

# Ahead of the Curve

2Q19 GDP expected to contract 0.5% yoy (-0.2% q/q)

- Gross Domestic Product (2Q19 P).** The year-over-year comparison would stand at -0.5% yoy, significantly lower than the +1.2% of the previous quarter. It should be mentioned that this would be partly driven by a negative base effect. Using seasonally figures we estimate a 0.2% q/ fall, adding two consecutive quarters in contraction. This result would be mainly due to weak industry performance, anticipated at -2.9% yoy (-0.5% q/q). In services, we have had mixed signals. On the bright side, retail sales stayed strong in the first two months of the period. Nevertheless, June's non-oil consumption goods imports, domestic automotive and ANTAD sales suggest an additional weakening in the month. With government activities still in contraction and a likely slowdown in transportation, we estimate services at +0.4% (+0.2% q/q). Taking into account that the monthly GDP proxy (IGAE) averaged -0.9% yoy in April and May, our GDP forecast would imply null expansion in June

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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

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## Mexico weekly calendar

DATE	HOUR (ET)	EVENT	PERIOD	UNIT	BANORTE	CONSENSUS	PREVIOUS
Mon 29-Jul	7:00am	Unemployment rate	June	%	<u>3.49</u>	--	3.51
		(sa)		%	<u>3.51</u>	--	3.48
Tue 30-Jul	10:00am	International reserves	Jul-27	US\$ bn	--	--	179.0
Tue 30-Jul	12:30pm	Government weekly auction: 1-, 3-, 6-month CETES; 10y Mbono (May'29); 5y Bondes D					
Tue 30-Jul	3:30pm	Budget balance (PSBRs)	June	MXN bn	--	--	73.2
Wed 31-Jul	7:00am	GDP	2Q18	% yoy	<u>-0.5</u>	-0.4	1.2
		(sa)		% q/q	<u>-0.2</u>	-0.2	-0.2
		Primary activities		% yoy	<u>1.7</u>	--	5.8
		Industrial production		% yoy	<u>-2.9</u>	--	-0.7
		Services		% yoy	<u>0.4</u>	--	1.9
Wed 31-Jul	10:00am	Comercial banking credit	June	% yoy	<u>4.9</u>	--	4.8
		Consumption		% yoy	<u>2.0</u>	--	1.8
		Housing		% yoy	<u>6.1</u>	--	6.0
		Non-banking private firms		% yoy	<u>5.4</u>	--	5.3
Thu 1-Aug	10:00am	Family remittances	June	US\$ mn	<u>3,021.1</u>	3,150.0	3,203.1
Thu 1-Aug	10:00am	Banxico's survey of economic expectations	July				
Thu 1-Aug	1:00pm	PMI's survey (IMEF)	July				
		Manufacturing		index	<u>48.6</u>	--	49.0
		Non-manufacturing		index	<u>47.5</u>	--	47.7

Source: Banorte; Bloomberg

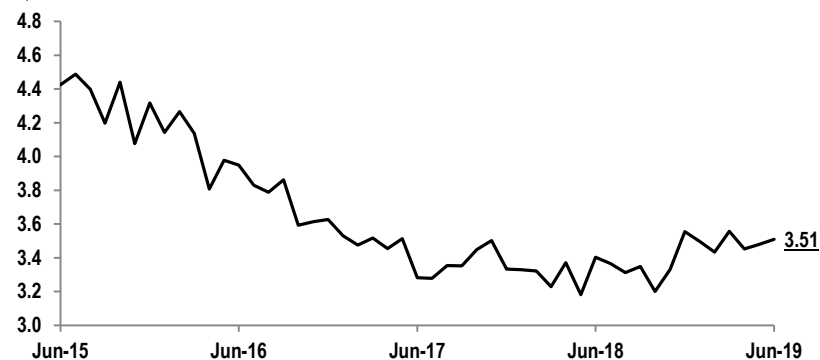
## Proceeding in chronological order...

**We expect a relatively stable unemployment rate in June.** We estimate the unemployment rate at 3.51% sa, above the 3.48% of the previous month. In our view its dynamic will be relatively stable. In this context, the annual pace of formal job creation stood in line with the figure from the previous month at 2.4%. This was a result of a net loss of 14,244 posts, mostly associated with temporary jobs. However, this is a relatively normal number due to the seasonality of the period.

Regarding economic activity, May's monthly GDP proxy (IGAE) stagnated in the monthly comparison, possibly resulting in greater slack in the labor market. Besides, we still believe that it is likely that above-average wage increases have also impacted employment growth. Business confidence was again lower when compared to May across all sectors, which could continue impacting hiring decisions among businesses. On a timelier basis, PMIs for June (which are compiled by *IMEF* in the 2<sup>nd</sup> half of the reference month) showed employment sub-indices still in contraction, with mixed signals among subsectors as manufacturing improved but non-manufacturing worsened.

### Unemployment rate

% , sa



Source: INEGI, Banorte

**Weekly international reserves report.** Last week, net international reserves increased by US\$265 million, closing at US\$179.0 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\$4.2 billion during 2019 (please refer to the following table).

### Banxico's foreign reserve accumulation detail

US\$, million

	2018	Jul 19, 2019	Jul 19, 2019	Year-to-date
	Balance		Flows	
International reserves (B)-(C)	174,793	179,020	265	4,228
(B) Gross international reserve	176,384	187,871	407	11,487
Pemex	--	--	231	357
Federal government	--	--	-124	6,996
Market operations	--	--	0	0
Other	--	--	300	4,133
(C) Short-term government's liabilities	1,592	8,851	142	7,259

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’31), 5-year Bondes D, in addition to the 1-, 3-, and 6-month zero-coupon Cetes (see following table). As usual, results will be released at 12:30pm (ET).

**Auction specifics (Tuesday, June 30<sup>th</sup>, 2019)**

	Maturity	Coupon rate, %	To be auctioned <sup>1</sup>	Previous yield <sup>2</sup>
<b>Cetes</b>				
1m	29-Aug-19	--	6,000	8.15
3m	31-Oct-19	--	9,000	8.15
6m	30-Jan-20	--	14,500	8.18
<b>Bondes D</b>				
5y	27-Jun-24	--	6,500	0.14
<b>Mbonos</b>				
10y	31-May-29	8.50	12,200	7.68

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

**MoF’s public finance report (June).** In this report, attention will center on the public balance as well as on PSBRs. It should be noted that the public deficit as of the end of May stood at +MXN\$32.4bn, better than the MXN\$79.1bn forecasted deficit. In addition, focus will be on revenues and spending, especially when compared to the MoF’s updated *2020 Macroeconomic Forecasts*. Finally, we will also look into public debt, which as of May stands at MXN\$10.4tn, equivalent to 41.9% of GDP (as measured by the HBPSBRs).

**Mexico’s preliminary 2Q19 GDP to contract both in the annual and quarterly comparisons.** The year-over-year rate would stand at -0.5% yoy, significantly lower than the +1.2% in 1Q19. This contraction would be partly driven by a negative base effect due to the timing of the Holy Week. Overall, this would imply a 0.4% yoy expansion in the first half of 2019 (1H18: 1.9%). Nevertheless and using seasonally figures, we estimate a 0.2% q/q fall, in contraction for a second consecutive quarter.

As we mentioned in our revision for full-year GDP (for details see: “*Mexico – Economic activity decelerates more than expected*”, [pdf](#)), industrial activity has been impacted by several shocks, ranging from blockades in railways to the stoppage of construction works in Mexico City. On the latter, the first significant signal was in May when this component fell 9.8%, trend which we expect to continue in coming months, albeit at a more favorable pace. Moreover, mining will continue to be a drag, driven by oil and gas production which fell 9.7% in April-May, with the current trend probably extending at least until the end of the year. Regarding manufacturing, figures so far show some relative resiliency despite slowing down, with an accumulated expansion of 0.1% yoy in the quarter (considering that the calendar effect has a more pronounced effect in this sector). In addition, more timely indicators, such as manufacturing exports and auto production, show a negative outlook for June, also consistent with IMEF’s PMI index that suggested an additional contraction. Considering these, we forecast a 2.9% fall in 2Q19 (0.5% q/q sa).

In services, we have had mixed signals. On the bright side, retail sales stayed strong in the first two months, growing 3.0%. Nevertheless, June's trade balance exhibited a weaker outlook for the closing month, as non-oil consumption imports declined 5.7%, its worst level year-to-date, while both domestic auto sales and ANTAD figures were also weak. Going to transportation, we expect a more muted performance on the back of the slowdown in manufacturing, with future dynamics still heavily influenced by what happens in that sector. Finally, government services will likely continue subtracting as spending in the quarter remained in negative territory, affected by austerity measures. All in all, services are estimated to expand 0.4% yoy (+0.2% q/q).

Considering that the monthly GDP proxy (IGAE) averaged a -0.9% yoy fall in April and May, our GDP forecast would imply null expansion in June. This would be explained by some pick-up in services for the month (1.1% yoy) but industry declining 2.9%, slightly better when compared to May. Finally, the primary sector would advance 3.2% in the month, equating to a 1.7% increase in the quarter.

**Banking credit will show a 4.9% yoy increase in June.** It is our take that credit to the non-financial sector continued flowing. We estimate a 4.9% yoy expansion in real terms as a result of a 2.0% increase in consumer credit, coupled with a 6.1% and 5.4% expansion in mortgages and corporate credit, in the same order.

**Remittances facing a challenging base effect in June.** We expect remittances at US\$ 3,021.1 million, still higher than the 12-month average of US\$2,840.9 million. However, it should be noted that the period is benefitted by a seasonal effect, driving the total flow higher. In the annual comparison, we expect a 3.8% contraction, driven by a challenging base effect. It should be noted that in June 2018, news surfaced regarding the child separation policy implemented by the US government, which triggered higher-than-average remittances. Considering this, and despite tensions remaining high –especially with the 2020 election looming closer–, these would not be enough to result in positive growth in annual terms.

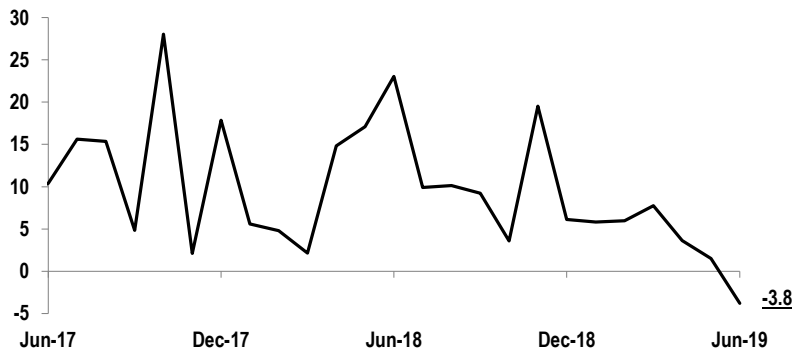
Regarding other variables, the Mexican peso depreciated slightly in the monthly average, going from 19.11 in May to 19.27 in June. It should be noted that this was driven by the threat of tariffs on all Mexican exports to the US, which faded after the first week as an agreement was reached. Considering the latter, the overall flow should have only been partially impacted, with only a temporary pick-up, remembering that a stronger peso tends to discourage remittances as its purchasing power in local currency decreases.

With this result, remittances would add up to US\$ 16,745.4 million so far in 2019, 3.1% above the same period of 2018. This would support our view that growth is slowing down gradually on lower US activity, which would lead to more modest employment growth of Mexican migrants. Recent trends point to a more pronounced slowdown, with employment among non-citizen Mexican migrants falling 3.4% yoy, adding three consecutive months in contraction.

We believe this group is among those with the highest propensity to send remittances, given their more vulnerable conditions, more so when taking into account current anti-migration sentiment among US authorities.

#### Family remittances

% yoy



Source: Banxico

**Banxico’s survey of economic expectations.** As usual, markets will focus on inflation forecasts. The median for 2019 is 3.7%, above our 3.5%. Moreover, the medium-term estimate remains above target, standing at 3.5%. In addition, estimates for the reference rate will be published. Our expectation is for Banxico to start an easing cycle as soon as November with a 25bps cut, with the reference rate by year-end at 8.00% (consensus: 8.00%).

Forecasts for GDP will also be released. In the last survey, economists’ growth for 2019 stood at 1.1%, above our 0.8%. For 2020 it stood at 1.7% (Banorte: 1.4%). We believe the median will likely decline further. Finally, we could see a marginal revision in the exchange rate, considering that the YE19 forecast stands at USD/MXN 19.78 (Banorte: 20.30).

**PMI’s to weaken once again in July.** We expect the manufacturing index at 48.6pts from 49.0pts sa in June. On balance, figures for manufacturing will continue to be pushed to the downside, limited by the sector’s deceleration in the US. In particular, the preliminary manufacturing PMI for July fell to 50.0pts from 50.6 in June, walking the tight-rope between expansion and contraction. Other figures also show a downward trend, albeit at a moderate pace, which would have negatively impact domestic production given the high degree of interconnection between supply chains of both countries. On the news front, the balance was positive as several members of the US government saw progress on migration. Despite this could probably translate to a lower probability of tariffs coming into effect, we believe this risk is still latent given shifting views by President Trump on foreign policy. On a sub-index level, we expect a decline in production, remembering that it picked-up considerably in the previous month. Moreover, new orders could stay below 50pts, with uncertainty mainly reflected within this component. Finally, we believe that employment could also fall after its strong performance in June.

We also expect the non-manufacturing index to fall further, coming in at 47.5pts from 47.7pts. It is worth remembering that this indicator is compiled from construction, commerce and services surveys, with the first sector expected to drive weakness. Considering news surrounding this sector as well as already known hard data -with a 9.8% fall in construction according to the industrial production report- we think pressures could extend in coming months. Looking at the breakdown, we believe employment could recover, while new orders and production continue to decline.

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**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 Godínez	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
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 Thalia 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	hugo.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.cebillos@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 Asset Management	pimentelr@banorte.com	(55) 5268 - 9004
Ricardo Velázquez Rodríguez	Head of International Banking	rvelazquez@banorte.com	(55) 5004 - 5279
Victor Antonio Roldan Ferrer	Head of Corporate Banking	victor.roldan.ferrer@banorte.com	(55) 5004 - 1454