Ahead of the Curve

November 1, 2019

Inflation to stay close to Banxico's target in October

- **Monthly inflation report (October).** We estimate headline inflation at +0.55% m/m, above the 0.26% of the previous month. Core inflation is expected at 0.25% (previous: 0.30%). As observed during the first half, the period's dynamic will be highly influenced by the reversal of electricity tariffs' subsidies in some states. We also see some pressures in agricultural goods, particularly tomatoes. With these results, annual inflation would come in at 3.03% from 3.00% in September, still practically in line with the central bank's target. The non-core component would stay low at 1.05%, although increasing relative to the 0.71% of the previous month. Core inflation would marginally improve to 3.69%, (previous: 3.75%).
- **Gross fixed investment (August).** We anticipate GFI at -4.6% yoy, stronger than the -7.6% in July, partially helped by a relatively favorable base-effect. We expect this to be driven by a relative recovery in construction (especially edification), estimated at -1.2% yoy from -6.1% in July. On the other hand, machinery and equipment would stay a laggard, estimated at -8.6% yoy (previous: -9.5%). As has been the case since around April, the imported component likely contracted at a higher pace, forecasted at -12.0% yoy on the back of capital goods imports falling 14.0%. The domestic component could fall back to -2.9% from -1.7% in the July, in our view affected to some extent by less working days in the annual comparison and the decline in this subcomponent within industrial production. More positive though and using seasonally adjusted figures, total investment could post a 1.3% m/m expansion

www.banorte.com
@analisis_fundam

Juan Carlos Alderete, CFA
Senior Economist, Mexico
juan.alderete.macal@banorte.com

Francisco Flores
Economist, Mexico
francisco.flores.serrano@banorte.com

Mexico weekly calendar

DATE	TIME (ET)	EVENT	PERIOD	UNIT	BANORTE	CONSENSUS	PREVIOUS
Tue 5-Nov	10:00am	International reserves	Nov-3	US$ bn	--	--	180.4
Tue 5-Nov	12:30pm	Government weekly auction: 1-, 3-, 6-, and 12-month Cetes; 20y MBono (Nov'38); 30y Udibono (Nov'50); 5y Bondes D					
Wed 6-Nov	7:00am	Consumer confidence (sa)	October	index	45.0	44.8	44.7
Wed 6-Nov	7:00am	Gross fixed investment	August	% yoy	-4.6	-6.0	-7.6
		sa		% m/m	1.3	--	-0.7
		Machinery and equipment		% yoy	-8.6	--	-9.5
		Domestic		% yoy	-2.9	--	-1.7
		Imported		% yoy	-12.0	--	-14.0
		Construction		% yoy	-1.2	--	-6.1
Wed 6-Nov	3:30pm	Citibanamex bi-weekly survey of economic expectations					
Thu 7-Nov	7:00am	CPI inflation	October	% m/m	0.55	0.52	0.26
				% yoy	3.03	3.00	3.00
		Core		% m/m	0.25	0.24	0.30
				% yoy	3.69	--	3.68
Fri 8-Nov		Wage negotiations	October	%	4.2	--	6.2

Source: Banorte; Bloomberg

Proceeding in chronological order...

Weekly international reserves report. Last week, net international reserves decreased US$29 million, closing at US$180.4 billion. According to Banxico's report, this comes mainly from a negative valuation effect in central bank assets. In this context, the central bank's international reserves have increased US$5.6 billion during 2019 (please refer to the following table).

Banxico's foreign reserve accumulation detail
US$, million

	2018	Oct 25, 2019	Oct 25, 2019	Year-to-date
	Balance		Flows	
International reserves (B)-(C)	174,793	180,432	-29	5,640
(B) Gross international reserve	176,384	183,314	-133	6,930
Pemex	--	--	-69	136
Federal government	--	--	22	1,187
Market operations	--	--	0	0
Other	--	--	-86	5,607
(C) Short-term government's liabilities	1,592	2,882	-103	1,290

Source: Banco de México

Weekly government bond auction. The Ministry of Finance (MoF) –via Banco de Mexico as its financial agent, will offer 20-year fixed-rate Mbonos (Nov'38), 30-year inflation-linked Udibonos (Nov'50), 5-year Bondes D, in addition to the 1-, 3-, 6-, and and 12-month zero-coupon Cetes (see following table). As usual, results will be released at 12:30pm (ET).

Auction specifics (Tuesday, November 5th, 2019)

	Maturity	Coupon rate, %	To be auctioned[1]	Previous yield[2]
Cetes				
1m	05-Dec-19	- -	6,000	7.62
3m	06-Feb-20	- -	13,000	7.59
6m	07-May-20	- -	14,500	7.49
12m	08-Oct-20	- -	14,500	7.18
Bondes D				
5y	24-Oct-24	- -	6,500	0.16
M Bono				
20y	18-Nov-38	8.50	3,500	7.30
Udibonos				
30y	03-Nov-50	4.00	UDIS 550	3.29

Source: Banorte with data from Banco de México 1. Except for Udibonos, which are expressed in UDI million, everything else is expressed in MXN million. 2. Yield-to-maturity reported for Cetes, Mbonos and Udibonos

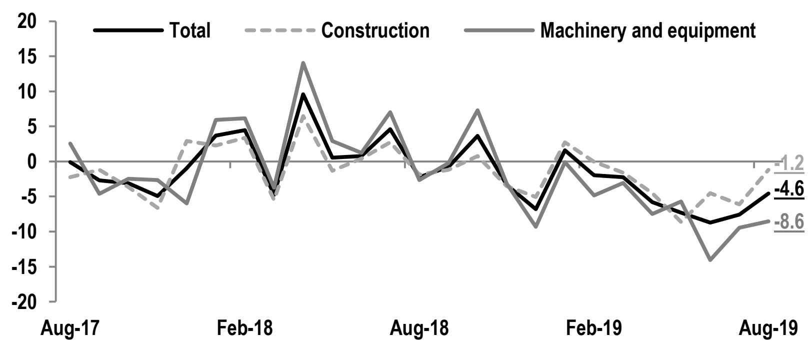
Some relief to gross fixed investment (GFI) in August. We anticipate GFI at -4.6% yoy, stronger than the -7.6% of the previous month, partially helped by a relatively favorable base-effect nonetheless in contraction in 7 out of 8 months so far published in 2019. More positive though, using seasonally adjusted figures this would result in a 1.3% m/m expansion. Although welcome news, it should be mentioned that the rebound would come only after three consecutive months falling strongly (simple average: -1.3% per month).

We anticipate this result to be driven by a relative recovery in construction (especially edification), estimated at -1.2% yoy from -6.1% in July. Our forecast is based on the upward surprise in the sector according to the IP report. For details, see: "*Industrial production – Recovery in mining and construction in August",* <pdf>, October 11th, 2019.

Although too early to call that construction has passed its bottom –particularly as the government's spending in physical assets according to public finance reports keeps contracting–, other indicators support this possibility, including: (1) The recovery in the sector's business confidence index, especially the 'adequate moment to invest' component, which has been improving since August; and (2) clear efforts by the Federal Government to push forward projects in association with the private sector in order to support economic growth.

On the other hand, machinery and equipment would stay a laggard, estimated at -8.6% yoy from -9.5% previously. As has been the case since around April, the imported component likely contracted at a higher pace, forecasted at -12.0% yoy as capital goods imports fell 14.0%. These have stayed weak, a situation that could have been exacerbated by exchange rate pressures in the month (the USD/MXN averaged 19.69 per dollar in August from 19.05 in the previous month, closing the period virtually at year-to-date highs of 20.06). The domestic component could fall back to -2.9% from -1.7% in July, in our view affected to some extent by less working days in the annual comparison and the fallback in this subcomponent within industrial production.

GFI
% yoy



Source: INEGI, Banorte

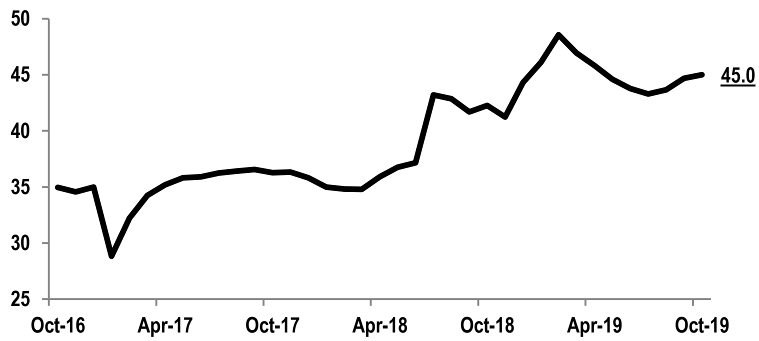
Consumer confidence to show a slight improvement again in October. We expect confidence to increase for a third consecutive time, estimated at 45.0pts sa from 44.7pts in September. However, it would stay below its year-to-date high (maximum: 48.6pts in February). In our view, several indicators point to an improvement, albeit more moderate than in the previous month.

Prices were broadly stable, with inflation at 3.01% yoy during the first half of the period, virtually unchanged to the average seen in September. In this regard, the perception of the fulfillment of the central bank's mandate could positively impact household's current and future conditions, as well as the index that measures purchasing power. In addition, the Mexican peso extended gains, standing around USD/MXN 19.20 at the end of October's survey period (on the 20th of the month) from 19.73 at September-end. This could result in an additional boost in the country's current conditions component.

Meanwhile, presidential approval rose for a second consecutive month, despite events that took place in Culiacan, Sinaloa on October 17th. According to *Oraculus*'s poll of polls, net approval stood at 51pts from 49pts in September, new high since last June when confidence stood at 43.8pts. In this context, we had thought that confidence seemed to be decoupling from political sentiment. Nevertheless, last month's increase in the country's expectations sub-index is making us reevaluate this hypothesis. In this context, we will take a close look to see if this behavior continues in October. On the contrary, there could be some fallout from current conditions, as activity remains muted.

All in all, we continue to believe that confidence will decline gradually. Among the factors, we highlight the dilution of political optimism and the stagnation of activity. However, we now think that the pace of decline could be even more moderate, as inflation and the exchange rate are contributing positively.

Consumer confidence
Index, sa



Source: INEGI

***Citibanamex* survey.** Markets will center on analysts' inflation forecasts for October (to be published on Thursday, November 7th) along with the 2019 year-end estimate. It will be important to see monetary policy assessments, particularly ahead of the November 14th meeting, in which we expect a 25bps rate cut. We will also pay attention to GDP growth and the exchange rate.

Annual inflation to remain close to the 3% target. We estimate headline inflation at +0.55% m/m, above the 0.26% of the previous month. Core inflation is expected at 0.25% (previous: 0.30%). Overall, and as observed during the first half of the period, dynamics will be highly influenced by the reversal of electricity tariffs' subsidies in some states. In this regard, these would contribute with +27bps. Regarding other energy goods, we expect an additional decrease in low-grade gasoline, with a total contribution during the month of -1bp. On the contrary, LP gas would keep climbing, although at a more moderate pace with a total impact of 6bps, in line with the recent behavior of international prices.

Going into agricultural goods, fruits and vegetables would add 4bps. In particular, our price monitoring suggests that tomatoes kept climbing, even after the +5.9% adjustment of the first half. In addition, we could see a relevant increase in *husk tomatoes*, although compensated by a decrease in avocadoes and other products. Meanwhile, meat and egg could reverse the fall of the first fortnight, with pressures in chicken which would result in a flat contribution from the sector.

The core component would contribute 19bps, with 10bps corresponding to core goods. In particular, processed foods would continue to be pressured (+7bps), while other goods would also keep climbing (+4pbs), albeit at a slower pace. In services, the increase would be shared by housing (+3bps) and other services (+5bps). Regarding the latter, and despite there not being a long weekend due to the *Day of the Dead* holiday, we expect a slight increase in airfares and tourism services.

With these, annual inflation would come in at 3.03% from 3.00% in September, still practically in line with the central bank's target. The non-core component would stay low at 1.05%, increasing relative to the 0.71% previously. Core inflation would marginally improve to 3.69%, (previous: 3.75%). Going forward, we continue believing that one of the key factors for inflation to hover around 3% will be non-core dynamics, which have been the main driver behind the return of inflation towards the central bank's target.

We forecast wage negotiations to climb 4.2% in October. This would be significantly below the 6.2% of the previous month. The moderation will be explained by the 3.5% increase received by the *Sindicato de Trabajadores del Instituto Mexicano del Seguro Social*, which is one of the largest unions in the country. We believe this raise will benefit around 430,000 employees, representing about 70% of the monthly total. In addition, we expect the remaining negotiations to belong mostly to workers in the private sector, remembering that these have averaged 6.4% during the year, a trend we expect to continue. Going forward and as mentioned in other releases, wage negotiations will likely remain skewed to the upside due to the revision of the minimum wage as well as the lagged impact from high inflation in the previous two years. However, we do not rule that the recent fall in inflation and the deceleration in economic activity could result in a lower pace of growth for salaries.

Analyst Certification

We, Gabriel Casillas Olvera, Delia Maria Paredes Mier, Alejandro Padilla Santana, Manuel Jiménez Zaldívar, Tania Abdul Massih Jacobo, Katia Celina Goya Ostos, Juan Carlos Alderete Macal, Víctor Hugo Cortes Castro, Marissa Garza Ostos, Miguel Alejandro Calvo Domínguez, Hugo Armando Gómez Solís, Gerardo Daniel Valle Trujillo, José Itzamna Espitia Hernández, Valentín III Mendoza Balderas, Santiago Leal Singer, Francisco José Flores Serrano, Luis Leopoldo López Salinas, Jorge Antonio Izquierdo Lobato and Leslie Thalía Orozco Vélez, 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.

Relevant statements

In accordance with current laws and internal procedures manuals, analysts are allowed to hold long or short positions in shares or securities issued by companies that are listed on the Mexican Stock Exchange and may be the subject of this report; nonetheless, equity analysts have to adhere to certain rules that regulate their participation in the market in order to prevent, among other things, the use of private information for their benefit and to avoid conflicts of interest. Analysts shall refrain from investing and holding transactions with securities or derivative instruments directly or through an intermediary person, with Securities subject to research reports, from 30 calendar days prior to the issuance date of the report in question, and up to 10 calendar days after its distribution date.

Compensation of Analysts.

Analysts' compensation is based on activities and services that are aimed at benefiting the investment clients of Casa de Bolsa Banorte and its subsidiaries. Such compensation is determined based on the general profitability of the Brokerage House and the Financial Group and on the individual performance of each analyst. However, investors should note that analysts do not receive direct payment or compensation for any specific transaction in investment banking or in other business areas.

Last-twelve-month activities of the business areas.

Grupo Financiero Banorte S.A.B. de C.V., through its business areas, provides services that include, among others, those corresponding to investment banking and corporate banking, to a large number of companies in Mexico and abroad. It may have provided, is providing or, in the future, will provide a service such as those mentioned to the companies or firms that are the subject of this report. Casa de Bolsa Banorte or its affiliates receive compensation from such corporations in consideration of the aforementioned services.

Over the course of the last twelve months, Grupo Financiero Banorte S.A.B. C.V., has not obtained compensation for services rendered by the investment bank or by any of its other business areas of the following companies or their subsidiaries, some of which could be analyzed within this report.

Activities of the business areas during the next three months.

Casa de Bolsa Banorte, Grupo Financiero Banorte or its subsidiaries expect to receive or intend to obtain revenue from the services provided by investment banking or any other of its business areas, by issuers or their subsidiaries, some of which could be analyzed in this report.

Securities holdings and other disclosures.

As of the end of last quarter, Grupo Financiero Banorte S.A.B. of C.V. has not held investments, directly or indirectly, in securities or derivative financial instruments, whose underlying securities are the subject of recommendations, representing 1% or more of its investment portfolio of outstanding securities or 1 % of the issuance or underlying of the securities issued.

None of the members of the Board of Grupo Financiero Banorte and Casa de Bolsa Banorte, along general managers and executives of an immediately below level, have any charges in the issuers that may be analyzed in this document.

The Analysts of Grupo Financiero Banorte S.A.B. of C.V. do not maintain direct investments or through an intermediary person, in the securities or derivative instruments object of this analysis report.

Guide for investment recommendations.

	Reference
BUY	When the share expected performance is greater than the MEXBOL estimated performance.
HOLD	When the share expected performance is similar to the MEXBOL estimated performance.
SELL	When the share expected performance is lower than the MEXBOL estimated performance.

Even though this document offers a general criterion of investment, we urge readers to seek advice from their own Consultants or Financial Advisors, in order to consider whether any of the values mentioned in this report are in line with their investment goals, risk and financial position.

Determination of Target Prices

For the calculation of estimated target prices for securities, analysts use a combination of methodologies generally accepted among financial analysts, including, but not limited to, multiples analysis, discounted cash flows, sum-of-the-parts or any other method that could be applicable in each specific case according to the current regulation. No guarantee can be given that the target prices calculated for the securities will be achieved by the analysts of Grupo Financiero Banorte S.A.B. C.V, since this depends on a large number of various endogenous and exogenous factors that affect the performance of the issuing company, the environment in which it performs, along with the influence of trends of the stock market, in which it is listed. Moreover, the investor must consider that the price of the securities or instruments can fluctuate against their interest and cause the partial and even total loss of the invested capital.

GRUPO FINANCIERO BANORTE S.A.B. de C.V.

Research and Strategy

Gabriel Casillas Olvera	Chief Economist and Head of Research	gabriel.casillas@banorte.com	(55) 4433 - 4695
Raquel Vázquez Godinez	Assistant	raquel.vazquez@banorte.com	(55) 1670 - 2967

Economic Analysis

Delia María Paredes Mier	Executive Director of Economic Analysis	delia.paredes@banorte.com	(55) 5268 - 1694
Katia Celina Goya Ostos	Senior, Global Economist	katia.goya@banorte.com	(55) 1670 - 1821
Juan Carlos Alderete Macal, CFA	Senior Economist, Mexico	juan.alderete.macal@banorte.com	(55) 1103 - 4046
Miguel Alejandro Calvo Domínguez	Economist, Regional	miguel.calvo@banorte.com	(55) 1670 - 2220
Francisco José Flores Serrano	Economist, Mexico	francisco.flores.serrano@banorte.com	(55) 1670 - 2957
Luis Leopoldo López Salinas	Analyst, Global Economist	luis.lopez.salinas@banorte.com	(55) 1103 - 4000 x 2707
Lourdes Calvo Fernández	Analyst (Edition)	lourdes.calvo@banorte.com	(55) 1103 - 4000 x 2611

Fixed income and FX Strategy

Alejandro Padilla Santana	Head Strategist – Fixed income and FX	alejandro.padilla@banorte.com	(55) 1103 - 4043
Santiago Leal Singer	FX Senior Strategist	santiago.leal@banorte.com	(55) 1670 - 2144
Leslie Thalía Orozco Vélez	Fixed Income and FX Strategist	leslie.orozco.velez@banorte.com	(55) 5268 - 1698

Equity Strategy

Manuel Jiménez Zaldivar	Director Equity Research — Telecommunications / Media	manuel.jimenez@banorte.com	(55) 5268 - 1671
Victor Hugo Cortes Castro	Technical Analysis	victorh.cortes@banorte.com	(55) 1670 - 1800
Marissa Garza Ostos	Equity Research – Conglomerates / Financials/ Mining / Petrochemicals	marissa.garza@banorte.com	(55) 1670 - 1719
José Itzamna Espitia Hernández	Equity Research – Airlines / Airports / Cement / Infrastructure / REITs	jose.espitia@banorte.com	(55) 1670 - 2249
Valentín III Mendoza Balderas	Equity Research – Auto Parts/ Consumer Discretionary / Real Estate / Retail	valentin.mendoza@banorte.com	(55) 1670 - 2250
Jorge Antonio Izquierdo Lobato	Analyst	jorge.izquierdo.lobato@banorte.com	(55) 1670 - 1746
Itzel Martínez Rojas	Analyst	itzel.martinez.rojas@banorte.com	(55) 1670 - 2251

Corporate Debt

Tania Abdul Massih Jacobo	Director Corporate Debt	tania.abdul@banorte.com	(55) 5268 - 1672
Hugo Armando Gómez Solís	Senior, Corporate Debt	hugoa.gomez@banorte.com	(55) 1670 - 2247
Gerardo Daniel Valle Trujillo	Manager, Corporate Debt	gerardo.valle.trujillo@banorte.com	(55) 1670 - 2248

Wholesale Banking

Armando Rodal Espinosa	Head of Wholesale Banking	armando.rodal@banorte.com	(55) 1670 - 1889
Alejandro Eric Faesi Puente	Head of Global Markets and Institutional Sales	alejandro.faesi@banorte.com	(55) 5268 - 1640
Alejandro Aguilar Ceballos	Head of Asset Management	alejandro.aguilar.ceballos@banorte.com	(55) 5268 - 9996
Arturo Monroy Ballesteros	Head of Investment Banking and Structured Finance	arturo.monroy.ballesteros@banorte.com	(55) 5004 - 1002
Gerardo Zamora Nanez	Head of Transactional Banking, Leasing and Factoring	gerardo.zamora@banorte.com	(81) 8318 - 5071
Jorge de la Vega Grajales	Head of Government Banking	jorge.delavega@banorte.com	(55) 5004 - 5121
Luis Pietrini Sheridan	Head of Private Banking	luis.pietrini@banorte.com	(55) 5004 - 1453
René Gerardo Pimentel Ibarrola	Head of Corporate Banking	pimentelr@banorte.com	(55) 5268 - 9004
Ricardo Velázquez Rodríguez	Head of International Banking	rvelazquez@banorte.com	(55) 5004 - 5279
Víctor Antonio Roldan Ferrer	Head of Commercial Banking	victor.roldan.ferrer@banorte.com	(55) 5004 - 1454