



# Mexico: sustainable stagnation?


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## Franklin Templeton Advisory Services Mexico (FTSAM)\*

- Established 2013.
- Subsidiary of Franklin Templeton Investments.
- Investment solutions for our clients taking into account their needs and the global and local environment.
- Portfolio management team with more than 20 years' experience.
- Pioneers in Mexican investments.

## Franklin Templeton Culture and Values

- Put clients first.
- Build relationships.
- Achieve quality results.
- Work with integrity.

## SUMMARY

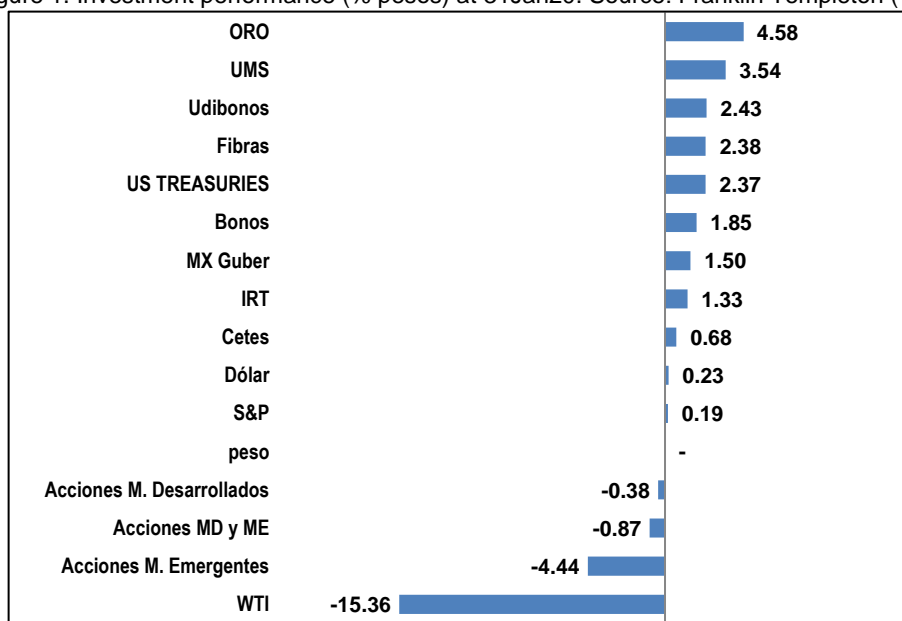
- Global. Markets have continued positive trend of 2019 but have been impacted by coronavirus.
- Mexico. Markets in line with global trend, with economy stable but stagnant, owing to government policies and insecurity.
- Global risks: coronavirus, brake in expansion, excessive liquidity, trade wars, geopolitics, Brexit/Europe, US elections.
- Local risks: private sector non-investment, insecurity, loss of investment grade.
- Investment scenarios with probabilities: positive (10%), negative (50%), middle (40%).
- Overweight ILS, profit-taking in REITs, benchmark weighting for stocks.

**"The greatest enemy of progress is not stagnation, but false progress" – Sydney J. Harris**

## January 2020: 2019 trends continue, but coronavirus affects markets

In January, positive trends in 2019 continued but were affected by the coronavirus, due to the effect it could have on Chinese growth, which favored bonds and affected risk investments. The most extreme were gold (+4.58%) and WTI oil (-15.36% - Figure 1) Although it is premature to estimate the virulence of the epidemic, the consensus is that the effect will be temporary and will not affect the longest economic expansion since World War II, with low growth. The main risks to this base scenario are unexpected consequences from record debt levels, increased geopolitical tensions, or escalation of the coronavirus. In Mexico, the biggest risks remain the government's inability to curb insecurity and increase private sector confidence.

Figure 1. Investment performance (% pesos) at 31Jan20. Source: Franklin Templeton ("FT")



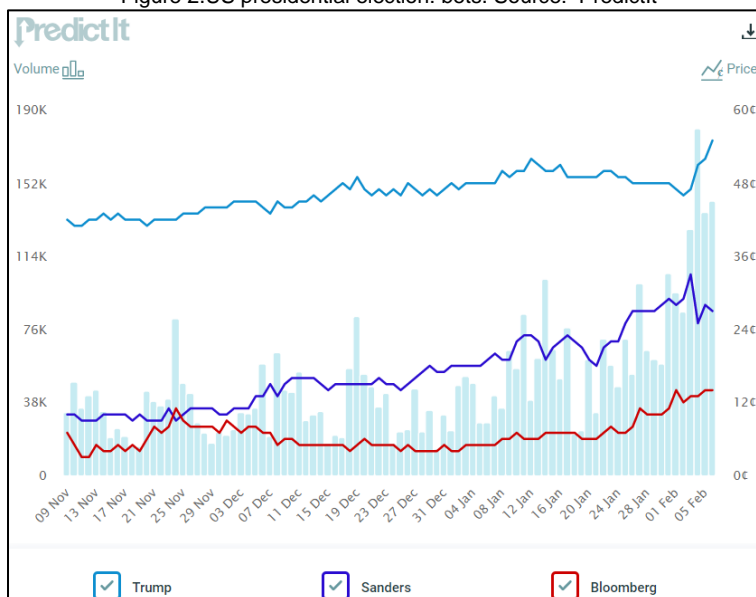
## POLITICS

### US

#### Trump impeachment

On February 5, as expected, Trump was acquitted by the Senate on both counts of abuse of power and obstruction of Congress. The process, considered by many to be a sham, ended in a distinctly partisan vote where only Republican Senator Mitt Romney voted against his party on one of the charges. The verdict ends a three-week trial and a four-month process where Trump appears to have been strengthened in the run-up to November's election, though it is difficult to weigh the electoral effect of his flagrant obstruction of the legal process. Trump remains a bettors' favorite (though not in the polls) owing to his understanding of the arithmetic of the electoral college and the lack of Democratic party cohesion (Figure 2).









Figure 2. US presidential election: bets. Source: PredictIt



## Elections

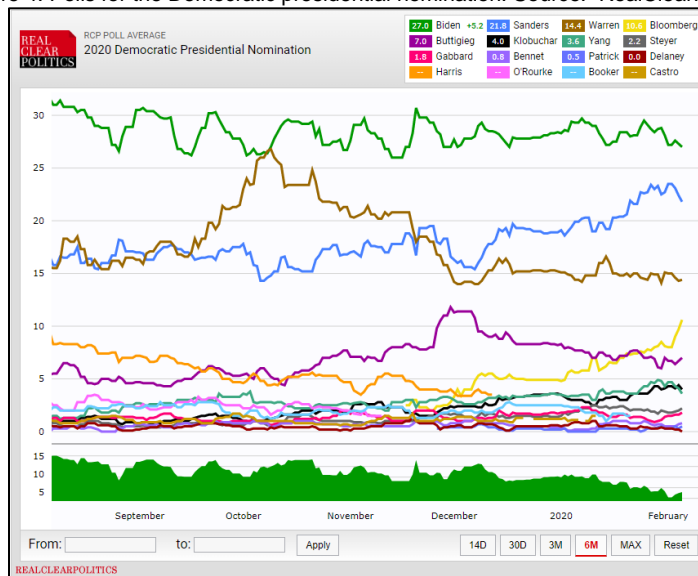
In February, the election primaries began in Iowa, where Trump swept the Republicans, and New Hampshire. The Democratic primary in Iowa was an organizational and technical disaster, with results very different from the polls. Buttigieg was a surprise winner in Iowa and second place in New Hampshire. Sanders did well in both states. Biden performed surprisingly badly, fourth in Iowa and fifth in New Hampshire (Figure 3).

Figure 3. Iowa and New Hampshire: Democratic primary results. Source: AP

IOWA				NEW HAMPSHIRE			
Candidato	Delegados	Porcentaje	Recuento	Candidato	Delegados	Porcentaje	Recuento
 Pete Buttigieg	13	26.2 %	564	 Bernie Sanders	9	25.7 %	75,859
 Bernie Sanders	12	26.1 %	562	 Pete Buttigieg	9	24.4 %	72,126
 Elizabeth Warren	8	18 %	387	 Amy Klobuchar	6	19.8 %	58,499
 Joe Biden	6	15.8 %	341	 Elizabeth Warren	0	9.2 %	27,241
Fuente: The Associated Press				Fuente: The Associated Press			
Comentarios				Comentarios			

It is premature to draw conclusions from two unrepresentative states. Michael Bloomberg continues to advance despite being ineligible for the first four primaries, and, with unlimited resources, has opted for a national strategy where he distances himself from the Democratic divide (between extremists and centrists) and presents himself as the viable centrist against Trump (Figure 4). On March 3 ("Super Tuesday") a third of the candidates will be decided and the number of contenders will be drastically reduced.

Figure 4. Polls for the Democratic presidential nomination. Source: RealClearPolitics



## USMCA

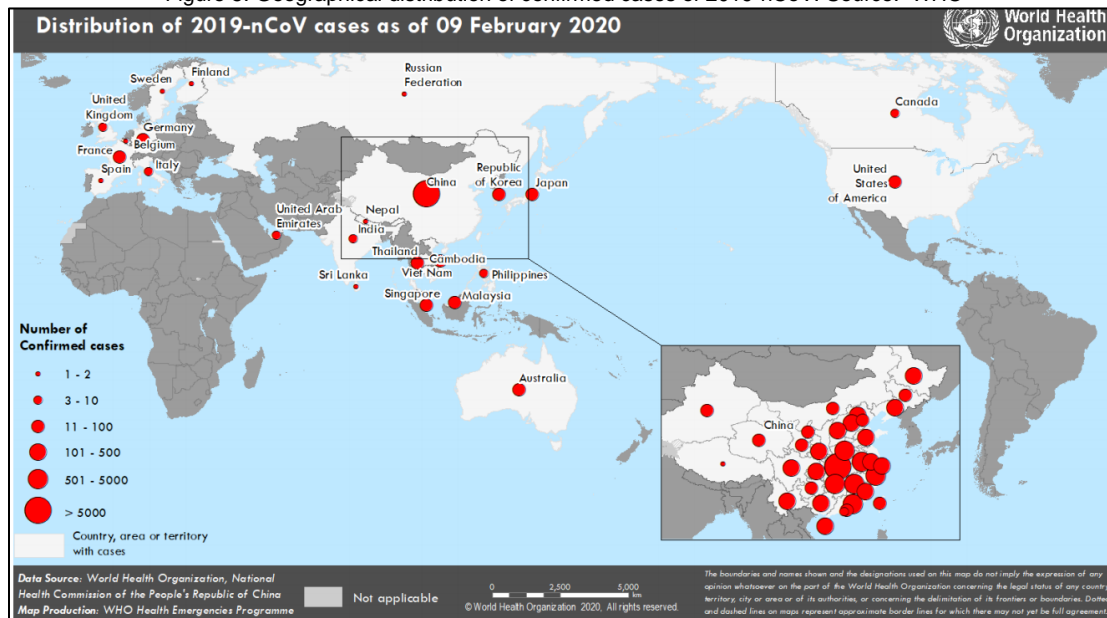
On January 16, the US Senate ratified the USMCA by a large bipartisan majority (89-10) during the impeachment process. Two weeks later Trump signed the deal into law, a major achievement of his administration ahead of the November elections. Canada's ratification could be complicated by Trudeau losing his majority in October, but its approval is expected before April. The agreement will not enter into force until 60 days after the necessary amendments to the law are made in all three countries.

## CHINA

### Coronavirus

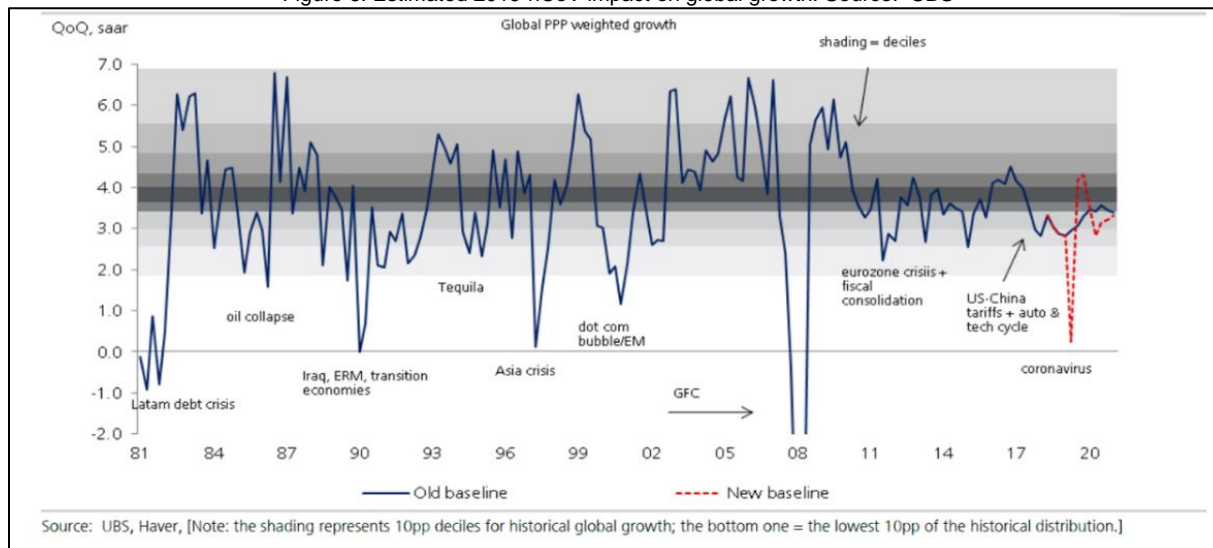
On December 30, 2019, the Chinese government reported an unusual outbreak of pneumonia in the city of Wuhan caused by a hitherto unknown coronavirus. The "2019-nCoV" virus has produced more than 60,000 confirmed cases (with +1,000 deaths and +6,000 recoveries) mostly in mainland China despite several preventive measures: quarantine of more than 48mn. people, extension of the Chinese New Year holiday until mid-February, and cancellation of flights, among others. The epidemic appears to be less virulent than others, indicating a mortality rate of 2% (SARS 10%; Ebola 50%).

Figure 5. Geographical distribution of confirmed cases of 2019-nCoV. Source: WHO



It is premature to measure the severity of the situation. Analysts expect a temporary impact on the Chinese and global economy as in previous cases (SARS, MERS). This view could change if the virus mutates, if cases outside China multiply, or if the Chinese government is deliberately underestimating the situation (Figure 6).

Figure 6. Estimated 2019-nCoV impact on global growth. Source: UBS

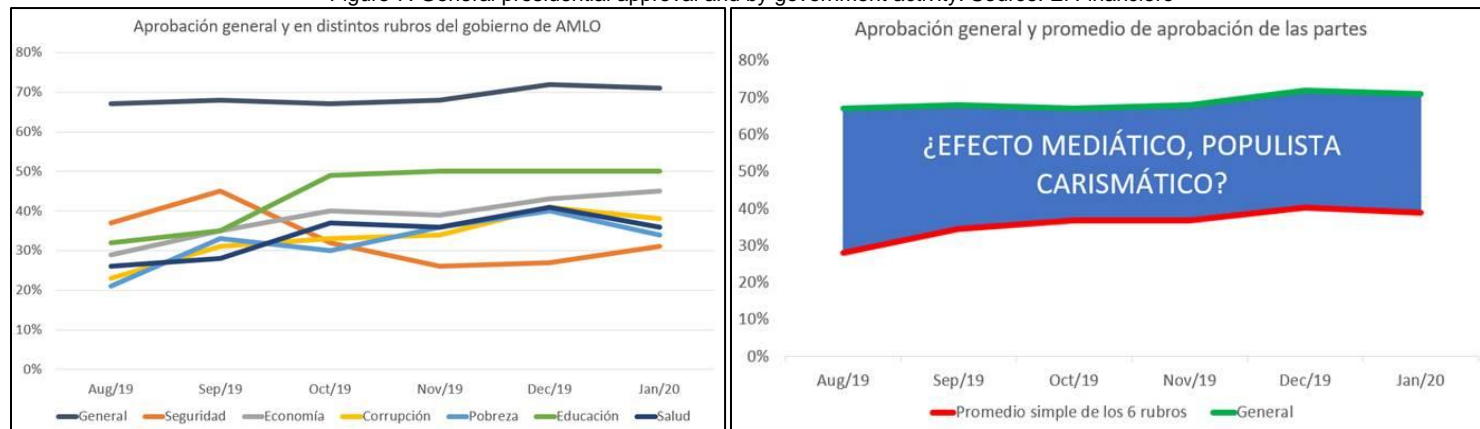


## MEXICO

### AMLO popularity

In a recent survey AMLO's approval rating was 71%, below its maximum, but high compared to recent history. Presidential approval is higher than the rating for each government activity. His personal popularity weighs more than economic stagnation, scandals over incompetent management of health and crime, the distraction of the "raffle" of the presidential plane, the threat of judicial changes that seem authoritarian and the divisions in the ruling Morena party. Meanwhile, the Morena power struggle could lead to a loss of control of Congress in the 2021 midterm elections.

Figure 7. General presidential approval and by government activity. Source: El Financiero



## ECONOMICS

### Global growth

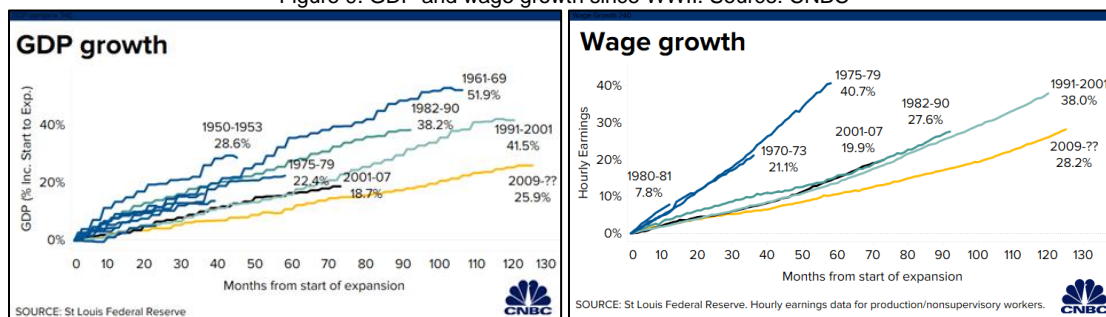
On January 20, the International Monetary Fund published its economic forecast for 2020. It estimates that world GDP will grow less in 2020 than 2019 but with lower growth in developed economies (2019: 1.7%; 2020: 1.6%) and higher growth in emerging economies (2019: 3.7%; 2020: 4.4%). In both cases it reduced its estimates compared to its previous publication in October 2019. For Mexico the estimate is 0% for 2019 and 1% for 2020 (Figure 8) and forecasts were also reduced from the previous report.

Figure 8. Growth estimates (%) 2019-2021. Source: IMF

	Year over Year					
	Estimate		Projections		Difference from Oct 2019 WEO Projections 1/	
	2018	2019	2020	2021	2020	2021
<b>World Output</b>	<b>3.6</b>	<b>2.9</b>	<b>3.3</b>	<b>3.4</b>	<b>-0.1</b>	<b>-0.2</b>
<b>Advanced Economies</b>	<b>2.2</b>	<b>1.7</b>	<b>1.6</b>	<b>1.6</b>	<b>-0.1</b>	<b>0.0</b>
United States	2.9	2.3	2.0	1.7	-0.1	0.0
Euro Area	1.9	1.2	1.3	1.4	-0.1	0.0
Germany	1.5	0.5	1.1	1.4	-0.1	0.0
France	1.7	1.3	1.3	1.3	0.0	0.0
Italy	0.8	0.2	0.5	0.7	0.0	-0.1
Spain	2.4	2.0	1.6	1.6	-0.2	-0.1
Japan	0.3	1.0	0.7	0.5	0.2	0.0
United Kingdom	1.3	1.3	1.4	1.5	0.0	0.0
Canada	1.9	1.5	1.8	1.8	0.0	0.0
Other Advanced Economies 3/	2.6	1.5	1.9	2.4	-0.1	0.1
<b>Emerging Market and Developing Economies</b>	<b>4.5</b>	<b>3.7</b>	<b>4.4</b>	<b>4.6</b>	<b>-0.2</b>	<b>-0.2</b>
Emerging and Developing Asia	6.4	5.6	5.8	5.9	-0.2	-0.3
China	6.6	6.1	6.0	5.8	0.2	-0.1
India 4/	6.8	4.8	5.8	6.5	-1.2	-0.9
ASEAN-5 5/	5.2	4.7	4.8	5.1	-0.1	-0.1
Emerging and Developing Europe	3.1	1.8	2.6	2.5	0.1	0.0
Russia	2.3	1.1	1.9	2.0	0.0	0.0
Latin America and the Caribbean	1.1	0.1	1.6	2.3	-0.2	-0.1
Brazil	1.3	1.2	2.2	2.3	0.2	-0.1
Mexico	2.1	0.0	1.0	1.6	-0.3	-0.3

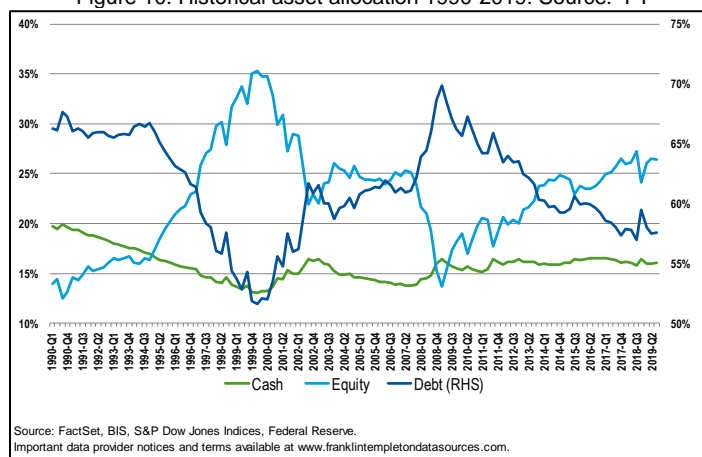
There is consensus that expansion will continue (Figure 9), even though historically low (and in many cases negative) rates reflect unprecedented levels of debt (see January Perspective, 2020), 3 times global GDP. This level of liquidity could have unexpected consequences for financial assets.

Figure 9. GDP and wage growth since WWII. Source: CNBC



An indicator of the cycle is the rotation between debt and stocks, which may imply its continuation (Figure 10).

Figure 10. Historical asset allocation 1990-2019. Source: FT



Source: FactSet, BIS, S&P Dow Jones Indices, Federal Reserve.  
Important data provider notices and terms available at [www.franklintempletondatasources.com](http://www.franklintempletondatasources.com).



## Fed decision

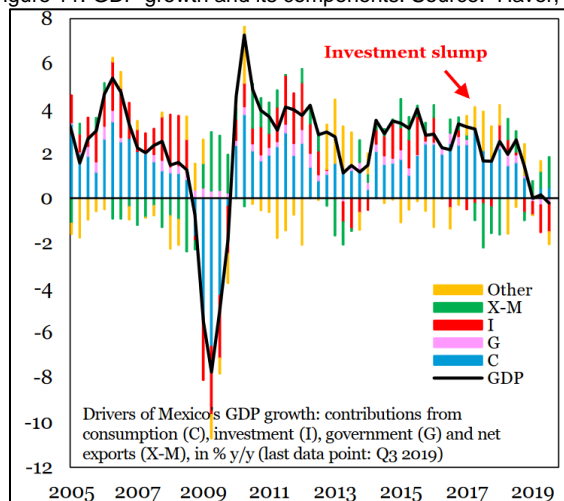
At its first meeting of 2020, the Fed unanimously decided to keep its rate unchanged in the 1.50%-1.75% range, noting that no change is expected in 2020. It is likely to reach its inflation target this year.

## MEXICO

### Economic growth

Analysts estimate that in 2019 growth in Mexico was negative because of a consumption slowdown and lack of investment caused by insecurity and confused government economic policies (Figure 11). By 2020, a slight improvement is expected due more to an increase in public investment, slowed in 2019 by the inexperience of the incoming government, than an increase in private investment that remains stalled owing to the opacity of government policy. AMLO seems to want to keep public finances balanced, Banxico autonomous and a stable exchange rate. But a consensus is forming that until the country's level of insecurity is reduced and economic policies are not resolved, five more years of stagnation are expected, with a fall in GDP per capita. This scenario could change if deterioration in GDP per capita occurs sooner than expected and affects interim elections in 2021.

Figure 11. GDP growth and its components. Source: Haver, IIF

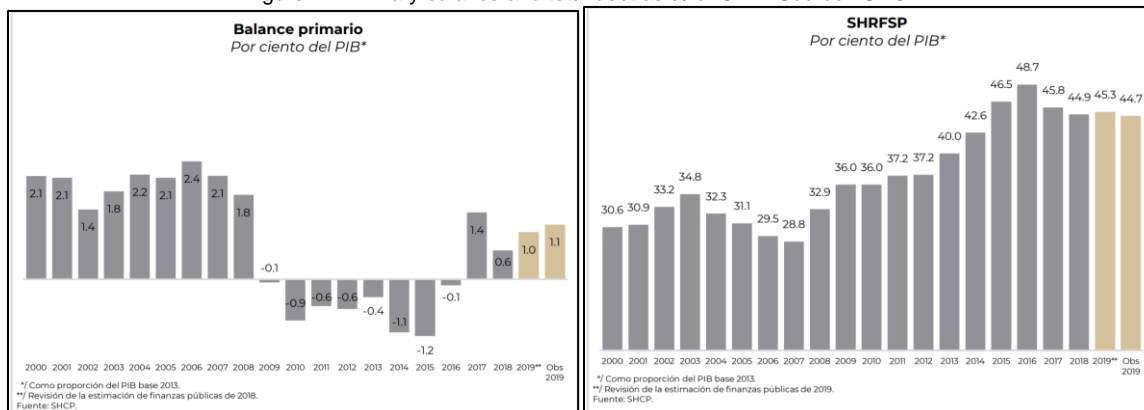


### Public finances

In January the Mexican Treasury published a better-than-projected report on public finances (Figure 12):

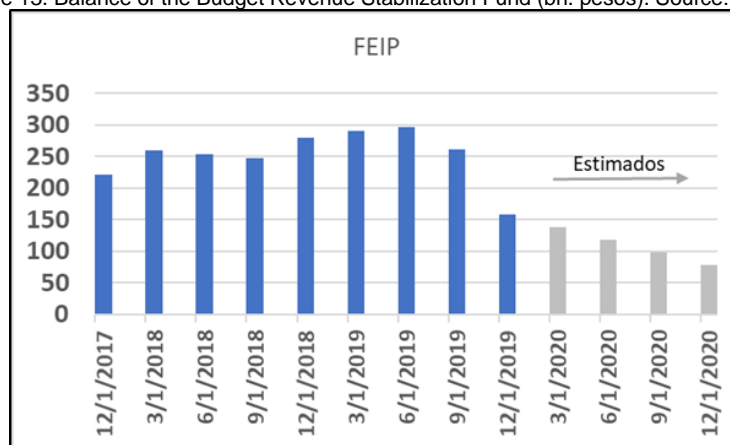
1. A primary surplus of 1.1% of GDP vs. 1.0% of GDP estimated in the 2019 budget and higher than the surplus of 0.6% of GDP recorded the previous year.
2. Total debt (RFSPs - SHRFSP) accounted for 44.7% of GDP, lower than the amount observed at the end of 2018 at 0.2% of GDP and the 2019 budget estimate of 45.3% of GDP.

Figure 12. Primary balance and total debt as % of GDP. Source: SHCP



Positive results are relevant to rating agencies (Moody's usually publishes its reviews between February and April). The report shows that the government has used the stabilization funds and estimates that by the end of 2020 there will be \$79bn. pesos compared to \$280bn. at end- 2018 (Figure 13).

Figure 13. Balance of the Budget Revenue Stabilization Fund (bn. pesos). Source: SHCP



## RISKS AND SCENARIOS

The objective is Mexican economic growth. In the positive scenario, all risks turn out favorable for growth, in the negative, unfavorable, and in the middle, mixed. Estimates for each scenario are given in Figure 14.

### RISKS

#### Global

- Global: excess liquidity destabilizes cycle and markets
- US: recession after record expansion
- Global: trade wars
- Geopolitics: Europe, Middle East, Russia, China, North Korea, Latin America
- EM: crisis and contagion
- Biological (e.g. coronavirus) or climate (e.g. Australia) emergency

#### Mexican

- Government
- Security
- Corruption
- Governance
- Oil
- Debt rating

### SCENARIOS

#### Positive (10%)

- Global. Monetary policy does not derail cycle or markets
- US: expansion continues, trade disputes but no major consequences.
- Geopolitical risks do not materialize.
- Global growth.
- EM: no crisis or contagion.
- Coronavirus resolved quickly
- Mexico: government functions, spending drives infrastructure/consumption, anticorruption and antiviolence measures work, ratings upgrade.

#### Negative (50%)

- Monetary policy derails cycle
- US: expansion stops, trade wars affect global commerce.
- Geopolitical risks materialize.
- Global recession.
- EM: crisis and contagion.
- Coronavirus goes global
- Mexico: government dysfunctional, spending out of control, anticorruption and violence measures backfire, ratings downgrade.

#### Middle (40%)

- Adequate monetary policy, but uncertain.
- US: slow expansion continues, rhetorical trade disputes.
- Geopolitical: materialize partially.
- Global slowdown, unsynchronized.
- EM: crisis and some contagion from vulnerable countries.
- Coronavirus similar to SARS
- Mexico: government partially functional, continued mixed signals, ratings stable.

Figure 14. Estimates for scenarios (\*observed) 2020 Source: FT

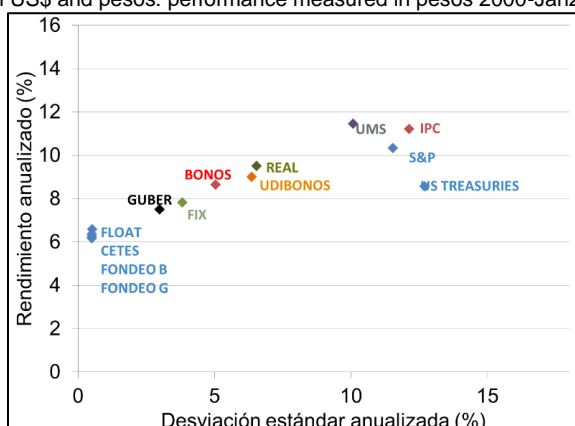
	Scenarios for 2020			2019
	High	Low	Base	Forecast
	Probability	10%	50%	40%
<u>US</u>				
Economy	> 1.80%	< 1.80%	1.80%	2.3%*
Inflation	> 2.10%	< 2.10%	2.10%	1.8%*
Budget deficit	< 4.80%	> 4.80%	4.80%	4.7%*
Current account deficit	< 2.40%	> 2.40%	2.40%	2.40%
Fed Funds rate	> 1.72%	< 1.72%	1.72%	1.75%*
TNote 10 US	> 1.94%	< 1.94%	1.94%	1.92%*
Oil (WTI)	> \$52.23	< \$52.23	52.23	61.06*
<u>Mexico</u>				
Economy	> 1.00%	< 1.00%	1.00%	0.00%
Inflation	> 3.40%	< 3.40%	3.40%	2.83%*
Budget deficit	< 2.40%	> 2.40%	2.40%	1.60%*
Current account deficit	< 1.00%	> 1.00%	1.00%	0.40%
Cetes28 (year end)	> 6.35%	< 6.35%	6.35%	7.30%*
Peso/US\$ (year end)	< \$19.2	> \$19.2	19.20	18.86*

## MARKETS

### Investments in US\$ and pesos: comparative performance

Following the depreciation of the peso owing to Trump's emergence, in the long run (2000-2020) the gap between peso investment and US\$, both converted to pesos, has narrowed. However, investments in pesos have outperformed US\$ investments (Figure 15).

Figure 15. Investments in US\$ and pesos: performance measured in pesos 2000-Jan2020. Source: FT



### The US\$ and the peso

During December and January, the peso strengthened owing to lower trade tensions and the return of foreign investors to local debt instruments (Figures 16 and 17). Sentiment measured by Banxico deteriorated: 25% better (previous 28%), 56% same (53%), 19% worse (19%).

Figure 16. Peso vs. US\$: 1980-Feb2020. Source: FT

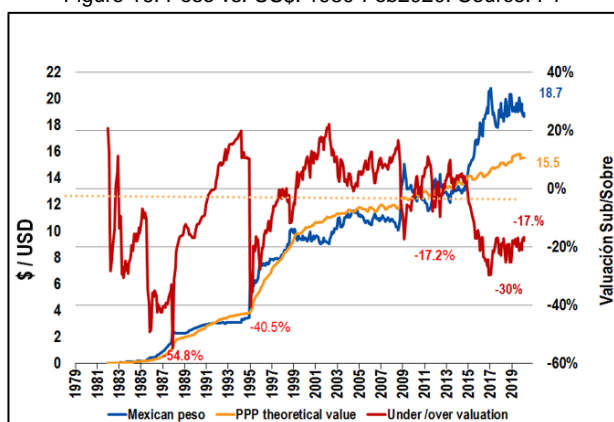
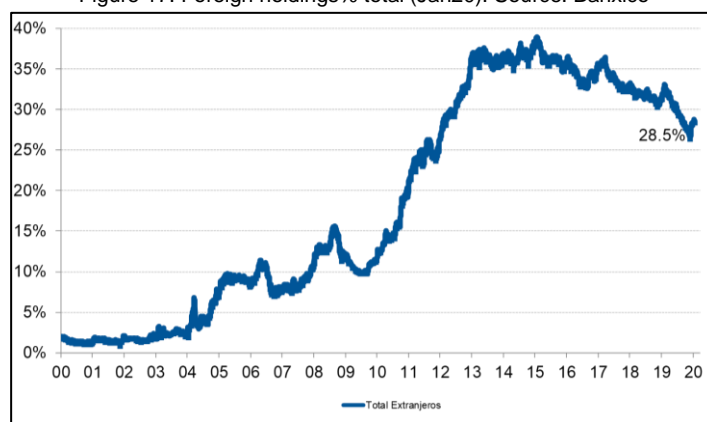


Figure 17. Foreign holdings% total (Jan20). Source: Banxico





## Debt

Mixed rate movements are expected in EM and DM by end-2020, with the majority rising (Figure 18).

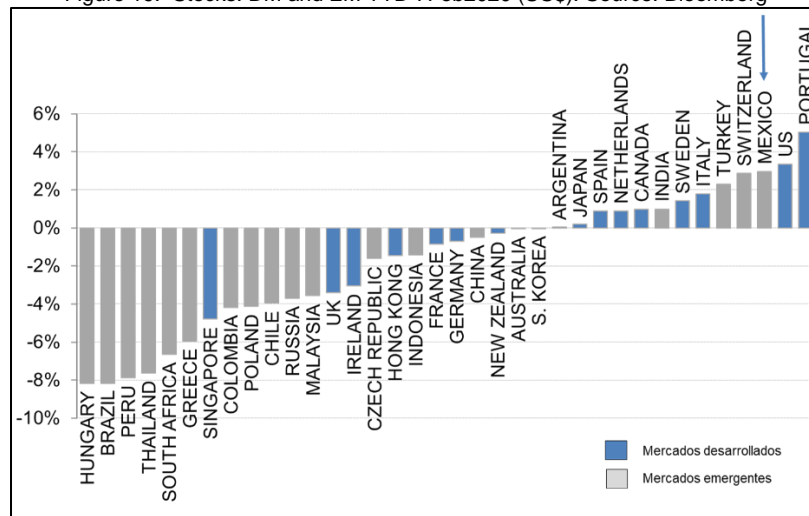
Figure 18. DM and EM: nominal rates 10 years estimated at Dec2020 (Feb20). Source: Bloomberg, FT

Developed				Emerging			
local 10y yields (%)				local 10y yields (%)			
	4Q20e	Actual	(bps)		4Q20e	Actual	(bps)
US	1.94	1.58	35.66	China	2.99	2.81	18.4
Euro Area	(0.30)	(0.39)	8.6	India	6.46	6.44	1.9
Japan	(0.05)	(0.04)	-1	Rusia	6.59	6.12	47.4
Britain	0.99	0.57	42	Brasil	6.44	6.65	-20.5
Australia	1.03	1.04	-1.2	México	6.86	6.65	20.9
Canada	1.71	1.33	38.5	Corea del sur	1.75	1.60	14.8
Germany	(0.30)	(0.39)	8.6	Indonesia	7.00	6.58	41.6
France	(0.01)	(0.14)	12.6	Turquia	10.84	10.67	17

## Stocks

In 2020, uncertainty over the effect of coronavirus on China affected almost all stock markets (Figure 19).

Figure 19. Stocks: DM and EM YTD 7Feb2020 (US\$). Source: Bloomberg



## REITs (Fibras)

Since inception, REITs have outperformed stocks (Figure 20). During 2019 they recovered markedly vs. 2018, owing to better prospects for USMCA. Performance in 2020 will depend mainly on interest rates and trade tensions (Figure 21).

Figure 20. REITs vs. IRT since inception (Mar2011) and Jan19-7Feb20. Source: Bloomberg

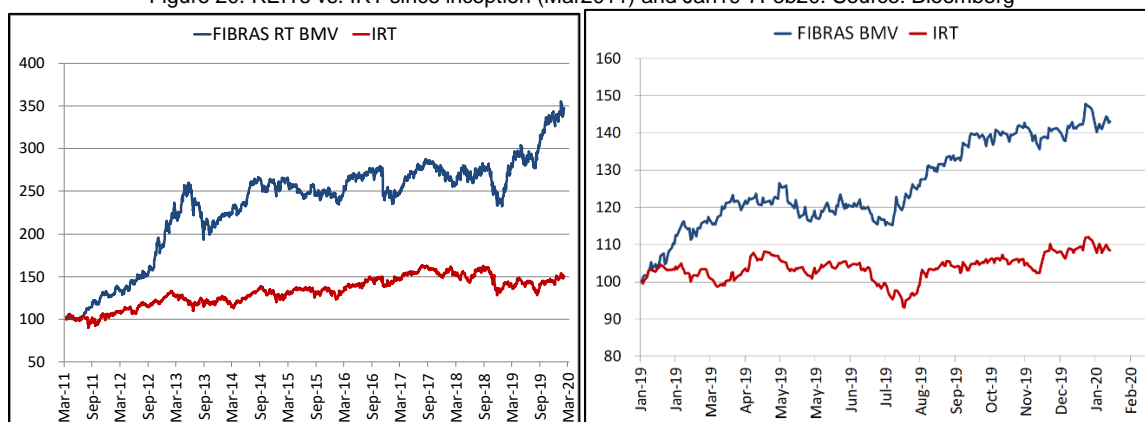


Figure 21. REITs: valuation and dividends (Feb2020). Source: BTG

	Market Cap  (US\$m)	Dividend Yield %			Price / NAV	
		Current	2019E	2020E	2019E	2020E
Mexican FIBRAs						
Fibra Uno	6,459	7.5%	7.5%	7.6%	0.74	0.75
Fibra MQ	1,055	7.1%	6.8%	7.6%	0.72	0.68
Fibra Shop	272	8.8%	8.8%	8.6%	0.45	0.42
Fibra Terrafina	1,288	9.1%	8.3%	8.8%	0.83	0.81
Fibra Danhos	2,130	8.5%	8.4%	8.5%	0.72	0.74
Fibra Prologis	1,417	5.7%	5.7%	6.5%	0.87	0.88
Fibra Hotelera	357	8.2%	11.3%	11.6%	0.50	0.50
Fibra Inn	221	6.3%	13.3%	13.7%	0.39	0.38
Fibra Monterrey	613	9.8%	6.1%	6.9%	0.95	0.94

## Conclusion

By 2020, the global economy appears to be growing at a slower pace, but with the risk that any event could break the financial asset bubble caused by the record level of the debt-to-GDP ratio: a biological, geopolitical or climate event, or a market-generated event (e.g. cryptocurrencies). In Mexico, there is a growing consensus that a stable financial situation, but with stagnation, is likely, with a consequent deterioration in GDP per capita, and non-economic risks (violence and/or legal insecurity). We continue to assign similar probabilities to each scenario: positive 10%, negative 50% and middle 40%, and recommend caution for portfolios denominated in pesos, with an overweight in inflation linked instruments (ILS), take profits on REITs and benchmark weighting in stocks.

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**Ramsé Gutierrez**  
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**Editor: Timothy Heyman**  
**February 14, 2020**

**Key financial variables: performance as of January 31, 2020**

During January, in Mexico, the IRT rose 1.33% and FIBRAS RT 2.38%. Nominal and real rates fell over all terms. The US\$ strengthened 0.23% against the peso. In the US: DJ and S&P500 fell. Nominal and real rates fell over all terms. WTI oil price was down 15.56%. Regarding the business climate according to Banxico, optimism fell to 25% (previous 28%), no change rose to 56% (53%), and pessimism remained at 19%.

Mexico					
Stock market and oil					
	31-Jan-20	31-Dec-19	Month	YTD	2019
IRT	62,082.53	61,268.94	1.33%	1.33%	7.92%
BIVA RT	960.83	946.08	1.56%	1.56%	8.97%
FIBRAS BMV RT	339.61	331.73	2.38%	2.38%	42.34%
Local currency (USD/MXN)	18.91	18.88	0.23%	0.23%	-4.00%
Mexican oil mix (USD/bbl)	48.15	56.14	-14.23%	-14.23%	25.62%
Nominal rates					
	31-Jan-20	31-Dec-19	Month	YTD	2019
CETES 28	7.28%	7.30%	-2 bps	-2 bps	-112 bps
CETES 360	6.54%	6.70%	-17 bps	-17 bps	-179 bps
M5	6.51%	6.75%	-24 bps	-24 bps	-177 bps
M10	6.62%	6.88%	-23 bps	-23 bps	-180 bps
M30	6.92%	7.19%	-27 bps	-27 bps	-170 bps
Real rates					
	31-Jan-20	31-Dec-19	Month	YTD	2019
UDIBONO 10	3.24%	3.39%	-16 bps	-16 bps	-72 bps
UDIBONO 30	3.30%	3.45%	-15 bps	-15 bps	-87 bps
Commodities					
	31-Jan-20	31-Dec-19	Month	YTD	2019
Gold	1,586.15	1,520.21	4.34%	4.34%	18.70%
WTI (USD/bbl)	51.56	61.06	-15.56%	-15.56%	36.63%
UMS					
	31-Jan-20	31-Dec-19	Month	YTD	2019
UMS 10 years	2.72%	3.19%	-48 bps	-48 bps	-173 bps
UMS 20 years	3.97%	4.12%	-15 bps	-15 bps	-166 bps
UMS 30 years	4.48%	4.61%	-13 bps	-13 bps	-123 bps
Stock markets (US\$)					
	31-Jan-20	31-Dec-19	Month	YTD	2019
MSCI Developed	9,921.11	9,979.03	-0.58%	-0.58%	28.40%
MSCI Emerging	2,451.39	2,571.14	-4.66%	-4.66%	18.90%
MSCI Mexico	9,021.82	8,899.97	1.37%	1.37%	11.77%
MSCI Brazil	7,413.44	8,011.67	-7.47%	-7.47%	26.66%

US					
Stock market					
	31-Jan-20	31-Dec-19	Month	YTD	2019
DJ	28,256.03	28,538.44	-0.99%	-0.99%	22.34%
S&P	3,225.62	3,230.78	-0.16%	-0.16%	28.88%
Nasdaq	9,150.94	8,972.60	1.99%	1.99%	35.23%
Nominal rates					
	31-Jan-20	31-Dec-19	Month	YTD	2019
Tbill 90	1.55%	1.55%	0 bps	0 bps	-90 bps
Tnote 5	1.32%	1.69%	-37 bps	-37 bps	-82 bps
Tnote 10	1.51%	1.92%	-41 bps	-41 bps	-77 bps
Tbond 30	1.99%	2.39%	-40 bps	-40 bps	-59 bps
Real rates					
	31-Jan-20	31-Dec-19	Month	YTD	2019
Tip 5	-0.28%	0.01%	-29 bps	-29 bps	-99 bps
Tip 10	-0.14%	0.15%	-29 bps	-29 bps	-83 bps
Tip 30	0.26%	0.58%	-32 bps	-32 bps	-83 bps

Bank of Mexico survey		
Indicator	2020	2020 anterior
PIB	1.00%	1.10%
Inflation	3.50%	3.44%
Cetes 28	6.51%	6.56%
Local currency	19.68	20.10
Business conditions		
	31-Jan-20	31-Dec-19
Optimism	25%	28%
No change	56%	53%
Pessimism	19%	19%

Source: Bloomberg, Bank of Mexico

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\*Timothy Heyman, President of FTSAM, founded Heyman y Asociados in 1985. In 2013, Franklin Templeton established FTSAM and merged it with Heyman y Asociados.

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