banco central Chile

MONETARY POLICY REPORT

JUNE 2024

FÍO-FÍO
Región Metropolitana

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JUNE 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: FÍO-FÍO - Región Metropolitana.

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*/ For the central scenario construction purposes, the statistical cut-off date is 12 June. This document was originally written in Spanish. In case of discrepancy or difference in interpretation, the Spanish version prevails.

SUMMARY

In general terms, the Chilean economy has evolved in line with forecasts in the March Report. Activity has been resuming a path of growth consistent with its trend, with demand performing somewhat better than expected. Inflation is around 3.5% annually and two-year expectations remain at 3%. On the external front, developments continue to be dominated by the adjustment of expectations for monetary policy in the United States. Going forward, local inflation is expected to see a significant rebound and converge to the target in the first half of 2026. This is influenced by the impact of the supply shock associated with higher electricity costs and a higher boost in domestic demand, which is partially offset by the lower real exchange rate (RER) projected with respect to March assumptions. For activity, the contractionary effect of energy costs on the real income of households is contrasted with the greater dynamism from domestic spending, which is expected to go hand in hand with the improvement of its fundamentals, including a higher projection for the copper price. The Board estimates that, if the assumptions in the central scenario materialize, the monetary policy rate (MPR) would have accumulated during the first half of the year the bulk of the MPR cuts foreseen for this year. The central scenario of this Report considers that the MPR will be reduced further over the monetary policy horizon, at a pace that will factor in the evolution of the macroeconomic scenario and its implications for the inflation trajectory.

As projected, activity has been increasing. In the first quarter, the deseasonalized GDP series posted a new advance with respect to the previous quarter (1.9%). As foreseen in the latest IPoM and was confirmed by the Imacec indexes of March and April, part of this growth came from supply-side factors that have been reversing.

The economy continues to show heterogeneity across sectors. The dynamism of the service sectors continues to stand out, which is coupled with the rebound in some branches of retail and wholesale trade. The weakness of construction remains the main counterpoint, with activity levels that remain low. Meanwhile, the greater boost in exports has favored the performance of some activities linked to the external sector, which has been influenced by the increase in international prices of certain products, among other elements.

Discounting inventories, domestic demand has been regaining momentum. Its performance in the first quarter exceeded expectations, especially in consumption. Household spending has recovered gradually in the context of increases in employment and real wages, which have been supporting the growth of the wage bill. The services component remains the most dynamic of private consumption, which was compounded with greater demand for non-durable goods in the first quarter. Government consumption also grew more than projected.

Although still weak, gross fixed capital formation (GFCF) halted the deterioration it showed during the second half of last year. Adjusting for seasonality, GFCF posted zero variation in the first quarter, reflecting a more stable behavior of both machinery and equipment and construction and works. Within the latter, the building segment was slower than engineering works, as confirmed by partial second-quarter information. In any case, every GFCF component contracted further on a year-on-year basis.

The annual variation of the total CPI remained around 3.5%, while that of the core CPI (i.e. without volatiles) dropped from 4.2 to 3.5% between February and May[1]/. In cumulative terms, the monthly variations of both measurements in recent months have been in line with expectations, which confirms that part of the high figures of early in the year obeyed to specific factors. By components of core inflation, the annual variation of the services part showed a significant decrease compared to the end of 2023 (from 7% in December to 5.3% in May), reflecting the indexation to lower inflation rates in a period of the year that concentrates adjustments to past inflation. Inflation expectations two years out remain at 3%.

Banks' lending interest rates have declined in line with the transmission of the reduction in the MPR, with banking credit showing a low dynamism. The latter occurs in a scenario of still weakening demand for credit, particularly the search for investment funding by firms. The supply conditions do not show changes in the margin, although they continue to be tight in some portfolios, which is influenced by factors such as a perception of greater risk on the part of the banks, in a context of worsening default indicators of individuals and firms. Overall, the behavior of commercial credit has been consistent with macroeconomic fundamentals, although it shows a certain slowdown that needs to be monitored (Box I.3).

The shallow state of the local capital market due to pension fund withdrawals continues to affect the economy, especially by its impact on the availability of longer-term funding. Longer-term interest rates have increased their correlation with its external counterparties, which remain high, directly affecting the corporate and mortgage credit costs.

Abroad, United States activity continues to drive global growth, although other countries have also improved their performance so far this year. In the American economy, the strength of domestic demand, especially household consumption, continues to stand out. The rest of the world maintains lower dynamism, although several countries in the Eurozone and Latin America grew more than expected at the beginning of the year. All this results in a marginal upward correction of the average growth of trading partners expected between 2024 and 2026 (3.0%; 2.9% in March).

Global inflation has continued to decline. However, the figures of the service components still are a focus of attention, especially in the United States, beyond the deceleration of their indicators at the margin (Box I.1). Services inflation has declined more slowly than goods inflation in most countries, accompanied by tight labor markets in several of them. Regarding costs, the oil price has fallen in recent months, while international freight rates remain high, although below the values observed during the pandemic.

External financial conditions remain tight, particularly for emerging economies, in a context in which expectations about the monetary policy of the Federal Reserve (Fed) continue to dominate the movements of global financial markets. Central banks in several countries have lowered their policy rates but have been cautious in signaling future actions. At the same time, long-term interest rates are at high levels and have increased their sensitivity to changes in the outlook for the Fed's next decisions. This occurs in a context of greater uncertainty about several more structural global factors, including increased defense spending —amid growing geopolitical tensions— and concerns about the sustainability of sovereign debts around the world, especially in the United States.

[1]/ For the purposes of macroeconomic analysis and the conduct of monetary policy, the Board uses the series with base year 2023, called the reference CPI, which considers information from the new basket only. For price-level restatement purposes of indexed contracts, bonds or securities, the annual variation of the CPI reported by the National Statistics Institute (INE) is used. This combines the CPI base 2018 and base 2023. As of May, it showed an annual increase of 4.1%.

In general, the local financial market has tended to follow global trends. However, the Chilean peso has had a more favorable evolution than other currencies compared to the last Report, in the context of a higher copper price. Since the March statistical close, the peso has appreciated nearly 5% against the dollar and more than 6% in multilateral terms (MER). In that period, the copper price accumulates an increase of around 11%. The latter brings together elements such as greater demand —especially from China— in the context of the energy transition and constrained supply (Box I.2).

Projections

In general terms, the macroeconomic scenario has evolved according to forecasts, although domestic demand grew somewhat more above expectations in the first quarter. The Chilean economy has been recovering a growth path in line with its trend, and inflation has continued to decline, while two-year inflation expectations remain at 3%. With respect to March, news in the central projection scenario is the best starting point of domestic demand, which will be sustained by a copper price hike, and the adjustment of electric rates, which will have a significant impact on inflation, particularly in 2025.

The central scenario assumes that the copper price will average US$4.3 per pound in 2024-2026, exceeding the March assumption of US$3.85. Estimates are that more than half of the increase accumulated in the copper price over this year is explained by more persistent factors (Box I.2). Projections include a positive impact of this adjustment in several dimensions, including investment, agents' expectations, and the current account balance.

On the other hand, new information is incorporated on the adjustment of electricity rates for regulated customers for the coming quarters. Based on the official antecedents after the publication of the Law on stabilization of power rates and the Preliminary Technical Report of the National Energy Commission, it is expected that the increase in electricity rates will contribute 1.45 percentage points (pp) to the accumulated variation of the CPI as of June 2025 (Box II.1). The main impact is concentrated in the value of electric bills included in the volatile component of the CPI. The inflation expectations implicit in the prices of financial assets and the reports of some market actors began to consider this factor in the days prior to the publication of this Report.

Headline inflation projections rise significantly, particularly for 2025. This is influenced by the impact of the supply shock associated with higher electricity prices and a greater boost in domestic demand. The outlook for core inflation considers limited indirect effects of the utility rate update, which refer to cost adjustments in firms with regulated rates and usual price and wage indexation processes (Box II.1). The projections for that component also include the impact of increased spending driven by the external sector. Part of these effects is offset by a RER that, compared to March, is adjusted sooner and converges to more appreciated levels throughout the projection horizon. This has a downward impact, especially on the projected inflation of goods.

Thus, the projection considers that annual inflation would close 2024 at 4.2% (3.8% in March). In 2025, it would culminate in 3.6% (3.0% in March), and average inflation would be 1.1pp higher during that year. Its convergence to 3% will occur in the first half of 2026. Reducing inflation assumes that the transmission of the electricity cost shock will operate according to usual patterns. In addition, it considers some downward adjustments to rates starting in the second half of 2025.

For activity, the scenario contains limited changes compared to March. For this year, GDP is expected to grow between 2.25% and 3.0%. The adjustment with respect to the previous range (2.0%-3.0%) is explained by better actual data on the spending side and the initial reach of the rise in the price of copper. Into the medium term, the effects of this latter element are offset by the negative impact that the adjustments in the electric bills have on households' disposable income. This influences the maintenance of the growth range between 1.5 and 2.5% for 2025 and 2026.

The demand estimate includes an improvement in GFCF projections. The revision to the copper price raises the prospects for mining investment, mainly in the next two years, which also has positive effects in other sectors. Other factors are added: for the immediate term, the smaller GFCF contraction expected in 2024, especially in the machinery and equipment component, in line with the assumption of a lower RER and lately the somewhat better performance of imports of these goods. In the medium term, financial conditions that will improve and the information from the latest survey of the Capital Goods Corporation are added, which includes 10% more investments for the period 2024-2027.

Consumption growth forecast is increased for this year and has few adjustments for the period 2025-2026. The labor market's evolution will continue to sustain the performance of the wage bill, in accordance with the progress of the business cycle, together with the contribution from the improvements in the aforementioned fundamentals. In the medium term, the contractionary effects of the increase in the electric bills will reduce the growth pace of private consumption. For the public component, a moderation of its expansion rates is expected for 2025 and 2026, according to the latest Public Finance Report.

Monetary policy

The Board estimates that, if the assumptions in the central scenario materialize, the MPR would have accumulated during the first half of the year the bulk of the MPR cuts foreseen for this year. In nominal terms, this trajectory is somewhat above assumptions in the latest IPoM. However, the real MPR of the current central scenario is lower than the one implicit in March scenario for the short-term, although similar on average for the next two years. This is consistent with the inflation targeting monetary policy framework, which allows supply shocks to be accommodated in the policy horizon and thus cushion their impact on activity, demand and employment.

The central scenario of this Report considers that the MPR will be reduced further over the monetary policy horizon, at a pace that will factor in the evolution of the macroeconomic scenario and its implications for the inflation trajectory.

There are scenarios where monetary policy could follow a path other than the central scenario, which are reflected in the MPR corridor. In this Report, the upper bound could occur in a scenario of more persistent than expected inflation. This could be the case if demand showed a greater boost than anticipated, or alternatively, if the electricity rate shock had more permanent effects on inflation; for example, hand in hand with greater second-round effects that reinforce the mechanisms of inflationary persistence. The lower bound, which assumes lower inflationary pressures, could occur if the impulse of the increased copper price on domestic demand was more moderate or if the contractionary effects of the aforementioned tariff adjustment on consumption were stronger. It could also occur in a situation of longer-lasting weakness of the most lagging economic sectors.

The current scenario gives more flexibility to monetary policy than in previous quarters, particularly due to the resolution of macroeconomic imbalances, the decline in inflation and inflation expectations aligned with the target. The Board will safeguard the compliance with the inflation target, evaluating, on the one hand, that the spread of the shock associated with electricity rates is as expected and that inflationary persistence does not increase. On the other hand, that monetary policy properly supports the economy when it has entered a process in which its growth is little by little approaching levels consistent with its trend and the labor market has improved.

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

	2022	2023	2024 (f)		2025 (f)		2026 (f)	
			Mar.24 IPoM	Jun.24 IPoM	Mar.24 IPoM	Jun.24 IPoM	Mar.24 IPoM	Jun.24 IPoM
Average CPI	11.6	7.3	3.8	3.7	3.4	4.5	3.0	3.0
December CPI	12.8	3.4	3.8	4.2	3.0	3.6	3.0	3.0
CPI in around 2 years (3)							3.0	3.0
Average core CPI	9.0	7.5	3.8	3.8	3.5	3.6	3.0	3.0
December core CPI	10.0	4.7	3.8	3.8	3.1	3.3	3.0	3.0
Core CPI around 2 years (3)							3.0	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 March 2024 IPoM corresponds to inflation forecast for the first quarter of 2026, for June 2024 IPoM to inflation forecast for the second 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)	
			Mar.24 IPoM	Jun.24 IPoM	Mar.24 IPoM	Jun.24 IPoM	Mar.24 IPoM	Jun.24 IPoM
					(annual change, percent)			
Terms of trade	-6.8	2.4	-3.2	1.4	-0.6	-0.3	0.9	1.6
Trading partners	2.9	3.3	3.0	3.1	2.8	2.9	2.9	2.9
World GDP at PPP	3.4	3.4	3.0	3.2	2.9	3.0	3.1	3.1
Developed GDP at PPP	2.6	1.5	1.1	1.4	1.4	1.5	1.9	1.8
Emerging GDP at PPP	3.8	4.5	4.1	4.2	3.8	3.9	3.8	3.9
					(levels)			
LME copper price (US$cent/pound)	400	385	385	430	385	430	385	430
Oil price, average WTI-Brent (US$/barrel)	97	80	81	80	76	76	72	72

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

TABLE 3: INTERNAL SCENARIO
(annual change, percent)

	2022	2023	2024 (f)		2025 (f)		2026 (f)	
			Mar.24 IPoM	Jun.24 IPoM	Mar.24 IPoM	Jun.24 IPoM	Mar.24 IPoM	Jun.24 IPoM
GDP	2.1	0.2	2.0 - 3.0	2.25 - 3.0	1.5 - 2.5	1.5 - 2.5	1.5- 2.5	1.5- 2.5
Domestic demand	2.3	-4.2	1.6	1.8	2.2	2.6	2.5	2.6
Domestic demand (w/o inventory	2.9	-3.2	1.0	2.0	2.1	2.6	2.1	2.4
Gross fixed capital form	3.9	-1.1	-2.0	-0.3	3.0	5.4	1.9	2.8
Total consumption	2.6	-3.9	2.0	2.8	1.9	1.7	2.2	2.3
Private consumption	1.6	-5.2	2.0	2.5	1.9	1.9	2.3	2.5
Goods and services exports	0.8	-0.3	4.5	5.9	2.7	3.1	1.8	1.9
Goods and services imports	1.5	-12.0	1.3	3.2	3.5	4.7	3.0	3.9
Current account (% of GDP)	-8.7	-3.6	-3.4	-2.1	-3.4	-2.5	-3.4	-2.7
Gross national saving (% of GDP)	16.9	19.4	20.0	19.2	20.6	19.5	20.3	19.5
Gross fixed capital formation (% of nominal GDP)	25.3	23.8	23.1	23.1	23.5	23.7	23.7	23.8

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

I. RECENT EVOLUTION OF THE MACROECONOMIC SCENARIO

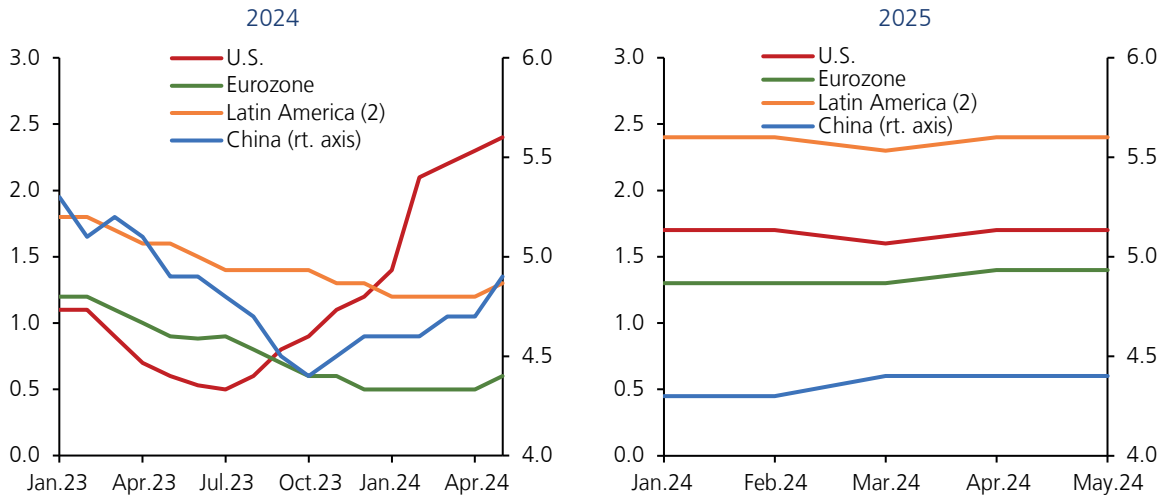
Global activity has continued to be supported mainly by the United States economy, with the global outlook remaining largely unchanged for this and next year. Global inflation has continued to decline, albeit at a more moderate pace. The U.S. Federal Reserve (Fed) has expressed caution, and the market outlook for its interest rate path has become more contractionary than expected in March, which has been reflected in global financial conditions. Locally, the macroeconomic scenario has evolved in line with expectations. Inflation is at around 3.5% per year, activity has been returning to a growth path consistent with its trend, and on the demand side, consumption has performed somewhat better than expected. Employment and wages continue to improve gradually and in line with the business cycle. Exports have shown a positive performance, thus favoring the current account balance. Bank credit remains tight and delinquency remains high, while short-term lending rates continue to show a normal pass-through of monetary policy decisions.

THE INTERNATIONAL SCENARIO

Global activity continues to be supported mainly by the United States, where domestic demand remained strong during the first quarter. On the margin, data from the United States give mixed signals that generally point to a moderation going forward (Figure I.1). Private consumption remained dynamic, favored by services, while investment accelerated —driven by the residential segment— and government spending slowed down. This, in a context of still strong labor indicators, beyond mixed recent signals. Other consumption fundamentals, such as the saving rate and households' financial burden, continue to suggest that the performance of this expenditure component will moderate in the future.

The rest of the world was somewhat more dynamic in the first quarter of the year —especially the Eurozone and Latin America—, but its growth rate and economic outlook are contained (Figure I.1). The Chinese economy accelerated during the first quarter, driven by the expansion of manufacturing activity, particularly in sectors linked to the energy transition. On the demand side, consumption and residential investment remained weak, which contrasted with the progress of non-residential investment and the momentum from the external sector. In the Eurozone, activity posted an unexpected rise in the first quarter, driven by a recovery in services in the region's main economies, while the manufacturing sector continued to lag. Germany's growth stood out, after contracting in 2023, while gross capital formation stood out, especially in the construction sector —which benefited from better weather conditions— and its external sector. In Latin America, activity in the first months of the year was also above market expectations, resulting in a slight improvement of the region's outlook.

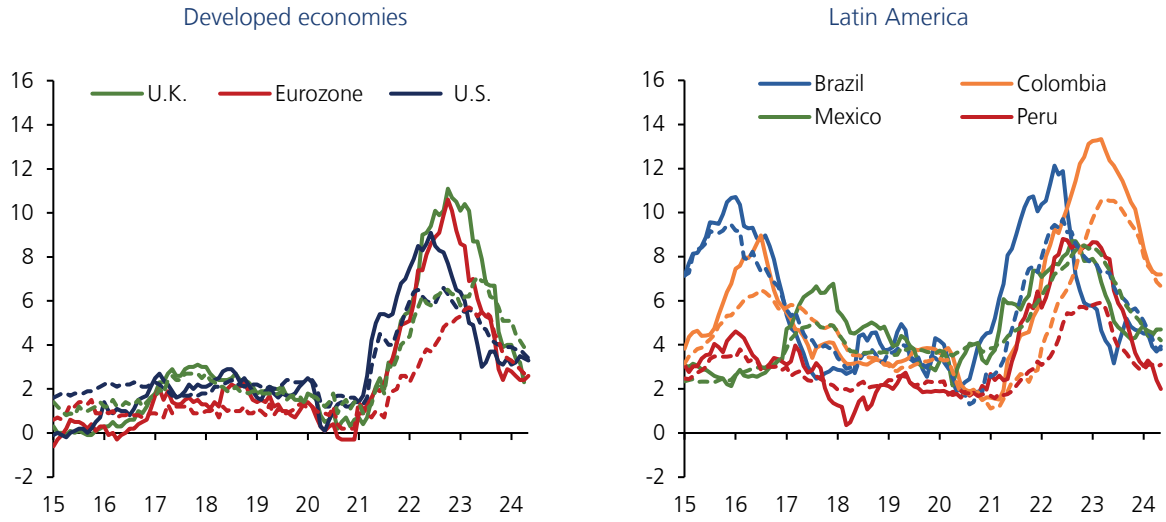
FIGURE I.1 GROWTH FORECAST (1)
(percent)



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

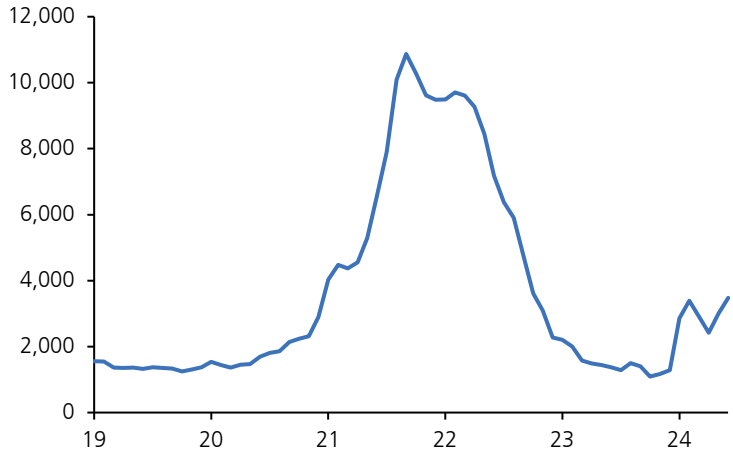
Global inflation has continued to decline, albeit at a more moderate pace. The slow decline in some services' components was noticeable, together with a mild reversal in energy's and the stabilization of goods' (Figure I.2) (Box I.1). In the United States, services inflation slowed down during May after several months of high figures, although its evolution continues to draw attention. The strength of these sectors and the indexation patterns help explain the high inflation of this component. This occurs in parallel with the strength of the labor market in the American economy. In Latin America and the Eurozone, services inflation has been slow to normalize, with labor markets exhibiting little slack. Meanwhile, goods inflation is showing signs of stabilization at the global level, maritime transportation costs remain high, and disruptions in certain routes due to the Red Sea conflict persist (Figure I.3).

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



(1) Dashed lines correspond to core inflation. (2) Core figures exclude foods and energy.
Source: Bloomberg.

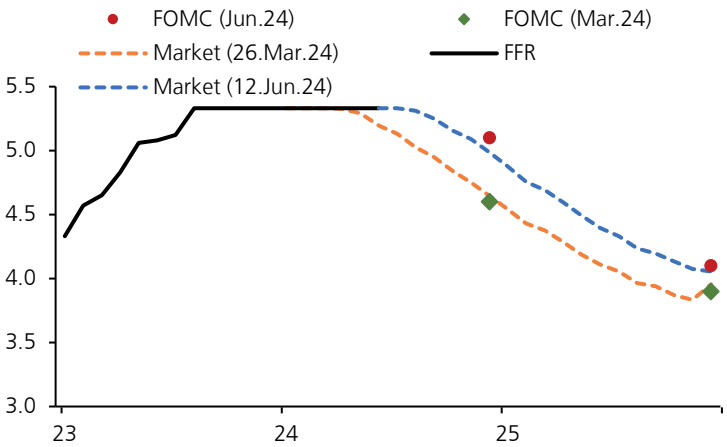
FIGURE I.3 OCEAN FREIGHT PRICES (*)
(dollars per 40-foot container)



(*) Freightos Index. Monthly data calculated as weekly data average. For June, data for the week of 2 June, i.e., the latest figure available at the statistical closing of this IPoM.
Source: Bloomberg.

The Fed has maintained a cautious message about when to start lowering interest rates, and the market outlook is tighter than it was in March (Figure I.4). At their June meeting, the Federal Open Market Committee (FOMC) policymakers insisted on the need for new data to gain greater confidence about the sustainability of the disinflationary process. At the same time, their inflation forecasts were raised and the median of the published dots rose in 2024, with one cut this year and four in 2025 (compared to the three cuts in each year forecast in March). Markets have been reassessing the expected path of rates there and have priced in fewer rate cuts this year compared to expectations some months ago.

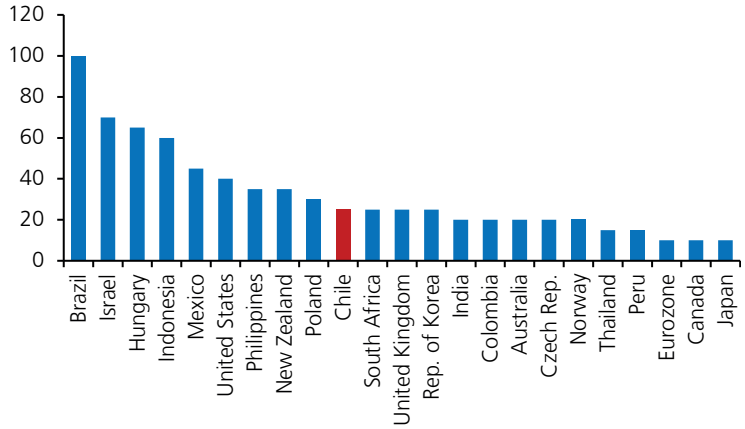
FIGURE I.4 FED FUNDS RATE (*)
(percentage points)



(*) FOMC projections correspond to the mid-range of the fed funds rate presented in March and June 2024; market projections are for the mid-range of the fed funds rate of futures at the statistical closing of the March IPoM (26.Mar.24) and at the statistical closing of this IPoM (12.Jun.24).
Sources: U.S. Federal Reserve and Bloomberg.

In the rest of the world, monetary policy has slowly reduced its tightening stance. The market outlook has become more contractionary in several Latin American economies (Figure I.5). The European Central Bank began its monetary easing with a 25-basis-point (bp) reduction at its June meeting, although it has insisted that its future decisions will hinge on the evolution of the economic scenario. The Bank of Sweden began its cycle of cuts in May and the Bank of Canada during June, both with 25bp reductions. In Latin America, several central banks have reinforced messages of caution regarding future rate cuts. Mexico and Peru paused their cutting cycle in their latest meetings, Brazil reduced the pace of cuts and Colombia slowly continued its monetary easing. This, in a context in which medium-term inflation expectations are above target in several economies in the region, Chile excepted.

FIGURE I.5 CHANGE IN EXPECTED MPR AT 2024.4Q SINCE MARCH IPOM (*)
(basis points)

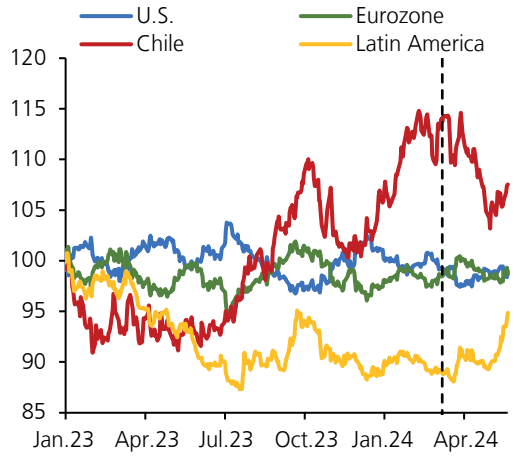


(*) According to Bloomberg surveys. For Chile, the change in the expected MPR for December 2024 between the June and March EEE is used.
Sources: Bloomberg and Central Bank of Chile.

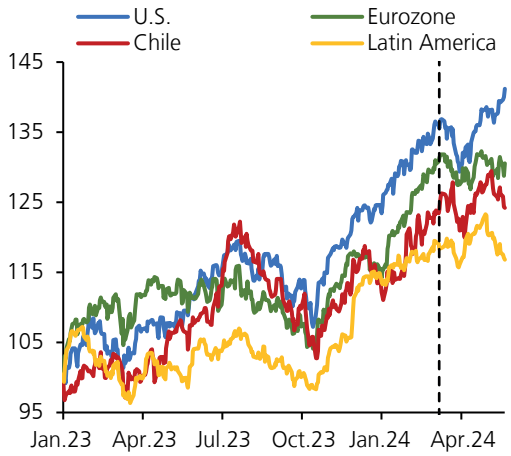
Financial conditions for the emerging world are somewhat tighter than in the March IPoM, in line with the expected further tightening of global monetary policy (Figure I.6). The evolution of global financial conditions remains largely subject to expectations regarding the Fed's actions. The publication of new data in the United States and the statements of its monetary authorities continue to dominate the movements of international financial markets. In recent months, with some fluctuations, a scenario with prospects of greater monetary restriction has taken shape, which generated increases in short- and long-term rates, and an appreciation of the dollar. Stock markets have shown mixed movements. The 10-year U.S. Treasury bond rates have remained at high levels, when compared with historical data. In a context of greater uncertainty regarding structural factors, these rates are showing greater than usual sensitivity to movements linked to monetary policy.

FIGURE I.6 FINANCIAL CONDITIONS

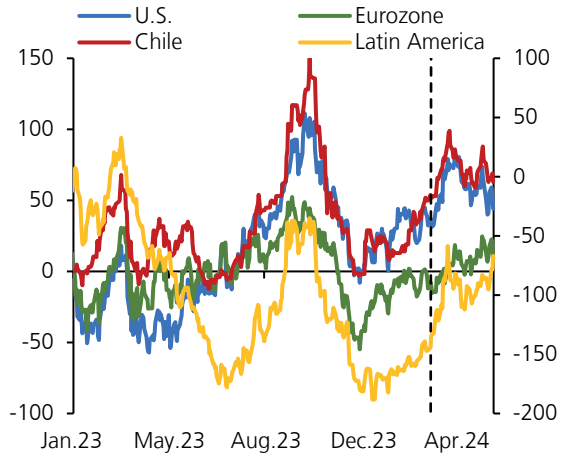
Currencies (1) (2) (3)
(index 2.Jan.23=100)



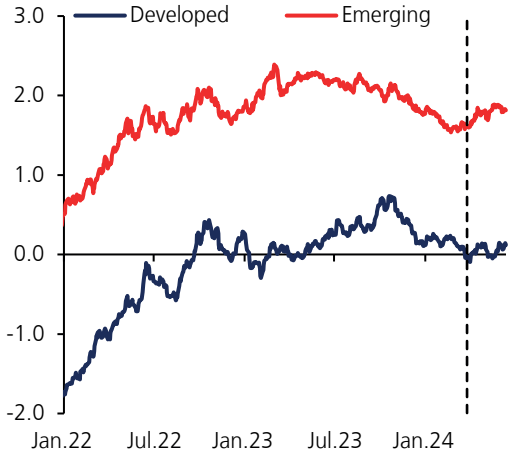
Stock markets (1) (2)
(index 2.Jan.23=100)



Interest rates on nominal 10-year bonds (1) (2) (4)
(difference with respect to 2.Jan.23, basis points)



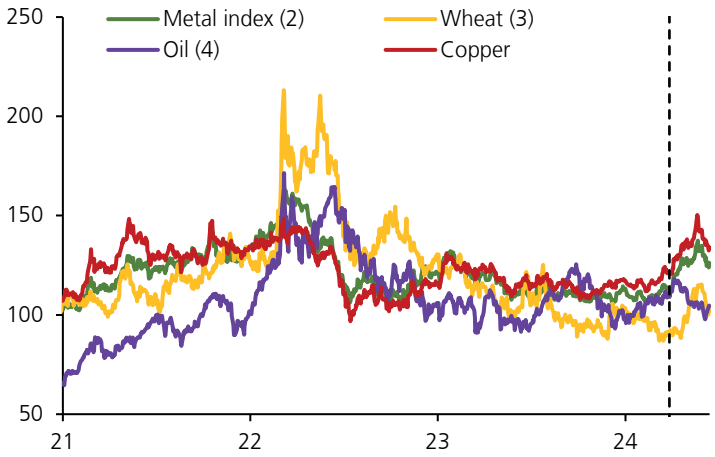
Goldman Sach financial conditions index (1) (5)
(standard deviations)



(1) Dashed vertical line marks statistical closing of March 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) For Latin America, it corresponds to the right axis. (5) 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, Malaysia, Indonesia, Philippines, South Africa, Hungary, Poland, Brazil, Mexico and Chile.
Sources: Central Bank of Chile, Bloomberg and Goldman Sachs.

With regard to commodities, it is worth noting the rise in the prices of metals, especially copper (Figure I.7). Demand for copper has remained strong, driven by its high usage in the context of the energy transition, especially by China. Supply problems and some degree of speculation on global inventory availability, among other factors, have added to this. More than half of the increase in the copper price since the beginning of the year is estimated to be persistent, leading to revise upward the projections in the central scenario to US$4.3 for the period 2024-2026 (Box I.2). Oil prices have fallen, although remaining slightly above those at the beginning of the year. At the statistical closing of this IPoM, copper was trading at around US$4.5 per pound and oil (WTI-Brent average) at around US$78 per barrel (+12% and -7% since the last IPoM, respectively). As for food, cereal prices have risen in recent months, especially wheat, driven by unfavorable supply prospects partly related to weather events. In May, the FAO index accumulated an increase of close to 3% with respect to February (last figure known at the cuttof date of the March IPoM).

FIGURE I.7 COMMODITY PRICES (1)
(index, 2010-2024 average=100)



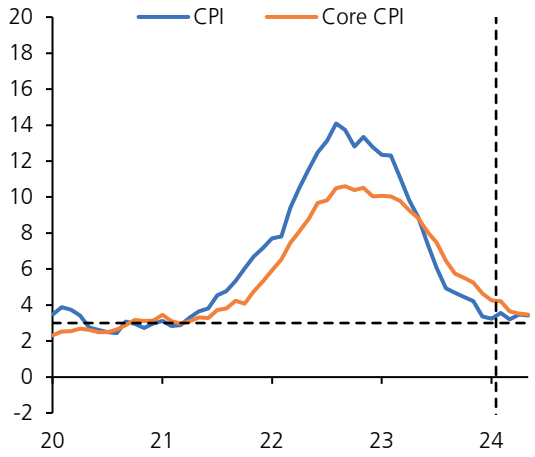
(1) Dashed vertical line marks statistical closing of March IPoM. (2) S&P GSCI Industrial Metals. (3) Prices of futures one-month ahead. (4) WTI-Brent average.
Source: Bloomberg.

THE DOMESTIC SCENARIO

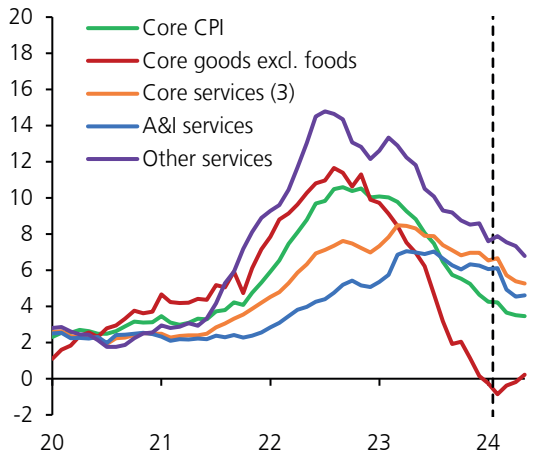
Annual variations of total and core (non-volatile) CPI were 3.4% and 3.5% in May, respectively (3.6% and 4.2% in February, the latest known figures for the March CPI)[1]/ (Figure I.8). Both figures have been in line with expectations, confirming that part of their high levels at the beginning of the year did correspond to one-off factors. Actually, property rental prices are again showing monthly variation rates around their historical averages after the high levels of early 2024. The core services component continued to be the main contribution to annual inflation (Figure I.9). However, the annual variation of this latter CPI component dropped significantly with respect to the end of 2023 (from 7% in December to 5.3% in May), reflecting indexation to lower rates of past inflation in season of the year where adjustments are concentrated.

FIGURE I.8

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

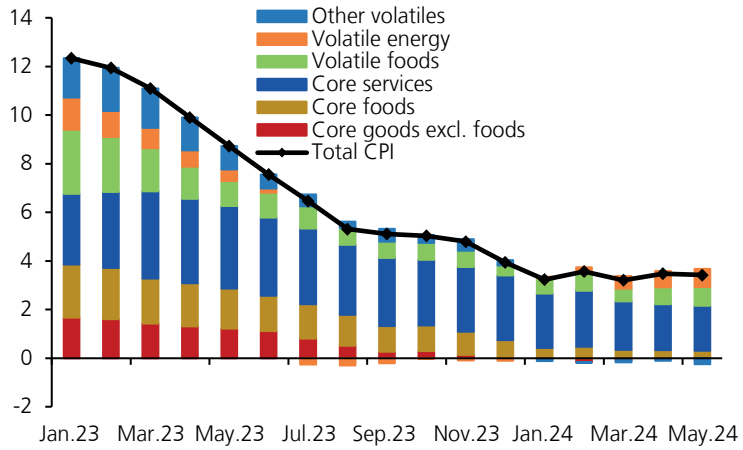


Core inflation (1) (2)
(annual change, percent)



(1) Series consider the 2023 CPI reference basket with the BCCh splice. (2) Dashed vertical line marks statistical closing of March 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.9 CONTRIBUTIONS TO ANNUAL CPI INFLATION (*)
(percentage points)



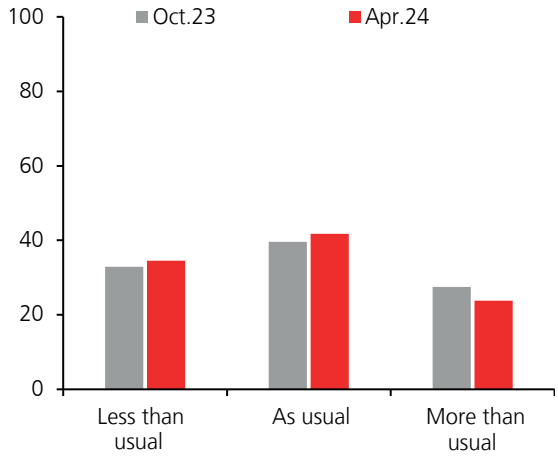
(*) As from January 2024, contributions are calculated by using indexes with annual base 2023=100, so they are not strictly comparable with previous figures.
Sources: Central Bank of Chile and National Statistics Institute (INE).

[1]/ The figures consider the 2023 CPI reference basket with the BCCh splice.

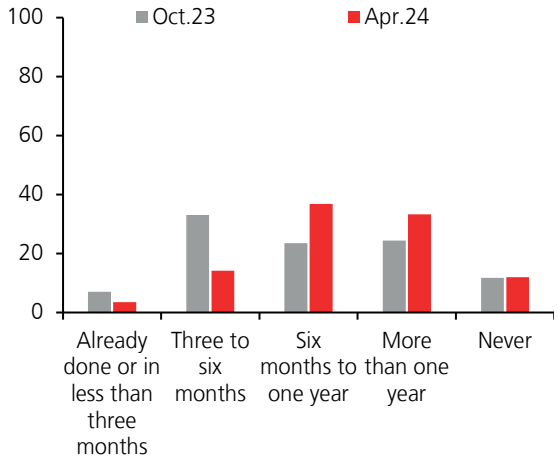
After a steady decline since the end of 2022, goods inflation has shown a more stable behavior. The core goods component —which excludes foods— has resumed positive monthly variation rates in recent months. It partly mirrors the external prices that have not repeated the decline of previous quarters, and a moderate pass-through of the exchange rate depreciation accumulated since last year. In the Business Perceptions Survey (EPN) published in May, the fraction of firms reporting a lower than usual pass-through of costs to prices increased. At the same time, the time span in which firms believe they can pass on the totality of their cost increase to prices was extended (Figure I.10). With respect to other components, the depreciation of the peso of previous months has also been reflected in the inflation of imported foods and fuel items. The latter has also been affected by the rise in oil prices in the first months of the year.

FIGURE I.10

EPN: Cost pass-through to prices and timing (1)
(percent of firms whose costs increased in last three months)



EPN: Timing of cost pass-through to prices (2)
(percent of firms whose costs increased in last three months)



(1) Responses to the question: "Regarding current or future transfers of costs to prices, are they higher or lower than usual?" (2) Responses to the question: "How long do you estimate it will take to transfer the totality of your cost increases of the last three months?".
Source: Central Bank of Chile.

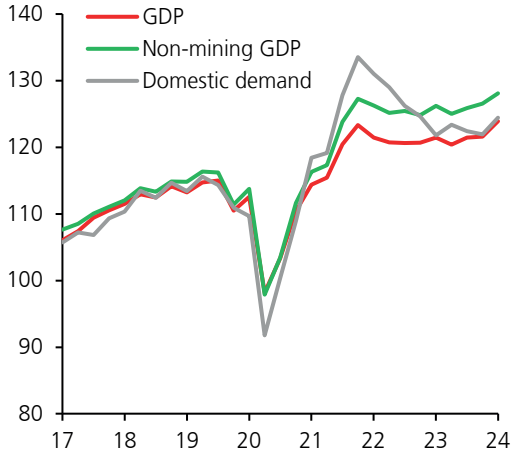
First-quarter activity was in line with what was anticipated in the March IPoM, with an economic growth that has moderated in recent months (Figure I.11). Seasonally adjusted total and non-mining GDP rose 1.9% and 1.2% quarter-on-quarter, respectively (2.3% and 1.5% annually). Part of the annual increase was explained by supply factors that provided a greater impulse at the beginning of the year and, to a lesser extent, due to a positive calendar effect.[2]/ The Imacec of March and April confirm the transitory nature of these elements.

[2]/ For details, see blog: La importancia del efecto calendario en la actividad económica chilena.

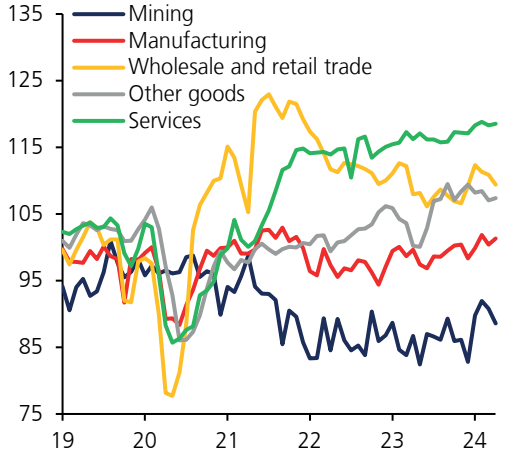
Both the quarterly figures and the Imacec show significant differences in performance among economic sectors (Figure I.11). The service sectors maintain greater dynamism and several branches of wholesale and retail trade have been gradually recovering. Sectors related to external demand have also had a more favorable behavior, driven by the better performance of our trading partners. In contrast, the weakness of the construction continues to stand out.

FIGURE I.11

Activity and demand
(index, 2013.Q1 = 100, real seasonally-adjusted series)



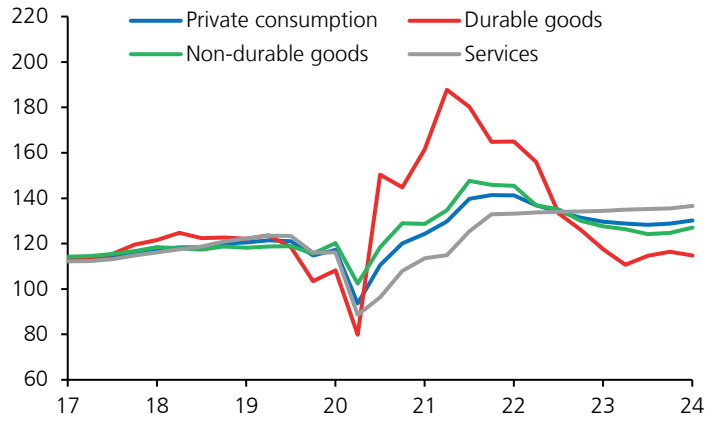
Imacec by sectors
(index, 2018 average = 100, real seasonally-adjusted series)



Source: Central Bank of Chile.

Regarding domestic demand, during the first quarter, the performance of total consumption—both public and private—was somewhat better than expected (Figure I.12). In this period, the seasonally adjusted series of household consumption increased by 1.1% compared to the previous quarter, mainly due to the recovery in the demand for non-durable goods and the growth of services. Several high-frequency indicators continue to suggest a gradual recovery of this spending component, such as the daily retail sales index (IVDCM), based on digital invoicing tax records, and the retail trade activity index (IACM). Automobile sales (ANAC) and imports of consumer goods have shown greater stability recently. In the public component, its better performance is related to an increase in health expenditures.

FIGURE I.12 PRIVATE CONSUMPTION BY COMPONENTS
(index, 2013.Q1 = 100, real seasonally-adjusted series)



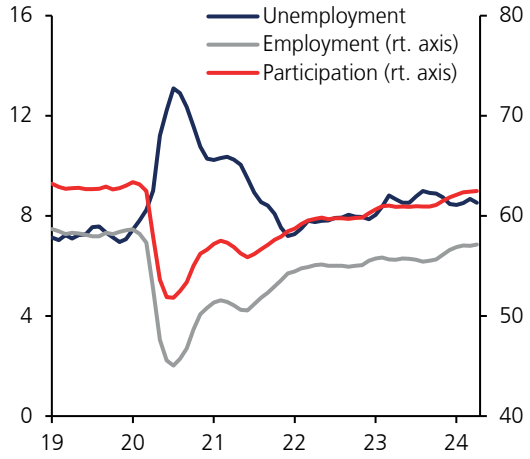
Source: Central Bank of Chile.

The better performance of consumption is consistent with the increase in the wage bill. In employment, there is a greater growth in formal salaried occupations during the last year, followed by self-employment. The unemployment rate continues to fluctuate around 8.5% (figure I.13). Real wages continue to increase, without significant changes after the National Institute of Statistics published its new wages series. Despite remaining in pessimistic territory, the Monthly Business Confidence Index (IMCE) shows an increase in employment expectations for a few months (figure I.13).

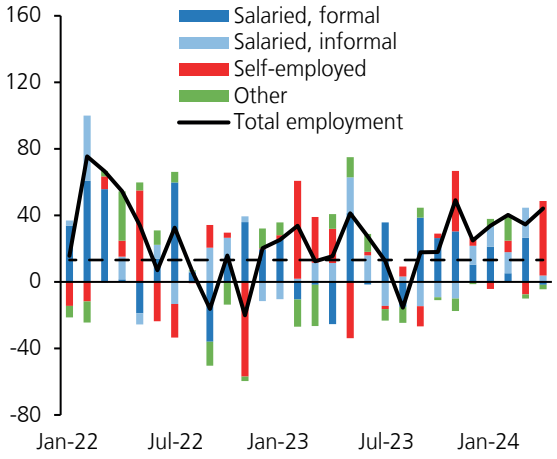
Gross fixed capital formation (GFCF) halted the sharp deterioration it showed in the second half of 2023, but its performance remains weak. Its seasonally adjusted series posted a near zero quarterly variation in the first quarter. Machinery and equipment, the component that contracted the most last year, showed a more stable behavior, which is also observed in the evolution of capital goods imports (Figure I.14). Construction and other works shows differences between its components, with a more favorable performance of engineering works linked to mining, compared to building works. In the real estate market, a low dynamism of demand for housing is observed, reflected in the high stock of finished units available for sale, which more than doubled between 2022 and 2024. The overall investment outlook is consistent with the May Business Perceptions Report (IPN) interviewees, who stated that, aside from maintaining their current production capacity, they do not foresee any major projects for this year.

FIGURE I.13 LABOR MARKET INDICATORS

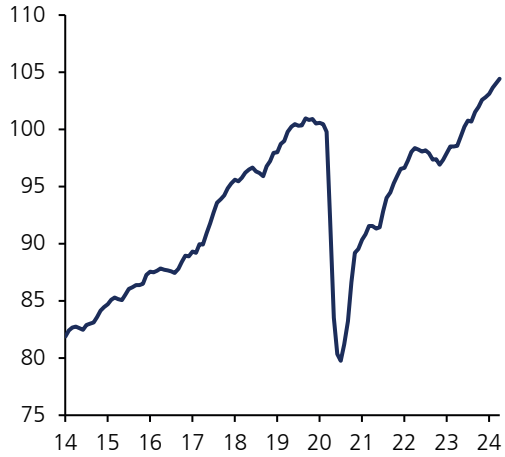
Unemployment, employment and participation rates
(percent)



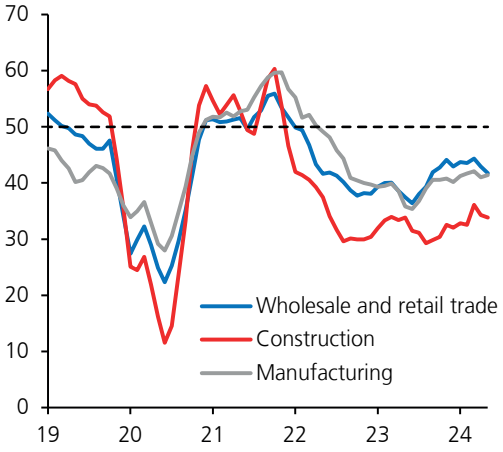
Employment by occupational category (1)
(moving quarter difference, thousands,
seasonally-adjusted)



Real wage bill (2)
(index 2019 = 100, seasonally-adjusted)



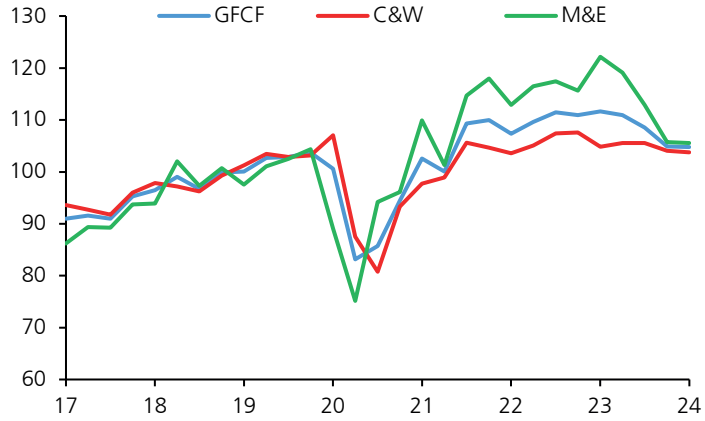
Employment IMCE (3)
(diffusion index, moving quarterly average)



(1) Total employment is the official data seasonally adjusted by the INE, while occupational categories were deseasonalized internally using X13-ARIMA-SEATS. Dashed line shows 2013-2019 average. "Other" includes employers, domestic service and unpaid family work. (2) Calculated using seasonally-adjusted series of the real LCI, hours worked and occupation. (3) Value above (below) 50 indicates optimism (pessimism).

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

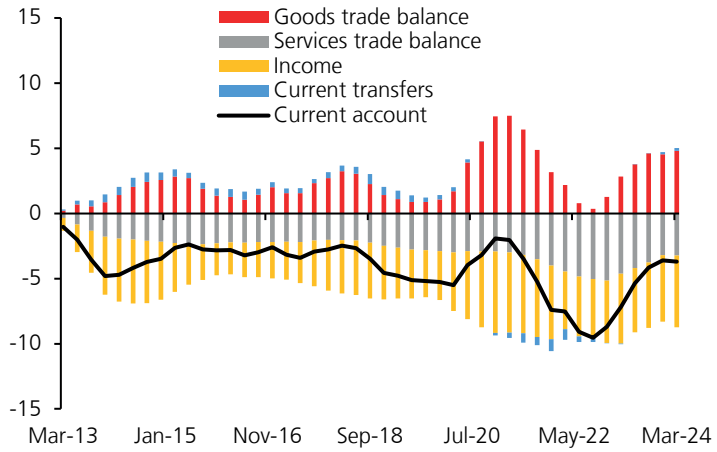
FIGURE I.14 GROSS FIXED CAPITAL FORMATION
(index, 2013.Q1 = 100, real seasonally-adjusted series)



Source: Central Bank of Chile

Exports have had a better performance, which has favored the current account balance (Figure I.15). The increase in shipments in the first quarter came against the backdrop of improving global demand, especially in the agricultural and mining sectors. Recently, the value of mining exports has increased due to the rise in the copper price. In the trade balance, this was partially offset by a fall in services exports—mainly due to a contraction in maritime freight rates—and a negative balance of investment income. With this, the current account deficit reached 3.7% of GDP in the first quarter (3.6% in the previous quarter). This evolution takes place in a context of improved national savings, especially the private component, whose cumulative annual sum reached 19.4% of GDP during the first quarter (17.5% in the same period the previous year).

FIGURE I.15 CURRENT ACCOUNT, CONTRIBUTIONS BY COMPONENT
(percent of GDP, moving annual sum)



Source: Central Bank of Chile

In general, the Chilean financial market has kept pace with the movements of its external peers (Figure I.6). Despite fluctuations, long-term rates rose by around 20 bp when considering the 10-day average before the closing of this and last Monetary Policy Reports, while the IPSA had moderate gains.

The peso has been affected by other factors, such as the rise in the copper price, which has caused it to appreciate more than other currencies (Figure I.6). Thus, since the last IPoM, the peso accumulated an appreciation of around 5% against the dollar and 6% in its multilateral measure.

The trajectory of short-term lending rates continues to reflect the normal pass-through of cuts in the monetary policy rate (MPR) (Figure I.16). Last May, the rate of commercial loans averaged 11.1% (16.1% in May 2023), a figure that reached 25.5% in consumption loans (28.7% a year ago). Longer-term rates, including mortgage rates, have remained high by historical comparison, consistent with the evolution of their external peers. Delinquency indicators, for all portfolios, and noncompliance (which consider the commercial portfolio) remain high, as was mentioned in the Financial Stability Report (IEF) for the first half of this year (Figure I.16). The Bank Lending Survey (ECB) for the first quarter of 2024 reported that the credit market continues to weaken on the supply side —as there are no significant changes in the conditions required by banking institutions— and on the demand side—which coincides with the perceptions of those surveyed in the May IPN, who declare that they are not more willing to take on debt in the short term. In any case, the evolution of commercial credit in recent quarters has been in line with macroeconomic fundamentals (Box I.3), which should be monitored with caution, especially due to certain weaknesses observed in the latest monthly indicators.

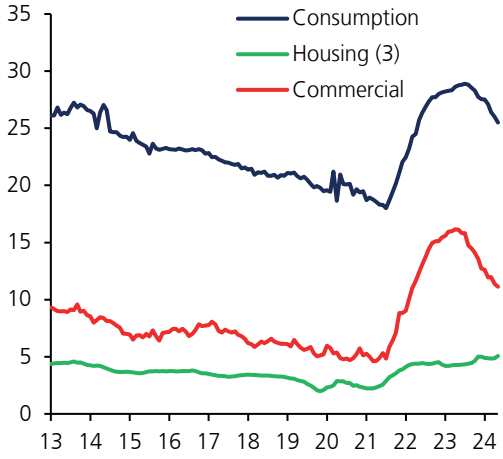
Regarding economic growth for this year, market and experts' expectations have risen over the last few months. The June Economic Expectations Survey (EEE) projects that GDP growth this year will be 2.6% and Consensus Forecasts foresees it at 2.4% (1.8% and 2.0%, respectively, in March). For 2025, expected growth is still above 2.0% (2.2% according to the EEE and 2.3% according to Consensus Forecasts).

The different measures of two-year inflation expectations—the EEE, the Financial Traders Survey (EOF) and financial asset prices—have remained at 3% (Figure I.17). As for businesses, the Survey of Price Determinants and Expectations (EDEP) for the moving quarter ended in April indicates that, by the end of the monetary policy horizon, inflation will reach 3.5% (4% in January, the last figure known at the statistical closing of the March IPoM). One year ahead, the EOF for June suggests that inflation will be 3%, while the EEE for the same month shows an expectation of 3.2%. On the other hand, at the closing of this IPoM, shorter-term inflation expectations were around 4% or more, as the adjustment in the electricity bill expected for the coming quarters began to be considered.

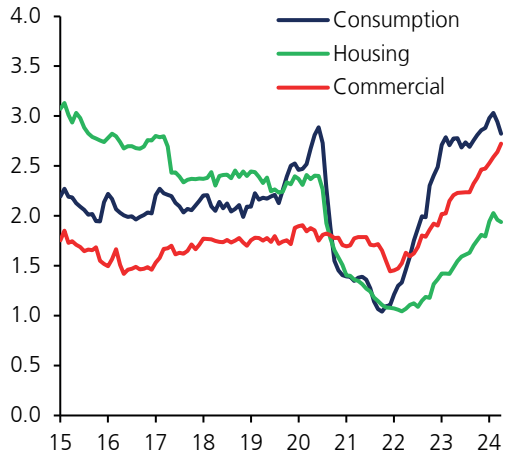
Prior to the publication of the IPoM, the MPR trajectories expected by specialists and the market one and two years ahead continue to suggest a gradual normalization of monetary policy. The June EES and EOF anticipate that, in twelve months, the MPR will be at 4.5%, while the overnight index swap (OIS) suggests that it will reach 4.75% in the same term. In the monetary policy horizon, the June EEE forecasts a 4% MPR, while the June EOF and the OIS rates anticipate that it will stand at 4.5% and 4.75%, respectively. Nominal one- and two-year OIS rates, which have also fluctuated, are slightly below those at the closing of the March IPoM.

FIGURE I.16

Lending interest rates (1) (2)
(percent)



Above-90-days delinquency ratio
(percent of respective portfolio)

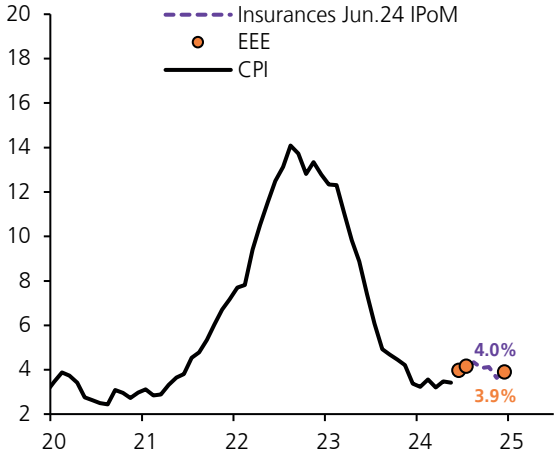


(1) Weighted average rates of all transactions performed each month in the Metropolitan Region. (2) Series seasonally-adjusted using Census X-12. (3) UF-indexed loans.

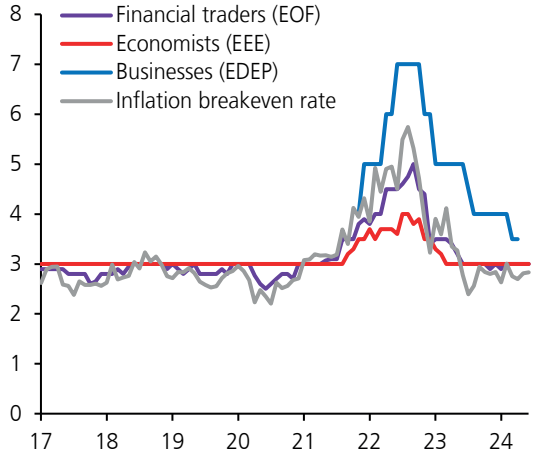
Source: Central Bank of Chile.

FIGURE I.17

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



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



(1) Series considers the 2023 CPI reference basket. Insurance considers average prices of the last 10 days to 12 June. (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 June 2024 Meeting. In months with no survey published, the latest available one is considered. (4) Breakeven inflation considers averaged prices of the last 10 days of each month. For June 2024 it uses the average of the last eight days as of 12 June.

Source: Central Bank of Chile.

BOX I.1:

Dynamics and outlook of services inflation around the world

The central scenario of this IPoM contemplates somewhat more persistent global inflation than usual, due to the outlook for the evolution of services. In contrast to goods, food and energy inflation, services inflation has remained high in many countries, with an impact on total inflation of around one percentage point above its pre-pandemic average (Figure I.18a). Given that services inflation tends to be more associated with domestic factors, its high synchronization at the global level is an unusual phenomenon. This box explores the reasons for this and analyzes what can be expected for services inflation going forward.

Estimates based on dynamic factor models confirm the greater global synchrony of services inflation. Bajraj et al. (2024) show that, while for the period 2015-2019 the common elements (captured by a global factor) explained around 15% of the variance of quarterly services inflation, this figure rose to around 50% by the post-pandemic period. The reasons for the coordination of high services inflation at the global level include the synchronization of pandemic-related shocks and the outbreak of war in Ukraine, as well as the policies adopted to address them. All this would have led to a significant increase in the correlation of global output gaps and similar dynamics in relative prices between services and goods (Bajraj et al., 2024).

One aspect worth noting is that, after the pandemic and war shocks, the prices of services lagged significantly behind the general price level (Figure I.18b). It is expected that the recovery that has been observed since early 2023 will continue into the coming quarters. So far, most of the change in the relative prices between goods and services can be explained by the fall in goods inflation. That process is largely complete and cannot be expected to continue contributing significantly to the reestablishment of relative prices, in line with historical evidence (Gascon and Martorana, 2024). Accordingly, the analysis of Peach et al. (2004), updated for the United States, suggests that services inflation would return to its pre-pandemic levels by mid-2025 (Bajraj et al., 2024), assuming the persistence of services inflation would follow the usual patterns.

There are risks, however. Evidence shows that services inflation persistence increases in periods of high inflation, as indexation mechanisms intensify (Borio et al., 2023). As an example, Bajraj et al. (2024) suggest that the level of services inflation persistence may have doubled during the 2021-2022 inflationary spike in the United States. Although it has been regularizing in recent months, it is still above the pre-pandemic level, which could delay the normalization of services inflation[1]/.

Finally, it must be noted that beyond the increase in the synchronization of services inflation at the global level, there are country-specific elements that have also played important roles and could affect the dynamics of relative prices in the future. These include the evolution of monetary and fiscal policies, migration dynamics, changes in investors' appetite for risk, productivity dynamics unique to each economy, as well as geopolitical developments that may have an impact on the prices of goods.

[1]/ Given the coordination of inflationary peaks across countries, the increase in persistence would add an additional coordination mechanism to global services inflation.

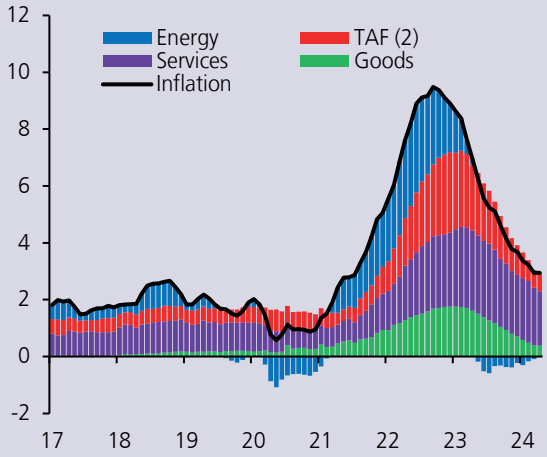
Chile observed a decline in both total and services inflation, after peaks that exceeded those of comparable economies. This was due to monetary and fiscal policy reactions, which helped to correct the significant macroeconomic imbalances of previous years. As in other economies, the decline in services inflation has been more gradual than in goods. This is influenced not only by the need to recompose relative prices, but also by the dynamics of sectoral activity gaps. While in the case of goods, the gap closed and turned negative by the end of 2022, the gap associated with services approached zero only at the end of last year, consistent with a slower decline in services inflation (see Box II.1 in the March 2024 IPoM).

Conclusion

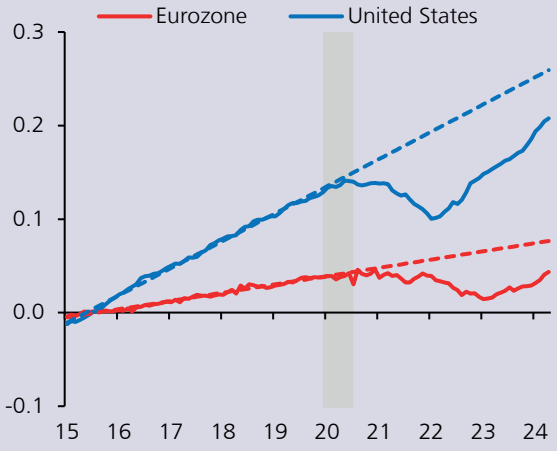
Services inflation has remained high in many economies, both developed and emerging, an unusual phenomenon due to the greater historical association of services with the domestic cycle. The evidence suggests that the normalization of services inflation will take a few more quarters, and could even be somewhat slower than usual due to the intensification of indexation mechanisms that would have occurred in this cycle. The central scenario envisages slightly higher than usual levels of persistence in services. In the United States, this could be coupled with more resilient than expected demand, which would further delay convergence.

FIGURE I.18

a) Contribution of main components to headline inflation (1)
(mean annual inflation, percent)



b) Relative prices between services and goods excluding foods and energy (3)
(deviation from 2015 level, logarithmic scale)



(1) Harmonized series of inflation and its components. Average of 53 countries. May 2024 figure not reported because it is not available for every country. (2) Tobacco, alcohol & foods. (3) Natural logarithm of the ratio between services CPI and CPI for industrial goods (excl. energy), both normalized to 2015=1. Dotted lines denote the linear projection of the trend between 2015 and 2019.
Sources: Global inflation data from Bajraj, Carlomagno, Ledezma, Pustilnik and Wlasiuk (2024); Central Bank of Chile, based on Bajraj, Carlomagno and Wlasiuk (2023).

BOX I.2:

Recent evolution of the copper price

Compared to the statistical closing of the March IPoM, the copper price has increased around 10% (+15% this year to date). Determining the persistence of this increase is important for evaluating the macro framing for the coming years, due to its effects on aggregate demand, expectations, the exchange rate and inflation, among others. This Box examines the causes of the recent increase in the price of the metal and estimates of its persistence.

The causes behind the price increase

The most common explanation among experts is that the recent dynamics are linked to news about supply constraints, in a context of structurally high demand given the importance of copper for the energy transition (electromobility, changes in the generation matrix, and electrification, among others). The relative scarcity is reflected both in the trend of global inventories (Figure I.19a) and in the reduced refining margins, which are close to zero. Morover, the sanctions against Russia on copper storage in the London Metal Exchange and the increase in speculative positions could have pressured the price beyond the imbalance between supply and demand.

The rise in copper price is occurring alongside a widespread increase in the prices of metals and other risky assets (Figure I.19b). A simple statistical exercise suggests that more than half of the increase in copper prices since the beginning of the year can be explained by the behavior of other metals (Zelpo *et al.*, 2024). In other words, there are elements common to the price of all metals that explain a significant part of the copper rally.

Zelpo *et al.* (2024) highlight five factors that could be behind the rise in metal prices. First, a 'green demand' shock, which also boosted the price of financial assets associated to the energy transition. Second, a 'growth' shock, associated with the strength of the U.S. economy, the resilience of China —which, despite more pessimistic views at the beginning of the year, seems to be consolidating growth of around 5%— and the prospects of India as the new driver of world growth. Third, geopolitical reasons would lead different governments to try to secure the supply of strategic commodities, including copper. Fourth, the increased appetite for risk since the beginning of the year, which has boosted the prices of various risky assets, especially in the United States. Finally, there are factors particular to copper, associated with supply and/or speculative elements. In line with the above, Zelpo *et al.* (2024) estimate that these specific factors explain less than half of the increase in copper prices since the beginning of the year.

Persistence going forward

The duration of high prices depends on the persistence of the factors that caused its increase. Although doing a precise assessment is a complex task, a relatively conservative assumption is that the entire copper-specific component and the one related to the increase in risk appetite would be transitory, while the rest would be persistent.[2]/ With this, more than half of the recent increase would persist (see Zelpo *et al.*, 2024). This would raise the medium-term outlook to around 10%.

This result is consistent with the change in the medium-term price outlook of various market agents. Consensus Forecasts' 2025 copper price outlook increased between 6% and 14% between January and May of this year. That

[1]/ In the copper-specific component, speculative factors (which are transitory) and possible supply-side elements also play a part. Since the main supply-related elements were known prior to the recent price increase, the conservative assumption is that the entire specific component is transitory.

of the Ministry of Finance rose slightly more than 8% between the fourth quarter of 2023 and the first quarter of 2024. This, in a context where the medium-term outlook has reacted quickly to the change in the spot price (see Zelpo *et al.*, 2024), in line with the interpretation of persistent elements in the recent rally.

After considering all these elements, the central scenario of this IPoM raises the forecasted copper price for 2024-2026 from US$3.85 to US$4.3 per pound.

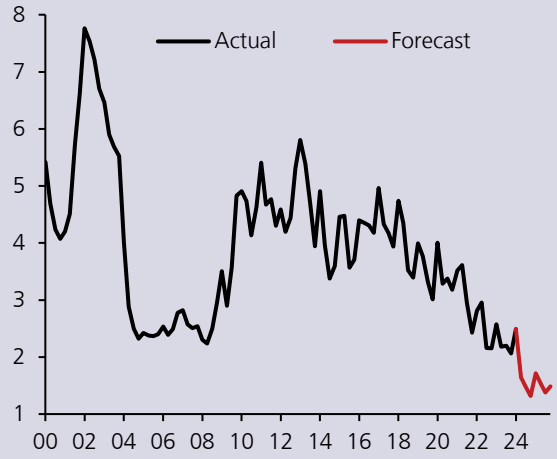
The higher price of copper will affect the local economy through various channels that operate with delays, and whose impacts increase as the rise becomes more persistent. First, it encourages investment in mining, which has indirect effects on other sectors, such as construction and entrepreneurial services. This generates positive impacts on employment, labor income, and consumption, in addition to improving household and business expectations (Albagli y Luttini, 2015). The gains in our terms of trade increase the current account balance, which tends to reverse as domestic spending and investment rise (Box V.1 in March 2013 IPoM). On the other hand, the rise in copper price leads to an appreciation of the peso, reducing short-term inflationary pressures. However, higher domestic demand and its effects on the activity gap increase them in the medium term. These effects are incorporated into the central scenario, in line with the anticipated rise in copper price. A larger and/or more persistent increase—if not offset by cost increases—would have stronger impacts on investment and other components of demand, including public spending through the structural balance fiscal rule. Such a situation is evaluated within sensitivity scenarios.

Conclusions

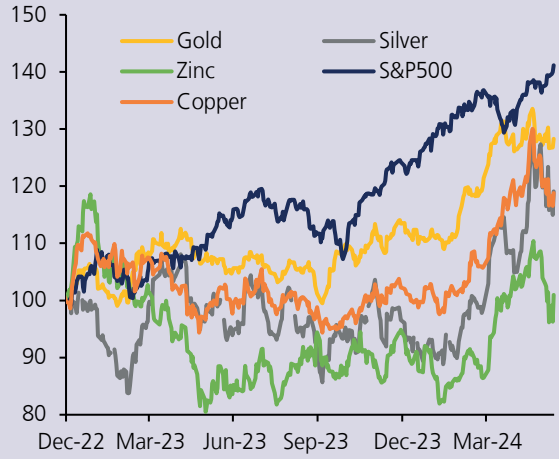
The recent episode of rising copper price occurs in a context of relative supply scarcity and high demand driven by several factors, most notably the energy transition. The central scenario of this IPoM revises up the projected price from US$3.85 to US$4.30 per pound for 2024-2026. In addition to the associated peso appreciation, the higher price will boost investment and other components of demand, whose effects on inflationary dynamics and monetary policy strategy will continue to be evaluated in the coming quarters.

FIGURE I.19

a) Global copper inventories (*)
(index Dec.22 = 100, nominal)



b) Asset prices
(index, 30.Dec.22 = 100)



(*) Total estimated level of visible inventories, as reported by CRU and measured as weeks worth of consumption.
Sources: CRU, Bloomberg and London Metal Exchange (LME).

BOX I.3:

Recent evolution of commercial credit

In the last year, the MPR has been lowered by 550 basis points, significantly reducing the restrictive stance of monetary policy. This lower MPR has been passed on to short-term bank lending rates, for loans to both firms and individuals (Chapter I, figure I.16). Nevertheless, the stock of commercial and consumer bank loans continues to show negative annual variation rates, although smaller than those observed a few quarters ago. This box presents additional background on the evolution of commercial bank credit and seeks to determine whether its evolution is consistent with the macroeconomic framework or whether, on the contrary, it would be contributing to amplify the cycle beyond the other Chile's economic fundamentals.

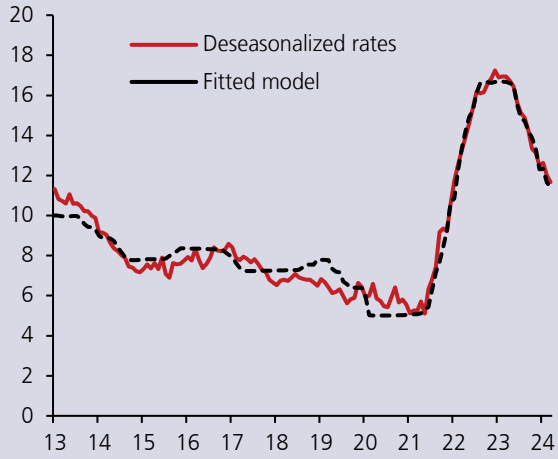
The current credit performance comes in a context in which, according to various sources, unfavorable supply and demand conditions are perceived. On the one hand, the Central Bank's Bank Lending Survey showed a tightening of lending conditions for several consecutive quarters, in the face of a weakening demand. The latest survey, for the first quarter of 2024, shows that commercial credit supply factors are perceived to be similar to those of the previous quarter[1]/, even though commercial credit rates have decreased as expected, following the MPR cuts (figure I.20a). On the other hand, demand factors weakened again, particularly due to lower investment. The May Business Perceptions Report paints a similar picture. The firms interviewed report that credit granting conditions are tight, although they have not deteriorated at the margin, and that their willingness to take on more debt is low.

However, to assess whether this information is consistent with the macroeconomic cycle, it is necessary to consider that the credit cycle in recent years has exhibited several peculiarities. First, as a result of the liquidity and credit support measures deployed during the Covid-19 crisis, commercial credit in Chile grew strongly in 2020-2021 (figure I.20b)[2]/. After that, the Chilean economy suffered a sharp inflationary process, where demand stimulus policies made a significant contribution. This prompted the Central Bank to rapidly raise the MPR, which was passed on to commercial credit interest rates, and was accompanied by a significant credit contraction, consistent with the conditions that were necessary for domestic spending to adjust and for inflation to converge to the 3% target in the two-year horizon (figure I.20a). Therefore, the current behavior of commercial credit should be evaluated in the context of a strong expansion in the first stages of the pandemic, followed by the contraction that was required in the process of adjusting spending and convergence of inflation to the target.

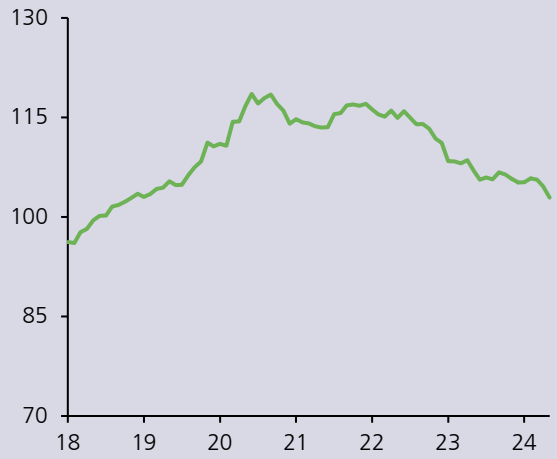
[1]/ See Financial Stability Report (IEF), first half 2024.
[2]/ The increase in commercial credit during the Covid-19 crisis implied a substantial difference with respect to other crises, giving credit an important countercyclical role. See Box I.1 in September 2020 IPoM and Financial Economic Series of March 2023 for more details.

FIGURE I.20

a) Interest rates con commercial loans (1)
(percent)



b) Real commercial loans (2)
(index, 2018=100)



(1) Commercial rates in pesos, including installments and revolving. Information as of 31 May, 2024. Data adjusted for composition effects: currency, amount, term, product. Seasonally adjusted rates using CENSUS X-12 and national calendar. National coverage (D32-33). Independent variables: SPC2 and MPR. (2) Accounting data up to April 2024. Data as of May 2024 based on files of the Monetary Information System (SIM01) based on stock in UFs. Excludes foreign trade.
Source: Central Bank of Chile based on Financial Market Commission (CMF) data.

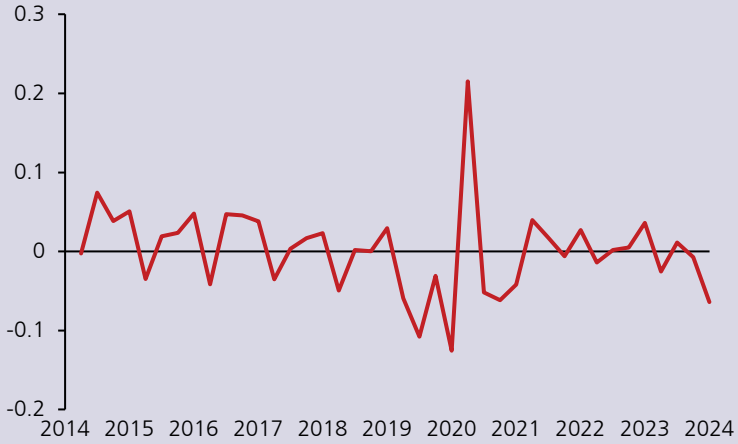
For a quantitative assessment of the consistency between commercial credit and the evolution of other macroeconomic variables, Bauducco *et al.* (2024) present evidence from individual information on the firms' bank debt and their performances, and from aggregate variables such as activity, expectations, non-performing debt and MPR for the period 2014.Q2-2024.Q1. The study seeks to explain the quarterly change in debt at the firm level using indicators of their performance such as changes in sales, employment and investment, as well as aggregate variables. Figure I.21 shows the average prediction errors, or residuals of this relationship, on a quarter-by-quarter basis. Significantly negative values would indicate that credit is unusually low, and vice-versa. The average residual of this regression is found to be close to zero until the first quarter of 2020, showing that corporate debt does not deviate from what would be expected given their performance and the business cycle. In 2020 the residual grew strongly, coinciding with the stimulus policies that encouraged companies to take on debt in response to the slump in activity. From 2022 onwards, this average residual returned to values around zero, suggesting that credit growth is in line with the performance of businesses and the behavior of the economy[3]/. Moreover, this result coincides with that obtained from a shock decomposition based on a structural model that incorporates a financial sector[4]/.

It is important to note that in the first quarter of 2024 (last point of the series) the average residual shows a negative value, suggesting a slower than expected credit growth for that quarter given the determinants considered. Considering the time variability of the average residuals, caution is recommended when interpreting the results of the last quarter and to continue monitoring the connection between credit and its determinants.

[3]/ For details, see Bauducco *et.al* (2024).

[4]/ See DTBC No.953 for a detailed description of the model.

FIGURE I.21 AVERAGE RESIDUALS OF FIRM-LEVEL REGRESSION OF COMMERCIAL CREDIT GROWTH ON VARIOUS DETERMINANTS
(variation rate)



Source: Bauducco *et al.* (2024).

Conclusions

Corporate credit activity has evolved in line with prevailing macroeconomic conditions. Evidence based on anonymized administrative microdata suggests that the evolution of commercial credit is driven by both corporate demand factors and macroeconomic factors, that is, activity, growth expectations and the MPR. However, recent data on commercial credit may indicate a further slowdown in the current quarter and call for some caution. The Central Bank will continue to closely monitor this and other financial variables.

II. FUTURE EVOLUTION OF MONETARY POLICY

The macroeconomic scenario has evolved in line with expectations in the March Monetary Policy Report (IPoM). Activity has resumed a growth path consistent with its trend, with demand performing somewhat better than expected. Headline inflation stands at around 3.5% annually[1]/ and its two-year expectations remain at 3%. In the international scenario, the outlook for the course of monetary policy in the United States has continued to be particularly relevant for the financial markets. The central scenario of this IPoM considers that the impulse that the Chilean economy will receive from abroad will be greater than was expected in March, due to the increase in the terms of trade — explained by the rise in the copper price— and, to a lesser extent, to a slight upward revision in the projected growth of our trading partners for 2024 and 2025. As for local inflation, it is projected to rise significantly in 2025 and converge to the target in the first half of 2026. This responds mainly to the supply shock associated with the increase in electricity costs and a higher boost in domestic demand. This will be partly offset by a more appreciated real exchange rate (RER) than expected in March. GDP is projected to grow between 2.25% and 3.0% this year (between 2.0% and 3.0% in March). For 2025 and 2026, the range of growth remains between 1.5% and 2.5%, which factors in the greater boost from domestic spending, favored by its improved fundamentals, including the higher expected copper price. This contrasts with the negative impact of energy costs on households' disposable income. The Board estimates that, if the assumptions in the central scenario materialize, the monetary policy rate (MPR) would have accumulated during the first half of the year the bulk of the MPR cuts foreseen for this year. The central scenario of this Report considers that the MPR will be reduced further over the monetary policy horizon, at a pace that will factor in the evolution of the macroeconomic scenario and its implications for the inflation trajectory.

ACTIVITY AND DEMAND PROJECTIONS IN THE CENTRAL SCENARIO

The external impulse to the Chilean economy is greater than expected in March, given the higher copper price and better expected terms of trade. In the central scenario of this IPoM, the copper price is expected to average US$4.3 per pound in the period 2024-2026 (US$3.85 in the previous IPoM). More than half of the cumulative increase in this price since the beginning of this year is estimated to be caused by more persistent factors (Box I.2). The projected price of a barrel of oil (WTI-Brent average) is largly unchanged: US$76 vs. US$77 in the period 2024-2026. The outlook for the international food price indexes (FAO) are revised slightly upward, in response to supply-side factors (table II.1 and figures I.7, II.1 and II.2).

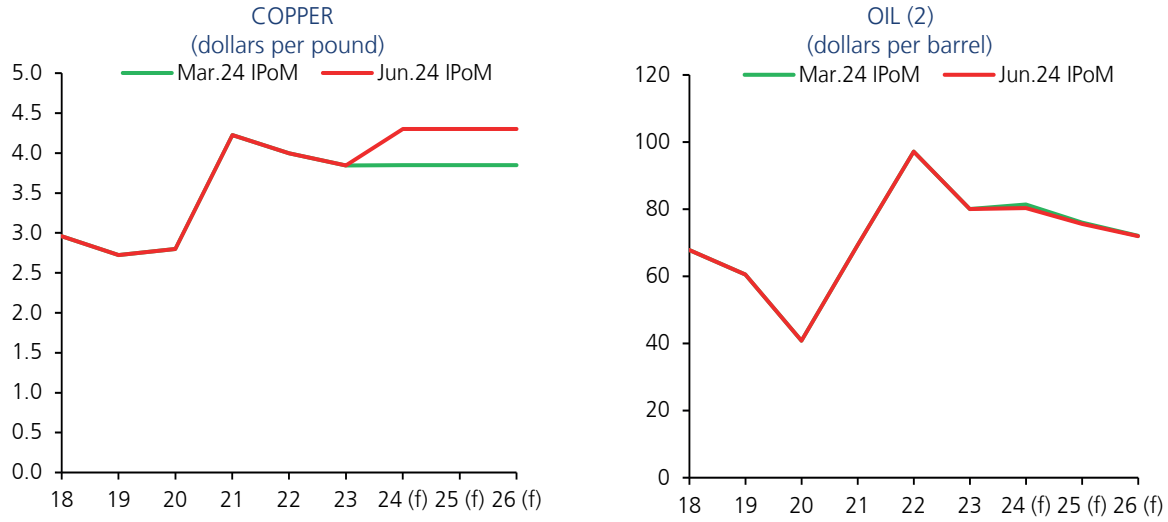
[1]/ For the purposes of macroeconomic analysis and the conduct of monetary policy, the Board uses the series with base year 2023, called the spliced reference CPI, which considers information from the new basket only. For price-level restatement purposes of indexed contracts, bonds or securities, the annual variation of the CPI reported by the National Statistics Institute (INE) is used. This combines the CPI base 2018 and base 2023.

TABLE II.1 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	1.4	-0.3	1.6
External prices (in US$)	0.6	4.4	-0.2	0.1	4.6	3.8
			(levels)			
LME copper price (US$cent/pound)	306	400	385	430	430	430
WTI oil price (US$/barrel)	72	94	78	78	73	69
Brent oil price (US$/barrel)	80	100	83	83	78	75
Gasoline parity price(US$/m3) (*)	610	850	721	697	633	607
US Federal Funds Rate (%)	0.7	1.9	5.2	5.5	4.8	3.9

(*) For definition, see Glossary of economic terms. (f) Forecast.
Source: Central Bank of Chile.

FIGURE II.1 COMMODITY PRICES FORECASTS (1)

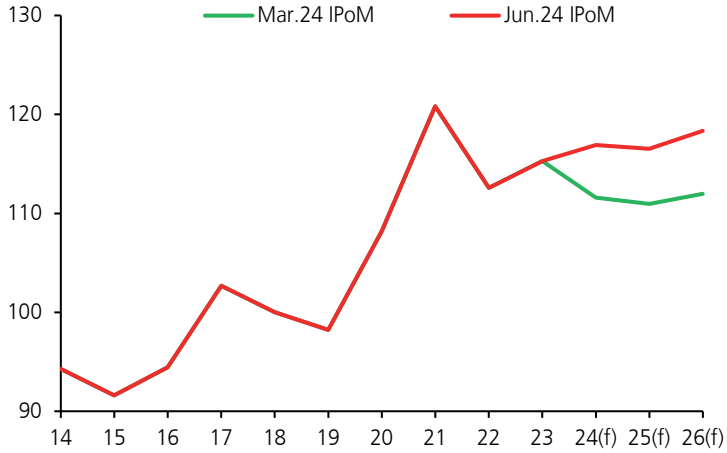


(1) Actual or projected average price for each year as conatained in respective Monetary Policy Report (IPoM).
(2) For oil, WTI-Brent average price per barrel. (f) Forecast.
Source: Central Bank of Chile.

The growth of our trading partners is revised for this and next year, due to better actual data for the first quarter of 2024 in some economies, as well as to the improved outlook, especially in the United States. In this country, domestic demand has sustained its dynamism, with private consumption being favored by services and investment driven by the residential component and intellectual property. In turn, investment in infrastructure is expected to continue to be driven by the Inflation Reduction Act and the development of Artificial Intelligence, while the residential component is expected to lose dynamism in line with the weaker sectoral figures. In both the Eurozone and Latin America, first quarter activity outpaced expectations and recent figures maintain a good performance. However, the pace of growth and the outlook remain subdued. China also showed greater dynamism in the first quarter and is expected to

grow close to 5% this year, although there is still significant heterogeneity among the different economic sectors and demand components. Overall, global and trading partners' growth in 2024 and 2025 will be slightly higher than expected in March (table II.2 and figure II.3).

FIGURE II.2 TERMS OF TRADE
(level, 2018=100)



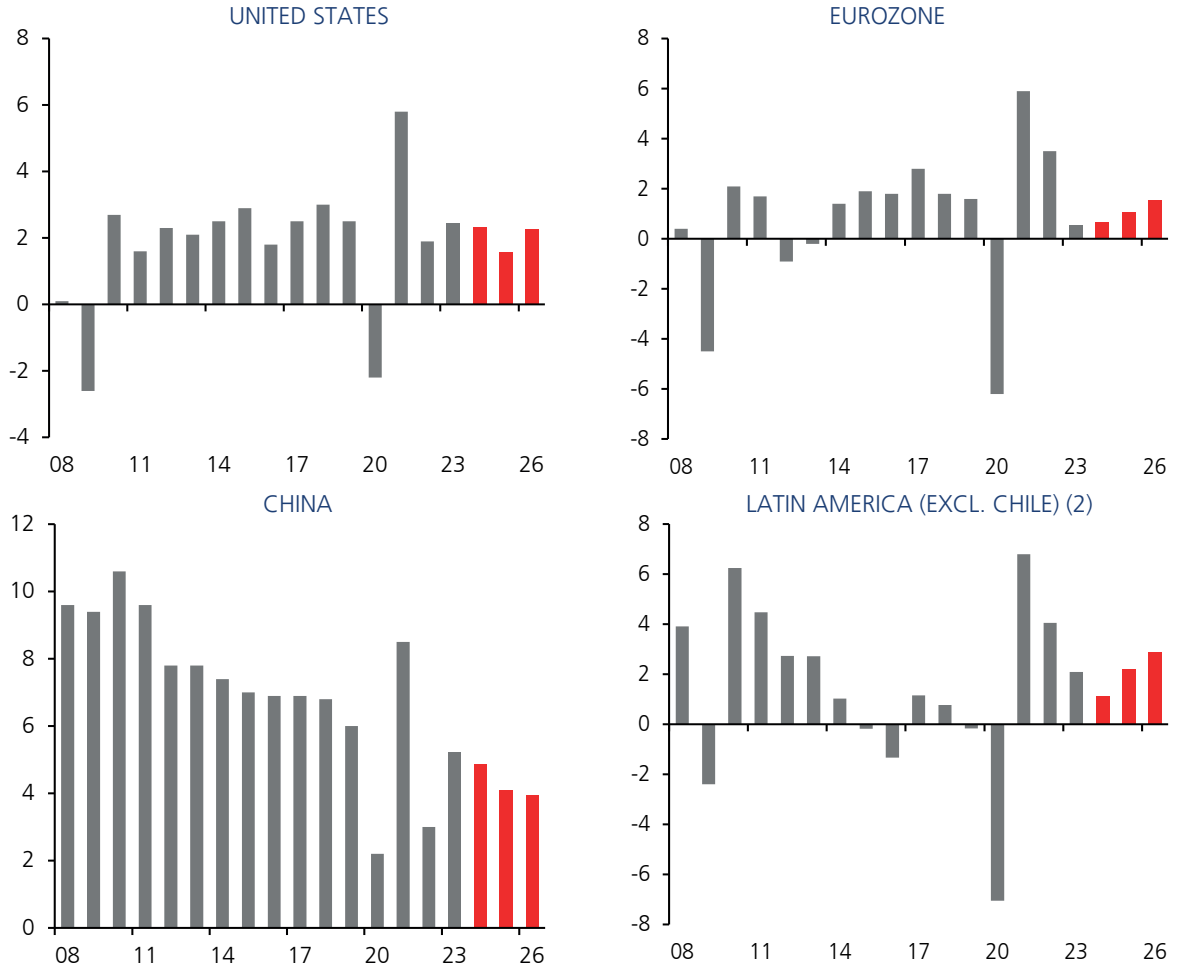
(f) Forecast.
Source: Central Bank of Chile.

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

	Aveg. 10-19	2022	2023 (e)	2024 (f)	2025 (f)	2026 (f)
World GDP at PPP	3.7	3.4	3.4	3.2	3.0	3.1
World GDP at market exchange rate	3.3	3.0	2.8	2.6	2.5	2.7
Trading partners	3.9	2.9	3.3	3.1	2.9	2.9
United States	2.4	1.9	2.5	2.3	1.6	2.3
Eurozone	1.4	3.5	0.6	0.6	1.1	1.6
Japan	1.2	1.0	1.9	0.6	1.6	0.6
China	7.7	3.0	5.2	4.9	4.1	3.9
India	6.7	7.0	7.8	7.0	6.5	6.5
Rest de Asia	4.5	4.2	3.2	4.2	3.7	3.4
Latin America (excl. Chile)	1.7	4.1	2.1	1.1	2.2	2.9
Commodity exp.	2.2	3.3	1.2	1.1	1.9	1.9

(*) 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.3 TRADING PARTNERS GROWTH PROJECTIONS (1)
(annual change, percent)

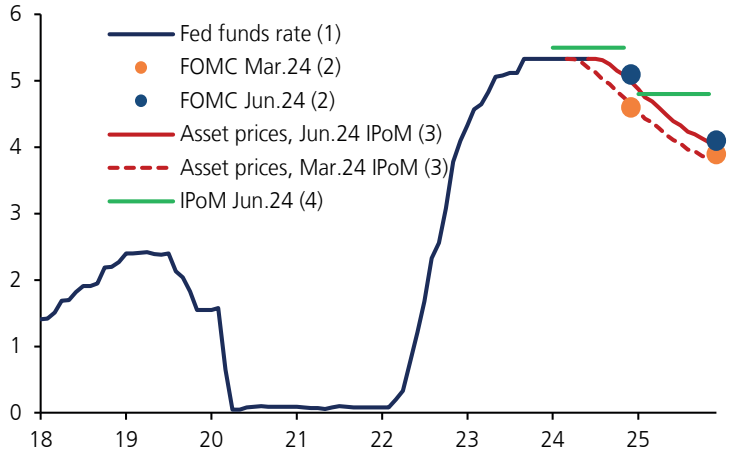


(1) Red bars correspond to the projections of the central scenario of this Monetary Policy Report (IPoM). (2) The Region considers Argentina, Bolivia, Brazil, Colombia, Ecuador, Mexico, Paraguay, Peru, Uruguay and Venezuela. The series projection is based on GPM model region made up by Brazil, Chile,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

The central scenario considers tighter international financial conditions than those contemplated in March. This reflects the more cautious monetary policies around the world, where news related to the outlook for the Fed funds rate (FFR) continues to dominate (figures I.5 and II.4). After a first quarter of surprises in the U.S. in terms of inflation, labor market and demand, the last few weeks have seen mixed developments. In any case, FOMC authorities have maintained a message of caution regarding the start of the interest rate cut and reiterated the need to wait for more information to gain more confidence about the process of inflation converging to the target. In addition, at their latest meeting in June, they revised up their outlook for inflation and for the FFR in 2024 (dots). All this has led the markets to revisit their interest rate outlook for the American economy and are now considering a smaller number of cuts in 2024 compared to what they expected a few months ago. These changes in

outlook have been accompanied by greater volatility in the financial markets markets and have increased short- and long-term interest rates in different economies. In this context, different central banks have continued with their tightening cycles or have initiated them, albeit with messages of caution regarding future decisions.

FIGURE II.4 EVOLUTION AND FORECASTS FOR THE FED FUNDS RATE
(percentage points)



(1) Actual Fed funds rate. Considers information up to June 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 this IPoM.
Sources: Bloomberg and U.S. Federal Reserve.

Local activity has been growing, in line with forecasts in the March IPoM. In any case, there is still heterogeneity across sectors (table II.3 and figures I.11, II.5 and II.6). In the first quarter, total and non-mining GDP —seasonally adjusted series — increased quarter on quarter. As anticipated in the March IPoM, the part of this stronger dynamism associated with supply-side factors has tended to reverse in recent months, as evidenced by the Imacec figures for March and April. By sectors, the performance of services, some commerce lines and some export items, favored by higher prices and greater external demand, stand out. In contrast, construction is still weak and with more pessimistic expectations compared to other industries.

Final demand (which excludes the change in inventories) in the first quarter exceeded expectations, especially in consumption. Gross fixed capital formation (GFCF) stopped the deterioration it showed in the second half of 2023, although it remains weak (table II.3 and figures I.11, II.12, I.13, II.5 and II.6). Both private and public consumption grew above expectations, with positive quarterly variations in their seasonally adjusted series. In household spending, the services component continues to be comparatively the most dynamic, and was compounded by the rebound in demand for non-durable goods in the first quarter. This, in a context in which the real wage bill has been favored by the increase in employment and real wages. Domestic financial conditions have improved (figures I.13 and I.17). Government consumption also exceeded projections. GFCF posted a quarterly variation close to zero in the first quarter (in its seasonally adjusted series), with a more stable behavior of its components. The construction and other works part continues to show a more favorable performance of engineering works compared to the low dynamism of the building segment.

The projection for local activity contains limited changes with respect to March assumption. In the central scenario, GDP is projected to grow between 2.25% and 3.0% (between 2.0% and 3.0% in March). This reflects both the better performance of consumption and investment in the first quarter and the usual practice of June IPoMs of cutting 25 basis points (bp) off the projected growth range for the current year. In addition, it takes into account the initial boost from the higher copper price on mining production and other industries' activity. The impacts of the latter element are also considered in the medium term, which will be offset by the negative effect of higher electricity rates on households' disposable income, affecting private consumption. As a result, our projection for the GDP growth range in 2025 and 2026 is maintained between 1.5% and 2.5% (table II.3 and figures II.5 and II.6).

The outlook for domestic demand has become more favorable. The higher starting point observed in the first quarter is coupled with a better performance expected for GFCF due to the impact of the increased copper price and the appreciation of the real exchange rate (RER). For this year, a lower GFCF contraction is expected (-0.3% compared with -2% in March) due to the rebound of machinery and equipment, in line with the better recent and expected performance of capital goods imports, supported by the lower levels of the RER. In construction and other works, the higher copper price raises the outlook for mining investment, which will be more noticeable in 2025 and 2026, and will positively affect other sectors. The information from the latest surveys is consistent with this, with a level of mining investment in 2024-26 that would exceed by 30 to 40% that of 2023 according to the Capital Goods Corporation and Cochilco. All considered, GFCF is projected to grow 5.4 y 2.8% in 2025 and 2026, respectively (3.0 and 1.9% in March) (table II.3 and figures II.5 and II.6).

Projected consumption growth is increased for this year and remains similar for 2025 and 2026. By 2024, the higher starting point for this spending component, the improved performance of the real wage bill and the appreciation of the RER, are added to the gradual improvement in consumer confidence. In the medium term, these forces will be partly counterbalanced by the effect of the higher electric bills on households' disposable income. Thus, private consumption is expected to grow 2.5, 1.9 and 2.5% this and the next two years, respectively (2.0, 1.9 and 2.3%, in the March IPoM) (table II.3 and figures II.5 and II.6). Market expectations for GDP and private consumption growth in 2024 have increased over the last few months (Chapter I).

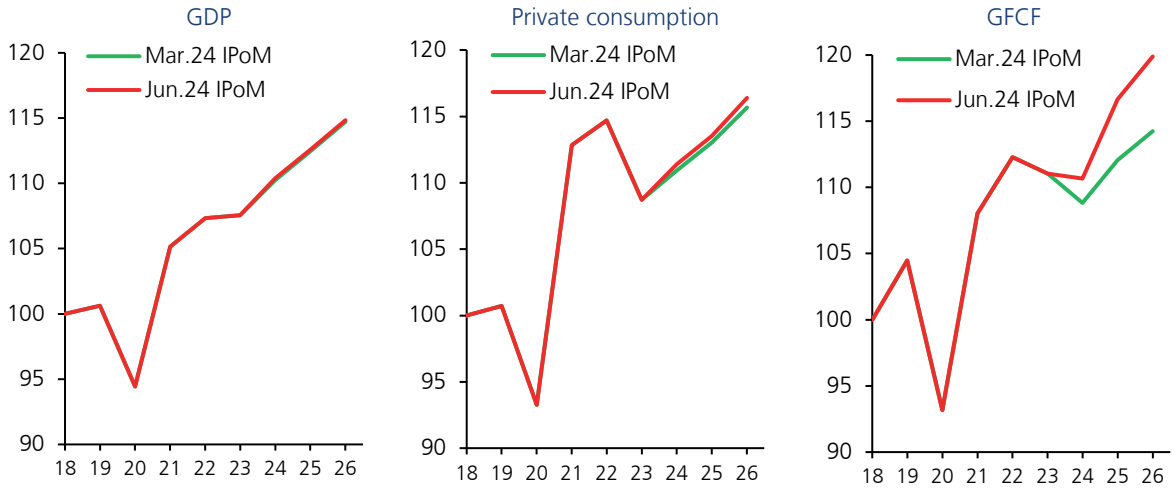
The central scenario assumes that the evolution of public spending will be consistent with estimates in the *Informe de Finanzas Públicas* (IFP) of the first half of 2024. Fiscal spending is estimated to grow by about 5.0% in real annual terms this year, before moderating to about 1% in 2025 and contracting to just under 2% in 2026. The structural balance is still expected to be on an upward trajectory over the projection horizon, from around -2% of GDP in 2024 to -0.5% in 2026.

TABLE II.3 ECONOMIC GROWTH AND CURRENT ACCOUNT

	2023	2024 (f)	2025 (f)	2026 (f)
		(annual change, percent)		
GDP	0.2	2.25-3.0	1.5-2.5	1.5-2.5
National income	0.8	2.6	2.7	2.5
Domestic demand	-4.2	1.8	2.6	2.6
Domestic demand (w/o inventory change)	-3.2	2.0	2.6	2.4
Gross fixed capital form	-1.1	-0.3	5.4	2.8
Total consumption	-3.9	2.8	1.7	2.3
Private consumption	-5.2	2.5	1.9	2.5
Goods and services exports	-0.3	5.9	3.1	1.9
Goods and services imports	-12.0	3.2	4.7	3.9
Current account (% of GDP)	-3.6	-2.1	-2.5	-2.7
Gross national saving (% of GDP)	19.4	19.2	19.5	19.5
Gross national investment (% of GDP)	23.0	21.3	21.9	22.1
GFCF (% of nominal GDP)	23.8	23.1	23.7	23.8
GFCF (% of real GDP)	23.8	23.1	23.8	24.0
		(US$ million)		
Current account	-11,899	-7,100	-8,900	-10,300
Trade balance	15,323	20,600	19,400	19,600
Exports	94,557	101,600	107,500	112,500
Imports	79,234	81,000	88,100	92,900
Services	-10,782	-10,300	-10,800	-11,600
Rent	-17,009	-17,900	-17,900	-18,700
Current transfers	568	500	400	400

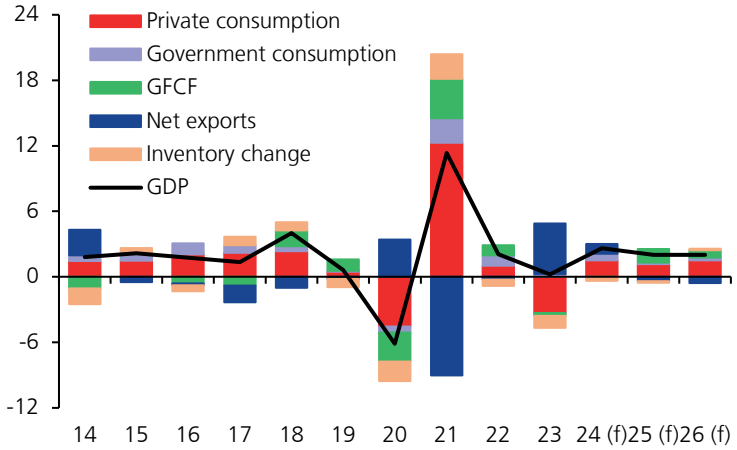
(f) Forecast.
Source: Central Bank of Chile.

FIGURE II.5 ACTIVITY, PRIVATE CONSUMPTION AND GFCF (*)
(index, 2018 =100)



(*) For 2024, 2025 and 2026, considers midpoint of GDP growth ranges projected in respective MP Reports.
Source: Central Bank of Chile.

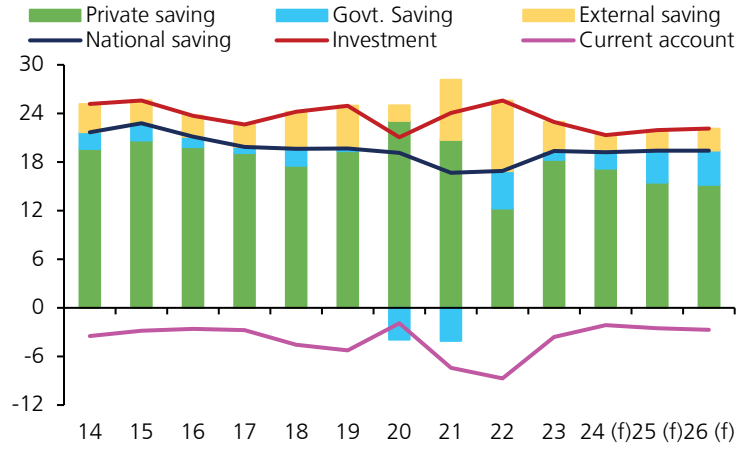
FIGURE II.6 GDP GROWTH AND AGGREGATE DEMAND COMPONENTS CONTRIBUTIONS (*)
(annual change, percentage points)



(*) For 2024, 2025 and 2026, considers midpoint of GDP growth ranges projected in this Report's central scenario. (f) Forecast.
Source: Central Bank of Chile.

The current account will run a smaller deficit over the entire projection horizon, moving from 2.1% this year to 2.7% in 2026 (3.4% for the 2024-2026 period in the March IPoM). This is largely explained by the improvement in the terms of trade. The central scenario considers higher exports, particularly from mining, driven by the rise in the copper price projection. Imports also increase, supported by a lower level of the RER and stronger investment. National savings remain unchanged this year and next and would be close to 20% of GDP in 2026 (table II.3 and figure II.7).

FIGURE II.7 CURRENT ACCOUNT: SAVINGS AND INVESTMENT (*)
(percentage of annual GDP)

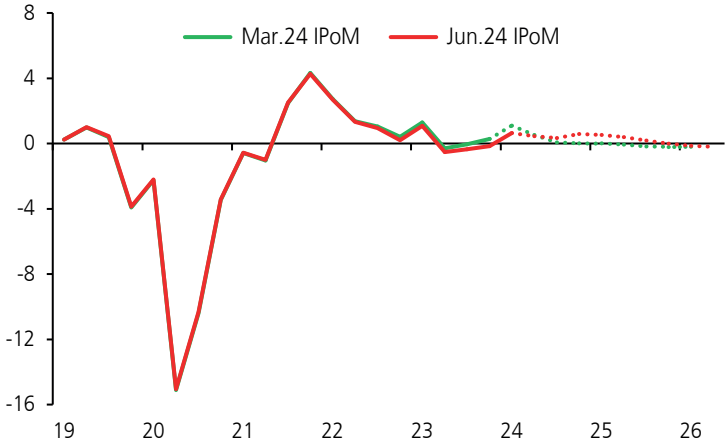


(*) The government savings component considers as actual data up to 2023 the general government's balance sheet; the government savings of the central government's balance sheet is used for the 2024-2026 forecast. (f) Forecast.
Source: Central Bank of Chile.

ACTIVITY GAP AND INFLATION'S CONVERGENCE TO THE TARGET

The activity gap is adjusted moderately from our March forecast (figure II.8). The latest available information led to a slightly upward re-estimation of potential GDP and a marginally downward one of the level of the activity gap in 2023. Going forward, a somewhat more positive gap is expected in response to the boost of higher copper prices on mining investment. Added to this is the positive effect of the higher copper price on business and consumer expectations, which will favor investment in the other sectors and private consumption. However, household spending is expected to moderate due to the negative effect of higher electricity rates on disposable income.

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



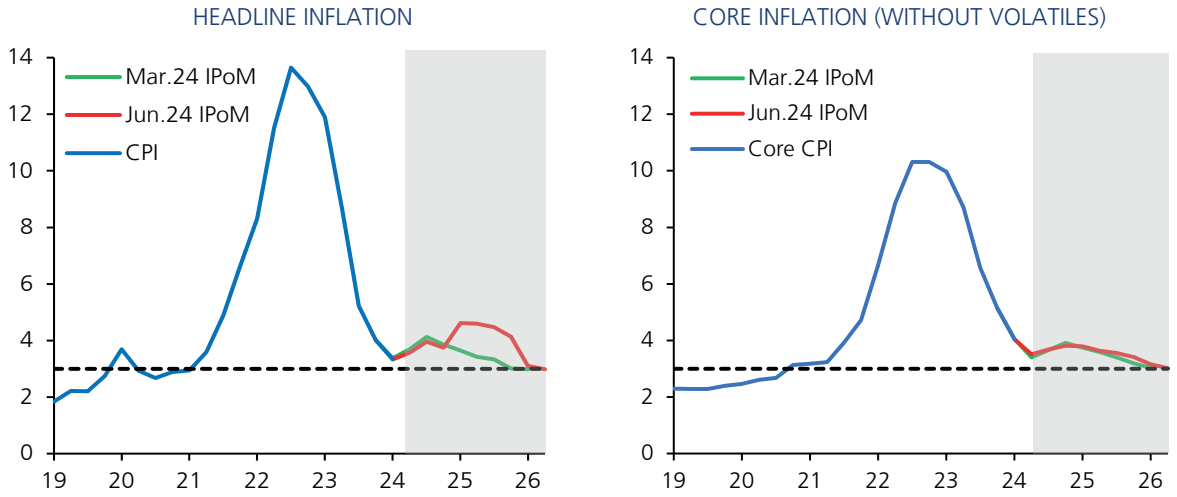
(1) Dotted lines show forecast.
(2) Forecast assumes structural paramenters updated in December 2023 Monetary Policy Report (IPoM) (trend GDP).
Source: Central Bank of Chile.

In the central scenario, projected inflation sees a significant increase, particularly for 2025. The main reason for this is the supply shock associated with the expected increase in electricity rates, in addition to the greater impulse from domestic demand. Based on official background information provided by the National Energy Commission related to the stabilization law approved in April, the higher cost of electricity is expected to add 1.45 percentage points (pp) to the cumulative inflation as of June 2025 (1.1pp more than assumed in the previous IPoM), with the greatest impact concentrated in the volatile component of the CPI, particularly in the electricity supply service. In addition to the direct effect of electricity on the CPI, the expected increase in inflation incorporates the effects via the increase in the costs of firms with regulated utility rates, price indexation and wage adjustments to this higher inflation, among others, which in any case are estimated to be limited and are mainly incorporated in the projection of the core CPI component (which excludes volatiles). Still, the direct effect explains most of the increase of 1.45pp expected in the CPI (Box II.1). This is partly offset by the RER appreciating earlier and more than projected in March, which translates into a lower projected goods inflation. The projection also considers greater domestic demand.

All in all, headline inflation is projected to end this and next year at 4.2% and 3.6% annually., respectively (3.8% and 3.0% annually in March). In the central scenario, inflation is expected to converge to the 3% target in the first half of 2026 (figure II.9 and table II.4). This inflationary trajectory assumes that the transmission of the electricity cost shock will operate according to usual

patterns. It also includes some downward readjustments to the rates that would take place from the second half of 2025. Meanwhile, inflation expectations implicit in financial asset prices and those contained in the reports of some market players also began to consider this factor and rose in the days prior to the publication of this IPoM.

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 second quarter 2024, shows forecast.
Sources: Central Bank of Chile and National Statistics Institute.

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

	2023	2024 (f)	2025 (f)	2026 (f)
Average CPI	7.3	3.7	4.5	3.0
December CPI	3.4	4.2	3.6	3.0
CPI in around 2 years (2)				3.0
Average core CPI	7.5	3.8	3.6	3.0
December core CPI	4.7	3.8	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 second quarter of 2026.
(f) Forecast.
Sources: Central Bank of Chile and National Statistics Institute (INE).

MONETARY POLICY STRATEGY: THE CENTRAL SCENARIO, SENSITIVITIES AND RISKS

The Board estimates that, if the assumptions in the central scenario materialize, the MPR would have accumulated during the first half of the year the bulk of the MPR cuts foreseen for this year. In nominal terms, this trajectory is somewhat above assumptions in the latest IPoM. However, the real MPR of the current central scenario is lower than the one implicit in March scenario for the short-term, although similar on average for the next two years. This is consistent with the inflation targeting monetary policy framework, which allows supply shocks to be accommodated in the policy horizon and thus cushion their impact on activity, demand and employment.

The central scenario of this Report considers that the MPR will be reduced further over the monetary policy horizon, at a pace that will factor in the evolution of the macroeconomic scenario and its implications for the inflation trajectory.

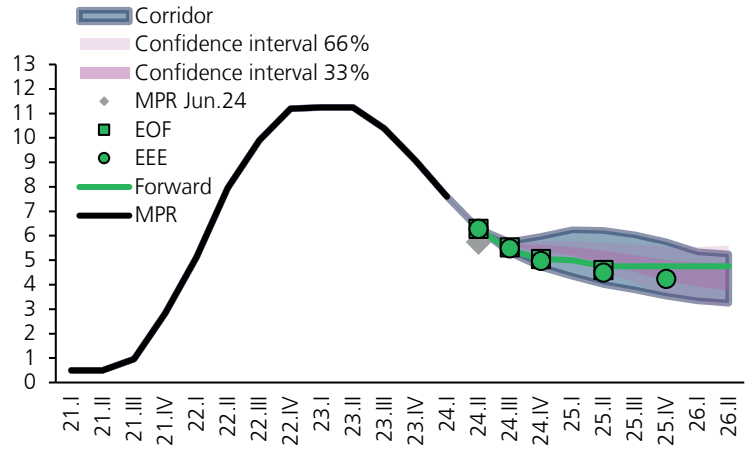
The current scenario gives more flexibility to monetary policy than in previous quarters, particularly due to the resolution of macroeconomic imbalances, the decline in inflation and inflation expectations aligned with the target. The Board will safeguard the compliance with the inflation target, evaluating, on the one hand, that the spread of the shock associated with electricity rates is as expected and that inflationary persistence does not increase. On the other hand, that monetary policy properly supports the economy when it has entered a process in which its growth is little by little approaching levels consistent with its trend and the labor market has improved.

The MPR corridor contains scenarios other than the central one and that have some probability of occurrence, in which monetary policy could take a different road (figures II.10 and II.11).

The upper bound of the MPR corridor reflects scenarios with greater inflationary pressures. Esto podría This could happen, for example, if domestic demand shows a greater than anticipated impulse, or alternatively, if the electricity rate shock has more permanent effects on inflation, where inflationary propagation and persistence mechanisms —such as indexation and wage indexation— could become more relevant. Moreover, it cannot be ruled out that external demand will be more dynamic and will boost world growth and, consequently, the prices of commodities, particularly copper, placing them above those assumed in the central scenario during the entire projection horizon. This situation would favor the expectations of households and firms, thus boosting investment, particularly in mining, as well as allowing for an increase in fiscal spending as a result of increased structural revenues. Both scenarios would generate stronger inflationary pressures and would require raising the MPR to ensure the convergence of inflation.

The lower bound of the MPR corridor is defined by scenarios with milder inflationary pressures. Such would be the case if, for example, the copper price increase drives an impulse on domestic demand that is weaker than assumed in the central scenario, particular on mining investment and consumption. This could also occur if the adjustment of electricity rates worsens the expectations of households and firms, which would further contract consumption and investment. Another possibility would be longer-lasting weak conditions of the most lagging economic sectors. The lower inflationary pressures that would result from any of these scenarios would require a more expansionary MPR than depicted in the central scenario, in order to ensure the convergence of inflation to the 3% target over the policy horizon.

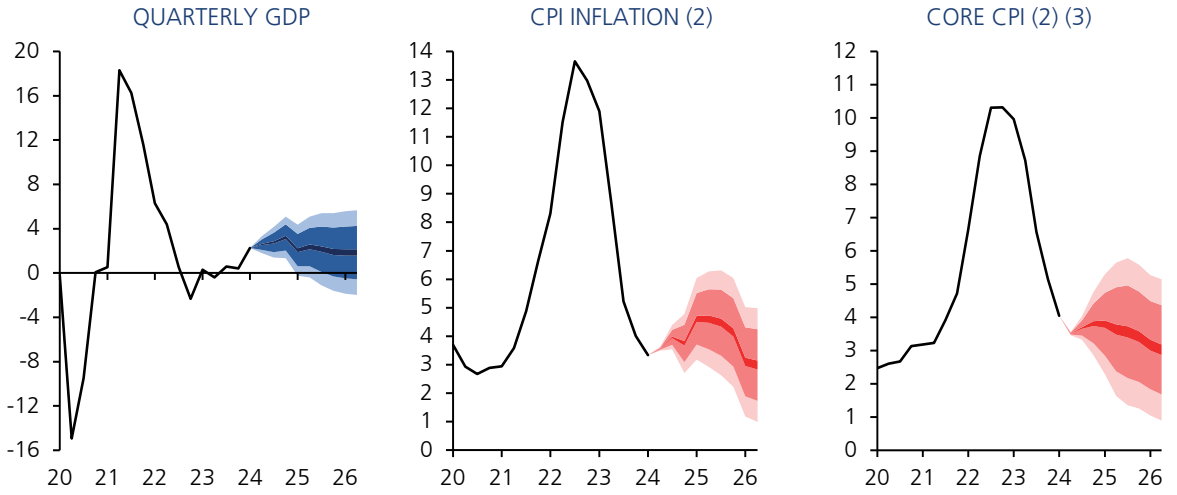
FIGURE II.10 MPR CORRIDOR (*)
(quarterly average, percent)



(*) 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 June Economic expectations survey (EEE) and June pre-MP meeting Financial traders survey (EOF) and the quarterly average smoothed forward curve as of June 12. 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 June 2024. Source: Central Bank of Chile.

There are other risk scenarios —with a lower probability of occurrence, but with more significant effects on the economy— which would call for a more intense monetary policy response that would exceed the boundaries of the MPR corridor. On the international front, a resurgence of geopolitical conflicts would trigger an increase in global risk aversion, eroding global financial conditions, especially those in emerging economies. This would contract stock markets and commodity prices, depreciate emerging currencies and increase risk premiums, among other effects. Nor can it be ruled out that markets might notice an overvaluation of assets associated with artificial intelligence or tighter fiscal balances, which would also generate bouts of risk aversion. As usual, the Board will remain vigilant to 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 two-year horizon.

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:

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.

banco central Chile

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