## Inflation Observatory

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## Chile

Economic Analysis

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## Inflation recorded 0.1% growth in December

Inflation recorded 0.1% growth in December, surprising a market that expected zero growth (BBVA: 0.0%). The CPI ended the year with a 3.0% change, right in the middle of the central bank's target range.

We expect 0.1% increases in January and February and 0.5% in March. We are revising our forecast for 2011 from 3.2% to 3.6%.

We think that the central bank's Board should put the policy rate back up 25 bps at its January meeting.

Six of the 12 divisions recorded price increases, especially transport (0.7% and contributing 0.151pp) and education (1.0% and contributing 0.059pp).

Five divisions posted negative results, including falls in clothing and shoes (-1.7% and contributing - 0.065pp) and recreation and culture (-0.5% and contributing -0.034pp). Only the furniture and items for the household and routine household maintenance division did not change during November.

Core inflation (IPCX), which excludes fruit, fresh food and fuel prices, saw a 0.3% change, accruing a 2.5% change in 2010. In turn, the CPIX1, which also excludes meat and fresh fish prices, regulated index-linked prices and financial services, posted a 0.1% change, accruing 0.1% for the year.

The increase in our inflation forecast from 3.2% to 3.6% is mainly due to our changed expectations regarding the value of the peso following the central bank's announcement of an intervention in the exchange market. The forecast has a definite positive bias because we think that there is an important risk of higher inflation due to domestic and external factors. On the domestic front, demand is still growing strongly and there are no signs yet of a slowdown. Externally, fuel and, particularly, food prices have been strong, which has had an impact on inflation in other emerging markets.

As regards implications on monetary policy, we think that the central bank should raise the reference rate. Recently opinions have been more in favor of the need for a pause to reinforce the dollar strengthening strategy through reserve accumulation. However, the aforementioned risks of higher inflation and decoupling expectations regarding the inflation target in recent days require an increase, because if the central bank does not make the most of this situation to make the necessary adjustment then when will it?