Chile

BCCh decides for a temporary pause

*** BCCh pause was the view of the majority of the market, but against our call for a cut.**
*** The Board hinted that inflation risks are balanced going forward, but the current levels are uncomfortable. We only see these back in target in time for April's meeting.**
*** We expect little rates and FX markets reaction on the back of today's decision.**

FACTS

The Central Bank of Chile (BCCh) kept its Monetary Policy Rate (TPM) unchanged at the prevailing 5.0% level. This was in line with the median of the analyst's and traders' surveys conducted by BCCh last week, as well as the expectation of 12 out of 20 analysts surveyed by Bloomberg. Our call was for a 25bp cut.

Regarding the post-meeting statement, BCCh's description of the external front was mostly unchanged from January, noting some positive developments in US indicators and uncertainty still reining on developments in the Eurozone. The Board saw an improvement in financial conditions, repeated the mention of rising commodity prices and noted the global weakening of the USD.

Domestically, BCCh stated that demand and economic activity advanced above the December Monetary Policy Report (MPR), while they were in line with the projections as of January. The Board saw annual inflation above target, a fact that was also true last month but was not explicitly mentioned in the post-meeting statement. A significant wording change took place regarding core measures of inflation, as BCCh saw them as having 'normalized'. As of December, BCCh saw them 'contained', while in January the description was on the specifics of the upside surprise brought by December's figures.

IMPLICATIONS

While the decision was not our call, we can hardly call it a surprise as it was the view adopted by the majority of the market. We maintain our call that there are two more cuts left in the current easing cycle, with a terminal TPM of 4.50%. The timing, though, has been brought back, but we still expect BCCh to reach that level in the 1H12.

The Board may have finally felt uncomfortable with lowering policy rates as inflation stood above 4%, according the reference to above-target inflation in the statement. We only expect annual inflation to return to the target by March (to be reported in early April).

Regarding economic activity, we expect the slowdown to continue, but to be gradual. Our main scenario is not one that would force the Central Bank to change its stance and cut rates aggressively. The external environment is reinforcing that view, for the moment.

In sum, the continuation of today's pause at the March meeting is a clear possibility.

The minutes of the meeting, to be released on February 29 should bring insight on the tactical discussion leading to the decision and the Board members' view of the monetary policy path ahead.

Fixed Income View

Going into this meeting, the market was pricing in only 25bp for this meeting and the next two, i.e. a path consistent with the stop and go easing action that the central bank may have initiated with today's decision. Since late January, the front end of the curve has come under renewed sell-off pressure, which was accelerated with the unexpectedly strong activity data for January. The 1-year CLP x Camara rate has sold off more than 30bp since 25 January. This has reduced the amount of previously

Jorge Morgenstern | +541141309229 | JORGE.MORGENSTERN@HSBC.COM.AR
Clyde Wardle | +12125253345 | CLYDE.WARDLE@US.HSBC.COM
Gordian Kemen | 2125252593 | GORDIAN.X.KEMEN@US.HSBC.COM
Issuer of report: HSBC Bank Argentina S.A.

implied hikes: while the implied policy rate (TPM) at the end of 2012 stood at 4.13% one month ago, it is now at 4.50%, i.e. 50bp of additional easing. We expect little market reaction on the back of today's decision.

Implications for CLP

The Chilean peso does show some tendency to move in line with interest rate differentials and so a surprise cut might have put some modest downward pressure on the CLP. However, given the rate decision was in line with the majority of analysts' expectations we would not expect to see a significant reaction for the CLP. In the present environment, external drivers remain the more important influence over moves in USD-CLP. In the near term we would expect to see some consolidation in the 480-490 area, with China's economic data releases providing a key focus and likely future direction both for commodity prices and the CLP. In terms of the potential for FX intervention, we do not anticipate BCCH re-starting USD purchases in the near term, despite some recently expressed concerns over the CLP's strength by the finance ministry.

BOTTOMLINE

BCCh paused and hinted that inflation risks are balanced going forward, but the current levels are uncomfortable. Waiting for those to recede may imply that the easing cycle won't continue until April.

Disclosure appendix

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Issuer of report
HSBC Bank Argentina S.A.
Bouchard 680 Piso 11 Buenos Aires, Argentina. Teléfono: + 54 11 4320-2800 Fax: + 54 11 4331-5999 Website: www.hsbc.com.ar

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