

Ahead of the Curve

Inflation to reach 3.67% in July and IMEF indicators to signal an extension of their advance in the same month

- Inflation (July).** We estimate headline inflation at 0.71% m/m, with core prices up 0.42%. We should mention that [the first fortnight surprised to the upside](#), particularly on higher core goods. At the non-core, energy prices contributed the most in the first half as both LP gas and gasolines still trended higher. We expect these to increase again in the second fortnight, albeit more modestly. With these results, annual inflation would reach 3.67% from 3.33% in June –highest since March– and the core to 3.87% from 3.71% previously. Meanwhile, the non-core is estimated at 3.06% from 2.16%, increasing for third consecutive month but still low relative to long-term averages
- IMEF indicators (July).** We estimate a rebound in both indicators for second consecutive month, once again driven by the gradual reopening of the economy. However, we still believe they will remain in contraction, even when observing signs of a recovery in other data. The manufacturing indicator would increase 4.4pts to 46.4pts, highest since February. On the other hand, the non-manufacturing index would increase 3.0pts, to 45.5pts

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www.banorte.com
@analisis_fundam

Juan Carlos Alderete, CFA
Director of Economic Research
juan.alderete.macal@banorte.com

Francisco Flores
Senior Economist, Mexico
francisco.flores.serrano@banorte.com

Winners of the award for best economic forecasters for Mexico in 2019, granted by *Refinitiv*



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Mexico weekly calendar

DATE	HOUR (ET)	EVENT	PERIOD	UNIT	BANORTE	CONSENSUS	PREVIOUS
Mon 3-Aug	10:00am	Family remittances	June	US\$ mn	<u>3,244.9</u>	--	3,379.4
Mon 3-Aug	10:00am	Banxico's survey of economic expectations	July				
Mon 3-Aug	1:00pm	PMI's survey (IMEF)	July				
		Manufacturing		indicator	<u>46.4</u>	--	42.0
		Non-manufacturing		indicator	<u>45.5</u>	--	42.5
Tue 4-Aug	10:00am	International reserves	Jul-31	US\$ bn	--	--	192.3
Wed 5-Aug	3:30pm	Citibanamex bi-weekly survey of economic expectations					
Thu 6-Aug	7:00am	Gross fixed investment	May	% y/y	<u>-39.6</u>	--	-36.9
		sa		% m/m	<u>-4.3</u>	--	-28.9
		Machinery and equipment		% y/y	<u>-44.8</u>	--	-37.9
		Construction		% y/y	<u>-35.3</u>	--	-36.2
Thu 6-Aug	7:00am	Private consumption	May	% y/y	--	--	-22.3
		sa		% m/m	--	--	-19.7
		Domestic (Goods and services)		% y/y	--	--	-21.2
		Imported (Goods)		% y/y	--	--	-31.8
Fri 7-Aug	7:00am	CPI inflation	July	% m/m	<u>0.71</u>	--	0.55
				% y/y	<u>3.67</u>	--	3.33
		Core		% m/m	<u>0.42</u>	--	0.37
				% y/y	<u>3.87</u>	--	3.71

Source: Banorte; Bloomberg

Proceeding in chronological order...

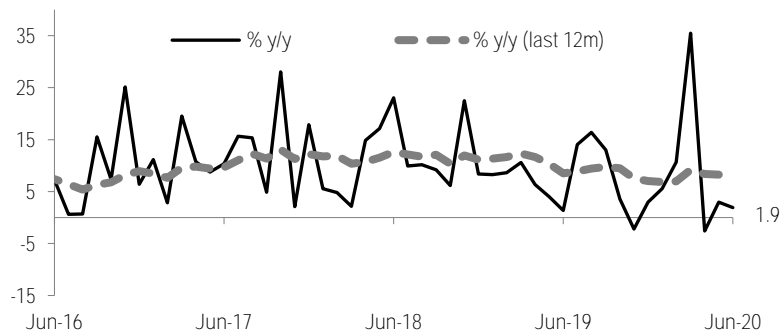
Remittances to slightly decelerate in June. We expect remittances to increase 1.9% y/y to US\$3,244.9 million, lower than the 3.0% expansion of the previous month. In this sense, flows have remained resilient in the last three months despite strong shocks to the US labor market. Nevertheless, we believe this situation cannot continue for much longer, considering that savings are probably being depleted and a strong recovery to pre-pandemic levels still looks distant. We expect migrants to continue their extraordinary efforts to support their families, giving some support to the figure.

In this context, employment conditions in June marginally improved relative to May, albeit remaining sharply worse when compared to levels seen before the pandemic. The unemployment rate among the Hispanic or Latino population came in at 14.5%, 2.1%-pts lower than the previous month's reading. Meanwhile, the total number of direct or indirect Mexican migrants rose by 140.6 thousand, still almost 700 thousand less than in March, limiting the possibility of additional upside. In terms of jobs, 943.9 thousand positions were created, with 89.6% concentrated among 'natives', with 'non-native citizens' and 'non-citizens' also improving, but much more modestly. This is relevant as we believe these two groups are likelier to send remittances, particularly the latter. It should be noted that since March, 1.8 million jobs have been lost between the three groups.

Moreover, there were relevant announcements on migration, as the Supreme Court upheld DACA (Deferred Action for Childhood Arrivals) on June 18th, while the Federal Administration announced travel restrictions on different types of visas, later backtracked on. Another relevant development was the approval of expedited procedures to extradite migrants with less than two years of residence in the US. In this sense, the balance is relatively mixed, which considering the current environment, possibly did not have a substantial effect in monthly performance. Finally, the Mexican peso traded slightly stronger, going from USD/MXN 23.42 in May to 22.30 in June. However, and similar to the situation already described, this probably did not have a significant impact on dynamics given migrants' efforts to send as much resources as possible.

All in all, performance should be telling over the path going forward, considering additional efforts to restart the US economy. Nevertheless, we still believe risks are tilted to the downside as the uptick in COVID-19 cases in July has pushed some cities and states to re-impose stricter social distancing measures, impacting the recovery of activity and thus, job creation.

Family remittances
% y/y



Source: Banxico

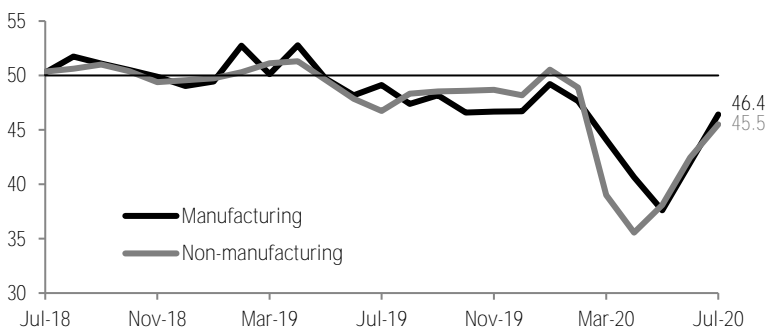
Banxico’s survey of economic expectations. As usual, market participants will focus on inflation, growth, reference rate, and exchange rate forecasts. In the first, analysts expect 2020 year-end inflation at 3.34%, below [our 3.7% estimate](#). Considering latest inflation dynamics, we do not rule out some marginal revisions to the upside. Meanwhile, medium and long-term expectations could remain unchanged, still above target. On GDP, this year’s estimate stands at -8.8% (Banorte: -9.8%). It should be noted that the survey was carried out before the release of the [2Q20 preliminary report](#), leading us to believe that changes might be modest. The current view on the reference rate by YE20 is 4.50%, which could remain unchanged given recent dynamics in more timely surveys (Banorte: 4.00%). Finally, the year-end exchange rate stands at USD/MXN 22.66, which could also show marginal adjustments (Banorte: 22.00).

IMEF indicators to keep improving in July. We estimate an additional rebound in both indicators, once again driven by the gradual reopening of the economy. However, we still believe they will remain in contraction territory, even when observing signs of a recovery in other data.

The manufacturing indicator would increase 4.4pts to 46.4pts, highest since February. Signals in the latest [trade balance report](#) and [2Q20 GDP](#) suggest the economy started to bounce back in June, although still at a very gradual pace. Considering that restrictions were relatively similar in July, coupled with a rise in mobility according to *Apple* and *Google*, we believe activity will show an additional improvement. This is supported by higher dynamism in the US, with *Markit’s* PMI standing at 51.3pts from 49.8pts. According to the report, the rebound in production was explained by a greater inflow of raw materials, which we believe is a favorable signal for the sector in Mexico. In addition, comments from industry representatives and other anecdotal evidence suggests a better performance. In this context, we anticipate new orders and production to be the components with the highest increases, with modest adjustments in the rest, with special attention on employment. Going forward, we will investigate performance in the US given that the increase in cases has resulted in some states implementing stay-at-home orders once again, possibly causing new disruptions to supply chains and thus affecting domestic production.

The non-manufacturing index would also improve, although its advance would be more moderate, increasing 3.0pts to 45.5pts. Although we expect increases in categories such as commerce and basic services, recreational and tourism-related services would continue showing significant weakness given the extension of the pandemic. In the former, we think the increase would be explained by higher mobility, as previously mentioned, but more so by the reopening of malls and other stores in several states (such as Mexico City and the State of Mexico). Meanwhile, it is likely that other defensive categories, such as financials and health care, will remain resilient. On the other hand, even though we have seen a slight increase in seated diners in *Open Table* figures, data still shows strong declines in the annual comparison, leading us to believe that an advance would only be marginal. In the next few months we believe performance of this sector relative to the manufacturing indicators will be slower, with the latter benefiting from greater external demand –supported by stimulus measures in the US– while the non-manufacturing would be impacted by the deterioration in employment conditions, and as a result, consumption fundamentals.

IMEF indicators
Diffusion indicators, sa



Source: IMEF

Weekly international reserves report. Last week, net international reserves increased by US\$824 million, closing at US\$192.3 billion. According to Banxico’s report, this was explained by: (1) Sales of US\$540 million from the Federal Government to the central bank; and (2) a positive valuation effect in institutional assets of US\$284 million. In this context, the central bank’s international reserves have increased by US\$11.4 billion so far in 2020 (please refer to the following table).

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

	2019		Jul 24, 2020	
	Balance	Jul 24, 2020	Balance	Flows
International reserves (B)-(C)	180,877	192,292	824	11,415
(B) Gross international reserve	183,028	197,744	518	14,716
Pemex	--	--	648	3,367
Federal government	--	--	-234	6,391
Market operations	--	--	0	0
Other	--	--	104	4,958
(C) Short-term government's liabilities	2,151	5,451	-306	3,301

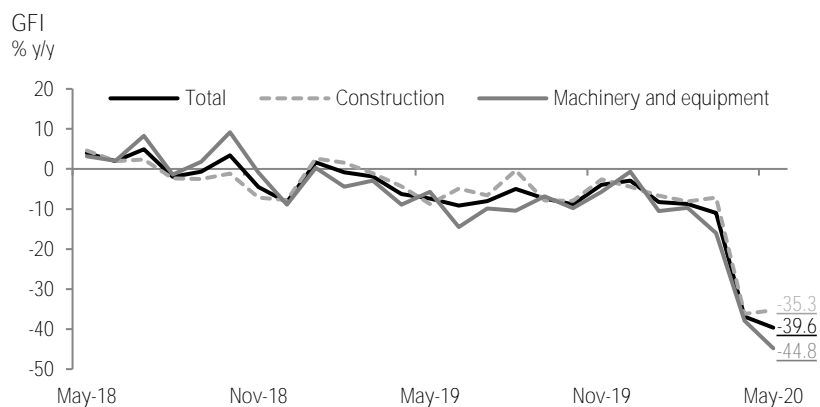
Source: Banco de México

Another considerable drop in investment in May. We expect GFI to decline 39.6% y/y, below the -36.9% of the previous month. This would be explained by additional weakness due to the pandemic shock –evidenced in several reports for the period– as well as an adverse impact in terms of working days in the annual comparison, even after a more favorable base effect. Despite of this, the figure would remain slightly above the lows seen in the midst of the Tequila Crisis (2Q95 and 3Q95). In monthly terms we expect a 4.3% m/m contraction (sa).

All sectors would remain negative, albeit with the fall exacerbated by machinery and equipment (M&Eq.), coming in at -44.8% y/y (previous: -37.9%). Relative to April, we believe the plunge will be more sizable in the imported component (-38.7% vs. -28.9% previously), although with domestic M&Eq staying in deep negative territory (-53.4% vs -52.6%). In the former, the [trade balance report](#) showed a 38.3% y/y contraction in capital goods imports, a new low since late 1995. Accumulated currency weakness was likely an additional drag. For the domestic branch, manufacturing data within the [IP report](#) remain unfavorable, but hinted at a slight rebound. We saw additional declines in relevant categories such as M&Eq manufacturing and electrical/electronic equipment; meanwhile, transportation showed a marginal recovery.

In construction, we could see a slight increase in the annual comparison, coming in at -35.3% vs. -36.2% in the previous month. This is similar to dynamics within industrial activity, where we saw a 36.3% decline, 1.6%-pts higher than April. Nevertheless, this was mostly due to a favorable base effect, given that monthly figures did show an additional deterioration. In this sense, aggregate trend and confidence indicators were lower again, standing at new historical lows until improving in June. Meanwhile, public finance data showed that federal spending in physical investments went up 48.4% y/y in real terms. Nevertheless, this does not seem to have translated strongly into higher activity.

Going forward we could start seeing a recovery given the restart of construction and other sectors within manufacturing, on top of the recent uptick in [capital goods imports](#). Nevertheless, it is our take that an investment rebound will be very slow, impacted by uncertainty about the short- and medium-term outlook amid many unknowns regarding the virus and its implications for the economy. In addition, and given the effects of the shock so far, the financial position of many businesses has been compromised, which is very relevant for capital spending possibilities.



Source: INEGI, Banorte

Weakness to persist in private consumption during May. In the last few months, private consumption in the domestic market has fallen in the annual comparison as a result of the pandemic. In particular, in April it declined 22.3% y/y, lowest in history. We believe this comes as a result of both stores closing down, limiting purchasing options and triggering changes in consumption patterns, as well as the shock on employment conditions, leading to people being more careful with their spending. In this sense, dynamics have been telling so far, seeing strong declines in purchases of durables (domestic: -48.3% y/y; imported: -46.6%) and semi-durable goods (domestic: -75.6%; imported: -33.3%) in April. Meanwhile, consumption of non-durable items –where food and healthcare items are included– have posted a more resilient performance within [retail sales](#) (domestic: -5.7%; imported: -16.9%). In this sense, attention in May’s report will be on their relative performance, still anticipating weakness to persist.

Annual headline and core inflation to increase in July. We estimate headline inflation at 0.71% m/m (previous: 0.55%), with core prices up 0.42% after advancing 0.37% in the previous month. We should mention that the [first fortnight surprised to the upside](#), particularly on higher core goods. At the non-core, energy prices contributed the most in the first half (19bps out of a total 17bps of this category, with around -2bps from agricultural goods) as both LP gas and gasolines still trended higher. We expect these to increase again in the second fortnight, albeit more modestly. With these results, annual inflation would reach 3.67% from 3.33% in June –highest since March– and the core to 3.87% from 3.71% previously. Meanwhile, the non-core is estimated at 3.06% from 2.16%, increasing for third consecutive month but still low relative to long-term averages.

Within the core, pressures are likely to prevail in goods, expected at 0.7% from 0.6% in June. Our monitoring suggests a relative normalization in the recent acceleration of price hikes, with the economy adjusting to the gradual reopening. Nevertheless, downside seems limited somewhat by a significantly weaker MXN relative to the same period a year ago. The latter may be gaining more relevance, with the recent pick up in other goods –which have a more modest share of essential items relative to processed foods, mainly medicines– potentially as an important signal. In contrast, services will remain very contained, expected at 0.1%. We highlight that the second fortnight is typically negative in airfares and tourism services on summer seasonality. Although we expect this to repeat, we believe it will be more modest as airlines’ profit margins are already quite challenged.

Going to the non-core, we expect agricultural goods at -1.2% and energy at 4.0%, albeit with the latter moderating in the second fortnight after trending significantly higher since the second half of May. We expect low-grade gasoline up by 1% 2w/2w (previous: 3.0%), with US prices and the exchange rate more stable, while subsidies to excise taxes remain at zero. LP gas would observe similar dynamics after recent pressures. In agricultural goods, our monitoring identified a reversal of the decline in fresh fruits and vegetables in the second half of the month. Specifically, we observed higher prices in tomatoes, with scattered reports of lower production and some focalized problems due to heavy rains. Others relevant increases included apples and lemons. On the other hand, within meat and egg we expect only a modest uptick.

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We, Gabriel Casillas Olvera, Alejandro Padilla Santana, Delia María Paredes Mier, Juan Carlos Alderete Macal, Manuel Jiménez Zaldivar, Marissa Garza Ostos, Tania Abdul Massih Jacobo, Francisco José Flores Serrano, Katia Celina Goya Ostos, Santiago Leal Singer, José Itzamna Espitia Hernández, Valentín III Mendoza Balderas, Víctor Hugo Cortes Castro, Hugo Armando Gómez Solís, Miguel Alejandro Calvo Domínguez, Luis Leopoldo López Salinas, Leslie Thalía Orozco Vélez, Gerardo Daniel Valle Trujillo, Eridani Ruibal Ortega and Juan Barbier Arizmendi, certify that the points of view expressed in this document are a faithful reflection of our personal opinion on the company (s) or firm (s) within this report, along with its affiliates and/or securities issued. Moreover, we also state that we have not received, nor receive, or will receive compensation other than that of Grupo Financiero Banorte S.A.B. of C.V. for the provision of our services.

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GRUPO FINANCIERO BANORTE S.A.B. de C.V.

Research and Strategy			
Gabriel Casillas Olvera	IRO and Chief Economist	gabriel.casillas@banorte.com	(55) 4433 - 4695
Raquel Vázquez Godínez	Assistant	raquel.vazquez@banorte.com	(55) 1670 - 2967
Lourdes Calvo Fernández	Analyst (Edition)	lourdes.calvo@banorte.com	(55) 1103 - 4000 x 2611
Economic Research and Financial Market Strategy			
Alejandro Padilla Santana	Executive Director of Economic Research and Financial Markets Strategy	alejandro.padilla@banorte.com	(55) 1103 - 4043
Itzel Martínez Rojas	Analyst	itzel.martinez.rojas@banorte.com	(55) 1670 - 2251
Economic Research			
Juan Carlos Alderete Macal, CFA	Director of Economic Research	juan.alderete.macal@banorte.com	(55) 1103 - 4046
Francisco José Flores Serrano	Senior Economist, Mexico	francisco.flores.serrano@banorte.com	(55) 1670 - 2957
Katía Celina Goya Ostos	Senior Economist, Global	katia.goya@banorte.com	(55) 1670 - 1821
Luis Leopoldo López Salinas	Economist, Global	luis.lopez.salinas@banorte.com	(55) 1103 - 4000 x 2707
Market Strategy			
Manuel Jiménez Zaldivar	Director of Market Strategy	manuel.jimenez@banorte.com	(55) 5268 - 1671
Fixed income and FX Strategy			
Santiago Leal Singer	Senior Strategist, Fixed Income and FX	santiago.leal@banorte.com	(55) 1670 - 2144
Leslie Thalía Orozco Vélez	Strategist, Fixed Income and FX	leslie.orozco.velez@banorte.com	(55) 5268 - 1698
Equity Strategy			
Marissa Garza Ostos	Director of Equity Strategy	marissa.garza@banorte.com	(55) 1670 - 1719
José Itzamna Espitia Hernández	Senior Strategist, Equity	jose.espitia@banorte.com	(55) 1670 - 2249
Valentín III Mendoza Balderas	Senior Strategist, Equity	valentin.mendoza@banorte.com	(55) 1670 - 2250
Víctor Hugo Cortes Castro	Senior Strategist, Technical	victorh.cortes@banorte.com	(55) 1670 - 1800
Eridani Ruibal Ortega	Analyst	eridani.ruibal.ortega@banorte.com	(55) 1103 - 4000 x 2755
Juan Barbier Arizmendi	Analyst	juan.barbier@banorte.com	(55) 1670 - 1746
Corporate Debt			
Tania Abdul Massih Jacobo	Director of Corporate Debt	tania.abdul@banorte.com	(55) 5268 - 1672
Hugo Armando Gómez Solís	Senior Analyst, Corporate Debt	hugoa.gomez@banorte.com	(55) 1670 - 2247
Gerardo Daniel Valle Trujillo	Analyst, Corporate Debt	gerardo.valle.trujillo@banorte.com	(55) 1670 - 2248
Economic Studies			
Delia María Paredes Mier	Executive Director of Economic Studies	delia.paredes@banorte.com	(55) 5268 - 1694
Miguel Alejandro Calvo Domínguez	Senior Analyst, Economic Studies	miguel.calvo@banorte.com	(55) 1670 - 2220
Wholesale Banking			
Armando Rodal Espinosa	Head of Wholesale Banking	armando.rodal@banorte.com	(81) 8319 - 6895
Alejandro Aguilar Ceballos	Head of Asset Management	alejandro.aguilar.cebaldos@banorte.com	(55) 5268 - 9996
Alejandro Eric Faesi Puente	Head of Global Markets and Institutional Sales	alejandro.faesi@banorte.com	(55) 5268 - 1640
Alejandro Frigolet Vázquez Vela	Head of Sólida Banorte	alejandro.frigolet.vazquezvela@banorte.com	(55) 5268 - 1656
Arturo Monroy Ballesteros	Head of Investment Banking and Structured Finance	arturo.monroy.ballesteros@banorte.com	(55) 5004 - 1002
Carlos Alberto Arciniega Navarro	Head of Treasury Services	carlos.arciniega@banorte.com	(81) 1103 - 4091
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
Lizza Velarde Torres	Executive Director of Wholesale Banking	lizza.velarde@banorte.com	(55) 4433 - 4676
Oswaldo Brondo Menchaca	Head of Specialized Banking Services	oswaldo.brondo@banorte.com	(55) 5004 - 1423
Raúl Alejandro Arauzo Romero	Head of Transactional Banking	alejandro.arauzo@banorte.com	(55) 5261 - 4910
René Gerardo Pimentel Ibarrola	Head of Corporate Banking	pimentelr@banorte.com	(55) 5268 - 9004
Ricardo Velázquez Rodríguez	Head of International Banking	rvelazquez@banorte.com	(55) 5004 - 5279
Víctor Antonio Roldan Ferrer	Head of Commercial Banking	victor.rolan.ferrer@banorte.com	(55) 5004 - 1454