

# Mexico

# Economic Outlook

3Q20

Economic Effects of the Health Emergency

July 2020

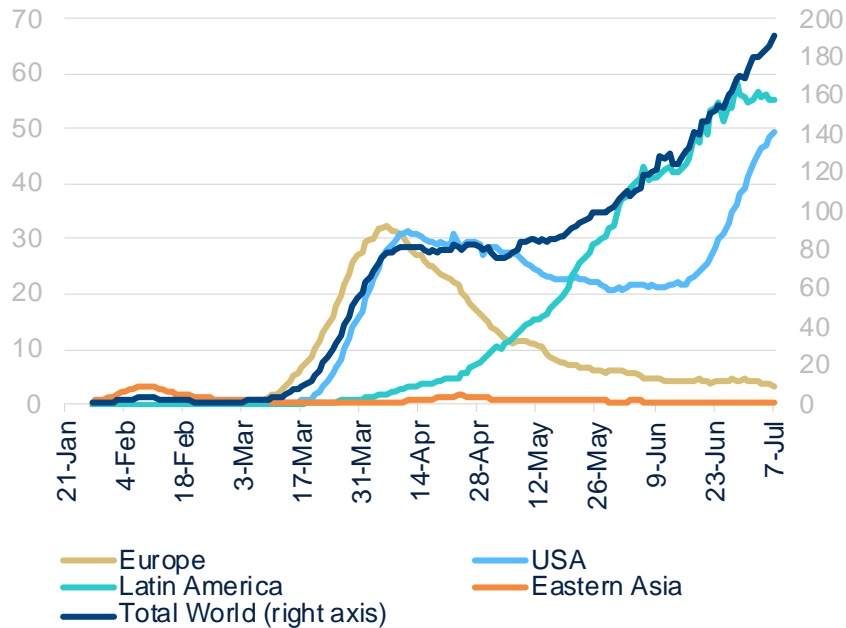
01

# Global Economic Outlook 3Q20

# The pandemic continues to spread, particularly in the Americas and South Asia, despite the fall in infections in Europe and East Asia

## DAILY CASES OF COVID-19

(THOUSANDS OF PEOPLE, MOVING AVERAGE OF LAST 7 DAYS)

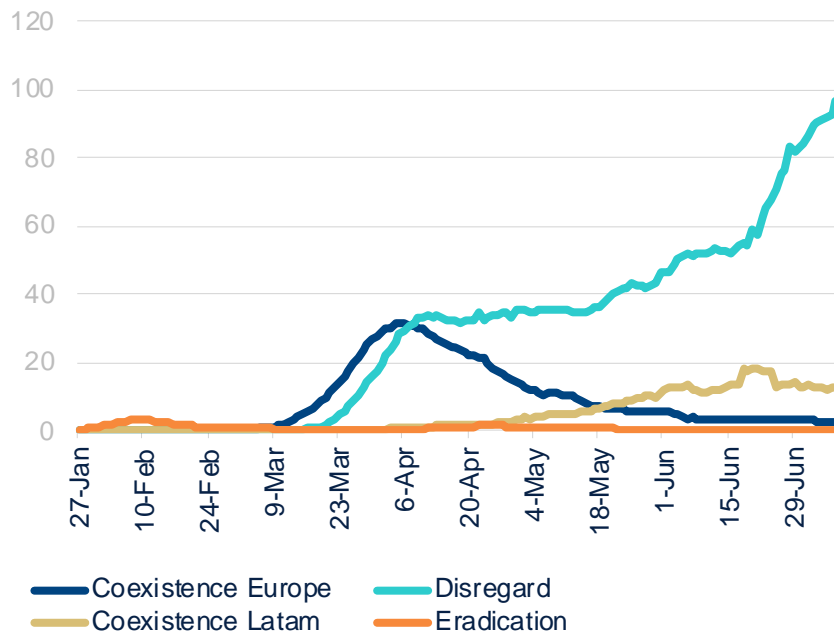


- **China's pattern** (shock and short and immediate lockdown to eradicate the virus), which was thought to be the model for other regions, **is not being repeated in other countries.**
- **Europe has cut the number of cases considerably, in order to coexist with the virus at tolerable levels, but failure to eliminate the virus makes it more difficult to completely normalize the economy.**
- **Other regions** (the US, Latin America and India, among others) **have further to go and are following different strategies.**

## Three policy approaches mark the development of the epidemic

### DAILY CASES OF COVID-19

(THOUSANDS OF PEOPLE, MOVING AVERAGE OF LAST 7 DAYS)



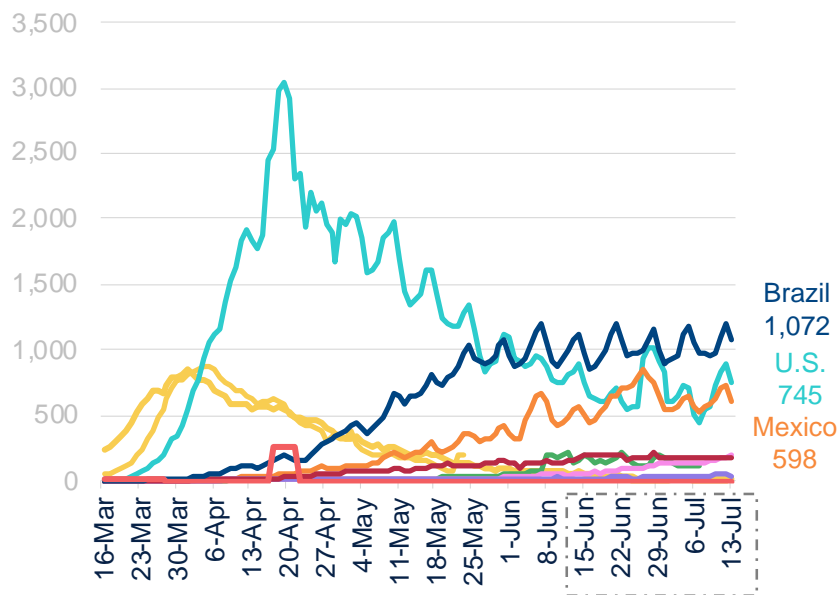
### Three policy approaches:

- **Virus eradication** – implemented in East Asian countries that acted early and decisively.
- **Coexistence with the virus** at tolerable levels for the health system – successfully implemented in Europe and less successfully so far in Latin America.
- **Relatively low intervention** by central governments resigned to the situation – position adopted by countries such as Brazil, Mexico, the US and Sweden.

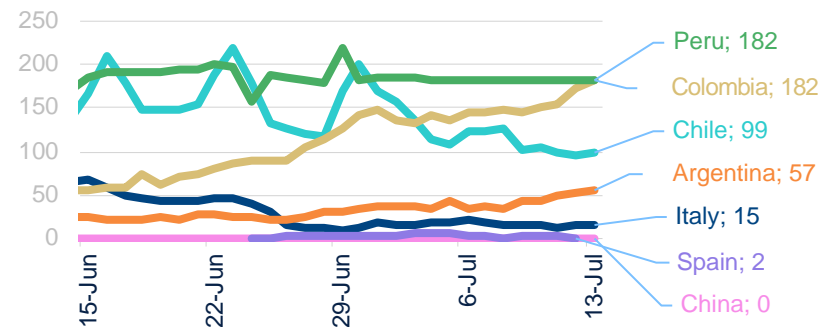
# Daily deaths due to COVID-19

## DAILY DEATHS DUE TO COVID-19 IN SELECTED COUNTRIES, JULY 13, 2020

(5-DAY MOVING AVERAGE)



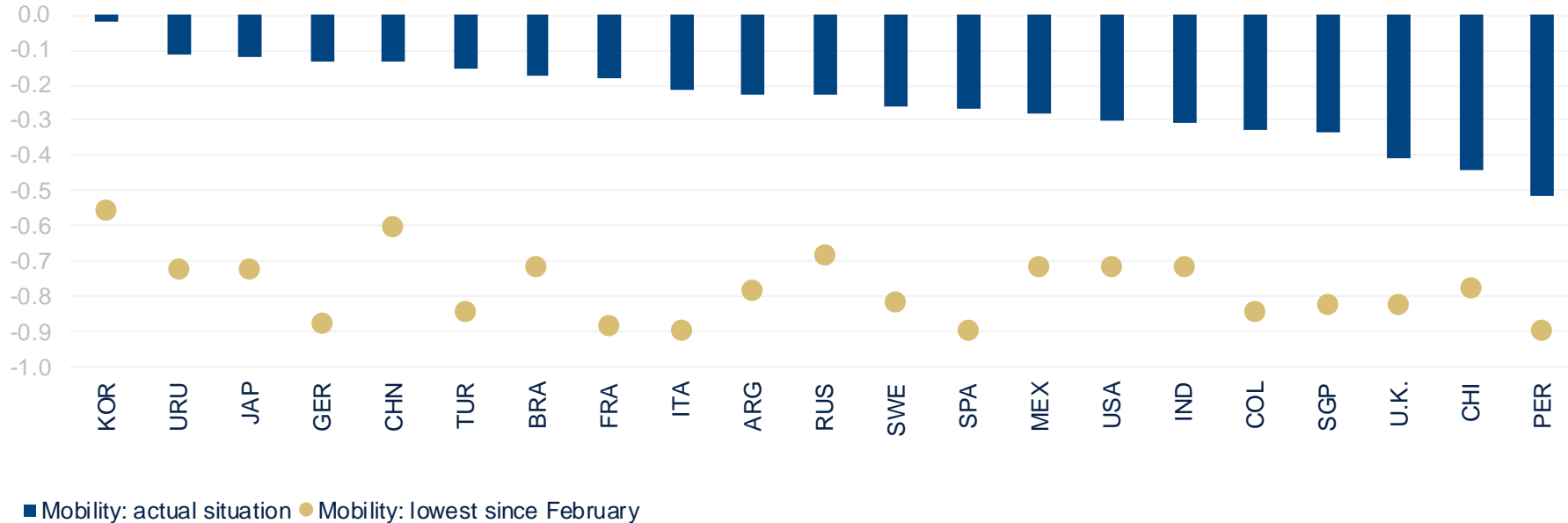
- Mexico is already the country with the fourth highest number of confirmed deaths (+35,000) due to COVID-19 in the world, surpassed only by the United States, Brazil and the United Kingdom.
- In the last three weeks, Mexico has seen an average of 650 deaths a day.



# Despite facing different epidemiological phases and policies, national economies are already deploying their exit strategies

## WORKPLACE MOBILITY INDICATOR (\*)

(HIGHER VALUES INDICATE GREATER MOBILITY: 0 = PRE-COVID MOBILITY; -1 = TOTAL ABSENCE OF MOBILITY)



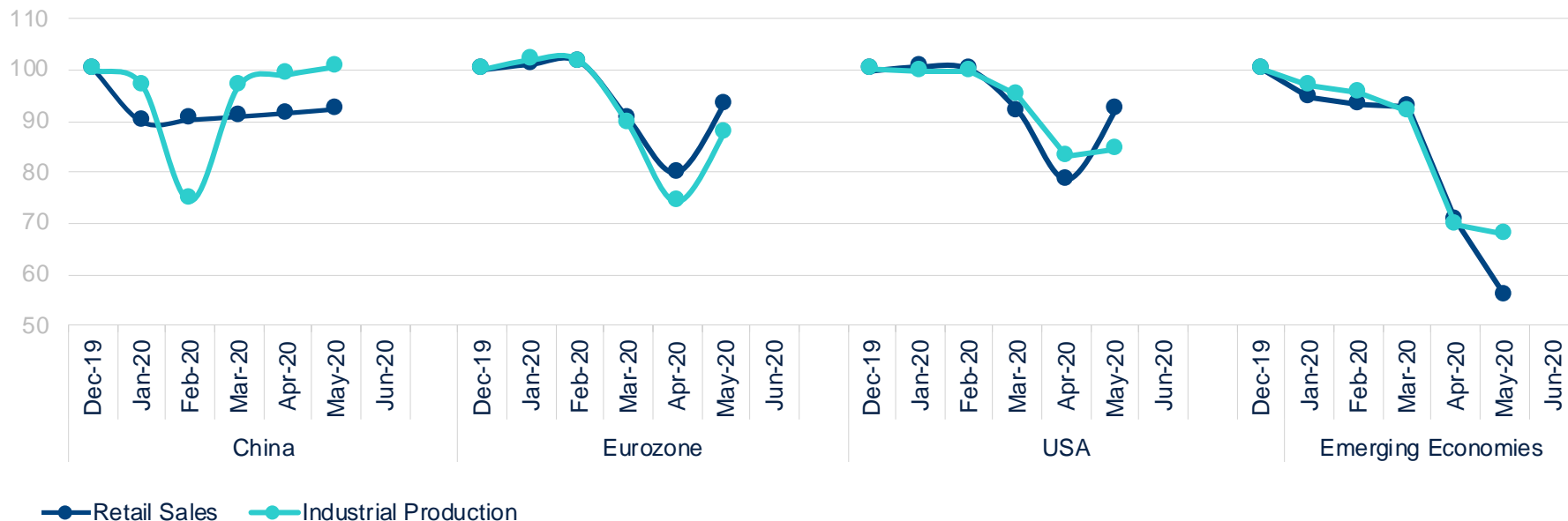
(\*) The mobility indicator reflects a trend in mobility over the reference period (January 3 to February 6). Current situation: average of the last 7 days up to June 29. Minimum from February: lowest 7-day moving average since the beginning of February.

Source: BBVA Research based on Google Mobility Reports

# Activity indicators paint a less positive picture and suggest that economic normalization will take time.

## RETAIL SALES AND INDUSTRIAL OUTPUT(\*)

(INDICES: DECEMBER/2019 = 100, SEASONALLY ADJUSTED DATA)



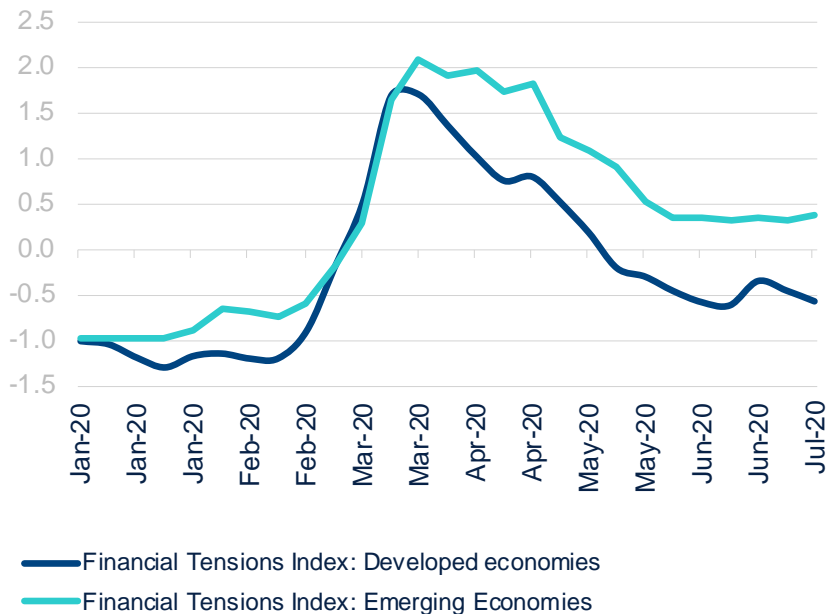
(\*) For the eurozone, the industrial output data for May represents the average (weighted) monthly growth of Germany, Spain, France and Italy. For emerging economies, the data reflects the simple average of the data from Mexico, Brazil, Russia, Singapore and Turkey. In this case, the June data reflects the partial information available.

Source: BBVA Research based on data from Haver.

# Despite the divergent evolution of the pandemic, financial markets remain stable thanks to stimuli and the partial recovery of activity

## FINANCIAL STRESS

(FINANCIAL STRESS INDEX: AVERAGE SINCE 2006 = 0)

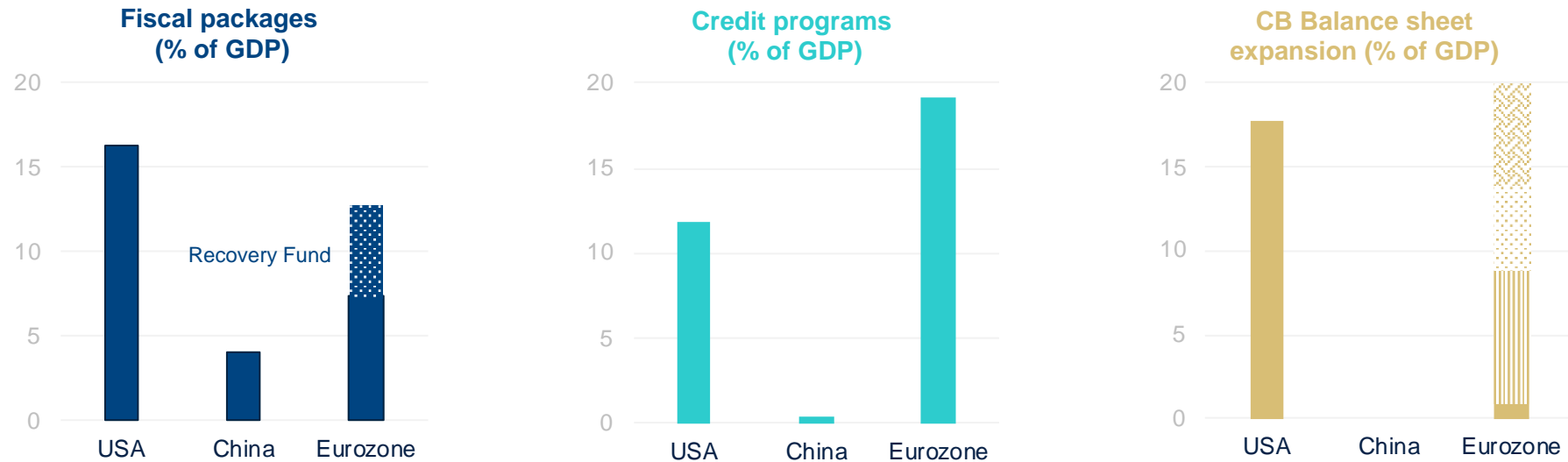


- Revision of the growth forecast for 2020: from -4.4% to -5.1%.
- By the end of 1Q20, the strong economic stimuli of the leading advanced economies reversed financial tensions.
- In 2Q20, market stabilization has consolidated:
  - First steps to lift lockdown
  - Rebound in activity
  - Strengthening of fiscal and monetary measures



# Following massive stimuli in response to the pandemic, there is now additional support at the European level (recovery fund, PEPP and TTRO)

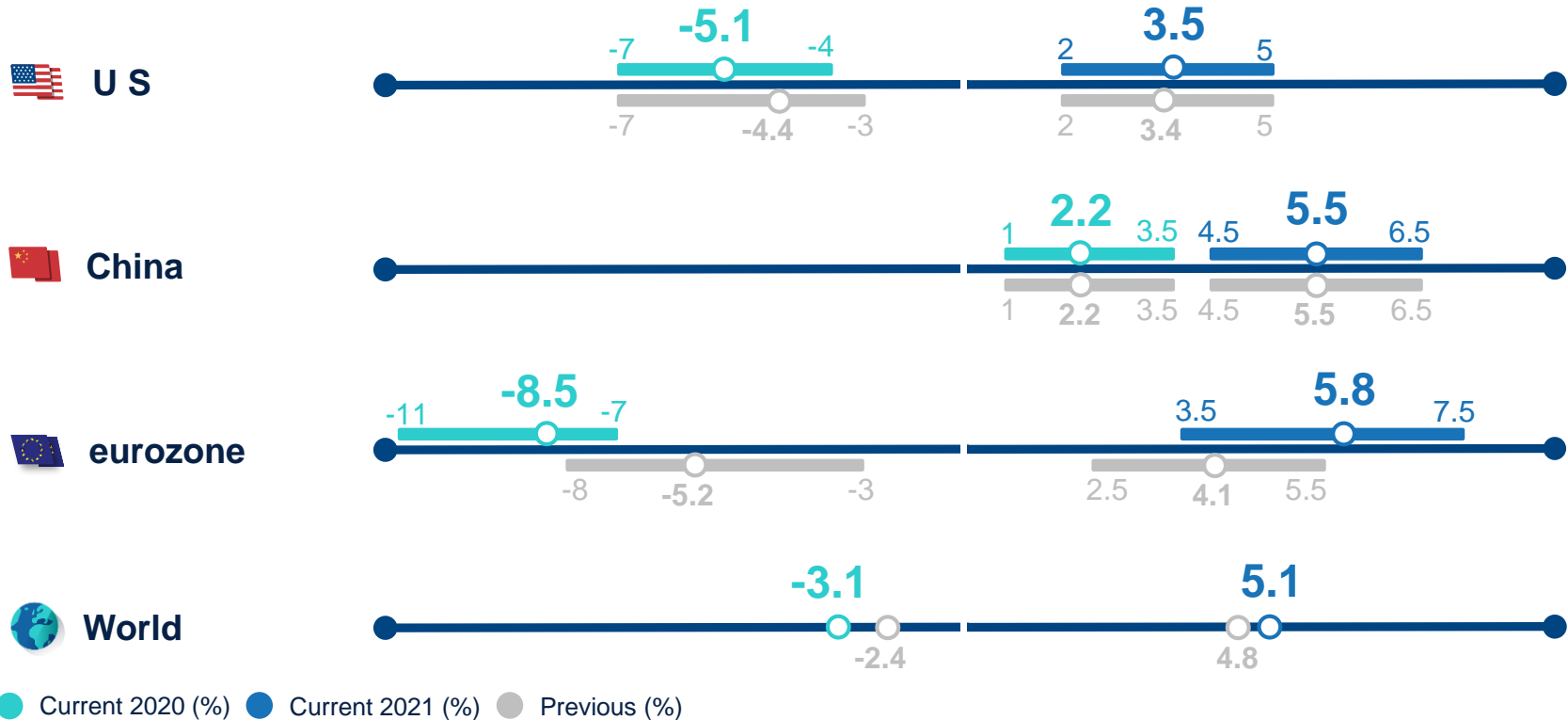
## ECONOMIC STIMULI IN THE US, CHINA AND THE EUROZONE (\*)



(\*) Fiscal packages: increased expenditure, reduced revenue and resources contributed to loans and guarantee funds. For the eurozone, this represents supranational programs, including the proposed EU recovery fund and excluding the ESM, plus the average of the packages announced in Germany, France, Italy and Spain. Credit programs: For the US, this includes the total amount of the Fed's credit facilities. For the eurozone, this represents the average of the credit guarantee funds of Germany, France, Italy and Spain. Interest rates: One-year LPR rates are used as a reference for China. Central bank balance sheets: projected increase in total assets during 2020.

Source: BBVA Research based on data from local statistics

**Growth forecasts for 2020 have been revised downward. For 2021 have been revised upward, with a greater cumulative output loss in the two-year period**



## Uncertainty will remain high. Many factors, particularly the availability of a vaccine, may generate alternative scenarios



### Epidemiological uncertainty

- Control of the pandemic
- Reopening process
- New waves of infection
- Vaccine or treatment



### Financial uncertainty

- Financial stress
- Flows to emerging economies
- Deterioration of corporate, public sector and bank balance sheets



### Economic uncertainty

- Effectiveness of stimuli
- Significant disruptions in sectors and value chains
- Potential GDP
- Inflationary changes



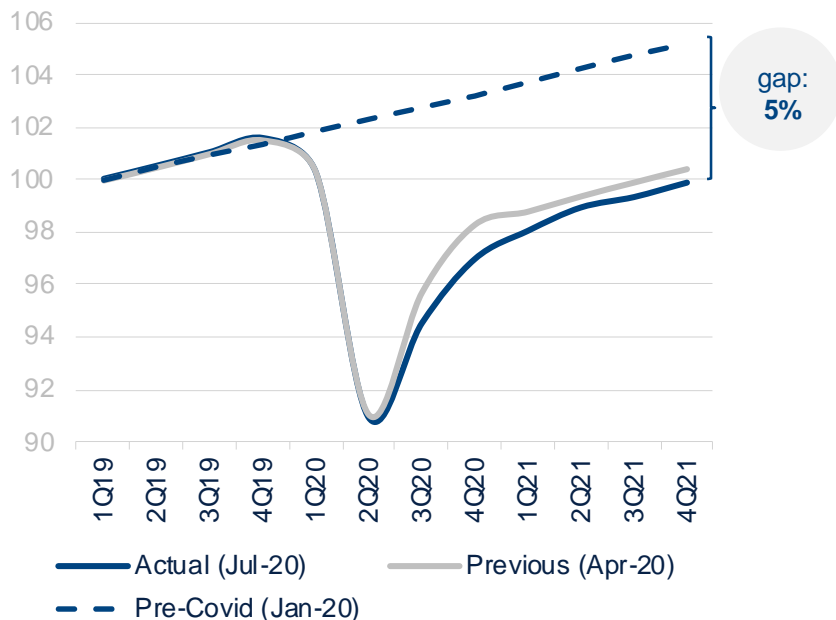
### Geopolitical uncertainty

- Protectionism
- Multiple pockets of regional tension
- Social protests
- *Brexit*

# US: Data suggests that activity bottomed out in April, but the new coronavirus outbreak threatens consolidation of the recovery

## GDP: LEVEL

(LEVEL: SEASONALLY ADJUSTED QUARTERLY INDEX)



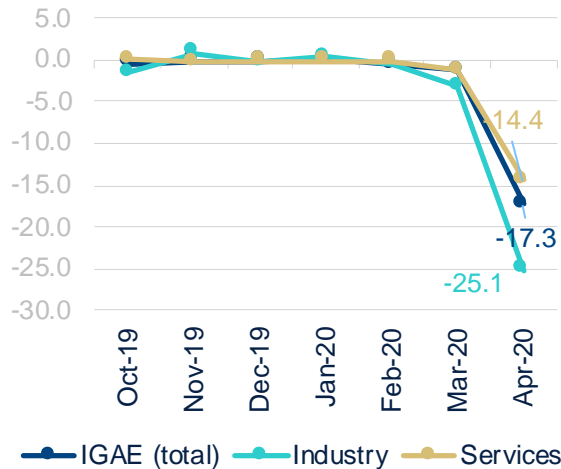
- A delayed exit, weak employment and lower agent confidence have led to a revision of the 2020 growth forecast from -4.4% to -5.1%.
- Interest rates will remain at zero until 2023. The Fed's balance sheet will continue to grow.
- New fiscal and monetary stimuli are likely.
- The unemployment rate, which reached 14.7% in April and 11.1% in June, will fall to 8.6% in 2020 and 7.4% in 2021.
- Given the possibility of new lockdown measures and possible tensions with China, uncertainty remains and risks are on the downside.

# 02

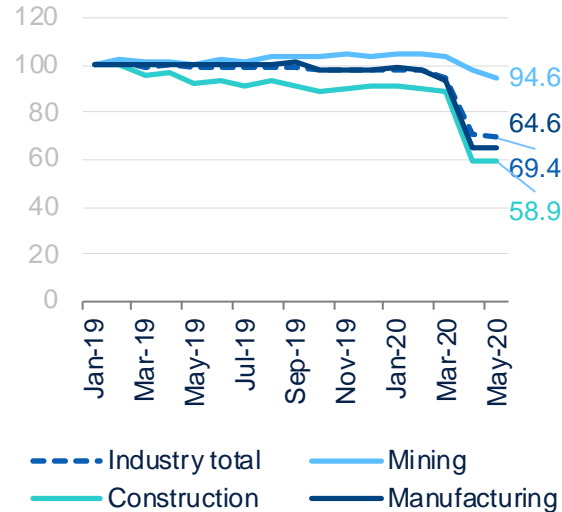
Economic activity bottomed out in April, but there are still risks ahead

# Economic activity bottomed out in 2Q20

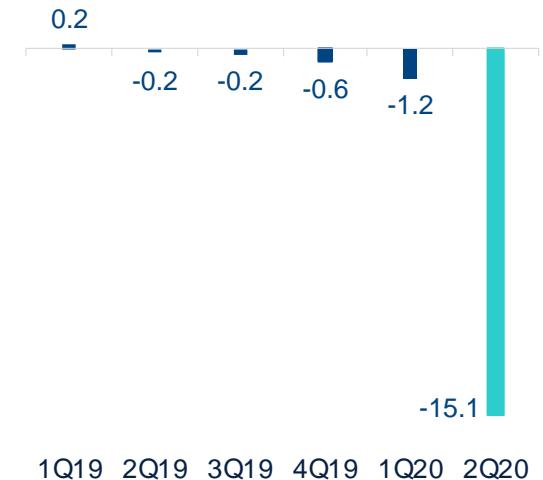
**IGAE**  
(% MoM, SA)



**INDUSTRIAL ACTIVITY**  
(INDEX 2019/01 = 100, SA)



**GDP**  
(% QoQ, SA)

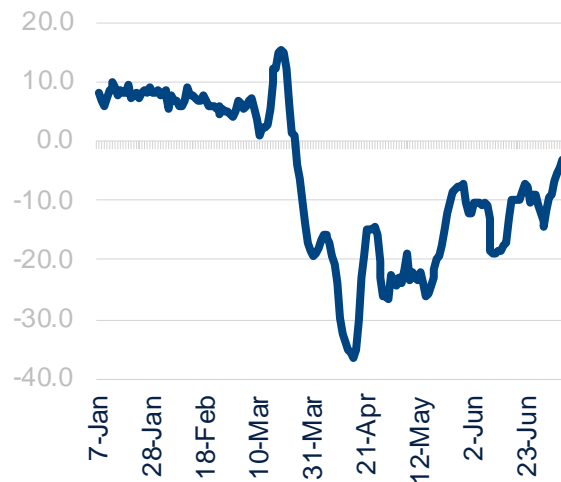


Source: BBVA Research/INEGI.

Risks persist in light of the lack of counter-cyclical policies, the deterioration of the investment climate, and potential stagnation in recovery due to a lack of control over the pandemic.

# Consumption bottomed out in April: the BBVA Consumer Index recorded a fall of (-)19.5% in 2Q20

**BBVA CONSUMER INDEX\***  
(% YoY, REAL, 7-DAY MOVING AVERAGE)

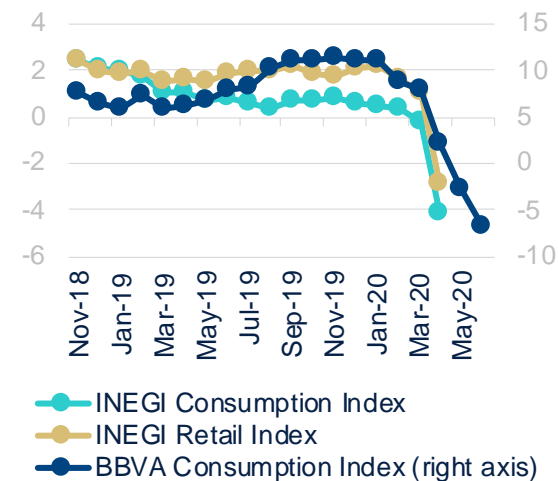


\* Closing date: July 7, 2020.  
Source: BBVA Research/INEGI.

**BBVA CONSUMER INDEX: TOURISM AND FOOD\***  
(% YoY, REAL, 7-DAY MOVING AVERAGE)



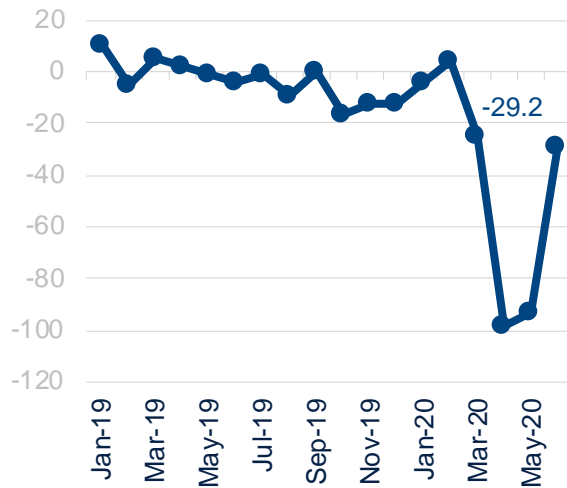
**BBVA CONSUMER INDEX VS. INEGI CONSUMER INDICES**  
(% YoY, REAL, 6-MONTH MOVING AVERAGE)



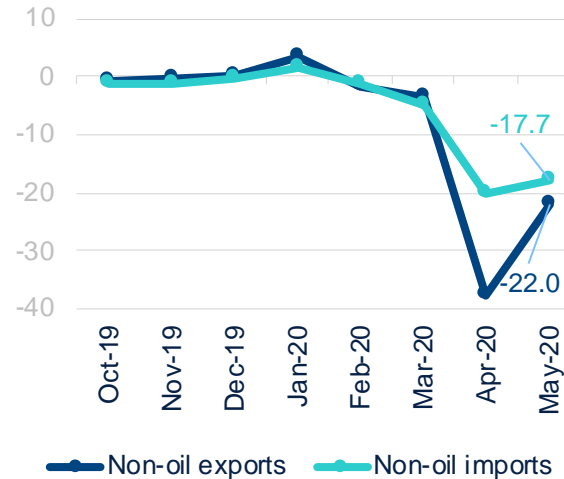
The path to recovery will be long and stony amid the long-term shock to employment and household income, and the lack of a support network from the government.

# The latest data shows a partial recovery of the automotive industry, linked to the industrial sector of the United States.

**PRODUCTION OF LIGHT VEHICLES**  
(INDEX 2019/01 = 100, ORIGINAL SERIES)



**NON-OIL EXPORTS AND IMPORTS**  
(% MoM, SA)



**NON-OIL EXPORTS AND ISM NEW ORDERS INDEX**  
(% YoY SA, 6-MONTH MOVING AVERAGE)



Source: BBVA Research/INEGI.

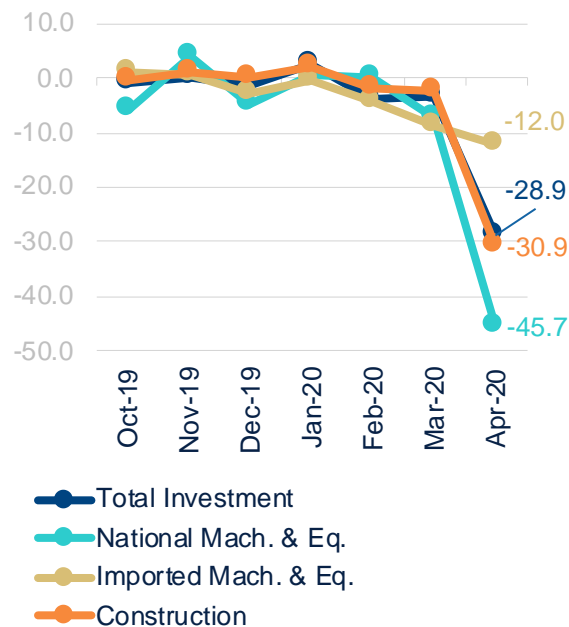
The risk of stagnation persists due to a lack of control over the pandemic



# Long-term shocks to future production capacity due to the government's economic decisions

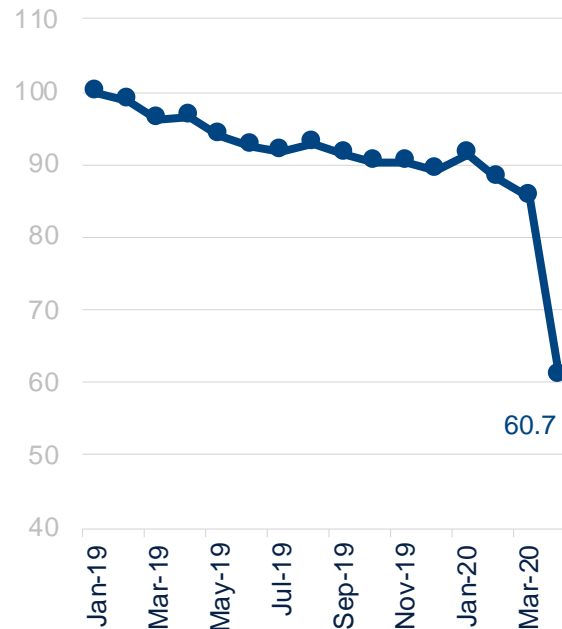
## GROSS FIXED INVESTMENT

(% MoM, SA)



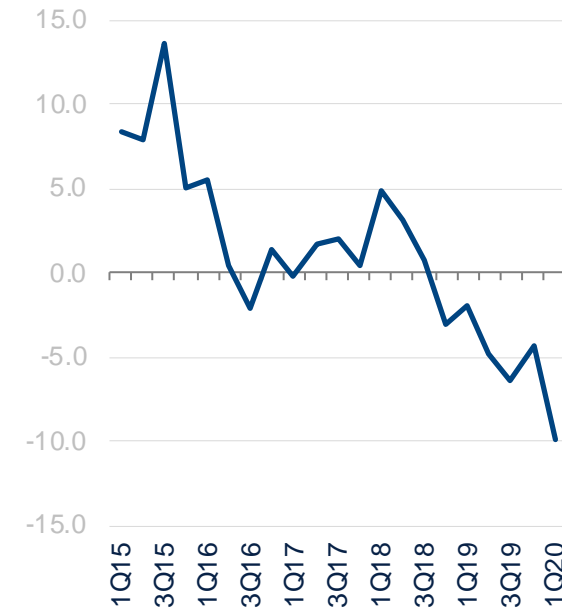
## GROSS FIXED INVESTMENT

(INDEX 2019/01 = 100, SA)



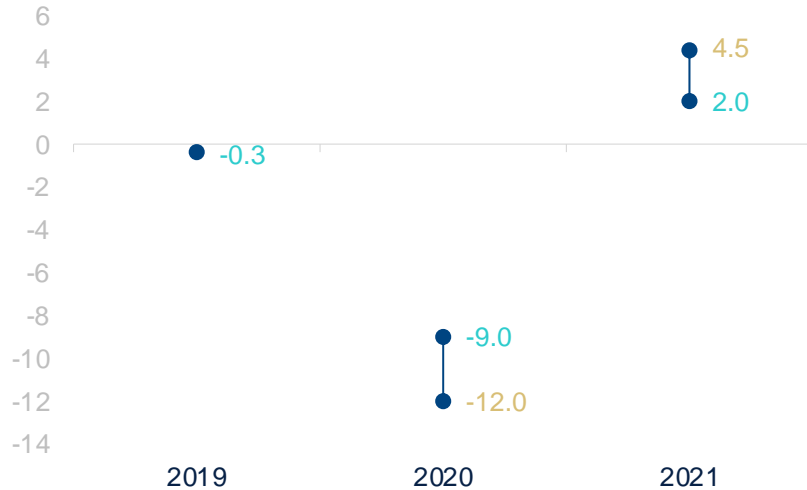
## PRIVATE INVESTMENT

(% YoY, SA)

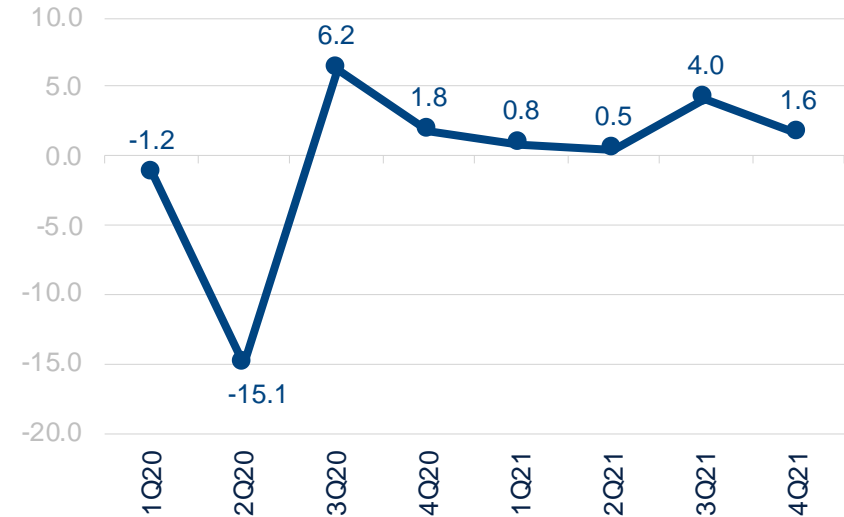


## We anticipate GDP will fall between 9% and 12% in 2020 (point estimate -10.0%)

**GDP**  
(ANNUAL % CHANGE, SA)



**GDP**  
(% QoQ, SA)



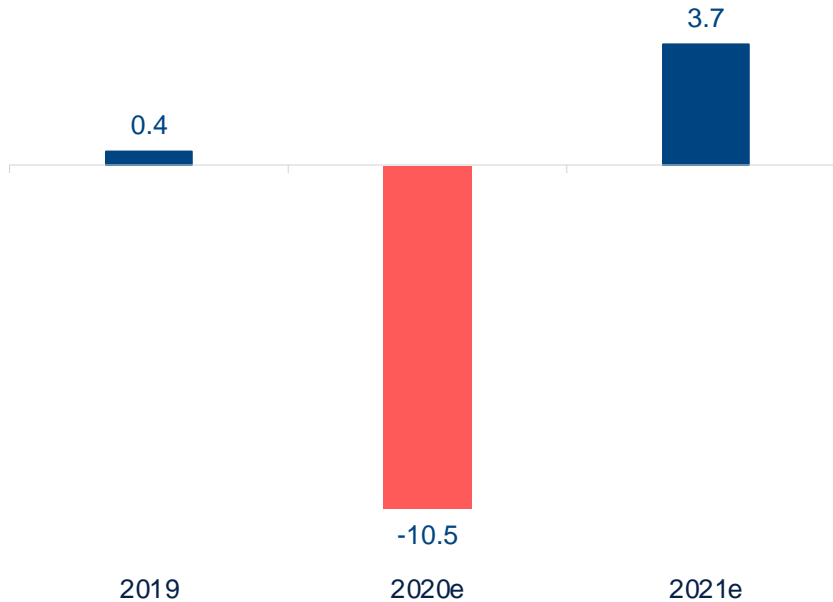
Source: BBVA Research/INEGI

Meanwhile, we expect a rebound to a range of between 2.0% and 4.5% in 2021 (point estimate 3.7%), assuming that a vaccine is widely available in 3Q21

# Private consumption will fall as a result of the negative impact on household income; private investment will shrink significantly

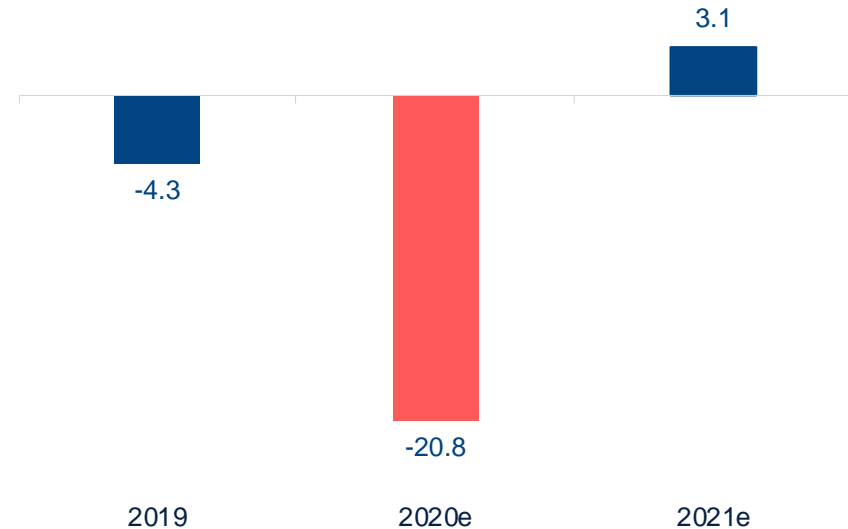
## PRIVATE CONSUMPTION

(ANNUAL % CHNAGE, SA)



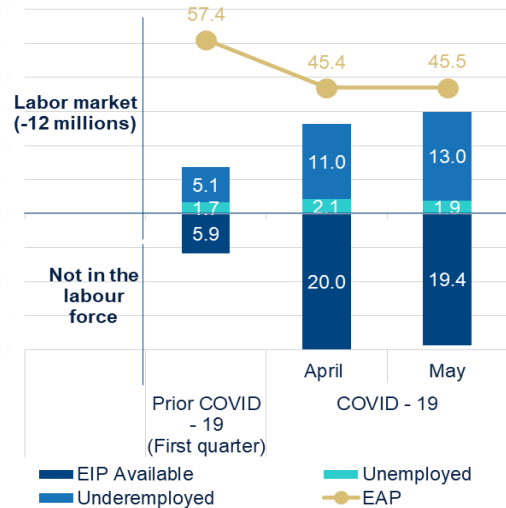
## PRIVATE INVESTMENT

(ANNUAL % CHANGE, SA)



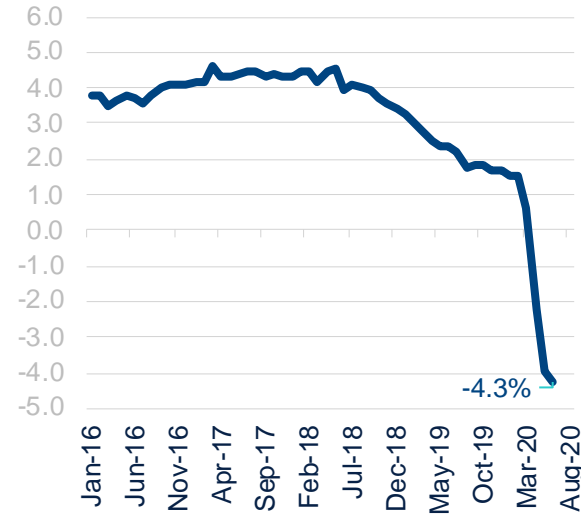
# The COVID-19 pandemic has taken its toll on 22 million workers and has wiped out more than 1.1 million jobs in the formal sector

## IMPACT OF COVID-19 ON EMPLOYMENT ACTIVITY (MILLIONS)



Source: BBVA Research/INEGI (ENOE AND ETOE)

## FORMAL EMPLOYMENT (% ANNUAL CHANGE)



Source: BBVA Research/IMSS

## REAL AVERAGE WAGES AND TOTAL FORMAL PAYROLL (% ANNUAL CHANGE)



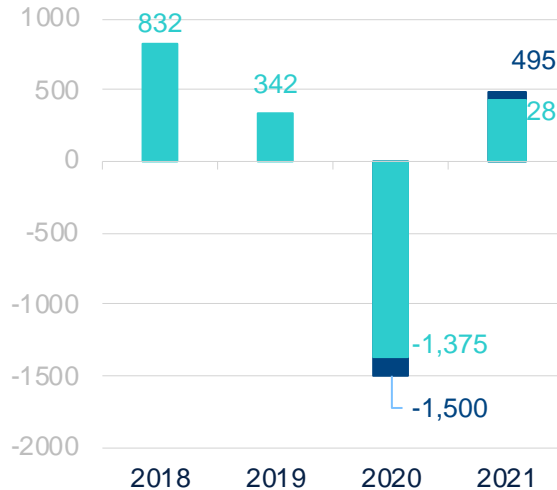
Source: BBVA Research/IMSS

Thus far, job losses have mostly affected low-income workers and in turn, the total formal payroll has remained positive; however, at the likelihood of further job losses by the end of the year, the total formal payroll may experience negative figures

# We expect 1.37 million jobs to be lost by year-end 2020, and the road to recovery will be long as job creation will likely be slow in years to come

## FORMAL EMPLOYMENT

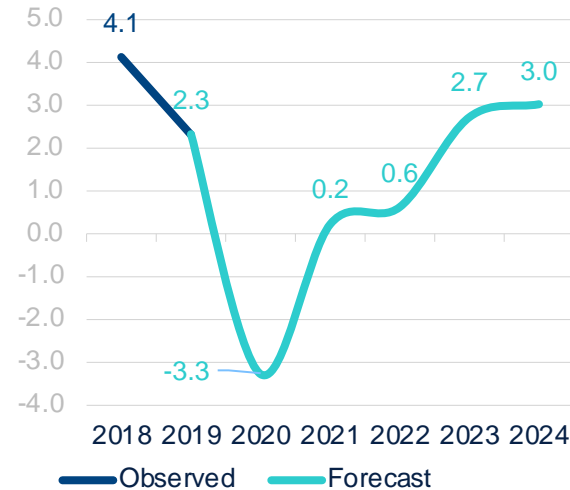
(NET JOB CREATION AT THE END OF DECEMBER OF EACH YEAR, IN THOUSANDS)



Source: BBVA Research/IMSS

## FORMAL EMPLOYMENT

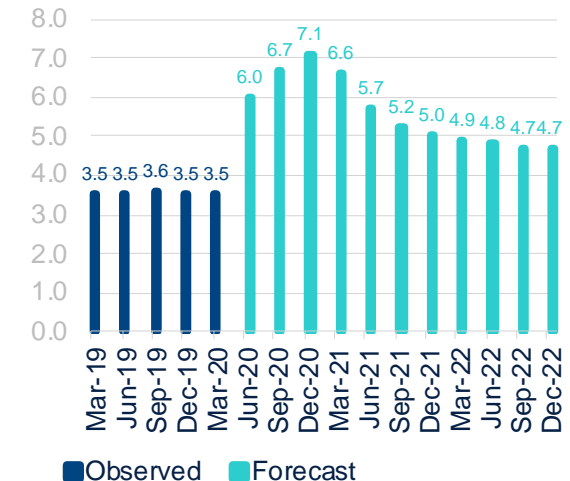
(AVERAGE ANNUAL % VARIATION)



Source: BBVA Research/IMSS

## UNEMPLOYMENT RATE

(% COMPARED TO THE EAP)

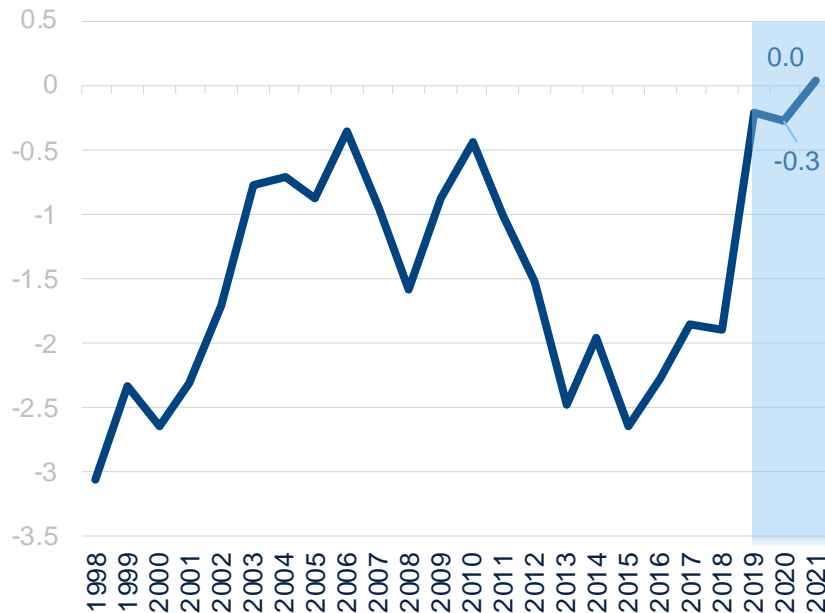


Source: BBVA Research/INEGI

The population's exit from the job market during the pandemic is temporary and, as such, reintegration will have negative effects on the rate of unemployment, underemployment, and informality. As a result of slow economic recovery, negative effects on the labor market will remain until 2024.

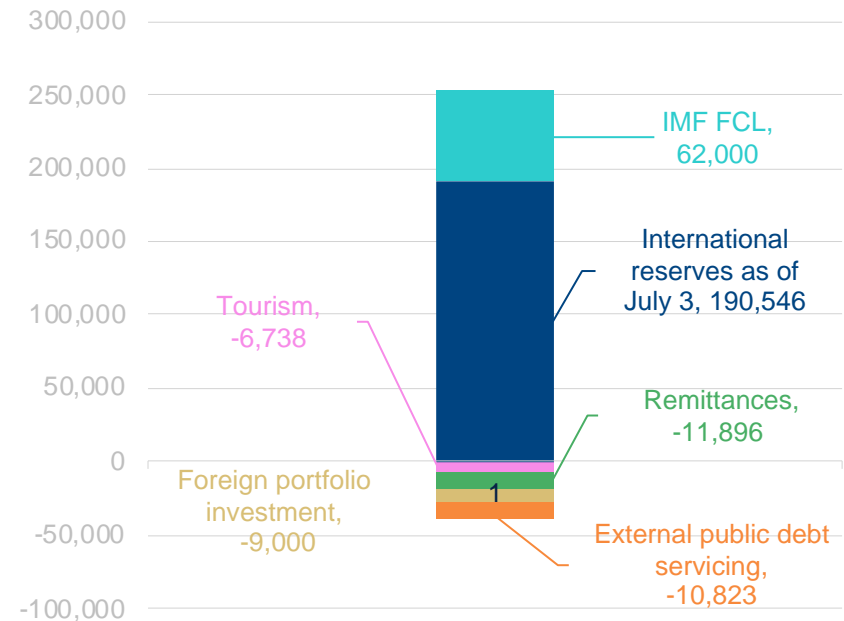
# The current account deficit will stand around 0.3% of GDP in 2020, without entailing any significant risks to the balance of payments

## CURRENT ACCOUNT (% OF GDP)



Source: BBVA Research/Banxico

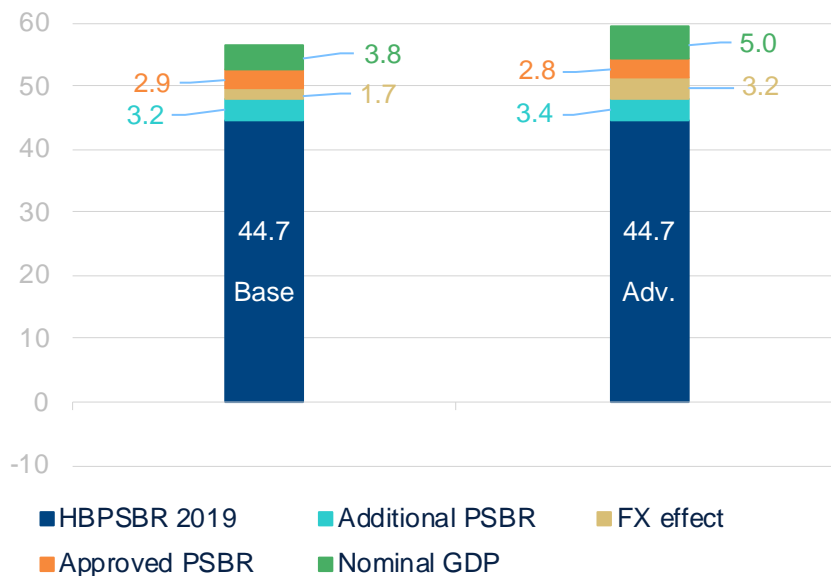
## ESTIMATES OF FOREIGN CAPITAL OUTFLOWS AND INTERNATIONAL RESERVES IN 2020 (IN MILLIONS OF USD)



Source: BBVA Research/Banxico and IMF

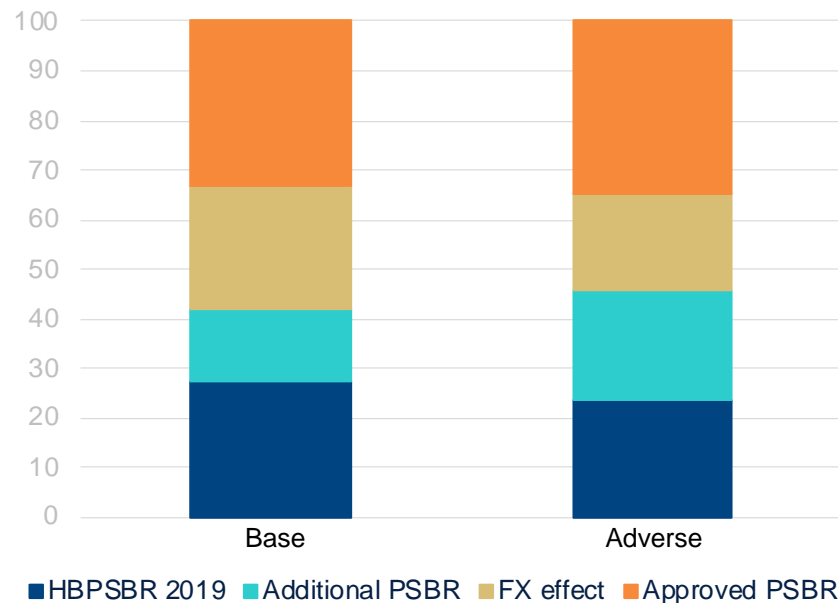
# Public debt could increase by 15 percentage points of GDP (to 59%) with an annual economic contraction of 12% in 2020

**CONTRIBUTION OF FACTORS TO SHRFSP IN FORECASTS OF THE CENTRAL AND ADVERSE SCENARIO FOR 2020 (% OF GDP)**



Source: BBVA Research/INEGI and SHCP (Secretaría de Hacienda y Crédito Público — Ministry of Finance and Public Credit)

**IMPACT ON THE INCREASE IN SHRFSP IN THE CENTRAL AND ADVERSE SCENARIOS FOR 2020 (%)**

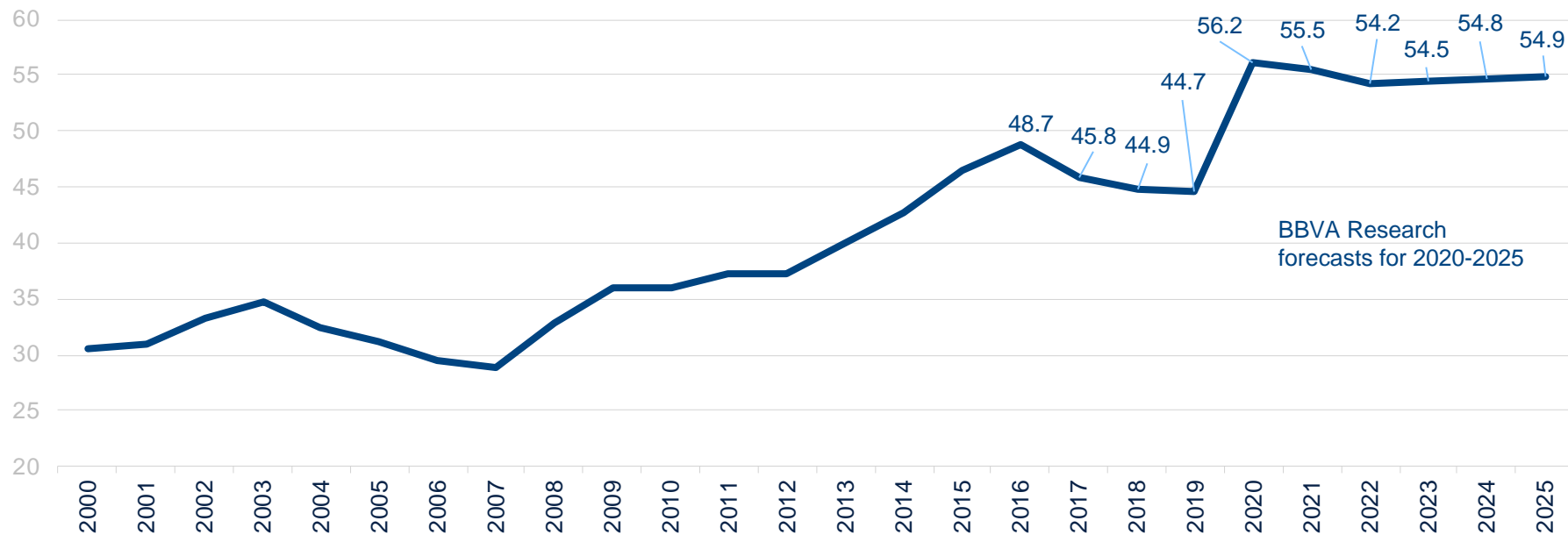


Source: BBVA Research/INEGI and SHCP

# The HBPSBR (Historical Balance of Public Sector Borrowing Requirements) will rise to around 56% of GDP in 2020 and 2021

## HISTORICAL BALANCE OF PUBLIC SECTOR BORROWING REQUIREMENTS

(% OF GDP)





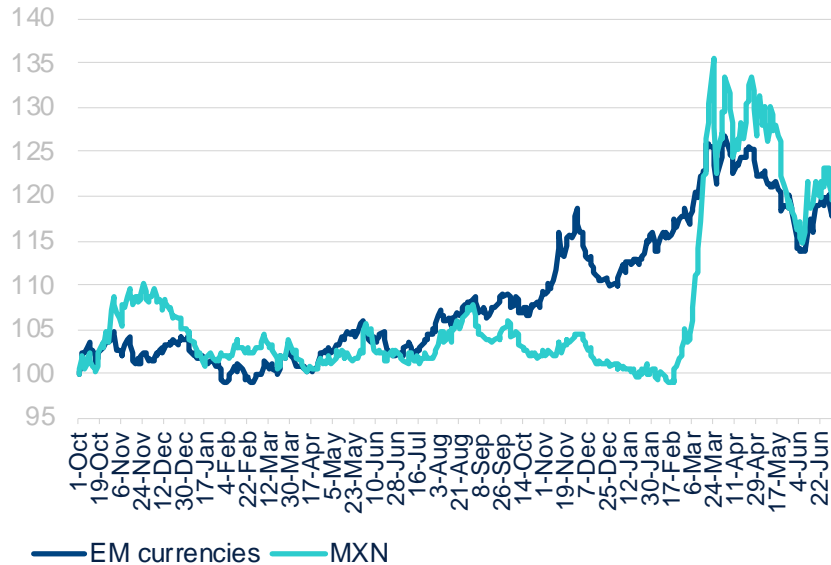
# 03

Negative differentiation of the Mexican peso; volatile inflation in the short term and lower interest rates for a prolonged period

# The Mexican peso depreciated much more than the average for EM currencies in February-March and has remained more volatile since then

## THE MEXICAN PESO COMPARED TO OTHER EM CURRENCIES\* SINCE OCTOBER 2018

(INDEX, OCT. 1, 2018 = 100)

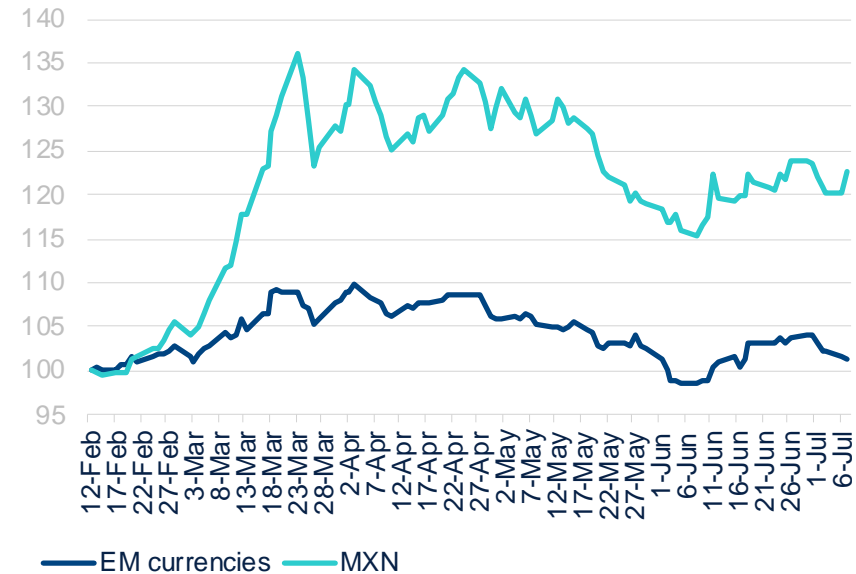


\*Weighted liquidity average and compared to trade based on a new weighting by JP Morgan after removing the Mexican peso; own calculations.

Source: BBVA Research/Bloomberg

## THE MEXICAN PESO COMPARED TO OTHER EM CURRENCIES\* SINCE MID-FEBRUARY 2020

(INDEX, FEB. 12, 2020 = 100)

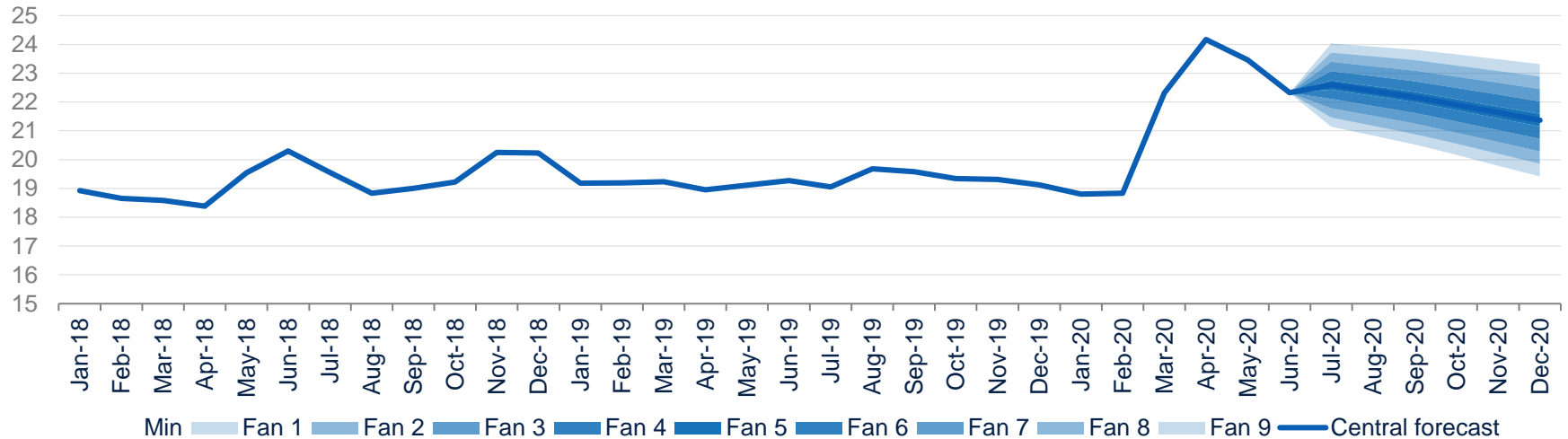


\*Weighted liquidity average and compared to trade based on a new weighting by JP Morgan after removing the Mexican peso; own calculations.

Source: BBVA Research/Bloomberg

# We expect exchange rate levels of around 20.8 to 21.4 MXN/USA by year-end

## EXCHANGE RATE (MXN/USD)

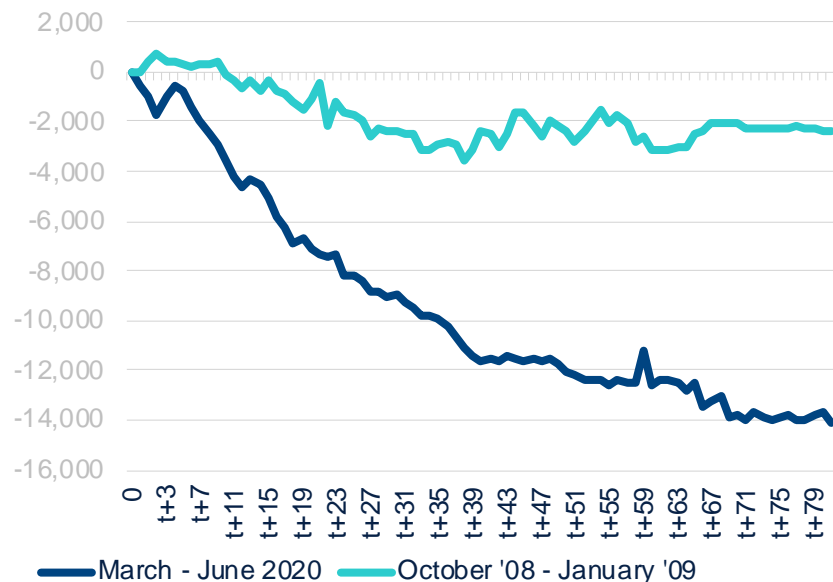


Source: BBVA Research/Bloomberg

It is unlikely that a real depreciation of around 25–30% will be permanent. Therefore, the Mexican peso will appreciate when global risk aversion toward EMs diminishes

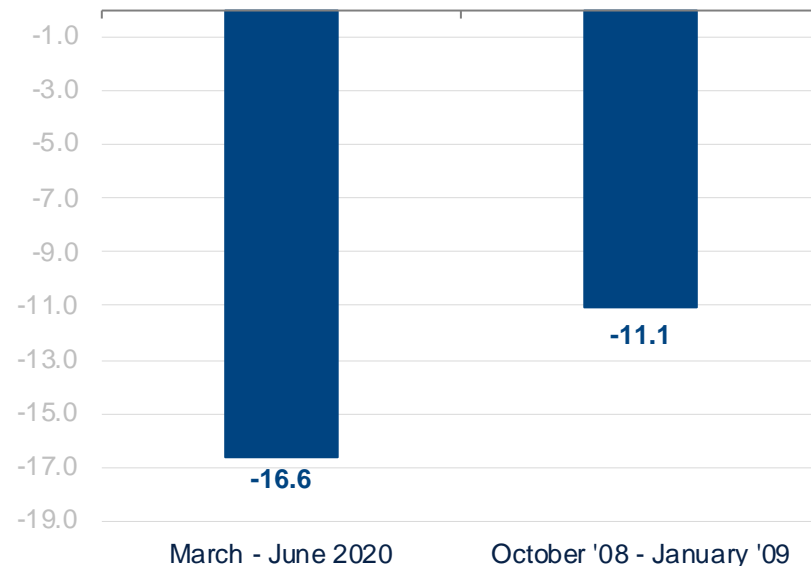
## Foreign holdings of Mbonds have decreased by USD 14 billion since March, but outflows seem to have stopped recently

**CUMULATIVE CHANGE IN FOREIGN HOLDINGS OF MBONDS, BETWEEN OCT. '08 TO JAN. '09 AND MAR. TO JUN. '20 (IN MILLIONS OF USD, NOMINAL VALUE)**



As of June 29  
Source: BBVA Research/Banxico

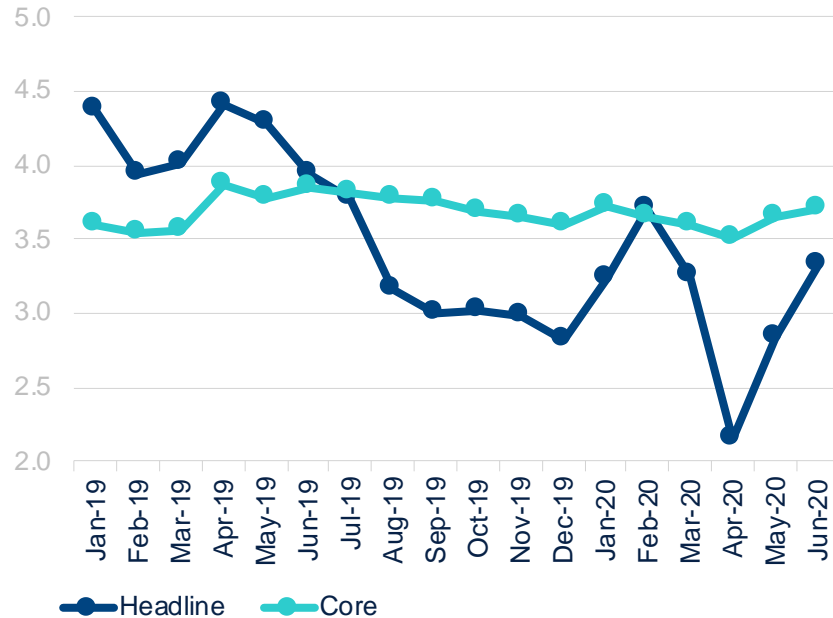
**CUMULATIVE CHANGE IN FOREIGN HOLDINGS OF MBONDS, BETWEEN OCT. '08 TO JAN. '09 AND MAR. TO JUN. '20 (% MXN)**



As of June 29  
Source: BBVA Research/Banxico

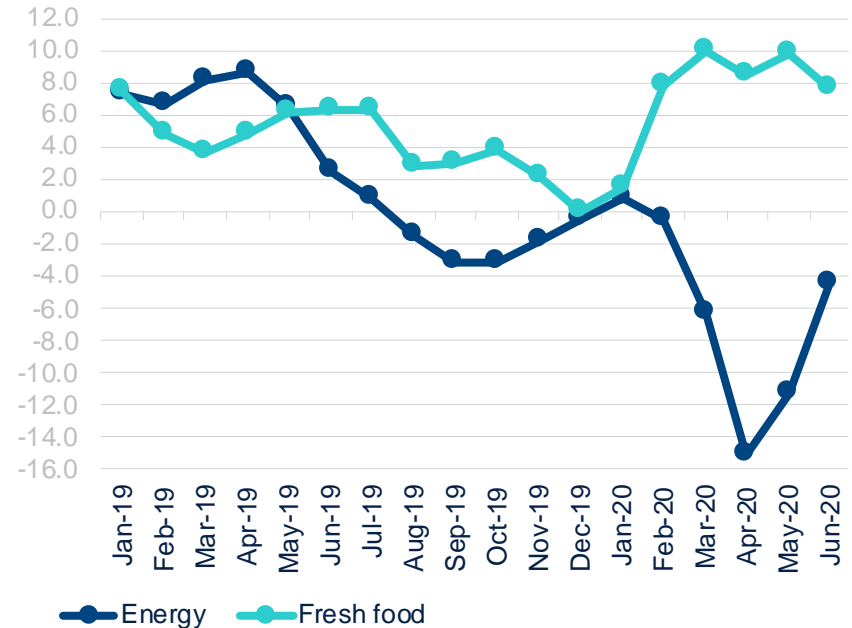
# Increase in inflation volatility: strong rebound in energy prices and pressure on fresh food prices

## HEADLINE AND CORE INFLATION\* (YoY % CHANGE)



Source: BBVA Research/INEGI

## NON-CORE INFLATION OF FRESH FOOD AND ENERGY (YoY % CHANGE)

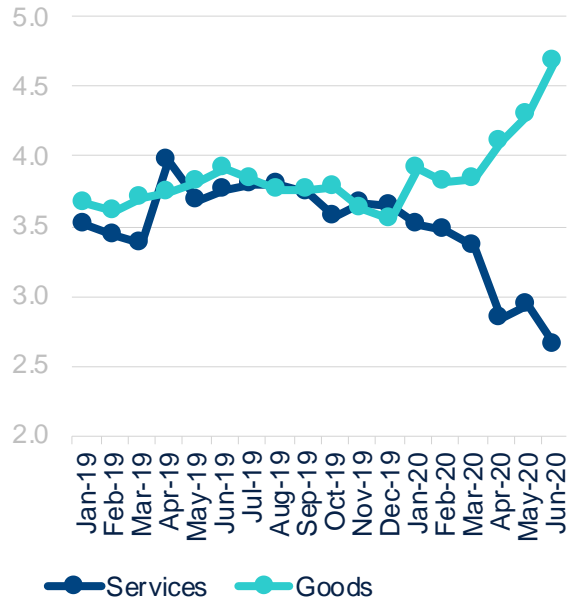


Source: BBVA Research/Banxico

# The downward trend in service inflation is offset by the upward trend in goods inflation

## CORE INFLATION: GOODS AND SERVICES

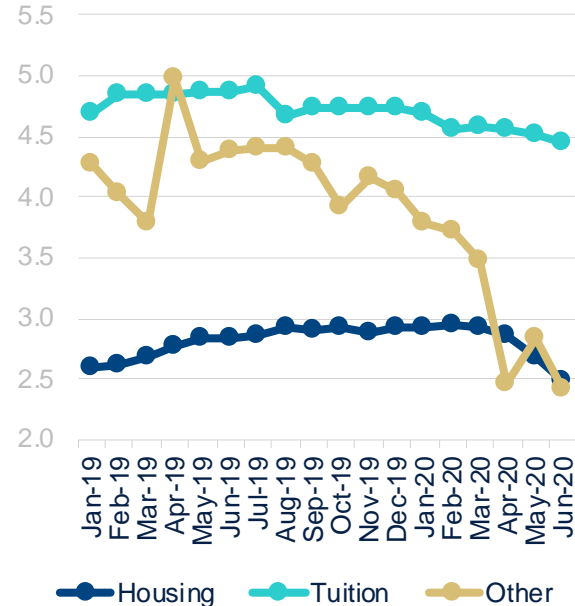
(YoY % CHANGE)



Source: BBVA Research/INEGI

## SERVICES: HOUSING, EDUCATION AND OTHERS

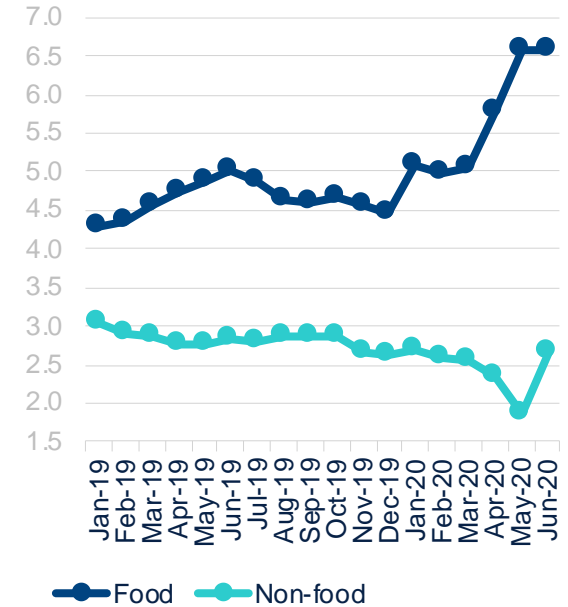
(YoY % CHANGE)



Source: BBVA Research/Banxico

## GOODS: FOOD AND OTHERS

(YoY % CHANGE)

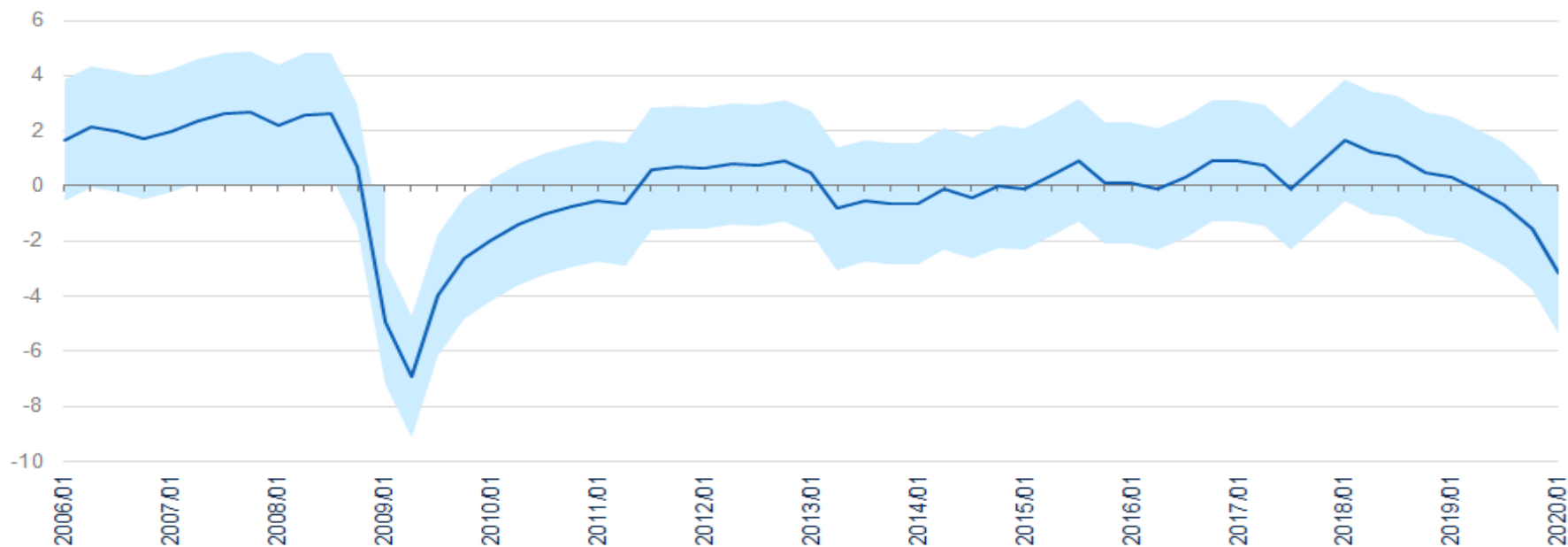


Source: BBVA Research/Banxico

# Inflation will most likely remain low and will not pose any problems for the monetary policy

## OUTPUT GAP\*

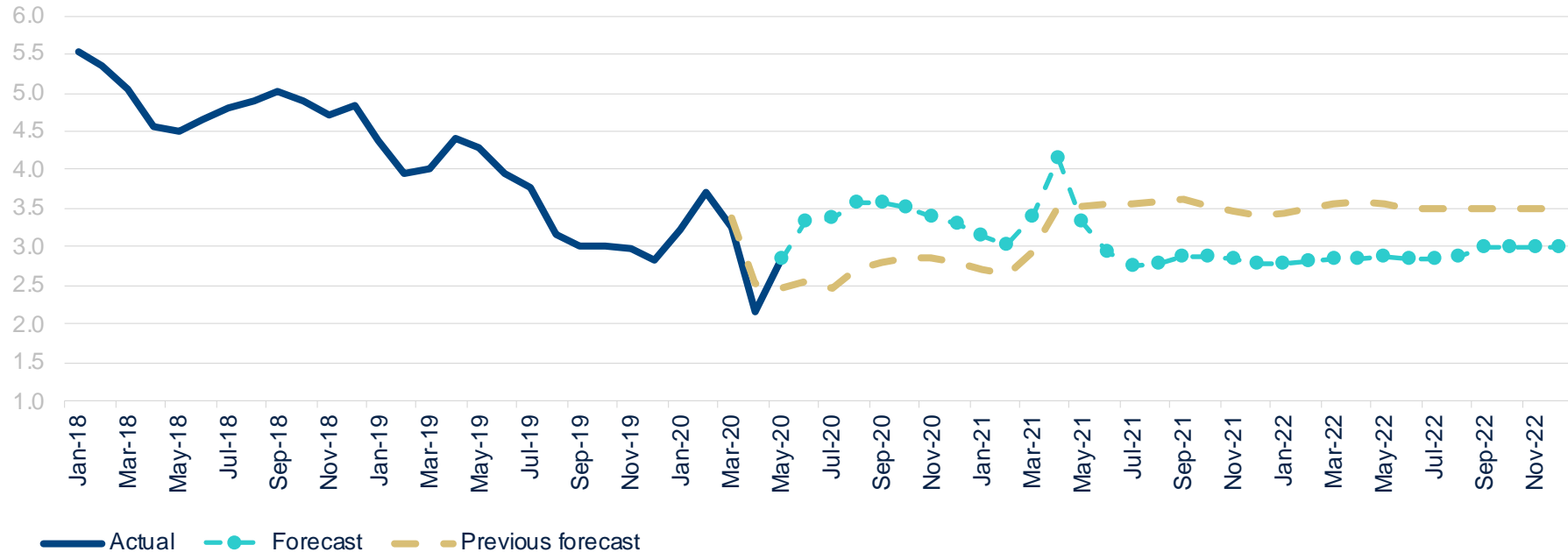
(% Y)



**We expect headline inflation to be higher and volatile in the short term, driven by the temporary effects of supply, but lower from 2021 onward**

## HEADLINE INFLATION FORECASTS

(YoY % CHANGE)

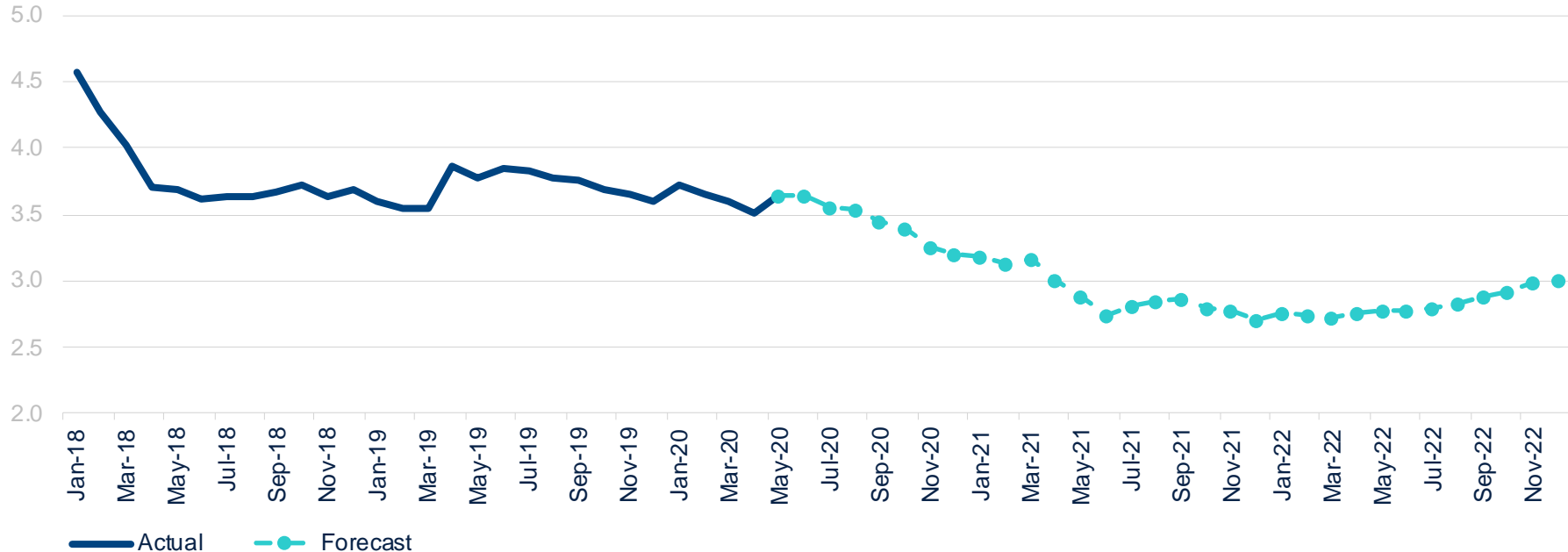




# Core inflation will continue to gradually decrease in the short term and will decrease more sharply the following year

## CORE INFLATION FORECASTS

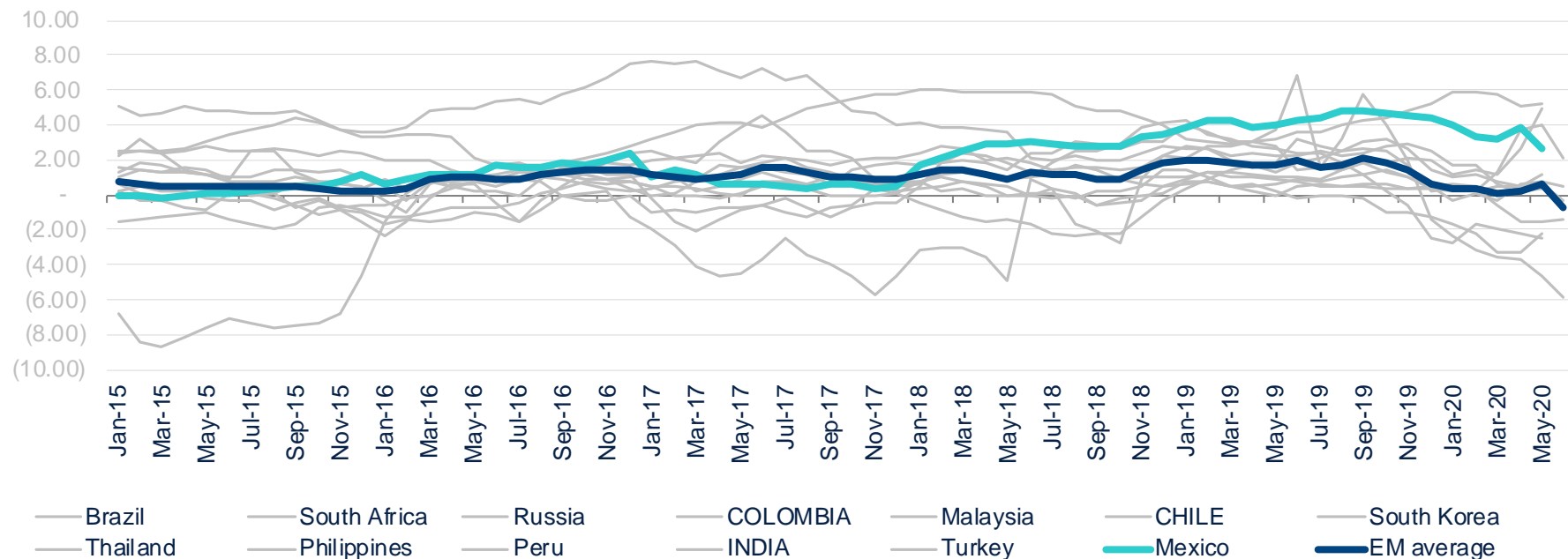
(YoY % CHANGE)



# Banxico has maintained very high real rates for a long time

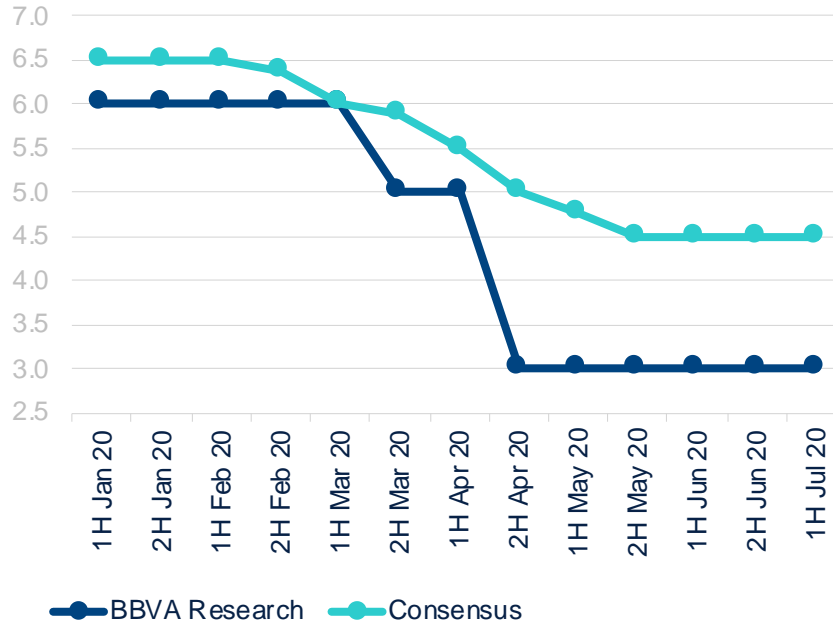
## REAL EX-POST MONETARY POLICY RATES IN EMERGING ECONOMIES

(%)



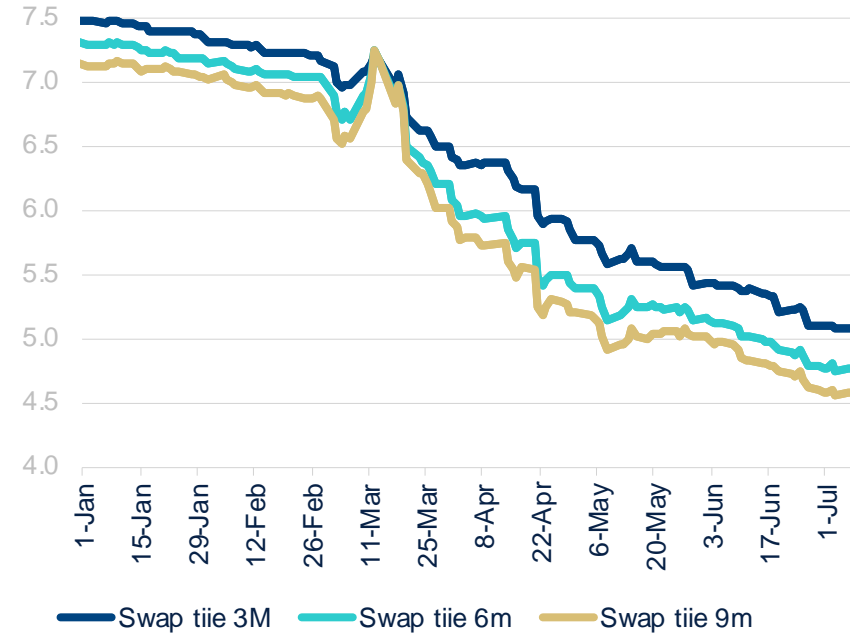
# We continue to expect that Banxico will slash rates much further than currently expected, until they are around 0%

## ANALYSTS' EXPECTATIONS FOR THE MONETARY RATE: BBVA RESEARCH VS. CONSENSUS (%)



Source: BBVA Research/Banxico

## MARKET EXPECTATIONS FOR THE TIE RATE TIE SWAP RATES (%)

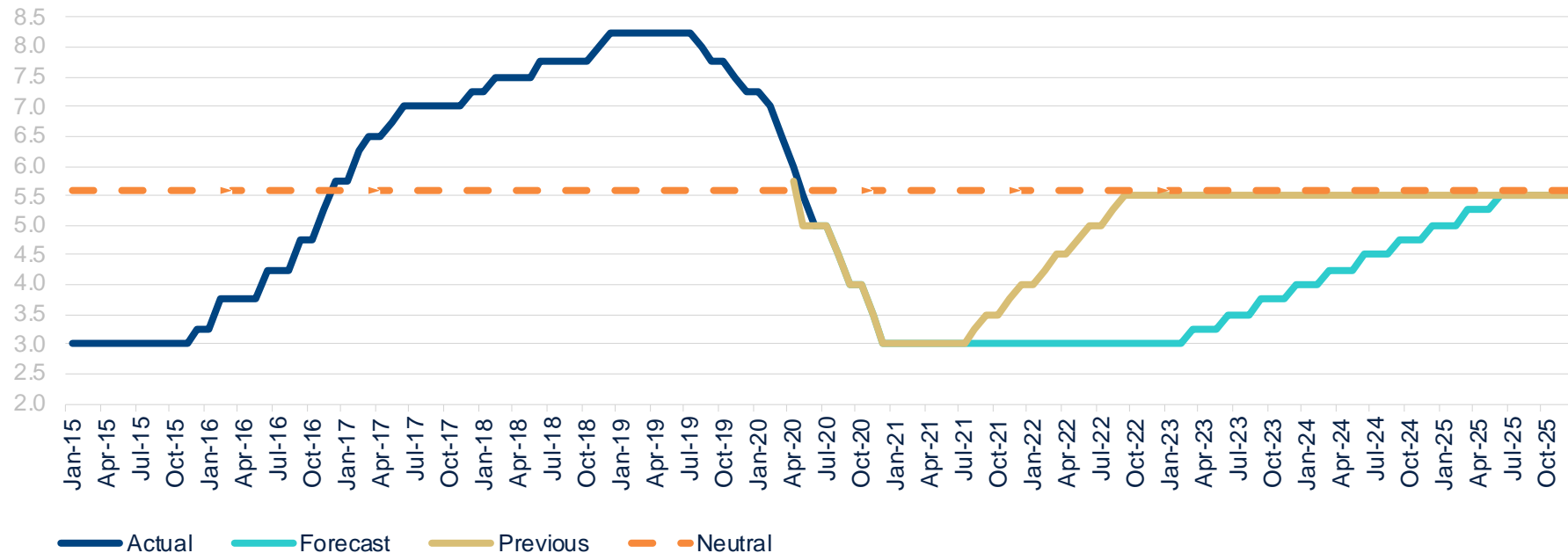


Source: BBVA Research/INEGI

**We continue to expect Banxico to take the policy rate to 3% by year end, but we now forecast that it will keep it at this level for a longer period of time**

## MONETARY POLICY RATES

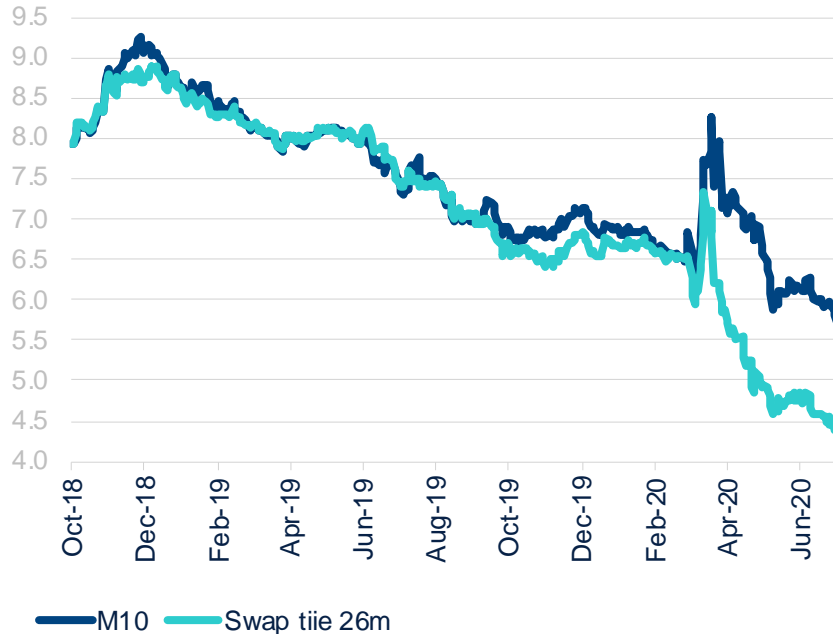
(%)



# Long-term interest rates have continued to decrease gradually, and rates are expected to be cut further

## M10 AND 26-MONTH TIE-IRS

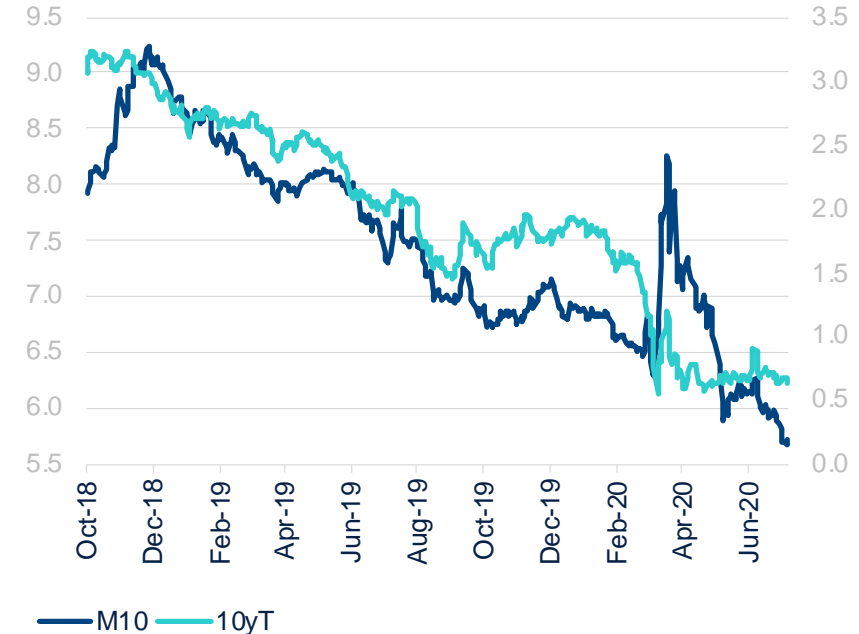
(%)



Source: BBVA Research/Banxico

## M10 AND 10-YEAR TREASURY NOTES

(%)

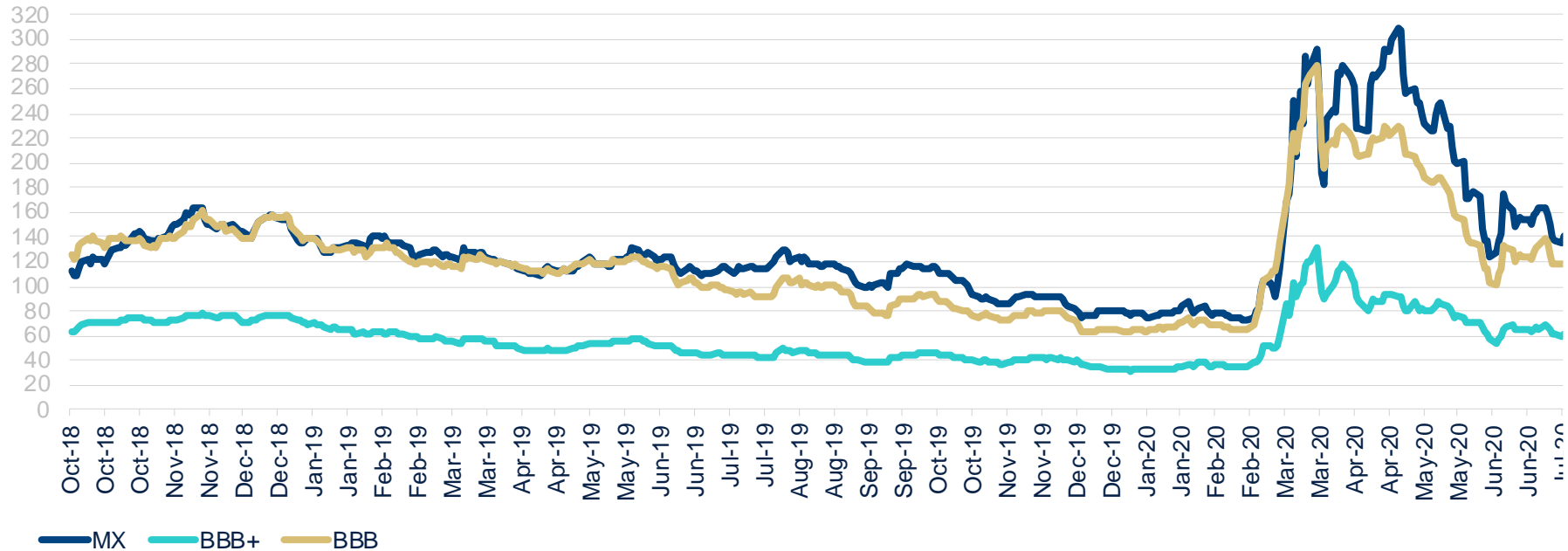


Source: BBVA Research/INEGI

# However, higher risk premiums will continue to weigh on interest rates in the long term

## CDS

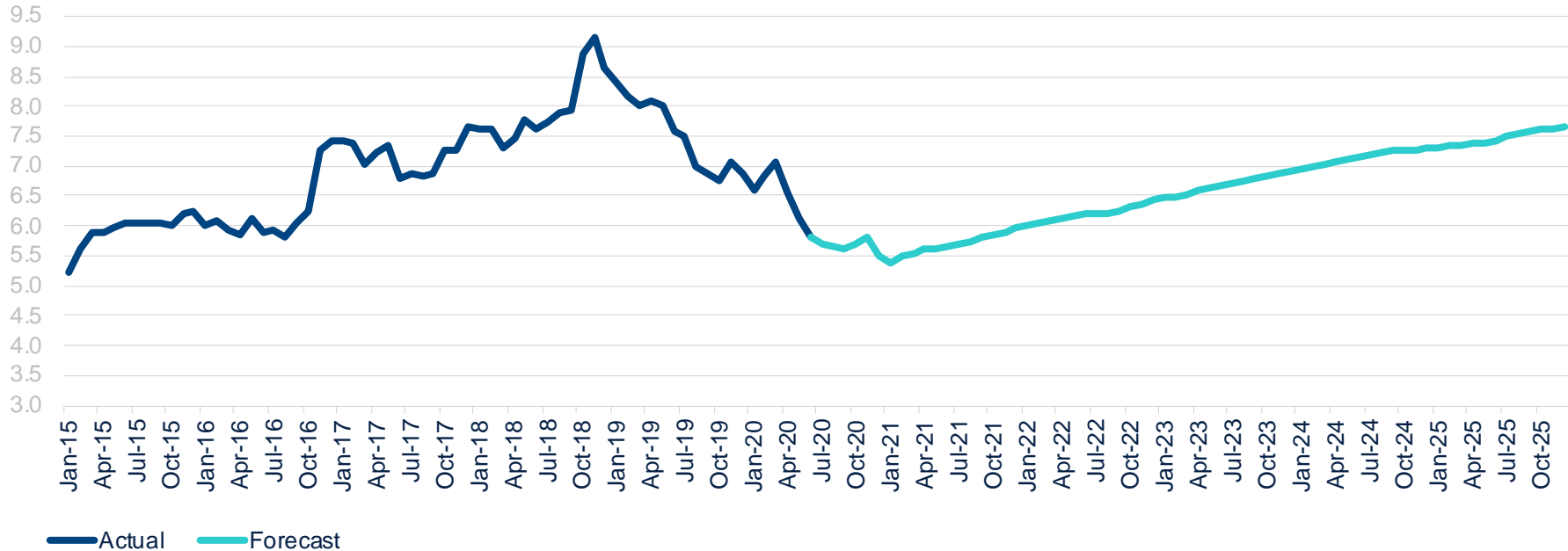
(%)



# We expect an M10 rate of 5.5% at the year end, and a gradual upward trend from 2021

## FORECAST OF M10 RATES

(%)



# Mexico

# Economic Outlook

3Q20

Economic Effects of the Health Emergency

July 2020