

Ahead of the Curve

Annual inflation in May should moderate, albeit with the core still relatively high

- Monthly inflation report (May).** We estimate headline inflation at -0.25% m/m and core at 0.15%, both lower than the previous month. Apart from the usual seasonal effect of lower electricity tariffs in the first half, dynamics would be helped by non-core prices, especially fresh fruits and vegetables. At the core level, we anticipate some components such as processed foods, other goods, and other services to remain relatively pressured. With these results, annual inflation would moderate slightly to 4.32% from 4.41%, while core inflation would also fall to 3.76% from 3.87%, still relatively elevated. In particular, non-core inflation would decline to 5.98% from 6.08%, still higher than the figure at the end of March of 5.47%
- Consumer confidence (May).** We expect confidence to fall for a third consecutive month to 109.7pts (-3.4% m/m). As we have mentioned previously, the correlation with political sentiment has been high. In this respect and according to some surveys, the president's approval ratings have declined. To the latter, we should add some pressures in relevant inflation components and a modest depreciation of the Mexican peso. Going forward, we believe consumer confidence will keep declining gradually

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Document for distribution among the general public

Mexico weekly calendar

DATE	HOOR (ET)	EVENT	PERIOD	UNIT	BANORTE	CONSENSUS	PREVIOUS
Mon 3-Jun	10:00am	Family remittances	April	US\$ mn	<u>2,803.8</u>	--	2,896.8
Mon 3-Jun	10:00am	Banxico's survey of economic expectations	May				
Mon 3-Jun	1:00pm	PMI's survey (IMEF)	May				
		Manufacturing		index	<u>50.9</u>	--	52.0
		Non-manufacturing		index	<u>51.6</u>	--	52.4
Tue 4-Jun	9:00am	Consumer confidence	May	index	<u>109.7</u>	--	110.9
Tue 4-Jun	10:00am	International reserves	May-31	US\$ bn	--	--	177.3
Tue 4-Jun	12:30pm	Government weekly auction: 1-, 3-, and 6-months Cetes; 30y MBono (Nov'47); 5y Bondes D					
Wed 5-Jun	4:30pm	Citibanamex bi-weekly survey of economic expectations					
Thu 6-Jun	9:00am	Gross fixed investment	March	% yoy	<u>-2.1</u>	--	-1.9
		Machinery and equipment		% yoy	<u>-2.0</u>	--	-4.8
		Domestic		% yoy	<u>-3.1</u>	--	-6.8
		Imported		% yoy	<u>-1.3</u>	--	-3.6
		Construction		% yoy	<u>-2.2</u>	--	0.0
Fri 7-Jun	9:00am	CPI inflation	May	% m/m	<u>-0.25</u>	--	0.05
				% yoy	<u>4.32</u>	--	4.41
		Core		% m/m	<u>0.15</u>	--	0.46
				% yoy	<u>3.76</u>	--	3.87

Source: Banorte; Bloomberg

Proceeding in chronological order...

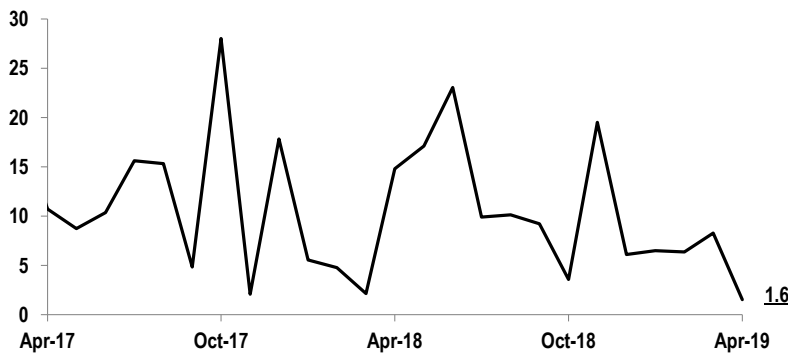
Remittances to grow modestly in April. We expect remittances at US\$ 2,803.8 million (1.6% yoy), moderating relative the previous month at 8.3%. We highlight that the latter is due to a great extent by a challenging base effect, as growth in the same period of 2018 surged to 14.8%. Nevertheless, this would be also be driven by recent trends suggesting that employment of Mexican migrants in the US has been cooling down. Although figures for April were not readily available, we have recently observed that employment by those without citizenship contracted (-0.5% yoy) while those with citizenship moderated at the margin. We believe immigration policies will keep influencing positively the pace of remittances. In particular, tensions increased in April as a result of increased checks at border crossings along more aggressive rhetoric by President Trump.

Moreover, the Mexican peso appreciated slightly, averaging an inch below 19.00 per dollar from 19.25 in the previous month, its strongest since September 2018. This does not encourage higher remittances as the purchasing power in local currency declines. Nevertheless, it is our take that the effect would be relatively modest and asymmetric relative to the historical response observed when the peso depreciates strongly, which induces higher inflows into Mexico.

On a year-to-date basis, remittances would add up to US\$ 10,502.8 million, 5.6% higher than the previous year but significantly below the 7.1% until March. Along with comments from some Banxico members, we believe remittances could slow down gradually following economic activity in the US, which eventually would lead to lower employment growth of Mexican migrants. Nevertheless, we believe they will remain positive overall, which would be also consistent with slower growth in consumption.

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 also be published. Our expectation is for Banxico to start an easing cycle as soon as November with a 25bps cut in said meeting.

Forecasts for GDP will also be published. In the last survey, economists maintained growth estimates for 2019 at 1.5%, in line with our call. For 2020 it was also revised lower to 1.8% from 1.9%. Finally, we could see a marginal revision in the exchange rate, considering that the YE19 forecast stands at USD/MXN 19.80 (Banorte: 20.30).

PMI indices to decline in May, especially manufacturing. We expect the manufacturing index to fall to 50.9pts from 52.0pts sa in April. On balance, news in manufacturing were negative. First, in the previous month the deliveries component was pushed higher by delays in the transit of freight transportation at the US border. As a result, this component picked-up to an almost 2.5 year high in April. In a similar fashion, the inventories component increased significantly. Therefore and as conditions at the border have normalized somewhat, we expect both of them to reverse this. A positive development was that tariffs to Mexican exports of aluminum and steel were lifted. We believe the production component could increase slightly given that new orders have stayed in expansion since the beginning of the year. Nevertheless, the US PMI in May fell to 50.6pts from 52.6pts in the previous month. Overall, we think the surge in the previous month is likely to fade away, with manufacturing still contained by global growth and trade jitters –which escalated between the US and China– along a relatively strong level of the exchange rate.

In services, we anticipate a more modest decline to 51.6pts from 52.4pts, albeit with risks skewed to the downside. According to recent data, dynamism in the sector has been moderating, which in our view could impact the new orders component the most. Moreover, we anticipate employment to fall below the 50pts threshold, with the pace of formal job creation persistently decelerating while labor-intensive industries could start reflecting more forcefully some of the accumulated effect of higher inflation in recent months. Production could have held up relatively strong as signaled by the performance of new orders, which have picked up for five consecutive months. In this respect, this is the only subcomponent in which we expect a better performance.

If our forecasts materialize, they would be consistent with an extension of the slowdown in activity, particularly in industry, with services also more modest but still good. In this sense, the non-tradeable sector is likely to continue exhibiting a better performance when compared to those more exposed to the external front, albeit with increased risks to the downside.

Weekly international reserves report. Last week, net international reserves increased US\$231 million, closing at US\$177.3 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\$2.5 billion during 2019 (please refer to the following table).

Banxico's foreign reserve accumulation detail

US\$, million

	2018	May 24, 2019	May 24, 2019	Year-to-date
	Balance		Flows	
International reserves (B)-(C)	174,793	177,322	231	2,530
(B) Gross international reserve	176,384	184,860	401	8,476
Pemex	--	--	186	233
Federal government	--	--	-89	5,945
Market operations	--	--	0	0
Other	--	--	305	2,298
(C) Short-term government's liabilities	1,592	7,537	170	5,946

Source: Banco de México

Weekly government bond auction. The Ministry of Finance (MoF) –via Banco de Mexico as its financial agent, will offer 30-year fixed-rate Mbonos (Nov'47), 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, May 28th, 2019)

	Maturity	Coupon rate, %	To be auctioned ¹	Previous yield ²
Cetes				
1m	04-Jul-19	--	9,000	8.05
3m	05-Sep-19	--	12,000	8.25
6m	05-Dec-19	--	13,000	8.26
Bondes D				
5y	25-Apr-24	--	6,000	0.13
Mbonos				
30y	07-Nov-47	8.00	4,000	8.57

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

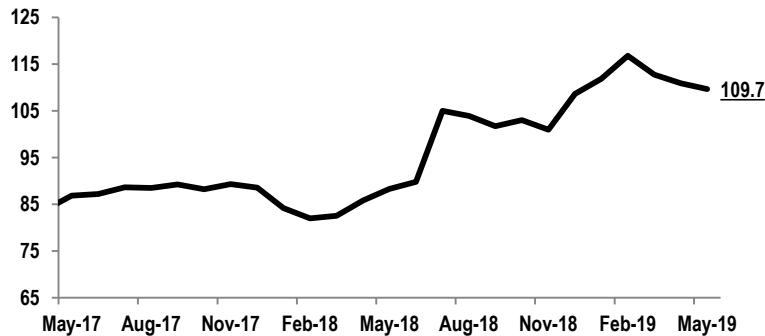
Consumer confidence likely extended its decline for second consecutive month. We expect confidence to fall for a third consecutive month, to 109.7pts from 110.9 in April, which would result in a 3.4% m/m decline with seasonally-adjusted data. As mentioned in other publications, we believe high levels of confidence relative to history are influenced by favorable sentiment about the new government. Nevertheless, in recent months the president's approval ratings have declined. In particular and according to *El Economista* newspaper / *Consulta Mitofsky*, its approval fell from 64.6% in April to 60% by May 19th, practically at the end of the survey period.

To the latter, we add some of the most relevant components within inflation saw higher pressures, such as processed foods and meat and egg, which are bought by consumers with a relatively higher frequency. Annual inflation during the 1st half of May in these categories ended at 4.83% and 3.23%, respectively. Moreover, the Mexican peso depreciated modestly, going from 18.93 to 19.09 per dollar in the interbank market.

Going forward, we believe consumer confidence will keep declining gradually as political optimism fades away, eventually returning towards its long-term average. Nevertheless, the path could be very volatile (as a result of the specific political events in the period).

Consumer confidence

Index, nsa

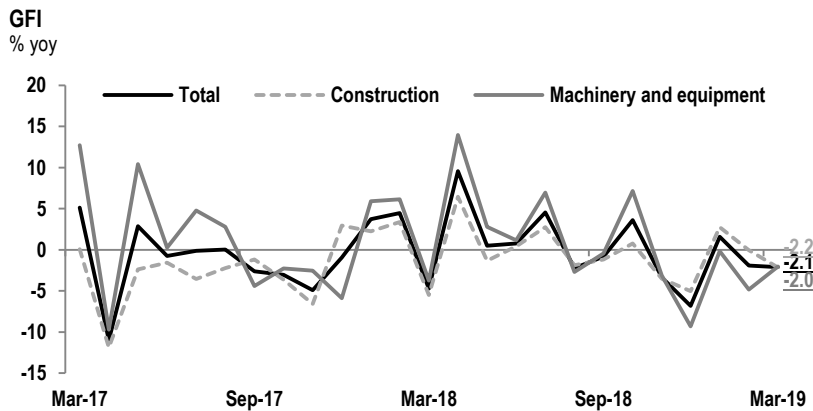


Source: INEGI

Citibanamex Survey. Market focus will center on analysts' inflation forecasts for May (to be published on Friday, June 7th) along with the 2019 year-end estimate. It will be important to see monetary policy assessments for the rest of the year, particularly considering the revisions to both GDP and inflation forecasts in Banxico's Quarterly Report. We will also be paying attention to forecasts for GDP growth and USD/MXN exchange rate.

Gross fixed investment to extend its weakness in March. We anticipate GFI at -2.1% yoy, which would result in a second consecutive month in contraction. This would be quite weak considering that the month was benefitted with additional labor days. Nevertheless, activity according to the IGAE reached 1.3% yoy (-0.6% m/m when using seasonally adjusted data). The worst expected performance would be in construction, which we estimate at -2.2% after being flat in February. In this respect, the IP report showed this sector at -2.9% yoy, lowest year-to-date and with a significant fall particularly in civil engineering (-8%).

On the other hand, we anticipate machinery and equipment (M&E) at -2%. The domestic component is likely to remain negative for tenth consecutive month, at -3.1% in spite of a favorable base effect. The imported component would be more positive, estimated at -1.3% from -3.6% in February. This would be driven by the relative rebound in capital goods imports to +0.2% according to the trade balance. Despite of the latter, performance of investment in the Mexican economy should remain weak, a backdrop we expect to linger at least in 2019. In our view, both the public and private sectors will keep resenting higher uncertainty, lower levels of activity, delays in spending from the Federal government, and high local financing costs.



Source: INEGI, Banorte

Inflation in May helped by the non-core component. We estimate headline at -0.25% m/m and core at 0.15%, both lower than the previous month. Apart from the usual seasonal effect of lower electricity tariffs in the first half, dynamics would be helped by non-core prices, especially fresh fruits and vegetables. Regarding this, our monitoring has not shown a significant effect in tomato prices from the 17.5% tariff imposed by the US at the beginning of May, while other relevant items such as onions and chilies have declined. As a result, we estimate this category to subtract 3bps to the monthly figure. In a similar fashion, we did not identify clear pressures in the “meat and egg” category due to the swine fever in China affecting pig herds, while products such as chicken have also had important downward adjustments. Overall, agro prices would add 4bps, mostly because of pressures in the latter category in the first half of May. Moreover, low-grade gasoline is expected with a -1bp contribution, even with the moderation in fiscal subsidies in recent weeks, while LP and natural gas were also contained. Energy would subtract 38bps.

At the core, we anticipate some components such as processed foods (+2.5bps), other goods (+2bps), and other services (+3.7bps), to remain relatively pressured. We have recently seen some upward adjustments in housing and online streaming services, among others. In this respect, Banxico has kept flagging some concern about dynamics in these sub-indices.

With these results, annual inflation would moderate slightly to 4.32% from 4.41%, while core inflation would also fall to 3.76% from 3.87%, still relatively elevated. In particular, non-core inflation would decline to 5.98% from 6.08%, still higher than the figure at the end of March of 5.47%.

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HOLD	<i>When the share expected performance is similar to the MEXBOL estimated performance.</i>
SELL	<i>When the share expected performance is lower than the MEXBOL estimated performance.</i>

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