

External Stability Monitor

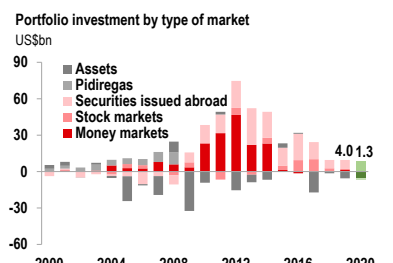
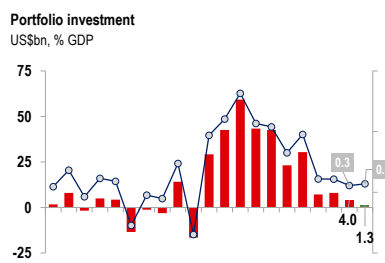
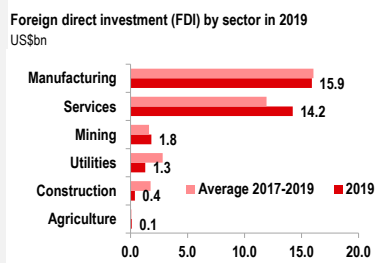
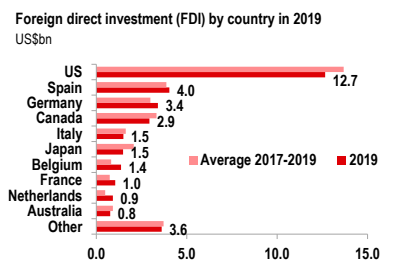
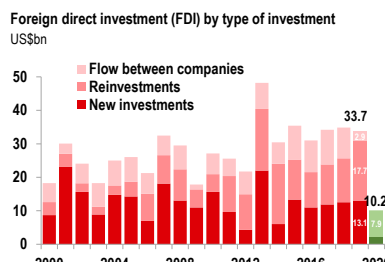
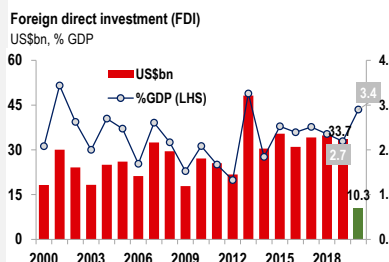
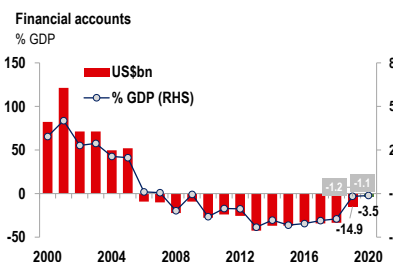
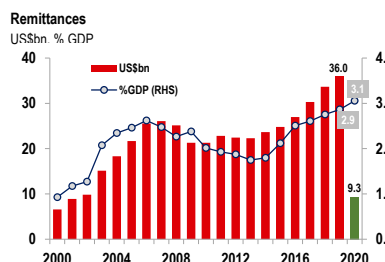
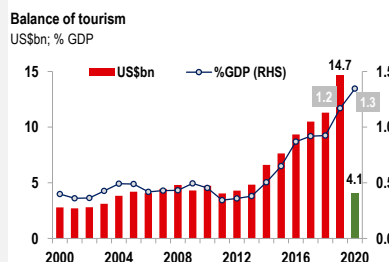
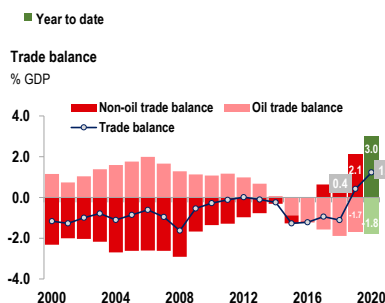
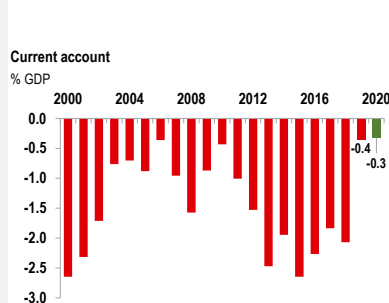
June 24, 2020

- In an open economy, the flow of both goods and capital takes special relevance.
- Market volatility could eventually translate into capital outflows that can be detrimental to economic stability, especially since they could force costly and disruptive adjustments to the real economy.
- The Mexican economy has enjoyed several years of stability in the external sector, explained by several factors:
 - 1) A flexible exchange rate regime, which allows the adjustment of the current account deficit;
 - 2) A non-oil trade balance with a cyclical behavior, so that if exports slow down, so do imports of intermediate goods, with the deficit remaining under control;
 - 3) An increasing flow of remittances and a significant growth in the tourism sector, which translates into a surplus balance of tourist services in the current account;
 - 4) More than enough foreign investment flows to finance the current account deficit; and
 - 5) Portfolio investments on the back of the country's appeal in terms of economic prospects and interest rate levels, among others
- Nevertheless, in the past few years, portfolio flows have ebbed away on the back of U.S. Fed's (brief) tightening cycle, along with uncertainty generated as a result of both global and domestic factors.

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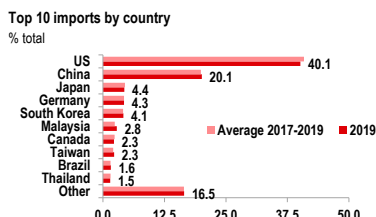
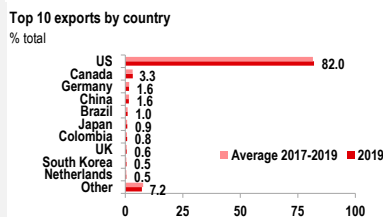
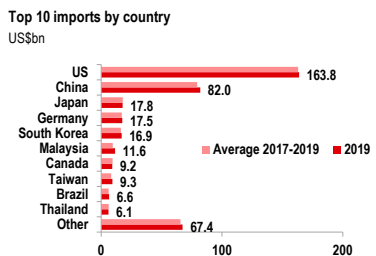
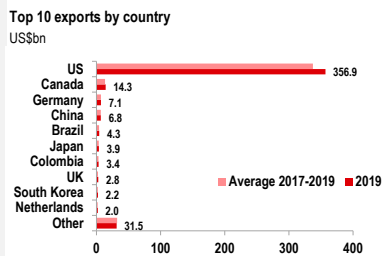
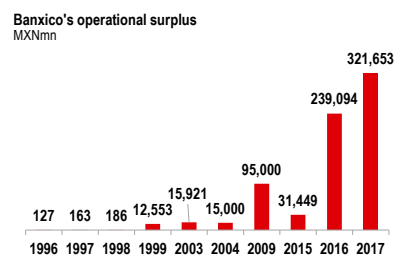
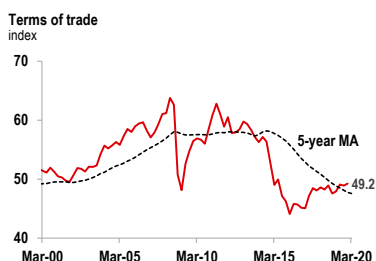
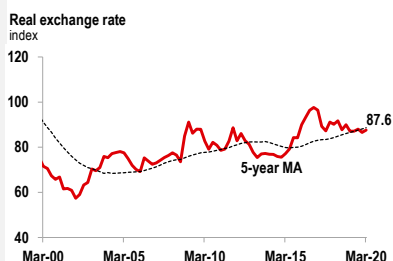
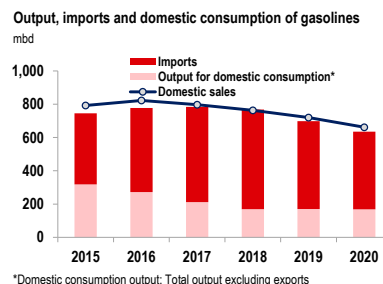
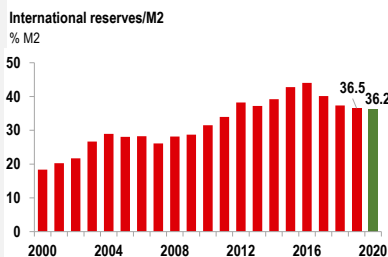
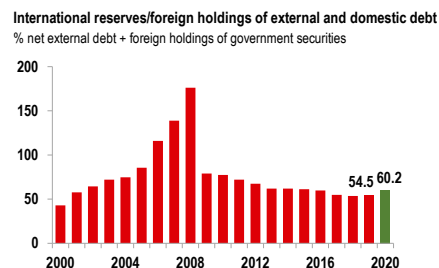
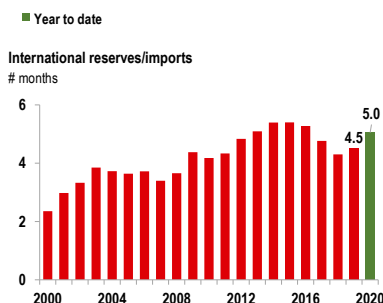
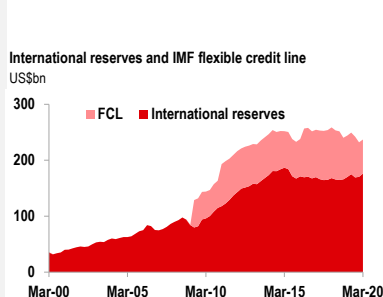
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Document for the general public



Solid external fundamentals

- International reserves, coupled with the *Flexible Credit Line* granted by the IMF, underpin the country's external position, which remains relatively strong.
- In this context, in the event of a sudden stop in the capital account, international reserves would serve to finance around 5 months of imports in 1Q20, while representing 36.2% of the money supply. In terms of possible negative portfolio investment flows, reserves represent 60% of net external debt and foreign holdings of government securities.
- Nevertheless, we highlight that gasoline consumption in the country comes mostly from imports, which becomes especially sensitive in terms of the finances of Pemex, which is the main importer, as well as the government, which controls the prices, especially in periods in which there is volatility in the exchange rate and in energy prices.
- In terms of the real exchange rate, according to Banxico's data as of March 2020, the exchange rate was slightly below the average observed in the last 5 years, which would suggest that the nominal exchange rate was roughly at fair value.
- Moreover, the terms of trade (export prices over import prices) deteriorated significantly from 2014, when oil export prices fell sharply only to recover incipiently from the end of 2017.



Relevant dates for the external sector

Event	Date
IMF/World Bank Spring Meetings	April 13-19, 20
OPEC meetings	9-Jun-20
OECD Economic Outlook	10-Jun-20
IMF World Economic Outlook update	24-Jun-20
Renewal of swap line with the U.S. Fed	Sep-20
IMF/World Bank Annual Meetings	12-18 Oct, 20
World Economic Outlook	13-Oct-20
Meeting of APEC ministers	8-9 Nov, 20
G20 summit	21-21 Nov, 20
60th Anniversary of OECD convention	14-Dec-20
Renewal of Flexible Credit Line with IMF	1-Nov-21

Making sense of external accounts...

- Banxico reports balance of payments figures according to the guidelines included in the sixth edition of the *IMF Balance of Payments and International Investment Position Manual*
- The current account (-0.4% of GDP in 2019) shows flows between residents and nonresidents and it is composed by:
 - 1) The trade balance (0.4% of GDP);
 - 2) The balance of services (-0.7% of GDP);
 - 3) Net primary income (-2.9% of GDP), which includes the balance of tourism; and
 - 4) Net secondary income (2.8% of GDP), where we highlight the flow of remittances
- The trade balance registers the flow exports and imports of goods. In Mexico it is important to make the distinction between the trade balance of oil (-1.7% of GDP) and non-oil goods (2.1% of GDP).
- In the balance of services (-0.7% of GDP), we highlight the balance of the tourism sector (US\$17.4bn or 1.2% of GDP in 2019), which represent the third largest inflow to the country, after remittances (US\$36bn) and FDI (US\$33.7bn).
- Net primary income (-2.9% of GDP) shows the flow of payments to the different factors of production, as it is the case of wages, dividends, interest payments among others.
- Net secondary income (2.8% of GDP) is the flow between residents and non-residents of transfers. In Mexico, the balance of this account is positive given the large flow of remittances sent by Mexican workers abroad. (2.9% of GDP).
- The capital account (0.004% of GDP in 2019) shows credit and debit entries for nonproduced nonfinancial assets and capital transfers between residents and nonresidents.
- The financial account (1.4% of GDP) shows net acquisition and disposal of financial assets and liabilities. Within this account we highlight:
 - 1) Direct investments, which are those made by non-residents in the country with long-term benefits;
 - 2) Portfolio investments that include investments in financial assets;
 - 3) Other investments, credit and deposits in other countries;
 - 4) Financial derivatives; and
 - 5) Reserves, which include all domestic holdings in a foreign currency
- According to the IMF, the balance in the financial account (-1.2% of GDP) equals the sum of the current account balance (-0.4% of GDP), the capital account (-0.004% of GDP), as well as errors and omissions (-0.8% of GDP).
- Reserve assets are those external assets that are readily available to and controlled by monetary authorities for meeting balance of payments financing needs, for intervention in exchange markets to affect the currency exchange rate, and for other related purposes (such as maintaining confidence in the currency and the economy, and serving as a basis for foreign borrowing).
- As a result, we believe that the following measures are relevant to gauge to the solidity of international reserves:
 - 1) International reserves in months of imports (4.5 months on average in 2019);
 - 2) International reserves as a percentage of money supply (36.5% of M2 in 2019); and
 - 3) International reserves as a percentage of external debt and foreign holdings of government securities (54.5% in 2019)

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.

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	Reference
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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.

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