Santander

Inflationary surprise brings relief to fixed income market

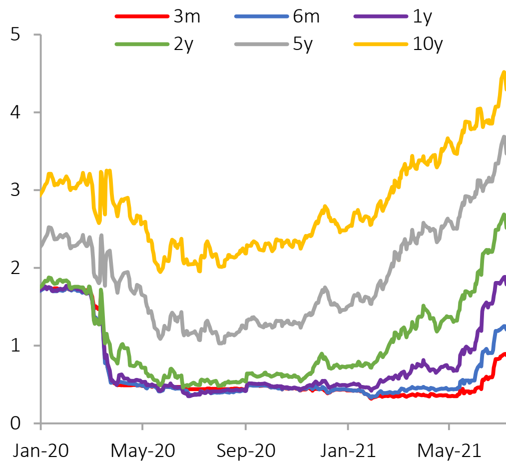
The low June CPI record (0.1%, below the 0.3% expected by the market) once again showed that inflationary pressures remain contained, despite the strong impulse that consumption has had. After the data was known, the local fixed income market had a substantial adjustment, with falls in rates at different terms (10-year sovereign bond in pesos: -28bp, up to 4.6%; 10-year UF bond: -14bp up to 1.7%). This came amid widespread cuts in rates globally, after the publication of the Fed minutes on Wednesday, which reaffirmed the dovish tone for monetary policy in that country.

Local rates have been under constant pressure for several weeks, which has brought them to levels not seen since the beginning of 2019 (BTP10 4.6%). Behind this have been the higher risk premiums derived from the political scene; the lower demand for fixed income instruments after withdrawals from pension funds and the greater supply of papers issued by the treasury to finance its deficit. Added to this was a faster recovery in the economy and the change in tone of the Central Bank in its last report, which pointed to an early start of the process of increases in the MPR.

Regarding the latter, the inflation data released this week makes the monetary policy decision that the Central Bank must face at its next meeting (July 14) more complex. Among the elements considered by the issuing institute needed to start the rate hikes soon is a relatively high inflation projection (CPI as of December 2021 at 4.4%). However, the June CPI confirmed the view that inflation probably will not rise as much as the report had suggested. This, added to how unbalanced the recovery of the activity is being - highly affected by transitory fiscal measures -; the slack in the labor market and the risks of the pandemic make it advisable to be cautious when withdrawing the monetary stimulus. In fact, the central banks of the main countries, despite robust growth prospects for the year and increases in inflation, have stressed the need to continue supporting their economies.

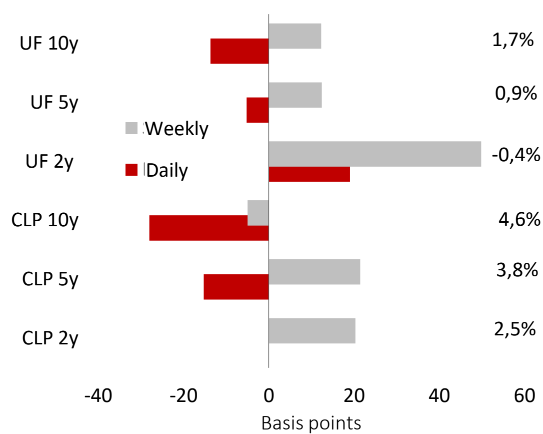
The Council is likely to decide to initiate rate hikes at its next RPM. However, these will be slower than what the market - influenced by the monetary authority's own announcements - has been internalizing. In fact, after inflation data, swap rates fell significantly, around 15 bp.

Swap rates highs are detained and marginally recede



Source: Bloomberg and Santander

Benchmark bond rates decrease after the CPI data



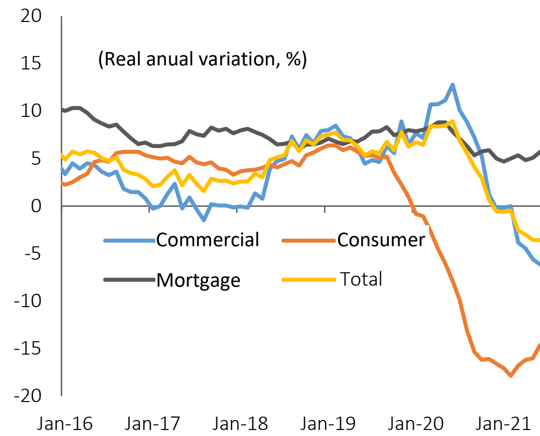
Source: Bloomberg and Santander

Bank loans continue to decline

In June, credit continued to show negative growth rates (-3.6% annually, similar to the previous month), mainly due to the reduction in loans to companies (-6.1%). According to the Central Bank's Bank Credit Survey (ECB), this segment faces more conservative supply conditions and weaker demand compared to the previous quarter. Although growth prospects for the year have improved, the medium-term outlook is highly uncertain due to the political climate, which has increased credit risk and could be delaying investment decisions. On the other hand, many companies still have high liquidity and high leverage ratios.

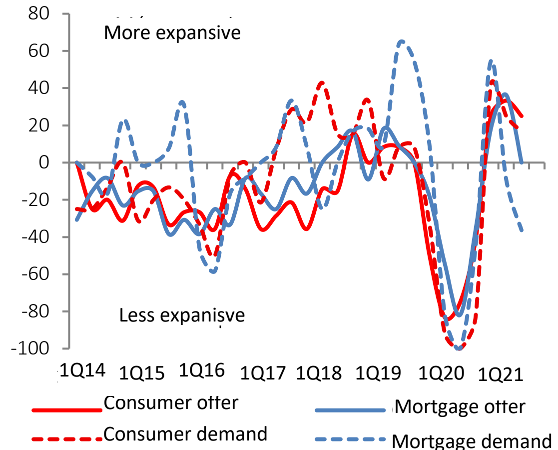
Consumer loans also show a significant contraction (-14.6%), although somewhat less negative than in the previous month. Consumer credit began to decline after the social outbreak at the end of 2019 and continued to be hit by the pandemic. Most recently, liquidity injections and state aid have contributed to reducing the demand for this type of placements and have made it possible to lower leverage levels and default. Along these lines, the ECB highlights that this is the only segment with more flexible approval and demand standards. The latter has resulted in higher amounts of credit in relation to income. Finally, home loans maintain stable growth (5.7%), in a context of unchanged approval standards.

Bank loans continue in negative territory



Source: BCCh and Santander

The consumer segments maintains more flexible offer and stronger demand



Source: BCCh and Santander

Global markets hurt by incipient coronavirus outbreaks

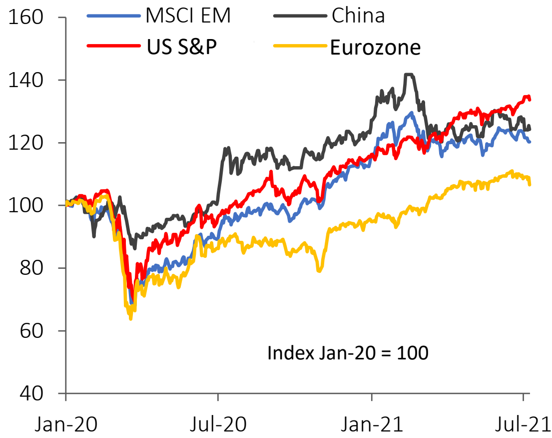
Fears of a new wave of contagion worldwide due to the expansion of the Delta variant pushed the global stock markets back (between -1% and -3%) -except for the Chinese market, which remained stable- and an increase was observed in risk aversion (VIX: +4 points). Both the Federal Reserve (Fed) and the European Central Bank (ECB) supported a stance of monetary prudence and tolerance to inflationary pressures, in a context that they described as unusually uncertain. This caused further falls in long-term interest rates (-10 bp on average), in line with a containment of inflationary expectations.

According to the Fed's minutes –corresponding to the June meeting-, the members of the Board have not yet seen the materialisation of a substantial advance in activity, rather they highlighted a balance between inflationary risks and relatively high unemployment (climbed to 5.9% in June). Thus, the act mentions that some appeal for a "patient" approach to a policy change, given the high level of uncertainty as a result of the pandemic. This was taken by the market as a dovish bias, while they did not shed light on when they would begin to reduce monthly bond purchases, causing the return curve to flatten.

For its part, the ECB revised its monetary policy strategy by modifying the limits of its inflation target, from a level close to but below 2.0% to a “symmetric level of 2%, in the medium term”. By making the 2% ceiling more flexible, they confirm the tolerance for inflation to be temporarily above this level, something that is expected this year due to the low bases of comparison, the impact of the increase in fuels, the dissipation of the effect of the VAT cut in Germany in 2020 and the tightness in some supply chains.

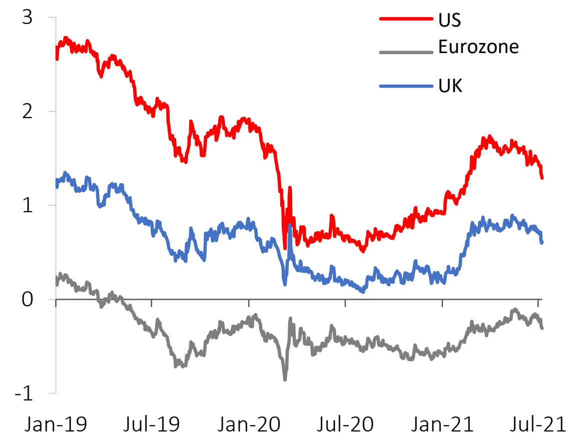
Finally, the declaration of Tokyo in a state of emergency due to sanitary restrictions between July and August has contained economic expectations in Japan -mainly in the sectors linked to tourism and gastronomy-, two weeks before the start of the Olympic Games, causing a 2% drop in the stock market.

Exchange indexes, with the exception of China, fall due to fears of a new wave of contagion



Source: Bloomberg and Santander

Long term rates again recede in the week, with contained inflation expectations



Source: Bloomberg and Santander