Global market rout triggers an expansion of the FX NDF program

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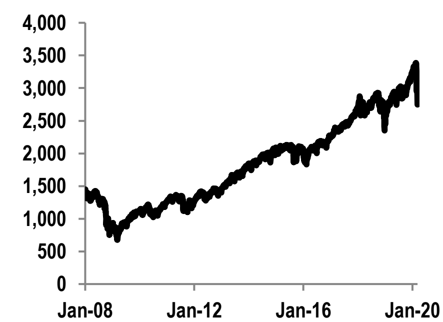
- **Global financial markets are in crisis mode, reacting to the COVID-19 outbreak, along recent announcements by Saudi Arabia and Russia in the oil front**
- **Although the oil sector is still important both for GDP and fiscal accounts –mainly oil-related income– in Mexico, its contribution is much lower when compared to previous periods of instability**
- **Moreover, our country has various mechanisms to cope with shocks such as the one we are currently experiencing, including: (1) FX policy; (2) monetary policy; and (3) fiscal policy**
- **In this respect, the FX Commission, acting as the first line of defense, announced today an increase in the notional amount of the non-deliverable FX forwards program, from US$ 20 to 30 billion**
- **We believe this measure will contribute positively for the markets to adjust in a more orderly fashion, dampening volatility shocks to the Mexican peso**
- **Mexico has solid macroeconomic fundamentals, which we believe will remain in place, going forward**

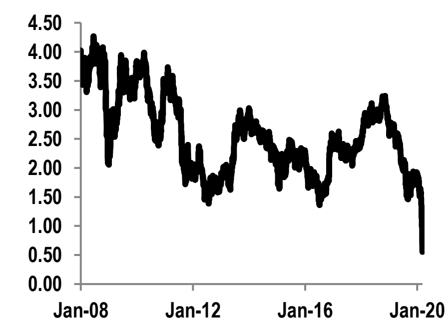
Global markets in crisis mode. Stock markets are exhibiting deep losses, government bond yields in advanced economies have reached new lows in history, and emerging market currencies are facing strong pressures (see charts below). The announcement of a new program by Saudi Arabia to increase crude-oil production levels induced a crash close to 30% in oil prices. The latter has been coupled with heightened concerns among market participants about the global expansion due to the novel Coronavirus, COVID-19, which threatens to be the catalyst for the next global economic recession. The landscape portrayed by financial markets does not necessarily means that the world is in crisis from an economic viewpoint. Nonetheless, it increases risks to the current phase of the global business cycle, which has extended by more than ten years, in a context in which it has lasted five years on average in the past.

S&P 500
Index



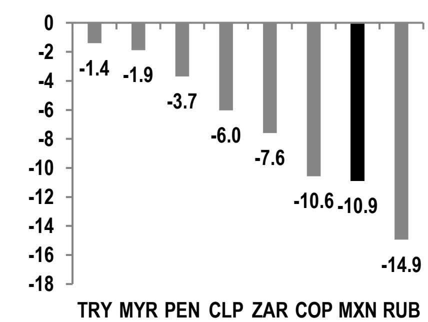
Source: Bloomberg

10-year Treasury note
Yield, %



Source: Bloomberg

Selected currencies*
Accumulated performance since Feb-14



* Against the US dollar
Source: Bloomberg

Today, oil is less relevant for Mexico than before. The dependence of our country to this commodity is less relative to other tumultuous episodes in the oil market, leading us to believe that the impact from these adjustments will be more limited. In particular, we highlight its lower contribution to GDP and fiscal accounts, which in our view will be key for its economic impact to be more modest, as seen in the table below. Moreover, we highlight that the most significant effect from oil price changes is in fiscal accounts, according to partial elasticities estimated by the Ministry of Finance (MoF), as shown in the table below. Nevertheless, it should be reminded that this year's Budget has been hedged with a minimum price of 49US$/bbl with the purchase of financial derivatives and other resources such as those in the Stabilization Fund (*Fondo de Estabilización de los Ingresos Presupuestarios* (FEIP), in Spanish). In our view, this could be key to cope with the current market shock.

Oil in Mexico: Participation and elasticities

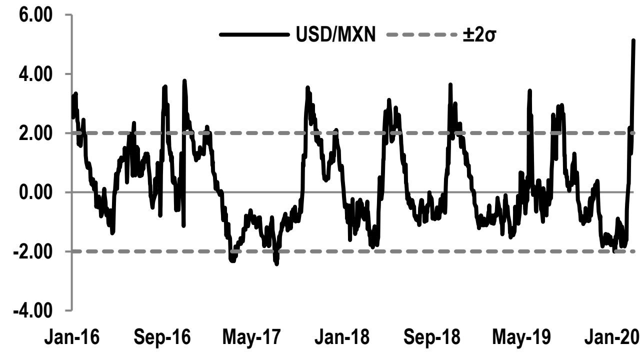
	2019		2013	
	MX$ million	% of total	MX$ million	% of total
Trade balance (US$ million)				
Exports	25,985	5.6	49,481	13.0
Imports	47,207	10.4	40,868	10.7
GDP[1]				
% of GDP	769,300	3.8	1,063,164	6.5
Public finances				
% of total revenues	955,055	17.7	1,344,488	35.4
% of debt (Pemex)	1,983,174	18.3	841,305	11.3

	CGPE 2020	
Elasticities from the Ministry of Finance	**MX$ million**	**% of GDP**
An additional dollar on oil prices	13,776	0.05
An appreciation of 10 cents in the USD/MXN	-3,420	-0.01
Oil income (-)	-3,832	-0.01
Financial costs (+)	413	0.00

1. In nominal terms
Source: Banorte with data from INEGI, SHCP

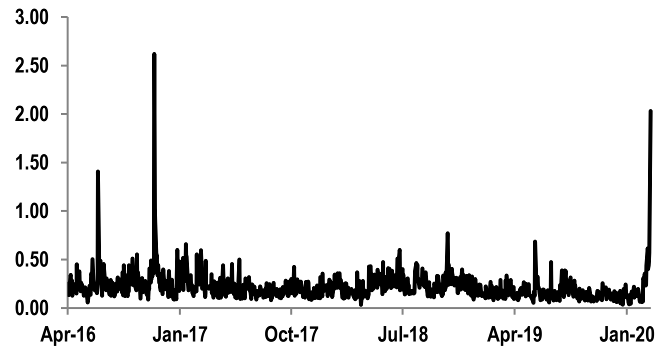
One of the lines of defense against a potential crisis has been deployed. We highlight that Mexico has the same mechanisms than the previous administration to deal with a crisis, including: (1) FX policy; (2) monetary policy; and (3) fiscal policy. Regarding the first, the FX Commission –with members from both Banxico and the MoF– has at their disposal a toolbox that has been developed along the years to deal with strong bouts of volatility in global markets as these have a direct impact in the Mexican currency, particularly against the US dollar. In this respect, the Commission announced earlier today the increase of the maximum amount to be offered in non-deliverable forwards, from US$20 to US$30 billion. As of today, the amount outstanding of these instruments is at US$5.5 billion. We believe this measure will contribute positively for the markets to adjust in a more orderly fashion, dampening volatility shocks to the Mexican peso, as it has happened in previous episodes (see charts below).

Z-score: USD/MXN
Standard deviations using 90-day moving averages



Source: Banorte with data from Bloomberg

Intraday range of the Mexican peso
USD/MXN



Source: Banorte with data from Bloomberg

In terms of monetary policy, the combination of a relatively high repo rate and an annual inflation within Banxico's confidence interval gives leeway to the central bank to ease monetary conditions with a prudent approach. From the fiscal side, the government has less room for maneuver to stimulate the economy. However, we acknowledge a strong likelihood of holding sound fiscal accounts. It is worth mentioning that the rationale behind the use of half of the FEIP last year relied on prepaying debt from Pemex (improving the SOE's debt profile) and not to offset a wider deficit amid lower fiscal revenues (due to the difference between the projected and observed GDP growth figures). Considering these conditions, nowadays Mexico counts on using the same mechanisms as in previous administrations, including the FEIP's outstanding balance and other stability funds, and all the schemes relied upon the *Federal Law on Budget and Treasury Responsibility* (LFPRH given its acronym in Spanish).

The economy is in a better position *vis-à-vis* the 2008-2009 crisis. Mexico's macroeconomic framework depicts a solid stance, standing as a significant buffer against the adverse conditions in the global backdrop. It is relevant to stress out that the negative impact of the 2008-2009 crisis was less severe in comparison with other countries (especially emerging markets) given its sound macro position at that moment. Under this context, several macroeconomic indicators continue improving following the great crisis abovementioned, including a lower exposure in terms of the current account deficit –from 1.5% to 0.2% of GDP–and the replenishment of international reserves, explained both by its balance increasing to US$184.3 billion, as well as the addition of the IMF's Flexible Credit Line (FCL), as seen in the table below. Moreover, Stability Funds are in healthy levels even when considering the partial use during last year. Nevertheless, we acknowledge that some risks have increased, in particular the debt profile of Pemex as percentage of the *Public Sector Borrowing Requirements Historical Balance* (PSBRHB).

Variables related to exchange rate, monetary, and fiscal policy in Mexico

	February 2020			September 2008		
	MX$ million	US$ million	% GDP	MX$ million	US$ million	% GDP
Current account balance	- -	-2,444.0	-0.2	- -	-12,495.1	-1.1
International reserves	- -	245,448.2	21.0	- -	83,553.0	7.3
Without FCL	- -	184,250.0	16.0	- -	83,553.0	7.3
FCL	- -	61,198.2	5.4	- -	0	0
Nominal reference rate: US and Mexico (%)[1]						
US		1.125			2.00	
Mexico		7.00			8.25	
Spread (bps)		588			625	
Real reference rate: US and Mexico (%)[2]						
US		-1.25			-2.95	
Mexico		3.40			3.91	
Spread (bps)		465			686	
Total government debt (HBPSBR)[3]	10,872,269.3	564,840.2	44.7	3,522,289.5	322,306.1	33.8
Public balance (PSBR)[3]	-564,675.1	-29,336.2	-2.3	131,195.0	12,005.0	1.3
Stabilization funds[3]	239,765.0	12,456.4	1.0	88,320.4	8,081.7	0.9
FEIP	158,544.0	8,236.7	0.6	57,284.6	5,241.8	0.6
FEIF	60,461.0	3,141.1	0.2	21,606.2	1,977.1	0.2
FMP	20,760.0	1,078.5	0.1	- -	- -	- -
Other funds	- -	- -	- -	9,429.6	862.9	0.1
	MX$ million	% total revenues	% GDP	MX$ million	% total revenues	% GDP
Oil-related fiscal income[3]	955,054.9	17.7	3.9	925,283.8	37.2	7.5

1. Data up to March 9
2.Data up to March 9, using geometrical difference between repo rate and inflation for 12 months ahead
3. For February 2020 we use data for YE19, while for September 2008 we use data for YE07
Source: Banorte with data from INEGI, Banxico, MoF, and Bloomberg

Mexico needs to send a message to boost confidence. The federal government has similar mechanisms to tackle a crisis as in previous administrations. In addition, we recognize the efforts from President Lopez-Obrador to build confidence and support with business leaders and investors (global and local). Specially in terms of the economic policies that were promised during his campaign and well elaborated in his books “2018: la salida” (“2018: the exit”) (2017) and “Hacia una economía moral” (“Towards a moral economy”) (2019). However, we acknowledge that today’s challenges in the world require a consistent and consolidated message from the government –including the legislative power–, in order to boost confidence with a strategic target to foster investment and private consumption.

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