Ahead of the Curve

Banxico's *Quarterly Report* will likely show modest changes to macro forecasts

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- **Banxico's *Quarterly Report* (2Q21).** Contrary to other reports, focus will shift from inflation forecasts, as they were updated in the last policy statement (on August 12th). Hence, we believe attention will center on updated GDP and macro forecasts. In case we see adjustments, we believe these could be quite moderate. In addition, we will be looking into relevant topics that can be included in the *grey boxes*, especially if they take on inflation dynamics. Considering the latest skew from the Board, it is our take that the document will maintain a hawkish bias

- **IMEF indicators (August).** We expect both categories to fall relative to July, albeit remaining in expansion. This would be consistent with a more modest pace of economic growth in the third quarter. The deterioration of epidemiological conditions continued in August, although its effect is still uncertain. In this respect, these indicators may provide us the first signals about its potential impact, if indeed present. Specifically, we expect manufacturing at 51.8pts from 52.2pts in July, while non-manufacturing would stand at 51.5pts from 52.9pts

Mexico weekly calendar

DATE	TIME (ET)	EVENT	PERIOD	UNIT	BANORTE	CONSENSUS	PREVIOUS
Mon 30-Aug		Budget balance (measured with PSBR)	July	MX$ bn	--	--	-396.8
Tue 31-Aug	10:00am	Commercial banking credit	July	% y/y in real terms	-10.8	--	-11.8
		Consumption		% y/y in real terms	-7.3	--	-8.5
		Mortgages		% y/y in real terms	3.2	--	2.9
		Corporates		% y/y in real terms	-15.9	--	-16.9
Tue 31-Aug	10:00am	International reserves	Aug-27	US$ bn	--	--	193.2
Tue 31-Aug	1:30pm	Banxico's Quarterly Report	2Q21				
Wed 1-Sep		Annual Presidential address and start of sessions in Congress after summer break					
Wed 1-Sep	10:00am	Family remittances	July	US$ mn	3,195.8	--	4,400.0
Wed 1-Sep	10:00am	Banxico's survey of economic expectations	August				
Wed 1-Sep	1:00pm	PMI's survey (IMEF)	August				
		Manufacturing		index	51.8	--	52.2
		Non-manufacturing		index	51.5	--	52.9
Thu 2-Sep	7:00am	Consumer confidence (sa)	August	index	45.1	--	44.3

Source: Banorte; Bloomberg

Proceeding in chronological order…

MoF's public finance report (Jan-Jul). Attention will center on the Public Balance and Public Sector Borrowing Requirements (PSBR) in the first seven months of the year. With this being a monthly report, we do not expect updates on the macro framework and other fiscal variables. As such, the comparisons will be made relative to the latest quarterly report. In this context, until June, the PSBR deficit amounted to $396.8 billion, equivalent to 1.5% of GDP. We will also pay attention to revenue and spending dynamics in the annual comparison, looking for clues about activity levels and possible expenditure adjustments. Lastly, we will analyze public debt, which on June stood at MXN$12.4tn (as measured by the Historical Balance of the PSBR), which represents 47.9% of GDP.

Banking credit to continue recovering at a mild pace. As in the previous couple of months, figures would continue to benefit from a less challenging base effect, remembering that credit decelerated sharply through the second half of last year. However, another relevant part of the dynamic would continue to be related to economic performance and overall sentiment. In this sense, we believe that both businesses and consumers remain somewhat hesitant to take out loans given some prevailing uncertainty. As a result, we forecast a mild improvement, with total credit at -10.8% (previous: -11.8%). By sectors, consumer loans would stand at -7.3%, with corporates weaker at -15.9%. Mortgages would remain as the most stable –relatively isolated from base effects– at 3.2%. We should mention that the effect of inflation is relatively negligible, as it improved by 7bps to 5.81%.

Weekly international reserves report. Last week, net international reserves decreased by US$60 million, closing at US$193.2 billion (please refer to the following table). According to Banxico's report, this was explained by a negative valuation effect in institutional assets. So far this year, the central bank's international reserves have declined by US$2.5 billion.

Banxico's foreign reserve accumulation details
US$, million

	2020	Aug 20, 2021	Aug 20, 2021	Year-to-date
	Balance		Lows	
International reserves (B)-(C)	195,667	193,154	-60	-2,514
(B) Gross international reserve	199,056	199,390	-124	334
Pemex	--	--	0	449
Federal government	--	--	-58	274
Market operations	--	--	0	0
Other	--	--	-66	-388
(C) Short-term government's liabilities	3,389	6,237	-64	2,848

Source: Banco de México

Attention on growth estimates and *grey boxes* within Banxico's 2Q21 *Quarterly Report*. On Tuesday –breaking with tradition–, the central bank will release its 2Q21 *Quarterly Report* (QR) at 1:30pm (ET). As usual, its publication will be accompanied by a press conference from the Board, leaded by Governor Alejandro Díaz de León. Contrary to other reports, focus will shift from inflation forecasts, as they were updated in the last policy statement (on August 12th), along some key comments about them in the corresponding minutes.

Hence, we believe attention will center on updated GDP and macro forecasts, along other relevant topics in the *grey boxes*. Despite of this, considering the latest skew from the Board, it is our take that the document will maintain a hawkish bias.

On growth, the mid-point estimate for 2021 currently stands at 6.0%. This is close to market analysts' expectations –with the median in the latest Banxico survey at 6.1%– and several international organizations, such as the IMF (6.3%). The World Bank and OECD are lagging in their updates (both at 5.0%). The latest position from the central bank is that "*…The recovery of the Mexican economy […] is expected to endure for the rest of the year, while risks related to the growing number of infections persist…*". We do not rule out a marginal upward adjustment as we forecast an expansion of 6.2% and sequential growth in the third and fourth quarters. However, some of the most recent signals, including 2Q21 GDP and other timely data, suggest added caution might be necessary. The key driver remains the evolution of the virus, with contagions on the rise. Other challenges are in the pipeline, such as the possibility of a stronger rebound as children return to school. This comes on top of additional risks for industry, with reports that supply-chain issues –especially the scarcity of semiconductors– could extend through the end of the year and even into 2022. On the bright side, mobility has remained resilient, likely boosted by progress on the vaccination front. As a result, this could give support to categories such as retail sales –mainly non-essential items–, along others related to entertainment and tourism, which have still ways to go to reach pre-pandemic levels. Considering this, if a revision does happen it will likely be mild, with closer attention to the outlined risks and their possible balance.

Other indicators, such as employment and external accounts (trade balance and current account), will likely see slight revisions as they incorporate the latest known data and modest revisions to the economic outlook. Meanwhile, we expect a broad range of topics to be covered in the traditional *grey boxes*. Given the recent allocation of SDRs to Banxico by the IMF, we could also see a *box* explaining some details about reserve assets.

We will still be on the look for expanded comments in inflation. First, it is not entirely clear if the central bank will update estimates as they were released less than a month ago. For the current quarter (3Q21), Banxico estimated average inflation at 5.6% y/y, with data so far close at 5.7%. With a more favorable base effect ahead, it is likely that this forecast will materialize. In our view, it also seems that it already incorporates part of the downward adjustment on the price of LP gas, making a potential revision modest at best. Moreover, and as it is usual, we could see an expanded balance of risks, with additional factors outlined vs. the statement, illustrating some of the possible paths outlined in the fan charts. Any *grey box* touching upon the issues affecting inflation and its dynamics, including possible passthrough effects from higher commodity prices (especially energy, particularly in the price of LP gas), and the stickiness to the downside of the core, among many others, would also be very important.

Considering a quite challenging outlook for inflation –both globally and domestically–, along a reduction in the room to maneuver in terms of the relative monetary stance –both to the Fed and other EMs–, we continue to believe that Banxico will have to continue with its hiking cycle. In particular, we still expect three additional 25bps increases in the reference rate this year, taking it to 5.25%. In addition, for 2022 we see two additional hikes of the same magnitude at the start of the year and one more at the end, closing at 6.00%. Nevertheless, it is important to mention that given high uncertainty and data dependency, the outlook might change due to unexpected circumstances that impact the path for inflation and its expectations.

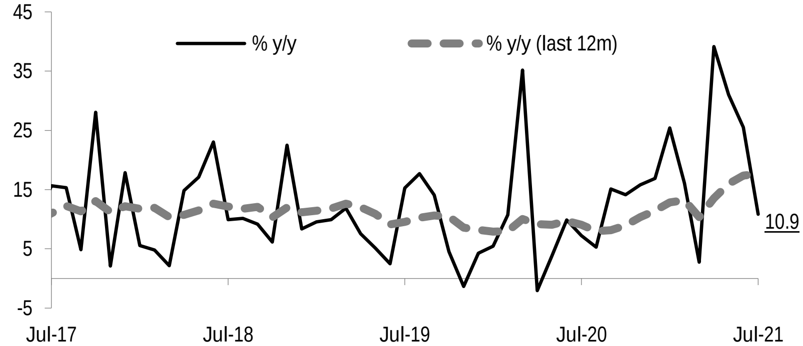
Remittances will likely decelerate in July. We expect remittances at US$3,915.8 million (+10.9% y/y), slowing down relative to June and below US$ 4 billion for the first time since March. Despite of the latter, we think inflows should remain strong, supported by overall US economic strength, vaccinations and the reopening of the economy.

Nevertheless, we are more cautious at the margin due to the start of the expiration of additional unemployment benefits since mid-June. Specifically, 21 out of 50 states cancelled the disbursement of US$300 a week for unemployed people, with another 4 more in July. Because of their high Hispanic population, we highlight Texas and Florida (both in June 26th) in the former group, as well as Arizona in the latter (July 10th). On the contrary, the top state in which this group resides is California, which will end them until early September, when the measure expires nationwide. Hence, we expect only a partial impact. In the labor market, the unemployment rate among Hispanics and Latinos in the US plunged from 7.4% in May to 6.6% in July, lowest since the pandemic started. Although positive, the details were less favorable. Specifically, working-age Mexican migrants fell for a fifth consecutive month, with 140.9 thousand fewer people. On the other hand, there were 33.6 thousand fewer unemployed –including 'natives', 'non-native citizens', and 'non-citizens' (legal or illegal)–, which may be related to the expiration of benefits mentioned above. Meanwhile, employed people fell by 2.4 thousand. Nevertheless, about 36.0 thousand less Mexican migrants dropped from the labor force, so the implied unemployment rate for this specific group fell more modestly, from 6.6% to 6.5% in the same period.

On migration, the Department of Homeland Security announced on July 26th that they would resume the enforcement of expedited removal of people along the US-Mexico border. This policy prevents migrants from waiting in the US while they undertake migration procedures. The Biden administration argued that this, instituted during the Trump presidency, was decided in part because of concerns over the spread of 'delta'. Although likely with a very limited impact, it is coupled with further extensions of border closures for non-essential travel. These stricter measures have been imposed as detentions at the US border keep increasing, with July reaching a new high of 212,672 persons.

All in all, we will analyze carefully this month's figure to gauge if there is a significant impact from these developments in remittances dynamics, which have been surprising to the upside persistently since the pandemic started. For now, we maintain our call of inflows between US$48 to 48.5 billion in full-year 2021.

Family remittances
% y/y



Source: Banxico

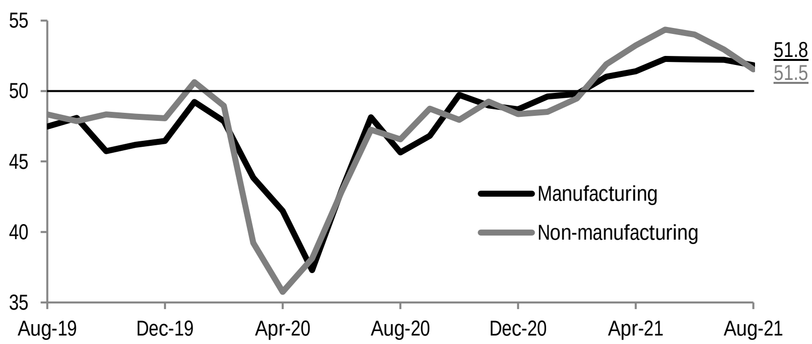
Banxico's survey of economic expectations. As usual, market participants will focus on inflation, growth, reference rate, and exchange rate forecasts. In the first, analysts expect 2021 year-end inflation at 6.0% y/y, an inch below our 6.1%. Based on the latest data, we will pay close attention to possible adjustments. We do not expect significant moves in medium and long-term expectations, albeit still above target. On GDP, this year's estimate stands at 6.1%, lower than our 6.2%, with some uncertainty on revisions given the latest wave of COVID-19 cases. The current view on the reference rate by YE21 is that it will reach 5.00%, suggesting two additional 25bps hikes this year (vs. our forecast of three increases to 5.25%). Finally, the year-end exchange rate stands at USD/MXN 20.38 (Banorte: 20.20), possibly with marginal changes.

IMEF indicators to moderate in August. We expect both indicators to fall relative to July, albeit remaining in expansion. This would be consistent with a more modest pace of economic growth in the third quarter. As we have mentioned, the deterioration of epidemiological conditions continued in August, although its effect is still uncertain. In this respect, these indicators may provide us the first signals about its potential impact, if indeed present.

We expect manufacturing at 51.8pts from 52.2pts in July. Broadly speaking, available information confirms that challenges persist. In the US, *Markit*'s PMI manufacturing fell to 61.2pts in August from 63.4pts in the previous month. Although this is a four-month low, it remains well above 50pts, so it signals a still high expansion. Details showed that 'production' moderated quite strongly due to capacity constraints, material shortages and, this time around, more contagions of the 'delta' variant. Nevertheless, 'new orders' improved at the margin, while input costs and output prices remain on the upside. This points to limits to growth because of supply restrictions, not weak demand, so a persistent contraction is less likely. On the other hand, there were other domestic issues. First, constant blockades of railways (e.g. in Uruapan, Michoacán, since July 31st) which have mainly affected the transportation of goods from the port of *Lázaro Cárdenas*. Second, the explosion of an oil platform in the *Ku-Maloob-Zaap* complex in Campeche, on August 22nd. Pemex's CEO, Octavio Oropeza, estimated that output in 125 wells was affected, with a loss of 421,000 barrels a day. Despite estimating that production could be fully restored by the end of the month, we do not rule out a temporary impact on companies related to this sector.

We expect non-manufacturing at 51.5pts from 52.9pts. Available data is, in our view, mostly negative. Specifically, the COVID-19 backdrop kept worsening, with some services (mostly government, such as administrative processes in Mexico City) suspended or moderating due to this situation. The 'traffic light' indicator worsened in the period, a situation that may have affected the 'production' component due to more cautiousness and/or less traffic. Nevertheless, mobility indicators available do not show a meaningful impact. The exchange rate –which several people associate with the health of the economy– depreciated at the margin, averaging slightly more than 20.00 per dollar from 19.89 in July, and even climbing towards 20.42 by the end of the month. On the more positive side, LP gas prices plunged 15.1% 2w/2w in the 1st-half of August, which may have released some households' available income. Lastly, employment in July kept improving despite higher uncertainty.

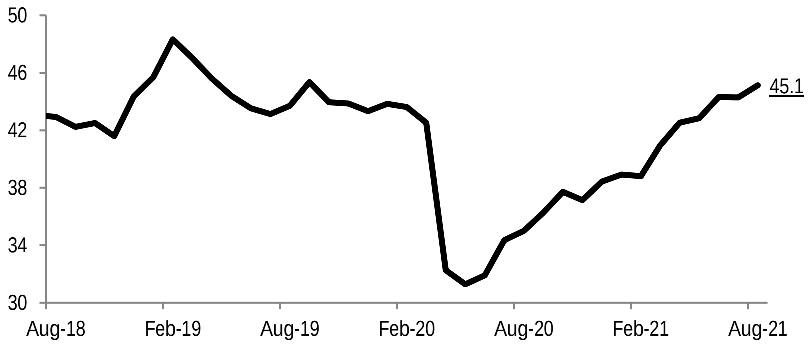
IMEF indicators
Diffusion indicators, sa



Source: IMEF, Banorte

Consumer confidence to improve in August, boosted by lower gas prices. We expect confidence at 45.1pts (seasonally adjusted), much better than the 44.3pts from July and a new high since September 2019. We believe the key factor behind the improvement would be the recent decline in gas prices –as seen in inflation for the first half of the period–. The effect could be large as it was sudden, thus triggering a relevant reaction among consumers. In our view, this could be a positive for the 'purchasing power' and 'current household' conditions components. However, other factors would dampen the increase, such as: (1) Worsening COVID-19 conditions, as daily cases reached new highs several times in the month; and (2) other negative trends in inflation, such as in food items. Other key indicators may have had a limited impact, with the MXN broadly stable during the sample period (albeit depreciating in the last few days) and with the pace of vaccinations moderating but remaining high.

Consumer confidence
Pts, seasonally adjusted



Source: INEGI

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