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# Mexican Macro Update & Monetary Policy Outlook

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Scotiabank Mexico

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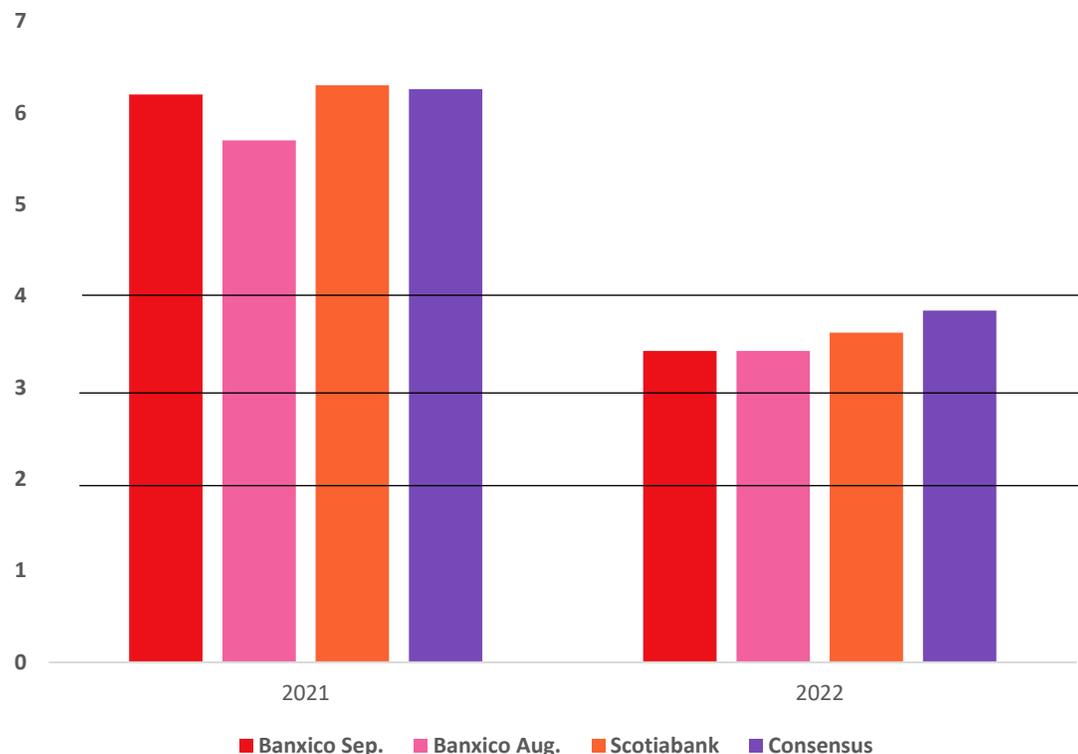
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# Mexican inflation risks not just supply side

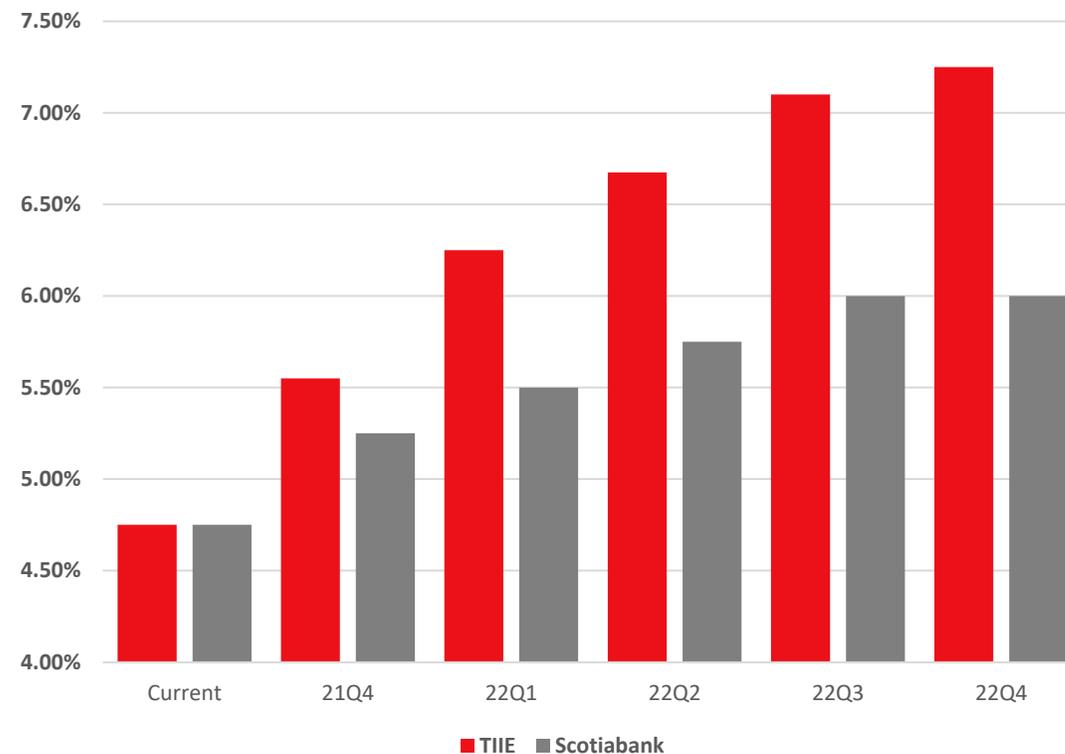
# Inflation expectations are generally aligned— policy rates have some dispersion

**Inflation Forecasts  
(y/y % e.o.p.)**



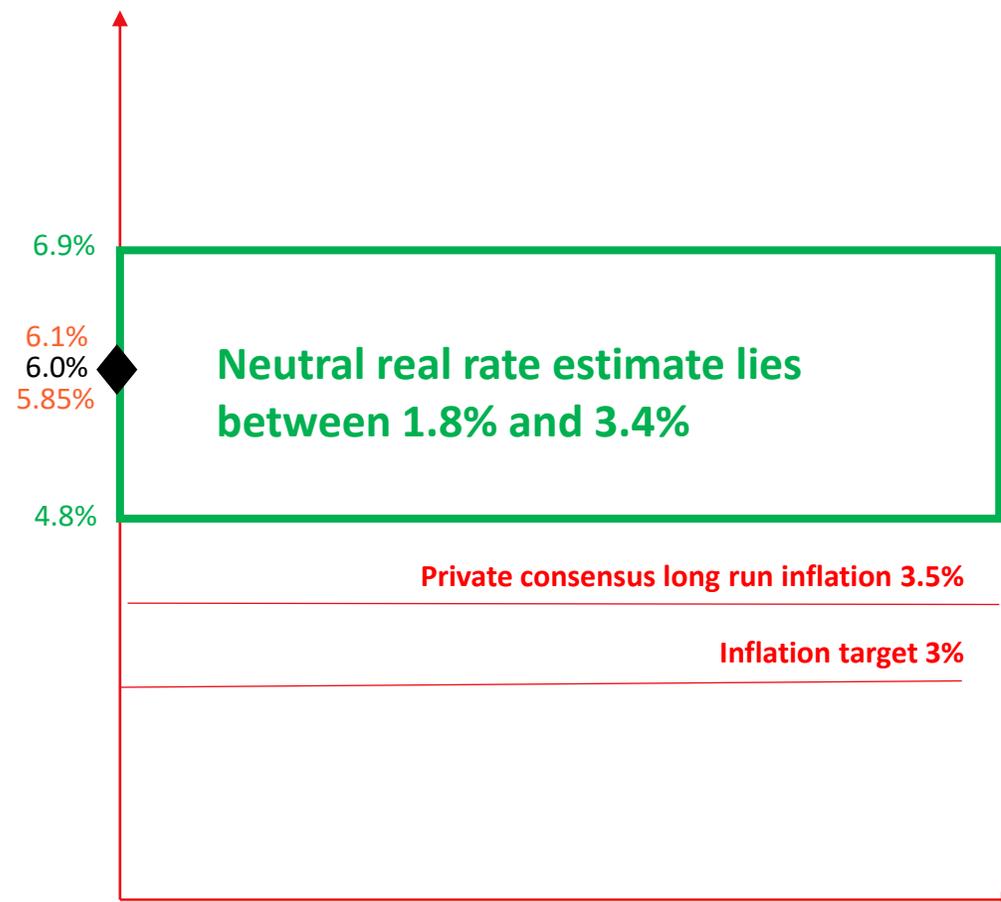
Sources: Scotiabank Economics, Banxico.

**Expectations for Banxico's Policy Rate  
(%)**



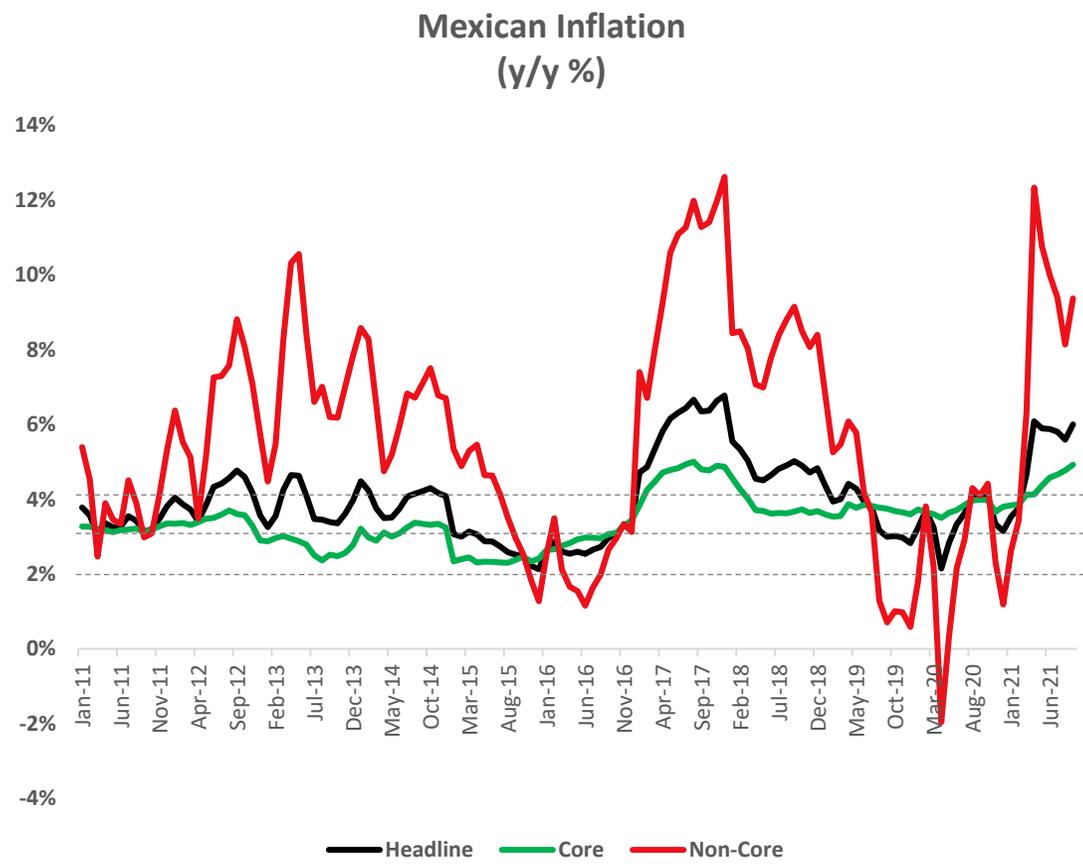
Sources: Scotiabank Economics, Bloomberg.

# Markets expecting a terminal rate at 7.5%, neutral settings are around 6.0%

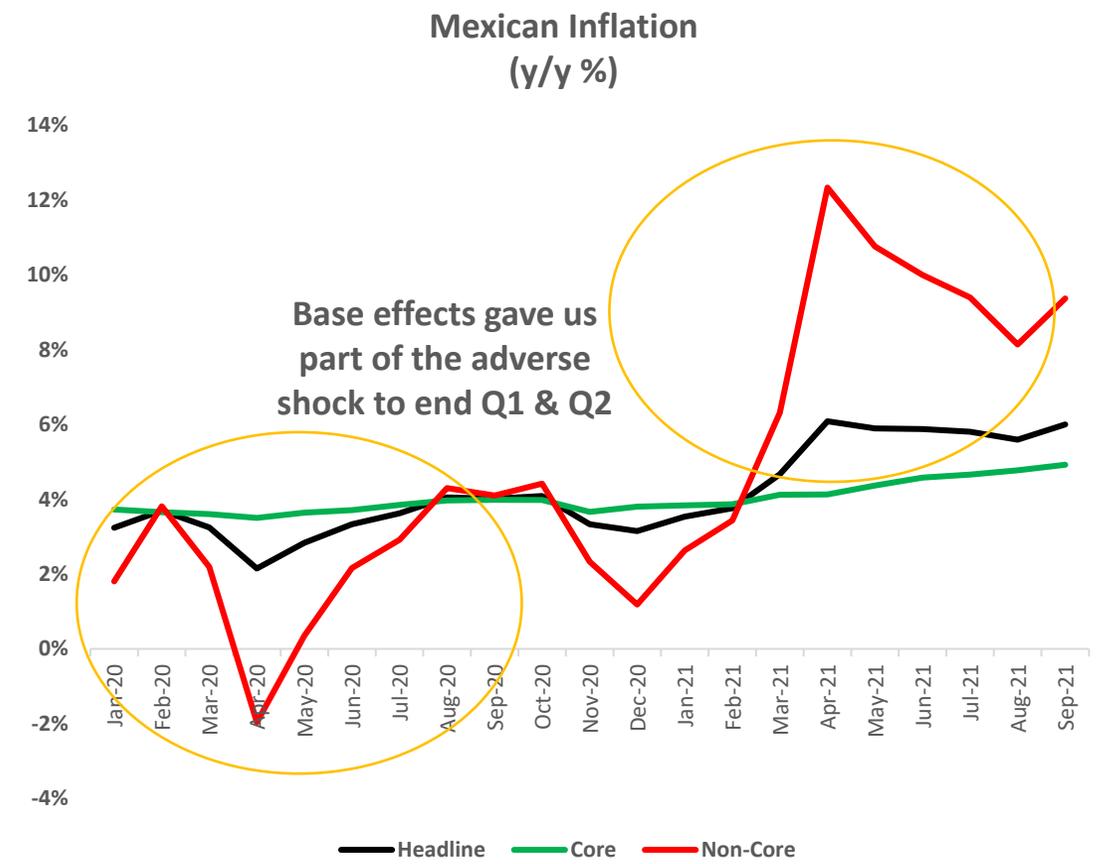


Sources: Scotiabank Economics, Banxico.

# Were going through one of the two strongest core inflation shocks of the past decade



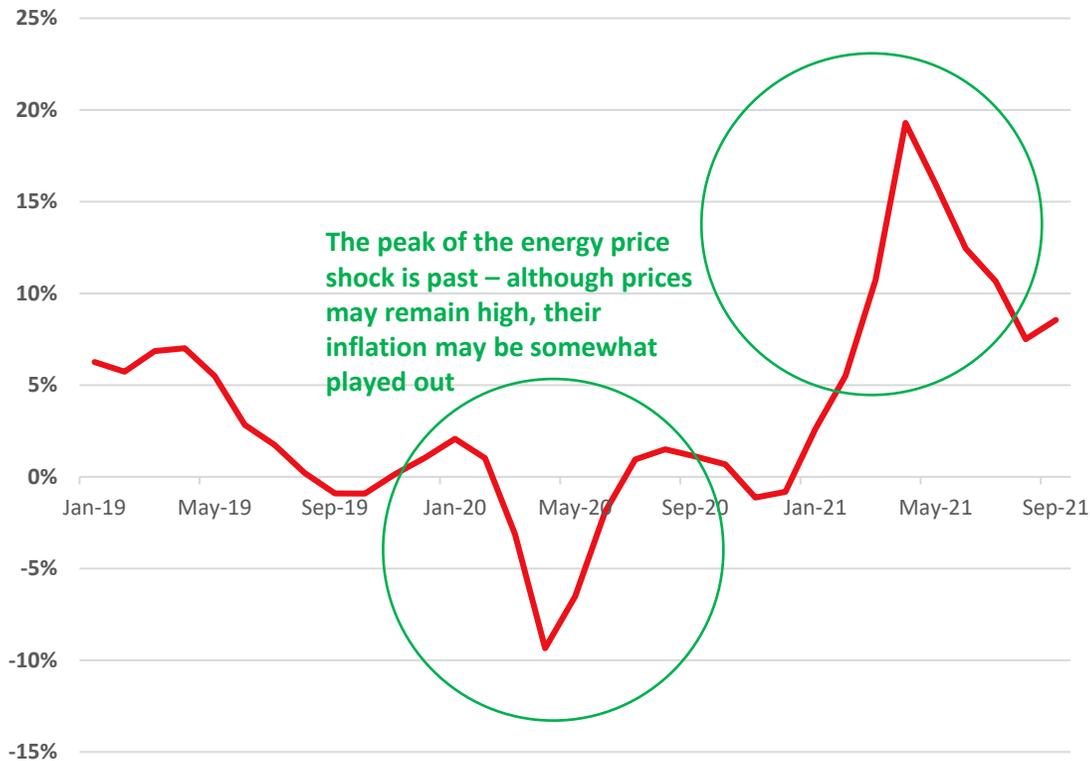
Sources: Scotiabank Economics, INEGI.



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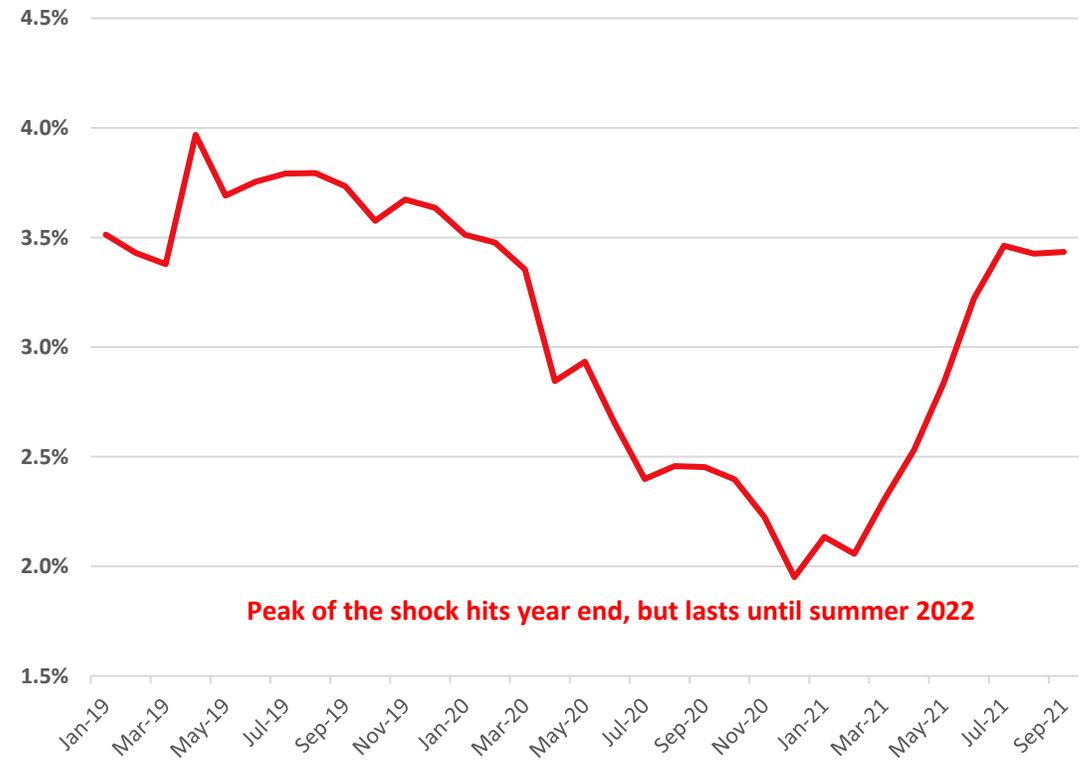
# The ghosts of inflation shocks past and future...

**Energy & Administered Price Inflation (y/y %)**



Sources: Scotiabank Economics, INEGI.

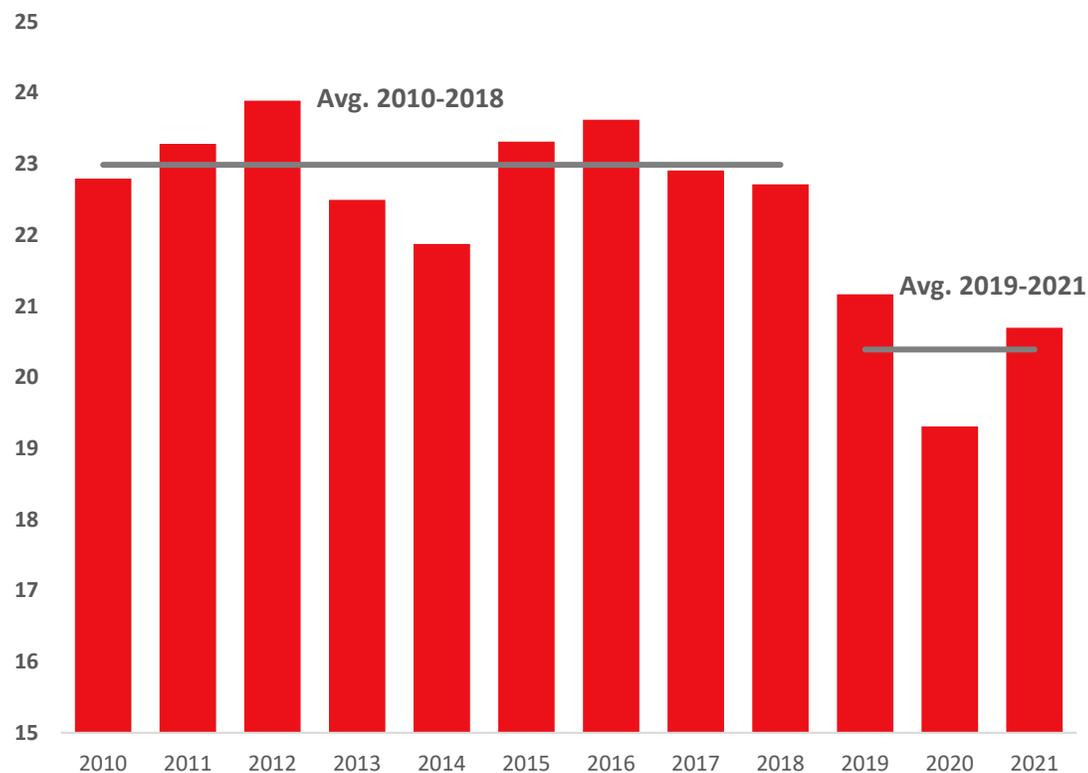
**Services Inflation (y/y %)**



Sources Scotiabank Economics, INEGI.

# Drop in investment should impact potential growth

**Total Investment**  
(% of GDP)



Sources: Scotiabank Economics, IMF.

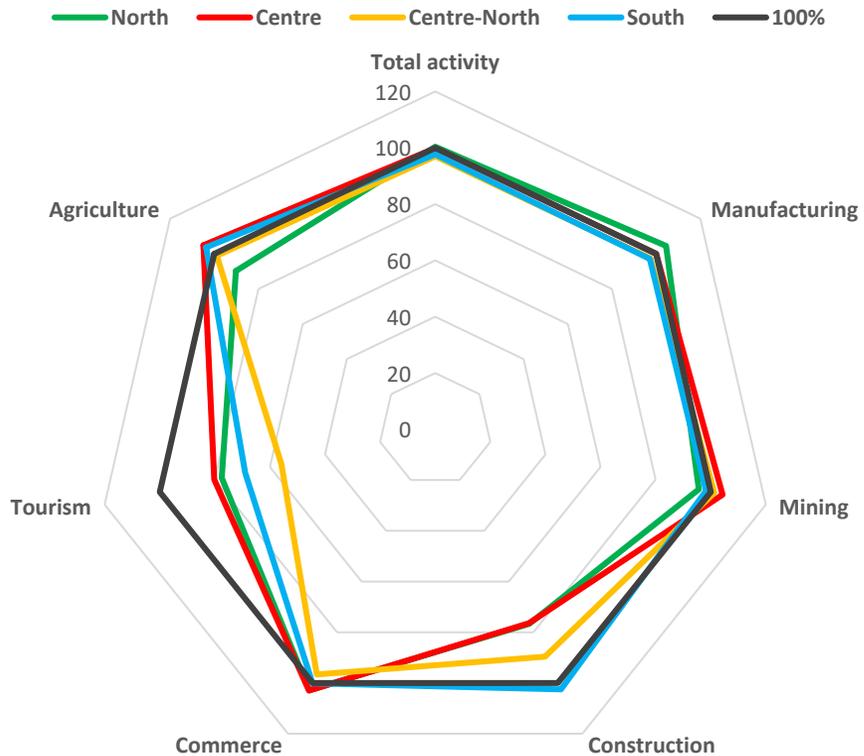
**Mexico Flow of Foreign Direct Investment, Total**  
(12m. rolling sum, US\$ mn)



Sources: Scotiabank Economics, Banxico.

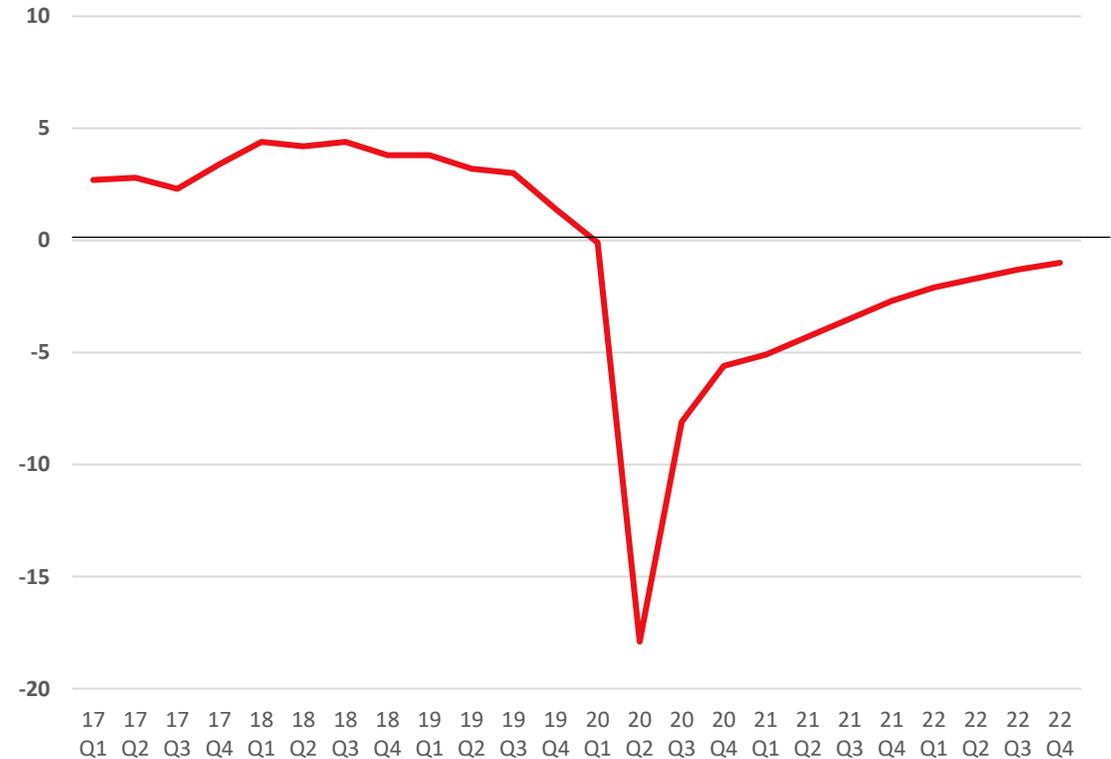
# Banxico expects output gap to be nearly shut by end-2022...but we argue not all output gaps are equally important

Regional Economic Activity  
(21Q2 as % of activity in 20Q1)



Sources: Scotiabank Economics, Banxico.

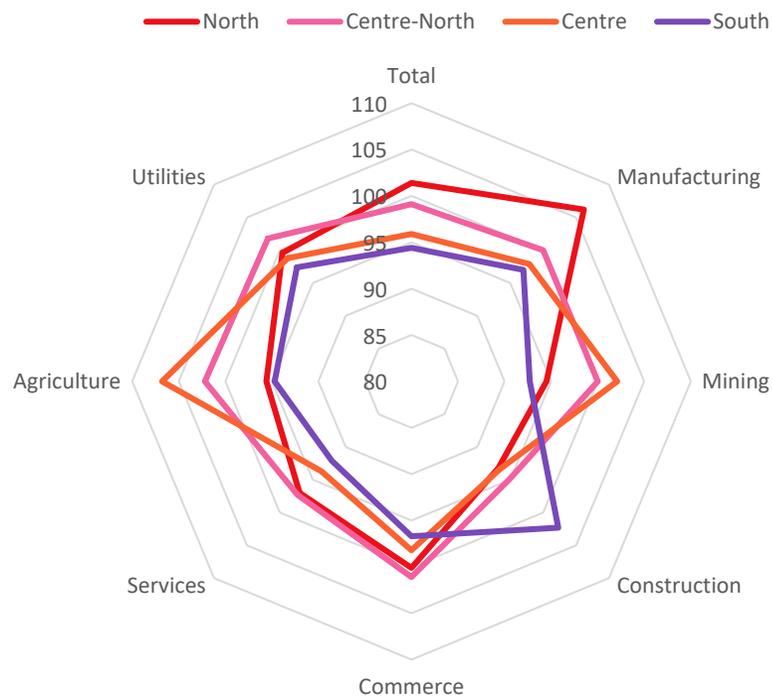
Banxico's Output Gap Estimate  
(% of potential GDP)



Sources: Scotiabank Economics, Banxico.

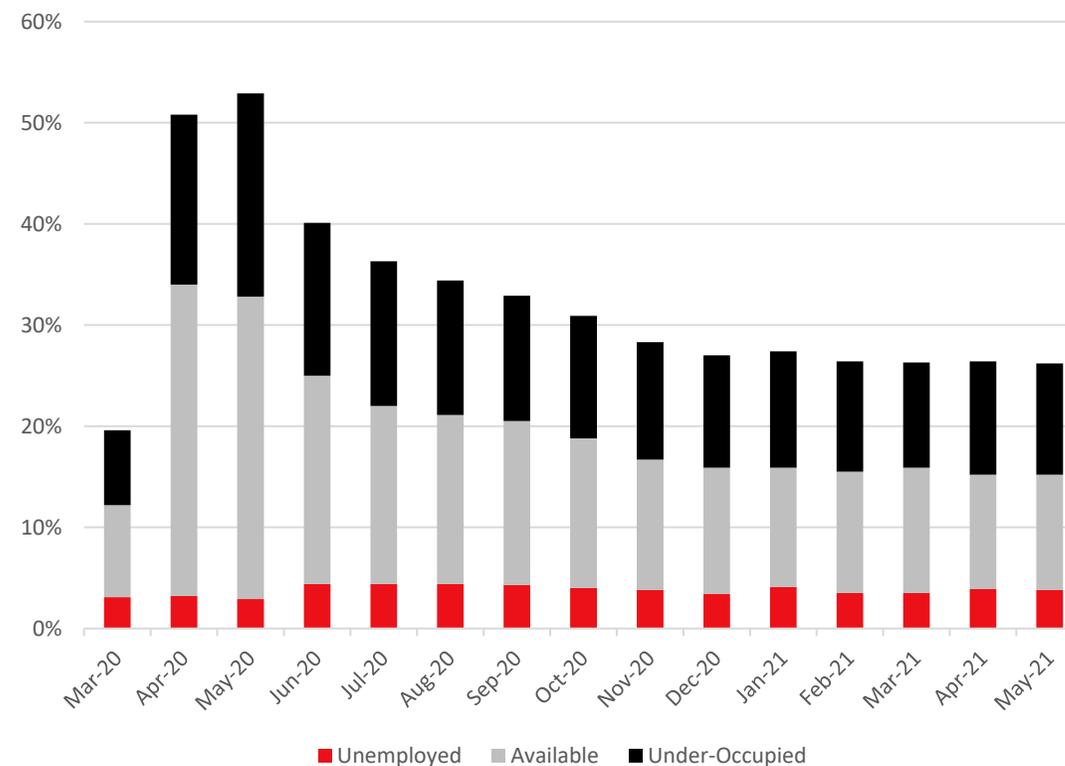
# Labour market is recovering, but slack remains

**Number of Social Security Institute Affiliated Formal Jobs (21Q2 as % of their level Feb-2020)**



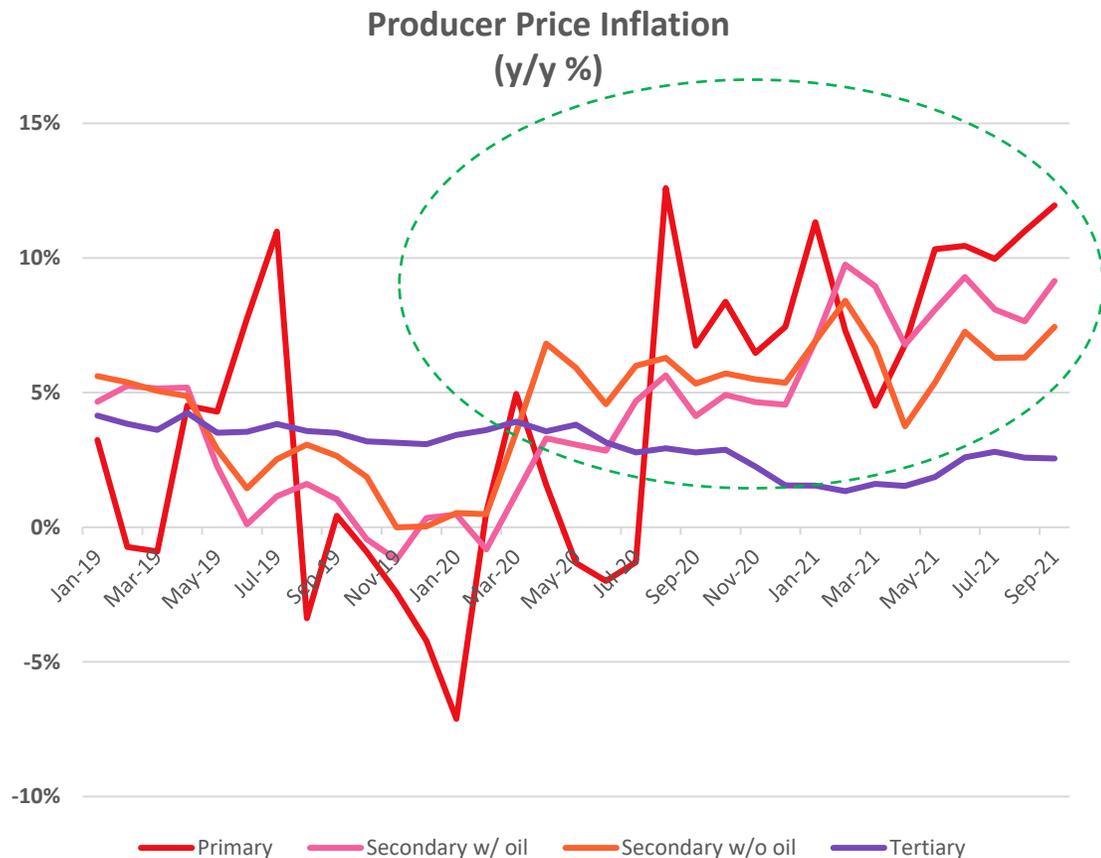
Sources: Scotiabank Economics, Banxico.

**Mexican Labour Gap (% of Economically Active Population)**

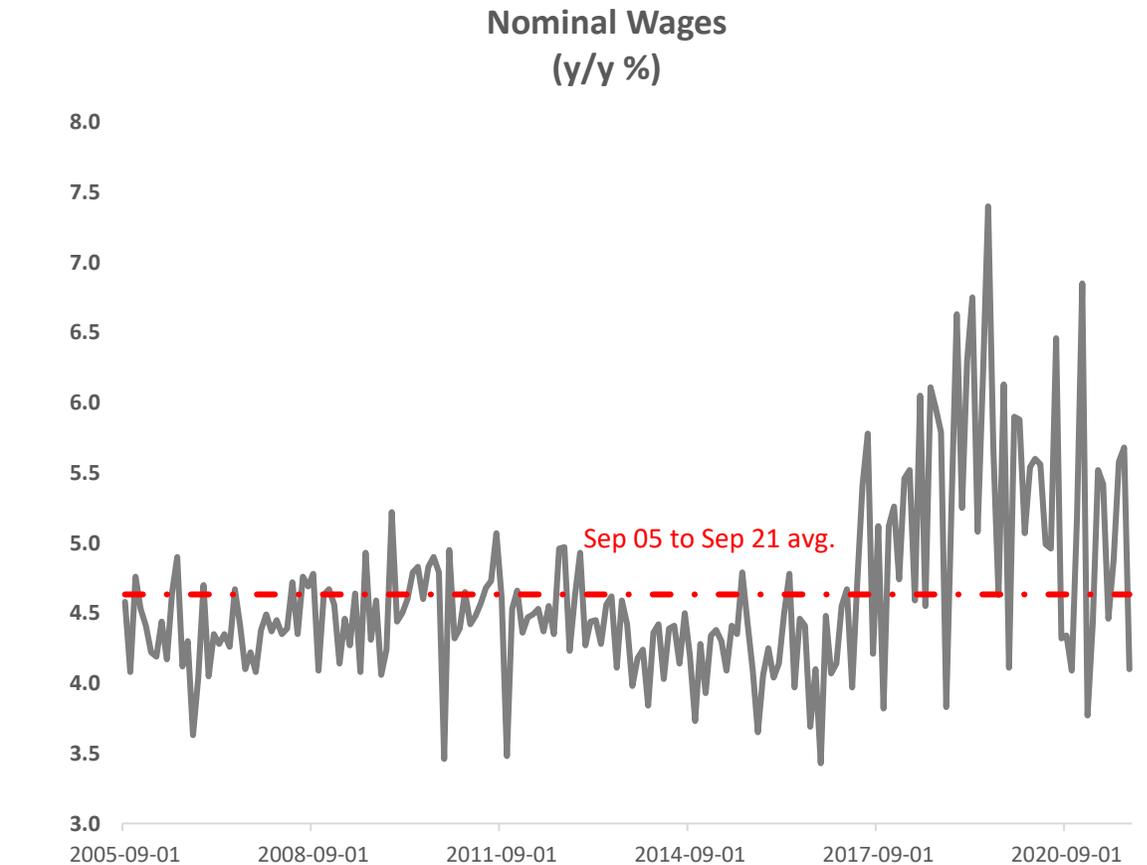


Sources: Scotiabank Economics, IMCO.

# Producer price pressures are mounting, and are more painful for a country where the slump lasted 8 quarters—rather than a couple



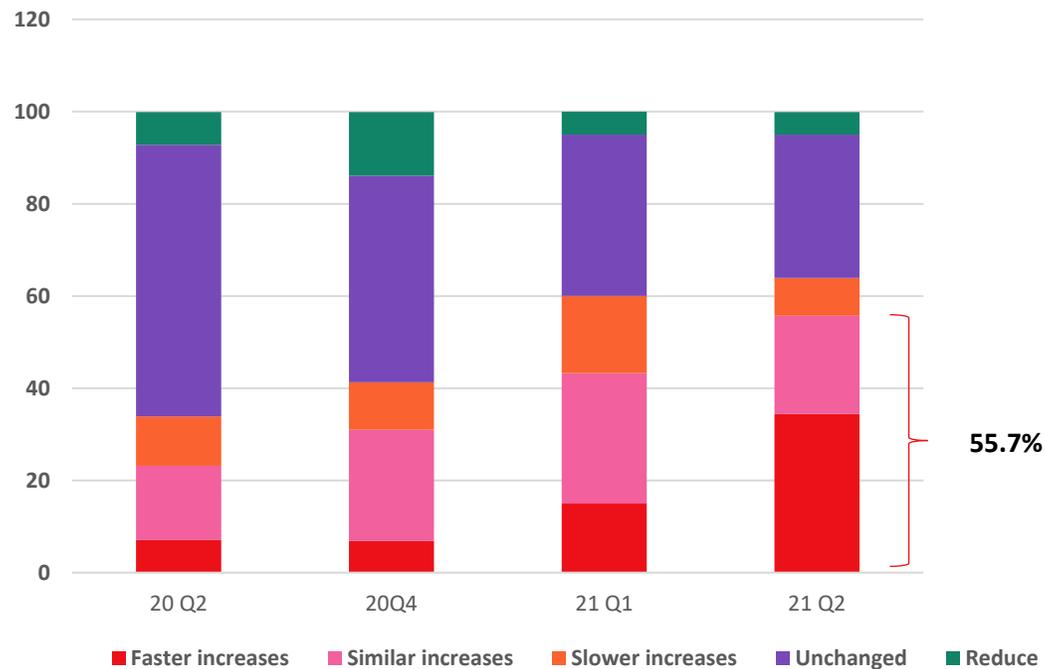
Sources: Scotiabank Economics, INEGI.



Sources: Scotiabank Economics, Bloomberg.

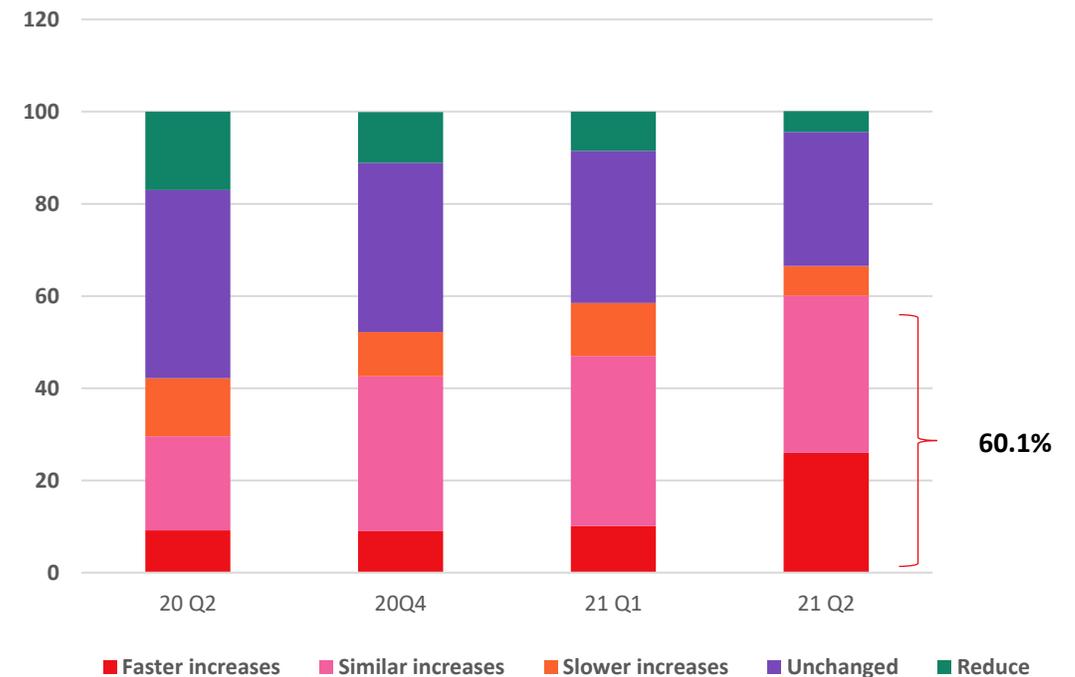
# Are PPI pressures and the length of the recession the reason behind firms seeking large price increases?

Manufacturing Corporate Leaders Expectations for their prices in the coming 12m. (%)



Sources: Scotiabank Economics, Banxico.

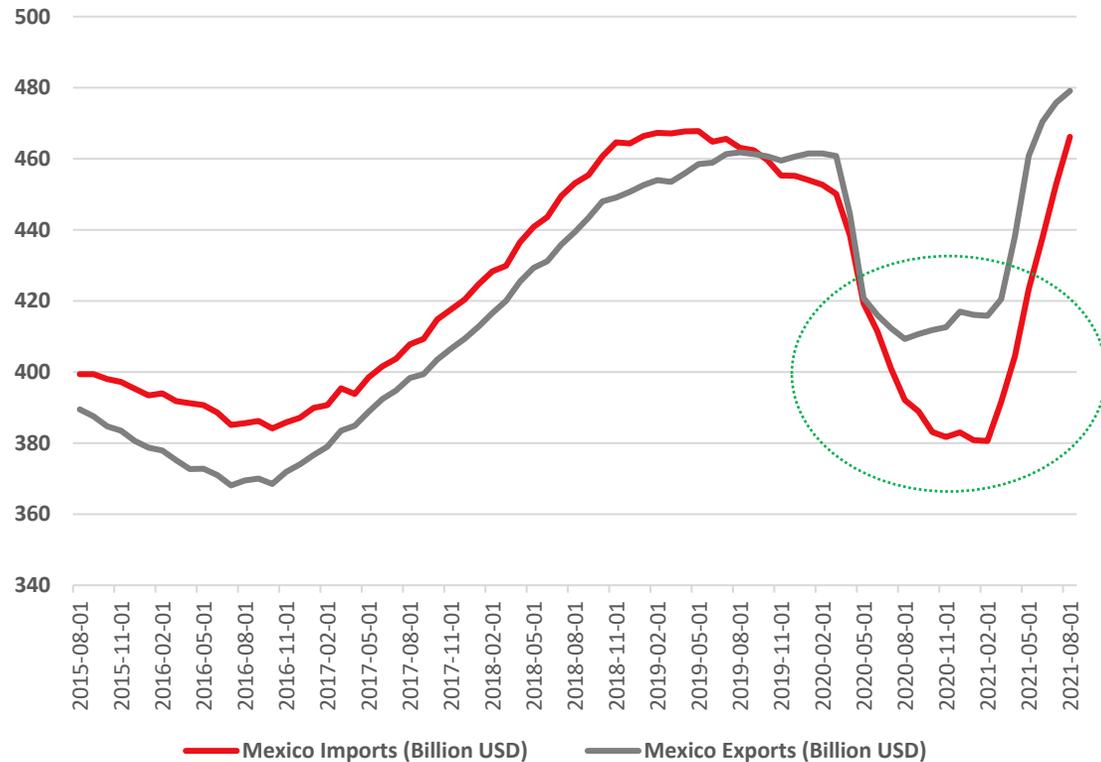
Non-Manufacturing Corporate Leaders Expectations for their prices in the coming 12m. (%)



Sources: Scotiabank Economics, Banxico.

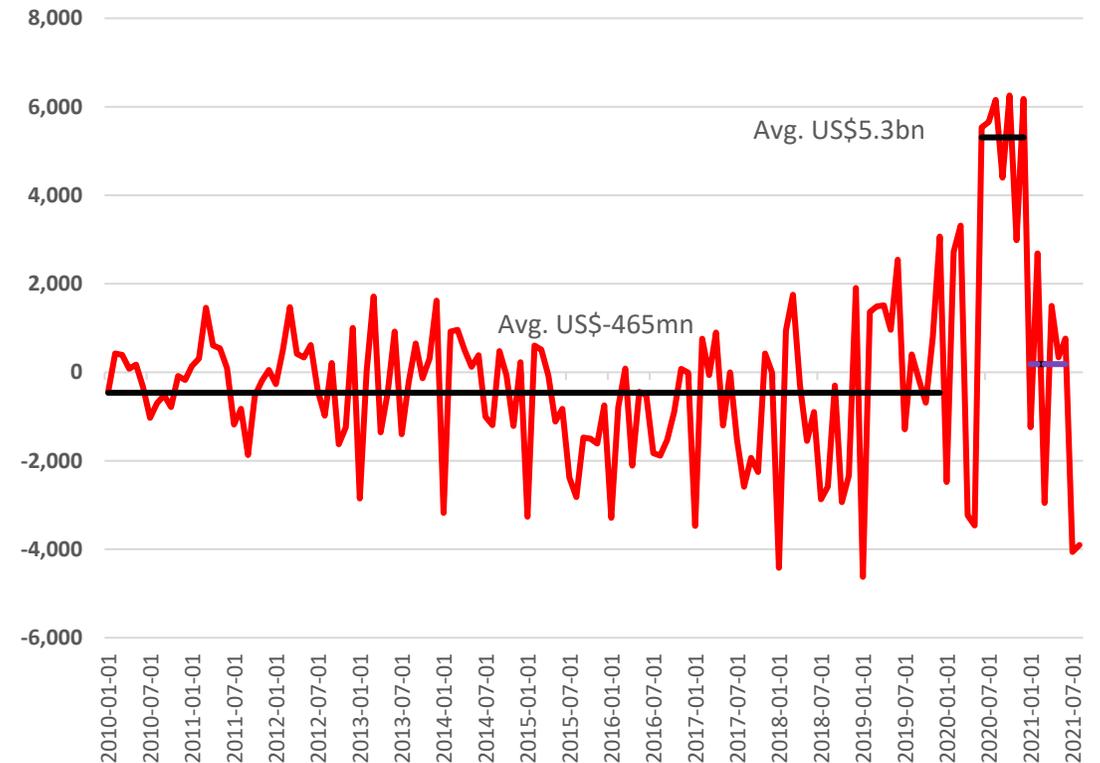
# Trade support for MXN is eroding

Mexican Imports & Exports  
(12m. rolling sum)



Sources: Scotiabank Economics, Bloomberg.

Mexican Trade Balance  
(US\$ mn)



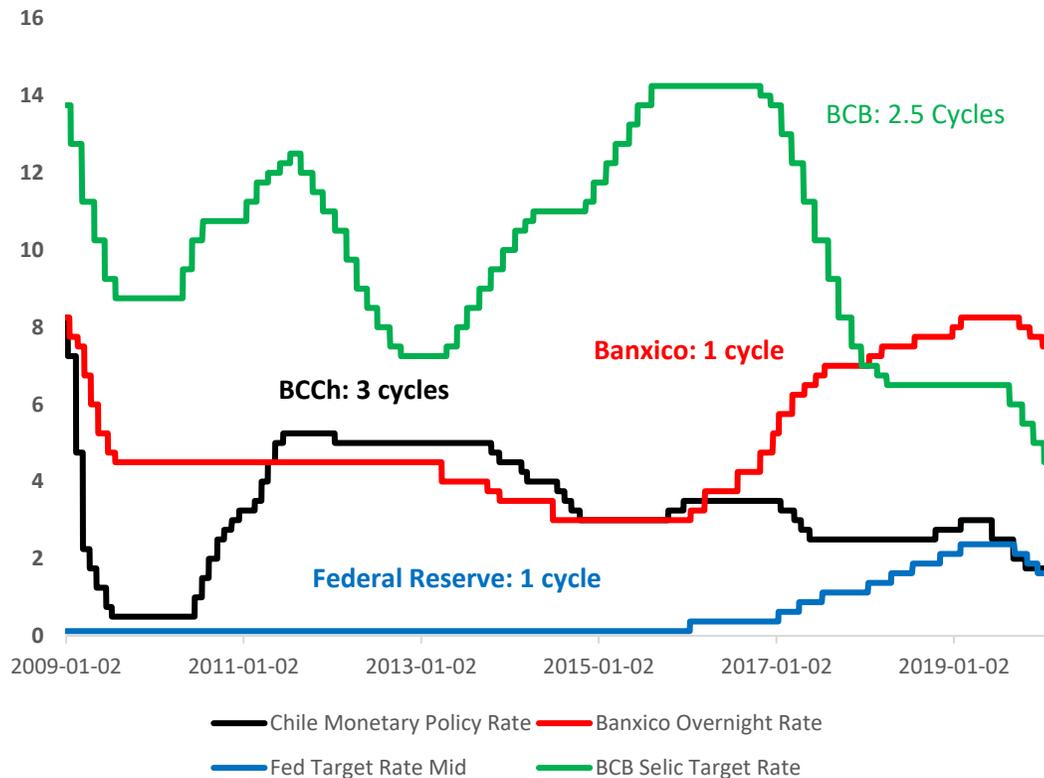
Sources: Scotiabank Economics, Bloomberg.



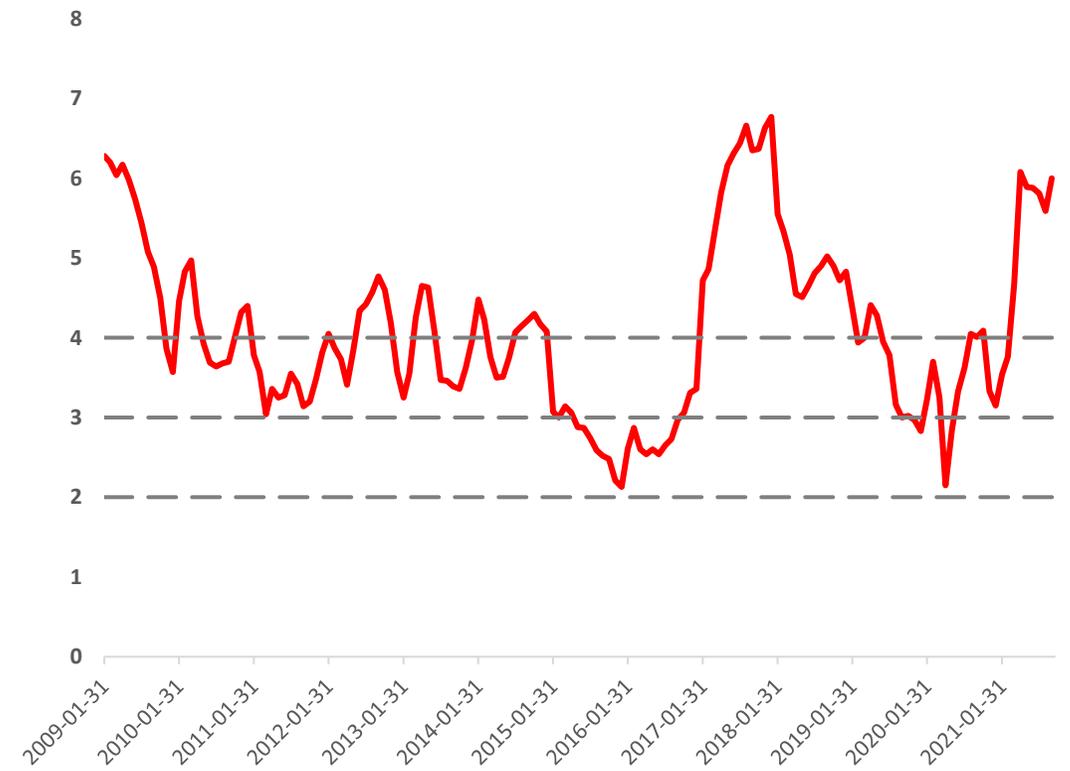
**Banxico's Board going through a structural  
recomposition**

# '09-'19 Banxico had steady hand on rates relative to regional CBs, despite inflation shocks

2009-2019 Monetary Policy Moves  
(CB Target Rates, %)

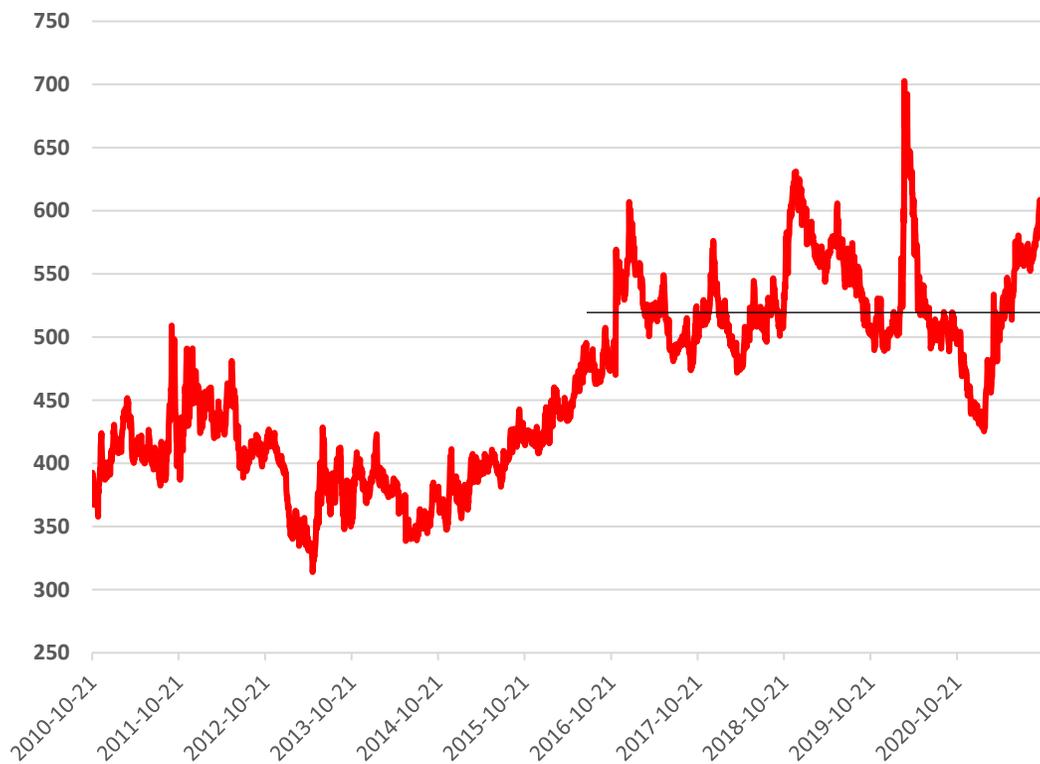


Mexican Headline Inflation  
(y/y %)



# Rising spread with flat credit premium? Markets pricing in higher inflation?

10yr TIIE – 10yr US Swaps  
(bps)



Sources: Scotiabank Economics, Bloomberg.

5yr Mexican CDS  
(bps)



Sources: Scotiabank Economics, Bloomberg.

# Breakevens also agree with higher inflation going forward



Sources: Scotiabank Economics, Bloomberg.

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