Ahead of the Curve

Inflation likely to end 2019 below Banxico's 3.0% target

- **Monthly inflation report (December).** We estimate headline inflation at +0.50% m/m and the core at 0.40%. Most of the increase in the latter component would stem from other services, contributing +15bps. This would be mostly driven by high seasonality in categories related to tourism, such as air fares, tourism services and hotels. We estimate goods to add 11bps. On the other hand, we expect pressures in some agricultural goods (11bps) along additional increases in energy, including gasolines (3bps) and LP gas (4bps). With these figures, annual inflation would close 2019 at 2.76%, below our expectations and at its lowest since August 2016

- **Industrial production (November).** We anticipate a 1.8% yoy decline. Nevertheless, with seasonally-adjusted figures we see activity 1.0% m/m higher, almost reversing the fall in October. The main support would come from mining (+1.4% yoy) –particularly in oil– instead of a rebound in auto within manufacturing (-1.6% yoy). In construction we expect a 6.0% yoy drop on the back of persistently weak business confidence and low capital spending in the public sector. It is virtually certain that industry will exhibit its weakest year since 2009, affected to some extent by global trade uncertainty. We remain more positive about activity in 2020, as uncertainty diminishes and efforts to stabilize oil production continue, currently forecasting a 0.6% yoy advance.

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Mexico weekly calendar

DATE	HOUR (ET)	EVENT	PERIOD	UNIT	BANORTE	CONSENSUS	PREVIOUS
Tue 7-Jan	10:00am	International reserves	Jan-3	US$ mn	--	--	180.7
Tue 7-Jan	12:30pm	Government weekly auction: 1-, 3-, 6-month CETES; 3y MBono (Mar'23); 3y Udibonos (Jun'22)					
Tue 7-Jan	4:30pm	Citibanamex survey of expectations					
Thu 9-Jan	7:00am	CPI inflation	December	% m/m	0.50	0.50	0.81
				% yoy	2.76	2.76	2.97
		Core		% m/m	0.40	0.41	0.22
				% yoy	3.59	--	3.65
Fri 10-Jan		Wage negotiations	December	%	5.8	--	5.6
Fri 10-Jan	7:00am	Consumer confidence	December	index	44.0	--	43.5
Fri 10-Jan	7:00am	Industrial production	November	% yoy	-1.8	-1.6	-3.0
		(sa)		% m/m	1.0	1.0	-1.1
		Mining		% m/m	1.4	--	-2.1
		Utilities		% m/m	3.8	--	4.1
		Construction		% m/m	-6.0	--	-9.3
		Manufacturing		% m/m	-1.6	--	-1.2

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 3-year fixed-rate Mbonos (Mar'23), 3-year Udibonos (Jun'22), 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, January 7th, 2020)

	Maturity	Coupon rate, %	To be auctioned[1]	Previous yield[2]
Cetes				
1m	06-Feb-20	- -	11,000	7.25
3m	08-Apr-20	- -	13,000	7.30
6m	02-Jul-20	- -	14,000	7.25
M Bono				
3y	09-Mar-23	6.75	10,500	6.76
Udibono				
3y	09-Jun-22	2.00	UDIS 875	3.54

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 increased US$237 million, closing at US$180.7 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$6.0 billion during 2019 (please refer to the following table).

Banxico's foreign reserve accumulation detail
US$, million

	2018	Dec 27, 2019	Dec 27, 2019	Year-to-date
	Balance		Flows	
International reserves (B)-(C)	174,793	180,749	237	5,957
(B) Gross international reserve	176,384	184,181	186	7,796
Pemex	--	--	-35	74
Federal government	--	--	-25	1,954
Market operations	--	--	0	0
Other	--	--	246	5,768
(C) Short-term government's liabilities	1,592	3,431	-51	1,839

Source: Banco de México

Annual inflation to keep falling, aided by an improvement in both core and non-core dynamics. We estimate headline inflation at +0.50% m/m in December, below the 0.81% of the previous month. Core inflation is expected at 0.40% (previous: 0.22%), translating into a 30bps contribution. Half of the impact of the latter would stem from other services (+15bps). This is in line with typical seasonal patterns, with almost 50% related to tourism (air fares, tourism services and hotels). Also in line with usual behavior, these started to revert during the second half of the month. Regarding core goods, these would add 11bps, seven corresponding to processed foods and four to other goods, the latter starting to benefit by some discounts as the holiday season unwinds.

Going into the non-core component, this would increase 0.77%, adding 19bps to the headline. We estimate 11bps from agricultural goods, driven by increases in the prices of onions and tomatoes, with the first extending recent pressures while the second would reverse the decline of the previous fortnight.

Energy would continue climbing, in line with their recent trend. In particular, we expect gasolines to add 3bps in a context of lower tax subsidies and higher international prices, despite an appreciation of the MXN. LP gas would add 4bps, although with a more stable performance in the last part of the month.

With these results, annual inflation would close 2019 at 2.76%, below our expectations and at its lowest since August 2016 (with monthly figures). Non-core inflation would keep declining, now at 0.36%, a new historical low. Core inflation would keep improving at a low pace, standing at 3.59%.

Wage negotiations to climb 5.8% in December. This would be an inch above the 5.6% of November, which we believe will be partly explained by the large number of negotiations in the private sector relative to the public branch, remembering that increases in the former tend to be higher than the latter. On average, wages have increased 6.4% for employees in private companies, while those of public workers have advanced only 3.4% (from January to November 2019). We also expect some negotiations to be influenced by the 20% increase in the minimum wage, which despite taking effect on January 1st, 2020, was announced back on December 17th. We expect the impact of this measure to be mostly seen in 2020, particularly in the first months of the year. Given that we believe this will be one of the main drivers for wage dynamics in 2020, we do not rule out that the average increase even surpasses those of 2019, which we expect close to 5.4% (in nominal terms) taking into account December's print. Nonetheless, it should also be taken into account that dynamism in formal employment has diminished on the back of lower levels of activity, which would be a headwind for more sizable increases.

Industrial production to rebound modestly in November, supported by mining. We anticipate a 1.8% yoy decline. Nevertheless, with seasonally-adjusted figures we see activity 1.0% m/m higher, almost reversing the fall in October, which was driven by construction and manufacturing, with the latter affected by temporary shocks. Contrary to our expectations, the main support would come from mining –particularly in oil– instead of a strong rebound in manufacturing.

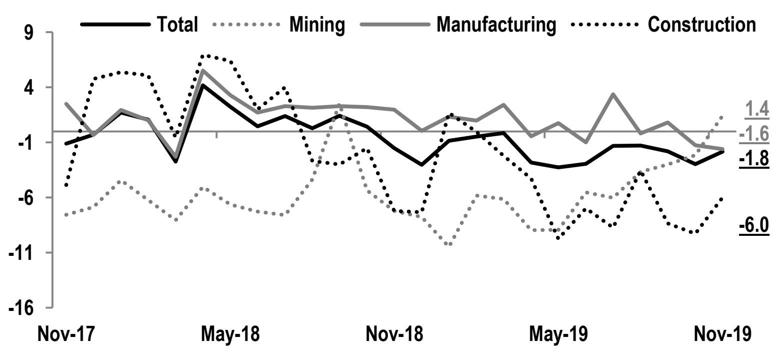
We forecast mining at +1.4% yoy, which would be the first positive print since September 2018, when it was distorted to the upside by a base-effect related to natural disasters in the same month of 2017. In this respect, Pemex's crude-oil production at 1,722kbpd (+0.3%), is more positive than in said period. Gas also improved, at 5.0%. On a longer-term basis, production has stabilized more clearly since last May, with this alone helping explain the more modest drag in annual terms –given that the denominator in the calculation becomes less challenging with the passage of time, and which could have a more sizable effect as soon as January 2020 if this stabilization extends further.

In construction, we expect a 6.0% yoy drop. This would still be weak despite standing being above the -9.3% of the previous month, as it would be only because of a more favorable base-effect. Available data suggests challenges remain, particularly with business confidence at new lows since February 2018. In terms of employment the annual rate remains negative, at -1.0%, while public finance data showed a 11.1% yoy decline in capital spending real terms, backtracking gains in October and signaling a low chance of additional support from government spending. Overall, the sector keeps failing to show higher dynamism. We are hopeful but cautious about a stronger performance in 2020, with some potential help from the private sector.

In manufacturing and contrary to our previous expectations of a stronger rebound, we forecast a 1.6% yoy decline. This would be driven by two factors. First, data in the auto sector improved sequentially albeit less than expected, with production according to AMIA falling 12.9% yoy, more than the -7.5% in exports. This suggests an inventory drawdown as operations normalized in the US, but limits to production likely due to missing imported parts. In second place and more worrisome, the rest of manufacturing exports plunged 2.2%, while non-oil intermediate-goods imports, closely related to the sector, were also weaker. On a more positive note, US manufacturing strengthened at the margin despite being in contraction in annual terms for five consecutive months.

Lastly, the advance signal from December's IMEF manufacturing suggests the sector remains contained at 46.8pts, with eight consecutive months in contraction. It is virtually a fact that industry will exhibit its weakest year since 2009, affected to some extent by global dynamics in which we highlight surging trade uncertainty. We remain more positive about industrial activity in 2020, as the latter diminishes and efforts to stabilize oil production continue, currently forecasting a 0.6% yoy advance.

Industrial production
% yoy



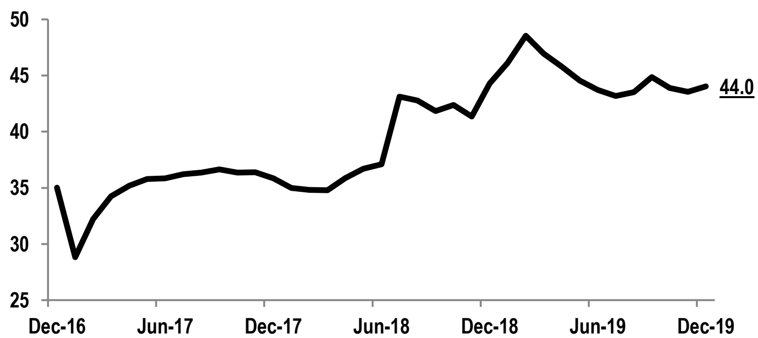
Source: INEGI, Banorte

Consumer confidence to increase in December despite lower presidential approval. We expect confidence to pick up slightly relative to the previous month, to 44.0pts (seasonally-adjusted). This would be the first increase since September, in our view mostly driven by components related to households' conditions and purchasing power, on the back of positive news and indicators during the period.

In this regard, we believe several events during or quite close to the survey period will likely impact consumers' optimism positively and could help reduce uncertainty, including: (1) The announcement of the [20% minimum wage increase for 2020](), highest in 44 years (December 16th); (2) [changes to the USMCA agreement]() agreed with the US and Canada, paving way for ratification early next year (December 10th); and (3) the [first phase of the government's Infrastructure Program](), which consists of commitments by the private sector (November 26th). In terms of hard indicators, the Mexican peso appreciated from 19.56 to 18.94 per dollar during the survey period –also helped by the US/China trade deal, among other factors– while inflation fell from 2.85% at the end of November to 2.63% in the first half of December, with non-core prices negative in annual terms for the first time in history.

Nonetheless, two main headwinds could limit the size of the uptick. First, the President's net approval declined from 41% to 34% according to *Oraculus*, a new low since the start of the administration. The correlation with this indicator remains positive, although its magnitude (beta) seems to have declined. Specifically, confidence fell only modestly in November despite a strong correction lower in the net approval indicator. Country components (both current conditions and expectations) did react more strongly, so we believe these will be affected the most in the month. Second, recent hard data on economic activity keeps confirming limited to null dynamism, with sectors such as industry affected by temporary factors, and remittances moderating. Overall, we continue believing confidence will decline gradually towards its longer-term average, albeit with some volatility along the way.

Consumer confidence
Index, sa



Source: INEGI

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