banco central Chile

MONETARY POLICY MEETING

JANUARY 2025

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Monetary policy meeting No. 311, held on 27-28 January 2025.

Present: Rosanna Costa, Governor; Stepanka Novy, Vice-Governor; Alberto Naudon, Board member; Luis Felipe Céspedes, Board member; Claudio Soto, Board member.

Also present: Luis Óscar Herrera, General Manager; Juan Pablo Araya, Legal Counsel and Attestor; Elías Albagli, Monetary Policy Division Director; Ricardo Consiglio, Financial Markets Division Director; Rosario Celedón, Financial Policy Division Director; Gloria Peña, Statistics and Data Division Director; Michel Moure, Institutional Affairs Division Director; Markus Kirchner, Macroeconomic Analysis Manager; Enrique Orellana, Monetary Policy Strategy and Communication Manager; Sofía Bauducco, Economic Research Manager; Guillermo Carlomagno, International Analysis Manager; Felipe Musa, Market Strategy and Operations Manager; Miguel Fuentes, Financial Stability Manager; David Kohn, Head of Mass Information Analysis Department; Rodrigo Wagner, Advisor to the Finance Minister; Erika Arraño, Senior Economist; Marlys Pabst Secretary General.

1. Background

The international scenario

The external scenario continued to present great uncertainty. Global financial markets had been volatile in the weeks prior to our monetary policy meeting, amid the change of the US Administration and other sources of uncertainty, such as the ongoing war tensions and fears regarding the global fiscal situation. Compared with the December meeting, long-term rates had risen across the board and the dollar had strengthened globally, beyond a weakening at the margin.

In the United States, the Federal Reserve (Fed) had signaled a slower decline in the fed funds rate (FFR) in future meetings. At its December meeting, the median of the dots had included only two cuts in 2025 (four at the September meeting), in line with market expectations, amid still dynamic activity in the country, while partial fourth-quarter indicators confirmed a favorable performance. In turn, signals from the labor market showed declining concerns about an over-adjustment of the sector. In December, total inflation had matched the market's forecasts.

The Chinese economy had accelerated in the fourth quarter in response to the stimulus measures implemented in previous quarters and a higher contribution from net exports. As a result, it achieved 5% growth in 2024,

in line with the authorities' target. In the Eurozone, activity continued to show low growth and significant differences across countries and sectors. While the services sectors remained resilient, manufacturing output remained weak.

In Latin America, activity remained resilient, although with some heterogeneity from one country to another. In Mexico and Peru, growth had accelerated, in contrast to Brazil, where activity had lost some dynamism, and Colombia, which posted a slight contraction. This occurred while inflation had slowed down its pace of convergence to the respective targets. The central banks of the region's main economies had cut their benchmark rates. The most notable exception was Brazil, where the monetary authority had accumulated increases of 175 basis points since September and the market outlook pointed to a further increase in January.

As for commodities, the price of a barrel of oil had risen by more than 6% since the last meeting, driven mainly by new US sanctions against Russia and uncertainty about the actions of the new US government. The price of a pound of copper had risen 3.5% and was close to US$4.2, favored by more positive news from China and some doubts regarding inventories and global supply. The FAO index had declined during December, with a fall in the sugar and oils sub-indexes.

The domestic scenario

In December, the annual variation of total and core CPI (i.e., CPI without volatile items) had increased to 4.5% and 4.3%, respectively. December's monthly figure had been below the projection in the December Monetary Policy Report (IPoM). This was mainly explained by food prices, while in the other components category, divergences were limited. Recent inflationary dynamics had been influenced by the combined increase of several cost factors, among which the depreciation of the peso, higher labor costs and the increase in electricity rates stood out. Regarding two-year inflation expectations, while the median of the Economic Expectations Survey (EEE) was at 3%, the Financial Traders Survey (EOF) had risen to 3.5%.

Available data for the fourth quarter of 2024 pointed to a somewhat stronger performance of local activity than assumed in the last IPoM. In November, the impulse coming from some items linked to manufacturing and exports —such as agriculture and livestock— had accounted for the monthly growth (0.3%) shown by the deseasonalized Imacec series. Both wholesale and retail trade had also shown month-on-month increases. Indicators linked to domestic demand suggested that between the end of 2024 and the beginning of 2025, that it had evolved around expectations. Retail sales (Transbank), automobile sales (ANAC) and consumer imports had shown favorable results in their latest figures. On the investment side, some sources showed good signs for the first quarter (consumer imports and the Capital Goods Corporation's survey), while others pointed in the opposite direction. Job creation continued to show low dynamism, with a seasonally adjusted unemployment rate that remained at around 8.5%. Meanwhile, annual wage growth remained high, although its monthly expansion rate had slowed in recent records.

The local financial market had been following global trends. Since the last Meeting, short and long-term nominal rates had risen, which contrasted with the fall in indexed rates, particularly for short terms. The peso had depreciated against the dollar, influenced largely by the latter's evolution internationally.

The cuts to the monetary policy rate (MPR) had continued to be passed on to the interest rates of consumer and commercial bank loans, which stood at 23.2% and 8.7%, respectively, according to available figures (75 and 55 bp below those considered at the previous meeting). Bank credit remained weak, especially for its commercial component. The Bank Lending Survey for the fourth quarter of 2024 indicated that lending standards remained largely unchanged. The demand for credit related to the consumer and mortgage segments was perceived to be more dynamic, while that linked to businesses was seen as stable.

Both the January EEE and the EOF prior to this meeting expected a pause in the MPR cuts, anticipating that it would remain at 5.0%. This was in line with projections implicit in the prices of financial assets. In the one-year term, the EEE, the EOF and the forward curve expected the MPR to be set between 4.5% and 5.0%.

2. Background analysis and discussion

On the external front, the scenario continued to be dominated by economic uncertainty and geopolitical tensions. The Fed's tone had become more contractionary, as activity in the United States continued to give positive surprises. Regarding inflation, although it did not differ from expectations, it remained high, mainly in its services component. The labor market, despite some easing, was still resilient, and the effect that the new government's anti-immigration measures would have on wages was also unclear. There were also potential decisions on tariff, tax and regulatory issues. Overall, there was agreement that the magnitude of the doubts in all these areas had not changed much, as the sources of global uncertainty remained. All this translated into a strong appreciation of the dollar and higher interest rates for all maturities, thus tightening financial conditions globally.

In Chile, the macroeconomic scenario was broadly in line with the December IPoM forecast. Although inflation at the end of 2024 had remained somewhat below the forecast, trend indicators remained generally upward, velocities were still above those consistent with the target and short-term projections continued to point to nearly 5% annually in the first part of 2025. The activity and labor market gaps were narrow. The Imacec showed higher than expected figures, although influenced by one-off factors, while the deseasonalized unemployment rate remained at around 8.5%. Commercial credit showed a slight rebound in the margin, still insufficient to clearly indicate a change in trend.

There was an agreement that the most striking factor in the macroeconomic scenario was the evolution of two-year inflation expectations. Although the median of the responses in the Economic Expectations Survey remained at 3%, a significant fraction believed that inflation would be higher. Meanwhile, the Financial

Traders Survey showed that two-year inflation would be above target. In addition, financial asset prices, although with some known distortions, also pointed to figures above the target.

It was considered premature to establish whether the evolution of two years inflation expectations would have an impact in inflationary persistence. In any case, it was a red flag that the Bank could not ignore, because it would end up affecting inflation dynamics. It was recalled that in some episodes in which two-year inflation expectations were above the 3% target, a much more aggressive monetary policy reaction had been required, which had put a further burden on the economy.

3. Analysis of monetary policy options

All five Board members agreed that the only plausible option for this meeting was to hold the MPR at 5%. Several Board members indicated that, on the one hand, keep the MPR was fully compatible with what was communicated in the last IPoM, when it was pointed out that it should not be surprising to enter a stage in which there would be pauses for the monetary policy interest rate. On the other hand, it opened the way if it were deemed necessary to reevaluate the monetary strategy consistent with the achievement of the target, a matter that would be addressed in the next IPoM.

Several Board members stressed the need to emphasize the Board's concern about the evolution of two-year inflation expectations, reaffirming that the Bank was prepared to do whatever was necessary in case it assessed that achieving the inflation target was at risk. One Board member added that it should be made clear that the Bank would act with appropriate severity, which implied being willing to change the direction of monetary policy and move rates upwards, if necessary. He added that this did not mean that this was the most likely scenario, but it was part of what may be the case should the need arise. Several Board members indicated that, in any case, the next IPoM would provide new background information that would allow for a better assessment of this matter.

4. Monetary policy decision

Governor Costa, Vice-Governor Novy and Board members Naudon, Céspedes and Soto voted for holding the MPR at 5%.

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