Ahead of the Curve

August 16, 2019

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Expecting a slight downward revision to 2Q19 GDP to -0.8% yoy (0.0% q/q)

- **Gross domestic product (2Q19 F).** We anticipate activity at -0.8% yoy, 10bps below the preliminary estimate of -0.7%, driven by slight downward revisions in industry and services. Using seasonally-adjusted figures, we anticipate an adjustment to flat relative to the previous quarter, from a first estimate of +0.1% q/q. As already published, industrial activity would be -3.0% yoy, with this sector still facing a challenging backdrop as manufacturing in the US slows down in the midst of the recent escalation in trade tensions with China. Services would decline to zero in the annual comparison, with several signals in both surveys and hard data showing a deceleration despite still strong real wage gains. This quarterly performance would be consistent with June's IGAE at -0.8% (+0.3% m/m)

- **Inflation report (1H-Aug).** We estimate headline inflation at +0.05% 2w/2w, with the core at +0.13%. The non-core component would be very favorable, declining 0.20% 2w/2w after three consecutive fortnights in positive territory, subtracting 5bps to the headline. In particular, we expect both energy and agricultural prices to decline. Going to the core component, we expect it to add 9bps, which would be relatively positive for a second fortnight in a row. With these results, annual inflation would moderate strongly, standing at 3.41% from 3.78% in July, a new low since December 2016. The non-core component would be the main driver of this steep fall, expected to decline from 3.64% yoy to 2.28%, its lowest in three years. On the other hand, core inflation would inch lower from 3.82% to 3.78%, moderating at a much slower pace but with a positive signal as it has been declining since reaching 3.9% in April

Mexico weekly calendar

DATE	TIME (ET)	EVENT	PERIOD	UNIT	BANORTE	CONSENSUS	PREVIOUS
Tue 20-Aug	10:00am	**International reserves**	Aug-16	US$ bn	--	--	173.4
Tue 20-Aug	12:30pm	**Government weekly auction: 1-, 3-, 6-month CETES; 3y Mbono (Dec'21); 3y Udibonos (Jun'22)**					
Tue 20-Aug	3:30pm	**Citibanamex bi-weekly survey of economic expectations**					
Wed 21-Aug	7:00am	**Retail sales**	June	% yoy	2.0	1.7	2.8
		sa		% m/m	0.0	0.0	0.7
Thu 22-Aug	7:00am	**CPI inflation**	1H-Aug	% 2w/2w	0.05	0.14	0.06
				% yoy	3.41	3.51	3.72
		Core		% 2w/2w	0.13	0.16	0.08
				% yoy	3.78	--	3.83
Fri 23-Aug	7:00am	**GDP**	2Q19	% yoy	-0.8	-0.7	-0.7
		sa		% q/q	0.0	0.0	0.1
		Primary activities		% yoy	1.4	--	1.4
		Industrial production		% yoy	-3.0	--	-2.8
		Services		% yoy	0.0	--	0.1
Fri 23-Aug	7:00am	**Economic activity indicator**	June	% yoy	-0.8	-0.6	-0.4
		sa		% m/m	0.3	--	-0.3
		Primary activities		% yoy	2.3	--	0.5
		Industrial production		% yoy	-2.9	--	-3.3
		Services		% yoy	-0.1	--	0.9
Fri 23-Aug	10:00am	**Current account**	2Q19	US$ bn	1.2	-3.2	-5.6

Source: Banorte; Bloomberg

Proceeding in chronological order...

Weekly international reserves report. Last week, net international reserves increased by US$417 million, closing at US$179.8 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$5.0 billion during 2019 (please refer to the following table).

Banxico's foreign reserve accumulation detail
US$, million

	2018	Aug 9, 2019	Aug 9, 2019	Year-to-date
	Balance		Flows	
International reserves (B)-(C)	174,793	179,815	417	5,022
(B) Gross international reserve	176,384	188,571	327	12,187
Pemex	--	--	157	368
Federal government	--	--	-279	7,036
Market operations	--	--	0	0
Other	--	--	448	4,783
(C) Short-term government's liabilities	1,592	8,756	-91	7,165

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 inflation-linked 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, August 20th, 2019)

	Maturity	Coupon rate, %	To be auctioned[1]	Previous yield[2]
Cetes				
1m	19-Sep-19	- -	6,000	8.05
3m	21-Nov-19	- -	9,000	8.04
6m	13-Feb-20	- -	13,000	7.97
Mbonos				
3y	09-Dec-21	7.25	10.500	7.37
Udibonos				
3y	09-Jun-22	2.00	UDIS 1,125	3.46

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

***Citibanamex* Survey.** Markets will center on analysts' inflation forecasts for the first half of August (to be published on Thursday, August 24th) along with the 2019 year-end estimate. It will be important to see monetary policy assessments, particularly after last monetary policy decision, in which Banxico surprisingly cut the reference rate by 25bps to 8.00%. We will also pay attention to GDP growth and the exchange rate.

Retail sales growth to slow down in June. We anticipate a 2.0% yoy increase, below the 2.8% of in the previous month. We believe that the latter will be driven by both a more difficult base effect and a moderation in dynamism in advanced data released so far. Moreover, and using seasonally-adjusted figures, we estimate a flat reading after two consecutive months in positive territory, which would be a mild slowdown, considering the deceleration of economic activity observed in other sectors.

The annual figure is likely to be impacted by a relatively more challenging base-effect. In particular, it should be noted that the World Cup took place in June-July 2018, with Mexico's team playing its first three games during the second half of the first month. In this respect, categories such as supermarket, convenience, and departmental stores, and appliances and computers, surged 8.1% and 11.4% in June 2018, respectively, from 3.6% and 9.2% in the previous month, in the same order. Additionally, this month had one less working day in the annual comparison, which tends to be slightly negative for sales. Overall, retail sales were up 2.2%, higher than the 1.6% observed in May.

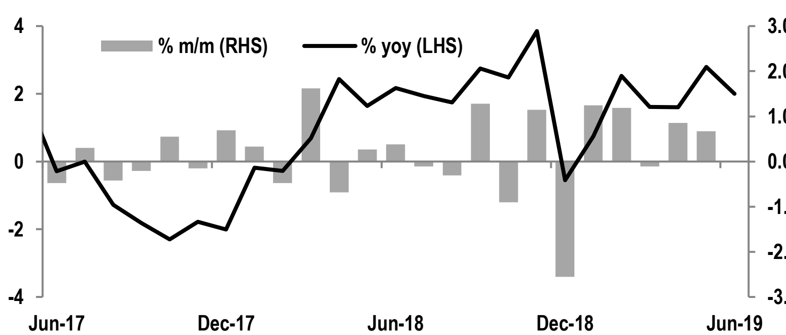
Additional to these factors, other indicators also suggest a slowdown. We highlight the 5.7% yoy decline in non-oil consumption imports, which is its lowest print year-to-date and its fourth consecutive month in contraction. According to ANTAD, sales slowed to 0.5% from 1.1% yoy in real terms in May, with Walmart's same-store sales also more modest at 0.7% (from 1.3% previously). Auto sales plunged 11.4%, weakest so far in 2019 and with a double-digit decline for third month in a row. In our view, these data along information already published for July, are consistent with a weak outlook for domestic demand.

On a more positive note, inflation kept moderating, driven by low pressures at the non-core level. This has lifted real wage growth modestly, which picked-up from 2.3% in May to 2.5%, still above its long-term average. Formal job creation has slowed down significantly on an annual basis, albeit still with a net positive performance as it grew 2.4% in the period. The Mexican peso stayed relatively strong in spite of some pressures in the first days of the month. In our view, these remain as the main supports for private consumption. Nevertheless, the purchasing power component according to the consumer confidence index declined further both in June and July, in our view reflecting higher degree of uncertainty, lower pace of job creation and the broad slowdown of the economy.

We are still anticipating that social transfers programs help consumption to accelerate by year-end, with key projects such apprenticeship for the youth (*Jóvenes Construyendo el Futuro*) already reaching its membership goal for 2019, according to the Labor Ministry. Nevertheless, austerity measures remain in place despite recent announcement of a relative acceleration in government spending for the rest of the year.

Retail sales

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



Source: INEGI, Banorte

Annual inflation in 1H-Aug to decline strongly on non-core prices. We estimate headline inflation at +0.05% 2w/2w, with the core at +0.13%. The non-core component would be very favorable, declining 0.2% 2w/2w after three consecutive fortnights in positive territory. In particular, we expect energy prices to fall 0.2%, contributing with -2bps. We believe electricity will be modestly aided by the *Energy Regulatory Commission* (CRE, in Spanish) announced 0.8% monthly decrease in the basic tariff, resulting in a -0.4bps contribution. Moreover, LP gas and low-grade gasoline are also expected to subtract to the headline, estimated at -0.5bps and -0.6bps, respectively. Although we observed that fiscal subsidies to the latter declined modestly during the period, we still see a negative contribution as gasoline prices in the US decreased, helping compensate for stronger pressures to the Mexican peso, mostly on trade jitters around the world and the Fed decision. Additionally, we anticipate a -0.4% decline in agricultural goods prices, contributing with -4bps to the headline, and roughly evenly split between fresh fruits and vegetables, and meat and egg.

Going to the core component, we expect it to add 9bps to the headline, which would be relatively positive for a second fortnight in a row. In our view, core goods will be relatively well-behaved, with contributions of 3bps and 2bps from processed foods and other goods, in the same order. Within services, we noted that the seasonal decline in airfares and tourism seems to have been front-loaded to the 2H-July, which helps drive our view that these categories are likely to decline, albeit relatively less when compared to recent years. Specifically, we anticipate these to fall 1.8bps and 1.6bps, respectively.

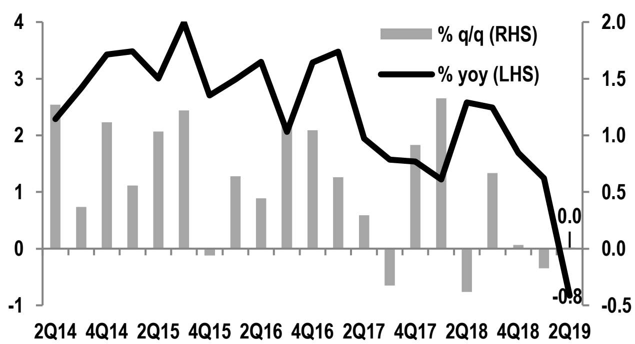
With these results, annual inflation would moderate strongly, standing at 3.41% from 3.78% in July, a new low since December 2016. The non-core component would be the main driver of this steep fall, expected to decline from 3.64% yoy in July to 2.28%, its lowest in three years. Given its recent dynamic, the Federal government compromise to at least keep electricity and gasoline prices constant in real terms, and a favorable base-effect –in biweekly terms, annual non-core inflation stood at 8.5% exactly one year ago, with a high of 9.4% in 2H-Sep–, this component is likely to keep supporting the decline in the headline. On the other hand, core inflation would inch lower to 3.78% from 3.82% previously, moderating at a much slower pace but with a positive signal as it has been declining since reaching 3.9% in April.

Mexico's final 2Q19 GDP to be revised down on lower secondary and tertiary activities. We anticipate 2Q19 GDP at -0.8% yoy, 10bps below the -0.7% of the preliminary estimate, driven by slight downward revisions in both industry and services. Using seasonally-adjusted figures, we anticipate an adjustment to a flat reading when compared to the previous quarter, from a first estimate of +0.1% q/q. In this respect, we estimate June's IGAE at -0.8% (+0.3% m/m) from about -0.5% yoy in the first print. This would be due to an uptick of 2.3% in the primary sector, the decline of 2.9% in industry, and -0.1% the tertiary sector.

As already published, industrial activity in June was weaker than implied in the advance report, resulting in a downgrade to the quarterly performance from -2.8% to -3.0% yoy. As previously mentioned (see: "*Activity rebounds in June, but challenges remain*", <pdf>, August 9th, 2019), all sectors improved sequentially, albeit not enough to compensate for the -2.5% m/m observed in May, which was revised weaker. In this respect, we maintain our view that the sector is still facing a challenging backdrop, with manufacturing in the US slowing down further in the midst of the recent escalation in trade tensions with China. Although on a full-year basis a gradual improvement is expected, particularly in construction, we believe it will remain weak at -1.5% yoy.

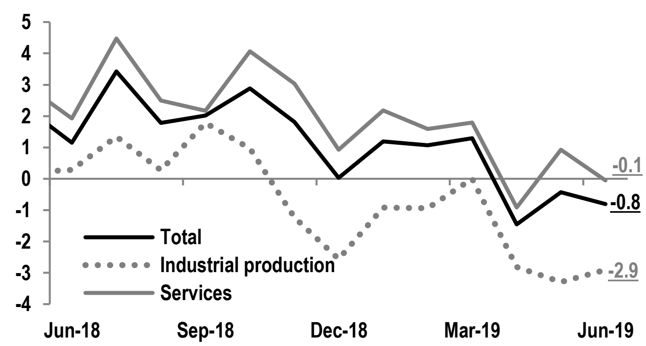
In services, we expect a decline to zero from 0.1% yoy during the quarter. This figure incorporates our retail sales estimate for June at 2.0% as mentioned above. We are more concerned about the potential effect on transportation due to the weak print of -0.8% in manufacturing, which is its lowest monthly print since October 2016 when excluding those periods distorted by the timing of the Holy Week. Performance would be limited, with services in June according to IMEF falling further into contraction territory to 47.7pts, with particular signs of weakness in components such as employment (which according to formal job creation figures in the sector, has stabilized at around 2.8%, quite low relative to its recent history) and new orders. Other hard data, such as private consumption in May was up barely 0.2% yoy, confirm other signals of a deceleration in services despite of still strong real wage gains.

GDP
% yoy (nsa), q/q (sa)



Source: INEGI, Banorte

IGAE
% yoy (nsa)



Source: INEGI, Banorte

Current account (2Q19): Banorte: US$1,216 million; previous: -US$5,634 million. We are forecasting a US$1.2bn surplus in the current account. According to data already released, trade balance during the period in question amounted to +US$4.9bn, while remittances increased 1.4% yoy amounting to US$9.2bn in the period in question.

Analyst Certification

We, Gabriel Casillas Olvera, Delia Maria Paredes Mier, Alejandro Padilla Santana, Manuel Jiménez Zaldívar, Tania Abdul Massih Jacobo, Katia Celina Goya Ostos, Juan Carlos Alderete Macal, Víctor Hugo Cortes Castro, Marissa Garza Ostos, Miguel Alejandro Calvo Domínguez, Hugo Armando Gómez Solís, Gerardo Daniel Valle Trujillo, José Itzamna Espitia Hernández, Valentín III Mendoza Balderas, Santiago Leal Singer, Francisco José Flores Serrano, Luis Leopoldo López Salinas, Jorge Antonio Izquierdo Lobato and Leslie Thalía Orozco Vélez, 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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HOLD	When the share expected performance is similar to the MEXBOL estimated performance.
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