Ahead of the Curve

We expect 1Q20 aggregate demand at -2.0% y/y, mainly on domestic weakness

June 12, 2020

www.banorte.com
@analisis_fundam

Juan Carlos Alderete, CFA
Director of Economic Research
juan.alderete.macal@banorte.com

Francisco Flores
Senior Economist, Mexico
francisco.flores.serrano@banorte.com

Winners of the award for best economic forecasters for Mexico in 2019, granted by *Refinitiv*

STARMINE AWARDS FOR REUTERS POLLS FROM REFINITIV

Document for distribution among the general public

- **Aggregate supply and demand (1Q20).** We expect a 2.0% y/y contraction, a new low since 3Q09, in the midst of the global financial crisis. Despite the favorable effect from an additional day due to the leap year, the impact from COVID-19 in March more than outweighed for this, especially on the external sector. On supply, GDP showed a 1.4% contraction, while we expect imports to fall 2.8%, dragged by worldwide supply chain disruptions. Weakness would prevail for domestic demand, as it started from a relatively bad position even before the pandemic. Consumption (-0.4%) and investment (-9.3%) would be negative, with the latter showing a very strong contraction. On the contrary, government spending (+0.2%) and exports (+0.7%) would exhibit some resiliency, with the latter partly supported from an inventory drawdown, especially of raw materials to compensate for supply issues. All in all, we believe the report will help us refine details about what happened at the early stage of the pandemic. In broad terms, it is our take that domestic demand stayed very weak, particularly in terms of investment but also in consumption, while external demand held up better, as exemplified by exports

Mexico weekly calendar

DATE	TIME (ET)	EVENT	PERIOD	UNIT	BANORTE	CONSENSUS	PREVIOUS
Tue 16-Jun	**10:00am**	**International reserves**	Jun-12	US$ bn	--	--	187.2
Fri 19-Jun	**7:00am**	**Aggregate supply and demand**	1Q20	% y/y	-2.0	--	-1.6
		Private consumption		% y/y	-0.4	--	0.9
		Government spending		% y/y	0.2	--	-0.2
		Gross fixed investment		% y/y	-9.3	--	-5.2
		Exports		% y/y	0.7	--	-2.8
		Imports		% y/y	-2.8	--	-4.5

Source: Banorte; Bloomberg

Proceeding in chronological order...

Weekly international reserves report. Last week, net international reserves fell by US$68 million, closing at US$187.2 billion. According to Banxico's report, this was explained by a negative valuation effect in institutional assets. In this context, the central bank's international reserves have increased by US$6.4 billion during 2020 (please refer to the following table).

Banxico's foreign reserve accumulation details
US$, million

	2019	Jun 5, 2020	Jun 5, 2020	Year-to-date
	Balance		Flows	
International reserves (B)-(C)	180,877	187,247	-68	6,370
(B) Gross international reserve	183,028	196,914	-482	13,887
Pemex	--	--	0	2,624
Federal government	--	--	-31	7,168
Market operations	--	--	0	0
Other	--	--	-451	4,094
(C) Short-term government's liabilities	2,151	9,667	-414	7,516

Source: Banco de México

Aggregate demand in 1Q20 at its weakest since 3Q09. We expect both aggregate supply and demand to show a 2.0% y/y contraction, considerably below the -1.6% of the previous quarter and at a new low since the 2009 financial crisis. Despite the favorable effect from one additional day due to the leap year, the impact from COVID-19 in March more than outweighed for this, especially on the external sector. Weakness would prevail for domestic demand, as it started from a relatively bad position even before the pandemic.

On the supply side, GDP fell 1.4% y/y, with relevant effects across the board from the pandemic, specifically in March. In this sense, we anticipate imports to decline 2.8%, affected mainly by supply chain disruptions –particularly in China but also in Europe and the US–. Within the trade balance and in dollar terms, monthly dynamics were already weak even before COVID-19, with an accumulated decline in imports of 3.5% y/y in Jan-Feb. Nevertheless, they fell to -6.7% in March. Therefore, goods fell 4.6% in the quarter. Incorporating services using current account data, expenditures fell 5.0% in 1Q20. Nonetheless, this was lessened by the depreciation of the Mexican peso, which slipped 4.2% y/y, trading at 20.01 per dollar on average in the period. When adjusting for the latter, imports of goods and services in local currency terms declined only 1.1%.

Going into demand, exports held up relatively better in the period, so we anticipate a 0.7% expansion. Contrary to imports, performance in the first two months within the trade balance was positive, edging-up 1.6%, to then fall only 1.7% in March. In this sense, the total for the quarter came in at +0.4%. When including services, revenues decreased 0.4% in USD but were up +3.7% in MXN.

Regarding consumption, we forecast a 0.4% contraction, also dragged by weakness in March. According to the monthly indicator, this sector fell 0.7% in the quarter, its first negative print since 4Q09. While January and February were skewed to the upside –with the latter highly benefited by the leap year at +0.5% (-0.7% using sa figures)–, March was also struck by the pandemic.

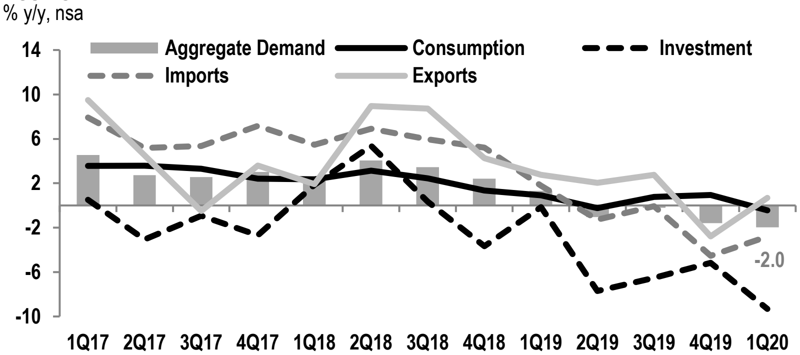
In the last month, both durable and semi-durable goods were down heavily (both domestic but much more imported goods), while non-durables picked up, probably supported by preemptive purchases of essential goods.

Regarding investment, the quarterly tracking from the monthly GFI index shows a 9.3% contraction. As we outlined in our monthly reports, dynamics have been weak for a while now, but March showed a steeper decline as a result of the outbreak, especially in imported M&Eq. While this would be stronger than our preliminary estimate of -11.2%, it is still a significant contraction.

We see a slight uptick in government spending at +0.2%. Nevertheless, one key factor would be only a less challenging base effect, as it contracted 0.8% in 1Q19. According to public finance reports, total spending by the Federal Government increased 6.2% y/y in real terms, with non-capital spending up 7.8%. Nevertheless, we are wary of these figures as they include social programs' transfers, not accounted for in this sector within aggregate demand. In addition, bank account balances for states and municipalities increased about 21.2%, likely limiting the upside as they suggest an accumulation of resources.

Finally, we believe we could see a slight decrease in inventories, with businesses tapping into them to face supply chain disruptions, particularly regarding raw materials All in all, we consider the report will help us refine the details about the early-stage effects of the pandemic. In broad terms, domestic demand stayed very weak, particularly in terms of investment but also in consumption, while external demand held up better (as portrayed in exports). These are reflected in persistent declines in imports and more resilient exports, resulting in a bias towards a higher surplus (or lower deficit) in both the trade and current account balances. Moreover, these figures will help us to hone-in on the trends going into 2Q20, which, in any case, is very likely be the most affected quarter in the year by a significant magnitude.

Aggregate demand
% y/y, nsa



Source: INEGI, Banorte

Analyst Certification

We, Gabriel Casillas Olvera, Alejandro Padilla Santana, Delia María Paredes Mier, Juan Carlos Alderete Macal, Manuel Jiménez Zaldívar, Marissa Garza Ostos, Tania Abdul Massih Jacobo, Francisco José Flores Serrano, Katia Celina Goya Ostos, Santiago Leal Singer, José Itzamna Espitia Hernández, Valentín III Mendoza Balderas, Víctor Hugo Cortes Castro, Hugo Armando Gómez Solís, Miguel Alejandro Calvo Domínguez, Luis Leopoldo López Salinas, Leslie Thalía Orozco Vélez, Gerardo Daniel Valle Trujillo, Eridani Ruibal Ortega and Juan Barbier Arizmendi, certify that the points of view expressed in this document are a faithful reflection of our personal opinion on the company (s) or firm (s) within this report, along with its affiliates and/or securities issued. Moreover, we also state that we have not received, nor receive, or will receive compensation other than that of Grupo Financiero Banorte S.A.B. of C.V for the provision of our services.

Relevant statements.

In accordance with current laws and internal procedures manuals, analysts are allowed to hold long or short positions in shares or securities issued by companies that are listed on the Mexican Stock Exchange and may be the subject of this report; nonetheless, equity analysts have to adhere to certain rules that regulate their participation in the market in order to prevent, among other things, the use of private information for their benefit and to avoid conflicts of interest. Analysts shall refrain from investing and holding transactions with securities or derivative instruments directly or through an intermediary person, with Securities subject to research reports, from 30 calendar days prior to the issuance date of the report in question, and up to 10 calendar days after its distribution date.

Compensation of Analysts.

Analysts' compensation is based on activities and services that are aimed at benefiting the investment clients of Casa de Bolsa Banorte and its subsidiaries. Such compensation is determined based on the general profitability of the Brokerage House and the Financial Group and on the individual performance of each analyst. However, investors should note that analysts do not receive direct payment or compensation for any specific transaction in investment banking or in other business areas.

Last-twelve-month activities of the business areas.

Grupo Financiero Banorte S.A.B. de C.V., *through its business areas, provides services that include, among others, those corresponding to investment banking and corporate banking, to a large number of companies in Mexico and abroad. It may have provided, is providing or, in the future, will provide a service such as those mentioned to the companies or firms that are the subject of this report. Casa de Bolsa Banorte or its affiliates receive compensation from such corporations in consideration of the aforementioned services.*

Over the course of the last twelve months, Grupo Financiero Banorte S.A.B. C.V., has not obtained compensation for services rendered by the investment bank or by any of its other business areas of the following companies or their subsidiaries, some of which could be analyzed within this report.

Activities of the business areas during the next three months.

Casa de Bolsa Banorte, Grupo Financiero Banorte or its subsidiaries expect to receive or intend to obtain revenue from the services provided by investment banking or any other of its business areas, by issuers or their subsidiaries, some of which could be analyzed in this report.

Securities holdings and other disclosures.

As of the end of last quarter, Grupo Financiero Banorte S.A.B. of C.V. has not held investments, directly or indirectly, in securities or derivative financial instruments, whose underlying securities are the subject of recommendations, representing 1% or more of its investment portfolio of outstanding securities or 1 % of the issuance or underlying of the securities issued.

None of the members of the Board of Grupo Financiero Banorte and Casa de Bolsa Banorte, along general managers and executives of an immediately below level, have any charges in the issuers that may be analyzed in this document.

The Analysts of Grupo Financiero Banorte S.A.B. of C.V. do not maintain direct investments or through an intermediary person, in the securities or derivative instruments object of this analysis report.

Guide for investment recommendations.

	Reference
BUY	When the share expected performance is greater than the MEXBOL estimated performance.
HOLD	When the share expected performance is similar to the MEXBOL estimated performance.
SELL	When the share expected performance is lower than the MEXBOL estimated performance.

Even though this document offers a general criterion of investment, we urge readers to seek advice from their own Consultants or Financial Advisors, in order to consider whether any of the values mentioned in this report are in line with their investment goals, risk and financial position.

Determination of Target Prices

For the calculation of estimated target prices for securities, analysts use a combination of methodologies generally accepted among financial analysts, including, but not limited to, multiples analysis, discounted cash flows, sum-of-the-parts or any other method that could be applicable in each specific case according to the current regulation. No guarantee can be given that the target prices calculated for the securities will be achieved by the analysts of Grupo Financiero Banorte S.A.B. C.V, since this depends on a large number of various endogenous and exogenous factors that affect the performance of the issuing company, the environment in which it performs, along with the influence of trends of the stock market, in which it is listed. Moreover, the investor must consider that the price of the securities or instruments can fluctuate against their interest and cause the partial and even total loss of the invested capital.

GRUPO FINANCIERO BANORTE S.A.B. de C.V.

Research and Strategy			
Gabriel Casillas Olvera	IRO and Chief Economist	gabriel.casillas@banorte.com	(55) 4433 - 4695
Raquel Vázquez Godinez	Assistant	raquel.vazquez@banorte.com	(55) 1670 - 2967
Lourdes Calvo Fernández	Analyst (Edition)	lourdes.calvo@banorte.com	(55) 1103 - 4000 x 2611
Economic Research and Financial Market Strategy			
Alejandro Padilla Santana	Executive Director of Economic Research and Financial Markets Strategy	alejandro.padilla@banorte.com	(55) 1103 - 4043
Itzel Martínez Rojas	Analyst	itzel.martinez.rojas@banorte.com	(55) 1670 - 2251
Economic Research			
Juan Carlos Alderete Macal, CFA	Director of Economic Research	juan.alderete.macal@banorte.com	(55) 1103 - 4046
Francisco José Flores Serrano	Senior Economist, Mexico	francisco.flores.serrano@banorte.com	(55) 1670 - 2957
Katia Celina Goya Ostos	Senior Economist, Global	katia.goya@banorte.com	(55) 1670 - 1821
Luis Leopoldo López Salinas	Economist, Global	luis.lopez.salinas@banorte.com	(55) 1103 - 4000 x 2707
Market Strategy			
Manuel Jiménez Zaldívar	Director of Market Strategy	manuel.jimenez@banorte.com	(55) 5268 - 1671
Fixed income and FX Strategy			
Santiago Leal Singer	Senior Strategist, Fixed Income and FX	santiago.leal@banorte.com	(55) 1670 - 2144
Leslie Thalía Orozco Vélez	Strategist, Fixed Income and FX	leslie.orozco.velez@banorte.com	(55) 5268 - 1698
Equity Strategy			
Marissa Garza Ostos	Director of Equity Strategy	marissa.garza@banorte.com	(55) 1670 - 1719
José Itzamna Espitia Hernández	Senior Strategist, Equity	jose.espitia@banorte.com	(55) 1670 - 2249
Valentín III Mendoza Balderas	Senior Strategist, Equity	valentin.mendoza@banorte.com	(55) 1670 - 2250
Víctor Hugo Cortes Castro	Senior Strategist, Technical	victorh.cortes@banorte.com	(55) 1670 - 1800
Eridani Ruibal Ortega	Analyst	eridani.ruibal.ortega@banorte.com	(55) 1103 - 4000 x 2755
Juan Barbier Arizmendi	Analyst	juan.barbier@banorte.com	(55) 1670 - 1746
Corporate Debt			
Tania Abdul Massih Jacobo	Director of Corporate Debt	tania.abdul@banorte.com	(55) 5268 - 1672
Hugo Armando Gómez Solís	Senior Analyst, Corporate Debt	hugoa.gomez@banorte.com	(55) 1670 - 2247
Gerardo Daniel Valle Trujillo	Analyst, Corporate Debt	gerardo.valle.trujillo@banorte.com	(55) 1670 - 2248
Economic Studies			
Delia María Paredes Mier	Executive Director of Economic Studies	delia.paredes@banorte.com	(55) 5268 - 1694
Miguel Alejandro Calvo Domínguez	Senior Analyst, Economic Studies	miguel.calvo@banorte.com	(55) 1670 - 2220
Wholesale Banking			
Armando Rodal Espinosa	Head of Wholesale Banking	armando.rodal@banorte.com	(81) 8319 - 6895
Alejandro Aguilar Ceballos	Head of Asset Management	alejandro.aguilar.ceballos@banorte.com	(55) 5268 - 9996
Alejandro Eric Faesi Puente	Head of Global Markets and Institutional Sales	alejandro.faesi@banorte.com	(55) 5268 - 1640
Alejandro Frigolet Vázquez Vela	Head of Sólida Banorte	alejandro.frigolet.vazquezvela@banorte.com	(55) 5268 - 1656
Arturo Monroy Ballesteros	Head of Investment Banking and Structured Finance	arturo.monroy.ballesteros@banorte.com	(55) 5004 - 1002
Carlos Alberto Arciniega Navarro	Head of Treasury Services	carlos.arciniega@banorte.com	(81) 1103 - 4091
Gerardo Zamora Nanez	Head of Transactional Banking, Leasing and Factoring	gerardo.zamora@banorte.com	(81) 8318 - 5071
Jorge de la Vega Grajales	Head of Government Banking	jorge.delavega@banorte.com	(55) 5004 - 5121
Luis Pietrini Sheridan	Head of Private Banking	luis.pietrini@banorte.com	(55) 5004 - 1453
Lizza Velarde Torres	Executive Director of Wholesale Banking	lizza.velarde@banorte.com	(55) 4433 - 4676
Osvaldo Brondo Menchaca	Head of Specialized Banking Services	osvaldo.brondo@banorte.com	(55) 5004 - 1423
Raúl Alejandro Arauzo Romero	Head of Transactional Banking	alejandro.arauzo@banorte.com	(55) 5261 - 4910
René Gerardo Pimentel Ibarrola	Head of Corporate Banking	pimentelr@banorte.com	(55) 5268 - 9004
Ricardo Velázquez Rodríguez	Head of International Banking	rvelazquez@banorte.com	(55) 5004 - 5279
Víctor Antonio Roldan Ferrer	Head of Commercial Banking	victor.roldan.ferrer@banorte.com	(55) 5004 - 1454