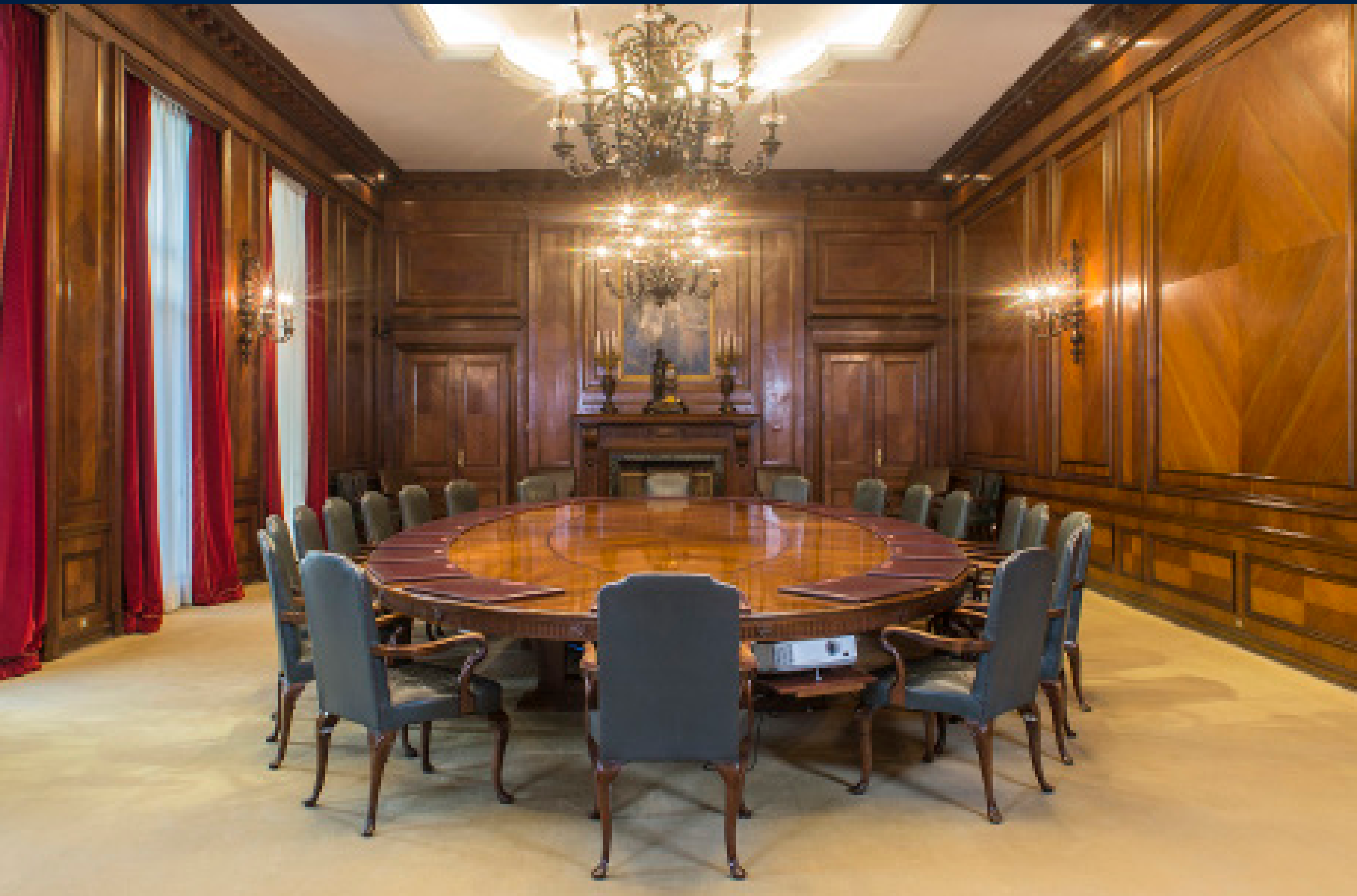
MONETARY POLICY MEETING

DECEMBER 2024



MONETARY POLICY MEETING

Monetary policy session No. 310, held on 17 December 2024.

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

Present the Finance Minister, Mario Marcel.

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, International 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 Operations and Strategy Manager; Rodrigo Wagner, Advisor to the Finance Minister; Marlys Pabst, Secretary General.

1. Background

Inflation was above forecasts of recent months. Annual CPI change had reached 4.2% in November and was expected to end the year at 4.8%, to then fluctuate around 5% during the first half of 2025.

The higher short-term inflationary trajectory responded to a mix of cost factors that had emerged simultaneously, contributing to the narrowing of the firms' operating margins and leading to a higher-than-expected pass-through to final prices.

On the one hand, there was the appreciation of the dollar—which had pushed up the exchange rate, triggered by increased world uncertainty. The sources of uncertainty were related to ongoing war tensions, fears about the fiscal and sovereign debt situation in the world and the impact of a possible reconfiguration of international trade. This, in a context of concerns about the policies to be adopted by the incoming U.S. administration. For its part, the Federal Reserve had started to cut its interest rate in September, mitigating a risk that had been significant until recently. However, uncertainty persisted as to the pace and point of arrival of this process. In this scenario, long-term interest rates remained high around the world today, and it was estimated that this combination of elements would continue to influence international funding conditions.

On the other hand, there was the rise in local labor costs. Wage indicators had shown significant expansion rates, despite the weak outlook on the employment side. The increase in wages owed to a number of factors, including the recovery of real wages after the high inflation of previous years and the upward adjustment of the minimum wage.

Into the medium term, cost pressures were expected to ease gradually and the evolution of inflation would be determined by domestic demand, particularly by a deteriorated performance of household consumption, which had been rather flat over the second and third quarters of 2024, amid slow job creation, a peso depreciation in real terms, and still pessimistic expectations.

About the projections in the central scenario of the December Monetary Policy Report (IPoM), the convergence of inflation to the target would not deviate much from previous estimates, with an outlook for activity that was mostly unchanged, but with consumption growing at a slower pace than was estimated in September.

2. Background analysis and discussion

The discussion touched on the evolution of inflation and its outlook, and it was agreed that the short-term outlook had become more challenging. On the one hand, inflation was higher than expected in the last IPoM, with a surprise that was mainly concentrated in the core component, due to cost factors. Moreover, the December IPoM projection scenario assumed that this higher core inflation would remain over the next year; in fact, the average inflation forecast for the non-volatile CPI increased by half a percentage point in 2025. For headline inflation, this meant that it would fluctuate around 5% throughout the first half of 2025.

It was noted that there were several elements pointing to lower inflationary pressures in the medium term. On the one hand, the slowdown in demand, particularly from private consumption, had been somewhat greater than expected and its outlook was being revised downward. This in a scenario of tighter global financial conditions, particularly with a higher long-term rate and a more appreciated dollar. All this responded naturally to an external environment of greater uncertainty, which had been discussed in detail in the December IPoM. Another element that could reduce future inflationary pressures was the expected evolution of the real exchange rate, which was projected to decline over the two-year policy horizon.

It was discussed that although medium-term forces were relevant to achieving convergence to the target, there were risks. The materialization of new inflationary pressures in the context of high inflation could generate less favorable inflationary dynamics. In this sense, the external scenario was dominated by uncertainty, which could become a source of greater pressure on prices. Geopolitical tensions had given rise to hotbeds of tension in different countries. Added to the economic uncertainty fueled by high public debt were the evolution of fiscal policy in several developed countries, especially in the United States, and future developments in trade policy. It was also discussed that there was a possibility that the forces that would push inflation back in the medium term would be stronger, particularly if the weakness of domestic demand became greater. In the short term, the evolution of fuel prices could be added.

3. Analysis of monetary policy options

All five Board members agreed that the evaluation of the December IPoM's central scenario yielded that the monetary policy rate (MPR) had to follow a downward trajectory during the projection horizon. There was agreement that this trajectory should consider the existence of significant risks, particularly in terms of the short-term inflation outlook. It showed an annual CPI variation that would rise to levels near 5% during the first half of 2025, with an upward biased balance of short-term risks.

In this context, the Board members agreed that caution was needed while accumulating information from one meeting to the next, assessing their implications for inflationary convergence and thus determining the timing of the MPR cuts. It was added that, between now and the next IPoM, there would be a set of background information that would allow a better assessment of whether some of the risks mentioned had materialized and, if so, to adjust the monetary strategy accordingly. In this scenario, all the Board Members considered that the plausible options at this meeting were: (i) to reduce the MPR by 25 basis points (bp); and (ii) to keep the MPR at 5.25%.

Regarding the 25 bp cut option, it was noted that it was consistent with both the process of reducing the level of monetary policy tightening initiated in mid-2023 and the convergence of inflation to the 3% target over the two-year policy horizon. All the Board members agreed that for this option to be consistent with the identified risks, it was necessary to communicate that the window for future pauses was open. One Board member pointed out that, with such a decision, the MPR was moving closer to the range considered neutral, which made it natural that the movements from now on should be gradual and paused.

About the option of holding the MPR flat, some Board members said that, in their opinion, this alternative gave more weight to present risks and better reflected the discomfort represented by an inflation of 5%, with short-term risks biased upwards.

4. Monetary policy decision

Governor Costa, Vice-Governor Novy and Board members Naudon, Céspedes and Soto voted for reducing the monetary policy rate MPR by 25 basis points, to 5%.