Ahead of the Curve

Less growth and high inflation in Banxico's 3Q21 *Quarterly Report*

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- **Banxico's *Quarterly Report* (3Q21).** On Wednesday, the central bank will release its 3Q21 *Quarterly Report* (QR) at 1:30pm (ET). As usual, its publication will be accompanied by a press conference from the Board, led by Governor Alejandro Díaz de León. Like previous reports, attention will center on updates to GDP and other economic variables, on top of relevant subjects that could be included in the *grey boxes*. We should remember that the relevance of inflation forecasts within the document has decreased since they started to be updated in each policy meeting. Nevertheless, we do not rule out a possible revision given recent dynamics, while being on the look for expanded comments about this. We expect the document to maintain a hawkish tone, similar to the last statement and minutes

- **IMEF indicators (November).** We expect higher prints in both, with manufacturing up to 51.0pts from 50.3pts in the previous month, and non-manufacturing at 52.3pts from 52.1pts. We believe the former will be helped by a better performance in the US, albeit limited as supply chain issues remain in place. For the latter, better COVID-19 dynamics likely boosted confidence, although we cannot rule out headwinds because of higher prices

Mexico weekly calendar

DATE	TIME (ET)	EVENT	PERIOD	UNIT	BANORTE	CONSENSUS	PREVIOUS
Mon 29-Nov	7:00am	Unemployment rate	October	%	4.02	4.11	4.18
		sa		%	3.96	--	3.93
30-nov		Non-manufacturing		index	-6.9	--	-7.7
	10:00am	Comercial banking credit	October	% y/y in real terms	-4.0	--	-4.8
		Consumption		% y/y in real terms	3.2	--	3.3
		Mortgages		% y/y in real terms	-10.7	--	-11.9
Tue 30-Nov		Corporates		% y/y in real terms	--	--	198.6
Tue 30-Nov	10:00am	International reserves	Nov-26	US$ bn	--	--	-544.1
Wed 1-Dec		Budget balance (measured with PSBR)	October	MX$ bn	4,698.6		4,403.0
Wed 1-Dec	10:00am	Family remittances	October	US$ mn			
Wed 1-Dec	10:00am	Banxico's survey of economic expectations	November				
	1:00pm	PMI's survey (IMEF)	November		51.0	--	50.7
		Manufacturing		index	52.3	--	52.1
Wed 1-Dec	1:30pm	Banxico's Quarterly Report	3Q21				

Source: Banorte; Bloomberg

Proceeding in chronological order…

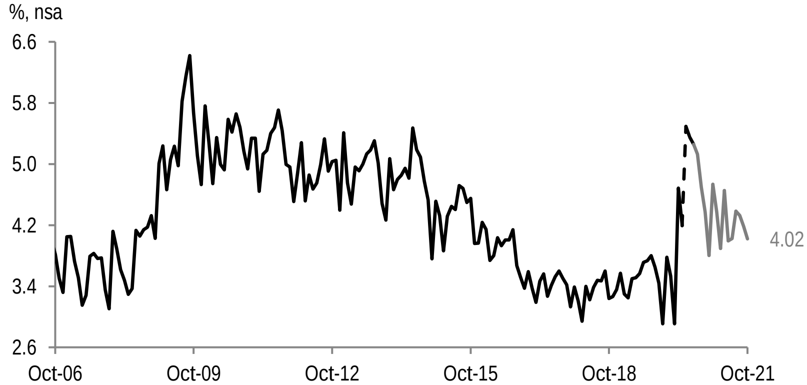
Employment gains to resume in October, despite mixed signs about performance. We estimate the unemployment rate at 4.02% (original figures), down 14bps relative to September. This would be explained entirely by a seasonal effect, turning more positive after being pressured in the two previous months, likely related to the holiday summer period. In fact, with seasonally adjusted figures we expect stability, with the rate coming in at 3.96% from 3.93%. [At the moment](), we mentioned that despite a decline in this metric, results from the labor market were not favorable given an additional loss of jobs. So far, signs are somewhat mixed, highlighting to the upside two point: (1) An important improvement surrounding the virus, fostering higher mobility; and (2) apparent signs of a recovery in economic activity after some recent weakness.

If these two points materialize, which is incorporated to some extent in our forecast, we believe that a larger amount of people might return to the labor force to seek for a job and possibly, finding it. Therefore, the participation rate could rise after declines in the last two months. Importantly, the part-time rate could decline, aided by looser distancing measures. Meanwhile, we believe there is some uncertainty regarding informality, with a somewhat disperse behavior in the last reports. Lastly, on wages we keep anticipating increases, responding both to the hike in the minimum wage at the beginning of the year, but more importantly to recent price pressures.

Forward looking data are mixed. Employment affiliated to IMSS rose by 172.7 thousand positions, similar to the uptick seen in September. Nevertheless, with seasonally adjusted figures this becomes a loss of 1.2 thousand jobs, which is a warning sign for the month. Employment indices within aggregate trend indicators showed mixed signals, with moderate declines in construction and manufacturing, but with strong advances in commerce and private non-financial services. Finally, employment components within [IMEF indicators]() were higher, with both the manufacturing and non-manufacturing advancing 0.9pts each.

If we see an improvement in this report, we believe the signal about a rebound in 4Q21 would be much clearer, suggesting a recovery in fundamentals which would be key to trigger a greater acceleration in activity.

Unemployment rate
%, nsa



Source: INEGI, Banorte

Banking credit to continue improving. Continuing with the trend seen in previous months, figures would keep benefiting from a less challenging base effect, which helps explain part of the improvement. We should remember that, during 2020, both corporate and consumer loans decelerated, which is resulting in an arithmetic boost for figures. Nevertheless, we consider that data for the month could show higher dynamism at the margin, aided by the recovery in economic activity after some weakness in previous months. Despite of this, we consider that some challenges for a larger acceleration prevail, mainly those associated to the pandemic, with some caution probably continuing for both businesses and consumers. At the margin, another factor subtracting dynamism is an acceleration in inflation, rising 24bps to 6.24%. As such, we expect total credit at -6.9% (previous: -7.7%). By sectors, consumer loans would stand at -4.0%, with corporates still weak at -10.7%. Mortgages would remain as the most stable –relatively isolated from base effects– at 3.2%.

Weekly international reserves report. Last week, net international reserves declined by US$202 million, closing at US$198.6 billion (please refer to the following table). According to Banxico's report, this was explained by: (1) The annual payment of the commission corresponding to the Flexible Credit Line to the IMF of US$127 million; and (2) a negative valuation effect in institutional assets of US$75 million. 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	Nov 19, 2021	Nov 19, 2021	Year-to-date
	Balance		Flows	
International reserves (B)-(C)	195,667	198,586	-202	2,919
(B) Gross international reserve	199,056	212,082	1,122	13,026
Pemex	--	--	0	1,234
Federal government	--	--	-61	-1,326
Market operations	--	--	0	0
Other	--	--	1,183	13,118
(C) Short-term government's liabilities	3,389	13,496	1,324	10,107

Source: Banco de México

MoF's public finance report (Jan-Oct). Attention will center on the Public Balance and Public Sector Borrowing Requirements (PSBR). Given that this is not a quarterly report, we do not expect updates on the macro framework and other fiscal variables. As such, the comparisons will be made relative to the last quarterly update, which showed modest revisions vs. the estimates outlined in the 2022 General Policy Criteria. Until September, the PSBR deficit amounted to $544.1 billion, with the traditional public deficit at $362.0 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 the same period (as measured by the Historical Balance of the PSBR), equivalent to 48.5% of GDP.

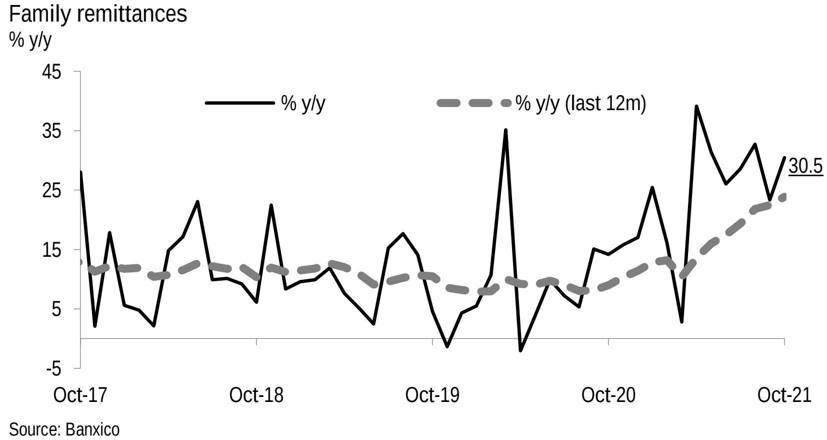
Remittances to remain supported by labor market gains in October. We expect remittances at US$4,698.6 million, which would be its second highest print, only behind the historical maximum reached in August. We believe higher economic dynamism in the US will be the main driver, in turn helping the labor market show renewed strength after a weaker-than-expected third quarter.

Specifically, the unemployment rate among Hispanics and Latinos in the US fell by about 40bps in the period, from 6.3% in September to 5.9% in October. According to our calculations, the same metric for working-age Mexicans declined to 5.6% from 5.8% in the period, reaching its lowest since February 2020, before the pandemic hit. In absolute terms, migrants surged by 329.7 thousand people, with employees up by 306.4k –including 'natives', 'non-native citizens', and 'non-citizens' (legal or illegal)– while those catalogued as unemployed fell by 29k. In our view, measures such as the expiration of additional unemployment benefits and the return to in-person classes in September may have helped some families to search –and find– a new job. Moreover, the latest wave of COVID-19 contagions peaked around mid-September, with the relative improvement possibly helping services the most. News about the authorization of vaccine booster shots and new antiviral treatments likely helped consumer confidence, at least temporarily. Overall, we believe marginal developments in this front have been favorable, a situation that could be reflected in inflows.

The exchange rate depreciated to 20.46 per dollar on average from 20.05 in the previous month, highest since March. Although a stronger dollar increases the purchasing power of resources sent to Mexico in local currency terms, we believe this has not been a strong determinant of inflows. Specifically, migrants keep sending as much as possible to help their families. In this sense, it is our take that inflation may be a more meaningful headwind as it hurts purchasing power, particularly if price increases are not matched by higher wages despite reports of scarcity of workers to fill available positions.

We think remittances will keep growing at a strong pace, helped by: (1) The recovery of activity levels and employment in the US despite prevailing risks because of the pandemic; and (2) stimulus programs that are still in place to help families deal with the multiple disruptions associated with the COVID-19 shock. We maintain our full-year 2021 forecast at US$49.5-50.5 billion –which would represent a new historical high–, as well as our call of healthy growth in 2022, helping underpin the recovery of domestic consumption.

Family remittances



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 6.6% y/y, lower than our 7.3%. Meanwhile, the forecast for 2022 stands at 3.8%.

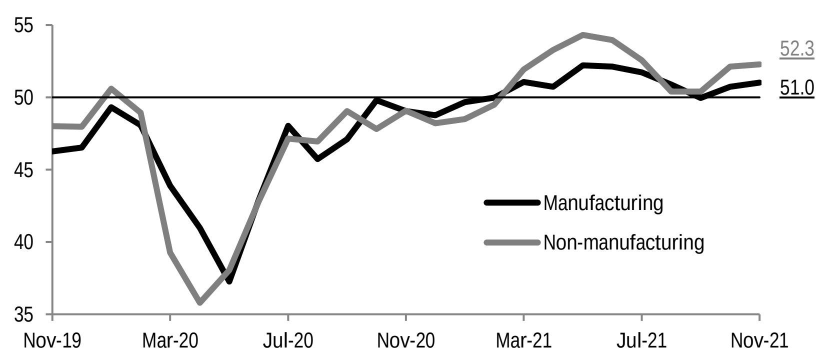
However, considering recent pressures, we expect further increases on short-term estimates, including for 2021 and 2022. Meanwhile, we do not expect significant moves in medium and long-term expectations, still above target. On GDP, this year stands at 6.0%, above our 5.7%, with 2022 at 2.9%. Nevertheless, as final 3Q21 GDP was released, the figure will likely be adjusted. The current view about the reference rate by YE21 is that it will reach 5.25%, in line with our forecast, while the median for 2022 is 6.00% (Banorte: 6.50%). Finally, the year-end exchange rate stands at USD/MXN 20.43 (Banorte: 20.50), possibly with upward changes given recent dynamics, with 2022 at 21.02.

IMEF indicators to signal a gradual recovery kept going in November. After a downbeat performance of activity in the third quarter, we expect both indicators to signal that the recovery continued throughout the middle of 4Q21. Specifically, we see manufacturing at 51.0pts from 50.7pts in the previous month, while non-manufacturing would tick higher, reaching 52.3pts after a sizable upward move in October.

In manufacturing, we expect a modest rebound. *Markit's* PMI manufacturing increased to 59.1pts from 58.4pts in October, with anecdotical evidence that the scarcity of raw materials is gradually lessening. The US administration keeps working on reducing bottlenecks, advancing in this front despite the difficulty of turning them around very quickly. Domestically, stoppages in the auto sector continued. Nevertheless, and as far as we know, they have been less stringent than during the summer. Overall, growth would stay limited because of supply chain challenges, which remain firmly in place.

In non-manufacturing, we expect additional improvements in the epidemiological front to have helped confidence. In this respect, mobility indicators moved higher at the margin, even surpassing pre-pandemic benchmarks. Moreover, the 'traffic light' indicator currently shows only one state (Baja California) not in green. We believe the population keeps guiding some of their decisions with this indicator. Discounts from *El Buen Fin* (Mexico's Black Friday) may also provide some boost, with preliminary reports stating that sales grew close to 10% y/y despite less days from this initiative. On the contrary, we do not rule out some headwinds from higher prices, with inflation still hurting consumers' purchasing power. In this sense, details from the report's subcomponents will remain quite relevant.

IMEF indicators
Diffusion indicators, sa



Source: IMEF, Banorte

Attention on growth estimates within Banxico's 3Q21 *Quarterly Report*. On Wednesday, the central bank will release its 3Q21 *Quarterly Report* (QR) at 1:30pm (ET). As usual, its publication will be accompanied by a press conference from the Board, led by Governor Alejandro Díaz de León. Like previous reports, attention will center on updates to GDP and other economic variables, on top of relevant subjects that could be included in the *grey boxes*. We should remember that the relevance of inflation forecasts within the document has decreased since they started to be updated in each policy meeting. Nevertheless, we do not rule out a possible revision given recent dynamics, while being on the look for expanded comments about this. We expect the document to maintain a hawkish tone, similar to the last statement and minutes.

On growth, the mid-point for 2021's estimate by the central bank stands at 6.2%. This is higher than the last survey of the institution at 6.0%, showing some downward revisions after the lackluster results in 3Q21. We expect a 5.7% increase. In a recent interview, Governor Alejandro Díaz de León mentioned that it is likely that growth estimates are revised down, at least for this year. This is more negative than suggested in the last statement, where the only mention was that activity had declined, but with a recovery expected in the last quarter. The latter is consistent with signs from timely indicators that seem to suggest to an acceleration towards the end of the year, likely aided by the improvement in the epidemiological front. This could trigger higher consumption, especially in services. Nevertheless, we keep thinking that uncertainty prevails for industry, especially manufacturing, with reports that bottlenecks continue despite decreasing at the margin lately. In this sense, a downward revision for this year is practically a fact.

The estimate for 2022 could show more stability and even an adjustment in the opposite direction due to base effects and a favorable outlook for the US. Currently, the forecast stands at 3.0% (Banxico survey: 2.9%). We consider that risks are broadly balanced, although it will be very important to have the vision from the institution. Progress on vaccinations could partly dampen some of the risks associated to a possible wave triggered by winter. In addition, a recovery in fundamentals could spur higher consumption in as people grow tired of the pandemic. On the other hand, recent comments point to supply issues likely extending at least during the first half of the year, especially on semiconductors. We will be watching closely to this update and related risks, both to the upside and downside as well as the possible skew.

Other indicators, such as employment and external accounts (trade balance and current account) would show revisions consistent with adjustments on the GDP estimate, as well as most recent data. Specifically, on employment related to IMSS we expect an upward increase given favorable results in the last few months. Meanwhile, we expect revisions on external indicators, with more persistent trade deficits and a relevant deficit current account deficit in 3Q21.

On inflation, we do not fully rule out a new adjustment on the path given the latest surprise in the print of the 1st half of November. Nevertheless, given that the last update happened on November 11th and that in the previous report there were no changes, it is not entirely clear if they would want to update them.

So far, inflation in 4Q21 has averaged 6.5% y/y. To reach the 6.8% average by the institution, this would have to come in between 7.1%-7.2% for the remainder of the period. In our opinion, this is quite feasible. An important subject will be the return of *El Buen Fin* discounts (Mexico's Black Friday), which in our opinion were more modest, as well as dynamics on the holiday season on reports of low inventories. Meanwhile, we do not rule out some distortions given the adoption of other discounts such as Black Friday and Cyber Monday, similar to what was seen in 2020.

Regarding *grey boxes*, we expect most of them to concentrate on related themes to inflation given current conditions. In addition of possibly analyzing domestic conditions, we could see studies over commodities prices or prices in other regions, mainly the US. We could also see studies on activities, which might focus on the impact to 3Q21 GDP, in addition on investigations on other fronts.

We maintain our expectation of a 25bps hike in December, taking the rate to 5.25%. After this, we keep anticipating five 25bps increases in 2022, tentatively in the February, March, May, October, and December meetings –awaiting the release of the official calendar in this publication– with which the rate would reach 6.50% by the end of the year. However, considering some recent events, along relevant comments within the minutes, we consider that the possibility of a faster tightening cycle has increased. Therefore, we will be looking into clues in the release that could help validate or reject this scenario.

Analyst Certification

We, Alejandro Padilla Santana, 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, Víctor Hugo Cortes Castro, Hugo Armando Gómez Solís, Miguel Alejandro Calvo Domínguez, Luis Leopoldo López Salinas, Leslie Thalía Orozco Vélez and Gerardo Daniel Valle Trujillo, 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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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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