

Mexico Economic Outlook

2Q21

01

Global Outlook 2Q21

The global economy continues to recover despite the still complex epidemiological context

2020



Beginning and expansion of the pandemic, lockdowns, and vaccines developments



Massive fiscal and monetary stimuli



Sharp rise in financial volatility, followed by a gradual normalization

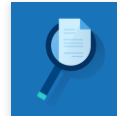


Incomplete and heterogeneous GDP rebound after the initial crash

Start of 2021



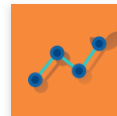
Start of vaccination, at different paces



Reinforced stimuli (fiscal packages in the US)



Gradual normalization of long term yields in the US / return of risk appetite

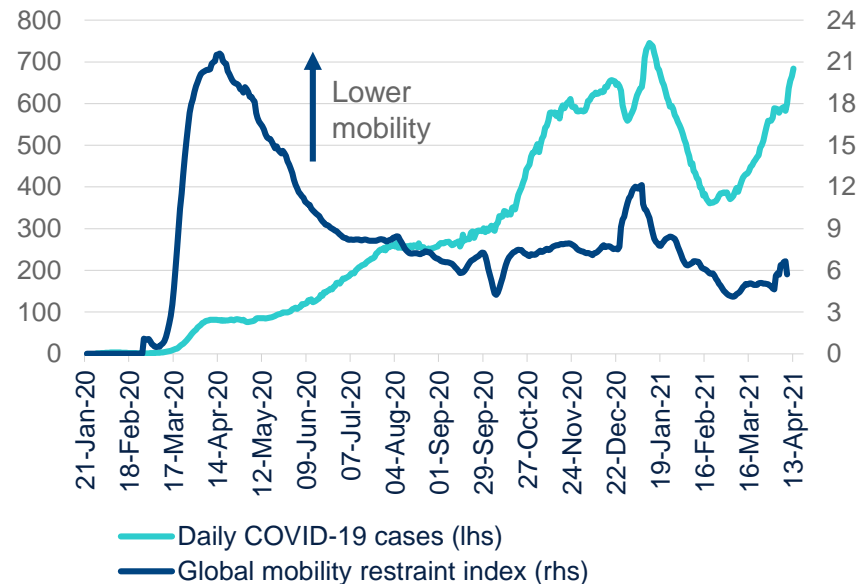


Recovery at different paces, depending on vaccination and stimuli

COVID-19 infections have increased again, following a sharp decrease at the start of the year, but mobility remains relatively high

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

(CASES: THOUSANDS OF PEOPLE , 7-DAY MOVING AVERAGE)



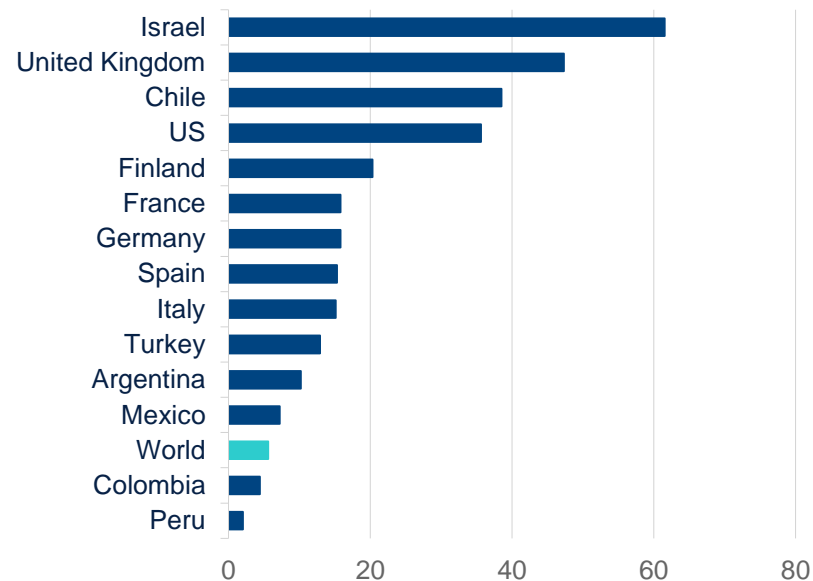
- Recent augment in infections in the US and, mainly, in Europe and Latin America, which have been forced to consider new restrictions.
- Virus mutations facilitate its spread.
- Less severe restrictions have limited the effect of contagions on mobility and on economic activity.

(*) The mobility restraint index reflects changes with respect to the period of reference (January 3 to February 6 2020). Higher values represent lower mobility. BBVA Research based on data from John Hopkins University and Google.

Vaccination has advanced quickly in some areas, but supply restrictions have limited the progress in most countries

POPULATION VACCINATED

(% OF POPULATION THAT HAS RECEIVED AT LEAST ONE DOSE OF THE ANTI-COVID VACCINE AS OF APRIL 11 2021)

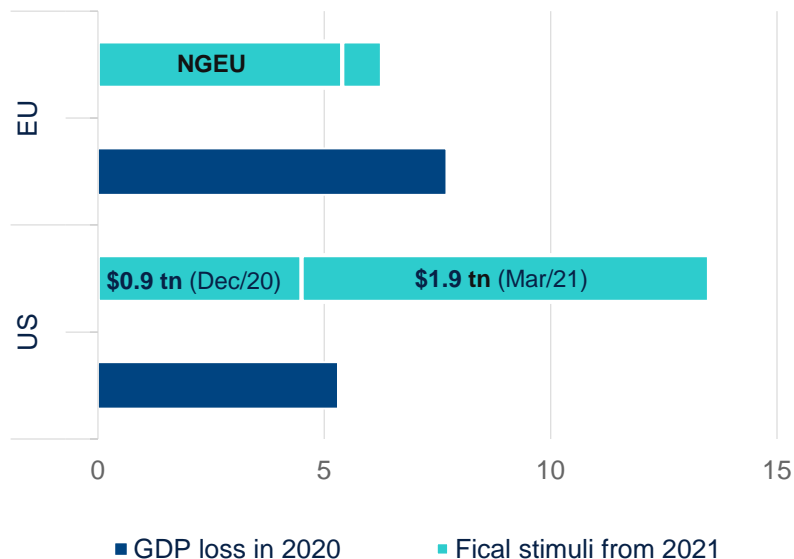


- The inoculation process advances with **heterogeneity** across countries.
- A **growing but still insufficient** supply has prevented a quicker rollout of vaccines.
- **Logistical and confidence problems** have also weighed negatively on the pace of vaccination.
- The available vaccines exhibit a **high rate of effectiveness**, according to growing evidence.
- The example of leading countries in vaccination suggests that **too early opening carries risks**.

The new fiscal impulse in the US reinforces the view that economic policy is fully committed with the recovery

GDP LOSS IN 2020 AND FISCAL STIMULUS(*)

(PP, % OF GDP)



- **Fiscal policy in the US:** approved measures supporting consumption (13% of GDP) and measures supporting investment currently being discussed (up to 15% of GDP over the next 10-15 years).
- **The Fed** is not worried about inflation and has suggested it will keep interest rates at zero level through at least 2023.
- In **Europe** the focus is on making **NGEU funds** available from mid year on.
- The **ECB** is intensifying asset purchases in this quarter with the aim of preserving the monetary policy accommodative stance.

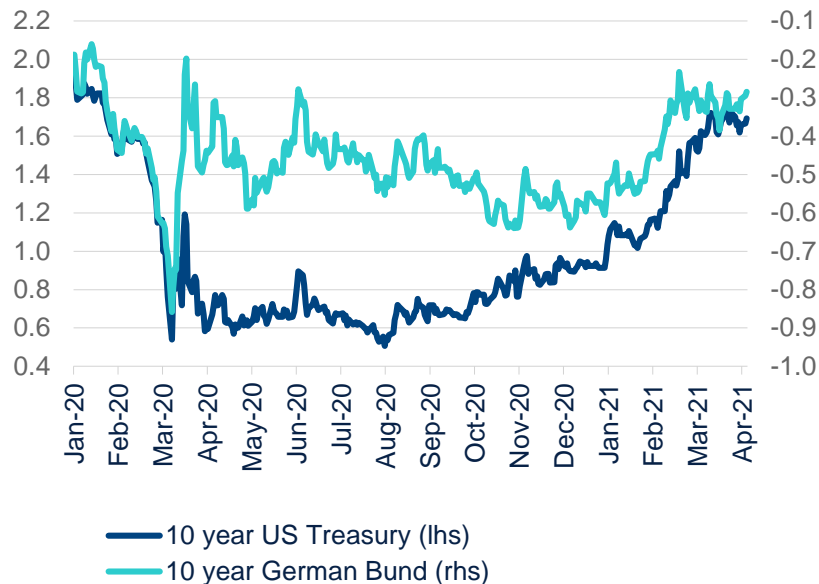
(*) GDP loss in 2020: difference between forecasted GDP before the crisis and the actual data. Fiscal stimuli to be implemented from 2021. US: USD 900 billions approved in Dec 2020 and USD 1.900 billion approved in Mar 2021. EU: NGEU and measures announced by the main countries in the region.

Source: BBVA Research.

Fast vaccination and the fiscal impulse in the US have triggered a rise in long term yields

10-YEAR BOND YIELDS

(%)



- Fiscal measures in the US have reinforced growth and inflation prospects.
- Markets have brought forward their forecasts for the withdrawal of monetary stimuli.
- Long term debt yields have significantly increased in the US, but it remains at low levels.
- Equity markets have exhibited volatility episodes.

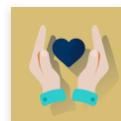
Reinforced recovery prospects on stimuli and vaccines rollout; inflation and financial stress to remain contained, despite risks

Rest of 2021

2022



Mass vaccination
with high heterogeneity across countries



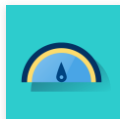
“New normal”



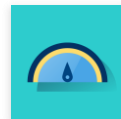
Reinforced fiscal stimulus
and unchanged rates in G3



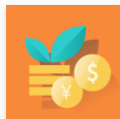
Reinforced fiscal stimulus, unchanged rates
in G3 and start of Fed tapering



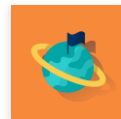
Limited risk aversion, gradual rise of long term
rates and a slightly dollar depreciation



Limited risk aversion, gradual rise of long
term rates and a slightly dollar depreciation

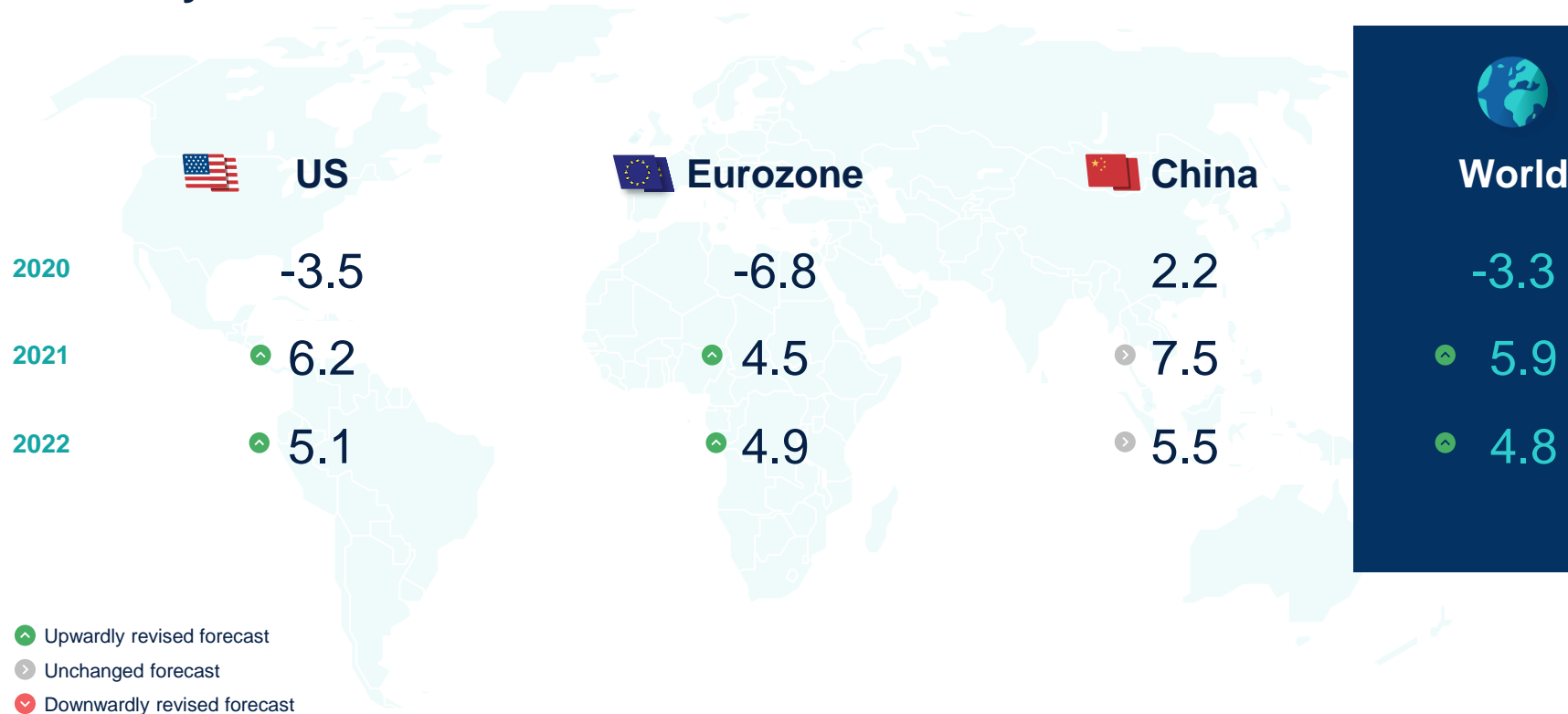


Global recovery,
led by the US and China



Global recovery,
including in Europe and emerging markets

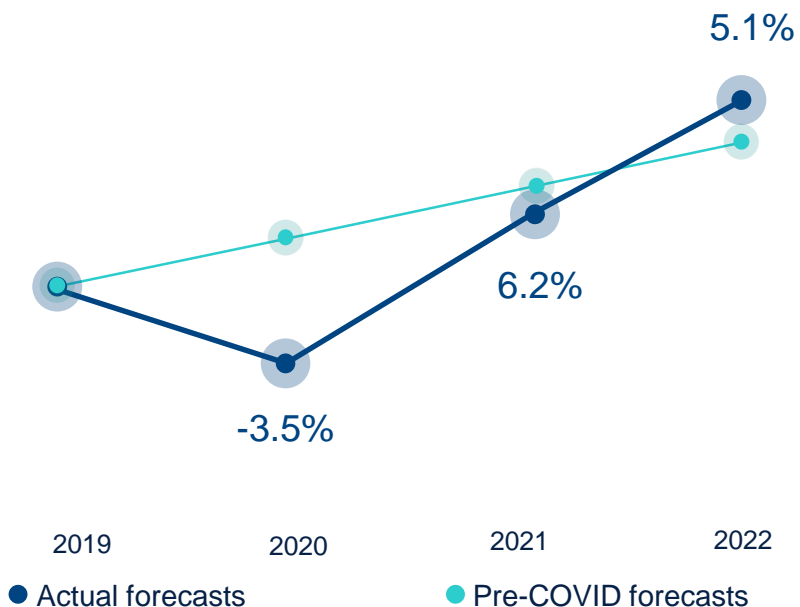
Global growth will be higher than previously forecast and it will be led by the US and China



US: growth will pick up sharply, but the Fed will take some time before starting to withdraw the monetary stimulus

US: REAL GDP

(LINES REPRESENT GDP LEVEL AND FIGURES REPRESENT ACTUAL GDP GROWTH FORECASTS)



Source: BBVA Research.

- Revised growth (2021: +2.6 pp; 2022: + 2.7 pp) on stimulus and fast vaccination.
- Approved fiscal measures will have a particularly strong effect on consumption.
- A new, investment-focused fiscal package is likely to be approved in 2021.
- Inflation will rebound, but will remain under control, averaging 2.5% in 2021.
- The labor market recovery will be gradual and the Fed will only start hiking rates in 2023

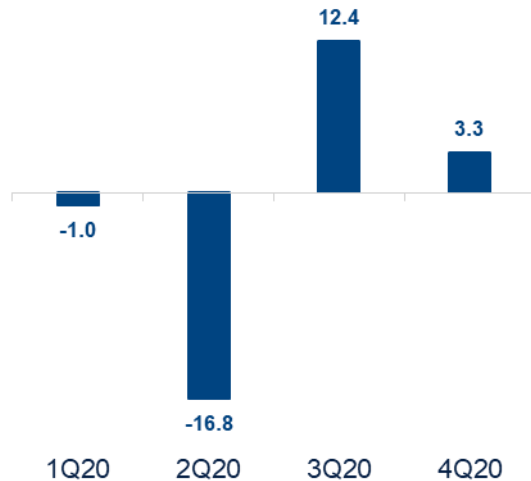
02

GDP rebounds more sharply in 2021

as a result of greater dynamism than expected and accelerated growth in the US

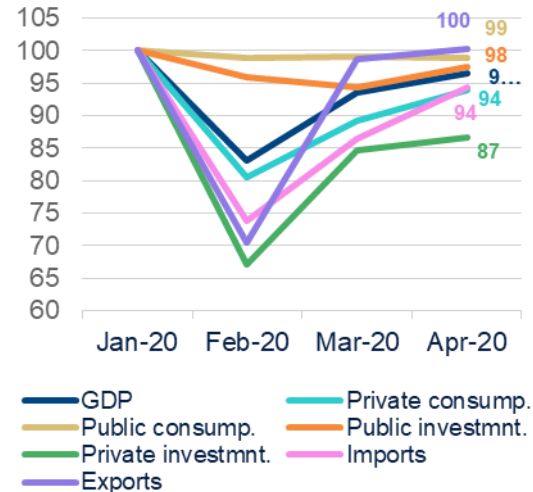
GDP 3% below its pre-COVID level. Per demand component: worse return on investment (13% lower); exports recovered

GDP
(% Q/Q, ACTUAL, SA)



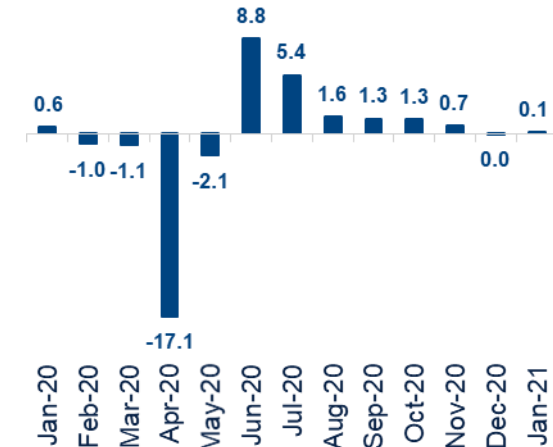
Source: BBVA Research, INEGI.

GDP AND COMPONENTS
(1Q20 INDEX = 100)



Source: BBVA Research, INEGI.

IGAE
(% M/M, ACTUAL, SA)

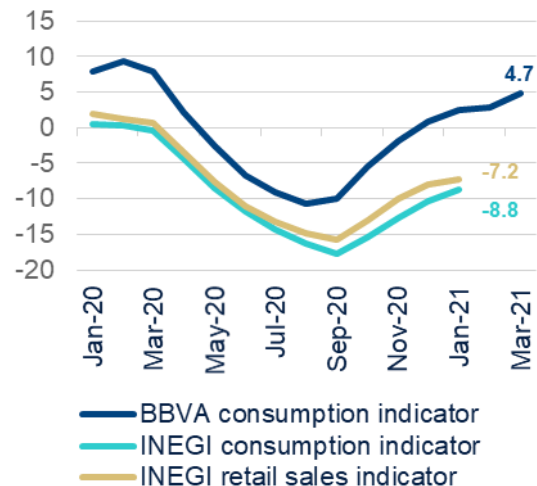


Source: BBVA Research, INEGI.

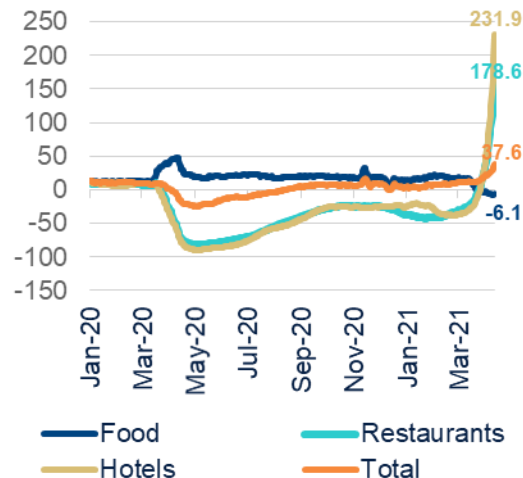
We expect growth to continue in 1Q21 with a positive effect on 2021.

Consumption gains strength in March; demand restructured toward services (hotels and restaurants)

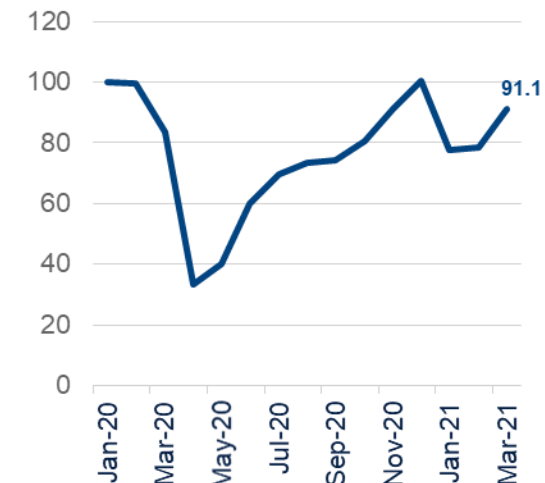
CONSUMPTION: BBVA AND INEGI INDICES (% Y/Y, REAL, 6-MONTH MOV. AVG.)



BBVA CONSUMPTION INDICES* (% Y/Y, ACTUAL, 28-DAY CUMULATIVE)



LIGHT VEHICLE SALES (JAN 2020 INDEX = 100)



Source: BBVA Research, INEGI.

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

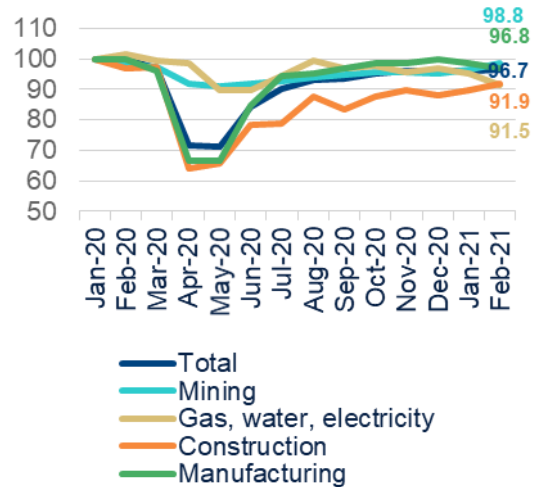
Source: BBVA Research, INEGI.

A faster return to normal puts a more positive trend on consumption, and thus on our growth estimates.

Industry was surprisingly strong in February (0.4% MoM), driven by construction; manufacturing (-2.1% MoM) will recover in March

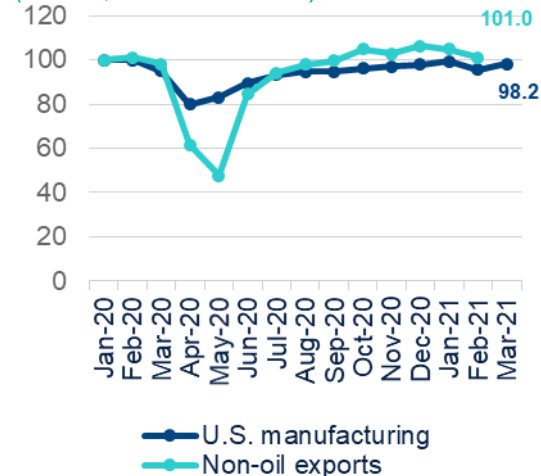
INDUSTRIAL PRODUCTION

(INDEX, JAN 2020 = 100)



MANUFACTURING IN THE US AND NON-OIL EXPORTS

(INDEX, JAN 2020 = 100)



NON-OIL EXPORTS AND ISM NEW ORDERS

(% Y/Y, 6MMA, ISM 6 MONTHS PRIOR)



Source: BBVA Research, INEGI.

Source: BBVA Research, INEGI.

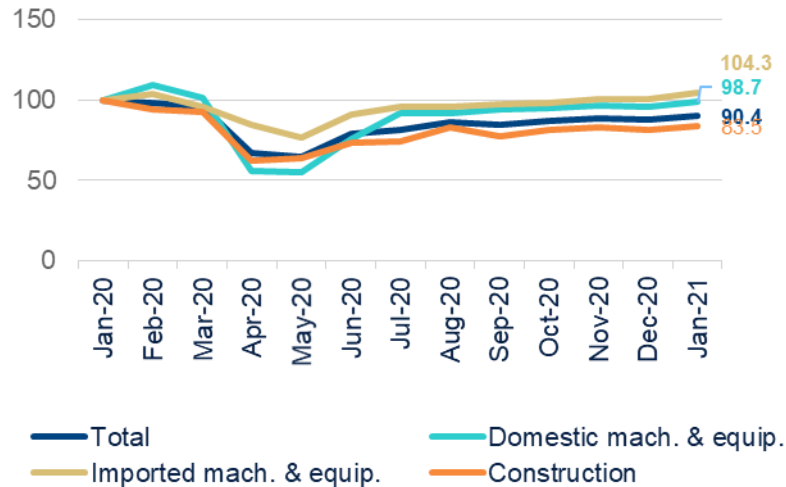
Source: BBVA Research, INEGI.

A faster growth rate in the US will boost external demand in the coming years.

Slow investment recovery (10% below the pre-COVID level); a challenging environment lies ahead

GROSS FIXED INVESTMENT

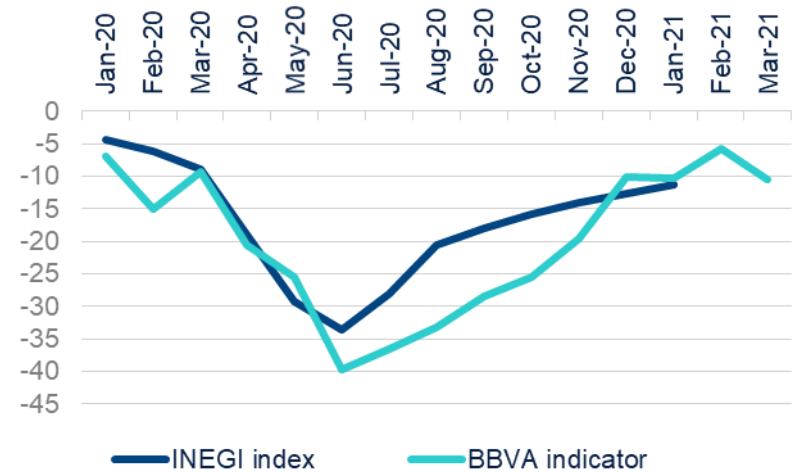
(INDEX, JAN 2020 = 100, SA)



Source: BBVA Research, INEGI.

INVESTMENT: INEGI AND BBVA*

(% REAL ANNUAL CHANGE)



Source: BBVA Research, INEGI.

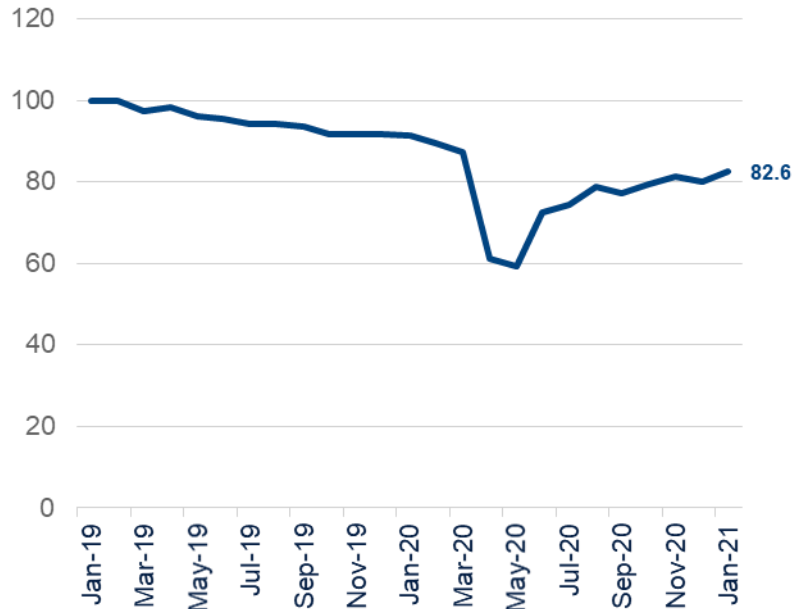
*Cut-off date: April 8, 2021.

Temporary inconsistency issues as a result of questionable changes in economic policies will continue to burden investing.

Total investment stands 17% below its January 2019 level; 69% of total investment earmarked for the tertiary sector

GROSS FIXED INVESTMENT

(INDEX, JAN 2019 = 100)



Source: BBVA Research, INEGI.

COMPOSITION OF INVESTMENT

(%, 2019)

■ Tertiary sector

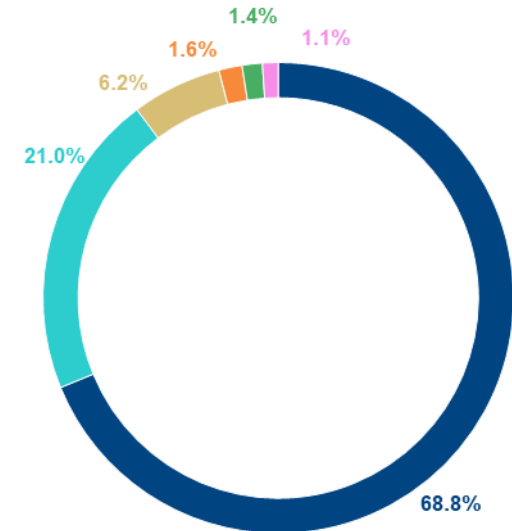
■ Manufacturing

■ Mining

■ Construction

■ Gas, water electricity

■ Primary sector

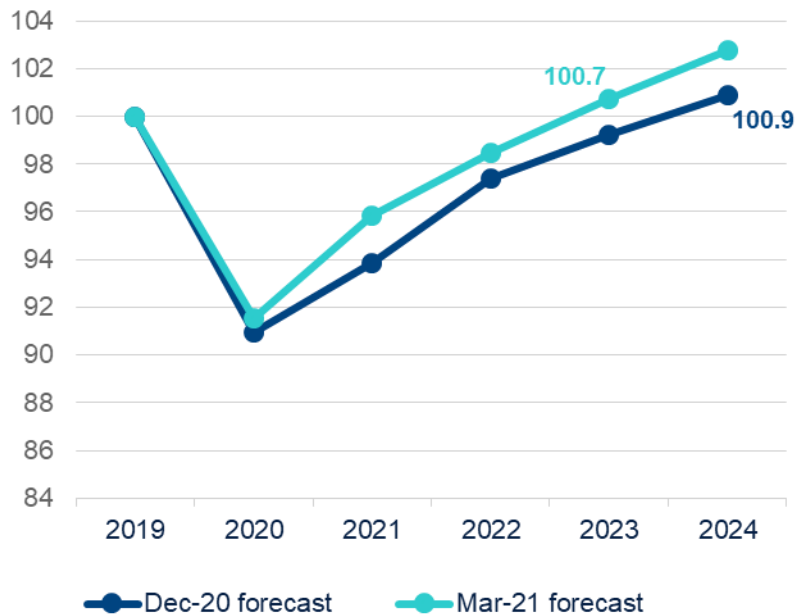


Source: BBVA Research, INEGI.

Upward revision of growth for 2021 (to 4.7%). Upward trend due to 1Q21 data, the US and faster vaccine rollout

GDP

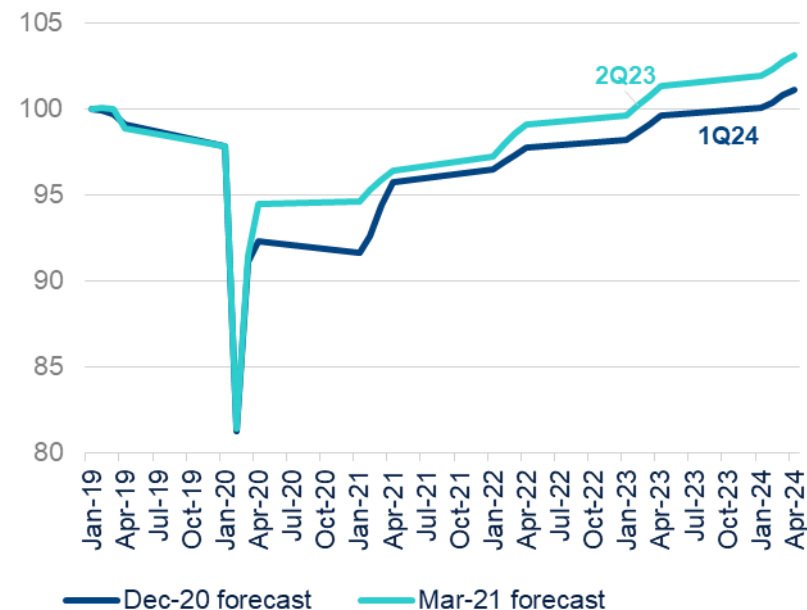
(INDEX 2019 = 100)



Source: BBVA Research, INEGI.

GDP

(INDEX 1Q19 = 100)

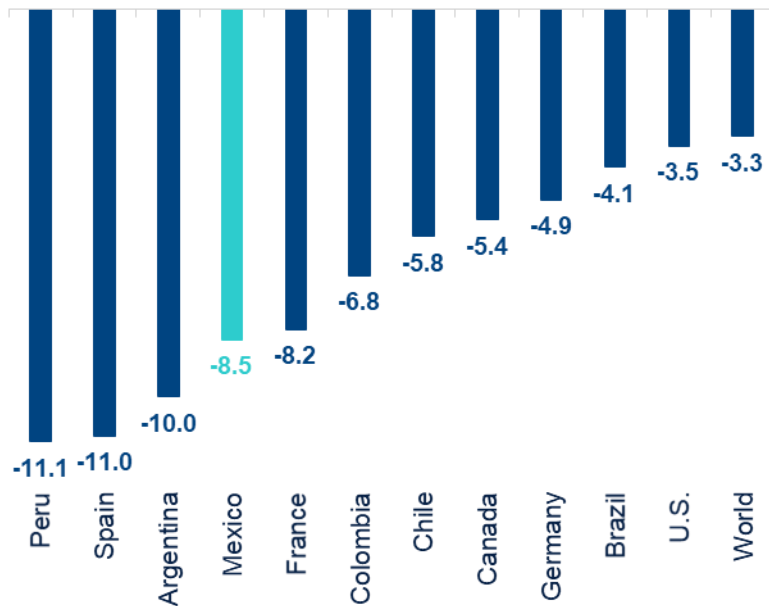


Source: BBVA Research, INEGI.

The impact of the pandemic on activity was greater in Mexico than in developed economies and LATAM countries such as Brazil, Chile & Colombia

GDP 2020

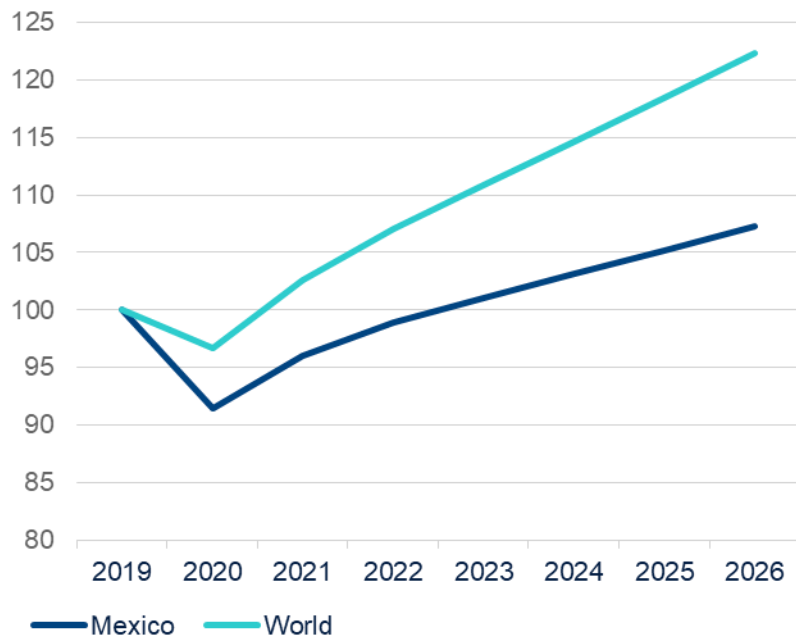
(% REAL ANNUAL CHANGE)



- In 2020, GDP shrank 2.4 times more in Mexico than in the US, and 1.6 times more than in Canada.
- Within the group of comparable LATAM countries, Argentina and Peru recorded the greatest contractions.

Mexico's GDP should reach its pre-COVID level in 2023 (IMF); global recovery should occur in 2021

GDP (INDEX 2019 = 100)

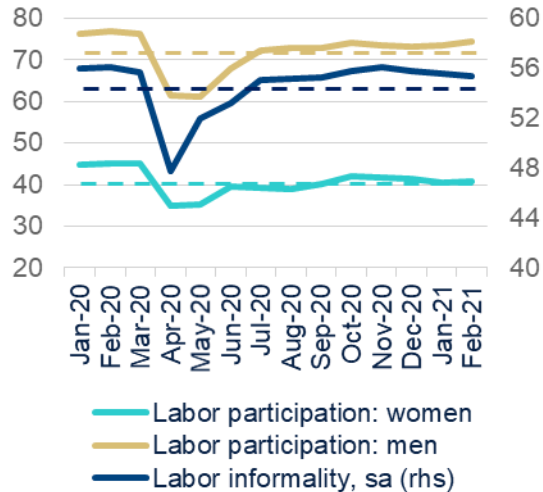


- By 2026, global GDP should exceed 2019 levels by 22.3% (IMF).
- By 2026, Mexico's GDP should exceed 2019 levels by 7.3% (IMF).

The first quarter of the year is dominated by labor market contraction and weak formal job creation by the IMSS (Mexican Social Security Institute)

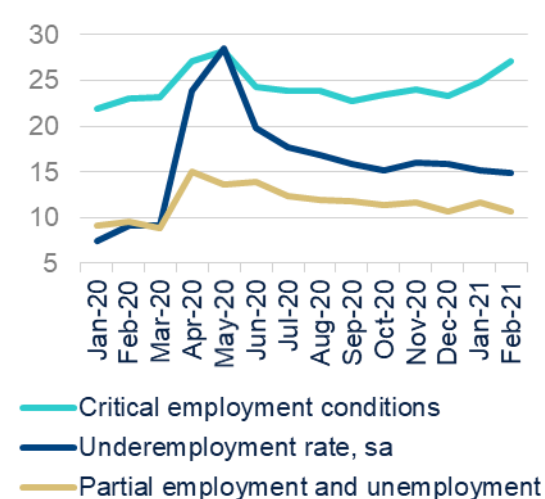
LABOR MARKET RATES

(% EAP, % EMPLOYED)



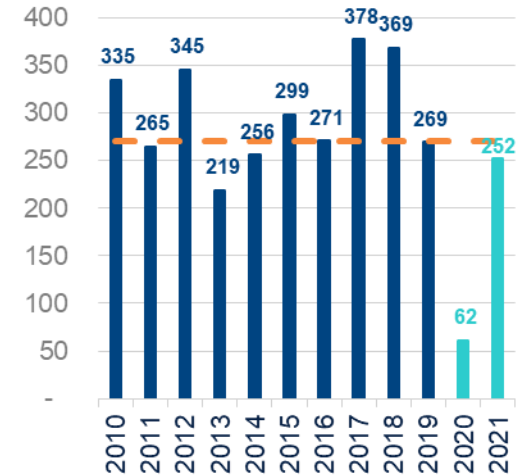
LABOR MARKET RATES

(% EAP, % EMPLOYED)



IMSS FORMAL EMPLOYMENT

(CUMULATIVE CHANGE JAN–MAR, THOUSAND)



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

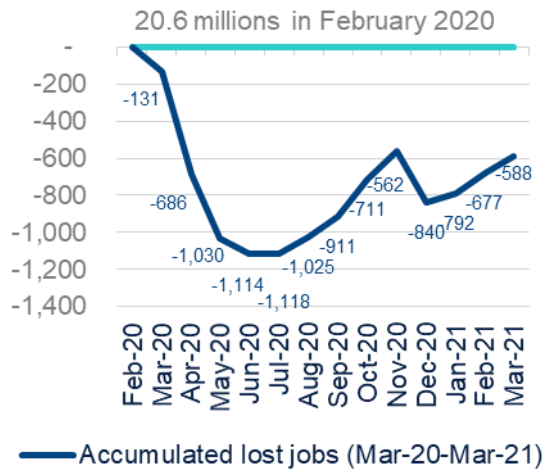
Source: BBVA Research, INEGI.

Source: BBVA Research, IMSS.

Gradual recovery with high levels of informal employment, under-employment, critical employment conditions.

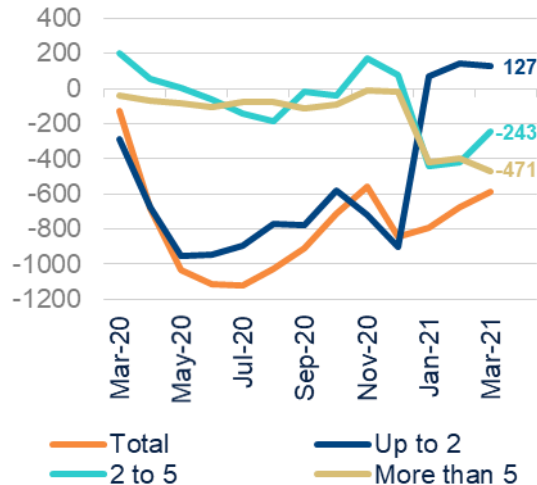
588,000 fewer formal jobs than before the pandemic. Job recovery in low-paying jobs

IMSS FORMAL EMPLOYMENT (CUM. CHANGE*, THOUSAND)



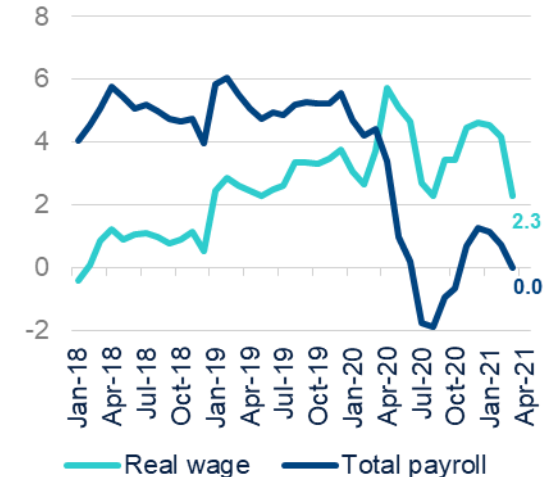
*Cumulative change since March 2020.
Source: BBVA Research, IMSS.

IMSS FORMAL EMPLOYMENT PER MINIMUM WAGE RANGE (CUM. CHANGE*, THOUSAND)



*Cumulative change since March 2020.
Source: BBVA Research, IMSS.

WAGES AND TOTAL PAYROLL (% REAL ANNUAL CHANGE)

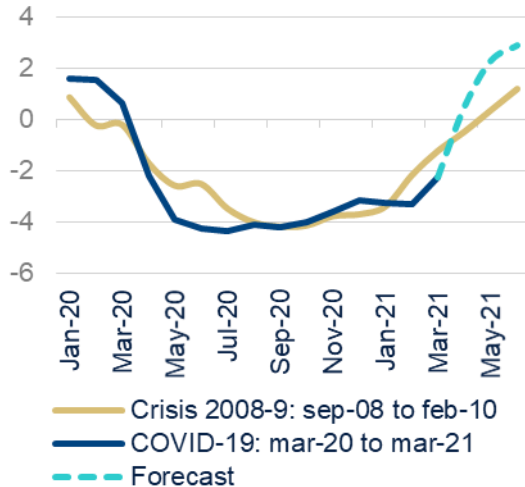


Source: BBVA Research, IMSS.

The slowdown in the real wage rate is partially explained by the performance of inflation and slow job creation, consequently leaving the formal total payroll without a clear path to recovery.

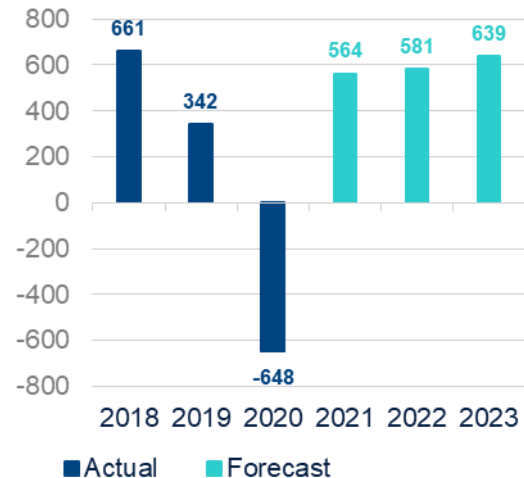
The outlook for IMSS formal job creation is improving; however, we do not expect a return to pre-pandemic levels until 2022

FORMAL EMPLOYMENT (% ANNUAL CHANGE)



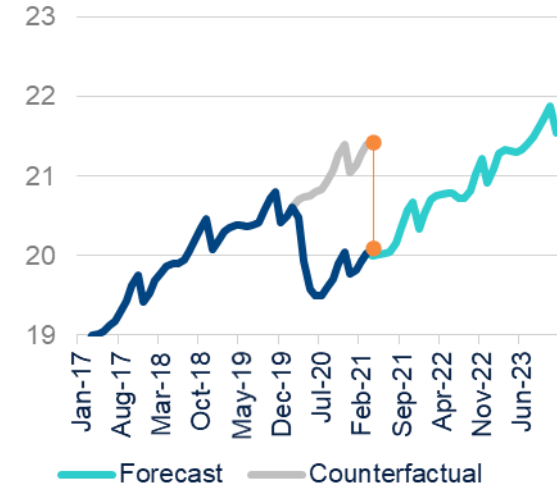
Source: BBVA Research, IMSS.

FORMAL EMPLOYMENT (THOUSANDS, ANNUAL CHANGE TO DEC)



Source: BBVA Research, IMSS.

FORMAL EMPLOYMENT (MILLIONS)



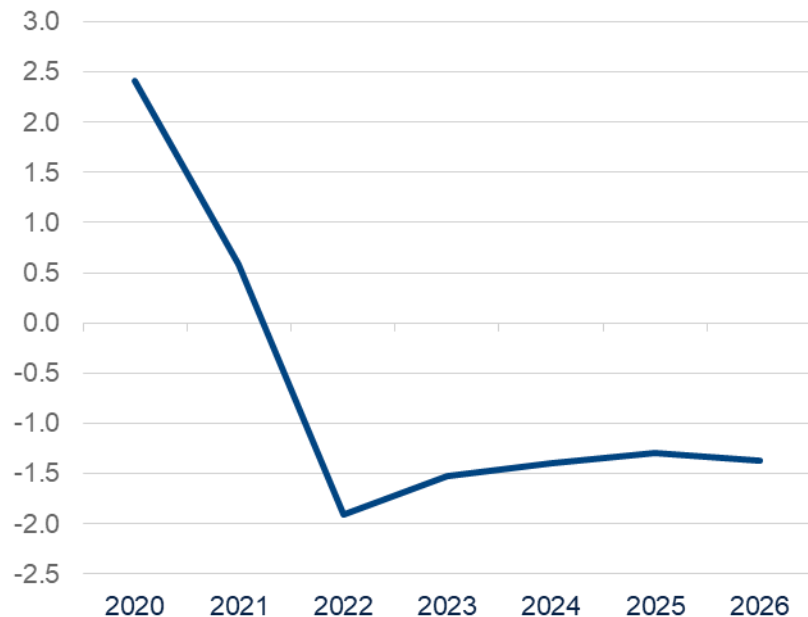
Source: BBVA Research, IMSS.

High year-on-year rates may be seen in the coming months, partially explained by a base effect.

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

CURRENT ACCOUNT FORECASTS FOR 2020–2026

(% OF GDP)



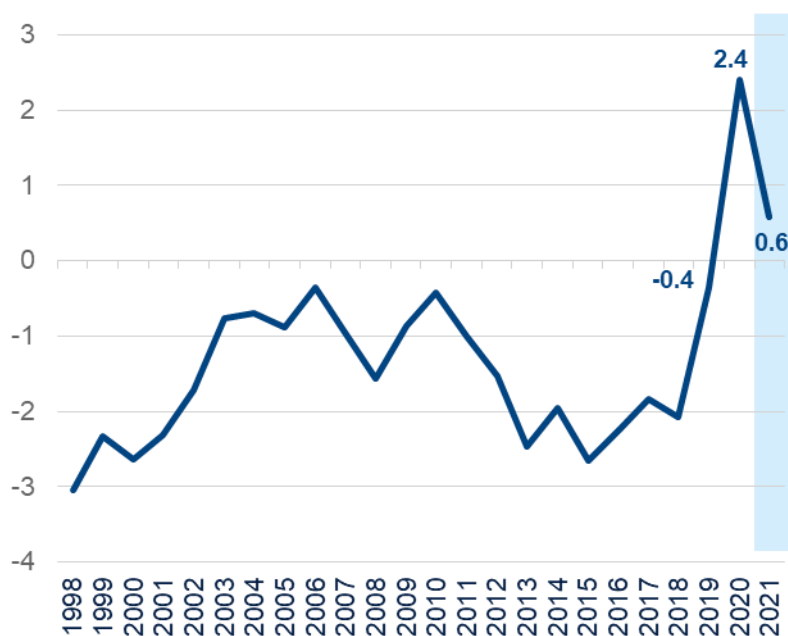
Lower potential growth will stabilize the current account deficit at approx. 1.3% of GDP in the medium term:

- **International remittances at record highs** support domestic demand, but the performance of capital goods imports will remain weak in 2021.
- **USMCA, near-shoring and recovery in global manufacturing** will drive the normalization of intermediate and capital goods imports starting in 2022.

The current account was significantly reversed in 2020 after recording an unexpected surplus during 2H20

CURRENT ACCOUNT

(% OF GDP)



Source: BBVA Research, Banxico.

BREAKDOWN OF GOODS IMPORTS

(% Y/Y)



Source: BBVA Research, INEGI.

Meeting fiscal targets for this year and coming years will be quite a challenge without fiscal reform

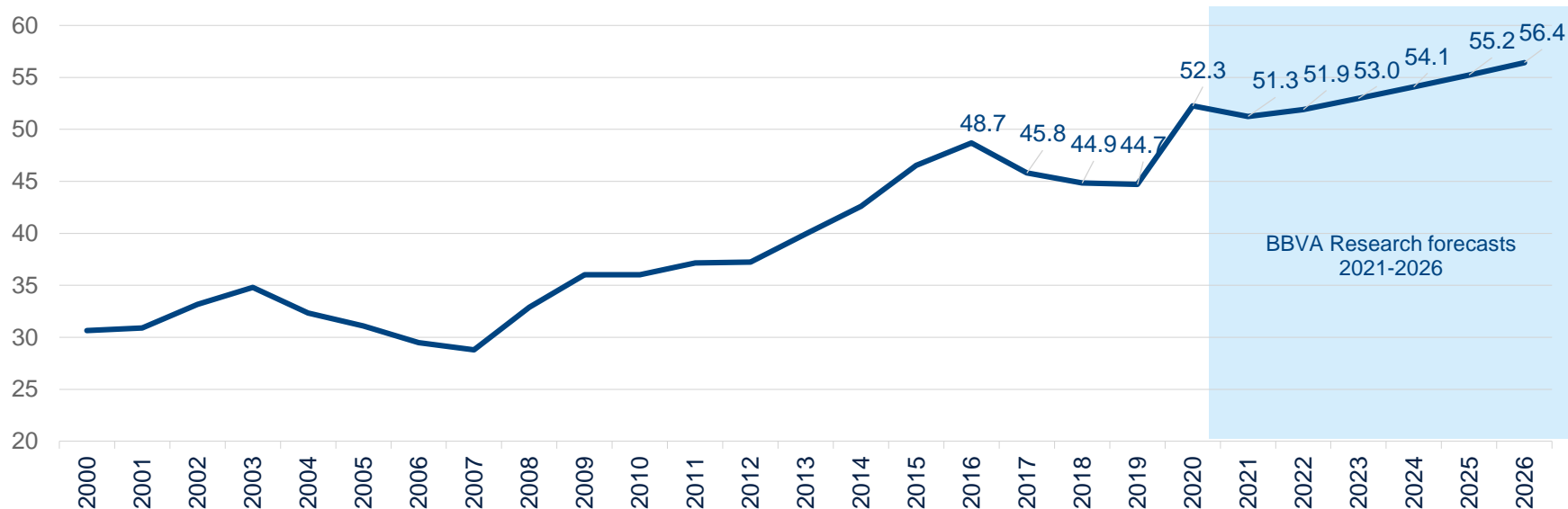
According to the document titled General Economic Policy Preliminary Guidelines for 2022:

- Forecasts for 2021 for the primary balance, public sector borrowing requirements (PSBR) and public debt are 0.0%, -3.3% and 51.4% of GDP respectively.
- For 2022, the corresponding forecasts are 0.6%, -2.9% and 51.1% of GDP respectively.
- The expected trend for public debt is estimated to be 49.9% of GDP in 2026.
- The federal government will continue to support Pemex in repaying its debts as long as there is additional income from the tax structure and government finances are not affected.

Public debt will rise to 56% of GDP by 2026 unless there is fiscal reform to boost tax revenue

HISTORICAL BALANCE OF PUBLIC SECTOR BORROWING REQUIREMENTS

(% OF GDP)



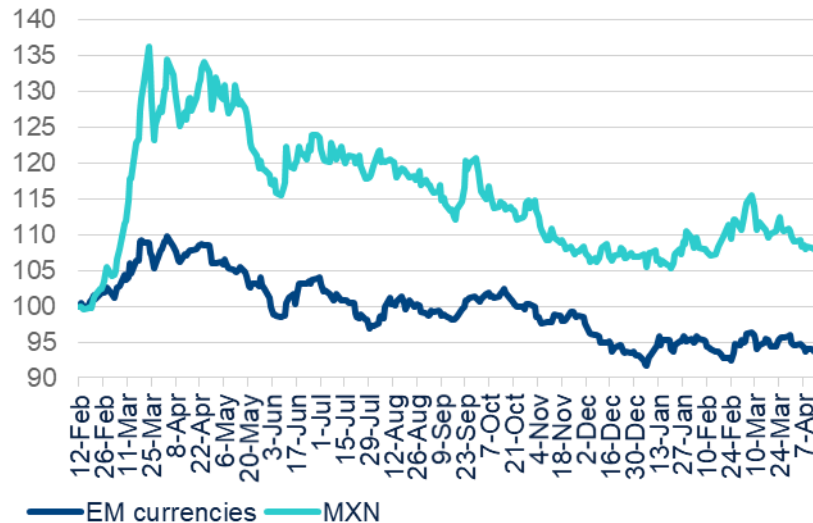
03

Relative strength of the peso

Peso shows stronger relative performance, but it still lags behind the average performance of EM currencies since February 2020

RELATIVE PERFORMANCE OF THE MXN COMPARED TO OTHER EM CURRENCIES SINCE FEBRUARY 2020*

(INDEX, FEBRUARY 12, 2020 = 100)

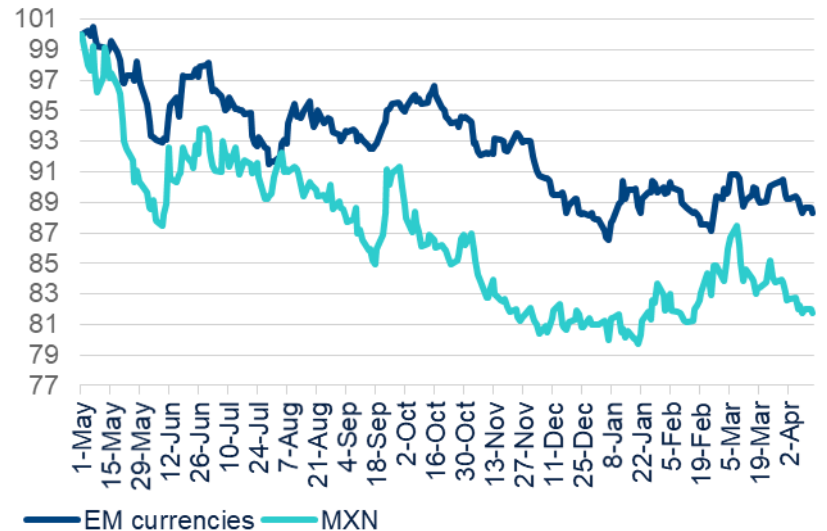


Based on a new weighting of the JP Morgan Emerging Markets Currency Index after removing the MXN; own calculations.

Source: BBVA Research, Bloomberg.

RELATIVE PERFORMANCE OF THE MXN COMPARED TO OTHER EM CURRENCIES* SINCE MAY 2020

(INDEX, MAY 1, 2020 = 100)

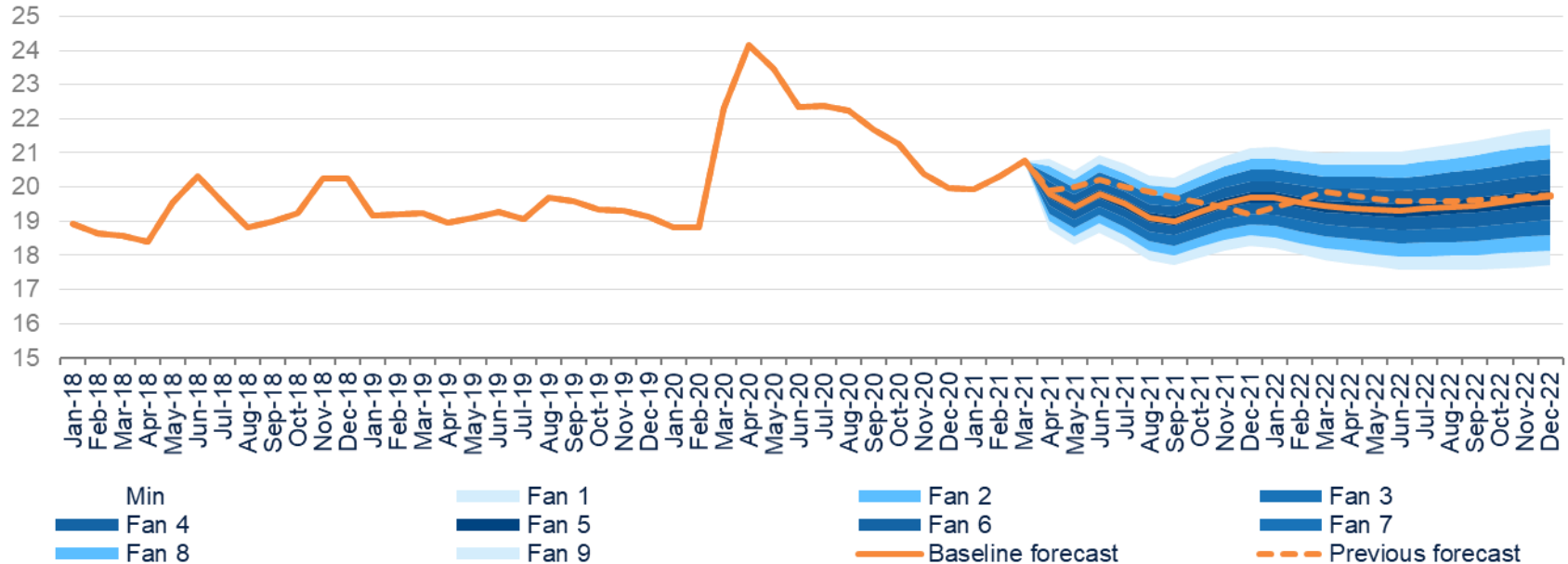


Based on a new weighting of the JP Morgan Emerging Markets Currency Index after removing the MXN; own calculations.

Source: BBVA Research, Bloomberg.

Hope for normality through global vaccination and a pursuit for yields could lead to the MXN appreciating to 19.70 pps by year-end

EXCHANGE RATE (PESOS/USD)



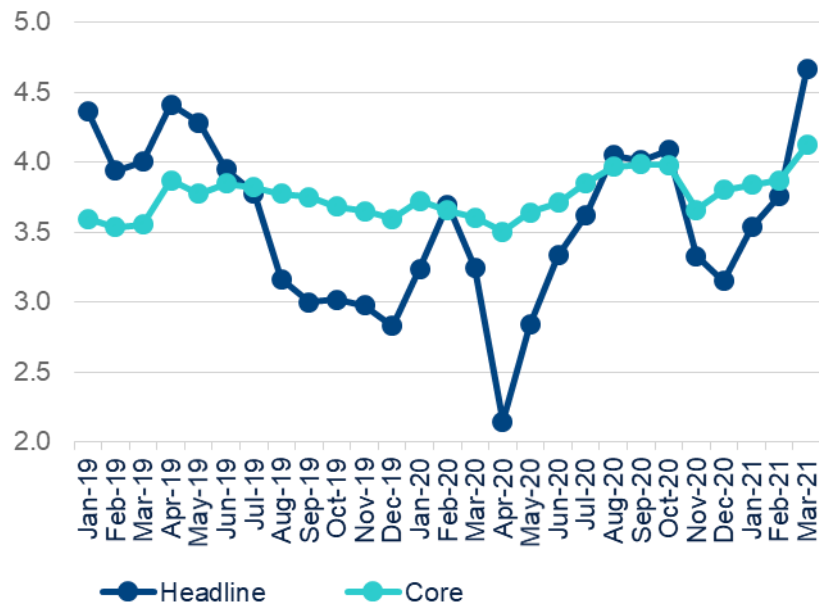
04

Banxico began
a lengthy pause

Rising energy prices continue to raise headline inflation; core inflation unexpectedly exceeded 4.0% in March

HEADLINE & CORE INFLATION

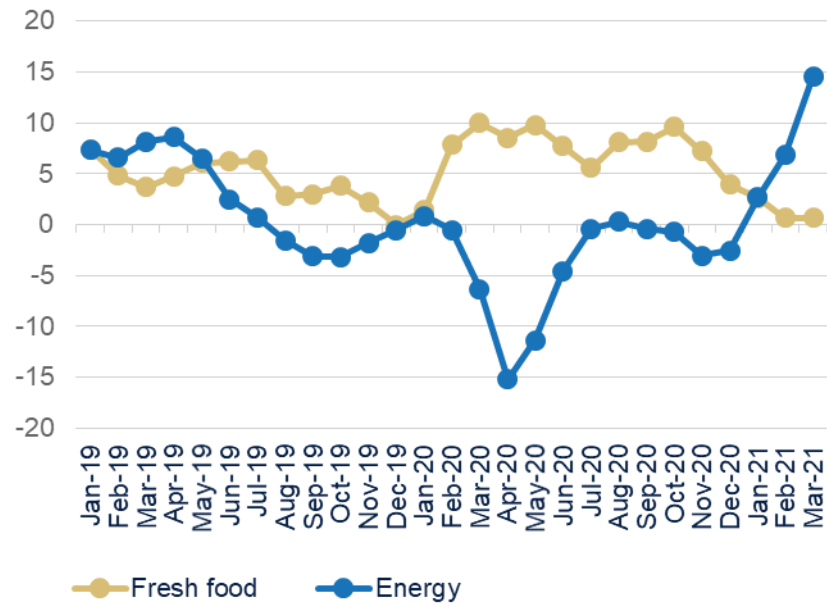
(Y/Y CHANGE %)



Source: BBVA Research, INEGI.

NON-CORE INFLATION: FRESH FOOD AND ENERGY

(Y/Y CHANGE %)

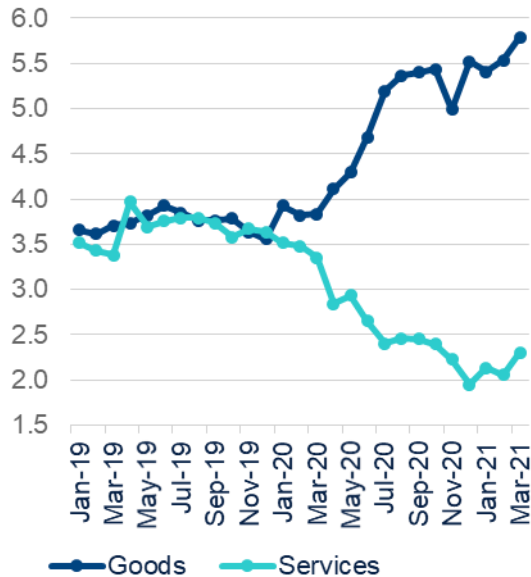


Source: BBVA Research, INEGI.

Service inflation drops but pressure remains on goods inflation; core inflation will slow with changes in relative demand

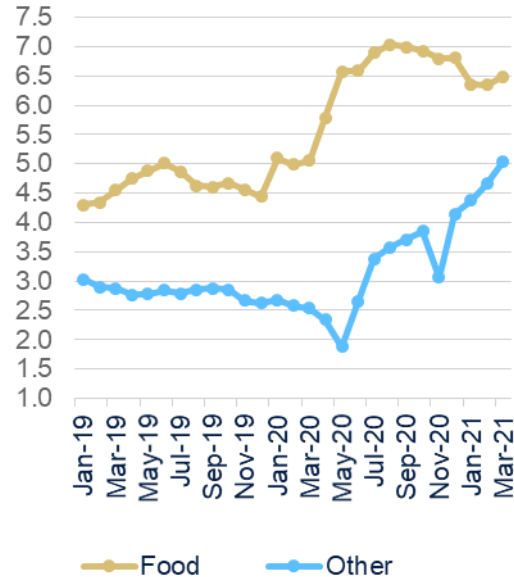
CORE INFLATION: GOODS VS. SERVICES

(Y/Y CHANGE %)



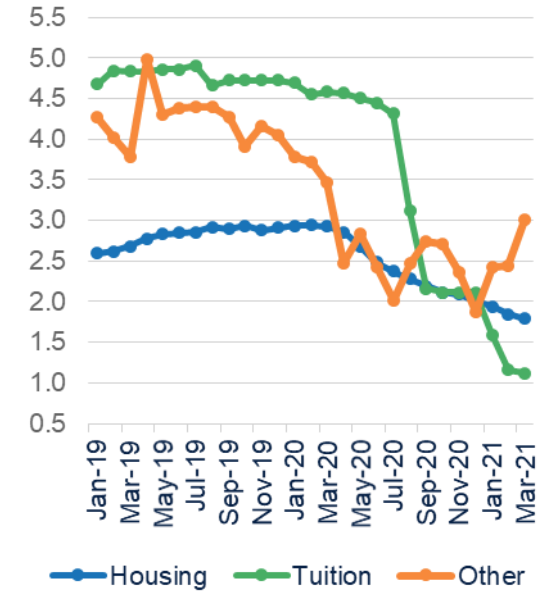
GOODS: FOOD AND OTHERS

(Y/Y CHANGE %)



SERVICES: HOUSING, EDUCATION AND OTHERS

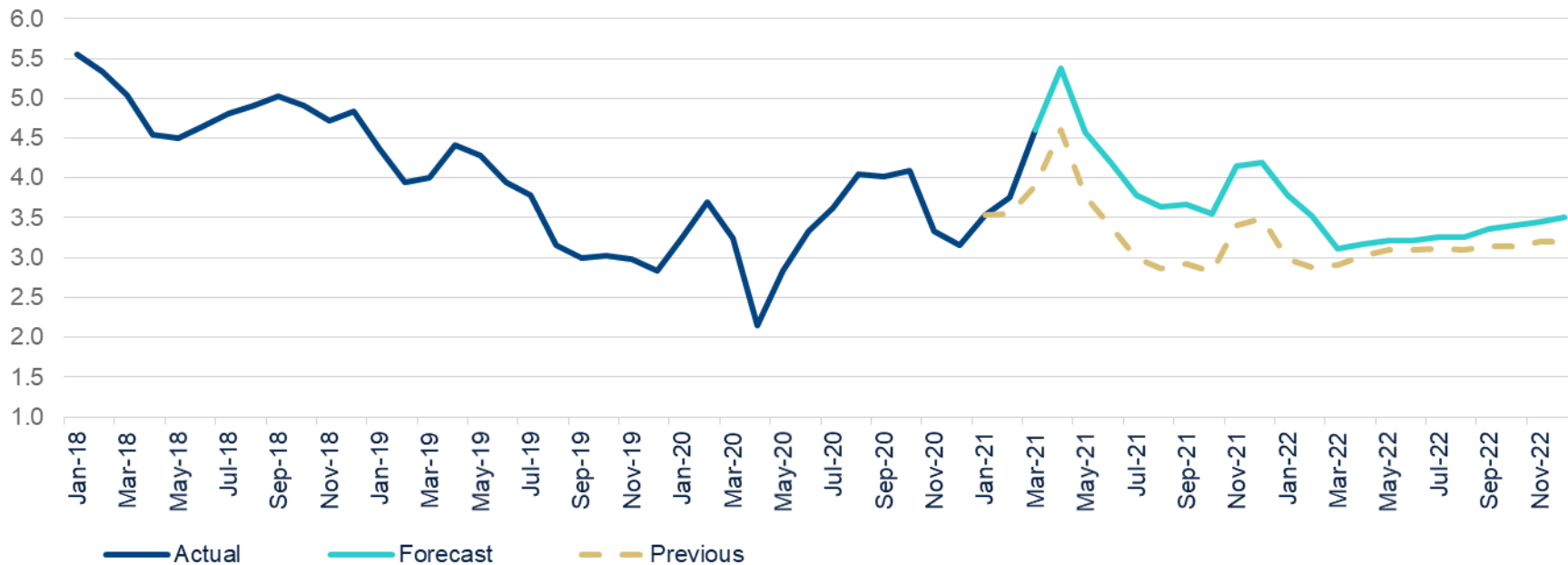
(Y/Y CHANGE %)



Headline inflation will peak in April, but will stand below 4.0% in Q3 before rising to 4.2% at year-end

HEADLINE INFLATION FORECASTS

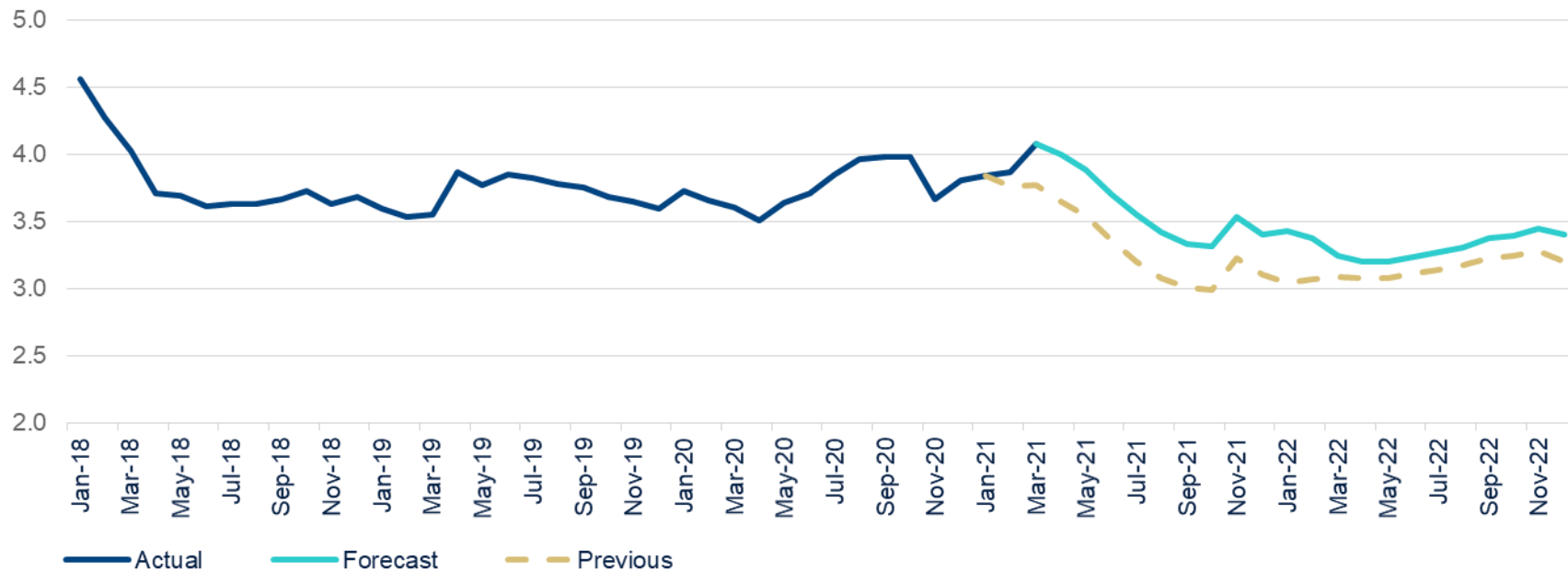
(Y/Y CHANGE %)



We continue to predict a gradual decline in core inflation, but expect slightly higher levels by year-end

CORE INFLATION FORECASTS

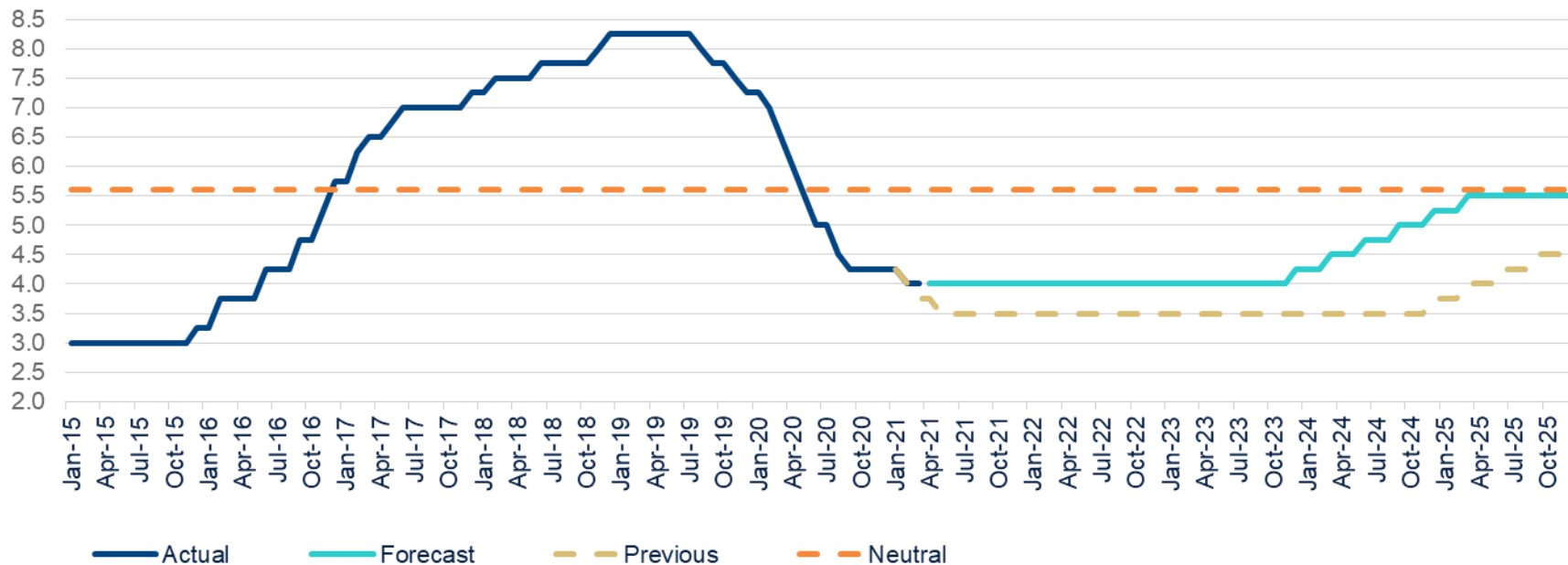
(Y/Y CHANGE %)



The Banxico Governing Board will be in no hurry to start a potential cycle of rate increases

OUTLOOK FOR THE MONETARY RATE

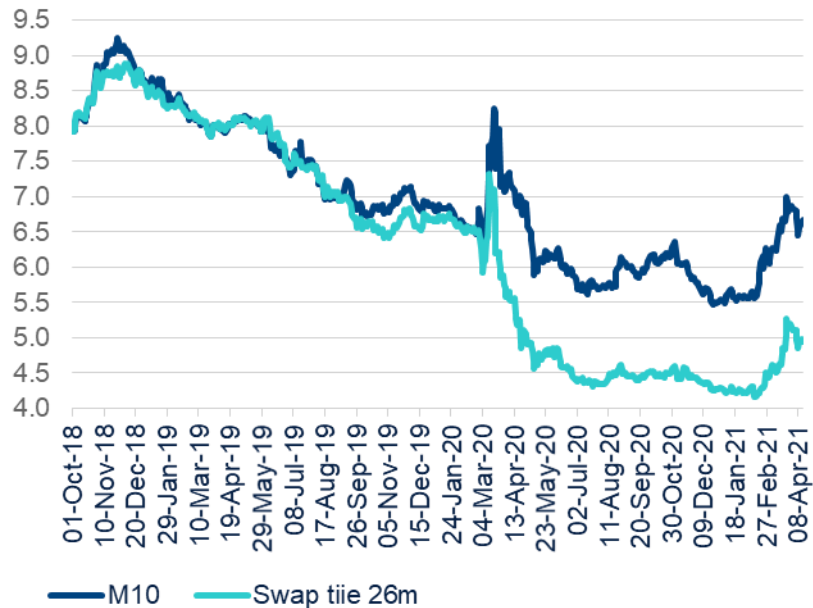
(%)



Long-term rates have increased due to rising rates in the US and changes in expectations on monetary policy

MARKET EXPECTATIONS FOR THE MONETARY RATE* AND THE M10 INTEREST RATE

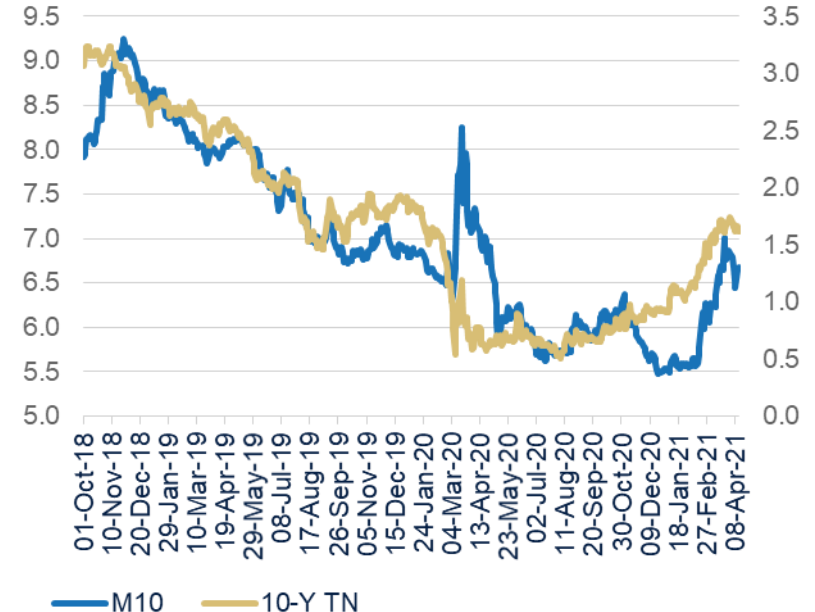
(%, *26-MONTH TIIE SWAP)



Source: BBVA Research, Bloomberg.

LONG-TERM INTEREST RATES, M10 VERSUS 10-YEAR TREASURY NOTE

(%)



Source: BBVA Research, Bloomberg.

05

Conclusions and summary of forecasts

Conclusions and forecasts

Partial and gradual rebound in GDP.

- We have revised our growth forecast for 2021 upward to 4.7% from 3.2%; upward trend due to recent 1Q21 data.
- The US will drive Mexico's growth; further acceleration subject to faster vaccine rollout.
- Upward trend for 2022 (current forecast: 2.8%), albeit cautious in view of a challenging domestic situation.
- We expect that the pace of job creation will gain traction in 2H21 as the economy normalizes. We expect formal private employment to return to the pre-pandemic level in 4Q22.

Banxico began a lengthy pause.

- We expect headline inflation of 4.2% by year-end (below 4.0% in Q3), with core inflation falling to 3.4%.
- Banxico's flexibility cycle has come to an end, but they are clearly not considering raising rates.
- The Banxico Governing Board is in no hurry to start a cycle of rate increases, so a lengthy pause will follow.
- We expect the monetary rate to remain at 4.00% throughout 2021 and 2022; a more dovish scenario compared to market expectations.

21 Hopes for normality linked to global vaccine rollout and the pursuit for yields could lead to the MXN appreciating to 19.70 ppp by year-end.

- Expectations of a current account surplus for 2021 also foster the appreciation of the MXN.

Public finances: Public debt (as a % of GDP) will increase to 56% of GDP by 2026 if no fiscal reform is introduced to increase tax revenues.

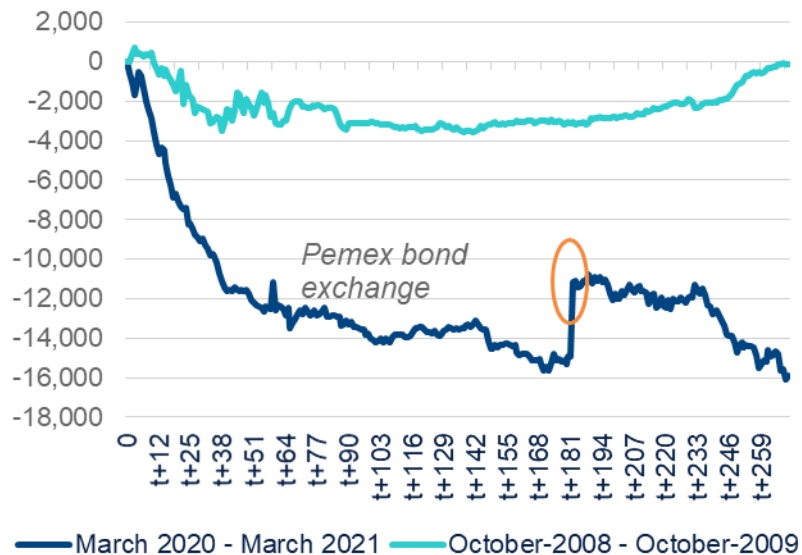
Forecasts

		2019	2020	2021	2022	2023
GDP (YY change %)	new	0.0	-8.5	4.7	2.8	2.3
	previous			3.2	3.8	1.9
Employment (%, end of period)	new	1.7	-3.2	2.8	2.9	3.0
	previous			1.8	2.7	3.3
Inflation (%, end of period)	new	2.8	3.2	4.2	3.5	3.5
	previous			3.5	3.2	3.2
Monetary rate (%, end of period)	new	7.25	4.25	4.00	4.00	4.25
	previous			3.50	3.50	3.50
Exchange rate (ppd, end of period)	new	18.9	19.9	19.7	19.7	20.0
	previous			19.2	19.8	19.7
M10 (%, end of period)	new	6.89	5.5	6.50	7.15	7.50
	previous			5.2	5.8	6.5
Fiscal balance (PSBR, % GDP)	new	-1.6	-2.9	-3.0	-3.0	-3.0
	previous			-3.0	-2.1	-2.1
Current account (% of GDP)	new	-0.1	2.8	0.6	-1.9	-1.5
	previous			1.1	-1.9	-1.5

The mass sale of M bonds resumed following the increase in long-term rates. A year later, this sale outstrips that of the global financial crisis

CUMULATIVE CHANGE IN FOREIGN HOLDING OF M BONDS

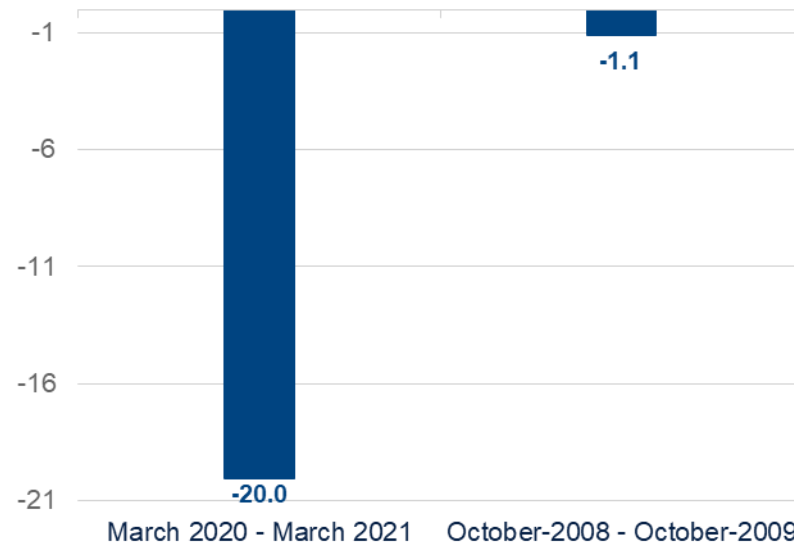
(USD MILLIONS, NOMINAL VALUE)



As of March 30.
Source: BBVA Research, Banxico.

CUMULATIVE CHANGE IN FOREIGN HOLDING OF M BONDS

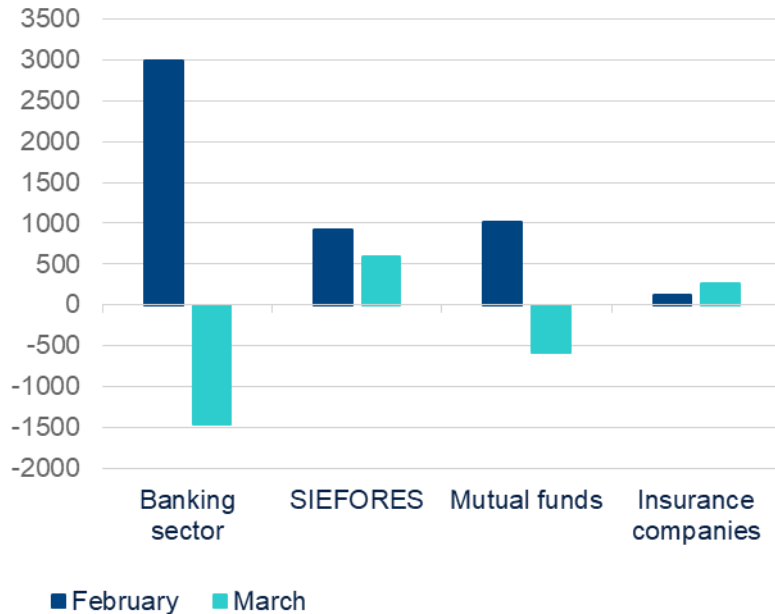
(% MXN, NOMINAL VALUE)



As of March 30.
Source: BBVA Research, Banxico.

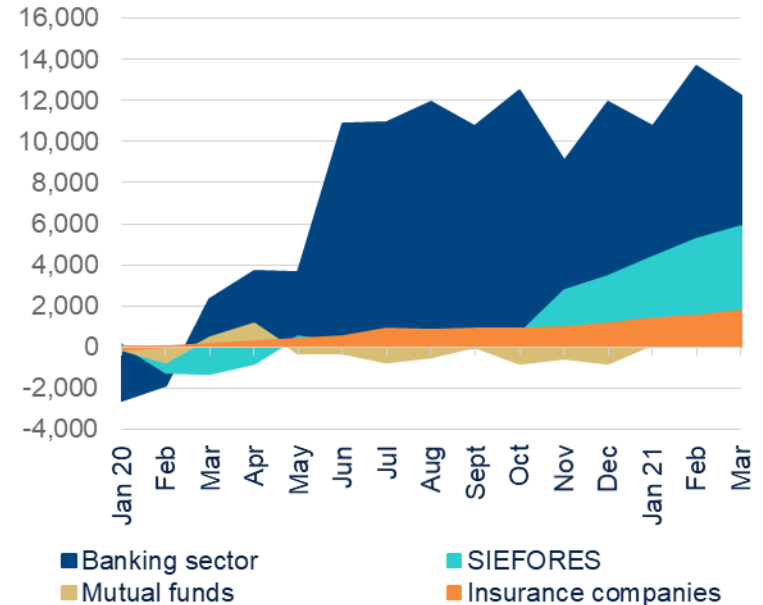
The increase in long-term rates attracted pension fund managers and insurance companies in March. Banks and investment funds sold M bonds

CHANGE IN DOMESTIC HOLDING OF M BONDS (USD MILLIONS, NOMINAL VALUE)



As of March 30.
Source: BBVA Research, Banxico.

DOMESTIC HOLDING OF M BONDS, CUMULATIVE CHANGE (USD MILLIONS, NOMINAL VALUE)



As of March 30.
Source: BBVA Research, Banxico.

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Mexico Economic Outlook

2Q21