Central Bank could raise the monetary policy rate by at least 50 bp in the next MPM

Next week will be relevant both for the monetary policy decision that the Central Bank (BCCh) must take on August 31 and for the update of the scenario in the September Report, where guidance for the withdrawal of forward stimuli will be established.

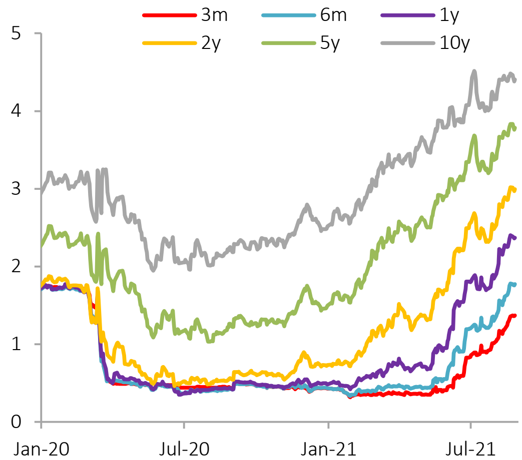
In recent weeks, the improvement in sanitary conditions has made it possible to move towards greater reopening (in the next few days 97% of the country's population will be in phase 4), which has led to the advancement of the sectors that until now have been lagging behind, such as services and construction. For its part, consumption maintains significant dynamism due to liquidity from the third withdrawal of pension funds and the boost from the universal IFE. We estimate that the Imacec for July would have had a new advance with an annual growth of 18%. This, added to the revisions of the GDP of the first semester, makes us foresee that the Central Bank will raise its growth projections for the year to a range of between 10% and 11%.

The strong dynamism of demand, in a context where supply is still restricted, has generated significant inflationary pressures. Thus, the market - and our own projections - have been aligned with the latest Central Bank estimates, with a CPI closing the year at around 4.5%. The medium-term prospects have also started to move upwards and everything indicates that next year inflation will close above the target, around 3.5%.

Given the above, we estimate as the most likely scenario that in the next Monetary Policy Meeting (MPM) the Central Bank will increase the Monetary Policy Rate (MPR) by 50 bp, to place it at 1.25%, and that it will make additional increases in the following meetings this year, in order to end the year with a MPR between 1.75% and 2%. All in all, we do not rule out that the Board may decide to get ahead of the curve and raise the MPR more intensely next week, by 75 bp. This would give space to proceed more slowly in the following meetings and calibrate possible risks derived from the pandemic itself and the magnitude of the fiscal adjustment that is expected for next year (the budget will be known at the end of September, before the next MPM). In particular, the strong expansion in spending this year (+ 32% YoY) should give rise to a contraction next year, in order to avoid a divergent path for debt. This will impose a slow down on demand during 2022, giving space for the issuing institute to act slowly and keep the MPR below its neutral value (3.5%) throughout the next year.

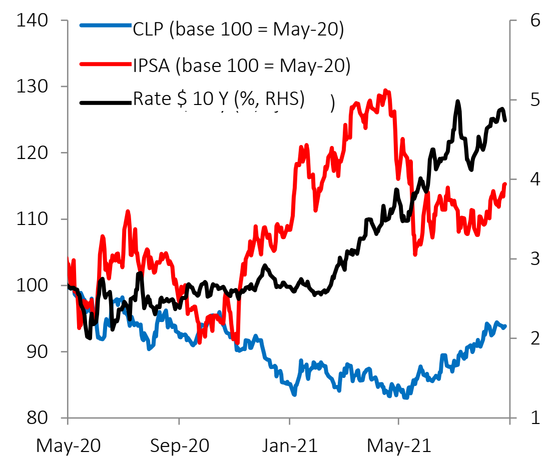
Swap rates have experienced a significant increase in recent weeks and point to an increase in the MPR that is considerably more pronounced than what we consider to be the most likely scenario (2.25% at the end of 2021; 3.75% at the end of 2022). Long-term rates have moderated in recent days (4.8%), after significant increases in previous weeks. For its part, the exchange rate has remained more depreciated, fluctuating around $785 due to fears about the Chinese economy, domestic political uncertainty and a stronger dollar against possible tapering announcements at Jackson Hole.

Swap rates reflect the acceleration of the withdrawal of monetary stimulus



Source: Bloomberg and Santander

Local assets take a break and return to positive territory



Source: Bloomberg and Santander

Adjustment to MEPCO once again contains increases in gasoline

During the first week of August, the Government adjusted the parameters of the Fuel Price Stabilization Mechanism (MEPCO) to induce a drop in gasoline prices close to $ 20 per liter. The operation of this mechanism has allowed the values to remain relatively stable in subsequent weeks -including the one that has just ended, avoiding the $6 increase that would have been registered without these changes in parameters. All this, in a context of high volatility in the international price of oil, which tended to recover in recent days after falling almost 10% last week due to the expectation of lower demand associated with the evolution of the pandemic in the world and the slowdown in China.

Given the above, in August the average price of gasoline will decline -after seven months of increases of around 3% per month-, which will take pressure off the CPI for the month. We estimate that the latter will moderate after the surprise in July (0.8%) and would have a variation of between 0.2% and 0.3%, mainly affected by the food and housing.

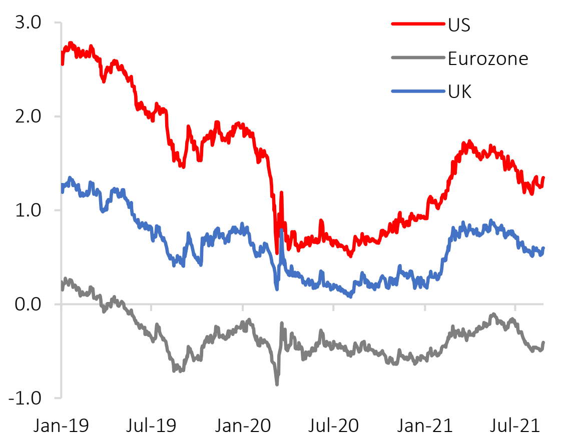
Jerome Powell does not specify announcements of the possible start of tapering and maintains the dovish bias

The markets have been very attentive to the Jackson Hole convention that is taking place these days and the possible announcements that the president of the Fed, Jerome Powell could make. However, in his intervention, although he remarked that it was possible that the tapering (beginning of the withdrawal of quantitative monetary stimuli) began this year, he did not refer to specific dates. In general, he put forward a position that could be considered dovish, insisting on the transitory nature of inflation - highly concentrated in increases in durable goods prices, which even before the pandemic exhibited a downward trend - and on the fact that the labor market has not yet fully recovered from the effects of the pandemic. In fact, while the unemployment rate has decreased (5.4% in July), in part this is because many people have left the workforce. In addition, on the margin there is the risk of the reappearance of infections due to the delta variant, which could slow down progress in labor matters.

A highlight of Powell's intervention was the reaffirmation that the initiation of the rate hike process was something separate from tapering. This would only occur when inflation persistently asserted itself at the 2% target, and was on the way to exceeding that value for some time. This, because according to the monetary scheme announced last year, for the Fed what is relevant is that inflation is located, on average, at 2%. Given this, if prices have risen less than that figure over a period of time, then it is necessary to let them rise more.

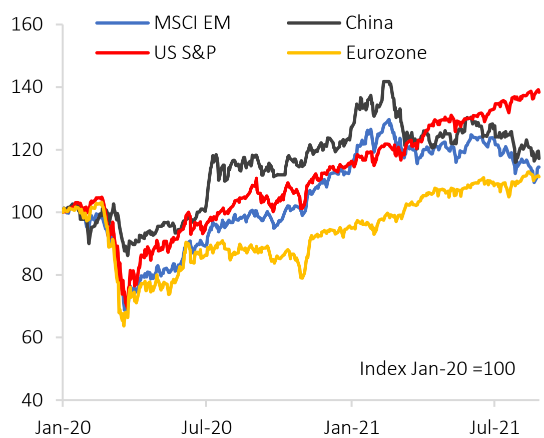
Following Powell's presentation, markets reacted by increasing. Stock indices rebounded, with the S&P 500 reaching new historical records (exceeding 4,500 points) and the MSCI Global closed the week with gains (+ 2%), highlighting the recovery of emerging markets and Latin America (+ 4%). Although long-term rates in the main economies fell after the Fed's intervention (-2bp on average), they ended the week higher (+ 7bp on average), especially the T10 in the US, which remains at around 1.3%. Commodities, meanwhile, reversed their previous falls and rebounded strongly in the week, especially WTI oil (+ 10%) and to a lesser extent copper (+ 4%), with a global dollar showing weakening (DXY: + 0.8%) and in the midst of an aversion to risk that remains limited (VIX: 16.5 points).

Long term rates of developed economies reverse the trend and increased during the week



Source: Bloomberg and Santander.

Stock exchanges globally recovered previous falls and closed with advances



Source: Bloomberg and Santander.

The economic figures showed a moderation in global PMIs in August, where the services sector has been the most affected by the possible impacts of the spread of Covid-19. However, the manufacturing components, in general, remain optimistic.

In the US, initial unemployment benefits (353,000 vs. 350,000 expected) stabilized at minimum levels since the pandemic began, a sign that reinforces the good reading of the labor market. In addition, the second revision of the GDP of 2Q21, although it was slightly lower than anticipated (6.6% vs. 6.7%), confirms the solidity of personal consumption that grew 11.9% (12.2% expected). In the political sphere, the House of Representatives approved the budget framework for US $ 3.5 billion and agreed to vote before September 27 on the infrastructure bill for US $ 1 billion, which has already been approved by the Senate, giving a boost to the favorable economic outlook.

In Europe, a broad discussion regarding the course of monetary policy emerges from the minutes corresponding to the July meeting of the European Central Bank. At its next meeting (September 9), in addition to the update of the macroeconomic projections, news regarding the rate of asset purchases and reactions to what may happen with tapering in the US are expected. In Germany, confidence of consumers in September surprised on the downside (-1.2 vs. -0.5% expected), while the IFO survey of expectations for August fell beyond what was projected (97.5 vs. 100.0 expected), led by the fall in the business climate component (99.4 vs. 100.4 expected). For its part, China celebrated during the week not having registered major local contagions of Covid-19 and the Bank of Korea (BOK) increased the monetary policy rate by 25 bp, taking it to 0.75% and surprising the market consensus that anticipated a maintenance.