Economic uncertainty persists after the referendum

Once the manner in which the constitutional process will proceed is clearer, and more defined "margins" are established for future discussion, the valuation of local assets could rise.

Highlights

- **Global inflation continues to strain markets.** Despite the fall in energy prices, the rising core inflation in developed markets has raised expectations of additional monetary policy strictures by major central banks, further straining global financial conditions. As a result, stock markets have fallen sharply, long-term interest rates have risen, and the dollar has appreciated globally.

- **Local assets remain volatile**. The referendum result tended to appreciate the exchange rate and strengthen the stock market. Nevertheless, tightening global conditions and domestic political issues have led to reversals in these prices. In the future, a clear and defined roadmap for the constitutional process could contribute to the revaluation of assets.

- **The economy continued to contract in July.** The decline in the Imacec (-1.1% MoM) reflected the adjustment process faced by the domestic demand. The economy will continue to decline in the future. The next Imacec (August) will show the first negative year-on-year changes. The year will close with an average growth of 1.75%, but in 2023 activity will contract by 1%.

- **Fiscal situation improves.** Despite the decline in revenues due to the moderation of domestic spending, the extraordinary revenues from the Payment of Substitutive Tax for Final Taxes (ISFUT for its acronym in Spanish) and the lithium contract from the Chilean Economic Development Agency (CORFO) will make the fiscal balance end in positive territory this year (0.3% of GDP). However, in 2023, fiscal accounts could deteriorate due to lower revenues and higher spending.

- **Prices continue to surprise on the upside.** The CPI for August (1.2%) was above expectations and pushed inflation up to 14.1%, confirming that pressures remain high despite the moderation in consumption. Overall, we expect prices to start moderating in the coming months and the year to end with inflation at around 12%.

- **The Central Bank surprises with an aggressive MPR hike of 100 basis points**. While the decision was intended to accelerate the end of the hiking cycle, an additional more moderate rate hike may occur in October. Lower inflationary pressures and a weaker economy towards the end of the year would lead to a process of MPR cuts starting in early 2023.

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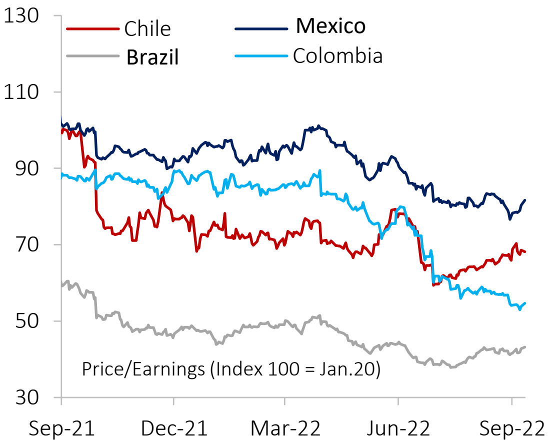
Chile's financial prices move amid the political scenario and global inflation fears

Before the 4 September referendum, local asset prices had tended to appreciate significantly, incorporating the signals from the various opinion polls that pointed to a Rejectionist victory. The ratification of this option in the referendum, with a historic voter turnout (86%) and a much larger gap than expected (23%, compared to the "Approval"), generated further gains for the local stock index IPSA (which temporarily surpassed 6,000 points) and the Peso, which traded below $880.

Nevertheless, this became less pronounced as the days went by, as new political issues became apparent, and the external scenario became more complex. Negotiations concerning the constituent process' future showed that the political scene remains tense. On the one hand, global financial conditions tightened again after the surprise CPI data in the US. This led, at the close of this report, to the exchange rate being above $920 - driven by the global strengthening of the dollar - and the IPSA dropping to levels close to 5,600 points.

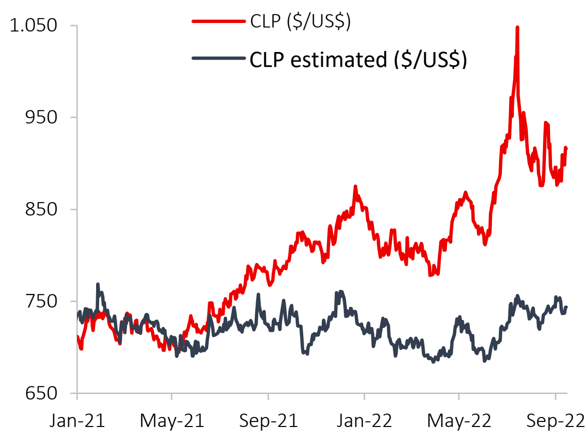
On the other hand, after rising during August, bond market rates tended to fall after the referendum, in line with decreases in sovereign risk premia (CDS5y: 126 vs 145 in August). Thus, the BTP10 closed at around 6.5% (-38 bps for the month) and the BTU10 at 2.2% (-24 bps).

The IPSA has recovered, unlike other stock markets in the region



Source: Bloomberg and Santander

Exchange rate has tended to appreciate with fluctuations

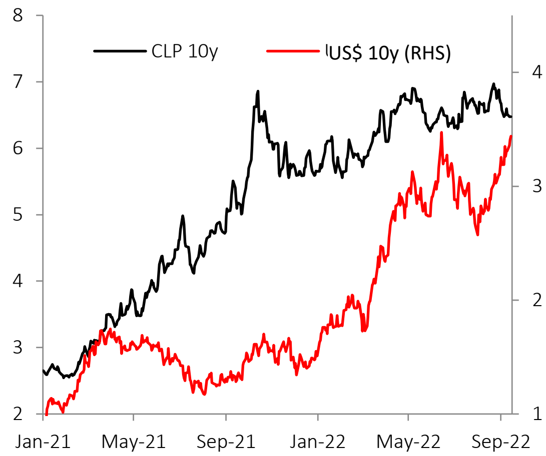


Source: Bloomberg and Santander

In the future, there will be different forces driving local asset prices. It is likely that the US Federal Reserve will continue an aggressive process of rate hikes, with the subsequent strengthening of the dollar globally and falls in risky asset prices. Furthermore, signs of weakness in the Chinese economy could lead to additional copper price declines. Both factors would put upward pressure on the exchange rate and tend to weaken the local stock market. Regarding the Peso, it should be added that the Central Bank's foreign exchange intervention programme is ending, and the daily sales have decreased.

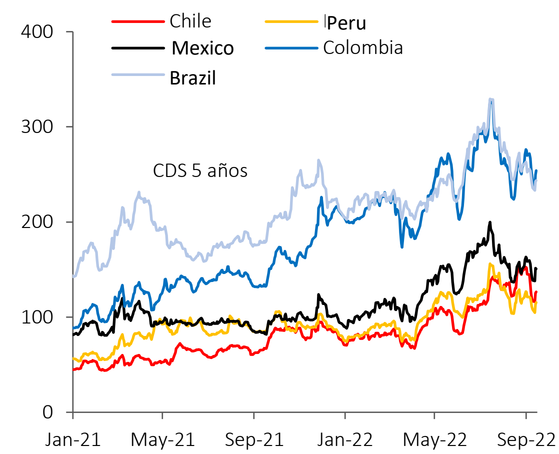
In addition, an agreement that establishes a clear and defined route for the constitutional process, that offers greater certainty as to the "margins" for discussion, could contribute to a revaluation of assets. Against this background, we expect the parity to close the year around $900 and the stock market to recover some of the losses of the last few days.

Chile's long-term nominal rates drop



Source: Bloomberg and Santander

Sovereign risk premiums tighten



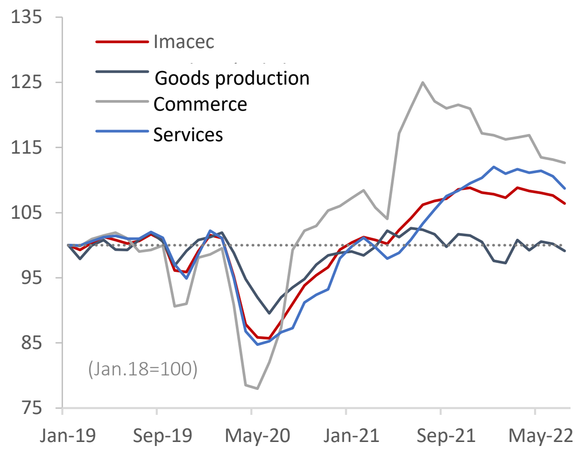
Source: Bloomberg and Santander

Activity continues to decline

The Imacec for July showed again a significant decline (-1.1% MoM seasonally adjusted, 1% YoY), confirming the economy's continuing weakness which had become apparent for several months. By sectors, services showed the largest decline (-1.7% MoM seasonally adjusted) and trade completed three months of consecutive drops (-0.4% MoM seasonally adjusted), reflecting the consumption adjustment.

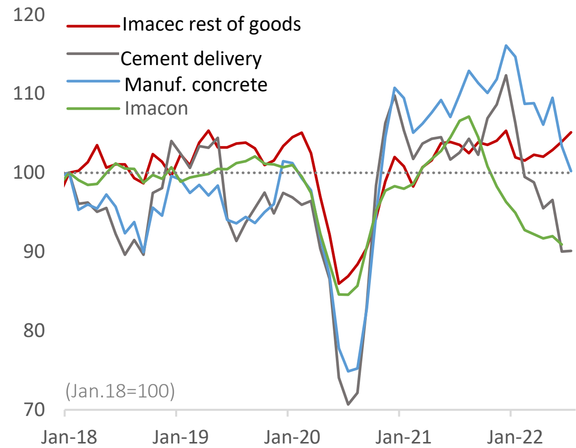
Manufacturing also contracted (0.6% MoM seasonally adjusted), but the "other goods" sector (which includes construction) rebounded (1.1% MoM seasonally adjusted), which is probably related with temporary factors in the construction sector (completion of works that had been progressing previously).

Economic activity has continued to decline



Source: Central Bank and Santander

Some sectors that have surprised on the upside could start to drop

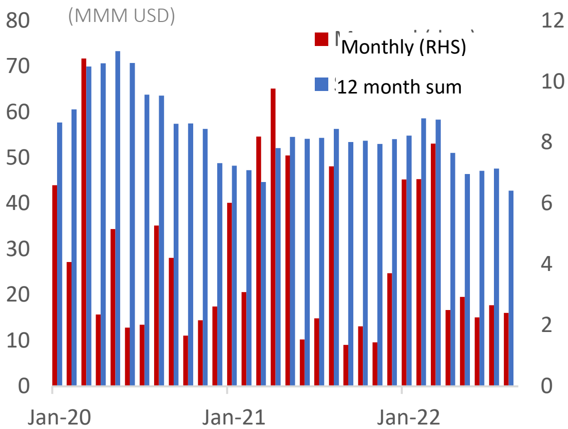


Source: Central Bank, CCHC, INE and Santander

In August, several consumption-related indicators continued to display losses. Daily trade sales published by the Central Bank fell 18% YoY in real terms during the first fortnight, and car sales declined 6.8% YoY. Nominal consumer imports rebounded - probably influenced by prices - but durable goods imports remained weak. On the other hand, consumer loans fell more sharply than in previous months (-2% YoY), and business confidence continued to decline. Against this background, we estimate that the Imacec for the month had a further monthly decline and, in annual terms, will show the first contraction, with a fall of around 1.5%.

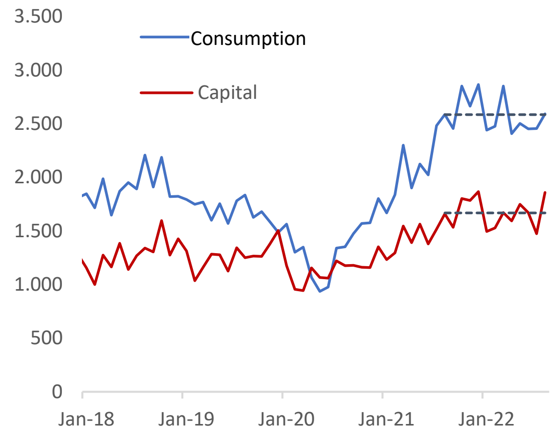
In the future, consumption will continue declining due to the liquidity drain and the deterioration of the labour market. On the investment side, projections are not promising. Real estate sales have contracted -which will condition new developments-, projects entering environmental processing are stagnating, and the investment outlook from the monthly Business Confidence Indicator (IMCE) remains in negative territory. Thus, we confirm our estimate of a growth of around 1.75% this year and a fall of 1% of GDP in 2023.

Investment projects submitted to the Strategic Environmental Impact Assessment (SEIA) have stagnated in recent months



Source: SEIA and Santander

Imports fail to advance in a year, sustained by rising prices



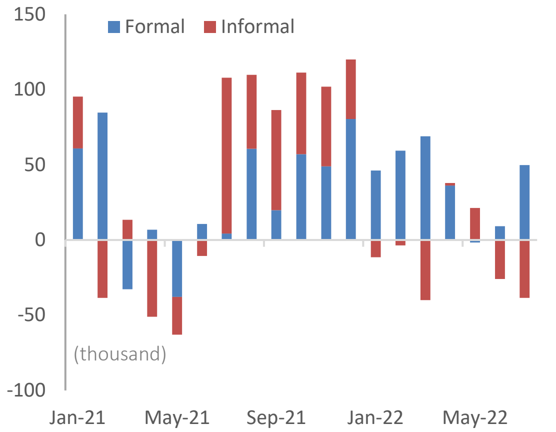
Source: Central Bank and Santander

The labour market is weakening

Jobs have stagnated for several months, with employment figures at around 8.85 million, down from 9.1 million before the pandemic. In July, as in previous months, there was a net creation of female employment, while male employment showed a net contraction for the fourth consecutive quarter. By type of employment, there was some recovery in formal jobs, while informal jobs declined. However, the unemployment rate rose to 7.9%, still affected by low labour participation.

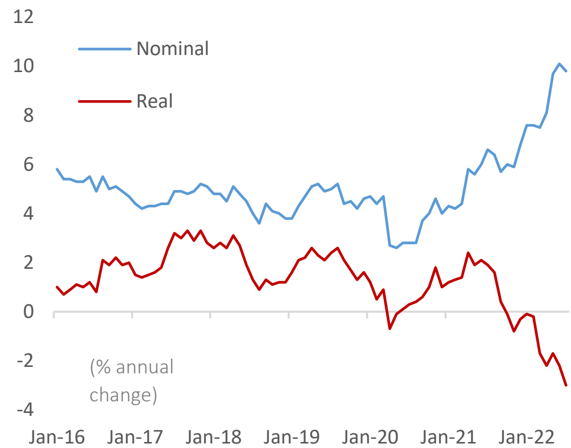
In the future, job creation will remain weak. While showing a slight recovery at the margin, the job vacancy index remains below the levels observed during the first half of 2019 and without much prospect of improvement. This suggests that demand for labour has moderated. Furthermore, real wages continue to contract (-3% YoY) due to the impact of the inflationary shock. Hence, the wage bill has continued its downward adjustment.

Formal jobs are sustaining the weak employment growth



Source: Central Bank and Santander

Real wages declined by 3% YoY, a new record in more than a decade



Source: Central Bank, CCHC, INE and Santander

Fiscal accounts improve as lithium prices rise

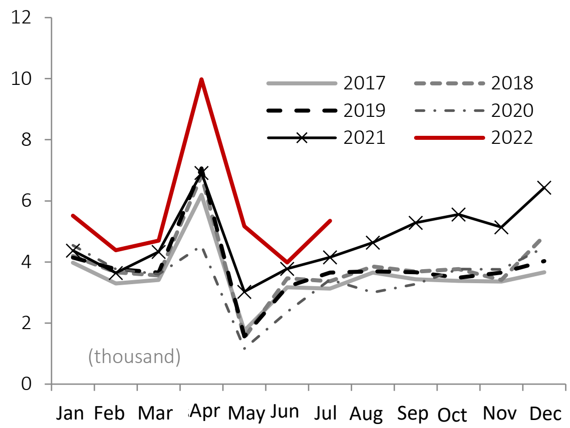
Tax revenues have continued to surprise on the upside. The lithium contract between Corfo and SQM and Albemarle implied an income of $945 billion in July due to the strong increase in the lithium price - which in one year went from US$6,000 to US$54,000 per m3 sold by SQM -. This income should recur to a similar amount in October. All this complemented the significant upturn in tax revenues in the second quarter due to the tax return operation. This has offset the fall in value-added tax revenue (-5.7% real annual rate), weakened by the slowdown in domestic demand. Spending, however, remains relatively weak, although it should accelerate somewhat towards the end of the year. Thus, if the spending set out in the budget is implemented along with complementary laws passed during the year, and the price of lithium remains high, we assess that the public accounts will close with a small surplus of around 0.3% of GDP.

In 2023, revenues will moderate substantially due to the economic contraction and the fact that one-off factors that had an impact this year will not be present (Substitute Tax to the Income Fund Ledger FUT, ISFUT). The latter does not consider possible new resources coming from the tax reform under discussion in Congress. Furthermore, spending will expand between 3% and 4%, consistent with the government's commitments to the fiscal rule. As a result, the government deficit will rise again to around 3% of GDP.

This week, the government announced a programme centred on six pillars to mitigate the investment fall, especially during 2023. Among the tax measures are the postponement of the enactment of some taxes (SMEs, part of the mining royalty, among others), transitional semi-instantaneous depreciation and the elimination of tax changes in leasing contracts.

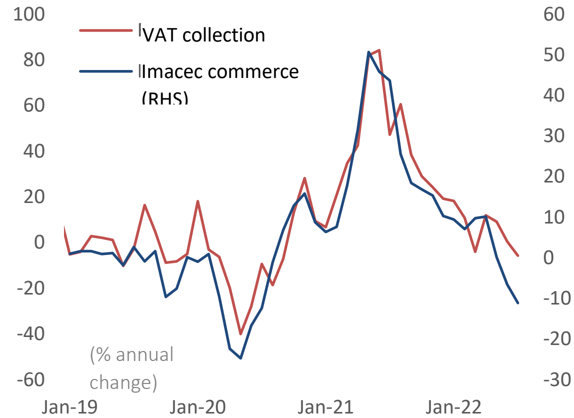
In order to boost the real estate sector, state guarantees are provided for the financing of 10% of the down payment on mortgage loans and the extension of coverage up to 100% in the event of an auction of the property, to facilitate access to loans. The 10% increase in public investment spending by 2023 and the inclusion of a US$ 1.84 billion infrastructure programme are also noteworthy. Other measures focus on streamlining, reactivating and simplifying the government's investment and payment processes.

July revenues strongly benefited from the lithium contract...



Source: Central Bank and Santander

...but weak economic prospects will affect future revenue collection



Source: Central Bank, CCHC, INE and Santander

CPI for August again exceeds expectations

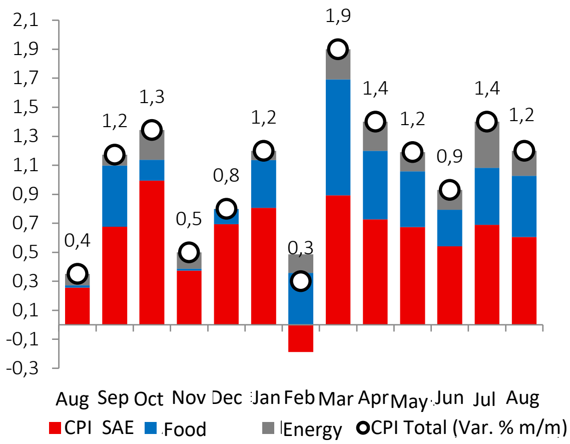
At 1.2%, the CPI was slightly higher than expected (Bloomberg: 1%; Santander 1%), pushing the year-on-year change to 14.1%, a new peak record in 30 years. The highest markers once again corresponded to the food and transport divisions, to which was added the seasonal increase in clothing. Price hikes excluding volatile items, although moderating slightly, were once again high (CPI excluding volatile items: 0.9% MoM; 10.8% YoY). Moreover, the diffusion index shows that 69% of prices rose in the month, well above the norm for the eighth month of the year, as has been the case in previous months.

The figures continue to show broad and persistent inflationary pressures. A breakdown of the larger price changes reveals some second-round effects - rent increases, linked to past inflation, and rises in restaurant and hotel prices caused by increases in supply costs - and lagging effects of international price and exchange rate movements, such as rises in meat and fuel prices.

In the future, we expect the CPI to moderate gradually. Internationally, food and fuel prices, along with freight costs, have been falling steadily for several weeks. On a local level, the Peso is somewhat stronger than its July average, when it reached a record low before the Central Bank's intervention, and consumption is showing signs of slowing down.

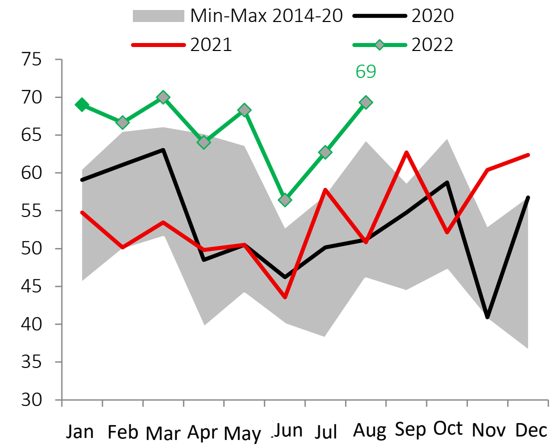
In September - a month where the CPI is traditionally high due to seasonal effects - we will see a moderation in the rise of petrol prices (last week they experienced a slight fall after 54 weeks of hikes), which will help to keep the record more contained. On the other hand, significant rises in food prices continue to be observed, with bread and meats being among the most frequent. With this, we project the change in the CPI to be somewhat below 1% - around 0.9% - bringing its annual change to around 13.5%, marking its first decline since February 2021. Subsequently, we will continue to see more limited rises, ending the year at around 12%.

The food sector continues to be a major contributor to price hikes



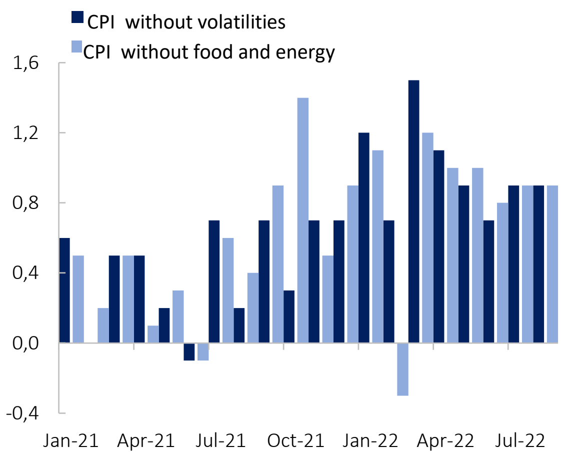
Source: National Institute of Statistics and Santander

The percentage of prices rising in the month remains at record peaks



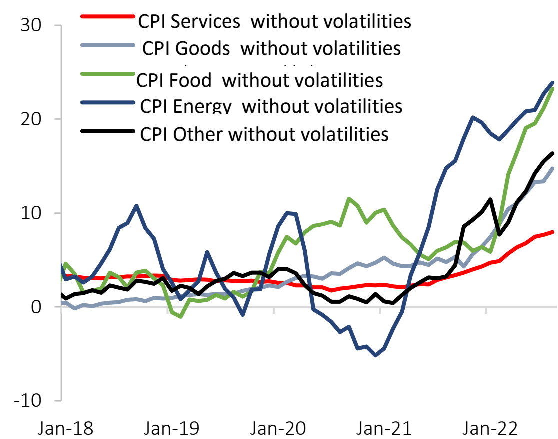
Source: National Institute of Statistics and Santander

Underlying measures remain high



Source: National Institute of Statistics, Central Bank and Santander

All measures of inflation continue to accelerate



Source: National Institute of Statistics and Santander

The Central Bank raises the rate higher than expected

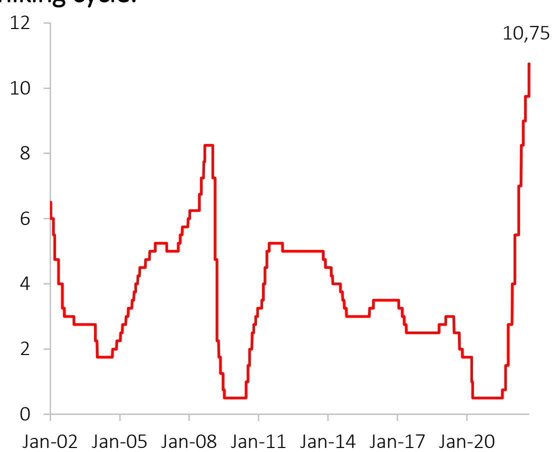
There was a broad consensus that the Central Bank would raise the MPR preceding the September Monetary Policy Meeting, as annual inflation reached above 13%, and medium-term expectations continued to move away from the 3% target. Nevertheless, activity had begun to show signs of moderation, the exchange rate had declined, and international food and energy prices were falling, which would eventually be absorbed by the local prices. Therefore, the market estimated that the MPR hike would be moderate, between 50 bps and 75 bps, with the possibility that there could be another increase in October and thus conclude the cycle with the MPR in a range between 10.5% and 11%.

Despite this, the Council decided - in a split decision - to raise the rate more aggressively (100 bps), leaving it at 10.75%, around its final level as reported in its statement and in the September Monetary Policy Report (IPoM). Consistent with the above, a neutral bias was suggested, implying that, in the absence of surprises, the process of hikes would pause from October onwards.

Notwithstanding, the inflationary surprise in August (1.2% MoM) and the pressures that remain high raise the possibility of an additional hike at the October meeting. Thus, while we consider that no further MPR hikes are likely, we do not rule out additional, but limited, hikes of about 25 bps. The final level of the MPR for this cycle would thus be between 10.75% and 11%.

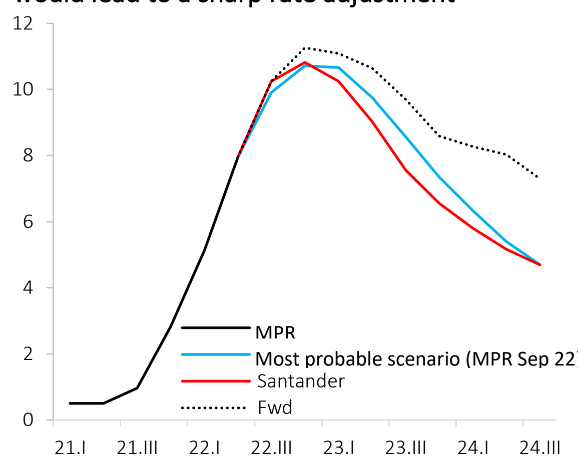
In the future, moderating inflation and a weak economy should help to dampen inflationary expectations. If this is the case, in the December Monetary Policy Report (IPoM), the Council could begin to outline a monetary easing strategy that would materialise in the first quarter of 2023, which would bring the MPR to a range between 6% and 6.5% by the end of next year. This implies somewhat more pronounced rate cuts than suggested in the last IPoM and swap rate corridor but is consistent with a slight decline in real rates, which is necessary to avoid over-adjustment and a deeper and more inefficient downturn in the economy.

MPR rises to 10.75% and is near the peak of this hiking cycle.



Source: Central Bank and Santander

A fall in activity and moderation of inflation would lead to a sharp rate adjustment



Source: Bloomberg, Central Bank and Santander

Global financial conditions continue to tighten amid high inflationary pressures

While some commodity prices have continued to fall - aggregate energy index: -5% - global inflationary persistence remains a major concern for markets. The latest CPI figures have again surprised on the upside (Eurozone CPI: 9.1% YoY vs 9% expected; US CPI: 8.3% YoY vs 8.1% expected; UK CPI: 9.9 vs 10 expected), highlighting the acceleration of the core component in the US (0.6% MoM vs 0.3% expected).

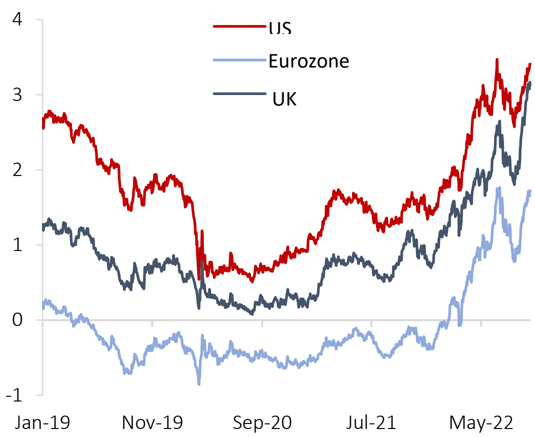
Against this backdrop, financial conditions tightened again amid the prospect of more aggressive actions by major central banks. For both the Fed and the ECB, aggressive rate hikes are expected at their upcoming meetings, with hikes of at least +75 bps for each. In the case of the Fed, some analysts even point to a larger increase of 100 bps. In addition, the Bank of England could raise its MPR by 50 bps next week.

Consequently, international stock markets have seen further declines (MSCI global: -7% in the month; MSCI emerging markets: -3%; US: -8%; Eurozone: -6%), the dollar has strengthened (2% in multilateral terms, reaching new all-time highs), and long-term interest rates have rebounded (+65 bps on average, with T10 in the US approaching 3.5%). On the other hand, risk aversion has risen again (VIX: +7 points).

Furthermore, the energy crisis in Europe due to the war between Russia and Ukraine has heightened recessionary fears. August activity indicators in Europe showed a further slowdown (composite PMI: 48.9 vs 49.2 previously), and investor confidence has continued to fall in the first figures of September (ZEW survey: -60.7 vs -54.9 previously; Sentix index: -31.8 vs -25.2 previously). In the US, despite the rise in the unemployment rate (3.7% vs 3.5% expected), the labour market continues to show signs of strengthening (initial unemployment claims: 222 thousand vs 235 thousand expected; job creation: 315 thousand vs 298 thousand expected). On the other hand, the revision of figures confirmed that Q2 GDP contracted (-0.6% QoQ vs -1.6% in 1Q22) while the latest economic figures reflected stagnation (durable goods orders: -0.1% vs 0% expected; industrial orders: -1% vs 0.2% expected; ISM manufacturing: 52.8 vs 52.8 previous; composite PMI: 44.6 vs 45 previous).

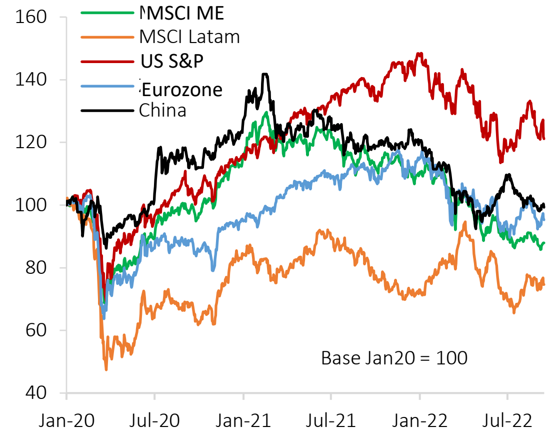
In line with its zero-tolerance policy on Covid-19, China has re-imposed sanitary restrictions, fuelling inflationary risk and pressure on freight and global supply costs. This is amid an economic outlook for the country that continues to correct downwards (GDP 2022: 3.5% expected by the Bloomberg median vs 3.9% the previous month), despite the authorities' efforts to ensure the necessary stimulus.

Long-term interest rates rise sharply



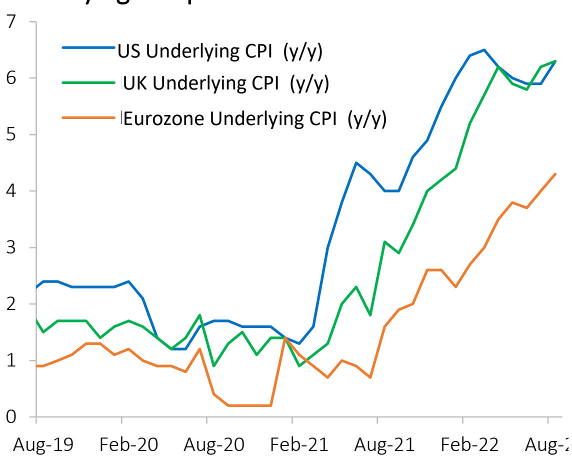
Source: Bloomberg and Santander

Global stock indices retreat



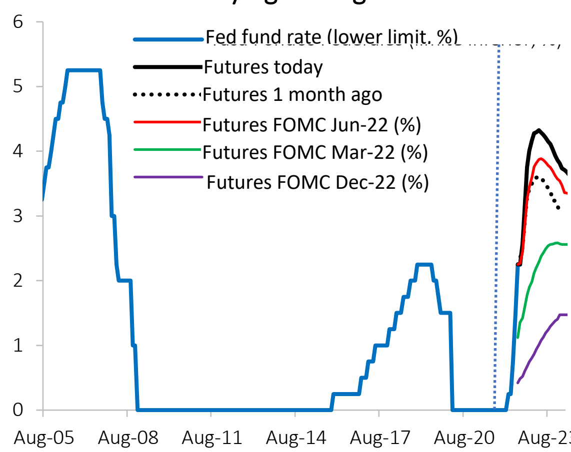
Source: Bloomberg and Santander

Persistent inflationary pressures in the underlying components stand out



Source: Bloomberg and Santander

Global financial conditions strain in anticipation of further monetary tightening



Source: Bloomberg and Santander

National Accounts	2016	2017	2018	2019	2020	2021	2022 P	2023 P
GDP (% real var. YoY)	1.8	1.4	4.0	0.8	-6.0	11.7	1.8	-1.0
Domestic demand (% real var. YoY)	1.9	2.9	5.0	1.0	-9.3	21.6	1.9	-3.3
Total consumption (% real var. YoY)	4.1	3.8	3.6	0.7	-7.2	18.2	2.8	-3.7
Private consumption (% real var. YoY)	3.3	3.6	3.8	0.7	-8.0	20.3	2.2	-4.5
Public consumption (% real var. YoY)	7.6	4.7	3.1	0.5	-4.0	10.3	5.1	-0.7
Gross fixed capital formation (% real var. YoY))	-2.4	-3.3	6.5	4.7	-9.3	17.6	-2.1	-4.4
Exports (% real var. YoY)	0.6	-1.0	4.9	-2.5	-1.1	-1.5	0.8	1.7
Imports (% real var. YoY)	1.2	4.5	8.6	-1.7	-12.7	31.3	1.4	-5.3
GDP (US$ billion)	249.5	276.5	296.0	279.0	253.5	316.8	306.0	311.0
GDP per capita (US$ thousand)	13.7	15.0	15.8	14.6	13.0	16.1	15.5	15.6
Population (million)	18.2	18.4	18.8	19.1	19.5	19.7	19.8	20.0

Payment Balance	2016	2017	2018	2019	2020	2021	2022 P	2023 P
Trade balance (US$ billion)	5.0	7.5	4.4	3.0	19.0	10.5	10.5	10.3
Exports (US$ billion)	60.8	68.9	74.8	68.8	74.1	94.7	97.0	87.0
Imports (US$ billion)	55.8	61.4	70.4	65.8	55.1	84.1	86.5	76.7
Current account (US$ billion)	-6.5	-7.6	-13.3	-14.5	-4.3	-20.3	-18.3	-9.2
Current account (% GDP)	-2.6	-2.8	-4.6	-5.2	-1.7	-6.6	-6.0	-3.0
Copper price (year average US$/lb)	2.2	2.8	3.0	2.7	2.8	4.2	3.9	3.6
WTI oil price (year average US$/bbl)	43.2	50.9	64.8	57.0	39.0	68.0	96.0	82.0

Money and Exchange Market	2016	2017	2018	2019	2020	2021	2022 P	2023 P
CPI Inflation (% var. YoY up to December)	2.7	2.3	2.6	3.0	3.0	7.2	12.0	5.7
CPI Inflation (% var. YoY average)	3.8	2.2	2.4	2.3	3.0	4.5	11.5	8.0
CPI Inflation excluding food and energy (IPC-SAE) (% var. YoY up to December)	2.8	1.9	2.3	2.5	2.6	6.4	8.7	5.5
CLP/US$ exchange rate (annual exercise)	667	615	696	745	711	852	900	910
CLP/US$ exchange rate (year average)	677	649	640	703	792	759	862	905
Monetary policy rate (% year end)	3.5	2.5	2.8	1.8	0.5	4.0	11.0	6.3
Monetary policy rate (% year average)	3.5	2.7	2.5	2.5	0.8	1.2	8.5	8.8

Fiscal Policy	2016	2017	2018	2019	2020	2021	2022 P	2023 P
Public expenditure (% real var. YoY)	3.8	4.8	3.5	4.1	11.0	31.6	-24.0	3.0
Central Government balance (% GDP)	-2.7	-2.8	-1.7	-2.9	-7.3	-7.7	0.3	-3.0
Central Gov. gross Debt (US$ billion)	53.4	68.9	70.2	74.4	91.6	102.0	106.0	118.0