

# Ahead of the Curve

## Inflation to 3.28% y/y in January from 2.83% at year-end 2019

- Monthly inflation (January).** We estimate headline inflation at +0.53% m/m in January and core inflation at 0.33% (previous: 0.41%). Although the second fortnight exhibited less price pressures according to our monitoring, we highlight that increases in the first half at the core level would result in this subcomponent reaching its highest for a comparable period since 2017. This was driven in great part by higher excise taxes and start-of-the-year price adjustments. With these figures, annual inflation would increase to 3.28% from 2.83% in year-end 2019, with the core to 3.73% from 3.59%, in the same order. Going forward, we remain focused on the potential effect from the minimum wage increase along the one that could stem from greater economic slack. In this respect, the main support behind our call for only 3 additional 25bps rate cuts by Banxico in 2020 rests to a great extent in our view of higher inflation going forward

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**Mexico weekly calendar**

DATE	TIME (ET)	EVENT	PERIOD	UNIT	BANORTE	CONSENSUS	PREVIOUS
Tue 4-Feb	10:00am	Family remittances	December	US\$ million	<u>3,045.7</u>	3,000.0	2,898.0
Tue 4-Feb	10:00am	Banxico's survey of economic expectations	January				
Tue 4-Feb	12:30pm	Government weekly auction: 1-, 3-, 6-month CETES; 3y Mbono (Mar'23); 3y Udibonos (Nov'23)					
Tue 4-Feb	1:00pm	PMI's survey (IMEF)	January				
		Manufacturing		index	<u>47.1</u>	--	46.8
		Non-manufacturing		index	<u>49.3</u>	--	48.8
Wed 5-Feb	10:00am	International reserves	Feb-1	US\$ billion	--	--	182.4
Wed 5-Feb	4:30pm	Citibanamex bi-weekly survey of economic expectations					
Fri 7-Feb	7:00am	CPI inflation	January	% m/m	<u>0.53</u>	0.53	0.56
				% y/y	<u>3.28</u>	3.26	2.83
		Core		% m/m	<u>0.33</u>	0.38	0.41
				% y/y	<u>3.73</u>	--	3.59
Fri 7-Feb	7:00am	Consumer confidence	January	index	<u>43.0</u>	--	43.4

Source: Banorte; Bloomberg

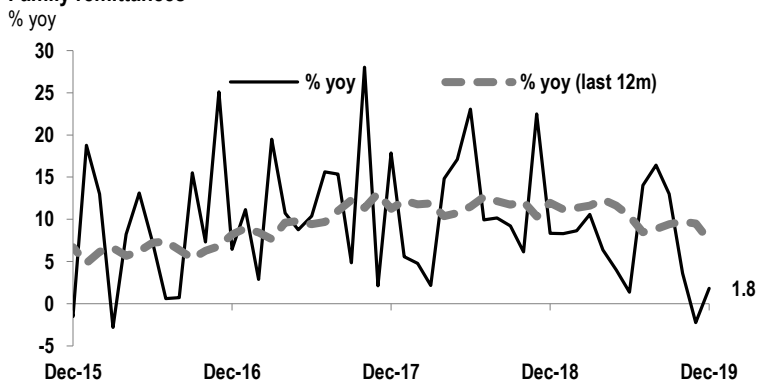
### Proceeding in chronological order...

**Remittances back to positive growth in December.** We expect remittances at US\$3,045.7 million, up 1.8% yoy, bouncing back after the -2.3% observed in November. We note the period is typically skewed to the upside, as migrants tend to send more remittances due to the holiday period, compensating for fewer working days in the month.

News reports about migration were scarce, leading us to believe these did not have a significant impact. Going to other variables, the Mexican peso appreciated, averaging USD/MXN 19.11 (previous: 19.33). However, the overall trajectory was markedly downward as it closed around 18.93, which could have had an unfavorable impact in the monthly amount.

With this figure, remittances would have added up to US\$36,010.9 in 2019, 6.9% above the same period of the previous year and a new historical high. However, this would be below the 11.2% advance of 2018, in our view explained at least in part by lower dynamism in Mexican migrants' employment conditions in the US. Going into 2020, we think one of the key factors to explain the behavior of this variable will be the electoral cycle in the US, given that, in case of a resumption of threats against migrants, they could opt to send a higher amount of resources to our country.

#### Family remittances



Source: Banxico

**Banxico's survey of economic expectations.** As usual, market participants will focus on inflation, growth, the reference rate, and exchange rate forecasts. Regarding the first, analysts expect 2020 year-end inflation at 3.46%, below our 3.6% estimate. Medium and long-term expectations could remain relatively unchanged, still above target. On growth, the estimate for this year is at 1.1% (Banorte: 0.8%). The current view on the reference rate by YE20 is 6.50%, in line with our expectations. Finally, the exchange rate estimate for year-end 2020 stands at USD/MXN 20.00 (Banorte: 19.80).

**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 (Nov'23), 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, February 4<sup>th</sup>, 2020)**

	Maturity	Coupon rate, %	To be auctioned <sup>1</sup>	Previous yield <sup>2</sup>
<b>Cetes</b>				
1m	05-mar-20	--	5,000	7.04
3m	07-may-20	--	5,000	7.08
6m	30-jul-20	--	11,500	7.03
<b>M Bono</b>				
3y	09-mar-23	6.75	10,500	6.80
<b>Udibono</b>				
3y	16-nov-23	3.50	UDIS 875	3.56

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

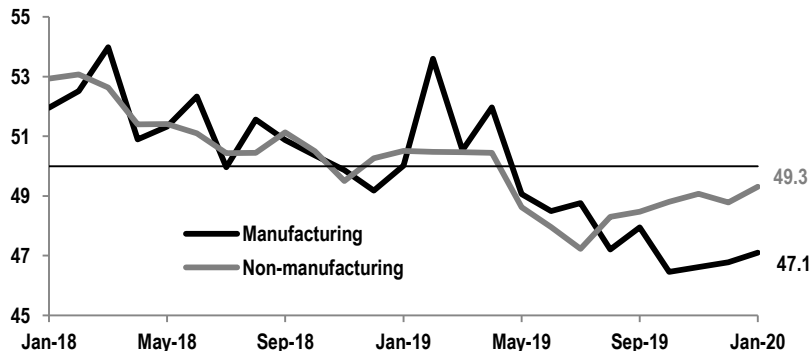
**Modest rebound in January’s IMEF indicators.** We expect the IMEF manufacturing indicator at 47.1pts, slightly higher than in December and up for a fourth consecutive month. We believe some additional support could come from recent developments in terms of trade tensions and USMCA, with the latter finally ratified by the US this week and Canada moving swiftly forward. Nonetheless, manufacturing exports have weakened after taking into account the rebound in autos, suggesting limited upside. Meanwhile, the US PMI fell to 51.7pts in January, with weaker export orders and relatively soft foreign client demand. Lastly, we are uncertain about the potential impact, if any, that the suspension of the *737 Max* by Boeing may have in Mexico’s aerospace industry.

We also forecast the non-manufacturing indicator higher, to 49.3pts from 48.8pts in the previous month. The main driver would be the signal provided by higher business confidence in December, particularly sectors more closely related to domestic demand (services and commerce) along construction, which IMEF includes in this indicator. Moreover and similar to the USMCA mentioned above, we believe a potential positive effect could stem from the 20% minimum wage increase. Lastly, it is our take that the “Coronavirus”, which has dampened mobility and services in other countries (notably China), is not likely to have had an effect domestically, although it is an issue worth looking in coming months.

All in all and despite the anticipated increase, we highlight that both would remain in contraction territory for a ninth straight month, consistent with most other data that keeps pointing to low levels of economic dynamism.

**IMEF indices**

Indices, seasonally-adjusted



Source: IMEF

**Weekly international reserves report.** Last week, net international reserves increased US\$1,192 million, closing at US\$182.4 billion. According to Banxico's report, this comes from: (1) Dollar sales from Pemex to the monetary authority amounting to US\$850 million; and (2) a positive valuation effect in central bank assets of US\$342 million. In this context, the central bank's international reserves have increased US\$1,525 million during 2020 (please refer to the following table).

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

	2019	Jan 24, 2020	Jan 24, 2020	Year-to-date
	Balance		Flows	
International reserves (B)-(C)	180,877	182,402	1,192	1,525
(B) Gross international reserve	183,028	188,813	162	5,786
Pemex	--	--	179	881
Federal government	--	--	-252	4,432
Market operations	--	--	0	0
Other	--	--	236	473
(C) Short-term government's liabilities	2,151	6,411	-1,030	4,260

Source: Banco de México

**Citibanamex survey.** Markets will center on analysts' inflation forecasts for January (to be published on Friday, February 7<sup>th</sup>) along with the 2020 year-end estimate. It will be important to see monetary policy assessments, particularly ahead of the February 13<sup>th</sup> meeting, in which we expect a 25bps rate cut. We will also pay attention to GDP growth estimates and the exchange rate at YE20.

**Higher inflation in January on the back of tax increases and start-of-the-year adjustments.** We estimate headline inflation at +0.53% m/m in January and core inflation at 0.33% (previous: 0.41%), with the latter contributing 25bps. As already known, large part of this would be from dynamics in the first half of the month, highlighting the considerable impact in processed food from excise tax hikes. Evidence of this includes the 7.6% 2w/2w increase in cigarettes, the largest contribution of any good or service during the first fortnight. In this context, we estimate this category to contribute 20bps in the month. Services would increase marginally, with slight pressures in both housing (+4bps) and education (+2bps), the latter showing its typical seasonality due to adjustments in college and high school tuitions. Other services would subtract close to 4bps on tourism-related declines at the turn of the year.

The non-core component would increase 1.44% m/m, adding 28bps. During the first half, fresh fruits and vegetables extended the rise of the latter part of 2019. However, our price monitoring showed diminished pressures for the rest of the period. We estimate this category's contribution close to 23bps. Meat and egg would be more muted, at -1bp. In energy, gasoline would continue climbing albeit at a more moderate pace, with a total contribution of +4bps. However, these would be offset by the decline in LP gas, falling by a similar magnitude.

With these, annual inflation would increase to 3.28% from 2.83% in year-end 2019. Core inflation would climb to 3.73% from 3.59%, highest since last August. As previously mentioned, this was largely anticipated by us and the central bank. However, our estimated path still contemplates higher inflation in the short- and medium-term relative to Banxico's current forecasts.

Going forward, we remain focused on the potential effect from the minimum wage increase along the one that could stem from greater economic slack. All in all, the main support behind our call for only 3 additional 25bps cuts by Banxico this year rests to a great extent in our expectation of higher inflation going forward.

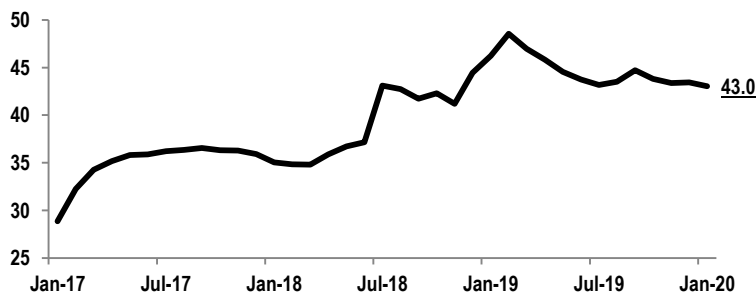
**Consumer confidence to inch lower in January.** We expect confidence at 43.0pts (seasonally-adjusted). Developments during the period were mixed, which on balance we estimate could result in a slight decline relative to the previous month. If our forecast materializes, confidence would reach its lowest since the start of the current administration, although still significantly above its long-term average (with the 5-year and 10-year both close to 38.5pts).

In our view, two main factors could drive the decline. First, [relatively high inflation in the 1<sup>st</sup> half of January](#), influenced by change-of-year price increases, higher excise taxes in some categories, new state taxes and updated government tariffs, among others. Second, an adverse effect among consumers due to the transition to another health scheme for people not affiliated to social security institutions for workers with a formal job (IMSS and ISSSTE). Apart from these, available data about the president’s approval rating, which remains correlated somewhat to confidence levels, suggests a decline in his popularity. We believe these may impact current conditions and expectations about the country the most.

Nonetheless, we see the decline as modest on the back of other, more favorable factors. Among them, the [unemployment rate in December declined to its lowest in the history of the series](#), while real wages grew 3.8% y/y by last year’s close, highest in 2019. The Mexican peso was resilient, reaching up to 18.67 per dollar, strongest since mid-2018. We believe these may have helped mostly the purchasing power component, although formal job creation has slowed down and most recent data about [economic activity shows continued weakness](#). Last but not least, the fact that the index was broadly unchanged in December –impacted by lower current conditions, both in households and nationwide– despite positive news, such as the 20% minimum wage hike and agreed changes to the USMCA agreement, signals that further upside is limited, in our view due to low economic dynamism.

**Consumer confidence**

Index, sa



Source: INEGI

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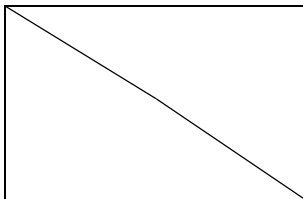
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