Ahead of the Curve

GDP deceleration in 3Q21, albeit still expanding in sequential terms

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- **Gross domestic product (3Q21 P).** We forecast GDP at 6.4% y/y. With seasonally adjusted data, we estimate a 0.6% q/q advance, slowing down relative to the 1.5% seen in the second quarter. Contrary to the latter period, we believe conditions for growth were more difficult, including the effect from the 'third wave' of COVID-19 because of the *delta* variant worldwide, supply chain issues affecting manufacturing, persistently higher inflation, and other idiosyncratic factors. Given these, our estimated sequential advance would be relatively good news, albeit lower than our previously held view. By sector, we expect primary activities at 1.7% q/q (2.9% y/y); industry would be quite resilient at 1.0% (5.7% y/y) –especially because of construction–; and services probably slowed down meaningfully, standing at 0.5% (6.8% y/y), consistent with other signals of more modest domestic demand

Mexico weekly calendar

DATE	TIME (ET)	EVENT	PERIOD	UNIT	BANORTE	CONSENSUS	PREVIOUS
Mon 25-Oct	7:00am	Economic activity indicator	August	% y/y	6.5	6.4	7.1
		sa		% m/m	0.1	0.2	0.5
		Primary activities		% y/y	5.8	--	-0.7
		Industrial production		% y/y	5.5	--	7.3
		Services		% y/y	7.3	--	7.4
Mon 25-Oct	7:00am	Unemployment rate	September	%	4.43	4.25	4.33
		sa		%	4.10	--	4.05
Tue 26-Oct	10:00am	International reserves	Oct-22	US$ bn	--	--	198.4
Wed 27-Oct	7:00am	Trade balance	September	US$ mn	-3,028.8	-2,543.7	-3,902.2
		Exports		% y/y	0.6	--	9.0
		Imports		% y/y	22.5	--	43.3
Fri 29-Oct	7:00am	GDP	3Q21 (P)	% y/y	6.4	6.2	19.6
		sa		% q/q	0.6	0.1	1.5
		Primary activities		% y/y	2.9	--	6.7
		Industrial production		% y/y	5.7	--	27.9
		Services		% y/y	6.8	--	17.1
Fri 29-Oct	10:00am	Commercial banking credit	September	% y/y in real terms	-8.4	--	-8.6
		Consumption		% y/y in real terms	-5.3	--	-5.6
		Mortgages		% y/y in real terms	3.5	--	3.6
		Corporates		% y/y in real terms	-13.2	--	-13.2
Fri 29-Oct		Budget balance (measured with PSBR)	September	MX$ bn	--	--	-451.6

Source: Banorte; Bloomberg

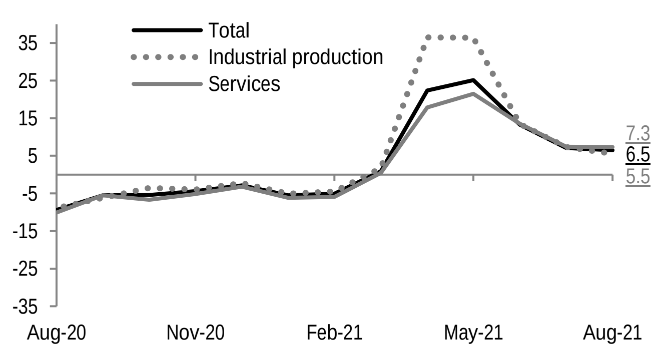
Proceeding in chronological order…

August's GDP-proxy to barely inch higher sequentially. We expect the *Global Economic Activity Indicator* (IGAE) at 6.5% y/y. With seasonally adjusted figures, this would result in a 5.9% y/y advance, slightly lower than the mid-point of INEGI's *Timely Indicator of Economic Activity*, at 6.2%. Sequentially, the economy would have barely grown 0.1% m/m, decelerating at the margin. In this sense, we think conditions were more challenging. COVID-19 daily cases reached a new high near the end of the period, in our view making economic agents more cautious. Moreover, harsher weather due to the hurricane season and a relative deterioration in other fundamentals (highlighting employment) suggest a more modest recovery, although still positive.

By sectors, and as already known, industry managed to stay above water at 0.4% m/m (5.5% y/y), better than expectations and lifted by construction. In contrast, mining fell 0.1% while manufacturing inched higher by 0.2%. All in all, data keeps pointing to several drags in the sector, especially in the latter.

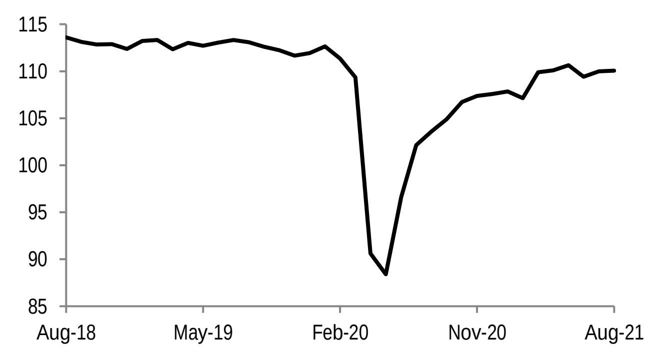
For services, we estimate a 0.1% contraction (+7.3% y/y), with a renewed impact from the pandemic, although less in magnitude than in other waves of contagion. In this sense, it seems that its main effect was on confidence, both for businesses and consumers. We also think high inflation is increasingly hurting real incomes and performance. Specifically, pressures have been more elevated in food items. The one-off adjustment lower in LP gas prices after the introduction of maximum prices in the first half likely softened the blow, albeit we believe the overall effect was still negative. In this backdrop, available data for the period is mostly weaker. Among them, vehicle sales were at 78,235 units, up only by 1.4% y/y from 12.7% in the previous month. Gasoline sales were also lower sequentially, at -0.4% y/y. The pace of recovery in banking credit was also more modest, while we saw some labor market weakness –although with total employment affiliated to IMSS in services up by 275k. Retail sales were resilient at 0.0% m/m, despite negative signals. The country's hotel occupancy stood at 41.6%, also signaling a slowdown even after accounting for seasonal factors. Lastly, we expect agriculture at 0.9% m/m (5.8% y/y), with exports showing more dynamism despite hurricanes Grace and Ida. Nevertheless, they would be lower than trade data, likely biased upward given strong price increases, according to inflation figures.

IGAE
% y/y (nsa)



Source: INEGI, Banorte

IGAE
Index (sa)



Source: INEGI, Banorte

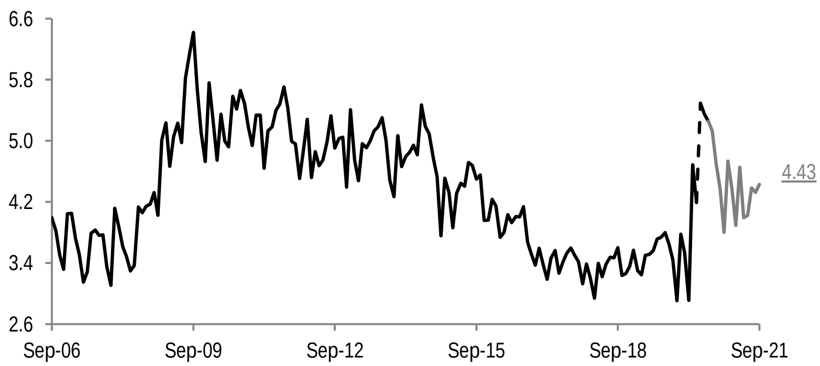
Employment gains to resume in September, albeit with a higher jobless rate. We estimate the unemployment rate at 4.43% (original figures), up 10bps relative to August. The seasonal skew is even more adverse than in previous months, likely still impacted by the holiday period and the return to classes. As such, the increase with seasonally adjusted figures is more modest, up from 4.05% to 4.10.%. After a setback in the previous month amid a more challenging backdrop, we expect job creation to resume, explained by: (1) Better signals about economic activity at the margin; (2) a fall in the number of daily cases of COVID-19; and (3) the return to in-person classes. We believe the latter will be very important, allowing more people to return to the labor force. Nevertheless, the number of people looking for a job might be higher vs. those who effectively found one, explaining the increase in the unemployment rate. Moreover, we believe there is greater uncertainty about the forecast given the start of the reform to the *Federal Labor Law* regarding outsourcing.

On complementary indicators, the participation rate could increase, explained by the return of people mentioned above. We believe underemployment could improve at the margin, albeit still limited by persistent sanitary restrictions. Meanwhile, we will be looking at informality, with some uncertainty about its dynamics. Wages could trend higher, impacted by greater inflationary pressures in the last few months, among other factors.

Sector-related figures were mostly positive. Employment affiliated to IMSS rose by 174.1 thousand positions, its largest increase in almost a year. Nevertheless, with seasonally adjusted figures it was more modest at 64.8 thousand. Related indices within aggregate trend indicators were mostly favorable, with gains in three out of the four-major sectors: construction, commerce, and private non-financial services. Only manufacturing was unchanged. Employment components within IMEF indicators were either better –which was the case for manufacturing, up 0.4pts– or stable –as seen in non-manufacturing–.

We believe this report, as well as those in coming months, will be very important to evaluate not only the economic recovery, but also the effect from: (1) The recent labor reform; and (2) the return to in-person classes. Considering that some schools maintain hybrid systems, the effect of the latter might be more modest than originally anticipated.

Unemployment rate
%, nsa



Source: INEGI, Banorte

Weekly international reserves report. Last week, net international reserves rose by US$40 million, closing at US$198.5 billion (please refer to the following table). According to Banxico's report, this was mainly explained by a negative valuation effect in institutional assets. So far this year, the central bank's international reserves have increased by US$2.9 billion.

Banxico's foreign reserve accumulation details
US$, million

	2020	Oct 15, 2021	Oct 15, 2021	Year-to-date
	Balance		Flows	
International reserves (B)-(C)	195,667	198,522	40	2,855
(B) Gross international reserve	199,056	211,105	-581	12,049
Pemex	--	--	0	949
Federal government	--	--	-357	-607
Market operations	--	--	0	0
Other	--	--	-224	11,707
(C) Short-term government's liabilities	3,389	12,583	-621	9,194

Source: Banco de México

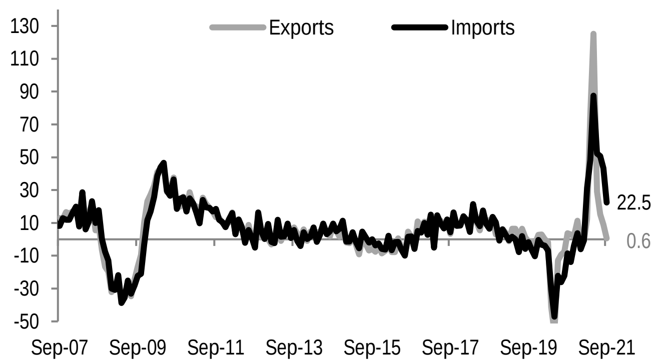
Trade balance to remain in deficit in September. We estimate a US$3,028.8 million deficit, with total exports and imports up 0.6% and 22.5% y/y, respectively. Base effects would keep playing a meaningful role. We see lingering weakness associated to supply chain problems. Nevertheless, we believe these could be having a more sizable impact in the former than in the latter.

By sectors, we expect a US$2,260.3 million oil balance deficit. We see a sequential acceleration in shipments abroad, mainly on higher prices. Specifically, the Mexican oil mix traded at 67.71 US$/bbl on average from 64.29 in August. Nevertheless, data on volumes shows some stability despite comments from Pemex that production at the *Ku-Maloob-Zaap* oilfield stabilized following a fire in late August. At the margin, we believe hurricane *Nicholas* may have had an impact by the middle of the month, albeit not ruling out other operating issues behind this. We will focus on reports by the company and CNH to confirm these figures. In this backdrop, we anticipate exports at 58.7% y/y. Going to imports, and contrary to crude oil, reference prices for gasoline were lower, with some signals also of a decline in volumes. The latter would be consistent with news of higher refining capacity, especially at the refinery in Madero, Tamaulipas.

The non-oil balance would have a US$768.4 million deficit. We expect exports and imports at -1.7% and 17.8%, in the same order. In the former, we highlight agricultural (-4.9%) and manufacturing (-2.4%). Within the latter, weakness would again be concentrated in autos (-21.4%), with strong disruptions due to the lack of supplies, especially semiconductors. In this respect, AMIA reported a total of 195.3 thousand vehicles sent (-24.2% y/y), its lowest since last year's lockdowns. Among the companies that announced stoppages were Audi, GM, Nissan and several of their providers. This weakness was also evident in the US, with the sector's industrial production down 11.6%. On the contrary, 'other' manufacturing would remain stronger at the margin, up 8.1%. Nevertheless, not all signals are positive, with a sequential deceleration in US industrial production. Moreover, we do not rule out an impact from higher costs, both inputs and transportation. In imports we still see some caution, with reports about port congestions still present and in some cases exacerbating. This factor could have adverse effects in all sectors, affecting dynamism broadly.

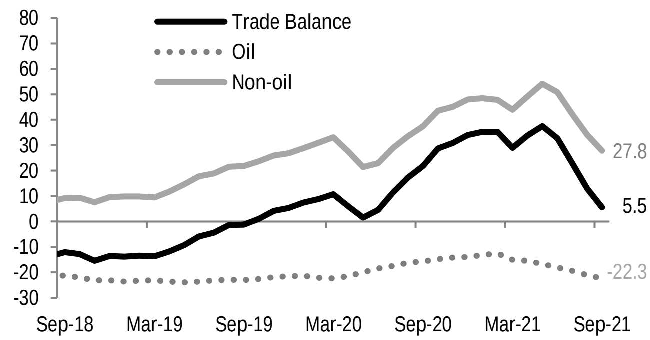
Moreover, and factoring-in that activity may not have rebounded strongly, it is likely that domestic demand remained depressed, limiting growth in both consumption and capital goods. Hence, we anticipate +28.0% and +27.1%, respectively, still benefitted by base effects. Intermediate goods would stand at 15.5%, resenting supply shocks the most. Nevertheless, we believe that this data could be stronger only because of higher prices and not because of volumes, as they are presented in nominal terms.

Exports and Imports
% y/y nsa



Source: INEGI, Banorte

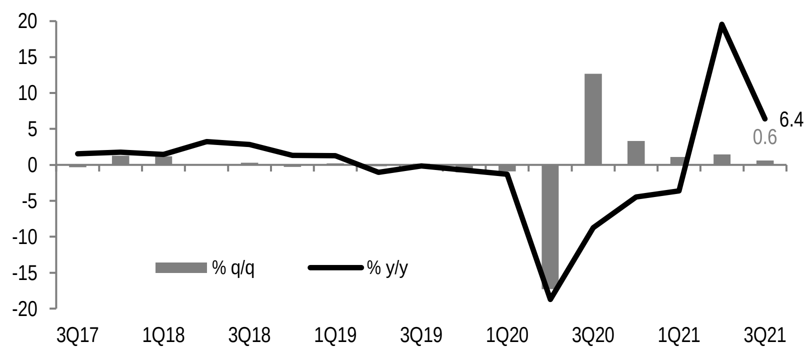
Trade balance
US$ billion, 12-month rolling sum



Source: INEGI, Banorte

3Q21 GDP to grow at a more modest pace. We forecast GDP at 6.4% y/y. With seasonally adjusted data, we estimate a 0.6% q/q advance, slowing down relative to the 1.5% seen in the second quarter. Contrary to the latter period, we believe conditions for growth were more difficult, including the effect from the 'third wave' of COVID-19 because of the *delta* variant worldwide, supply chain issues affecting manufacturing, persistently higher inflation, and other idiosyncratic factors. Given these, our estimated sequential advance would be relatively good news, albeit lower than our previously held view. By sector, we expect primary activities at 1.7% q/q (2.9% y/y); industry would be quite resilient at 1.0% (5.7% y/y) –especially because of construction–; and services probably slowed down meaningfully, standing at 0.5% (6.8% y/y), consistent with other signals of more modest domestic demand.

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



Source: INEGI, Banorte

Given our view for the GDP-proxy monthly (IGAE) in August (see above), we focus on September's likely performance. Broadly, our call is consistent with a modest acceleration of 0.4% m/m, driven by relatively better epidemiological conditions –supporting a rebound in confidence levels, among others– as well as no significant weather-related disruptions, as far as we know. This would be better than implied by INEGI's *Timely Indicator of Economic Activity*.

In industry, manufacturing is likely to remain a drag, anticipating a slight contraction in the last month of the quarter. The IMEF manufacturing PMI and Markit's indicator showed that the sector is in contraction, while auto production fell further according to AMIA. Moreover, manufacturing within US industrial production slowed down to 5.0% y/y from 5.9% in August. Meanwhile, we penciled in a slight sequential rebound in mining –after three consecutive months down and no major weather disruption in the Gulf of Mexico– and utilities. Regarding construction, business confidence indicators rebounded, with components related to present conditions (both for companies and the country) leading the move higher. Aggregate trend indicators also improved at the margin, reaffirming their upward trend since June 2020, when the economy started to reopen.

Going to services, we believe an acceleration is due, with available data mixed to more positive at the margin. Among them, we note that ANTAD sales accelerated both in same- and total-stores, up 3.9% and 5.6% y/y in real terms, respectively. The move was led mainly by departmental stores and supermarkets, consistent with the slight increase in mobility. Consumer confidence rebounded after two consecutive months lower, while employment in the sector according to IMSS data picked up to 93,013 new jobs. We also think a boost to education may be in store because of the return to in-person classes, including related services such as maintenance works and transportation. Nevertheless, we should mention that the return was gradual and has not been completed yet. On the contrary, we are somewhat wary about a strong rebound because of: (1) Persistent price pressures which put a dent on real incomes; (2) the decline of IMEF's non-manufacturing indicator to 50.1pts, although still in expansion; and (3) quite weak auto sales with only 76,930 units according to AMIA, a new low since July 2020 and with the annual rate at -1.1%, with big-ticket items possibly still resenting high uncertainty and this particular sector mired with supply issues.

If our estimate materializes, risks to our 6.2% full-year GDP estimate would be increasingly skewed to the downside. Our main concern stems from price dynamics, especially as we believe pressures will remain at least through the end of the year. Moreover, industry is still in a difficult position, which could dampen growth in trade volumes. Hence, we will keep looking closely at incoming data about performance, especially to gauge more precisely risks into 2022. For now, we expect the recovery to extend further, although we are more cautious given recent figures and events, both globally and locally.

Banking credit to keep improving in annual terms. As in the past four months, figures should keep benefiting from a less challenging base effect. We recall that credit decelerated sharply in the second half of last year, especially corporates, but also consumer loans.

However, with challenges for the recovery, the rebound in credit has not been as vigorous as for the economy. In this sense, we think both businesses and consumers have stayed cautious, awaiting clearer signs about the outlook ahead. We should mention that the effect of inflation is negative, as it worsened by 41bps to 6.00%, overriding most gains. As a result, we forecast a mild improvement, with total credit at -8.4% (previous: -8.6%). By sectors, consumer loans would stand at -5.3%, with corporates still weak at -13.2%. Mortgages would remain as the most stable –relatively isolated from base effects– at 3.5%.

MoF's public finance report (Jan-Sep). Attention will center on the Public Balance and Public Sector Borrowing Requirements (PSBR). Despite this being a quarterly report, we do not expect updates on the macro framework and other fiscal variables, considering that MoF did this as part of the *2022 Budget* on September 8th. As such, the comparisons will be made relative to this last release. Until August, the PSBR deficit amounted to $451.6 billion, with the traditional public deficit at $262.4 billion. We will also pay attention to revenue and spending dynamics in the annual comparison. Lastly, we will analyze public debt, which stood at MXN$12.6tn in August (as measured by the Historical Balance of the PSBR).

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We, Alejandro Padilla Santana, Delia María Paredes Mier, Juan Carlos Alderete Macal, Manuel Jiménez Zaldívar, Marissa Garza Ostos, Francisco José Flores Serrano, Katia Celina Goya Ostos, Santiago Leal Singer, José Itzamna Espitia Hernández, Alik Daniel García Alvarez, Víctor Hugo Cortes Castro, Hugo Armando Gómez Solís, Miguel Alejandro Calvo Domínguez, Luis Leopoldo López Salinas, Leslie Thalía Orozco Vélez, Gerardo Daniel Valle Trujillo 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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