

## Ahead of the Curve

### Banxico to accelerate the tightening pace with a 75bps hike to 7.75%

- **Banxico's monetary policy decision (June-23).** We expect a 75bps hike, taking the rate to 7.75%. We consider that conditions for this move are quite clear, taking into account: (1) The 75bps hike by the Fed, and its recent impact on financial markets; and (2) a complex inflationary backdrop domestically, with persistent pressures in the core component. In addition, most recent comments from Board members seem to clearly support a move of this magnitude. On top of the bigger adjustment, we expect the tone to remain hawkish, which would help corroborate our view of another 75bps hike in the August 11<sup>th</sup> meeting
- **Inflation (1H-June).** We expect headline inflation at 0.41% 2w/2w, which would be quite high compared to the 0.19% five-year average. The period's dynamics would be characterized by generalized pressures, in addition to having a more challenging seasonality relative to the previous month. We anticipate an acceleration in the core to +0.45% (contribution: +34bps). Meanwhile, the non-core would rise 0.29% (+7bps). If our forecasts are correct, annual inflation will climb from 7.65% on average in May to 7.80%. Both the core and the non-core would accelerate at the margin. The first would come in at 7.43% (previous: 7.28%), with the latter at 8.91% (previous: 8.77%)

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Mexico weekly calendar

DATE	TIME (ET)	EVENT	PERIOD	UNIT	BANORTE	CONSENSUS	PREVIOUS
Tue 21-Jun	7:00am	Timely Indicator of Economic Activity (sa)	May	% y/y	--	--	1.8
Tue 21-Jun	8:00am	Aggregate supply and demand	1Q22	% y/y	3.4	3.7	3.0
		Private consumption		% y/y	6.4	--	5.7
		Investment		% y/y	5.6	--	6.7
		Government spending		% y/y	1.0	--	0.6
		Exports		% y/y	6.2	--	4.5
		Imports		% y/y	7.5	--	8.2
Tue 21-Jun	10:00am	International reserves	Jun-17	US\$ bn	--	--	198.7
Tue 21-Jun	4:30pm	Citibanamex bi-weekly survey of economic expectations					
Thu 23-Jun	7:00am	CPI inflation	1H June	% 2w/2w	0.41	0.32	0.30
				%y/y	7.80	7.70	7.72
		Core		%2w/2w	0.45	0.35	0.29
				%y/y	7.43	7.31	7.32
Thu 23-Jun	7:00am	Retail Sales	April	% y/y	4.7	4.3	3.8
		sa		% m/m	0.5	0.2	0.4
Thu 23-Jun	2:00pm	Banxico's monetary policy decision	Jun-23	%	7.75	7.75	7.00
Fri 24-Jun	7:00am	Economic activity indicator	April	% y/y	1.2	1.3	0.4
		sa		% m/m	1.0	0.6	0.3
		Primary activities		% y/y	3.9	--	6.5
		Industrial production		% y/y	2.7	--	2.7
		Services		% y/y	0.5	--	-0.9

Source: Banorte; Bloomberg

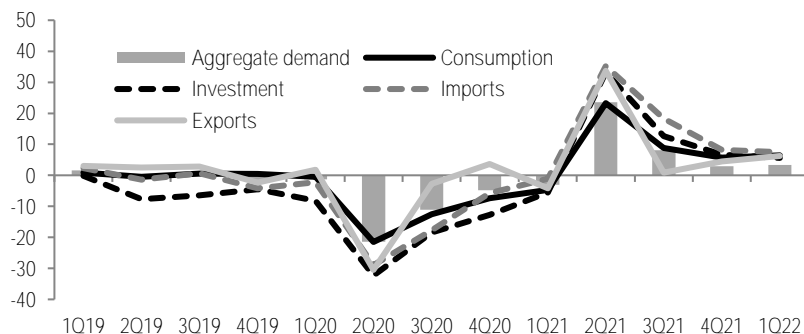
Proceeding in chronological order...

**Aggregate demand in 1Q22 higher on domestic absorption.** We expect both aggregate supply and demand at 3.4% y/y. From the supply side, we already know that [GDP grew 1.8% y/y](#), gaining dynamism as it was up 1.0% q/q. Specifically, industry was resilient, while services surprised higher. Moreover, we see imports at 7.5% y/y, quite elevated considering a more difficult base effect. Converting trade balance data to MXN at current prices, inbound shipments of goods picked up 21.6% y/y, with the current account –also including services– stronger at 22.5%. This is slightly higher than when figures are expressed in USD as the Mexican peso fell 0.8% on average in annual terms. Nevertheless, and like recent quarters, growth should be dampened by inflationary pressures, which remains very high and tends to widen the gap between figures in nominal and real terms.

On demand, private consumption (+6.4%) will likely be the main positive driver, in turn reflecting higher dynamism in imports from the supply-side. [The monthly indicator](#) picked up 8.6%, with imported goods (15.0%) still stronger than domestic ones. Services accelerated to 11.9%. Employment gains, less impact from rising COVID-19 cases, and strong remittances were among the positive factors. On the other hand, investment (5.6%) was also better than originally expected, especially because of non-residential construction (10.2%). This was related to more federal government spending in priority projects. Lastly, government current expenditures picked up 4.6% y/y, its lowest pace since 3Q20. States' accounts in Banxico also signal reduced spending. Nevertheless, we pencil in +1.0%, slightly above the previous quarter as the base effect is more favorable. Exports are estimated at 6.2%. In a similar fashion to shipments abroad, services led the move, consistent with the [balance of payments](#) that showed a rebound in foreigner travelers to Mexico as pandemic fears receded and the US economy remained strong –also supporting demand for Mexican goods in said country–.

If we are right, the overarching message would be that domestic absorption had a good performance in 1Q22 considering local and global headwinds. Data suggests this continued at least until April, with May more mixed. Nevertheless, they have been strong enough for us to reiterate our above-consensus forecast for Mexico's GDP at 2.1%. Despite of this, pre-pandemic levels will probably be reached until late 2022 or early 2023 at best.

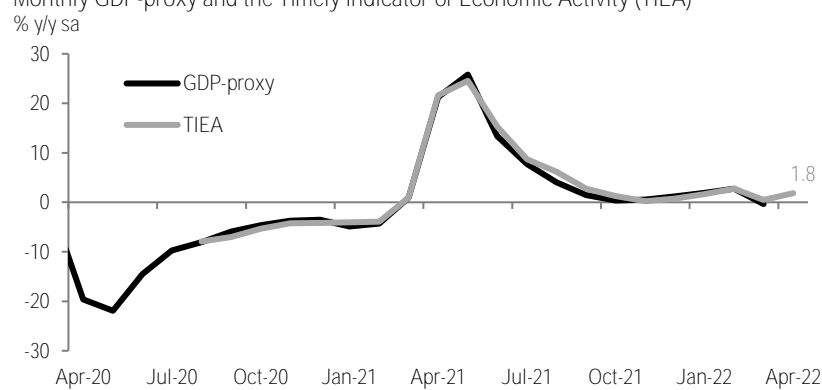
Aggregate demand  
% y/y, nsa



Source: INEGI, Banorte

**Signals in May from *Timely Indicator of Economic Activity* likely to point to a moderation.** This release will include the first estimate for May, as well as revised figures for April. We recall that March's mid-point forecast stood at 0.5% y/y (using sa figures), well above the -0.3% in the [GDP-proxy \(IGAE\)](#). Turning to April, the [IP report](#) surprised strongly to the upside. In addition, signs for services suggest a rebound after the moderation in the previous month. As such, sequential growth will likely be positive. For May, signals are mixed and suggest a moderation. Specifically, we believe the effects from lockdowns in China will be more evident, while we stated to see a slight acceleration in contagions towards the end of the period. Nevertheless, strength abroad and a consolidation in domestic fundamentals may have compensated for this. As such, both [IMEF indicators](#) moderated, but ANTAD sales maintained dynamism.

Monthly GDP-proxy and the Timely Indicator of Economic Activity (TIEA)



Source: INEGI

**Weekly international reserves report.** Last week, net international reserves decreased by US\$568 million, closing at US\$198.7 billion (please refer to the following table). This was mainly explained by a negative valuation effect in institutional assets. Year-to-date, the central bank's international reserves have fallen by US\$3.7 billion.

Banxico's foreign reserve accumulation details  
US\$, million

	2021	Jun 10, 2022	Jun 10, 2022	Year-to-date
	Balance		Flows	
International reserves (B)-(C)	202,399	198,742	-568	-3,657
(B) Gross international reserve	207,745	204,789	198	-2,956
Pemex	--	--	0	350
Federal government	--	--	-40	1,022
Market operations	--	--	0	0
Other	--	--	237	-4,328
(C) Short-term government's liabilities	5,346	6,046	766	701

Source: Banco de México

**Inflation in the 1<sup>st</sup> half of June to remain high, with generalized pressures.** We expect headline inflation at 0.41% 2w/2w. This would be quite high compared to the 0.19% five-year average, and even higher than the figures seen in the last two years (2020: 0.32%, 2021: 0.34%). The period's dynamics would be characterized by generalized pressures, in addition to having a more challenging seasonality relative to the previous month. We anticipate an acceleration in the core to +0.45% (contribution: +34bps). Meanwhile, the non-core would rise 0.29% (+7bps).

If our forecasts are correct, annual inflation will climb from 7.65% on average in May to 7.80%. Both the core and the non-core would accelerate at the margin. The first would come in at 7.43% (previous: 7.28%), with the latter at 8.91% (previous: 8.77%).

In fortnightly terms, within the core, goods would advance 0.5% (+22bp), mainly driven by processed foods (0.6%; +14bp). In that regard, news were unfavorable, highlighting Coca-Cola FEMSA's announcement about an increase in prices (+6.6% on average for its entire portfolio). Furthermore, based on our monitoring, we also identified pressures on beers (related their inputs, mainly glass) and on products related to wheat. 'Other goods' would rise 0.4% (+8bp), rebounding after the discount season and where we continue to anticipate pressures due to the increase in input costs. Services would rise 0.4% (+13bps), with our monitoring suggesting widespread pressures. Within 'other services' (+6.3%; +11bp), we expect advances both in tourism –with the start of college holidays and in preparation for the rest of the summer– and non-tourism categories, expecting businesses to continue to increasing prices given the pressure on their margins in the latter. Housing would be relatively high vs. what we have seen in recent years at +0.1% (+2bps).

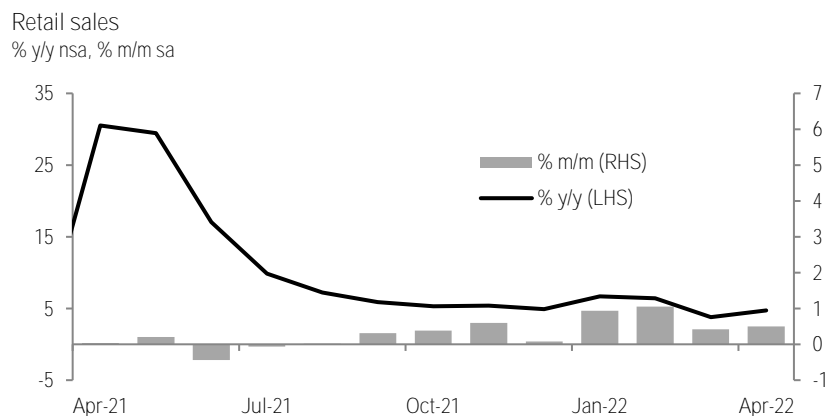
In the non-core, energy prices would reestablish an upward trend at 0.16% (+2bps), despite a mixed behavior inside. Electricity would climb 1.1% (+2bps), with gasolines also higher, with low-grade fuel at +0.7% (+4bps). The latter would happen despite additional increases to the excise tax subsidy, with international references extending higher. Nevertheless, LP gas would fall 1.7% (-4bps), with a moderation in prices abroad. Agricultural prices would moderate their pace of increases, rising 0.5% (+5bps) with our monitoring suggesting less pressures on both components. Fruits and vegetables would increase by 0.5% (+3bps), anticipating increases in bananas and potatoes, albeit with declines in tomatoes and onions. Meat and egg would rise 0.4% (+3bps) still impacted by bird flu contagions, mainly in the US, despite being more focalized in Mexico.

**Retail sales to maintain their positive trend in April.** We estimate +4.7% y/y, which translates into a 0.5% m/m increase, accelerating at the margin and stringing nine months higher. Favorable results likely continued despite a more challenging backdrop, driven by: (1) Additional progress in consumption fundamentals; (2) stability in contagions and high mobility; and (3) more spending in the *Easter* holiday after two years into the pandemic. Nevertheless, among the potential setbacks we note: (1) The absence of payments from social programs as they were paid earlier to comply with the electoral ban; and (2) prevailing [inflationary pressures](#), especially in food.

Consistent with this, timely data are mostly better. ANTAD sales picked-up strongly despite high inflation. Specifically, all-stores sales advanced 8.1% y/y in real terms (previous 3.2%), while same-stores grew 6.1% (previous: 1.3%). We did not identify specific sales or programs that may have triggered this, making us think the result is especially positive. Similarly, auto sales accelerated to 6.0% m/m (using our in-house seasonal adjustment model). In line with higher mobility, gasoline sales –measured by volume– were also stronger, reaching 700.1kbpd, its highest since August 2019.

On fundamentals, [employment gains continued](#) with one million new jobs, on top of an acceleration in wages. Meanwhile, [remittances gathered dynamism](#) and [consumer loans](#) added a fourth month higher.

Going forward, what we know for May suggests that growth continued, albeit likely at a slower pace. Specifically, we believe that the effects from China's lockdowns in China will be more evident (in imports within the trade balance, as well as consumption), while [IMEF's non-manufacturing PMI](#) moderated for a second straight month. Nevertheless, fundamentals will remain as the key driver, on top of the positive effect because of *Hot Sale* discounts, which in our view was more widespread and has already been seen in the latest figures from ANTAD.



Source: INEGI, Banorte

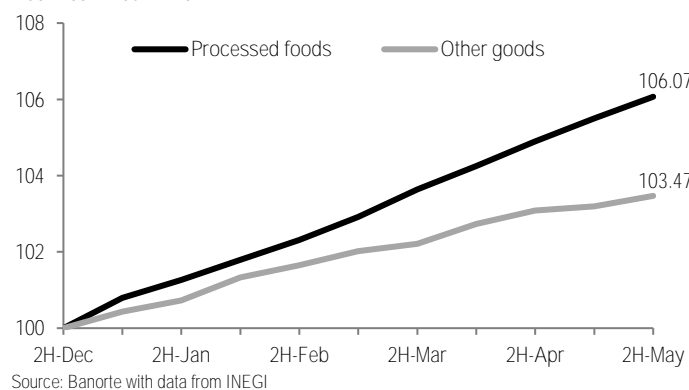
**We expect Banxico to move on with faster hikes, taking the rate to 7.75%.** We estimate a 75bps hike, taking the rate to 7.75%, which matches *Bloomberg's* median, with all 13 analysts surveyed at the close of this edition forecasting this outcome. We consider that conditions for this move are quite clear, taking into account: (1) The 75bps hike by the Fed, and its recent impact on financial markets; and (2) a complex inflationary backdrop domestically, with persistent pressures in the core component. In addition, most recent comments from Board members seem to clearly support a move of this magnitude. On top of the bigger adjustment, we expect the tone to remain hawkish, which would help corroborate our view of another 75bps hike in the August 11<sup>th</sup> meeting.

After the volatility surge since late last week just before its decision, the Federal Reserve increased the Fed funds range by 75bps last Wednesday. In addition, Chairman Powell kept the door open for at least one additional hike of this magnitude. Given the relevance of the relative monetary stance with said country, Governor Victoria Rodríguez commented during the presentation of the *Financial Stability Report* that they will factor in this at their upcoming meeting. She also said that disorderly changes in foreign interest rates are a risk for financial stability. Although we already had the view of a 75bps hike by Banxico even if the Fed had increased the rate by only 50bps, we believe that, just because of this move alone, the most likely course for our central bank is clearer.

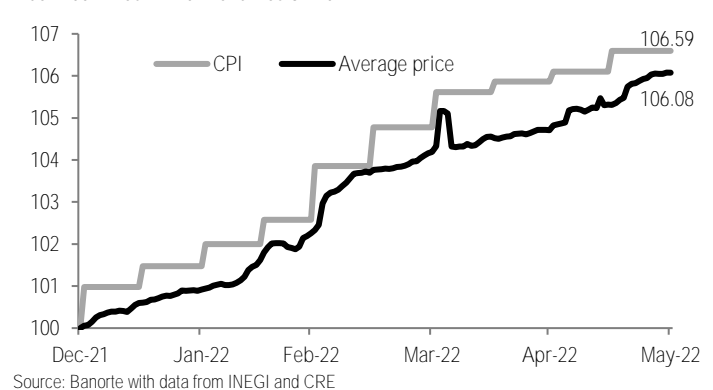
Regarding financial market dynamics, local interest rates already discount our scenario. In particular, the Mbonos' curve flattened with average gains of 10bps after the Fed's decision; however, the curve has accumulated pressures of 75bps at the short-end and 26bps at the long-end since the last decision by Banxico, reflecting the adjustment in market expectations towards a more restrictive stance. In this sense, the 2s/30s spread moved from 4bps to -38bps. Going to the MXN, it appreciated to around USD/MXN 20.25 just after the Fed decision. Nevertheless, pressures returned on lower global risk appetite due to increasing fears of a recession. The cross closed the week at 20.32, above the 20.24 seen in the previous decision (May 12<sup>th</sup>), and widely surpassing the 19.53 low in early June. Although adjustments have been orderly, market dynamics and volatility support the need for Banxico to maintain a prudent stance—which has historically characterized the central bank. In our opinion, the latter suggest that they must at least match the Fed's decision.

Regarding prices, annual inflation remains quite high, with the headline stabilizing around 7.6-7.7%. Nevertheless, the core rose at the margin once again, [reaching 7.28% in May](#)—with 16 straight months higher and at a new high since 2001. For the 1<sup>st</sup> half of June, we see an additional acceleration to 7.43% which suggests we have not reached a peak yet (see [section above](#)). At the margin, we believe there will be a slight negative effect after the *Hot Sale* discounts in some goods, on top of additional pressures in processed foods (chart below, left). Meanwhile, some components in energy have maintained an upward trend, although relatively modest so far. In gasolines, the trend so far in the year, both within CPI and in average prices from the *Energy Regulatory Commission* (CRE in Spanish) has clearly been to the upside despite subsidies to excise taxes (chart below, right). Finally, we believe it is still early to evaluate the effects from the [Plan Against Inflation](#), considering that the most meaningful actions involved the elimination of tariffs that came into effect until mid-May. Meanwhile, it is likely that these effects will be modest or even dilute completely in a challenging international context for commodities' prices.

Core inflation: Processed foods and other goods  
Index 100 = Dec-2H-2021



Low-grade gasoline: CPI and CRE average price  
Index 100 = Dec-2H-2021 and Dec-31-2021



In this backdrop, headline inflation so far in 1Q22 (April-May) has averaged 7.7%, 10bps above the current central bank's forecast. Although it is not entirely unlikely that this figure will be met, we believe it might be difficult considering current conditions.

On the core, the average is 7.2%, in line with expectations. However, our forecasts suggest that it is practically a fact that it must be adjusted up once again. Nevertheless, given accumulated adjustments and the possibility of new shocks, among other factors, we can't rule out that the convergence to the target will be delayed even further. The latter constitutes one of the key factors to anticipate a faster pace of hikes in the short-term. Lastly, the balance of risks will remain to the upside and could even be judged as even more deteriorated.

Banxico: CPI forecasts  
% y/y, quarterly average

	1Q22	2Q22	3Q22	4Q22	1Q23	2Q23	3Q23	4Q23	1Q24
Headline	7.3*	7.6	7.0	6.4	5.3	3.5	3.2	3.2	3.1
Core	6.5*	7.2	6.6	5.9	4.8	3.6	3.3	3.1	3.0

Source: Banco de México. \*Observed data

Regarding Board members, the most active in the last few weeks has been Deputy Governor Jonathan Heath. He has participated in several places, including posts on *Twitter*, a speech in a forum organized by the Mexican bourse (BMV in Spanish) and an interview with *Milenio* newspaper. In our opinion, his participations show a very hawkish tone, validating our expectation that he will probably support a 75bps increase. He mentioned that “...*I can practically assure that, in my personal opinion, there will be a majority and we will see a 75bps hike (in June)...*”, although specifying that “...*the fundamental discussion will be if in August we hike by another 75 or we return to 50....* In the interview with *Milenio*, he argued that “...*we haven't begun to discuss 100bps [...] I don't think that a 100bps hike will happen, it would be better 75, two or three times in a row, because if you increase by 100bps, you can't follow with 100 and 100...*”. The latter leads us to believe that his decision to hike 75bps is virtually a fact, expecting his choice on whether to continue at the same pace, at least in August. Apart from this, Deputy Governor Gerardo Esquivel was the only one with public comments, which commented on inequality. However, we believe it is likely that he will also vote for 75bps despite identifying him as the most dovish member. In particular, this is on the back of his comments that “...*it is unnecessary and even imprudent to adopt a pace of rate increases above that of the Federal Reserve...*”. Therefore, we could have a unanimous decision again.

We believe the tone of the statement and a more challenging environment –in terms of the inflation outlook, global monetary tightening, and financial volatility– will support our call of a relatively rapid tightening in the remainder of the year. The primary target is to take the *ex ante* real rate to positive territory quickly. As such, we keep anticipating the reference rate to reach 9.50% by the end of the year, which matches our forecast for this cycle's terminal rate.

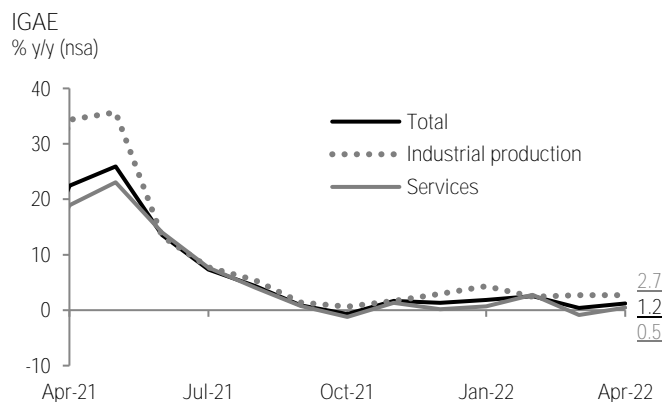
**April's GDP-proxy to accelerate on broad strength across industry and services.** We expect the *Global Economic Activity Indicator* (IGAE) at 1.2% y/y, higher than the 0.4% seen in March. With seasonally adjusted figures, this translates into a 1.9% y/y expansion, remembering that original figures are skewed lower due to the timing of the *Easter* holiday relative to last year. This would be better than the mid-point of INEGI's [Timely Indicator of Economic Activity](#) first forecast at 1.8%. Sequentially, we expect an increase of 1.0% m/m, quite strong considering the +0.3% from the previous month.

As we know, [industry grew 0.6% m/m](#) (2.7% y/y). Dynamism was explained by mining at 1.4% –boosted by related services– and manufacturing at +1.2% –with 15 out of the 21 subsectors higher–. Meanwhile, we expect agriculture at -1.9% (3.9% y/y), backtracking after the +4.5% increase in March, with [slight price pressures](#), particularly in meat & egg, suggesting a moderation.

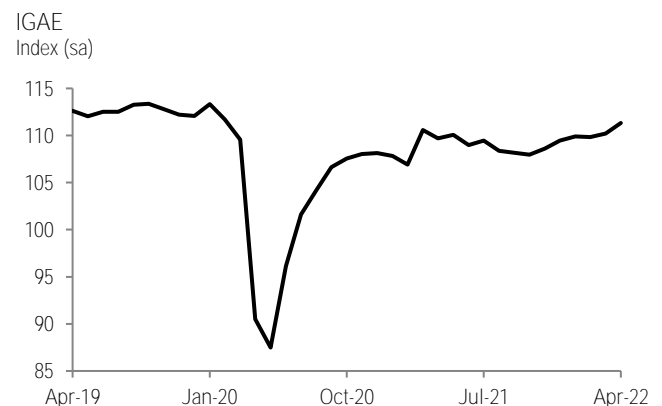
In services we expect an expansion of 1.2% m/m (0.5% y/y), rebounding strongly after a 0.1% decline in the previous month. We believe that part of the acceleration is tied to the *Easter* holiday, with people deciding to take advantage of the holiday period after the distortions in the previous two months, on top of stability in epidemiological conditions. As such, overall conditions for the sector seem to be favorable, even despite a deceleration in IMEF's non-manufacturing PMI to 53.0pts. Among the favorable points, we highlight the [1.1 million rise in jobs](#) (with 876.7 thousand positions in services). By sectors, commerce indicators seem to be quite positive (see [section above](#)). Signals for tourism seem to be more mixed, with hotel occupancy rates improving at the margin to 59.4%, consistent with the holiday period. However, air passenger traffic moderated to 5.0 million from 6.5 million the previous month.

Although this seems to suggest some weakness, we believe this is not that negative, considering: (1) Figures in the previous month are boosted by foreign visitors due to the *Spring Break* in the US; and (2) domestic tourists may have preferred ground transportation, situation which seems to be backed by higher gasoline sales. At the margin, this could result in additional increases in entertainment and lodging, with transportation moderating. Meanwhile, we believe volatility will continue in professional and support services, not ruling out a rebound after the 1.4% contraction in the previous month. In more essential categories, education and healthcare could rebound marginally, while government services could be more mixed.

We believe that this result would be favorable in a context of higher uncertainty globally (e.g. war in Ukraine and lockdowns in China) and the extension in domestic inflationary pressures. As such, we believe that this print supports our view of growth in 2Q22 GDP, although we do expect a moderation in following months for our +0.3% q/q forecast to materialize.



Source: INEGI, Banorte



Source: INEGI, Banorte

## Analyst Certification

We, Alejandro Padilla Santana, Juan Carlos Alderete Macal, Alejandro Cervantes Llamas, Manuel Jiménez Zaldivar, Marissa Garza Ostos, Katia Celina Goya Ostos, Francisco José Flores Serrano, José Luis García Casales, Víctor Hugo Cortes Castro, José Itzamna Espitia Hernández, Carlos Hernández García, Leslie Thalía Orozco Vélez, Hugo Armando Gómez Solís, Yazmín Selene Pérez Enríquez, Miguel Alejandro Calvo Domínguez, Daniela Olea Suárez, José De Jesús Ramírez Martínez, Gerardo Daniel Valle Trujillo, Luis Leopoldo López Salinas, Isaías Rodríguez Sobrino, Paola Soto Leal, Oscar Rodolfo Olivós Ortiz, Daniel Sebastián Sosa Aguilar and Salvador Austria Valencia 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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	Reference
<b>BUY</b>	When the share expected performance is greater than the MEXBOL estimated performance.
<b>HOLD</b>	When the share expected performance is similar to the MEXBOL estimated performance.
<b>SELL</b>	When the share expected performance is lower than the MEXBOL estimated performance.

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