

Mexico Economic Outlook

1Q21

January 2021

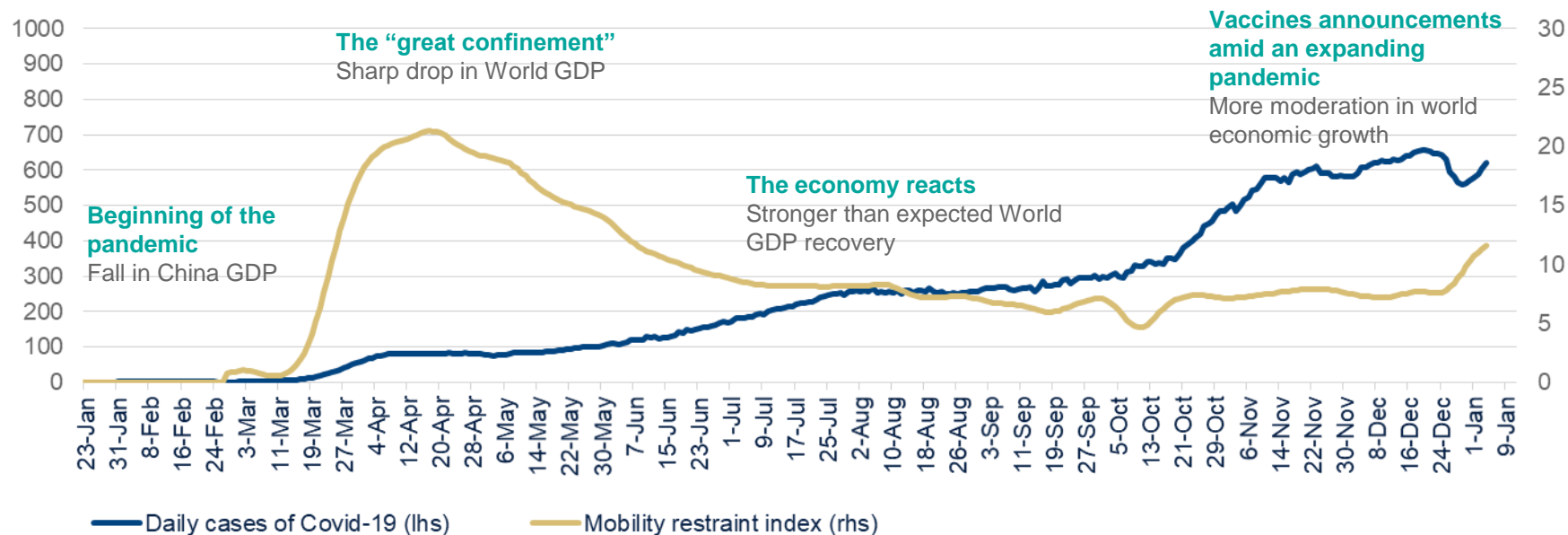
01

Global outlook 1Q21

Covid-19 vaccines are a key development after a year marked by the expansion of the pandemic, lockdowns and an economic crisis

WORLD DAILY CASES OF COVID-19 AND GLOBAL MOBILITY RESTRAINT INDEX (*)

(DAILY CASES: THOUSANDS OF PEOPLE, 7-DAY MOVING AVERAGE; INDEX: HIGHER VALUES INDICATE LOWER MOBILITY)



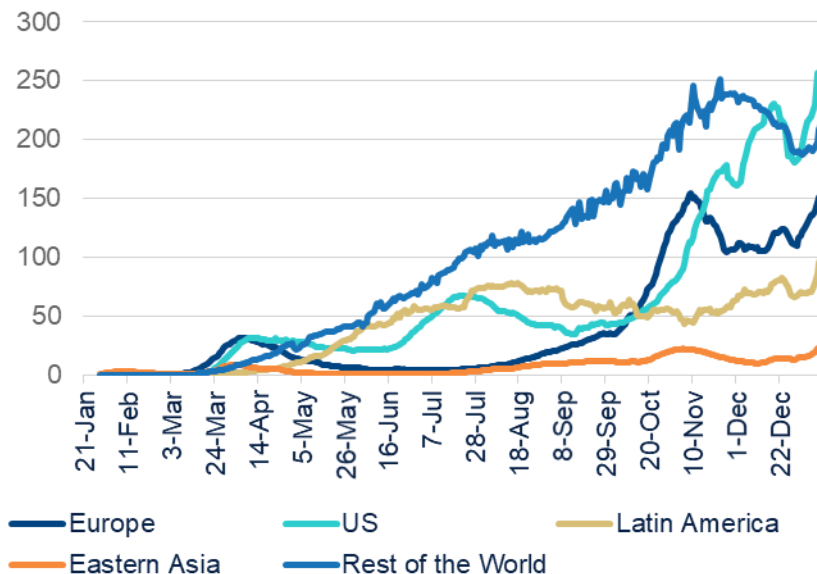
*: The mobility restraint index reflects changes with respect to the period of reference (January 3 to February 6 2020). It is the simple average of all countries within Google Mobility Reports.

BBVA Research based on data from John Hopkins University and Google.

Infections have surged in the last months, particularly in the US and Europe; the new strains of the virus pose a threat

DAILY CASES OF COVID-19 (*)

(THOUSANDS OF PEOPLE, 7-DAY MOVING AVERAGE)



- In the **US**, **Europe** and **Latam** contagions have increased again in the last few weeks.
- **Eastern Asia** is experiencing outbreaks, but the situation remains under control.
- **Rising uncertainty** on the evolution of the pandemic due to **the new strains** of the virus.
- **Mobility** has decreased again, particularly in recent weeks and in Europe, but less than in the first wave.

(*): Europe: Germany, Spain, France, Italy, Portugal, United Kingdom, and Turkey. Latin America: Argentina, Brazil, Chile, Colombia, Mexico, Peru and Uruguay. Eastern Asia: China, South Korea, Japan and Singapur.

Source: BBVA Research based on data from John Hopkins University.

Covid-19 vaccine inoculation process has already started in some of the main world economies, in line with expectations

EU



Population covered by the vaccine purchase contracts already signed

(not all approved yet)

Inoculation started at a low pace with the BioNTech/Pfizer vaccine.

US



Population covered by the vaccine purchase contracts already signed

(not all approved yet)

Inoculation started with the BioNTech/Pfizer and Moderna vaccines.

CHINA

Inoculation started with the Sinopharm vaccine.

OTHER REGIONS

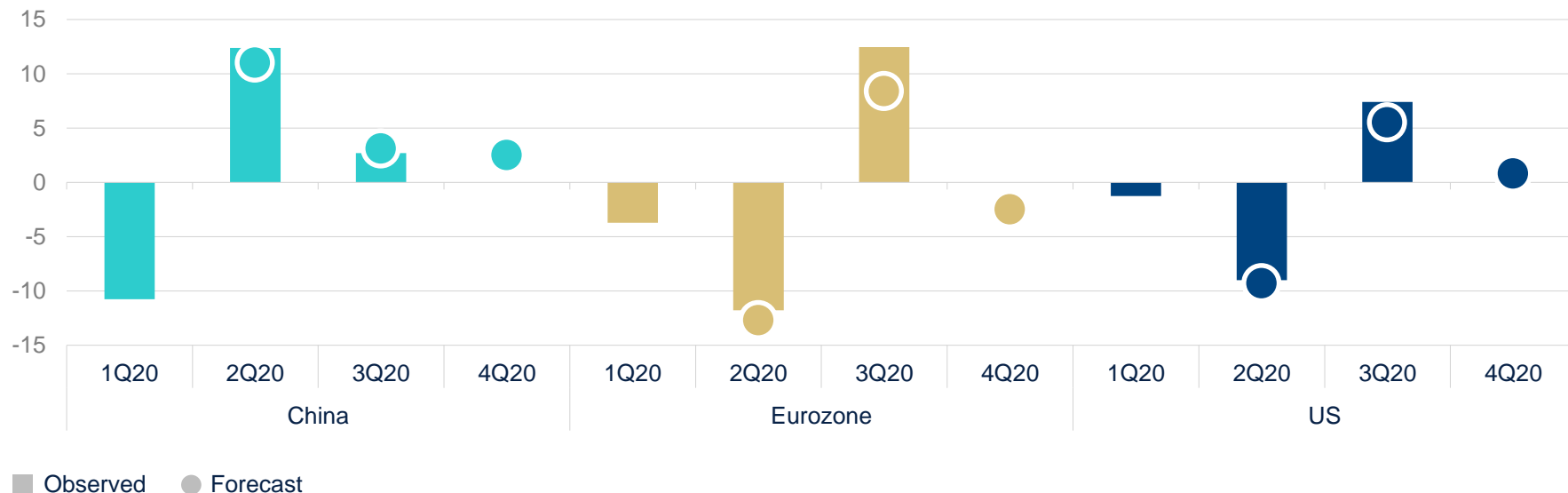
Heterogeneity across countries.

Ongoing vaccination in Israel, United Kingdom, Russia, Argentina, Chile, Mexico etc.

Economic growth has picked up significantly more than expected in the third quarter, but has moderated in the fourth due to the increase in infections

GDP: OBSERVED AND FORECASTED

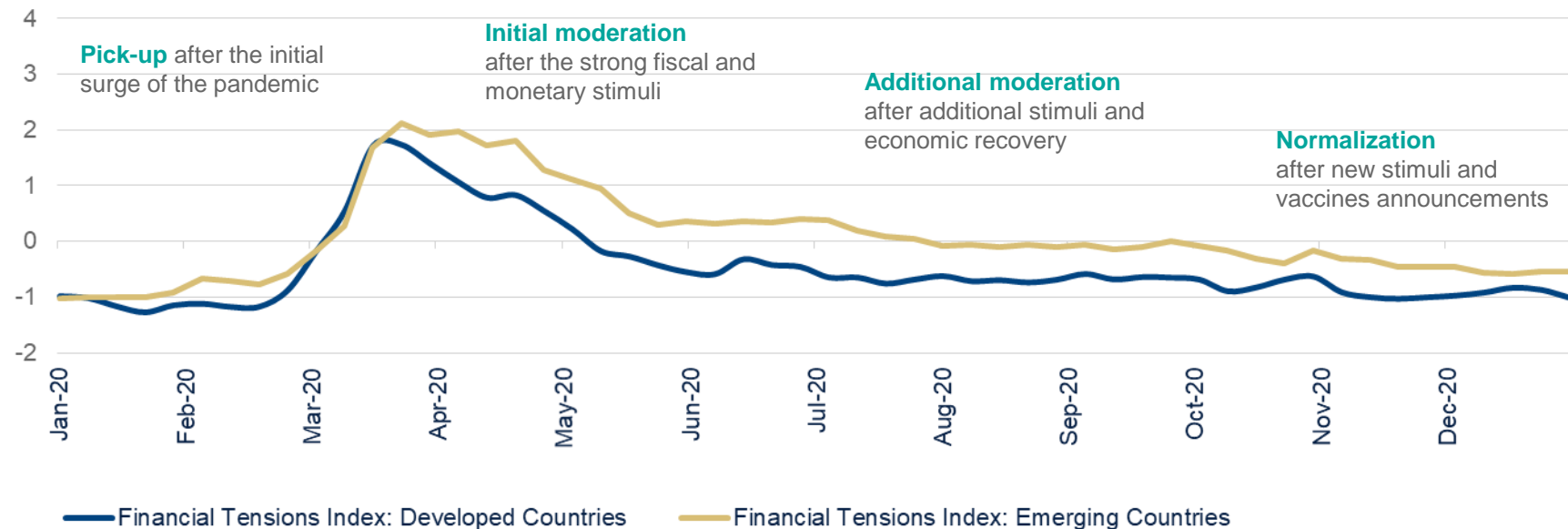
(Q/Q %)



Financial tensions have converged to pre-crisis levels, thanks to economic stimuli and the vaccine development

FINANCIAL TENSIONS

(FINANCIAL TENSIONS INDEX: AVERAGE FROM 2006 = 0)



A large-scale distribution of vaccines will pave the way for economic recovery, which will be gradual and heterogeneous across countries

MAIN ASSUMPTIONS BEHIND FORECASTS, UNDER A HIGHLY UNCERTAIN ENVIRONMENT

COVID-19



Massive distribution of vaccines in the main economies in 1H21 and afterwards in the others.

Return to “normality” in 2022

Economic Policy



Stimuli will be maintained, or even amplified, at least until the recovery consolidates.

Financial Markets



Volatility and risk aversion will remain relatively low, in 2021-22.

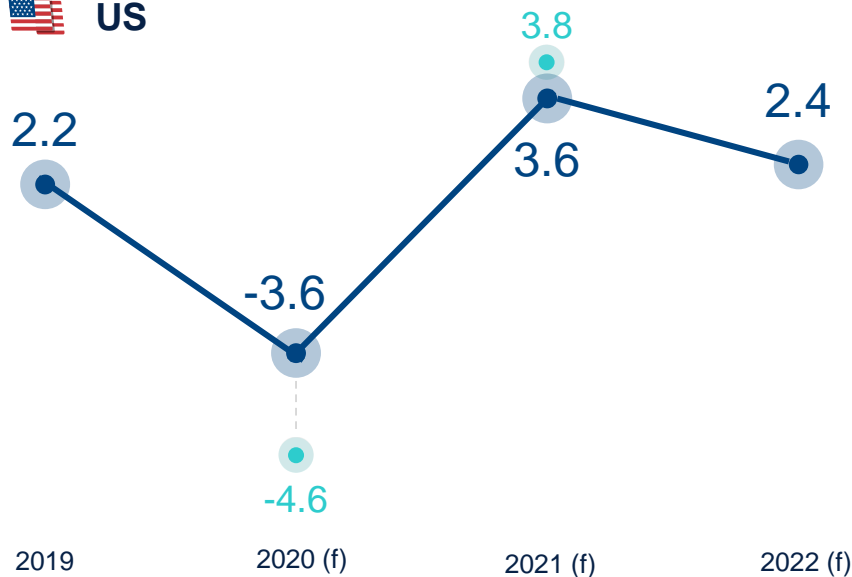
US: GDP is forecast to grow 3.6% in 2021 and 2.4% in 2022, but prospects of more stimuli add an upward bias to these figures

GDP: ANNUAL GROWTH

(%)



US



● Actual ● Previous

(f): forecast.

Source: BBVA Research.

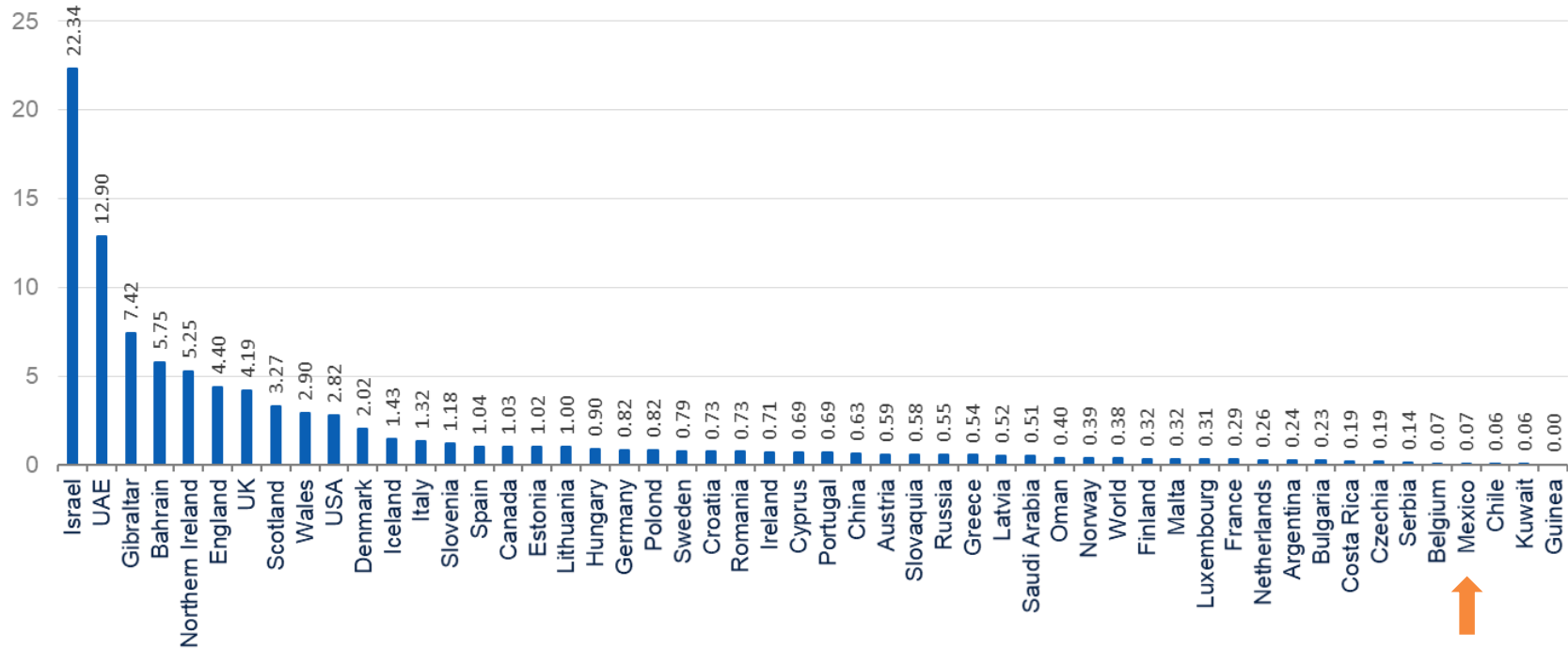
- Growth is moderating at the end of 2020 and beginning of 2021, due to the pandemic.
- Given that the Democratic Party will control the Presidency and Congress, there are reinforced expectations of new stimuli to sustain the recovery.
- More fiscal measures will be announced soon, adding an upward bias to growth forecasts.
- Fed will keep supporting the economy through asset purchases and unchanged rates until 2025.
- Inflation will stay around 2%.
- Covid evolution and its effects on the economy remain as the main sources of uncertainty.

02

Risks to economic activity
in 2021 associated with
the severity of the
pandemic

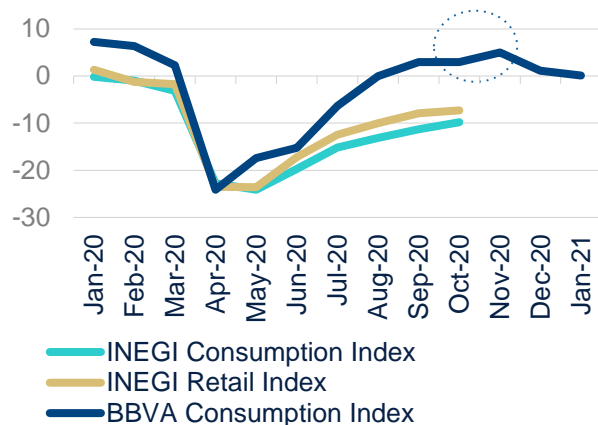
Mexico is among the slowest of the countries that have already started the vaccination process

VACCINATIONS GIVEN PER 100 PEOPLE, JANUARY 13, 2021
(NUMBER)

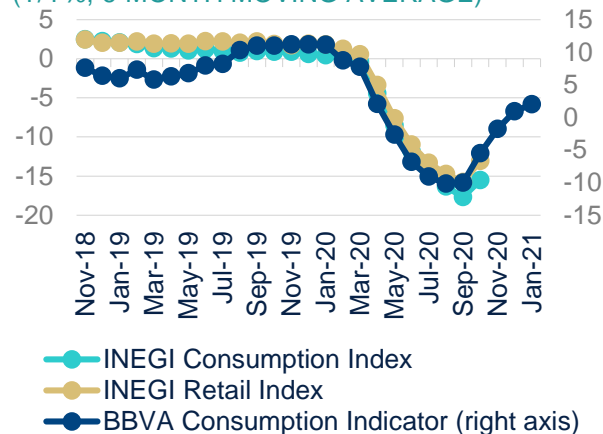


Economic activity is facing headwinds in 2021 given the increase in COVID cases and the closing of activities; we are forecasting a -0.8% fall in GDP in 1Q21

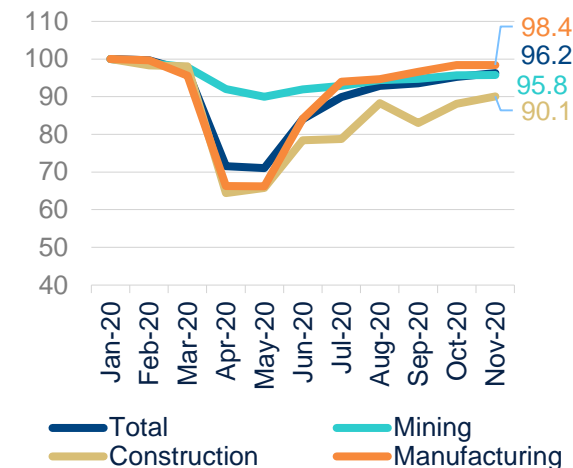
**BBVA CONSUMPTION INDICATOR*
AND INEGI CONSUMPTION
INDICATORS**
(Y/Y%, REAL)



**BBVA CONSUMPTION INDICATOR*
AND INEGI CONSUMPTION
INDICATORS**
(Y/Y%, 6-MONTH MOVING AVERAGE)



INDUSTRIAL ACTIVITY
(INDEX, JAN. 2020=100)

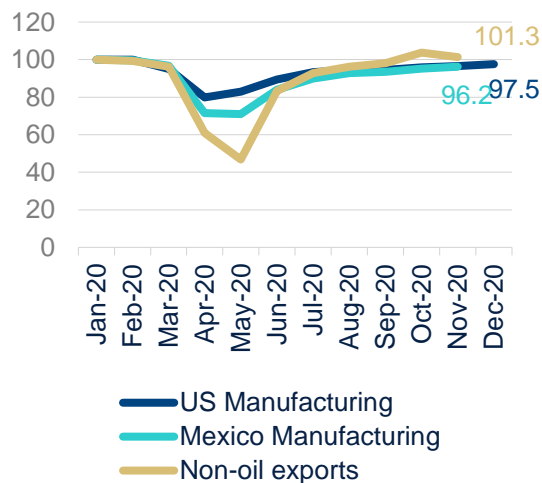


*Closing date: January 12, 2021.
Source: BBVA Research/INEGI

The external sector is performing better than domestic demand, driven by the greater dynamism of the US manufacturing sector.

The recovery in external demand is being consolidated as a result of the resilience of the US manufacturing sector

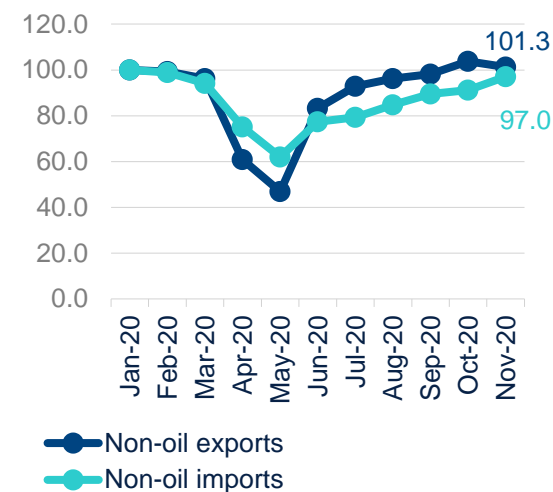
NON-OIL AND MANUFACTURING EXPORTS MEXICO/US
(INDEX, JAN. 2020=100)



NON-OIL EXPORTS AND ISM NEW ORDERS (Y/Y%, 6M MOVING AVERAGE, ISM 6M BACK)



NON-OIL EXPORTS AND IMPORTS
(INDEX, JAN. 2020=100, SWDA)

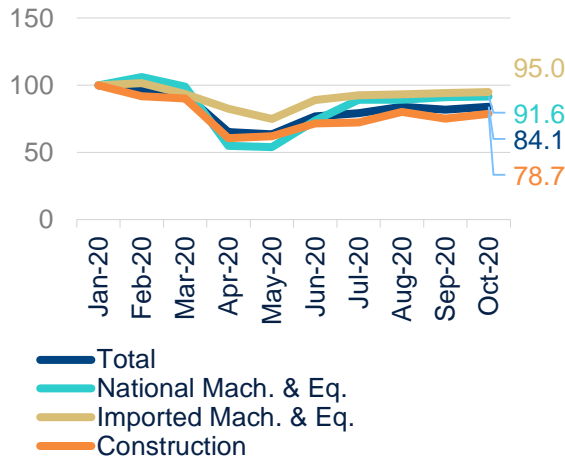


Source: BBVA Research/INEGI

As this is essential activity, there is less of a risk factor associated with COVID.

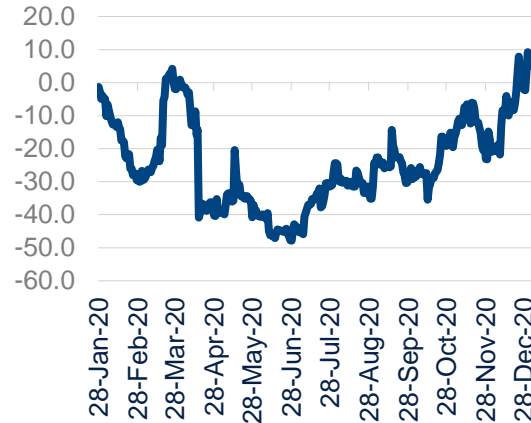
Investment remains 16% below its pre-COVID level; machinery and equipment is performing better than construction with the boost from external demand

INEGI GROSS FIXED INVESTMENT
(INDEX, JAN. 2020 = 100, SWDA)

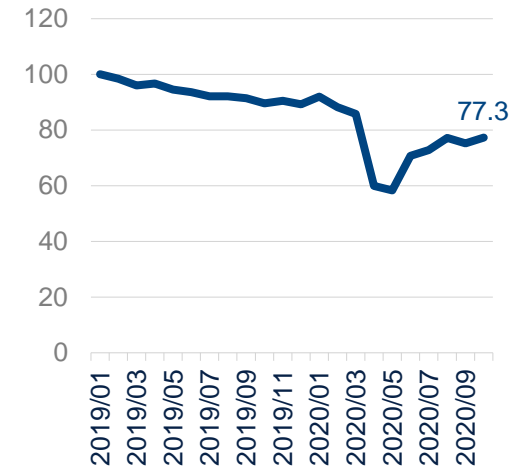


*Cut-off date: January 12, 2021.
Source: BBVA Research/INEGI

BBVA INVESTMENT INDICATOR*
(Y/Y%, 28 DAY MOVING AVERAGE)



INEGI GROSS FIXED INVESTMENT
(INDEX, JAN. 2019 = 100)

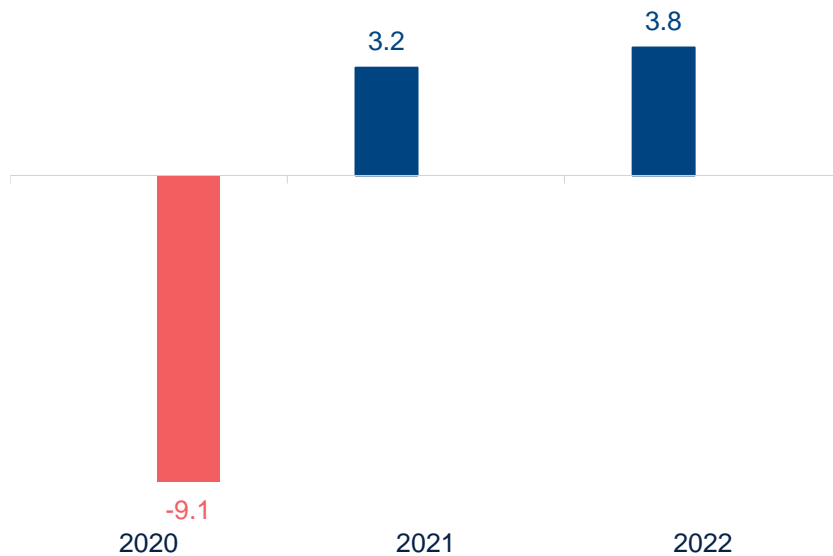


Slow rate of recovery for private investment, reaching 91% of its pre-COVID level at the close of 2021.

We have revised our growth forecast for 2021 downward to 3.2% (3.7% previously); we estimate growth of 3.8% in 2022 (3.5% previously)

GDP

(Y/Y % CHANGE)



RISKS



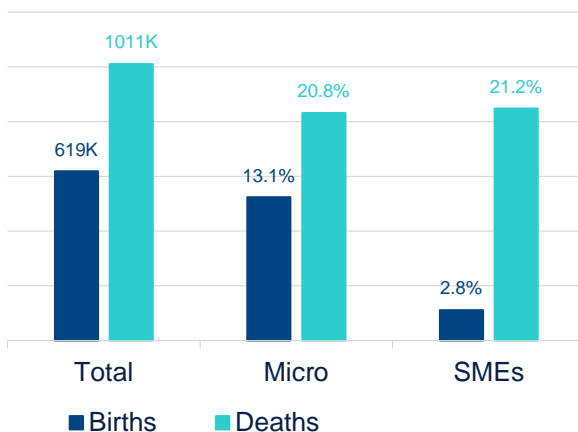
Extension of the closure of non-essential activities.



Delay in the production/ administration of the vaccine.

Strong deterioration in the labor market in 2020: Up to 1 million formal companies and jobs destroyed

IMPACT OF COVID 19 ON THE DEMOGRAPHICS OF COMPANIES* (THOUSANDS AND % OF THE TOTAL IN EACH CATEGORY)

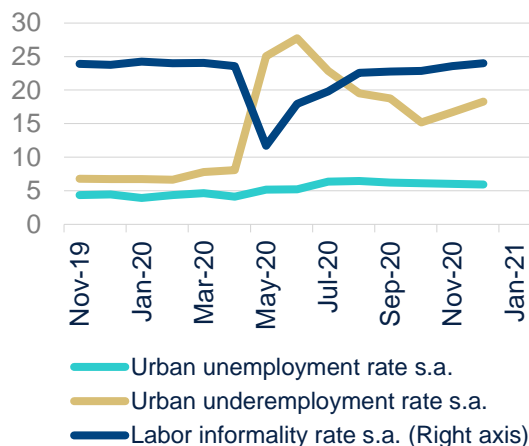


BBVA Research/INEGI

*Study on the Demographics of Businesses (EDN) 2020 carried out from May-19 to Sept-20

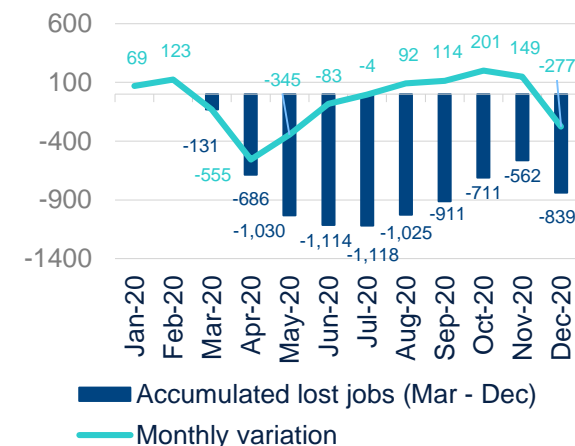
Companies as a whole: Start 4.86 million; End 4.47 million.

LABOR MARKET RATES (%)



Source: BBVA Research/INEGI

LOSS OF FORMAL EMPLOYMENT (THOUSANDS, MARCH TO DECEMBER)

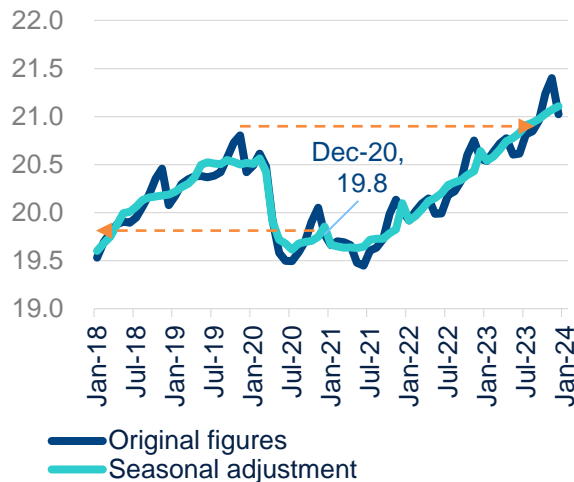


Source: BBVA Research/IMSS

Reopening of the economy with high levels of underemployment, recovery of informal employment and weakness in formal job creation.

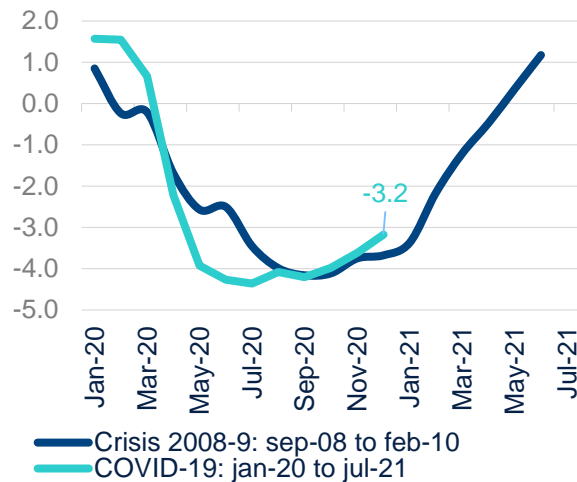
With the loss of jobs in 2020 we have returned to the levels seen in March 2018; we expect a slow recovery during 2021

FORMAL EMPLOYMENT (IMSS)
(MILLIONS)



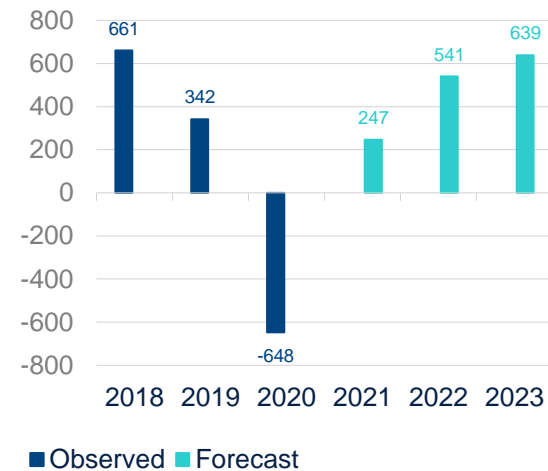
Source: BBVA Research/IMSS
Seasonally adjusted, X-13 ARIMA-SEATS

FORMAL EMPLOYMENT (IMSS)
(% ANNUAL CHANGE)



Source: BBVA Research/IMSS

FORMAL EMPLOYMENT (IMSS)
(THOUSANDS TO DEC.)



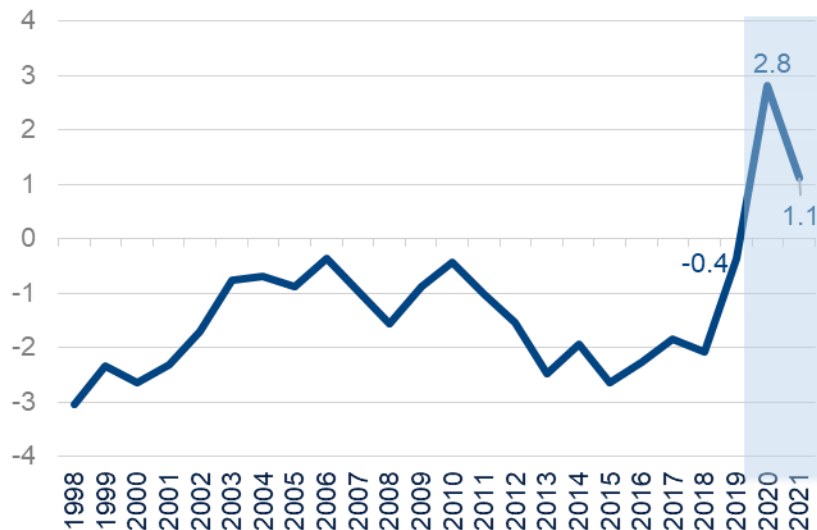
Source: BBVA Research/IMSS

On the basis of this scenario, we maintain our forecast that pre-pandemic employment levels will rebound solidly during 2023.

The current account trend saw a significant reversal in 2020 on registering a sizeable surplus in 3Q20, which reflects internal weakness

CURRENT ACCOUNT

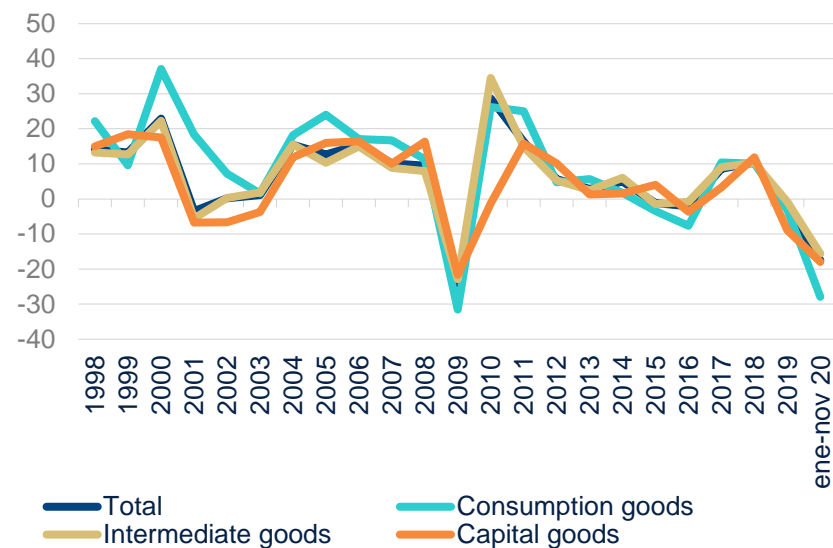
(% OF GDP)



Source: BBVA Research/Banxico

IMPORTS BY TYPE OF GOOD

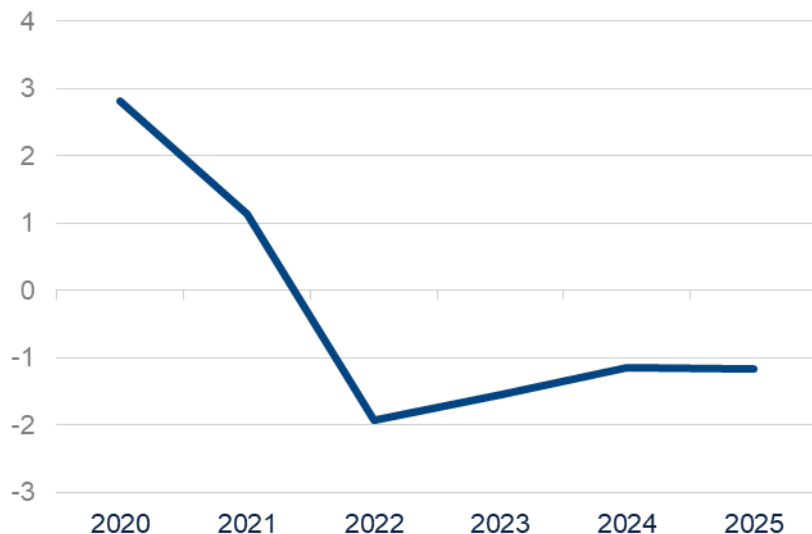
(Y/Y%)



Source: BBVA Research/INEGI

The long road to recovery in domestic demand will be reflected in a current account surplus in 2020 and 2021

CURRENT ACCOUNT FORECASTS 2020–2025 (% OF GDP)



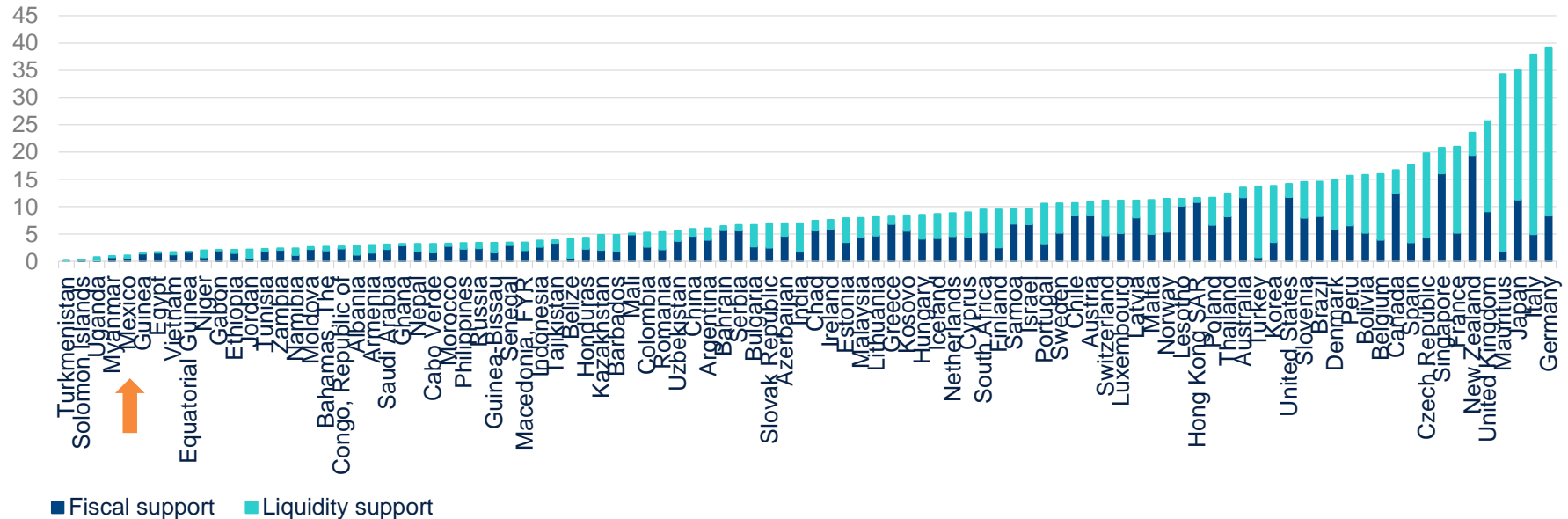
Lower potential growth will stabilize the current account deficit at around 1.2% of GDP in the medium term:

- More investment portfolio flows for this year, contributing to a current account surplus since imports are not expected to close the gap with exports.
- USMCA, near-shoring and the recovery of global manufacturing will support the normalization of imports of intermediate goods and capital from 2022.
- International remittances are at record highs and this will support domestic demand but imports of capital will remain weak.

The fiscal response to the pandemic in Mexico has been one of the lowest around the world

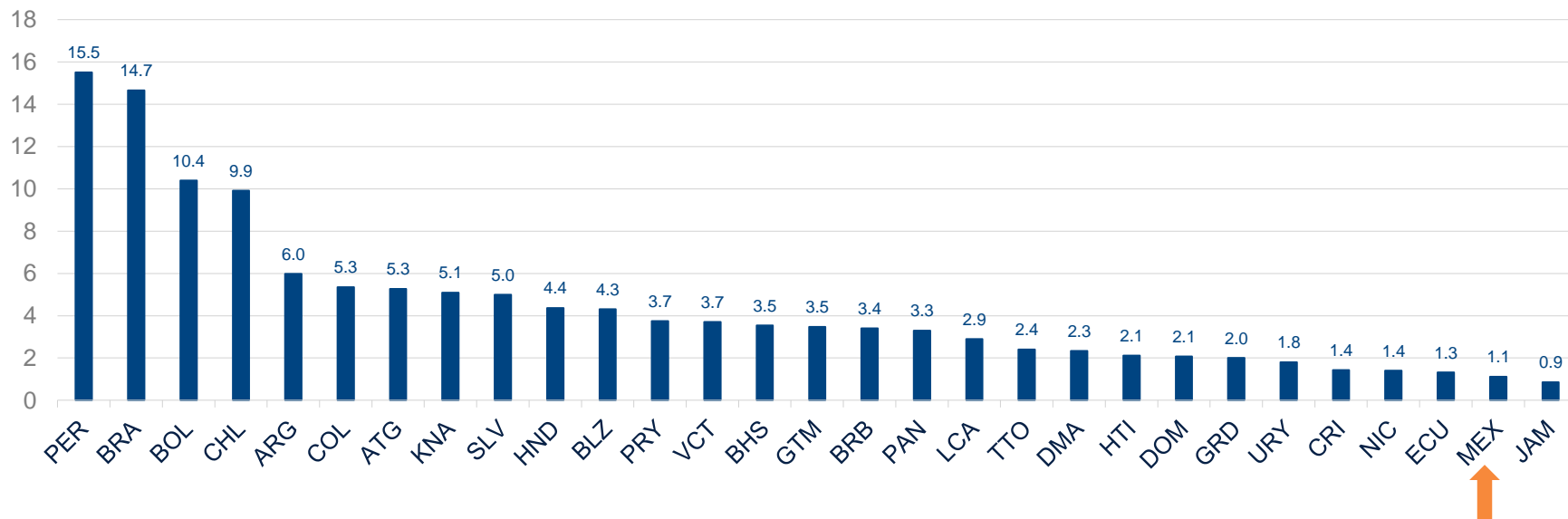
FISCAL PACKAGES ANNOUNCED IN RESPONSE TO THE COVID-19 PANDEMIC

(% OF GDP)



The fiscal response to the pandemic in Mexico was the second lowest in the region of Latin America and the Caribbean

FISCAL PACKAGES ANNOUNCED IN RESPONSE TO THE COVID-19 PANDEMIC IN LATIN AMERICA AND THE CARIBBEAN (% OF GDP)



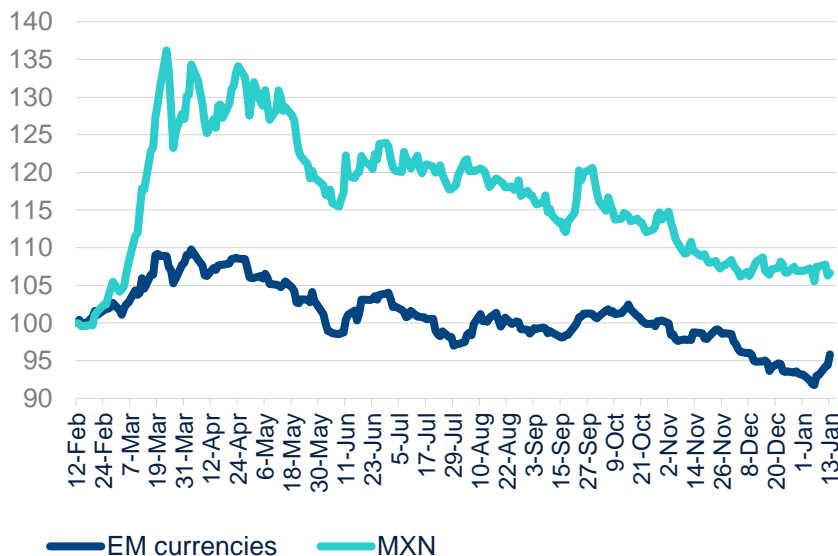
03

There is still some leeway
for the peso to appreciate
further

In 2H20 the peso recovered a good amount of the territory it had lost in 1H20

PERFORMANCE OF THE PESO COMPARED TO OTHER EMERGING CURRENCIES*

(INDEX, FEB 12, 2020 = 100)

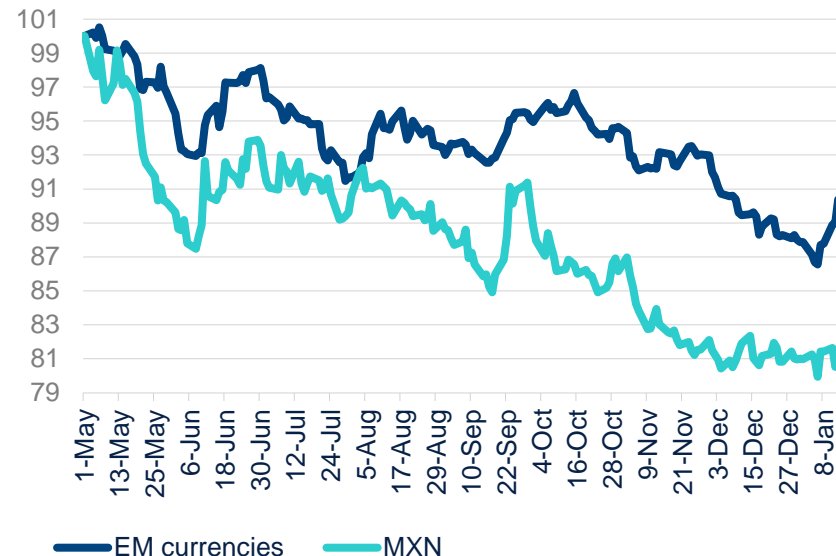


* Based on a reweighting of the JP Morgan Emerging Market Currencies index Index after removing the MXN; own calculations.

Source: BBVA Research/Bloomberg

PERFORMANCE OF THE PESO COMPARED TO OTHER EMERGING CURRENCIES*

(INDEX, MAY 1, 2020 = 100)



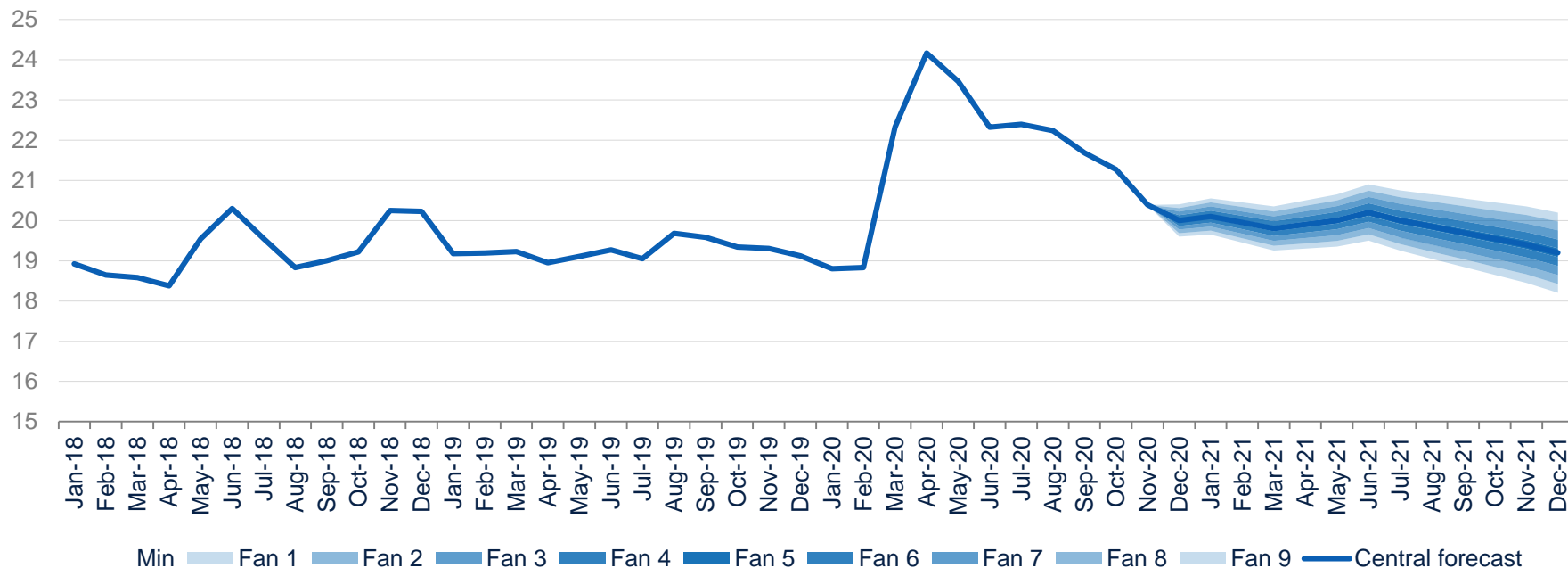
* Based on a reweighting of the JP Morgan Emerging Market Currencies index Index after removing the MXN; own calculations.

Source: BBVA Research/Bloomberg

Immunization against COVID-19 and the increased search for a return could lead to the appreciation of the peso to levels of 19.2 pesos to the dollar by the end of 2021

EXCHANGE RATE

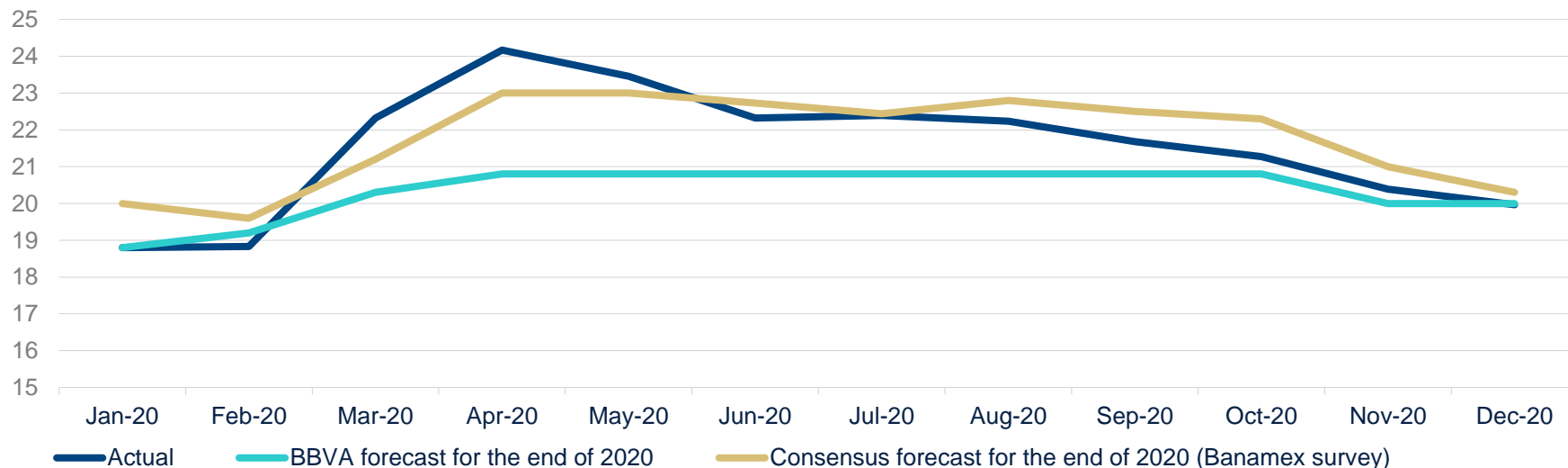
(PESOS/USD)



As we had been forecasting since the start of the pandemic, the peso recovered after the strong rebound in global risk aversion

EXCHANGE RATE AND FORECASTS FOR YEAR END 2020

(PESOS/USD)



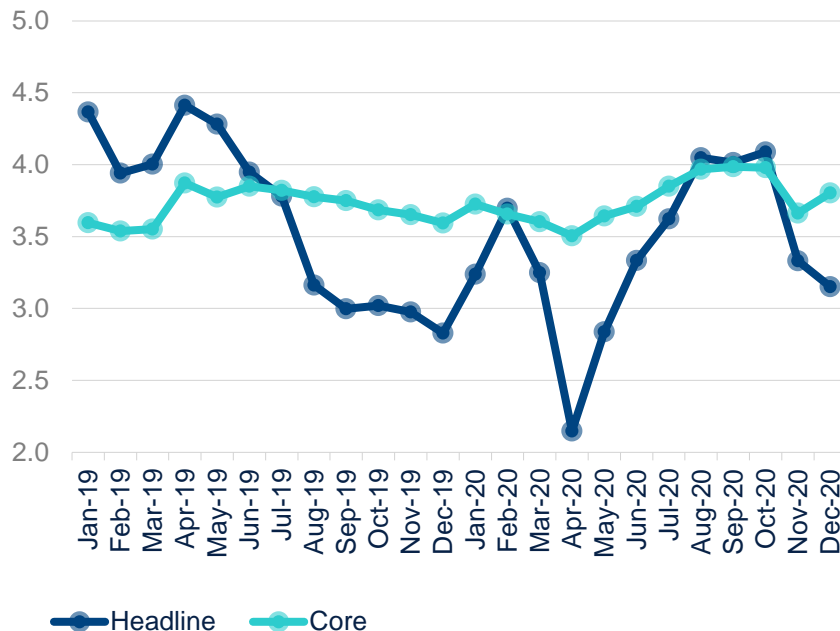
04

We are forecasting low
and relatively stable
inflation and lower rates
for a prolonged period

Low headline inflation in 2020 resulting from the reduction in energy prices and sharp slowdown in services

HEADLINE & CORE INFLATION

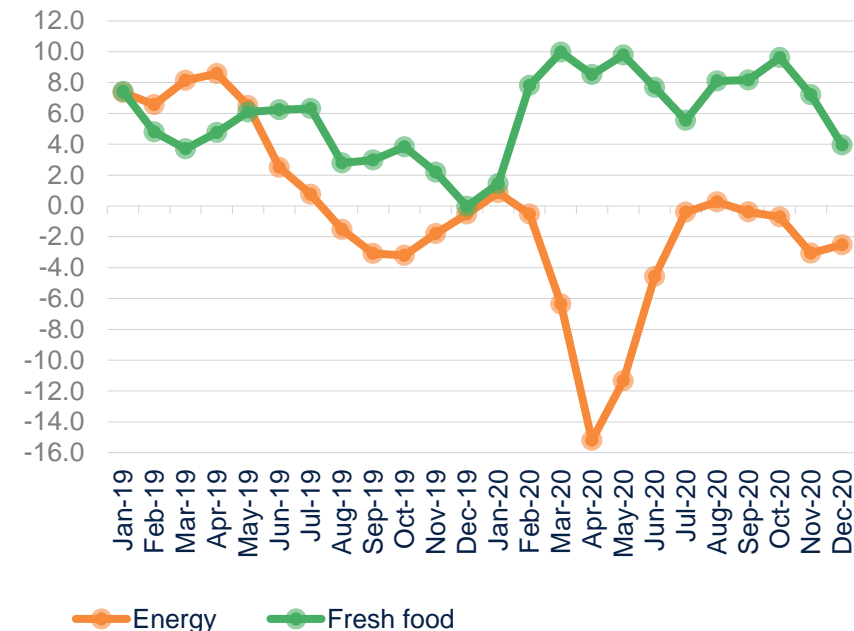
(% CHANGE Y/Y)



Source: BBVA Research/INEGI

NON-CORE INFLATION: ENERGY AND FARMING

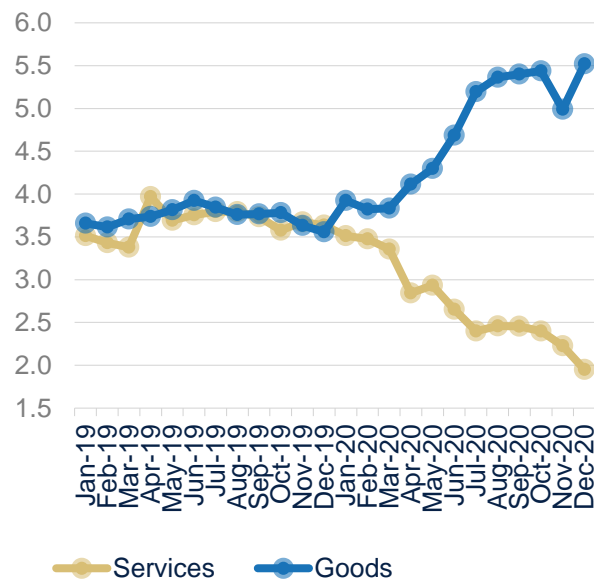
(% CHANGE Y/Y)



Source: BBVA Research/INEGI

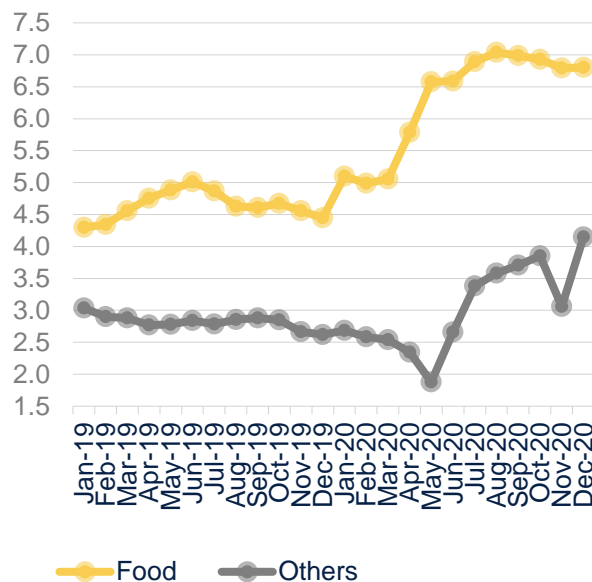
However, there will be rigidity in the reduction of core inflation due to pressure on the prices of goods, which we forecast will gradually ease during 2021

CORE INFLATION: GOODS AND SERVICES
(% CHANGE Y/Y)



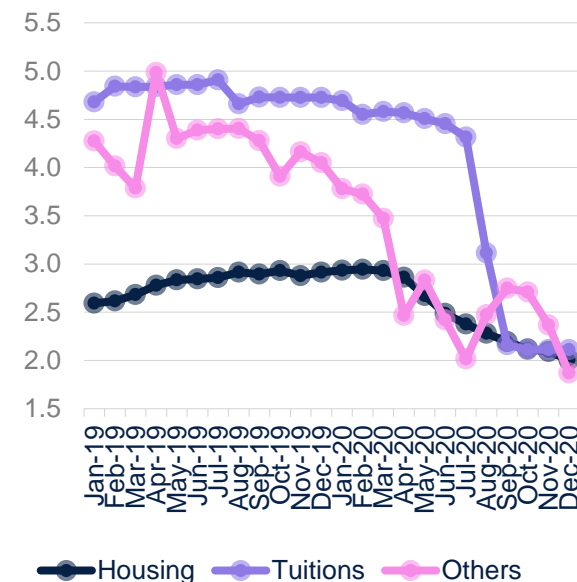
Source: BBVA Research/INEGI

GOODS: FOOD AND OTHER
(% CHANGE Y/Y)



Source: BBVA Research/INEGI

SERVICES: HOUSING, EDUCATION AND OTHER
(% CHANGE Y/Y)

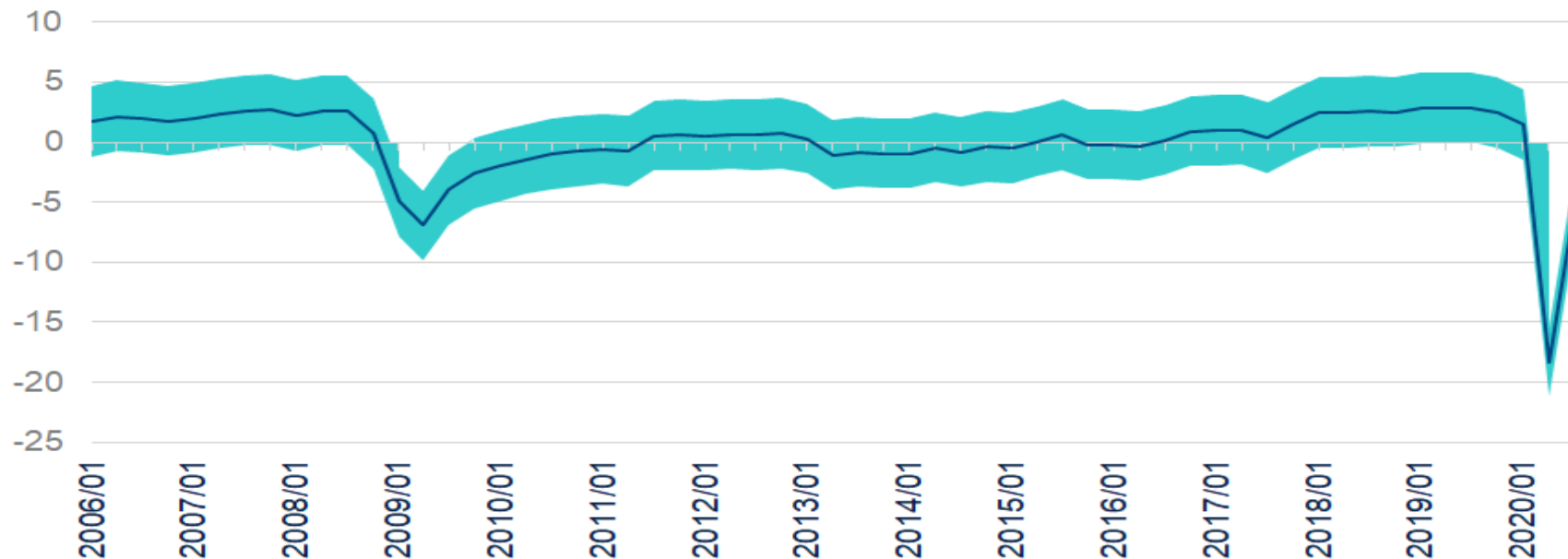


Source: BBVA Research/INEGI

It is likely that in a context of weak demand, goods inflation will moderate

OUTPUT GAP

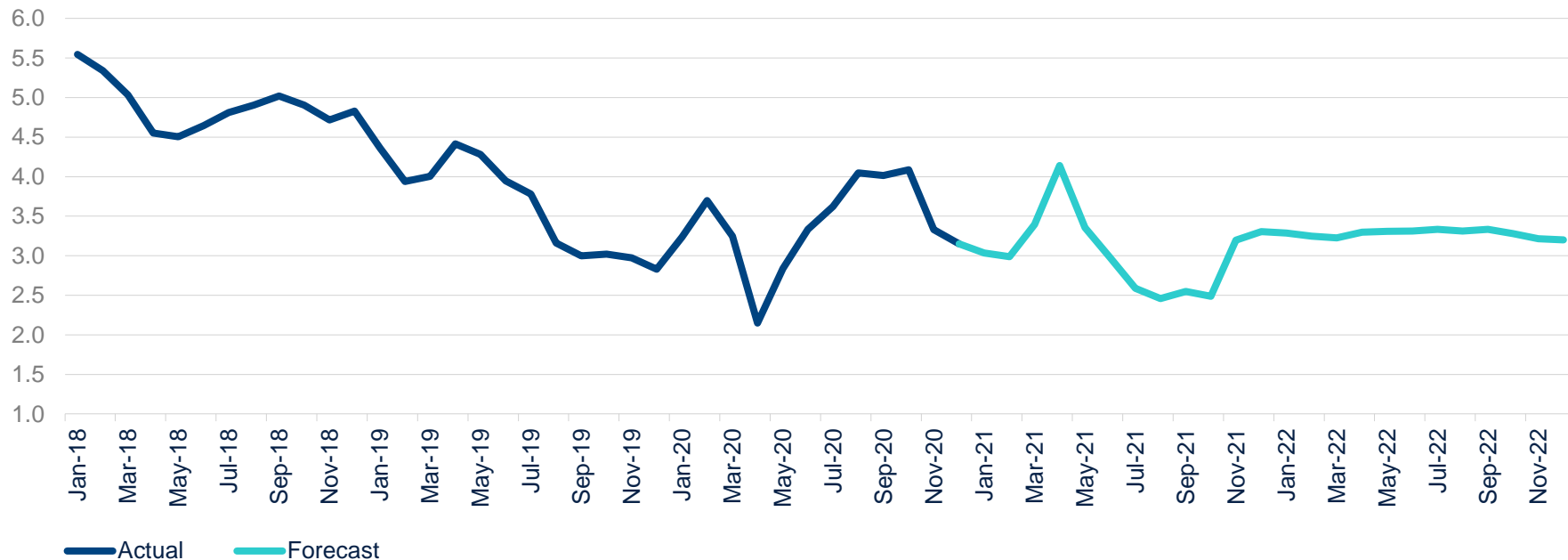
(% GDP)



We expect that during 2021–22 inflation will fluctuate at levels slightly above 3.0%, increasing in April due to base effects

HEADLINE INFLATION FORECASTS

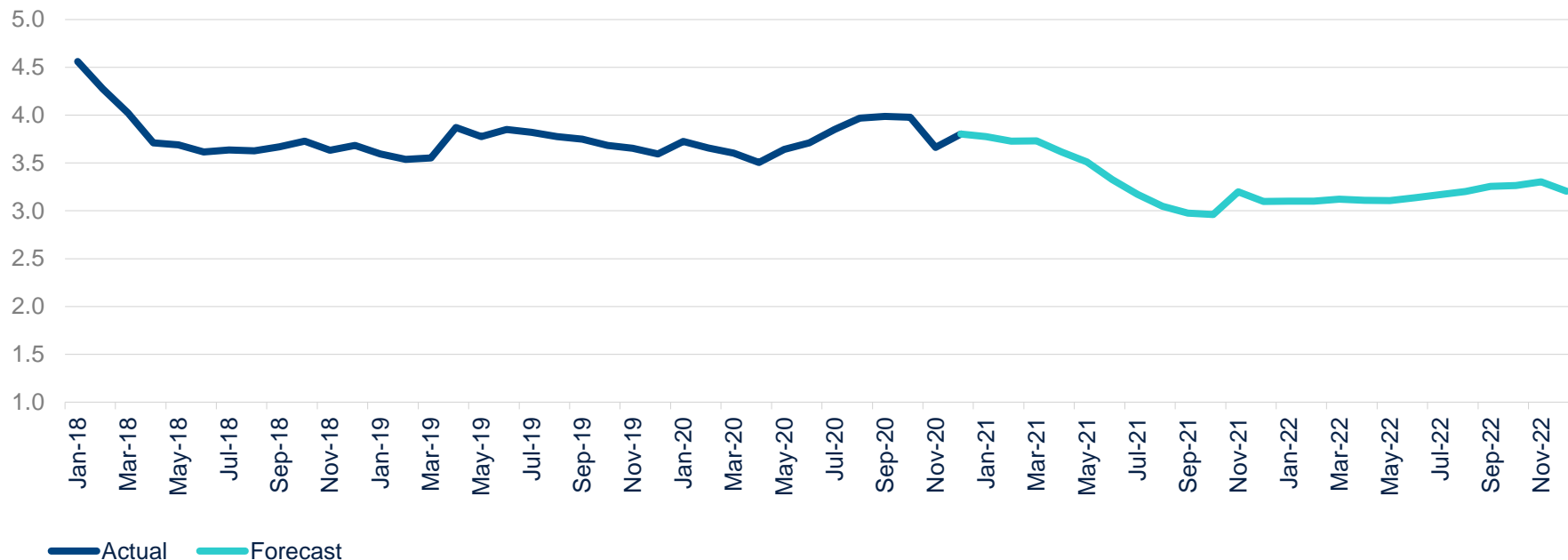
(% CHANGE Y/Y)



We expect core inflation to gradually fall; the sustained weakness in demand will break the recent rigidity

CORE INFLATION FORECASTS

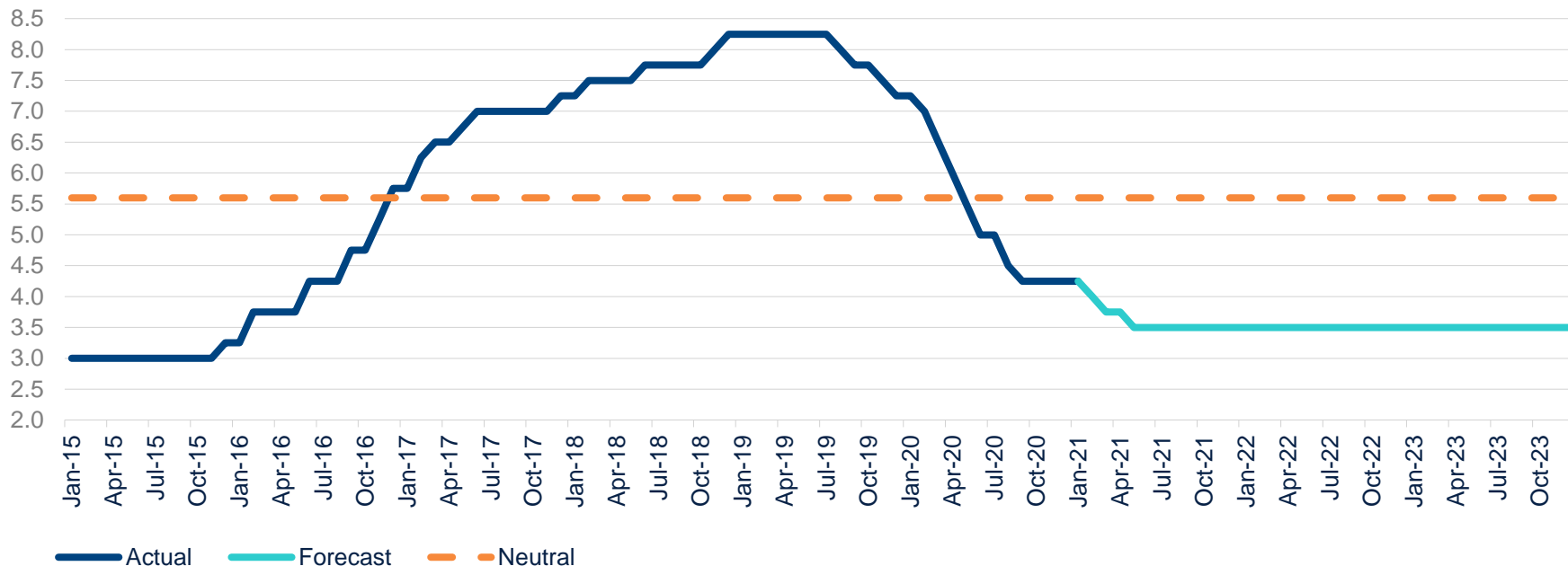
(% CHANGE Y/Y)



We anticipate that Banxico will resume the cycle of reductions in February, taking the monetary rate to 3.5% in May, with room for further reductions

OUTLOOK FOR THE MONETARY RATE

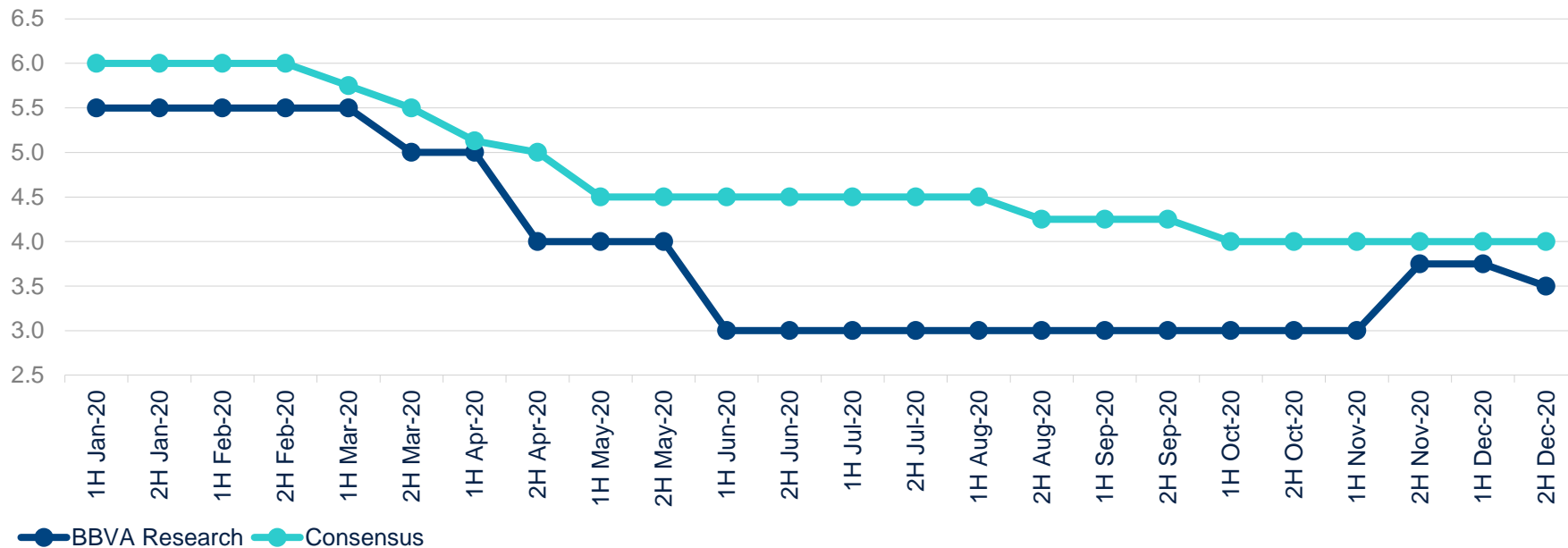
(%)



And we forecast that it will remain at this level for the duration of 2H21, 2022 and 2023; a lower level than forecast by the consensus

EXPECTATIONS FOR THE MONETARY RATE AT THE END OF 2021: BBVA RESEARCH VS. CONSENSUS

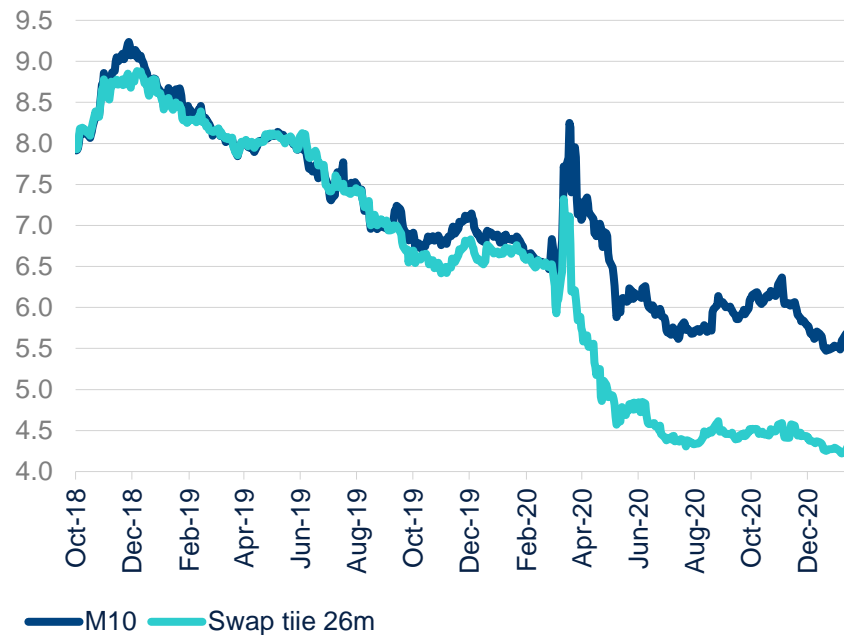
(%)



The greater risk appetite is behind the reduction in long-term rates; we forecast 5.2% for M10 at the end of 2021

M10 and 26-MONTH TIE SWAPS (%)

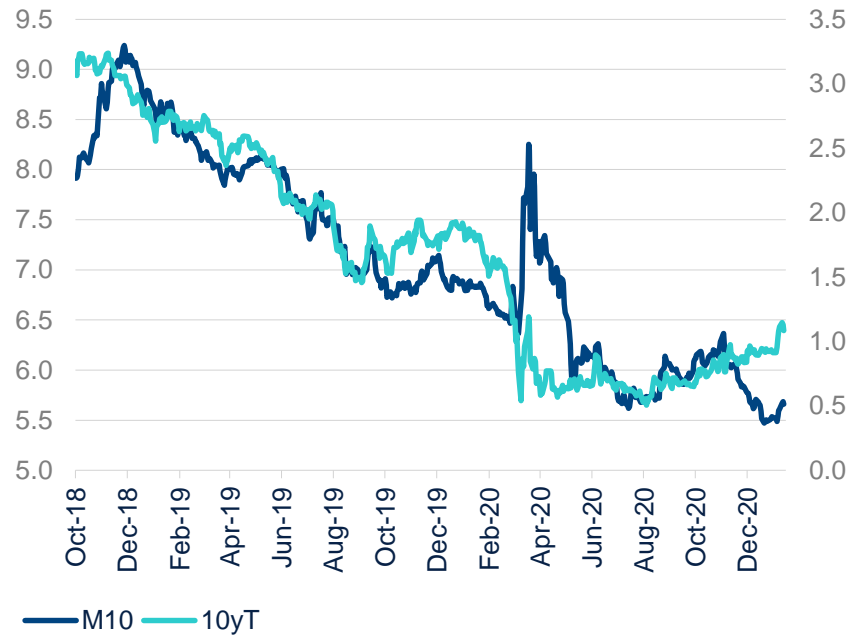
(%)



Source: BBVA Research/Bloomberg

M10 AND 10-YEAR TREASURY NOTES (%)

(%)



Source: BBVA Research/Bloomberg

05

Main messages and summary of forecasts

Main messages (I)



Economic activity is facing significant risks in 1Q21 from the increase in the number of people infected:

- The shutdown of activities imposed since the last week of December will have a serious impact on private consumption. There remain risks associated with the extension of the period during which activities are suspended and the rollout of the vaccine. We have revised our growth forecast for 2021 downward to 3.2% (3.7% previously) given the weakness of domestic demand. The external sector is showing more dynamism, boosted by the resilience of US manufacturing.
- The labor market has been strongly affected in 2020 with the destruction of up to 1.1 million jobs. We still expect to see employment return to its pre-pandemic level by 2023.

Main messages (II)



We are forecasting low and relatively stable inflation during 2021–22 and lower interest rates for a prolonged period:

- Core inflation has shown downward rigidity for longer than we forecast; however, we continue to expect the weakness in demand to end up breaking this rigidity.
- We expect Banxico to resume the cycle of reductions in February and we forecast that after reaching 3.50%, the monetary rate will remain stable at this level during 2H21, 2022 and 2023.



Immunization against COVID-19 and the increased risk appetite could lead to the appreciation of the peso to levels of around 19.2 pesos to the dollar by the end of 2021.



Public debt will stabilize at around 53% in the coming years as long as fiscal reforms are implemented. We are forecasting an Operating Surplus for Banxico of 264 billion pesos (1.1% of GDP).

Forecasts

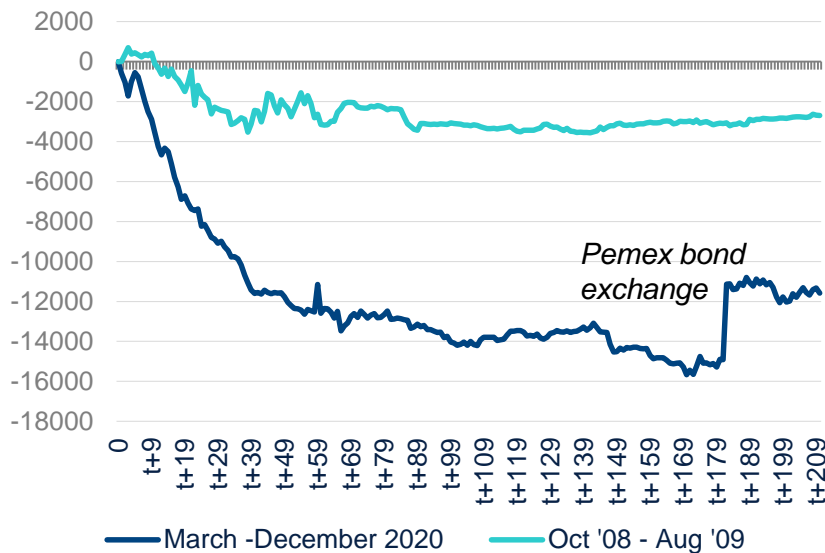
| | | 2019 | 2020 | 2021 | 2022 | 2023 |
|----------------------------------|----------|------|-------------|-------------|-------------|-------------|
| GDP (% change y/y) | new | 0.0 | -9.1 | 3.2 | 3.8 | 1.9 |
| | previous | | -9.3 | 3.7 | 3.5 | 1.5 |
| Employment (% eop) | new | 1.7 | -3.6 | 1.2 | 2.7 | 3.1 |
| | previous | | | 1.8 | 2.7 | 3.3 |
| Inflation (% eop) | new | 2.8 | 3.2 | 3.3 | 3.2 | 3.2 |
| | previous | | | 2.8 | 3.0 | 3.0 |
| Monetary rate (% eop) | new | 7.25 | 4.25 | 3.50 | 3.50 | 3.50 |
| | previous | | | 3.0 | 3.0 | 3.0 |
| Exchange rate (peso/dollar, eop) | new | 19.1 | 19.9 | 19.2 | 19.8 | 19.7 |
| | previous | | | 20.5 | 20.5 | 20.5 |
| M10 (% eop) | new | 6.89 | 5.5 | 5.2 | 5.8 | 6.5 |
| | previous | | | 5.8 | 6.2 | 6.8 |
| Fiscal balance (% GDP) | new | -1.6 | -3.0 | -3.0 | -2.1 | -2.1 |
| | previous | | -3.6 | -3.8 | -2.1 | -2.1 |
| Current account (% GDP) | new | -0.1 | 2.8 | 1.1 | -1.9 | -1.5 |
| | previous | | -0.2 | 0.0 | -2.2 | -1.5 |

04

Appendix

The cumulative fall in foreign M-bond holdings came to a halt at the end of the year

CUMULATIVE CHANGE IN FOREIGN M-BOND HOLDINGS, OCT '08 – AUG '09 AND MAR-DEC '20
(USD MILLION, NOMINAL VALUE)



As of December 31, 2020
Source: BBVA Research/Banxico

CUMULATIVE CHANGE IN FOREIGN M-BOND HOLDINGS, OCT '08 – AUG '09 AND MAR-DEC '20
(% NOMINAL VALUE IN PESOS)



As of December 31, 2020
Source: BBVA Research/Banxico

The banks acquired most of the bonds sold by foreign holders

CHANGE IN RESIDENT-HELD M-BONDS ON NOVEMBER 20, 2020*

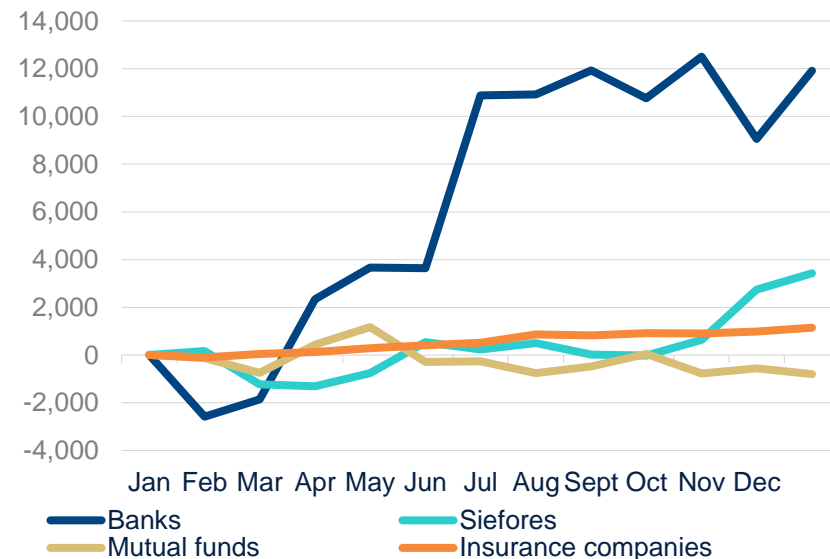
(USD MILLIONS, NOMINAL VALUE)



*On November 19 the total circulation of M-Bonds increased by USD 4.109 billion as the Repos with Banxico increased by USD 4.757 billion. On November 20 the holding of the banks fell by USD 3.51 billion while the foreign holding increased by USD 3.786 billion.

Source: BBVA Research/Banxico

RESIDENT-HELD M-BONDS, CUMULATIVE CHANGE (USD MILLIONS, NOMINAL VALUE)



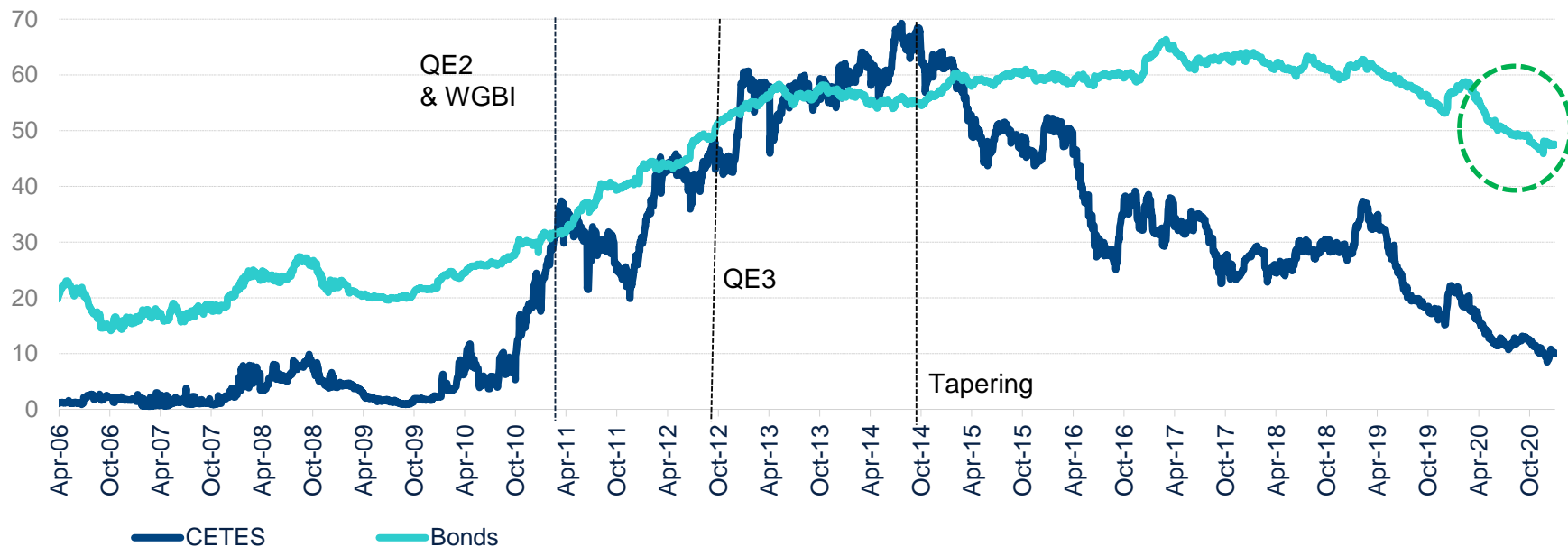
As of December 31, 2020

Source: BBVA Research/Banxico

Despite the favorable global liquidity conditions, foreign investors have reduced their demand for M-bonds

FOREIGN HOLDING OF CETES AND M-BONDS

(% OF TOTAL IN CIRCULATION)



Mexico Economic Outlook

1Q21

January 2021