BBVA Research

Mexico Economic Outlook

3Q22

Creating Opportunities

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01

Global Economic Outlook 3Q22

Creating Opportunities

In a complex and uncertain environment, central banks have been forced to accelerate rate hikes in order to tackle inflation

RECENT DEVELOPMENTS IN THE WORLD ECONOMY

COMMODITIES
Energy and food prices under heavy pressure due to war in Ukraine

SUPPLY DISRUPTIONS
Persistent bottlenecks due to war and covid mobility restrictions in China

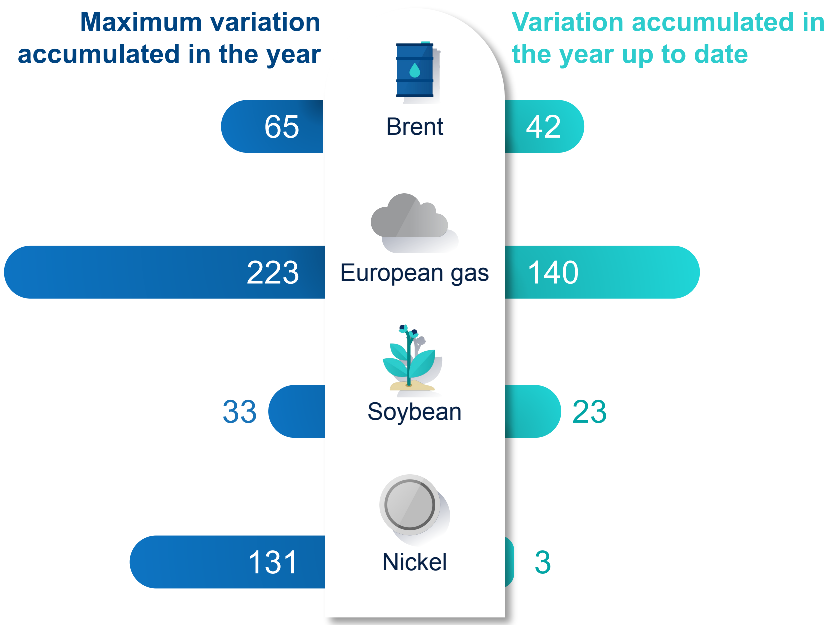
DEMAND RESILIENCE
Robust employment and accumulated savings; weakness caused by covid in China

HIGH, PERSISTENT AND GENERALIZED INFLATION
Prices also pressured by incipient second-round effects and structural factors (such as de-globalization), with a risk of de-anchoring expectations.

MORE AGGRESSIVE CENTRAL BANKS AND FINANCIAL VOLATILITY
Stronger and earlier monetary tightening, particularly in the U.S., to reduce demand, which has kept financial volatility high.

Commodity prices have risen more than expected after the war, despite recent global slowdown concerns

COMMODITY PRICES
(ACCUMULATED PERCENTAGE VARIATION IN THE YEAR UP TO JULY 11, 2022)

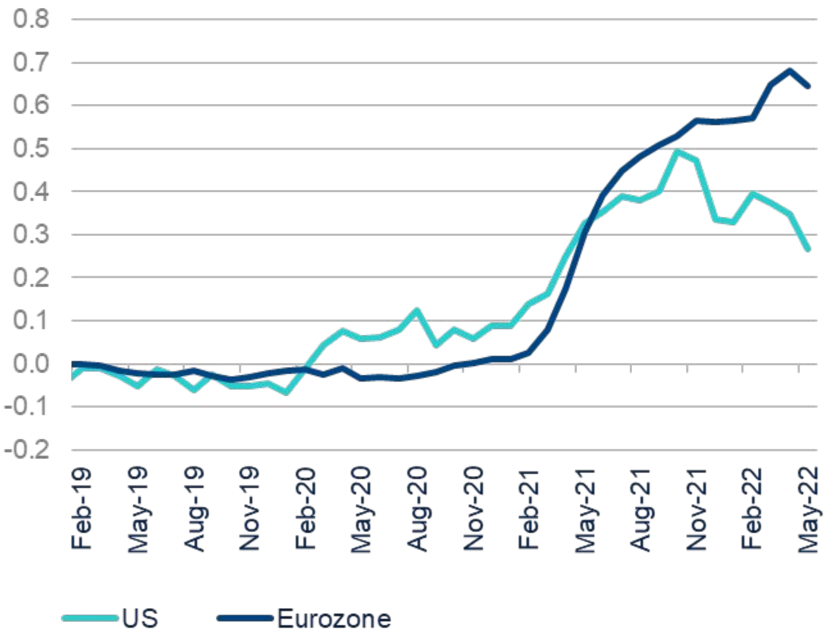


Source: BBVA Research based on data from Haver.

- War and sanctions have pressured commodity prices:
  - oil: affected by sanctions against Russia
  - gas: pressured by fears of supply restrictions by Russia
  - food: impacted by fertilizer prices and disruptions in Ukraine
  - metals: less direct exposure to the war, but pressured by energy transition
- The risk of a sharp global slowdown has recently triggered falls in commodity prices (but not in the gas price in Europe).

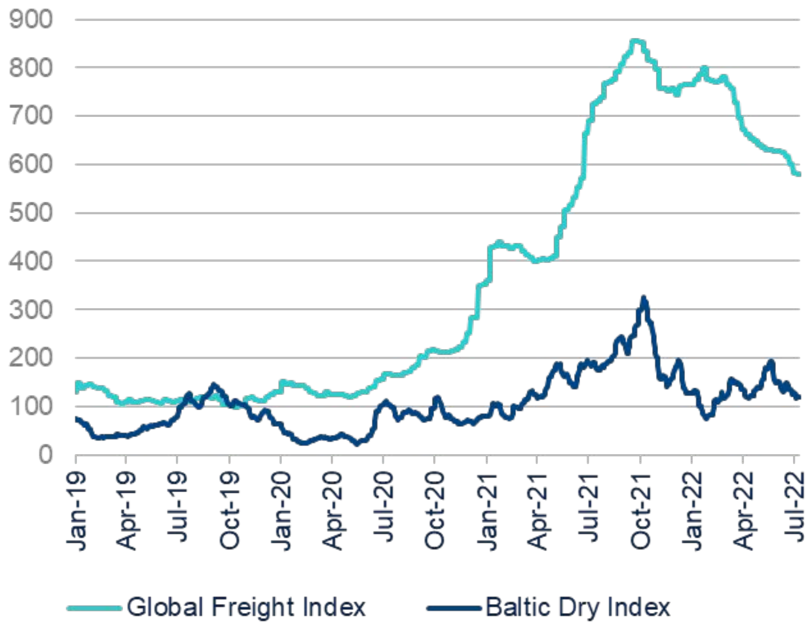
Bottlenecks remain at very high levels, but there are signs of improvement, mainly in the US

BBVA RESEARCH BOTTLENECK INDEX
(INDEX: AVERAGE SINCE 2003 = 0)



Source: BBVA Research.

CONTAINER FREIGHT RATES: GLOBAL AND BALTIC
(INDEX: 2012 = 100)

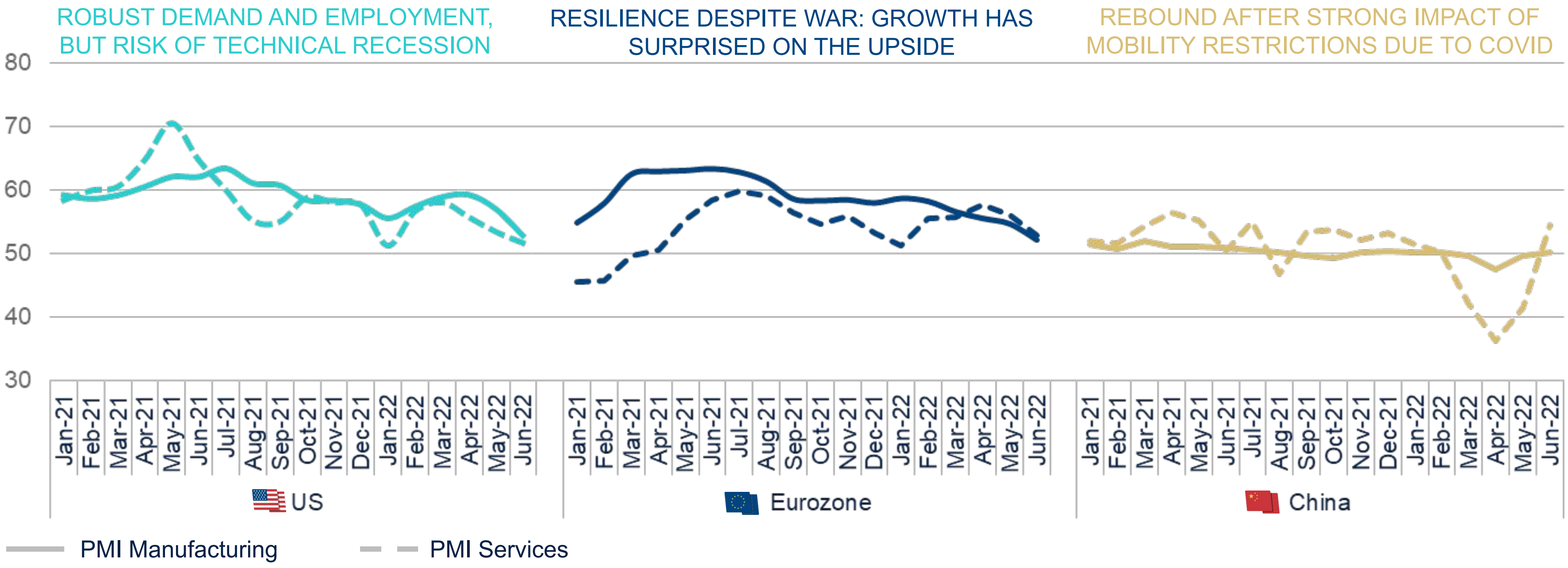


Source: BBVA Research based on data from Haver.

Growth is easing, but demand remains resilient given the high level of accumulated savings and the dynamism of both consumption and services

PMI INDICATORS

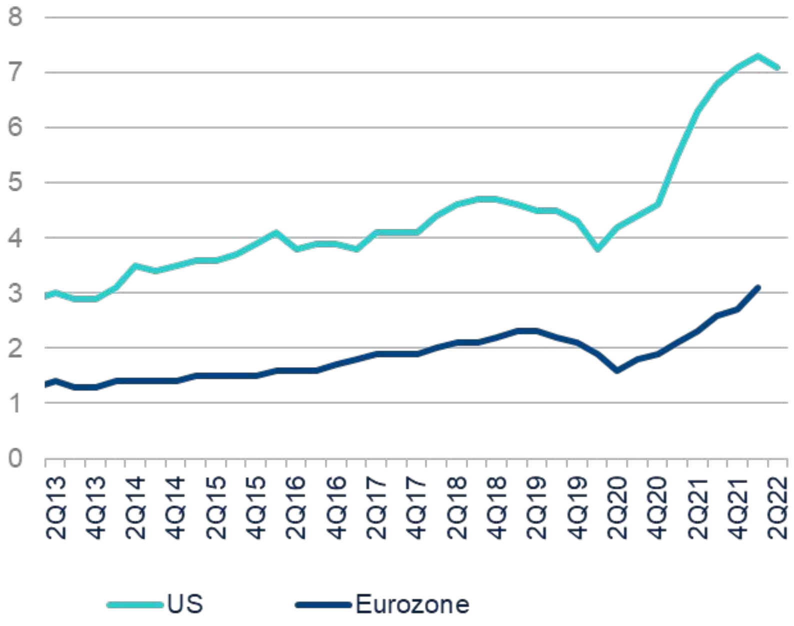
(MORE THAN 50: EXPANSION; LESS THAN 50: CONTRACTION)



Source: BBVA Research based on data from Haver.

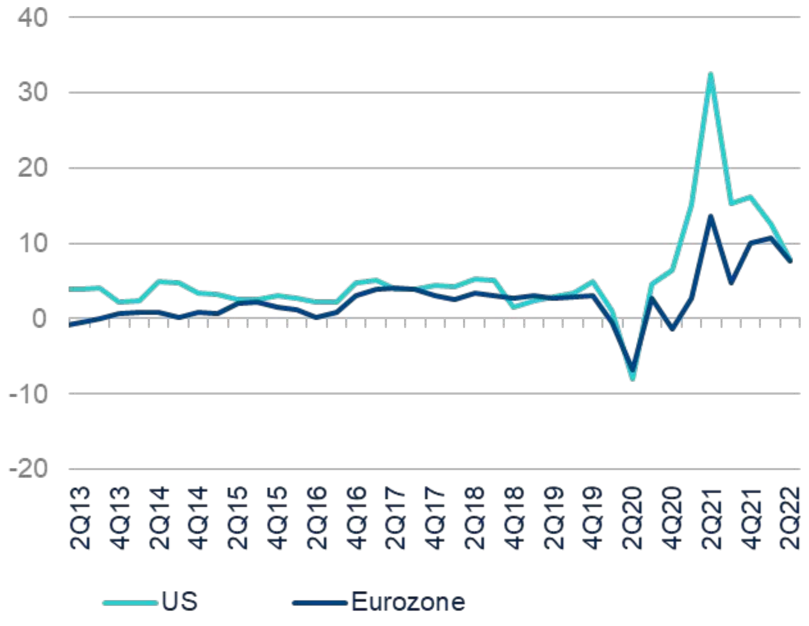
Dynamic labor markets support private consumption, but reinforce concerns about inflationary dynamics

LABOR MARKET: VACANCY RATE
(%, QUARTERLY AVERAGES)



* Vacancies as a proportion of the sum of total employment and the number of vacancies.
Source: BBVA Research based on data from Haver.

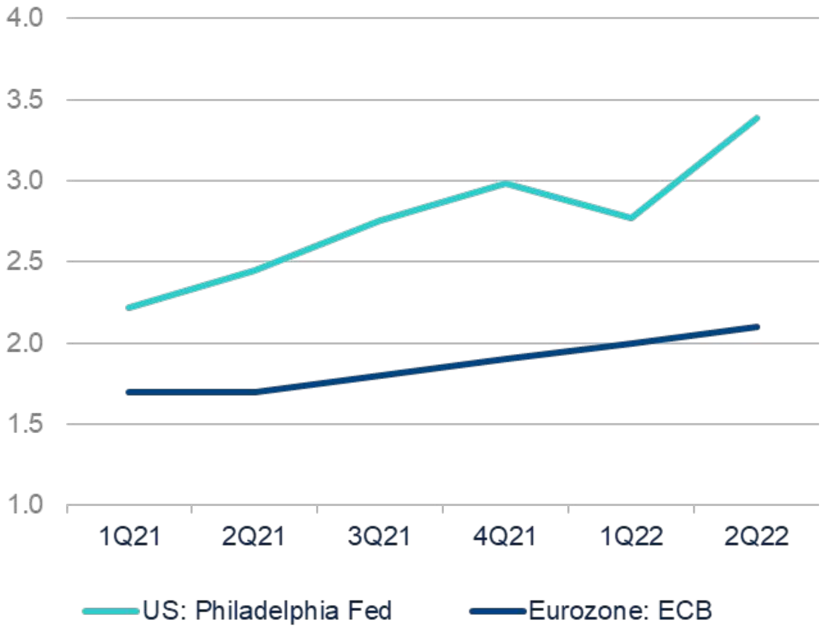
PRIVATE CONSUMPTION: RETAIL SALES
(% Y/Y, QUARTERLY AVERAGES)



Source: BBVA Research based on data from Haver.

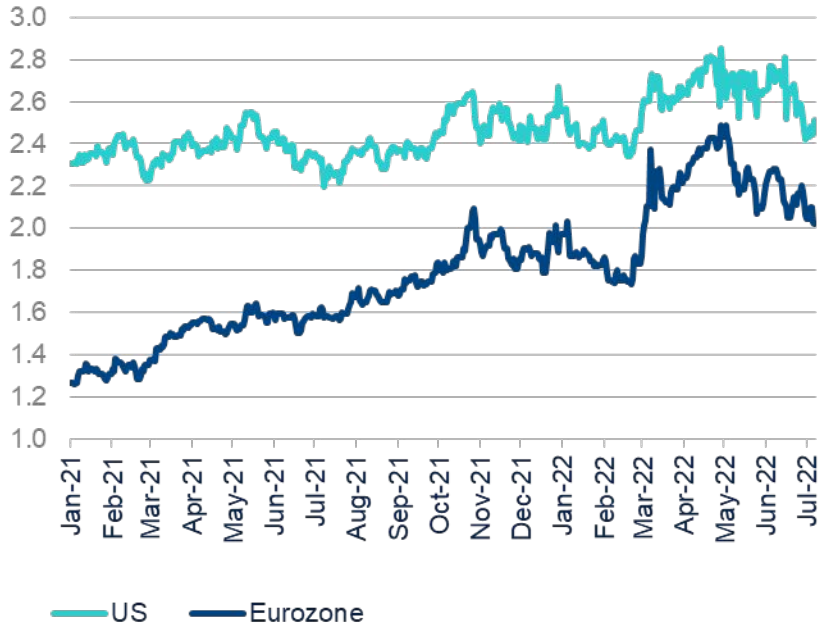
Long-term inflation expectations remain well anchored

5-YEAR INFLATION EXPECTATIONS: ANALYSTS SURVEYS (%)



Source: BBVA Research based on data from the Fed and the ECB.

LONG-TERM INFLATION EXPECTATIONS: MARKETS* (%)

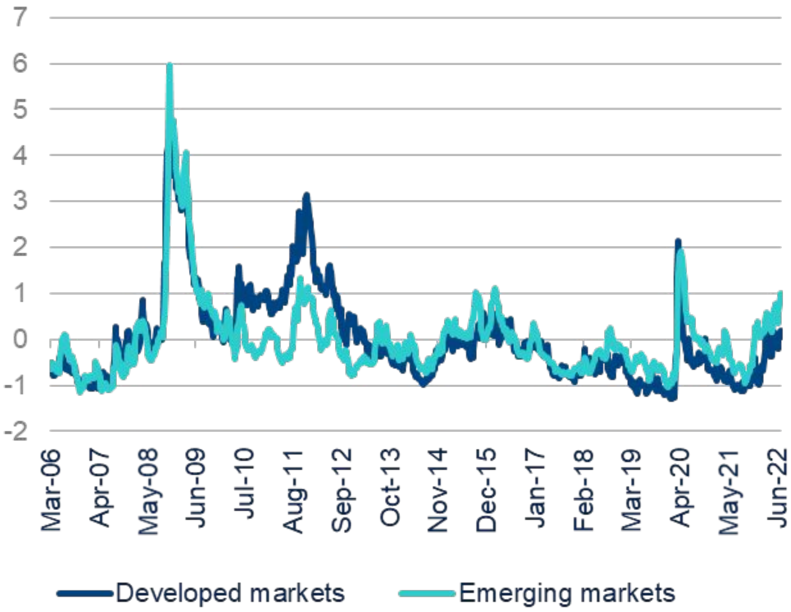


* Based on 5Y5Y forward swaps

Source: BBVA Research based on Haver data.

Central banks hawkish tone in response to rising inflation, in a context of activity slowdown, has increased financial volatility

BBVA RESEARCH FINANCIAL TENSIONS INDEX
(INDEX: AVERAGE SINCE 2005 = 0)



Source: BBVA Research.

- The Fed has raised rates to 1.75% (+150bp since March) and has indicated further significant adjustments in the coming months.
- The ECB has indicated that its rate hike cycle will begin this month and that it will address the risk of fragmentation with flexible PEPP reinvestment and a new instrument.
- Sovereign bond yields have risen sharply since March, although they have recently moderated due to cyclical risk.
- Stock markets have fallen, risk premia have moved higher and the dollar has appreciated.

The interest rate hikes needed to anchor inflation expectations will have a negative impact on activity and cause recessionary episodes

BBVA RESEARCH CENTRAL SCENARIO

MONETARY TIGHTENING
Impact through demand (consumption/investment), financial burdens/wealth, credit...

COMMODITIES
Price pressure will be compounded by gas shortages in the Eurozone (at least in the coming winter).

SUPPLY DISRUPTIONS
In the absence of new negative shocks, supply bottlenecks reduce gradually

GROWTH SLOWDOWN
Mild recessions in the Eurozone, due to gas shortages, and in the U.S., due to interest rate hikes

INFLATION MODERATES SLOWLY
It remains well above inflation target in 2022-23

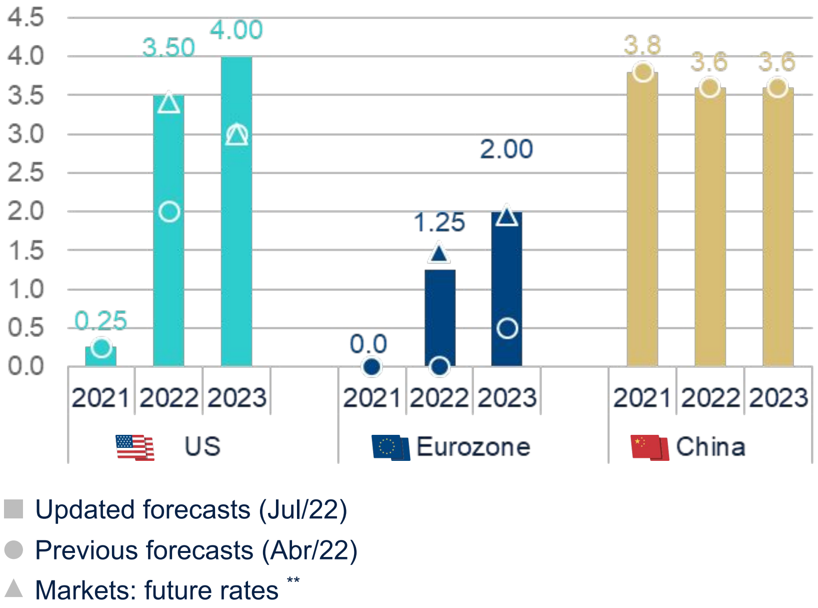
FINANCIAL VOLATILITY
Stronger dollar, higher risk premia, capital outflows from EM

RISKS: BIAS TOWARDS LOWER GROWTH WITH THE POSSIBILITY OF A CRISIS
A more persistent inflation could trigger more negative macroeconomic scenarios

Interest rates will rise more and sooner than expected; they are expected to reach restrictive levels in the US and be close to neutral in the Eurozone

MONETARY POLICY INTEREST RATES*

(%, END OF PERIOD)



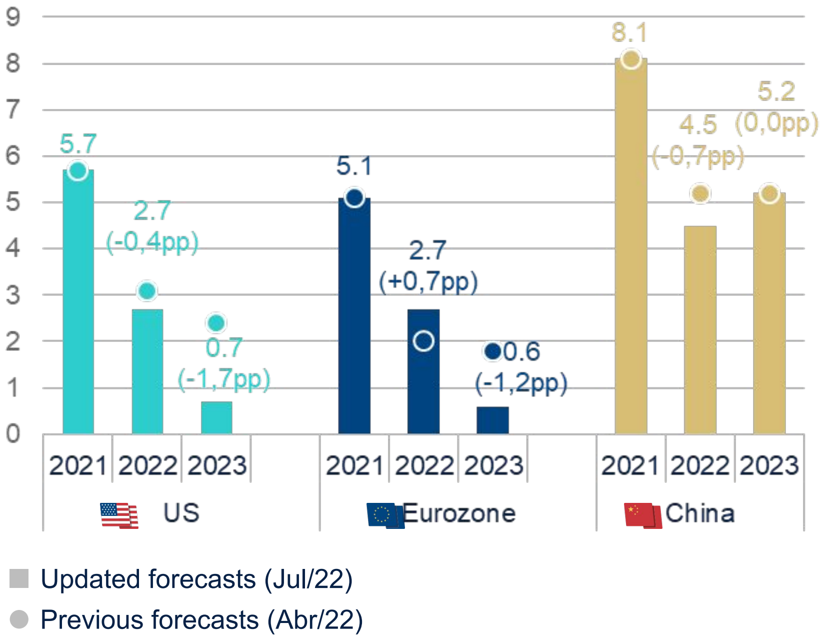
* In the case of the Eurozone, interest rates on refinancing operations.
** Data as of July 11.
Source: BBVA Research based on Bloomberg data.

- The Fed is expected to raise rates to 4.0%, above equilibrium levels (between 2% and 3%), while continuing to reduce its balance sheet.
- The ECB is already starting its rate hike cycle, which will be less aggressive than the Fed's due to lower demand pressures and the risk of financial fragmentation.
- Unlike the US, fiscal policy in the Eurozone will focus on growth, through NGEU funds and the suspension of fiscal rules until 2023.
- In China, policies will continue to exhibit a moderately expansionary tone.

Global slowdown: after growing 6.2% in 2021, world GDP will grow 3.4% in 2022 and 2.5% in 2023 (respectively, 0.6pp and 1.1pp less than expected)

GDP: ANNUAL GROWTH IN REAL TERMS

(%)



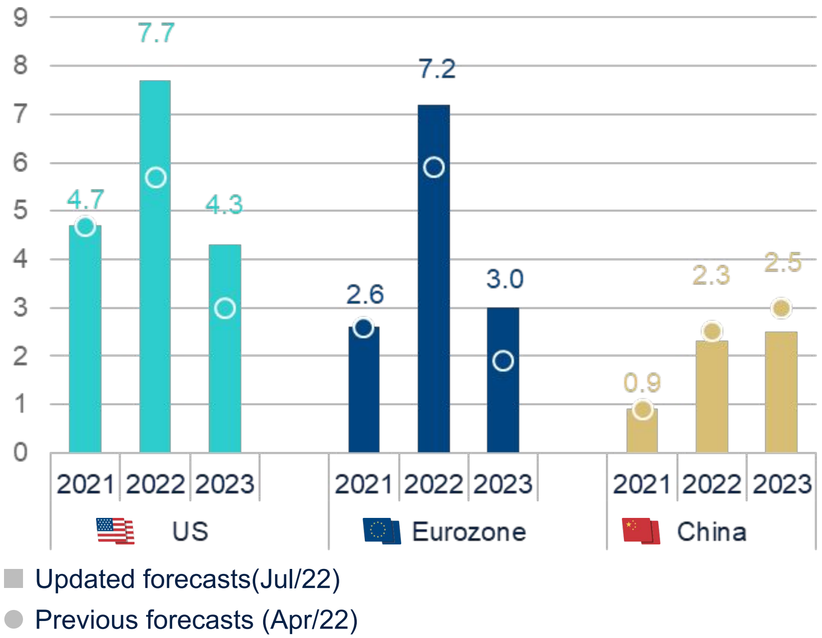
* Forecast change in parentheses.
Source: BBVA Research.

- Rising rates will likely push the US into a recession in 2023, which is expected to be mild given robust employment and sound household and financial system balance sheets.
- In the Eurozone, the impact of the war will be stronger in the coming quarters due to the expected gas restrictions, pushing GDP growth to slightly negative rates.
- In China, growth will recover from the impact of recent lockdowns, but the "zero-covid" policy remains as a potential problem.

Inflation to remain well above central bank targets, mainly in the short term

INFLATION:CPI

(Y/Y %, PERIOD AVERAGE)



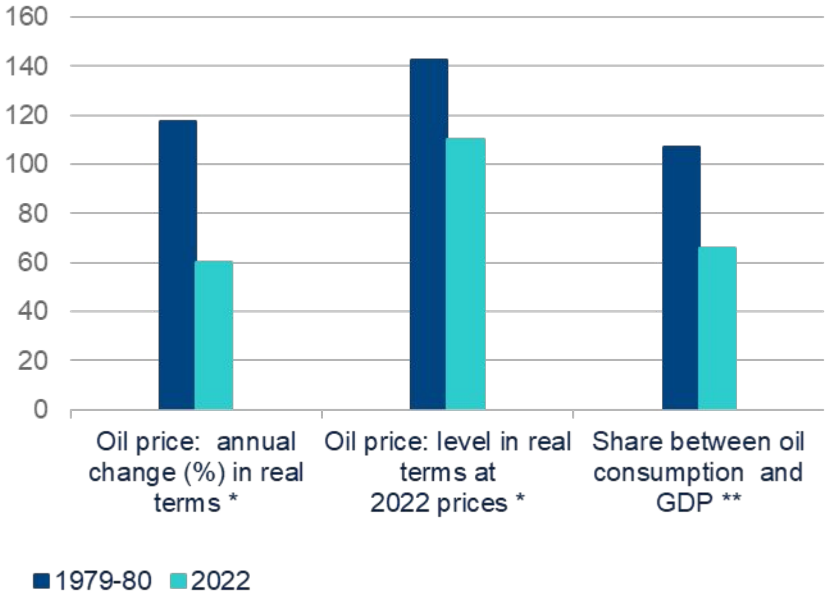
Source: BBVA Research.

- Upward revision of inflation forecasts, mainly due to higher commodity prices.
- Inflation will eventually decline as current shocks lose strength and central banks continue to act
- Slowing demand will reduce the scope for significant wage increases, making a wage-price spiral unlikely.

The likelihood of a prolonged period of higher inflation has increased, but a return to the inflationary spiral of the 1970s remains far away

OIL: PRICE AND INTENSITY OF USE

(PRICE VARIATION AND INTENSITY: %; PRICE LEVEL: USD/BARREL)



* Maximum observed in each period.
** For the world economy.
Source: BBVA Research based on data from the Fed and Haver.

- A less vulnerable economic structure:
  - less oil-intensive production
  - more open economies and lower levels of unionization make a wage-price spiral less likely
- A more credible monetary policy:
  - independent
  - with explicit inflation targets
  - with exclusive prerogative to fight inflation
  - with effective action and monitoring tools

Risks: further inflationary persistence could trigger more aggressive interest rate hikes and a sharp macroeconomic deterioration

MAIN SHORT-TERM RISKS TO THE WORLD ECONOMY

- Persistent inflation
- More severe recession
- Financial fragmentation in the EZ
- Tension in debt and emerging markets
- Stagflation
- Deterioration of the war in Ukraine or other geopolitical conflicts
- Hard-landing in China
- Covid
- Social tensions and populism

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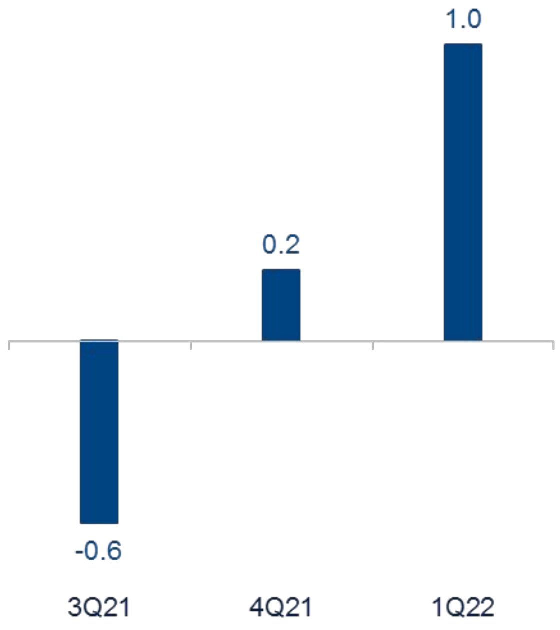
02

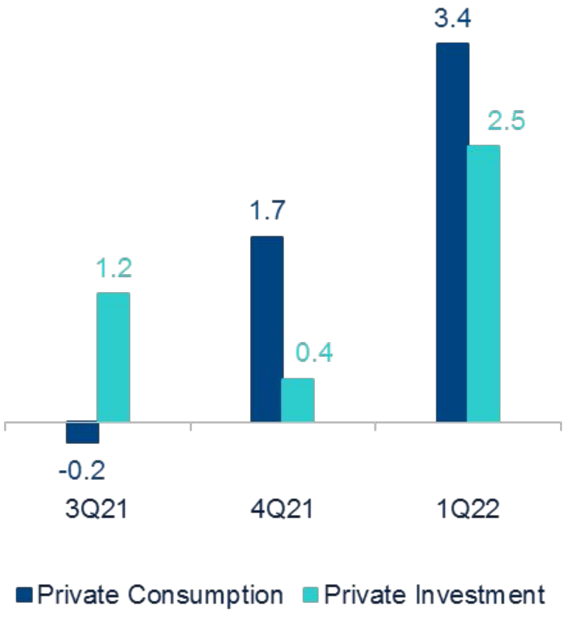
Economic dynamism of 1Q22 will not last long

GDP rebounded in 1Q22 on stronger consumption; the services sector led the higher dynamism

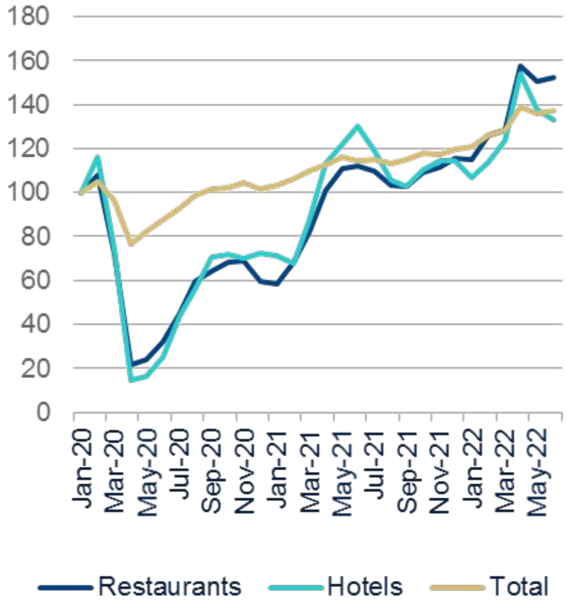
GDP
(Q/Q%, SA)



PRIVATE CONSUMPTION AND PRIVATE INVESTMENT (Q/Q%, SA)



BBVA RESEARCH BIG DATA CONSUMPTION INDICATOR
(JAN/2020 INDEX = 100)

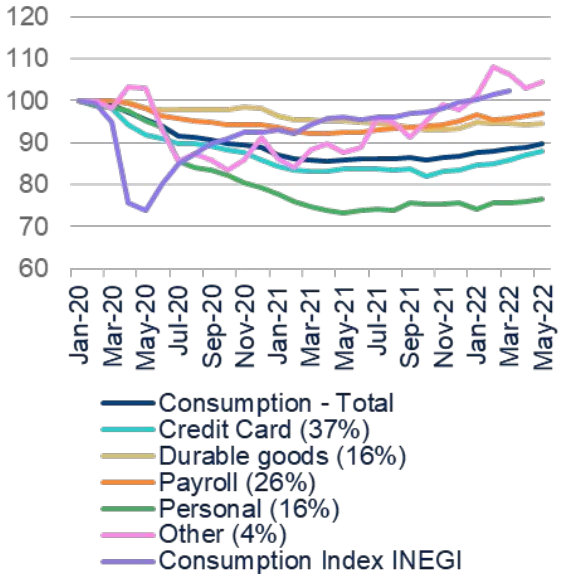


Source: BBVA Research/INEGI.

Consumer credit and formal employment support household spending

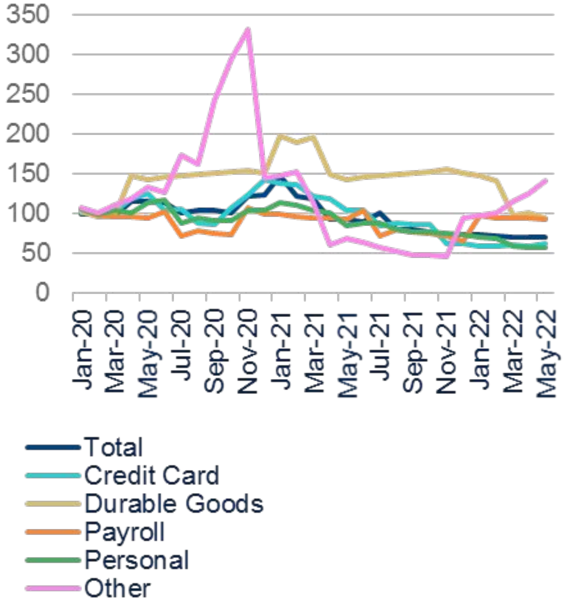
BALANCE OF CONSUMER CREDIT AND INEGI CONSUMPTION INDEX

(JAN/2020 INDEX = 100)*



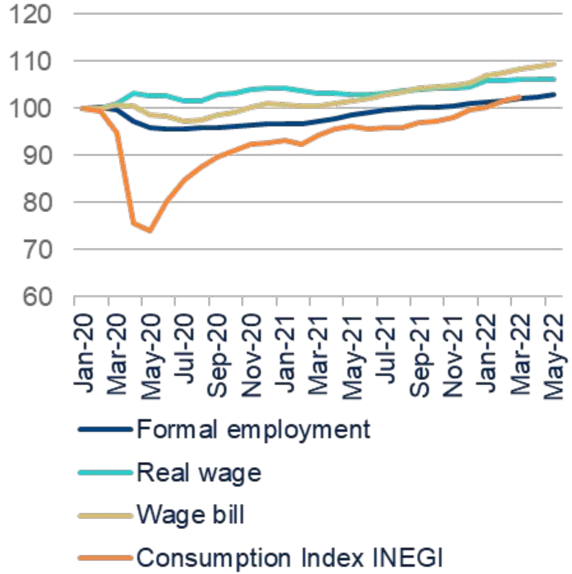
CONSUMER CREDIT NPL INDICES

(JAN/2020 INDEX = 100)



FORMAL EMPLOYMENT INDICATORS AND INEGI CONSUMPTION INDEX

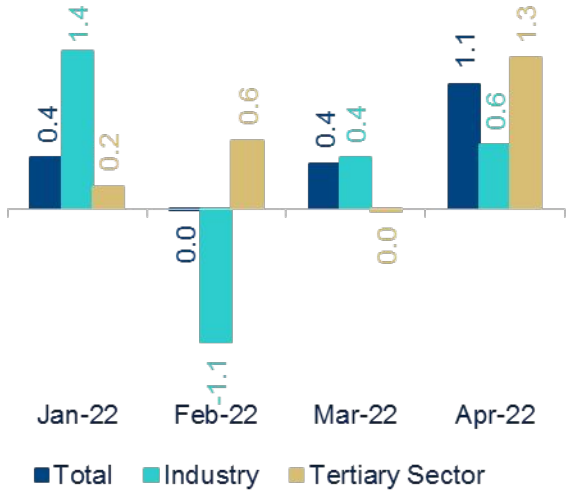
(JAN/2020 INDEX = 100)



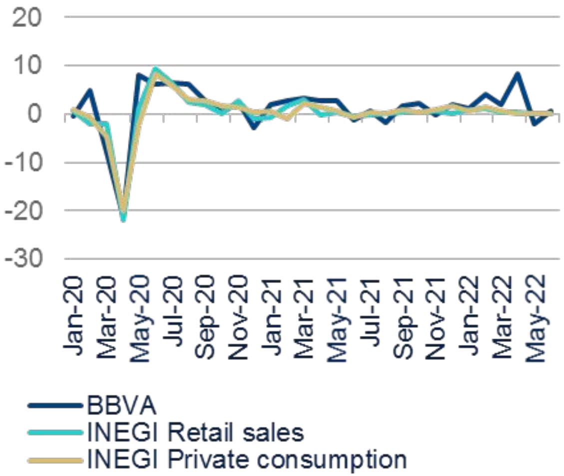
*Percentage share of the total consumer portfolio is shown between brackets (%) The category “Other” includes microcredits and leases.
Source: BBVA Research/INEGI/Banxico.

The April IGAE points to positive data in 2Q22, boosted by the tertiary sector

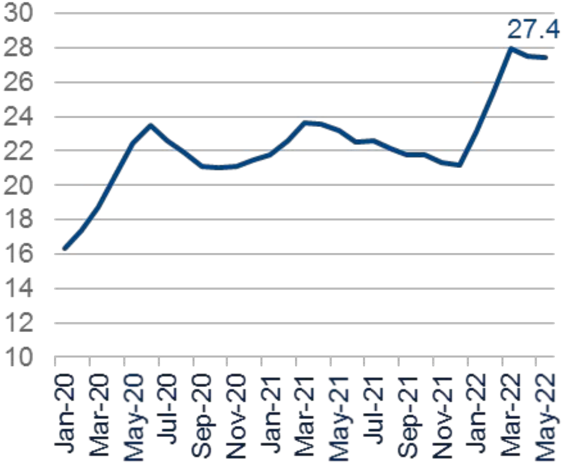
IGAE
(M/M%, SA)



CONSUMPTION INDICES: BBVA* & INEGI
(M/M%, SA)



CRITICAL EMPLOYMENT CONDITIONS INDEX
(% URBAN, 3-MONTH MOVING AVERAGE)

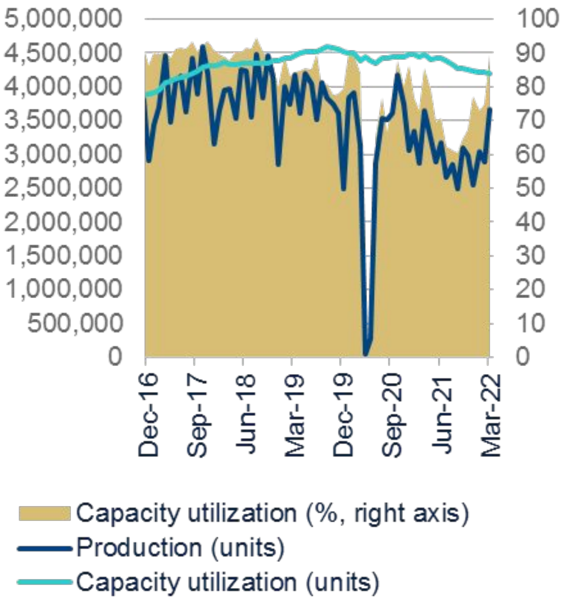


"Cut-off date: June 30, 2022.
Source: BBVA Research/INEGI.

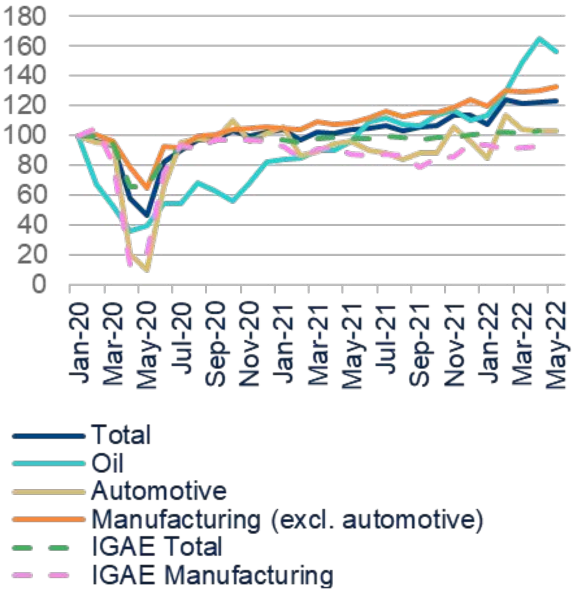
The BBVA Research Big Data Consumption Indicator and the INEGI Critical Employment Conditions Index point to a steady slowdown in May-June, which we expect to be extended into 2H22 and 2023.

Bottlenecks have temporarily cleared, in particular in the automotive sector

LIGHT VEHICLES INDUSTRY
(UNITS AND CAPACITY UTILIZATION, %)



EXPORTS BY SECTOR AND IGAE
(JAN 2020 INDEX = 100)

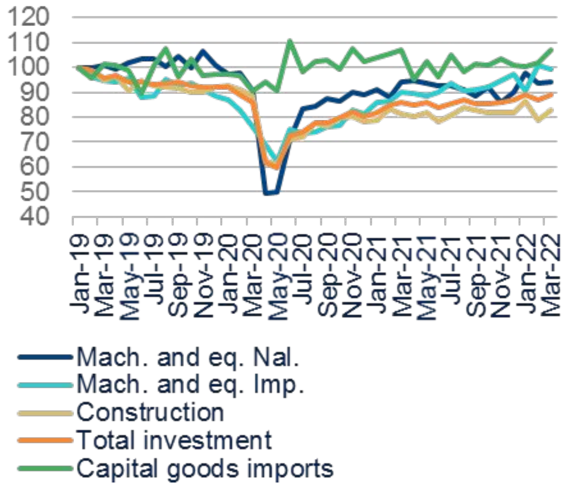


ISM NEW ORDERS FROM U.S. AND NON-OIL EXPORTS
(% Y/Y, 6M MOVING AVERAGE, ISM 6M LAG)

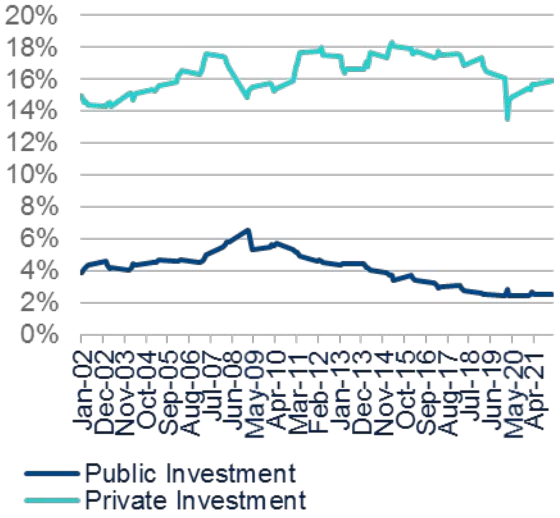
Source: BBVA Research/INEGI.

Investment is 9% below its Jan/2019 level; the global value chains are driving the machinery and equipment sector

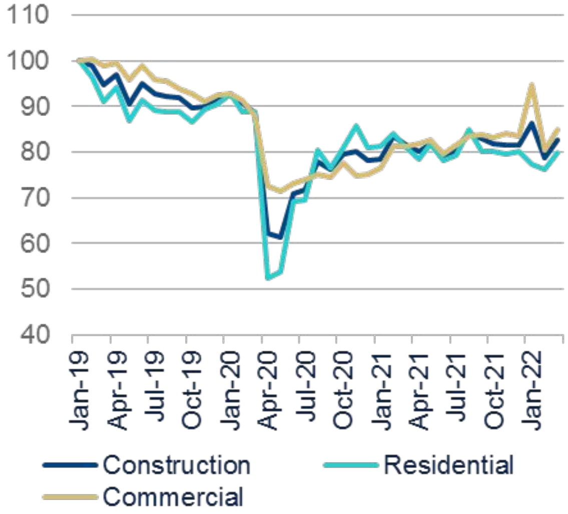
INEGI INVESTMENT AND CAPITAL GOODS IMPORT INDEX
(JAN/19 INDEX = 100)



INVESTMENT: PUBLIC AND PRIVATE
(% GDP)



CONSTRUCTION: COMPONENTS
(JAN/19 INDEX = 100)

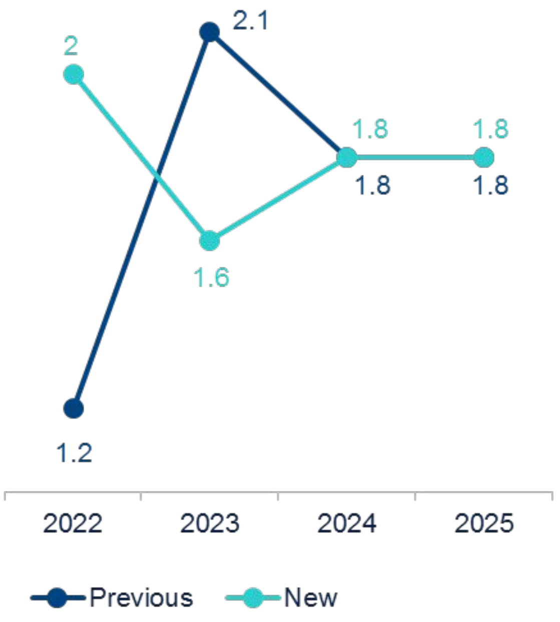


Source: BBVA Research, INEGI.

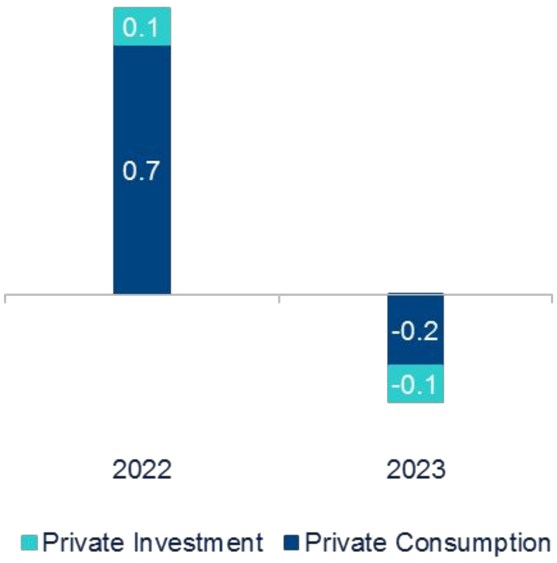
Technical recession in the U.S. in 2H23, with effects on investment.

Upward revision to our growth estimate for 2022 to 2.0% (1.2% prev.); 1.6% for 2023 (2.1% prev.)

GDP
(% ANNUAL CHANGE, SA)



GDP REVISION: BREAKDOWN FOR 2022 AND 2023 (PERCENTAGE POINTS)

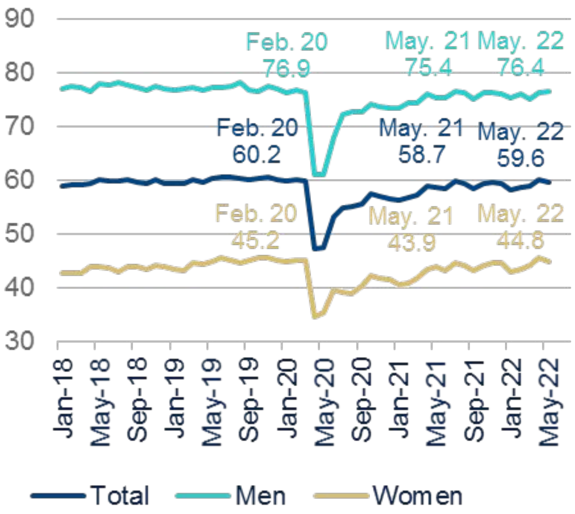


GDP
(Q/Q%, SA)

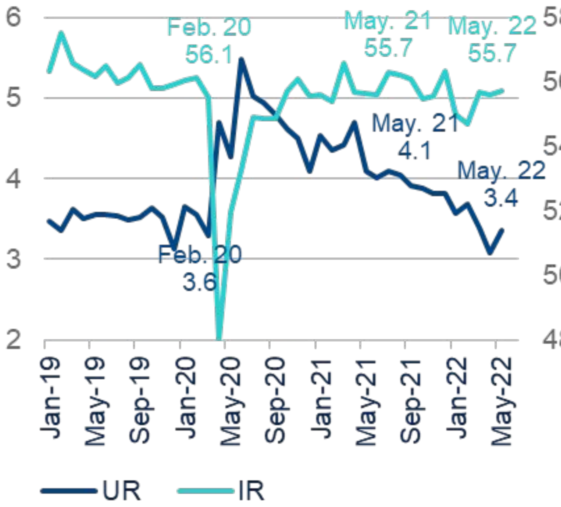
Source: BBVA Research.

Labor supply continues with moderate growth; there is concern that the critical employment conditions rate does not show signs of improvement

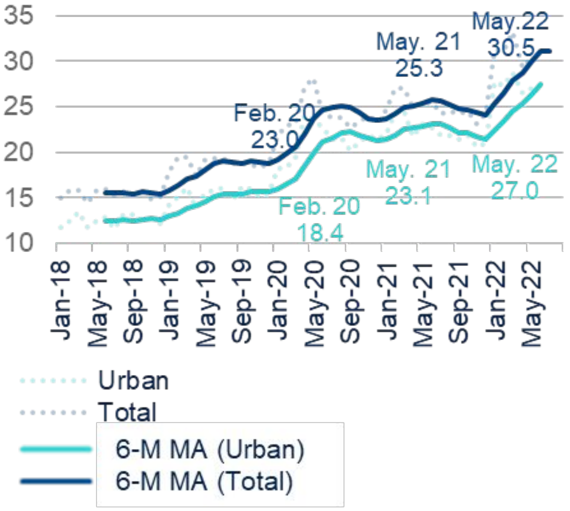
LABOR PARTICIPATION RATE
(% POPULATION OVER 15 YEARS)



UNEMPLOYMENT RATE (UR) AND INFORMALITY RATE (IR) (%)



CRITICAL EMPLOYMENT CONDITIONS RATE (CECR) (%)

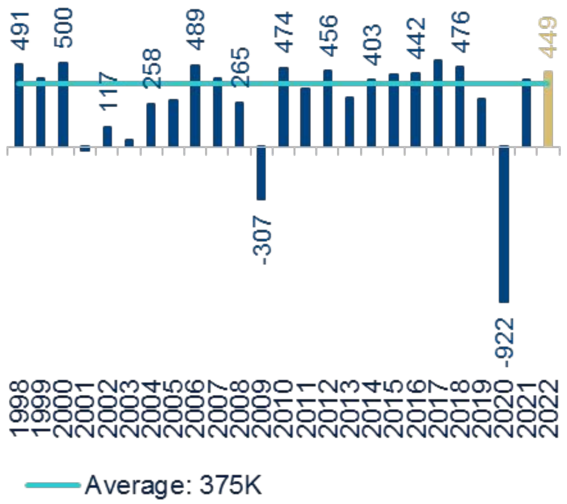


Source: BBVA Research, ENOE.

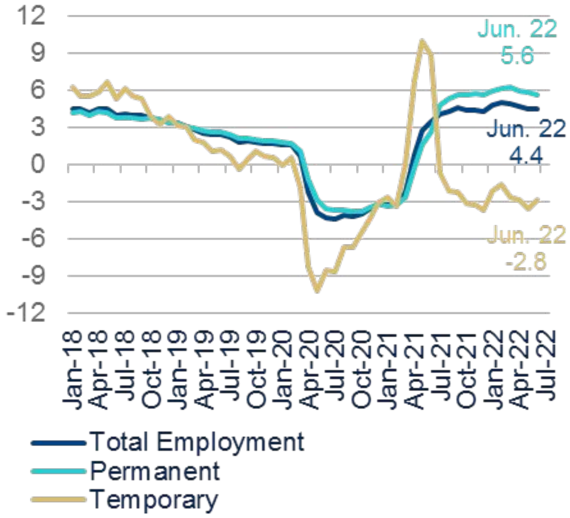
Employment informality reacts to the moderate increase in job offers and remains at pre-pandemic levels. As expected, the unemployment rate also responded, with a slight rise in May.

As forecast, the growth in formal employment shows signs of slowing, but it should gain traction at the end of the year ...

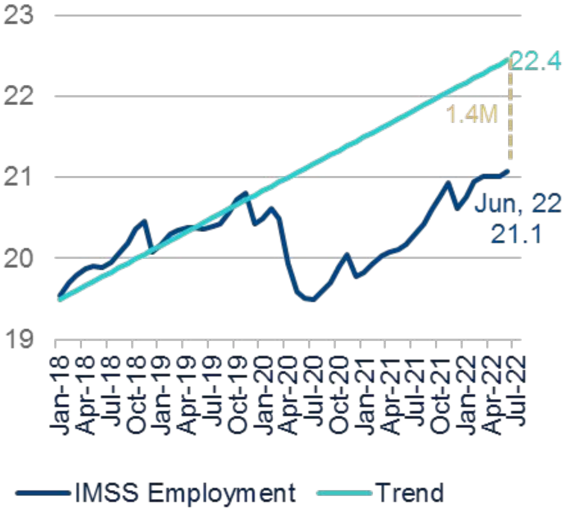
FORMAL EMPLOYMENT, IMSS
(CUM. JAN-MAY, THOUSANDS)



FORMAL EMPLOYMENT, IMSS
(ANNUAL CHANGE,%)



FORMAL EMPLOYMENT, IMSS
(MILLIONS)

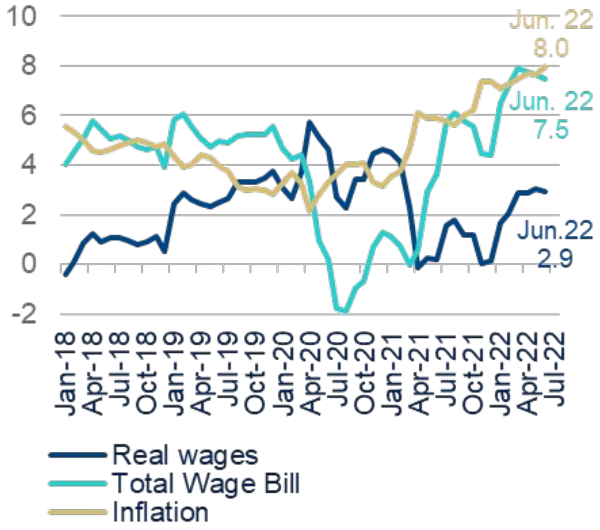


Source: BBVA Research, IMSS.

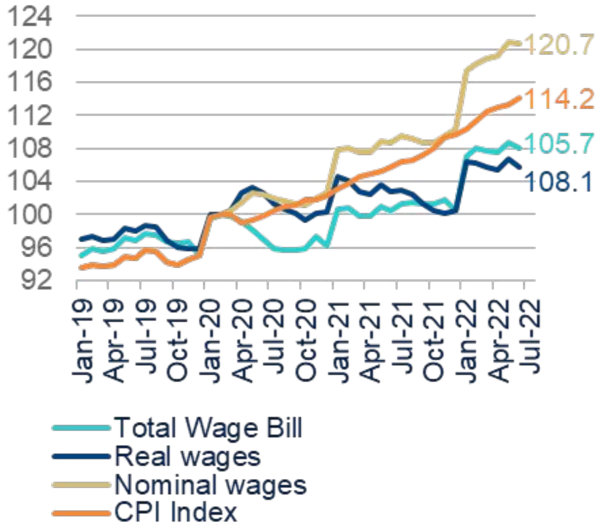
... but formal employment remains 1.4 million below the pre-pandemic trend level.

Job creation and wage reviews have driven real wages and total wage bill, despite high inflation levels

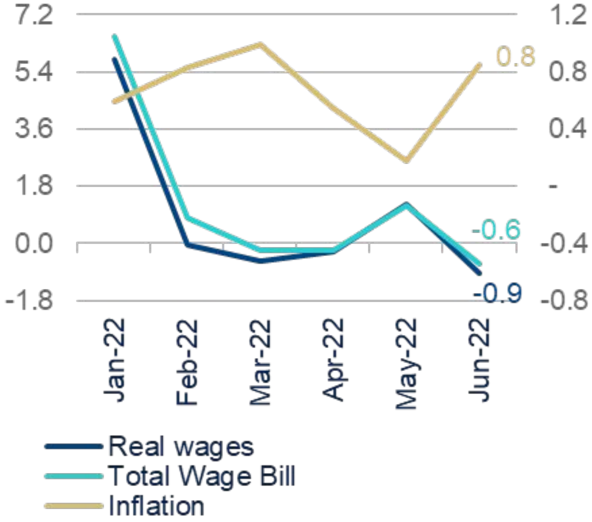
REAL WAGES AND TOTAL WAGE BILL, IMSS (ANNUAL % CHANGE)



REAL WAGES AND TOTAL WAGE BILL, IMSS (FEB. 2020 INDEX = 100)



REAL WAGES AND TOTAL WAGE BILL, IMSS (MONTHLY % CHANGE)

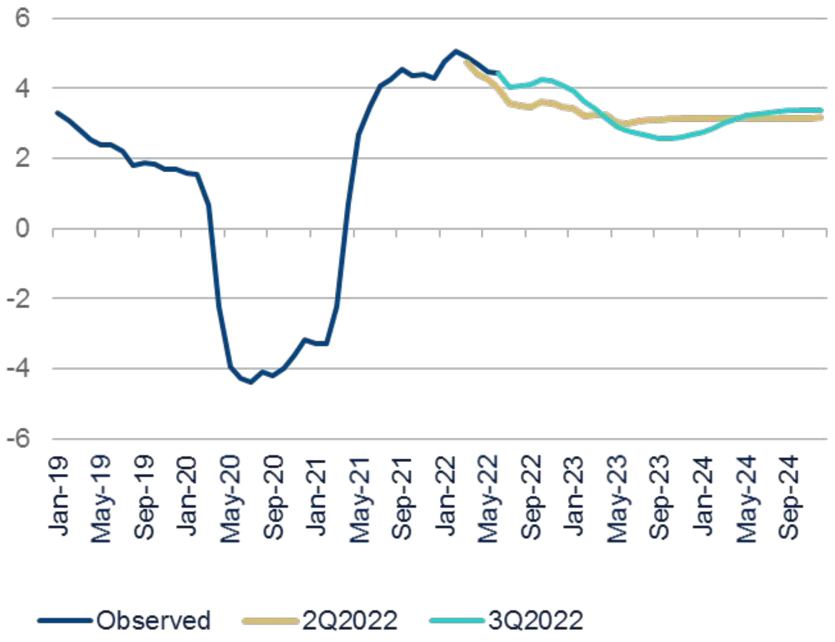


Source: BBVA Research, IMSS.

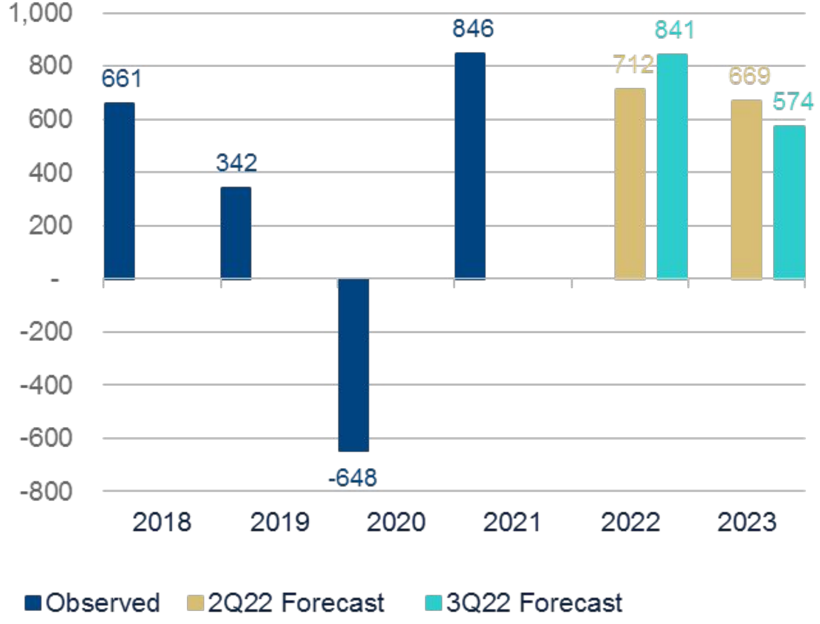
However, the monthly changes show that employment is weakening, and it may lose ground in the face of inflation, which will continue to be high for the rest of the year.

We expect that job creation will gain traction at the end of the year, but we anticipate a lower employment growth in 2023

FORMAL EMPLOYMENT, IMSS
(ANNUAL % CHANGE)



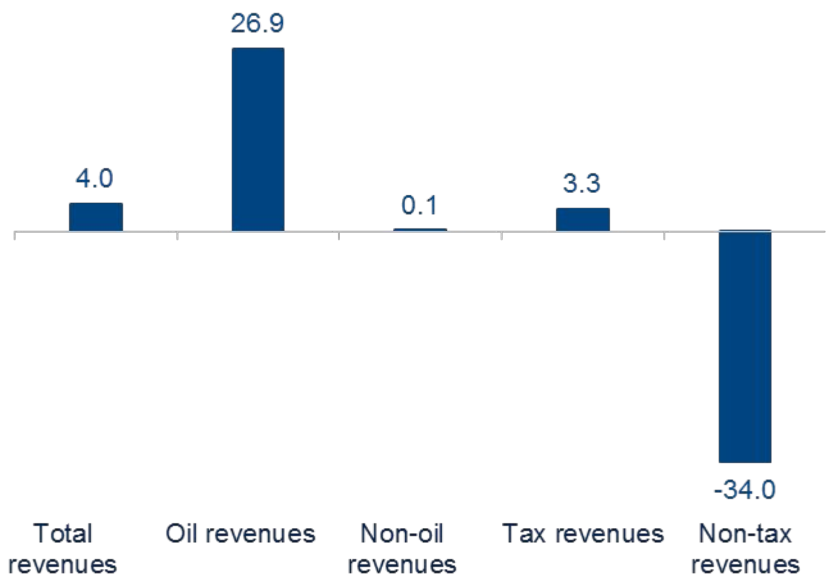
FORMAL EMPLOYMENT, IMSS
(ANNUAL CHANGE, FDP, THOUSANDS)



Source: BBVA Research, IMSS.

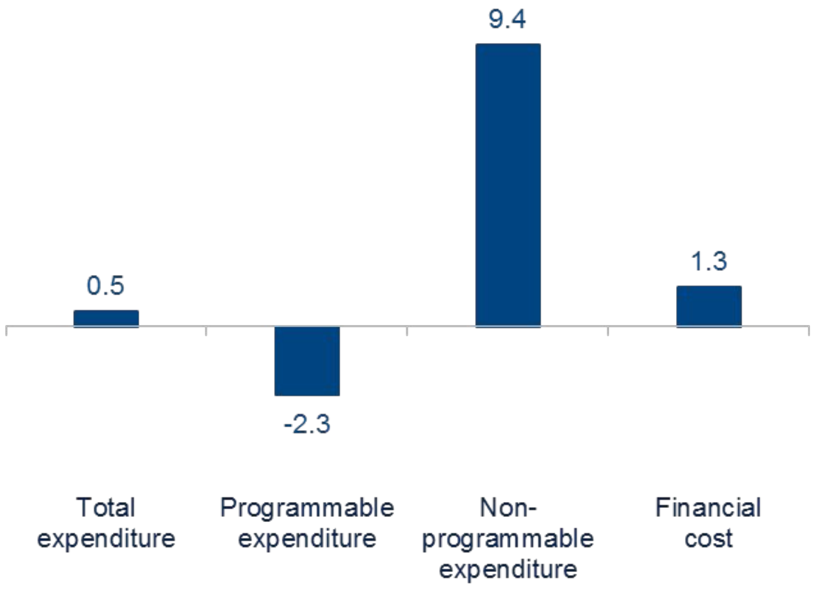
Public revenues in January-May 2022 were boosted by oil revenues

PUBLIC REVENUES AND MAIN COMPONENTS IN JANUARY-MAY 2022
(REAL ANNUAL % CHANGE)



Source: BBVA Research / SHCP.

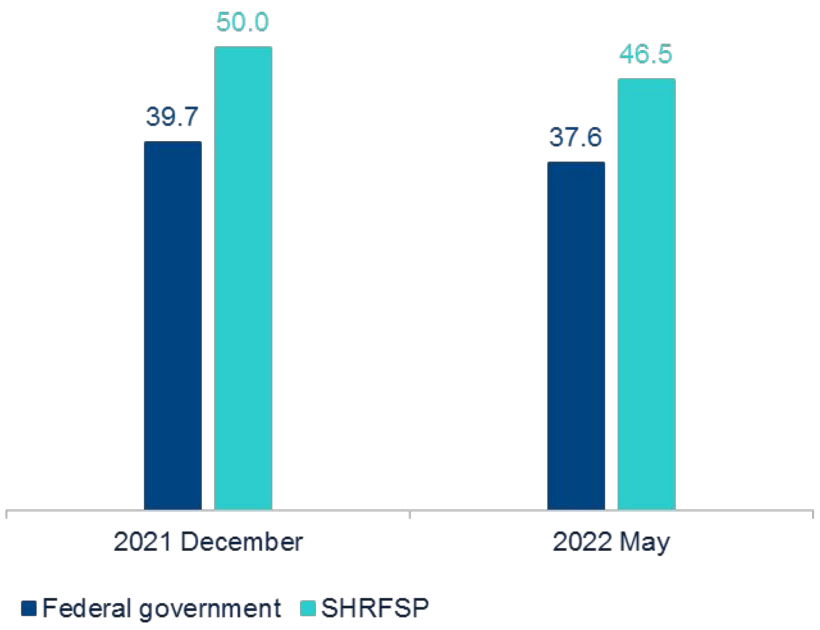
PUBLIC EXPENDITURE AND MAIN COMPONENTS IN JANUARY-MAY 2022
(REAL ANNUAL % CHANGE)



Source: BBVA Research / SHCP.

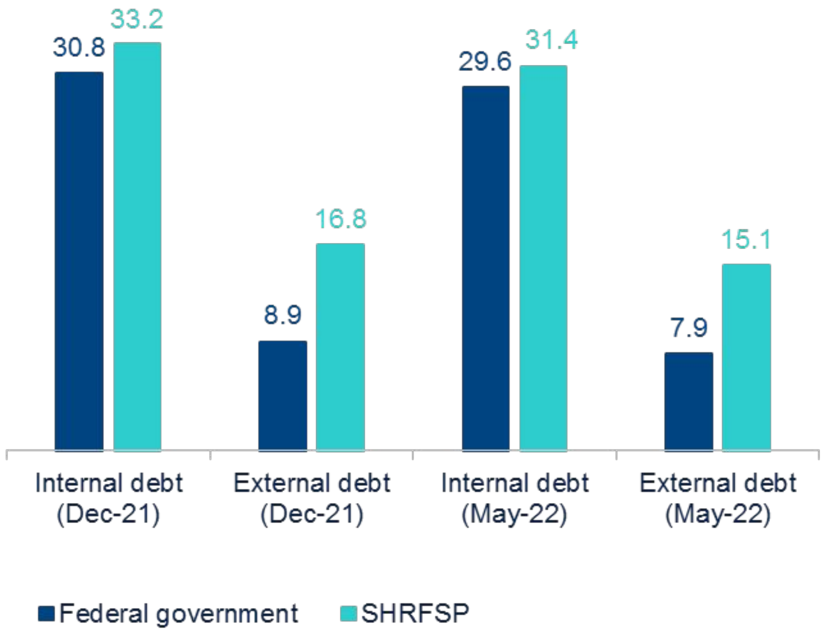
The internal and external components of the SHRFSP (% of GDP) contributed 1.8 pp and 1.7 pp respectively to the reduction of this quotient

PUBLIC DEBT
(% OF GDP)



Source: BBVA Research / SHCP.

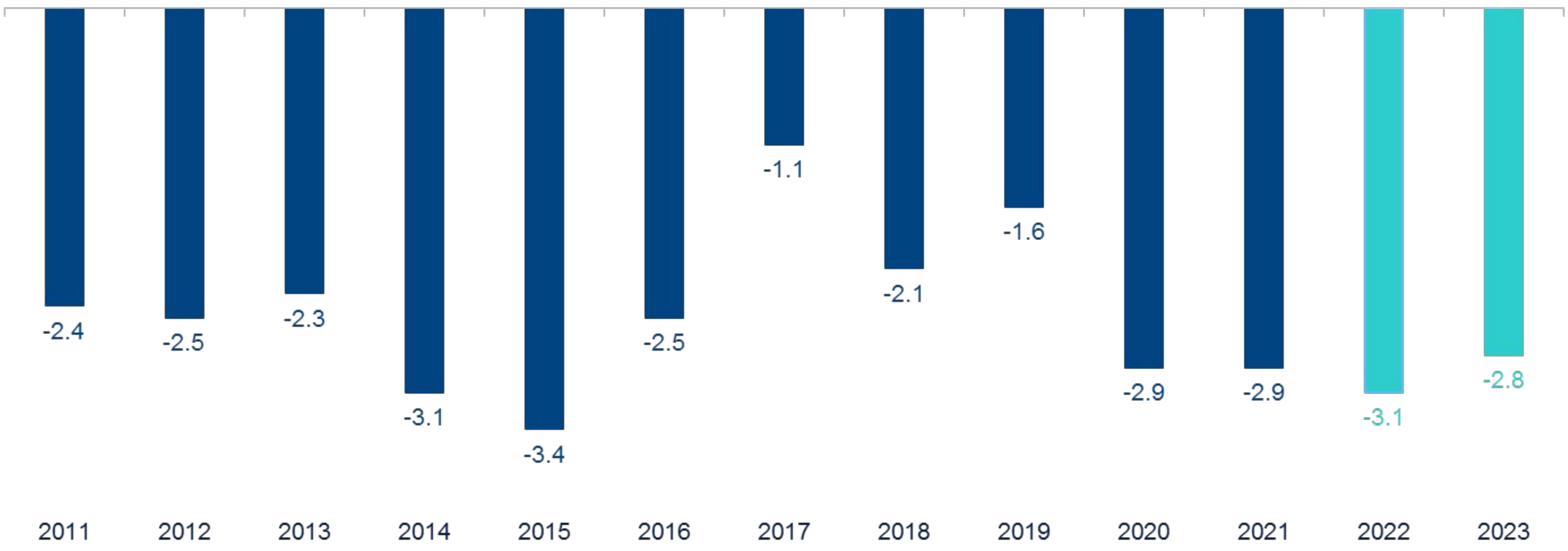
INTERNAL AND EXTERNAL GOVERNMENT DEBT
(% OF GDP)



Source: BBVA Research / SHCP.

For 2022 and 2023 we expect the public deficit to remain at around the levels observed in recent years

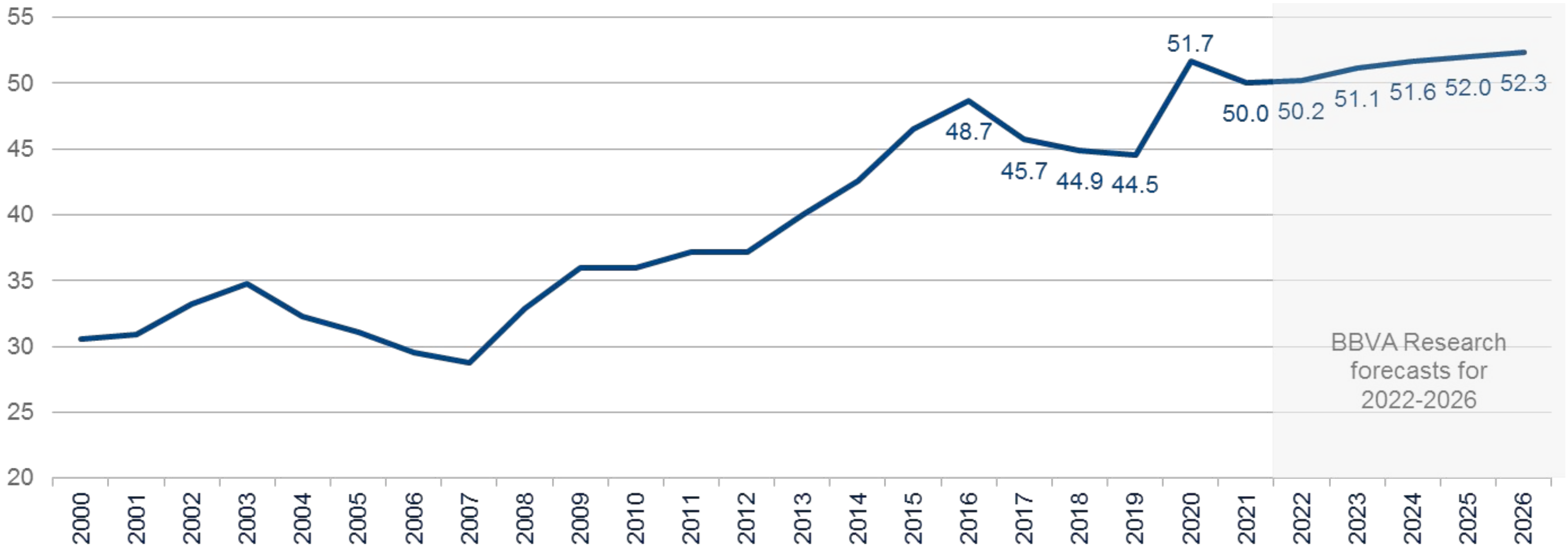
PUBLIC-SECTOR BUDGET BALANCE
(% OF GDP)



Source: BBVA Research / SHCP.

Public debt will increase slowly in the medium term to levels of around 52.3% of GDP in 2026

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



Source: BBVA Research / SHCP.

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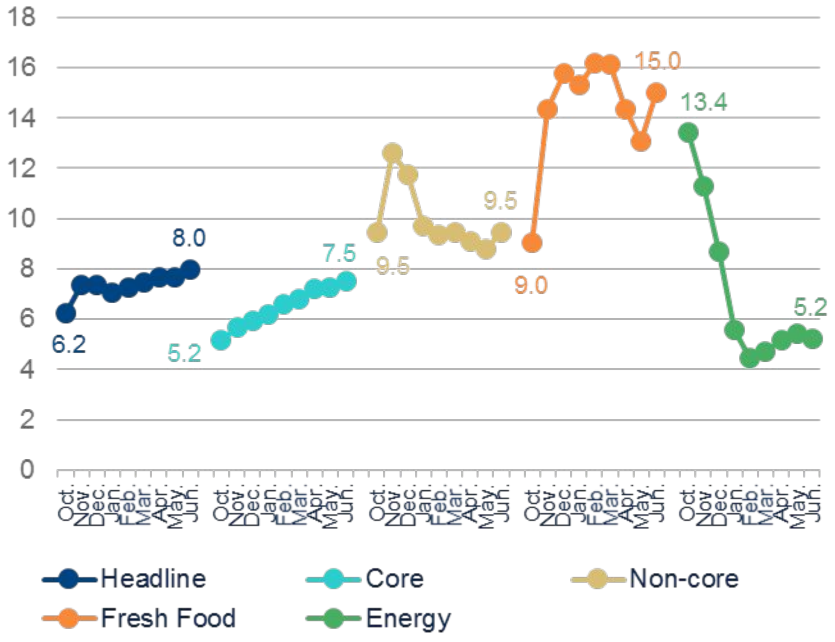
03

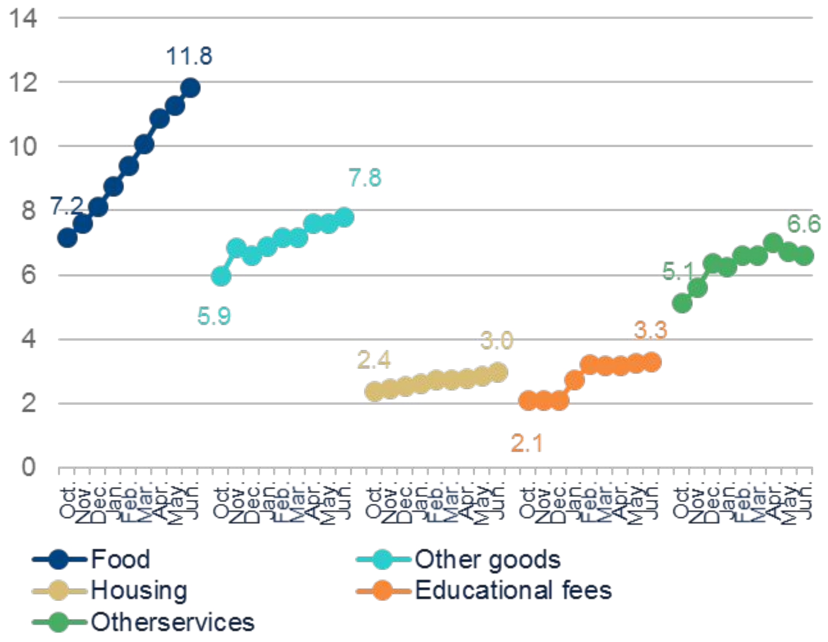
Higher inflation and interest rates

Non-core inflation has fallen, thanks to gasoline subsidies, but core inflation has continued to increase

BREAKDOWN OF HEADLINE INFLATION
(ANNUAL % CHANGE)



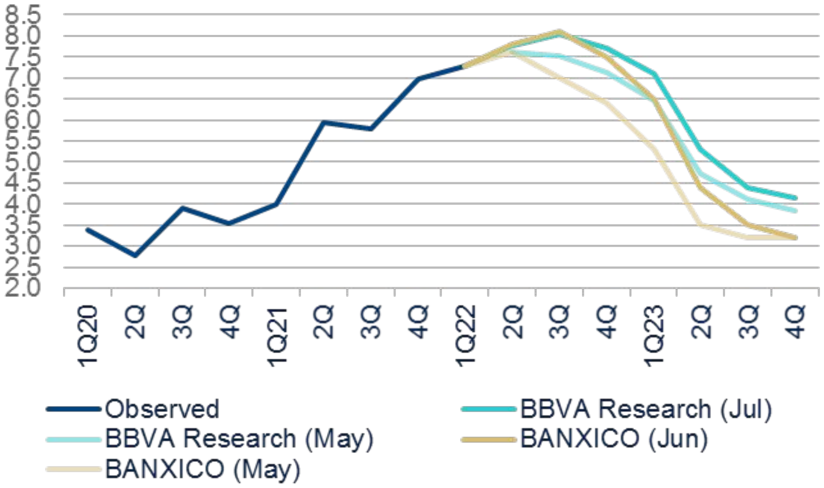
BREAKDOWN OF CORE INFLATION
(ANNUAL % CHANGE)



Source: BBVA Research, INEGI.

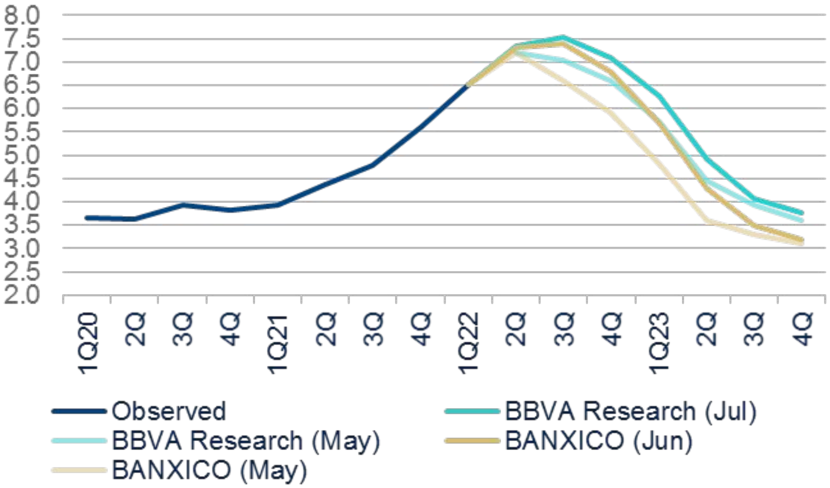
Once more we are shifting the peak inflation level, which we now forecast for Q3

PROSPECT FOR HEADLINE INFLATION
(QUARTERLY % CHANGE, QUARTERLY AVERAGE)



	4Q22	4Q23	4Q24	4Q25	4Q26	4Q27
3Q22	**7.7**	**4.1**	**3.5**	**3.6**	**3.5**	**3.6**
2Q22	5.7	3.7	3.6	3.5	3.5	3.5
Banxico	7.5	3.2				

OUTLOOK FOR CORE INFLATION
(ANNUAL % CHANGE, QUARTERLY AVERAGE)

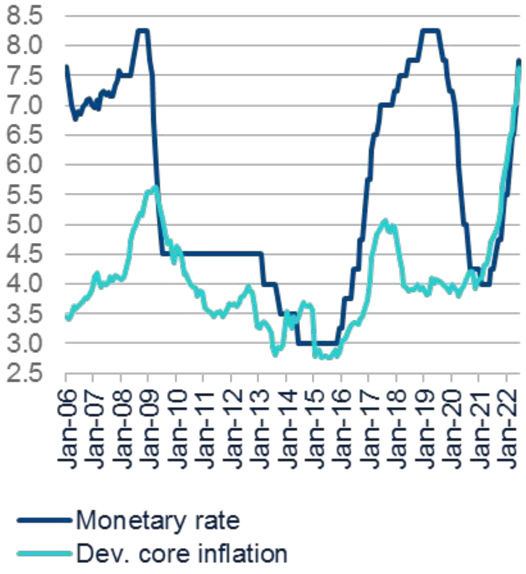


	4Q22	4Q23	4Q24	4Q25	4Q26	4Q27
3Q22	**7.1**	**3.8**	**3.3**	**3.3**	**3.3**	**3.3**
2Q22	5.3	3.5	3.3	3.3	3.3	3.3
Banxico	6.8	3.2				

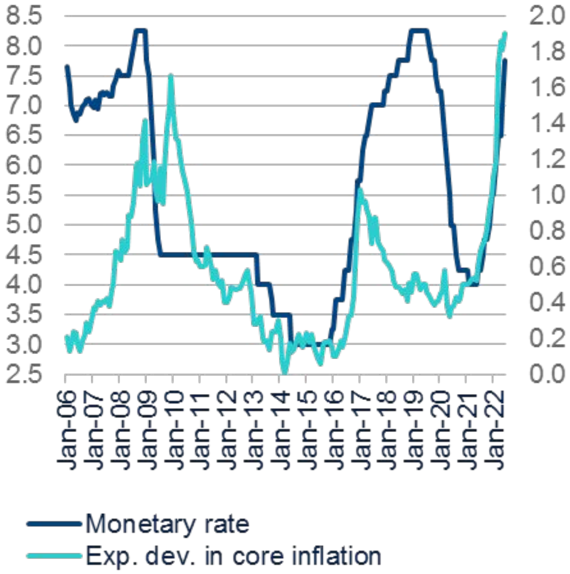
Source: BBVA Research, INEGI, BANXICO.

Banxico will continue to raise the policy rate to avoid the de-anchoring of expectations and maintain a wide interest rate spread

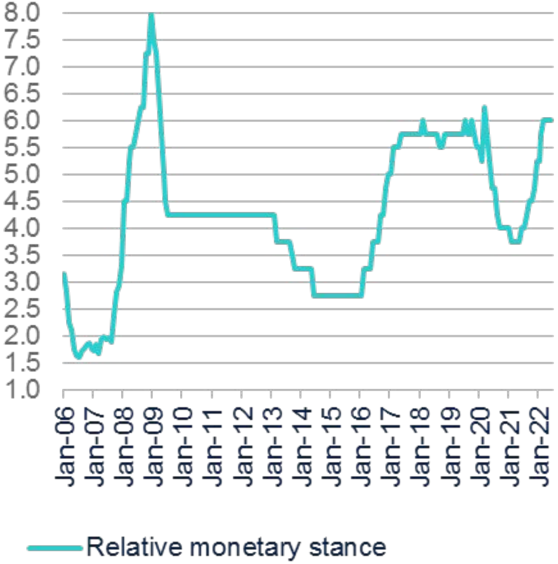
MONETARY RATE AND DEVIATION FROM CORE INFLATION TARGET (% AND PP)



MONETARY RATE AND DEVIATION FROM EXPECTATIONS OF CORE INFLATION WITH RESPECT TO THE TARGET (12 MONTHS, % AND PP)



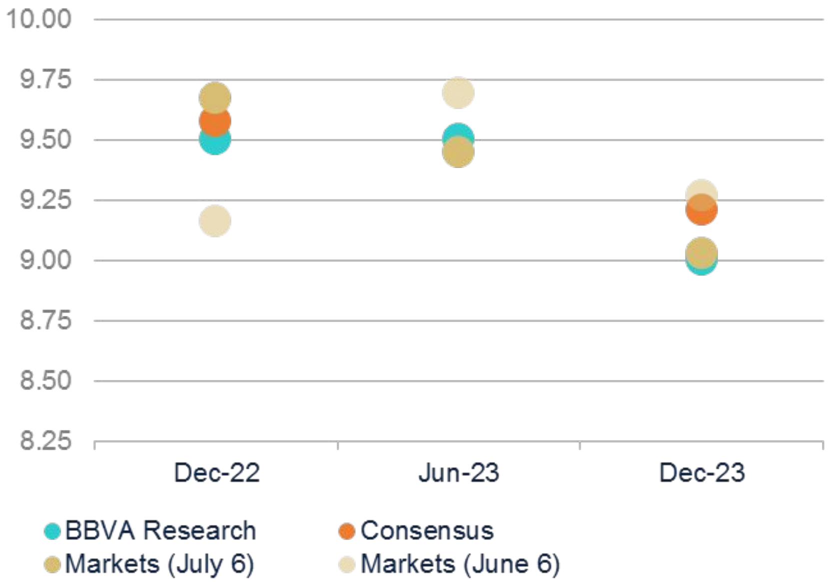
RELATIVE MONETARY STANCE: MONETARY RATE VS FEDERAL FUND RATE (PP)



Source: BBVA Research, BANXICO, INEGI & Bloomberg.

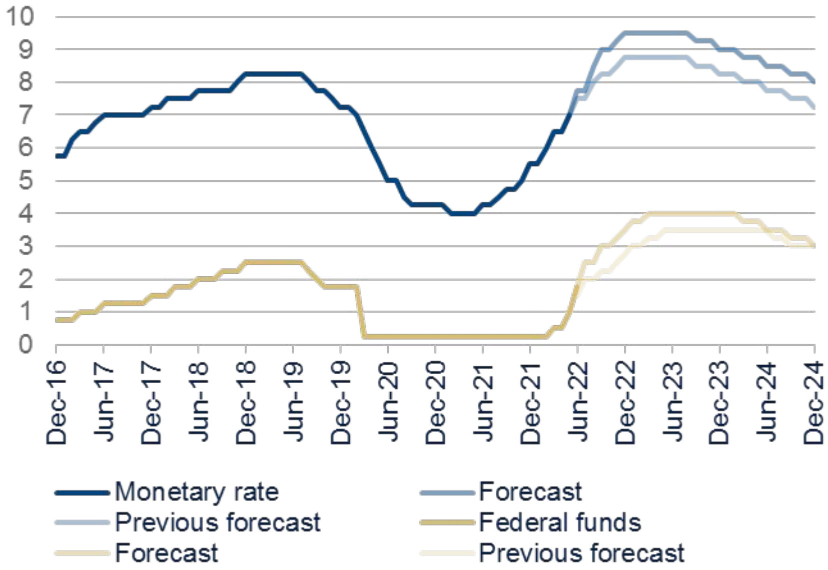
Banxico accelerated its rate hike pace: we now forecast a closing rate for the cycle of 9.50%, which we expect will be reached at the end of the year

OUTLOOK FOR THE MONETARY RATE: BBVA RESEARCH VS ANALYSTS AND MARKET EXPECTATIONS (%)



Data as at July 6
Source: BBVA Research, Banamex Surveys and Bloomberg.

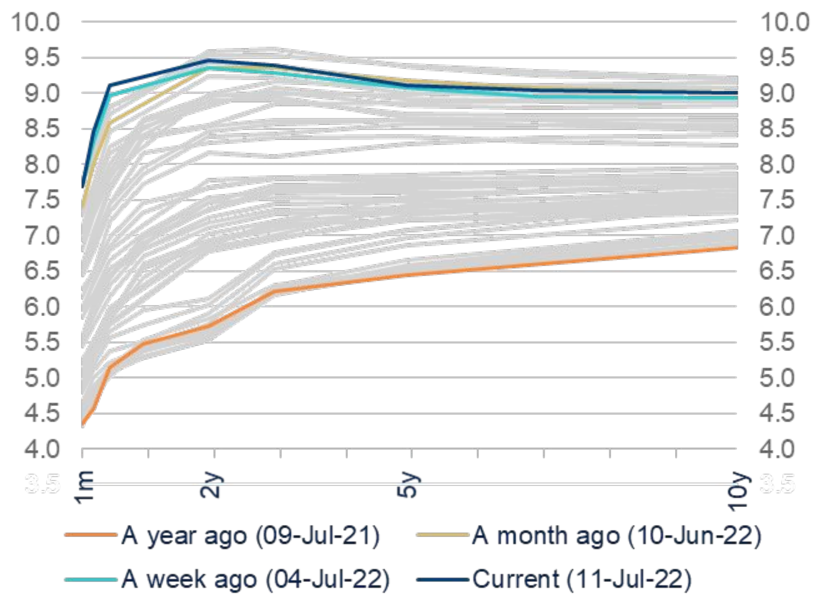
OUTLOOK FOR THE MONETARY RATE AND THE FEDERAL FUND RATE (%)



Source: BBVA Research, BANXICO, Bloomberg.

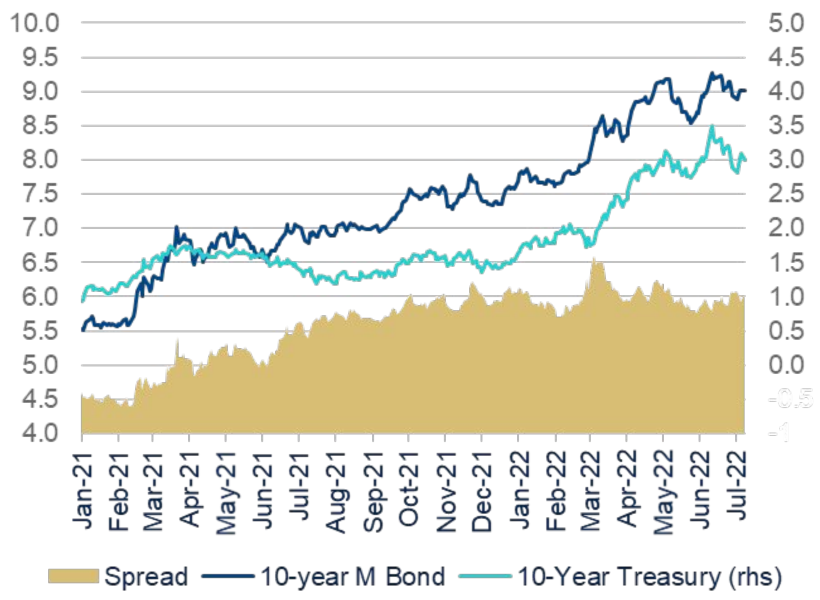
A ~600 bps spread between M10 bonds and 10-year Treasuries keeps moving sideways as the tightening process in both Mexico and the US keeps going

MX SOVEREIGN YIELD CURVE
(%)



The gray lines show weekly yield curves over the last 12 months.
Source: BBVA Research based on data by Bloomberg.

MX AND US 10-YEAR YIELDS
(%)

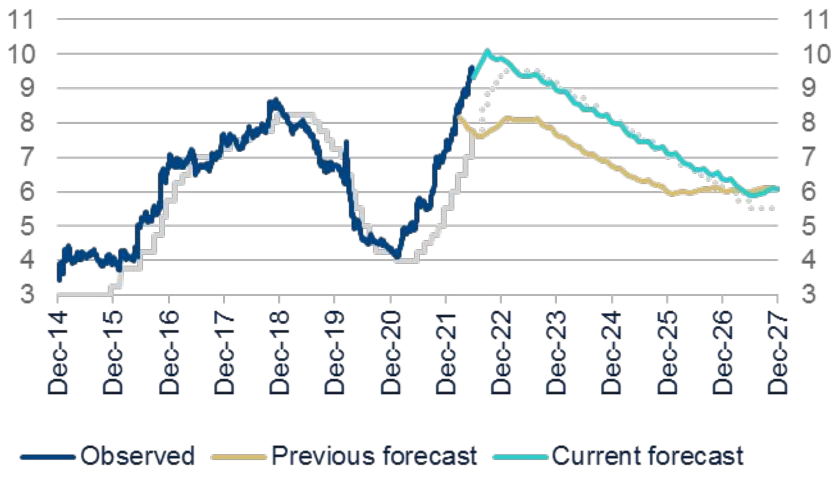


Source: BBVA Research based on data by Bloomberg and Haver Analytics.

Interest rates continue to rise in amid the uncertainty about the terminal level of the Banxico target rate

2-YEAR M BOND YIELD

(%)

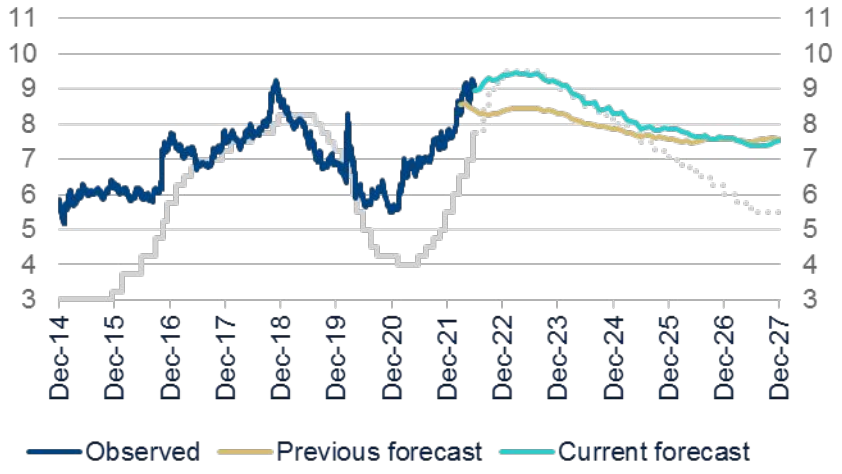


2-year M bond	22	23	24	25	26	27
Current forecast	**9.9**	**9.0**	**8.0**	**7.1**	**6.4**	**6.1**
Previous forecast	8.0	7.7	6.7	6.0	6.1	6.1

Source: BBVA Research based on data by Bloomberg and Haver Analytics.

10-YEAR M BOND YIELD

(%)

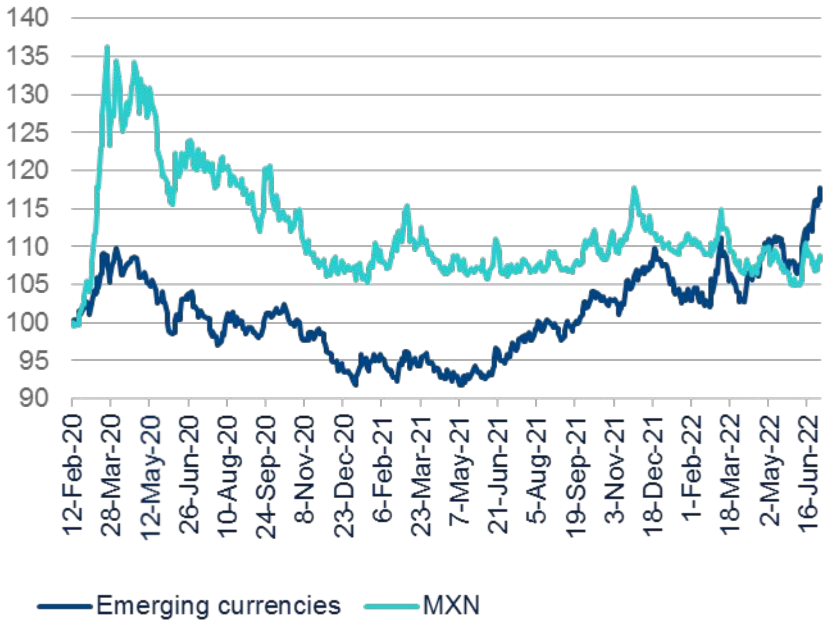


10-year M bond	22	23	24	25	26	27
Current forecast	**9.4**	**9.2**	**8.3**	**7.8**	**7.6**	**7.5**
Previous forecast	8.4	8.3	7.8	7.6	7.6	7.6

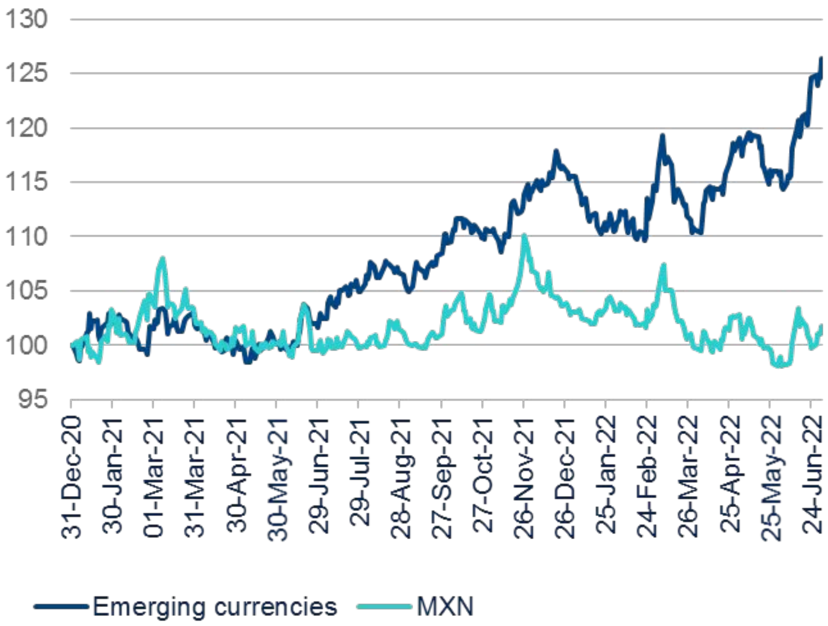
Source: BBVA Research based on data by Bloomberg and Haver Analytics.

The relatively better performance of the peso reflects an improved fiscal position, low current-account deficit and a high interest rate spread

RELATIVE PERFORMANCE OF EMERGING CURRENCIES[1] (FEB 12 2020 INDEX = 100)



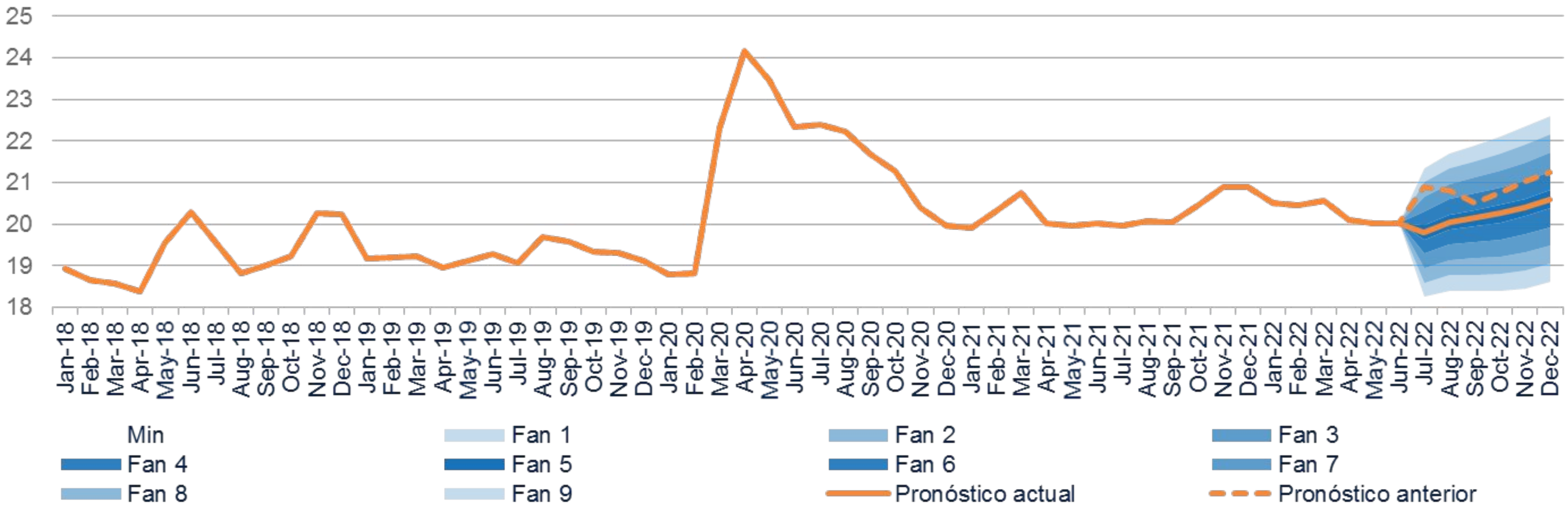
RELATIVE PERFORMANCE OF EMERGING CURRENCIES[1] (DEC 31 2020 INDEX = 100)



1: Based on a reweighting of the JP Morgan EM Currency Index after removing the Mexican peso; own calculations.
Source: BBVA Research, Bloomberg.

The broad interest-rate differentials continue to keep the peso relatively strong; we forecast 20.6 and 20.8 peso/USD at the end of 2022 and 2023

EXCHANGE RATE
(PESOS/USD)



Source: BBVA Research / Bloomberg.

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04

Main messages and summary of forecasts

Main messages

Growth estimate

Upward revision to our growth estimate for 2022 to 2.0% (previous: 1.2%); downward revision for 2023 to 1.6% (previous: 2.1%).

- Economic activity gained traction in 1Q22 on stronger consumption.
- Consumer credit and formal employment are maintaining household expenditure; the BBVA Research Big Data Consumption Indicator and the INEGI Index of Critical Employment Conditions point to a gradual slowdown to 2H22, which we expect to extend to 2023.
- Bottlenecks have temporary cleared particularly in the automotive sector.
- Investment is 11% below pre-COVID levels; the global value chains are boosting the machinery and equipment sector. Technical recession in the U.S. in 2H23 with negative effects on investment.

Gains in formal employment and wage reviews have boosted wages and total wage bill, offsetting the loss in purchasing power of wages given the high inflation levels. Despite the slowdown of job creation in the second quarter of the year, we expect it to gain traction in the following quarters. Given our economic growth revision for the following year, we expect lower employment growth than in our previous forecast.

Main messages

Inflation

Banxico will continue to raise the policy rate to avoid expectations from de-anchoring and maintain a wide differential in interest rates.

- Non-core inflation has fallen, thanks to gasoline subsidies, but core inflation has continued to increase.
- Banxico accelerated its rate hikes: we now forecast a 9.50% terminal rate for the cycle, which we expect will be reached by the end of the year.
- The spread between 10-year yields in Mexico and the U.S. continues to hover around 600 bps as the process of monetary tightening continues.

Exchange rate

The broad interest-rate differentials continue to keep the peso relatively strong; we forecast an exchange-rate of 20.6 and 20.8 pesos/USD at the end of 2022 and 2023.

Summary of forecasts

		2020	2021	2022	2023	2024
GDP (Annual % change)	new	-8.3	5.0	**2.0**	**1.6**	**1.8**
	previous			1.2	2.1	1.8
Employment (%, eop)	new	-3.2	4.3	**4.1**	**2.7**	**3.4**
	previous			3.5	3.1	3.2
Inflation (%, eop)	new	3.2	7.4	**7.7**	**4.1**	**3.6**
	previous			5.6	3.6	3.6
Monetary policy rate (%, eop)	new	4.25	5.50	**9.50**	**9.00**	**8.00**
	previous			8.75	8.25	7.25
Exchange rate (peso/USD, eop)	new	20.0	20.9	**20.6**	**20.8**	**21.0**
	previous			21.2	21.5	21.7
M10 (%, eop)	new	5.5	7.6	**9.4**	**9.2**	**8.3**
	previous			8.4	8.3	7.8
Fiscal balance (% GDP)	new	-2.9	-2.9	**-3.1**	**-2.8**	**-2.4**
	previous			-3.3	-2.7	-2.4
Current account (% GDP)	new	2.3	-0.4	**-0.8**	**-0.8**	**-1.5**
	previous			-0.8	-0.8	-1.5

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BBVA Research

Mexico Economic Outlook

3Q22

Creating Opportunities