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## Latam Daily: Chile—BCCh Surprises with 100 bps Hike

- **Chile: BCCh surprises and raises the benchmark rate by 100 bps with a relatively neutral bias**

## CHILE: BCCH SURPRISES AND RAISES THE BENCHMARK RATE BY 100 BPS WITH A RELATIVELY NEUTRAL BIAS

**BCCh implicitly paves the way for an early process of rate cuts.**

**On Tuesday, September 6, the central bank of Chile (BCCh) increased the benchmark rate by 100 basis points (bps), above market expectations and ours (between 50 and 75 bps).**

With this, the Monetary Policy Rate (MPR) rose to 10.75%. On the one hand, the decision was divided within the Board, where Ms Griffith-Jones voted for +75 bps, Ms Costa, Mr Naudon and Mr Céspedes voted for +100 bps and Mr García voted for +125 bps. On the other hand, the BCCh changed its bias to neutral (from hawkish in the last meeting), conditioning the next decisions on incoming inflation figures. Although the BCCh will publish the *Monetary Policy Report* for September in the early hours of Wednesday, September 7, this decision has several peculiarities that lead us to analyze them preliminarily.

An increase that places the MPR at 10.75%, which is “around” the maximum level of the rate corridor according to the BCCh. Based on this, we believe that the updated BCCh scenario will have the same implied terminal MPR as our base scenario (11%). **Considering the above, the Board's strategy seems to be to move quickly towards the terminal MPR of this contractionary cycle instead of doing it gradually as it has historically. Here are some of the objectives that this decision could have:**

1. **Achieve greater anchoring of inflationary expectations by surprising market agents, surveys and forwards.** Generate a short-term interest rate differential in favor of the Chilean peso (CLP) higher than that implicit in markets.
- **The Board would be evaluating, as we have indicated several times at Scotiabank, whether to promptly start the process of reducing the MPR if the base scenario is realised.** Having continued to raise the MPR during the next few meetings would mean delaying—missing several meetings—the process of reducing the MPR, which seems to be earlier than the market considers and more in line with our view (Q1-23). The domestic and external macroeconomic diagnosis of the BCCh is clearly unfavorable for the Chilean economy across all its dimensions.
- **Additionally, the intention to have a soft and gradual rate reduction process instead of an aggressive one could be behind today's decision.** In this way, by reaching the terminal MPR of this cycle early, the easing process can be started less aggressively.
2. **Dissent in the Board on the size of increase in the MPR.** Rarely has there been such significant dissent within the Board. In fact, it is the first time that there are 3 different votes (75, 100, or 125 bps). This difference of opinion partially questions the credibility of this surprise decision but, at the same time, demonstrates the autonomy of the Board and its ability to show valuable dissent. On the other hand, it also shows that the strategy of moving quickly to the terminal MPR is not endorsed by the entire Board, with Mr. García probably the most inclined to reach the terminal rate soon (11%) and pave the way for cuts in the coming months. Given this scenario, we see a risk that the BCCh could bring rate cuts forward (before Q1-23) and insist that the MPR will end between 3.5% and 4% by December 2023. The cuts in the MPR (or at least a dovish bias) could start as soon as the December 2022 meeting.

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September 7, 2022

**We continue to see a more intense disinflationary process than the one contemplated by the market,** especially after a plebiscite result that will lead to moderate structural reforms and a less favorable political scenario for additional fiscal aid. In this context, we do not rule out that the BCCh indicates in its Monetary Policy Report that the adjustment of the current account deficit towards sustainable levels has been underway since just last July.

—Jorge Selaive, Anibal Alarcón, & Waldo Riveras

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