Economic Research
Mexico

Ahead of the Curve

Looking for clues on activity at the start of 4Q20

- **IMEF PMI indicators (October).** We expect both indicators to improve again. Nevertheless, performance would be mixed, with gains in the manufacturing sector outpacing non-manufacturing, in contrast with the latest dynamics. We estimate manufacturing at 48.5pts, above August's 46.4pts. Once again, we believe performance will continue to be driven by strength abroad, despite some warning signs domestically. The non-manufacturing indicator could stand at 49.7pts, modestly surpassing the previous print (49.3pts), with more marginal gains but still positive due to the population's fatigue about the pandemic

- **Family remittances (September).** Strong dynamism is likely to have continued, estimating inflows of US$3,468.6 million, up 11.8% y/y and above the +5.3% seen in August. The result would be mainly driven by labor market conditions in the US, which kept improving. Despite of the latter, we recognize that the lack of additional fiscal stimulus in that country represents a downside risk. If our forecast materializes, remittances would stand at US$29.9 billion year-to-date, consistent with our update that contemplates total inflows in 2020 of around US$39 billion

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

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Mexico weekly calendar

DATE	HOUR (ET)	EVENT	PERIOD	UNIT	BANORTE	CONSENSUS	PREVIOUS
Mon 2-Nov		Markets closed due to the Day of the Dead holiday					
Tue 3-Nov	11:00am	Family remmittances	September	US$ mn	3,468.6	--	3,574.2
Tue 3-Nov	11:00am	Banxico's survey of economic expectations	October				
Tue 3-Nov	2:00pm	PMI's survey (IMEF)	October				
		Manufacturing		index	48.5	--	46.4
		Non-manufacturing		index	49.7	--	49.3
Thu 5-Nov	8:00am	Consumer confidence (sa)	October	index	36.3	--	35.9
Thu 5-Nov	4:30pm	Citibanamex bi-weekly survey of expectations					
Fri 6-Nov	8:00am	Gross fixed investment	August	% y/y	-16.2	-16.2	-21.2
		sa		% m/m	6.4	--	4.4
		Machinery and equipment		% y/y	-18.5	--	-18.0
		Construction		% y/y	-14.4	--	-23.7
Fri 6-Nov	8:00am	Private consumption	August	% y/y	--	--	-15.1
		sa		% m/m	--	--	5.2
		Domestic (Goods and services)		% y/y	--	--	-14.2
		Imported (Goods)		% y/y	--	--	-23.2

Source: Banorte; Bloomberg

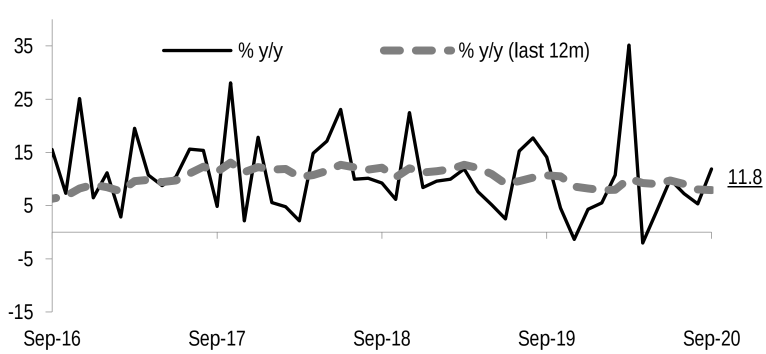
Proceeding in chronological order…

Remittances to accelerate in September on job gains. We expect remittances to increase 11.8% y/y to US$3,468.6 million, above the +5.3% seen in August and breaking with three months of slowdown. In this backdrop, the previous month stayed resilient even though some fiscal support measures expired in the US at the end of July. Specifically, the weekly payment of US$600 as part of expanded unemployment benefits was not disbursed, likely impacting income for some legal migrants in the country. We do not rule out that migrants used part of their savings to continue sending a relatively stable amount to their families, given expectations that the program would be resumed.

Our view of a strong result rests mainly on labor market conditions in the US, which kept improving, although the lack of measures in this front represents a risk,. Specifically, the unemployment rate among Hispanics and Latinos fell by 20bps to 10.3%. Focusing on working-age Mexican immigrants –including 'natives', 'non-native citizens', and 'non-citizens' (legal or illegal)–, total employment rose by 147.8 thousand. Inside, losses were observed in the first two groups, with the third one concentrating gains of 402.6 thousand jobs. This is relevant as we consider this cohort is more likely to send remittances to our country as they may have closer ties with their families in Mexico.

During the month, several reports surfaced on migrants being mistreated by ICE and other authorities, especially on healthcare issues. On a positive note, a judge blocked increases in immigration fees, which could have been beneficial for those looking for a citizenship as they might have freed up resources and sent back to their families. Meanwhile, we do not rule out higher flows due to the anti-immigration rhetoric from President Trump, especially given how close we are to Election Day. Meanwhile, and possible skewing results lower, the exchange rate appreciated to USD/MXN 21.68 on average from 22.21 in the previous month. Nevertheless, this relative strength of the peso was mostly in the first half of the month, so its effect could be quite modest. If our forecast materializes, remittances would stand at US$29.9 billion year-to-date, up 9.6% y/y. This would be consistent with our update that contemplates total inflows this year of around US$39 billion.

Family remittances
% y/y



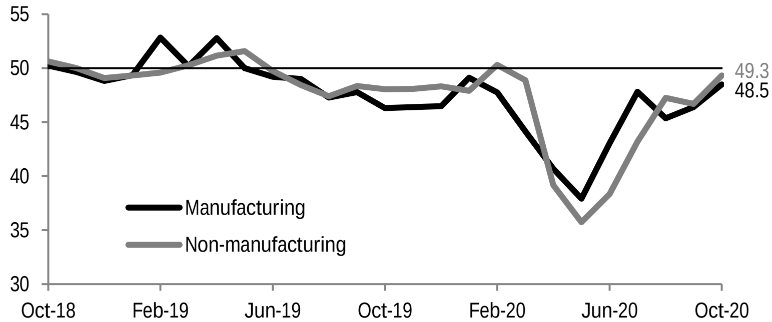
Source: Banxico

Banxico's survey of economic expectations. As usual, market participants will focus on inflation, growth, reference rate, and exchange rate forecasts. In the first, analysts expect 2020 year-end inflation at 3.86%, above our 3.7%. Although forecasts could extend further up given recent dynamics, we believe it would be modest when compared to past revisions. Meanwhile, medium and long-term expectations will likely remain unchanged, still above target. On GDP, this year's estimate stands at -9.8% (Banorte: -9.0%). In line with our recent move and given signals that the recovery has continued extension in the recovery, we could see upward adjustments. The current view on the reference rate by YE20 is 4.25%, in line with its current level. Finally, the year-end exchange rate estimate stands at USD/MXN 22.00, in line with our expectation.

IMEF indicators to extend their rebound in October. We expect both indicators to improve again. Nevertheless, performance would be mixed, with gains in the manufacturing sector outpacing non-manufacturing, in contrast with the latest dynamics. We estimate manufacturing at 48.5pts, above August's 46.4pts. In a timely manner, *Markit*'s PMI in the US ticked up to 53.3pts, 0.1pts higher than in August. In this report we saw a rebound in 'new orders', which we expect to have had a favorable effect in the same category in our country. This also seems supported by other regional indicators, such as the *Empire Manufacturing* and *Philly Fed*. Nevertheless, the expansion in Mexico would be higher, catching up to recent gains in that country. Domestically, epidemiological conditions started to deteriorate after improving in August and September. The most concerning fact is that some relevant states for manufacturing –such as Chihuahua, Baja California and San Luis Potosí– worsened by the end of the period, even with the first retracing to 'red' in the 'traffic light' indicator. This could be a relevant headwind, as non-essential industries would have to suspend operations under the guidelines of the plan. It should be mentioned that September's print suggested a modest increase, similar to what we saw in manufacturing exports. In the latter, the auto sector declined sequentially, which leads us to believe that the indicator might be a little skewed towards this category. We will remain on the look over the correlation between the indicator and figures for the sector, especially as winter is closing in, which could be adverse for the evolution of the pandemic.

The non-manufacturing indicator could stand at 49.7pts, surpassing the previous print (49.3pts), but still below the 50pt expansion threshold. We believe fatigue will help performance. Anecdotal evidence suggests additional dynamism. In addition, formal employment added two months to the upside, while the informal sector has improved since May. Nevertheless, the pace of the rebound would be more modest relative to the +2.6pts of September, given that: (1) The number of new businesses reopening has moderated; (2) prevailing social-distancing measures; and (3) the deterioration in epidemiological conditions. All in all, additional signals are needed to confirm the overall strength of this sector, which in our view faces more headwinds.

IMEF indicators
Diffusion indicators, sa



Source: IMEF

Weekly international reserves report. Last week, net international reserves increased by US$442 million, closing at US$194.5 billion. According to Banxico's report, this was explained by: (1) US$450 million sales from Pemex to the central bank; and (2) a negative valuation effect in institutional assets of US$8 million. The central bank's international reserves have expanded by US$13.6 billion so far in 2020 (please refer to the following table).

Banxico's foreign reserve accumulation details
US$, million

	2019	Oct 23, 2020	Oct 23, 2020	Year-to-date
	Balance		Flows	
International reserves (B)-(C)	180,877	194,471	442	13,594
(B) Gross international reserve	183,028	200,372	318	17,345
Pemex	--	--	475	5,224
Federal government	--	--	-140	6,901
Market operations	--	--	0	0
Other	--	--	-17	5,220
(C) Short-term government's liabilities	2,151	5,901	-123	3,751

Source: Banco de México

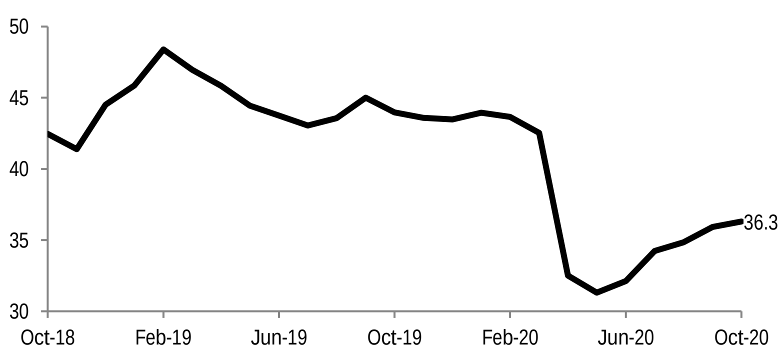
Consumer confidence to inch higher in October. We expect confidence at 36.3pts (seasonally adjusted), higher than the 35.9pts observed in September but with the magnitude of the improvement decelerating. In our view, this indicator has been more closely related to economic activity since the pandemic broke, in turn influenced by the state of re-openings. In this respect, most recent hard data, such as September's trade balance and employment, suggest that the sequential rebound continued. In addition, the Mexican peso performed better in October, averaging 21.37 per dollar (up to the 20th, which is the last day of the survey's collection period) from 21.65 in September. Although modest, it might be relevant as the currency has historically been a relevant gauge of the state of the economy for the population.

Despite of this, we see more marginal gains due to several factors. First, the base effect is more difficult as the index has picked up continuously since June. Second, mobility indicators have stagnated relative to September. This is likely because the reopening process has not stopped, albeit more modest at the margin given its accumulated advance. In turn, other drivers may have impacted specific components.

Regarding families' purchasing power, we highlight that inflation in the 1st half of October surprised to the upside, mainly on higher prices of fresh fruits and vegetables, which we believe are among the most sensitive for households. Other news could may have influenced the assessment about present conditions, including: (1) Hurricanes in the Gulf of Mexico, including Delta which landed on the Yucatán peninsula in the first days of the month; (2) railway blockades in Chihuahua and Michoacán; (3) the recent increase in COVID-19 cases, without ruling out that this may be seen more clearly until November; and (4) some discontent about the extinction of federal trusts during the approval process of the 2021 Budget. On the contrary, expectations components likely stayed more resilient, as the population remains hopeful of a solution to the pandemic. We also believe some optimism may be reflected after the Supreme Court approved a referendum on trials of past political actors.

The full recovery of confidence will probably take time, similar to our view for the whole economy and given the impact already accumulated in terms of employment conditions. In this sense, our estimate is still almost 17% lower than the level observed in February. Meanwhile, setbacks are possible, which in our view may be mainly due to: (1) A spike in cases and more stringent restrictions, as we have seen in Europe currently and in some northern states (*e.g.* Chihuahua, Nuevo León); (2) negative news in terms of the development of effective treatments and/or vaccines; and (3) other challenges due to the winter season, including the possibility of renewed lockdowns.

Consumer confidence
Pts, seasonally adjusted



Source: Banorte with data from INEGI

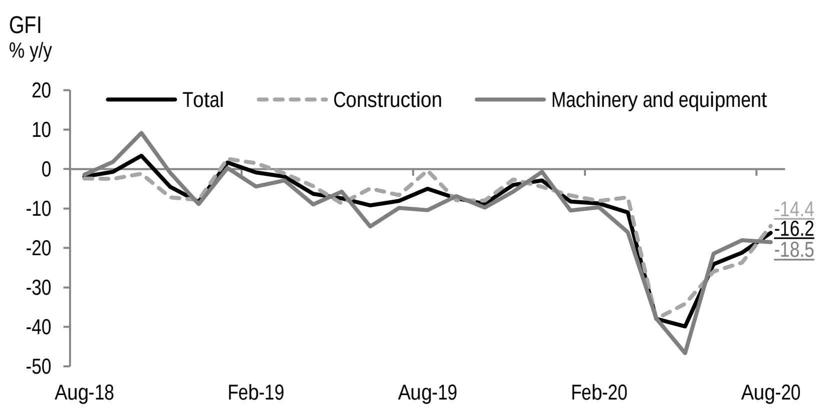
Investment to strengthen in August. We expect GFI to fall 16.2% y/y, above the -21.2% of the previous month. In our view, the economic reopening and an imrpoved outlook on COVID-19 in that period helped performance. In monthly terms, we estimate a 6.4% expansion, accelerating relative to the +4.4% previously. With these, the level of the index would be about 12.7% below February, still highly impacted by the pandemic.

The sequential move higher would be driven by construction, expecting it at -14.4% y/y from -23.7% in July. This would happen despite a more challenging base effect and even with one working day less in the annual comparison. In this respect, the last industrial production report showed a 13.7% y/y contraction 9.9%-pts better relative to June.

Considering that the rebound was centered in edification, we expect this to translate into a better performance in the residential sector. Meanwhile, non-residential construction (more related to infrastructure projects) will likely lag, considering the 17.4% y/y decline in real terms in physical investment spending by the Federal Government.

We anticipate Machinery and Equipment (M&Eq.) at -18.5% y/y (previous: -18.0%), with a mixed performance. We expect the imported component at -18.9% (previous: -14.6%), impacted by a more challenging base and a weak signal from the trade balance. Specifically, capital goods imports fell 19.8% from -15.9% in July, also with a negative base effect. The exchange rate appreciated slightly, at USD/MXN 22.21 on average from 22.40, so we do not expect a substantial impact on performance. The domestic component would stand at -17.9%, above July's -23.1%. Specifically, signals within industrial production in sectors such as M&Eq., electronical and electric equipment, among others, suggest higher dynamism, even despite a stronger decline in auto production relative to July –with the latter figure probably distorted on changes to the usual calendar of auto plants for maintenance and retooling.

Going forward, we still expect investment to stay muted in coming months despite the acceleration forecasted for August. We believe that uncertainty will continue to weigh on this component of aggregate demand, at least until the outlook about a vaccine and/or possible treatment of COVID-19 becomes clearer. This is clearly reflected in business confidence, which has not showed any substantial gains since July, especially in the 'adequate moment to invest' component. From the demand side, banking credit to businesses has furthered its decline and is almost in contraction territory in the annual comparison, suggesting that appetite for leverage and new investments is low. In our view, weaker companies' balance sheets and limited prospects of a sizable boost in revenues keep dampening investment prospects despite lower benchmark short-term interest rates due to Banxico's easing. On a more favorable note, September's capital goods imports improved. Finally, the latest public-private investment plan was presented in early October, with some new projects starting as soon as in 4Q20, which could help counter at least some of the persistent weakness observed in public investment in recent years.



Source: INEGI, Banorte

Private consumption to keep improving in August, albeit at a slower pace. In July, consumption stood at -15.1% y/y, above the -18.2% seen in June. In sequential terms activity rose 5.2% m/m. The recovery was centered on goods, both domestic and imported, with services lagging. In August we could see a relative acceleration in the latter, benefited by additional reopening efforts. In this context, cinemas and museums, among other services, reopened in Mexico City at the middle of the month. This, on top of additional positive cues from retail sales and trade balance suggest that consumption will keep improving. Nevertheless, the performance of some components within the monthly GDP-proxy (IGAE) point to a more modest uptick. Going forward, and despite signs of an additional rebound in September, we believe the road to recovery will be complicated, with some domestic factors, apart from COVID-19, also weighing on activity.

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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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