Mass vaccinations ease fears and strengthen markets

Our growth projections for Chile have been revised upwards. A more buoyant closure at the end of 2020, the swift and expeditious deployment of the vaccination process and a more favourable external scenario prompt us to correct our 2021 GDP estimate from 4.5% to a range between 5.5% and 6.5%.

Highlights

Global markets react optimistically to the decline in infections and progress in the mass vaccination process. Stock indices in several economies are at record highs, but those in Europe are not yet back to pre-pandemic levels.

***Commodity* prices rise strongly**. Increased optimism concerning the global scenario and supply constraints are causing oil to regain its value prior to the health crisis. Copper, meanwhile, reached levels not seen for more than eight years.

Our growth projections for Chile have been revised upwards. A more dynamic closure at the end of 2020, the swift and expeditious deployment of the vaccination process and a more favourable external scenario prompt us to correct our 2021 GDP estimate from 4.5% to a range between 5.5% and 6.5%. Nevertheless, the balance of risks to activity remains on the downside.

Weak job creation reflects a still lagging labour market. Despite the decline in the unemployment rate, there are still about one million fewer people in employment than a year ago, and formal jobs show little progress.

Surprise in January's CPI leads us to revise the inflation projection. Contextualising the recent acceleration in prices is the abundant liquidity received by households alongside restricted inventories. Once these factors dissipate, wide capacity gaps will contain inflationary pressures. Even so, the year will close with the CPI above target.

Monetary conditions will remain highly expansionary. Despite higher inflation, the economy's weakness and the risks to a sustained recovery allow considerable leeway for the Central Bank to keep the key interest rate at its minimum level until well into 2022.

CLAUDIO SOTO
Chief Economist
claudio.soto.gamboa@santander.cl

GABRIEL CESTAU
Economist
gabriel.cestau@santander.cl

LORENA PALOMEQUE
Economist
lorena.palomeque@santander.cl

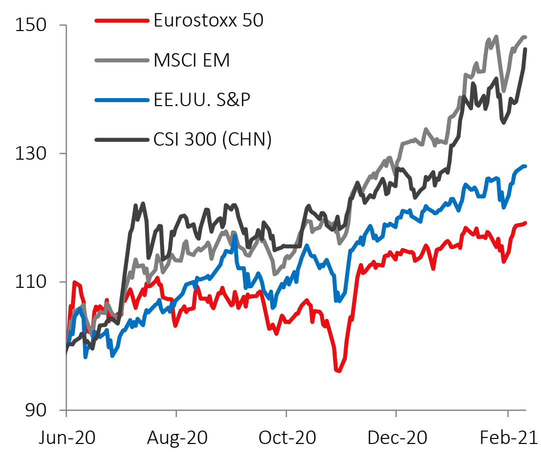
SINDY OLEA
Economist
sindy.olea@santander.cl

MIGUEL SANTANA
Economist
miguelpatricio.santana@santander.cl

FABIÁN SEPÚLVEDA
Economist
fabian.sepulveda@santander.cl

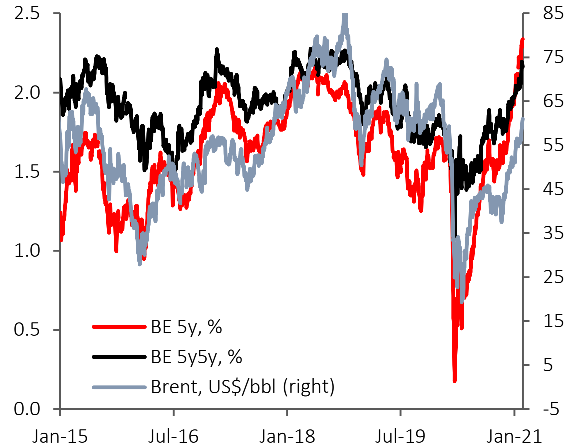
In recent weeks, renewed optimism has caused global markets to rebound, with several reaching new record highs. Of note is the nearly 4% hike in the US S&P 500 since the beginning of the year, and China's CSI 300 index, which has increased by more than 11% over the same period. In Europe, stock markets have also reacted positively but remain below pre-pandemic levels.

Global markets rise as infection declines, and vaccination rollouts begin.



Source: Reuters and Santander

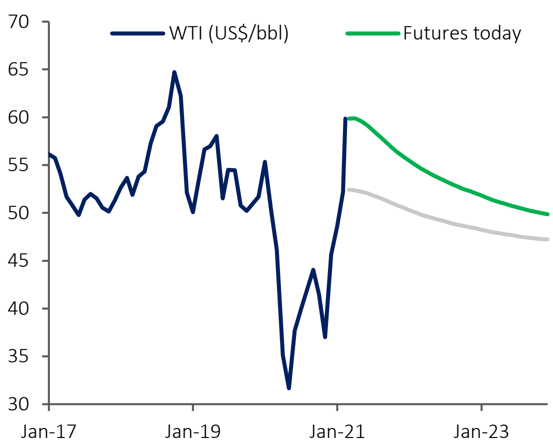
US inflation projections have climbed.



Source: Reuters and Santander

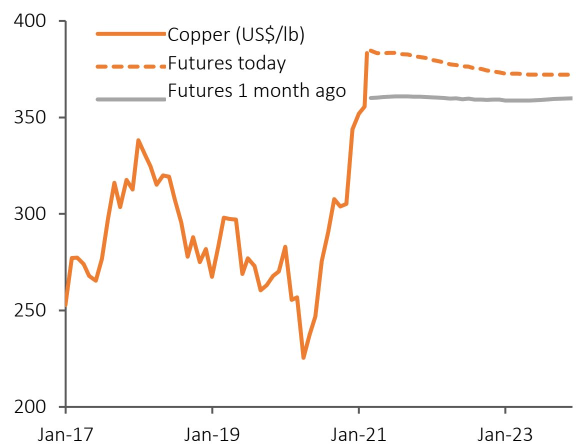
In this context, long-term rates in the US have trended upwards, especially the three-year rates, and medium-term inflation expectations have risen. Commodity prices have climbed again, with the significant increase in the price of copper standing out, which, after retreating towards the end of January, rose sharply in the most recent period and surpassed US$3.8 per pound during the last week. Additionally, the oil price has returned to pre-pandemic levels with the prospect of a faster recovery in demand and a market where supply is perceived to be constrained in the short term by OPEC's significant production cuts.

Oil price has returned to pre-pandemic levels



Source: Bloomberg and Santander

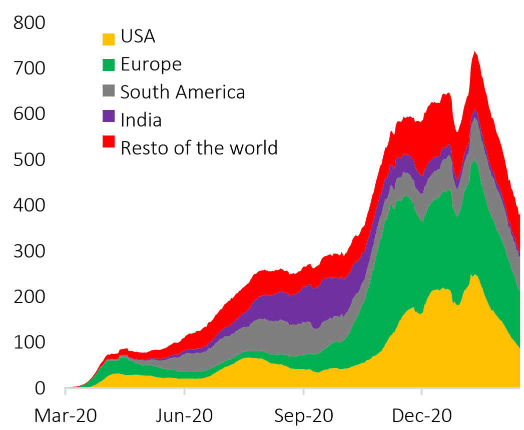
Copper reaches levels not seen in more than eight years



Source: Bloomberg and Santander

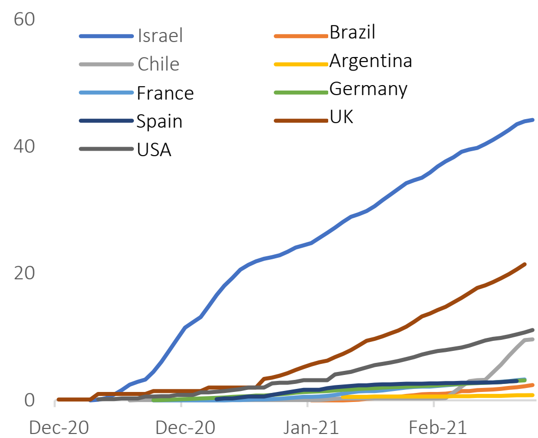
The mass vaccination progress and the decline in the number of new infections globally have certainly been the main drivers in different markets. Good corporate profit reports and a high likelihood of the approval of the substantial fiscal stimulus package proposed by the newly inaugurated Biden administration are also relevant factors. Overall, the vaccination process - which will set the pace of recovery going forward - has been inconsistent. The US and UK's rollouts stand out among the advanced economies while the Eurozone is lagging. Meanwhile, Israel, the UAE, and Chile stand out among the emerging economies due to the high level of coverage reached within weeks of starting mass inoculations.

Containment measures reduce infections



Source: OWID and Santander

Vaccination process progresses, albeit unevenly



People vaccinated every 100

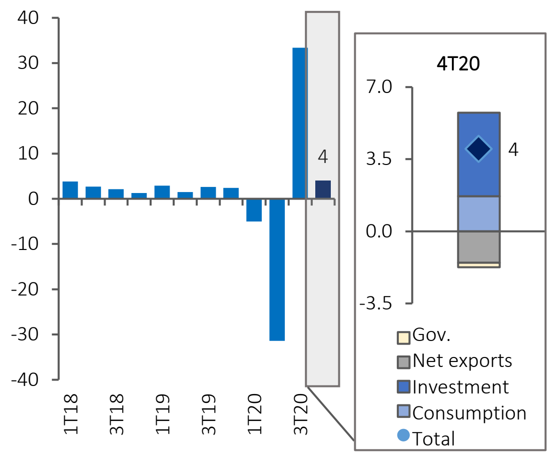
Source: OWID and Santander

Beyond optimism, real sector data show recovery has lost momentum

In the US, the activity's expansion rate slowed in 4Q20, reflecting the new wave of contagion seen from November. The GDP grew by 4.0% QoQ annualised, somewhat below the 4.2% projected by surveys and much lower than in the third quarter. Therefore, the year ended with a real decline of 3.5%, one of the lowest among advanced countries. The labour market, on the other hand, has continued to fall behind. In January, the unemployment rate stood at 6.3%, slightly better than expected, but non-agricultural job creation was only 49,000, well below the more than 100,000 new jobs anticipated by the market, leaving total employment almost 6.5% below its pre-pandemic level.

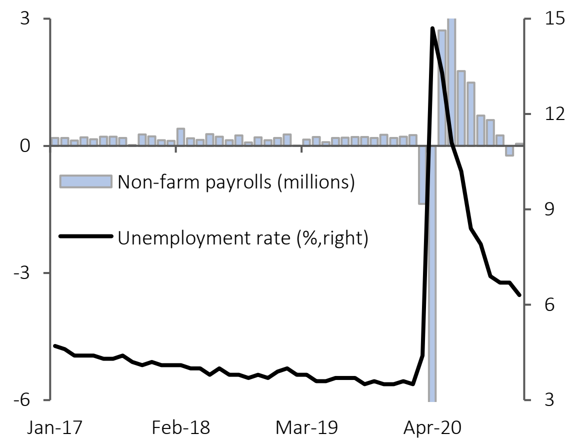
Given the above, Fed Chairman Jerome Powell has remarked the need to maintain the monetary stimulus and advocated extending aid to households to ensure the economy recovers and returns to full employment.

US recovery has slowed down



Source: Bloomberg and Santander

Low US job creation reveals a still weakened labour market

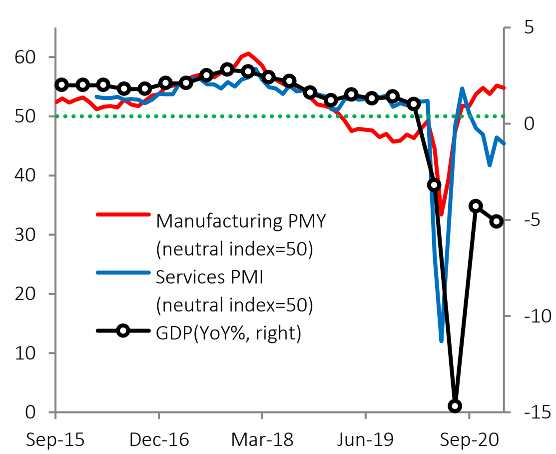


Source: Bloomberg and Santander

In the Eurozone, the fourth-quarter GDP fell by 5.1% YoY, a decline over the third quarter. As a result, the bloc contracted by 6.8% during the year, the largest contraction since World War II. The year's beginning continued the trend of previous months, with the manufacturing sector expanding, but with services still being impacted by the containment measures in several countries.

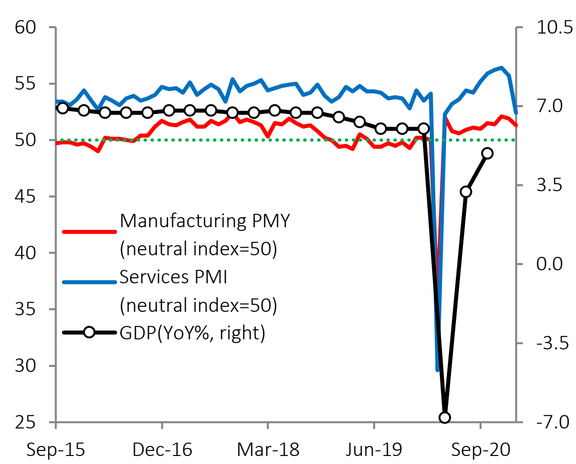
The short-term outlook for the region remains complex, given the slow vaccination rollout process. Even in Germany, healthcare authorities have maintained that restrictions will remain in place during the first quarter and that vaccines will be in short supply during this period. Likewise, the International Monetary Fund (IMF), in its latest update of projections in January, stated that the bloc would recover more slowly than other economies in the world.

New wave of contagions in Europe in late 2020 impacted service sectors



Source: Bloomberg and Santander

China's economy remains dynamic, despite moderation in some activities



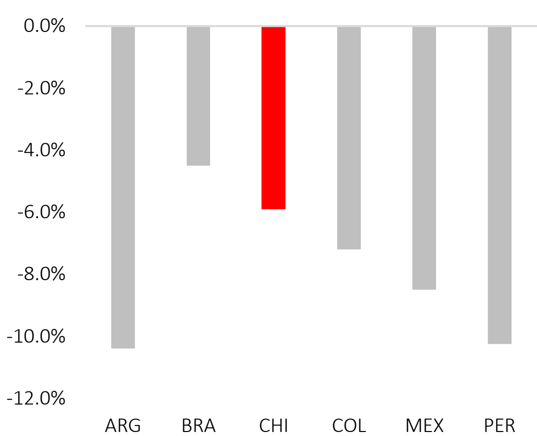
Source: Bloomberg and Santander

Unlike most countries, China managed to grow during 2020 (2.3%), aided by an early control of the pandemic, government stimulus plans and a dynamic industrial sector, which benefited from external demand for medical supplies. As 2021 began, new health restrictions enforced to contain incipient outbreaks of contagion led to a sharp moderation in the services sectors. The manufacturing sectors, on the other hand, maintained their pace of expansion. In the coming quarters, China is expected to continue to show strength. Although the progress of the vaccination programme in that country is unknown, high coverage will likely be achieved rapidly.

In Latin America, the pandemic continues to strain healthcare systems and affect the pace of recovery. While a moderation of new cases has been observed in some countries, contagion remains high in general. According to the latest IMF estimates, 2020 closed with a decline of around -7.4%, although some countries did manage to end the period with activity levels close to their pre-pandemic levels, as is the case of Brazil.

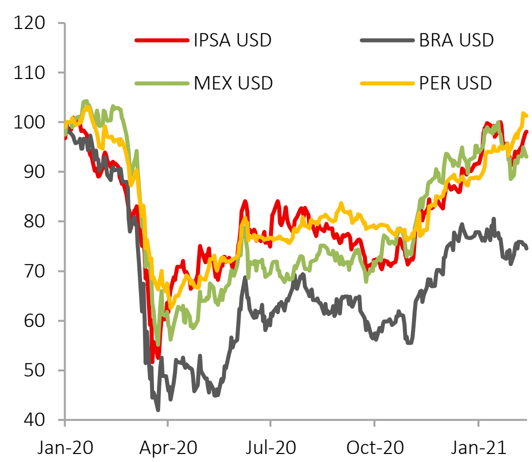
The road to a full recovery will be particularly challenging for several economies in the region in the foreseeable future. The slow start of the vaccination process, the reduced resource availability and the weak capacity of healthcare systems will make it difficult to regain the levels of activity lost to the pandemic. The start of the year has not been particularly encouraging. In Mexico, the manufacturing PMI increased during January but remained on negative grounds. Meanwhile in Brazil, the manufacturing sector fell sharply, maintaining the slow growth pace seen towards the end of last year. On the political front, the Congress passed a law granting the Central Bank autonomy and adding a full employment target to its mandate, which we believe is an essential improvement in the monetary policy's institutional strength.

Latin America had one of the most severe impacts on growth in 2020.



Source: Banrep; BCCh; BCRP; IMF (WEO Jan.21)

Stock markets in the region have shown mixed performances in recent weeks.

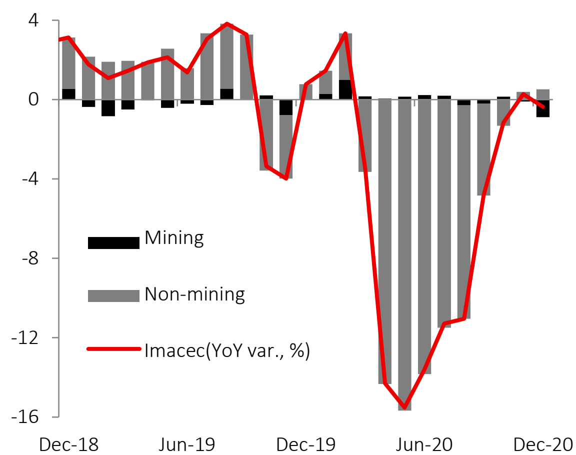


Source: Bloomberg and Santander

A surprising Imacec and the rapid rollout of the vaccination process led us to substantially revise Chile's growth projection.

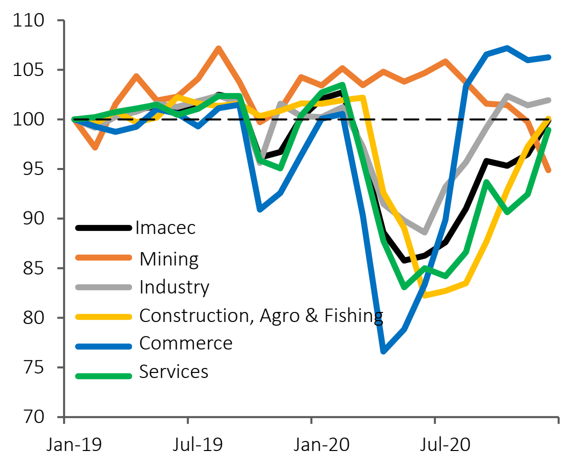
December's Imacec, while not positive (-0.4% YoY), was well above expectations, displaying a strong acceleration over the previous month (3.5% MoM non-seasonally adjusted). With this figure, 2020 would have endured a 6% contraction, in line with the values we had been forecasting for some months. While this is the largest fall in activity since the financial crisis of the 1980s, it was one of the smallest among the region's economies.

Imacec in December was better than anticipated



Source: BCCh and Santander

Services and construction show strong recovery, but the mining sector is hampered

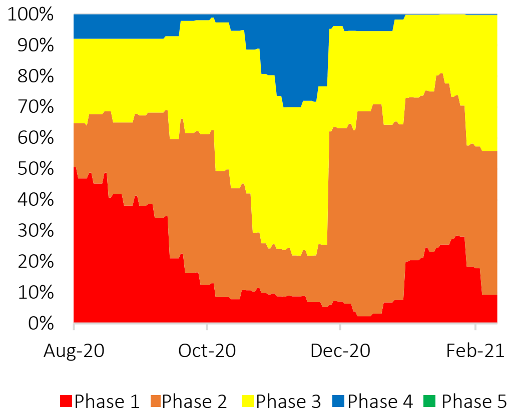


Source: BCCh and Santander

The year ended with a poor activity performance for the mining sector (-9.2% YoY), affected by low ore grades. In turn, despite the new wave of contagion since November and the increment in social distancing measures, the non-mining sectors showed a strong rebound (0.6% YoY; 4.4% MoM). Behind this figure was, on the one hand, the boost to consumption resulting from the second withdrawal of pension funds and, on the other hand, the operational adjustment of several activities to the new measures.

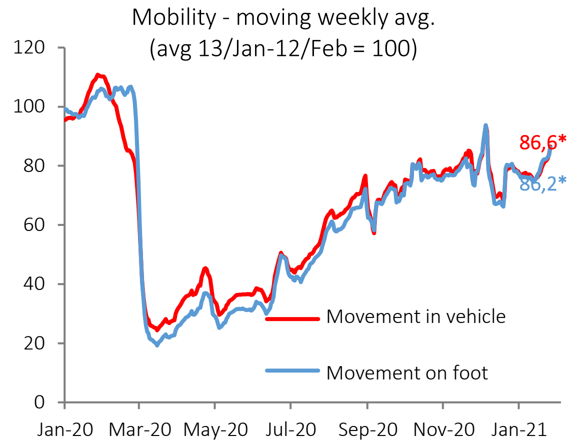
In 2021, activity has been subject to divergent forces so far. On the one hand, the new wave of infections caused the quarantined population to rise from less than 5% to more than 25% during January, affecting the functioning of several activities. On the other hand, the optimism fostered by the progress in the vaccination process, together with an abundant liquidity caused by the second withdrawal of pension funds, would have supported consumption during the first month of the year. Overall, we estimate that the activity level would have declined slightly from December, with an annual variation of -2.5%. In the rest of the quarter, activity is expected to be affected by both a moderation of consumption once the drive of the pension fund withdrawals dilutes and by the protraction of confinement measures which, although lower than a few weeks ago, are still significant.

Health restrictions increased significantly in January as 2021 begins...



Source: Ministry of Health and Santander

...and mobility halted its normalisation process...

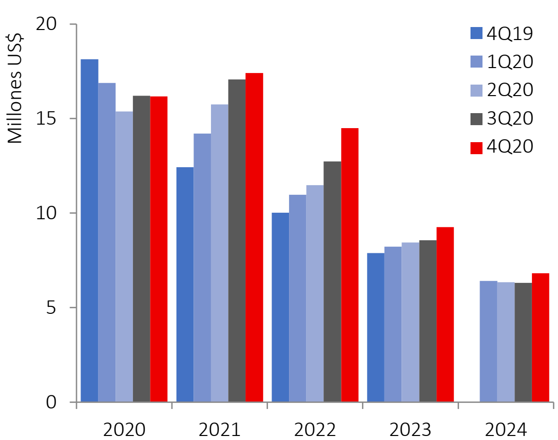


* Excludes plebiscite day

Source: Apple and Santander

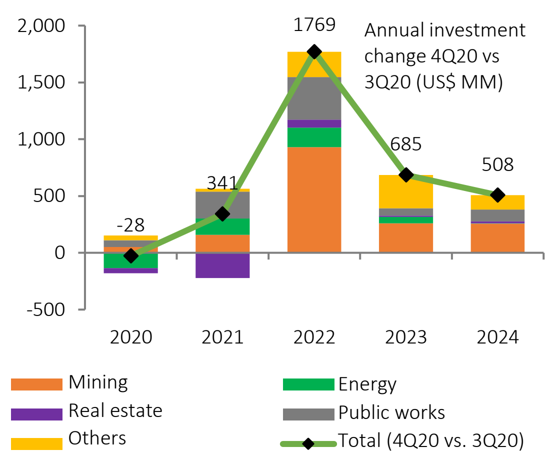
Nevertheless, we have substantially revised our growth projection for the year from 4.5% to range between 5.5% and 6.5%. This review is based on several factors. Firstly, the end of 2020 yielded better results than we had anticipated, which means the activity levels are starting the year on a better footing. Secondly, the vaccination rollout has progressed faster than we had contemplated, and the risks to this process are more restricted, as the logistical system has responded well, and vaccine shipments have materialised within the stipulated timeframe. Third, the external scenario is more favourable. Progress in the vaccination rollout in several major economies has improved the outlook for the year. In the case of China, the significant progress of its manufacturing sector and the stimulus plans have given a new boost to copper, with prices reaching their highest levels in almost a decade. Lastly, the recent CBC (Capital Goods Corporation) cadastre, covering the period up to the end of last year, points to a greater dynamism in investment projects from this year onwards, led by public works and mining sectors.

Investment projects for the five-year period 2020-2024 revised upwards again



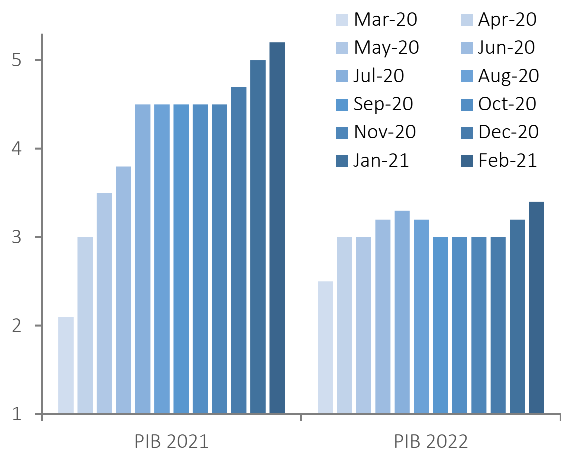
Source: CBC and Santander

Mining and public works are responsible for most of the increase in programmed investment.



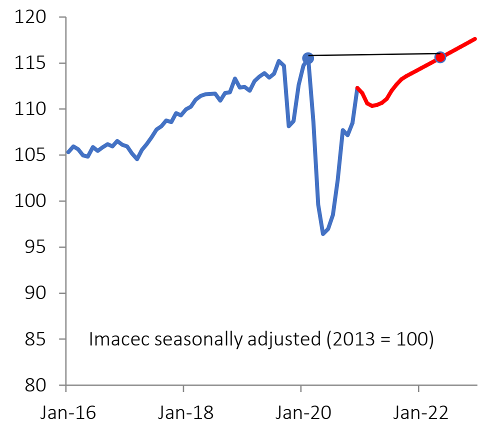
Source: CBC and Santander

Growth forecasts for Chile have risen



Source: Economic Expectations Survey (BCCh) and Santander

We project that the economy will recover to pre-pandemic levels in the first half of 2022.



Source: BCCh and Santander

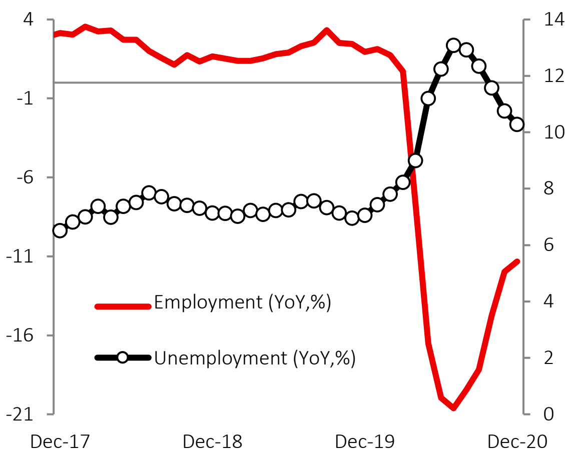
Nonetheless, risks to the recovery remain on the downside. On the one hand, there is the pandemic; new outbreaks are not excluded over the period necessary for high vaccination coverage to achieve herd immunity, which is expected to be achieved towards the third quarter. There is also the risk that mutations in the virus will make the vaccines less effective, thus delaying immunity. On the other hand, there are the risks concerning the internal political scenario and the climate of tension that is still perceived, as reflected in the events in Panguipulli.

Labour market still lagging

The unemployment rate for the moving quarter ending in December was somewhat lower than anticipated (10.3% vs 10.6% estimated). Nevertheless, job creation declined significantly over the previous months, with only 109,000 new jobs (vs 249,000 in the previous month). The most significant slowdown was observed among the self-employed, who increased by only 20,000 persons, while wage earners rose by 94,000. On the other hand, and in contrast to previous months, job creation at the margin was noted in formal jobs, although the expansion pace remains low. Therefore, there are more than one million fewer people in employment compared to February 2020.

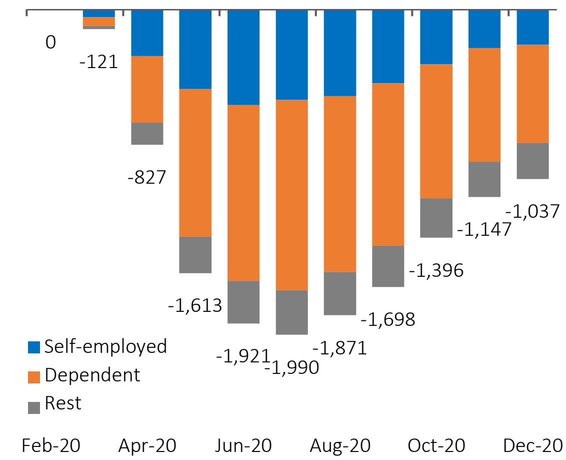
The labour force also remains well below pre-pandemic levels, with a year-on-year fall of 8.5% in December. Beyond the discouragement that the pandemic may have fostered in the search for work, compounded to mobility restrictions, some anecdotal evidence suggests that the income effect of households' liquidity shocks may have reduced the labour supply. This would have led to labour shortages in some sectors, such as construction and agriculture. This, however, would be a transitory phenomenon, and in the coming months, we should see a rebound in the participation rate.

The unemployment rate has fallen ...



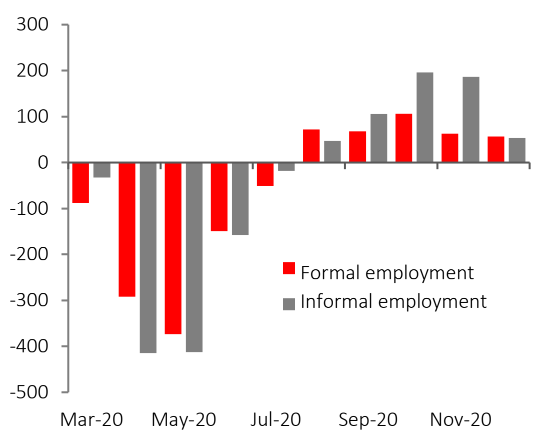
Source: INE and Santander

...but employment remains well below its pre-pandemic level



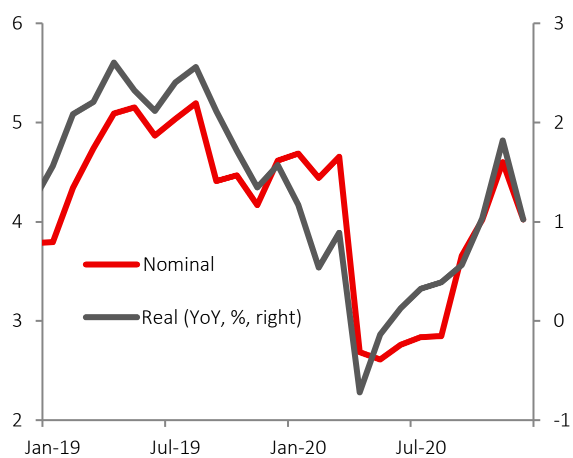
Source: INE and Santander

Formal job creation remains weak



Source: INE and Santander

Wages slowed down in December, affected by health-related restrictions

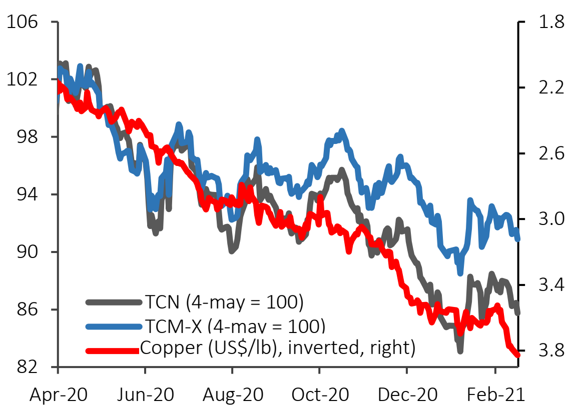


Source: INE and Santander

Domestic financial prices rise

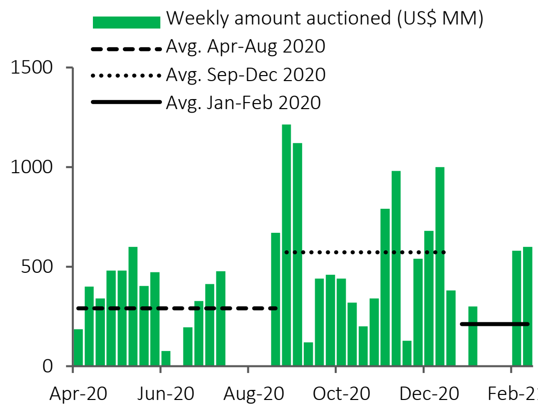
Akin to the major stock markets, local share prices have performed well so far this year. The local stock index IPSA has risen by almost 10%, one of the best performers in the region, driven by the improved outlook for the country's economic activity. Additionally, the exchange rate, which had depreciated during the first days of January to around $740, has appreciated again, aided by the sharp rise in the price of copper. The recent depreciating trend of the dollar at a global level and the currency auctions of the Ministry of Finance have also contributed, as they reinitiated the sale of dollars at a US$ 120 million per day rate, accruing US$ 1.42 billion during February.

Recent Peso appreciation aligns with rising copper prices



Source: BCCh, Bloomberg and Santander

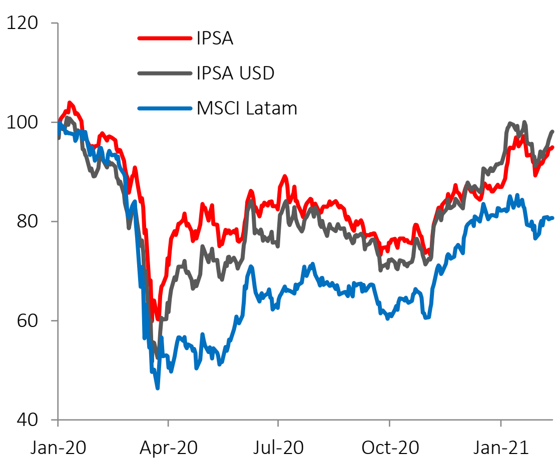
Ministry of Finance resumes sale of dollars



Source: Ministry of Finance and Santander

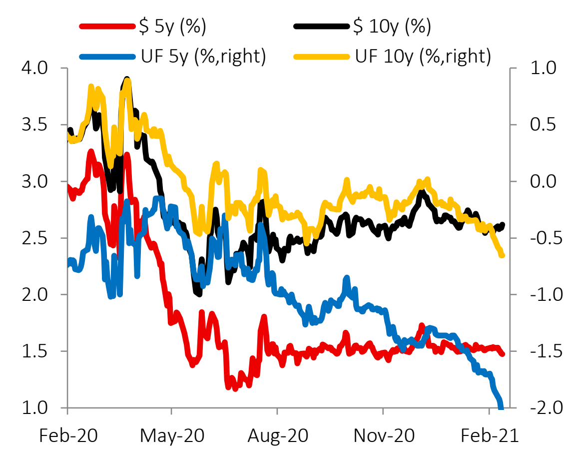
The bond market has shown mixed variations. Despite the international trend, nominal rates have remained relatively stable, influenced by the large amount of liquidity in the local market. Meanwhile, real rates have adjusted sharply downwards due to the upward correction in inflation expectations. Once the short-term elements holding down prices dissipate, real rates may adjust.

The IPSA recovers its upward trend



Source: Bloomberg and Santander

Real rates fall in line with higher inflation expectations



Source: BCCh, RiskAmerica and Santander

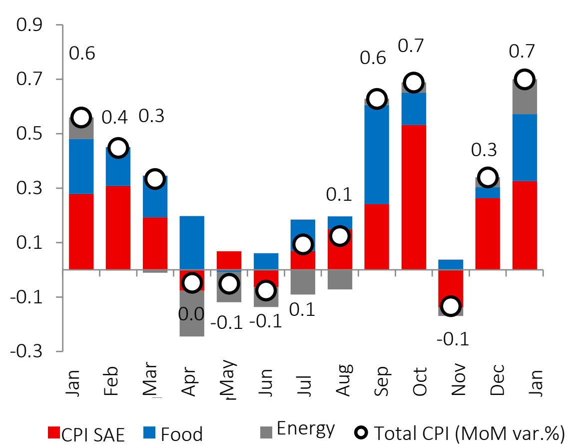
Transitional factors put pressure on prices

The January CPI (0.7%) surprised strongly on the upside (0.5% expected by the market) and was the highest for this month since 1998. The main surprise hikes were in food (1.2% MoM) and items such as camping and sports equipment, restaurants, and personal care products (2.5% MoM). Moreover, the fall in clothing was lower than expected (-0.9% MoM) in a month where there is traditionally an end-of-season liquidation. This brought inflation to 3.1% YoY, while core inflation, excluding food and energy, remained below the Central Bank's target at 2.6% YoY.

Despite the substantial increase in the CPI, the diffusion index - the percentage of products increasing in price - settled in the middle of the range of recent years, indicating that widespread price increases did not cause the acceleration in the price index. Non-tradable goods maintained limited increases (2.1% YoY), partly because several services showed null price variations. Tradable goods, on the other hand, accelerated significantly (4.0% YoY).

Despite the record high during January, we estimate that the acceleration in inflation is transitory in nature and is explained by a rebound in demand due to the liquidity shock received by households and supply constraints that have kept inventories restricted. As these factors fade, the effect of significant productivity gaps in the economy on price dynamics will predominate. Thus, the pace of monthly changes in the CPI should tend to moderate. Overall, we assess we will see a high level again during February and only towards the second quarter should a moderation occur. Nevertheless, recent surprises lead us to correct our year-end inflation projection significantly to 3.3%.

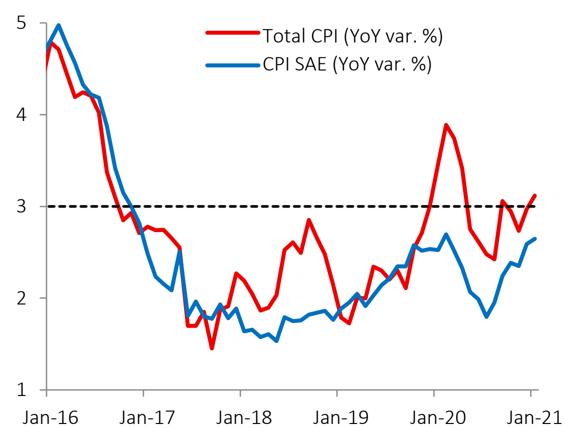
Rises in food and energy explain surprise increase in January CPI



Source: Bloomberg and Santander

Note: CPI SAE= CPI sans

Inflation settles around the target



Source: Bloomberg and Santander

Despite rising inflation, the Central Bank will keep an expansionary monetary policy

At its January policy meeting, the Central Bank maintained the Monetary Policy Rate (MPR) at 0.5% and expanded liquidity measures. In the meeting's agenda, and in line with our analysis, the Central Bank stressed that the rebound in inflation is caused by temporary elements, which will dissipate further. For the same reason, the high monetary impulse remains valid. We assess that, while the significant capacity gaps could close faster than previously envisioned, the economy will remain below capacity for a prolonged period, with a relatively weak labour market. This will give the Central Bank room to leave the rate unchanged until at least the second half of next year.

The Council announced a new phase of the Conditional Credit Facility (FCIC) for US$ 10 billion and added the state-guaranteed A5 and A6 commercial portfolio to the eligible collateral. With this, the Central Bank will accept portfolios defined as Normal Portfolio (debtor category A1, A2, A3, A4, A5 and A6) from high to sufficient credit quality, with an expected loss of up to 9%. Like the original FCIC, this facility is extended for six months at a rate equivalent to the prevailing MPR. So far, the FCIC has not been fully utilised (almost

US$ 30 billion out of a total of US$ 40 billion had been drawn down), partly due to a lack of collateral and, to a lesser extent, to a more restricted demand.

The expansion of the FCIC is in line with the new guarantee programme Fogape Reactiva. This programme seeks to expand financing by broadening the risk that banks can take. To this end, it raises the maximum rate for loans benefiting from the guarantee to 7.2%. In this way, the extension of the FCIC, with a broader range of collateral and the new Fogape will reverse the credit slowdown observed in the latter part of the year.

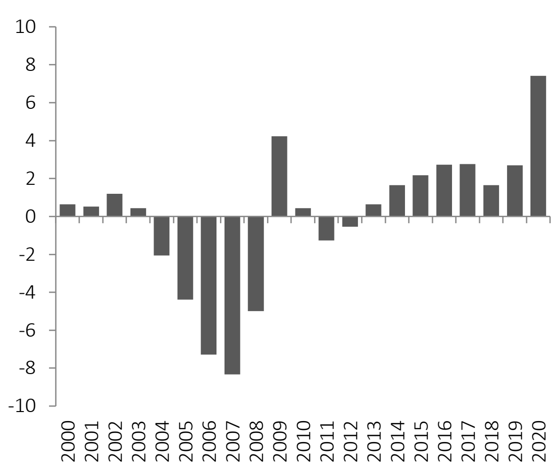
The Treasury closed 2020 with a deficit of 7.4% of the GDP.

Tax revenues declined significantly during 2020, impacted by the macroeconomic cycle and the tax relief measures announced at the beginning of the pandemic. Nevertheless, in the latter part of the year, revenue collection tended to accelerate, favoured by the recovery of activity and high copper prices. Expenditure, on the other hand, received a strong boost from measures to support households and businesses. Nevertheless, public investment was significantly under-executed due to the difficulty in materialising projects. Overall, total expenditure reached 27.6% of the GDP, its highest level in several decades.

On the balance sheet, the Treasury closed the year with a deficit of 7.4% of the GDP, well below the 8.2% projected in the third quarter by the Public Finances Report. The main reason for this difference lies in a significant increase in mining revenues due to higher copper prices. In turn, public debt rose to 33.0% of the GDP, increasing 6.1 pp over the end of the previous year. On the international scale, this is a low variation. For example, Brazil, Mexico, and Peru increased their debt by around 12% of the GDP, and developed countries had even larger increments.

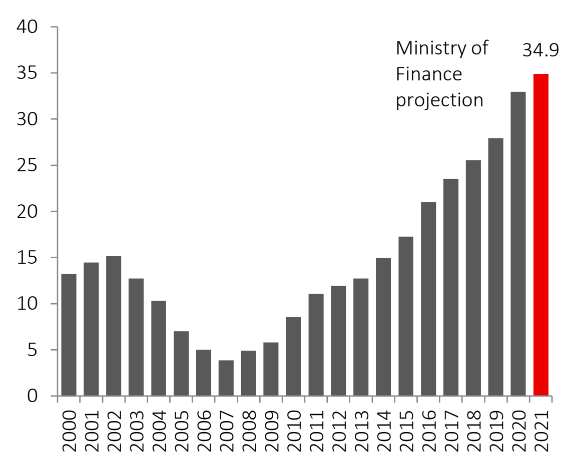
For 2021, the Ministry of Finance estimates a fiscal deficit of 3.3% of the GDP, supported by a 5% GDP expansion (8.8% of domestic demand), an average CPI of 3% and copper at US$ 3.35/lb. Additionally, public debt would be around 35% of the GDP.

The fiscal deficit closed the year at 7.4% of the GDP.



Source: Dipres and Santander

Public debt to be around 35% in 2021



Source: Dipres and Santander

CONTACT

(56 2) 2320 1021

Access to our Reports at:

@

https://banco.santander.cl/estudios