Central Bank shows signs of gradualness in its withdrawal from monetary stimulus

The minutes of the Monetary Policy Meeting (RPM), held on July 13 and 14 and published today, give clear signs of a somewhat more dovish conduct in monetary policy compared to what is considered by the market.

In the first place, the alternatives evaluated by the Board were to keep the Monetary Policy Rate (MPR) at the level of 0.5% or increase it by 25 bp, to 0.75%. Thus, although it opted for the second alternative, a more aggressive increase (of up to 50bp) was not under discussion, as the swap rates had been reflecting. In fact, the minutes emphasize that several advisers indicated that "market prices had tended to internalize a process of tightening monetary policy faster than was considered appropriate given the central scenario of the June Report."

Second, the minutes add that going forward, changes in the MPR will depend on the evolution of the economy, highlighting that "medium-term risks and the need to understand more precisely the state of the labor market and the evolution of credit make it convenient for the pace of monetary policy adjustment to be gradual”. The foregoing reflects a monetary management that will be highly dependent on the evolution of the data.

In this context, we consider that in the next MPR to be held on August 31, both maintaining the MPR at 0.75% and increasing it again will be presented as equally valid alternatives. The first reflects a scenario consistent with a recovery in activity that could be influenced by transitory elements and that still requires a high monetary stimulus.

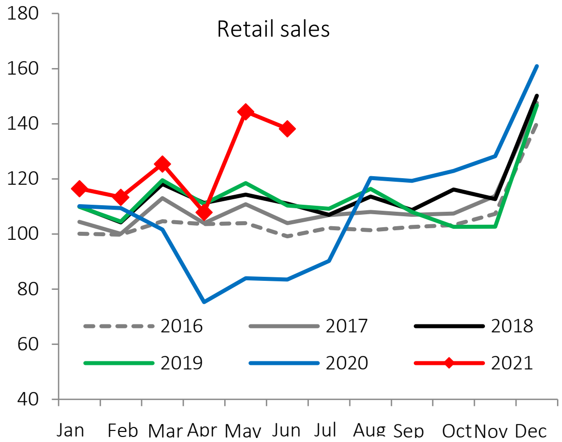
Activity data for June show mixed results, in a context where there was greater confinement

Although retail sales in June showed strong year-on-year growth (66% y / y), this expansion had a moderate decline compared to the previous month, after the rebound observed in May. The highest incidences were related to durable and semi-durable goods (clothing and footwear, home electronics and new vehicles), due to the impact of the latest injections of liquidity both due to withdrawals of pension funds and tax aid.

The manufacturing industry surprised positively with a rise of 14.6% (Santander: 12%; Bloomberg: 10%), with positive impacts in the food and beverage sectors. As has been the trend in previous months, the chemicals division has been affected by the lower availability of raw materials for methanol. Meanwhile, mining production had a slight monthly contraction, in line with its seasonal patterns. The behavior of this sector throughout the year confirms that the productive capacity of mining is close to its maximum levels, since there has been no substantive growth associated with the higher price of the mineral.

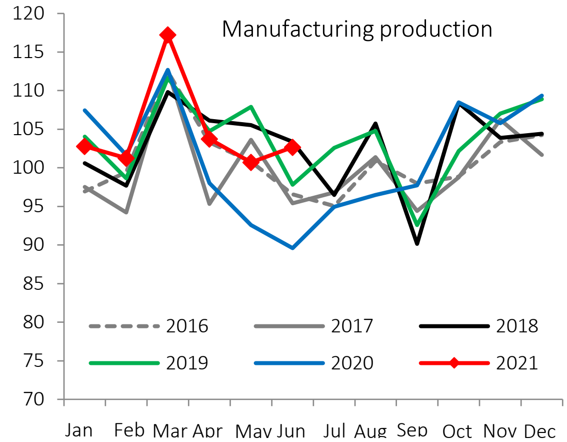
Considering the sectoral results, we estimate that the Imacec for June –which will be released on Monday– would have had a slight monthly increase compared to May, which would imply an annual expansion of around 17%. It should be noted that the low comparison bases will continue to be relevant in the coming months, so double-digit growth will also continue in July and August.

Retail commerce had a slightly monthly decline, but record levels remain



Source: INE and Santander

A positive surprise from manufacturing, growing in a month when it usually decelerates.



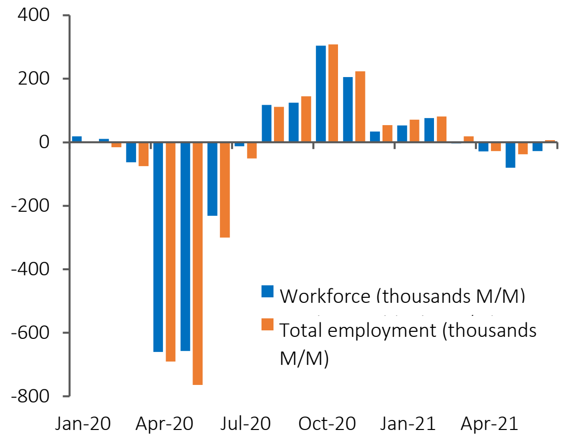
Source: INE and Santander

Although the unemployment rate decreases, the labor market remains weak

Behind the drop in the unemployment rate (from 10% to 9.5%) was a further reduction in the labor force (-53 thousand people), while employment remained relatively constant with close to 1 million fewer people working with respect to the start of the pandemic. The persistent decline in labor force participation (56% vs. 63% in a normal context) is explained by various factors associated with the pandemic (need for care at home, uncertainty about the deconfinement process, fear of contagion).

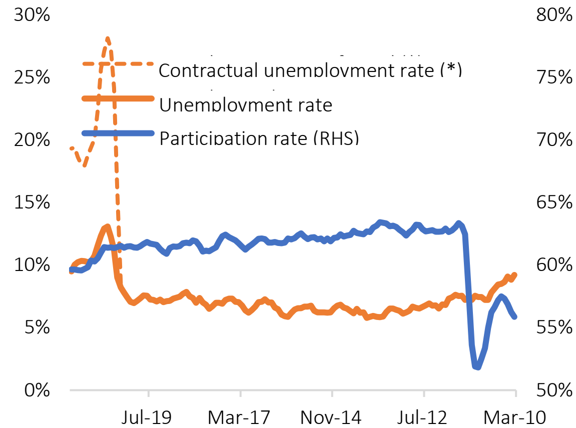
On the one hand, it is to be expected that as the health situation improves, people will rejoin the labor market and that, in principle, demand will be able to absorb the recovery in supply. However, there are labor-intensive sectors that have already adapted to function in the context of the pandemic (especially Commerce). Therefore, in the medium term the unemployment rate in the new normal could converge to levels somewhat higher than the historical ones.

The labor force retreats again, while employment remains stagnant



Note: Seasonally adjusted figures
Source: INE and Santander

Unemployment declines, but only due to lower participation



Note: Contractual unemployment is estimated from the population of working age and the participation in 2019

The FED gives the first signals for the start of tapering

As expected, the US Federal Reserve decided to keep its reference rate in a range between 0.0% and 0.25%. In the statement of the FOMC meeting, the main change was related to the forward guidance for the beginning of the withdrawal of quantitative stimuli (Tapering), which could be about to begin. The Committee mentioned that, since December, the economy has advanced towards the objectives of price stability and maximum employment, therefore "they will continue to evaluate this progress in future meetings." The traditional Jackson Hole symposium, to be held August 26-28, is a likely setting for possible announcements in this regard. However, the market interpreted the communication with a more dovish bias, which encouraged asset prices and led to long rates falling marginally (-2 bp for the week).

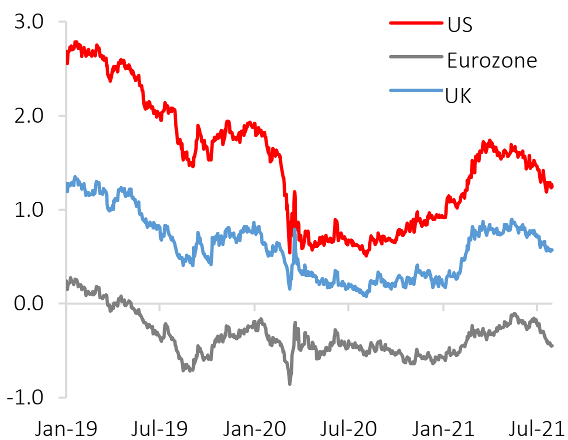
Second-quarter activity data for the US had a positive reading. Although the 6.5% annualized GDP growth was lower than expected (8.4%), the solid growth in personal consumption (11.8% vs. 10.5% expected) encouraged the markets. In this way, the S&P 500 climbed to historical highs, exceeding 4,400 points and the dollar tended to appreciate globally (DXY: 1%).

In the Euro Zone, after two consecutive quarterly falls, the preliminary GDP for 2Q21 exceeded expectations (2.0% vs 1.5%) and annual inflation in July varied 2.2% (2.0% expected), in line with the new symmetric target of around 2%. However, in some countries the activity results were lower than expected, with Germany standing out (1.5% vs. 2.0%), which had an impact on the European stock market, which reacted with falls at the close of this report.

Despite the authorities' efforts to calm the mood of market agents, the Chinese stock market fell 5% in the week, following the impact of regulatory reforms that would alter the business model of private companies in the education sector.

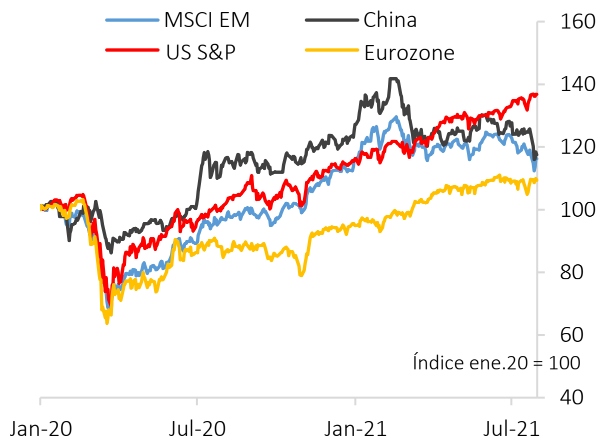
During the week, the International Monetary Fund updated its projections, keeping global growth prospects at 6% for 2021, but increasing those for 2022 to 4.9% (50bp more than in April). Emphasis was placed on the change in the composition of the forecast, with a widening of the gap between advanced countries and the rest due to greater access to vaccines against Covid-19 and the response capacity of economic policy. Multilateral action - at the discretion of the international body - will be essential to reduce divergences and thereby strengthen prospects for the world as a whole. The risks are still skewed to the downside, associated with a slower vaccination rate and a tightening of financial conditions in a context where the acceleration of inflation may be more persistent than expected.

Long-term rates of developed countries may continue the downward trend



Source: Bloomberg and Santander

Global markets closed the week with mixed movements



Source: Bloomberg and Santander