

Latam Economic Update

- **Mexico: Inflation ticked up in August; 2021 budget proposal sent to Congress**

MEXICO: INFLATION TICKED UP IN AUGUST; 2021 BUDGET PROPOSAL SENT TO CONGRESS

I. Headline inflation's upside trend continued in August

Headline inflation for August came in at 4.05% y/y (versus 3.16% y/y a year earlier), its highest level in 15 months—above market expectations and just over the upper limit of Banxico's target range (chart 1).

- Core inflation rose from 3.85% y/y to 3.97% y/y (versus 3.78% y/y a year earlier).
- The non-core component increased from 2.92% y/y to 4.30% y/y (versus 1.28% y/y in the same the month in 2019), a new high since June 2019.

On a sequential basis, headline inflation came in at 0.39% m/m, in line with analysts' expectations of 0.38% m/m.

- Core inflation was 0.32% m/m, above the average anticipated by the analysts' consensus of 0.28% m/m and also higher than the 0.20% m/m recorded a year ago in August 2019.
- Non-core prices rose 0.63% m/m, down from 1.48% m/m in July (versus -0.70% m/m a year earlier). Non-core price growth was driven by the increase in agricultural prices during August, particularly fruit and vegetable prices.

We maintain our broad economic outlook for the remainder of the year and we continue to expect that the reference rate will be held at 4.50% through end-2020 owing to the rising inflationary pressures that have been observed since May.

II. Finance minister delivered the 2021 budget proposal to Congress

Mexico's finance minister delivered the 2021 budget plan to Congress on the evening of Tuesday, September 8, and the proposal is set to continue the government's tight approach to fiscal management. The budget plan, which must be approved by Congress, expected the economy to contract by -8.0% y/y this year. This was a somewhat more optimistic view than the outlook anticipated by the private sector in the *Citibanamex Financial Markets Analyst Expectations Survey*, published on September 7, which projected a -9.9% y/y contraction in 2020; it was also much better than Banxico's worst-case scenario that forecast a -13% y/y slump for 2020. The budget's outlook for 2021 is stronger, with GDP growth pegged at 4.6% y/y for next year.

For the third year of Andrés Manuel López Obrador's government, the Ministry of Finance has proposed a reduction in net expenditure of -0.3% y/y. This would be the first annual spending reduction since 2017,

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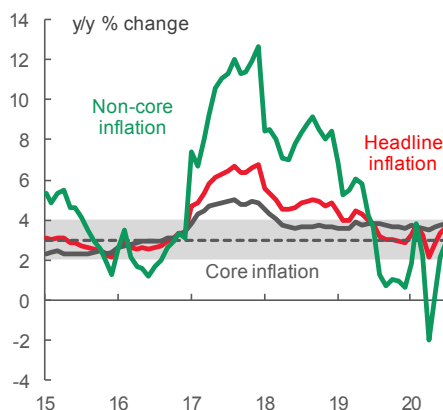
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Chart 1

Mexico: Headline and Core Inflation



Sources: Scotiabank Economics, INEGI.

when expenditure was cut by -3.9% y/y. President Lopez Obrador and Finance Minister Arturo Herrera have said Mexico's economy is not in a position to raise spending to deal with the COVID-19 crisis. With the proposed level of spending, the public-sector's financial balance is set to result in a deficit of -2.9% of GDP in 2021. At the same time, the 2021 primary balance is set to record a surplus of less than 1% of GDP in 2021.

On the revenue side for 2021, tax, income, and fee collections are expected to come down from the levels projected for the end of 2020. This decline is forecast to be driven by non-recurrent income, where extraordinary inflows related to the health and economic crisis are not contemplated for next year. Oil revenues, associated with smaller production and softer prices, are also projected to come down in 2021 and are expected to be accompanied by weakness in non-oil tax revenues.

Overall, the 2021 budget proposal is marked by the continued promotion of austerity and an ongoing refusal either to take on additional debt or increase taxes to finance responses to the pandemic.

—Miguel Saldaña & Paulina Villanueva

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