2020 IMF/WB annual meetings - Dealing with the effects of a severe sanitary crisis

- **The IMF/WB Fall annual meetings took place last week**
- **The update of the *World Economic Outlook* anticipates a more vigorous economic revival, but a long, unequal, and uncertain recovery**
- **Fiscal and monetary stimulus have been key. However, governments face significant challenges ahead in order to continue to maintain them in place, as there is no much space for further monetary stimulus, while increasing debt levels with a smaller base of potential GDP could be dangerous**
- **In our view, discussions took place around these topics:**
  (1) COVID-19 pandemic, its economic impact, the recovery, and the space to continue to implement monetary and fiscal stimulus;
  (2) The US electoral process and the big difference its outcome could represent for the world; and
  (3) Structural challenges, in which climate change was one of the highlights

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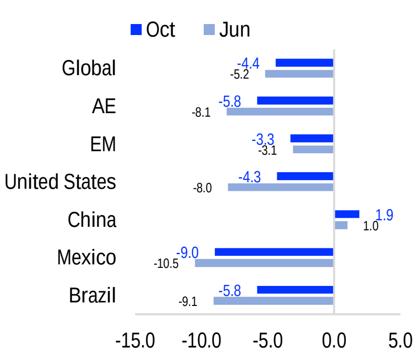
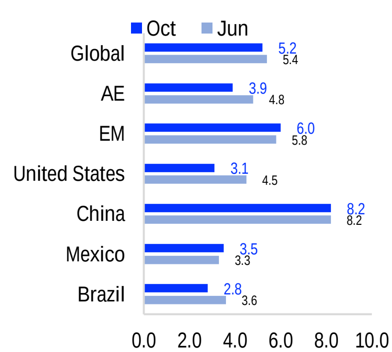
Virtual meetings. The International Monetary Fund (IMF) and the World Bank (WB) Fall annual meetings took place last week. The meetings took place in a virtual fashion, given the health emergency that COVID-19 is posing. As a result, this time the IMF Managing Director, Kristalina Georgieva, the Chairman of the World Bank, David Malpass, as well as the finance ministers, governors of the central banks, and other participants of both, the public and the private sector, have to discuss the most important issues affecting the world, currently experiencing its worst recession in almost a century. It is worth noting that in contrast to the Spring meetings, the Fall meetings are usually when policymakers set the agenda for the following year, as well as in terms of other medium-term issues.

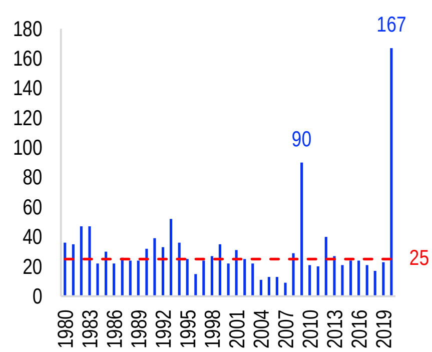
2020, GDP growth forecasts
% annual



2021 GDP growth forecasts
% annual



Countries facing GDP contraction
Number of countries*



Source: Banorte with data from the International Monetary Fund
*The total number of IMF-WB members countries is currently 195. The red dotted line is the median of the number of countries facing a GDP contraction.

World Economic Outlook: A more vigorous revival… Gita Gopinath, the IMF Chief Economist, begun the presentation of the World Economic Outlook saying that "…these are difficult times, yet there are some reasons to be hopeful…", referring to the number of scientific efforts to find and develop a vaccine to immunize the population from COVID-19, as quickly as possible, as well as to the most recent data on economic activity, which are fostering upward revisions to the majority of GDP growth forecasts for this and next year. In this context, the IMF staff modified its projection for global GDP growth to -4.4%, from 5.2% for this year, and to 5.2%, from 5.4% for next year. In the particular case of Mexico, the forecast was lifted to -9%, from -10.5% previously for year 2020 (2021: 3.5%). The revision for the US was quite substantial for 2020 to -4.3%, from -8% (2021: 3.1%), while for China, the positive projection for this year was not only reaffirmed, but even upgraded to 1.9%, from 1% previously (2021: 8.2%), as it can be observed in the charts above. However, there are now more countries that are supposed to face a GDP contraction this year vis-à-vis June WEO: 167, instead of 157 using June's IMF projections (please see the chart above on the extreme right).

…mainly explained by the major fiscal and monetary stimulus… The upward revision of the abovementioned forecasts was mainly due to: (1) Data on economic activity for 2Q20 in the largest advanced economies came in better than expected; (2) economic recovery in China was quicker than anticipated; and (3) signals that economic revival in 3Q20 has accelerated. In this context, the IMF staff mentioned that this has been possible mainly explained by the significant and timely implementation of fiscal and monetary stimulus, as well as regulatory policies, that allowed families to maintain their income, firms to protect their cash flows, and banks to continue to provide credit.

…however, the IMF foresees a long, unequal, and uncertain recovery. However, the main title of this *WEO* was "A Long and Difficult Ascent". On the one hand, the nature of the pandemic has sparked a revival in which not all sectors are able to reopen at the same time, or even some that actually do, face a weak demand. Moreover, there will be high transition costs of fast-forwarding the insertion of the digital world for certain sectors of the economy. As a result, the IMF recommends the fiscal, monetary, and regulatory authorities to keep their lax policies for a longer period of time, and gradually remove them, as there are strong signs of economic recovery. Furthermore, both, the IMF and the WB signaled that economic recovery from this recession will need coordinated policy actions across countries.

Significant setback on the progress in reducing global poverty and living standards improvement. Unfortunately, the impact of economic activity as well as on the population living standards has been quite substantial and we do not know yet the severity and duration that this pandemic will have. In this context, IMF staff, as well as the fiscal and monetary authorities across the globe, and heads and representatives of the private sector that participated in the meetings, highlighted the sad reversion that the pandemic is causing on inequality improvement and poverty reduction.

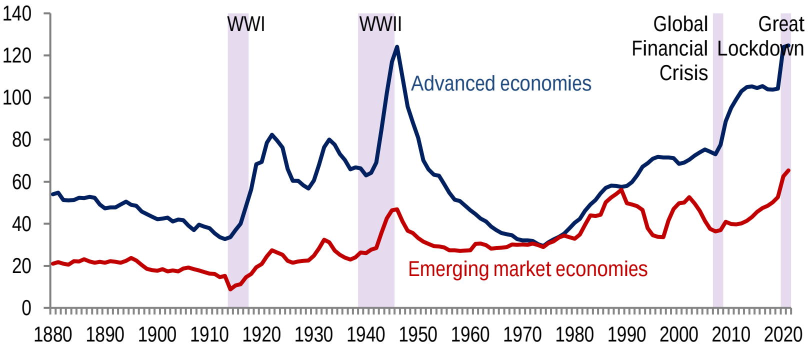
People either relying on their daily wage or working in the informal sector -which are outside of a safety net of health services, for example-, are facing a significant decline in their income level, since the lockdowns were implemented. These circumstances could exacerbate with the structural change that the world is also experiencing. In fact, on the one hand, the IMF estimates that for this year, the number of people living under the so-called 'poverty line' of US$ 1.90 a day could increase by 90 million. On the other hand, they all warned that the massive closure of schools -despite the virtual capabilities that some have-, is going to have a considerable negative impact in the construction of human capital.

Space for further fiscal and monetary stimulus

Policy accommodation as a key feature for sustained economic recovery. As previously discussed in this document, the global economy plunged in 2Q20 at a worst-ever rate, impacted by the COVID-19 outbreak. Thereupon, economic activity started showing signs of recovery in the 3Q20 supported by a twofold policy strategy: plans to reopen the economy (*e.g.* less severe quarantines) and the announcement of unprecedented fiscal and monetary stimuli. Given the importance of policy response to the pace of recovery, several discussions among policymakers, investors and almost all the attendees to this year's virtual meetings were centered on the leeway of governments and central banks to provide additional accommodation. Some of the recommendations from the IMF, coming from its October's Fiscal Monitor are centered in the following idea: "*Policies will need first to respond to the immediate health crisis, but over time foster the economic recovery and address the long-term challenges of the post-pandemic economy*".

However, the landscape from a policy standpoint remains challenging. Monetary policy worldwide is facing a short-term conundrum in terms of its maneuvering space –given that central banks have almost drain their capacity in terms of conventional tools– pushing them into uncharted waters (*e.g.* negative short-term real rates, yield curve control or even the controversial idea of *helicopter money*). In contrast, it seems that fiscal policy remains as the more level-headed approach to stimulate the pace of recovery, although slipping into a mid-term risk when facing the aftermath effects coming in the form of higher –and in some cases unsustainable– debt levels (see chart below).

Historical Patterns of General Government Debt
% of GDP



Source: Banorte with data from IMF

Hope for additional fiscal stimulus. At this juncture, fiscal policy will continue playing a key role by providing a more rapid and direct stimulus to the economy, especially to households and firms. The fiscal response from the 196 countries tracked by the IMF hovers around US$13 trillion or nearly 15% of world's GDP, with a strong likelihood of additional stimuli in the next months. World Bank and IMF officials, such as Kristalina Georgieva, have urged countries that have fiscal space to increase de policy response. It is most likely that the additional fiscal aid will come primarily from advanced economies, with investors focus on the current impasse in the US between democrats and republicans. Consensus among attendees to the meetings hovers around a nearly US$2 trillion package after the elections.

Monetary policy may move to uncharted waters. We have to bear in mind that the response from central banks following WHO's decision to declare the Coronavirus as a pandemic on March 11th was rapid, with almost 97 countries trimming interest rates in a coordinated and unprecedented fashion. Major central banks such as the Fed, ECB and BoJ have expressed their desire to keep loose monetary conditions for longer and explore any means necessary to foster the pace of economic recovery. However, they have also acknowledged the less room of maneuver within their conventional tools, also calling on the idea that additional fiscal aid is needed. It was a common view from the participants to this year's event that the next step will focus on more aggressive asset purchases programs and yield control. In EM we have observed central banks exploring new mechanisms to stimulate the economy, such as QE strategies that were not previously used during the 2008-2009 crisis.

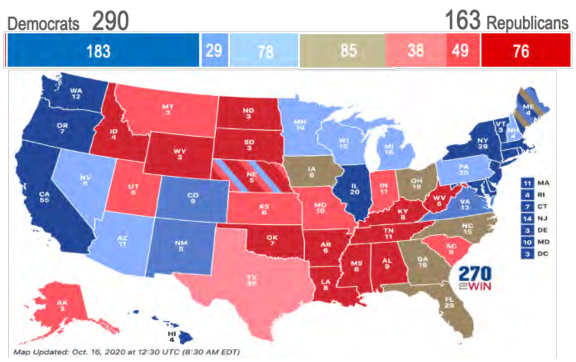
There was a strong debate about MMT. When dealing with the options to tackle the adverse effects of the COVID-19 pandemic on the economy, we observed a more intensifying debate hovering around the thesis of Modern Monetary Theory (MMT). Traditionally, the use of expansionary fiscal policy is constrained by debt levels, however –according to MMT– the current low rate environment is granting reserve-currency countries the opportunity to increasing the money supply (*i.e.* printing more money) to increase the capacity of policy response. According to MMT proponents such as economists Stephanie Kelton or Warren Mosler hint that the only constraint faced by these governments when conducting a more aggressing spending strategy is the availability of "real resources". So far, this is a highly controversial topic, but echoing every forum.

Relevance of the US electoral process

U.S. election was at the forefront of the discussions. The election is the single most important geopolitical risks of the year, not only because of the pandemic, that could make it difficult for people to go out and vote in many states, but because this could eventually be a contested election, won by a very narrow margin. Moreover, the result of the election could represent a crossroads between four more years of the current aggressive, erratic policies and, if the democratic candidate wins, a fresh new start, bringing back the U.S. to the fore of international politics, embracing climate change initiatives and promoting international cooperation in general. Recent polls give vice president Biden (Democrat) 9 points lead vs. incumbent Donald Trump (Republican).

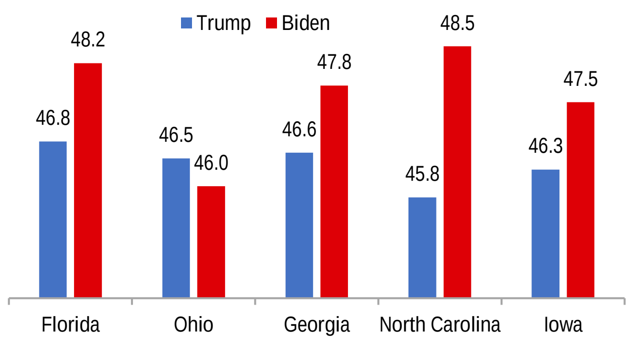
Nevertheless, even though support for vice president Biden surged in national opinions polls, while President Trump dropped off, this was so to a lesser extent in swing states. In this context, recall that 270 electoral votes are needed in order to be elected president. According to consensus in *270towin.org*, Mr. Biden could have up to 290 electoral votes and Mr. Trump 163 with 85 votes being a toss-up (see figure below on the left). These 85 votes come mainly from four so called *swing* states such as Florida (29 votes), Ohio (18 votes), Georgia (16 votes), North Carolina (15 votes) and Iowa (6 votes). In all of these states, even though Biden lead in the polls, it is within the margin of error, as shown in the chart below on the right.

Electoral map: October 2020



Source: 270towin.org

Electoral preferences in swing states
%



Source: Real Clear Politics

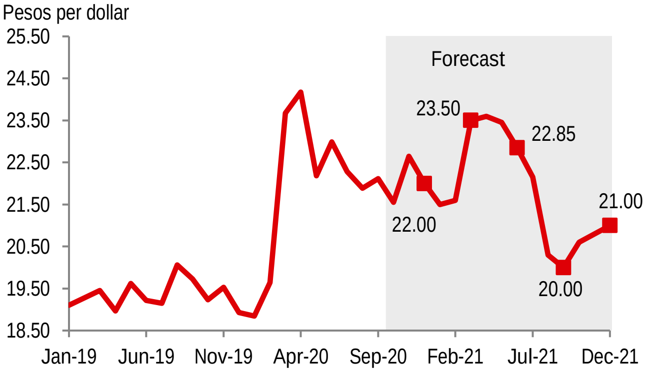
Turnout could be key in this election. More than ever, high levels of participation are expected next November 3rd, although the pandemic could eventually deter some voters as already mentioned. In the event of a low turn-out, it is possible that a winner could not be called on Election Day. Under this scenario, there is an increased probability of seeing disputes arising in several states, which should be resolved by December 8th, before the electoral college casts their vote (December 14th). If by this last date, none of the candidates get to 270 votes, the House of Representatives gets to choose. Bear in mind that the House is currently dominated by the Democratic Party (232 representatives vs. 197 Republicans, 1 libertarian and 5 vacant).

Getting the pandemic under control, first thing on the list. An overarching pressure for the new administration will be fighting the pandemic, both from the sanitary as well as from the economic viewpoint. Here is where the discussions on fiscal stimulus come into play. Discussions during the meetings recognized that the support given by both monetary and fiscal authorities was key to cushion the blow at the beginning of the pandemic, and it is still needed. Nobody expect at this point that a fiscal relief bill will be passed through Congress before the election, but it is highly probable to have one after it. The difference will be the size of the stimulus, which will depend, not only on who is in the White House, but also on who is in control of the Senate. If Republicans retain control of this chamber -which is the more likely scenario-, then we could expect a relatively lean bill with a more hawkish fiscal stance in the following two years, independently of who lives in the White House. But, if there is a Democratic victory, support will be more significant, with fiscal stance more on the dovish side in the next two years.

Moreover, it is worth noting that Joe Biden has also in his mind a redistribution agenda, which include the reversion of the tax cuts seen under Trump's reform. In this context, even if such agenda starts to correct US social and economic imbalances it would weigh in the short run on the corporate earnings outlook.

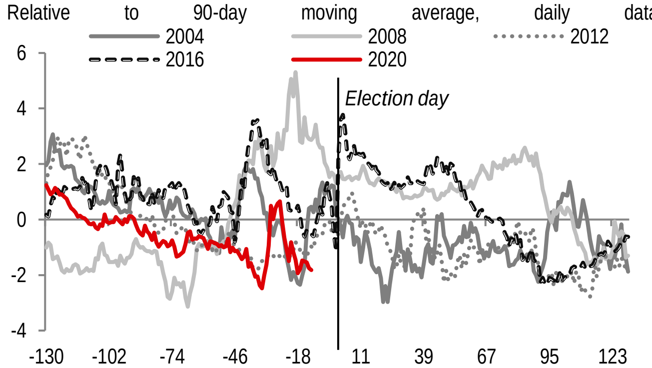
Fiscal stimulus would entail a weaker dollar going forward. We expect a momentary USD appreciation and higher volatility around the Election Day, which could be extended if it is a contested election. Nevertheless, the outlook is for a weaker dollar looking ahead, as fiscal policy will continue to be dominant over the medium term. Such weakness is expected to be reflected particularly against the Japanese Yen and the Euro, but in EM markets, idiosyncratic factors will also weigh. In this context, we expect the Mexican peso to observe some pressure in the coming weeks, to levels around 23.00 as in previous elections (see chart below right), to then come back to our USD/MXN 22.00 for year-end forecast, as shown in the chart below left.

USD/MXN
Pesos per dollar



Source: Bloomberg, Banorte

USD/MXN: Z-score*
Relative to 90-day moving average, daily data



Source: Bloomberg, Banorte * Up means MXN depreciation

Bringing America back to the international arena. Under a Joe Biden's White House, the second item on the list of priorities, would be bringing back the U.S. leadership in international issues such as climate change and trade, among others. Biden is expected to reach out to European allies joining back to the *Paris Agreement*, the *World Health Organization* (WHO) and participating more actively on *North Atlantic Treaty Organization*. In terms of the relationship with China, tensions are bound to persist as long as President Xi remains in power, but the general opinion is that issues with China could be tackled showing a common front, particularly with European countries.

Difficult outlook for developing economies

Emerging markets are facing a challenging landscape, especially in the Latam region. The common denominator in every conversation or panel about EM was the loss of growth potential steered by the SARS-CoV-2 outbreak. Within IMF's *World Economic Outlook* released last week (see table below), the expected performance of GDP in 2020 and 2021 in EM excluding China and India is lower in comparison with advanced economies. This can be explained by three main factors: (1) Lower growth inertia previous to the pandemic; (2) limited policy response; and (3) the divergence in the performance of contagion curves limiting economic activity.

Overview of the IMF's World Economic Outlook Projections
% annual

		Projections Oct. 20		Projections Jun. 20	
	2019	2020	2021	2020	2021
Global	2.8	-4.4	5.2	-5.2	5.4
Advanced Economies	1.7	-5.8	3.9	-8.1	4.8
United States	2.2	-4.3	3.1	-8.0	4.5
Eurozone	1.3	-8.3	5.2	-10.2	6.0
Emerging Markets	3.7	-3.3	6.0	-3.1	5.8
China	6.1	1.9	8.2	1.0	8.2
Mexico	-0.3	-9.0	3.5	-10.5	3.3

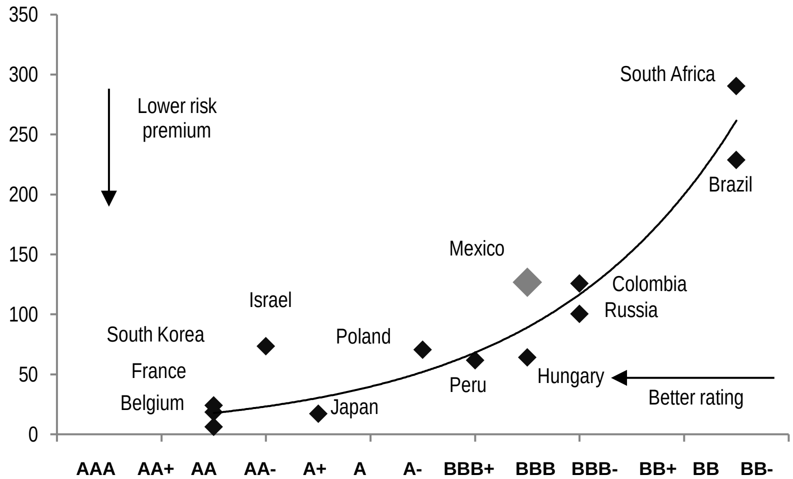
Source: IMF

Investors depicted a less promising view about Latam. In this context, the expectations for the Latam region are less promising, with IMF's forecasts showing a likely decline in 2020's GDP of -8.1% (compared with -4.4% for the entire world, -5.8% in advanced economies and -3.3% in the entire EM sample) and an estimated recovery of 3.6% in 2021 (World 5.2%, AE 3.9%, EM 6.0%). The rationale behind a less optimistic view about the region relies in several conditions: (1) Latam economies have a greater dependence on commodity-related exports, external funding and tourism; (2) current dynamics in external and fiscal accounts, in addition to a less resilient inflation, that is limiting the degree for policy accommodation *vis-à-vis* other regions; (3) downside risks coming from trade policies and geopolitical uncertainty; (4) the combination of a wider output gap and weaker inertial growth before the Coronavirus pandemic aggravated the shock to the region's economy; and (5) some idiosyncratic factors associated to macroeconomic imbalances in some countries (*e.g.* Argentina and Venezuela) or concerns about policy predictability (*e.g.* Brazil).

Attendees remained cautious about growth dynamics in Mexico. In terms of Mexico, the comments targeted three main topics: trade and diplomatic relations with the US, persistent lower growth below potential and the limited policy response to the Coronavirus pandemic. As mentioned before in this document, consensus is betting on a Biden win –most likely accompanied by a "blue wave"– which is observed as positive for several features within this strategic relation in terms of trade, investments, migration and geopolitical cooperation. Joe Biden is seen as an experimented public figure with a more conciliatory approach. In addition, with the USMCA trade agreement already implemented, Mexico can benefit for nearshoring strategies that could potentially boost market share in terms of US trade versus China. With respect to economic performance, almost every investor and attendee to this year's virtual meetings acknowledged that the macro framework remains stable, but the country has been growing below potential in the last 10 to 15 years. In this regard, there was a wide consensus that Mexico requires a structural change in terms of rule of law and productivity to boost potential growth. Moreover, when analyzing the economic policies, almost all the participants referred to IMF's recent publication of the concluding statement of the 2020 Article IV consultations for Mexico. In general terms, investors stressed out that Mexico has depicted a lower fiscal response in comparison to its Latam peers, but acknowledging that this prudent approach could avoid the debt problems that are expected in other countries like Brazil.

When discussing Banxico, there was a common belief that the central bank has finished its easing cycle. If something with one final cut to come in the near future. Finally, there was a split view about the credit rating profile, with expectations about additional downgrades next year, but with opposing views about the investment grade status – optimism about holding it in a 12- to 24-month horizon, but uncertain about the mid-term–, confirming current valuation of country risk premium in financial markets (see chart below).

5-year CDS and S&P Global credit rating
Basis points in vertical axis, credit rating in horizontal axis



Source: Banorte with data from Bloomberg and S&P Global Ratings

Structural challenge: Climate change, demographics, and technological change

A new global architecture for new global challenges? While the argument for international cooperation was present in most of the meetings, there were several discussions whether the Bretton Wood's institutions are still valid or if a new global architecture is needed in the context of the challenges that the world is facing. Kristalina Georgieva, Managing Director at the IMF, considered that we are currently at a similar crossroad as we were back when the Bretton Woods convention took place back in 1944 with countries needing to deal with immediate devastation from the COVID-19 pandemic along with the need to lay the foundations for a more prosperous, sustainable world. In this context, the general view was that international cooperation is as important as ever and that the U.S. should not view institutions as some charity, they donate to but as a vehicle for their leadership in terms of debt-relief, health, among others. Nonetheless, focus of institutions should shift to issues such as sustainability, climate change, human capital protections and how to lead economic prospects within a changing technological paradigm.

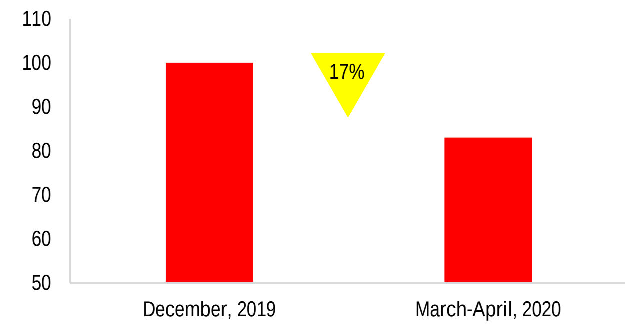
Discussions on human capital, sustainability and technology more present than ever. Underlying in all of the discussions during the meetings was the need of planning a recovery aiming to reduce inequality, boost human and physical capital with a sustainable focus and the role that technologies would have in all these processes. In fact, many investors suggested that, when looking at where to allocate their resources -despite the prospects of low interest rates for the foreseeable future which could lead for yield searching-, they are becoming increasingly focused not only on returns but in environmental, social and governance measures (ESG) to assess the sustainability of their investments. They highlighted that, in the case of countries, sustainability of growth, viability of institutions and credibility are becoming key in capital allocation decisions. For instance, in the case of fiscal support, the amount is not only important, but also if the strategy is going to pay-off in terms of long-term growth and the environment, among others.

In the case of human capital, discussions were centered in the need to protect the most vulnerable. They highlighted the need to strengthen health and education systems, accelerating gender equality. Moreover, the pandemic has accelerated some long-term trends, largely technology centered, that are restructuring the global economy and that, if left unattended, could tend to exacerbate inequalities. This is the case of the technology which allowed some knowledge-based sectors to continue to work from home while unemployment in other less-educated environments hit harder. In this context, many large companies see the pandemics as an opportunity to reduce in size and cost. A smaller permanent workforce, a larger contingent workforce, less office space and smaller travel budgets will be more common in the post-pandemic world. Nevertheless, digital transformation could give a long-term productivity boost, as it is the case of remote medicine, which trend accelerated during the lockdowns.

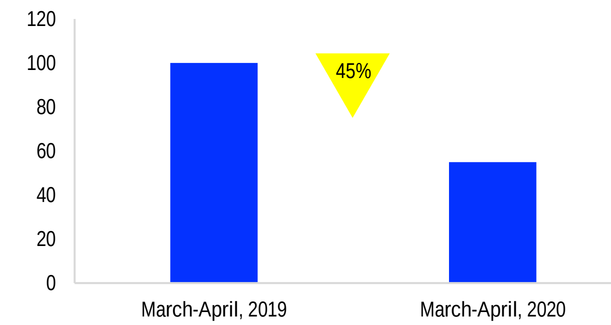
Challenges in digital finances were also a big part of discussions. As we have already mentioned in the section above, technology brings a lot of advantages and also big challenges. In the financial sector, challenges come, among others, from the need of interoperability of systems and governance to enable better market and data access as well as connectivity services. Moreover, there were deep discussions on the ethical use of data. With rapidly digitizing world there is the need to establish principles and organizational frameworks based on principles of fairness, ethics, accountability and transparency. Finally, another big challenge for banks and insurers have to do with the expansion of the Cloud, which enabled business continuity during the pandemic but raised a lot of questions in terms of compliance.

Climate change awareness. The sudden appearance of wildlife in urban areas and beaches, as well as the significant reduction in air pollution levels, during the implementation of the lockdowns, globally, has been noticeable. NASA (National Aeronautics and Space Administration) estimates that the levels of nitrogen dioxides -one of the most important pollutants of modern cities-, fell between 30% and 60% in January and February 2020, with respect to the same period of time in year 2019, in several cities in China, and in March 2020 vis-à-vis the same month last year in several cities in Europe and the US (please see chart below on the left). Moreover, greenhouse gas emissions have declined 17% between March and April, compared to the end of last year, according to a research piece published in *Nature Climate Change* (char below on the right). The majority of IMF/WB meetings' participants underscored the awareness that the pandemic has brought about, particularly as it has left no doubt that human beings have an impact on climate change, something that an important part of the population still did not believe.

Nitrogen dioxide levels in urban areas
Index 100 = March-April 2019



Greenhouse gas emissions
Index 100 = December 2019



Source: Banorte with data from NASA and *Nature Climate Change* magazine

Final notes

High level of uncertainty, with doubts about the space of economic policy, and acceleration of structural change. Even though there are signs of a quicker than anticipated economic revival, a long, unequal, and uncertain recovery is expected. The more vigorous economic data that has been observed since the reopening took place has been mainly explained by the significant and timely implementation of fiscal and monetary stimulus. Nevertheless, countries are facing considerable challenges to maintain the stimulus programs in place, particularly because of the limited monetary policy space, as well as the potentially negative consequences if governments continue to increase their indebtedness levels, with a weakening base of potential GDP. Furthermore, Covid-19 pandemic has accelerated the digitalization process of the global economy, creating deep structural changes for which governments and firms were not prepared to deal with. Fortunately, confinement polices has increased the global awareness on climate change.

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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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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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Determination of Target Prices

For the calculation of estimated target prices for securities, analysts use a combination of methodologies generally accepted among financial analysts, including, but not limited to, multiples analysis, discounted cash flows, sum-of-the-parts or any other method that could be applicable in each specific case according to the current regulation. No guarantee can be given that the target prices calculated for the securities will be achieved by the analysts of Grupo Financiero Banorte S.A.B. C.V, since this depends on a large number of various endogenous and exogenous factors that affect the performance of the issuing company, the environment in which it performs, along with the influence of trends of the stock market, in which it is listed. Moreover, the investor must consider that the price of the securities or instruments can fluctuate against their interest and cause the partial and even total loss of the invested capital.

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