Ahead of the Curve

Annual inflation to pick up to 3.5% in February

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- **Monthly inflation (February).** We estimate headline inflation at +0.27% m/m and core inflation at 0.36%, Goods would add 16bps, with more muted pressures in processed foods and other goods in the second half of the period despite the adjustment higher in the exchange rate. We expect a fairly-even share between other services and housing (both with 5bps). The non-core component would remain flat in the month, although with some pressure in both fresh fruits and vegetables –particularly tomatoes–and meat and egg. With these, annual inflation would increase to 3.55% from 3.24% in January. Core inflation would decline marginally, to 3.65% from 3.73%. Going forward, our main focus is still in the effects from both the potential upside to prices from the minimum wage increase compared with the downward bias induced by higher economic slack

- **Industrial production (January).** We anticipate a 1.3% y/y contraction, adding 15 months in negative territory and challenged by adverse base effects. With seasonally-adjusted data we estimate a 0.4% m/m increase, with the three main sectors up. Mining would be the strongest (2.4% m/m) on higher crude-oil and gas output. Manufacturing would stand at +0.4%, supported by autos albeit more modest in the rest, following the performance in the US. We see construction climbing 0.5%, limited by low business confidence and physical investments by the Federal Government. We do not expect disruptions from the Coronavirus outbreak in the period, although it is something we will look carefully in coming months as it is likely to affect at least the rest of the quarter and possibly extend into 2Q20

Mexico weekly calendar

DATE	HOUR (ET)	EVENT	PERIOD	UNIT	BANORTE	CONSENSUS	PREVIOUS
Mon 9-Mar	**8:00am**	**CPI inflation**	February	% m/m	0.27	0.29	0.48
				% y/y	3.55	3.56	3.24
		Core		% m/m	0.36	0.37	0.33
				% y/y	3.65	--	3.73
Tue 10-Mar		**Wage negotiations**	February	%	5.9	--	5.0
Tue 10-Mar	**11:00am**	**International reserves**	Mar-6	US$ bn	--	--	184.3
Fri 13-Mar	**8:00am**	**Industrial production**	January	% y/y	-1.3	--	-1.0
		sa		% m/m	0.4	--	-0.3
		Mining		% y/y	4.4	--	0.4
		Utilities		% y/y	4.8	--	5.6
		Construction		% y/y	-8.6	--	-4.5
		Manufacturing		% y/y	-0.3	--	-0.5

Source: Banorte; Bloomberg

Proceeding in chronological order…

Core goods to keep pushing headline inflation higher in February. We estimate headline inflation at +0.27% m/m (previous: 0.48%) and core inflation at 0.36% (previous: 0.33%), with the total monthly contribution stemming from the latter. Goods would add 16bps, with processed foods pressured in the second half of the month and resulting in a monthly impact of 9bps. In a similar fashion, other goods would be more muted in the second half after the end of the discount season accounted in the first half, reaching a monthly contribution of 7bps. In services, we expect a fairly-even share between other services and housing (both with 5bps). In the former, we think the impact from the minimum wage hasn't been as significant as expected, compensated by higher economic slack.

The non-core component would remain flat in the month. We expect +5bps from agricultural goods, mostly from meat and egg. Reports point to a rebound in fruits and vegetables during the second half. In this sense, the head of the *Consumer Protection Agency*, Ricardo Sheffield Padilla, mentioned that adverse climate conditions impacted tomato harvesting, reducing supply. In addition, he stated that chicken continued trending up, adding to pressures already observed in eggs. Going to energy, we highlight that the subsidy for low-grade gasoline remained virtually at zero in the entire fortnight. This happened in a context of higher volatility both the international reference price and the Mexican peso. Although the first was unchanged on average, the currency did depreciate given the negative market reaction to the Coronavirus outbreak. In this sense, we expect a total contribution from gasoline in the month at -4bps, explained by the behavior in the first half of February. Meanwhile, LP gas would trend lower once again at -3bps. Finally, government tariffs would edge-up 2bps.

With these, annual inflation would increase to 3.55% from 3.24% in January. Moreover, core inflation would decline marginally, to 3.65% from 3.73%. Going forward, our main focus is still in the effects from both the potential upside to prices from the minimum wage increase compared with the downward bias induced by higher economic slack. Even though there is more uncertainty over Banxico's actions after the surprise 50bps cut by the Fed, we continue expecting the local central bank cutting the reference rate in only an additional 50bps in the remainder of the year. We believe the latter will be heavily influenced by the monetary authority's inflation estimates, which were recently revised up and still significant risks in the outlook, along the exchange rate and the evolution of other financial stability risks. Nonetheless, the bias is clearly towards even lower rates, so we do not rule out a 50bps cut in their upcoming meeting.

Wage negotiations to climb 5.9% in February. We expect an acceleration relative to the 5.0% of the previous month, although below the 6.4% observed in the same period of 2019. Part of the spike last year was explained by both the 100% increase seen in the minimum wage (MW) in the Northern border (and 16% in rest of the country) coupled with the aftermath from practically city-wide strikes in Matamoros, Tamaulipas. This month's dynamic will continue to be explained by the 20% increase to the MW, along larger amount of negotiations in the private sector, which are typically above those in the public branch. We expect the former to increase close to 5.9% and the latter near 3.5%.

Weekly international reserves report. Last week, net international reserves increased US$913 million, closing at US$184.3 billion. According to Banxico's report, this was mainly due to a positive valuation effect in institutional assets. In this context, the central bank's international reserves have increased by US$3.4 billion during 2020 (please refer to the following table).

Banxico's foreign reserve accumulation detail
US$, million

	2019	Feb 28, 2020	Feb 28, 2020	Year-to-date
	Balance		Flows	
International reserves (B)-(C)	180,877	184,250	913	3,372
(B) Gross international reserve	183,028	188,405	172	5,378
Pemex	--	--	-470	1,234
Federal government	--	--	-113	2,282
Market operations	--	--	0	0
Other	--	--	755	1,861
(C) Short-term government's liabilities	2,151	4,156	-741	2,005

Source: Banco de México

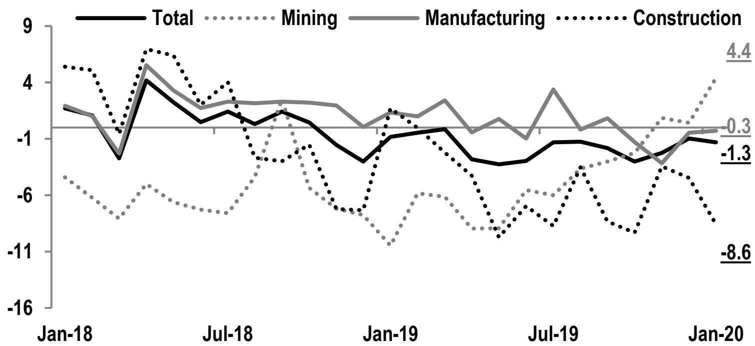
Industrial production to pick up modestly, mainly supported by mining. We anticipate a 1.3% y/y contraction, adding 15 months in negative territory. The month is challenged by an adverse base effect in both construction and manufacturing, despite a favorable shift in mining. In short-term dynamics, we expect a 0.4% m/m increase, with growth in the three main sectors. Despite the latter suggesting stronger dynamics at the turn of the year, the Coronavirus outbreak and associated supply disruptions will be additional challenges, likely extending at least to the full quarter and possibly into 2Q20.

On a sector basis, mining would climb 4.4% y/y, best since February 2012 –additionally benefited by one more day due to the leap year–. In this context, domestic oil production reported by the CNH, which aggregates output from both Pemex and private firms, edged-up 6.4% y/y, supporting the sector's improvement. Gas was also stronger. In monthly terms, the sector would expand 2.4%, best since last August.

In construction, we estimate -8.6% y/y (+0.5% m/m). Business confidence kept falling after a marginal improvement in December, with the 'adequate moment to invest' component reaching a new historical low by February. Adding to the negative trend, physical investment by the Federal Government plunged 15.2% y/y in real terms, skewed downwards by energy sector investments, which might not have had a sizable impact on construction, although still negative.

Finally, in manufacturing, we estimate a slight 0.3% y/y decline (0.4% m/m). Some positive signals were observed, particularly in autos (as evidenced by stronger exports and production), although with continued weakness in the US, as well as in other sectors within manufacturing, which would push the figure lower. This is consistent with the continued deceleration in the pace of formal job creation in the sector, persistently to the downside since the start of 2019. The monthly comparison would be consistent with the advance in IMEF's manufacturing PMI. Regarding the impact from the Coronavirus, signals from the trade balance report suggest no significant disruptions, although it is something we will look carefully in coming months.

Industrial production
% y/y



Source: INEGI, Banorte

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