MONTHLY ECONOMIC OUTLOOK

# Faint light at the end of the tunnel

## Highlights

- Activity within the major economies is showing the first signs of recovery, in hand with the gradual end of lockdown. The effects of the pandemic on activity are, however, estimated to be very severe, leading to the most significant contraction in 80 years.

- Financial markets are still optimistic, but stock markets in developed countries are stalling due to the significant resurgence of the pandemic and renewed tensions between the US and China, as a result of the new Security Act in Hong Kong. In the meantime, raw material prices rose again, driven by good activity figures from China and supply restrictions.

- Activity in Chile during May continued to decline due to the evolution of the pandemic and the strengthening of containment measures. While trade and services have been the most affected, the manufacturing sector showed a sharp deterioration in May and mining could suffer in July due to the suspension of some operations given the high prevalence of the disease in the Antofagasta Region.

- The labour market has been severely impacted, with a decline of almost 1.5 million jobs within the three months ending in May. The fall in employment could have been even higher, were it not for the employment protection programme. Overall, the employment figures will continue to deteriorate in the future.

- The Central Bank expanded liquidity measures to address the crisis, with an increase in the amounts of the Conditional Credit Facility for Increasing Placements (FCIC) and a new asset purchase programme. We consider it is feasible the Central Bank may review the technical minimum of the Monetary Policy Rate (TPM) and may cut the governing rate at one of its next meetings.

- Tax revenues have shown a sharp drop affected by the macroeconomic cycle and tax deferrals to help families and businesses. To date, expenditure has grown moderately, but we expect it to accelerate in the coming months, leading to a deficit of nearly 10% of GDP for the year.


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## Global economy shows a weak recovery, but pandemic resurgence raises alarm

In recent weeks, daily Covid-19 transmission cases have continued to rise globally due to the spread of the pandemic in emerging countries and recurrences in some advanced economies, mainly in the US. Notwithstanding, several have shown a gradual recovery, consistent with the easing of confinement. In this context, riskier assets have been subject to higher price volatility, mainly in developed markets, which after significant ups and downs, are trading at levels similar to those of a month ago. The emerging markets, on the other hand, have made significant increases, helped by positive data on activity within China. In fact, China's stock markets have shown a remarkable rebound over the last week, spurred on by the announcement of less severe stock market regulations and by publications in state media that are calling forth a healthy bull market.

In many countries, the collapse in activity during March and April was greater than feared at the time, and the recovery is likely to be slower. Given the above, the outlook for 2020 continues to be revised downwards. In its June update, the IMF cut this year's growth projections for the world from -3% in April to -4.9%. Particularly noteworthy is the sharp fall in activity in Latin America (-9.4%) and in the advanced economies (-8%), with major recessions in the US and the Eurozone.

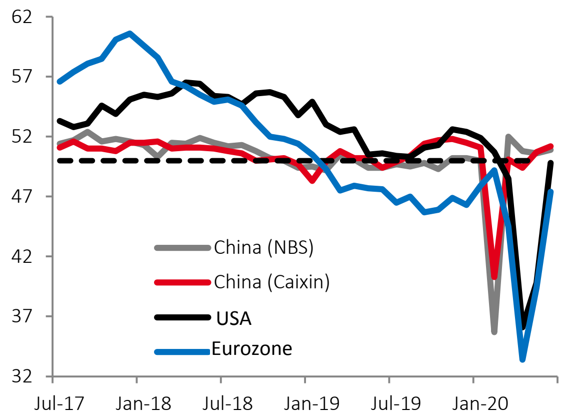
The process of ending lockdown in the advanced countries has ensued a timid recovery of activity. In the US, several data from May showed improvements compared to April: retail sales rose by more than 17% and durable goods orders recovered by almost 16%. However, most indicators were still far from their levels before the pandemic. Industrial production stands out although, despite a timid improvement in the margin, it was still almost 15% lower than in February. In June, the manufacturing and services PMI rose substantially, and the labour market showed considerable job creation (4.8 million), bringing the unemployment rate down to 11.1%. However, daily mobility data suggest that recovery could have been halted by July, hampered by the strong resurgence of the pandemic in the US.

In the Eurozone, June's manufacturing PMI also unexpectedly rose, though it remains in the contractionary zone. Throughout May and June, as factories have restarted their operations, progress has been made in industrial production. The services also show signs of improvement with the reopening of trade and leisure activities. As a result, the services PMI rose to 48.3, still below its neutral pivot. At the same time, and despite some improvement, consumer confidence remains low, in a context where unemployment is increasing.

In China, retail sales, industrial production and urban investment increased in May, although less than anticipated. For June, expectations are more promising: the manufacturing PMIs -both for NBS and Caixin- rose again and were clearly in an expansionary zone. PMIs for services also increased and, in the case of Caixin, reached their highest record in a decade. All things considered, the external sector of the Asian economy remains weak, with exports contracting in May.

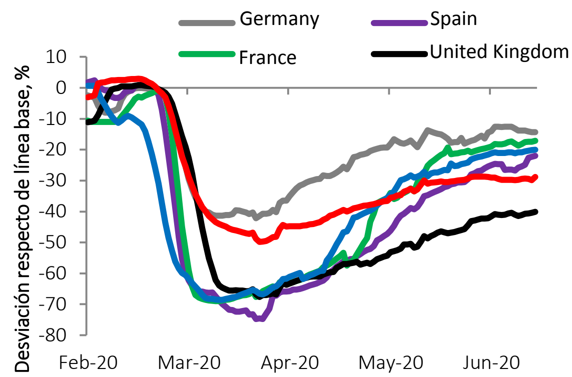
Under this scenario, governments and central banks have continued to deploy stimuli. The Fed will begin a robust programme of corporate bond purchases, after making a grim assessment of the state of the economy. In this context, benchmark rates in this country moved downwards, particularly in the long-term segment, where 10-year bond yields fell to 0.7%.

The PMI of the major economies is recovering.




Source: Bloomberg and Santander

But mobility has stalled their recovery due to the resurgence of the pandemic

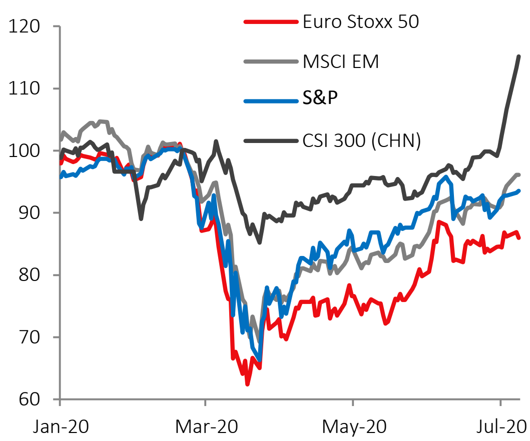



Source: Google and Santander

Throughout the month, the European Fund has continued its procedures which, according to the European Commission's proposal, will comprise resources of 750 billion euros to implement investment programmes and structural transformation of the block's economies. Two-thirds of the resources will be transferred and distributed asymmetrically among the member countries. A relevant part of the financing of this fund will be done through the joint issue of European debt, an extremely significant step in the construction of fiscal institutionality for the block.

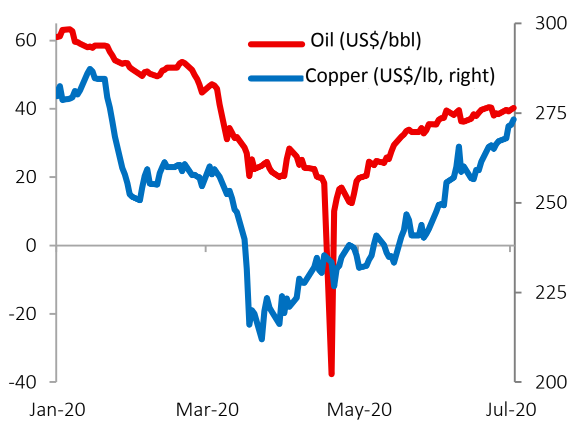
China's recovery has supported the demand for raw materials. This, together with supply constraints, has caused commodity prices to rise again. Crude oil rose by 12% in the month since our last report, reaching almost $41 a barrel as of the date this report was issued. On the other hand, the value of copper had a strong rise of more than 7%, trading over US$ 2.81 per pound in the last few days. This has been influenced not only by the prospect of increased demand but also by the news about halts of work in Chile due to the Covid-19.

The volatility of asset prices has increased in the face of mixed signals for activity.




Source: Bloomberg and Santander

Basic commodity prices keep rising, especially copper.



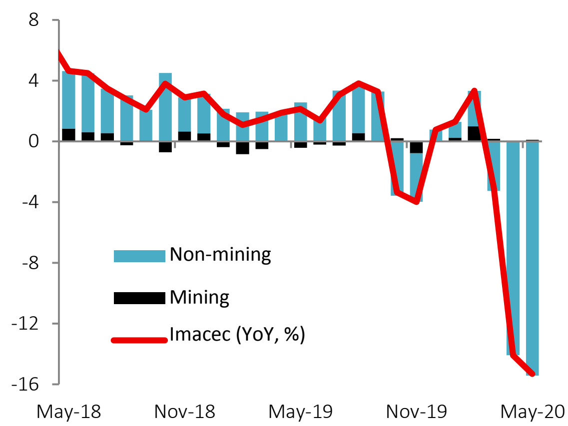

Source: Bloomberg and Santander

## After a severe drop in April, local activity is again receding in May

May's Imacec recorded the largest year-on-year drop (-15.3%) since records began, reflecting a further contraction of the economy at the margin (-3.4% MoM). This can be explained mainly by the intensifying containment measures decreed in the middle of the month -general quarantine in Santiago and other communes - due to the strong advance of the pandemic during that period. As expected, the largest falls occurred in non-mining sectors (-17% YoY; -3.7% MoM), particularly in the most labour-intensive activities (trade and services).

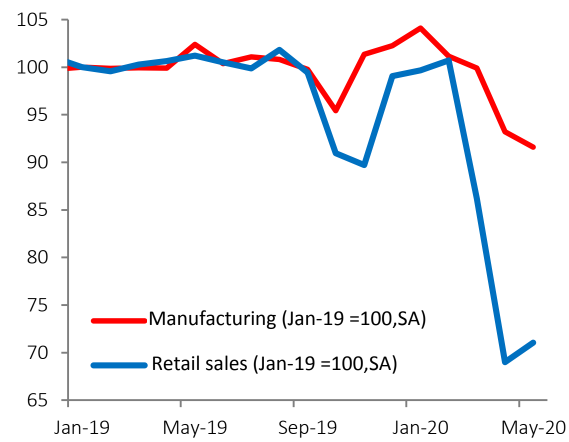
Nevertheless, according to National Institute of Statistics (INE) data, the fall in retail sales (-28.7%) was somewhat less than the previous month, indicating a certain adaptation of the sector to the new conditions of mobility. On the other hand, the manufacturing industry continued to decline and had a more intense contraction than expected (-13.3% YoY). To some degree, this could highlight the impact of containment measures that have prevented the normal development of some activities in this sector. There is also, moreover, the lower domestic demand and, in particular, the slowdown in investment. Mining is one of the few sectors that has shown itself to be resilient and achieved an annual expansion of 1.2% in May. Nevertheless, the increase in contagion in the Antofagasta Region has led to the stalling of some operations, which could have repercussions on mining activity in July.

The contraction of activity intensifies.




Source: BCCh and Santander

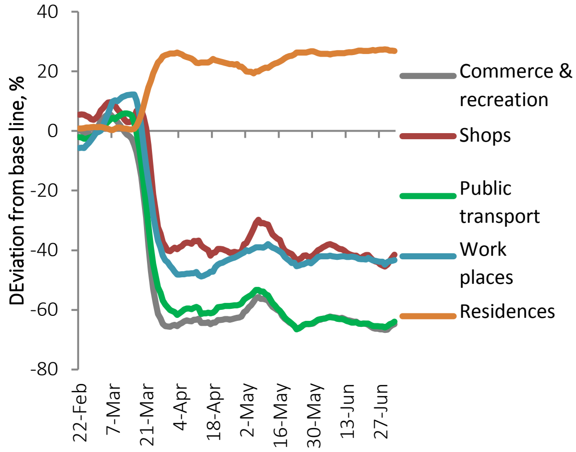
Trade shows a weak recovery, but manufacturing continues to fall.




Source: INE and Santander

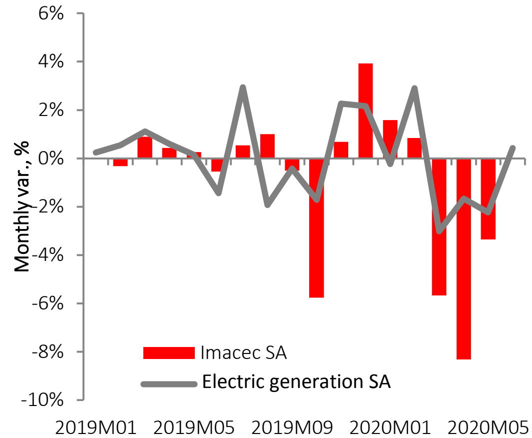
We assess that by June the Imacec should display a restricted monthly decline, much less intense than the previous months. The reason for this is that the expansion of quarantines during this period were more limited and because a number of activities that were already at operating minimums cannot be further reduced. Some evidence points precisely in that direction: electricity generation showed a slight monthly increase, new car sales showed a somewhat smaller contraction and mobility rates remained relatively flat. Despite this, the annual variation of the Imacec should be somewhat lower than in May, at around -16%.

Measures of confinement have kept limited mobility.




Source: Google and Santander

The slight recovery in power generation could suggest that the Imacec has stopped falling.

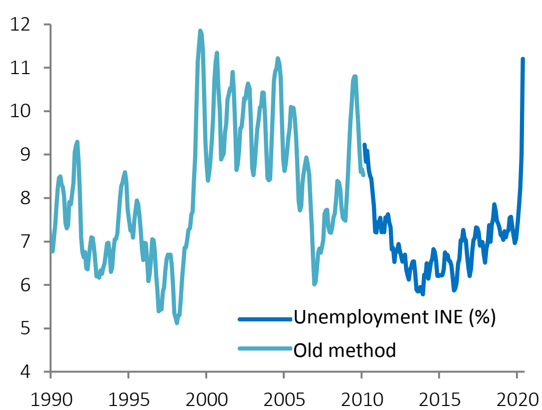



Source: BCCh, CEN and Santander

## Deterioration in the labour market reflects the impact of social distancing in labour-intensive sectors

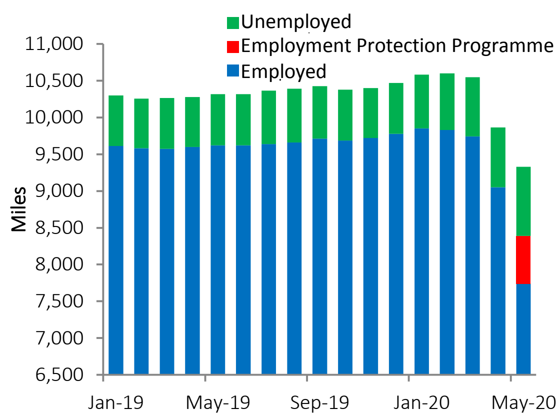
The labour market deteriorated sharply in the last three months since May. The unemployment rate rose to 11.2% -similar to the peaks reached during the Asian crisis- despite a sharp drop in the participation rate that prevented a further increase in unemployment. Nevertheless, the unemployment rate was very substantial: compared to the January-March period, before the pandemic, there were 1.5 million fewer jobs (-16.5% YoY). This was observed despite the fact that a significant number of people that were classified as "employed" were subject to the Employment Protection Programme (over 650,000, 8% of the employees). Given that these figures correspond to a moving quarter that incorporates a month where the impact of this was not yet fully evident (March), it is likely that we will see even more significant downturns in future records.

The unemployment rate reached levels similar to previous periods of stress




Source: INE and Santander

Excluding people in the employment protection scheme, almost 1.5 million jobs have been lost since March

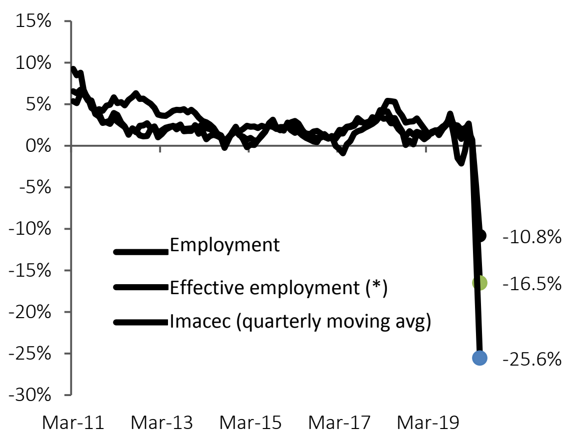



Source: INE and Santander

One important point to note is that "actual" employment fell much more sharply than the total number of people employed. More specifically, if employed individuals in "temporary absence" had been excluded -690,000 according to the INE, corresponding mostly to individuals in the employment protection plan-, the fall in employment would have been much more substantial, in the order of 26% per year. Therefore, if those employed in temporary absence had been considered unemployed, the unemployment rate could have risen to 24%. On the other hand, if there had not been such a significant decline in the workforce, the unemployment rate might have exceeded 30%.

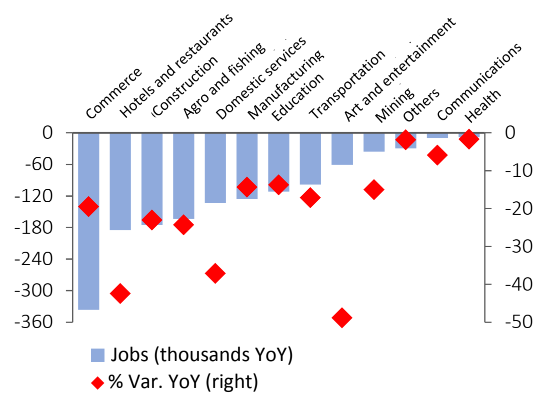
It should be noted that the decrease in actual employment is much higher than the drop in GDP (measured by the Imacec), which during the March-May period reached -11%. The reason for this is that the lower economic activity due to the pandemic has occurred precisely in those areas that are more labour-intensive.

The fall in actual employment has been far greater than the contraction in activity.




(*) Actual employment defined as non-absent workers.
Source: INE and Santander

Job losses have been most severe in sectors with high workforce levels.



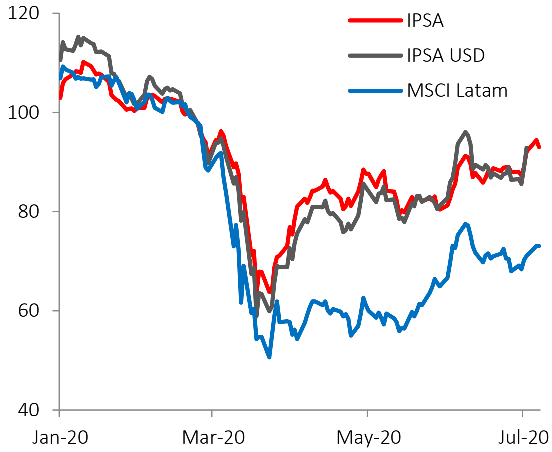

Source: INE, BCCh and Santander

As a matter of fact, the sectors where the highest number of jobs have been reduced are those where social interaction is most intense and which have been directly affected by the confinement measures (Trade, -337 thousand; Hotel and Restaurants, -185 thousand; Construction, -175 thousand). The sectors less affected by these type of measures, such as Mining and Manufacturing, have also seen significant employment losses, although less intense, with falls of around 15%.

## Local assets show strong recovery in June

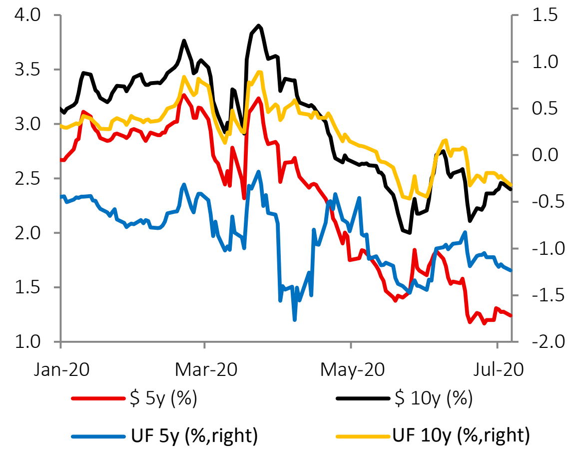
Local stock index IPSA had a significant rebound in the month and rose 6.3% since the last report was issued, almost 4,200 points, reflecting an increased risk appetite. Local interest rates tended to fall during the month, impacted by high levels of liquidity in the market. Consequently, five-year sovereign rates in Pesos reached new lows, trading at around 1.3%. The longest rates, at 10 years, remained slightly below 2.5%. For their part, real rates continued to trade in negative values, even those with long terms. These low levels, at least in the mid part of the curve, should be kept in line with the extraordinary lines deployed by the Central Bank, in particular the Conditional Credit Facility for Increasing Placements (FCIC), which was increased by US$ 16 billion at the last Monetary Policy Meeting.

Stock markets rebound as markets become more optimistic.




Source: BCCh and Santander

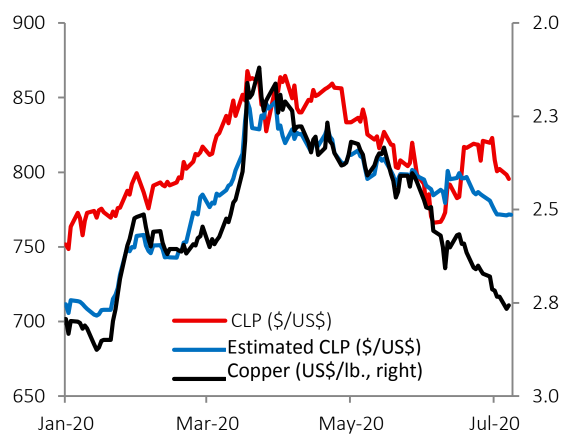
Local rates have a tendency to fall.




Source: Bloomberg and Santander

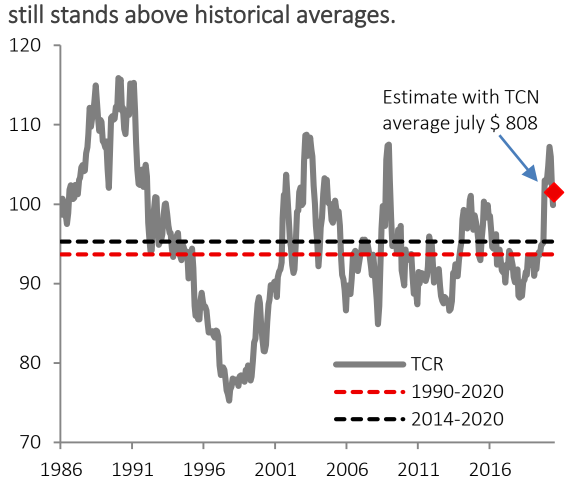
In late June and early July, the Peso tended to strengthen, appreciating more than 3% on average. Nevertheless, it has remained at similar levels to those of our last report. These movements were driven by international investors' greater risk-appetite and the sharp increase in the price of copper, which was mitigated by the abundance of liquidity being injected by the Central Bank. In real terms, the exchange rate remains above its historical average values, reflecting the relative weakness of domestic demand in relation to the most important trading partners**.**

Nominal exchange rate appreciates, boosted by its fundamentals.




Source: Bloomberg and Santander

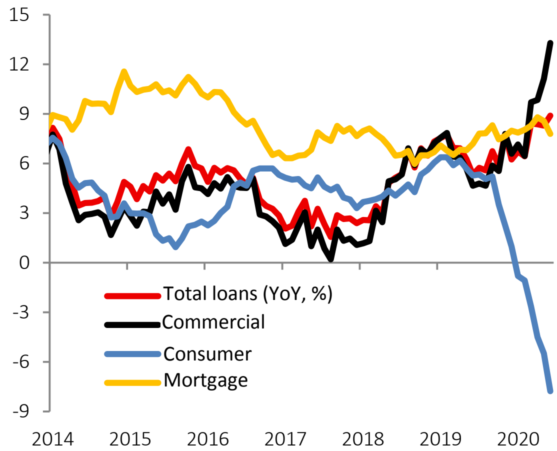
The real exchange rate is corrected downwards but still stands above historical averages.




Source: BCCh and Santander

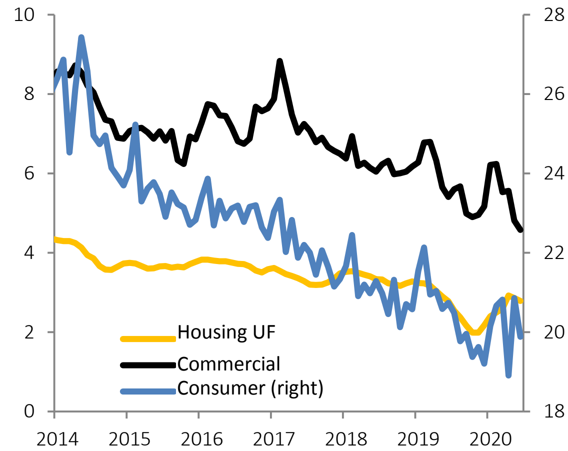
Banking loans continue the divergent trajectory that they have been displaying for some months now. Consumer loans have continued to contract strongly (-7.8% YoY in June), while commercial loans have risen sharply (13.3% YoY in June), thanks to the guarantee programme implemented by the government. Mortgage loans have remained relatively stable. Average commercial loan rates have declined due to the limits imposed by the guarantee programme, while consumer rates also show a reduction in the margin as well as the mortgage rates.

Commercial loans continue to grow, and consumer loans further decrease.




Source: BCCh and Santander.

Interest rates remain restricted.




Source: BCCh and Santander.

## Further contraction of the CPI (-0.1%) reflects the low inflationary pressures the economy is facing.

As anticipated, the CPI fell again on a monthly basis, bringing inflation down to 2.6%. This is how a trend towards disinflation is being consolidated, driven by a weak domestic demand, a less volatile dollar and some unaffected prices, both due to regulatory issues and methodological aspects.

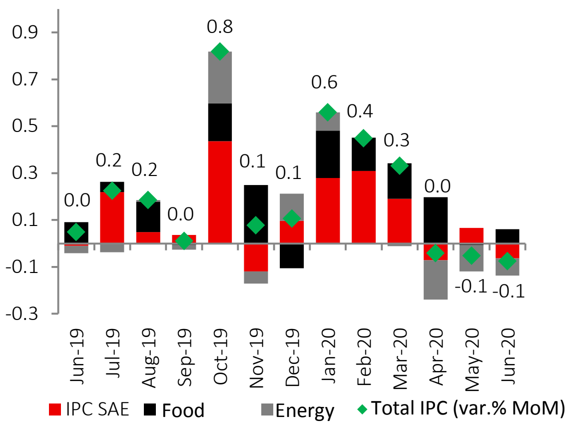
Just as in the previous months, the National Institute of Statistics (INE) had to allocate prices from where it was unable to obtain them by the usual methods. This time around, 26.9% of prices had to be accounted for by this mechanism, slightly less than the previous month, but still well above the usual (in the Restaurants and Hotels division this figure is still over 75%).

After the sharp price increases at the beginning of the year, food prices expanded moderately in June (0.3% MoM; 6.4% YoY). In contrast, the Leisure and Culture sector had a significant increase, reflecting the impact of digital taxes on some streaming services. In the month's data, the decline in the health sector caused by the fall in drug prices was noteworthy.

Similarly to the general index, core inflation as measured by the CPI sans food and fuel inflation, contracted by 0.1% while its annual variation fell to 2%. On the other hand, services inflation remains stable (0% MoM; 2% YoY), as does the CPI of non-tradables (0% MoM; 1.9% YoY). In turn, the diffusion index shows that 46.2% of prices rose, similar to the pattern of recent years.

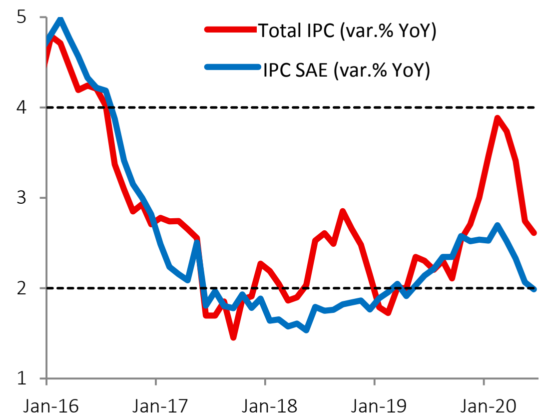
As the year progresses, we anticipate that inflation will remain weak and fall to below 2% in the first part of 2021. Weak domestic demand will ease pressures, which will be partially offset by the expected rise in fuel prices, consistent with the oil price recovery of recent weeks.

For the second month in a row, the CPI registers a negative variation.




Source: INE and Santander

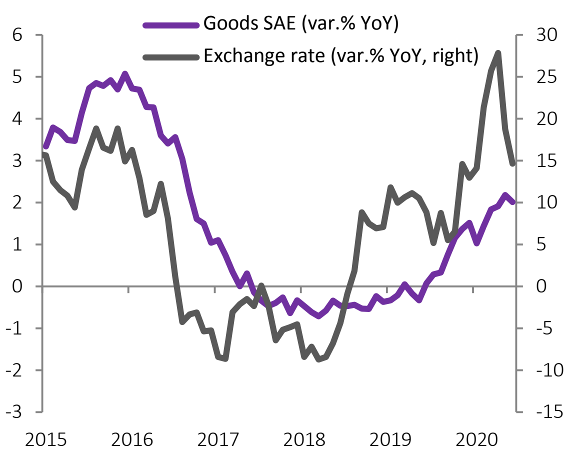
Annual inflation drops sharply.




Source: INE and Santander

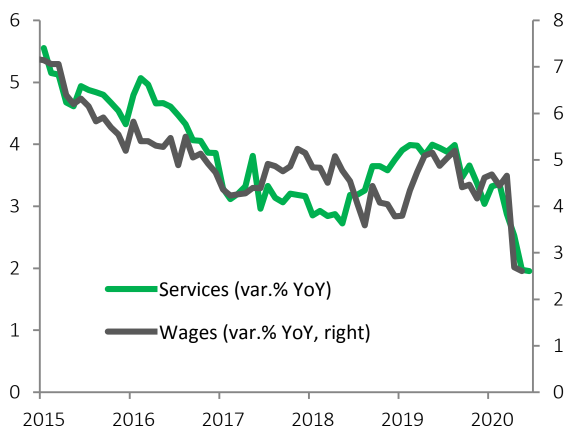
Note: SAE= sans food and energy

Exchange rate dynamics will take the pressure off the prices of goods.




Source: INE, BCCh and Santander

Services inflation has a pronounced downward trend in line with the deceleration of salaries.



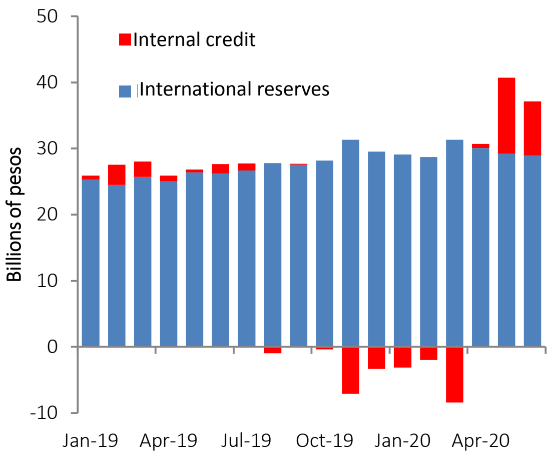

Source: INE and Santander

## Monetary policy rate could decline again

After the aggressive reduction of the Monetary Policy Rate (TPM) to its technical minimum (0.5%) at the end of March, the Central Bank has implemented several measures to expand liquidity and thereby boost the economy. This has meant a sharp increase in the Central Bank's balance sheet. During its last Monetary Policy Meeting (MPM), the Council decided to extend the Conditional Credit Facility for Increasing Placements (FCIC) for up to US$ 16 billion. Furthermore, the increase of the asset purchase programme was announced, focusing initially on bank bonds and the repurchase of equity. Congress is discussing a constitutional reform that would allow the Central Bank to buy public debt securities in the secondary markets, as is done in most countries. This would allow for a broader range of tools to provide greater stimulus.

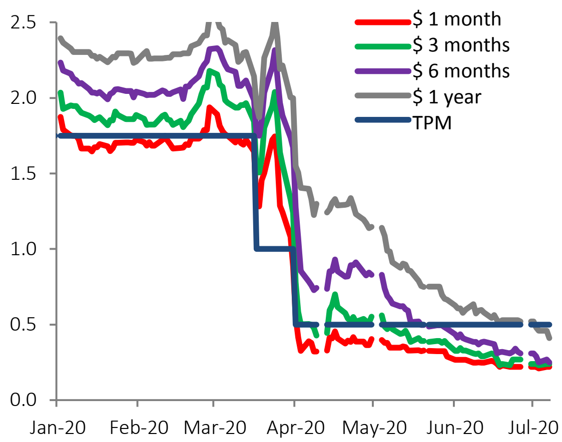
Given the sharp slowdown that the economy is facing and the low inflationary pressures, it is necessary a further macroeconomic impulse. Therefore, the Council deciding to revise the technical minimum for the MPR and reduce it below 0.5% cannot be ruled out. At the time, it was assessed that such a minimum would prevent portfolio adjustments that could distort money markets. Today, though, that risk is very low. Indeed, deposit rates are already trading below 0.5%. On the other hand, the impact of a reduction to the MPR at present is much more concrete, since it directly affects the cost of medium-term lines of credit provided by the Central Bank to banks and impacts the rates of secured loans. In light of the above, it is possible that the next Monetary Policy Meeting will include a further cut in the governing rate.

Thanks to the liquidity injection measures, domestic credit has expanded strongly




Source: INE, BCCh and Santander

Deposit rates have fallen with the Monetary Policy Rate (TPM)




Source: BCCh and Santander

## The fiscal deficit is projected to increase significantly

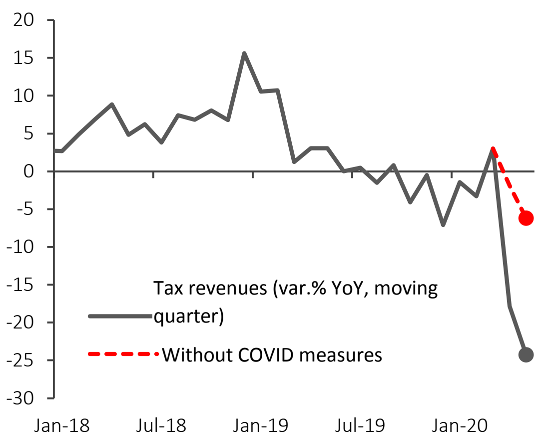
In its Public Finance Report (IFP) for the second quarter, Dipres updated its income and expense projections, including the US$ 12 billion of additional resources -for the next 24 months- defined within the "Covid Agreement" between the government and the Senate Finance Committee. According to the report, an expansion in spending of 11.4% is expected during the year, while revenues would contract by 16%, bringing the deficit to 9.6% of GDP. In 2021 the deficit is estimated to fall to 4.2% of the GDP, due in large part to the reversal of temporary support measures that will mean a partial recovery of income.

Although these projections are subject to the evolution of the pandemic and the macro situation, as of May, the fiscal execution already showed the economic contraction's impact on the fiscal accounts. The government's income in the first five months of the year accumulated a variation of -12.8% compared to 2019. The fiscal measures to address the crisis resulting from Covid-19 have meant lower revenues of $2.118 billion. If these amounts had been accrued, the accumulated contraction of April and May would have been 8.3%, versus -34% that was registered in said two-month period, thus showing that the economic impact on the fiscal accounts has been substantial, exceeding the adopted tax relief measures.

In turn, total fiscal expenditure has shown a moderate expansion (4.8%, accumulated between January and May) but exhibiting an important change in composition. Capital spending contracted by 9%, which reflects the difficulty in pursuing investment initiatives amidst social distancing measures. Conversely, current expenditure grew by 6.8%

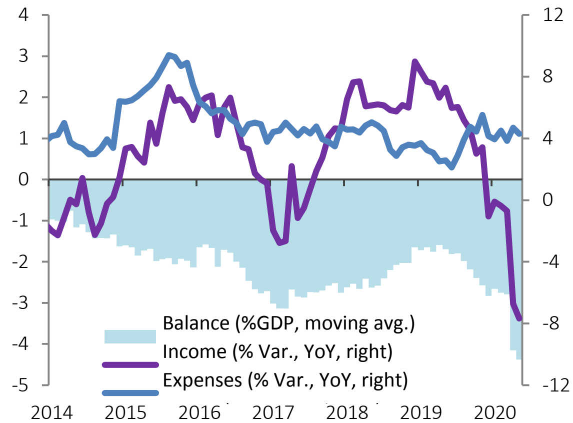
between January and May. The latter has been driven by subsidies, partially offset by a decline in the purchase of goods and services. As a result, the accumulated deficit over the last twelve months stands at 4.4% of GDP. In the future, the pace of income will continue to be slow, while expenditure should accelerate. Therefore, we assess that the deficit will close the year at around 10% of the GDP, similar to the Dipres projection. Gross debt will end the year at around 35% of the GDP and could come close to 40% next year.

In addition to the tax relief measures, tax revenues are declining at the margin.




Source: Dipres and Santander

The deficit in the last twelve months reached 4.4% of GDP.




Source: Dipres and Santander

## Macroeconomic projections

| National Accounts | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 E | 2021 P |
|---|---|---|---|---|---|---|---|---|
| GDP (real var. % YoY) | 1.8 | 2.3 | 1.7 | 1.2 | 3.9 | 1.1 | -5.5 | 4.5 |
| Internal demand (real var. % YoY) | -0.5 | 2.5 | 1.8 | 2.9 | 4.7 | 1.0 | -8.0 | 6.0 |
| Total consumption (real var. % YoY) | 2.9 | 2.6 | 3.5 | 3.6 | 3.8 | 2.9 | -5.0 | 4.0 |
| Private consumption (real var. % YoY) | 2.7 | 2.1 | 2.7 | 3.4 | 3.7 | 1.1 | -6.5 | 4.0 |
| Public consumption (real var. % YoY) | 3.8 | 4.8 | 7.2 | 4.6 | 4.3 | -0.3 | 2.5 | 4.0 |
| Gross fixed capital formation. (real var. % YoY) | -4.8 | -0.3 | -1.3 | -3.1 | 4.8 | 4.2 | -8.5 | 6.0 |
| Exports (real var. % YoY) | 0.3 | -1.7 | 0.5 | -1.5 | 5.0 | -2.3 | -3.0 | 2.0 |
| Imports (real var. % YoY) | -6.5 | -1.1 | 0.9 | 4.6 | 7.9 | -2.3 | -11.0 | 8.0 |
| GDP (US$ billions) | 260.6 | 244.3 | 250.6 | 277.1 | 298.9 | 282.7 | 245 | 265 |
| GDP per capita (US$ thousands) | 14.6 | 13.6 | 13.8 | 15.0 | 15.9 | 14.8 | 12.5 | 13.1 |
| Population (millions) | 17.8 | 18.0 | 18.2 | 18.4 | 18.8 | 19.1 | 19.5 | 19.7 |

| Balance of Payments | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 E | 2021 P |
|---|---|---|---|---|---|---|---|---|
| Trade balance (US$ billions) | 6.5 | 3.4 | 4.9 | 7.4 | 4.6 | 4.2 | 11.0 | 10.0 |
| Exports (US$ billions) | 75.1 | 62.0 | 60.7 | 68.8 | 75.2 | 69.9 | 65.0 | 68.5 |
| Imports (US$ billions) | 68.6 | 58.6 | 55.9 | 61.4 | 70.6 | 65.7 | 54.0 | 58.5 |
| Current account (US$ billions) | -5.2 | -5.7 | -5.0 | -6.4 | -10,6 | -10,9 | -2.0 | -3.8 |
| Current account (GDP%) | -2.0 | -2.4 | -2.0 | -2.3 | -3.6 | -3.9 | -0.8 | -1.4 |
| Price of copper (annual average, US$/lbs.) | 3.11 | 2.50 | 2.21 | 2.80 | 2.96 | 2.72 | 2.40 | 2.50 |
| WTI oil price (annual average US$/bbl.) | 93.1 | 48.7 | 43.2 | 50.9 | 64.8 | 57.0 | 39.0 | 48.0 |

| Money and Exchange Market | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 E | 2021 P |
|---|---|---|---|---|---|---|---|---|
| CPI Inflation (var. YoY, % by December) | 4.6 | 4.4 | 2.7 | 2.3 | 2.6 | 3.0 | 2.0 | 2.5 |
| CPI Inflation (var. YoY, average %) | 4.7 | 4.3 | 3.8 | 2.2 | 2.4 | 2.3 | 2.8 | 2.2 |
| CPI sans food and fuel inflation (IPC-SAE) (var. YoY, % by December) | 4.3 | 4.7 | 2.8 | 1.9 | 2.3 | 2.5 | 2.0 | 2.1 |
| CLP/US$ exchange rate (year's exercise) | 607 | 707 | 667 | 615 | 696 | 745 | 810 | 790 |
| CLP/US$ exchange rate (year average) | 570 | 654 | 677 | 649 | 640 | 703 | 805 | 800 |
| Monetary policy rate (year's exercise, %) | 3.00 | 3.50 | 3.50 | 2.50 | 2.75 | 1.75 | 0.50 | 0.50 |
| Monetary policy rate (%, year average) | 3.75 | 3.06 | 3.5 | 2.7 | 2.52 | 2.48 | 0.78 | 0.52 |

| Fiscal Policy | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 E | 2021 P |
|---|---|---|---|---|---|---|---|---|
| Public expenditure (real var. % YoY) | 6.4 | 7.4 | 3.8 | 4.8 | 3.5 | 4.1 | 12.9% | 2.5% |
| Central Government balance (% GDP) | -1.6 | -2.2 | -2.7 | -2.8 | -1.6 | -2.8 | -10.0% | -5.0% |
| Central Gov. gross debt (US$ billions) | 36.6 | 39.0 | 53.4 | 68.9 | 70.2 | 74.4 | 80.3 | 98.1 |

Source: BCCh, INE and Santander

# CONTACT

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