Economic Research
Mexico

Ahead of the Curve

We estimate a historical decline of 19.5% in 2Q20 GDP due to the pandemic shock

- **Gross domestic product (2Q20).** We expect GDP to fall -19.5% y/y in the second quarter of 2020, sharply affected by social distancing measures and other efforts to combat the virus. We should mention that with the negative surprise in today's IGAE print, we adjusted marginally lower (-10bps) our forecast for the quarter relative to the original estimate. Our forecast implies an improvement in June, as signals suggest a recovery given the gradual restart of the economy, although still very weak in annual terms. On a sequential basis, we expect GDP to decline 17.9% q/q. Specifically, we anticipate industry to contract 26.3% y/y (-23.4% q/q) and services at -17.6% y/y (-16.5% q/q)
- **Trade balance (June).** We estimate a US$2,246.9 million surplus, which compares to the US$3,522.6 million deficit of the previous month. We believe this would result from the resumption in some sectors of the economy –mainly non-oil–, albeit at lower levels. In this sense, total trade (exports plus imports) would result at US$54,900.5 million, which implies a 25.1% y/y decline, improving relative to the -52.0% in May. Total exports would decline 24.7% y/y, while imports could stand at -25.6%. Inside, the oil balance would worsen on higher prices for both exports and imports, with volumes declining for the former and rising for the latter. On non-oil, a better performance in manufacturing exports, boosted by better figures in the US, coupled with weakness in consumption and capital goods imports would result in a surplus

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Mexico weekly calendar

DATE	HOUR (ET)	EVENT	PERIOD	UNIT	BANORTE	CONSENSUS	PREVIOUS
Mon 27-Jul	7:00am	Trade balance	June	US$ mn	2,246.9	--	-3,522.6
		Total exports		% y/y	-24.7	--	-56.7
		Oil exports		% y/y	-53.3	--	-63.8
		Non-oil exports		% y/y	-23.1	--	-56.3
		Total imports		% y/y	-25.6	--	-47.1
Tue 28-Jul	10:00am	International reserves	Jul-24	US$ bn	--	--	191.5
Tue 28-Jul		Pemex releases corporate results for 2Q20					
Thu 30-Jul	7:00am	GDP	2Q20	% y/y	-19.5	-21.2	-1.4
		(sa)		% q/q	-17.9	--	-1.2
		Primary activities		% y/y	0.1	--	1.4
		Industrial production		% y/y	-26.3	--	-2.9
		Services		% y/y	-17.6	--	-0.7
Thu 30-Jul	3:30pm	Budget balance (PSBRs)	June	$ bn	--	--	180.7
Fri 31-Jul	10:00am	Comercial banking credit	June	% y/y real terms	4.7	--	5.3
		Consumption		% y/y real terms	-4.9	--	-4.2
		Housing		% y/y real terms	5.6	--	6.2
		Non-banking private firms		% y/y real terms	8.1	--	8.5

Source: Banorte; Bloomberg

Proceeding in chronological order…

Trade to start to regain momentum in June. We estimate a US$ 2,246.9 million surplus, which compares to the US$3,522.6 million deficit of the previous month. We believe this is a result of the resumption in some sectors of the economy – mainly in non-oil–, albeit at lower levels. In this sense, total trade (exports plus imports) would result at US$54,900.5 million, which implies a 25.1% y/y decline, improving relative to the -52.0% seen in May. Total exports would decline 24.7% y/y, while imports could stand at -25.6%. Inside, the oil balance would worsen on higher prices for both exports and imports, with volumes declining for the former and rising for the latter. Meanwhile, on non-oil, a better performance in manufacturing exports, boosted by better figures in the US, coupled with weakness in consumption and capital goods imports would result in a surplus.

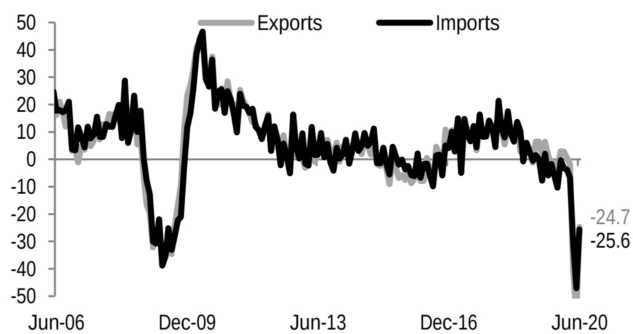
In oil, we anticipate a US$1,547.4 million deficit, back to more normal levels although still influenced by dynamics related to the pandemic. On exports, prices continued to recover –with the Mexican oil mix averaging 33.54 US$/bbl vs. 24.72 US$/bbl in the previous month–, although still negative in the annual comparison at -41.8% (previous: -60.3%). On volumes, the 100kbpd cut continued in the month, which on top of possible disruptions from the suspension of payments to Pemex's suppliers, probably resulted in additional declines. This is supported by data from US imports, which shows a marginal deceleration relative to the previous month. In this sense, we expect total oil exports at -53.3% y/y, with crude at -57.2%. On imports, we forecast a more favorable performance, driven higher by both prices and volumes. In the former, gasoline futures in the US came in at -33.2% y/y, improving relative to the -51.7% seen in the previous month. In addition, export figures from the US suggest higher volumes, which is consistent with signals of higher mobility and the gradual restart of activity, albeit still weak on the overall impact to the economy. In this context we anticipate oil consumption goods imports at -44.3%. Meanwhile intermediate imports would be slightly better at -30.2%, partially aided by higher dynamism in manufacturing.

The non-oil balance would come in at a US$3,794.3 million surplus, breaking with two consecutive months of deficits. In this sense, we believe that some of the possible inventory build-up in the previous two months, as imports outpaced exports, might be favorable on the restart, as raw materials will probably be more readily available. We estimate exports at -23.1%, with imports at -24.4%. Within the former, we expect higher dynamism on the back of the designation of new essential activities, most relevant in this case being auto manufacturing and non-oil mining. In this sense, the leader of the National Council of Export Manufacturers, Luis Aguirre Lang, stated that since the second half of the month "*…almost 100% of businesses dedicated to manufacturing exports resumed activities…*", which bodes well for the sector. In this context, AMIA's auto exports came in at -38.8% y/y, much better than the -95.1% in May. Therefore, we anticipate a decline of 34.7% within the trade balance report.

In addition, regarding other manufacturing exports we anticipate a 17.8% contraction, aided by higher dynamism in US industrial production, climbing to -10.9% from -15.4%. Meanwhile, non-oil mining would also improve, although remaining negative at -14.9%, with agricultural exports also slightly higher at -2.3%.

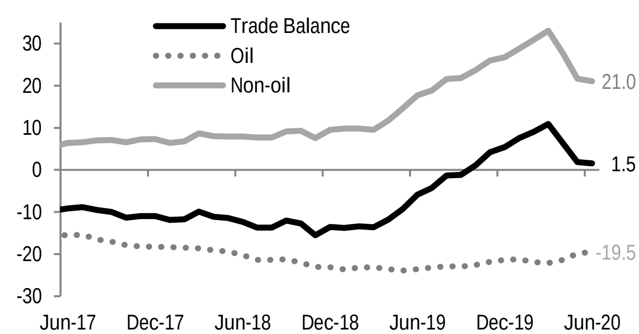
On imports, available data suggests a slightly performance relative to the previous month, with greater dynamism in the US, with the ISM exports index increasing to 47.6pts from 39.5pts in May. In particular, we believe this will have a favorable impact on intermediate goods imports, declining 23.8% y/y. Nevertheless, given prevailing uncertainty as well as the impact on jobs and changing consumption patterns, we expect relatively more weakness in capital (-19.4%) and consumption goods (-33.8%). On the former, we should mention that there is a more favorable base effect, with levels still low. Regarding the latter, signals from China's exports seem to back this sentiment, as they fell more strongly in May, which considering the time lag between shipments and arrivals, would cause disruptions in June as a result of higher inventories coupled with lower demand.

Exports and Imports
% y/y nsa



Source: INEGI, Banorte

Trade balance
US$ billion, 12-month rolling sum



Source: INEGI, Banorte

Weekly international reserves report. Last week, net international reserves increased by US$347 million, closing at US$191.5 billion. According to Banxico's report, this was explained by: (1) Sales of US$150 million from the Federal Government to the central bank; (2) Sales of US$100 million from Pemex to the monetary authority; and (3) a positive valuation effect in institutional assets of US$97 million. In this context, the central bank's international reserves have increased by US$10.6 billion during 2020 (please refer to the following table).

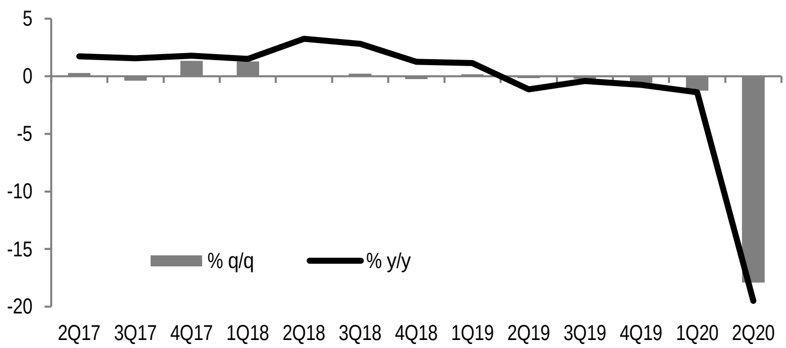
Banxico's foreign reserve accumulation details
US$, million

	2019	Jul 17, 2020	Jul 17, 2020	Year-to-date
	Balance		Flows	
International reserves (B)-(C)	180,877	191,468	347	10,591
(B) Gross international reserve	183,028	197,226	147	14,198
Pemex	--	--	100	2,719
Federal government	--	--	-227	6,625
Market operations	--	--	0	0
Other	--	--	274	4,854
(C) Short-term government's liabilities	2,151	5,757	-200	3,607

Source: Banco de México

Massive impact on economic activity in 2Q20 in the midst of the COVID-19 pandemic. We expect GDP to fall -19.5% y/y in the second quarter of 2020, sharply affected by social distancing measures and other efforts to combat the virus. We should mention that with the negative surprise in today's IGAE print, we adjusted marginally lower (-10bps) our forecast for the quarter relative to the original estimate. Activity in the first two months of the period (April and May) according to that indicator came in at -21.3% y/y. In this sense, our forecast implies an improvement in June, as signals suggest a recovery given the gradual restart of the economy, although still very weak in annual terms. On a sequential basis, we expect GDP to decline 17.9% q/q, as shown in the chart below.

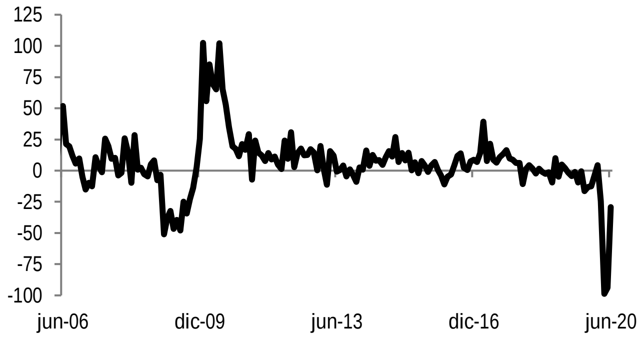
GDP
% y/y nsa; % q/q sa



Source: INEGI, Banorte

In industry June's key driver was likely the designation of three new essential activities: auto manufacturing, construction and non-oil mining. On the first, we have already seen positive developments as auto production climbed to 238,946 units, equivalent to a 29.3% y/y decline from 93.7% in May (see chart below on the left). In this context, IMEF's manufacturing PMI climbed 4.4pts to 42.0pts, with relevant increases in 'new orders' and 'production', which gives some support to our expectations of a recovery. We must also add favorable comments from business chamber leaders which suggest a more widespread advance, as outlined in the trade balance section. In addition, the improvement in US industry, considering the high degree of supply chains connection, should also bode better for the sector. In oil mining, it should be recalled that the production cut of 100kbpd started in May and extended through June, which along reports of the suspension of payments to Pemex providers, would result in a decline in annual terms. In non-oil, its designation as essential will likely be positive. This happened in a context in which commodity prices recovered, providing an additional incentive to producers to scale production up, particularly when compared to previous months. Going to construction, we highlight that IMSS's formal jobs report showed that this was one of two sectors with net gains, at 98,503 new posts. This is similar to confidence and aggregate trend indicators for the sector (chart below, right), which were better relative to May, albeit still near historical lows. This would also be helped by its designation as essential, as even though public sector works continued, they represent a low share when compared to the private sector. Considering these factors, we estimate a contraction of 26.3% y/y (-23.4% q/q) in the quarter.

Auto production
% y/y



Source: INEGI; AMIA

Construction: aggregate trend and confidence indicators
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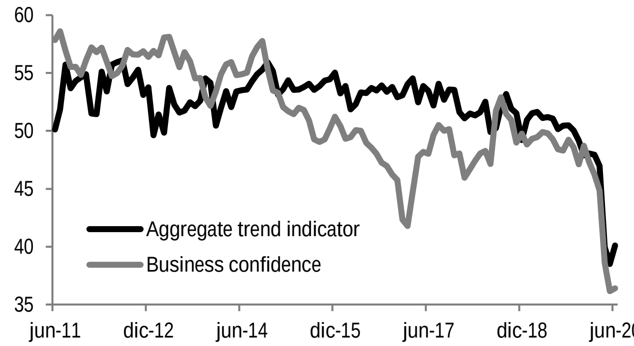
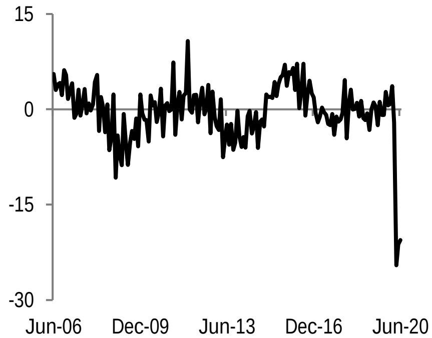


Source: INEGI

In services we anticipate a 17.6% y/y contraction (-16.5% q/q). Although the latest signals are also better, results within May's IGAE dampened some of our optimism as we had also seen them in said month. In particular, during June and in a broad sense, IMEF's non-manufacturing PMI also edged-up by 4.4pts, standing at 42.5pts, also with relevant increases in 'production' and 'new orders', similar to manufacturing. Meanwhile, aggregate trend indicators for both non-financial services and commerce rebounded, even surpassing levels in March, which we consider to be very favorable. However, and looking inside, we still expect to see targeted shocks in non-essential sectors, mainly tourism and entertainment, albeit marginally better relative to April and May. Regarding lodging and restaurants, hotel occupancy rates stood at 4.3% in the first week of June (vs. the 3.1% average in May), while *Open Table* figures showed an average annual decline in seated diners in June of -90.7% (previous: -98.4%). On recreational services, guidelines for the reopening of museums and archeological sites suggest they remained closed in June, while massive events such as concerts and sporting events were still suspended. In this sense, we believe both remain very weak. Going into transportation, air passenger traffic in privately-operated airports declined 82.5% y/y, which implies a 10.5%-pts rise relative to the previous month. Moreover, we believe there will be an additional boost from higher manufacturing and trade. Retail could also improve, albeit less so, as signals from ANTAD's same-store sales suggest only a marginal uptick, coming in at -20.5% y/y in real terms, up from -21.2% (see chart below on the left). On a slightly more positive note, auto sales stood at -41.1% y/y vs. -59.0% in May. In addition, higher mobility, as suggested by both *Apple* and *Google*'s data, may have pushed gasoline sales up (see charts in the middle and right). However, we remain cautious as distortions from changing consumption patterns, on top of weaker fundamentals, continue to weigh heavily on performance. Finally, we expect education and healthcare, as well as financial services, to remain resilient, hovering close to current levels.

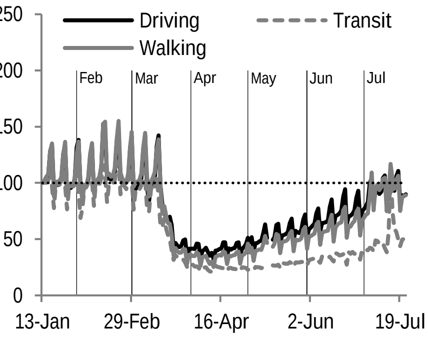
All in all, after an historical plunge in 2Q20 we anticipate a sequential recovery in the second half of the year. However, we still believe risks are tilted to the downside as policy flexibility is constrained in terms of stimulus given mandated austerity measures, uncertainty remains high given the lack (at least until now) of an effective treatment and/or vaccine, and the hit the pandemic has exerted on both aggregate demand and key industries (e.g. air travel, lodging, entertainment). Therefore, we maintain our full-year forecast at -9.8% y/y for 2020.

ANTAD same-store sales
% y/y in real terms



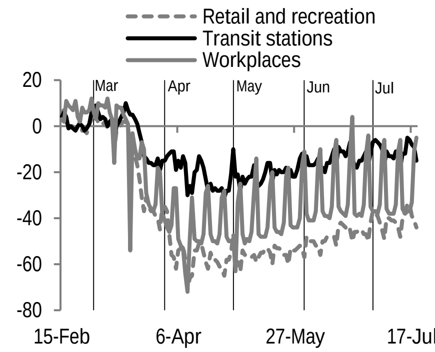
Source: Banorte with data from ANTAD and INEGI

Change in routing requests in Apple Maps in Mexico
Deviation from level seen in January 13



Source: Apple

Movement trends in public places according to Google
Deviation from the trend as a percentage change



Source: Google

MoF's public finance report (May). Attention will center on Public Balance and Public Sector Borrowing Requirements (PSBR) –with the latter at -$180.7 billion in May– and comparing them to forecasts in the *2021 Preliminary Economic Policy Assumptions.* We will also be looking at the primary balance, as it will relay more data about the additional pace of spending on efforts to combat COVID-19, increasing sharply in the last few months. Regarding revenues and spending, we will also be watching performance in the annual comparison, particularly the former, as these could offer additional insights on economic activity. Finally, we will also analyze public debt, which as of May stood at MXN$11.8tn (as measured by the HBPSBRs).

Banking credit to grow 4.7% y/y in June, once again driven by corporates. This would be below the +5.3% observed in May. As already mentioned, this would be explained by the 8.1% expansion in credit to corporates, remembering that businesses have tapped their credit lines in the previous three months given increased liquidity needs. Meanwhile, mortgages would marginally decelerate, growing 5.6%. Finally, consumer credit would remain in negative territory at -4.9%, lowest since August 2010. It should be noted there is a negative effect from inflation, which came in at 3.33% y/y in June, 50bps above May's print.

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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