

Highlights of the Mexican Economy during the 2Q'21

Macro – Economic Quarterly Report
July 05, 2021



Front View of Mexico’s Central Bank, “BANXICO”, Mexico City; Mexico
Source: Public Domain

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An improvement in economic growth expectations can define the second quarter of 2021 (2Q'21). However, the negative aspect came from the acceleration of inflation, which led the Federal Reserve (FED) to announce an eventual shift in its monetary policy. The above implied an adjustment within financial markets and represents future risk. In Mexico, inflation accelerated significantly to around 6.0% in the last three months; this caused the Central Bank of Mexico (BANXICO) to respond with the beginning of a possible cycle of interest rate rises that could increase the reference interest rate to 4.75% by the end of 2021.

By the end of June 2021, growth expectations improved to 6.2% from 3.1% expected at the beginning of the year. *(See Exhibit 1)* The data supporting this review is:

- 1) The Indicator of Economic Activity (IGAE) registered annual growths of 21.63% and 24.78% in April and May, respectively; in both cases, higher than the declines registered in the same months of 2020 (-19.82% and -21.45%).
- 2) Indicators related to consumption, which represents approximately 60% of GDP, show resiliency in their recovery:
 - a) In April and May, ANTAD's Same-Store Sales (SSS) increased more than 30% annually due to the reactivation of economic activities throughout the country. These raises in SSS are considerably higher than the declines observed in the same months of 2020 when they oscillated around 20%. *(See Exhibit 2)*
 - b) The recovery of consumer confidence explains the strong growth of ANTAD's SSS. This indicator showed annual growth rates above 30% in April and May and is already at levels higher than those observed before the pandemic. *(See Exhibit 2)*

In June, inflation in Mexico will be around 6.0% per year for the third consecutive month; the following factors alter this behavior:

- 1) Headline Inflation:
 - Oil presents a 51.42% YTD significant increase, which, due to its general effect on the economy, caused energy prices to grow 19.3% annually in March. As to June, this increase has decreased to 13.36%; however, it is still in double digits. *(See Exhibit 3)*
 - Climate change this year has caused a significant increase in the international price of the grains that Mexico imports; thus, for June, the prices of agricultural products have a 7.22% YoY increase with a relevant impact on the basic food basket.
- 2) Core Inflation:
 - The substantial rise in the prices of industrial metals (17.58% in the Bloomberg Commodity Index "BCOM") represents a supply shock that has had an upward impact on production costs. The preceding has brought the YTD growth of the prices of goods contemplated in the core basket to 5.90%. *(See Exhibit 3)*
 - Additionally, the recovery of domestic consumption has favored increases in the prices of services. As a result, this inflation stood at 3.11% annually in June, close to the 3.0% target. Still, it has increased gradually in the year with the recovery of regular economic

activity and will further accelerate towards September, when the economy operates at total capacity.

The persistent increase in inflation led BANXICO to raise its reference rate in June; this corrected February's 25 bps decrease. Thus, BANXICO's reference rate stands at 4.25% in what seems to be the beginning of an upward cycle in the central bank's reference rate.

There is the possibility of a further acceleration of inflation in August when the economy operates at total capacity and students return to school. Thus, at the September meeting, BANXICO could announce a new 25 bps increase and, if inflationary expectations remain high, another one of the same magnitudes in December, leaving the reference rate at 4.75% by the end of 2021.

BANXICO's decision to raise its reference rate is technically correct, given the persistent increase in core inflation. In addition, it seems convenient in terms of propping up the central bank's anti-inflationary commitment in the uncertain context of its change of Governor. Noteworthy that recently President López Obrador announced that he would not ratify the current Governor Agustín Díaz de León in his position. Besides, the President said he would propose the current Secretary of Finance and Public Credit Arturo Herrera to fill his role.

The spot exchange rate closed on June 30, 2021, at MXN\$ 19.94 per 1 USD; it was noteworthy that the exchange rate reached its maximum value for the year on March 03, 2021 (MXN\$ 21.49), and since that the peso has registered a 7.21% appreciation. (*See Exhibit 4*)

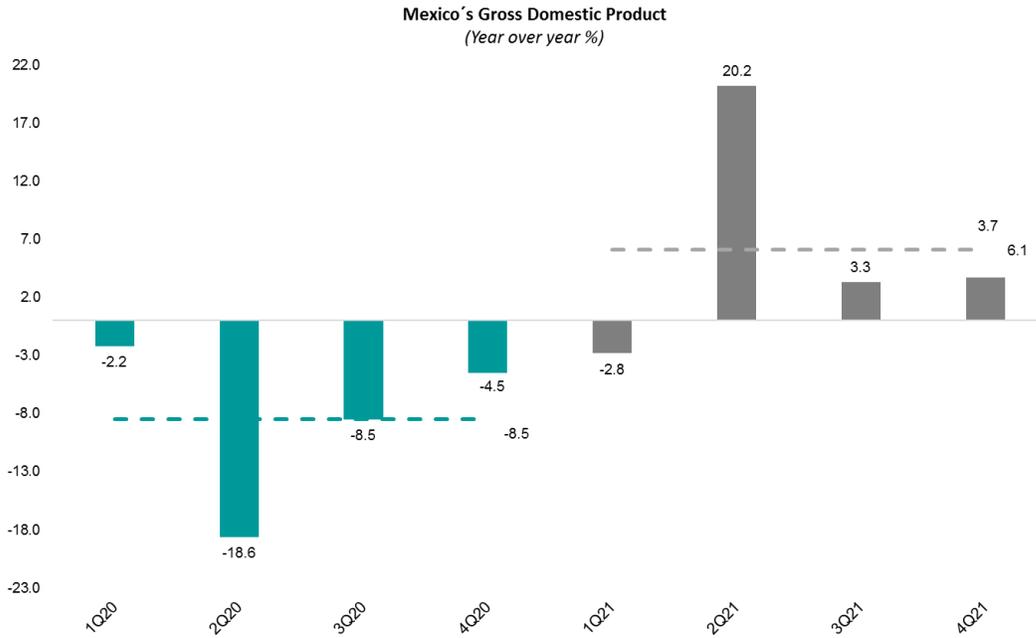
The stability of the exchange rate is supported by the Mexican external accounts:

- From January to April, trade with the United States (US\$ 208.64 billion) resulted in a US\$ 35.44 billion surplus in favor of Mexico. If a similar behavior continues, the surplus is forecast to reach US\$ 106.34 billion by 2021.
- Remittances accumulated up to May totaled US\$ 19.17 billion; if the trend continues, it is possible that in 2021 the flow of remittances will total US\$ 44 billion.
- In addition to the above, an upward cycle in BANXICO's reference rate could increase the attractiveness of investments given the high local rate and relative exchange rate stability.

Arnulfo Rodriguez

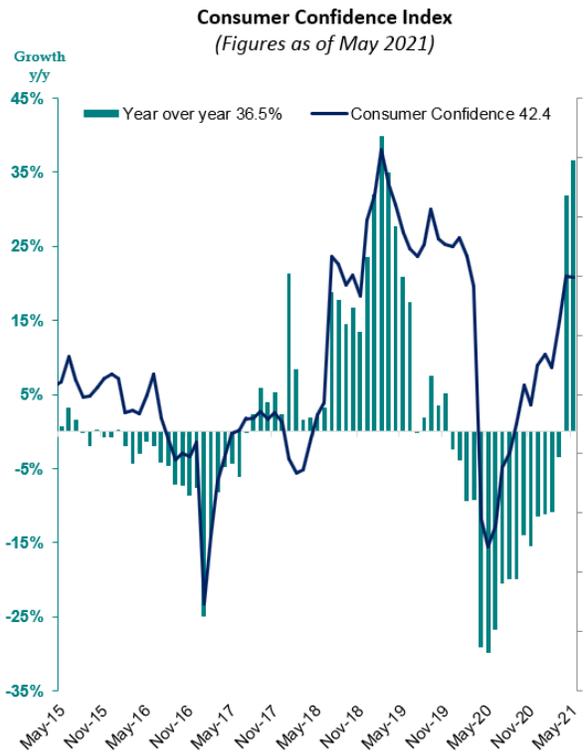
Senior Macro & Debt Strategist

Exhibit 1

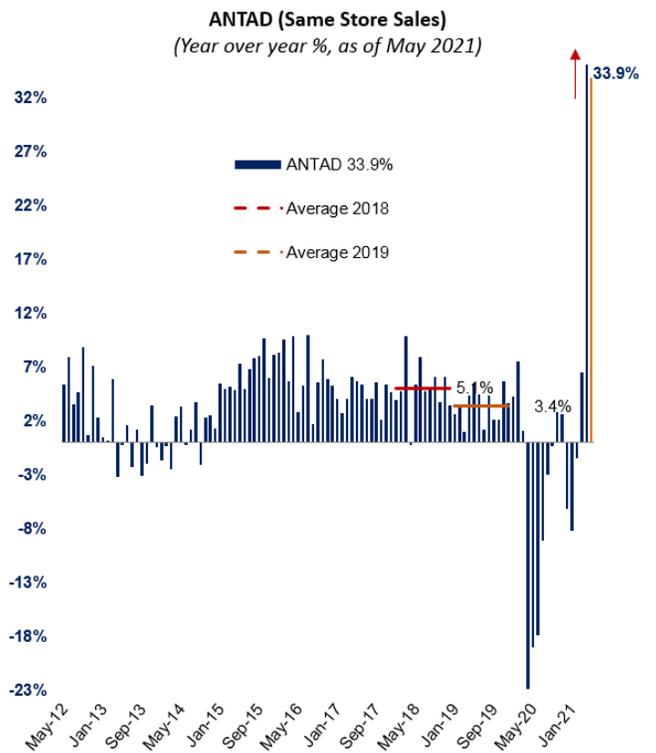


Source: INEGI

Exhibit 2



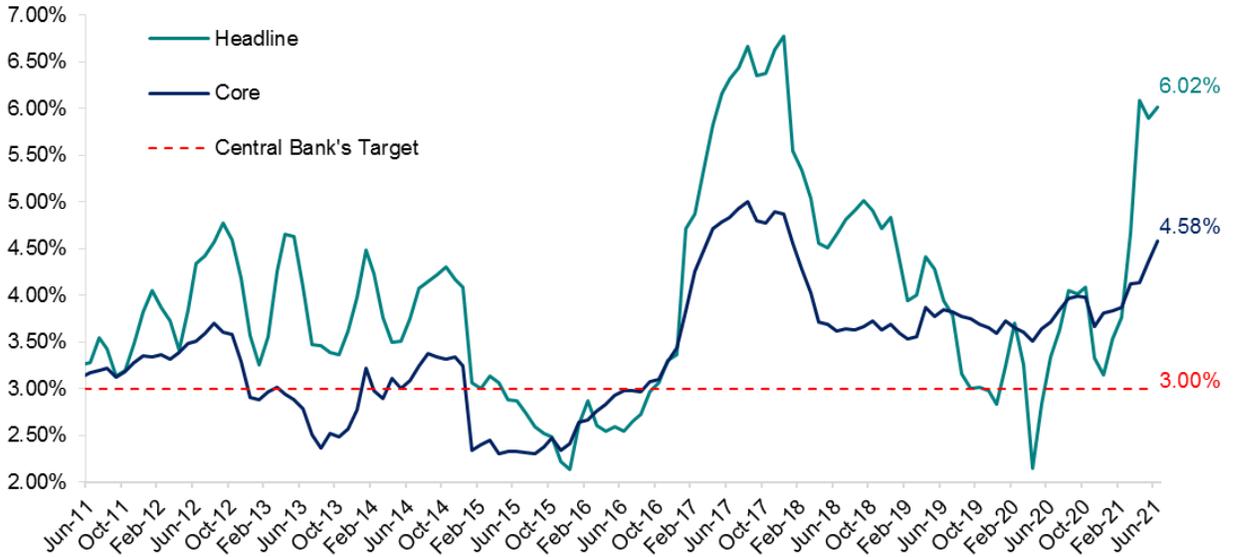
Source: INEGI & Banxico



Source: ANTAD

Exhibit 3

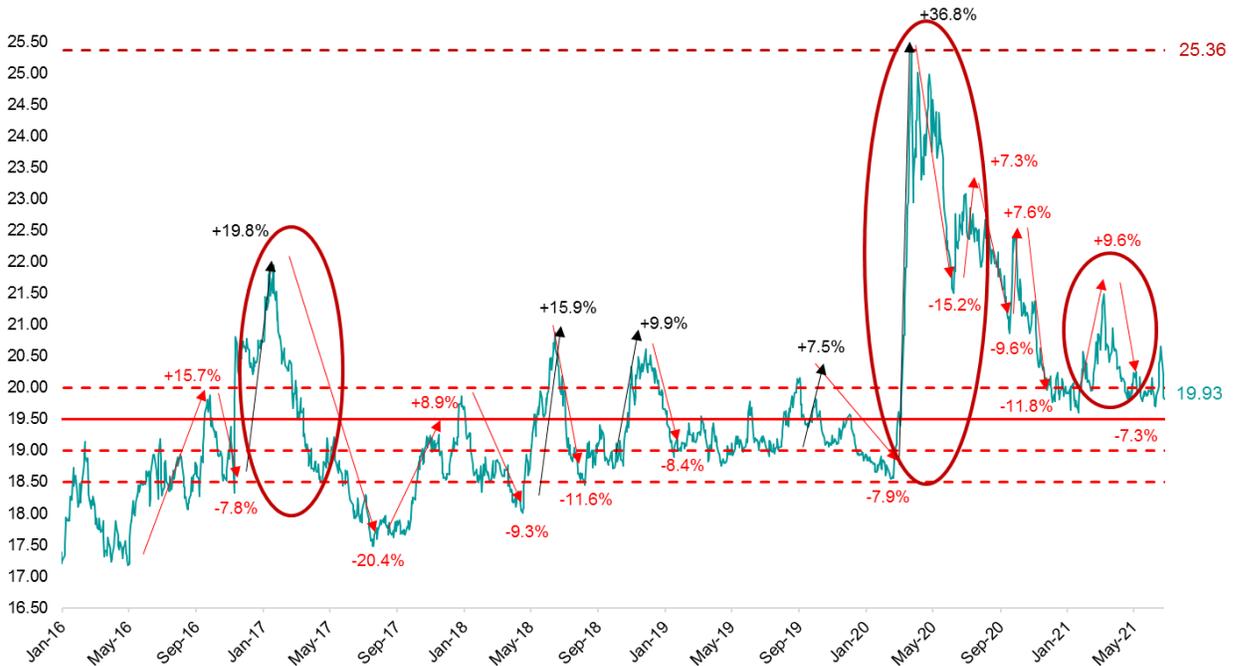
Inflation
(Year over Year % Change)



Source: INEGI

Exhibit 4

Spot Exchange Rate MXN/USD
(Figures as of June 30, 2021)



Source: Bloomberg

Glossary

Basis Points (bps)	Refers to a common unit of measure for interest rates and other percentages in finance. One basis point is equal to 1/100th of 1%, or 0.01%, or 0.0001.
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Bloomberg Commodity Index (BCOM)	Is calculated on an excess return basis and reflects commodity futures price movements. The index rebalances annually weighted 2/3 by trading and 1/3 by world production and weight-caps are applied at the commodity, sector and group level for diversification. Roll period typically occurs from the 6th-10th business day based on the roll schedule. <i>You cannot invest directly into an index.</i>
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Central Bank of Mexico (BANXICO)	Is the Central Bank of Mexico, monetary authority and lender of last resource. The main objective of the Central Bank of Mexico is to maintain a low and stable inflation.
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Coronavirus Disease (COVID-19)	Is an infectious disease caused by a newly discovered coronavirus.
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Economic Activity Global Indicator (IGAE)	It is the Economic Activity Global Indicator (IGAE by its name in Spanish) and measures the evolution of the economic activity in Mexico.
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Exchange Rate	Is the value of one nation's currency versus the currency of another nation or economic zone.
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Federal Reserve (FED)	Is the central bank of the United States and arguably the most powerful financial institution in the world. It was founded to provide the country with a safe, flexible, and stable monetary and financial system.
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Gross Domestic Product (GDP)	Is a monetary measure of the market value of all the final goods and services produced in a specific time period
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Inflation	Is a measure that examines the weighted average of prices of a basket of consumer goods and services, such as transportation, food, and medical care. It is calculated by taking price changes for each item in the predetermined basket of goods and averaging them.
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Monetary Policy	Is the process of drafting, announcing, and implementing the plan of actions taken by the central bank, currency board, or other competent monetary authority of a country that controls the quantity of money in an economy and the channels by which new money is supplied.
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National Association of Self-Service and Departmental Stores (ANTAD)	Entity responsible of promoting the development of retail and its suppliers within the Mexican market.
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Reference Interest Rate	Is an interest rate benchmark used to set other interest rates. Various types of transactions use different reference rate benchmarks, but the most common include the Fed Funds Rate, LIBOR, the prime rate, and the rate on benchmark U.S. Treasury securities.
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Remittances	Funds an expatriate sends to his/her country of origin via wire, mail, or online transfer. These peer-to-peer transfers of funds across borders are economically significant for many of the countries that receive them.
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Same Store Sales (SSS)	Are also referred to as comparable-store sales or identical-store sales, measures the sales of a company's existing stores that have operated for more than one year, excluding sales of new stores.
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Trade Surplus	An economic measure of a positive balance of trade, where a country's exports exceed its imports.
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Sky View of Reforma Avenue, “BANXICO”, Mexico City; Mexico

Source: CANVA

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