Ahead of the Curve

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Inflation in the 1st half of March pressured by the non-core component

- **Bi-weekly inflation report (1H-March).** We estimate headline inflation at 0.31% 2w/2w, higher than the previous print of 0.14%. Core inflation would stand at 0.20%. Inflation during the period will be mostly explained by pressures in the non-core component, with a rebound in agro prices and an extension of the recent increase in gasoline. Regarding non-core, we expect some pressures ahead of the holiday on March 18th, taking into account that airfares and tourism services typically reflect this one- to two-weeks in advance. With these, annual inflation would increase from 3.94% in February to 4.01%, marginally above Banxico's variability range, with non-core climbing to 5.6% from 5.3% but core inflation well-behaved, falling marginally from 3.54% to 3.52%.

- **Aggregate supply and demand (4Q18).** We expect a broad deceleration at 2.6% yoy, consistent with weaker economic activity –particularly in December– and significantly below the 3.6% of the previous quarter. The supply-side expansion will be explained by the previously reported 1.7% GDP growth (previous: 2.5%) and a slowdown in imports, from 6.3% in 3Q18 to 5.0%. Taking a look at demand, private consumption would increase 1.5%, decelerating from 2.2% in 3Q18. Investment would decline 2.3% as previously reported, exports are estimated at +7.5% and government spending would be broadly unchanged at 0.9%. With these results, aggregate supply and demand in 2018 would have increased 3.1% with respect to the previous year

Mexico weekly calendar

DATE	HOUR (ET)	EVENT	PERIOD	UNIT	BANORTE	CONSENSUS	PREVIOUS
Tue 19-Mar	1:30pm	Government weekly auction: 1-, 3-, 6-month CETES; 5y Mbono (Sep'24); 10y Udibonos (Nov'28)					
Wed 20-Mar	11:00am	International reserves	Mar-15	US$ bn	--	--	175.8
Wed 20-Mar	4:30pm	Citibanamex bi-weekly survey of economic expectations					
Thu 21-Mar	10:00am	Aggregate Demand	4Q18	% yoy	2.6	--	3.6
		Private consumption		% yoy	1.5	--	2.2
		Government consumption		% yoy	0.9	--	1.0
		Gross-fixed investment		% yoy	-2.3	--	0.3
Fri 22-Mar	10:00am	CPI inflation	1H-Mar	% 2w/2w	0.31	--	0.14
				% yoy	4.01	--	3.99
		Core		% 2w/2w	0.20	--	0.19
				% yoy	3.52	--	3.56

Source: Banorte; Bloomberg

Proceeding in chronological order...

Weekly government bond auction. The Ministry of Finance (MoF) –via Banco de Mexico as its financial agent, will offer 5-year fixed-rate Mbonos (Sep'24), 10-year inflation-linked Udibonos (Nov'28), in addition to the "traditional" 1-, 3-, and 6-month zero-coupon Cetes (please refer to the following table). As usual, results will be released at 12:30pm (ET).

Auction specifics (Tuesday, March 19th, 2019)

	Maturity	Coupon rate, %	To be auctioned[1]	Previous yield[2]
Cetes				
1m	17-Apr-19	- -	5,000	8.09
3m	20-Jun-19	- -	5,000	8.11
6m	12-Sep-19	- -	10,500	8.23
Mbonos				
5y	05-sep-24	8.00	9,700	8.10
Mbonos				
10y	30-nov-28	4.00	UDIS 800	4.11

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

Weekly international reserves report. Last week, net international reserves grew by US$121 million, closing at US$175.8 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$975 million during 2019 (please refer to the following table).

Banxico's foreign reserve accumulation detail
US$, million

	2018	Mar 8, 2019	Mar 8, 2019	Year-to-date
	Balance		Flows	
International reserves (B)-(C)	174,793	175,767	121	975
(B) Gross international reserve	176,384	181,377	60	4,993
Pemex	--	--	15	229
Federal government	--	--	211	4,040
Market operations	--	--	0	0
Other	--	--	-166	725
(C) Short-term government's liabilities	1,592	5,610	-61	4,018

Source: Banco de México

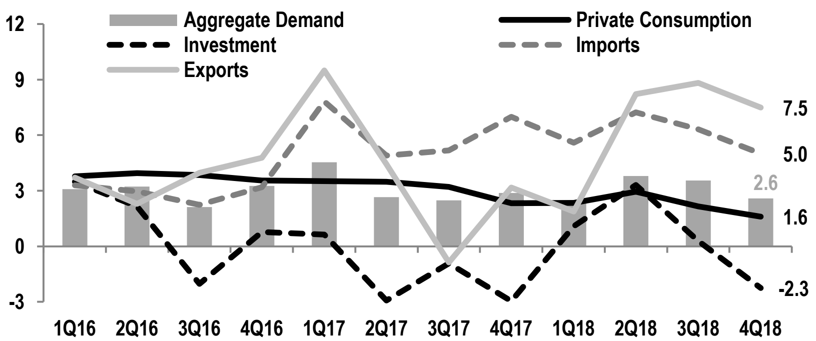
***Citibanamex* Survey.** Market focus will center on analysts' inflation forecasts for the first half of March (to be published on Friday, March 22nd) along with the 2019 year-end estimate. Furthermore, it will be important to see monetary policy assessments for the rest of the year. We will also be watching forecasts for GDP growth and USD/MXN exchange rate.

Aggregate demand in 4Q18 would show a broad deceleration. We expect a 2.6% yoy increase in aggregate supply and demand, significantly below the 3.6% advance of the previous quarter. We estimate a broad deceleration by component, consistent with weaker economic activity –particularly in the last month of the year–. In this regard, the supply-side expansion will be explained by the previously reported 1.7% GDP growth (previous: 2.5%) and a slowdown in imports, from 6.3% in 3Q18 to 5.0%, mainly due to weakness in December particularly the oil balance.

Taking a look at demand, private consumption would increase 1.5%, also more modest relative to the 2.2% expansion in 3Q18. In this sense, the monthly proxy indicator published by *INEGI* showed a pretty significant slowdown, with the 3-month average growth rate declining to its lowest since 2013. As already published, investment was also weak, falling 2.3% as the last two months of the year were in negative territory, driven by domestic M&Eq. Moreover, both the imported component and construction also contracted in the last month of the quarter. Expected performance of external activity would be biased in the same direction as other components, with exports estimated to grow by 7.5%, 130bps lower than the previous print. Lastly, government spending would be at 0.9%, mostly unchanged to its recent trend and lower than in the 1st half of the year, given the end of the electoral process.

With these results, aggregate supply and demand in 2018 would have increased by 3.1%, matching the advance observed in the previous year. Consumption would be at 2.3% (2017: 3.1%), investment would recover to 0.6% (-1.6%) and exports at 6.6%, accelerating strongly when compared to the previous year at 3.9%).

Aggregate demand
% yoy (nsa)



Source: INEGI, Banorte

Inflation in 1H-March pushed upwards by non-core items. We estimate headline inflation at 0.31% 2w/2w, higher than the 0.14% of the previous print. Core inflation would stand at 0.20%, marginally above the previous figure of 0.19%. Inflation during the period will be mostly explained by pressures in the non-core component, expecting a rebound in agro prices and an extension of the recent increase in gasoline prices. Regarding agricultural goods, we expect a 10bps contribution, from which 8bps would be from fruits and vegetables. In this respect, our price monitoring shows pressures in tomatoes and lemons, with a slight respite in chilies.

On the other hand, energy would add 7bps, with 8bps would be due to gasoline (7bps from low-grade and 1bp in high-grade). It is worth noting that last Friday, the Federal government announced for the first time in fifteen weeks a fiscal stimulus of 9.4 cents per liter in excise taxes, upping it to 75.6 cents today. This is relevant as although it will likely not impact prices in the first half, it could help limit pressures for the monthly figure.

Regarding non-core inflation, we expect some pressures ahead of the holiday on March 18th, taking into account that airfares and tourism services typically reflect this one- to two-weeks in advance. Considering this, we anticipate a 7bps contribution from other services. Regarding goods, our monitoring signaled price increase concentrated in processed foods, adding 5bps, while other goods would only contribute 1bp.

With these, annual inflation would increase from 3.94% in February to 4.01%, marginally above Banxico's variability range. The latter would be driven by an increase in non-core inflation, climbing to 5.6% from 5.3% in February, and which had shown a significant downward trend since the end of December. Despite of this, core inflation would fall marginally from 3.54% to 3.52%. We reiterate our call that inflation will keep evolving in a favorable way, converging to our 3.5% yoy forecast by year-end. Considering this, we still anticipate that the outlook for both inflation and economic growth will be enough for Banxico to cut the reference rate as soon as June.

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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, Francisco Duarte Alcocer, 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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