MARKET OUTLOOK

N° **375** / WEEK JUNE 10 -14 2019

HIGHLIGHTS

- **Commercial tensions remain high.** The tense relationship between the United States and China has begun to open a new focus with disputes between the US government and Germany. The agreement with Mexico, which avoided the increase in tariffs, is subject to testing.

- **Oil had a hectic week.** After the attack on two oil tankers in the Strait of Hormuz, oil prices rose, but then fell due to estimates of lower demand. However, the geopolitical conflict in the Persian Gulf will maintain the value of crude oil subject to volatility.

- **June's Monetary Policy Report adjusts structural parameters and reduces growth for the year.** The latest report of the Central Bank adjusted downward the growth prospects for this year, down to a range of 2.75% -3.5% (previously 3% -4%), explained by the deterioration of the external scenario and a start of year below expectations.

- **The surprising Central Bank decision could be followed by additional cuts before the end of the year.** At the June MPR, prior to the publication of the latest Monetary Policy Report, the Central Bank surprised by applying a 50bp cut to the rate, an adjustment not seen since 2009. We estimate that it could be followed by additional cuts before the end of the year if growth eventually ends up below the range projected by the issuing institute.

Commercial tensions remain high

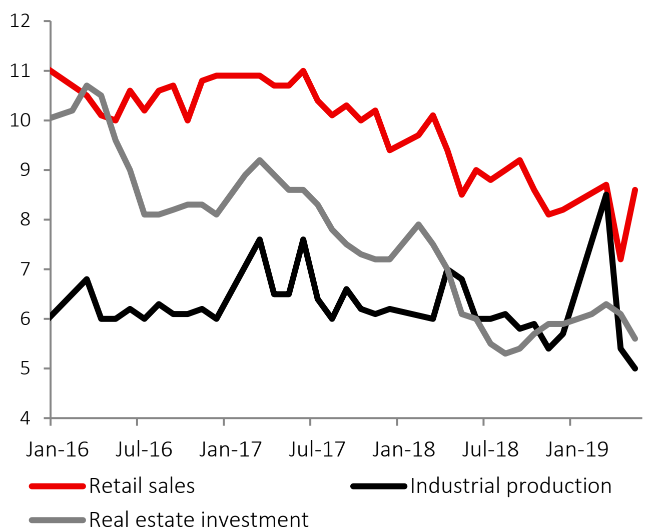
The USA and Mexico reached an immigration agreement and tariff threats were dropped. However, Washington continues to affirm that the success of the negotiation will depend on AMLO managing to stop the flow of people from their country to the United States. However, although at this point there is a relief from the tensions, the White House is opening a new front with Germany for the handling of the euro and for the development of more intense energy ties with Russia due to the construction of a gas pipeline between both countries.

Meanwhile, President Trump insists that the resolution of the conflict with Beijing will only be resolved after a personal meeting with President Xi. The trade negotiations are broken for the time being, but the Asian country is redesigning its negotiating team with the recruitment of its ambassador in Switzerland, Yu, an expert in trade negotiations whose experience includes important agreements in the WTO and with the US. In this way, Vice President Liu would leave the first line, which would be transferred to the Ministry of Commerce. However, President Xi is facing a sword of Damocles, because he can not be weak in the face of the demands of a foreign power, but he must contribute so that the economy of his country regains momentum.

The Asian giant is acknowledging the blows from the west, which is reflected in weak export growth (1.1% y / y) and a deep contraction in imports (8.5% y / y). The latter is especially worrying for Chile, since China is our main trading partner, and copper imports contracted 23% YoY. On the external front, during May industrial production grew only 5% y / y, much less than estimated and exhibited its lowest level in 17 years. On the other hand, urban investment expanded only 5.6% YoY, also below the forecast. The positive note came from retail sales that increased 8.6% YoY, above expectations.

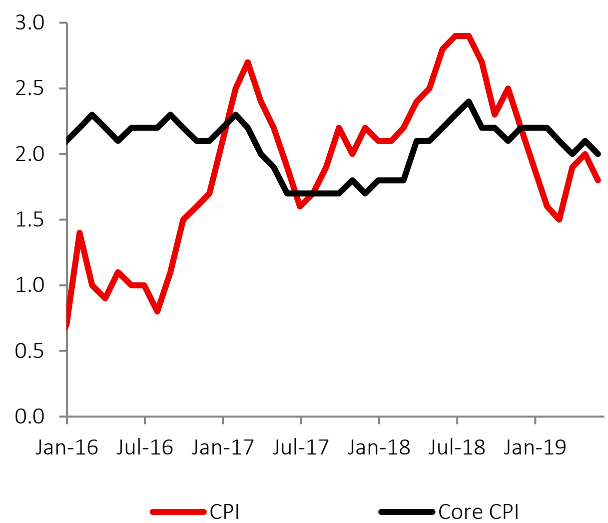
In the US, where inflation for May expanded as expected (1.8% y / y), and even core inflation (2%) was below expectations, the likelihood of the Fed making two additional cuts in the reference rate increases. Undoubtedly, it will not be at the next meeting, where before they should adjust their dots, but it could be in the subsequent one. However, fears of a rapid loss of dynamism in the US are somewhat lower after the solid expansion of retail sales of 0.5% m / m and the upward revision of the previous month's results. In addition, the expectations of SMEs have improved somewhat and the confidence measured by the University of Michigan is as expected.

Graph 1: China's activity indicators (var. annual, %)



Source: Bloomberg and Santander

Graph 2: US Inflation (var. annual, %)



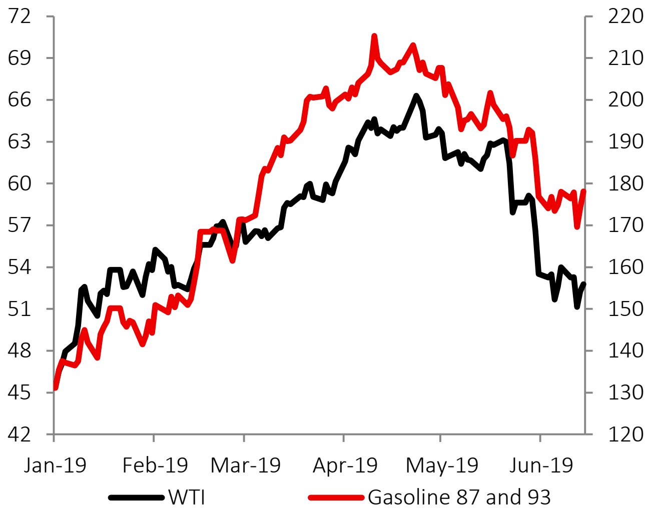
Source: Bloomberg and Santander

The euro zone still does not seem to have reached a point of stabilization, industrial production contracted 0.5% m/m and economic expectations (-3.3 pts. In Sentix) are around their lowest of the last five years. Additionally, tensions with the United Kingdom are still present, where the favorite candidate to succeed Theresa May is Boris Johnson, who has established that with or without agreement his country will leave the European Union on October 31st.

Oil had a hectic week

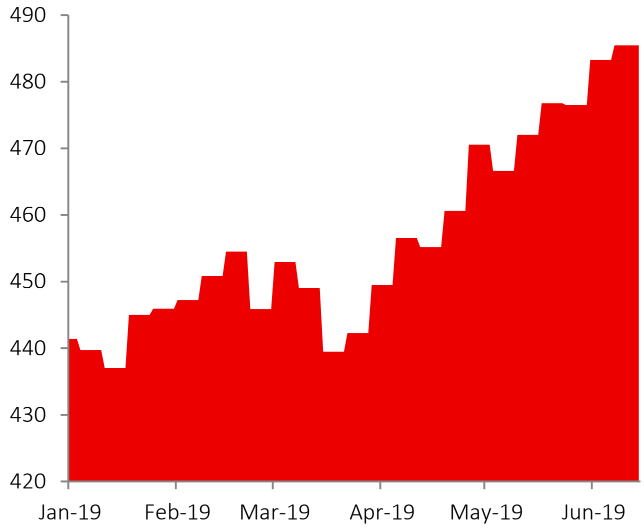
Oil lived intense days, with its price suddenly rising more than 2% after attacks on two oil tankers in the Strait of Hormuz for which the US blamed Iran. However, prices later returned to their previous levels (WTI: US $ 52.7 per barrel), when the International Energy Agency cut its demand forecast for this year. However, they pointed out that there should be a recovery of the values during the next year due to the stimuli of the central banks to revive the economy. That said, there will be more clarity on the evolution of prices after the OPEC meeting at the end of the month.

Graph 3: Oil Price (WTI) and USA Gulf Coast fuels (US$/gallon and US$/bbl.)



Source: Bloomberg and Santander

Graph 4: Oil stocks (million bpd)



Source: Bloomberg and Santander

June's Monetary Policy Report adjusts structural parameters and reduces growth for the year

The publication of the second quarter IPoM contextualized the unexpected decision taken by the Central Bank in its latest RPM, where it cut the reference rate by 50bp, to 2.5%. The report included a review of the structural parameters that define the monetary policy-neutral rate and potential GDP-as well as a re-evaluation of the short-term outlook for the economy.

Regarding the adjustment of parameters, the Council recognized the favorable impact of migration on the labor force, which would have meant raising the trend growth of the economy from a range of 3% -3.5% to 3.25% -3 , 75%. With this, the potential GDP would have risen from 3.2% to 3.4%. This, added to the lower projected growth for the year, led the Board to review the capacity gap of the economy at -0.7%, considerably more than the -0.1% previously estimated. This means that to achieve the convergence of inflation to the target, greater stimulus is required.

The second important parametric change was the downward revision of the MPR, which defines the degree of expansiveness of monetary policy. Thus, while in the previous Monetary Policy Report it was estimated that this was between 4% and 4.5%, it is now between 3.75% and 4.25%, similar to what we previously estimated. This drop was mainly due to the fall in external long-term rates, since the upward revision of potential GDP rather merited an upward correction of the neutral MPR. However, this lower rate means that the monetary impulse was lower than previously considered.

On the other hand, the Central Bank corrected downward its estimate of growth for the year, from a range of 3% to 4%, to 2.75% -3.5%. Behind the lower growth is the slower start to the year and a major investment review, which should grow 4.5% (instead of the 6.2% projected in the previous Report). The reasons are some specific phenomena that affected the supply sectors in the first part of the year, and the deterioration of the external scenario due to the commercial war and political tensions in Europe. This has translated into a decrease in global trade, lower terms of trade and a loss of dynamism of Chile's trading partners, in particular, of the countries in the region. Unlike the previous Monetary Policy Report, this time the Central Bank introduced a downward bias in its activity projections, realizing that the worst external scenario could have greater effects on the local economy.

Table 1: GDP according to expense (var. annual, %)

		2019		2020		2021	
	2018	IPoM Mar-19	IPoM Jun-19	IPoM Mar-19	IPoM Jun-19	IPoM Mar-19	IPoM Jun-19
GDP (%)	4.0	3-4	**2.75 - 3.5**	3-4	**3-4**	2,75-3,75	**3-4**
Internal demand (%)	4.7	3.7	**2.9**	3.5	**3.8**	3.3	**3.5**
Gross fixed capital form. (%)	4.7	6.2	**4.5**	4.3	**5.1**	3.9	**4.1**
Total consumption (%)	3.7	3.3	**3.1**	3.5	**3.5**	3.4	**3.4**
Exports (%)	5.0	3.6	**0.6**	2.9	**3.6**	2.9	**2.7**
Imports (%)	7.6	4.5	**0.6**	2.9	**4.3**	2.6	**2.7**
Current account (% GDP)	-3.1	-2.9	**-2.9**	-2.7	**-2.8**	-2.7	**-2.8**

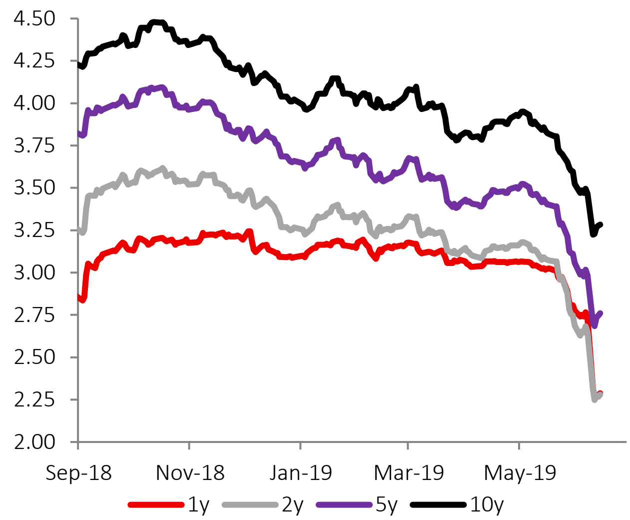
Source: BCCh and Santander

In terms of inflation, the report notes that it has remained low and that pressure on prices remains limited, despite a couple of surprises in recent months. However, it revises upwards its projection for the CPI for the year, from 2.6% to 2.8%, due to the incidence of increases in some regulated prices.

In this way, the diagnosis contained in the report justifies the surprise adjustment of 50 basis points of the MPR last Friday. Considering that the adjustment of the neutral rate implies that with a 25 bp cut, the same monetary impulse as previously estimated was maintained, and that the adjustment of the potential GDP could justify the additional cut, the recognition of the deterioration in the external scenario and the local perspectives open space to re-apply rate reductions towards the end of the year. This is what the market understood, since the swap rates -which already included a lower MPR prior to the decision notified by the Central Bank- adjusted to the lower rate, while maintaining additional cuts before the end of the year.

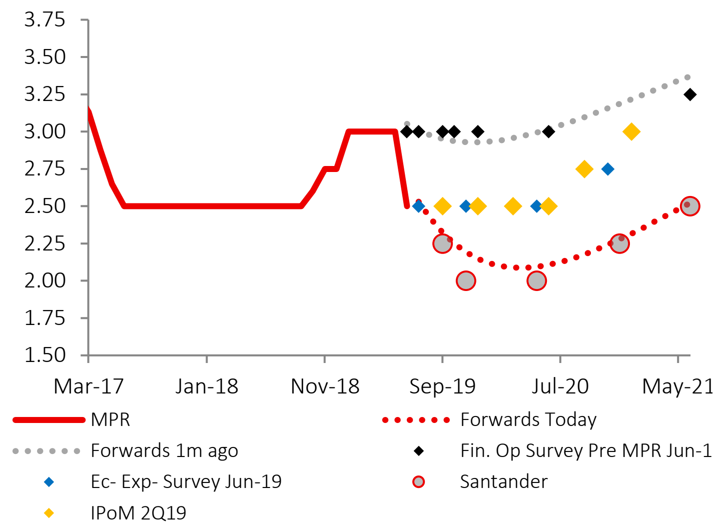
Although the issuing entity estimates that the MPR will remain at its current level during the coming quarters and that a normalization process would begin gradually during 2020, we anticipate that if a scenario of lower growth than that contemplated by the issuing institute materializes, it could produce new cuts that would bring the MPR to 2% by the end of the year.

Graph 5: Swap rates (%)



Source: Bloomberg and Santander

Graph 6: MPR Expectations (%)



Source: Bloomberg, BCCh and Santander

Stricke in Chuquicamata

More than 3,000 workers from Chuquicamata left work early this Friday after failing to reach a labor agreement this week with Codelco. The Chuquicamata 1, 2 and 3 unions rejected the state miner's latest proposal on Wednesday, saying it did not meet key demands, which included an adequate health care plan, fair treatment for workers and retirement benefits. The three unions represent 80% of the mine's workforce.

The effects of this paralysis on the national economy would be much more limited than those observed during the Escondida strike in 2017. The first reason for this is that the production capacity of Chiquicamata is a quarter of that of Escondida. The second reason is that the positions are closer to those of 2017, which led to a 43-day strike at the BHP mine.

PUBLISHED DATA / last week

DAY	COUNTRY	INDICATOR	PERIOD	PREVIOUS	ESTIMATION	EFFECTIVE
MONDAY 10	China	Exports	May	-2.7% Y/Y	-3.8% Y/Y	1.1% Y/Y
	China	Imports	May	4.0% Y/Y	-3.8% Y/Y	-8.5% Y/Y
TUESDAY 11	Chile	Economic Expectations Survey	June	ND	ND	ND
	USA	Producer Price Index	May	2.2% Y/Y	2.0% Y/Y	1.8% Y/Y
	China	Producer Price Index	May	0.9% Y/Y	0.6% Y/Y	0.6% Y/Y
WEDNESDAY 12	USA	Consumer Price Index	May	2.0% Y/Y	1.9% Y/Y	1.8% Y/Y
	USA	Core CPI	May	2.1% Y/Y	2.1% Y/Y	2.0% Y/Y
	Brazil	Retail sales	April	-4.5% Y/Y	2.9% Y/Y	1.7% Y/Y
THURSDAY 13	Eurozone	Industrial production	April	-0.4% Y/Y	-0.5% Y/Y	-0.5% Y/Y
	Brazil	Service activity	April	-2.3% Y/Y	-0.5% Y/Y	-0.7% Y/Y
FRIDAY 14	USA	Retail sales	May	-0.2% M/M	0.6% M/M	0.5% M/M
	USA	Industrial production	May	-0.5% M/M	0.2% M/M	0.4% M/M
	China	Retail sales	May	7.2% Y/Y	8.1% Y/Y	8.6% Y/Y
	China	Industrial production	May	5.4% Y/Y	5.5% Y/Y	5.0% Y/Y

DATA THAT WILL BE PUBLISHED / this week

DAY	COUNTRY	INDICATOR	PERIOD	PREVIOUS	ESTIMATION
MONDAY 17	USA	Manufacturing sector survey NY Fed	June	17.8	12.75
	China	Housing prices	May	10.7% Y/Y	
TUESDAY 18	Eurozone	Final CPI	May	1.2% Y/Y	1.2% Y/Y
	USA	Home starts	May	1,235 thous.	1,240 thous.
WEDNESDAY 19	USA	Fed *fund rate*	June	2.25%-2.5%	2.25%-2.5%
	Japan	Monetary Policy Rate	June	-0.1%	
THURSDAY 20	USA	Current account	1Q19	US$ -134.4 bn.	US$ -124.2 bn.
	USA	Manufacturing survey Fed Philadelphia	June	16.6	11.5
	Eurozone	Preliminary consumer confidence	June	-6.5	-6.5
FRIDAY 21	USA	PMI manufacturing, Markit	June	50.5	50.4
	USA	PMI services, Markit	June	50.9	50.9
	Eurozone	PMI manufacturing, Markit	June	47.7	48.0
	Eurozone	PMI services, Markit	June	52.9	52.9

MACROECONOMIC PROJECTIONS

National Accounts	2013	2014	2015	2016	2017	2018	2019 P	2020 P
GDP (real var % YoY)	4.0	1.8	2.3	1.7	1.3	4.0	3.0	3.2
Internal demand (real var. % YoY)	3.6	-0.5	2.5	1.8	2.9	4.7	3.3	3.4
Total consumption (real var. % YoY)	4.3	2.9	2.6	3.4	3.2	3.7	3.2	3.2
Private consumption (real var. % YoY)	4.6	2.7	2.1	2.6	3.0	4.0	3.4	3.4
Public consumption (real var. % YoY)	2.8	3.8	4.8	7.2	4.4	2.2	2.4	2.5
Gross fixed capital formation. (real var. % YoY)	3.3	-4.8	-0.3	-1.3	-2.7	4.7	5.4	4.8
Public expenditure (real var. % YoY)	4.6	6.3	8.4	3.8	4.7	3.4	3.6	3.8
Manufacturing Production (real var. % YoY)	2.0	-0.7	0.3	-2.4	1.6	3.3	2.2	1.7
Exports (real var. % YoY)	3.3	0.3	-1.7	0.5	-1.1	5.0	2.0	2.0
Imports (real var. % YoY)	2.0	-6.5	-1.1	0.9	4.7	7.6	3.3	2.6
GDP (US$ billions)	278.5	260.6	244.3	250.6	277.9	298.8	304.5	323.2
GDP per capita (US$ thousands)	15.8	14.6	13.6	13.8	15.1	15.9	15.9	16.6
Population (millions)	17.6	17.8	18.0	18.2	18.4	18.8	19.1	19.5

Balance of Payments	2013	2014	2015	2016	2017	2018	2019 P	2020 P
Trade balance (US$ billions)	2.0	6.5	3.4	4.9	7.4	4.7	3.0	2.4
Exports (US$ billions)	76.8	75.1	62.0	60.7	68.9	75.5	77.0	80.9
Imports (US$ billions)	74.8	68.6	58.6	55.9	61.5	70.8	74.0	78.5
Current account (US$ billions)	-11.2	-4.3	-5.6	-4.0	-6.0	-9.2	-8.5	-9.3
Current account (GDP%)	-4.1	-1.7	-2.3	-1.6	-2.1	-3.1	-3.5	-3.4
Terms of trade index (var. % YoY)	-2.7	-2.4	-2.9	3.1	9.0	-1.8	0.9	1.5
Price of copper (annual average, US$/lbs.)	3.32	3.11	2.50	2.21	2.80	2.96	2.90	3.00
WTI oil price (annual average US$/bbl.)	97.9	93.1	48.7	43.2	51.0	64.8	60.0	61.0

Source: BCCh, INE and Santander.

Note: Year of reference for the national accounts. = 2013

MACROECONOMIC PROJECTIONS

Exchange rate and Monetary Market	2013	2014	2015	2016	2017	2018	2019 P	2020 P
CPI Inflation (var. YoY, % by December)	3.0	4.6	4.4	2.7	2.3	2.6	2.6	2.9
CPI Inflation (var. YoY, average %)	1.8	4.7	4.3	3.8	2.2	2.4	2.1	2.9
CPI sans food and fuel inflation (IPC-SAE) (var. YoY, % by December)	2.1	4.3	4.7	2.8	1.9	2.3	2.4	2.6
CLP/US$ exchange rate (year's exercise)	524	607	707	667	615	696	660	667
CLP/US$ exchange rate (year average)	495	570	654	677	649	640	663	664
Monetary policy rate (year's exercise, %)	4.5	3	3.5	3.5	2.5	2.75	3.00	3.25
Monetary policy rate (year's average, %)	4.92	3.75	3.06	3.5	2.7	2.52	2.98	3.19
BCU-10 (%,)	2.2	1.5	1.6	1.5	1.8	1.5	1.6	1.7
BCP-10 (year's exercise, %)	5.2	4.3	4.7	4.4	4.5	4.2	4.0	4.2

Labor Market	2013	2014	2015	2016	2017	2018	2019 P	2020 P
Compensation Index (real var. % YoY)	3.9	1.8	1.8	1.4	2.4	1.9	2.3	2.4
Unemployment rate (annual average)	6.0	6.4	6.2	6.5	6.7	7.0	6.8	6.7
Employment creation rate (average var. % YoY)	2.1	1.6	1.4	1.3	1.8	1.6	1.9	2.1
Wage bill average (real var. % YoY)	6.0	3.4	3.2	2.8	4.2	3.5	4.2	4.5

Fiscal Policy Indicators	2013	2014	2015	2016	2017	2018	2019 P	2020 P
Central Government balance (% GDP)	-0.6	-1.6	-2.2	-2.7	-2.8	-1.7	-2.0	-1.7
Central Gov. gross debt (US$ billions)	33.5	36.6	39.0	53.3	69.0	70.2	78.1	86.5

Source: BCCh, INE and Santander.

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