

Ahead of the Curve

January 4, 2019

Inflation in 2018 to close at 4.8% yoy, while industrial production will likely be consistent with a deceleration of economic activity in 4Q18

- **Monthly inflation report (December).** We expect inflation at 0.72% m/m in the headline (from 0.85% in November) and +0.47% at the core level (from 0.25%). With these results, 12-month inflation would stand at 4.85%, rounding down to 4.8% at one decimal point (in line with our expectations). Inflation during the period is likely to have been driven in great part by surging agricultural prices in 1H-Dec, explaining 43bps of the monthly print. In this respect, we estimate non-core inflation at 8.5% yoy. Going to core inflation, we expect at 3.69% yoy from 3.63% in the previous month, limited to the downside on seasonality in core goods due to the holiday period. Going forward, we remain focused on the following factors: (1) Dynamics in agricultural prices after their recent increase; (2) the lagged impact on gasoline from lower international oil prices and recent strength in the currency, but with higher excise taxes in 2019; (3) the behavior of core goods as Banxico remains focused on pass-through risks; and (4) the potential effect from an above average increase in the minimum wage
- **Industrial production (November).** We estimate a moderation in industrial activity to 0.5% yoy from 1.0% in the previous month. Mining is likely to remain a drag, expected to fall 6.9%. In manufacturing, both soft and hard data known so far suggest a deceleration (1.9% expected vs 2.5% in November). Construction could rebound 3.1% from 1.4%, but mostly because of a favorable base effect. With seasonally adjusted figures, industrial production would expand 0.2% after falling 1.6% in November, which was its steepest decrease since October 2015

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Document for distribution among the general public

Mexico weekly calendar

DATE	HOUR (ET)	EVENT	PERIOD	UNIT	BANORTE	CONSENSUS	PREVIOUS
Mon 7-Jan	4:30pm	Citibanamex survey of expectations					
Tue 8-Jan	10:00am	International reserves	Jan-6	US\$ mn	--	--	174.6
Tue 8-Jan	12:30pm	Government weekly auction: 1-, 3-, 6-, 12-month CETES; 10y MBono (May'29); 30y Udibonos (Nov'46); 5y Bondes D					
Wed 9-Jan	9:00am	CPI inflation	December	% m/m	<u>0.72</u>	--	0.47
				% yoy	<u>4.85</u>	--	4.72
		Core		% m/m	<u>0.47</u>	--	0.25
				% yoy	<u>3.69</u>	--	3.63
Thu 10-Jan		Wage negotiations	December	%	<u>5.1</u>	--	5.3
Thu 10-Jan	9:00am	Consumer confidence	December	index	<u>100.4</u>	--	100.9
Fri 11-Jan	9:00am	Industrial production	November	% yoy	<u>0.5</u>	--	1.0
		(sa)		% m/m	<u>0.2</u>	--	-1.6
		Mining		% m/m	<u>-6.9</u>	--	-5.6
		Utilities		% m/m	<u>-3.4</u>	--	4.8
		Construction		% m/m	<u>3.1</u>	--	1.4
		Manufacturing		% m/m	<u>1.9</u>	--	2.5

Source: Banorte; Bloomberg

Proceeding in chronological order...

Citibanamex Survey. Market focus will center on analysts' inflation forecasts for December (to be published on Wednesday, January 9st). Furthermore, attention will be on monetary policy assessments, particularly after the publication of the minutes of the last monetary policy meeting last Thursday. In addition, this publication will contain forecasts for growth and the USD/MXN exchange rate.

Weekly international reserves report. Last week, net international reserves rose by US\$215 million, closing at US\$174.6 billion. According to Banxico's report, this figure comes mainly from a positive valuation effect in central bank assets. In this context, the central bank's international reserves have increased US\$1.8 billion during almost the whole of 2018 (please refer to the following table).

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

	2017	Dec 28, 2018	Dec 28, 2018	Year-to-date
	Balance		Flows	
International reserves (B)-(C)	172,802	174,609	215	1,807
(B) Gross international reserve	175,450	176,066	-1,851	616
Pemex	--	--	-202	-783
Federal government	--	--	-1,743	84
Market operations	--	--	0	0
Other	--	--	94	1,315
(C) Short-term government's liabilities	2,648	1,457	-2,066	-1,191

Source: Banco de México

Weekly government bond auction. The Ministry of Finance (MoF) –via Banco de Mexico as its financial agent–, will offer 10-year fixed-rate Mbonos (May'29), 30-year inflation-linked Udibonos (Nov'46), 5-year Bondes D, in addition to the “more traditional” 1-, 3-, 6-, and 12-month zero-coupon Cetes (please refer to the following table). As usual, results will be released at 12:30pm (ET).

Auction specifics (Tuesday, January 8th, 2019)

	Maturity	Coupon rate, %	To be auctioned ¹	Previous yield ²
Cetes				
1m	07-Feb-19	--	6,000	8.06
3m	11-Apr-19	--	10,000	8.30
6m	04-Jul-19	--	10,000	8.59
12m	02-Jan-20	--	12,500	8.67
Bondes D				
5y	21-Dec-23	--	5,500	0.17
M Bono				
10y	31-May-29	8.50	10,200	9.11
Udibonos				
30y	08-Nov-46	4.00	UDIS 450	4.60

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

Inflation in 2018 expected to end at 4.8% yoy, in line with our forecast. This annual figure would be consistent with our estimate of a 0.72% m/m increase in the headline (from 0.85% in November) and +0.47% at the core (from 0.25%). Inflation during the period is likely to have been driven in great part by the surge in agricultural prices, explaining 43bps of the monthly print. Nevertheless and according to our price monitor, this increase was concentrated in the first half of December as agro prices waned in recent days (expected at -0.3% 2w/2w), mostly due to a decrease in tomatoes (which have a relatively high weight in both the headline and non-core indices). On the other hand, we expect a contribution of 3bps from meat and egg. Going to energy, we expect a negative monthly contribution of 8bps, driven by low-grade gasoline (-8bps) which has fell modestly as a result of lower international reference prices and a stronger Mexican peso, actually helping to compensate from a lower subsidy in terms of excise taxes. Moreover, we expect marginal contributions from LP and natural gas. All in all, we estimate non-core inflation at 8.5% yoy from 8.1% in November, still elevated as it includes the effect of higher agro prices mostly during the first half of the month. Going to core inflation, we expect at 3.69% yoy from 3.63% in November, limited to the downside as a result of seasonality in core goods due to the holiday season (even when considering lower airfares and tourism services in this fortnightly print).

With these results, 12-month inflation would stand at 4.85%, rounding down to 4.8% at one decimal point, albeit higher than the 4.72% seen in November. Going forward, we remain focused on the following factors: (1) Dynamics in agricultural prices after their recent and hefty increase; (2) the lagged impact on gasoline from lower international oil prices and recent strength in the currency, but combined with higher excise taxes starting in 2019 as the new pricing policy of the current administration starts; (3) the behavior of core goods, particularly as Banxico remains focused on higher pass-through risks from peso weakness; and (4) the potential effect from an above average increase in the minimum wage (for details, see: “*The National Commission for Minimum Wages agreed on a 16.2% increase for 2019*”, December 17th, 2018, <[pdf](#)>).

Wage negotiations could have increased 5.1% in December, slightly below the previous print at 5.3%. It is worth noting that given that it is the last month of the year, the pace of negotiations tends to slow down, particularly in the public sector, thus giving a greater weight to the private sector. In this regard, year-to-date negotiations have climbed 4.9%, with a 5.7% expansion in the private sector and 3.4% in the public branch. Going forward, we believe that wage negotiations will remain pressured to the upside given the minimum wage increase announced on December 17th –and coming into effect on January 1st–. In particular, we expect that the contagion effect could be greater in the northern border considering that the adjustment in that region was +100% vs. the +16.2% in the rest of the country.

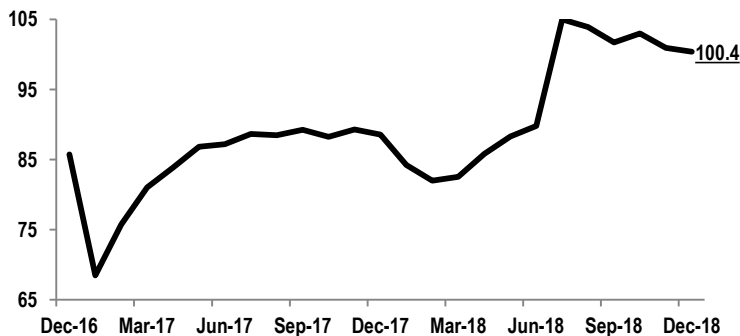
Food inflation and a likely increase in unemployment to impact consumer confidence in December. We expect consumer confidence to stand at 100.4pts, slightly below the 100.9pts seen in the previous print. In this context, we expect a 1.0% m/m contraction when using seasonally adjusted figures, a more moderate adjustment after the 1.6% contraction seen in November.

We believe the main factor that will continue to push confidence to the downside will be the recent increase in food prices, both in the core and non-core components. Agricultural goods' prices posted a 2.6% 2w/2w increase in the first half of December, which was on top of a 3.5% rise seen in the second half of the previous month, both surprising significantly to the upside when compared to recent years and consensus expectations. We believe this could be reflected in December's survey given the sample collection period –from the 1st to the 20th of every month–. On top of the latter, we also believe that unemployment will start to rise as a result of some of the austerity measures implemented by the Federal Government.

On the contrary, there were some favorable factors which help explain the moderation in the rate of contraction. Among these, we highlight: (1) The above average minimum wage increase announced on December 17th; and (2) the appreciation of the Mexican peso from levels around USD/MXN 20.20 at the beginning of the month, to below 20.00 by December 20th.

Going forward, we believe that confidence will be limited to the upside despite several factors in play. On a positive note, the convergence of inflation towards target could have a favorable impact in household current expectations as well as in the purchasing power component. On the flip side, we expect optimism surrounding the new administration to keep moderating, as seen in the recent trajectory of the country's expectations component. With this, we expect confidence to fall back below the 100pts threshold, particularly in a challenging global and local context which is likely to result in more moderate growth ahead.

Consumer confidence
Index, nsa



Source: INEGI

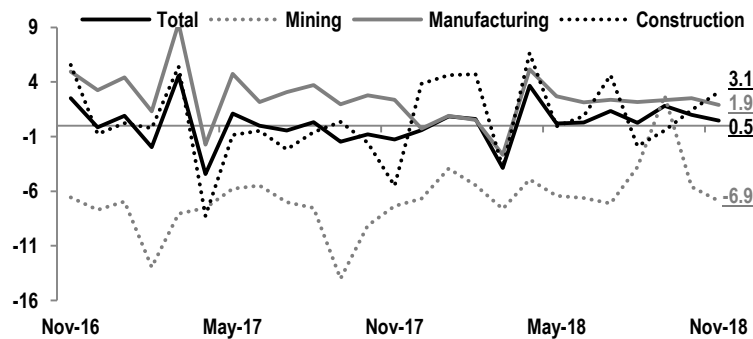
Industrial production to advance marginally after last month's plunge. We estimate a moderation in industrial activity to 0.5% yoy from 1.0% in the previous month. With seasonally adjusted figures, this would result in a 0.2% expansion after falling 1.6% in November, which was its steepest decrease since October 2015.

In our view, most known data suggests a relative deceleration in annual terms, especially in the manufacturing sector, which we estimate at 1.9% yoy vs 2.5% in the previous print. The following factors support our view: (1) November was the third consecutive month of contraction in auto production, at -1.3%; (2) growth in US manufacturing has been moderating; (3) local PMI manufacturing data has been weak during all 4Q18, particularly in the new orders and employment components; and (4) global trade has decelerated recently. On the contrary, imports of non-oil intermediate goods have held up relatively strong although they also decelerated in November.

In mining, we expect a strong contraction of 6.9% yoy. As in recent years, oil extraction figures from PEMEX show a steep decline at -8.1%. Moreover, we anticipate that non-oil mining will remain a drag, extending the decline observed in the last nine months. Last but not least, we expect a relative rebound in construction due to a favorable base effect, advancing 3.1% yoy vs 1.4% in the previous month. In this respect, this sector plunged 5.5% in November 2017. Adjusting for this effect, we believe that the sector will present a modest advance relative to the previous month, supported by the residential sector.

Industrial production

% yoy



Source: INEGI, Banorte

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