

Ahead of the Curve

Timely 2Q20 data will help gauge the magnitude of the impact of COVID-19 on the economy

- IMEF's PMIs (May).** We estimate a modest rebound in both indicators after reaching new historical lows in April, albeit staying in deep contraction territory. Manufacturing would stand at 41.2pts and non-manufacturing at 38.1pts. These results would signal a limited improvement in conditions, believing that last month showed the deepest plunge in this recession. Broadly speaking, this increase would be driven by efforts and plans to gradually reopen economies –both domestically and externally– along fiscal and monetary stimulus measures worldwide to combat the economic effects of the pandemic
- Family remittances (April).** We anticipate relative strength in inflows to continue in the month at US\$3,139.7 million, up 6.9% y/y after surging 35.8% in March, which was a new historical high in absolute terms. In our view, the result will likely be influenced by a plethora of drivers, both to the upside and downside. Among those with a negative impact we highlight job losses in the US and mobility restrictions at the border. To the upside, we believe an important catalyst could be direct transfers as part of the implementation of fiscal stimulus measures (one-time payments to permanent residents with annual income below US\$75,000). Going forward, we still believe that remittances will be pressured on global economic woes on the back of the pandemic, particularly employment conditions in the US

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Winners of the award for best economic forecasters for Mexico in 2019, granted by *Refinitiv*



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Mexico weekly calendar

DATE	HOUR (ET)	EVENT	PERIOD	UNIT	BANORTE	CONSENSUS	PREVIOUS
Mon 3-Jun	10:00am	Family remittances	April	US\$ mn	<u>3,139.7</u>	--	4,016.1
Mon 3-Jun	10:00am	Banxico's survey of economic expectations	May				
Mon 3-Jun	1:00pm	PMI's survey (IMEF)	May				
		Manufacturing		index	<u>41.2</u>	--	40.5
		Non-manufacturing		index	<u>38.1</u>	--	35.5
Tue 4-Jun	10:00am	International reserves	May-31	US\$ bn	--	--	187.2
Thu 6-Jun	7:00am	Gross fixed investment	March	% y/y	<u>-10.9</u>	--	-8.6
		sa		% m/m	<u>-2.6</u>	--	-1.7
		Machinery and equipment		% y/y	<u>-16.4</u>	--	-9.5
		Domestic		% y/y	<u>-11.6</u>	--	-4.7
		Imported		% y/y	<u>-19.6</u>	--	-12.5
		Construction		% y/y	<u>-6.9</u>	--	-8.1
Wed 5-Jun	4:30pm	Citibanamex bi-weekly survey of economic expectations					

Source: Banorte; Bloomberg

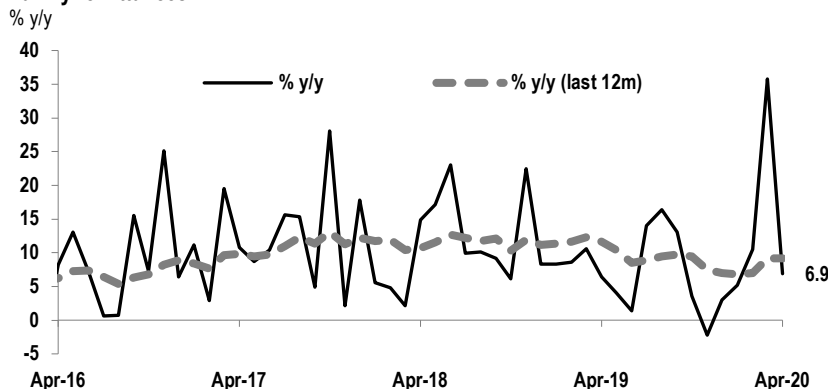
Proceeding in chronological order...

Remittances to stay resilient in April. We expect remittances at US\$3,139.7 million, up 6.9% y/y after surging 35.8% in March. It should be mentioned that the amount of inflows in said period stood at a new historical high, in our view influenced by the impact of COVID-19. This was very surprising to both us and the market, as we expected a contraction on more adverse employment conditions and uncertainty in the migrant community because of the pandemic. Nonetheless, other factors, such as the depreciation of the exchange rate –which incentives inflows–, and the possible delivery of additional resources to help their families south of the border, more than compensated for the former.

We should also mention that the result will likely be influenced by a plethora of drivers, both to the upside and downside. Among those with a negative impact we highlight two: job losses in the US and mobility restrictions at the border. In the former, nonfarm payrolls fell by 20.5 million in the month, driving the unemployment rate to 14.7%. Specifically, Mexican migrants lost almost 3 million jobs. Among them, ‘natives’ –people with Mexican parents born in the US– saw a decline of 1.8 million, ‘non-native citizens’ fell by 202k and ‘non-citizens’ –where illegal migrants are accounted for– saw a decline of 911k. On the second, restrictions on border crossings by foot remain in place since March 21st, in our view making more difficult to send remittances.

To the upside, we believe an important catalyst could be direct transfers as part of the implementation of fiscal stimulus measures. These are one-time payments to permanent residents with an annual income below US\$75,000. We believe a relevant share of migrants catalogued as ‘natives’ and ‘non-native citizens’ could have benefited from these. Both groups could also have received unemployment benefits, helping compensate at least partially for layoffs. On the other hand, the MXN depreciated 7.8% m/m, trading at 24.27 per dollar on average in the month. We estimate it is unlikely to see a repetition of inflows as strong as last month given the decline in available resources. Nevertheless, stimulus measures in the US and the constant effort of migrants to send money abroad despite adversity will help compensate to some extent for job losses, resulting in a relatively high amount sent, at least for now.

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 2020 year-end inflation at 2.90%, below our 3.20% estimate. Considering the latest inflation print surprised higher, we do not rule out some moderate revisions to the upside. Meanwhile, medium and long-term expectations could remain unchanged, still above target. On GDP, this year's estimate stands at -7.1% (Banorte: -7.8%). We expect some revisions, with a wide range of estimates prevailing given the high degree of uncertainty around it. The current view on the reference rate by YE20 is 5.00%, which could also be adjusted given the dovish tone of the central bank (Banorte: 4.50%). Finally, the year-end exchange rate stands at USD/MXN 23.05, which could also show marginal adjustments (Banorte: 22.00).

IMEF indicators to pick up modestly in May. We estimate a modest rebound in both indicators after reaching new historical lows in April, albeit staying in deep contraction territory. These would signal a limited improvement in conditions, believing that last month showed the deepest plunge in this recession. Broadly speaking, we expect this increase to be driven by efforts and plans to gradually reopen economies –both [domestically](#) and externally– along fiscal and monetary stimulus measures worldwide to combat the economic effects from the pandemic. Nonetheless, it would still be consistent with a contraction in the month, as social distancing measures remained in place in Mexico.

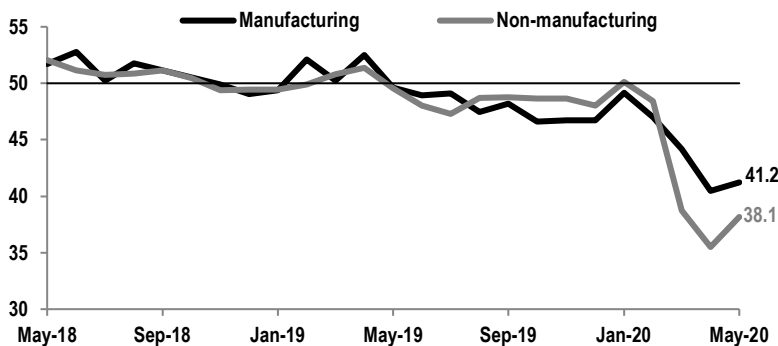
We estimate the manufacturing indicator at 41.2pts. Our forecast takes the hint from the US PMI for May, which picked up to 39.8pts from 36.1pts in April. According to *Markit*, the pace of deterioration was still high –particularly in production and new orders– but at a more modest pace as businesses slowly returned to work. Moreover, foreign demand remained specially muted, with new export orders still declining heavily but also at a reduced rate. This is also consistent with output measures in other regional indicators such as the Philly Fed and Dallas manufacturing. In Mexico, the federal government added key industries such as construction, auto manufacturing and non-oil mining as essential activities. News suggest some issues have been encountered to get operations back in track as sanitary measures have to be in place before authorization. Nevertheless, automakers such as GM, Toyota, Nissan and Honda have gradually restarted, along other auto parts makers.

In non-manufacturing, we see a slightly stronger rebound, to 38.1pts from 35.5pts. In this respect, *Apple* and *Google* mobility data show a slight advance relative to April. Based on how the survey is designed, this would also imply an uptick in the indicator. Moreover, the government started to deliver unsecured loans to small businesses at the end of April, accelerating through the month. Although relatively limited in scope and resources, we believe these could also have boosted sentiment. The Mexican peso has rallied from their weakest levels in March and April, currently close to 22.00 per dollar in the interbank market. On the contrary, other data was still weak. Among them, inflation for the first half of May surged to its highest for the same period since 2002. We note this was mainly due to the hefty increase in processed foods and fresh fruits and vegetables, in our view among the categories that impact consumers the most. Gasoline prices also rebounded, although their impact is likely more limited given lower demand.

As a result, it is our take that IMEF indicators may have passed their lowest level, consistent with activity being hit the most in April. It is our take that both indicators could grind slowly higher in coming months as activities gradually reopen, although they will likely stay in contraction territory for most or even all of the rest of 2020, with the economy already exhibiting low dynamism even before the pandemic hit.

IMEF indices

Diffusion indices, sa



Source: IMEF

Weekly international reserves report. Last week, net international reserves increased by US\$250 million, closing at US\$187.1 billion. According to Banxico's report, this was explained by: (1) An increase of US\$200 million from dollar sales from Pemex to the central bank; and (2) a positive valuation effect in institutional assets of US\$50 million. In this context, the central bank's international reserves have increased by US\$6.3 billion during 2020 (please refer to the following table).

Banxico's foreign reserve accumulation details

US\$, million

	2019	May 22, 2020	May 22, 2020	Year-to-date
	Balance		Flows	
International reserves (B)-(C)	180,877	187,172	250	6,295
(B) Gross international reserve	183,028	197,070	459	14,042
Pemex	--	--	280	2,704
Federal government	--	--	-85	7,226
Market operations	--	--	0	0
Other	--	--	264	4,112
(C) Short-term government's liabilities	2,151	9,898	209	7,747

Source: Banco de México

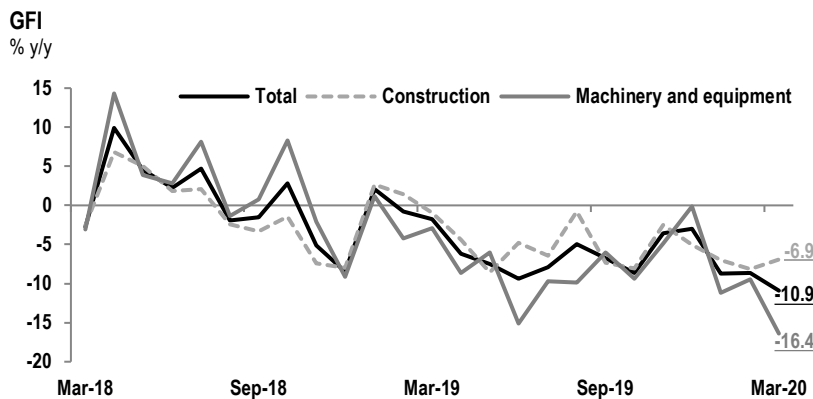
Gross fixed investment to plunge in March. We anticipate GFI at -10.9% y/y, below the -8.6% of the previous month. With seasonally adjusted data we forecast a 2.6% m/m decline, adding two consecutive negative months. Figures would start to show some of the effects of COVID-19, particularly in machinery and equipment given supply chain disruptions. Construction seems to have stayed relatively resilient, albeit coming from a place of weakness before the outbreak.

We anticipate total machinery and equipment at -16.4% y/y. The hardest hit would be the imported component at -19.6%. This is not surprising as capital goods imports within the trade balance fell 18.1%, with an even higher impact already adverted in April, dipping 26.7%. An additional shock in this sector might be a result of losses in the Mexican peso—recording a 20.1% depreciation YTD until March—, increasing the cost of these type of investments.

The domestic component would fall 11.6%, skewed down by disruptions in local output, with M&Eq. at -13.7% and transportation at -20.3% within [industrial production](#). It should be noted that transportation accounts for around 55% of total investment in domestic machinery and equipment, so auto sector problems are expected to make an important dent to performance.

We expect construction at -6.9% y/y. In this regard, industrial production showed a contraction of 7.5% in this sector’s activity, improving relative to the -9.0% from the previous month, albeit benefited also by an additional working day. As has been the recent trend, edification (-4.7%) outperformed civil engineering (-17.8%). The latter contrasts with federal government public spending data, which showed a 34.2% y/y increase in physical investments. Nevertheless, and as has been the case in the last few months, methodological differences –mainly related to oil drilling– have resulted in better prints in GFI relative to the industrial production report, leading us to believe a slight outperformance is once again in order.

Going forward, we expect investment to contract more rapidly in 2Q20, particularly in April and May. This would be a result of a much worse outlook as stronger social distancing measures were enacted and the economy slowed down meaningfully. Moreover, private construction was classified as a non-essential sector. In addition, we expect investment in machinery and equipment to dip very strongly, with the auto industry and many other businesses also deemed as non-essential. Another factor that will certainly impact investment levels is the unusual degree of uncertainty, as portrayed by business confidence metrics in April. In particular, the component related to the ‘adequate moment to invest’ for three out of the four main sectors (construction, commerce and non-financial services) plunged to new historical lows. Therefore, we expect investment spending to remain very depressed, at least until the outlook in terms of activity levels and uncertainty shifts decisively for the better.



Source: INEGI, Banorte

Analyst Certification

We, Gabriel Casillas Olvera, Alejandro Padilla Santana, Delia María Paredes Mier, Juan Carlos Alderete Macal, Manuel Jiménez Zaldivar, 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 Thalia Orozco Vélez, Gerardo Daniel Valle Trujillo and Eridani Ruibal Ortega, 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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