Scotiabank

GLOBAL ECONOMICS

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Latam Daily: Chile's BCCh Surprises; Colombia's BanRep Expected to Move

- **Chile: Monetary policy rate raised 150 bps to 5.50% ; Universal Guaranteed Pension moves forward**
- **Colombia: Monetary policy preview**

CHILE: MONETARY POLICY RATE RAISED 150 BPS TO 5.50%; UNIVERSAL GUARANTEED PENSION MOVES FORWARD

I. Path of MPR contingent on inflation surprises; GDP in 2021 and 2022 likely to be revised upwards

On Wednesday, January 26, the central bank (BCCh) surprised markets and Scotiabank Economics with a 150 basis points (bps) increase in the benchmark Monetary Policy Rate (MPR), to 5.5%. Markets had expected a smaller increase of between 100 bps (Economic Expectations Survey) and 125 bps (Financial Traders Survey and Scotiabank).

In our view, the BCCh is potentially facing the most worrisome de-anchoring of inflation expectations in the last two decades. While expectations of inflation three years ahead are slightly above 3%, the market now expects the MPR to reach 7.0% in the first half of this year. In such situations, gradual increases in the benchmark rate may prove insufficient to reverse expectations. Three conditions must be satisfied to contain this type of de-anchoring: first, that the MPR move decisively into restrictive territory; second, disinflationary surprises compared to market expectations; and third, an easing of inflationary pressures (slower consumption growth and Chilean peso appreciation).

The good news is that the CLP has appreciated in recent weeks, while some slowdown in consumption is expected this semester. Consequently, with yesterday's aggressive increase in the MPR, only one condition—disinflationary surprises—is missing. And that should materialize in the first months of the year. Our view is that the market has more implied inflation than is likely in the first quarter and surprises could come as early as January's CPI (Scotiabank forecasts 0.4% m/m). In this scenario, the BCCh could park the MPR at 6.5–6.75% in March; otherwise, it would be necessary to go further to generate a disinflationary surprise. The central bank will have to wait for inflation and activity data for the first months of 2022 to calibrate the terminal MPR. For now, our view is that inflation could surprise on the downside, but that activity slows more gradually than is expected by the BCCh. This mix of activity and inflation leads us to anticipate that the MPR will be at 6.5–6.75% this semester and will not fall over the rest of the year, as the market estimates.

In terms of the conjuncture, the BCCh has acknowledged upward surprises in economic activity that would place 2021 GDP growth in the upper part of the projected range and provide a favourable base for 2022 growth. These effects will likely be reflected in the projections of the new *Monetary Policy Report* (March 30). However, because the momentum effect of a stronger-than-expected end to 2021 is not factored into the current projection, we anticipate an upward correction of GDP growth for this year. Inflation has also exceeded both market and BCCh expectations, driven by greater inflationary pressures from the external side. Given the recent inflation surprises, an upward correction is also expected in the central bank's inflation projection for the end of 2022, which stands at 3.7% according to the last *Monetary Policy Report*, but which the market anticipates around 4.7% (Scotiabank at 4.5%).

II. Congress approved the Universal Guaranteed Pension

On Wednesday, January 26, Congress passed the bill creating the Universal Guaranteed Pension (PGU) and its financing. The initiative will provide a contribution of up to CLP 185,000 (USD 231) for all those over 65 who are in the 90% of the lowest income brackets, whether they are retired or not, benefiting 2.2 million people. According to government estimates, the first stage of benefit payments will begin in the third week of February, targeting around 1.5 million people.

The estimated annual fiscal cost of the PGU is 0.98% of GDP, which will be financed in part by the modification of some current tax exemptions such as the single tax rate on capital gains, VAT to all services, the special credit to construction companies in VAT, among others (0.67% of GDP). At the same time, provisions for higher spending associated with the pension reform (0.31% of GDP) are included in the 2022 budget law. With this financing, the government will avoid a deterioration of the structural fiscal deficit this year, which is projected at 3.9% of GDP.

According to our estimates, the PGU could contribute around 0.2–0.3 percentage points of additional GDP growth in 2022 owing to the positive impact that will have over the private consumption.

—Jorge Selaive, Anibal Alarcón, & Waldo Riveras

COLOMBIA: MONETARY POLICY PREVIEW

BanRep's first monetary policy meeting of the year is tomorrow, January 28, with most analysts expecting the Board to hike the policy rate by 75 bps to 3.75%. This call is consistent with our forecast, which projects 75 bps hikes coming out of both the January and March meetings, reaching the end of the hiking cycle by mid-2022 at a terminal rate of 5%, our projection of the nominal neutral rate. In this respect, while we expect the central bank to accelerate the hiking cycle, we don't anticipate a higher terminal rate because of a slow convergence of inflation to the target range next year.

Key points to consider ahead of Friday's BanRep vote:

- At its December 17 meeting, BanRep increased its rate by 50 bps in a hawkish split vote (four votes for 50 bps versus three votes for 75 bps), which left the door wide open to speed up the hiking cycle.
- Since December's meeting, new information has pointed to upside inflation pressures. Headline inflation closed 2021 at the highest level in five years at 5.62%, leading to greater indexation effects, while the 10.07% increase in the minimum wage leads to price pressures in key labour-intensive services. Other prices, such as foodstuff, gasoline, and tradable goods, have continued increasing.
- The economy remains open despite the new COVID-19 wave, which is developing with high speed, supporting still strong domestic demand. In fact, the market consensus expects final 2021 growth to come in around 10%.
- BanRep's Board will have a fresh macroeconomic scenario from the staff in the meeting tomorrow. The staff's assessments regarding upside inflation risks and recent monetary policy announcements from the Federal Reserve will be hugely influential. At the same time, long-term assumptions on the real rate are key inputs to forecasts of the terminal rate. Similarly, it will be important to compare the staff's expected path for the monetary policy rate with that of the market consensus.

All things considered, our base case scenario calls for a 75 bps hike in this Friday's meeting. However, a split decision featuring a vote (and possibly more) for a 100 bps hike can not be dismissed given higher inflation pressures and global interest rate risks.

Looking ahead, inflation developments will determine if the terminal rate in the hiking cycle surpasses the nominal neutral rate but, for now, we estimate a terminal rate at 5%.

—Sergio Olarte & Jackeline Piraján