OCTOBER MONTHLY ECONOMIC OUTLOOK
October 14, 2020

Recovery process continues

The Imacec rose again in August, albeit less than anticipated. Several factors suggest that in September we will see a more substantial rise. Worldwide, outbreaks of the pandemic continue to be a source of concern.

Highlights

- The easing of lockdown measures and the liquidity injections households received have allowed the recovery process to continue. Although August's Imacec rose less than anticipated (2.8% MoM), good figures are expected for the rest of the year, which would result in the economy closing with a contraction of between 5% and 6%.

- The labour market showed a slight recovery in August, driven by the easing of lockdown measures. The unemployment rate fell to 12.9% but could rise again as the labour force recovers faster than employment.

- The CPI for September (0.6%) was higher than expected due to a substantial expansion in consumption. Although inflation was above the target (3.1%), we estimate that this will be a transitory effect as the capacity gaps remain wide open.

- Local asset prices are affected by idiosyncratic factors. Despite the recovery in the price of copper, the Peso depreciated again in recent weeks, while the IPSA made a very timid advance, smaller than other stock markets in the region.

- The Government's budget proposal plans to maintain a significant volume of expenditure over the next year, in line with the political agreement set in June. Regardless of a substantial upturn in revenues, the deficit will remain high.

- The recovery of the global economy has continued, but at a slower pace due to new pandemic outbreaks. Optimistic data in China and the potential for further fiscal stimulus has encouraged markets. In this context, the IMF revised its GDP projection for the year upwards from -4.9% to -4.4%.

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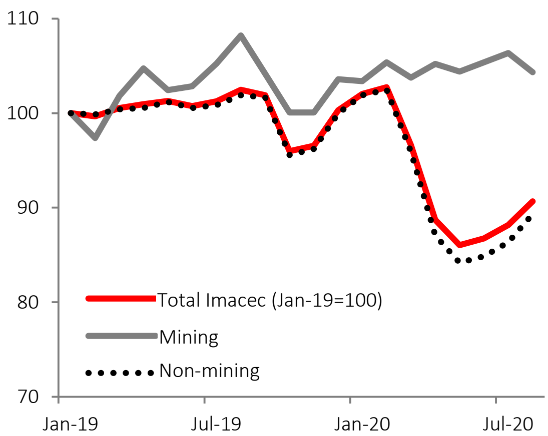
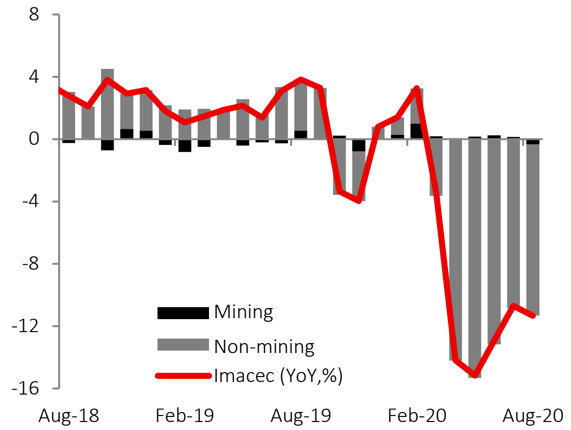
During August, the activity measured by the Imacec showed some recovery (2.8% compared to July, -11.3% YoY), but less intense than expected. In the month, the easing of lockdown measures began to materialize, mobility increased, and the injection of liquidity through the withdrawal of pension funds and fiscal subsidies gave a healthy boost to consumption. In fact, the National Institute of Statistics (INE) data showed that retail trade was more than 30% higher than in July and was even higher than before the pandemic. The negative surprises came from the mining sector, which contracted after several months of healthy records, the manufacturing industry, which showed slower-than-expected progress, the construction sector, and some services still affected by social distancing measures.

Activity continued to recover in August, but at a slower pace than expected



Non-seasonal series
Source: BCCh and Santander

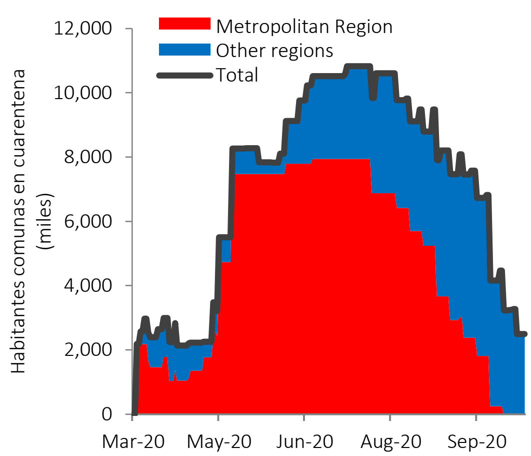
Annual variation in the Imacec declined, influenced by a more demanding comparison basis



Source: BCCh and Santander

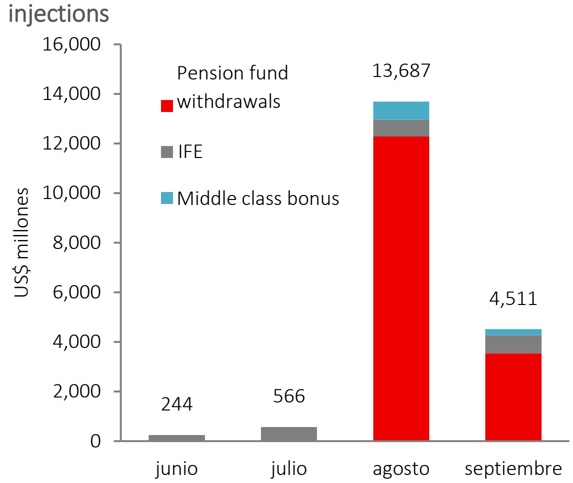
Despite this, we will continue to see improvements in activity in future records due to several factors. On the one hand, the easing of lockdown measures has continued, and the percentage of the population subject to quarantine has fallen considerably. This has been reflected in the mobility, which, according to Apple's indicators, is already over 70% of what would be a normal situation.

Easing of lockdown continues



Source: Ministry of Health and Santander

Households recently received significant liquidity injections

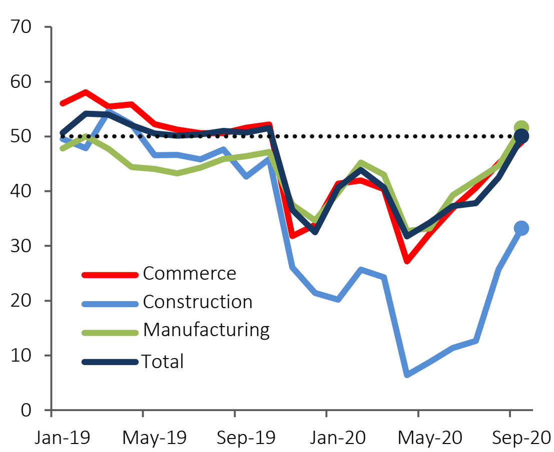


Source: Ministry of Finance, S. Pensiones, and Santander

On the other hand, the liquidity shock provided by the withdrawal of pension funds and government subsidies is to be considered. According to the Superintendency of Pensions records, nearly US$ 16 billion had been delivered by the end of September, equivalent to 6% of GDP, with an average amount of $1.4 million for almost 10 million people. Added to this are the amounts from the Government's Emergency Family Income, which in July reached US$ 690 million and in August US$ 735 million. This strong injection of resources will continue to boost consumption until the end of the year.

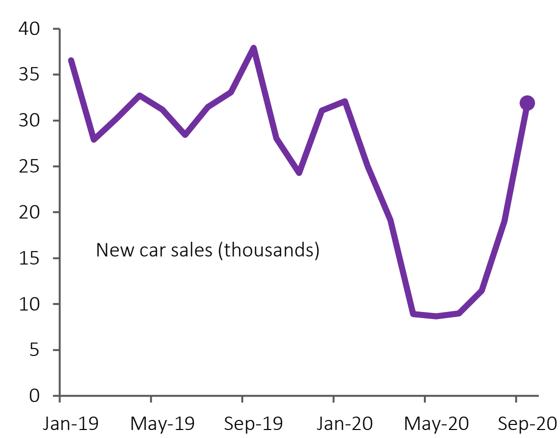
By September, some indicators are already showing a more robust recovery. New car sales rose sharply to pre-pandemic levels, electricity generation advanced after falling in August, and business confidence, as measured by the IMCE, reached its highest level since October last year. It is worth noting that the perception of the country's situation is slightly optimistic (50.4). This comes in addition to improved foreign trade data: exports grew by 3.7% YoY (vs. -10.8% in August) favoured by a high copper price, and imports contracted less intensely than in previous months (-12.6% YoY vs. -22.4% in August). Given this background, we expect a monthly increase in the Imacec of just over 5% compared to August, which would imply an annual variation of around -6%.

Business confidence returns to neutral ground



Source: Icare-UAI and Santander

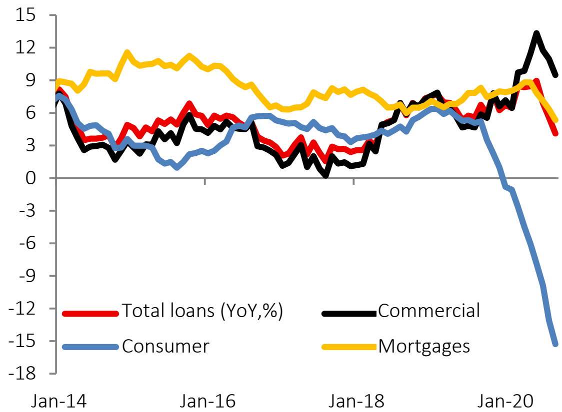
Car sales rise sharply to pre-pandemic levels



Source: ANAC and Santander

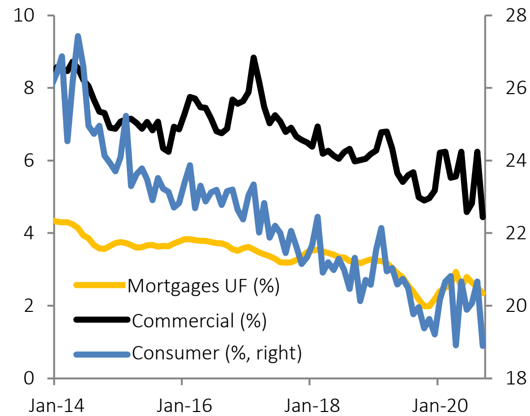
Commercial loans have continued to expand, but there has been a loss of momentum in recent months. This is because investments still remain minimal and companies that were supported at the pandemic's beginning to safeguard their liquidity no longer need as much funding. Consumer credit has continued to fall, but indicators of non-performing loans declined due to increased liquidity among individuals. Mortgage loans have also slowed down, reflecting the lower demand for housing since the pandemic struck.

Loans slow down for the second month in a row



Source: BCCh and Santander.

Average loan rates fall again



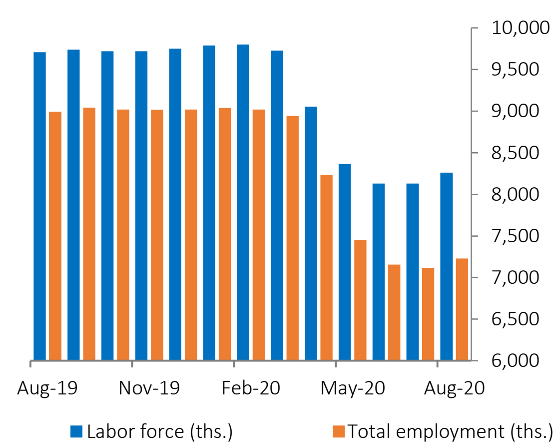
Source: CMF and Santander.

We maintain our outlook for the year of a GDP contraction ranging between -5% and -6%. This is given the assumption that the easing of lockdown measures will continue and that there will be no significant resurgences of the pandemic that would require the reinstatement of strict quarantine measures.

The labour market shows the first signs of improvement

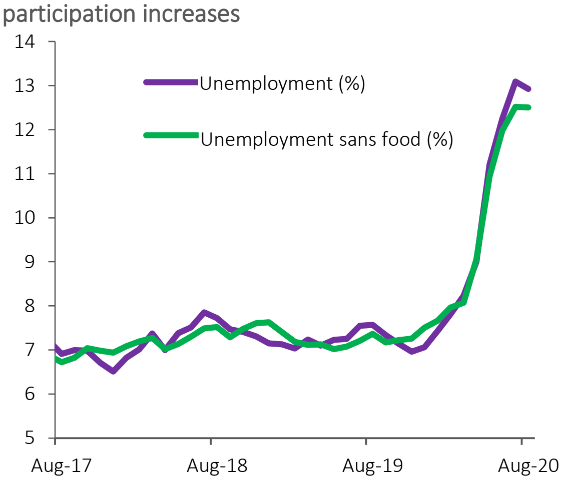
After successive falls since the beginning of the pandemic, there was an increase in employment (120,000 jobs) during August. The workforce also rebounded, although somewhat less intensely. As a result, the unemployment rate declined marginally (12.9% vs. 13.1% the previous month). Thus, the labour market's progress remains restricted, considering the almost two million jobs lost between February and July.

Labour force rebound was less than expected



Source: INE and Santander

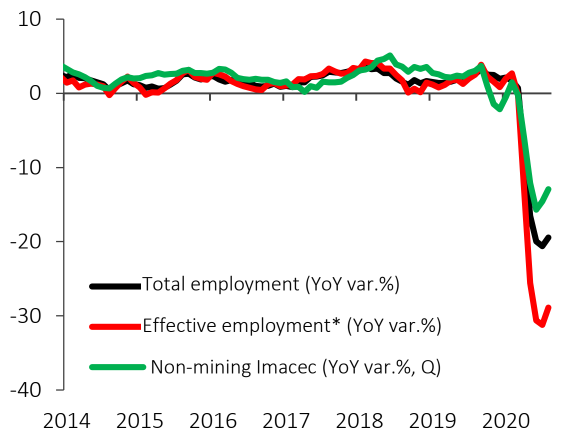
Unemployment stabilizes but could rise as participation increases



Source: INE and Santander

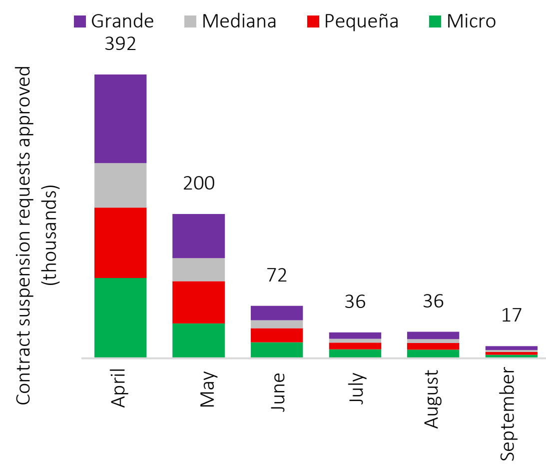
In the future, as the economy recovers and lockdowns are lifted, we will continue to see a recovery in employment. The easing of lockdown measures will also mean that workers with suspended contracts can return to their activities, which will not impact total employment, but actual employment –which excludes absent workers. According to the latest report from the Superintendency of Pensions, more than 750,000 workers have been under some form of the Employment Protection Law approved as of September 27th. But in recent months, the flow of new workers under this program has significantly reduced. According to a report by the Ministry of Labour released on September 20th, some 410,000 workers have already returned to work.

A significant gap remains between activity and actual employment



Note: Effective employment excludes absent employees.
Source: INE and Santander

The rate of new workers assigned to employment protection decreases



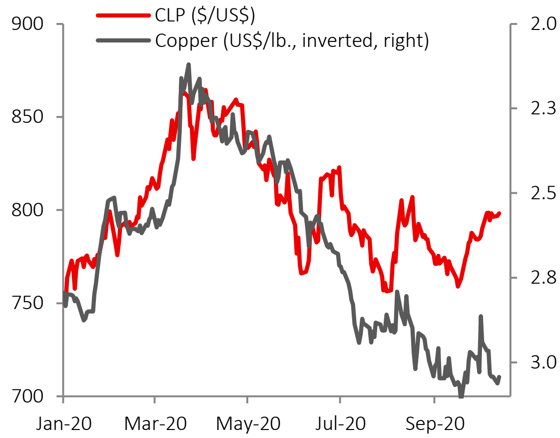
Source: SPensiones and Santander

The August wage index remained at similar levels to those of previous months, with an annual increase of 2.9% (0.4% in real terms). Meanwhile, the minimum wage readjustment continues to be discussed in Congress after the Government's initial proposal was not successful. The Government's latest indication poses an increase of $6,000 (+1.9%) with a further revision in April. The bill was approved by the Senate but may have to be discussed in a Joint Committee as it does not have enough support in the Chamber of Deputies.

Local assets lose value

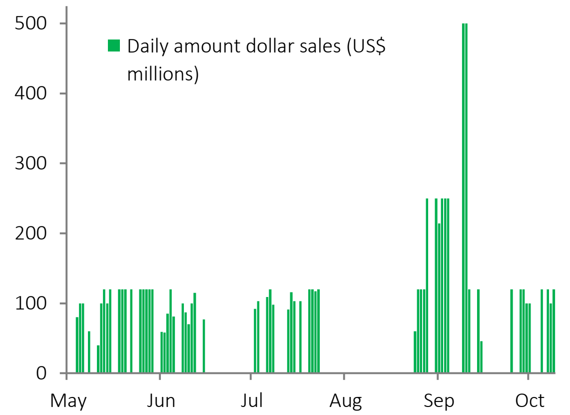
After appreciating until mid-September, the Peso has depreciated in recent weeks, trading at around $800, notwithstanding the sharp rise in the price of copper and the global weakness of the dollar. The fluctuations of the Peso are explained by the uncertainty in the wake of the constitutional referendum and the Ministry of Finance's slower pace of dollar sales.

The recent depreciation in the exchange rate due to local factors



Source: Bloomberg and Santander

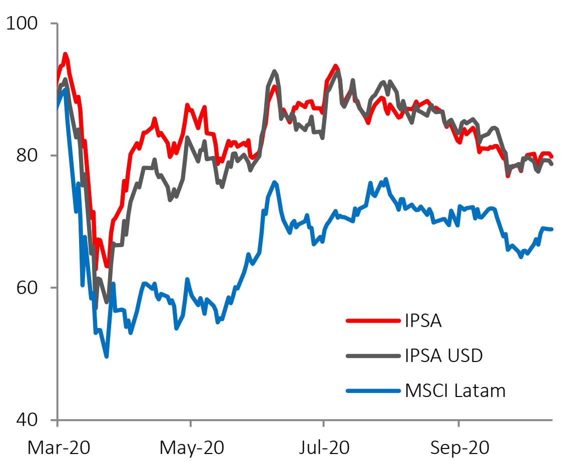
Ministry of Finance has slowed down its pace of dollar sales



Source: Bloomberg and Santander

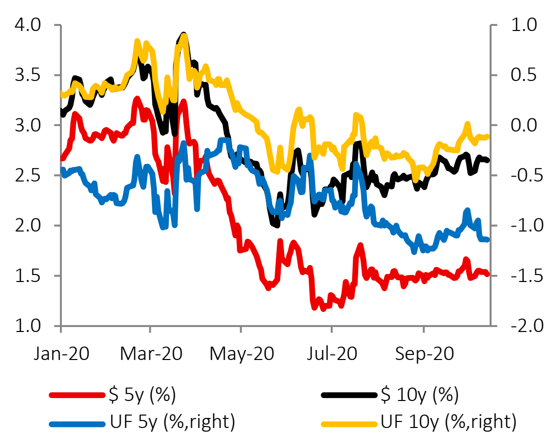
However, the local stock index IPSA has made a shy recovery after reaching a low of around 3,500 points at the end of September. This increase has been smaller than that of the region's stock markets, which reveals that the factors influencing the exchange rate have also impacted risky assets. Long-term interest rates have partially reversed the hikes observed towards the end of September and remain close to historical lows in the case of real rates.

IPSA has performed worse than the stock markets in the region



Source: Bloomberg and Santander

Real long-term rates remain at around historical lows



Source: Bloomberg and Santander

A substantial increase in the CPI reflects the impact of measures that support household consumption

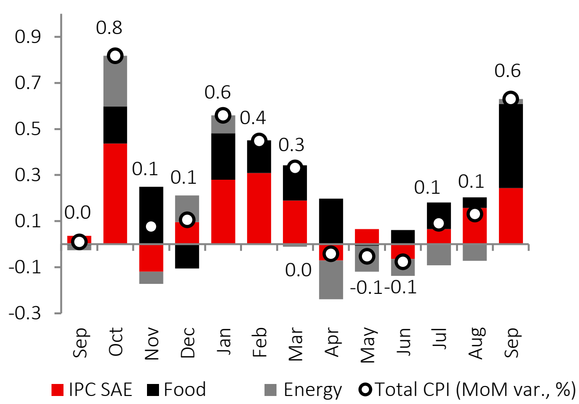
September's CPI (0.6% MoM) was substantially higher than what a sizeable part of the market expected (Bloomberg: 0.3%; EEA: 0.2%; EOF: 0.3%; forwards: 0.4%) and somewhat above our estimate (Santander: 0.5%). Explaining this record were increases in food (1.8% MoM), mainly in meat and vegetables; household equipment (1% MoM), and clothing (1.7% MoM). Beyond some seasonal factors during September - more pronounced this year - these increases reflect the consumption momentum resulting from the liquidity injections that households have received. We had already indicated some time ago that one of the consequences of the pension fund's withdrawal would be the increased price pressures (see Technical note: Macroeconomic impact of pension fund withdrawal). Services had a restricted increase, and their annual variation (1.7%) remained below the Central Bank's tolerance range. Excluding food and energy prices (IPCSAE), the month rose by 0.3%. As a result, the CPI's annual variation grew up to 3.1%, while core inflation rose to 2.2%.

Worthy of note is that the price allocation rate remained high (28.2%) and had a particularly strong impact on clothing and household equipment prices this month. Nevertheless, it is unclear what bias could have been introduced in the measurements.

In the future, we anticipate a moderation in price growth. Those items that suffered hikes due to seasonal factors should have some reversal during October. Nevertheless, the pressures caused by the consumption drive will remain for some time. Added to this are specific factors such as the reversal in the stamp tax (0.1pp incidence) and the fact that the exchange rate has tended to depreciate in recent weeks. Thus, we estimate that October's CPI will have a variation of around 0.2% MoM. Hence, we anticipate that we will close the year with an inflation of 2.3%, close to what the Central Bank projected in its last Monetary Policy Report (IPoM).

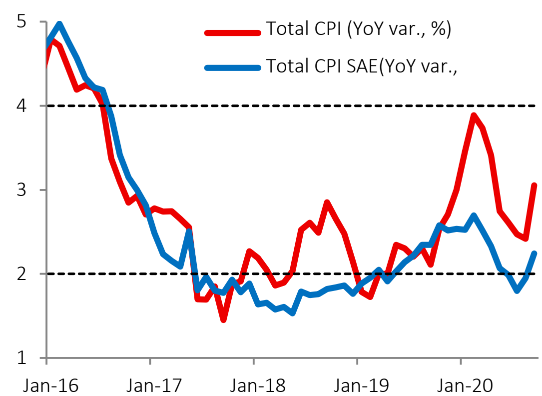
In the medium term, the large gaps in the economy will continue to restrain price hikes. Therefore, we expect inflation to fall back below the 3% target during 2021 and to converge towards this level only during 2022.

The increase in prices was driven by food



Note: SAE= sans food and energy
Source: INE and Santander

On an annual basis, inflation returns to around 3%, but core inflation remains low



Source: INE and Santander

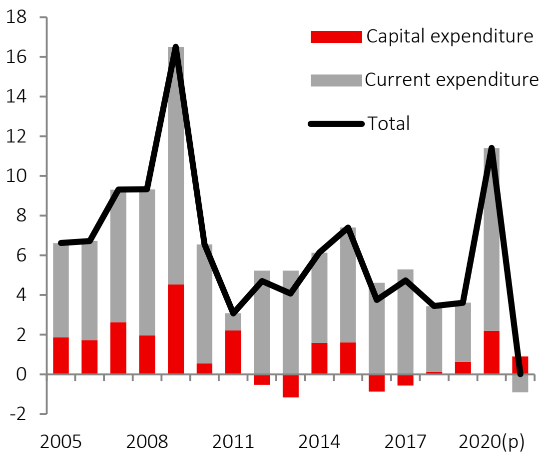
The fiscal budget for 2021 is part of the political agreement undertaken in June

In early September, the Government submitted the 2021 budget bill to Congress, which entails a total expenditure of US$ 73.3 billion. The figure represents a real increase of 0% with respect to the Ministry of Finance's estimate for 2020, which, in turn, is equivalent to a rise of 11.4% in contrast to actual expenditure in 2019. In 2021, the highest level of fiscal spending in 2020 - which has been boosted by the measures to tackle the economic crisis resulting from the Covid-19 - would be maintained, resorting to the Transitory Emergency Fund. The amount of the latter would be US$

5.225 billion (7% of the budget), which shows the magnitude of the exceptional measures, and shows how much spending could fall back once they are exhausted.

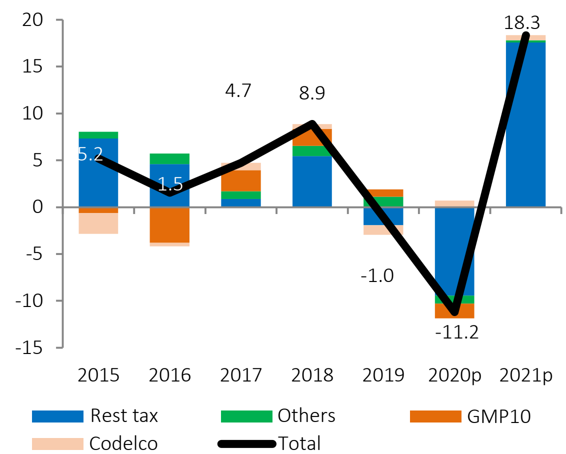
Alongside the budget proposal, the Public Finance Report was presented, according to which tax revenues would contract by 11.2% this year and expand by 18% in 2021. While the recovery in revenues next year is consistent with the increased buoyancy expected for the economy and the reversal of some tax relief measures implemented this year, we believe that the Public Finance Report (IFP) projection may turn out to be somewhat optimistic.

The budget proposal implies keeping expenditure constant



Source: Dipres and Santander

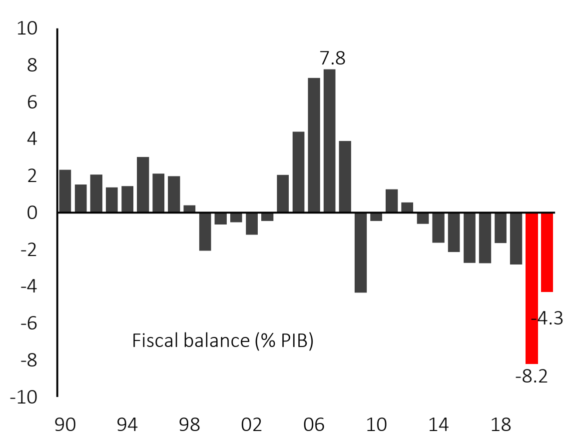
Official projection points to a strong rebound in revenue



Source: Dipres and Santander

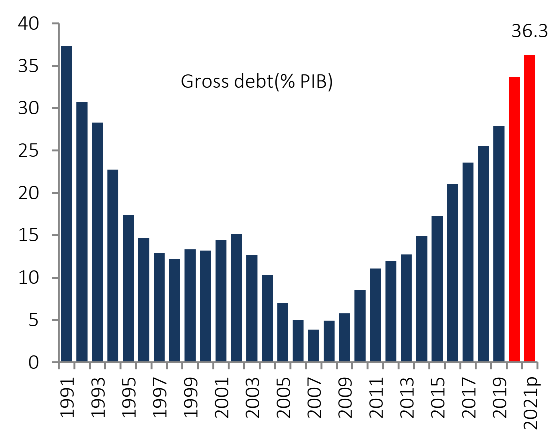
Given the revenue estimates, the fiscal deficit in 2020 would reach 8.2% of the GDP, while next year, it would fall to 4.3% of the GDP. Expenditure financing needs will generate an accelerated increase in gross debt, which by the end of 2021 would already exceed 36%, its highest level since 1991.

Recovery in revenue and GDP next year will mean a reduction in the fiscal deficit



Source: Dipres and Santander

Gross debt would reach its highest level in 30 years by 2021



Source: Dipres and Santander

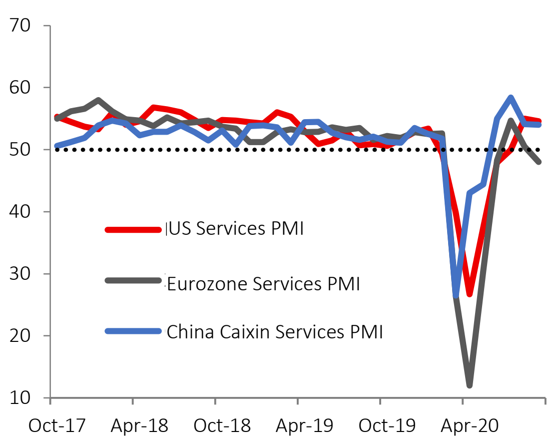
Global scenario marked by pandemic outbreaks and possible new fiscal stimulus measures

The latest international activity data show that recovery in advanced countries has lost momentum due to new outbreaks of the pandemic in the northern hemisphere that have forced several governments to re-implement social distancing measures. As a result, the services PMIs in both the US and Europe fell back in September, and in the latter's case, below the neutral pivot. In turn, the manufacturing sectors continued to expand, although they remain well below what was observed before the pandemic.

In China, the manufacturing PMI fell slightly in September (53.0 vs. 53.1 in August), but foreign trade data showed unusual buoyancy. Exports grew 9.9% YoY while imports increased by 13.2% YoY, well above expectations (0.3%). Noteworthy were the US's agricultural imports and the purchases of copper (62% YoY) that reflect the impulse of the industrial sector.

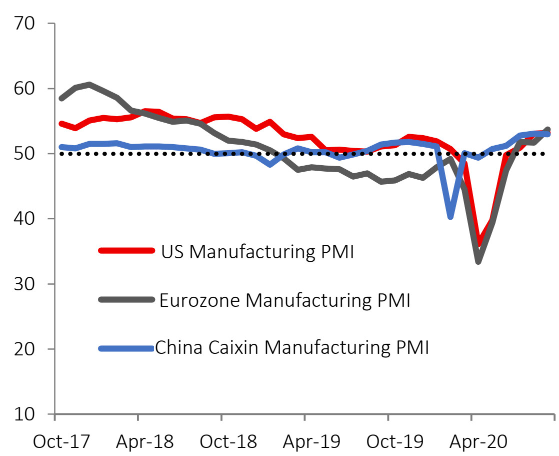
In this context, the IMF revised its activity forecast upwards for the year from -4.9% in June to -4.4%, in light of less negative results in the second quarter in some economies and a faster rebound in the third quarter. Despite this, the IMF noted that risks remain high.

Services lose strength due to resurgence of contagion



Source: Reuters and Santander

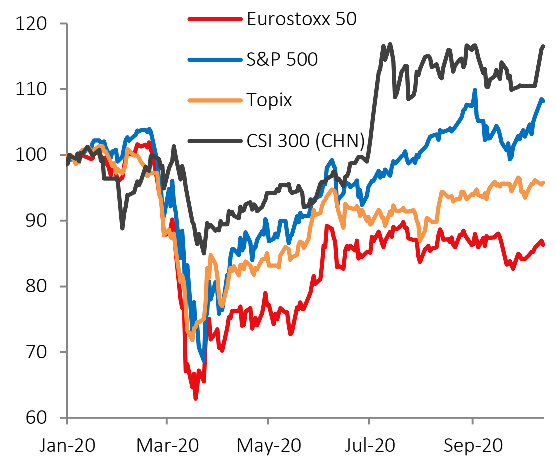
Manufacturing continues to recover, but remains well below its pre-pandemic level



Source: Reuters and Santander

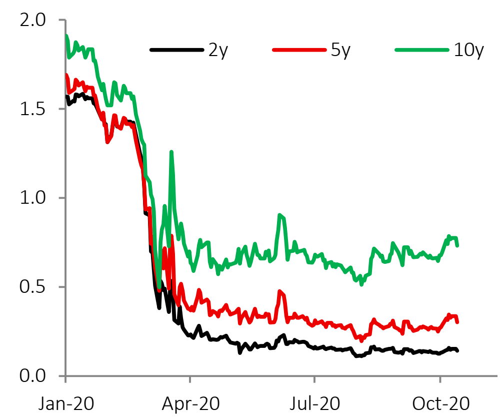
Stock markets have tended to rally in recent weeks due to the increasing possibility of a new fiscal stimulus package in the US, which would range from US$1.6 billion to US$2.2 billion. The S&P 500 has thus regained much of the ground it lost in September, and other markets have also benefited. Furthermore, long rates have increased significantly, but the dollar has tended to weaken.

North American market rebound fails to spread



Source: Reuters and Santander

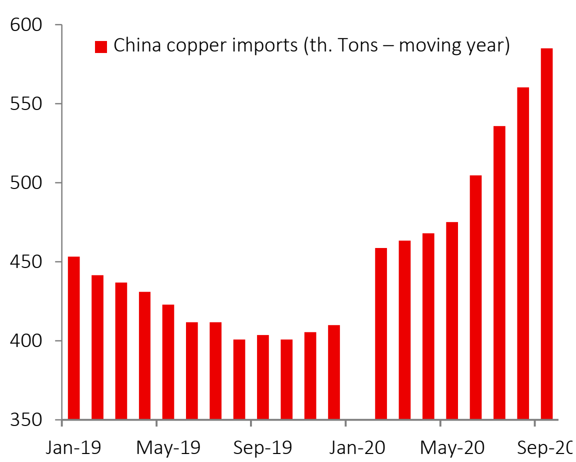
The prospect of a new fiscal stimulus has raised rates in the US.



Source: Reuters and Santander

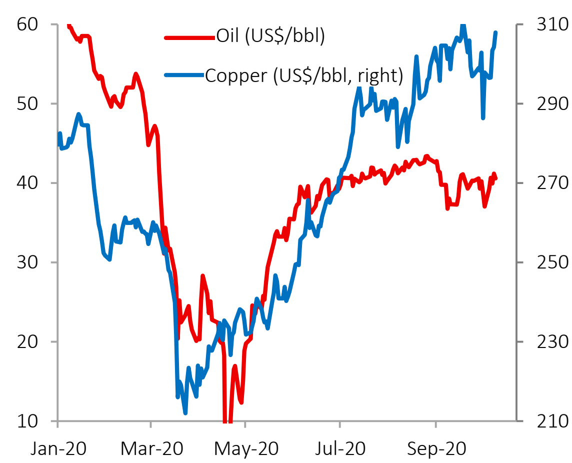
Commodity prices have also recovered in recent weeks. The copper price has returned to about US$3.05 per pound, driven by the strong growth in Chinese imports. In turn, the price of oil has risen to US$40 a barrel, still below the value observed at the beginning of last month. A weak demand and an increased OPEC production have been important factors behind this performance.

China's copper imports remain buoyant and drive up the price of copper



Source: Reuters and Santander

Raw material prices recover



Source: Reuters 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	2.3	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	790	800
CLP/US$ exchange rate (year average)	570	654	677	649	640	703	800	795
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	11.4	0.0
Central Government balance (% GDP)	-1.6	-2.2	-2.7	-2.8	-1.6	-2.8	-8.2	-4.5%
Central Gov. gross debt (US$ billions)	36.6	39.0	53.4	68.9	70.2	74.4	82.6	94.5

Source: BCCh, INE, and Santander

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