MONTHLY ECONOMIC OUTLOOK

Local economy begins to show signs of recovery

Highlights

- Disparate paces in the lockdown easing and the economic recovery produce mixed results in the global markets. As of the date this report was issued, the US stock market presented a significant correction, influenced by new geopolitical tensions with China that threaten the technology sector.
- Updating the Federal Reserve's policy framework will imply a more expansionary bias in the conduct of monetary policy in the United States. Long rates tended to fall once the new scheme was introduced, and subsequently rose again.
- Local activity shows signs of recovery for the second month in a row, although still well below pre-pandemic levels.
- The lifting of quarantines and the strong liquidity shock to households will stimulate demand in the coming months. As a result, the economy will shrink by 5-6% by 2020.
- The price of risky assets fall at the margin, whereas long-term UF (Chilean inflation-linked currency) rates reach new lows. The exchange rate appreciated again, influenced by the high price of copper and the foreign exchange auctions by the Ministry of Finance.
- August's CPI (0.1% MoM) showed that inflationary pressures remain restricted. In September we expect a rebound, but the basis for comparison will lead to inflation closing the year at 2.2%, well below the Central Bank's target.
- Not surprisingly, the Central Bank maintained the Monetary Policy Rate during September. In its latest Monetary Policy Report (IPoM) the growth and inflation projections were revised upwards, recognising the impact of the liquidity injection to households in recent weeks.
- Public spending accelerated in July, reflecting the supportive measures put in place by the Government. Revenues showed some recovery, but the annual fiscal deficit continued to widen and reached 5.5% of GDP.

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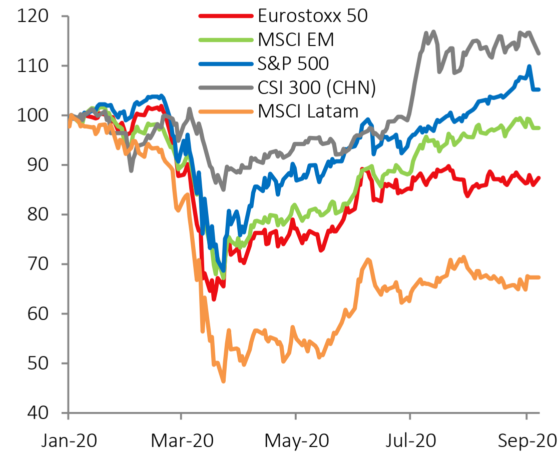
After mixed performances, prices of risky assets suffer a significant drop at the margin

Since the close of our previous report in mid-August, global markets have shown mixed performances, influenced by the different phases of the lockdown easing, different rhythms in the recovery processes between the different economies and, most recently, by renewed tensions between the United States and China.

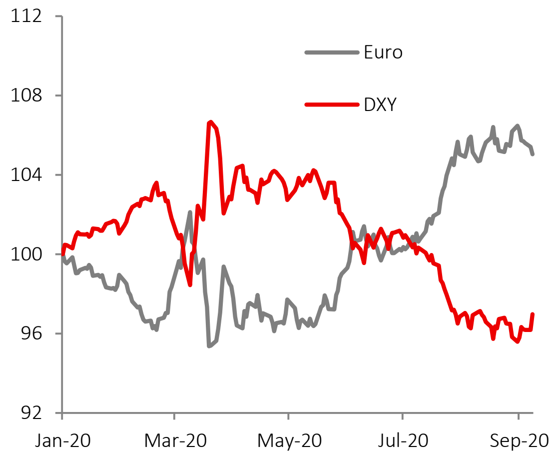
Until a few days ago, US stock market indices were at record levels, bolstered by abundant liquidity, good quarterly results for technology companies and progress in the economy's recovery. August's PMIs were positive, especially the manufacturing PMI (manufacturing ISM: 56.0 vs 54.2 July), and unemployment fell again (8.4% vs 9.8% July). In this context, long-term interest rates tended to rise, although after the update of the Federal Reserve's monetary policy scheme – announced at the Jackson Hole conference at the end of August - they were temporarily set back. Over the past few days, the US stock market has suffered significant falls, with declines of more than 5% from its peak. This is due to new geopolitical tensions with China affecting the valuation of the technology companies that had led the stock market rises of recent weeks.

Mixed results in international markets



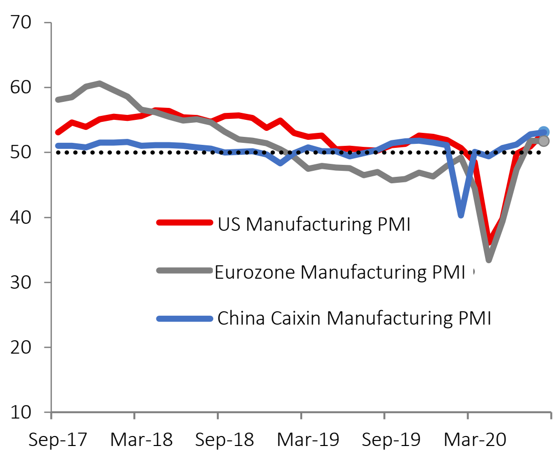
Source: Bloomberg and Santander

Dollar remains relatively weak



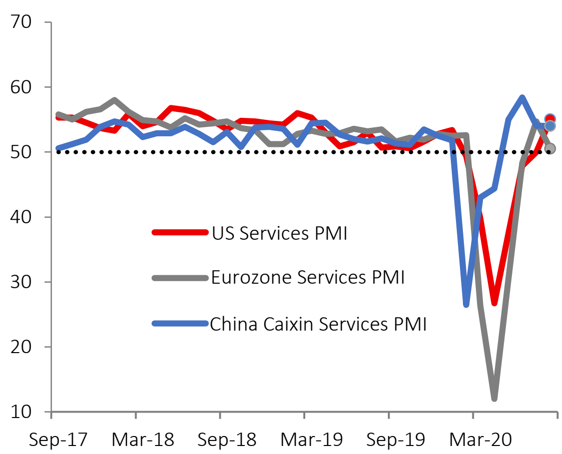
Source: Bloomberg and Santander

PMI shows that recovery of major economies has continued in August…



Source: Bloomberg and Santander

… but services in Europe have suffered from the resurgence of the pandemic

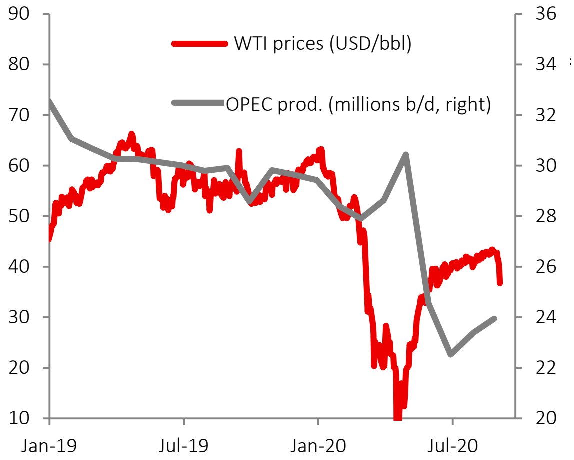


Source: Bloomberg and Santander

In Europe the economy-related data has been unsatisfactory, reflecting the impact of the pandemic's outbreaks on several sectors, particularly tourism. Industrial orders of production during July sharply reduced their pace of recovery (2.8% MoM vs 27.9% June) and August PMIs retreated. The services sector was the most notable, being located only slightly above the expansion pivot (50.1).

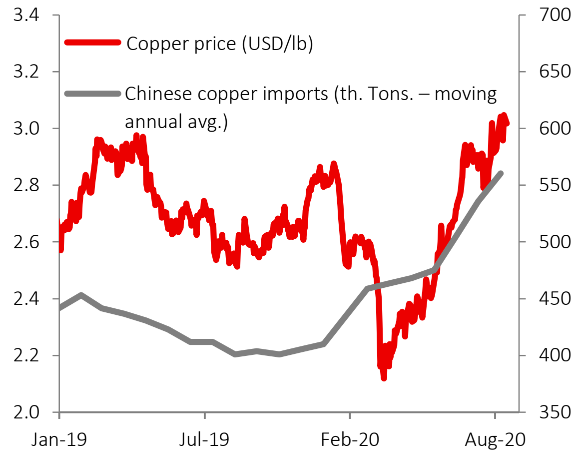
Commodity prices have shown mixed trends in recent weeks. The value of WTI oil fell by over 13% as a result of increased crude oil production by the OPEC and lower demand for fuel in the US. This, in a context where private estimates suggest that it will take three years to recover demand to the pre-pandemic level. Conversely, the price of copper has risen again and has been around US$/lb 3 for several days. This movement is driven by the strong growth of metal imports from China (66% YoY in August), whose economy continues to show a solid recovery in conjunction with its manufacturing sector.

Oil price undergoes important correction in the margin



Source: Bloomberg and Santander

Strong Chinese demand keeps the copper price high

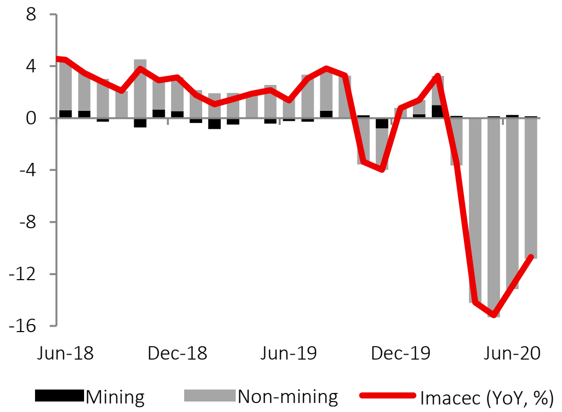


Source: Bloomberg and Santander

Incipient process of recovery of the local economy

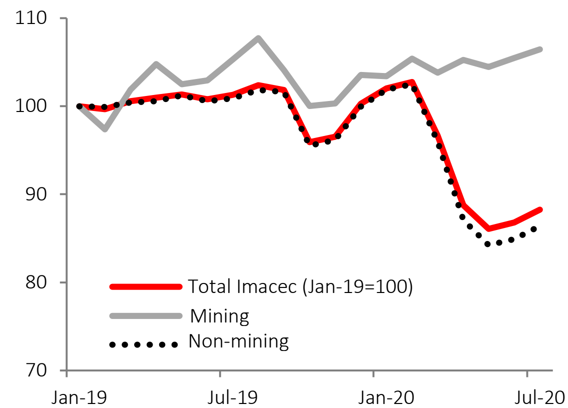
In Chile, July's Imacec (-10.7% YoY) surprised on the upside and was less negative than during the previous months (-15.2% YoY in May, -12.9% YoY in June). Like this, the process of recovery in activity continued for the second month in a row (1.7% MoM; 0.8% MoM in June). This reflects the capacity of some sectors to adapt to the new conditions imposed by the pandemic –particularly commerce and some personal services– and the resilience of some activities –particularly mining–, which again expanded at the margin (0.9% MoM; 1.4% YoY).

For the second month in a row, the economy showed signs of recovery



Source: BCCh and Santander

Gap from normal levels of activity remains very wide



Non-seasonal series

Source: BCCh and Santander

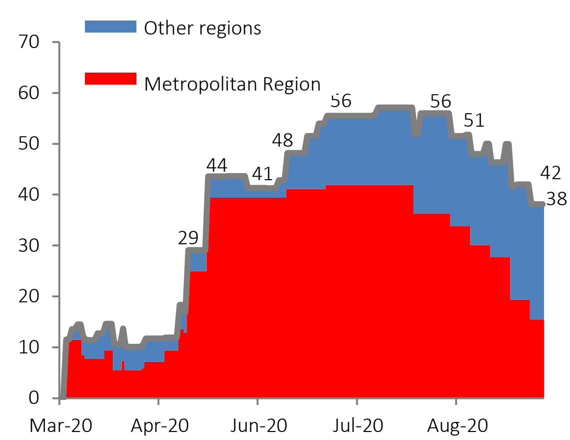
By August, we assess that the progressive lifting of containment measures, which has resulted in increased mobility, and the liquidity injections to households, both through fiscal transfers and pension fund withdrawals (see Technical Note: Macroeconomic impact of pension fund withdrawals), will contribute to a significant rise in the activity.

Preliminary indicators already show signs of improved performance, especially within trade. New car sales increased sharply from the previous month (over 19 thousand units versus 11.5 thousand in July and only 9 thousand in May), debit card transactions have risen and the evidence of electronic bills, presented by the Central Bank in the Monetary Policy Report (IPoM), has also increased in the margin. The Monthly Indicator of Business Confidence (MIBC) survey shows that the perception of the trade demand situation rose significantly in August, reaching optimistic levels similar to those of a year ago.

Partial indicators from other sectors also reflect improvements, but at a more gradual pace. The MIBC's perception of activity indicators for construction and manufacturing rose in August but remain below the neutral pivot. In turn, electricity generation, after having fallen significantly in July, experienced a restricted recovery (0.1% MoM).

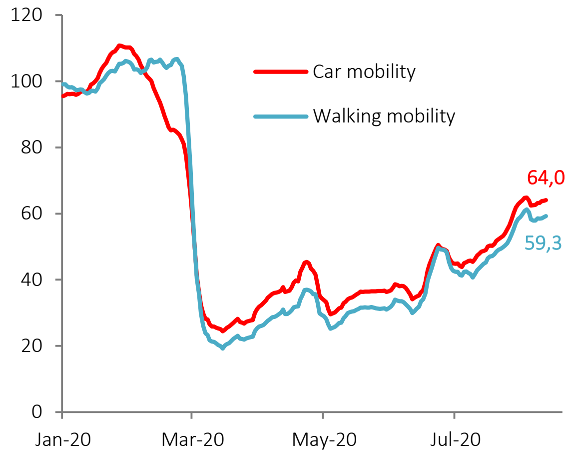
This background leads us to estimate that activity would have risen between 3% and 4% during August compared to the previous month. Nevertheless, this is still far below its normal operating levels. Alongside the month's basis of comparison, which is more demanding, the Imacec's annual variation will remain quite negative, between -10% and -11%.

Easing of lockdown continues



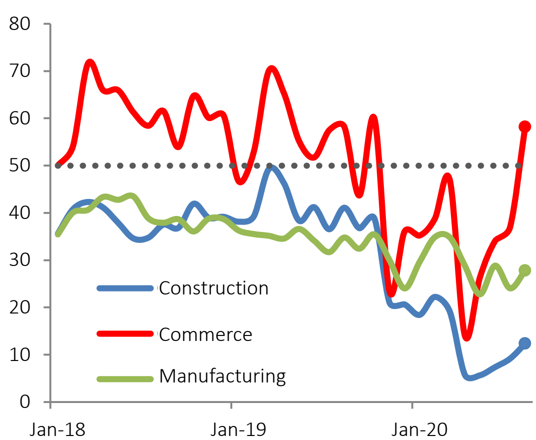
Source: M. Health and Santander

Mobility has continued to rise



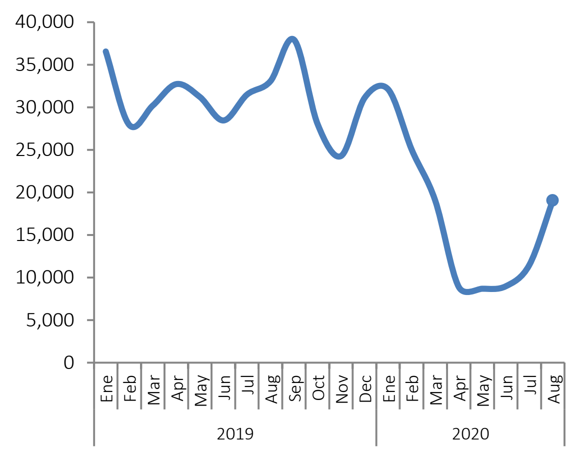
Source: Apple Inc. and Santander

Trade companies detect a recovery in demand



Source: ICARE-UAI and Santander

Light vehicle sales recover in August

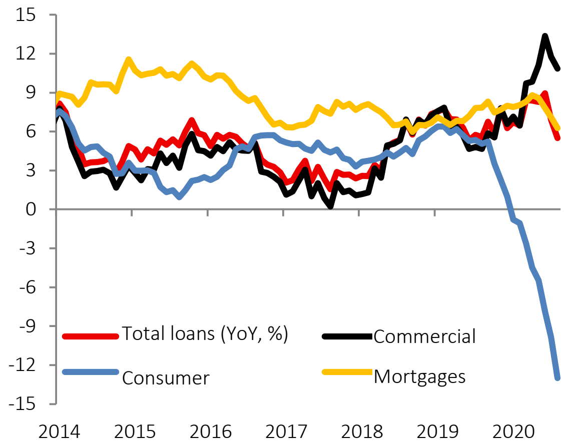


Source: ANAC and Santander

In September we will see a substantial improvement in the annual expansion figures which means that during the third quarter the annual contraction of GDP will be around 9%. In the latter part of the year, the low basis of comparison will cause the twelve-month changes in activity to be positive, which will induce the economy to close with a contraction of between 5% and 6% in 2020, somewhat below the last Central Bank projection in its September Monetary Policy Report. If this were to happen, the resulting figure would be comparably positive regarding those of other emerging economies, which will suffer much more significant effects on their activity.

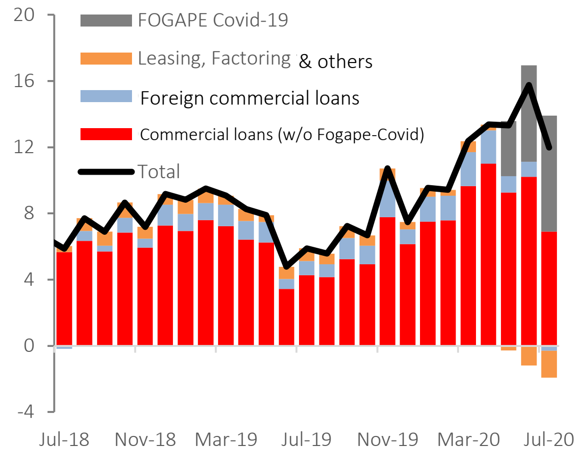
Several elements suggest that the recovery in 2021 will be moderate. Credit, which had shown unusual counter-cyclical behaviour, supported by the Central Bank's stimulus measures and the Government's guarantee programme, has lost dynamism in recent weeks. Commercial loans, excluding Fogape-Covid credits, have moderated their expansion reflecting a weak demand, while consumer loans continue to deepen their contraction. Meanwhile, the temporary boost to household spending from liquidity-providing measures will dissipate at the beginning of next year, which could lead to a slowdown in the activity.

Loans slow down for the second month in a row



Source: BCCh and Santander.

Commercial loans with Fogape-Covid warrants are stabilised



Source: CMF and Santander.

From then on, the contribution of investment to the recovery of demand and the generation of jobs will be crucial. The inventory of the Capital Goods Corporation indicates that many projects have been postponed due to health restrictions and should materialise next year. Furthermore, the Government has announced a major public investment plan. Nonetheless, there are risks. On the one hand, the business climate has been hampered by political uncertainty, which could worsen in the coming months. On the other hand, the high leverage many companies have experienced could be an obstacle in engaging in investment projects. Against this background, the authorities' macroeconomic stimulus policies will be key.

In the medium term, the capacity for growth has been affected. The trend GDP estimate of the Finance Ministry's Expert Committee was again revised downwards to 1.5%. This figure means that per capita GDP growth in the coming years will be very low, making it difficult to make progress in improving people's living conditions. It is, therefore, necessary to rethink growth as a priority goal for the country.

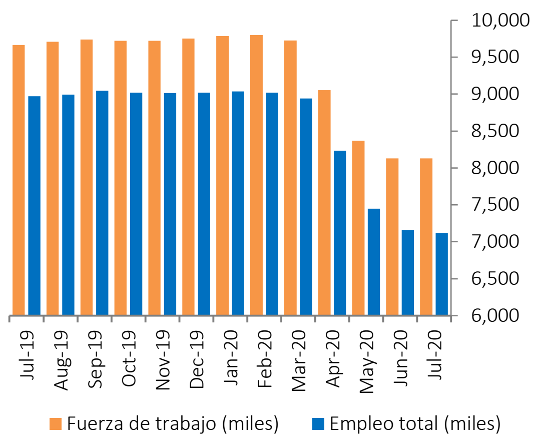
Despite a possible recovery in employment, return to the labour market will lead to a further increase in unemployment

As expected, unemployment rose again in the moving quarter ending in July (13.1% versus 12.2% in June), reflecting the impact of the quarantine strengthening during June and July. Nevertheless, there has been some stabilisation, both in terms of employment and workforce. Adjusted for seasonal factors, 39 thousand jobs were lost (295 thousand in June, 780 thousand in May), and there was a slight increase in the workforce. On the other hand, absenteeism remains at record levels (760 thousand more than a year ago), consistent with the number of people who have become subject to the Employment Protection Act.

The sharp fall in effective employment has more than doubled the contraction of the product. This implies that average labour productivity is tending to increase, reflecting the optimisation of some processes, especially in the logistics and distribution chain. Unfortunately, this may also reflect underreporting in employment surveys, where some jobs could fail to be captured accurately (see Technical Note: Dynamics of productivity during the pandemic).

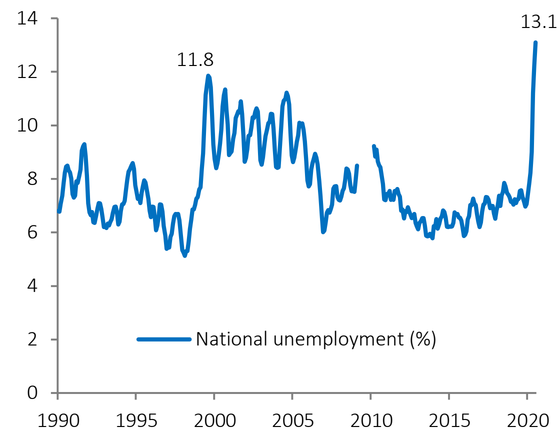
As the easing of lockdown progresses, a rapid recovery of some jobs may take place, particularly within the sectors most affected by the quarantine such as trade and construction. In the case of individuals covered by the Employment Protection Act, their reincorporation will not affect the total employment statistics. That said, the return to the labour market of many people who were unwilling or unable to seek work in the worst months of the pandemic will also take place. It is therefore very likely that there will be increases in employment coupled with further increases in the unemployment rate. For example, if the labour force returns to the level it had in the first quarter, but employment only recovers half of what it has lost since March, the unemployment rate could be close to 18%.

After severe falls, employment and workforce stabilise



Source: INE and Santander

Unemployment could continue to rise when people return to the labour market

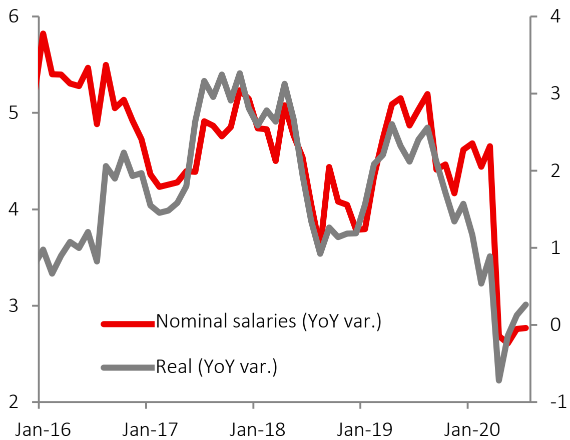


Source: INE and Santander

In this context, remunerations have remained contained (2.8% YoY in July, like the records of previous months). Last week, the Government announced their proposal to Congress of a zero adjustment to the minimum wage, in the context of the first negotiation undertaken since the approval of the Law scheduling a series of readjustments in September 2018, with the last readjustment implemented this March. Finally, the Government introduced the draft bill with an adjustment of 0.4%, equivalent to $1.5 billion, in line with the accumulated inflation between March and August. As of the date this report was issued, the Government had agreed to lower the project's urgency to provide more room for reaching an agreement with the opposition parties.

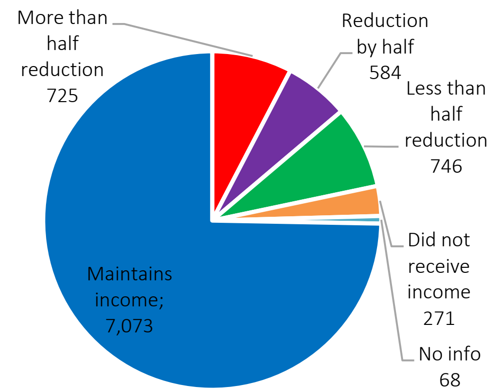
It is important to note that, because of adjustments to working hours due to the pandemic, wages do not adequately reflect the income of employed persons. Complementary information gathered by the National Institute of Statistics (INE) shows that, in fact, 25% of employed people have had their income reduced (2.4 million people) and 17% are receiving half or less of their regular income.

Wages remain stagnant



Source: INE and Santander

Adjustments in working hours have led to reductions in the income of employed persons

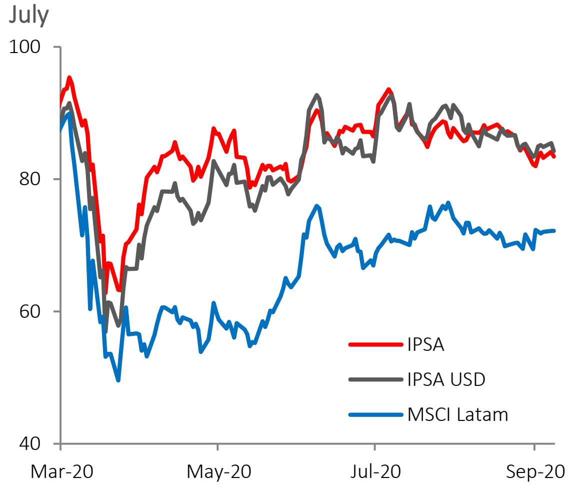


Source: INE and Santander

Prices of local risk assets fall, but the exchange rate appreciates again

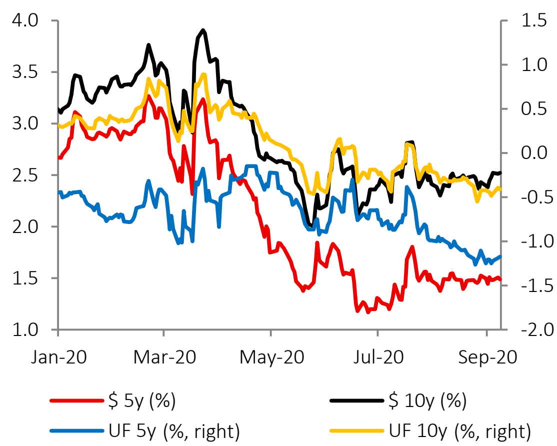
During August the local stock index IPSA had tended to stabilise, with some fluctuations, at around 4,000 points. In the last few weeks nevertheless, it has fallen significantly (almost 6%), dropping back to levels akin to those of June. Behind this was the weak performance within retail and other sectors that were affected by the pandemic, as well as portfolio adjustments that dragged the UF fixed-income rates to new historic lows. Thus, the five-yearly adjustable rates were quoted at around -1.2%, while the 10-year rates were at -0.5%.

The IPSA has fallen nearly 7% since the beginning of July



Source: Bloomberg and Santander

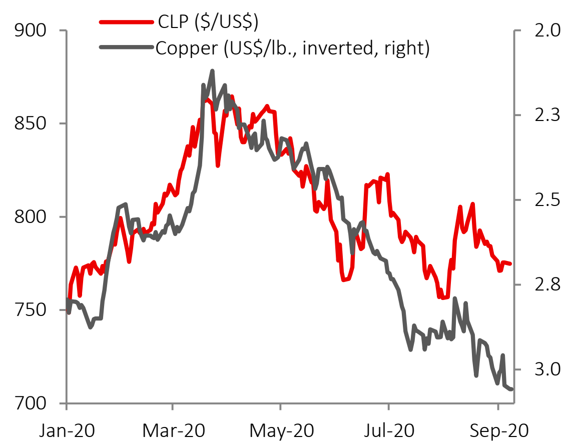
UF rates are at historical lows



Source: Bloomberg and Santander

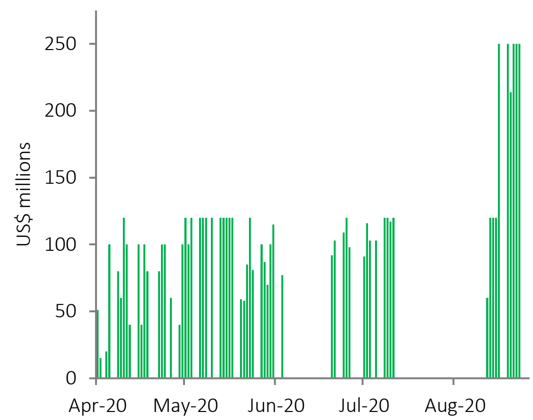
After depreciating sharply to over $800 by mid-August, the exchange rate has tended to appreciate again to around $775 when this report was issued. The strengthening of the Peso has been influenced by the Dollar's global weakness and the high copper value, which has stabilised at around US$3 per pound. It has also prompted the Finance Ministry to resume selling dollars on the local market, after suspending the auction programme at the end of July. Most recently, the Finance Ministry auctioned up to US$ 250 million per day, injecting US$ 1,884 million between the 24th of August and the 4th of September. It also reported that up to US$ 2.5 billion would be auctioned during September.

After reaching over $800 in mid-August, the exchange rate appreciated again



Source: Bloomberg and Santander

Ministry of Finance resumes dollar auction with higher daily amounts



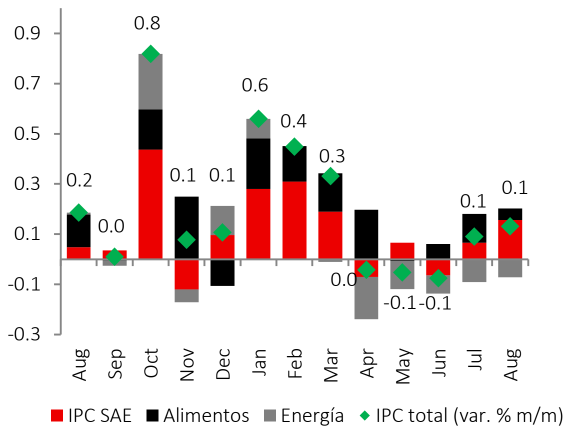
Source: Ministry of Finance and Santander

August's CPI shows that inflationary pressures remain low

In line with expectations, the CPI varied by 0.1% in August (2.4% YoY), indicating that inflationary pressures remain restricted. Weak domestic demand, low international fuel prices and, more recently, the appreciation of the Peso, have kept inflation away from the Central Bank's target. Nevertheless, the latest record showed some rebound in core inflation (CPI excluding food and energy) from 1.8% YoY in July to 1.9% YoY. This is because of specific increases in some assets that could be reflecting the liquidity *shock* that households received during the month, as was in the case of shoes and certain food products. On the other hand, the fall in services inflation halted in a context where priced allocations remain high (26.5% vs 27.5% July).

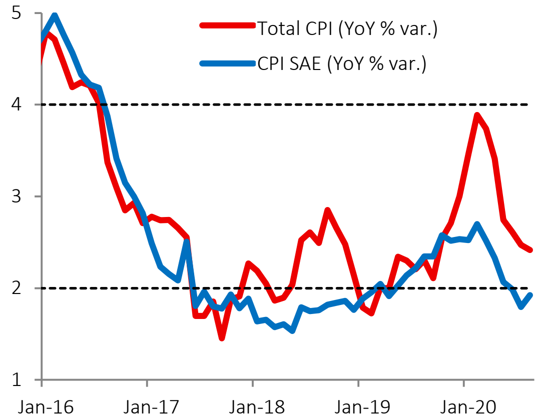
In the future, we will see a slight upturn in the CPI's monthly fluctuations, due to both seasonal phenomena and to greater pressures on the demand for pension fund withdrawals and public transfers. By September we assess that the CPI will have increased by around 0.3% MoM; although it will close the year at around 2.2% YoY due to more demanding bases in the latter period. This figure is somewhat lower than the latest Central Bank's projection stated in the last Monetary Policy Report (2.4%). By the beginning of next year, inflationary records may temporarily fall below 2% and then converge, very gradually, towards the target. This development will depend on whether the pandemic recedes, and the economy recovers healthily.

August's CPI was in line with expectations



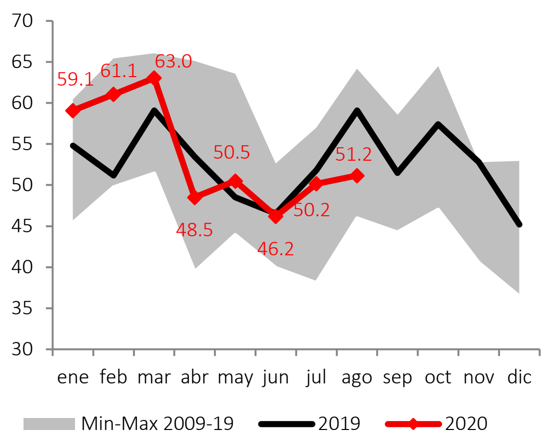
Source: INE and Santander

Core inflation has risen slightly but remains very low



Source: INE and Santander. SAE=sans energy & food

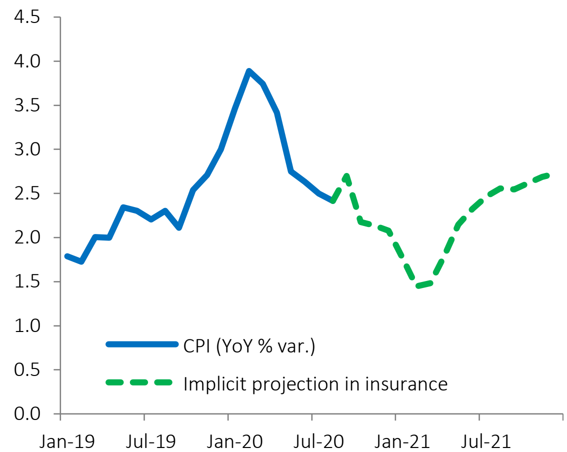
Diffusion index shows that pressures remain low



Note: Inflationary diffusion defined as the percentage of products that increased in price in the month.

Source: INE and Santander

Inflation will continue to fall until the beginning of 2021



Source: INE and Santander

The Central Bank restates that the Monetary Policy Rate will remain at its technical minimum for an extended period

Not surprisingly, the Central Bank Board kept the Monetary Policy Rate at 0.5% at the last Monetary Policy Meeting and indicated that it would remain at that level for much of its two-year policy horizon. This reassures that the Monetary Policy Rate (TPM) will remain at its technical minimum well into 2022.

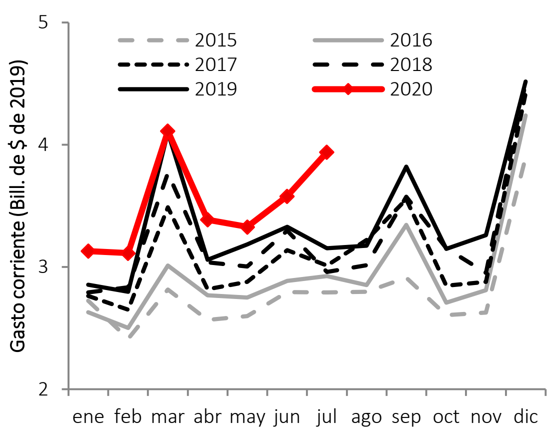
Last September's IPoM was somewhat more optimistic, highlighting the economy's gradual recovery process, in light of the lack of confidence and the strong boost given by the liquidity injections subsequent to the government measures and the withdrawal of pension funds. In this context, the projections for growth and inflation were revised upwards. Nonetheless, the CPI is expected to remain under target for a long time, and there are still many risks to the economy.

Additionally, they stated they would continue assessing options in order to adjust the monetary impulse to the needs of the economy and to support the financial stability if required. This relates to the new constitutional power given to the Central Bank to buy sovereign debt securities in secondary markets. We assess that, in the current scenario, there will be no need to resort to such a tool. Long-term rates have declined and are at historical lows. If the Central Bank deemed it necessary to increase the monetary impulse, it could revise the technical minimum for the Monetary Policy Rate (TPM) and cut it by 25 basis points. Given the mechanism of operation of the Conditional Credit Facility for Increasing Placements (FCIC) line and the COVID-19 credits, this could generate a greater stimulus directly. Only if long-term rates rise abruptly would the Central Bank use the new power to buy government debt to reduce its volatility.

Fiscal spending accelerates in July as household support policies materialise

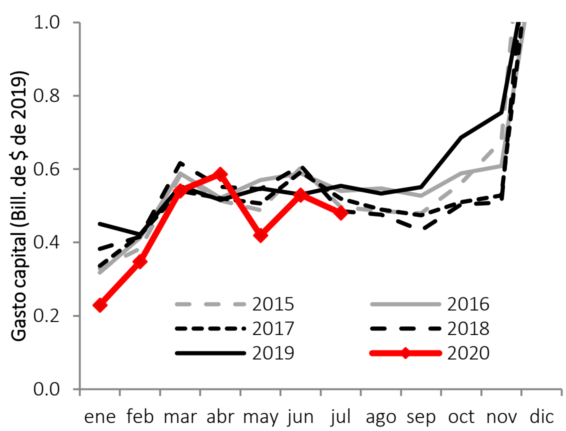
After showing a moderate rebound in the second quarter, public spending accelerated in July (19.2% YoY) due to the implementation of several of the Government support measures, such as the Emergency Family Income (IFE). This was reflected in the grants and donations component, which had a record growth (53.7% YoY). Thus, current expenditure expanded by almost 25% during the month and accumulated an increase of 9.4% so far this year. On the other hand, the implementation of public investment continues to lag behind, due in part to the difficulties in developing public works in communes under quarantine. Thus, capital expenditures shrank by 12.3% per year in the first seven months of the year.

Current expenditure rises driven by transfers to households



Source: Dipres and Santander

Capital expenditure execution still lagging far behind

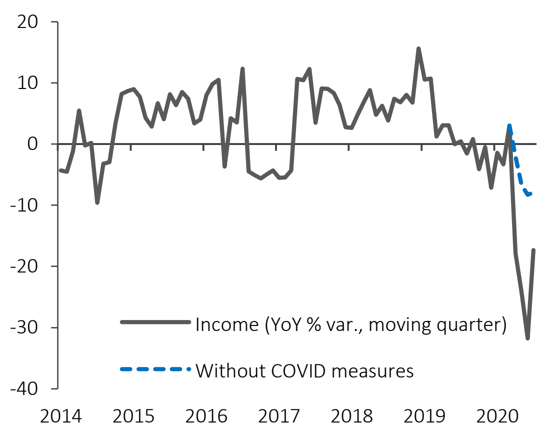


Note: December's performance usually exceeds $1 billion, but the axis was cut to facilitate the reading of other months.
Source: Dipres and Santander

Additionally, although revenues continued to contract in July (-6.3% YoY), the decline was less abrupt than in previous months due to a lower incidence of corporate tax relief measures (in July, August and September only those companies whose revenues have been affected will be eligible for this benefit). The VAT postponement and the suspension of Provisional Monthly Payments had led to average reductions in revenue of about US$ 750 million per month between April and June, while in July it reached US$ 280 million.

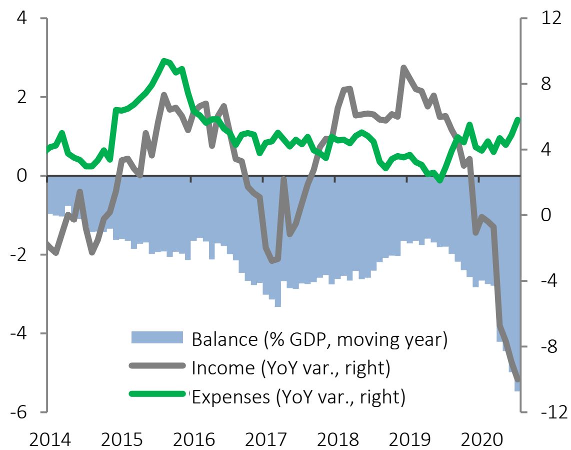
With this outcome, the cumulative fiscal deficit for the last twelve months up to July rises to 5.5% of the GDP. The substantial contraction in income during the second quarter of this year accounts for most of the deterioration. Without the tax relief measures, the deficit would have been around 4% of the GDP.

Reduced impact of tax relief measures leads to partial recovery of revenues



Source: Dipres and Santander

Higher expenditure execution and shrinking revenues widen the government deficit



Source: Dipres and Santander

Macroeconomic projections

National Accounts	2014	2015	2016	2017	2018	2019	2020 E	2021 P
GDP (real var. % YoY)	1.8	2.3	1.7	1.2	3.9	1.1	-6.0/-5.0	4.0/5.0
Internal demand (real var. % YoY)	-0.5	2.5	1.8	2.9	4.7	1.0	-9.0	7.0
Total consumption (real var. % YoY)	2.9	2.6	3.5	3.6	3.8	2.9	-9.0	8.0
Private consumption (real var. % YoY)	2.7	2.1	2.7	3.4	3.7	1.1	-9.5	8.0
Public consumption (real var. % YoY)	3.8	4.8	7.2	4.6	4.3	-0.3	-5.0	7.0
Gross fixed capital formation. (real var. % YoY)	-4.8	-0.3	-1.3	-3.1	4.8	4.2	-8.5	5.0
Exports (real var. % YoY)	0.3	-1.7	0.5	-1.5	5.0	-2.3	-1.5	2.5
Imports (real var. % YoY)	-6.5	-1.1	0.9	4.6	7.9	-2.3	-14.0	11.0
GDP (US$ billions)	260.6	244.3	250.6	277.1	298.9	282.7	245	265
GDP per capita (US$ thousands)	14.6	13.6	13.8	15.0	15.9	14.8	12.5	13.1
Population (millions)	17.8	18.0	18.2	18.4	18.8	19.1	19.5	19.7

Balance of Payments	2014	2015	2016	2017	2018	2019	2020 E	2021 P
Trade balance (US$ billions)	6.5	3.4	4.9	7.4	4.6	4.2	15.5	11.5
Exports (US$ billions)	75.1	62.0	60.7	68.8	75.2	69.9	69.5	71.5
Imports (US$ billions)	68.6	58.6	55.9	61.4	70.6	65.7	54.0	60.0
Current account (US$ billions)	-5.2	-5.7	-5.0	-6.4	-10.6	-10.9	-2.0	-4.0
Current account (GDP%)	-2.0	-2.4	-2.0	-2.3	-3.6	-3.9	-1.0	-1.5
Price of copper (annual average, US$/lbs.)	3.11	2.50	2.21	2.80	2.96	2.72	2.75	2.85
WTI oil price (annual average US$/bbl.)	93.1	48.7	43.2	50.9	64.8	57.0	39.0	48.0

Money and Exchange Market	2014	2015	2016	2017	2018	2019	2020 E	2021 P
CPI Inflation (var. YoY, % by December)	4.6	4.4	2.7	2.3	2.6	3.0	2.2	2.5
CPI Inflation (var. YoY, average %)	4.7	4.3	3.8	2.2	2.4	2.3	2.9	2.3
CPI sans food and fuel inflation (IPC-SAE) (var. YoY, % by December)	4.3	4.7	2.8	1.9	2.3	2.5	2.0	2.0
CLP/US$ exchange rate (year's exercise)	607	707	667	615	696	745	810	790
CLP/US$ exchange rate (year average)	570	654	677	649	640	703	805	800
Monetary policy rate (year's exercise, %)	3.00	3.50	3.50	2.50	2.75	1.75	0.50	0.50
Monetary policy rate (%, year average)	3.75	3.06	3.5	2.7	2.52	2.48	0.78	0.50

Fiscal Policy	2014	2015	2016	2017	2018	2019	2020 E	2021 P
Public expenditure (real var. % YoY)	6.4	7.4	3.8	4.8	3.5	4.1	13.0%	2.5%
Central Government balance (% GDP)	-1.6	-2.2	-2.7	-2.8	-1.6	-2.8	-10.0%	-5.0%
Central Gov. gross debt (US$ billions)	36.6	39.0	53.4	68.9	70.2	74.4	80.3	98.1

Source: BCCh, INE and Santander

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