ESTUDIOS

2021 OUTLOOK

A bumpy road to recovery

Santander

Introduction

The year 2020 will be remembered for the pandemic that hit the world, with severe social and economic impacts. The health systems were stressed to the maximum and activity was contracted, with millions of jobs destroyed worldwide. This increased political tensions that had been incubated in various countries.

In the year that just began there will be an economic recovery, but there is still a bumpy road ahead. To reach a more definitive recovery, it is key that a relevant fraction of the population will have to have been vaccinated. Mass inoculation processes have begun in many places, but there are still doubts as to the effectiveness of some of the principal vaccines and it is not clear the logistic capacity for its production and distribution in the scale that is needed worldwide. In some countries, herd immunity will be reached mid-year, but in others the process will be much longer and they will be exposed to more waves of the pandemic and new quarantine measures.

Past the gradual return to a sanitary normality, the pandemic will leave marks that will persist through time. In the economic aspect, companies, many of which have survived thanks to state help measures, could not be viable after these funds are withdrawn. On the other hand, the damages to the labor market could last a long time, particularly those most affected by the pandemic in sectors that are labor intensive. Furthermore, the new conditions accelerate the technological transformation towards automatization which will counteract the creation of job posts.

Another consequence of the pandemic can be seen in the political sphere, where there will be a drive to have a bigger State, and where the correlations of power and influence in the world will shift.

In Chile, along with the impacts of the pandemic and the recovery process, we will live a year marked by an intense political agenda. The most relevant events are the election of the members that will form the Constitutional Convention who will redact the new constitution, and presidential elections and the end of the year. In the case of the constitutional process, there are an elevated number of lists that have signed up, with a large participate of independents, which shows a large diversity of interests and visions within the society and points towards a fragmented convention. Because of this, the process will not be exempt of tensions and polarizing discourse. Taking all this into account, it is to be expected that the final result should be a framework that will give the bases for more stabilization and will permit the country to advance in its development.

In this document the Economic Studies team of Banco Santander give our vision about the economic situation in Chile and the world and our perspectives for the year. With this, we seek to contribute to the diagnosis and public debate of the challenges that we must face to continue advancing in the country's progress.

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EXECUTIVE SUMMARY

2020 will be a year historically remembered for the Covid-19 pandemic and its severe health impact on the world's population, as well as its social and economic consequences. The virus, which was detected in humans during December 2019 within China, had spread rapidly across continents by the end of last year's first quarter. Although its lethality has been contained, its ease and speed of transmission have led to a significant number of people becoming infected - around 96 million globally - of whom more than two million have died.

Containment measures to slow its advance rate - and thus avoid the collapse of healthcare systems- and the very fear people have of contagion, led to an unprecedented contraction of global activity in the second quarter of 2020 and a severe rise in unemployment. During the third quarter of the year, as contagion declined in several regions of the world, activity began to rebound, boosted by manufacturing. Services remained weak, which contributed to a sluggish recovery in labour markets.

The year closed with bittersweet news. On the one hand, various vaccines proved to be effective, and mass inoculation processes have gradually initiated. On the other hand, the second wave of infections in advanced countries has proven to be even more severe than the first, leading to a further decline in activity, especially in Europe. As a result, we assess that the global economy closed with a contraction of 4.5%, the largest since the Second World War.

Governments and central banks worldwide reacted by applying significant stimulus measures to help the most vulnerable sectors and contain possible effects of a second wave on activity and employment. Strong liquidity injections pushed back interest rates at all terms, dragging long rates to historic lows, and boosting riskier assets. Thus, stock markets have rallied strongly since mid-year, also helped in recent months by the news on vaccines.

Other conflicts that had been on the agenda before the pandemic were relegated to the background. The trade war between China and the United States showed little change and the new US government is expected to take a less confrontational approach in its relationship with China. Nonetheless, sources of conflict between the two countries will remain latent. In Europe, a Brexit deal was reached, and the United Kingdom has finally ceased being a Member State of the European Union. So far, the new relationship regime has not generated major disruptions.

In Chile, the pandemic had a severe impact on activity starting mid-March, even before the most severe containment measures were adopted. The population's inherent fear of contagion led to strong physical distancing efforts, which had a particularly serious impact on the service sectors and the labour market. April's Imacec had its largest monthly contraction since records began and nearly two million jobs were lost during the second quarter. Nevertheless, exports, particularly the mining sector, were resilient and maintained a relatively stable performance despite the overall contraction in demand.

The Central Bank responded swiftly, cutting the Monetary Policy Rate to its technical minimum of 0.5% at the end of March. This was followed by the implementation of a set of quantitative measures. Meanwhile, the government postponed a series of taxes to support households and businesses' liquidity and implemented an emergency income programme for the most vulnerable families. An employment protection scheme and a line of state guarantees were also launched to keep credit flowing. The combination of measures, coupled with revenue losses due to the macroeconomic situation, meant that the public deficit closed the year at around 7.5% of GDP, which, although close to twice what was projected in January, was lower than that of other countries. As a result, public debt climbed to more than 32% of GDP.

In the second half of the year, as the number of infections declined, mobility gradually recovered, and the boosting measures began to be felt more clearly. All this allowed a partial recovery of activity and employment. The first constitutional reform authorising the withdrawal of pension funds allowed households to receive a substantial injection of liquidity between August and September, giving a significant boost to consumption.

A second withdrawal was authorised at the end of the year, which may have provided additional support, but whose effect is expected to quickly fade away. Additionally, the country benefited from a sizeable rise in terms of trade, thanks to a high copper price. **Overall, the year closed with a contraction of around 6%, the largest decrease in activity since the financial crisis of the early 1980s**.

This year's economic recovery will depend critically on the evolution of the pandemic. Globally, the upsurge of cases in the northern hemisphere and new mass confinement measures suggest a slow start. Additionally, the vaccination campaign, coupled with stimulating actions, has offered hopes for returning to a more normal situation by the end of the first half of the year. As a result, the world is expected to expand by around 4.9%, led by China, India and, to a lesser extent, Europe, which will benefit from low comparison bases.

At a local level, over the last few weeks, infections have increased, and the easing of lockdown measures has been halted and even reversed in some communes. This situation could worsen, possibly leading to further declines in activity in the short term. While the vaccination process has started, the many logistical challenges make it difficult to expect herd immunity to be achieved by the first half of 2021. If this does not happen, the economy will continue to be weighed down and, despite a low base of comparison, growth will be only 4.5%. Thus, only around mid-2022 will the pre-pandemic level of activity be restored.

In the future, the economy will face two major challenges. Firstly, there is the labour market situation, where a low capacity for job creation could cause unemployment to remain high for a prolonged period, with employment becoming precarious. This could germinate into new social conflicts and give rise to short-sighted political agendas. Secondly, there is the unravelling of internal political points of contention and, in particular, the drafting of the new constitution. This process will remain subject to high uncertainty until mid-2022 when the ratification of a new constitutional document should be on the ballot, which could impact the recovery of investment. Nevertheless, a series of milestones are expected to resolve some uncertainties. Meanwhile, the establishment of new rules of coexistence of general approval can provide greater stability, which would be favourable for long-term growth and investment. The Constituent Convention responsible for drafting the document will be very diverse, with no hegemonic forces likely to leverage control. For this very reason, it is necessary to be prepared for a rocky process where polarisation and disagreements could occur. Hopefully, the outcome will offer a space for agreements that supports the foundations of development.

SANTANDER PROJECTIONS

Table 1. Relevant variables

Commodities	2019	2020	2021	2022
Average Copper (US$/lb)	2.72	2.80	3.40	3.10
Average WTI oil price (US$/bbl.)	57	39	50	55
Inflation	**2019**	**2020**	**2021**	**2022**
CPI, annual average (%)	2.3	3.0	2.8	2.7
CPI, end of year (%)	3.0	3.0	2.4	3.0
Core CPI , annual average (%)	2.2	2.3	2.1	2.3
Core CPI, end of year (%)	2.5	2.6	1.7	2.6
Financial conditions	**2019**	**2020**	**2021**	**2022**
Exchange rate, annual average ($/US$)	703	792	750	765
Exchange rate, end of year ($/US$)	745	711	760	770
MPR, end of year (%)	1.75	0.50	0.50	1.00
Labour market	**2019**	**2020**	**2021**	**2022**
Unemployment rate, annual average (%)	7.2	10.8	9.5	7.5

Source: Bloomberg and Santander

Table 2. Global growth (%)

	2018	2019	2020	2021	2022
Advanced economies	2.3	1.7	-5.8	3.7	2.7
Eurozone	1.9	1.2	-8.0	5.0	3.5
United States	2.9	2.3	-3.5	3.0	2.0
Japan	0.8	0.9	-4.0	2.5	2.0
Emerging and developing economies	4.5	3.7	-3.6	5.7	5.1
Latin America and the Caribbean	1.1	0.0	-8.1	3.5	4.0
China	6.7	6.1	2.3	8.5	6.0
India	6.1	4.2	-10.3	7.0	8.0
World*	3.6	2.8	-4.5	4.9	4.1

* Calculation of purchasing power parity.

Note: 2020 estimated and 2021-2021 projected

Source: IMF and Santander

Table 3. National Accounts and Payment Balances (%)

	2019	2020	2021	2022
GDP	1.1	-6.0	4.5	4.8
Domestic demand	1.0	-9.2	6.3	5.8
Total consumption	0.8	-7.7	5.3	5.3
Private	1.1	-8.9	5.1	5.9
Government	-0.3	-2.5	5.9	2.9
Investment in fixed capital	4.2	-13.0	8.7	7.2
Construction	5.7	-14.4	5.4	9.3
Machinery and equipment	1.7	-10.7	13.6	4.2
Var. inventories (incidence)	-0.5	-0.3	0.4	0.3
Exports	-2.3	-2.0	1.5	3.4
Imports	-2.3	-13.1	7.6	7.4
Current account (GDP %)	-3.9	1.0	-0.7	-1.7

Note: 2020 estimated and 2021-2021 projected.

Source: BCCh and Santander

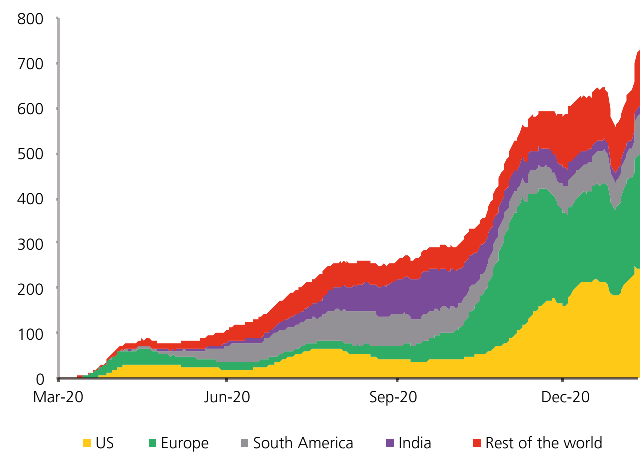
GLOBAL SCENARIO

The pandemic has caused the biggest health, human and economic crisis in decades. The virus, which originated in China by late 2019, spread rapidly across the world during February and March last year. Although its lethality is relatively low, its ease of transmission and its impact on people's health have raised alarms. In an attempt to slow the spread of the disease and prevent the collapse of healthcare systems worldwide, authorities restricted several activities and implemented quarantines. Together with the physical distancing caused by the fear of contagion itself, this had an unprecedented impact on the global economy, which suffered a severe contraction in the first half of the year.

To the best of their ability, governments sought to counter the pandemic's effects through expansionary macroeconomic policies, both fiscal and monetary in nature. This translated into a sharp increase in public debt, which, in the case of advanced economies, rose from 115% of the GDP on average to over 125.5% of the GDP by the end of 2020. In emerging economies, reduced access to international markets and higher risk premiums limited their ability to respond. In Latin America, this coupled to deficiencies in institutional capacity.

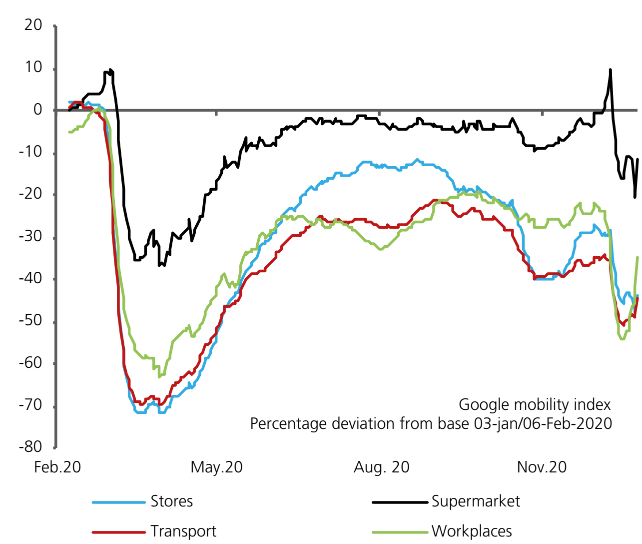
In the second half of the year, a decline in contagion in several regions was followed by a gradual opening process and most economies partially recovered, bolstered by stimulating measures. Notwithstanding, the global GDP fell by 4.5% during the year, the largest contraction since the end of the Second World War. Advanced economies contracted by approximately 6% while emerging economies contracted by only 3.6% due to China's strong rebound in the second half of the year. In the meantime, labour markets suffered severe shocks, and millions of jobs were lost globally.

More than 96 million people have contracted Covid worldwide



Source: Our World in Data and Santander.

Waves of contagion have led to sharp drops in mobility

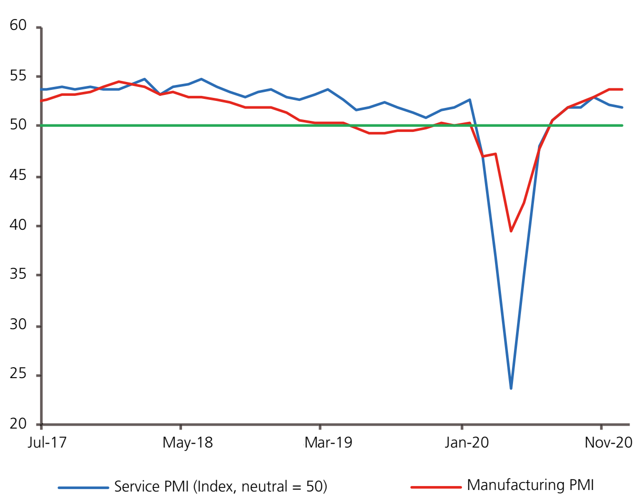


Source: Google and Santander.
Simple average of USA, UK, Spain, Germany, and France.

In our 2020 Outlook report, published in mid-January last year, we outlined several political events that we expected to create uncertainty and affect economic activity: the US presidential election, Brexit negotiations, trade war and socio-political tensions in several countries. While these events were a source of volatility, they were overshadowed by the pandemic.

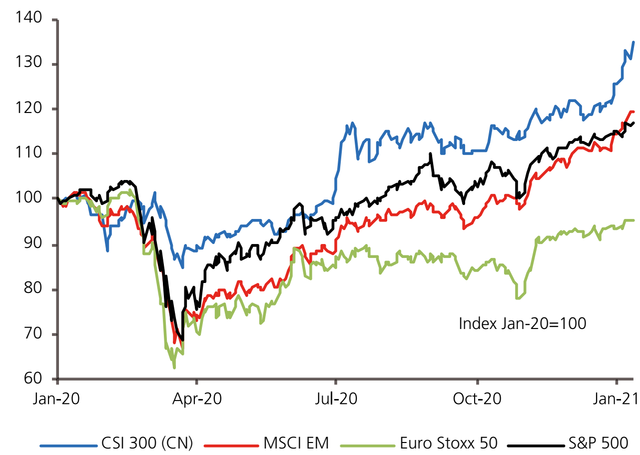
Despite the severe recession, several major stock markets closed the year at record levels. With the spread of Covid-19 across continents at the end of the first annual quarter, stock markets plummeted. However, by April stock markets began to recover, boosted by stimulus policy announcements. As the year closed, and despite a strong resurgence of infections in the northern hemisphere, stock markets continued to rally on optimism over vaccine developments. Long-term interest rates, in turn, fell to record lows, supported by ample liquidity injected by major central banks.

Activity collapsed in the second quarter, especially in the services sector



Source: Bloomberg and Santander

Despite severe impacts on activity, stock markets ended the year on an upward trend



Source: Bloomberg and Santander

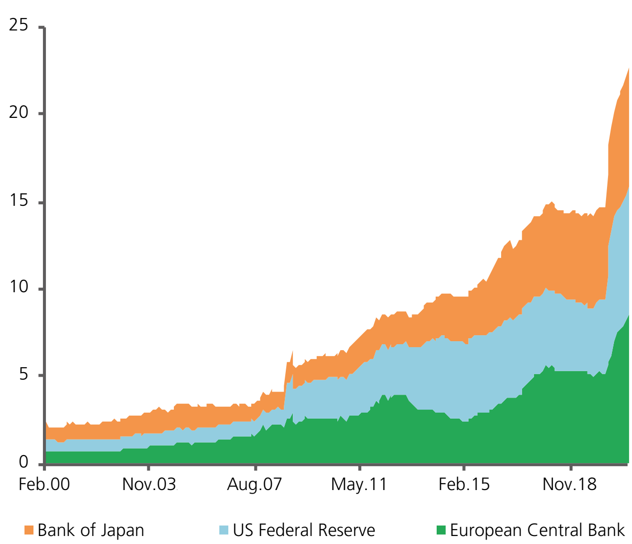
During 2021, growth will be strongly conditioned by the evolution of infections and the vaccination process. Once herd immunity is achieved - with between 60-70% of the population vaccinated - activity can begin to move towards pre-pandemic levels, although some sectors will remain affected for longer. Several countries have already started inoculation campaigns but are still far from reaching a significant population percentage. This may not happen in developed countries until the end of the second annual quarter, while it will take longer elsewhere. For the same reason, it is expected that physical distancing measures will continue to be necessary at a global level for a good part of the year.

The pandemic resurgence in recent months has meant starting 2021 with new confinement measures, which will cause many economies to contract again during the first annual quarter. In our baseline scenario, we assume that these restrictions will be gradually lifted beginning the second quarter and that a more definite recovery process will start during the second half of the year. As a result, we expect overall activity to grow by around 4.9%. Advanced economies will expand by 3.7% and will only reach pre-pandemic levels by 2022. Meanwhile, emerging economies will grow by 5.7%, led by China's strong dynamism and a partial recovery in India.

Advanced and several emerging countries are expected to uphold significant fiscal impulses. The monetary policy of major markets will remain expansionary, with rates at minimum levels for a prolonged period and, possibly, new liquidity injections. This will ensure that riskier assets remain appreciated.

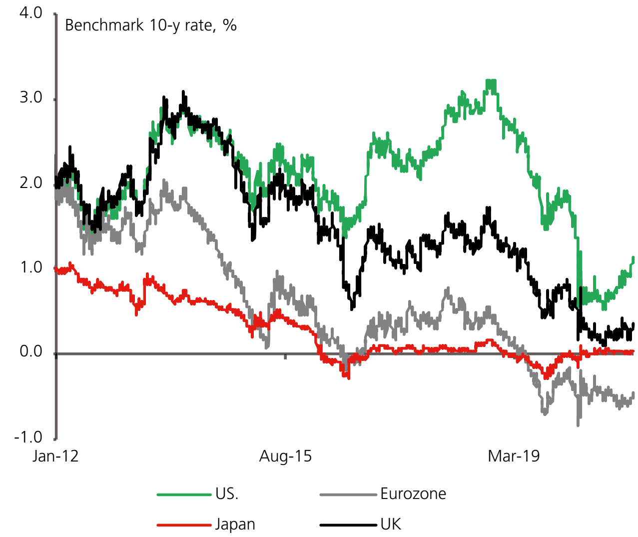
The balance of risks displays a downward bias. On the one hand, it is possible that the second wave of infections will intensify or that there will be a new outbreak before the mass deployment of vaccines takes effect, which would cause a major dent in the activity. On the other hand, immunisation campaigns are likely to be slower than expected, due to delays in vaccine production, logistical difficulties, or the population's own reluctance to be inoculated. There is also the possibility that the labour market takes too long to recover, which would dampen consumption and lead to political instability. Finally, the viability of thousands of businesses that have survived on state aid is unclear. Once these aids are lifted, there could be massive bankruptcies causing financial stress.

Global liquidity expanded sharply...



Source: Bloomberg and Santander

... pushing down interest rates.



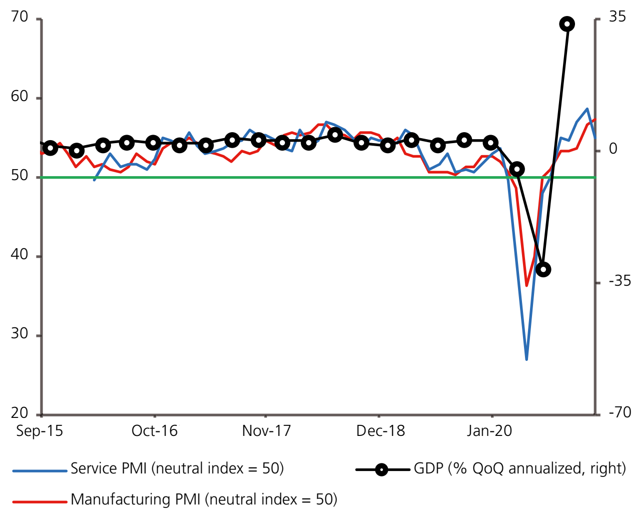
Source: Bloomberg and Santander

Advanced economies counter pandemic with substantive stimulus packages

As in most countries, the United States was severely hit by the pandemic. The first effects were seen towards the end of the first annual quarter when the economy contracted by 5% (annualised QoQ). In the second quarter, once the contagion wave swept across the country, the GDP plummeted by more than 30%. With 20 million jobs lost in April, the labour market suffered, raising the unemployment rate to almost 15%, the highest since the Great Depression of the 1930s.

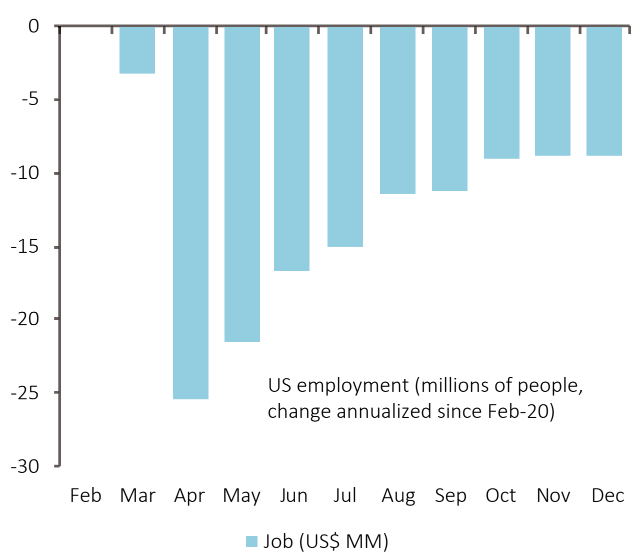
In the third quarter, the gradual easing of several restrictions, the adaptation of several sectors to the new conditions imposed by the pandemic and stimulating macroeconomic measures caused activity to rebound strongly, rising 33.4% (annualised QoQ). The labour market also began its recovery, albeit at a slower pace. In the last annual quarter, a new wave of contagions caused the economy to lose momentum and job creation to stall. In this light, we estimate that the GDP ended the year with a fall of 3,5% during 2020.

After falling in the first half of the year, US activity has rebounded…



Source: Bloomberg and Santander

... but the employment recovery has stalled.



Source: Bloomberg and Santander

Macroeconomic policies played an important role in containing the economic impacts of the pandemic. Fiscal measures focused on direct aid to individuals, supporting small and medium-sized businesses, extending unemployment insurance, and offering worker retention incentives. The package is estimated to have cost US$ 3.8 billion, equivalent to 18% of the GDP.

In March, when the pandemic heavily struck the financial markets, the Federal Reserve (Fed) deployed a comprehensive set of measures, cutting the federal funds rate to its minimum range (0% - 0.25%) and recommenced asset purchases. This expanded the size of the balance sheet significantly, from 19% of GDP in February to 36% at the end of the year. In August, at the Jackson Hole conference, Jerome Powell formalised the Fed's new monetary policy outline, setting an asymmetric target for unemployment and aiming for inflation to reach the 2% target average, introducing a clear expansionary bias to future monetary policy conduct.

After acting as a safe-haven asset during the first quarter of 2020, the dollar depreciated globally, closing the year 7% below its value at the end of 2019. Strong liquidity injections by the Fed and the prospect of an expansionary monetary policy for a prolonged time, coupled with the increase in risk appetite driven by the progress of virus treatments and expectations of a faster recovery outside the US, accounted for much of the depreciation of the US currency.

The presidential election was the most important political event of the year. With an unprecedented voter turnout, the Democratic candidate Joseph Biden defeated President Trump by a comfortable margin. The election was marked by Trump's disregard for the results and accusations of electoral fraud. The certification of the Democrat's triumph was disturbed by supporters of the outgoing president storming into the Capitol, resulting in five casualties. As of the date this report was issued, the House of Representatives was approving a new impeachment against President Trump for inciting insurrection. Meanwhile, the Democratic Party won a majority in both the House of Representatives and the Senate in the congressional election, which means that President Biden will have ample room for manoeuvre to deploy his government programme. In the short term, the implementation of a new stimulus package is expected to counteract the loss of momentum in the economy. In the medium term, the chances of a meaningful tax reform to fund the ambitious infrastructure and climate change plan are certainly greater.

This year we expect the US to gradually resume its growth path and expand by around 3%. The country has already begun the process of mass inoculation, which, although slower than expected, should allow the consolidation of recovery by mid-year.

Box 1: Vaccination process in Chile and the world

The vaccination process is key to achieving herd immunity quickly and thereby beginning a process of economic and social activity normalisation. Since mid-year, more than 100 laboratories worldwide have been engaged in vaccine developments. Of these, around 10 have successfully passed the necessary clinical trials, being approved by countries primarily for emergency use.

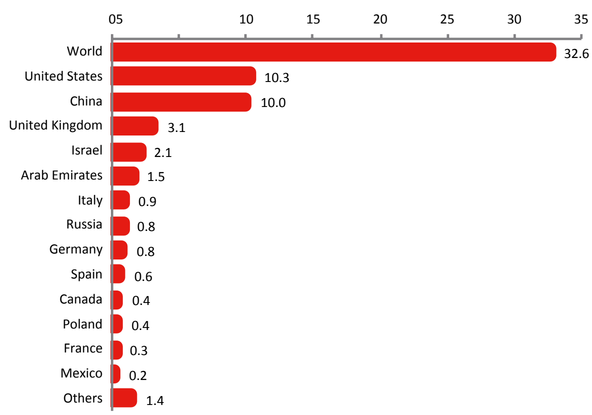
Developer	How it works	Status
Pfizer-BioNTech (USA, Germany)	mRNA	Approved in Saudi Arabia and other countries. Only for emergency use in the US and EU.
Moderna (USA)	mRNA	Only for emergency use in the US, EU, and other countries.
Gamaleya (Russia)	Ad26, Ad5	Early use in Russia. Only for emergency use in Belarus, Argentina, and others.
Oxford-AstraZeneca (United Kingdom, Sweden)	ChAdOx1	Only for emergency use in Russia, India and other countries.
CanSino (China)	Ad5	Limited use in China
Johnson & Johnson (USA, Belgium)	Ad26	Not used
Vector Institute (Russia)	Protein	Early use in Russia
Novavax (USA)	Protein	Not used
Sinopharm (China)	Inactivated Virus	Approved in China, and other countries
Sinovac (China)	Inactivated Virus	Emergency use in Egypt. Limited use in China, Indonesia, and other countries
Sinopharm-Wuhan (China)	Inactivated Virus	Limited use in China and the UAE
Bharat Biotech (India)	Inactivated Virus	Emergency use in India

Source: Our World in Data and Santander

With this, immunisation campaigns around the world have been initiated. As of the date this report was redacted, the United States was leading in terms of doses administered with more than 10 million, followed closely by China. However, adjusted by population size, Israel is in the lead with almost 25% of its population inoculated.

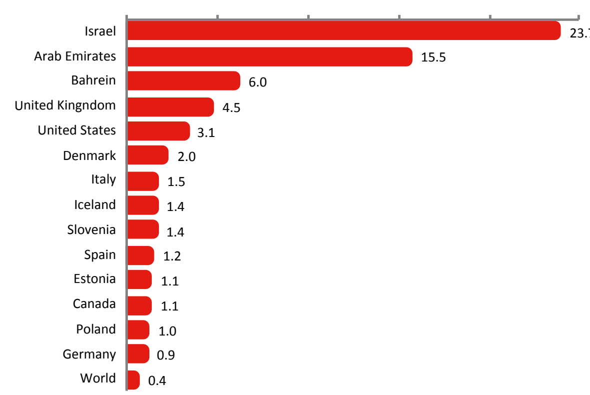
In Chile, almost 11,000 people have been vaccinated, primarily health sector personnel, which still represents a very small fraction of the population. The country has agreed to purchase 36 million doses of vaccine from four suppliers (Pfizer, Sinovac, Johnson & Johnson and AstraZeneca), covering more than 100% of the population. According to various sources, 10 million doses should arrive during the first half of the year to cover the critical population by the first annual quarter, and the bulk of the target population by the end of the second quarter. So far, the country has received 110,000 doses from Pfizer-BioNTech and is expected to receive 1.6 million doses in the first quarter, followed by 550,000 doses per month. The first shipment from China's Sinovac is scheduled to arrive by the end of January.

Doses administered (millions)



Source: Our World in Data and Santander
Data revised 14-Jan-2021

Doses administered (per 100 inhabitants)



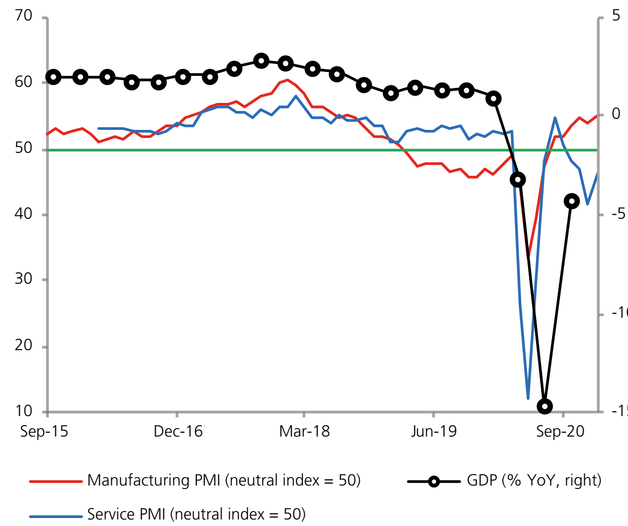
Source: Our World in Data and Santander
Data revised 14-Jan-2021

In 2020, the Eurozone experienced its longest recession since its creation in the late 1990s. The pandemic's initial outbreak was particularly intense in the southern countries of the bloc, with a very high fatality rate. This led to the imposition of severe restrictions that led to an annual contraction of almost 15% in the second quarter. During the third quarter, there was a partial recovery in the activity but contrariwise what was observed in the US, services remained particularly weak.

On the other hand, while suffering from the pandemic, the labour market deteriorated moderately due to a series of measures to encourage job retention. This raised unemployment from a low of around 7% in February to 8.7% in July at the pandemic's initial peak. Towards the end of 2020, a second wave of very aggressive contagions forced further containment measures, which would have led to a further contraction in the latter half of the year, culminating in an annual decline of more than 8%.

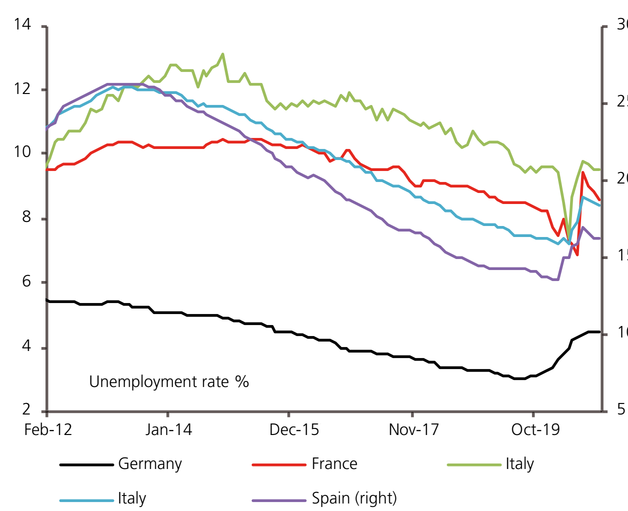
Like the US, bloc governments implemented substantive fiscal stimulus policies. Additionally, measures were taken by the European Community, which temporarily eased the debt ceiling and approved a large stimulus package of 750 billion euros. For the first time, the funding for this package will come from joint debt issuances by member countries, which is an additional step towards a joint fiscal scheme. The resources will be used not only for economic recovery but also for structural reforms to strengthen the bloc's growth potential and implement a green agenda.

The second wave of contagion has dampened the Eurozone recovery



Source: Bloomberg and Santander

European labour market suffered less than in other countries due to employment protection measures



Source: Bloomberg and Santander

In the meantime, the European Central Bank (ECB) adopted a series of measures to maintain expansionary financial conditions. In particular, it established a new emergency asset purchase programme for up to EUR 1,350 billion and injected liquidity through term refinancing operations. As a result, the ECB's balance sheet again expanded considerably, reaching US$ 8,500 billion.

We expect that the vaccination process and stimulus measures will allow the Eurozone to make a significant recovery for this year. Nevertheless, during the first half of the year, the resurgence of cases and the new containment measures will cause the economy to contract. A gradual rise should begin during the second quarter, which would accelerate once the population achieves immunity. Hence, we estimate that the GDP will grow by around 5% and only in 2022 will it recover to pre-pandemic levels.

In the United Kingdom, the impacts of Covid-19 were compounded by tensions arising from negotiations with the European Union over its post-Brexit trading relationship. At the end of the year, an agreement was reached which, while leaving issues such as financial services on hold, avoided a "hard" Brexit. Although the agreement does not include tariffs or quotas, there will be controls on products imported from the EU, which could impact logistics chains. Furthermore, citizens' free movement will be limited, and work visas will be implemented for people from EU countries. This new framework of understanding implies that many of the new restrictions do not apply to Northern Ireland. Most recently, Scotland reiterated its intention to gain independence from the United Kingdom and re-join the European Union.

The economic impact of pandemic has been particularly severe in the UK. Despite substantial stimulus packages, the GDP is estimated to have fallen by almost 10% during 2020. Hereafter, the country faces the dual challenge of overcoming the disease's impacts and adapting to the new conditions of its relationship to continental Europe after Brexit. The pandemic's second wave impact has been particularly intense, partly due to a virus mutation detected on the island, which will harm the economy again during the first half of the year.

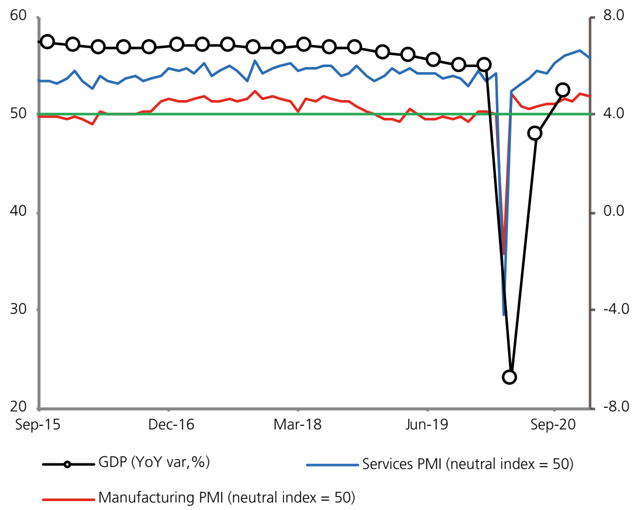
Emerging economies face different prospects

Unlike most countries, China managed to contain the infections early on, with very aggressive measures and a sophisticated traceability system. Consequently, after falling by 10% (annualised QoQ) in the first quarter of the year, the economy rebounded by 11% in the second quarter and continued to expand in the third and fourth quarters. This meant a growth of 2.3% at the end of 2020. Although this is the smallest expansion since the 1970s, the fact that a positive figure has been achieved is remarkable. Beyond sanitary control, the recovery was underpinned by substantial government investment programmes which, among other things, implied a considerable increase in the demand for copper.

Despite the pandemic, the government carried on implementing structural reforms, including opening the financial sector and the improvement in the protection of intellectual property rights. The country's external sector benefited from manufacture demands to replenish inventories elsewhere in the world, and buy medical supplies, which led exports to grow by more than 20% in November. As of the date this report was issued, new outbreaks of Covid-19 had led to new lockdowns in some cities, which could slow down the pace of growth in the first half of the year. Overall, we estimate that China will expand significantly during 2021, by 8.5%.

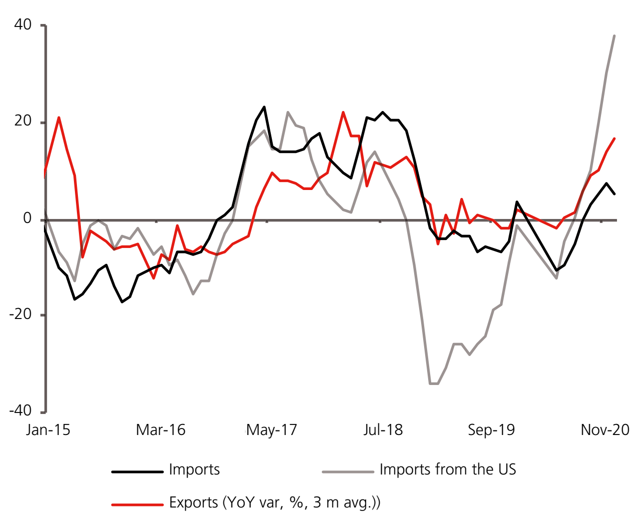
Concerning its relationship with the US, it is expected that the new American government will take a less confrontational approach. There is, however, a strategic nature to the dispute between the two nations, motivated by the Asian country's hegemonic ambitions. Therefore, as stated in previous reports, frictions will continue to exist, even more so after the recent advance of China's global influence, heightened by its role in developing and distributing Covid-19 vaccines.

China was severely impacted but has seen a robust rise in the second half of the year.



Source: Bloomberg and Santander

China's external sector has rebounded, but imports lose strength at the margin



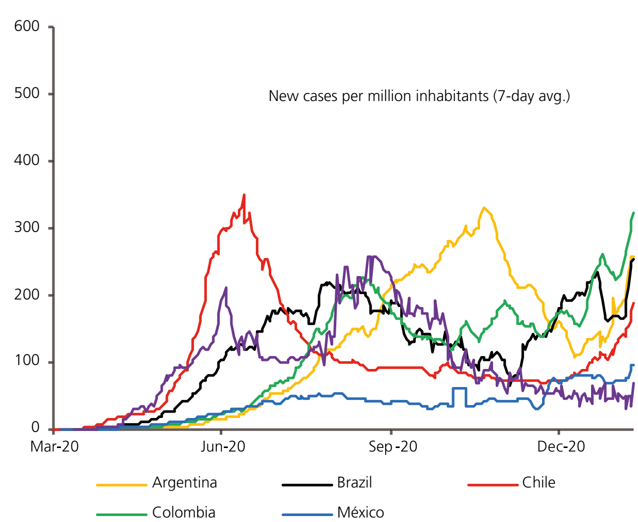
Source: Bloomberg and Santander

Latin America has been one of the regions most impacted by the pandemic, which has caused severe health and economic damage. In several countries, the virus exposed the fragility of healthcare systems and inefficiency in design and implementations of public policies. In some of these countries, the capacity to deploy macroeconomic support policies was limited mostly due to funding difficulties.

The decline in activity was very substantial in the first half of the year, with contractions values above the double digits within the region's leading countries. As in other parts of the world, the second half of the year saw a gradual recovery driven by the ease of confinement measures and, in some cases, stimulus policies. Notwithstanding, the region closed 2020 with a drop slightly over 8% in the activity, one of the most severe globally.

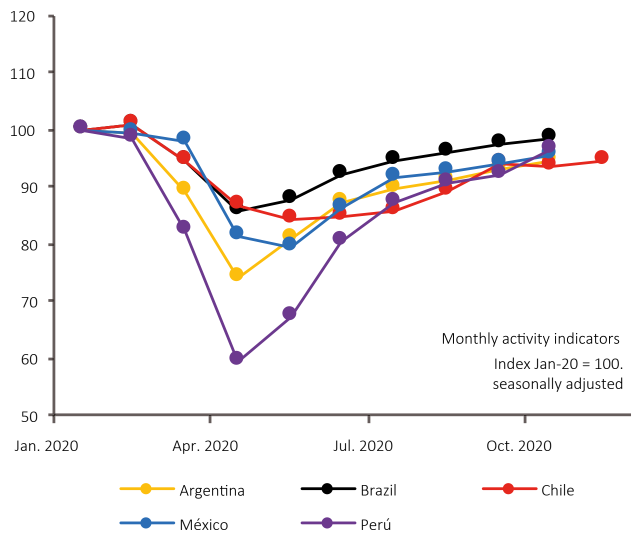
For this year, we expect activity to recover moderately, with a growth of 3.5% YoY. This means the level of activity is expected to remain well below the pre-pandemic situation. For this same reason, the employment situation will be fragile, and unemployment will remain relatively high. The latter could lead to further social upheavals, fostering instability and uncertainty, which could undermine a more sustained recovery.

Latin America has been one of the pandemic's hardest-hit regions.



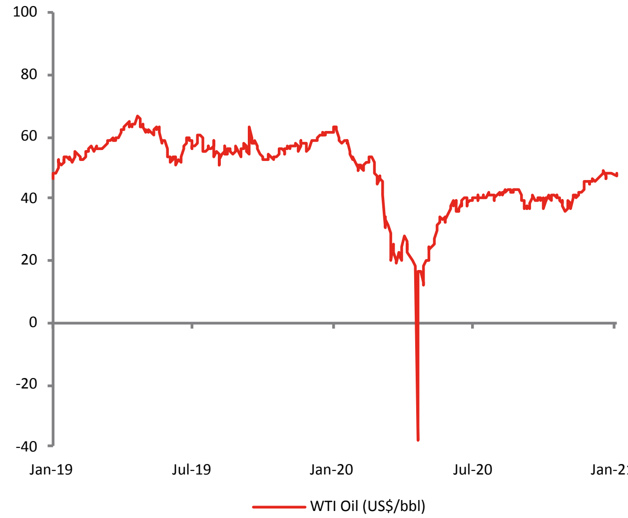
Source: Our World in Data and Santander

Some of the region's economies suffered sharp declines but have begun to recover.



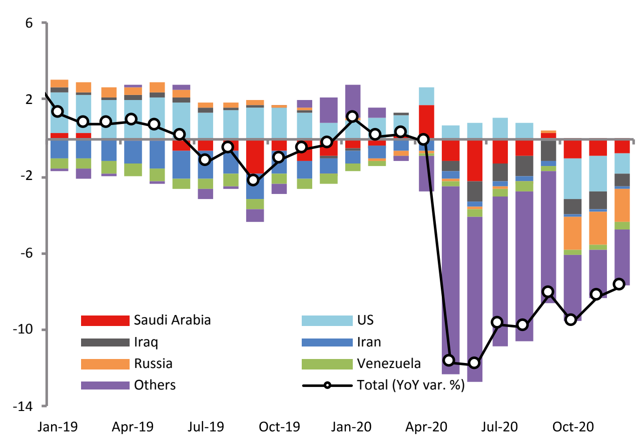
Source: Bloomberg and Santander

Oil prices fall sharply…



Source: Bloomberg and Santander

… despite sharp production adjustment



Source: Bloomberg and Santander

Commodity prices show mixed trends

As the health crisis spread worldwide, the sharp contraction in demand and the uncertainty pertaining to the evolution of global activity led to significant falls in the values of the primary commodities. Oil traded in negative territory for a couple of days in April due to technical reasons.

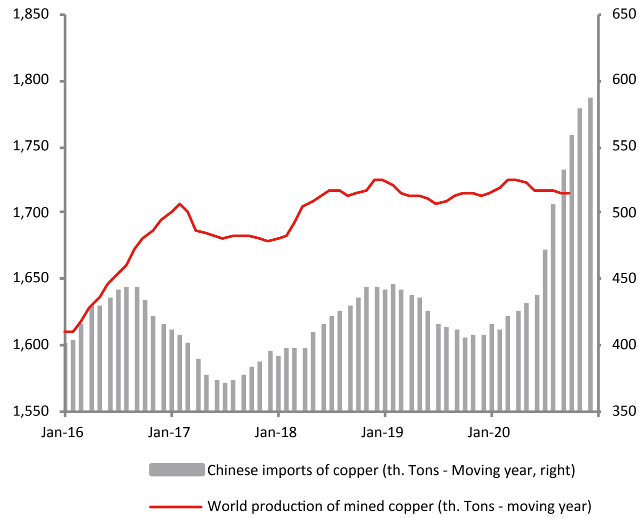
Prices tended to rise during the second half of the year, but their recovery was not homogeneous. Crude oil remained below its pre-pandemic levels and closed the year with an annual decline of more than 30%. In turn, the price of metals rose significantly in the second half of the year, underpinned by strong Chinese demand. Among these, the price of copper stood out, ending 2020 26% above its 2019 end-of-year value

In the future, price developments will reflect both cyclical and structural phenomena. In the case of crude oil, fuel demand will take some time to recover in the short term, predominantly because of the sharp drop in the use of aviation kerosene, which will remain below the levels prior to the onset of the health crisis. In the medium term, the technological changes necessary to address climate challenges will continue to restrict the use of fossil fuels. In the meantime, there is ample global production capacity, which has increased in recent years with fracking and the extension of extraction licences in the US. While OPEC, together with a group of other producers, including Russia, has tried to contain supply by cutting pumping, it has not been able to reverse the downward pressure on prices. Thus, we project the oil value to rise only moderately during 2021 and 2022, without recovering to 2019 levels.

In the case of copper, there is no significant spare capacity. Supply has been rather restricted, and there is a growing demand due to urban electrification processes in China and new uses of metal (e.g., electromobility). Furthermore, a high number of projects is not expected to come into production in the next few years at a global level. In Chile, the pandemic is expected to delay in up to a year and a half the entry of new production, according to Cochilco. Consequently, the price of the metal is projected to remain robust for several years to come.

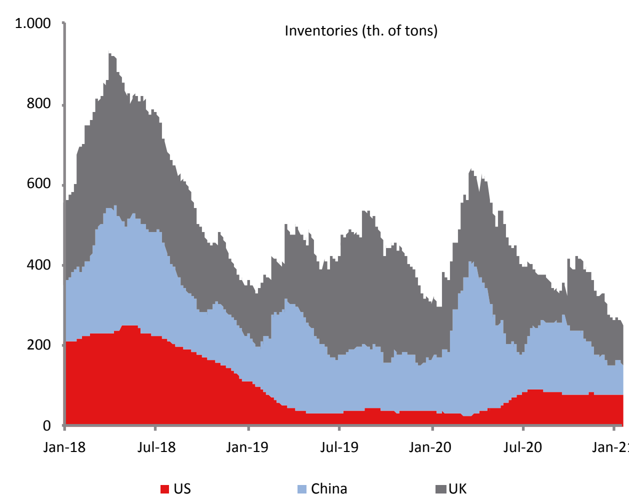
In the short term overall, beyond the quick recovery of Chinese demand, the temporary decrease in supply due to production disruptions caused by the health crisis -a reduction of around 700,000 metric tonnes or 3% of world supply- has put downward pressure on inventories and propelled the value of copper above its long-term fundamentals, decoupling it from other metals. In this context, we estimate that once supply recovers, the price could fall back and close the year at around 3.2 US$/lb. Thus, the average for the year would be approximately 3.4 US$/lb. This may then approach its long-term value in 2022, which we estimate to be around US$3/lb.

Rising demand for copper has not been matched by supply…



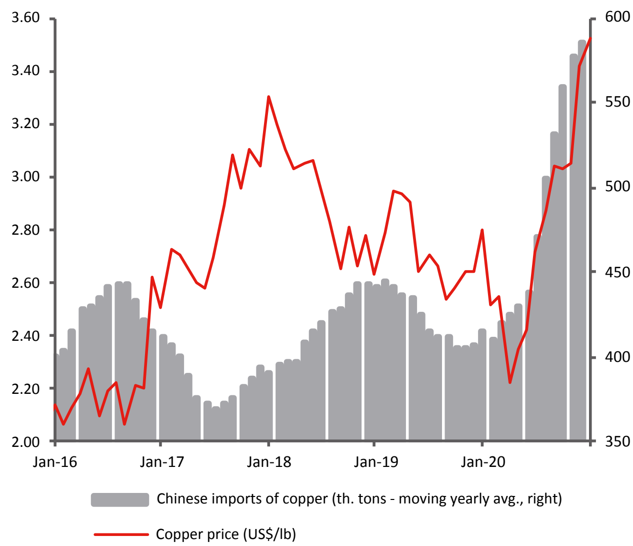
Source: Bloomberg and Santander

... and so inventories have fallen.



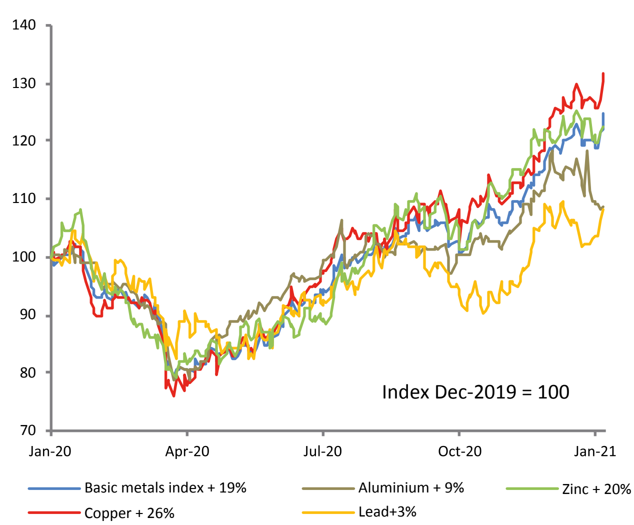
Source: Bloomberg and Santander

Copper prices reached levels not seen since the raw materials super-cycle



Fuente: Bloomberg y Santander

Other metals have also risen, but to a lesser extent



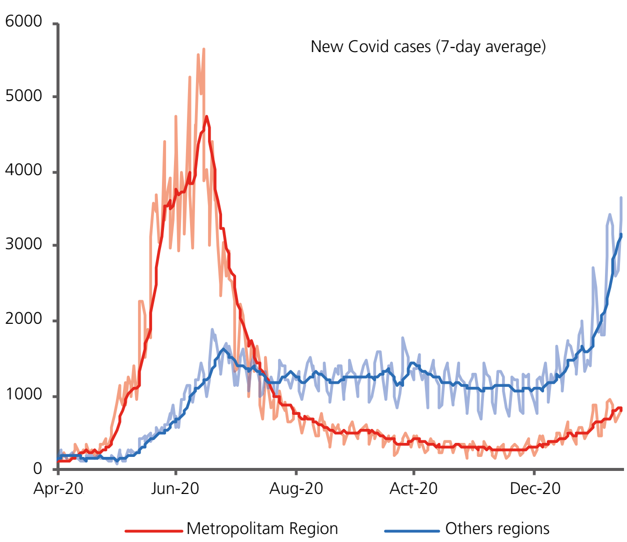
Source: Bloomberg and Santander

LOCAL SCENARIO

Unprecedented contraction in activity caused by the pandemic

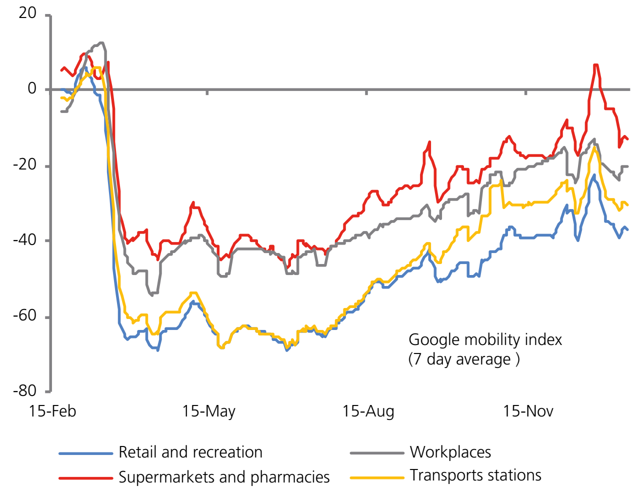
After partially recovering from the social upheaval's toll during the summer of last year, the national economy suffered the pandemic's severe impact. The first infections in the country occurred in early March, and by the second half of the month, the number of cases had exceeded a hundred. At that time, the population's own fear led to a strong social distancing, which resulted in a further decline in the activity, which was deepened once the authority imposed confinement measures between April and June. As a result, the second quarter's GDP fell by more than 15% over the previous year.

The first peak in infections was reached in the middle of the year, and recently they have again accelerated.



Source: Ministry of Health and Santander

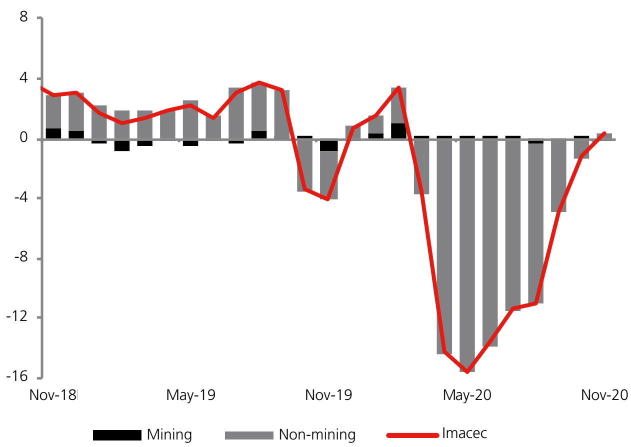
Mobility contracted dramatically in mid-March



Source: Google and Santander

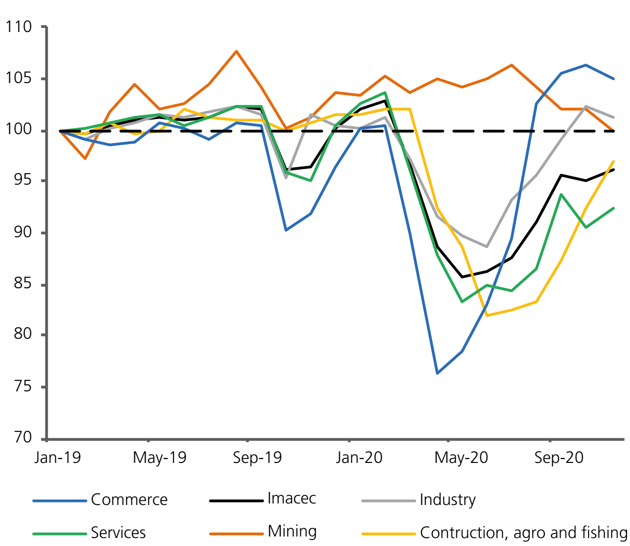
From July onwards, a decline in contagion numbers and increased mobility allowed the economy a gradual recovery, bolstered by stimulus measures from the Central Bank and the government. During the third quarter, households began to receive monetary subsidies (Bono Covid and Ingreso Familiar de Emergencia/Family Emergency Income, IFE), which towards the end of the year amounted to about US$ 3.8 billion (1.5% of the GDP). Additionally, the first constitutional reform for the early withdrawal of pension funds meant a liquidity injection of more than US$18 billion (7% of the GDP). According to the Central Bank data, fiscal support measures and withdrawals of pension funds have more than compensated for the decline in labour income and caused household disposable incomes to expand by more than 35% during the third quarter. Together with increased mobility, this gave a substantial boost to consumption. Trade grew at double-digit rates and even surpassed pre-pandemic levels. The manufacturing sector also improved, albeit to a lesser extent.

During the second quarter, activity contracted by 15%.



Source: BCCh and Santander

The services sector has been one of the most affected by the pandemic.

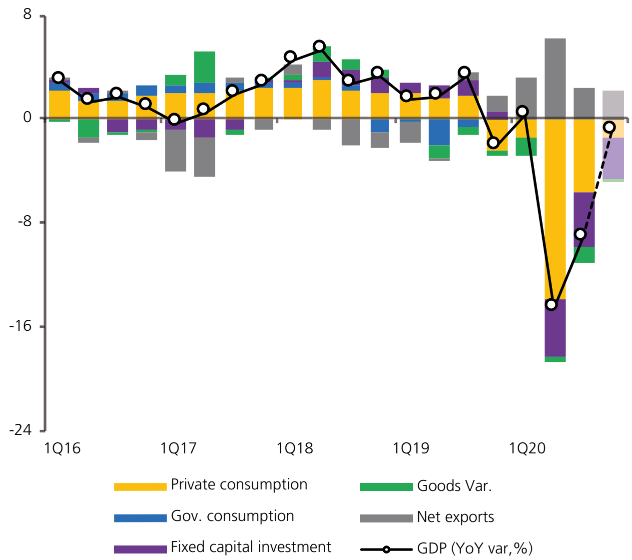


Source: BCCh and Santander

The year ended with bittersweet news. Akin to elsewhere, progress in vaccine development brought optimism to local financial markets, which was coupled with improving external conditions for the economy, predominantly in the terms-of-trade gain from the high copper price. However, the acceleration of infections raised red flags and set back the opening process that had begun during the second half of the year. Although November's Imacec (monthly activity index) showed the first year-on-year expansion since the start of the pandemic in Chile - aided by a low comparison base- the recovery pace was clearly slower than in previous months. **In December, we assess that the Imacec would have registered an annual change ranging from -1% to -2%, which would have closed the year's GDP contraction at around 6%.**

The component of demand the pandemic hit the hardest was consumption, with a 20% decline during the second quarter. Services were severely affected, given the relevance of people interaction in the sector. Durable goods spending also adjusted sharply at the prospect of job losses and the increased uncertainty generated by the health crisis. Nevertheless, the gradual opening-up process and the adjustment of system logistics to online sales, coupled with the strong injection of liquidity to households, led to a rapid recovery in consumption in the third quarter. The durable component even surpassed pre-pandemic levels by far, but services, while showing an increase, remained well below the pre-pandemic level. In the fourth quarter, the recovery in consumption appears to have stalled. Durable goods purchase lost momentum as the liquidity shock faded, while the other components showed little progress. The second withdrawal of pension funds, approved during December, would have had some impact towards the end of the year, albeit less than the first withdrawal. Consequently, private consumption was estimated to close 2020 with a contraction of close to 9%.

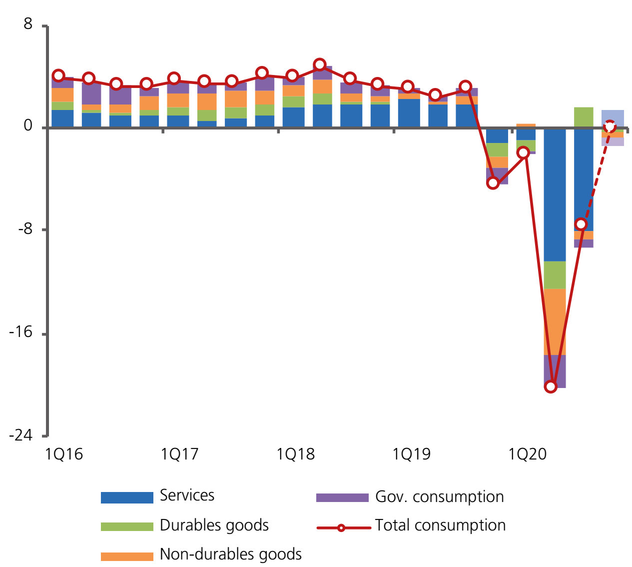
Consumption was the hardest hit component of demand



Note: 4Q20 corresponds to Santander estimate

Source: BCCh and Santander

Liquidity injections were a boost to the spending of durable goods during the third quarter



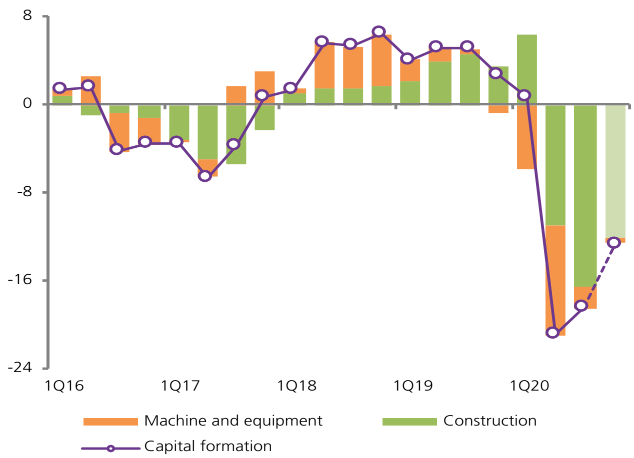
Note: 4Q20 corresponds to Santander estimate

Source: BCCh and Santander

Gross capital formation was also hit by the pandemic. Uncertainty about the economic consequences of the virus led many companies to hold back their investments. The worst-hit component initially was machinery and equipment - already on decline after the social outbreak of 2019 - due to supply disruptions in the countries of origin and cancellations of purchase orders. Later, during the second quarter, confinement measures meant that many projects could not go ahead, with a consequent impact on the construction segment. There was a rapid recovery in machinery investment in the third quarter, reaching close to pre-pandemic levels. Nevertheless, the construction component remained subdued and only in the fourth quarter did it reportedly start to rise. Therefore, the gross capital formation would have contracted by almost 13% during the year.

Many companies managed to overcome the period of sharply declining income flows thanks to adjustments in their cost structures and significant liquidity support measures. On the fiscal side, the deferral of tax payments (VAT, PPM, and contributions) and, above all, the Fogape guarantee programme helped to keep credit flowing, despite the higher risk. As a result, the level of support increased significantly. This could have an impact on companies' future borrowing capacity, which in turn could affect investment. For this reason, it will be important that macroeconomic stimulus measures are sustained for a prolonged period.

Investment has been severely affected, with a sustained impact on construction.

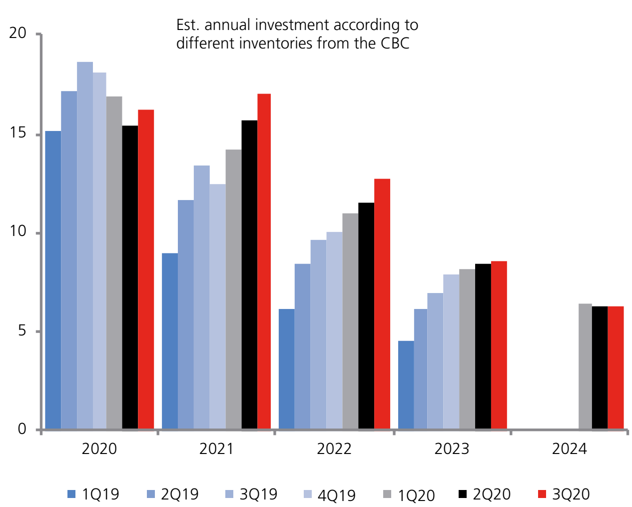


Note: 4Q20 corresponds to Santander's estimate

Source: BCCh and Santander

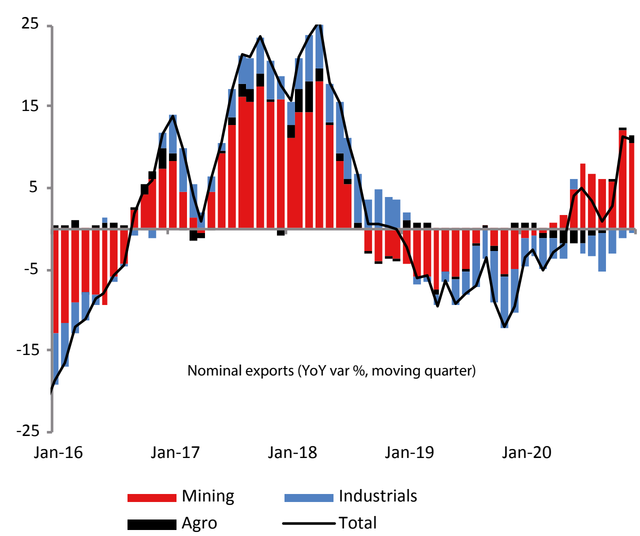
The external sector was resilient throughout the year. Overall, export activities were not significantly disrupted by the pandemic and, in the case of mining, agriculture and some industrial sectors, it benefited from the rapid recovery of Asian markets. Only services exports were affected due to the impact of the global decline in demand for maritime transport, one of the country's primary export services. Meanwhile, Imports increased the drops they had been registering since the end of 2019, especially during the second quarter. The lower domestic inflows reflected both the logistical difficulties imposed by the pandemic and the lower demand driven by the decline in consumption, investment, and inventory adjustment. The second half of the year brought a significant recovery in imports, spurred by the prospect of increased demand. Still, the year closed with a record trade balance of more than US$ 12 billion. The current account, in turn, would have been in surplus by 1% of the GDP

Major projects have been postponed



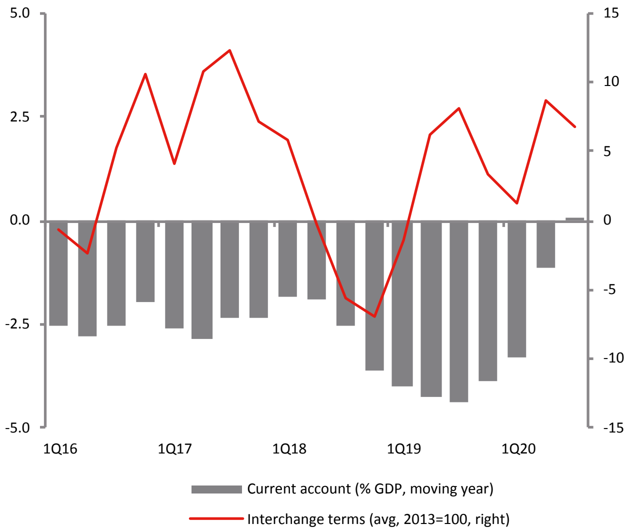
Source: Corporation of Capital Goods and Santander

The external sector has been resilient to the pandemic



Source: BCCh and Santander

The current account will end the year with a surplus

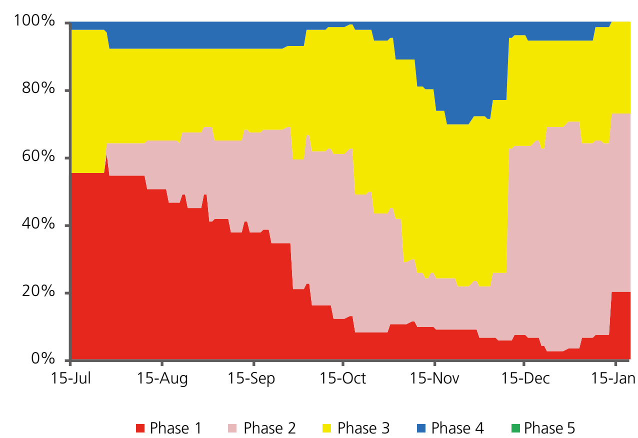


Source: BCCh and Santander

Like last year, economic performance during 2021 will be closely linked to the pandemic's evolution. As of the date this report was issued, the number of infections was on an upward trend, and the government was gradually reintroducing containment measures. Thus, the population under total lockdown (phase 1) increased from less than 5% on early January to about 20% in the second half of the month, while the population in phase 2 reached 50%. Considering this background, we are likely to see a further economic downturn in the first months of the year, albeit less pronounced than in the second quarter of last year due to the economic system's improved adaptation to operate under physical distancing.

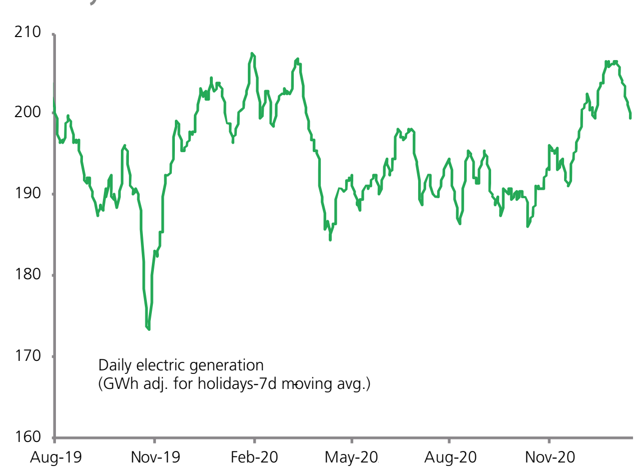
Once the vaccination process allows for effective herd immunity - which requires 65-70% of the population to be inoculated according to WHO experts - the activity should begin a sustained recovery towards pre-pandemic levels. The experience of March 2020's influenza vaccination campaign, with more than 3.5 million people inoculated in the first week, demonstrated the healthcare system's capacity to operate at fast and massive scales. Nevertheless, the logistical challenges for Covid-19 vaccines can be more complex (higher number of storage requirements, doses to be administered, patient registrations, etc.). Once a sufficient number of vaccines is available, relatively fast progress in reaching the target population should be possible. Assuming a favourable scenario, this could only happen towards the end of the second annual quarter. If this comes to pass, the second half of the year will see high rates of expansion.

After an easing of lockdown, restrictions have been re-imposed.



Source: Ministry of Health and Santander

Electricity generation shows a decline in activity in January

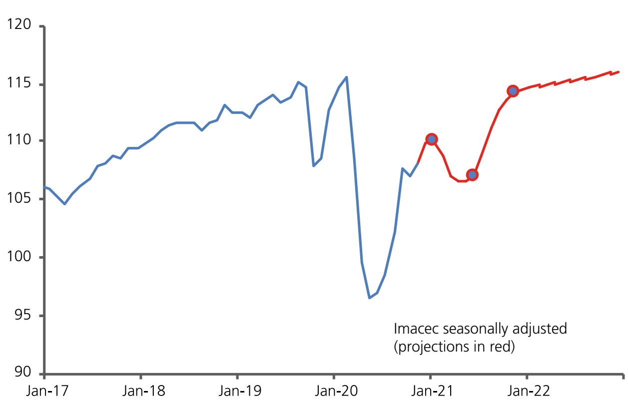


Source: National Electricity Coordinator and Santander

The evolution of consumption will be conditioned not only by the physical distance but also by the employment situation and the support that the government may provide. Employment may take a long time to recover since labour-intensive sectors - such as services and construction - will continue to operate at a sluggish pace. Therefore, in the most likely scenario, new family support schemes will be needed. In the case of investment, containment measures will impact the ability to implement several initiatives. In turn, the external sector will continue to benefit from the dynamism shown by the Asian economies -mainly China- and the recovery of advanced countries once herd immunity is achieved.

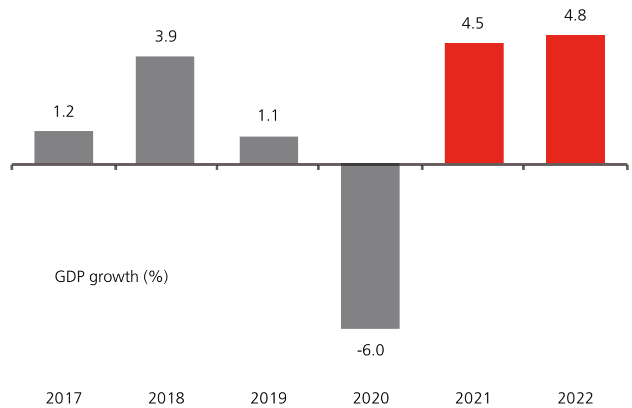
Based on these elements, in our most likely scenario, we estimate that the economy will expand by 4.5%, with the first quarter still on negative grounds. In 2022 we will continue to see relatively high growth figures ranging 4.5% to 5%, helped by a low comparison base.

Our baseline scenario assumes a fall in activity in the first months of 2021.



Source: BCCh and Santander

Thus, growth for the year reached 4.5%.



Source: BCCh and Santander

The risks of our scenario have a downwards bias. Firstly, there is the evolution of the pandemic and the process of inoculation. The appearance of new, more aggressive strains may require more drastic containment measures in the early part of the year. Meanwhile, both in Chile and globally, the vaccination process could be slower, delaying a sustained recovery.

Secondly, there is the domestic political scene, dominated by the constituent process and the parliamentary and presidential elections at the end of the year. Regarding the election of constituents, around 70 lists were registered throughout the country with more than 2,000 candidates, several of which are independent. As a result, the Constituent Convention will be highly fragmented, without a political force with an apparent hegemony. Consequently, the deliberative process will be rocky and tense, and the more extreme positions are likely to be exacerbated. Considerable uncertainty will be generated as a result. Nevertheless, rather than affecting activity this year, this could impact investment decisions from 2022 onwards.

Box 2: Prospects by Sector

In the aftermath of the pandemic, the sectors most affected were those requiring the highest interpersonal contact levels. This is how personal services, restaurants and hotels, construction and transport all suffered contractions at values higher than double digits. Trade had a smaller fall due to the adaptation of network logistics and the strong liquidity injections received by households. In turn, certain activities displayed resilience. Noteworthy is the case of mining, which managed to grow during the year, favoured by high copper prices and a low comparison base, and other export sectors underpinned by the dynamism of demand from Asia.

Henceforth, the first half of the year will see a further contraction while the low comparison base will support higher growth rates during the second quarter. Some sectors will recover faster, but several will not reach their pre-pandemic levels until well into 2022. This will be the case for several services and the transport sector. Personal services depend very closely on the pre-emptive measures taken by the authorities. Among the latter, education and the possibility of returning to classes in person stand out. On the health sector, non-covid-19 care will be resumed as the pandemic allows it. In trade, the high comparison base during the second half of 2020 will mean that growth will be restricted this year. The same is true for the manufacturing industry, especially the branches that supply commerce. Mining will have a moderate expansion; while high prices will give it a boost, slow progress on structural projects and low ore grades will constrain further expansion. Activities linked to investment - construction and business services - will rebound, but a more dependable drive requires that some of the uncertainties that the country is experiencing settle.

GDP by sector of activity (% change YoY)

	2019	2020(e)	2021(p)	2022(p)
Agriculture and forestry	-2.1	-4.1	1.2	5.4
Fishing	1.3	-3.2	2.0	2.8
Mining	-2.3	1.8	-0.2	0.7
Manufacturing industry	0.6	-3.5	2.6	2.2
Electricity, gas, and water	-0.8	1.0	2.7	0.7
Construction	4.9	-17.2	2.7	14.8
Store	-0.3	-2.7	2.7	3.1
Restaurants and hotels	1.6	-32.4	8.7	23.4
Transport	2.1	-20.9	3.6	16.3
Communication	1.3	0.8	3.7	2.1
Financial services	6.0	3.0	4.0	2.1
Business services	2.7	-4.0	4.5	1.1
Housing services	2.3	-1.4	4.1	2.8
Personal services	-0.3	-15.0	12.8	10.1
Public administration	2.5	3.3	3.2	1.7
Gross Domestic Product	1.1	-6.0	4.5	4.8

e: estimated; p: projected.

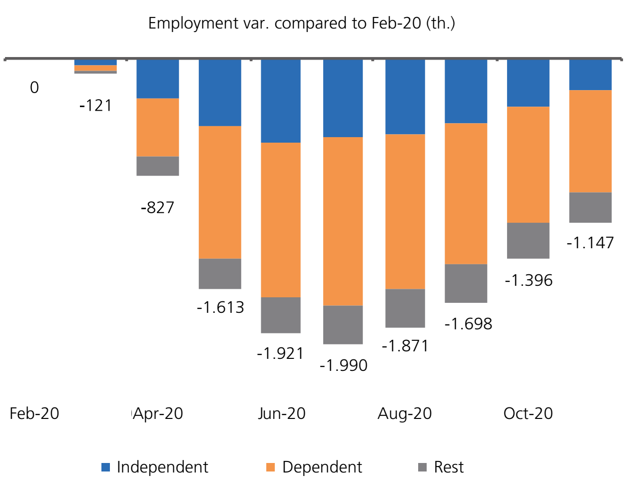
Source: BCCh and Santander

Labour market suffers twice over

The activity contraction, mainly in the most labour-intensive sectors, meant a sharp deterioration in the labour market. Between February and June, nearly two million jobs – mostly wage-earning - were lost, resulting in a drop of more than 20% in employment over the previous year. The contraction could have been greater without the protection programme, which allowed more than 600,000 workers to retain their employment relationship with their employers while absent from their jobs.

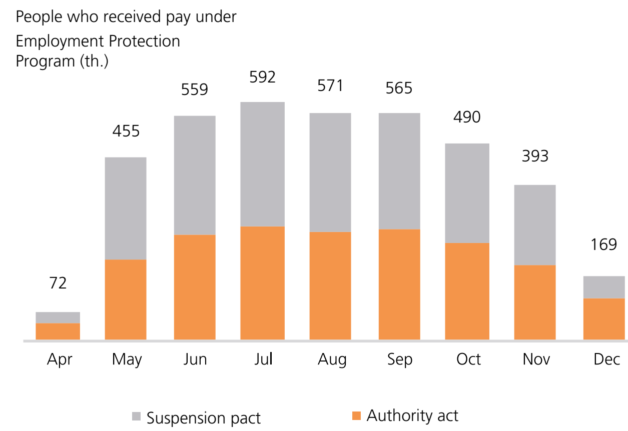
The unemployment rate rose substantially, but less than expected, considering the sharp decrease in jobs. The reason for this was the abrupt contraction of the labour force, discouraged by the obvious difficulty of finding employment in the pandemic context.

Employment is still prominently affected



Source: INE and Santander

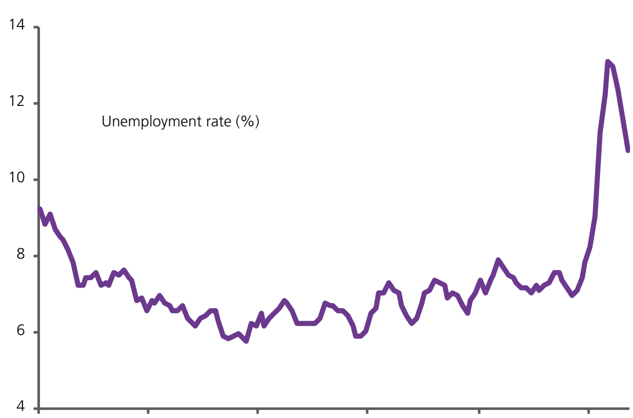
Nearly 600,000 people benefited from the employment protection programme



Source: Superintendence of Pensions and Santander

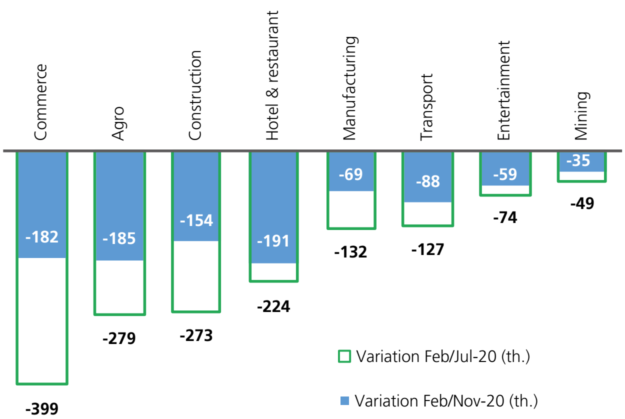
As expected, the most affected sectors were those whose activities were restricted by health measures and those where physical interaction is most intense. Of the almost 2 million jobs lost as of July, 900,000 belong to the trade, construction, and hotels and restaurants sectors. Other sectors that suffered significant contractions - albeit with a smaller impact on total employment - were domestic service, transport, and arts and recreation.

Lower labour force participation prevented a more substantial rise in unemployment



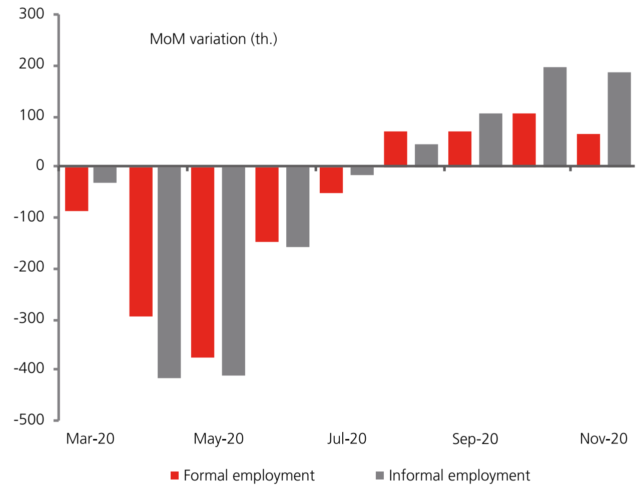
Source: INE and Santander

The most affected sectors were working is more intensive



Source: INE and Santander

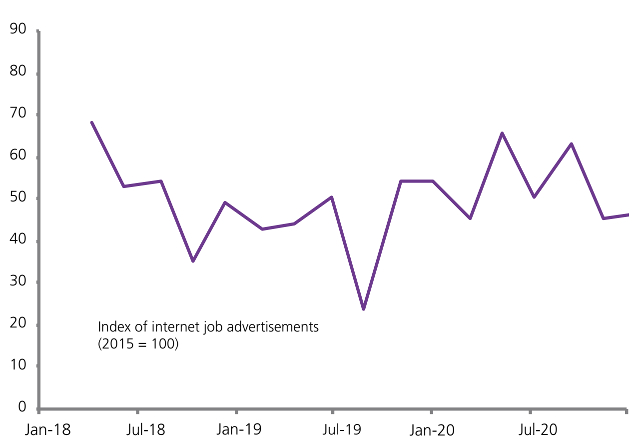
New job creation has been mainly informal



Source: INE and Santander

Towards the end of the third quarter, as activity started to recover, the labour market improved. Vacancies rose substantially and jobs were created, albeit mostly informally. Regardless, this process has been slow, and by the end of the year, there were still about 1 million fewer employed people than before the pandemic. Furthermore, some stagnation was observed at the peak, and it is possible that with the new containment measures, there will be a setback in the first half of this year.

Vacancies have risen, but not enough to fully recover employment.

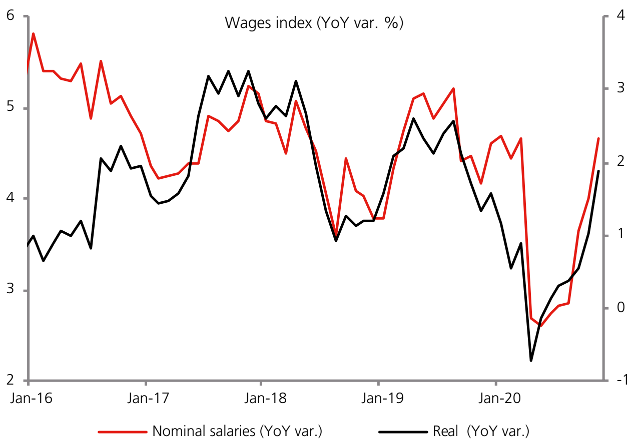


Source: BCCh and Santander

In this context, wages - which fell sharply during April - rose during the second half of the year and in November they recorded a year-on-year expansion of almost 5%. It should be noted, though, that this indicator is constructed based on company payrolls, so it does not capture the impact of the pandemic on the informal sector or on those who are self-employed.

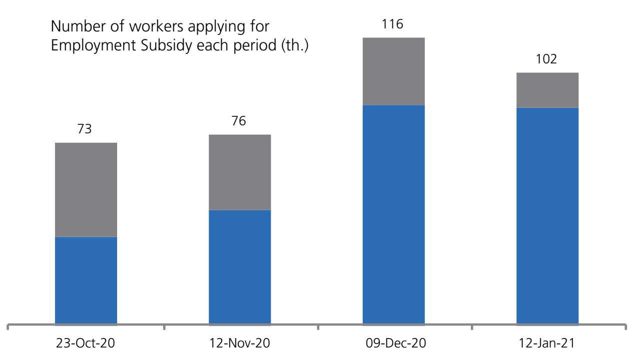
In the future, employment recovery will face a dual challenge. Firstly, there is the pandemic itself and its impact on job creation. To counteract this situation, the government launched an employment subsidy that seeks to encourage the return of workers with suspended contracts and to encourage companies to hire new workers by financing part of their salaries for up to six months. The programme, launched in September, committed resources of the order of US$ 2 billion and aimed to create up to 1 million jobs. Nevertheless, as of mid-January, only 366,000 people had applied. In the medium term, the biggest challenge will be to adapt to the accelerating process of technological transformation and automation, which will reduce job creation in some sectors. Thus, we are likely to go through a period where unemployment will remain relatively high. To this end, the growth of investment as a means of labour absorption will be essential.

After falling sharply, wages show recovery



Source: INE and Santander

Programa de subsidio al empleo ha tenido una demanda moderada

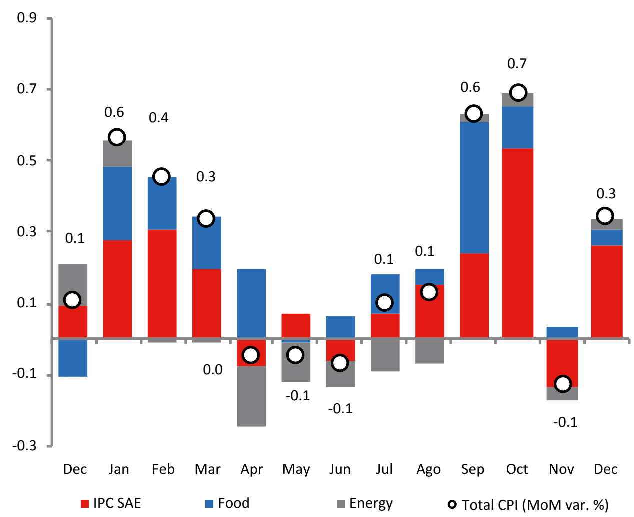


Fuente: Santander en base a información de prensa del Ministerio de Hacienda

Despite recent acceleration, inflation will remain low

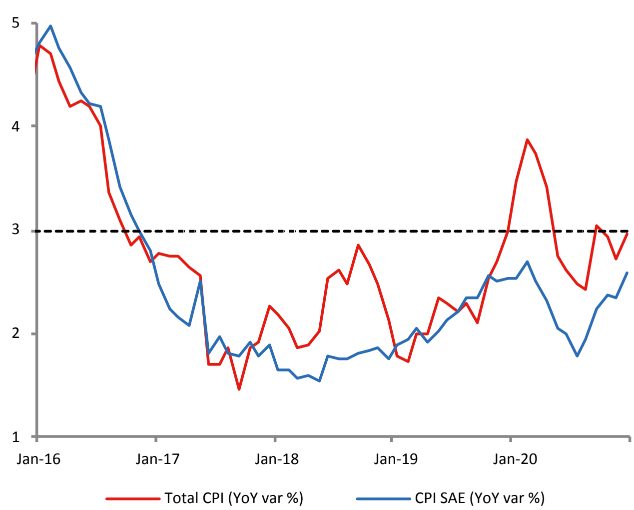
The year was marked by high volatility in inflation. Initially, there was a sharp acceleration in prices due to the exchange rate depreciation towards the end of 2019. Subsequently, the fall in the activity and the rise in unemployment caused inflation to recede rapidly. Affecting this was also how several prices were not measured through surveys and were manually inserted by the INE. In the latter half of the year, the increase in consumption due to the liquidity injections received by households accelerated prices again, which brought inflation to end the year within the 3.0% target for the second year in a row. In turn, core inflation closed at the lower value of 2.5%.

Inflation accelerated in the last months of the year due to temporary factors



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

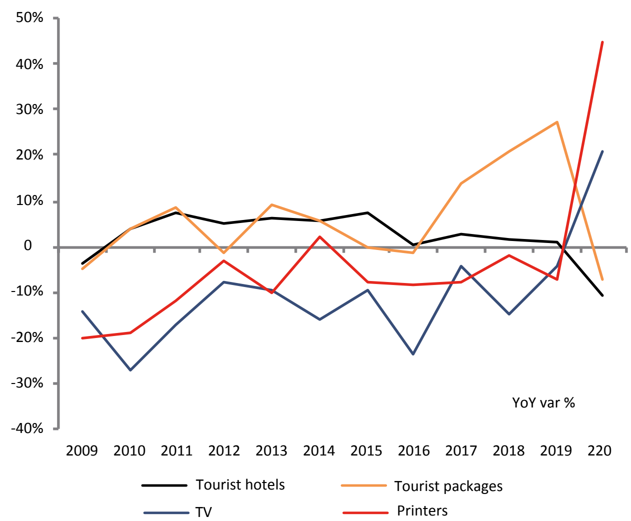
The year closed again on target at 3%



Source: INE and Santander

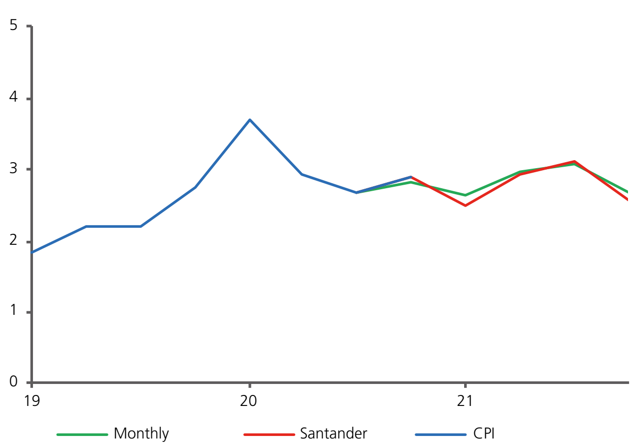
Over the course of the year, the CPI showed relevant changes, parting from the more recent historical patterns. In terms of raises, food increases were the largest since 2014, driven by a record rise in meat prices and significant increases in vegetable prices due to climatic conditions. There were also historic increases in items needed for telework and online classes and other household durables, especially after the withdrawal of pension funds (refrigerators 12%, new cars 7% and televisions 21%).

Services prices fell, but the costs of some durable goods rose sharply



Source: INE and Santander

In the future, inflationary pressures will remain subdued



Source: INE and Santander

Nevertheless, some prices remained unchanged for several months, especially in several services that ceased their provision or had a very significant performance level drop due to the pandemic. These include a series of activities related to recreation and culture. Other prices experienced historic falls, as in the case of hotel rates.

Hereafter, inflation will remain relatively subdued due to the dynamic of economic activity and the recent currency appreciation, which will inflict downward pressures on several prices. Another influencing factor will be that a series of tariffs in services with a high impact on the CPI, such as electricity and public transport, will remain frozen. As a result, we expect inflation to close this year below the target, at around 2.5%. In 2022, as activity recovers to pre-pandemic levels, more pressure will be placed on prices and inflation will be closer to the target.

Liquidity injections and guarantee programme offer support for loans

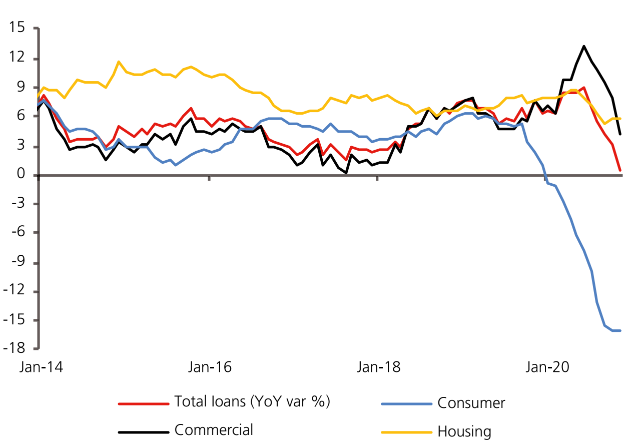
Commercial loans played an important counter-cyclical role in 2020. With the onset of the pandemic, there was a high demand for credit from businesses seeking liquidity in the face of heightened uncertainty. Following this, the state guarantee programme Fogape was instrumental to support lending once the sharp increase in risk became evident. As a result, trade credit grew by more than 13% in June, allowing companies to maintain liquidity in the face of falling cash flows. In the second half of the year, along with the recovery process, there was less dynamism in loans, and their pace of expansion returned to pre-health crisis levels.

Meanwhile, consumer loans accentuated the decline already perceived at the end of 2019, after the social upheaval, and ended the year decreasing more than 15%. Lower household spending due to the pandemic and early withdrawals from pension funds in the second half of the year largely explained this segment's behaviour. Mortgage loans, meanwhile, maintained a relatively stable pace of expansion until the second half of the year and then decelerated moderately.

Loans will grow at a moderate pace this year. In terms of commercial loans, there will continue to be considerable demand in the first months to compensate for lower sales flows. Then, once investment resumes its buoyancy, companies will seek funding for their projects. The high degree of company support- which as of September 2020 reached 134% of the GDP, according to the latest BCCh Financial Stability Report - could be a restricting factor. Also to consider is how, after a prolonged period of operating below capacity, the ability to generate revenue has suffered. Considering this, the Fogape 2.0 programme will be essential to keep liquidity flowing.

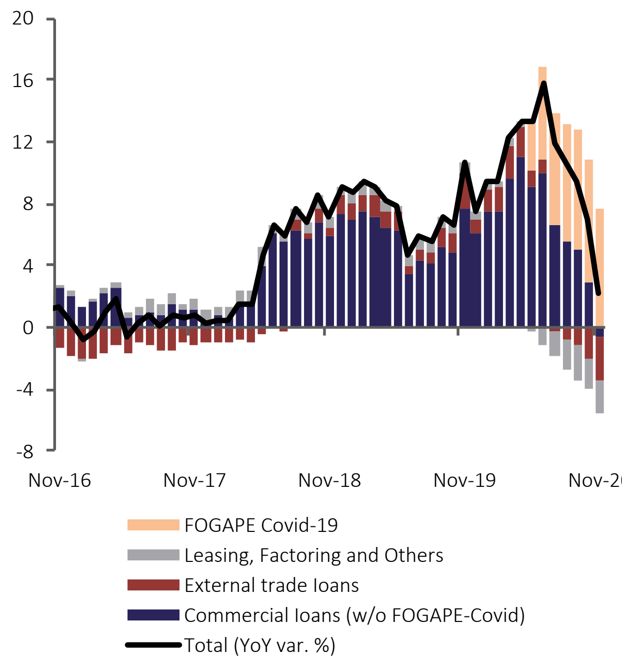
In the case of consumer loans, after more than a year of contraction there is room for them to start recovering, which will depend on the evolution of the labour market and that regulation does not introduce additional risk factors.

Commercial loans have been counter-cyclical in behaviour



Source: BCCh and Santander

The Fogape programme helped credit to keep flowing



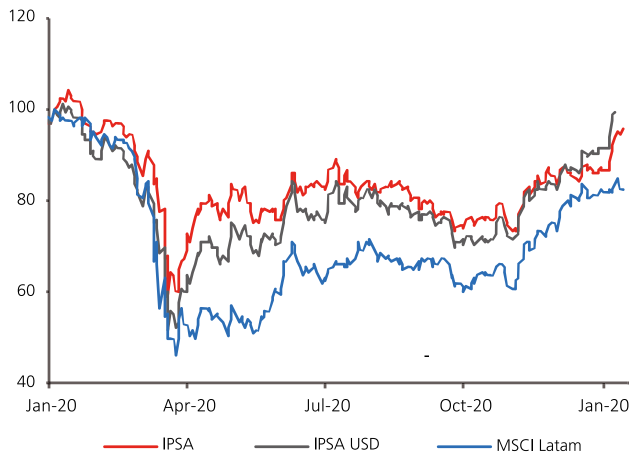
Source: CMF and Santander

Local financial prices showed mixed performances

As in most markets, the local stock exchange suffered a sharp fall in March as Covid-19 spread worldwide. The decline was less severe than in other emerging markets, partly because local prices had already taken a hit following the social upheaval. The Central Bank's prompt reaction, which aggressively lowered the policy rate, and the fact that the country was better prepared from a sanitary point of view than other emerging economies also contributed.

By the end of April, with substantial liquidity injections by the leading central banks, a recovery began to be observed in global markets and the local stock market. In the middle of the year, following the approval of the first early withdrawal of pension funds, the value of assets retreated again, but in the latter half of the year it resumed its upward trend leveraged by general optimism. Altogether, the local stock index IPSA closed the year with an annual decline of around 10%, a somewhat better performance than other Latin American stock markets.

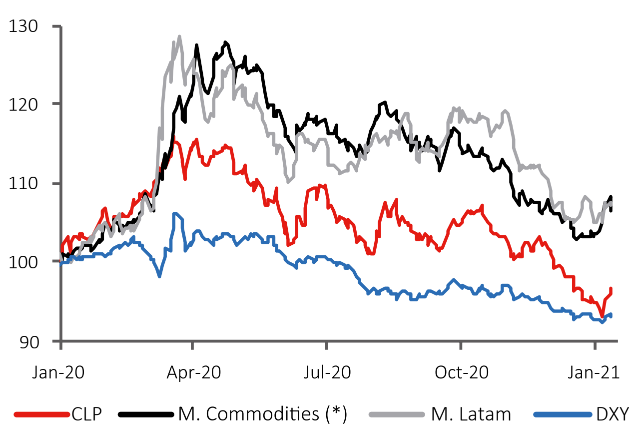
The IPSA closed the year on an upward trend but declining over 10% compared to the previous year.



Source: Bloomberg and Santander

The exchange rate began 2020 at levels close to $750, but it depreciated by more than 14% with the fall in asset prices during March and was above $860 during early April. This occurred in a context of sharply deteriorating economic expectations and high uncertainty, where copper fell more than 20% and the dollar became a global safe haven. From May onwards, amidst certain fluctuations, the Peso started to gain ground thanks to a strong recovery of copper and the dollar's global depreciation. In the second half of the year, this trend was accentuated by the liquidation of foreign assets by pension funds - more than US$ 8.5 billion between August and October -, bets in favour of the Peso by foreign investors and the dollar auctions that the Ministry of Finance began to carry out with greater intensity.

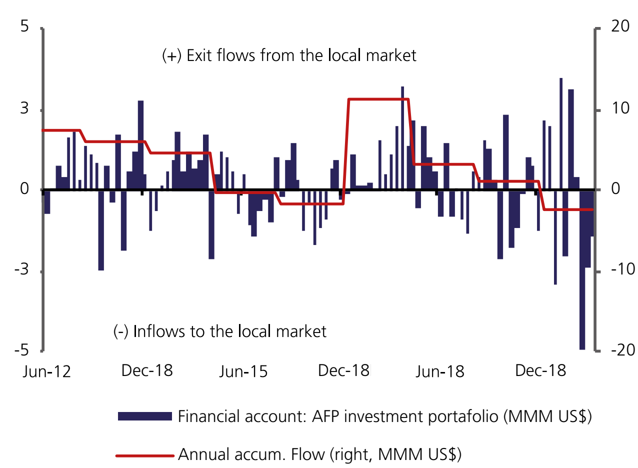
In contrast to other comparable currencies, the Peso appreciated



Note (*): M. Latam corresponds to the parities of Mexico, Brazil, Colombia, and Peru weighted by the GDP at Purchasing Power Parity. M. commodities correspond to the parities of New Zealand, Canada, South Africa, and Australia weighted by the GDP at Purchasing Power Parity.

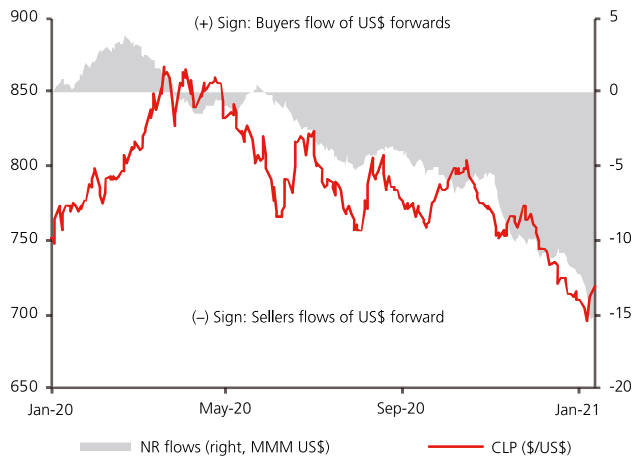
Source: Bloomberg and Santander

Pension fund flows have contributed to currency volatility



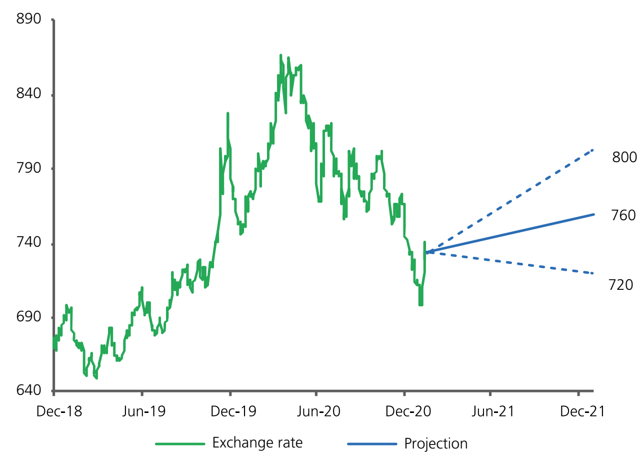
Source: BCCh and Santander

Since mid-year, foreign investors' bets accentuated exchange rate appreciation



Source: BCCh and Santander

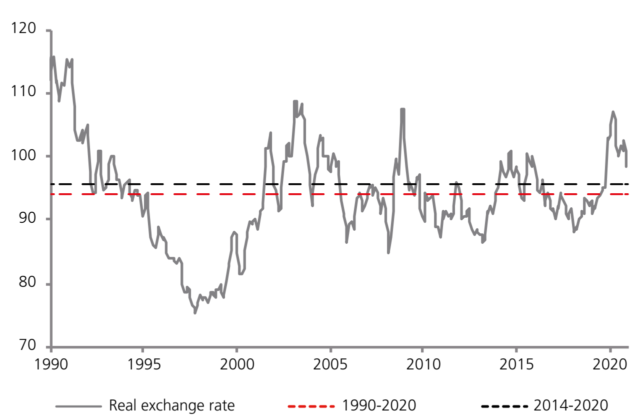
A moderate depreciation of the currency from its current levels is anticipated.



Source: Bloomberg and Santander

In real terms, April's exchange rate reached its highest value since 2008, almost 13% above its historical average. In the second part, along with the nominal appreciation, the real exchange rate declined but remained above its averages, reflecting the weak economy and some risk premiums.

Real exchange rate slightly above historical averages



Source: BCCh and Santander

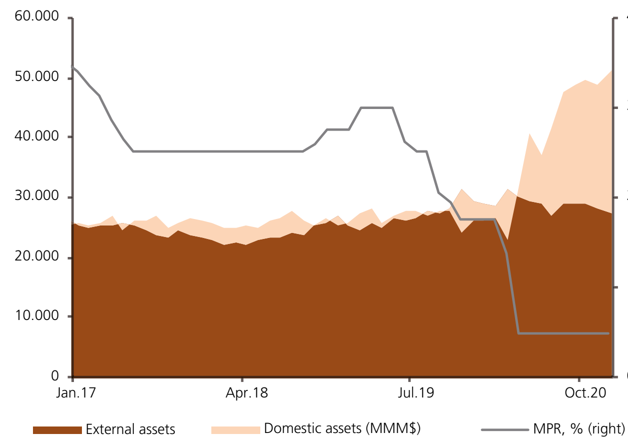
Future exchange rate movements will depend mainly on health conditions in Chile and the world, the global evolution of the dollar, the copper price, and the domestic political situation. Regarding the US currency, the fundamentals responsible for its relative weakness will remain in place. It is highly likely that the Fed will continue to inject liquidity and that the high budget deficit in the US will rise again with further stimulus packages. We also assess that the copper price should move back towards values more consistent with its long-term level, and average around US$3.4 per pound for the year. While any significant disruptions are not expected in the political scene, the string of elections during the year could polarise public discourse, introducing elements of uncertainty during the constitutional debate. Regarding this background, we anticipate that the exchange rate should, in the most likely scenario, depreciate moderately and close the year at around $760. An alternative scenario, with copper prices rising to US$ 3.8 per pound and the dollar depreciating again by about 3% internationally, would see the exchange rate close at $720. Finally, if the copper price goes to US$ 3 per pound and the dollar appreciates by around 2%, we estimate that the exchange rate would close the year at around $800.

Prompt Central Bank response helped contain pandemic impacts

In early March, the Central Bank warned of the risks ahead and, at the extraordinary monetary policy meeting in the middle of the month, aggressively cut the Monetary Policy Rate (MPR) by 75bp. Then, at the regular meeting later that month, the Council lowered the rate again by 50bp to its technical minimum of 0.5% and indicated that it would keep it at this level for an extended period. Simultaneously, it announced a series of unconventional measures to inject more liquidity into the market and facilitate the credit channel. Notable among these measures were the Conditional Credit Facility (FCIC) and the Liquidity Line of Credit (LCL), where banks were able to access very low-cost medium-term funding. Furthermore, the eligible collateral for regular liquidity operations was expanded to include corporate bonds and a bank bond purchase programme was implemented.

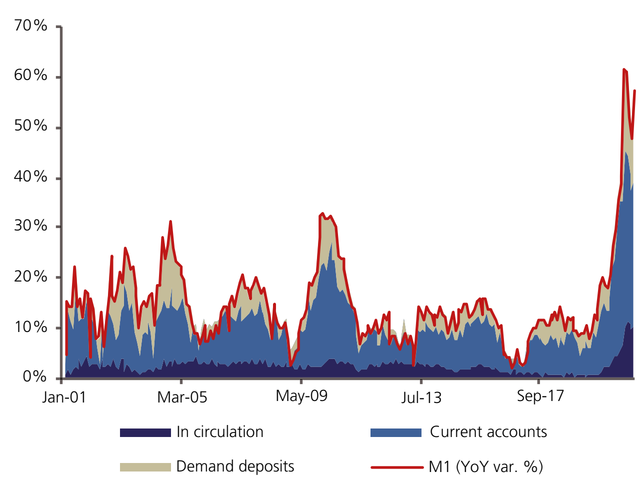
These measures led to an unprecedented expansion of the Central Bank's balance sheet, with assets rising from 15% of the GDP to over 25% by the year's end. As a result, liquidity was considerably increased, allowing the cost of credit funding to remain low. In the case of the FCIC line, its very design aimed at expanding loans with an emphasis on smaller companies and allowed it to leverage the Fogape guarantee programme launched by the government in the middle of the year. The first version of the FCIC was fully used, while the second version of the FCIC has used just under 35% of the US$ 16 billion made available by the authority.

The Central Bank has sharply expanded its balance sheet



Source: BCCh and Santander

The rate of money growth has tripled



Source: BCCh and Santander

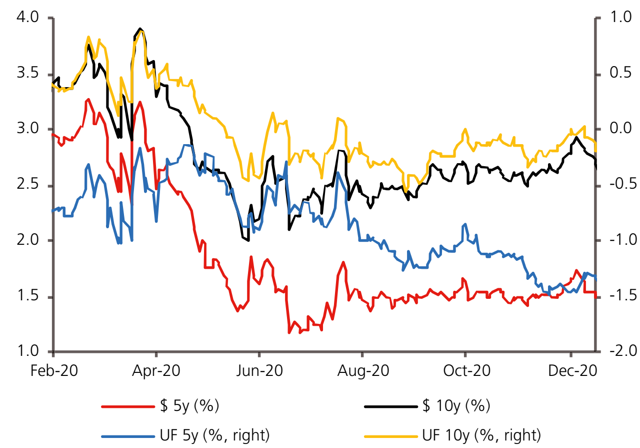
In response to monetary policy measures, bond market rates rapidly adjusted downwards, predominantly in the early half of the year. As a result, long nominal rates were at their lowest and real rates traded in negative territory. The adjustment in 5-year UF rates was remarkably abrupt, trading at around -1.5%. In the second half of the year, following the acceleration of inflation, nominal rates tended to rise, closing on average at about 100 bps below their value in the previous year.

Meanwhile, corporate spreads - which had already tightened in the wake of the social upheaval - rose again during the first quarter of last year as the pandemic intensified, reflecting the heightened risk. Nonetheless, the Central Bank's bond purchase programme helped depress these premiums quite a bit, even though they closed above historical levels.

For the future, as reiterated by the Council, the monetary drive will be maintained for a prolonged period, and non-standard measures will remain in place. We project that the MPR will stay at 0.5% until at least the second half of 2022 and then, as the economy recovers to pre-pandemic levels, a gradual normalisation process would begin. Further quantitative stimulus measures cannot be ruled out. If the Fogape 2.0 initiative goes ahead, the Central Bank could activate a new version of the FCIC. The approval of the constitutional reform allowing the Central Bank to buy Treasury bonds is another tool available to ensure the proper functioning of financial markets. Nevertheless, the Council is unlikely to make use of it this year. This should keep long-term rates low, although they could rise somewhat as the recovery reasserts itself once the vaccination process progresses.

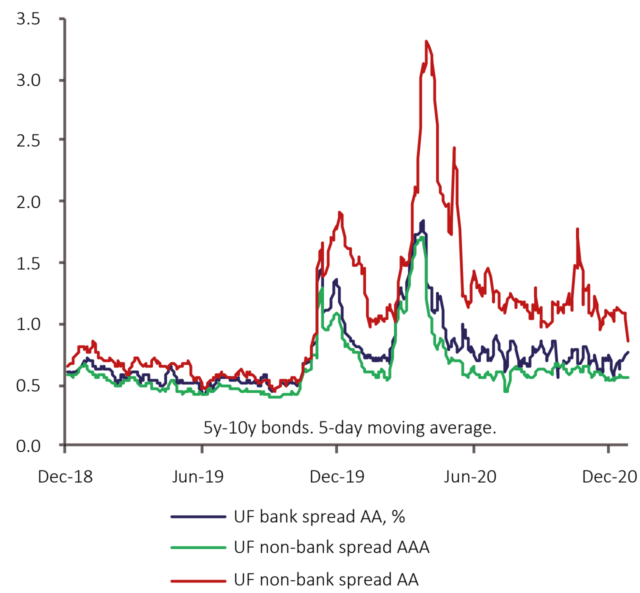
In the first half of January, the Central Bank announced a programme to accumulate international reserves of US$ 12 billion over 15 months, with purchases of US$ 40 million per day. This initiative aims to increase the level of reserves to 18% of the GDP from 13.4% in September 2020. This new dollar purchase is precautionary in nature, given the heightened risk scenario the local economy is facing following the social upheaval and the pandemic.

Government rates adjusted sharply downward



Source: BCCh, Riskamerica and Santander

Central Bank interventions helped to narrow spreads



Source: Risk America and Santander

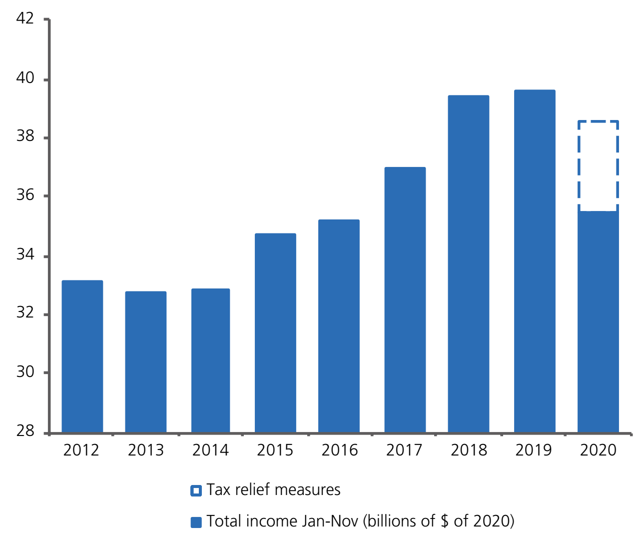
Unprecedented fiscal boost during 2020 will be continued this year

In the early months of the pandemic, the government focused on bolstering businesses and households' liquidity through tax relief measures. These included the suspension of the Monthly Provisional Payments (PPM) and the postponement of VAT payment and territorial taxes between April and September. Towards the end of May distribution of the Emergency Family Income began- which by the end of 2020 had accumulated payments of almost US$ 3.6 billion - and between August and September, the Middle-class Bond materialised, with an additional US$ 1 billion. These transfers were reflected in a sharp increase in current spending, which we estimate expanded by more than 12% during the year.

In turn, public investment had a slow execution, affected by difficulties in the materialisation of projects. Therefore, capital spending contracted by more than 10%, according to our estimates. Overall, total spending would have closed with an expansion of close to 11%, the largest since the financial crisis in 2009.

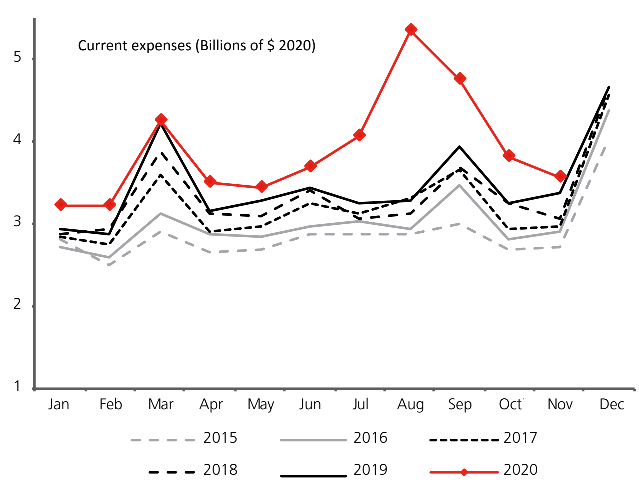
In terms of revenues, they were dented by tax deferrals and the contraction of aggregate demand. In the second half of the year, higher copper prices and a partial recovery in consumption helped restrict their fall. Even so, we estimate that revenues closed with a contraction of 10%. Hence, the fiscal deficit would have closed at just over 7.5% of the GDP, its highest level in more than 40 years. Gross debt, in turn, would have ended up at around 32% of the GDP.

Tax revenues affected by weak activity and tax relief measures



Source: Dipres and Santander

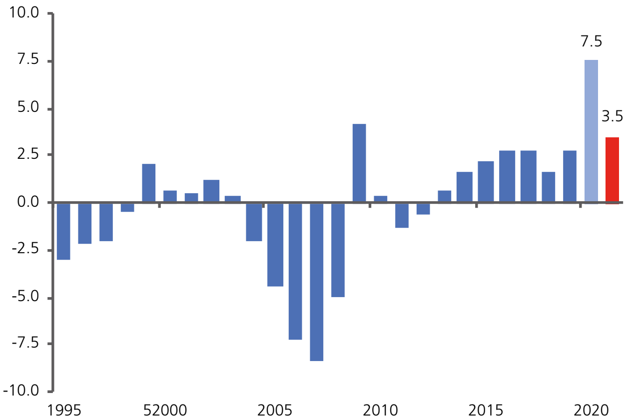
Current spending saw historic expansion due to family support measures



Fuente: Dipres y Santander

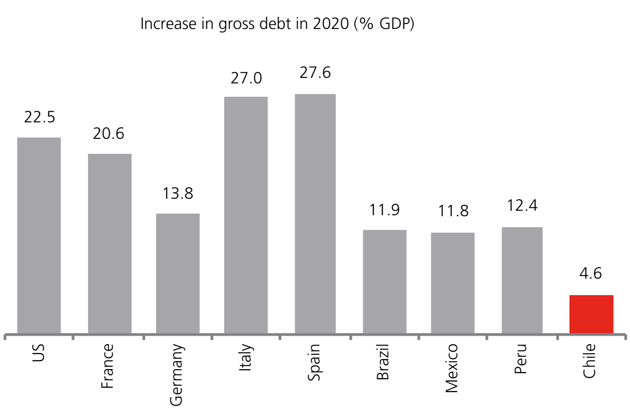
While the deficit generated by the emergency measures is the largest in recent history, it is not exceptionally high compared to the figures seen in advanced economies or other Latin American markets. Similarly, the increase in gross debt in Chile is reported to have been among the lowest globally, with which the indicator remains favourable in relative terms.

The fiscal deficit in Chile is estimated to be around 7.5% of GDP and is expected to fall by 2021



Source: Dipres and Santander

Gross debt will increase less than in other economies



Note: Figure for Chile is a Santander estimate based on Dipres data.

Source: IMF (Fiscal Monitor), Dipres and Santander.

The approved Budget for 2021 - based on the "Covid Agreement for Protection, Recovery and Fiscal Responsibility" - considers maintaining spending at a high level, with a strong emphasis on the capital component. Revenues should rebound significantly due to the reversal of tax measures, higher growth and a substantially higher copper price. According to our projections, the price of the metal will average close to US$3.4 a pound, well above the US$ 2.9 contemplated in the Budget. This would raise more than US$ 1.6 billion in additional revenue over and above the Budget (see Box 3). Therefore, the year's fiscal deficit will range between 3.5% and 4% of the GDP, below the 4.3% projected by the Dipres. Nevertheless, gross debt will continue to climb, exceeding 35% of the GDP by the end of the year.

In the future, the main challenge for fiscal policy will be to manage medium-term spending once the economic impact of the pandemic begins to subside. The agreement reached between the government and the opposition to make available exceptional resources to face the crisis (up to US$ 12 billion) considers that an important part of the fiscal impulse is transitory, so that from 2022 onwards we could see a decrease in the level of spending. The room the Treasury had available has allowed a robust response to the crisis, without putting pressure on sovereign risk premiums. Therefore, the long-term challenge is to recover room for manoeuvre to face future contingencies.

Box 3: copper price and tax revenues

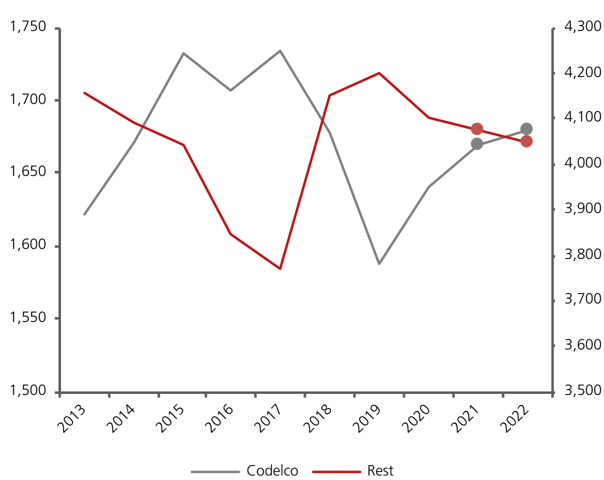
In recent weeks, the copper price has climbed to levels unseen for almost eight years, surpassing US$3.6 per pound. This has boosted our exports, put pressure on the exchange rate, and supported the government's revenue collection. If maintained at current levels, copper revenues will significantly impact treasury funds this year and the next.

In this box, we assess the impact on revenues of different metal price scenarios. To such effect, we use margin estimates constructed from Cochilco cost information and production projections for both Codelco and private mining. In these calculations, we do not consider possible endogenous exchange rates or cost adjustments to different prices.

Codelco's theoretical revenue for the year t ("gross copper") in dollars is estimated from the following equation: $T_{Codelco,t} = {}_{\tau a,t} (P_{Cu,t} - C_{Cu,t)}) X_{Codelco,t} + \tau_{b,t} P_{Cu,t} X_{Codelco,t}$, where $P_{Cu,t}$ is the average metal price, $C_{Cu,t}$ is the costs (cash-cost C3), $X_{Codelco,t}$ is the copper company's physical copper production in tonnes, τ_(a,t) is the income tax it pays (40%), and τ_(b,t) is the rate corresponding to the copper reserved Law. This rate was set at 10% until 2017 and then became 0%. This theoretical estimate leaves out Codelco's profit transfers to the state, which are decided every year and are not subject to a strict rule. Due to the dispersed data, we assume that Codelco has the same industry average cost as reported by Cochilco.

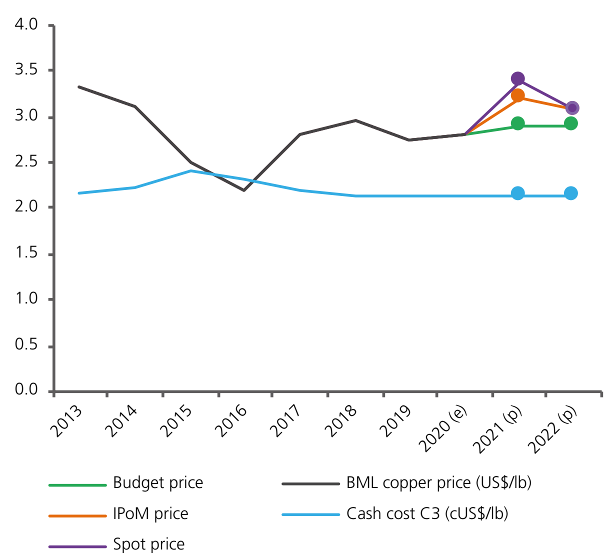
Private mining revenues are estimated in a similar way, but instead of using the actual margin for each year, a two-year average is considered. This is because profits volatility makes it difficult for Provisional Monthly Payments (PPM) of income tax to adequately capture tax payments. As a result, operating income plays a vital role and is determined based on the previous year's profit.

Physical copper production



Source: Cochilco and Santander

Copper price and production costs



Source: Cochilco, BCCh and Santander

Recent trends in physical volumes are considered for projecting quantities. In Codelco's case, therefore, there is a paced recovery towards the levels of a few years ago, sustained by the gradual entry into operation of some of the new structural projects. In turn, for the private sector, we expect some decline due to lower grades in some ore deposits. This would keep total production relatively stable over the next two years.

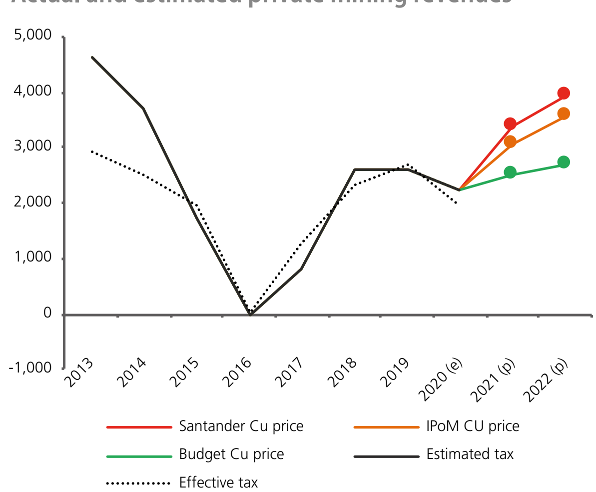
For costs, we assume that these will continue without significant variations around Cochilco's latest reported values of US$2.2 per pound. In terms of price value, we consider three scenarios. In the first, we take the assumption contemplated in the Budget Law (US$2.9 by 2021). The second scenario assumes the price projected in the last IPoM (US$/lb 3.2 for 2021 and US$/lb 3.1 for 2022). Finally, we consider our scenario, where the price averages US$/lb 3.4 this year and then falls to US$/lb 3.2 next year.

The total mining tax revenues obtained for the different scenarios show substantial differences. For example, if the current metal price is maintained, mining revenues could reach around US$5.25 billion, while under the Budget's projection, we estimate that they would reach only US$3.61 billion.

	Private mining			Codelco			Total		
	Current copper price	IPoM copper price	Santander copper price	Current copper price	IPoM copper price	Santander copper price	Current copper price	IPoM copper price	Santander copper price
2021	2500	3050	3410	1100	1545	1840	3610	4590	5250
2022	2675	3570	3925	1110	1410	1405	3785	4975	5330

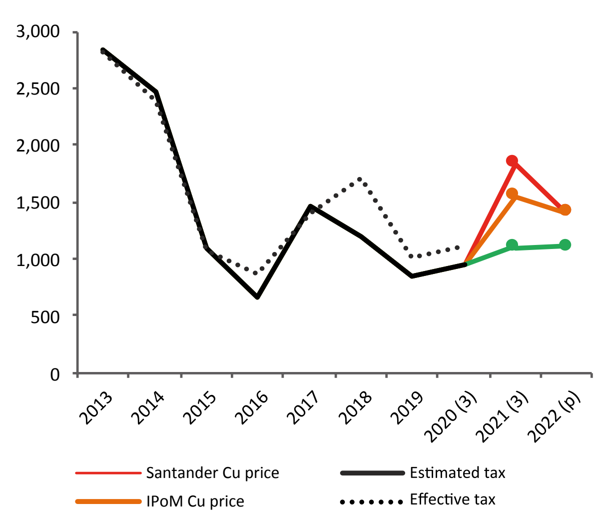
According to our estimates, the marginal effect of a one dollar cent increase in the copper price is approximately US$ 50 million. Nevertheless, since the relevant factor in the case of private mining is the average price over two years, to achieve the US$ 50 million per cent increase, the price must be maintained. The impact in the first year of the price increase is close to US$ 30 million per dollar cent. This number is slightly higher than reported by Dipres (Box 2, IFP 2019Q2).

Actual and estimated private mining revenues



Source: Dipres, Cochilco, BCCh and Santander

Actual and estimated Codelco revenues



Source: Dipres, Cochilco, BCCh and Santander

Main measures and actions taken to tackle Covid-19

Government support measures

Households:

- Covid-19 Bond of $50,000 per family dependent for those who are not formally employed. Fiscal cost: US$ 170 million.
- Emergency Family Income (IFE) of $100,000 per person for six months for 80% of the most vulnerable households added to IFE Covid.
- Additional Covid Bond, with a cash transfer to 60% of the most vulnerable population segment, that depending on the stage per commune, ranges from $25,000 to $100,000. Fiscal cost: US$ 3.4 billion.
- Middle-Class Bond of $500,000. Additionally, a four-year government loan programme (through the Treasury) of up to $1.95 million was established. Fiscal cost: US$ 1.7 billion.
- State guarantees to defer mortgage payments for up to 6 months for properties with an appraisal of less than 10,000 UF with state guarantee.
- Employment Protection Act (temporary suspension of employment until March 6th, 2021 or reduction of working hours until December 31st, 2021).
- Employment Subsidies: one for re-employment of suspended workers and one for new contracts. Part of the remuneration is funded for up to six months. The programme commits resources of US$ 2 billion.
- Creation of a solidarity fund for municipalities (US$ 100 million) to address social emergencies.

Companies:

- Suspension of provisional income tax payments until September and deferral until July of the annual income tax payment for SMEs.
- Deferral of VAT and contributions until September 2020. Reduction of stamp duty to 0% until September 2020.
- Tax measures: (1) reduction of the first category tax rate to 10% and PPM for SMEs until 2022; (2) 100% instant depreciation until 2022; and (3) extension to all of 2021 of the 90-day VAT payment.
- US$ 3 billion in state guarantees for Fogape to support loans of up to US$ 24 billion. The initial programme allowed for refinancing with a six-month deferral and a rate of MPR + 3% per annum. Currently, a Fogape Recupera (Fogape Recovers) that would extend the uses to investment and debt repayment at a rate of MPR + 7.2% annually is being processed.
- Two windows for early withdrawal of pension funds, with a minimum of 35 UF, if you have the funds, and a maximum of 150 UF. As of the date this report was issued, US$ 19.9 billion in payments have been made for the first withdrawal and US$ 13.184 billion for the second.

Main measures and actions taken to tackle Covid-19

Monetary Policy

- Reduction of the monetary policy rate (MPR) from 1.75% to 0.50%.
- Extension of the foreign exchange sales and repo programme until January 9th, 2021 (previously set at May 2020).
- An $8 billion bank bond purchase programme starting in March 2020 and an $8 billion special asset purchase programme beginning in June 2020, both of which are ongoing.
- Funding facility conditional to increased placements (FCIC1-LCL and FCIC2) of up to US$ 40 billion open to banks for 8 months from mid-June, with maturities up to March 2024, where the portfolio of individually assessed loans in the A1 to A3 ranges is accepted as a guarantee.
- Temporary suspension of compliance with term mismatch requirements effective until April 15th, 2021.
- Constitutional reform allowing the CB to buy Treasury debt in the secondary market.
- Spot Purchase and Forward Sale (CC-VP) of eligible instruments issued by banking companies for US$ 10 billion that began on August 3rd, 2020, closed and reopened on December 4th until February 15th, 2021.
- US$ 8 billion window for the purchase of term deposits and a repo window with banking companies with maturities between 7 and 180 days, valid until May 2021.
- Increased limits on investment in alternative assets for pension funds.
- Flexible Credit Line (FCL) with the IMF (up to USD 24 billion) and access to the Fed's Temporary Repo Facility for International and Foreign Monetary Authorities (FIMA).
- Expansion of the liquidity facility with the Central Bank of China from RMB 22 billion to RMB 50 billion (approximately US$ 7.1 billion).

Main measures and actions taken to tackle Covid-19

Regulation / Supervision

- Defer by one year (starting 2022) the application of the Risk-Weighted Assets requirements and the application of the additional capital buffer for systemically important banks, the associated conservation buffer requirements, and the effective capital cuts.
- Possibility of deferring up to 3 instalments on mortgage loans without altering the provisions.
- Facilities for banks to reschedule loan instalments (to SMEs and individuals) for up to 6 months, without this being considered a renegotiation.
- Possibility of not making additional provisions when rescheduling loans that are no more than 30 days past due: 6 months for mortgages, 6 months for commercial placements, 3 months for consumer loans (valid until August 31st).
- Possibility to use surplus mortgage collateral to guarantee loans to SMEs.
- An 18-month extension of the deadline for banks to dispose of assets received in payment.
- Modification of the treatment of the variation margin of derivatives allowing the value to be offset against the amount posted as collateral in favour of the counterparty, reducing the capital charge.
- Up to 15% of state guarantees may be treated as voluntary provisions. It was then decided to consider these guarantees, without limit, in the calculation of risk-weighted assets.
- Provisions may be kept constant when there is rescheduling for Covid-19 credits.
- Simplified procedure for the registration of long-term debt securities
- The Chilean Superintendency of Pensions incorporated new investment vehicles that will allow pension funds to indirectly channel financing to SMEs and established that when an alternative asset has a percentage of State guarantee, that guaranteed portion will not count towards the alternative asset limit.

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