Economic Research Department

BBVA

Chile

Inflation Observatory

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January 2009 inflation worse than forecasted

Francisca Lira
flira@bbva.cl

- **January's inflation was more negative than forecasted, reaching -0.8% mom and pushing the interannual path down to 6.3% (7.1% as at December). It can attributed to both volatile components and a major decline of core inflation (-0.2% mom).**
- **December payrolls show a slight increase (8.5% yoy) due to both the readjustment of wages in the public sector (10%) and the dismissal of less productive employees (low-salaried workers).**
- **We expect inflation to close 2009 at 2.4%, going through a minimum around 1.0% in October.**
- **We expect the BBCh to cut rates dramatically on Thursday (150 bp or probably 200 bp).**

January's inflation: January's inflation was considerably worse than forecasted, showing a 0.8% monthly fall. Thus, the interannual variation dropped down to 6.3% and continued the same sharp slowdown observed since the end of 2008.

On the other hand, core inflation showed a -0.2% mom variation, which was mainly attributable to clothing and footwear clearance sales, which were more aggressive than in previous years given the current sluggish demand. Nevertheless, the yoy variation of said indicator remains above 8.0%.

Wages: In November, the General Wage Index (IR) increased by 1.5% mom and 8.5% in the last 12 months. This is chiefly due to two factors: The impact of the 10% readjustment applied to the public sector and the methodology's typical characteristics showing average wage rises when low-salaried workers are dismissed, which might be affecting sectors such as mining and construction.

In turn, the inflationary fall has begun to translate into IR increases in real terms.

Inflation outlook: December's negative inflation composition consolidates the outlook of attaining the final target during 2009. We expect 2009 to close at 2.5%, after reaching a minimum of nearly 1.0% in October. Likewise, core inflation would reach the targeted figured by mid 2009.

Our forecasts regarding CPI variations in the next three months are: 0.1% in February; 0.5% in March and 0.3% in April. Both February and March might be affected by the intermodal transport rate increase (Feb. 12). March, on the other hand, might be influenced by normal readjustments to school tuition.

Valuation: The sharp inflation fall, coupled with a significant slowdown in economic growth, as shown by IMACEC (Monthly Economic Activity Indicator) in November and December, reinforce the need of the Central Bank to cut interest rates strongly since, with an estimated inflation around 2%, the actual risk-free interest rate –implicit to the Money Policy Rate- is nearly 5%, a clearly restrictive percentage. Thus, we expect a cut of 150 bp to be announced at next Thursday's meeting. Yet, the possibility of a sharper fall is not dismissed.