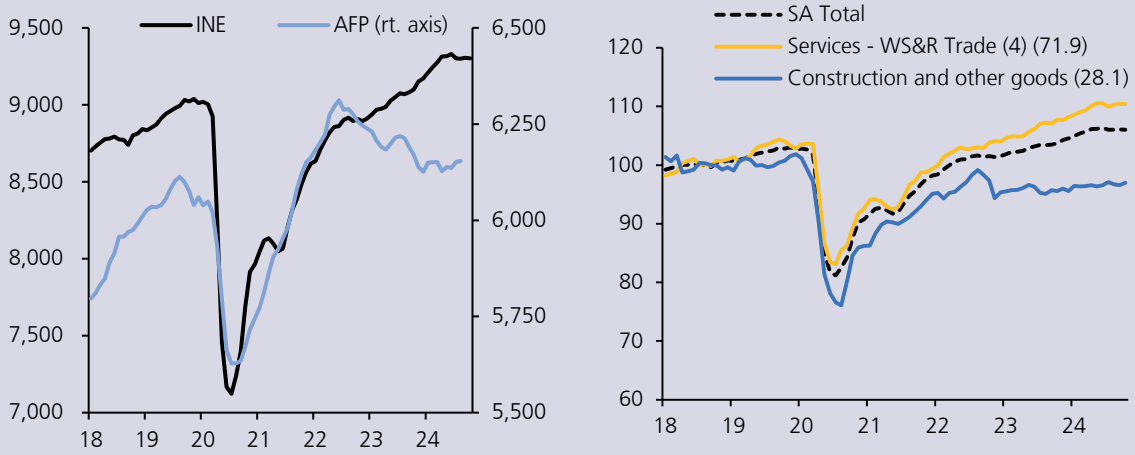


Source: Central Bank of Chile.

FIGURE I.21

a) INE total employment and AFP dependent affiliates (1)
(thousands, seasonally adjusted series)

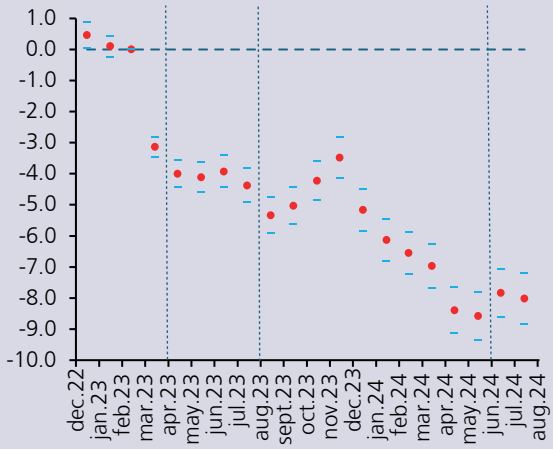
b) INE sectoral employment (1) (2) (3)
(index 2018 = 100, seasonally adjusted series)



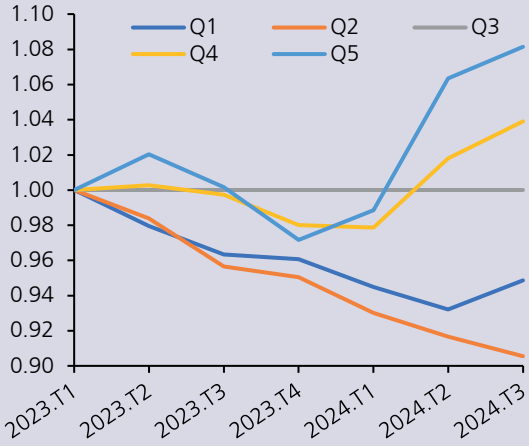
(1) Internal seasonal adjustment for INE sectoral employment and AFP dependent affiliates. (2) Other goods include agricultural, industrial, EGA and mining sectors. (3) Parentheses of the series indicate the percentage of participation in total employment in 2023. (4) WS&R Trade: wholesale and retail trade.
Sources: INE and Chilean Pensions Supervisor.

FIGURE I.22

a) Effect on average employment of treated firms (1)
(percent change)

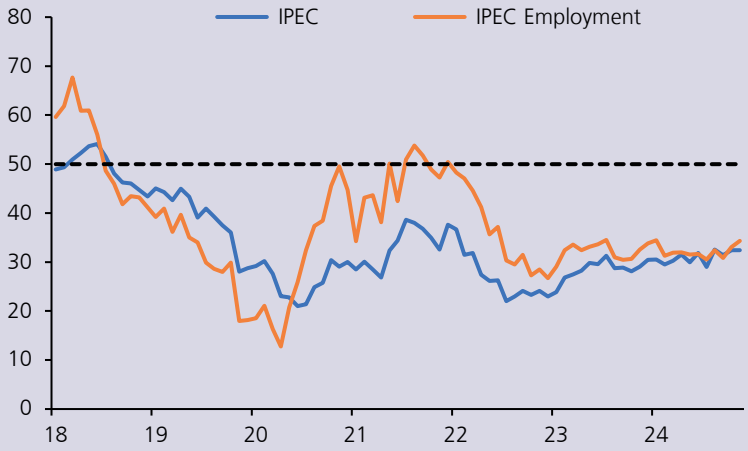


b) Face-to-face retail sales by quintile (2) (3)
(relative to the third quintile, index 2023.T1 = 100)



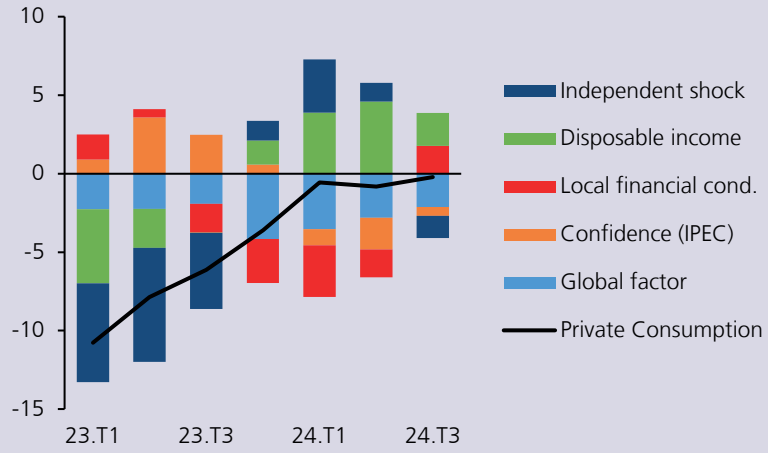
(1) Percent change in average employment of treated firms compared to non-treated firms. Treated firms: those whose proportion of workers affected by the minimum wage is greater than the median. More details in Albagli *et al.* (2024). (2) Face-to-face sales with Transbank and Getnet only. (3) The income quintile is proxied by the income quintile of the municipality in which the purchase is made. See Box I.3 of the June 2023 Report and García *et al.* (2023) for details on sources, coverage, representativeness and statistical filters. In the horizontal axis, T1-T4 stands for the respective quarter (in Spanish, "trimestre").
Sources: AFC Unemployment Insurers of Chile, Transbank and Getnet.

FIGURE I.23 ECONOMIC PERCEPTION INDEX (IPEC): TOTAL AND EMPLOYMENT (*)
(seasonally adjusted series)



(*) Value above (below) 50 indicates optimism (pessimism). Internal seasonal adjustment.
Source: GfK Adimark.

FIGURE I.24 SVAR FOR PRIVATE CONSUMPTION: GROWTH DECOMPOSITION BY DETERMINANTS
(contributions to annual variation, deviations from trend, percent points)



Source: Central Bank of Chile, following Albagli *et al.* (2019).

II. FUTURE EVOLUTION OF MONETARY POLICY

The short-term inflation scenario has become more challenging, in a context where headline inflation has exceeded expectations, and new cost pressures are observed coming from various fronts. These costs shocks have occurred simultaneously, which has contributed to the narrowing of firms' operating margins and leads to a pass-through to final prices higher than previously anticipated. Annual CPI inflation is expected to fluctuate around 5% during the first half of 2025. Thus, in the medium term, weaker domestic demand should mitigate inflationary pressures, so that the convergence of inflation to the 3% target will not deviate much from our previous estimate. The risk balance for inflation is biased upward in the short term, so caution is most needed. This means that the Board will steadily accumulate information regarding the progress of the economy in order to assess the timing for monetary policy report (MPR) cuts in the coming quarters.

ACTIVITY AND DEMAND PROJECTIONS IN THE CENTRAL SCENARIO

Projected growth in domestic demand is lowered for the period 2024-2026. In the private consumption, the projection factors in its poor performance during the second and third quarters of the year, the weakness of employment, the depreciation of the peso and still pessimistic consumer expectations (Box I.2). Meanwhile, certain elements will contribute to its gradual recovery over the projection horizon, including an easing of the financial burden and the reduction of short-term interest rates. The central scenario projects private consumption growth in real terms of 1.1% in 2024, 1.6% in 2025 and 2% in 2026 (1.7%, 1.9% and 2.2% in the September IPoM, respectively) (figures II.1 and II.2; table II.1).

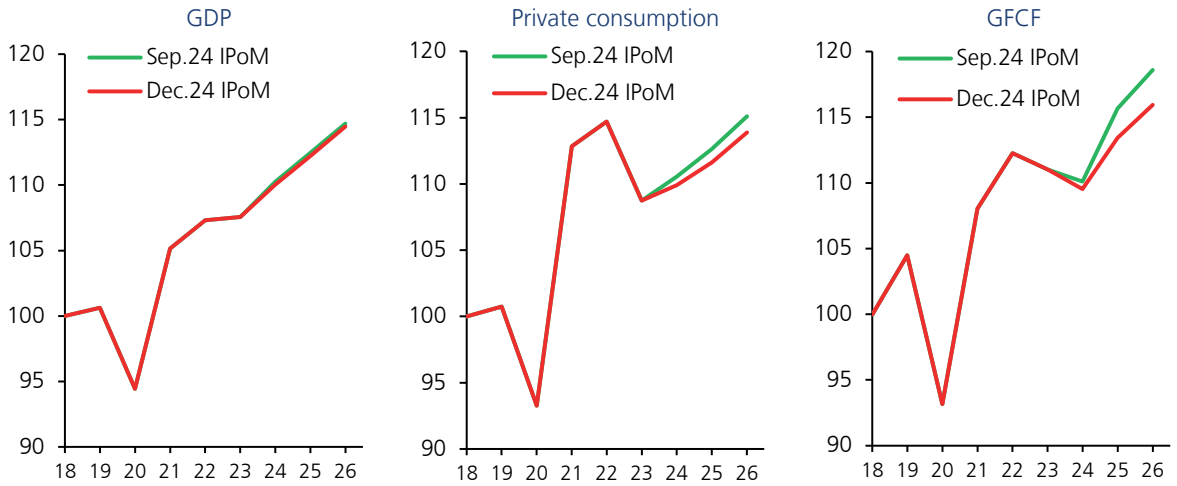
In the central scenario the Gross fixed capital formation (GFCF) forecast is also revised downwards, mostly for the non-mining sectors. The figures for the third quarter were in line with projections in the last IPoM, although the differences between its components and the heterogeneity across sectors remained (Chapter I). Most of the adjustments to the projections respond to the tightening of external financial conditions, amid increased uncertainty at the global level, which is reflected in the persistence of high long-term interest rates and the depreciation of the peso. In the central scenario, a slightly larger real annual contraction of GFCF is projected for this year (-1.3%, compared with -0.8% in the September IPoM) and a moderation of growth rates in 2025 and 2026 (3.6% and 2.2% respectively, versus 5.1% and 2.5% in the September IPoM, in each case) (figures II.1 and II.2; table II.1).

TABLE II.1 ECONOMIC GROWTH AND CURRENT ACCOUNT

	2023	2024 (f)	2025 (f)	2026 (f)
		(annual change, percent)		
GDP	0.2	2.3	1.5-2.5	1.5-2.5
National income	0.8	1.1	2.0	2.6
Domestic demand	-4.2	1.1	1.9	2.1
Domestic demand (w/o inventory change)	-3.2	0.9	2.2	2.3
Gross fixed capital formation	-1.1	-1.3	3.6	2.2
Total consumption	-3.9	1.5	1.8	2.4
Private consumption	-5.2	1.1	1.6	2.0
Goods and services exports	-0.3	5.6	3.8	2.8
Goods and services imports	-12.0	1.7	4.2	3.1
Current account (% of GDP)	-3.6	-2.4	-2.3	-2.3
Gross national saving (% of GDP)	19.4	20.4	19.7	20.0
Gross national investment (% of GDP)	23.0	22.8	22.0	22.2
GFCF (% of nominal GDP)	23.8	23.6	23.1	23.6
GFCF (% of real GDP)	23.8	22.9	23.3	23.4
		(US$ million)		
Current account	-11,899	-7,800	-7,800	-8,500
Trade balance	15,323	21,600	23,600	24,900
Exports	94,557	99,400	105,900	111,700
Imports	79,234	77,800	82,300	86,800
Services	-10,782	-9,200	-10,500	-11,300
Rent	-17,009	-20,200	-20,600	-21,900
Current transfers	568	0	-300	-200

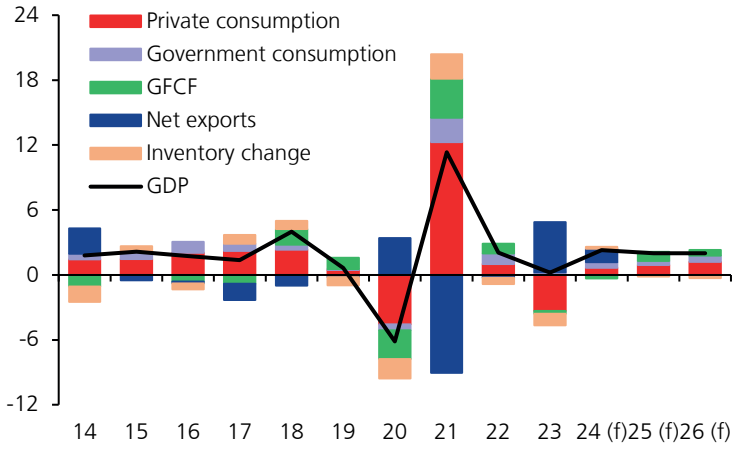
(f) Forecast.
Source: Central Bank of Chile.

FIGURE II.1 ACTIVITY, PRIVATE CONSUMPTION AND GFCF (*)
(index, 2018 =100)



(*) For 2024, 2025 and 2026 correspond to the projections contained in the respective Monetary Policy Report (IPoM). For 2025 and 2026, considers midpoint of GDP growth ranges projected in respective IPoM.
Source: Central Bank of Chile.Fuente: Banco Central de Chile.

FIGURE II.2 GDP GROWTH AND AGGREGATE DEMAND COMPONENTS CONTRIBUTIONS (*)
(annual change, percentage points)

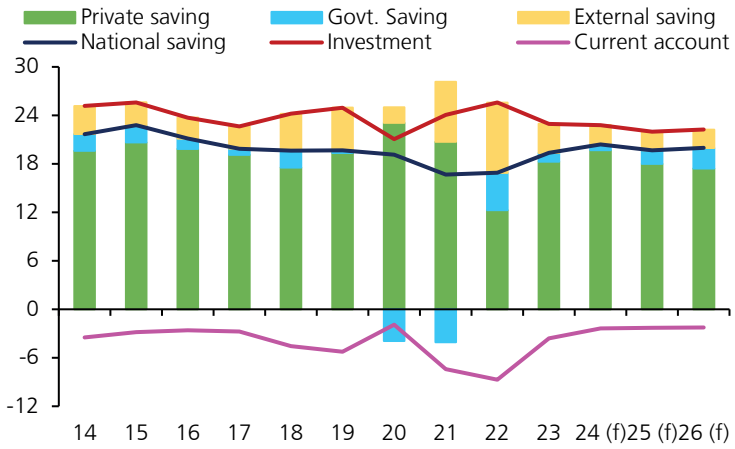


(*) For 2025 and 2026, considers midpoint of GDP growth ranges projected in this IPoM's central scenario.
(f) Forecast.
Source: Central Bank of Chile.

Projections include a real expansion of public spending that matches the one portrayed in the recently approved budget law. As a working assumption, the process of consolidating public finances is still expected to continue. All in all, the coming years present a challenging situation for complying with the fiscal rule.

The central scenario considers a slightly lower current account deficit for the next two years. On the one hand, this responds to the better outlook for exports of goods and services, which will be favored by the depreciation of the peso. This includes tourism-related consumption by non-residents and higher volume of goods shipped. On the other hand, imports will be reduced, in line with the adjustments in domestic demand. Seen from the savings-investment equilibrium, the biggest change is due to higher private savings than were expected in September, which will be offset by lower public sector savings, although the latter would continue to increase during the projection horizon (table II.1; figure II.3).

FIGURE II.3 CURRENT ACCOUNT: SAVINGS AND INVESTMENT (*)
(percentage of annual GDP)



(*) The government savings component considers as actual data up to 2023 the general government's balance sheet; the government savings of the central government's balance sheet is used for the 2024-2026 forecast.
(f) Forecast.
Source: Central Bank of Chile.

This scenario assumes that GDP will grow 2.3% annually in 2024, i.e., in the lower part of the September range (2.25%-2.75%). For 2025 and 2026, the projected growth ranges are held at 1.5%-2.5% annually. For this year, the scenario foresees lower non-mining GDP growth, based on actual data for the third quarter and a weaker outlook for the fourth quarter, particularly for construction and entrepreneurial services. For 2025 and 2026, the greater public spending and the boost from the external sector are counterbalanced by the expected weaker momentum of private spending, in both consumption and non-mining investment. Meanwhile, the positive outlook for mining remains (figures II.1 and II.2; table II.1).

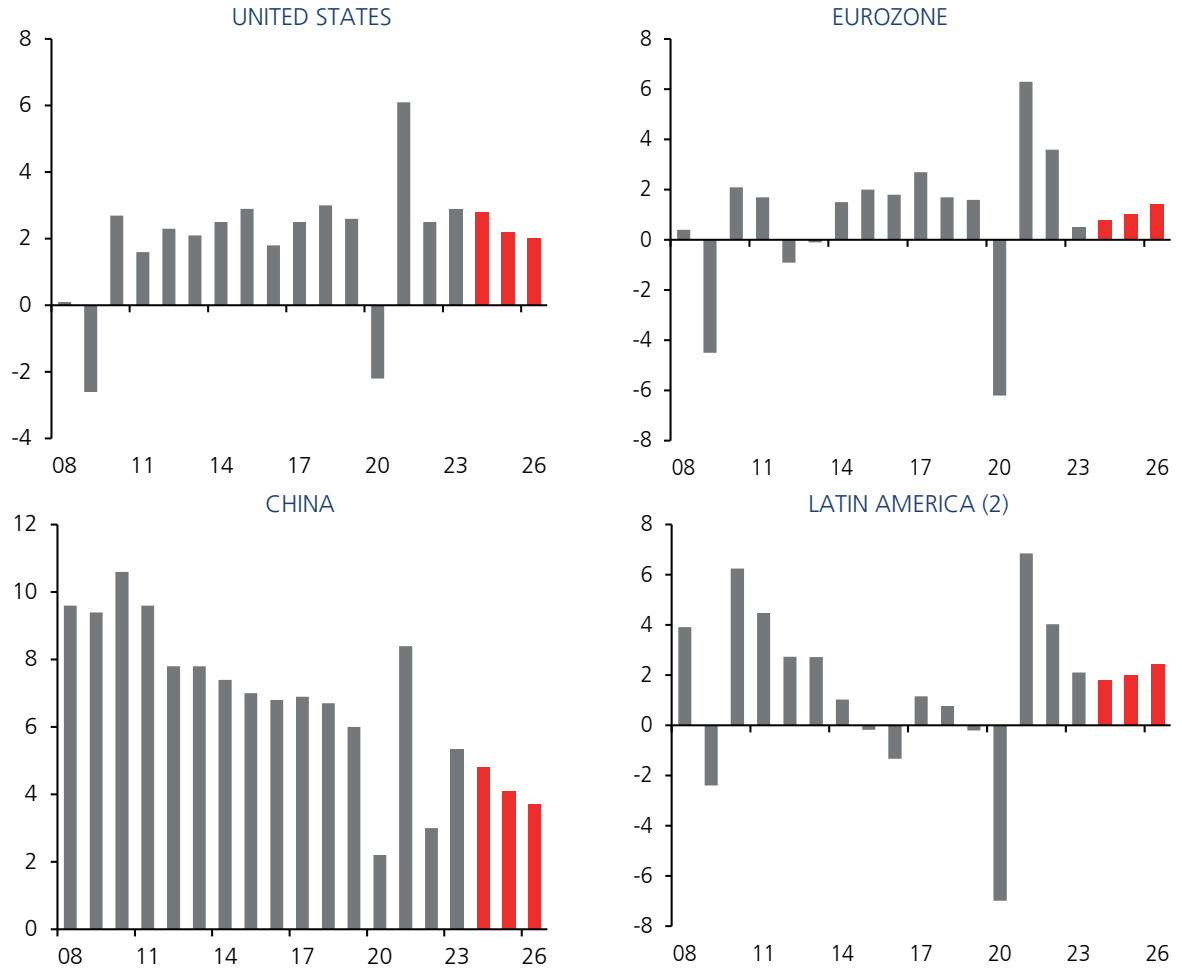
On the external front, the central scenario maintains world growth and trading partners' growth around 3% for the next two years. This represents no big change with respect to September IPoM, although it sees a more positive performance in the United States, partly due to the dynamism that private consumption has continued to show. For China, growth is still expected to decelerate over the next two years. The outlook for all other economies shows limited adjustments. The exception is Latin America, where several countries have seen better than expected figures, which result in a better performance of the region in 2024, and where the case of Brazil stands out (Chapter I) (figure II.4; table II.2).

TABLE II.2 WORLD GROWTH (*)
(annual change, percent)

	Aveg. 10-19	2022	2023 (e)	2024 (f)	2025 (f)	2026 (f)
World GDP at PPP	3.6	3.6	3.5	3.3	3.0	3.0
World GDP at market exchange rate	3.3	3.2	2.9	2.8	2.6	2.5
Trading partners	3.9	3.0	3.4	3.2	2.9	2.8
United States	2.4	2.5	2.9	2.8	2.2	2.0
Eurozone	1.4	3.6	0.5	0.8	1.0	1.4
Japan	1.2	1.1	1.7	-0.3	1.2	1.0
China	7.7	3.0	5.3	4.8	4.1	3.7
India	6.7	7.0	8.2	7.0	6.5	6.5
Rest de Asia	4.5	4.2	3.1	4.0	3.5	3.3
Latin America (excl. Chile)	1.7	4.0	2.1	1.8	2.0	2.5
Commodity exp.	2.2	3.4	1.3	1.1	1.8	2.0

(*) For definition, see Glossary of economic terms.
(f) Forecast.
(e) Estimate.
Source: Central Bank of Chile based on a sample of investment banks, Consensus Forecasts, the IMF, and statistics bureaus of respective countries.

FIGURE II.4 TRADING PARTNERS GROWTH PROJECTIONS (1)
(annual change, percent)



(1) Red bars correspond to the projections of the central scenario of this Monetary Policy Report (IPoM).
(2) The Region considers Argentina, Bolivia, Brazil, Colombia, Ecuador, Mexico, Paraguay, Peru, Uruguay and Venezuela. The series projection is based on GPM model region made up by Brazil, Chile, Colombia, Mexico and Peru.
Source: Central Bank of Chile.

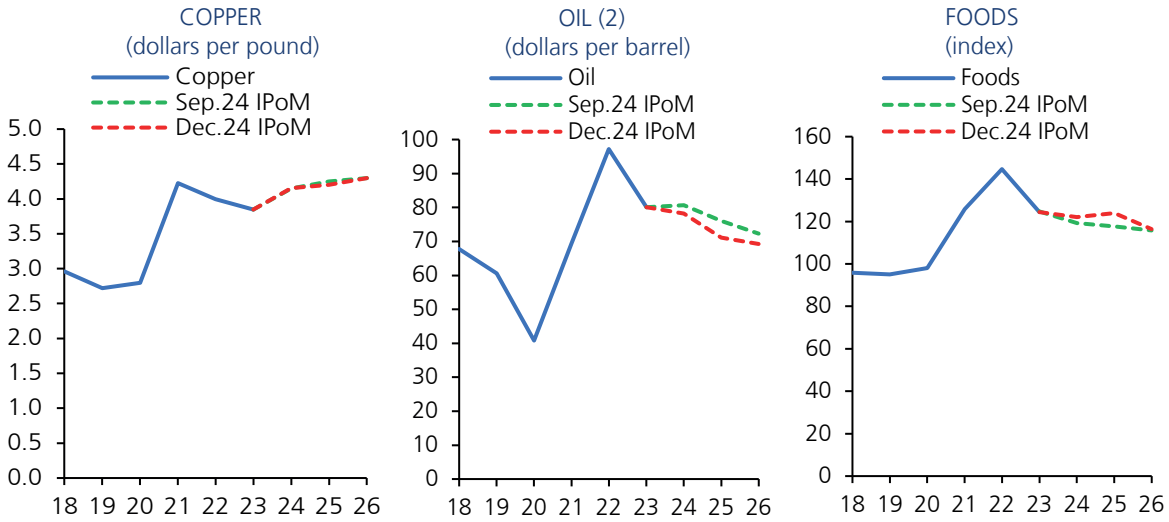
Projections for commodity prices see mixed corrections, amid the volatility that some of them have shown in recent months. All things considered, the terms of trade for the next two years are expected to be somewhat better than those contemplated in September. The central scenario estimates an average copper price that will follow a trend towards US$4.3 during the projection horizon, amid medium-term fundamentals that show no significant changes. In the case of oil (Brent-WTI average), the forecast is lower, due to a worsened outlook for world demand and some more favorable news on the supply side. Thus, oil is expected to trade around US$70 per barrel in 2025 and 2026 (versus US$76 and US$72 each year in September). International food prices (FAO index) are revised up due to higher prices of some items, explained by a fall in supply triggered by bad weather conditions, among other elements (table II.3 and figures II.5 and II.6).

TABLE II.3 INTERNATIONAL BASELINE SCENARIO ASSUMPTIONS

	Aveg. 10-19	2022	2023	2024 (f)	2025 (f)	2026 (f)
			(annual change, percent)			
Terms of trade	1.0	-6.8	2.4	0.9	-0.5	1.0
External prices (in US$)	0.6	4.4	-0.2	0.0	2.5	3.3
			(levels)			
LME copper price (US$cent/pound)	306	400	385	415	420	430
WTI oil price (US$/barrel)	72	94	78	76	69	67
Brent oil price (US$/barrel)	80	100	83	81	74	72
Gasoline parity price (US$/m3) (1)	610	850	721	660	572	554
US Federal Funds Rate (%) (2)	0.7	1.9	5.2	5.3	4.1	3.5

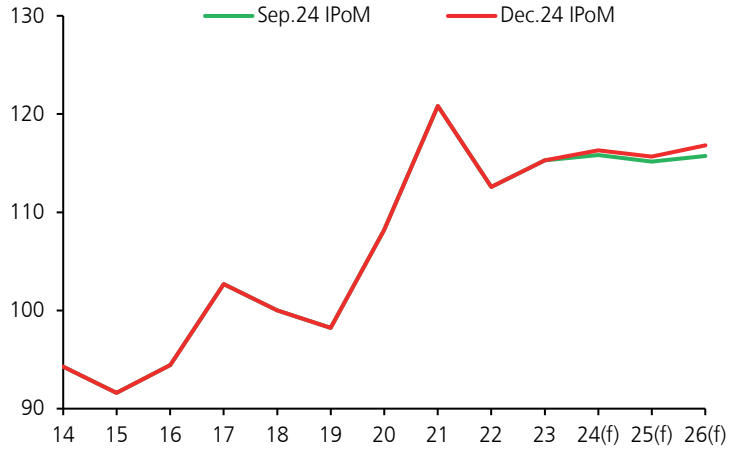
(1) For definition, see Glossary of economic terms.
(2) Annual average for the upper range of the Fed funds rate.
(f) Forecast.
Source: Central Bank of Chile.

FIGURE II.5 COMMODITY PRICES FORECASTS (1)



(1) Actual or projected (slashed lines) average price for each year as conatained in respective Monetary Policy Report (IPoM).
(2) For oil, WTI-Brent average price per barrel.
Sources: Central Bank of Chile and FAO.

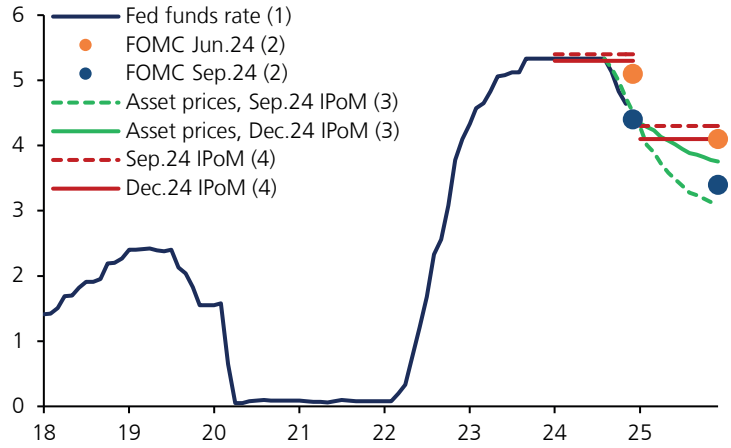
FIGURE II.6 TERMS OF TRADE
(level, 2018=100)



(f) Forecast.
Source: Central Bank of Chile.

The outlook for monetary policy in the United States remains unchanged with respect to the September IPoM. In addition, long-term interest rates are expected to remain high in a context of greater uncertainty in the international outlook. The process of the Fed's rate cuts will continue at a similar pace to that was considered in the central scenario of September IPoM. It is worth noting that the market has considerably increased its expected path for the fed funds rate (FFR) in 2025, getting closer to the September forecast. The projections of this IPoM consider a 25 basis point (bp) cut in December and three reductions in 2025 (four in the previous IPoM) (figure II.7). However, the doubts surrounding this process have continued to generate volatility in the financial markets and might continue to do so for some time. Long rates, meanwhile, are expected to remain high. This reflects the increase in term premiums built into these rates, in which, among other elements, uncertainty about the fiscal situation in several economies plays a part (Box I.1).

FIGURE II.7 EVOLUTION AND FORECASTS FOR THE FED FUNDS RATE
(percentage points)

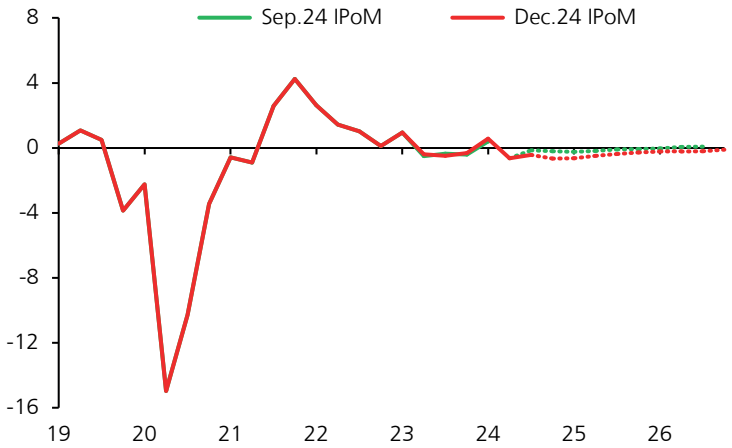


(1) Actual Fed funds rate. Considers information up to November 2024.
(2) Forecast of Federal Open Market Committee (FOMC) at respective meeting.
(3) Based on statistical cutoff dates of respective Monetary Policy Report (IPoM).
(4) Annual average for the upper range of Fed funds rate in 2024 and 2025, according to central scenario of each IPoM.
Sources: Bloomberg and U.S. Federal Reserve.

THE ACTIVITY GAP AND INFLATION'S CONVERGENCE TO THE TARGET

The activity gap is expected to remain slightly negative until the end of 2025, which will help mitigate inflationary pressures (figure II.8). Thereafter, it is expected to close steadily and return to its equilibrium levels as the economy continues to grow around its trend, demand recovers and the MPR cuts continue. The assessment regarding the level of the activity gap is consistent with an estimated narrow labor market gap, in a context in which the unemployment rate is slightly above the range that would be obtained for the reference unemployment rate —which considers the absence of cyclical pressures on inflation— using different methodologies (Box II.1).

FIGURE II.8 ACTIVITY GAP (1) (2)
(level, percentage points)



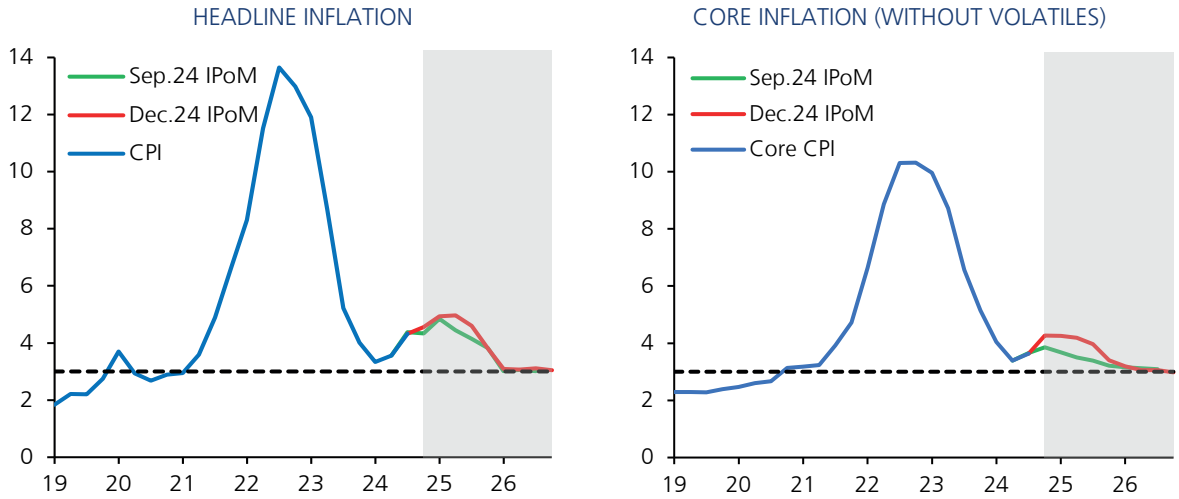
(1) Dotted lines show forecast.
(2) Forecast assumes structural paramenters updated in September 2024 Monetary Policy Report (IPoM) (trend and potential GDP).
Source: Central Bank of Chile.

In the short term, the central scenario incorporates a trajectory for total and core inflation that runs higher than was expected in September. This includes the effect of greater cost pressures and considers the slight positive difference with respect to the forecast that has accumulated with the inflationary figures of recent months. In addition to the upward surprise that inflation figures accumulated between August and November, there were several cost pressures. Some international prices (e.g., foods), labor costs and the depreciation of the peso stand out. The simultaneity of these shocks has narrowed business margins and leads to an estimate of a higher pass-through coefficient to final prices compared to previous quarters. Thus, the latter parameter is now assessed to be around its historical averages. Core inflation leads the revisions, with average inflation in 2025 being 0.5 percentage points higher than forecast in September. For total inflation, this is partially offset by downward corrections in some external prices, particularly for fuels (figure II.9; table II.4).

Headline inflation will rise in the coming months and will hover around 5% annually during the first half of 2025. It will then begin to diminish, ending the year at 3.6% and converging to 3% in the early months of 2026 (figure II.9; table II.4). Much of the inflationary convergence process is

justified by the weaker outlook for domestic demand and by easing cost pressures, including the gradual reduction of the real exchange rate. The latter is expected to increase as the impacts of increased uncertainty on financial variables recede, the FFR normalization process continues, and the copper price evolves as expected. The lessening of the financial burden on individuals and of short-term interest rates will support the recovery of consumption in the near future.

FIGURE II.9 INFLATION FORECAST (*)
(annual change, percent)



(*) Inflation figures consider 2023 CPI basket using BCCh splicing. Monthly and annual variations of this index do not coincide with official INE variations –useful for indexation purposes– as these use the previous basket series for base year changes. Gray area, as from fourth quarter 2024, shows forecast.
Sources: Central Bank of Chile and National Statistics Institute (INE).

TABLE II.4 INFLATION (1)
(annual change, percent)

	2023	2024 (f)	2025 (f)	2026 (f)
Average CPI	7.3	3.9	4.6	3.1
December CPI	3.4	4.8	3.6	3.0
CPI in around 2 years (2)				3.0
Average core CPI	7.5	3.8	3.9	3.1
December core CPI	4.7	4.5	3.3	3.0
Core CPI around 2 years (2)				3.0

(1) Inflation figures consider 2023 CPI basket using BCCh splicing. Monthly and annual variations of this index do not coincide with official INE variations –useful for indexation purposes– as these use the previous basket series for base year changes.
(2) Inflation forecast for the fourth quarter of 2026.
(f) Forecast.
Sources: Central Bank of Chile and National Statistics Institute (INE).

MONETARY POLICY STRATEGY: THE CENTRAL SCENARIO AND SENSITIVITIES

The short-term inflationary outlook has become more challenging due to increased cost pressures. These will lead inflation to fluctuate around 5% during the first half of 2025 according to the central scenario of this IPoM. All things considered, in the medium term, the weaker domestic demand would mitigate inflationary pressures. Thus, if the assumptions in the central scenario materialize, the MPR will follow a descending trajectory over the policy horizon.

The risk balance for inflation is biased upward in the short term, so caution is most needed. This means that the Board will steadily accumulate information regarding the progress of the economy in order to assess the timing for MPR cuts in the coming quarters.

The MPR corridor contains sensitivity scenarios —away from the central scenario and with a significant probability of occurrence— where monetary policy could take a different path (figures II.10 and II.11).

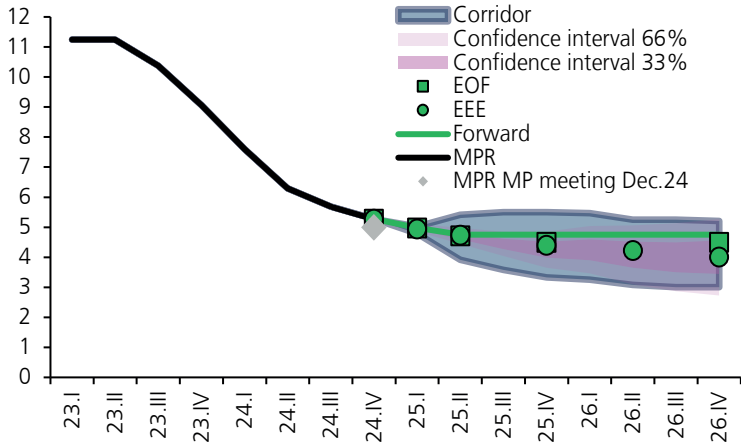
The upper boundary of the MPR corridor reflects scenarios with higher inflationary pressures, which in this case is associated with a stronger impact of cost pressures. The intensification of the latter and/or a higher pass-through to final prices by firms could heighten inflationary pressures in the economy, which would also magnify second-round effects and the possibility of see higher persistence. The short-term risks around these scenarios are greater, given the global uncertainty and the levels that inflation will reach in the central projection scenario. If such a scenario materializes, a more contractionary monetary policy path than foreseen in the central scenario would be required to ensure the convergence of inflation to the 3% target within the two-year monetary policy horizon.

The lower bound reflects the effects of increased uncertainty and weak international conditions on the evolution of domestic expenditure. A more abrupt deterioration of global financing conditions, associated with a worsening of the current sources of uncertainty, would further dampen agents' spending, especially in investment. There could also be a scenario where the labor market would deteriorate beyond expectations, generating capacity gaps that would be discordant with the convergence of inflation to the 3% target, requiring more significant reductions of the MPR.

The risk scenarios are related to global conditions, particularly on the financial front, but with more severe consequences that might force the MPR outside the corridor, in a context where new uncertainties have emerged[1]/. In particular, there are added concerns about commercial tensions and a potential de-globalization process. More extreme developments on this front, as well as the ongoing military conflicts and the fragile fiscal situation in several economies, do not permit to rule out more complex episodes of risk aversion in financial markets. This could give way to scenarios of a more pronounced exchange rate depreciation and greater contraction of activity, considering also that long rates have proven to be a weak buffer against the occurrence of negative shocks, particularly in the United States (Box I.1). Accordingly, the Board will remain watchful of possible deviations from the central scenario that may require changes in the monetary policy strategy, in order to ensure the convergence of inflation to the 3% target within the monetary policy horizon.

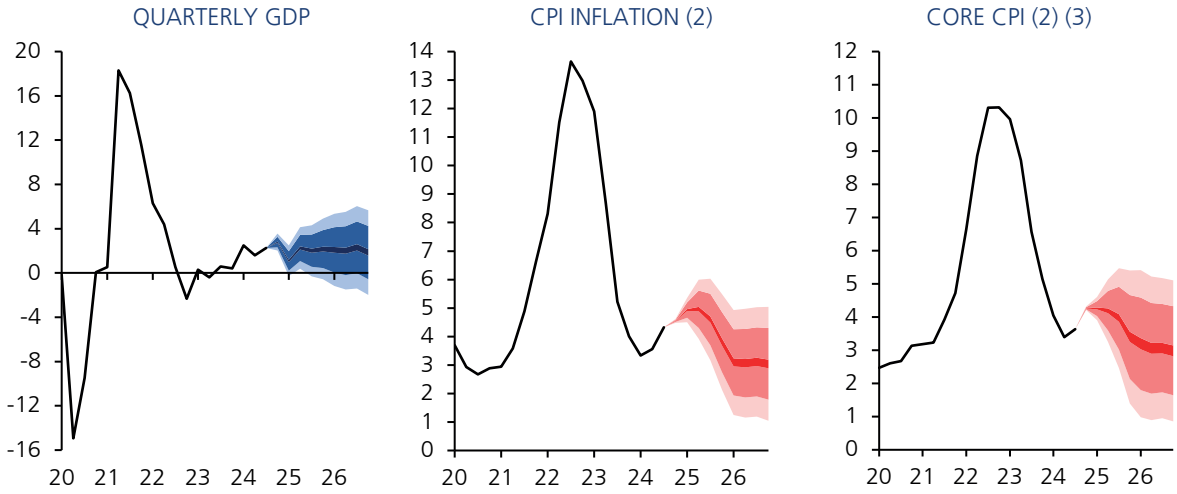
[1]/ The Financial Stability Report for the second semester of 2024 also reported risk factors linked to the external scenario.

FIGURE II.10 MPR CORRIDOR (*)
(quarterly average, percent)



(*) The 2025 and 2026 calendar considers two MP meetings per quarter. The corridor is built by following the methodology described in boxes V.1 of March 2020 Report and V.3 of March 2022 Report. It includes the December Economic expectations survey (EEE), the December pre-MP meeting Financial traders survey (EOF) and the quarterly average smoothed forward curve as of December 11. This is calculated by extracting the implicit MPR considering the forward curve over the overnight index swap (OIS) curve for up to 2 years, discounting the fixed rates of each maturity at the simple accrual of the OIS index. For the current quarter, the surveys and the forward curve consider the average of daily actual data and are completed with respective sources. Quarterly average considers working days in each quarter. Gray diamond corresponds to the MP decision of December 2024. Source: Central Bank of Chile.

FIGURE II.11 GROWTH AND INFLATION FORECASTS (1)
(annual change, percent)



(1) The figure shows the confidence interval of the central projection to the respective horizon (colored area). Includes 10, 70 and 90% confidence intervals around the central scenario. Confidence intervals are constructed from the RMSEs of the XMAS-MEP models, 2009-2017 average.
(2) Inflation figures consider the 2023 CPI basket using BCCh splice. The monthly and annual variations of this index do not coincide with the official INE variations –useful for indexation purposes– because the latter use the series of the previous basket for the base-year change.
(3) Measured with the CPI without volatiles.
Sources: Central Bank of Chile and National Statistics Institute (INE).

BOX II.1:

Labor market slack

During this year, the unemployment rate has fluctuated around 8.5%. At the same time, by various measures employment has been weak. Nonetheless, wages have risen substantially in recent months. In view of the above, there has been some discussion about the level of slack or gaps in the labor market.

This Box presents an assessment of labor market slack by analyzing the estimation of a set of measures of the benchmark unemployment rate over the last two decades. This rate is defined as the unemployment rate consistent with the absence of cyclical pressure on inflation[1]/, so it can be construed as a measure analogous to potential GDP. Periods in which the unemployment rate is above its benchmark would reflect capacity slack that would put downward pressure on inflation. The opposite would be the case if the unemployment rate were below its benchmark level.

Considering these estimates and the actual unemployment rate, the level of slack in the labor market is obtained, which complements the usual measurement of activity gaps. The different methodologies that measure the benchmark unemployment rate are reported in figure II.12[2]/. During 2024, the unemployment rate averaged 8.6%, which is slightly above the estimates for the benchmark unemployment rate. This would be consistent with the existence of limited slack in the labor market and with the assessment of the activity gap (Figure II.13). In the central scenario of this IPoM, this capacity slack will contribute to the convergence of inflation to its target over the projection horizon.

Estimates of the benchmark unemployment rate and unemployment gaps

Over a short time span, the benchmark unemployment rate may fluctuate due to transitory factors, such as cyclical changes in the composition of the labor force or short-term shocks affecting labor costs. In the medium term, it can also change its trend due to changes in structural factors, such as a persistent change in productivity growth, for example[3]/.

Levenier et al. (2024)) present five estimates of the benchmark unemployment rate obtained by using different methodologies. Most of the estimates show a downward trend between the mid-2000s and the mid 2010s, followed by an upward trend that continues to date. There are several factors that could explain this dynamic[4]/. The benchmark unemployment rate coincides with the period of a strong increase in copper prices, which was accompanied by a significant economic boom. The subsequent increase coincided with a period when total factor productivity showed negative growth rates, which had an adverse effect on trend GDP growth[5]/. It is also possible that the various regulatory changes that have

[1]/ In the international literature, the benchmark unemployment rate is also known as NAIRU (non-accelerating inflation rate of unemployment).

[2]/ Deseasonalized series.

[3]/ See, for example, Pissarides and Vallanti (2007). The medium-to-long term unemployment rate is defined as the rate that would prevail once the transitory shocks have dissipated. This measure is analogous to trend GDP, as it helps to determine the normal level of long-run economic activity.

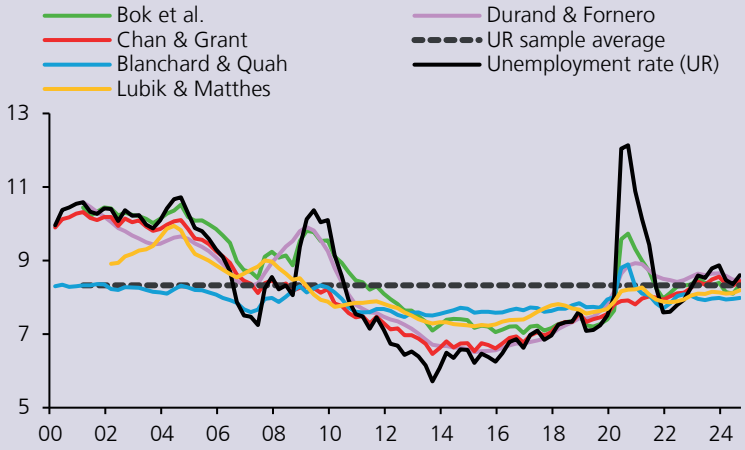
[4]/ The benchmark rate is estimated by using historical information and trends, so that current or near-future structural changes are not considered.

been made in the labor market in recent years have affected the pace of job creation and, therefore, the benchmark unemployment rate[6]/.

Conclusions

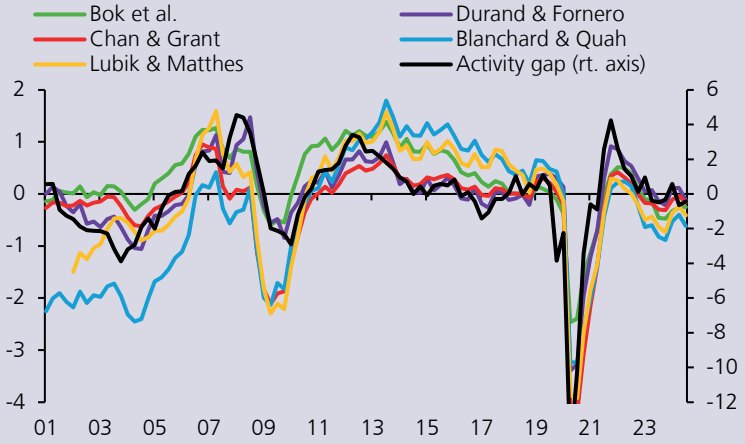
During 2024, the unemployment rate has averaged 8.6%, which is slightly above the estimates for the benchmark unemployment rate. This suggests the presence of limited slack in the labor market, in line with estimates for the activity gap.

FIGURE II.12 UNEMPLOYMENT RATE AND ESTIMATES OF ITS BENCHMARK LEVEL (*)
(percent, seasonally-adjusted series)



(*) Unemployment rate prior to the Jan-Feb-Mar 2010 mobile quarter corresponds to a splice using information from the ENE.
Sources: Levenier et al. (2024) based on National Statistics Institute (INE) and Central Bank of Chile.

FIGURE II.13 UNEMPLOYMENT AND ACTIVITY GAPS
(percentage points)



Sources: Levenier et al. (2024) based on National Statistics Institute (INE) and Central Bank of Chile.

[5]/ Total factor productivity performance has been documented in trend growth estimates. The most recent estimate was published in Box II.1 in the September 2024 IPoM.

[6]/ Different regulatory measures may affect the labor market differently. For an overall review, see Cahuc et al. (2014).

banco central Chile

MONETARY POLICY REPORT DECEMBER 2024