Mexico economic outlook

4Q21
Downward revision to our GDP growth forecast for 2021

Expected improvement in 2022
The COVID vaccine rollout in Mexico remains one of the slowest in the world.

Source: BBVA Research/Our World in Data.
Bottlenecks represent a brake on manufacturing

**LIGHT VEHICLE SECTOR**
(UNITS AND CAPACITY USED %)

**INDUSTRIAL OUTPUT**
(INDEX, JAN/2020=100)

**OUTPUT VALUE**
(INDEX, JAN/2021=100)

Source: BBVA Research/INEGI.
Consumption decelerates in 2H21; the boost from the reopening fades and negative impact from the Delta variant. Better outlook for 2022

*Closing date: September 30, 2021.
Source: BBVA Research/INEGI.
Slow investment growth in 3Q21; set to regain dynamism in 1H22 but still the weakest component of domestic demand

*Closing date: September 30, 2021. Source: BBVA Research/INEGI.
FDI (13% of GFCF) linked to value chains; domestic investment (87% of GFCF) goes to the tertiary sector

Source: BBVA Research/INEGI.
FDI in electricity projects fell 73% year-on-year in 2019 while FDI in manufacturing remained stable during 2017–2019

FDI in electricity projects fell 73% year-on-year in 2019 while FDI in manufacturing remained stable during 2017–2019

* The 2013 Model Group sale was excluded from the series
Source: BBVA Research, SE
Downward revision to our GDP growth forecast for 2021 to 6.0% (6.3% previously); upward revision for 2022 to 3.2% (3.0% previously)

Source: BBVA Research/INEGI.
Recovery in Mexico is slower than in other Latin American countries

GDP (MILLIONS OF MXN, SA)

CHANGE IN ECONOMIC ACTIVITY FROM FEB/2020 TO JUL/2021 (CAPITAL ECONOMICS) (%)

CURRENT VS PRE-PANDEMIC FORECASTS (% Y/Y CHANGE, SA)

Source: BBVA Research/INEGI/Capital Economics.
Incomplete labor market recovery. Risks persist in the face of a scenario of less economic growth and uncertainty due to COVID-19.

The recovery of the labor market is characterized by high levels of labor informality, underemployment, and an increase of low-quality jobs since the beginning of 2019.
3Q21 with unprecedented formal job creation in the last 24 years. Positive effects of the reform to eliminate outsourcing are identified.

As we anticipate employment near the pre-pandemic level, however, we still expect a negative seasonal adjustment in December, leaving the employment level close to 20.6 million workers in February 2020.
Positive effect on permanent employment after implementation of the reform to eliminate outsourcing

We estimate that since July 2021 more than 11.5% of formal workers may have changed their employment contract status as a result of the outsourcing reform, giving a strong boost to permanent employment during 3Q21.
At the aggregate level, the outsourcing reform has not had a negative impact on real wages or the total wage bill ...

... but we identified an adjustment in employment due to the minimum wage (MW) range in September; employment growth in the 2 to 5 MW category and fall in the more than 5 MW category. Despite the September inflation figure, real wages and the total wage bill remained above their pre-pandemic levels.
Given the recent employment growth, our outlook for the end of the year has improved. We are still far from the pre-pandemic trend (-1.3M)

We still expect a negative adjustment in employment in December; however, the reform to eliminate outsourcing could offset the adjustment.
The target for the 2021 primary balance will be easily achieved

PUBLIC AND PRIMARY BALANCES OBSERVED VS. PLANNED IN 1H21
(MILLIONS OF MXN)

PUBLIC AND PRIMARY BALANCES OBSERVED IN JANUARY–AUGUST 2021
(MILLIONS OF MXN)

Source: BBVA Research/SHCP
The 2022 economic package reinforces the commitment to fiscal discipline without creating or increasing taxes

- **Economic package**: The economic package proposes a primary deficit target of 0.3% of GDP and seeks to stabilize public debt at 51.0% of GDP.

- **Oil production**: The SHCP is forecasting a realistic oil production estimate with an average of 1.83 million barrels a day for next year.

- **Economic growth**: The 4.1% forecast for economic growth in 2022 is optimistic compared to our forecast of 3.2% and the consensus of economic analysts and other institutions, although it is in line with the IMF's forecast.

- **Tax revenue**: The forecast of higher tax revenues is based on tax collection improvements and simplification measures with more supervisory authority for tax compliance.

- **Fiscal pressures**: Fiscal pressures will increase over time due to the payment of pensions and retirement benefits, which will represent 22.3% of discretionary spending.

- **Federal government**: The federal government bought USD 7 billion from Banxico's international reserves and announced that it would be used to pay down Pemex's debt. This reinforces the view that Pemex's debt is government-backed.
Public debt (% of GDP) will remain stable in the medium term. The loss of investment grade appears highly unlikely in 2022–23.

HISTORICAL BALANCE OF PUBLIC SECTOR BORROWING REQUIREMENTS (% OF GDP)

Source: BBVA Research/SHCP
The initiative seeks to reverse the 2013 energy reform. If approved, it would damage competition, investment and sustainability

The current model is based on auctions managed by CENACE based on cost criteria, the balance between supply and demand, and everyone receiving the highest price

The initiative strengthens CFE at the expense of private competitors

- Private producers generate electricity on average 23.6% cheaper than the state-owned electricity company, CFE, which can be more than twice as expensive and more polluting

- The amendment guarantees CFE a 56% market share in electricity generation. It currently has 38%
- The independent energy regulators would disappear and their functions would be transferred to the Energy Ministry (Secretaría de Energía).
- CENACE, the institution that guarantees fair access to the infrastructure, would become part of CFE
- CFE would become a state company
- Existing contracts, permits and clean energy certificates would be canceled
- The CFE would be vertically and horizontally integrated with the incorporation of subsidiaries
- The government would have full control over lithium mining
The initiative seeks to reverse the 2013 energy reform. If approved, it would damage competition, investment and sustainability

- Damage to consumers and businesses with higher prices due to the greater market share of a less efficient company
- Huge fiscal risk
- It reduces incentives for investment, because performance is limited by law and not by competition. Uncertainty grows because of changes to rules and contract cancellations
- A sustainability regression: impossible to meet international commitments
- A lithium mining monopoly will mean inefficiencies

International treaties

- The proposal violates Chap. 14 (Investment) and Chap. 21 (Competition policy) and the USMCA ratchet clause
- Other trade agreements (Europe) and investment protection could be at risk
Inflationary pressures will prove temporary but the preemptive hiking cycle has not yet run its course.
Better relative performance of the peso since the start of Banxico's hiking, but it has weakened nonetheless

PERFORMANCE OF THE PESO COMPARED TO OTHER EMERGING CURRENCIES*
(INDEX FEB 12, 2020 = 100)

PERFORMANCE OF THE PESO COMPARED TO OTHER EMERGING CURRENCIES*
(INDEX DEC 31, 2020 = 100)

* Based on a re-weighting of the JP Morgan Emerging Market Currencies Index after removing the Mexican peso; own calculations. Source: BBVA Research/Bloomberg
We revised our exchange rate forecast to 19.85 from 19.70 pesos per dollar (ppd) by year-end and now expect it to reach 20.90 ppd by the end of 2022.

EXCHANGE RATE (MXN/USD)

Source: BBVA Research/Bloomberg
Higher core inflation explains the recent rise in headline inflation, but the movement is driven mostly by a change in relative prices.

**INFLATION: HEADLINE, CORE AND NON-CORE**  
(YOY % CHANGE)

**RELATIVE PRICES: GOODS/SERVICES**  
(INDEX FEB 2020 = 100)

**FUNDAMENTAL CORE INFLATION***  
(YOY % CHANGE)

Its components respond less to supply shocks and more to factors such as demand and slack in the economy.  
Source: BBVA Research/BANXICO.
Core goods inflation is not easing as core food prices keep climbing. Services inflation returned to higher levels following the reopening of the economy.
Core inflation will not ease until 2Q22; yet, we and the consensus maintain a more *dovish* view than priced in by markets for the monetary policy rate.

**HEADLINE INFLATION FORECASTS**
(YOY % CHANGE)

**CORE INFLATION FORECASTS**
(YOY % CHANGE)

**OUTLOOK FOR THE MONETARY POLICY RATE**
(%, EOP)

Source: BBVA Research, Banxico, Bloomberg and Banamex surveys.
We expect that the recent increase in the level of Mexico's yield curve will tend to moderate toward the end of the year.
Main messages and forecasts
Key points

Downward revision to our GDP growth forecast to 6.0% (previously 6.3%)

- **Weak domestic consumption**: the BBVA Research Big Data Consumption Indicator shows a contraction in private consumption in 3Q21 in the face of the weakening momentum after reopening and the negative impact of the Delta variant.
- **Continuing bottlenecks**: the automotive industry has been affected by persistent semiconductor and other input shortages.
- **Our baseline scenario assumes a gradual return to normal next year**, with an estimated growth for 2022 of 3.2% (compared to the previously forecast 3.0%).
- **The pace of formal job creation (IMSS) has increased in 2H21**, but high levels of labor informality and underemployment prevail.

**Banxico will raise the monetary rate at its next two meetings until it reaches 5.25%**

- Inflation will continue to face upward pressure for rest of the year due to changes in relative prices, but will fall significantly from 2Q22 onwards.

We have revised our forecast for the exchange rate upward to 19.85 from 19.70 ppd by year-end. We now expect it to reach 20.90 ppd by the end of 2022 in the face of a more challenging environment for risk assets with the Fed's tapering.
## Forecasts

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4Q21