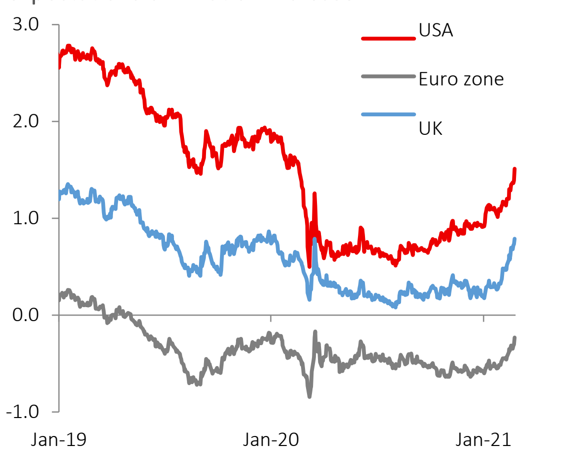
Financial markets battered as long-term interest rates rise

The week was marked by better perspectives of economic recovery, in hand with the reduction in the contagion and the advance in the process of mass vaccination, principally in the US and the UK. This increased commodity prices, in particular copper and oil, and fed expectations of an increment in inflation in the principal economies, causing a strong rise in the long-term interest rates, especially US Treasury rates (close to +50 bp during this month). It is important to note that at the close of this report, the upward trend in rates and commodity prices during the week began to moderate and in some cases partially revert downwards.

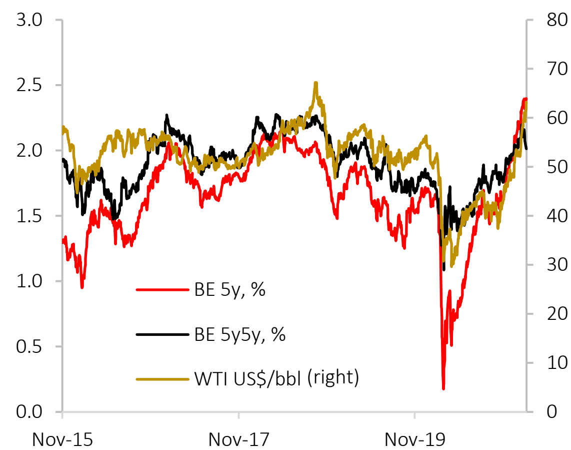
During the week, Fed chairman Jerome Powell tried to cool down market expectations signaling that the conditions to decrease stimulus given the economic context is still uncertain. Other central banks also emphasized that they are far from beginning a monetary normalization process.

Strong increase in long-term interest rates as expectations of inflation increase



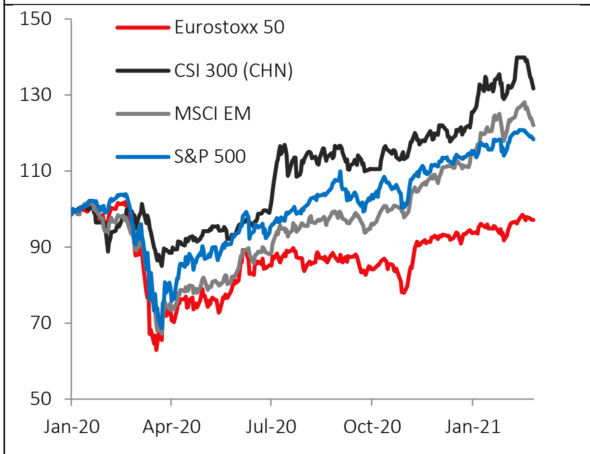
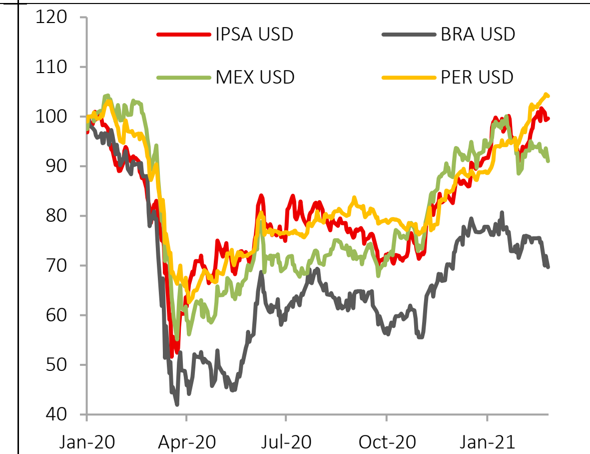
Source: Bloomberg and Santander

Increase in commodity prices feed inflationary expectations



BE: *Breakevens*
Source: Bloomberg and Santander

In response to the increase in long-term rates, the riskiest assets showed a strong correction in the last days. The S&P 500 and the Dow Jones decreased more than 4% compared to the levels at the end of January. In the week, the MSCI for Emerging Markets changed 3.2%, and Latin America -6%.

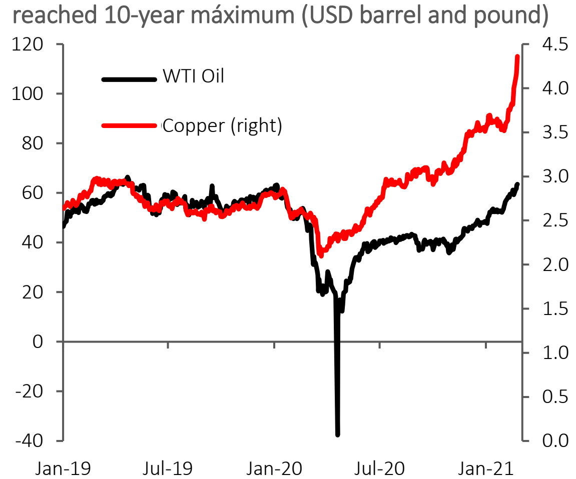
Global stock markets fall ass interest rates increase	With some exceptions, markets in the region follow international tendencies
	
Source: Bloomberg and Santander	Source: Bloomberg and Santander

Beyond the pandemic evolution, the promising expectations of global growth were reinforced by various indicators that surprised positively this week. In the US, jobless claims fell to 730,000 (838,000 expected, and 841,000 previously), its lowest level in the last three months, and durable goods orders increased 3.4% (0.7% expected and 1.1% previously). Additionally, the GDP growth for the 4Q20 was revised to 4.1% (from 4.0%). In Germany, the business climate index (IFO) reached a maximum in the last four months in February with 92.4 points (90.5 expected; 90.3 in January), highlighting the manufacturing sector which reached its highest value since November 2018.

Commodity prices reached record increases with better outlook for demand and still restricted supply

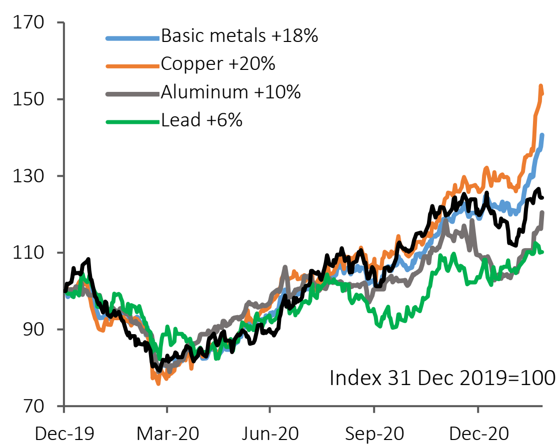
So far this year, the price of WTI oil has increased more than 30%, recovering the ground lost during the pandemic, while the price of copper increased 20%, reaching its maximum level since 2011. This week the positive trend was accentuated, with oil reaching US$62/barrel and copper closing at US$4.18/lb.

Price of oil reached prepandemic levels and copper reached 10-year máximum (USD barrel and pound)



Source: Bloomberg and Santander

Copper price increases more than other base metals



Source: Bloomberg and Santander

As we have stated in previous reports, behind these increase there are demand factors – as global growth expectations improve – as well as supply factors. In the case of oil, production has been restricted in the short term by the cuts from the OPEC and other producers until March of this year. Later, in April, these cuts should dissipate, adapting to the growth in demand, which is why futures prices show a decline in the coming months.

As for copper, less investments in the last years limit supply capacity, even more considering the less production that comes from the older mining laws. It is important to highlight that the growth expected for 2021 is simply the recovery of what was lost the previous year, particularly in Peru, which decreased production in 350,000 tons.

Financial assets in Chile follow global trends

In Chile, long rates were not oblivious to the international movements in rates, suffering strong adjustments upwards (10-year rates increasing 20 bp in the week) in a scenario where inflationary expectations have also increased. In this context, the IPSA fell 1%, amid a strong rally in commodity prices and an exchange rate, which despite an increase in copper prices, experience mixed movements and depreciated almost 1% in the week, in line with other Latin American currencies.

With increasing rates, the swap rates increased for terms longer than 1 year (+12bp in two years and +19bp in three years) pointing towards a normalization process that could begin in the latter part of the year. Different to what is implicit in these prices, we estimate that the Central Bank will be very cautious when it is time to increase rates – even if inflation is above the target – and in 2022 will increase the Monetary Policy Rate. The labor market still remains week, and the capacity gaps in the economy are still wide.

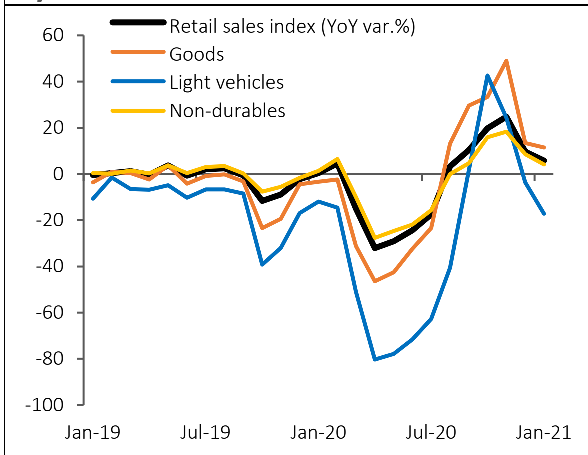
INE sector indicatios point towards a deceleration at the margin

In line with our estimates, Retail commerce reduced its growth rate (5.8% YoY vs. 9.7% in December), reflecting a more demanding comparison base and showing a moderation in the drive derived from the liquidity shocks to the homes, that had impacted significantly in the previous months. In effect, although the various components of durable goods remained dynamic, car sales declined once again, after record levels in October, which in turn decreased other line in retail commerce. This shows the impact of the second pension fund withdrawal was less than the first round, and will lose traction going forward.

The manufacturing sector disappointed in the first month of the year, with a contraction of 4.4% compared to the same month of 2020. Chemical products had a strong declines, due to less production of methanol in the southern part of the country. Beyond this one-time effect, the figure reflect a relatively weaker sector and shows there is still a long way to go to recover what was lost in the pandemic. Mining, for its part, had the habitual seasonal decrease and finished off at similar levels to the previous year (-0.4% YoY). Going forward, the elevated copper prices could incentivize production from smaller and medium-sized mines. However, in the case of larger mines, which are the ones that move the needle, the response capacity to price is limited in the short term, meaning that mining activity will still have constrained growth rates.

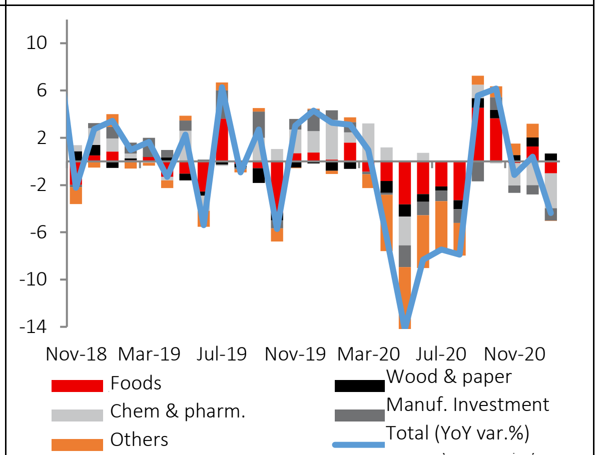
With the figures known today, we reaffirm our vision that the Imacec for January will have an annual contraction of around 2.5%, with a slight decreased compared to the seasonally adjusted level in December. In February we will continue to see activity remain subdued, but in March, as long as the vaccination process continues on schedule, it is possible that we could see a clearer recovery.

Commerce moderates its expansion as liquidity injections have a lower effect



Source: INE and Santander

Manufacturing activity remains lagged

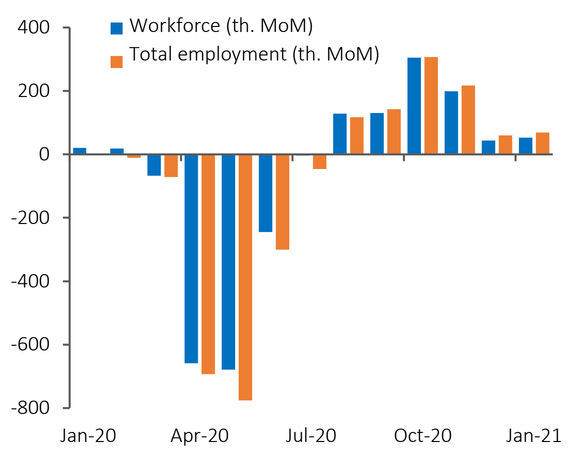
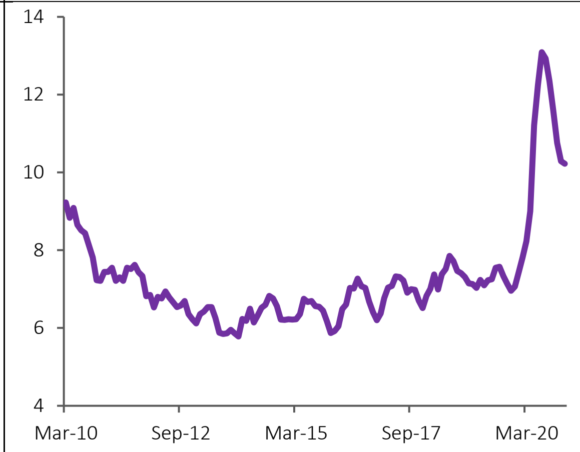


Source: INE and Santander

Labor market maintains low dynamism

For the second consecutive month in a row the employment figures from the INE show a lag in the recovery process. In seasonally adjusted terms, the increase in occupied job posts reached only 69 thousand, bringing total employment to remain around 1 million, below what it was the same month of 2020. The work force increased at a similar rhythm, leading the unemployment rate to reach 10.2% (versus 10.3% the previous month).

Although the recovery in activity should go hand in hand with a larger dynamism in the labor market, the context of the pandemic many sectors had to adjust their activities to follow social distancing. If such dynamics remains, it is expected that the recovery in employment should be slower than activity. This brings additional pressures on the unemployment rate once the vaccination process and looser mobility restrictions allow the labor force to reach pre pandemic levels.

Slow recovery in employment for the second consecutive month	Unemployment rate remains above 10% in the last three months
	
Note: Seasonally adjusted Source: INE and Santander	Source: INE and Santander