

Ahead of the Curve

September 6, 2019

Annual inflation could fall to 3.2% in August

- Inflation (August).** We estimate the headline at +0.02% m/m and the core at +0.20%, both below July's figures. The performance of the non-core component would be very favorable, declining 0.55% and with a negative contribution of 13bps. Most would be concentrated in fruits and vegetables and meat and egg, driven by their behavior in the first half of the month. Moreover, we expect the downward trend in energy to continue, benefited by additional reductions in LP gas and low-grade gasoline. We expect the core component to add 15bps, with a relevant increase in other goods. Nevertheless, other services would subtract around 4bps on lower air fares and tourism services, helping to compensate for the seasonal increase in education. With these results, annual inflation would moderate strongly, standing at 3.20% from 3.78% in July, a new low since October 2016. The non-core component would be fall from 3.64% yoy to 1.43% and the non-core to 3.77% from 3.82% in the same period
- Industrial production (July).** We estimate a ninth consecutive decline on an annual basis, at -1.8% yoy. In seasonally-adjusted terms, we anticipate a 0.4% m/m decline, reversing some of the +1.1% of the previous month. Overall, activity would remain dragged by both mining (-5.4% yoy) and construction (-7.6%), with the latter still weak according to data already published for the sector such as credit flows, employment and business confidence. In contrast, we see a stronger performance in manufacturing (1.9%), displaying some resiliency despite elevated trade tensions. Nevertheless, caution is still granted as manufacturing in the US has extended its slowdown. Going forward, we continue seeing challenges for industry even with some potential mitigating factors such as the recent depreciation of the peso, lower interest rates, and market share gains in the US market, mostly from China. Despite of this, we maintain our view that industrial activity will contract this year around 1.4%

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Document for distribution among the general public

Mexico weekly calendar

DATE	HOUR (EDT)	EVENT	PERIOD	UNIT	BANORTE	CONSENSUS	PREVIOUS	
Mon 9-Sep	7:00am	CPI inflation	Aug	% m/m	0.02	-0.02	0.38	
				% yoy	3.20	3.16	3.78	
			Core	% m/m	0.20	0.19	0.26	
				% yoy	3.77	--	3.82	
Tue 10-Sep		Wage negotiations	August	%	4.6	--	5.9	
Tue 10-Sep	10:00am	International reserves	Sep-6	US\$ bn	--	--	180.4	
Tue 10-Sep	12:30pm	Government weekly auction: 1-, 3-, 6-, 12-month CETES; 10y Mbono (May'29); 30y Udibono (Nov'46); 5y Bondes D						
Wed 11-Sep	7:00am	Industrial production	July	% yoy	-1.8	--	-2.9	
				(sa)	% m/m	-0.4	--	1.1
				Mining	% yoy	-5.4	--	-5.6
				Utilities	% yoy	-0.7	--	1.3
				Construction	% yoy	-7.6	--	-6.8
				Manufactures	% yoy	1.9	--	-0.8

Source: Banorte; Bloomberg

Proceeding in chronological order...

Annual inflation at a new low since late 2016. We estimate headline inflation at +0.02% m/m (previous: 0.38%), with the core at +0.20% (previous: 0.26%). The performance of the non-core component would be very favorable, declining 0.55% and representing a negative contribution of 13bps. Most of this would be concentrated in fruits and vegetables (-5bps) and meat and egg (-7bps). In this sense, the fall would be driven by the behavior observed in the first half of the month, when these components declined significantly on lower prices of some goods such as poultry, onions, avocados, and tomatoes. Nevertheless, our price monitoring suggests this performance will be partially reversed, with a positive contribution in the second fortnight.

On energy, we expect the downward trend to continue, benefited by additional reductions in LP gas prices, which would now add 5 consecutive months lower. Moreover, low-grade gasoline could still improve on lower international prices despite exchange rate pressures. In this context, excise tax subsidies also decreased to the previous month, while retail prices -according to our price monitor- kept falling.

Going to the core, we expect it to add 15bps to the headline, with a relevant increase in other goods (+8bps) due to important increases throughout the month. Meanwhile, we expect processed foods to add 3bps. Nevertheless, other services would subtract around 4bps, driven by lower air fares and tourism services given the end of the summer holiday period. The latter would help compensate for the seasonal increase in education (+4bps), with most of the impact already seen in the first half as classes restarted in colleges and high schools.

With these results, annual inflation would moderate strongly, standing at 3.20% from 3.78% in July, a new low since October 2016 when it reached 3.06%. The non-core component would be the main driver, expected to fall from 3.64% yoy in July to 1.43%. This behavior would be explained by agricultural goods (from 7.06% by YE18 to 3.12%) and energy (improving from 11.62% at YE18 to -1.53%). On the other hand, core inflation would fall to 3.77% from 3.82%, moderating at a much slower pace but with a positive signal as it has been declining since reaching 3.9% in April.

We forecast wage negotiations to climb 4.6% in August. This would be considerably below the 5.9% seen in the previous month. We believe this increase will be explained by a change in composition within the workers benefited by a revision, with the public sector recovering share. In this regard, we highlight the negotiation by workers from the Pemex union, which managed a 3.37% increase in their salary. Using data from previous years, we estimate the number of workers to be around 160,000, which could mean that they concentrate between 45% to 55% of total negotiations within the month. On the other hand, we expect the growth rate within the private sector to remain elevated, expanding around 6.2%.

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 out a moderation in the last quarter of the year given more favorable inflation conditions and a deceleration in economic activity.

Weekly international reserves report. Last week, net international reserves increased US\$114 million, closing at US\$180.4 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\$5.6 billion during 2019 (please refer to the following table).

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

	2018	Aug 30, 2019	Aug 30, 2019	Year-to-date
	Balance		Flows	
International reserves (B)-(C)	174,793	180,377	114	5,584
(B) Gross international reserve	176,384	189,351	263	12,967
Pemex	--	--	-152	19
Federal government	--	--	-22	7,319
Market operations	--	--	0	0
Other	--	--	437	5,630
(C) Short-term government's liabilities	1,592	8,974	149	7,383

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 Udibonos (Nov'46), 5-year Bondes D, in addition to the 1-, 3-, 6-, and 12-month zero-coupon Cetes (see following table). As usual, results will be released at 12:30pm (ET).

Auction specifics (Tuesday, September 10th, 2019)

	Maturity	Coupon rate, %	To be auctioned ¹	Previous yield ²
Cetes				
1m	10-Oct-19	--	6,000	7.81
3m	11-Dec-19	--	9,000	7.80
6m	12-Mar-20	--	14,500	7.63
12m	13-Aug-20	--	14,500	7.78
Bondes D				
5y	22-Aug-24	--	6,500	0.14
M Bono				
10y	31-May-29	8.50	12,200	7.53
Udibono				
30y	03-Nov-50	4.00	UDIS 600	3.58

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

July's industrial production to stay muted despite a rebound in manufacturing. We estimate industrial activity at -1.8% yoy from -2.9% in June. In seasonally-adjusted terms, we anticipate a 0.4% m/m decline, reversing some of the +1.1% of the previous month. Activity should remain dragged by both mining and construction, while manufacturing will likely be more positive, displaying resiliency even with elevated trade tensions, which have impacted the sector not only in Mexico but worldwide.

We expect mining at -5.4% yoy, adding almost five and half years below zero without interruption –banning the September 2018 rebound due to a base-effect related to the earthquakes and hurricane Katia in the previous year–. Crude oil production improved sequentially to 1,696kbbpd, although resulting in a 7.6% fall on an annual basis. Gas inched higher to 0.7%, strongest since March. In non-oil, we also see slightly better figures relative to June, although not enough to escape negative territory. Sector-wide employment keeps falling on an annual basis, consistent with lower activity without surging productivity levels.

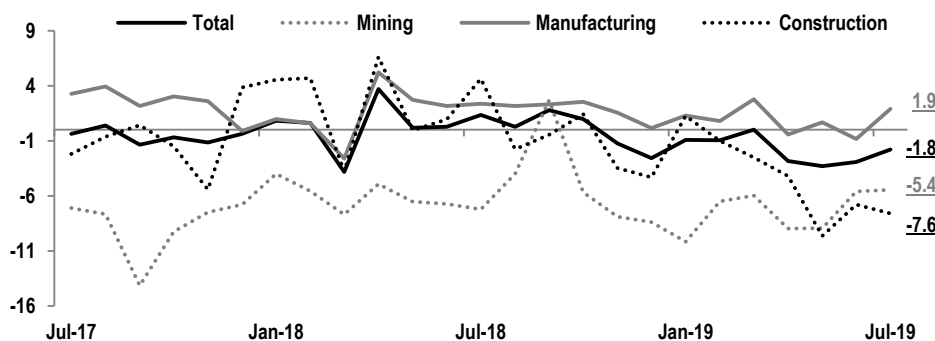
Moreover, we anticipate a 7.6% fall in construction, below the -6.8% in June and partially affected by a more difficult base-effect. In our view, the sector remains affected by the suspension of construction in Mexico City, which has been among the main drags since the start of the year. News reports suggest the government is aiming to reactivate the sector, with business chambers also looking for a stronger performance in 2H19. Nonetheless, it will likely remain on the downside at least this month, gradually improving as projects are kick-started. In this respect, other available data such as credit flows, employment, and business confidence, suggests that activity kept declining.

Last but not least and on a more positive note, manufacturing could improve to 1.9% from -0.8%, as suggested by the rebound in non-oil intermediate goods imports (+7.3% yoy) and exports. This signal is reinforced by auto production, back to positive after two consecutive months down. Nevertheless, caution is still granted as US manufacturing has extended its slowdown, including the -0.6% fall in July IP and the additional downshift in August ISM and PMI indices. This is likely to remain as a headwind given the deep integration of supply chains. Employment decelerated further, which we take as an additional sign of modest dynamism despite being a lagging indicator.

Going forward, we continue seeing challenges as the global economy slows, with high domestic and global uncertainty. On the other hand, some mitigating factors include: (1) The recent depreciation of the peso; (2) lower interest rates globally and also by Banxico; and (3) market share gains in the US, mostly from China. Despite all, we maintain our 2019 forecast of -1.4% in industrial activity.

Industrial production

% yoy



Source: INEGI, Banorte

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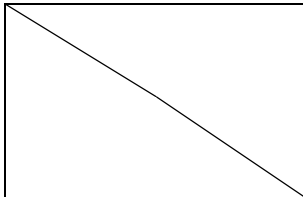
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