MONETARY POLICY REPORT

DECEMBER 2024

ZORZAL
Región de Coquimbo

SUMMARY

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

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

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

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

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

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

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

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

Projections

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

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

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

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

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

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

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

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

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

Monetary policy

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

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

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

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

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

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

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

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

TABLE 2: INTERNATIONAL SCENARIO

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

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

TABLE 3: INTERNAL SCENARIO
(annual change, percent)

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

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

FUTURE EVOLUTION OF MONETARY POLICY

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

ACTIVITY AND DEMAND PROJECTIONS IN THE CENTRAL SCENARIO

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

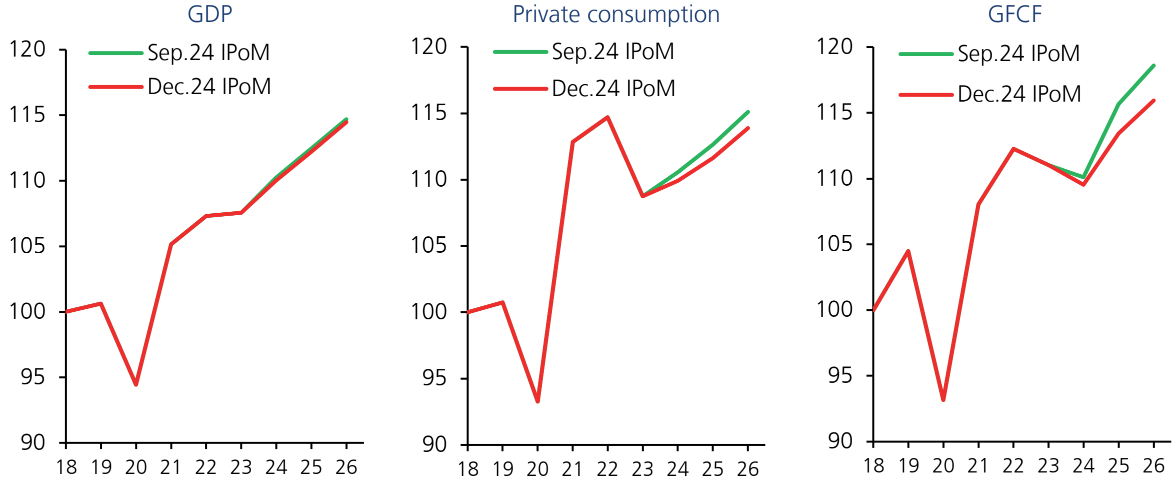
In the central scenario the Gross fixed capital formation (GFCF) forecast is also revised downwards, mostly for the non-mining sectors. The figures for the third quarter were in line with projections in the last IPoM, although the differences between its components and the heterogeneity across sectors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

TABLE 1 ECONOMIC GROWTH AND CURRENT ACCOUNT

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

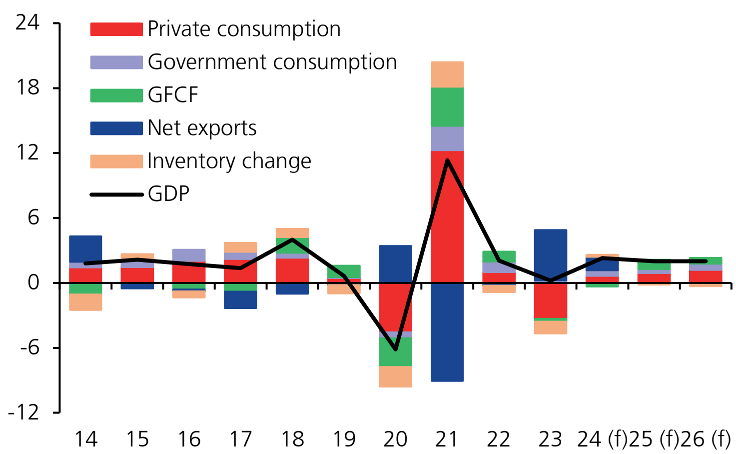
(f) Forecast.
Source: Central Bank of Chile.

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



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

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

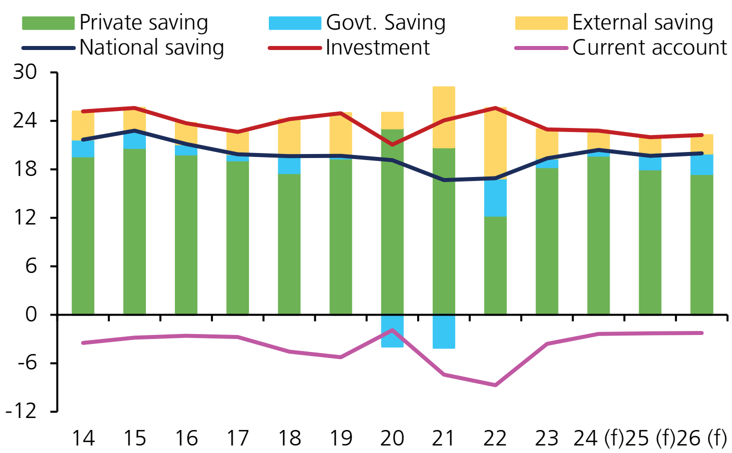


(*) For 2025 and 2026, considers midpoint of GDP growth ranges projected in this IPoM's central scenario.
(f) Forecast.
Source: Central Bank of Chile.

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

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

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



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

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

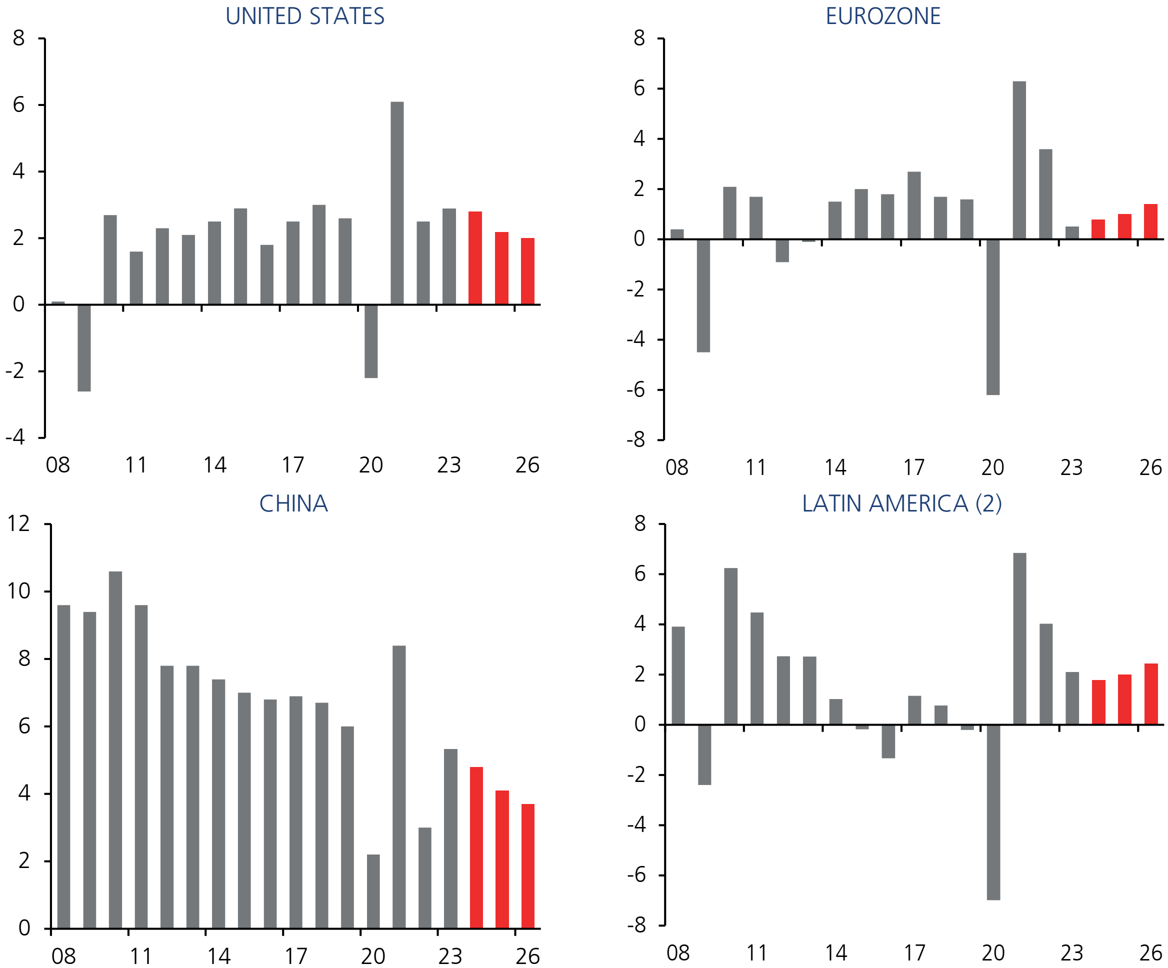
On the external front, the central scenario maintains world growth and trading partners' growth around 3% for the next two years. This represents no big change with respect to September IPoM, although it sees a more positive performance in the United States, partly due to the dynamism that private consumption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

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

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

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

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



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

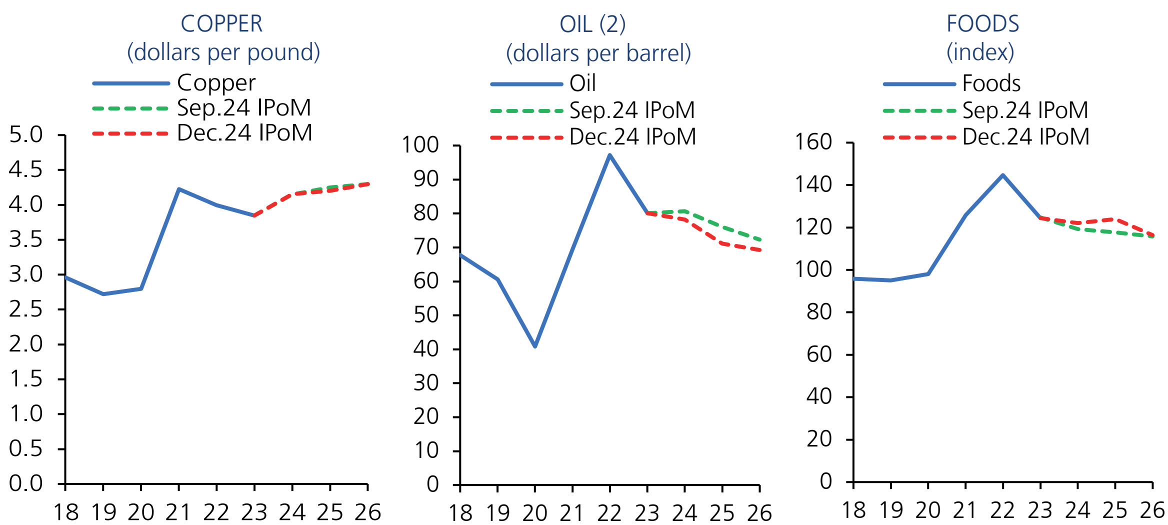
Projections for commodity prices see mixed corrections, amid the volatility that some of them have shown in recent months. All things considered, the terms of trade for the next two years are expected to be somewhat better than those contemplated in September. The central scenario estimates an average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

TABLE 3 INTERNATIONAL BASELINE SCENARIO ASSUMPTIONS

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

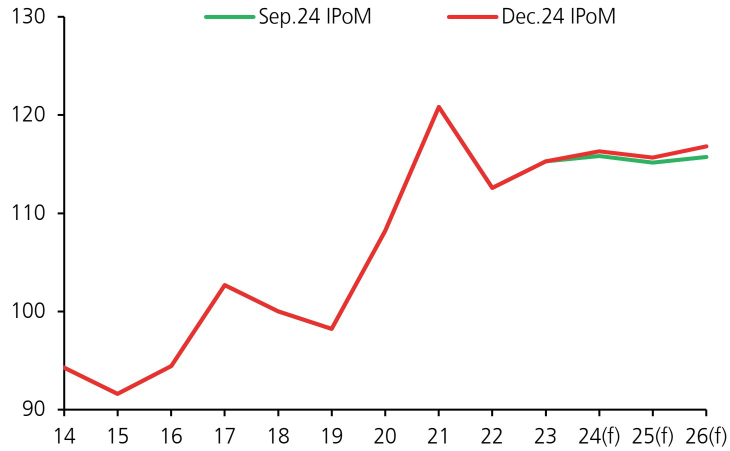
(1) For definition, see Glossary of economic terms.
(2) Annual average for the upper range of the Fed funds rate.
(f) Forecast.
Source: Central Bank of Chile.

FIGURE 5 COMMODITY PRICES FORECASTS (1)



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

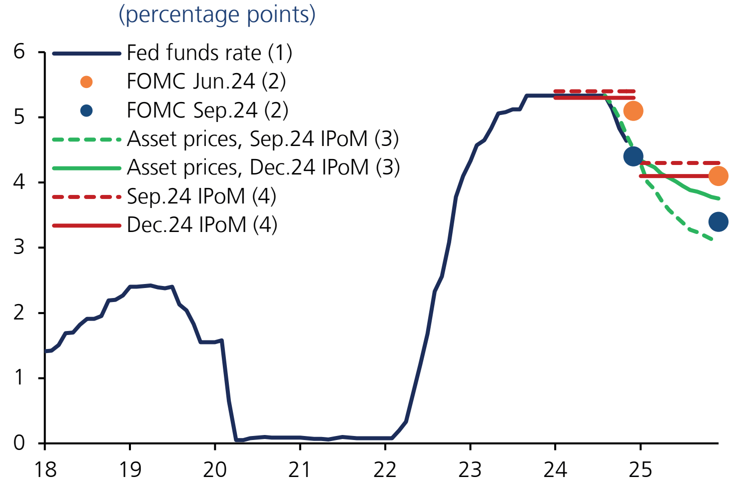
FIGURE 6 TERMS OF TRADE
(level, 2018=100)



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

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

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

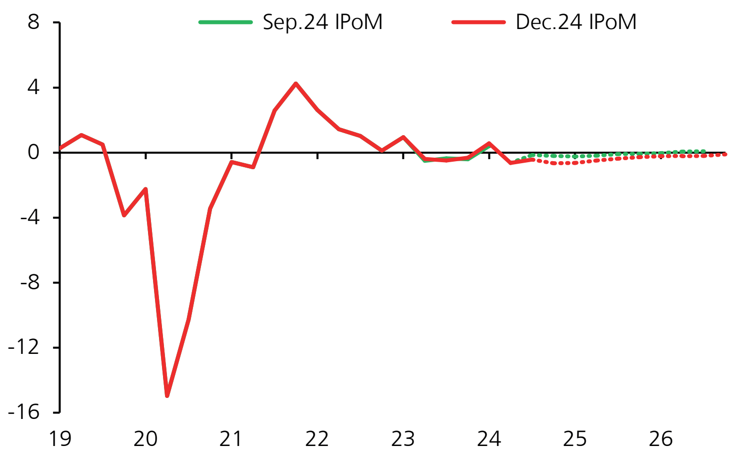


(1) Actual Fed funds rate. Considers information up to November 2024.
(2) Forecast of Federal Open Market Committee (FOMC) at respective meeting.
(3) Based on statistical cutoff dates of respective Monetary Policy Report (IPoM).
(4) Annual average for the upper range of Fed funds rate in 2024 and 2025,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

THE ACTIVITY GAP AND INFLATION'S CONVERGENCE TO THE TARGET

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

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

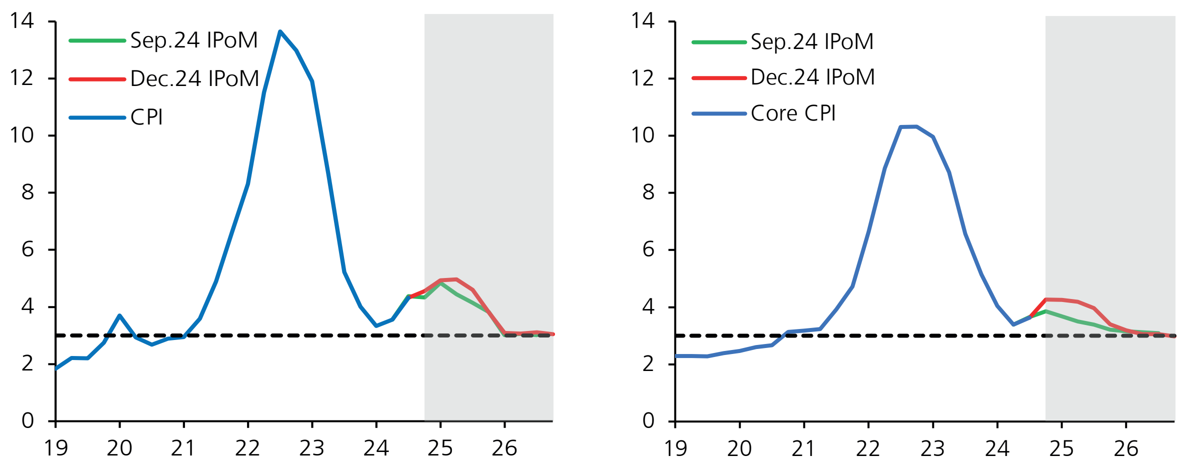


(1) Dotted lines show forecast.
(2) Forecast assumes structural paramenters updated in September 2024 Monetary Policy Report (IPoM) (trend and potential GDP).
Source: Central Bank of Chile.

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

Headline inflation will rise in the coming months and will hover around 5% annually during the first half of 2025. It will then begin to diminish, ending the year at 3.6% and converging to 3% in the early months of 2026 (figure 9; table 4). Much of the inflationary convergence process is justified by the weaker outlook for domestic demand and by easing cost pressures, including the gradual reduction of the real exchange rate. The latter is expected to increase as the impacts of increased uncertainty on financial variables recede, the FFR normalization process continues, and the copper price evolves as expected. The lessening of the financial burden on individuals and of short-term interest rates will support the recovery of consumption in the near future.

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



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

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

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

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

MONETARY POLICY STRATEGY: THE CENTRAL SCENARIO AND SENSITIVITIES

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

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

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

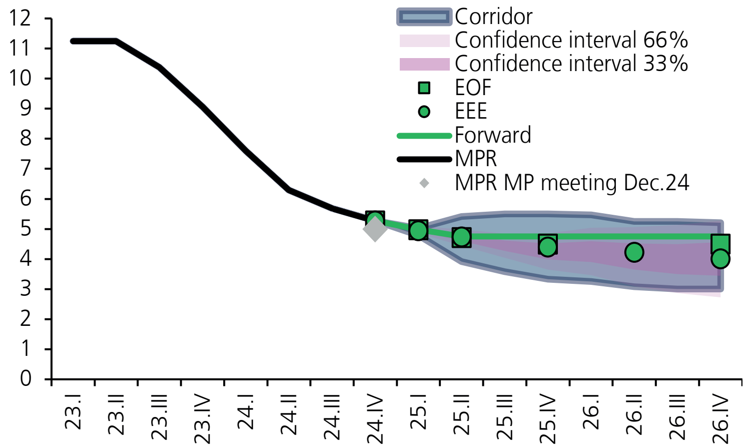
The upper boundary of the MPR corridor reflects scenarios with higher inflationary pressures, which in this case is associated with a stronger impact of cost pressures. The intensification of the latter and/or a higher pass-through to final prices by firms could heighten inflationary pressures in the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

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

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

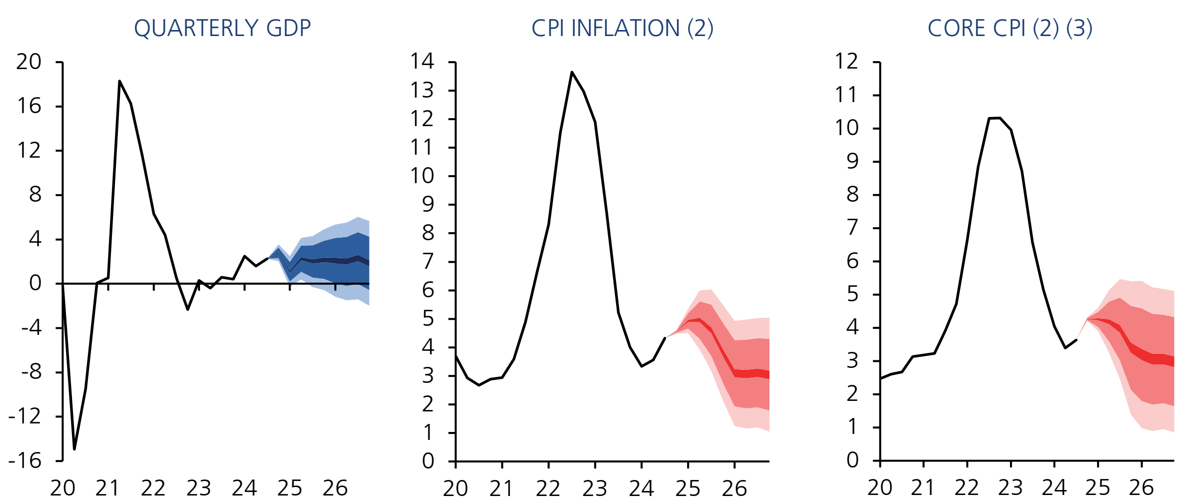
[1]/ The Financial Stability Report for the second semester of 2024 also reported risk factors linked to the external scenario.

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



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

FIGURE 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).

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MONETARY POLICY REPORT DECEMBER 2024