BOX II.1:

Impact on inflation of the unfreezing of electricity rates

At the end of April, a new law on the stabilization of electricity rates was enacted, establishing regulatory changes to end the freeze in force since the end of 2019. According to this law, the rates for regulated customers will need to rise to align with to the provisions established in the contracts of the electricity companies, and include an additional transitory charge to pay off the accumulated debt with them. The central scenario of this IPoM assumes that electricity bills will be adjusted in the coming months according to the criteria established in the new law and the background information provided by the Preliminary Technical Report published by the National Energy Commission (CNE) on 23 May[1]/. The anticipated increases will have a significant impact on inflation in the coming months. If the current background and the macroeconomic assumptions of the central scenario are confirmed, the cumulative effect on the CPI would be 145 bp by June 2025. This box summarizes the available information on electricity price adjustments and analyzes their implications on inflation.

Background information on the new price stabilization mechanism

From 2019 to date, three laws have been enacted modifying the mechanisms for adjusting electricity prices for regulated customers[2]/. Electricity bills contain three components: generation, distribution and transmission, whose weighting on the final price paid by households is around 70%, 20% and 10%, respectively, and whose rates should vary according to the various fixations that occur throughout the year, in compliance with current regulations[3]/.

The first of these three laws (Law 21,185) was approved in 2019, in order to prevent users from facing price increases that at that time were foreseen to be transitory. The subsequent increase in fuel prices and the depreciation of the exchange rate, created a discrepancy between the stabilized price and the one that should have been applied according to the supply contracts, accumulating a debt with the companies in the sector. Three years later, in 2022, Law 21,472 was enacted, modifying again the scheme for price adjustments and adding a charge for the gradual payment of the debt (called Customer Protection Mechanism or MPC).

Last April, Law 21.667 modified again the mechanisms for price adjustment and legislated on the charges to be added to the prices. According to this law, the electricity generation component of the prices faced by most households will increase along the next three semiannual rate-setting processes. In the process corresponding to the first half of 2024 (2024.1h), they will be adjusted considering the accumulated inflation since the last decree in force (the adjustment process of 2022.2h). In the subsequent half (2024.2h) prices will reach the levels agreed on in the original contracts with the generators. In the process to be applied

[1]/ According to the timetable published by the CNE, the final report will be published on 21 June and the decree determining the adjustments corresponding to the process for the first half of 2024 must be published in the Official Gazette on or before 5 July.
[2]/ According to data from the Ministry of Energy, these represent almost all households, while of the total energy consumed by non-mining companies, around 40% are regulated customers.
[3]/ For details, see the pricing process described by the CNE.

at the beginning of next year (2025.1h) prices will include the MPC charge for the gradual payment of the accumulated debt. The timing and magnitude of these adjustments will differ for companies subject to regulated rates, partly because they have already faced higher increases in recent years[4]/.

In addition to the expected increases in electricity generation, rises in the distribution and transmission components are also expected. Although these charges have a lower weighting in the final bill, they will still impact the standard bill of regulated customers.

The central scenario of this IPoM anticipates that regulated prices for most households will increase by an average of 57% over the next twelve months, followed by an average decline of 9% over the subsequent twelve months. For firms subject to regulated prices, the expected increases are 39% during the first year, with a decline of similar magnitude to those faced by households. These increases account for changes in all the components: generation, distribution and transmission (table II.5).

TABLE II.5 ESTIMATION OF ELECTRIC UTILITY RATES FOR REGULATED CUSTOMERS (*)
(cumulative percent variation)

Regulated customers	1st half'24 – 1st half'25	2nd half'25 – 2nd half'26
Households	57	-9
Firms	39	-8

(*) Estimate includes transitory subsidy until 2026 contained in Law 21,677 and adjustments in transmission and distribution charges according to the information available at the statistical closing of this IPoM, as well as the macroeconomic assumptions of the central scenario.
Source: Central Bank of Chile using official data provided by the National Energy Commission in connection with Law 21,667.

Impact on inflation

Electricity prices impact inflation through multiple channels. First, electricity supply services constitute 2.2% of the household consumption basket. Therefore, the increase faced by households has a direct effect on inflation. Second, companies producing goods and services use electricity as inputs in their processes. Consequently, the rise in electricity prices indirectly affects inflation as firms pass these cost increases on to sales prices. Finally, both direct and indirect effects have additional macroeconomic implications, including the indexation of prices to past inflation, changes in household purchasing power, the substitution effect, and the corresponding response of monetary policy, among other.

[4]/ In accordance with Law 21,667, the magnitude and timing of the expected variation of the regulated prices depends on the level of kWh/month consumption. For those users consuming over 350 kWh/month, the MPC charge will be incorporated as from the 2024 1st half process, while for those consuming less than 350 kWh/month, it will be incorporated as from the first half of 2025. Meanwhile, according to SEC information, around 90% of households consume less than 350 kWh/month, while most of the regulated companies are part of the highest consumption group.

The central scenario projections estimate a one-year inflationary impact of 145 bp on the total CPI (table II.6). Two years ahead, the inflationary effect is lower, due to the expected decline in electricity utility rates and their direct effect on the CPI. Regarding the expected one-year impact, the direct effect explains 122 bp of the increase[5]/[6], while the indirect effect and all other effects explain around 23 bp of additional inflation during the first year. To calibrate the indirect effect, Andalaft *et al.* (2024) use digital invoicing microdata to estimate the average pass-through of electricity cost increases to sales prices. Finally, by incorporating the expected trajectory of rates for households and firms, the XMAS structural model is used to calculate the general equilibrium results.

TABLE II.6 IIMPACT OF HIGHER ELECTRICITY RATES ON INFLATION
(basis points)

Expected impact on inflation	In one year	In two years
Direct	122	-28
Other (*)	23	6
Total	145	-22

(*) Others include indirect effect (pass-through of higher company costs), price indexation to past inflation, changes in households' purchasing power and substitution effect, among others.
Source: Central Bank of Chile.

Conclusions

Based on these calculations and the available information, the central scenario of this IPoM includes a one-year increase in inflation related to the augmented electricity prices of 145 bp, while the two-year effect is lower. Various factors could modify the expected effects of these price increases, such as the evolution of generation, distribution and transmission costs, which could change because they depend on certain macroeconomic variables (the exchange rate and fuel prices, among others). In addition, the measurement and coverage of the price subsidies contemplated in Law 21,667 may differ from what was considered. Finally, the pass-through of cost increases to prices by the firms could vary, for instance, depending on how far in advance the electricity rate increases are anticipated.

[5]/ The measurement of the direct effect considers the expected records for the standard accounts considered by the INE for the measurement of the CPI (between 200 and 250 kWh). It also considers the inclusion of a subsidy for the most vulnerable households according to the Social Registry of Households with a fiscal cost of US$ 120 million per year, in line with the provisions of Law 21,667. Its implementation is subject to the enactment of the respective supreme decree by the Ministry of Energy.
[6]/ In the March IPoM, the effect of the increase in the electric bill on the CPI was expected to be of 40 bp.