

Ahead of the Curve

March 1, 2019

We expect February inflation at 0.05% m/m while consumer confidence could continue picking up

- Monthly inflation report (February).** We estimate headline inflation at 0.05% m/m and core at 0.40% in February, with the former lower than the 0.09% observed in the previous month. Inflation during the period will be mostly benefitted by the downward surprise in agricultural prices during the first half, although with a rebound in the second part as a result of pressures in low-grade gasoline. With these results, annual inflation would decrease from 4.37% in January to 4.02%. By components, non-core inflation would drop heavily from 6.8% yoy to 5.6% yoy, while core would drop slightly from 3.6% to 3.5%
- Consumer confidence (February).** We expect consumer confidence to reach 112.1pts, marginally higher than the 111.9pts of the previous print. In this respect, recent polls show that optimism about the new federal administration has increased further, a factor we believe has increasingly influenced consumer sentiment. Opinions about the impact of recent transitory shocks, such as fuel distribution delays and railway blockades, are mixed at best. Moreover, business confidence in February picked up again, while other indicators such as inflation and the exchange rate have been well-behaved. Given the latter, we believe confidence will stay high despite the possibility of some retracement given its recent surge and signs of a deceleration in global and local economic growth.

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Document for distribution among the general public

Mexico weekly calendar

DATE	HOUR (ET)	EVENT	PERIOD	UNIT	BANORTE	CONSENSUS	PREVIOUS
Tue 5-Mar	9:00am	Consumer confidence	February	index	<u>112.1</u>	112.0	111.9
Tue 5-Mar	10:00am	International reserves	Mar-1	US\$ bn	--	--	175.7
Tue 5-Mar	12:30pm	Government weekly auction: 1-, 3-, 6-month CETES; 3y Mbono (Dec' 21); 3y Udibonos (Jun'22)					
Tue 5-Mar	4:30pm	Citibanamex bi-weekly survey of economic expectations					
Thu 7-Mar	9:00am	CPI inflation	February	% m/m	<u>0.05</u>	-0.03	0.09
				% yoy	<u>4.02</u>	3.94	4.37
		Core		% m/m	<u>0.40</u>	0.41	0.20
				% yoy	<u>3.51</u>	--	3.6
Fri 8-Mar		Wage negotiations	February	%	<u>5.4</u>	--	5.2
Fri 8-Mar	9:00am	Gross fixed investment	December	% yoy	<u>-5.1</u>	-5.0	-3.2
		Machinery and equipment		% yoy	<u>-6.1</u>	--	-3.0
		Domestic		% yoy	<u>-7.1</u>	--	-12.1
		Imported		% yoy	<u>-5.5</u>	--	3.0
		Construction		% yoy	<u>-4.3</u>	--	-3.3

Source: Banorte; Bloomberg

Proceeding in chronological order...

Consumer confidence to remain elevated in February. We expect consumer confidence to reach 112.1pts, marginally higher than the 111.9pts of the previous print. In our view, consumer confidence has been increasingly influenced by sentiment about the new federal administration, particularly since July when the index surged. In this respect and according to the poll by *Consulta Mitofsky* (compiled at the end of the month), President Lopez-Obrador’s popularity kept climbing, with his approval rating going from 66% in January to 67.1%. On an annual basis, respondents considered that the country’s economic and political conditions have improved meaningfully, with both at their highest since the last two administrations.

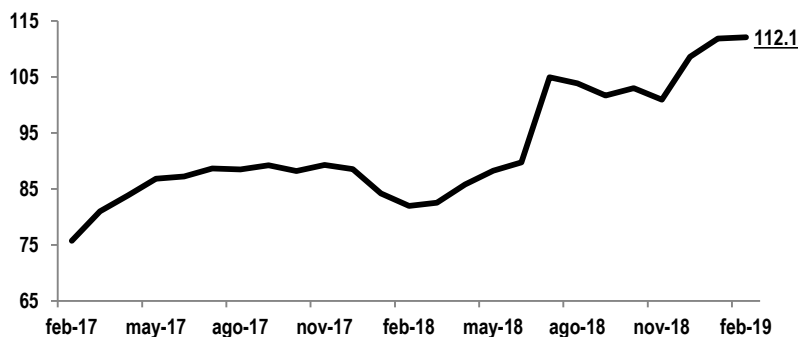
About the possible impact of delays in fuel distribution, a majority (51.4%) approved this measure because they were aimed at fighting fuel theft. Additionally, the impact of the abovementioned delays, along railway blockades, seems to be focalized to directly affected states in the central region (*e.g.* Michoacan, Guanajuato, Aguascalientes), as his popularity is lowest in these states. In addition, most of his initiatives have widespread acceptance, such as canceling pension to ex-presidents and eliminating medical insurance to public employees.

Apart from this structural shift in sentiment, recent inflation figures have benefitted from lower agricultural prices, which could help the households’ current conditions index. Moreover, the exchange rate was relatively stable, only depreciating by 0.6% (up to February 20th, the last day of the survey’s sample). Business confidence increased in the three sectors that comprise the report, and which historically has been an indicator with a strong long-term correlation with consumer confidence.

Going forward, we believe that confidence will stay high in coming months. Given its recent strength, we are less confident in our view that consumer confidence has already reached a local high given the support to sentiment due to political conditions. Nevertheless, in the very short term we can’t discard a slight retracement due to the impact of recent transitory shocks and signs of a global and local deceleration in GDP growth.

Consumer confidence

Index, nsa



Source: INEGI

Weekly international reserves report. Last week, net international reserves rose by US\$193 million, closing at US\$175.7 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\$901 million during 2019 (please refer to the following table).

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

	2018	Feb 22, 2019	Feb 22, 2019	Year-to-date
	Balance		Flows	
International reserves (B)-(C)	174,793	175,694	193	901
(B) Gross international reserve	176,384	180,555	270	4,171
Pemex	--	--	-10	34
Federal government	--	--	113	3,583
Market operations	--	--	0	0
Other	--	--	168	554
(C) Short-term government's liabilities	1,592	4,862	77	3,270

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 (Dic’21), 3-year Udibonos (Jun’22), 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 5th, 2019)

	Maturity	Coupon rate, %	To be auctioned ¹	Previous yield ²
Cetes				
1m	04-Apr-19	--	5,000	8.10
3m	06-Jun-19	--	5,000	8.12
6m	29-Aug-19	--	10,500	8.17
Mbonos				
3y	09-Dec-21	8.50	11,550	8.17
Udibonos				
3y	09-Jun-22	4.00	UDIS 1,125	4.18

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. Market focus will center on analysts’ inflation forecasts for February (to be published on Thursday, March 7th) along possible adjustments to the downside for the year-end 2019 estimate. Furthermore, it will be important to see monetary policy assessments after Banxico’s *Quarterly Report*, in which the central bank revised its growth forecast down while inflation estimations were largely unchanged. We will also be watching forecasts for GDP growth and USD/MXN exchange rate.

February inflation well behaved despite higher gasoline prices in the second half of the month. We estimate headline inflation at 0.05% m/m in February, slightly lower than the 0.09% of the previous month. Core inflation would reach 0.13% m/m, also below the previous print of 0.26%. Inflation during the period will be mostly benefitted by the downward surprise in agricultural prices during the first half, with the headline standing at -0.10% 2w/2w; nevertheless, we expect a rebound of +0.29% during the 2nd half, driven by pressures in low-grade gasoline.

Regarding non-core inflation, we expect a contribution of -26bps during the month. In particular, energy would add +9bps to the monthly figure, with gasoline basically as the sole driver as other categories in this sub-index mostly offset each other. Given the recent increase in prices, it will be important to watch if the federal government acts through fiscal incentives given its pricing policy which tries to avoid higher prices in real terms. On the contrary, and according to our price monitor, agricultural goods will likely extend their decline, albeit at a significantly more modest pace than recent figures. During the month, this category would subtract 38bps. In particular, this would have been driven by the strong decline in fresh fruits and vegetables in the previous print.

In the core component, we do not see any significant pressures in any particular category, contributing about 30bps to the headline. Our monthly estimate is consistent with a bi-weekly incidence of 10bps, almost evenly distributed between goods and services. Nevertheless, for the first category we see a monthly contribution of 18bps, considering the relatively high figure of the first half which could have been influenced by disruptions to supply chains.

With these results, annual inflation would decrease from 4.37% in January to 4.02%. By main components, non-core inflation would drop heavily to 5.6% yoy from 6.8%, extending the strong decline observed since the end of 2018 when it was closer to 9%. On the other hand, core-inflation would reach 3.5% from 3.6%, accumulating almost 20bps of decline since the beginning of the year, which we believe Banxico will see as positive in spite of reaffirming their concern about the resistance to the downside that core inflation has been exhibiting since mid-2018.

We forecast wage negotiations up 5.4% in February. This would represent a higher increase than the 5.2% seen in the previous month. This rise would continue to be driven by the 16.2% increase in the minimum wage, which came into effect on January 1st. Although there were a large number of revisions in the education sector, averaging a 3.35% raise, we believe that negotiations in other sectors more than compensated for the relatively low increase in the former. In this context, it should be noted that the negotiations in the private sector in January rose 5.7%, which leads us to believe that increases of a similar magnitude will continue in the coming months. Going forward, we anticipate wages will remain biased to the upside given the minimum wage increase as well as inflation persistently above target. However, once the latter returns to the target interval, we could see a moderation in revisions.

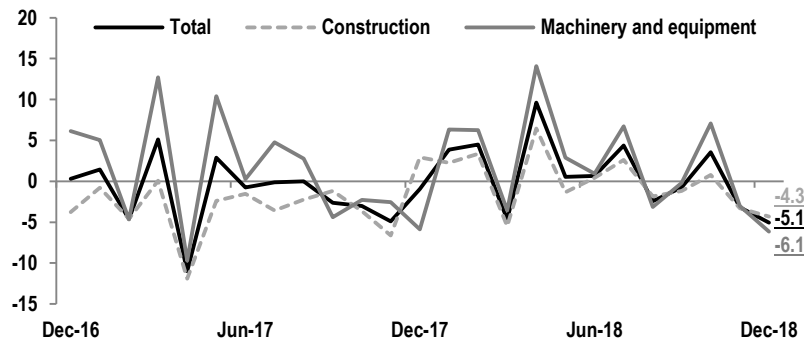
Gross fixed investment to end weak in December. We anticipate gross fixed investment at -5.1% yoy, in negative territory for a seventh straight month and deepening its decline in the annual comparison relative to November. With these figures, GFI in 2018 would reach +0.8% yoy but contract 1.6% in the quarter. Overall signals related to investment activity so far remain very weak, with businessmen likely still resenting the increase in uncertainty in the previous month that was coupled with higher volatility and financing costs.

In this respect, the “adequate moment to invest” component in business confidence indices extended their decline of November in all sectors except for commerce, with construction falling 9% m/m to 27.7pts, lowest since June and with three consecutive months on the downside. Moreover, activity in this latter sector fell strongly according to industrial production data, dragged by civil engineering projects which in our view were impacted by typical delays at the start of a new federal administration. Considering the latter, we estimate construction at -4.3% yoy.

Moreover, we estimate M&Eq at -6.1% yoy, exacerbating the contraction of 3% of the previous month. Capital goods imports plunged 4.1% in December, declining for the first time in more than one year in spite of the peso’s appreciation during the period, which tends to incentivize purchases abroad. As a result, we forecast the imported component at -5.5% yoy. In our view, this steep deceleration will also be reflected in the domestic component, estimated at -7.1% . This would be driven by weakness in manufacturing, taking into account the close relationship that some of these sectors have with locally-sourced investment.

All in all, we anticipate the weak performance of investment to extend this year, given the outlook for more modest economic growth, cyclically high levels of nominal and real interest rates, and overall uncertainty about mid- and long-term prospects for the Mexican economy, particularly in the business sector.

GFI
% yoy



Source: INEGI, Banorte

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