Ahead of the Curve

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Document for distribution among the general public

Economic activity in May likely remained weak

- **Global Economic Activity Indicator (May).** We estimate a 0.4% yoy contraction, dragged by the very weak performance in industry and a deceleration in services. Using seasonally-adjusted data, we anticipate a 0.2% m/m contraction. As already published, industrial production plunged 3.3% yoy, with construction particularly weak. On the other hand, we estimate services at 0.8%, which would be quite low even after taking into account a slightly negative base effect. Retail sales likely grew moderately, while government-related services and healthcare would remain affected by austerity measures of the Federal Government. If our forecast materializes, activity during the first two months of 2Q19 would be at -0.9% yoy, remembering that this metric is skewed to the downside because of the timing of the Holy Week. Nevertheless, it would be tracking at a weak pace, while June data released so far also suggests muted levels of activity

- **Inflation report (July-1H).** We estimate headline inflation at 0.22% 2w/2w and the core component at 0.15%. In contrast with recent fortnights, we anticipate the non-core component to have a positive contribution, rising 0.46% 2w/2w (equivalent to 11bps), with specific pressures in agricultural goods and, to a lesser extent, in energy prices. Regarding the core component, we believe most of the increase would be related to the summer holiday period, mostly impacting other services. With these results, annual inflation would keep moderating, standing at 3.79% from 3.95% in June, taking hold below the upper bound of Banxico's variability range. The core component would go to 3.79% from 3.85%

Mexico weekly calendar

DATE	TIME (ET)	EVENT	PERIOD	UNIT	BANORTE	CONSENSUS	PREVIOUS
Mon 22-Jul	**4:30pm**	**Citibanamex bi-weekly survey of economic expectations**					
Tue 23-Jul	**10:00am**	**International reserves**	Jul-20	US$ bn	--	--	178.8
Tue 23-Jul	**12:30pm**	**Government weekly auction: 1-, 3-, 6-months CETES; 3y Mbono (Dec'21); 3y Udibonos (Jun'22)**					
Wed 24-Jul	**9:00am**	**CPI inflation**	1H July	% 2w/2w	0.22	0.31	0.14
				% yoy	3.79	3.82	3.89
		Core		% 2w/2w	0.15	0.17	0.11
				% yoy	3.79	--	3.83
Thu 25-Jul	**9:00am**	**Retail sales**	May	% yoy	1.2		1.6
		(sa)		% m/m	-0.1		0.7
Fri 26-Jul	**9:00am**	**Economic activity indicator**	May	% yoy	-0.4		-1.4
		(sa)		% m/m	-0.2	--	0.1
		Primary activities		% yoy	1.2	--	1.3
		Industrial production		% yoy	-3.3	--	-2.9
		Services		% yoy	0.8	--	-0.8
Fri 26-Jul	**9:00am**	**Trade balance**	June	US$ mn	974.7		1,030.7
		Total exports		% yoy	4.9	--	6.7
		Oil exports		% yoy	-14.9	--	-6.9
		Non-oil exports		% yoy	6.3	--	7.7
		Total imports		% yoy	-0.1	--	0.1

Source: Banorte; Bloomberg

Proceeding in chronological order...

***Citibanamex* Survey.** Markets will center on analysts' inflation forecasts for the first half of July (to be published on Wednesday, July 24th) along with the 2019 year-end estimate. It will be important to see monetary policy assessments, particularly after the latest monetary policy minutes, in which we perceived a slightly dovish tone on inflation and growth, while concerns on financial stability were still present. We will also pay attention to GDP growth and the exchange rate.

Weekly international reserves report. Last week, net international reserves increased US$15 million, closing at US$178.8 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$4.0 billion during 2019 (please refer to the following table).

Banxico's foreign reserve accumulation detail
US$, million

	2018	Jul 12, 2019	Jul 12, 2019	Year-to-date
	Balance		Flows	
International reserves (B)-(C)	174,793	178,755	15	3,962
(B) Gross international reserve	176,384	187,464	-160	11,080
Pemex	--	--	-20	127
Federal government	--	--	-186	7,120
Market operations	--	--	0	0
Other	--	--	46	3,833
(C) Short-term government's liabilities	1,592	8,709	-175	7,118

Source: Banco de México

Weekly government bond auction. The Ministry of Finance (MoF) –via Banco de Mexico as its financial agent, will offer 3-year fixed-rate Mbonos (Dec'21), 3-year Udibonos (Jun'22), 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, June 25th, 2019)

	Maturity	Coupon rate, %	To be auctioned[1]	Previous yield[2]
Cetes				
1m	22-Aug-19	- -	6,000	8.13
3m	24-Oct-19	- -	9,000	8.17
6m	16-Jan-20	- -	14,500	8.20
Mbonos				
3y	9-Dec-21	7.25	9,700	7.57
Udibonos				
3y	09-Jun-22	2.00	UDIS 950	3.50

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-July to be driven by seasonal increases coupled with pressures in agricultural goods. We estimate the headline inflation at +0.22% 2w/2w and the core at +0.15%. In contrast with previous fortnights, the non-core component will have a positive impact on the period's inflation, rising 0.46% 2w/2w (equivalent to 11bps), with specific pressures in agricultural prices. In this context, our price monitoring showed significant increases in the price of chicken –which has been trending up in previous periods– as well on pork, driven higher by the swine flu outbreak in Asia. With this, meat and egg would add 5bps, with other 3bps stemming from fruits and vegetables.

Within the latter, we noted higher prices of onions and chilies, although tomatoes continued to show some stability. In addition, we expect a 3bps contribution from energy, with LP gas and low-grade gasoline partially reversing some of the decrease seen in previous fortnights. On this good, we highlight that the fiscal stimulus continued to decrease in the first days of the month, to then increase again on July 6, leading us to believe that the contribution would be of only 1.6bps.

Regarding the core component, we expect it to add 11bps to the headline. In particular, we believe that most of the increase would be explained by the summer holiday period. In this sense, we anticipate a 6bps expansion in other services. In detail, we expect more moderate contributions in air fares and tourism services, considering that these showed relevant increases in previous fortnights in anticipation of the holidays. Nevertheless, we expect other categories such as hotels and restaurants to reflect the period's seasonality. Regarding core goods, we expect a +4bps impact from processed foods and -1bp from other goods.

With these results, annual inflation would continue to moderate, standing at 3.79% from 3.95% in June, taking hold below the upper bound of Banxico's variability range. The core component would go to 3.79% from 3.85%. Finally, non-core inflation would result at 3.78% from 4.19%. In this context, and considering that some categories within the non-core sub-index stand at a cycle low, we will remain vigilant to possible negative shocks that could push inflation higher.

Retail sales to moderate in May. We estimate a slight deceleration to 1.2% yoy from 1.6% in the previous month, mainly driven by two factors: (1) A challenging base effect considering higher sales ahead of the *2018 FIFA World Cup* last year, which took place in June-July; and (2) mixed to negative signs in terms of fundamentals for consumption, as reflected recently in the moderation in services growth.

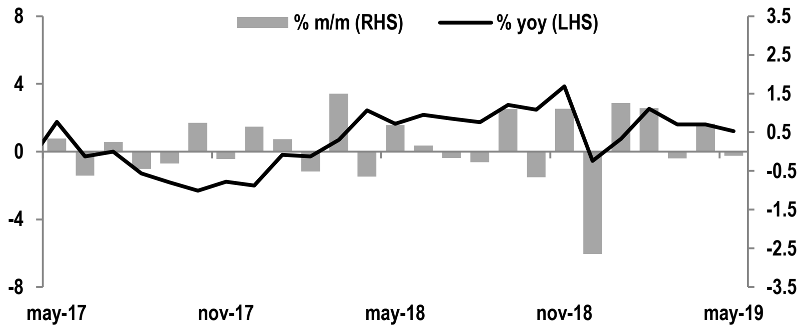
Regarding the latter, the pace of formal job creation keeps moderating at 2.4% yoy, lowest since March 2010. Real wages remain strong on a historical basis at 2.3%, albeit it seems that they have passed their top at 2.9% in February. The purchasing power component in May's consumer confidence index shifted down sequentially, while growth in remittances decelerated in its annual comparison.

Looking at more timely data for the sector, we highlight that non-oil consumption goods plunged 2.2%, adding three months in contraction. Also relevant, domestic auto sales declined 11.2% yoy in May. Recent figures suggest that the consumption of durable-goods has been most affected by the high levels of uncertainty. On a more positive note, real sales by ANTAD members grew a modest 1.1%, broadly in line with Walmex at 1.3%.

With austerity measures by the Federal Government and reports of delays on social transfers programs, we will be very attentive to the underlying details of the report as recent figures have shown some warning signs about dynamism in consumption. We believe this relative weakness likely extended further.

Despite of the latter, we are still anticipating that once these programs gather pace, consumption could accelerate modestly by the end of the year. Nonetheless, risks to consumption are clearly skewed to the downside based on its recent performance.

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



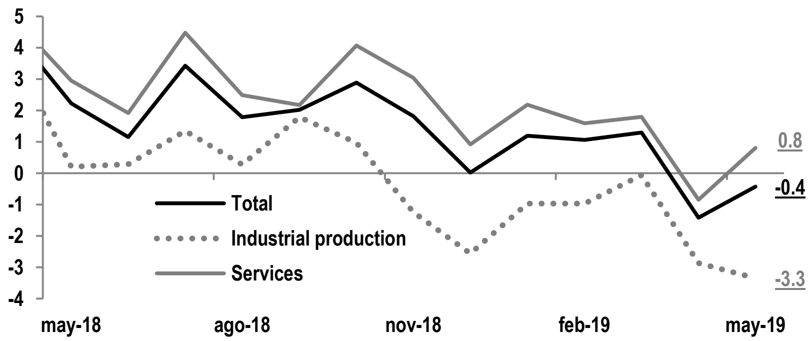
Source: INEGI, Banorte

IGAE to contract in May. We estimate the *Economic Activity Indicator* (IGAE) at -0.4% yoy, dragged by a very weak performance in secondary activities and a meaningful deceleration in services. Using seasonally-adjusted figures, we anticipate a 0.2% contraction after the modest +0.1% in May. As already published, industrial production plunged 3.3% yoy during the month (-2.1% m/m, with all sectors in contraction on a sequential basis). In particular, we highlight the 9.8% yoy decline in construction, which was the weakest print since April 2009 2010. For further details, see: "*Industrial production - Strongly negative in May, with all sectors in contraction*", <pdf>, July 12th, 2019.

On the other hand, we estimate a 0.8% yoy expansion in services. This would also be quite low even after taking into account a slightly negative base effect, not enough of a drag to explain the underlying performance. In this respect, we estimate retail sales to grow around 1.2%, as mentioned above, but dampened by weakness in government-related services and healthcare. This slowdown is estimated to be mainly due to austerity measures of the Federal Government. Meanwhile, we believe that the typical deceleration is spending is mainly affecting other categories within services, which has not been compensated by direct transfers related to social programs, which we believed would have a positive impact on consumption of non-durables goods. Last but not least, services employment picked up at the margin, to 2.8% yoy in May from 2.7% in the previous month. Despite of the latter, it has been growing at a sub-3% rate since March, a situation last seen five years ago, while net jobs created are also decelerating at the margin, putting additional pressure on this sector.

In case our forecast materializes, we estimate performance during the first two months of 2Q19 at -0.9% yoy, remembering that the quarter is skewed to the downside because of the timing of the Holy Week. Nevertheless it is tracking at a very weak pace, significantly increasing the chances of both an outright contraction in the annual comparison –for the first time since the Financial Crisis– and on a quarterly basis. Additionally, June data released so far such as IMEF indices and confidence indicators also suggest muted levels of activity in the last month of the quarter.

IGAE
% yoy (nsa)



Source: INEGI, Banorte

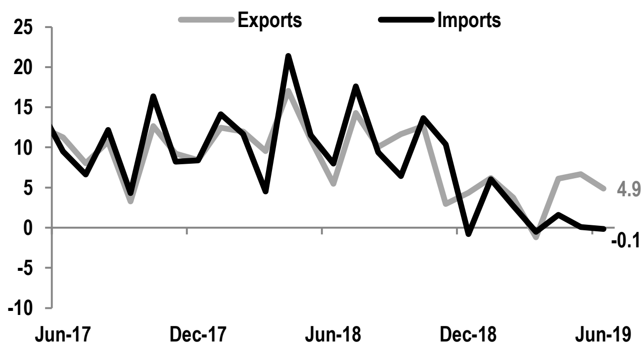
The trade balance will likely show another surplus in June. We expect a US$979.4 million surplus, which would be the fifth consecutive print in positive territory. We estimate exports to grow 4.9% yoy from 6.7% in the previous month, while imports would inch 0.1% lower from +0.1%. We must remember that trade tensions with the US increased as President Trump threatened to impose tariffs to all Mexican exports in the first days of the period. Despite of this, we believe the impact in terms of performance was likely marginal as: (1) The initial announcement, on May 30th, was highly unexpected; and (2) an agreement was reached rapidly, with the threat lasting only about a week (up to Jun 7th).

We anticipate the oil balance with a US$ 2,329.3 million deficit, higher than the –US$ 1,934.7 million in May. This would be mostly due to a strong 14.9% yoy decline in exports, affected both by price and volume dynamics. In particular, the Mexican oil mix averaged US$/bbl 57.67, -7.3% sequentially but 11% lower in the annual comparison, from only -2.9% in the previous month. According to our monitoring, total volumes fell, which would exacerbate the impact. Imports are also anticipated to decline (-5.1% yoy), but more modestly. Gasoline prices in the US were about 15% lower on a yearly basis, but available data suggest higher volumes, while intermediate goods are estimated at -5.9%. Consistent with its longer-term trend, the 12-month rolling balance would deteriorate further and at a gradual pace to -US$ 24,070.7 million, a new historical low.

The non-oil balance would reach +US$ 3,308.7 million surplus from +US$ 2,965.4 million in the previous month. Non-oil exports would climb 6.3%, with manufacturing anticipated to moderate to 6%, consistent with US sector activity in the month according to the industrial production report. By main categories, we anticipate strong performance in autos (+13.4%), maintaining its relative resiliency, with the slowdown mostly in others (1.8%). On the other hand, we expect imports 0.5% higher, slightly stronger than May at -0.2%. This would be driven by both consumption goods (+1.1% vs -2.2% in the previous month) and intermediate goods (1.8% vs 0.4%). Nevertheless, overall performance would be impacted by capital goods, which we estimate at -8.5% yoy from -3.0% in May. In our view, these will remain deteriorated on muted prospects for investment, with very high uncertainty and as signaled by business confidence and IMEF indicators, among others.

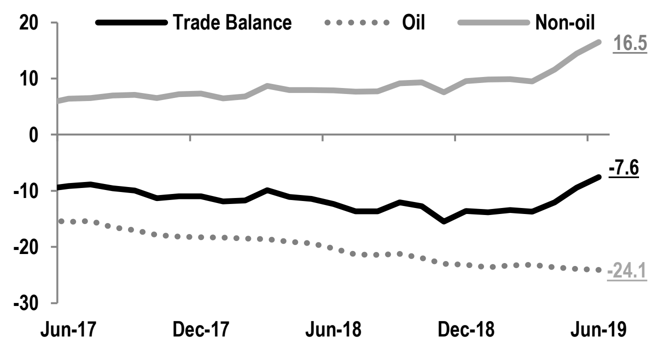
Our expectation of another surplus would be consistent with stronger dynamics in external relative to domestic demand. The former would mainly support manufacturing exports and intermediate goods imports. The latter would keep showing mostly in a limited rebound in consumption-goods imports and the decline in capital goods which are related to investment appetite. In this respect, although net trade would be positive for 2Q19 GDP, we believe the negative signal provided by these reports in the quarter in terms of private consumption will likely more than compensate for gains in the external front.

Exports and Imports
% yoy



Source: INEGI, Banorte

Trade balance
US$ billion, 12-month rolling sum



Source: INEGI, Banorte

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