

Ahead of the Curve

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Anticipating a pick-up in August's IGAE and inflation to stay at Banxico's target

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- Economic Activity Indicator (August).** We see a contraction of 0.1% yoy, below the +0.3% of the previous month. In seasonally-adjusted terms we anticipate a 0.5% m/m rebound (previous: -0.1%), led by the 0.8% advance of industrial activity. In services, we forecast +0.5% m/m after two consecutive months of declines, in a context of an improvement in the IMEF non-manufacturing index and consumer confidence. Nevertheless and on the contrary, business confidence has been contained and the pace of formal job creation extended its downtrend. With this, activity in the first two months of 3Q19 and on a year-to-date basis would coincide at barely 0.1% yoy. This would reaffirm that the economy has stagnated despite signs of a stronger performance in domestic demand in September, with the possibility of gradual recovery which in our view is more likely until the last quarter of the year
- Bi-weekly inflation report (1H-October).** We estimate a rebound in headline inflation to 0.38% 2w/2w. Core inflation would stand at 0.14% (previous: 0.12%) This increase is typical, largely explained by the reversal of electricity tariffs' subsidies in some states, which we anticipate at +16.7%. Agricultural goods would contribute 2.5bps. Within the core component we believe pressures will remain in goods (contributing 6bps), with services adding 5bps. In this context, the non-core component would explain 27bps, while the core would contribute with 11bps. With these results, annual inflation would come in at 2.99% from 3.00% in September. Non-core inflation would climb to 0.87%, increasing relative to the 0.57% and the core would improve marginally to 3.69%, lowest since March. In our view, inflation dynamics keep supporting additional cuts by Banxico, expecting -25bps in each of the two remaining decisions of the year, with the reference rate closing 2019 at 7.25%

Document for distribution among the general public

Mexico weekly calendar

DATE	HOUR (ET)	EVENT	PERIOD	UNIT	BANORTE	CONSENSUS	PREVIOUS
Tue 22-Oct	7:00am	Unemployment rate	September	%	<u>3.82</u>	--	3.74
		sa		%	<u>3.56</u>	--	3.57
Tue 22-Oct	10:00am	International reserves	Oct-19	US\$ bn	--	--	180.3
Tue 22-Oct	12:30pm	Government weekly auction: 1-, 3-, 6-month CETES; 10y Mbono (May'29); 5y Bondes D					
Tue 22-Oct	3:30pm	Citibanamex bi-weekly survey of economic expectations					
Thu 24-Oct	7:00am	CPI inflation	1H Oct	% 2w/2w	<u>0.38</u>	0.45	0.13
				% yoy	<u>2.99</u>	3.10	3.01
		Core		% 2w/2w	<u>0.14</u>	0.16	0.12
				% yoy	<u>3.69</u>	--	3.72
Thu 24-Oct	7:00am	Global economic indicator	August	% yoy	<u>-0.1</u>	0.5	0.3
		sa		% m/m	<u>0.5</u>	--	-0.1
		Primary activities		% yoy	<u>2.1</u>	--	4.1
		Industrial production		% yoy	<u>-1.3</u>	--	-1.8
		Services		% yoy	<u>0.3</u>	--	1.2
Fri 25-Oct	7:00am	Retail sales	August	% yoy	<u>1.9</u>	2.6	2.1
		sa		% m/m	<u>-0.1</u>	--	0.0

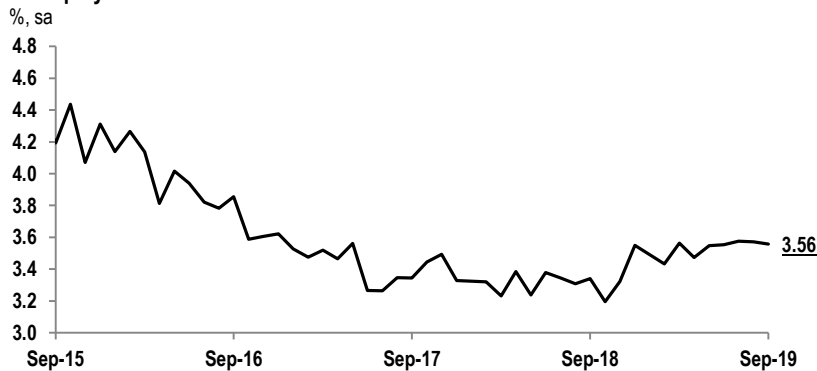
Source: Banorte; Bloomberg

Proceeding in chronological order...

Another modest downtick in September's unemployment rate. We estimate a 1bp decline to 3.56% sa. The main driver would be robust formal job creation, surging to 145,416 new jobs in the period, highest for the same month since 2016. Despite its unusual strength, other indicators suggest a more modest performance, including the employment component within both the non-manufacturing and manufacturing IMEF indices, staying in contraction at 47.5pts and 47.8pts, in the same order. More importantly though, economic activity remains muted according to the latest data from IGAE (-0.2% m/m in June), although with some green shoots in industry (+0.8% m/m in August).

Despite of this, we still see limited room for a strong decline in coming months. Although activity and business confidence by the end of 3Q19 have provided more favorable signs, they remain relatively low. Last but not least, temporary shocks such as the suspension of 6,000 factory jobs since October 1st by GM in Silao, Guanajuato, due to the workers' strike in the US, will likely have direct and indirect impacts on manufacturing employment.

Unemployment rate



Source: INEGI, Banorte

Weekly international reserves report. Last week, net international reserves decreased US\$472 million, closing at US\$180.3 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\$5.5 billion during 2019 (please refer to the following table).

Banxico's foreign reserve accumulation detail

US\$, million

	2018	Oct 11, 2019	Oct 11, 2019	Year-to-date
	Balance		Flows	
International reserves (B)-(C)	174,793	180,324	-472	5,532
(B) Gross international reserve	176,384	183,378	-256	6,994
Pemex	--	--	10	125
Federal government	--	--	80	1,326
Market operations	--	--	0	0
Other	--	--	-346	5,542
(C) Short-term government's liabilities	1,592	3,054	216	1,462

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), 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, October 22th, 2019)

	Maturity	Coupon rate, %	To be auctioned ¹	Previous yield ²
Cetes				
1m	21-Nov-19	--	6,000	7.67
3m	23-Jan-20	--	13,000	7.59
6m	23-Apr-20	--	14,500	7.45
Bondes D				
5y	22-Aug-24	--	6,500	0.16
M Bono				
10y	31-May-29	8.50	10,000	7.08

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

Citibanamex survey. Markets will center on analysts’ inflation forecasts for the first half of October (to be published on Thursday, October 24th) along with the 2019 year-end estimate. It will be important to see monetary policy assessments, particularly after the release of the last minutes and looking towards the November 14th meeting. We will also pay attention to GDP growth and the exchange rate.

Annual inflation to stay relatively unchanged. We estimate headline inflation at +0.38% 2w/2w, above the 0.13% of the previous fortnight. Core inflation is expected at 0.14% (previous: 0.12%). As is typical in this period, this is largely due to the reversal of electricity tariffs’ subsidies in some states. In particular, electricity tariffs would rise 16.7% (+24bps), remembering that in October we see a reciprocal upward adjustment relative to April’s reduction, which was -12.3%. In other products within energy, we expect LP gas to add 1bps to the headline, now with four consecutive fortnights higher. Meanwhile, low-grade gasoline would subtract 1bp, benefited by gains of the Mexican peso as well as lower international prices, in tandem with stability in excise tax subsidies. On agricultural goods we expect contained pressures, with fruits and vegetables at +1.5bps and meat and egg at +1bp. Within the former, we expect tomatoes to climb further, with onions and avocados partly offsetting this. On the latter, we forecast a slight increase in both chicken and pork. Within the core component we believe pressures in goods will remain, with a 6bps contribution. In line with previous periods, we expect a relatively even distribution between processed foods and other goods. In services, the increase would be shared by housing (+2bps) and other services (+3bps). In this context, the non-core component would add 27bps (+1.12% 2w/2w), while core would only contribute with 11bps.

With these results, annual inflation would come in at 2.99% from 3.00% in September, matching the print from the first half of the previous month. The non-core component would stay low at 0.87%, increasing relative to the 0.57% low in the first fortnight.

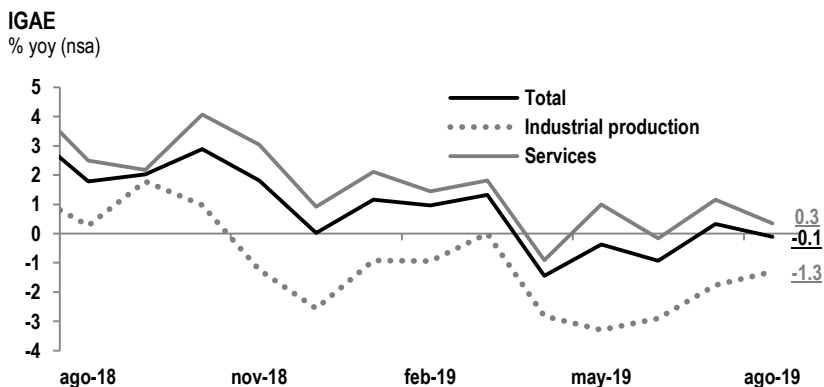
This would be explained by agricultural goods, while energy would extend its decline to -3.82%, a new historical low (series available since January 1988).

Core inflation would marginally improve to 3.69%, lowest since March. Going forward, we continue to believe 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.

IGAE to improve in August. We estimate the *Economic Activity Indicator* (IGAE) at -0.1% yoy, below the +0.3% of the previous month. Nevertheless, this would be in part due to less working days, with a rebound of 0.5% m/m in seasonally-adjusted terms (previous: -0.1%). This would be mostly on industrial activity, which picked-up to 0.8% m/m. For details, see: “*Industrial production – Recovery in mining and construction in August*”, <[pdf](#)>, October 11th, 2019. Despite of this latter result, we believe the outlook for IP remains mixed, with signs of a slowdown in US manufacturing and a temporary shock in October from GM’s labor strike, but with higher business confidence and the slight improvement in US-China negotiations recently.

In services, we estimate a 0.5% m/m advance but only after two consecutive months of declines. Despite of relatively subdued retail sales according to our forecast (see below), the IMEF non-manufacturing index rebounded to 48.1pts, led by the production component. Consumer confidence was also higher for the first time in five months on stronger purchasing power, arguably on the back of the recent decline in inflation. On the contrary, business confidence has been contained and the pace of formal job creation extended its downtrend, with a better performance in these indicators only until September. Last but not least, government spending remains in contraction, likely a drag as it fell 13.4% yoy.

With this result, activity in the first two months of 3Q19 and on a year-to-date basis would coincide at barely 0.1% yoy, albeit with more positive figures for September, particularly in some indicators of domestic demand. Nevertheless, this would reaffirm that the economy has stagnated, with signs of a gradual recovery which in our view is more likely only until the last quarter of the year.



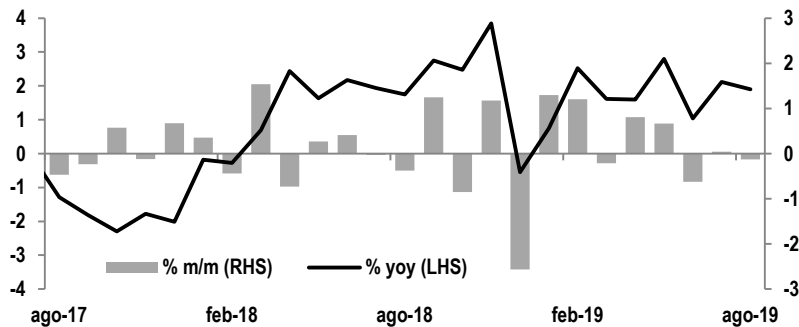
Source: INEGI, Banorte

August retail sales likely stable. We anticipate a 1.9% yoy increase, slightly lower than July and partially because of one less working day in the annual comparison, while the previous month had one more. In seasonally-adjusted terms we expect a 0.1% decline after a flat reading. The main signal supporting our view is weakness in non-oil consumption goods imports at -5.9% yoy, lowest year-to-date. On domestic demand, auto sales as a proxy for durable goods exacerbated their decline (-12.1%). On the other hand, and regarding non-durables, real sales at ANTAD (+1.2%) and Walmart (2.8%) improved. Nevertheless, some of this was likely due to a positive calendar effect (with one more Saturday in the month, which is positive for this type of establishments).

Despite of the latter, we are still positive about a better performance before year-end, based on fundamentals. The most significant upside surprise has been remittances, advancing at a double-digit pace of 17% yoy after +14.4% in the previous month. The final effect could be even better in local currency as the exchange rate increased to 19.68 per dollar on average. Not too far in terms of relevance, downside surprises in inflation have also helped, falling to 3.2% in August from 3.8% previously. As a result, consumer confidence has picked up, particularly the purchasing power component. Credit keeps flowing and interest rates have started to fall. Nevertheless and on the contrary, austerity by the Federal Government remains in place, while overall activity levels have stayed modest.

Retail sales

% yoy (nsa), % m/m (sa)



Source: INEGI, Banorte

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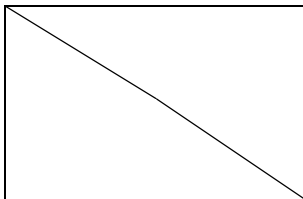
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