

Ahead of the Curve

Inflation to rebound in 1H-Apr while economic activity would moderate in February

- **Bi-weekly inflation report (1H-April).** We estimate the headline at -0.14% 2w/2w and core at 0.29%. Dynamics during the period would be influenced by the beginning of the seasonal fall in electricity tariffs due to summer discounts, along price increases due to the *Easter* holiday. With these results, annual inflation would return above the upper bound of Banxico's target range, to 4.27% from 4.00%, with core inflation increasing 3.55% in March to 3.82%
- **Economic Activity Indicator (February).** We expect economic activity at 0.8% yoy. In the monthly comparison we forecast a 0.2% contraction, which would reverse the advance of the previous month. In our view, data will be impacted by transitory shocks with a lagged effect as companies could have built-up inventories before cutting production. In this respect, we estimate services at 1.6% yoy, decelerating from the 2.2% advance in January, with a slowdown in retail sales to 0.3%. As published previously, industrial activity fell 0.8% yoy (+0.3% m/m). If our forecast materializes, the probability of an outright contraction in economic activity (with seasonally-adjusted figures) would increase at the margin.

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Mexico weekly calendar

DATE	HOUR (ET)	EVENT	PERIOD	UNIT	BANORTE	CONSENSUS	PREVIOUS
Mon 22-Apr	4:30pm	Citibanamex bi-weekly survey of economic expectations					
Tue 23-Apr	10:00am	Unemployment rate	March	%	<u>3.12</u>	3.11	3.30
		sa		%	<u>3.46</u>	3.46	3.42
Tue 23-Apr	10:00am	International reserves	Apr-17	US\$ bn	--	--	176.5
Tue 23-Apr	12:30pm	Government weekly auction: 1-, 3-, 6-, and 12-month Cetes; 30y MBono (Nov'47); 30y Udibono (Nov'46); 5y Bondes D					
Wed 24-Apr	9:00am	CPI inflation	1H Apr	% 2w/2w	<u>-0.14</u>	-0.14	0.12
				% yoy	<u>4.27</u>	4.25	4.06
		Core		% 2w/2w	<u>0.29</u>	0.24	0.14
				% yoy	<u>3.82</u>	--	3.60
Thu 25-Apr	9:00am	Retail sales	February	% yoy	<u>0.3</u>	0.5	0.9
		sa		% m/m	<u>0.8</u>	0.5	1.9
Fri 26-Apr	9:00am	Economic activity IGAE	February	% yoy	<u>0.8</u>	1.1	1.3
		sa		% m/m	<u>-0.2</u>	--	0.2
		Primary activities		% yoy	<u>1.2</u>	--	3.8
		Industrial production		% yoy	<u>-0.8</u>	--	-0.9
		Services		% yoy	<u>1.6</u>	--	2.2
Fri 26-Apr	9:00am	Trade balance	March	US\$ mn	<u>1,624.7</u>	2,062.0	1,221.6
		Total exports		% yoy	<u>4.5</u>	--	3.5
		Oil exports		% yoy	<u>-1.9</u>	--	-0.7
		Non-oil exports		% yoy	<u>4.9</u>	--	3.8
		Total imports		% yoy	<u>4.9</u>	--	2.7

Source: Banorte; Bloomberg

Proceeding in chronological order...

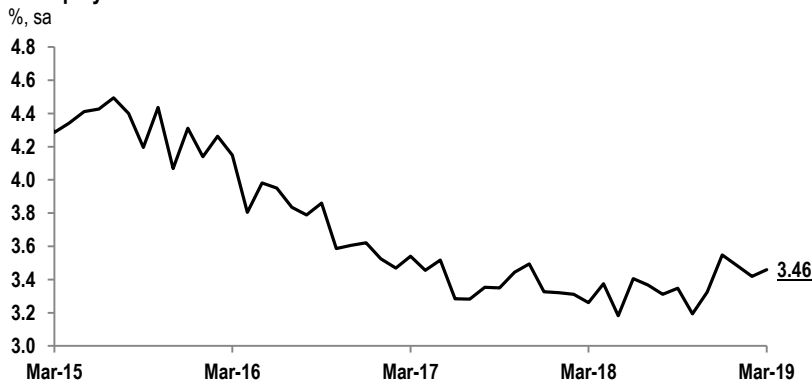
Citibanamex Survey. Market focus will center on analysts' inflation forecasts for the first half of April (to be published on Wednesday, April 24th) along with the 2019 year-end estimate. Furthermore, it will be important to see monetary policy assessments for the rest of the year, particularly after the latest minutes from Banxico. We will also be watching forecasts for GDP growth and USD/MXN exchange rate.

The unemployment rate could reflect the lower pace of economic activity and job creation. We estimate the unemployment rate at 3.46% sa in March, a slight increase relative to the 3.42% of the previous month. In our view, activity and the pace of job creation suggest that the unemployment rate may have picked up modestly, although with relatively high uncertainty about the net impact of recent temporary shocks to the economy.

It is worth noting that the pace of formal job creation keeps moderating, increasing 2.8% yoy in March, below the 3.1% of the previous month and its lowest since February 2014. This is relevant considering that the *Easter* holiday this year took place in April, while last year was in March. In this respect, the base-effect for this print would be positive given that labor days this year were higher, which would theoretically induce more employment at the margin. On the contrary, the employment component of the PMI non-manufacturing index actually increased in March by 2.3pts to 50.9pts, in expansion territory and strongest in almost one year.

Despite surprising to the downside in the last couple of months, we believe the decline in the unemployment rate is limited as economic activity has been weaker at the start of 2019, a situation we expect to continue at least during the first half. Considering that the unemployment rate is a lagging indicator, the *IGAE* grew only by 0.2% m/m in January but we expect it at -0.2% in February, erasing the advance seen in the first month of the year.

Unemployment rate



Source: INEGI, Banorte

Weekly international reserves report. Last week, net international reserves fell by US\$1 million, closing at US\$176.5 billion. According to Banxico's report, this figure comes mainly from a negative valuation effect in central bank assets. In this context, the central bank's international reserves have increased US\$1.7 billion during 2019 (please refer to the following table).

Banxico's foreign reserve accumulation detail

US\$, million

	2018	Apr 12, 2019	Apr 12, 2019	Year-to-date
	Balance		Flows	
International reserves (B)-(C)	174,793	176,465	-1	1,672
(B) Gross international reserve	176,384	184,340	2,681	7,956
Pemex	--	--	24	118
Federal government	--	--	2,582	6,399
Market operations	--	--	0	0
Other	--	--	75	1,438
(C) Short-term government's liabilities	1,592	7,875	2,682	6,283

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), 30-year inflation-linked Udibonos (Nov'46), 5-year Bondes D, in addition to the “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, April 23rd, 2019)

	Maturity	Coupon rate, %	To be auctioned ¹	Previous yield ²
Cetes				
1m	23-May-19	--	5,000	7.81
3m	25-Jul-19	--	9,000	8.05
6m	24-Oct-19	--	11,000	8.12
12m	23-Apr-20	--	13,000	8.05
Bondes D				
5y	29-Feb-24	--	6,000	0.15
Mbonos				
30y	07-Nov-47	8.00	4,000	8.47
Udibonos				
30y	08-Nov-46	4.00	UDIS 450	4.10

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 1H-April explained by lower energy prices, but with pressures in other services. We estimate headline inflation at -0.14% 2w/2w, while core inflation would stand at 0.29%, picking up from 0.14% in the previous print. Dynamics during the period would be influenced by the beginning of the seasonal fall in electricity tariffs due to summer discounts, along price increases due to the *Easter* holiday.

We anticipate non-core inflation at -1.4% 2w/2w. In particular, we anticipate a -33pbs contribution of energy, from which -30bps would be due to electricity tariffs. Moreover, we anticipate a decline of 2.5bps in low-grade gasoline, mostly as a result of a higher fiscal stimulus. Moreover, agricultural prices would subtract 4pb, from which fresh fruits would explain -5bps mainly on lower tomato prices and some chilies according to our price monitoring.

On the contrary, the core component would contribute +21bps. The bulk of the increase will likely be concentrated in other services. Specifically, prices of airfares (+3bps) and tourism services (+4bps) would reflect higher demand ahead of the holiday. Moreover, we expect core goods to remain relatively pressured, particularly processed foods in which we see a 0.2% 2w/2w advance.

With these results, annual inflation would return above the upper bound of Banxico's target range to 4.27% from 4.00%. Broadly speaking, this increase is consistent with our forecasted path, in which different dates for *Easter* in each year had a positive effect in March that reverts in April. This would also be observed at the core level, which would pick-up from 3.55% in March to 3.82%. Last but not least, non-core inflation also increases, going from 5.47% to 5.66%.

Mixed results for February retail sales, limited by autos. We estimate a 0.3% yoy increase, below the 0.9% of the previous month. In seasonally-adjusted terms, we expect a 0.8% m/m expansion, also lower than the latest print at 1.9%. Broadly speaking, advanced figures released so far show mixed results, with most improving in their annual comparison relative to January.

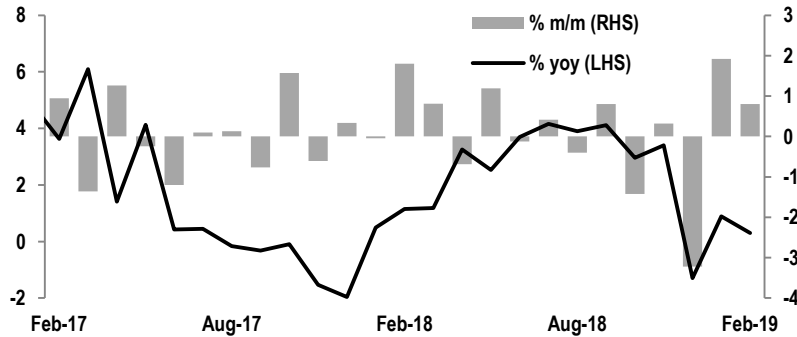
Auto sales fell 5.5% yoy according to *AMIA*, reverting back to negative territory after a surprise pickup of 1.8% in January. Moreover, the pace of formal job creation keeps moderating as it reached 3.1% in the month, lowest since April 2014. The FX rate was higher at the margin, going from 19.16 to 19.20 pesos per dollar on average, with the peso depreciating by 3% annually. According to Pemex, gasoline sales to distributors declined -6%, better at the margin when compared to the previous month when fuel distribution problems were strongest.

On a more positive note, the main support behind private consumption is likely to continue to be the recovery in real wages, growing 2.9% yoy, best since December 2003. This has been driven by both higher nominal wages and lower inflation, with the latter falling to 3.9% from 4.4% in the previous month. Nevertheless and as already mentioned, the impact is likely to be relatively limited due to the moderation in employment growth, while we believe high confidence will not be a catalyst for a stronger expansion in actual sales as they are increasingly driven by political optimism. Moreover, non-oil consumption imports reached 2.6% yoy, accelerating when compared to the 0.6% observed in January. Last but not least, both *ANTAD* and *Walmart* sales improved in their annual comparison, standing at -0.6% and +1.4%, respectively

If our forecast materializes, we believe retail sales growth in 1Q19 will be quite weak in annual terms, particularly considering the modest advance expected in February but also that March 2019 will be distorted negatively by the timing of the Easter holiday. Nevertheless, most fundamentals for consumption remain strong, highlighting real wage growth and the acceleration in the implementation of government transfers programs in recent weeks, along the still relatively elevated pace of growth in remittances.

Retail sales

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



Source: INEGI, Banorte

IGAE to weaken in February, impacted by transitory shocks. We estimate the *Economic Activity Indicator* (IGAE) at 0.8% yoy. In the monthly comparison (using seasonally-adjusted figures), we expect a 0.2% contraction, which would reverse the advance of the previous month. In our view, activity will be impacted by transitory shocks that were mostly experienced in January, but with a lagged effect as companies could have built-up inventories before cutting production.

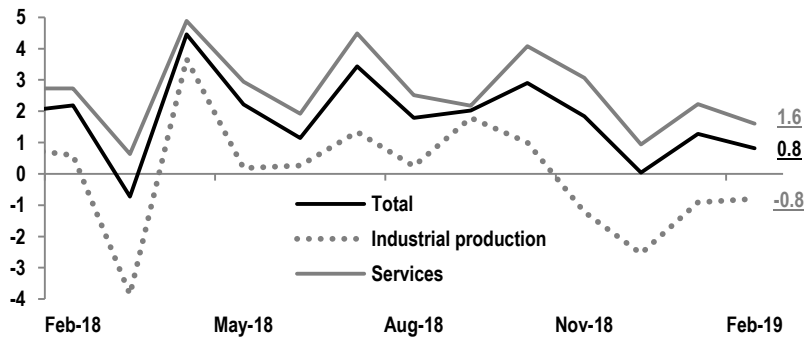
In this respect, we estimate services at 1.6% yoy, decelerating from the 2.2% advance in January. It is our take that transportation services could have remained affected by these shocks, particularly as the railway blockades in Michoacán were lifted until the middle of the month. The latter would be broadly consistent with the deceleration in manufacturing according to the industrial production report. Additionally and as already mentioned above, we forecast a slowdown in retail sales. Last but not least, employment in services maintains a downward trend as it grew 3% yoy, its weakest since August 2014.

As already known, industrial activity fell 0.8% yoy (+0.3% m/m) as a result of the fall in three out of the four sectors, highlighting the 6.4% decline in mining and of 1.1% in construction (and with significant payback from the strong print of the previous month). Nevertheless and as already mentioned, manufacturing grew 1.1%.

If our forecast materializes, the probability of an outright contraction in economic activity (with seasonally-adjusted figures) would increase at the margin. In particular, the 3m/3m saar would decline to -1.1% from -0.1% in January (to -0.3% from zero not annualized, respectively). Nevertheless, in the annual comparison a negative print is practically discarded as March data will be influenced positively by the timing of the *Easter* holiday.

IGAE

% yoy (nsa)



Source: INEGI, Banorte

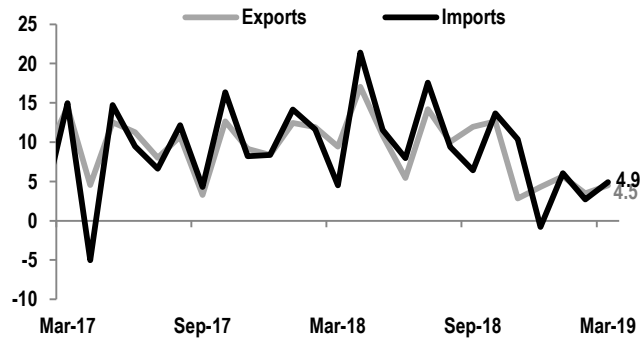
Trade balance likely with a surplus for a second consecutive month. We expect a US\$1,624.7 million surplus in March, slightly higher than the US\$ 1,221.6 million of the previous month. It is worth mentioning that growth in both exports and imports will likely be influenced by the timing of the *Easter* holiday, which was in March in 2018 as opposed to April this year. We estimate exports to grow 4.5% yoy from 3.5% in the previous month, while imports could pick up to 4.9% from 2.7%.

The oil balance is expected to worsen at the margin at –US\$ 1,806.4 million. This would be driven by lower exports (-1.9% yoy), as available information suggests crude-oil volumes dropping 8.5% yoy but with a positive price effect, with the Mexican oil mix from 57.02 to 59.96 US\$/bbl during the month. Despite of the latter, the decline in oil imports would moderate to -2.8% yoy, from -9.5% in February. In particular, gasoline prices in the US (our main source of this product) surged 22.4% m/m in March. We estimate this to lower the pace of decline in oil-related consumption goods to -15.4% yoy from -22.7%, aided also by stronger intermediate goods imports. All in all, with these figures the 12-month rolling deficit would reach US\$ 23.3 billion.

On the contrary, we estimate the non-oil balance to widen to a US\$ 3,431.0 million surplus from +US\$2,214.8 million previously. We see manufacturing exports improving to 5.3% yoy from 4%, driven by non-auto which we estimate at 7.6%. It is our take that these will recover some of the lost ground February (when it declined 2.3% m/m sa) as they were impacted by transitory supply chain disruptions. Autos would show a more modest gain of 1.6%, with a challenging base effect (growing at an above 15 percent rate in the same month of 2018) and autos in the US falling 1% according to the IP report, returning to negative after a brief pickup in the previous month. On the other hand, it is worth mentioning that the ISM manufacturing import component rebounded in March to 51.5pts. Non-oil imports are estimated at 5.9% yoy, higher than the 4.3% observed in February. This is partly explained by the timing of the *Easter* holiday and its effect on both labor days and in terms of a positive base effect, given that these fell 0.7% in 2018 (when the holiday was at the end of March). Consumption goods are seen as staying resilient at 4.4%, with intermediate goods at 6% while capital goods would remain weak at -0.4%.

Exports and Imports

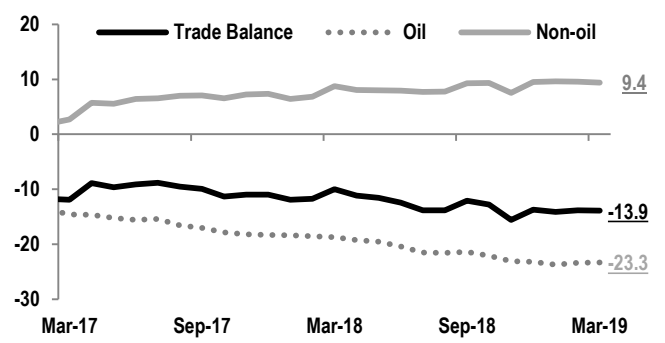
% yoy



Source: INEGI, Banorte

Trade balance

US\$ billion, 12-month rolling sum



Source: INEGI, Banorte

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