MARKET OUTLOOK

WEEK: 22 – 26 July, 2019

Highlights

- **The European Central Bank paves the way to expand the monetary stimulus.** As expected, the ECB kept its benchmark rate unchanged but paved the way for a cut in September. Its president, Mario Draghi, indicated that additional unconventional measures are being evaluated and called for activating fiscal policy, in a context where monetary policy is close to its expansive limits.

- **The IMF cuts global growth projections up to 3.2%, due to less dynamism in emerging economies. For** Chile, the international organization pointed to a growth of 3.2%, above the current market consensus.

- **The US economy grew above expectations in the second quarter (2.1% annualized q / q), driven by consumption and public spending.** The important dynamism of consumption is associated with the good moment of the labor market and the expansion of public spending. In contrast, investment fell due to the deterioration of the manufacturing sector due to the commercial conflict.

- **The solid consumption data could generate a dilemma for the Federal Reserve in the face of its next decisions.** A reduction in the rate is practically discounted at the meeting next week, but from then on the monetary impulse could be less than what is contemplated by the market.

- **The Peso continues to deteriorate in an environment of sharp declines in long-term local interest rates.** The local currency depreciated 1.3%, in line with the global appreciation of the DXY and a slight fall in the price of copper. Rates continued to decline after the July MPR and, in the case of long-term rates, reached new historical lows. There is a significant increase in the correlation between these rates and the US equivalents.

- **Unemployment increases in Greater Santiago.** According to the Occupation and Unemployment Survey of the University of Chile, unemployment in Greater Santiago reached 8.4% in the second quarter, above historical averages and higher than in the equivalent period of 2018 (7%), reflecting that the labor market remains weak. In line with this, the Consumer Confidence Index registered a significant decline (-11.8% y / y), with a deterioration in both the perception of the personal situation and the country.

The European Central Bank paves the way for rate cut in September

At its July meeting, the European Central Bank (ECB) left the reference interest rates unchanged and assured that they will remain at current or lower levels until at least the first half of 2020, which unlike the previous meeting, paves the way for a rate cut at the September meeting. The probability of this adjustment - implicit in financial prices - is 87% at the close of this report.

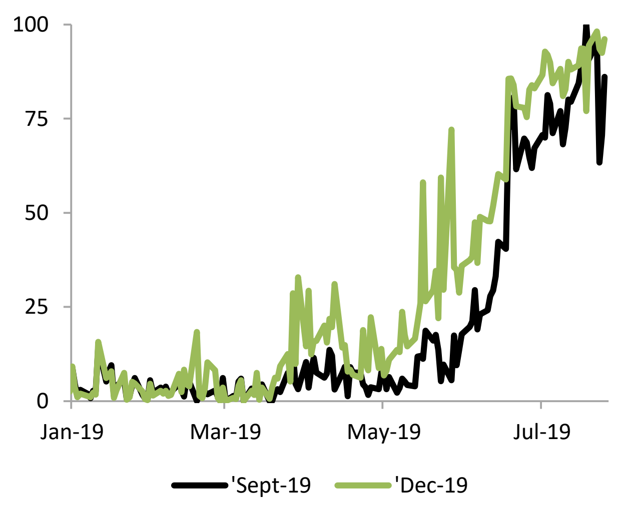
In addition, the council stressed the need for a very accommodative monetary policy orientation for a prolonged period because both observed and expected inflation have persistently remained below the target level.

At the press conference, Mario Draghi pointed out that the risks to growth are biased downwards, the transfer of improvements in the labor market to inflation has been slow and the manufacturing sector continues to deteriorate. Hence the need for greater stimulus, so they are reviewing options of a tiered rate for the deposit of excess reserves of banks and new asset purchase programs.

In addition, Draghi urged responsibility for fiscal policy if the economic outlook continues to worsen, given that monetary policy has already done enough. The same diagnosis follows from a recent survey of experts from the IGM Forum, where most of the economists consulted point to the lower space of monetary policy effectiveness and prioritize public spending to boost demand, which could imply an increase in debt.

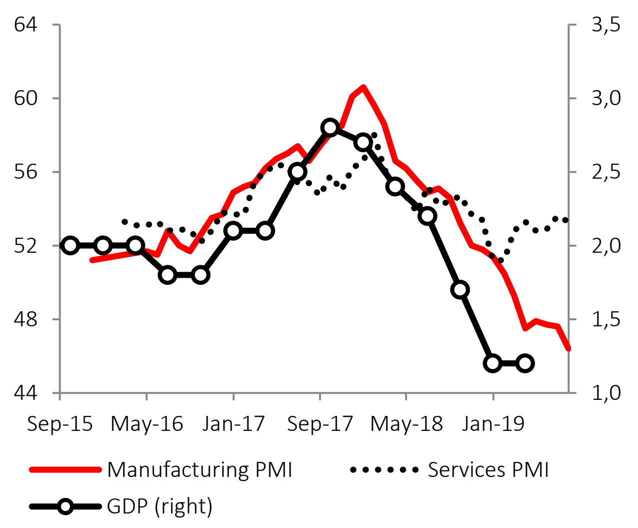
Preliminary data for the July PMIs again reflect the divergence between the manufacturing and services sectors in the Euro Zone. The latter was 53.3 slightly below June 53.6, while the manufacturing sector decreased to 46.4, from 47.6 the previous month. Manufacturing activity in Germany continued to show further deterioration.

Graph 1: Eurozone: Implicit probability of a rate cut (%)



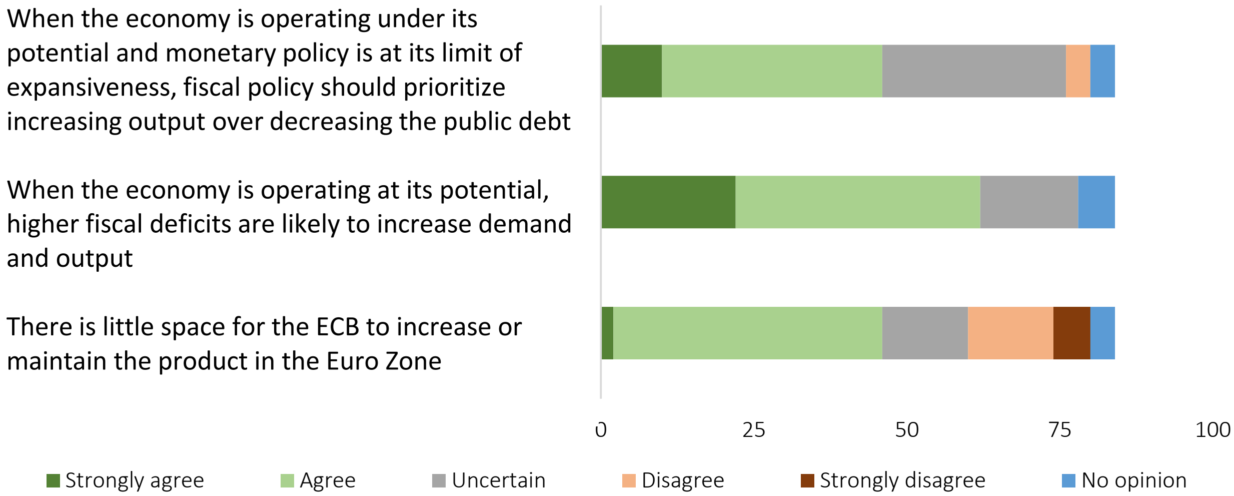
Source: Bloomberg and Santander

Graph 2: Eurozone: PMI and GDP (Index 50 = Neutral annual var. %)



Source: Bloomberg and Santander

Graph 3: European monetary and fiscal policy survey



Source: IGM Forum and Santander

IMF projections update highlights downside risks

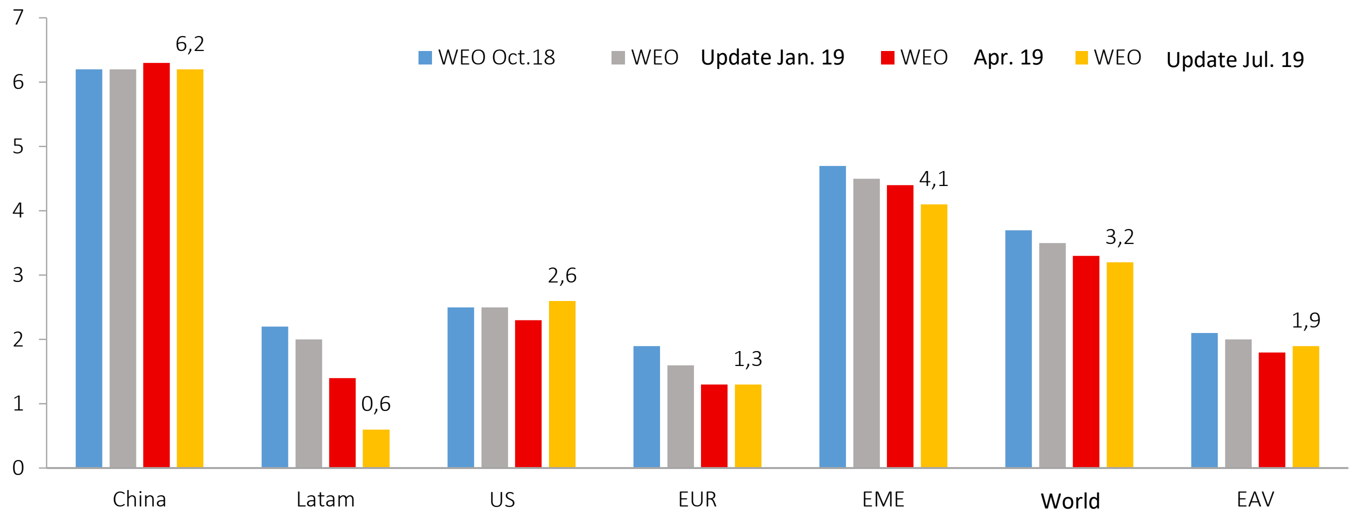
During this week the IMF presented in our country the update of its World Economic Outlook (WEO). Although the projection of global growth for 2019 was corrected slightly downwards - from 3.3% to 3.2% -, behind the adjustment there are different developments between developed countries and emerging economies.

While the expected expansion in 2019 of advanced economies increased slightly to 1.9%, prospects for emerging economies fell to 4.1%, from 4.4% in the April WEO. Although the deterioration is widespread within this group, Latin American countries suffered the largest cuts, with Brazil and Mexico leading the falls. In the case of the latter, the report highlights the socio-political factors that have affected trust and contributed to the uncertainty of the largest Latin American economies.

The projection for Chile was 3.2%, in line with what was presented by the Minister of Finance, but a few tenths above the market consensus (2.8% in the last Survey of Economic Expectations) and the Santander estimate (2.7%).

The adjustment for advanced economies is mainly due to the projected growth for the US. It went from 2.3% to 2.6%, which according to the IMF would be justified by the positive surprise of the first quarter activity in that country.

Graph 4: 2019 growth projections according to WEO (%)



Source: IMF (World Economic Outlook)

Although the IMF expects a generalized recovery during 2020, the report emphasizes that 70% of the eventual improvement involves the stabilization or recovery of economies that are under stress today. In this sense, the risks are biased downwards, as trade tensions or a disorderly Brexit could placate the momentum of more accommodative monetary policies. Other assumptions behind the recovery scenario are that the sentiment in the financial markets remains generally positive and that some temporary factors dissipate.

The WEO also brings relevant comments regarding the long-term challenges facing the global economy. Regarding the tensions around the "commercial and technological conflict" - as the IMF calls it to remind us that the latest actions go beyond the trade balance -, the report emphasizes that the powers involved should not use tariffs as a negotiation strategy. Instead, it calls for updating and strengthening instances such as the World Trade Organization, so that they can adequately channel the discontent that globalization generates in the population and that has triggered disputes between countries. It also states that there are other areas where international cooperation should be enhanced, such as climate change, corruption and international tax evasion and financial regulation.

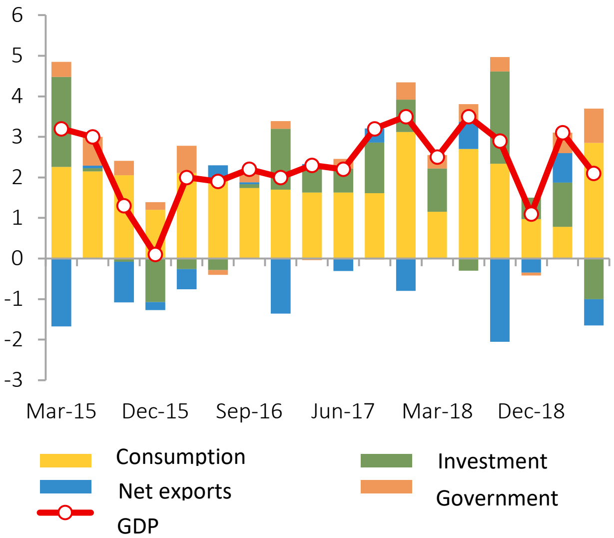
Federal Reserve could face a dilemma for the next meetings

The second quarter growth in the US (2.1% annualized q / q) was somewhat better than expected and accounted for the strength of consumption and public spending. Meanwhile, July PMIs - known during the week - were mixed, with a recovery in the services sector and a slight drop in manufacturing.

While 2018 growth was revised downwards - which accounts for a greater impact of the trade conflict on the US economy - and the underlying Q2 PCE (1.8%) was somewhat lower than expected, the solid rebound in consumption in the second quarter could generate a dilemma for the Fed since it has already given very clear signs of its intention to initiate a process of monetary relaxation, and the market has internalized three rate declines by mid- next year.

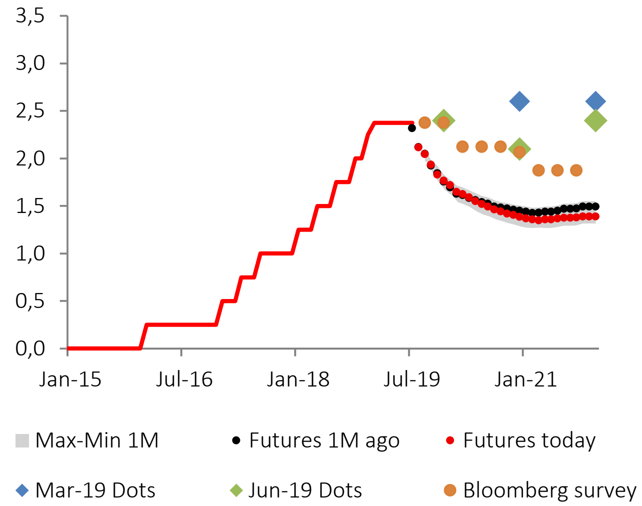
There is little doubt that the Fed will cut the rate at its meeting next week, but then it could remain unchanged for a prolonged period of continuing positive activity figures. Considering the expectations implicit in financial prices, if this scenario materializes, a significant reversal could be observed in the financial markets.

Graph 5: US GDP and components (var. q/q season. adj.)



Source: Federal Reserve of San Francisco

Graph 6: Fed Fund Rate Expectations (%)



Source: IMF (World Economic Outlook)

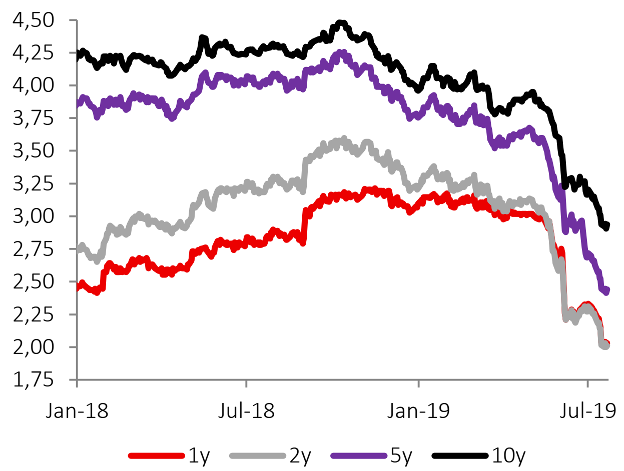
The peso continues to deteriorate in an environment of falling rates

In the local market, the peso continued to depreciate and closed the week at levels above $ 695 per dollar. The main factor that explains this trend is the global appreciation of the dollar. The price of copper showed a limited drop during the week and the flows of non-residents in the forward market were lower and pointed to an appreciation.

The global strength of the dollar responds to recent corporate results - which has positively surprised –and to the better growth prospects for the US. The IMF and the weakening of the euro after a more expansive forward guidance by the ECB

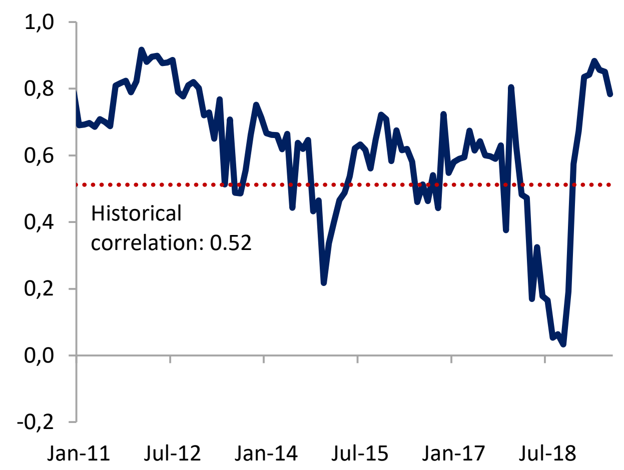
Local rates continued to decline after the July RPM. The long-term rates reached new historical lows in a context of greater monetary stimuli driven by the main central banks. It is noteworthy that swap rates have been below 3% in recent days, well below what is consistent with various estimates for the neutral interest rate. The data show that international liquidity conditions would be having a greater impact on local rates, with a significant increase in correlation between them and their counterparts in United States and the American rates in the last year.

Graph 7: Nominal swap rates (%)



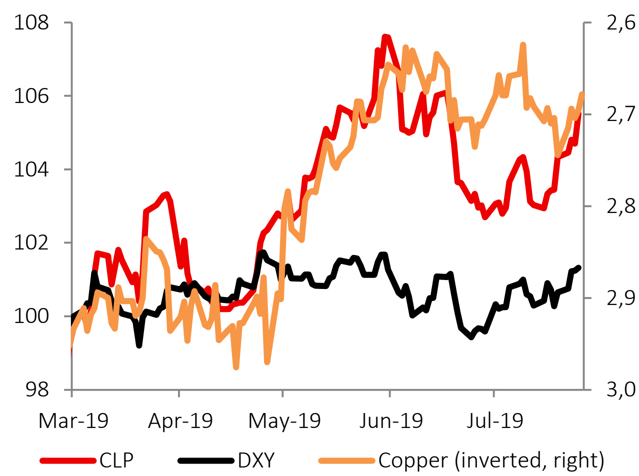
Source: Bloomberg and Santander

Graph 8: 1 yr Moving correlation of 10 yr US- CL swap rates (based on monthly returns)



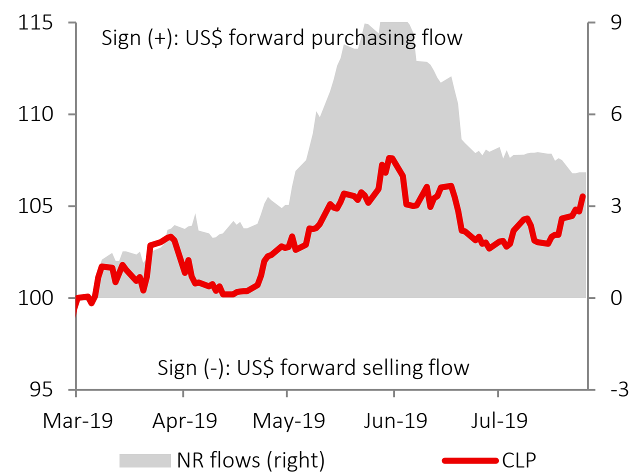
Source: Bloomberg and Santander

Graph 9: Exchange rate, DXY and cobre (Index 100 = Mar. 19, US$/lb.)



Source: Bloomberg and Santander

Graph 10: Exchange rate and non resident flows (Index 100 = Mar.19, thousands of US$ millions)



Source: Bloomberg and Santander

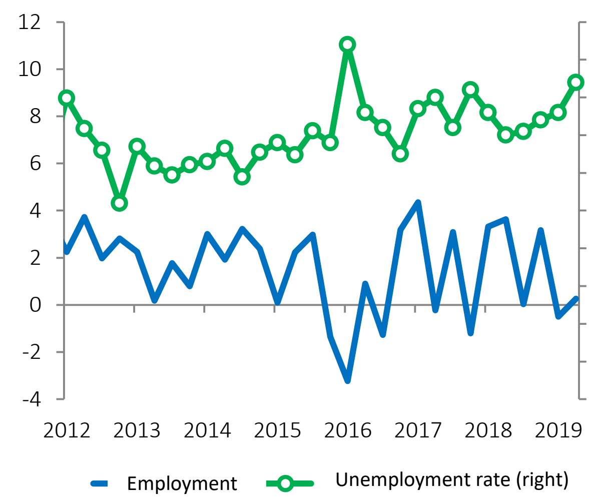
Figures from the University of Chile show deterioration of the labor market

The Occupation and Unemployment Survey of the Microdata Center of the University of Chile concluded that the unemployment rate in Greater Santiago reached 8.4% in the second quarter of the year (+1.4 pp y / y; +0, 8 pp q / q), the highest record since March 2016, standing above the historical average for the period that is 7.3%. In addition, the results are above 7.8% reported by the INE in the March-May period.

The deterioration would be explained by the economic slowdown and a greater labor participation derived from the migratory influence. However, the increase of 1.3% y / y in salaried employment and the reduction of 3.5% y / y of independent work stand out. By economic sectors, the highest unemployment is observed in construction with 9.2%, trade 9.0% and transport 8.1%.

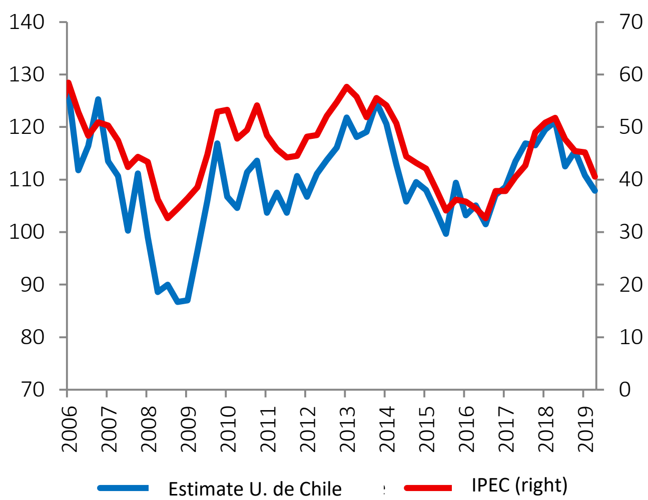
In addition to the deterioration of the labor market, the Consumer Confidence Index published simultaneously shows a contraction of 11.3 points y / y in the general indicator. All components are in decline: Expected Situation (-17 points y / y), Current Situation (-6.7 points y / y), Family Situation (-1.3 y / y) and Country Situation (-30. 9 points y / y). This is in line with the deterioration in the confidence of households that exhibit other indicators, such as the IPEC that has fallen persistently since mid-2018.

Graph 11: Employment and unemplyment rate in Greater Santiago (Annual var. % and %)



Source: Microdata Center and Santander

Graph 12: Confidence Index, U. de Chile and IPEC (Index Mar 2001=100; Index 50=neutral)



Source: Microdata Center, GfK and Santander

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DATA THAT WAS PUBLISHED / this week

DAY	COUNTRY	INDICATOR	PERIOD	PREVIOUS	ESTIMATION	ACTUAL
MONDAY 22	US	Activity index Fed Chicago	June	-0.05	0.10	-0.02
TUESDAY 23	Eurozone	Consumer confidence	July	-7.2	-7.2	-6.6
WEDNESDAY 24	US	PMI Markit manufacturing	July	50.6	51.2	50.0
	US	PMI Markit Services	July	51.5	51.8	52.2
	Eurozone	PMI Markit manufacturing	July	47.6	47.6	46.4
	Eurozone	PMI Markit Services	July	53.6	53.3	53.3
THURSDAY 25	US	Durable godos order	June	-1.3%	0.8%	2.0%
	US.	Unemplyment claims (thousands)	July	216k	220k	206k
	Eurozone	ECB reference rate	July	-0.4%	-0.4%	-0.400%
FRIDAY 26	US	GDP annualized q/q	2Q19	3.1%	1.8%	2.1%
	US	Personal consumption	2Q19	0.9%	4.0%	4.3%
	US	PCE Core q/q	2Q19	1.2%	2.0%	1.8%

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DATA THAT WILL BE PUBLISHED / next week

DAY	COUNTRY	INDICATOR	PERIOD	PREVIOUS	ESTIMATION
MONDAY 29	US.	Manufacturing Index Fed Dallas	July	-12.1	-5.0
TUESDAY 30	Eurozone	Economic confidence	July	103.3	102.7
	Eurozone	Consumer confidence	July	-6.6	-6.6
	China	PMI official manufacturing	July	49.4	49.6
	China	PMI official non-manufacturing	July	54.2	54.0
WEDNESDAY 31	Chile	Unemployment rate	June	7.1%	--
	Chile	Industrial production	June	-0.2%	--
	US	Fed Fund rates	July	2.50%	2.25%
	Eurozone	Unemployment rate	June	7.5%	7.5%
	Eurozone	GDP y/y	2Q	1.2%	1.0%
	Eurozone	Core inflation y/y	July	1.1%	1.0%
	Eurozone	Total inflation y/Y	July	1.2%	1.1%
	China	PMI Caixin manufacturing	July	49.4	49.6
THURSDAY 1	Chile	IMCE	July	50.16	--
	US	PMI Markit manufacturing	July	50.0	--
	Eurozone	PMI Markit manufacturing	July	46.4	46.4
FRIDAY2	Chile	Retail sales	June	3.3%	--
	Chile	Commercial activity	June	5.5%	--
	US	Non-agriculture job creation	July	224k	170k
	US	Unemployment rate	July	3.7%	3.7%

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