

## Ahead of the Curve

February 22, 2019

### Banxico will likely downgrade GDP forecasts in the 4Q18 Quarterly Report

- Banxico's Quarterly Report (4Q18).** Banco de Mexico will publish its Quarterly Report (QR) for 4Q18 on Wednesday around 1:30pm (ET). In our view, market participants will focus on the likely downgrade in the central bank's GDP growth forecast range, particularly for 2019, in which we expect the mid-point to decrease 30bps from 2.2% to 1.9%. Moreover, we believe estimates of headline inflation in 1H19 could be revised slightly lower after recent downward surprises, but not at the core level. We expect Banxico to reiterate the less hawkish bias that we perceived in the latest communiqué and minutes due to growth concerns, albeit maintaining its prudent stance given upside risks for inflation. We maintain our expectation of an unchanged reference rate at 8.25% this year, with a higher probability of a rate cut in 2020

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#### Mexico weekly calendar

DATE	HOURL (EST)	EVENT	PERIOD	UNIT	BANORTE	CONSENSUS	PREVIOUS
Mon 25-Feb	9:00am	GDP	2018	% yoy	<u>2.0</u>	--	2.0
Mon 25-Feb	9:00am	GDP	4Q18	% yoy	<u>1.7</u>	1.7	1.8
		(sa)		% q/q	<u>0.2</u>	0.3	0.3
		Primary activities		% yoy	<u>2.8</u>	--	2.8
		Industrial production		% yoy	<u>-0.9</u>	--	-0.7
		Services		% yoy	<u>2.8</u>	--	2.9
Mon 25-Feb	9:00am	Global economic indicator	December	% yoy	<u>0.2</u>	0.4	1.8
		(sa)		% m/m	<u>-0.9</u>	--	0.4
		Primary activities		% yoy	<u>4.0</u>	--	5.1
		Industrial production		% yoy	<u>-2.5</u>	--	-1.3
		Services		% yoy	<u>1.4</u>	--	3.0
Mon 25-Feb	10:00am	Current account	4Q18	US\$ bn	<u>-4.4</u>	--	-5.1
Tue 26-Feb	9:00am	Retail sales	December	% yoy	<u>2.5</u>	2.7	3.4
		sa		% m/m	<u>-1.3</u>	--	0.4
Tue 26-Feb	10:00am	International reserves	Feb-23	US\$ bn	--	--	175.5
Tue 26-Feb	12:30pm	Government weekly auction: 1-, 3-, 6-, 12-month CETES; 20y Mbono (Nov'38); 30y Udibonos (Nov'46); 5y Bondes D					
Wed 27-Feb	9:00am	Unemployment rate	January	%	<u>3.67</u>	3.70	3.35
		sa		%	<u>3.62</u>	3.70	3.57
Wed 27-Feb	9:00am	Trade balance	January	US\$ mn	<u>-3,491.3</u>	-3,650.0	1,836.3
		Total exports		% yoy	<u>5.1</u>	--	4.3
		Oil exports		% yoy	<u>13.9</u>	--	-16.8
		Non-oil exports		% yoy	<u>4.4</u>	--	6.6
		Total imports		% yoy	<u>1.8</u>	--	-0.8
Wed 27-Feb	1:30pm	Banxico's quarterly inflation report					
Thu 28-Feb	10:00am	Comercial banking credit	January	% yoy	<u>5.6</u>	--	4.9
		Consumption		% yoy	<u>1.7</u>	--	1.5
		Housing		% yoy	<u>4.6</u>	--	4.7
		Firms		% yoy	<u>7.2</u>	--	6.3
Fri 1-Mar	10:00am	Family remittances	January	US\$ mn	<u>2,478.6</u>	2,608.0	2,925.6
Fri 1-Mar	10:00am	Banxico's survey of economic expectations					
Fri 1-Mar	1:00pm	PMI's survey (IMEF)	February				
		Manufacturing		index	<u>50.1</u>	--	49.8
		Non-manufacturing		index	<u>50.4</u>	--	50.6
Fri 1-Mar	3:30pm	Budget balance	January	MXN bn	--	--	-547.6

Source: Banorte; Bloomberg

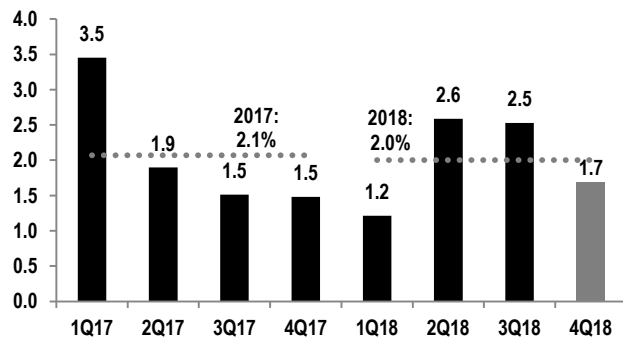
Proceeding in chronological order...

**We expect 2018 GDP to remain unchanged relative to the preliminary print, at 2.0% yoy.** This would be the end result in spite of our expectation that December economic activity will be revised lower. In this respect, we estimate GDP for 4Q18 at 1.7% yoy, 10bps lower than the preliminary print (chart below on the left). This would also be consistent with a 0.2% yoy expansion in the last month of the year using the GDP-proxy (*Global Economic Activity Indicator*, IGAE), which will be released simultaneously (chart below, right). The bulk of the change would be in industrial activity, as it has already been revised down to a contraction of 2.5% yoy in December from around -1.8% implied in the preliminary report. We also believe services will be weaker, with the sector going from 1.5% to 1.4%, with most of the impact in transportation, closely related to manufacturing. Considering this, secondary activities would have ended the quarter with a 0.9% yoy contraction, below the -0.7% originally published. On the other hand, services would end at 2.8% from 2.9% previously, with the same performance expected for the quarter in primary activities.

Going forward, we believe weakness in economic activity at the end of last year will continue at least in 1Q19. First, global growth has moderated, particularly in manufacturing. Second, we expect a negative impact due to some recent events, including delays in gasoline distribution in several states, railway blockades in Michoacán, and strikes in manufacturing companies in Tamaulipas. For details, see: “A slightly lower growth rate in 2019 due to certain transitory events”, <[pdf](#)>, February 15<sup>th</sup>, 2019.

**GDP**

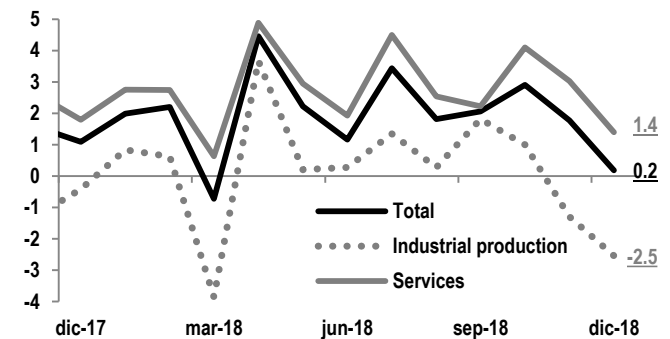
% yoy, full-year in dotted line



Source: INEGI, Banorte

**Global Economic Activity Indicator**

% yoy



Source: INEGI, Banorte

**The current account deficit in 4Q18 would moderate to US\$4,435 million.**

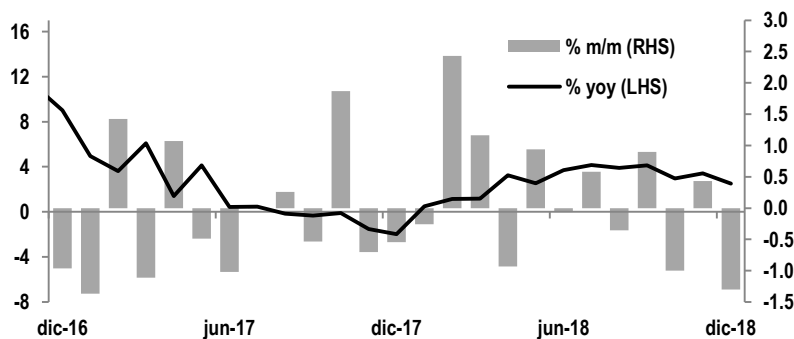
Next Monday, at 10:00am, Banxico will release its balance of payments report for the fourth quarter of last year. We are forecasting a US\$4.4bn deficit in the current account. According to data already released, the trade balance during the period amounted to -US\$3,482 million, while net transfers picked up as a result of 9.4% yoy increase in remittances. As a result, the current account in 2018 would be at a US\$ 21.5bn deficit, 12.6% wider than the US\$ 19.1bn deficit of the previous year.

**Retail sales will likely decelerate in December, along weaker economic activity.** We estimate a 2.5% yoy increase, below the 3.4% in November. In seasonally-adjusted terms, we expect a 1.3% m/m contraction. With these figures, retail sales in 4Q18 would fall 0.7% q/q after the +0.9% of the previous quarter. In our view, several signs suggest a deceleration, including: (1) Weakness in same-store sales according to *ANTAD*, falling 1.8% yoy in real terms, weakest since April; (2) auto sales falling 10.8%; (3) the steep increase in unemployment during the month, surging to a two-year high in seasonally adjusted terms; and (4) the deceleration in both non-oil consumption goods imports and the pace of real-wage gains.

On the contrary, consumer confidence surged to a new post-crisis high in December, a situation we attribute in great part to optimism about the start of the new administration. This was accompanied by announcements about higher minimum wages and tax cuts at the Northern Border starting in 2019, which could have impacted the behavior of beneficiaries on expectations of a higher permanent income. Other positive factors include the resiliency in remittances and the strengthening of the Mexican peso during the month. In this respect, we continue believing consumption will maintain a strong performance in spite of lower economic growth, but with the retail sector impacted at the start of 2019 by delays in fuel distribution, which could have reduced the incentive to go out.

#### Retail sales

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



Source: INEGI, Banorte

**Weekly international reserves report.** Last week, net international reserves fell by US\$10 million, closing at US\$175.5 billion. According to Banxico's report, this figure comes mainly from a negative valuation effect in central bank assets. In this context, the central bank's international reserves have increased US\$708 million during 2019 (please refer to the following table).

#### Banxico's foreign reserve accumulation detail

US\$, million

	2018	Feb 15, 2019	Feb 15, 2019	Year-to-date
	Balance		Flows	
International reserves (B)-(C)	174,793	175,501	-10	708
(B) Gross international reserve	176,384	180,285	-157	3,901
Pemex	--	--	-310	44
Federal government	--	--	138	3,470
Market operations	--	--	0	0
Other	--	--	15	387
(C) Short-term government's liabilities	1,592	4,784	-147	3,193

Source: Banco de México

**Weekly government bond auction.** The Ministry of Finance (MoF) –via Banco de Mexico as its financial agent, will offer 20-year fixed-rate Mbonos (Nov’38), 30-year Udibonos (Nov’46), 5-year Bondes D, in addition to the “traditional” 1-, 3-, 6-, and 12-month zero-coupon Cetes (please refer to the following table). As usual, results will be released at 12:30pm (ET).

**Auction specifics (Tuesday, February 19<sup>th</sup>, 2019)**

	Maturity	Coupon rate, %	To be auctioned <sup>1</sup>	Previous yield <sup>2</sup>
<b>Cetes</b>				
1m	28-Mar-19	--	5,000	7.85
3m	30-May-19	--	5,000	8.10
6m	29-Auo-19	--	10,500	8.19
12m	27-Feb-20	--	13,000	8.42
<b>Bondes D</b>				
5y	21-Dec-23	--	5,500	0.14
<b>Mbonos</b>				
20y	16-Nov-38	8.50	2,700	8.93
<b>Udibonos</b>				
30y	08-Nov-46	4.00	UDIS 450	4.29

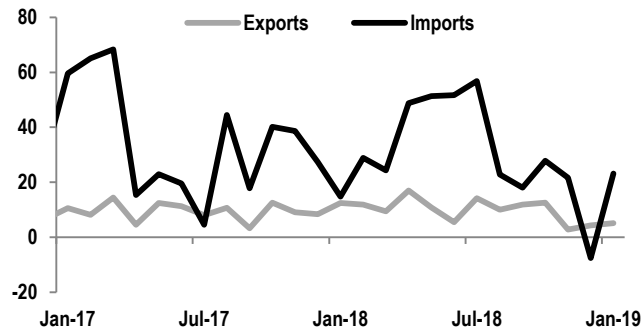
Source: Banorte with data from Banco de México 1. Except for Udibonos, which are expressed in UDI million, everything else is expressed in MXN million. 2. Yield-to-maturity reported for Cetes, Mbonos and Udibonos

**Trade balance expected to return to deficit.** We expect a US\$3,491.3 million deficit in January, back to negative after the surprise surplus of US\$ 1,836.3 million of the previous month, a historical high since the data is available (1991). Several events could have influenced the oil balance, which we expect with a US\$ 2,137.4 million deficit. Exports are estimated at 13.9% yoy, driven by a significant increase in volume. In particular, this would be due to a positive substitution effect for Mexico’s heavy crude-oil after US sanctions on Venezuela. Nevertheless, according to the Ministry of Energy imports also surged after declining strongly in December. As a result, we anticipate a 23.2% increase in this category. This occurred in a context in which the price of the Mexican crude oil mix fell 11.2% yoy, dampening the effect of volume growth when measured in cash.

Going to the non-oil balance, we expect a US\$ 1,353.9 million deficit, which we believe will be influenced by supply-chain disruptions. In autos this effect could be limited, with official data showing total exports growing 4.9% yoy, highest since September 2018. Moreover, the sector in the US remains relatively strong. Non-auto exports could moderate because of these problems, estimated at 3.5% yoy from 6% in December. We anticipate weakness in imports concentrated in non-oil consumption and capital goods, falling 3.4% and 8.5%, respectively. The latter would be explained to a great extent by the moderation in economic activity at the end of last year and the weak outlook for private investment.

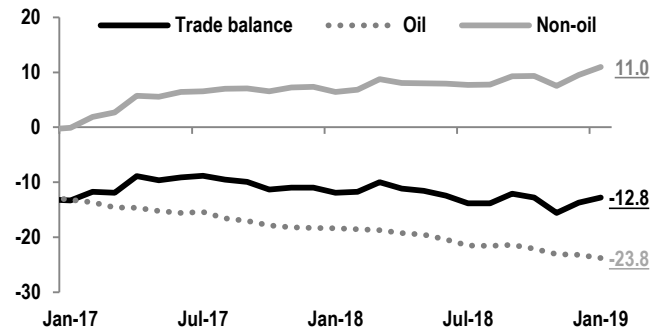
In conclusion, we estimate total exports and imports to grow 5.1% and 1.8%, respectively. With these, the 12-month rolling trade balance deficit would moderate to US\$ 12,775.9 million from US\$ 13,704.4 million in the previous month, driven by the relative improvement in the non-oil balance on the back of lower imports (see chart below on the right).

**Exports and Imports**  
% yoy



Source: INEGI, Banorte

**Trade balance**  
US\$ billion, 12-month rolling sum



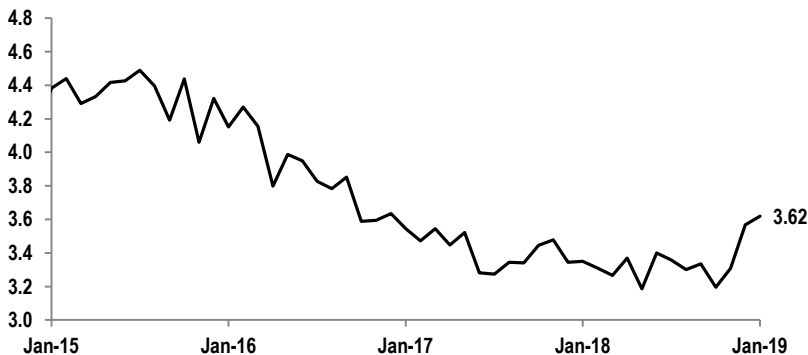
Source: INEGI, Banorte

**The unemployment rate could tick-up again in January.** We estimate the unemployment rate at 3.67% nsa, significantly above the 3.35% of the previous month. With seasonally-adjusted data, the unemployment rate had already increased meaningfully in December, with our forecast consistent with an additional marginal increase of 5bps to 3.62%.

In our opinion, this slight increase could reflect an impact on employment from supply chains disruptions, having a transitory and negative effect in the month. Nevertheless, the bulk of the increase would be driven by the deceleration in annual employment growth since the middle of 2018, currently at 2.5% yoy and the lowest since May 2014. This is relevant as employment in that period was impacted by the tax reform that started that year. Additionally, the unemployment rate could feel the impact of the moderation in economic activity that has been observed since last month.

All in all, we reiterate our view that unemployment reached its cyclical low last year, with a higher average level expected in 2019 both on greater local uncertainty and a global deceleration in economic activity, particularly in the manufacturing sector.

**Unemployment rate**  
%, sa



Source: INEGI, Banorte

**Banxico will likely downgrade its growth outlook in the 4Q18 Quarterly Report.** Banco de Mexico will publish its *Quarterly Report* (QR) for 4Q18 on Wednesday around 1:30pm (ET). The release will be accompanied by a press conference led by Governor Diaz de Leon. We expect the report to reaffirm the less hawkish bias that we perceived in the latest statement and minutes. Moreover, we expect market participants to focus on:

(1) *Likely downgrade in GDP forecasts.* In our opinion, GDP forecasts are likely to be revised lower, particularly for 2019. In its latest communiqué and minutes, Banxico maintained that risks were skewed to the downside, stemming from both external and domestic factors. In the former, they included trade tensions between the US and China and its impact in terms of lower global growth (which is already materializing in both countries), and the US shutdown, among others. Locally, they recognized the deceleration in 4Q18, while one member stated that it could extend to the first months of this year. We will be on watch for further details about the magnitude of the impact of recent transitory shocks, such as delays in fuel distribution and railway blockades. We have forecasted that these will reduce GDP by a cumulative 33bps in 2019, with our full-year estimate currently at 1.5% yoy. For details, see: “A *slightly lower growth rate in 2019 due to certain transitory events*”, <[pdf](#)>.

In this context, consensus GDP estimates are already below those of the central bank, a situation acknowledged in the minutes. In particular, the mid-point for 2019 GDP in Banxico’s 3Q18 QR is at 2.2%, 40bps higher than analysts at 1.8% according to January’s central bank survey (see table below). In our view, the central bank could lower its forecast range for 2019 GDP by around 30bps, with the mid-point going from 2.2% to 1.9%.

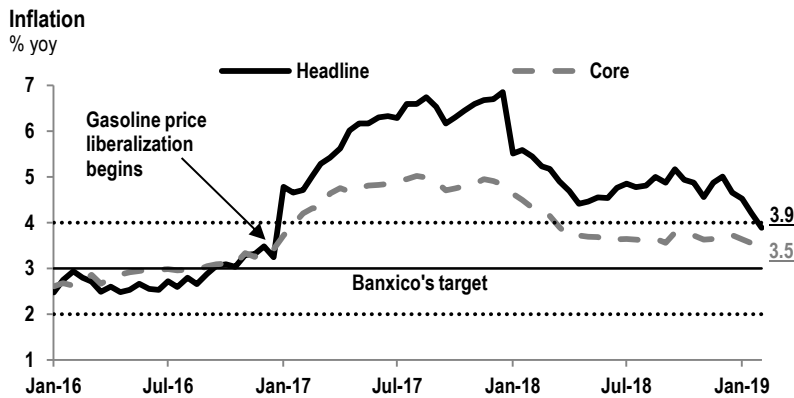
**GDP growth forecasts**

% yoy

Quarter	2019				2020			
	Banxico	Range	Consensus*	Range	Banxico	Range	Consensus*	Range
1Q18	2.7	2.2 - 3.2	2.4	1.6 - 3.0	--	--	2.6	0.9 - 3.3
2Q18	2.7	2.2 - 3.2	2.3	1.6 - 3.0	--	--	2.5	1.4 - 3.1
3Q18	2.3	1.8 - 2.8	2.1	1.6 - 2.8	--	--	2.4	0.5 - 3.1
4Q18	2.2	1.7 - 2.7	1.9	1.5 - 3.0	2.5	2.0 - 3.0	2.2	0.5 - 3.0
Last	--	--	1.8	1.0 - 2.8	--	--	2.0	0.5 - 3.2

Note: \*According to Banxico's survey median estimate at the mid-month of the quarter. For the central bank, the forecast in any given quarter is established according to the QR's release date, not its name  
Source: Banxico

(2) *Marking lower short-term headline inflation, with core persistently high.* Recent inflation figures have surprised lower, resulting in a meaningful shift in annual inflation from 4.83% in December to 3.89% in 1H-Feb, within the upper end of Banxico’s target range. This was acknowledged by the central bank in the minutes, attributed to the fall in the non-core component. We believe this is relevant as headline inflation had stayed above the 3% +/- 1% limit since January 2017, when the liberalization of gasoline prices began (see chart below). Moreover, we think upside risks to inflation due to demand-side pressures have decreased given the outlook for GDP, with the central bank forecasting it below potential in the period of influence of monetary policy.



Source: INEGI

Banxico has maintained a prudent stance as all members consider that the resistance to the downside of core inflation is a source of concern while expectations remain elevated. Additionally, even after recent positive surprises in the non-core component, most agree that the evolution of headline inflation has stayed in line with their estimates.

In this respect, annual inflation in January stood at 4.4% yoy, which is Banxico's current forecast for 1Q19. Nevertheless, it dipped to 3.89% in 1H-Feb, which in our view could result in a downward revision in the short-term forecasts, particularly the first half of the year. On the other hand, the possibility of a cut estimates for core inflation looks more complicated, currently at an average of 3.6% for the same period, even with one member stating in the minutes that the paths for all components could be converging towards the target faster than anticipated.

In conclusion, we believe the QR will reflect the less hawkish tone that we perceived in recent communications. In the overall balance, Banxico's Board is more concerned about upside risks to inflation, justifying the need to remain vigilant. The latter is driven by the high degree of uncertainty about the inflation outlook and as the recent fall in inflation has been due to the decline in the non-core component, while core inflation remains stubbornly high. Nevertheless, lower growth prospects, both globally and domestically, will likely result in higher slack in terms of the output gap. Considering these factors, coupled with our outlook for growth, inflation and global monetary policy, we maintain our view that the central bank will remain on hold at 8.25% for the rest of the year. Further ahead, we see a higher probability of a rate cut in 2020.

**Banking credit will show a 5.6% yoy increase in January.** It is our take that credit to the non-financial sector continued flowing in the first month of the year. In particular, we estimate a 5.6% yoy expansion in real terms to this sector as a result of a 1.7% increase in consumer credit, coupled with a 4.6% and 7.2% expansion in mortgages and corporate credit, in the same order.

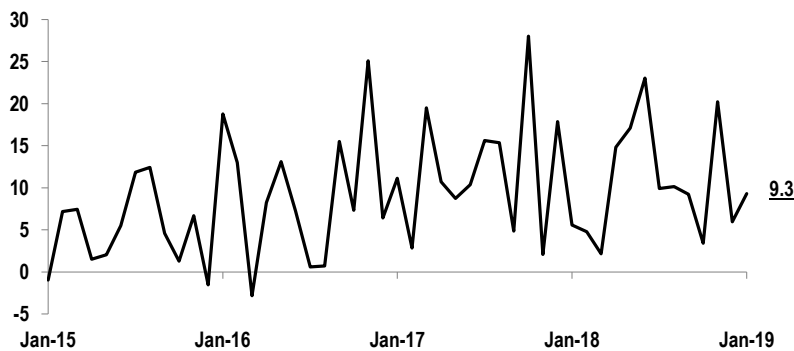
**Remittances to maintain their positive trend.** We expect remittances in January at US\$ 2,478.6 million (+9.3% yoy), slower than the full-year 2018 advance of 10.5% but still quite healthy. It is worth mentioning that the first month of the year is typically slow, which could be related to higher expenses in the holiday period. Moreover, we believe that a slight deceleration could be felt due to higher uncertainty due to the US shutdown. The Mexican peso appreciated quite strongly during the month at 4.7%, which could also dampen the recent dynamism.

Nevertheless anti-immigration rhetoric remained high, with the Border Wall at the center of this issue and which in our view has stimulated the flow of remittances. Additionally, employment of Mexican migrants with citizenship rebounded to positive territory in their annual comparison after two months of contraction, standing at +2.5%. On the other hand, migrants without citizenship also grew but at a more modest pace of 2.0%.

In conclusion, we believe that remittances in 2019 could moderate their pace of growth but will stay quite healthy, mainly as a result of an expected deceleration in economic activity in the US that could have an impact on the rate of employment creation for Mexican migrants.

**Family remittances**

% yoy



Source: Banxico

**Banxico’s survey of economic expectations.** As usual, market focus will center on inflation forecasts. The median for 2019 stands at 3.80%, above our 3.5% forecast. Moreover, the medium-term estimates remain above target, standing at 3.4%. In addition, estimates for the reference rate will also be published. Our expectation is for Banxico to remain on hold at 8.25% for the remainder of 2019.

Moreover, forecasts for GDP will also be published. In the last survey, economists expected growth in 2019 at 1.8%, above our 1.5% forecast. For 2020 it stands at 2.0%. Finally, regarding the exchange rate, we could see a marginal revision, considering that the YE19 forecast stands at USD/MXN 20.20 (Banorte: 21.30).

**MoF's public finance report (January).** In this report, attention will center on the public balance figures for the first month of 2019. It should be noted that PSBRs at the end of 2018 stood at a 2.3% of GDP deficit, marginally better than expected. In addition, attention will focus on the revenue and spending figures, especially when compared to the 2019 Budget. Finally, we will also look into public debt figures, which as of December stands at 44.8% of GDP (as measured by the HBPSBRs).

**PMI indices mixed but both in expansion in February.** It is worth considering that, after delays in fuel distribution and railway blockades at the end of January and the first half of February, the “deliveries” component in the previous month fell strongly in manufacturing but increased in the services sub-index. In our view, these changes could reverse somewhat as blockades were lifted in the by the end of the first half of the month. Moreover, “inventories” in manufacturing may also have rebounded given the normalization of supply chains since in recent weeks.

Considering the latter, we expect a slight rebound in the manufacturing PMI to 50.1pts, returning to expansion territory after three consecutive months in contraction. In a positive note, auto production accelerated significantly in January, a situation that could continue in February which could provide some support to the headline. Nevertheless, this could be limited given that US manufacturing showed mixed results but with a negative bias at the margin according to the PMI and Philly Fed indices. Moreover, strikes in Matamoros, Tamaulipas could limit the upside, although it worth noting that they ended in the first days of the month and the share of national production of this city is relatively low.

Going to the non-manufacturing index, we expect a slight deceleration to 50.4pts from 50.6pts. In our view, the main driver behind this would be the increase in unemployment observed since December. Nevertheless, the sector should remain in expansion territory as optimism about the outlook for the Mexican economy remains high while inflation has recently surprised to the downside, particularly in the non-core component. Last but not least, expectations about higher incomes remain elevated even if the deployment of new transfer programs by the federal administration has not formally began due to administrative delays.

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<b>HOLD</b>	<i>When the share expected performance is similar to the MEXBOL estimated performance.</i>
<b>SELL</b>	<i>When the share expected performance is lower than the MEXBOL estimated performance.</i>

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