Ahead of the Curve

Busy two weeks ahead, with Banxico's minutes and October's economic activity

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This is the last publication of the year. We will resume on January 6th. Happy Holidays!

Document for distribution among the general public

- **Banxico's minutes (December).** In our view, the minutes will help to shed more light about the possible depth of the easing cycle in 2020, which we believe was confirmed to continue in the latest statement. Nevertheless, the tone of the communique, while still dovish, was more modest than recent publications, introducing more uncertainty to our forecast. In this sense, we will pay special attention on Board members' comments about the balance of risks for inflation, voting results, and views on recent changes to the economic outlook. Although we are confident about our short-term call of 25bps cuts in the February, March and May meetings, we are more doubtful about the remaining 50bps for the rest of the year, with our current forecast calling for accumulated cuts of 125bps in 2020

Mexico weekly calendar

DATE	HOUR (ET)	EVENT	PERIOD	UNIT	BANORTE	CONSENSUS	PREVIOUS
Mon 23-Dec	**7:00am**	**Aggregate Demand**	3Q18	% yoy	-0.4	--	-1.0
		Private consumption		% yoy	0.6	--	-0.3
		Government consumption		% yoy	0.7	--	-2.3
		Gross-fixed investment		% yoy	-6.5	--	-7.3
Mon 23-Dec	**7:00am**	**CPI inflation**	1Q Dec	% 2w/2w	0.38	0.37	0.09
				% yoy	2.67	2.65	2.97
		Core		% 2w/2w	0.38	0.41	0.01
				% yoy	3.61	--	3.65
Mon 23-Dec	**12:30pm**	**Government weekly auction: 1-, 3-, 6-month CETES; 5y Mbono (Sep'24); 10y Udibonos (Nov'28)**					
Tue 24-Dec	**7:00am**	**Unemployment rate**	November	%	3.52	--	3.65
		sa		%	3.58	--	3.60
Tue 24-Dec	**7:00am**	**Global economic indicator**	October	% yoy	-1.4	--	0.1
		(sa)		% m/m	-0.9	--	0.3
		Primary activities		% yoy	0.3	--	9.4
		Industrial production		% yoy	-3.0	--	-1.8
		Services		% yoy	-0.9	--	0.6
Tue 24-Dec	**10:00am**	**International reserves**	Dec-21	US$ bn	--	--	180.6
Fri 27-Dec	**7:00am**	**Trade balance**	November	US$ mn	198.1	--	-725.6
		Total exports		% yoy	2.1	--	-1.5
		Oil exports		% yoy	-13.3	--	-30.4
		Non-oil exports		% yoy	3.1	--	0.4
		Total imports		% yoy	-4.1	--	-6.4
Mon 30-Dec	**12:30pm**	**Government weekly auction: 1-, 3-, 6-, 12-month CETES; 30y Mbono (Nov'47); 30y Udibonos (Nov'50); 5y Bondes D**					
Mon 30-Dec	**4:00pm**	**Budget balance**	November	MXN bn	--	--	-196.0
Tue 31-Dec	**10:00am**	**Comercial banking credit**	November	% yoy	3.1	--	2.6
		Consumption		% yoy	3.0	--	2.8
		Mortgage		% yoy	7.6	--	7.5
		Firms		% yoy	1.4	--	1.0
Tue 31-Dec	**10:00am**	**International reserves**	Dec-28	US$ bn	--	--	--
Thu 2-Jan	**10:00am**	**Family remittances**	November	US$ mn	3,008.5	--	3,125.5
Thu 2-Jan	**10:00am**	**Banxico's minutes**	December				
Thu 2-Jan	**1:00pm**	**PMI's survey (IMEF)**	December				
		Manufacturing		index	46.9	--	46.0
		Non-manufacturing		index	48.8	--	48.6

Source: Banorte; Bloomberg

Proceeding in chronological order...

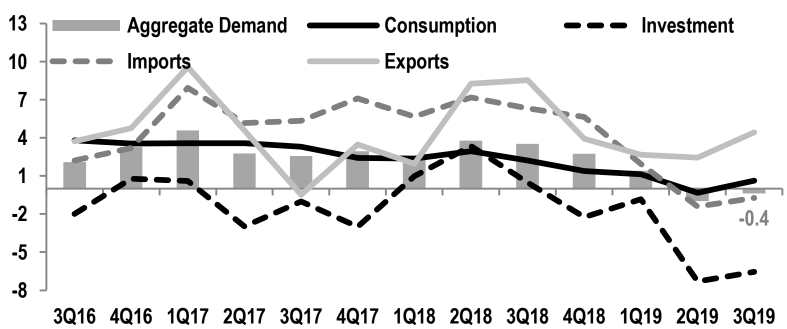
Weak aggregate demand in 3Q19 on investment, but slightly stronger consumption and government spending. We expect a 0.4% yoy contraction, above the -1.0% of the previous quarter. As has been the case since 4Q18, the main driver would be the drag from investment, at -6.5% yoy. As mentioned in our monthly reports, both public and private investment have been weak, with the former lower on fiscal constraints and the first year of government, and the latter particularly on imported machinery and equipment, and construction.

On a more positive note, we expect consumption to rebound to 0.6% yoy (from -0.3% previously). Data such as retail sales suggests a better performance, although still contained by purchases of domestic durable goods, at -6.7%. Nevertheless, and in line with trade balance figures, the imported component has improved. In this respect, we also expect total imports to fall 0.7%, stronger relative to the -1.4% of 2Q19. On the other hand, exports would improve to 4.4%, supported by resiliency in manufacturing and substitution effects due to US-China trade tensions.

In government we see a 0.7% expansion, the first positive print since 4Q18. The base effect is more favorable, taking into account that spending accelerated last year precisely in the second quarter, just ahead of the federal election. Spending has also improved as incoming officials have adapted more to their responsibilities. According to public finance reports, budgetary spending surged 6.8% yoy –in nominal terms–, strongest in a year. Nevertheless, bank account balances in states and municipalities showed an accumulation of resources, which could damp the positive effect.

For 2020, we see better results mainly in two key components. In consumption, we believe higher wages, low inflation, and social spending could help, regaining dynamism after moderating this year. In investment we also expect better performance, with more resources in infrastructure projects and with more enticing opportunities for the private sector after the recent agreement with the Federal Government. The USMCA deal may also help. Nonetheless, we still believe higher business confidence is needed, which so far remains low.

Aggregate demand
% yoy (nsa)



Source: INEGI, Banorte

Annual inflation to edge-down considerably, driven in large part by a favorable base effect. We estimate headline inflation at +0.38% 2w/2w in the first half of December, above the 0.09% of the previous fortnight. Core inflation is expected also at 0.38% (previous: 0.01%), which translates into a 29bps contribution. A large part of the impact would stem from the usual seasonality of the month, with substantial increases in other services, which would add 17bps, most of them concentrated in air fares and tourism (+12bps between both). Nevertheless, goods would also be pressured to the upside (+11bps), especially in other goods at +6.5bps, reversing the fall seen in the previous fortnight, in which the component was benefited by the discounts of *El Buen Fin* (Mexico's Black Friday).

Going into the non-core component, this would increase 0.38% too, but only adding 9bps to the headline. Regarding agricultural goods, we estimate a 7bps impact, driven largely by the seasonality in meat and egg, but also by specific pressures in onions and husk tomatoes. Nevertheless, the latter would be offset by declines in tomatoes and potatoes. Going to energy, LP gas could continue to climb, in line with the usual behavior for the period, adding 2bps and stringing six bi-weekly prints with an increase. Meanwhile, gasoline would remain relatively stable, with a practically null contribution in the period. This would happen in a context of climbing international prices, offset by the appreciation of the MXN.

With these results, annual inflation would come in at 2.67% from 2.97% in November, lowest since August 2016. The core component would continue to edge-down, standing at 3.61%, an eight-month low. In addition, the non-core component would slide into negative territory at -0.08%, the first time this happens in the history of the series. However, we should note that part of these declines are explained by a relevant base effect, remembering that in the same period of 2018 there were relevant pressures in prices, which is favorable for this year.

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 Udibonos (Nov'28), in addition to 1-, 3-, and 6-month zero-coupon Cetes (see following table). As usual, results will be released at 12:30pm (ET).

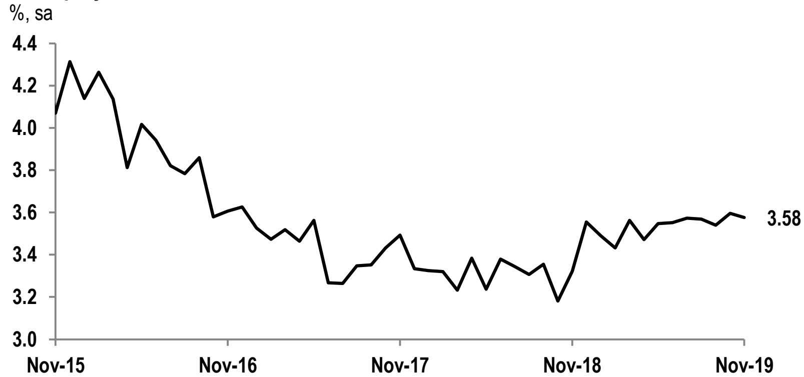
Auction specifics (Tuesday, December 17th, 2019)

	Maturity	Coupon rate, %	To be auctioned[1]	Previous yield[2]
Cetes				
1m	23-Jan-20	- -	6,000	6.80
3m	26-Mar-20	- -	10,000	7.14
6m	18-Jun-20	- -	10,000	7.24
M Bono				
5y	05-Sep-24	8.00	6,200	6.99
Udibono				
10y	30-Nov-28	4.00	UDIS 650	3.38

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

November's unemployment rate slightly higher after a hiccup in industry. We estimate a 2bps decline to 3.58% sa, which would modestly revert part of the last month's uptick. In particular, and remembering that data is survey-based, we believe that large part of the improvement would be explained by the relative recovery in industry, which was impacted strongly by a series of temporary shocks in October. Other positive signs include IMEF's employment sub-index within the manufacturing sector, which posted a significant recovery to 44.4pts from 43.5pts, which could also be explained by the latter factor. In addition, the services sector is stabilizing, with a 0.1pts increase to 48.3pts, which seems to validate the signal of a slight reduction in the unemployment rate. Regarding formal employment, in November there was a net job creation of 76,228 positions, which maintained the annual rate of expansion at 1.7%, showing some persistence around these levels since August and with the last three months showing an increase in the pace of job creation. Nevertheless, the outlook for economic activity, as well as known figures for the period, continue to be limited, still making us think that this will remain as the main obstacle for a considerable decline in the unemployment rate. As a result, we maintain our view that the unemployment rate will finish the year around 3.6%, with risks broadly balanced.

Unemployment rate
%, sa



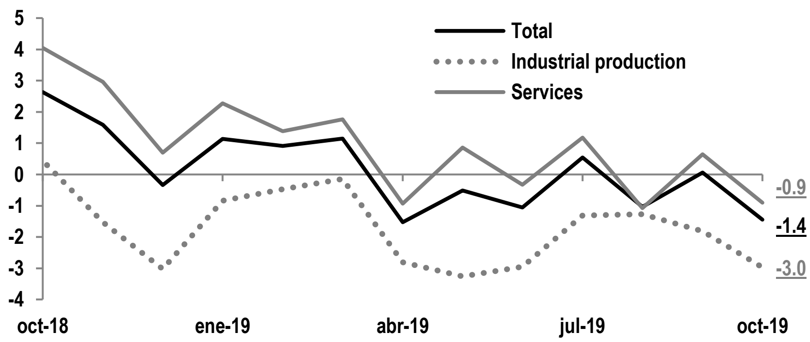
Source: INEGI, Banorte

The economy was likely weak in October. We estimate the *Economic Activity Indicator* (IGAE) at -1.4% yoy, below the 0.1% of the previous month. With seasonally-adjusted figures we anticipate a 0.9% m/m drop, which would be the weakest so far this year. As already known, industrial activity was very low, falling 1.1% m/m, affected by temporary shocks in autos and oil-related mining.

In services, we estimate a 0.9% yoy decline (-0.5% m/m). We believe this sector will also be affected by weakness in autos, impacting transportation services the most. Moreover, retail sales disappointed, growing only 0.4% yoy. On the other hand, the IMEF non-manufacturing index has stabilized in contraction territory, signaling relatively subdued levels of activity in terms of domestic demand. Relatedly, the unemployment rate picked up in the period despite formal job creation gathering some pace. We also anticipate government activities to stay negative, with public finance data showing that federal spending fell 5.1% yoy in real terms.

We maintain our -0.2% yoy GDP forecast for 4Q19, resulting in a full-year contraction of 0.1%, slightly below market expectations. Although this could likely be reversed in November as it was due to temporary shocks, other forward-looking indicators suggest activity has stayed limited, with the bright spot in some consumption figures, but overall consistent with our expectations of only a modest recovery in the last quarter of the year.

IGAE
% yoy (nsa)



Source: INEGI, Banorte

Weekly international reserves report. Last week, net international reserves increased US$147 million, closing at US$180.6 billion. According to Banxico's report, this comes from a positive valuation effect in central bank assets. In this context, the central bank's international reserves have increased US$5.8 billion during 2019 (please refer to the following table).

Banxico's foreign reserve accumulation detail
US$, million

	2018	Dec 13, 2019	Dec 13, 2019	Year-to-date
	Balance		Flows	
International reserves (B)-(C)	174,793	180,616	147	5,824
(B) Gross international reserve	176,384	185,781	317	9,397
Pemex	--	--	170	297
Federal government	--	--	-48	3,444
Market operations	--	--	0	0
Other	--	--	194	5,656
(C) Short-term government's liabilities	1,592	5,164	170	3,573

Source: Banco de México

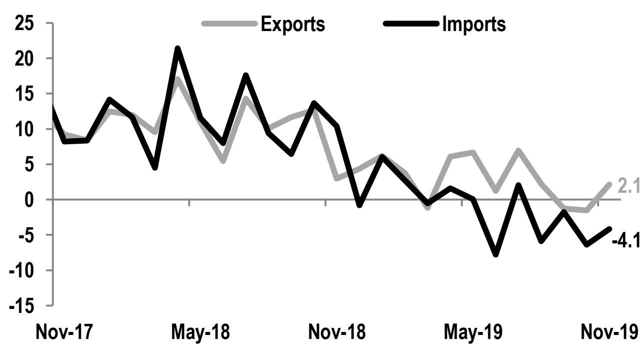
Trade balance back to surplus on recovery of auto and oil exports. We estimate a US$198.1 million surplus, back to positive after two months with moderate deficits. In particular, we forecast total exports to jump 2.1% yoy from -1.5% in October, while imports would recover more modestly, towards -4.1% from -6.4%. Both the oil- and non-oil balances would be more positive relative to October, at -2,115.4 and +2,313.5 million, respectively. Year-to-date, the accumulated balance if our forecast materializes would stand at +US$2,159.8 million, the first positive balance till November since 1997.

In oil, we estimate a relative recovery in exports despite staying negative, at -13.3% from -30.4%. According to our monitoring, the Mexican oil mix picked up slightly to 50.55 US$/bbl, with the annual comparison also benefitted by a base effect. Volumes were significantly higher in the period. As a result, we see crude-oil at -13.7%.

Regarding imports, we also expect some rebound, with gasoline prices and shipments from the US both climbing. Although we continue expecting higher production in 2020, the jury is still out on whether the recovery will be fast enough to lift the oil balance, with the 12-month rolling sum as of last month standing at -US$22.5 billion, slowly but surely increasing from an all-time low observed in May.

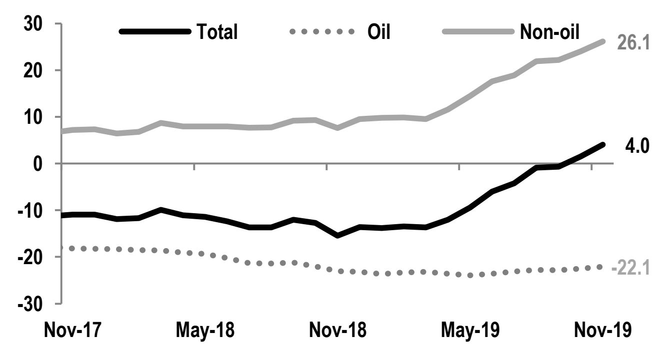
Going to non-oil, we forecast exports to advance 3.1% accelerating from 0.4% in the previous month. Recent weakness in exports has been mainly due to the shock in the auto sector on some temporary events. In this respect, it should be noted that AMIA shows exports remained negative, at -7.5% yoy. A more positive sign came from autos within US IP, which rebounded to 1.6% from -10.7% previously. Nevertheless, this would be much better than the -13.3% average decline in September-October, when the GM strike was in place. In particular, we see autos up 2.9%, while other manufacturing would moderate to 2.4%, maintaining a resilient performance. In imports, intermediate goods would also improve at the margin (-2.4%), given the more sizable advance in manufacturing exports. The weak spot would remain in capital goods, which are likely to keep falling at a double-digit pace in annual terms given that business confidence edged-down further during the period. Lastly, consumption goods would show a better performance, albeit decelerating at the margin to 3.1%

Exports and Imports
% yoy



Source: INEGI, Banorte

Trade balance
US$ billion, 12-month rolling sum



Source: INEGI, Banorte

Weekly government bond auction. The Ministry of Finance (MoF) –via Banco de Mexico as its financial agent, will offer 30-year fixed-rate Mbonos (Nov’47), 30-year inflation-linked Udibonos (Nov’50), 5-year Bondes D, in addition to the “more traditional” 1-, 3-, 6-, and 12-month zero-coupon Cetes. Details about the specific instruments to be offered will be released on December 27th.

MoF’s public finance report (November). Attention will center on the public balance and PSBRs, with the latter accumulating an MXN$196.0bn deficit in the first ten months of the year. It should be noted that the primary balance at the end of October stood at +MXN$296.5bn, better than the +MXN$191.4bn forecast. Focus will also be on revenues and spending, especially compared to the MoF’s updated *2019 Macroeconomic Forecasts*. In this context and on a year-to-date basis, revenues undershot the forecast by MXN$33.0bn, while expenditures have done so by MXN$155.4bn. Finally, we will also look at public debt, which as of October stood at MXN$10.6tn, equivalent to 42.5% of GDP (as measured by the HBPSBRs).

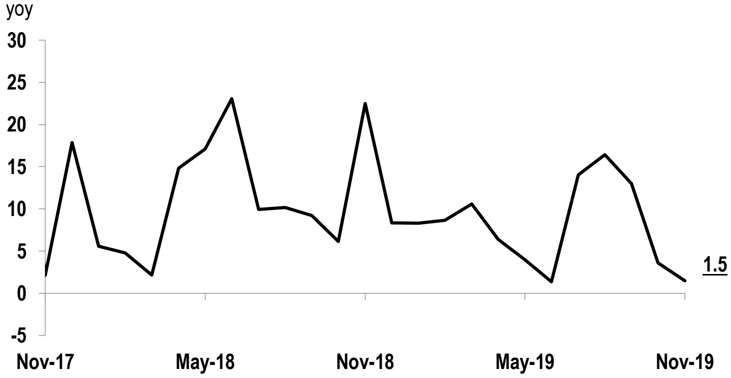
We expect banking credit to grow 3.1% yoy in November. It is our take that credit to the non-financial sector kept expanding during the month. We estimate a 3.1% yoy expansion in real terms, slightly higher than the 2.6% growth of the previous month. This would be driven by a 3.0% increase in consumer credit, coupled with a 7.6% and 1.4% expansion in mortgages and corporates, in the same order. In line with the previous month, there shouldn't be an additional boost from inflation, given that it stood at 2.97% in November, only 5bps below October's print.

Remittances to keep slowing down in November. We expect remittances at US$3,008.5 million, up 1.5% yoy, slowing down relative to the +3.6% of the previous month. Regarding the amount, we should remember that the figure is skewed to the downside due to *Thanksgiving*, which subtracts between one or two labor days depending on the sector of economic activity.

Overall, news about migration were negative, with the announcement of possible restrictions for asylum seekers which entered the US illegally and who are applying for a working permit, as well as the resolution date for *DACA*, which given the current composition of the Supreme Court, could end as soon as next June. Going to other variables, the Mexican peso was relatively stable, averaging USD/MXN 19.33 during the month (previous: 19.32). However, the overall trajectory was upwards, closing the month at around 19.54, which could have had a favorable impact in the monthly amount.

With this, remittances would add up to US$33,075.6 million so far in 2019, 7.8% above the same period of the previous year. We maintain our view that full-year growth will be slightly more modest when compared to the 11.2% of 2018, impacted by lower dynamism in Mexican migrants' employment growth in the US.

Family remittances
% yoy



Source: Banxico

Banxico's minutes to shed more light on the possible depth of the easing cycle. The statement from the last monetary policy decision of 2019 confirmed, in our view, that the central bank will continue easing into 2020, doing so in a prudent manner. However, we believe the tone, while still being dovish, was less than previous publications, reducing our conviction of the possible magnitude of the easing cycle. In this sense, we believe the minutes will be particularly relevant, with special attention on comments from different Board members on the balance of risks for inflation.

As we mentioned at the time of the decision, one of the most relevant adjustments was related to the possible pass-through of higher wages (when these exceed productivity gains) to prices, which we believe gained more importance for the Board after the recent minimum wage increase. It should be noted that this factor had already been set as the second most important in the list of upward risks for inflation in the previous decision. In this context, the fact that there were more specific comments on this point leads us to believe that, within the minutes, discussions on the matter will be plentiful, exploring the potential impact across the economy in terms of the lighthouse effect, employment conditions and the price formation process. Something we will probably see, is Deputy Governor Esquivel arguing that the impact on inflation should be limited, based on his recent comments in this respect on social media.

In addition, we will be look into the evolution of the reasons for dissenting for one of the Board members. Moreover, there is a small chance that the five members were not present, which would convey a different signal than if the vote was 4-1 (as this would imply that one member stopped voting for a 50bps cut). Other relevant points to watch include the evaluation of changes in the economic outlook, particularly: (1) The improvement in trade relations between the US and China; (2) progress on *Brexit* (after the results of the UK election); and (3) the agreement for the ratification of USMCA. Within these, we believe the most relevant will be about the implications these could have on growth, inflation, and financial stability.

Overall, we expect the document to shed light on whether we maintain our expectation about the magnitude of the easing cycle, remembering that we expect accumulated cuts of 125bps in 2020. Although we are certain about our short-term outlook of 25bps cuts in the February, March and May meetings, our doubts are concentrated on the remaining 50bps in the remainder of the year.

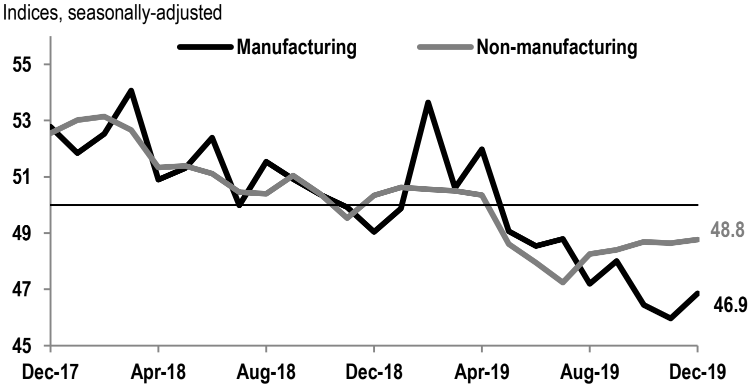
IMEF indicators to stay in contraction in December. Uncertainty about performance is higher than usual –given that as of today, the month has not even finished–. Despite of the latter, some signs of a modest improvement have emerged, which we use as the main inputs to our estimates.

We expect the manufacturing indicator at 46.9pts, reversing the accumulated decline of the previous two months, which we believe were distorted by weakness in autos due to GM's strike in the US. We anticipated some rebound in November, which failed to materialize and is somewhat concerning. Nevertheless, we take some comfort from the signal of the US flash PMI manufacturing index, which despite staying broadly stable at 52.5pts, saw advances in output and new orders, along renewed life in export orders. The latter is likely related to autos, with the impact clear in Mexico's IP and trade balance for October, but with other manufacturing resilient.

On the other hand, some optimism may also result from the agreement on changes to USMCA, particularly as the deal opens the way for a possible ratification in the US as soon as this year or in early 2020. This was coupled with the "Phase One" deal between the US and China. In our view, this may already be reflected north of the border, with output expectations by manufacturers highest since June, according to *Markit*.

In non-manufacturing we see a more modest uptick, to 48.8pts from 48.6pts in the previous month. Broadly speaking, our main concern remains the lack of evidence of stronger business confidence, with November data (latest available) declining across all sectors. Construction, included in this indicator, is also very weak, in our view limiting the potential upside. Other indicators such as consumer confidence and inflation were broadly stable. Meanwhile, we believe tentative signs of a stronger performance in consumption –including stronger-than-expected sales close to 7% in *El Buen Fin,* according to CONCANACO– may help the to continue showing some stabilization.

IMEF indices
Indices, seasonally-adjusted



Source: IMEF

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	Reference
BUY	When the share expected performance is greater than the MEXBOL estimated performance.
HOLD	When the share expected performance is similar to the MEXBOL estimated performance.
SELL	When the share expected performance is lower than the MEXBOL estimated performance.

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