Santander

MONTHLY ECONOMIC OUTLOOK

Activity recovers slightly faster than expected

December's Imacec reached higher than anticipated, and the GDP figure in 2019 stood at 1.2%. The activity expanded by 1.1% YoY, well above expectations, nevertheless, it must still go through a normalization process, and new disruptions cannot be ruled out in the future.

Coronavirus causes high volatility in financial markets. Concerns over the further spread of the disease and the possible impact on the Chinese economy pushed back financial markets, especially raw materials. However, China's announcement to reduce some tariffs offsets some of these falls.

Higher inflation during January was driven by currency depreciation and a substantial increase in specific products. Inflation over 3% is expected during the first half of the year. However, it could fall to 2.6% by the end of 2020.

The Monetary Policy Meeting during January was held with no surprises. The Central Bank maintained its Monetary Policy Rate (MPR) at 1.75%, and we expect this to continue unchanged throughout the year.

The fiscal deficit during 2019 was 2.8% of the GDP. This level was higher than the 2.2% estimated last September and almost 1 percentage point above what was projected when last year's Budget was drawn up. According to our projections, the deficit would reach 4.4% of the GDP by 2020.

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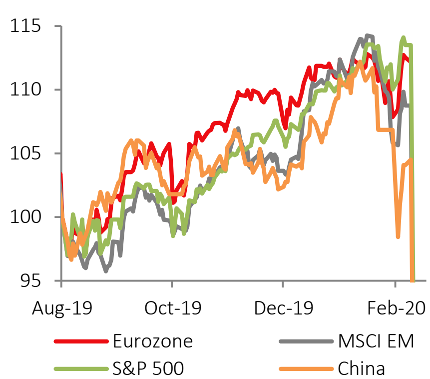
Coronavirus causes high volatility in financial markets

China's announcement to reduce some tariffs offset the falls in financial markets as a result of fears about the effects of coronavirus.

During the first month of the year, international financial markets were affected by the coronavirus outbreak originated in Wuhan, China. The concern of a rapid spread and the possible impact on China's economy created a greater aversion to risk, which made the stock markets and interest rates retreat, in tandem with sharp declines reflected by the prices of raw materials. The price of copper fell by almost 10%, while the price of oil fell by more than 18%. The OPEC technical committee recommended additional cuts to production during the second quarter of this year to address the fall in demand resulting from the health emergency affecting China.
However, the announcement of the Chinese government to halve the tariffs on US$75 billion of U.S. products bolstered a renewed optimism in the financial markets, largely reverting the stock markets' drop and, to a lesser extent, that of commodity prices.

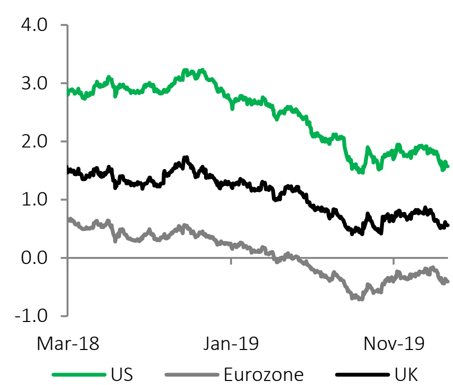
In turn, global manufacturing activity increased again in January and was slightly above the expansion pivot. The consolidation of this sector's recovery will be highly determined by the extent of the effects of the coronavirus on the Chinese economy and on global value chains, as well as by the development of protectionist measures among the major economies.

Graph 1: International Stock Exchanges (index 100 = Aug 19)



Source: Bloomberg and Santander

Graph 2: Government rates, 10 years (%)



Source: Bloomberg and Santander

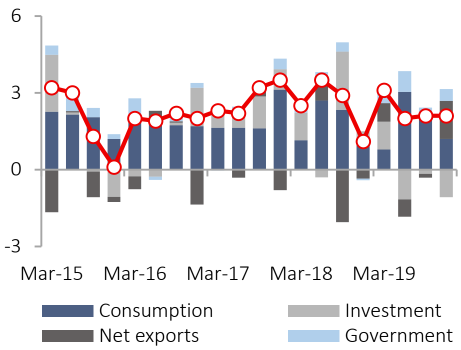
The U.S. closed 2019 with a growth of 2.3%, in line with what was expected.

In the United States, 4Q19 growth was slightly higher than expected (2.1% vs. 2%). Net exports boosted expansion –mainly due to a sharp drop in imports– while consumption showed a slowdown and investment remained contained. With this, the GDP expanded 2.3% in 2019, in line with our estimate.

The consumption deflator that excludes food and energy (the Fed's preferred inflation measure) fell noticeably in the fourth quarter (1.3% QoQ vs. the expected 1.6%), which is consistent with the loss of consumer dynamism and confirms the low inflationary pressures in this economy. Meanwhile, the labour market remained dynamic during January, and there was a non-agricultural employment creation of 225 thousand jobs, over the 160 thousand expected, while the unemployment rate increased to 3.6%.

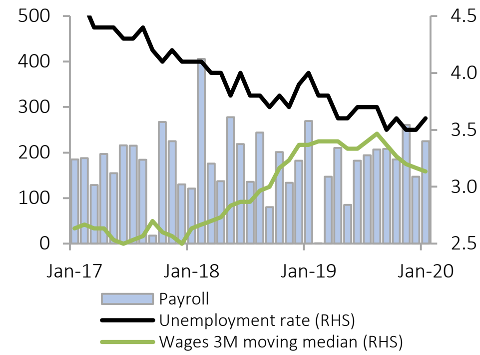
The Federal Reserve –during its January meeting– decided to maintain its range for the reference rate stable, as was widely anticipated by the market. While we assess that the federal funding rate will remain unchanged throughout the year, a low inflation and a slowdown in the economy could open the doors to a possible cut in the year.

Graph 3: United States GDP (%)



Source: Bloomberg and Santander

Graph 4: U.S. labour market (thousands, %)



Source: Bloomberg and Santander

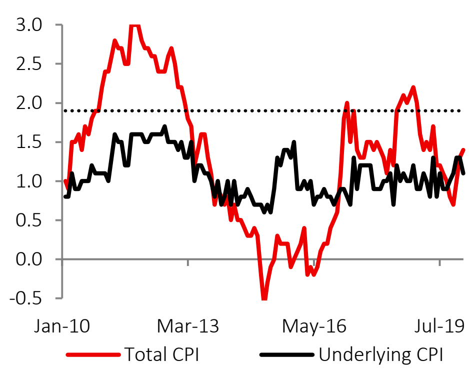
The Eurozone expanded by 1% in 4Q19, slightly below market expectations for the quarter (1.1%). With this, the GDP of the year grew 1.2%, less than the 1.5% we had projected at the beginning of 2019.

Manufacturing activity in the Eurozone shows emerging signs of recovery, although it remained in a pessimistic area.

Business confidence continues to improve, although inflation remains elusive. In January, prices grew 1.4% YoY, in line with expectations, while the underlying measure retreated to 1.1%, below survey expectations and far from the European Central Bank's target. Manufacturing activity in the first month of the year, meanwhile, increased slightly above expectations, although still pessimistic. The development of trade tensions with the U.S. will determine whether this incipient recovery will gather strength or abate, as the automotive sector would be one of the most vulnerable to a possible tariff imposition by Trump's administration.

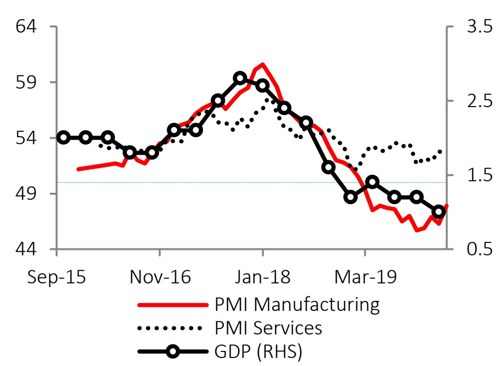
On January 31, the United Kingdom's departure from the European Union (EU) took effect, after three years of negotiations and almost half a century of being a member of the European community. A transitional period is in place until December 31, 2020, which could be prolonged for up to one more year. The United Kingdom must continue to respect European laws, although it will have no say in the community institutions.

Graph 5: Inflation in the Eurozone (%)



Source: Bloomberg and Santander

Graph 6: GDP and activity indicators (Neutral Index = 50, %)



Source: Bloomberg and Santander

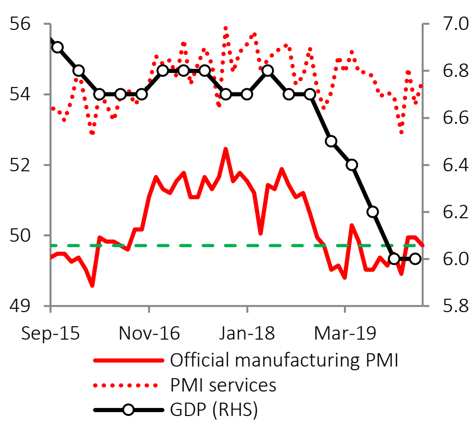
China expanded 6.1% during 2019, slightly below what we projected at the beginning of that year. The trade conflict alongside a weakened external sector and a less dynamic manufacturing industry explain this meagre performance, the lowest in almost 30 years.

As mentioned in the 2020 Outlook, our annual report, we expect China to decelerate up to 5.9% this year. However, this projection has a downward bias, which we will review further on. The interruption of some crucial productive activities caused by the health emergency, less confidence, and tighter financial conditions will have a negative effect on this year's activity. If the virus is quickly contained, and there is progress in the search for effective treatment, the downward revision in growth will be less.

Monetary authorities have already taken steps to preserve liquidity in the financial markets. The injections of net liquidity as of this year far exceeds that of previous years, which reflects the concern of the government to mitigate the effects of the coronavirus on the economy. For the same reason, additional fiscal incentives are expected to boost the economy.

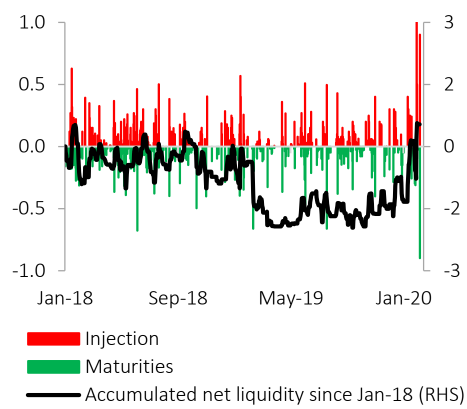
In this context, the manufacturing sector in China –measured by the official PMI– declined up to 50 points during January, right at the pivot level of the indicator. Meanwhile, the service sector continues to be dynamic and settled above market expectations (54.1 vs. 53).

Graph 7: China PMI and GDP (neutral = 50, %)



Source: Bloomberg and Santander

Graph 8: People's Bank of China (PBoC) Liquidity injections (billion CNY)



Source: Bloomberg and Santander

For Latin America, we are expecting a recovery throughout this year, driven primarily by Brazil. Nonetheless, the activity figures for the latter ranked below expectations in January, although they reflected progress in relation to the previous month. Industrial production stood at -1.2% YoY, while the manufacturing PMI drifted to optimistic grounds (51 points). Regarding the monetary policy, the Central Bank of Brazil reduced the rate to 4.25% (-25bps), in a context in which inflation remains contained.

A faster than expected recovery

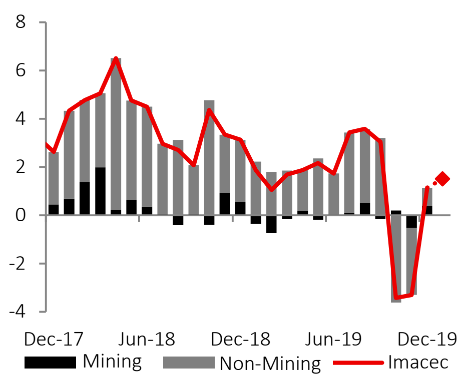
The December's Imacec expanded by 1.1% YoY, well above expectations. The contribution of the mining sector was particularly substantial, with an annual variation of 3.7%, after a contraction of 5.1% in November. Still, the growth of non-mining sectors by 0.8% YoY was also well above expectations. Considering these results, the GDP growth would have been 1.2% during 2019.

The monthly variation of the Imacec is the largest since April 2010, after the earthquake.

Meanwhile, the monthly variation in the seasonally adjusted series increased by 3.5%, the largest since April 2010, after the earthquake. Like this, the recovery of the economy in the aftermath of the social upheaval would be somewhat faster than initially anticipated. This would also be reflected in business expectations which, although still in a pessimistic zone, have had a recovery of more than eight points, according to the Monthly Indicator of Business Confidence (MIBC).

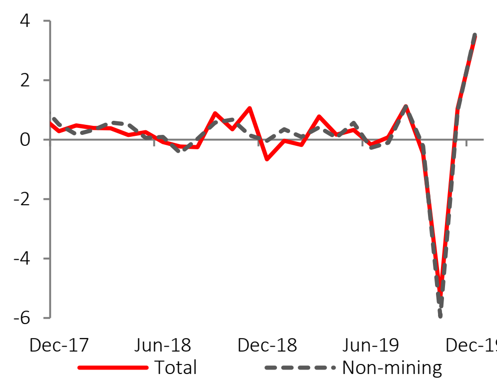
Nevertheless, it has been observed that the sectors that have been supporting the economy in recent times have rotated from services to construction –by the inertia of projects already underway– and the manufacturing industry, supported by a more depreciated exchange rate. Nevertheless, the activity will still have to go through a normalization period, and new disruptions cannot be ruled out in the future.

Graph 9: Imacec and sectors (annual var., %)



Source: BCCh and Santander

Graph 10: Seasonally adjusted Imacec (monthly var., %)



Source: BCCh and Santander

Businesses point to project deferral; low recruitment intentions; marginal cost increase; and narrow credit.

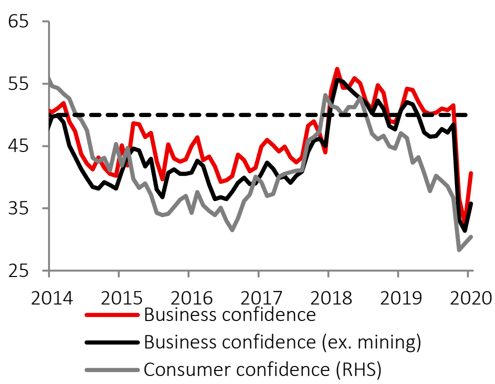
According to the latest Business Perceptions Report by the Central Bank, businesses have difficulties calibrating the consequences of social upheaval in general, and there is a high level of uncertainty regarding the outlook for 2020.

The report shows that the most affected sectors were those linked to tourism, hotels, and commerce, along with construction and real estate activities. Conversely, mining and the salmon industry have remained stable without further inconvenience. Overall, the majority of survey respondents are concerned about what could happen during March and April, in particular due to (i) fears that episodes of violence may emerge again, (ii) uncertainty about the outcome of the constitutional referendum, and (iii) questions regarding the progress of the Government's agenda.

A significant part of the respondents has decided to postpone investments. It should be noted however, that the large mining, forestry and salmon farming projects already underway will retain their drive. Meanwhile, people interviewed indicated that they are not hiring, while some sectors reported dismissals. In fact, they do not rule out a further reduction in staffing, depending on how the country's situation develops.

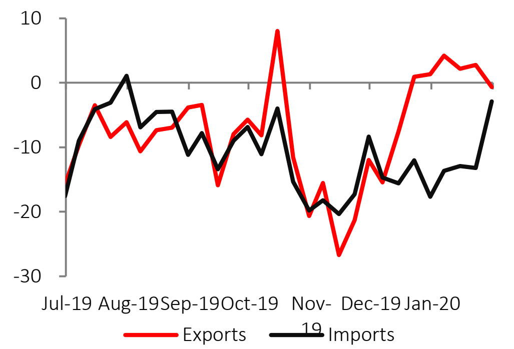
While facing a weak domestic demand, the external sector is showing a distinct recovery. Copper exports showed a sharp increase of 8.3% YoY during January, and although the total exports declined by 0.7% YoY, there has been a stronger dynamic in recent months. Meanwhile, imports recorded a 2.9% decline YoY, the tenth fall to happen within the last 12 months. We expect a greater contribution from the external sector this year, which would add around 1 percentage point of growth to the GDP, encouraged by a more depreciated exchange rate and a more favourable external scenario.

Graph 11: Imacec and sectors (annual var., %)



Source: Icare, GfK, and Santander

Graph 12: Weekly Foreign Trade (annual var., % - moving month)



Source: BCCh and Santander

The relevance of self-employment is increasing

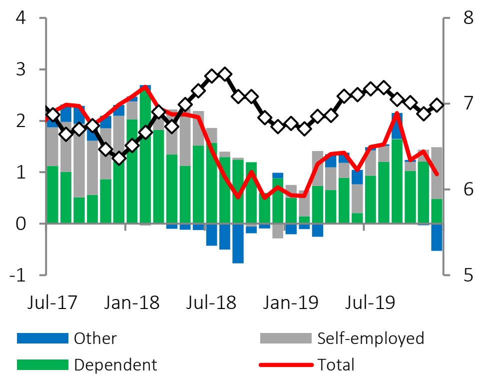
The labour market shows signs of deterioration.

The unemployment rate for the October-December period reached 7% and, although it placed three decimals over the same period in 2018, it was a positive surprise, as the social upheaval was expected to have a somewhat more significant impact on this indicator. Employment, in turn, expanded by 1% YoY (slowing down by 1.4% over the previous period), mainly influenced by the self-employed component that registered its greatest expansion since May 2018 (4.7% YoY), while wage employment grew only 0.5%.

In line with these results, there has been an unprecedented increase in the dismissals linked to company needs –registered by the Labour Office, which in January reached 132 thousand, more than trebling the records of an average month (around 40 thousand). Thus, the greater relevance of self-employment, as measured by the INE, would be explained in part by the transit to the informal sector of some dismissed workers.

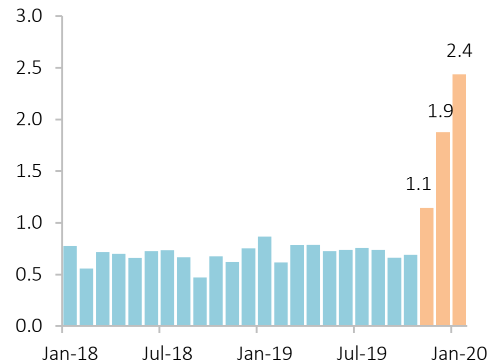
Meanwhile, the remuneration index closed 2019 with a nominal expansion of 4.5% YoY, which compares favourably with the 3.8% YoY recorded at the end of the previous year. However, given that inflation was 3% during December, the increase in real wages only rose from 1.2% in December of 2018 to 1.4% in December of 2019, around the historical minimums of this indicator.

Graph 13: Employment by category and unemployment rate (annual var. % and %)



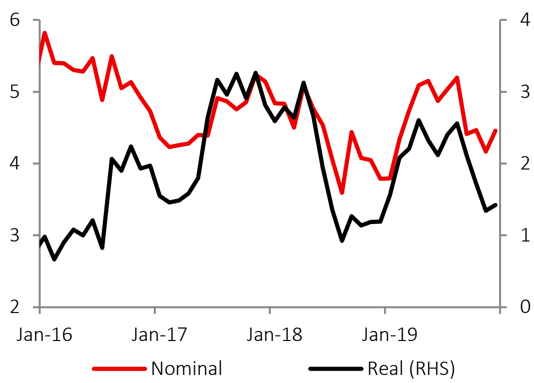
Source: INE and Santander

Graph 14: Dismissals due to company needs informed to the Labour Office (%of Social Security contributors)



Source: Labour Office, SPensiones and Santander

Graph 15: Compensation Index (annual var. %)



Source: INE and Santander

Local assets depreciate in line with the international trend

During January, local assets were affected by the international trend and fears regarding the impact of coronavirus on the Chinese economy. The local stock index IPSA retreated alongside the higher risk aversion in global markets, and at this report's conclusion, it accrued a slightly positive variation since early January.

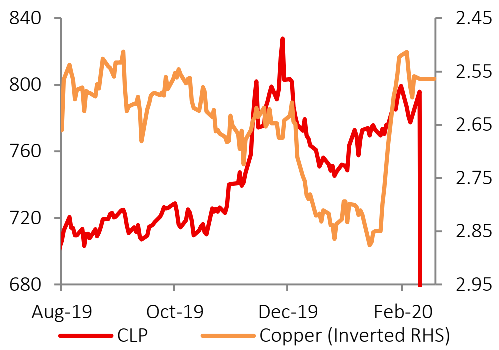
The exchange rate could be around $770 at year end.

Meanwhile, the exchange rate suffered more and depreciated in line with the regional currencies and other commodity-exporting economies. The depreciation of the Peso was around 6%, while the price of copper accumulated a decline of almost 10%. Fears that local exports will be affected by the coronavirus emergency, along with isolated disruptions to domestic public order, have also influenced in keeping the exchange rate depreciated over the last few days.

Non-residents in the forward dollar exchange market presented a buyer flow -outflow of the local market of about US$ 3 billion. Furthermore, liquidity conditions in local currency and in dollars remain stable and at levels prior to the onset of the social upheaval.

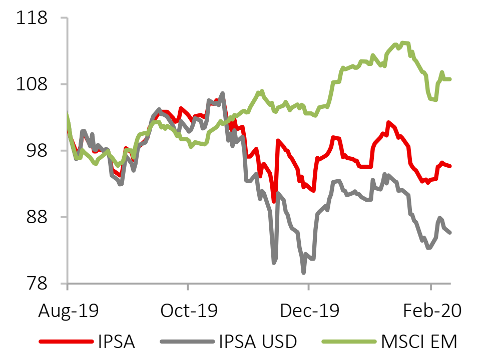
Interest rates showed greater stability. Government bond yields in Peso currency tended to rise, while rates in Unidad de Fomento (UF or Unit of Development) declined notably in the short term, and in line with higher inflation prospects. Furthermore, sovereign credit risk, measured by the five-year CDS, increased by just under 10 bps and currently stands at 48 bps, slightly above Peru's level.

Graph 16: Exchange rate and copper ($/US$, US$/lb.)



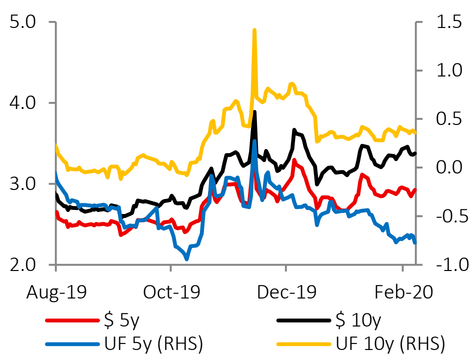
Source: Bloomberg and Santander

Graph 17: Local Stock Exchange (index 100 = Aug.18)



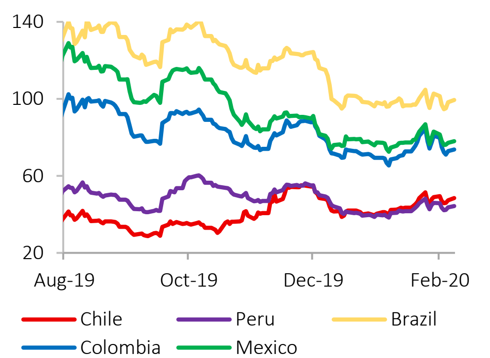
Source: Bloomberg and Santander

Graph 18: Nominal bond rates (%)



Source: Bloomberg and Santander

Graph 19: Latin American 5-years CDS (bp)



Source: BCCh and Santander

Higher inflation was driven by the exchange-rate depreciation and increases in specific products

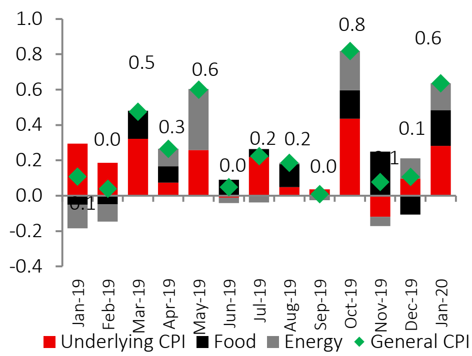
January's inflation settled at 0.6%. This increase was mainly caused by tourist packages (10.4% MoM), Interurban buses (9.7% MoM), and electricity (3% MoM). Depreciation of the exchange rate bolstered the evolution of tradable goods up to 4.4% YoY, while services varied 4% YoY.

Inflation in December 2020 should be 2.6%.

Drops in clothing, airfare, and hotels, however, indicate that the activity remains weak within the trade and services sectors. The lower dynamism of these sectors could prevent the complete pass-through of the exchange rate on prices, which would moderate inflation from the start of the second quarter. The prices of non-tradable goods remained stable, as did the underlying inflation, with both figures standing at 2.5% YoY.

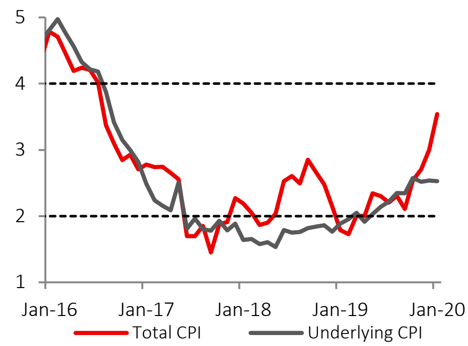
For this year, we expect inflationary registers of over 3% during the first part. However, we assess the CPI will accumulate a 2.6% variation by December, in line with the economy's more significant capacity gaps and the freezing of some regulated tariffs.

Graph 20: CPI (annual var., %)



Source: BCCh and Santander

Graph 21: General and underlying CPI (annual var. %)



Source: BCCh and Santander

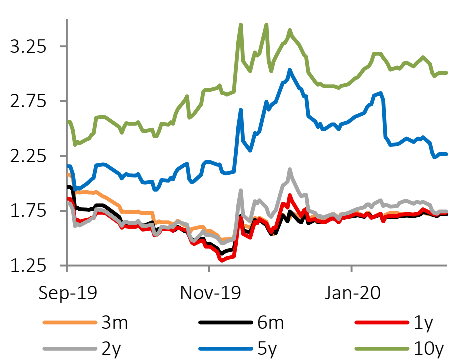
January's Monetary Policy Meeting was held without surprises

As expected, the Central Bank maintained its Monetary Policy Rate (MPR) at 1.75%. In their statement, the Central Bank highlighted a partial improvement to the external conditions, although they mentioned that the coronavirus emergency in China has impacted risk premiums and particularly affected the price of copper. At a domestic level, they recognized that inflation placed below the projected figure of the Monetary Policy Report and they maintain an ambiguous outlook of the future by indicating there are opposing forces that will impact prices.

The MPR should remain unchanged throughout this year.

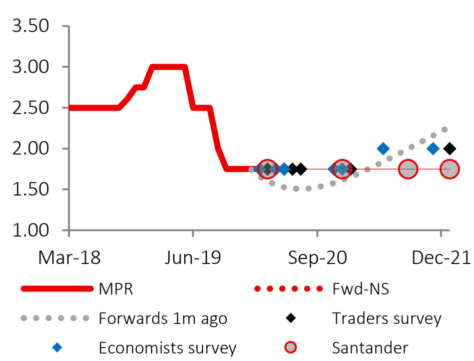
In the short term, we expect no changes to the MPR. The Central Bank has noted that for the duration of their intervention period –until May, in principal– a cut to the MPR would be inconsistent. Furthermore, the current weakness of the economy rules out raises to the rate. Once their intervention period concludes, cuts to the MPR could be considered. However, **we assess that the Council will be particularly cautious with its forthcoming moves. In a scenario of higher financial price sensitivity, a rate adjustment could induce greater volatility, which would be counterproductive to the initiative of providing a greater drive.**

Graph 22: Nominal swap rates (%)



Source: Bloomberg and Santander

Graph 23: MPR expectations (%)



Source: Bloomberg and Santander

The fiscal deficit was 2.8% of the GDP

Public expenditure grew by 4.2% in 2019.

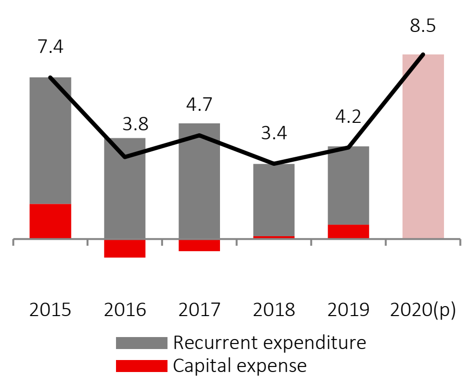
Real government expenditure grew by 4.2% in 2019, registering a slight over-execution over the approved budget (100.3%). Both current and capital expenditure grew at similar rates, with the latter having a higher boost in the second half of the year.

Conversely, the revenues were adversely affected by the weakness of domestic demand and the high bases of comparison, which contracted by 1.1% over 2018's figures. Non-mining tax revenues and Codelco's contributions had a negative impact on the result of the year. Thus, the actual fiscal deficit concluded 2019 preliminarily at 2.8% of the GDP; several points over the estimated 2.2% in September and almost a point over the 1.9% projected in the Budget design during September 2018.

The fiscal deficit could reach 4.4% of the GDP by 2020.

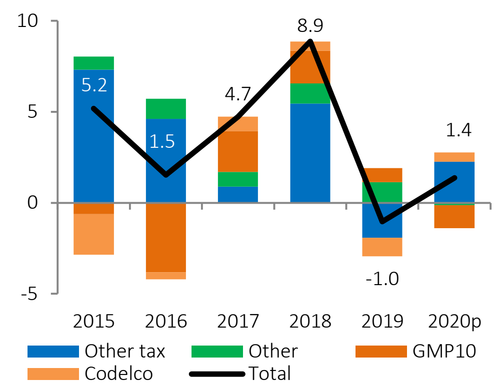
With the expenditure level for 2020 announced by the Government in its latest Public Finances Report –which incorporates the stimulus package, additional to the Budget's coverage– fiscal expansion could reach 8.5% this year. According to our estimates, revenues will grow by 1.4%. With this, the deficit could reach up to 4.4% of the GDP. In the near future we foresee low possibilities of reducing the structural deficit at the speed the government promised, so the debt will grow faster and be somewhat above 40% of GDP by 2024.

Graph 24: Government expenditure (annual var., %)



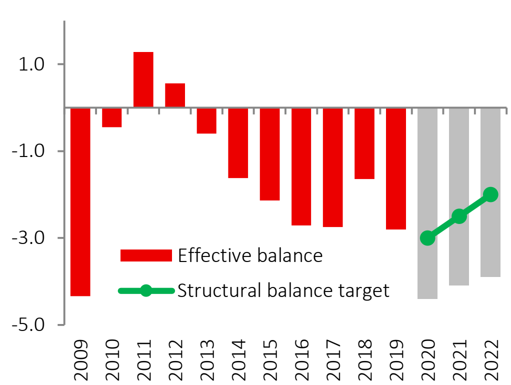
Source: Dipres, Ministry of Finance and Santander

Graph 25: Fiscal income (annual var., %)



Source: Dipres, Ministry of Finance and Santander

Graph 26: Fiscal effective balance and structural target (% GDP)



Source: Dipres, Ministry of Finance and Santander

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MACROECONOMIC PROJECTIONS

National Accounts	2014	2015	2016	2017	2018	2019 P	2020 P
GDP (real var. % YoY)	1.8	2.3	1.7	1.3	4.0	1.2	1.0
Internal demand (real var. % YoY)	-0.5	2.5	1.8	2.9	4.7	0.8	-0.7
Total consumption (real var. % YoY)	2.9	2.6	3.4	3.2	3.7	1.8	1.5
Private consumption (real var. % YoY)	2.7	2.1	2.6	3.0	4.0	1.7	0.9
Public consumption (real var. % YoY)	3.8	4.8	7.2	4.4	2.2	2.2	4.4
Gross fixed capital formation. (real var. % YoY)	-4.8	-0.3	-1.3	-2.7	4.7	3.1	-4.0
Public expenditure (var. real % YoY)	6.3	8.4	3.8	4.7	3.4	4.2	8.2
Manufacturing production (var. real % YoY)	-0.7	0.2	-1.1	1.8	3.9	-0.2	0.4
Exports (var. real % YoY)	0.3	-1.7	0.5	-1.1	5.0	-1.6	3.0
Imports (real var. % YoY)	-6.5	-1.1	0.9	4.7	7.6	-2.6	-3.0
GDP (US$ billions)	260.6	244.3	250.6	277.9	298.8	281.6	268.8
GDP per capita (US$ thousands)	14.6	13.6	13.8	15.1	15.9	14.8	13.7
Population (millions)	17.8	18.0	18.2	18.4	18.8	19.1	19.4

Balance of Payments	2014	2015	2016	2017	2018	2019 P	2020 P
Trade balance (US$ billions)	6.5	3.4	4.9	7.4	4.7	4.2	10.3
Exports (US$ billions)	75.1	62.0	60.7	68.9	75.5	69.7	71.5
Imports (US$ billions)	68.6	58.6	55.9	61.5	70.8	65.5	61.2
Current account (US$ billions)	-4.3	-5.6	-4.0	-6.0	-9.2	-8.4	-4.3
Current account (GDP%)	-1.7	-2.3	-1.6	-2.1	-3.1	-2.9	-1.6
Price of copper (annual average, US$/lbs.)	3.11	2.50	2.21	2.80	2.96	2.74	2.85
WTI oil price (annual average US$/bbl.)	93.1	48.7	43.2	51.0	64.5	57	61

Source: BCCh, INE, and Santander
Note: Reference year for national accounts = 2013

MACROECONOMIC PROJECTIONS

Exchange rate and Monetary Market	2014	2015	2016	2017	2018	2019	2020 P
CPI Inflation (var. YoY, % by December)	4.6	4.4	2.7	2.3	2.6	3.0	2.6
CPI Inflation (var. YoY, average %)	4.7	4.3	3.8	2.2	2.4	2.3	3.1
IPC-SAE inflation (var. YoY, % by December)	4.3	4.7	2.8	1.9	2.3	2.5	2.3
CLP/US$ exchange rate (year's exercise)	607	707	667	615	696	745	770
CLP/US$ exchange rate (year average)	570	654	677	649	640	703	772
Monetary policy rate (year's exercise, %)	3	3.5	3.5	2.5	2.75	1.75	1.75
Monetary policy rate (%, year average)	3.75	3.06	3.5	2.7	2.52	2.48	1.75

Fiscal Policy Indicators	2014	2015	2016	2017	2018	2019 P	2020 P
Central Government balance (% GDP)	-1.6	-2.2	-2.7	-2.8	-1.7	-2.8	-4.4
Central Gov. gross debt (US$ billions)	36.6	39.0	53.3	69.0	70.2	74.4	83.9

Source: BCCh, INE, and Santander

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