Ahead of the Curve

Trade balance and inflation figures could start to show some effects from COVID-19

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- **Trade balance (February).** We estimate a hefty US$3,511.8 million surplus, with the figure starting to show the effects from the COVID-19 outbreak in China, particularly in non-oil imports. Annual rates will be distorted to the upside due to the leap-year effect, something that we estimate will be clearer in exports' performance. In this respect, total exports would increase 3.9% y/y; while imports would fall 2.1%, marking its seventh consecutive months in contraction. Moreover, the period's seasonality is typically of a surplus, in some sense as payback from a typically high deficit in January

- **Inflation (1H-Mar).** We estimate headline inflation at +0.03% 2w/2w, with the core at 0.08%. Part of the period's dynamics will be explained by adjustments in prices due to the COVID-19 outbreak, as well as the shock in the oil market and its effect on prices. Nevertheless, we expect the impact in some components to be clearer in the second half of the month. With these results, annual inflation would decrease to 3.63% from 3.70% in February. The decline would be mostly driven by the core component, falling to 3.53% from 3.66%. In contrast, the non-core index would come in at 3.93% (previous: 3.81%)

Mexico weekly calendar

DATE	HOUR (ET)	EVENT	PERIOD	UNIT	BANORTE	CONSENSUS	PREVIOUS
Tue 24-Mar	8:00am	**CPI inflation**	1H-Mar	% 2w/2w	0.03	0.12	0.47
				% y/y	3.63	3.68	3.87
		Core		% 2w/2w	0.08	0.18	0.13
				% y/y	3.53	--	3.63
Tue 24-Mar	11:00am	**International reserves**	March-20	US$ bn	--	--	184.6
Wed 25-Mar	8:00am	**Retail sales**	January	% y/y	2.8	3.0	3.2
		sa		% m/m	0.5	--	-0.4
Thu 26-Mar	8:00am	**Global economic indicator**	January	% y/y	-0.2	-0.2	0.7
		sa		**% m/m**	0.2	0.2	0.2
		Primary activities		% y/y	2.5	--	0.4
		Industrial production		% y/y	-1.6	--	-1.0
		Services		% y/y	0.3	--	1.4
Thu 26-Mar	8:00am	**Unemployment rate**	February	%	3.59	3.60	3.79
		sa		%	3.61	3.69	3.66
Fri 27-Mar	8:00am	**Trade balance**	February	US$ mn	3,511.3	950.0	-2,415.8
		Total exports		% y/y	3.9	--	3.2
		Oil exports		% y/y	-2.4	--	13.7
		Non-oil exports		% y/y	4.4	--	2.5
		Total imports		% y/y	-2.1	--	-3.2

Source: Banorte; Bloomberg

Proceeding in chronological order...

Muted inflation on downward pressures from COVID-19 and the oil shock. We estimate headline inflation at +0.03% 2w/2w, picking up from +0.47% of the previous fortnight. Part of the period's dynamic will be explained by adjustments in prices due to the COVID-19 outbreak, as well as the shock in the oil market and its effect on prices. Nevertheless, we expect the impact in some components to be clearer in the second half of the month.

Inside, core inflation could rise 0.08% (previous: 0.13%), translating into a 6bps contribution. Goods would add 5bps, with 3bps in processed foods and the rest in other goods. We do not expect a sizable effect from peso weakness, at least for this period. Services could only add 1bp, with housing at +2bps and other services at -1bp. Specifically, the decrease in this latter would be explained by downward adjustments in tourism- related categories, starting to feel the brunt of lower demand due to the virus. However, others would continue pressuring the index, with the last figures starting to show an acceleration which might be related to the minimum wage hike.

The non-core component would decrease 0.15% 2w/2w (previous: 1.50%), subtracting 4bps to the headline. A key driver would be the -3bps in energy, largely explained by lower oil prices that triggered a decline in international gasoline prices. This latter category would subtract 2.3bps, with the fall in the reference price more than compensating for the depreciation of the MXN. So far, our monitoring points to a more sizable adjustment until the second fortnight, with some stability in the first week of the month even with a small subsidy to the excise tax. Meanwhile, agricultural goods would subtract 1bp, with fruits and vegetables at -3bps and meat and egg at +2bps. Within the first one we anticipate lower tomato prices, pulling back some after the recent increase, although husk tomatoes could still be higher. In the second, we expect chicken to keep climbing.

With these results, annual inflation would decrease to 3.63% from 3.70% in February. The reduction would be mostly driven by the core component, falling to 3.53% from 3.66%. In contrast, the non-core index would come in at 3.93% (previous: 3.81%). In the short term, a relevant decline could be observed due to current events. Moreover, we could see an additional benefit in the annual comparison as the seasonal increase due to the *Holy Week* holiday could be somewhat diluted in the current backdrop. Nevertheless, the medium term is more uncertain, depending on the duration of the outbreak as well as its impact on the exchange rate and energy prices, among other relevant drivers.

Weekly international reserves report. Last week, net international reserves decreased by US$952 million, closing at US$184.6 billion. According to Banxico's report, this was mainly due to a negative valuation effect in institutional assets. In this context, the central bank's international reserves have increased by US$3.7 billion during 2020 (please refer to the following table).

Banxico's foreign reserve accumulation details
US$, million

	2019	Mar 13, 2020	Mar 13, 2020	Year-to-date
	Balance		Flows	
International reserves (B)-(C)	180,877	184,619	-952	3,742
(B) Gross international reserve	183,028	188,755	-987	5,727
Pemex	--	--	166	1,468
Federal government	--	--	-217	1,975
Market operations	--	--	0	0
Other	--	--	-937	2,284
(C) Short-term government's liabilities	2,151	4,136	-35	1,985

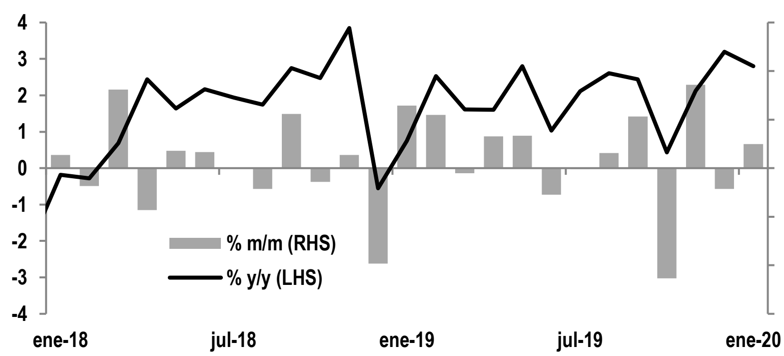
Source: Banco de México

Retail sales to stay strong in January. We anticipate a 2.8% y/y advance, slightly below the 3.2% observed in December. With seasonally-adjusted figures, sales would edge-up 0.5% m/m, erasing the -0.4% registered in the previous month, continuing with and overall favorable trend in the sector.

Some indicators so far still point to a relatively good performance, highlighting a marginal improvement in ANTAD's same store sales (0.8% y/y in real terms), now adding three months in positive territory. Meanwhile, vehicle sales improved to -6.0% from -8.3% in December. However, we saw some negative signs from consumption goods imports, at -0.6% (possibly skewed by the timing of the Chinese New Year) as well as a slight retracement in Walmart sales (-0.5%). All in all, we think these dynamics are consistent with a slight deceleration in the annual comparison.

In the short-term, we expect February's figures to be highly benefited by the leap year-effect, which has already started to show in some retailers (ANTAD: 3.7% y/y; Walmart: 4.4%). Nevertheless, in the medium term the downward risks have increased meaningfully due to the possible impacts from the COVID-19 outbreak. In our view, this may have a positive impact in March in terms of cautionary purchases, especially food and other non-durable items, albeit negative for durables and more widespread in case of a generalized quarantine.

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



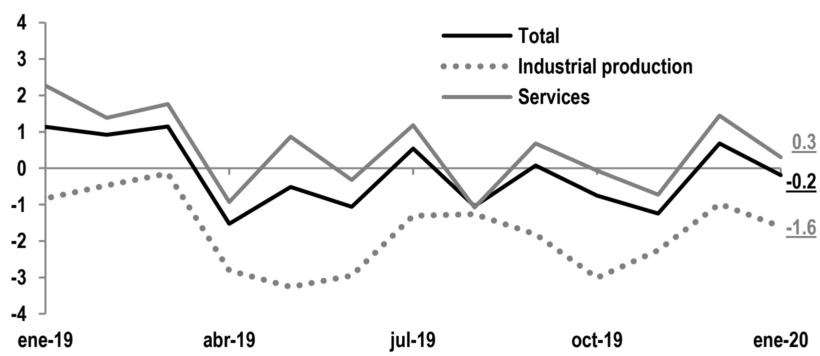
Source: INEGI, Banorte

January's economic activity to show a relative strong turn of the year. We expect the *Global Economic Activity Indicator* (IGAE) at -0.2% y/y, lower than the +0.7% observed in December. Part of this would be driven by a challenging base effect, as dynamics in the same month of 2019 were quite favorable at +1.1%, even despite some exogenous shocks. In this sense, we estimate a 0.2% m/m expansion with seasonally-adjusted figures, matching December. The latter would be positive as two consecutive up months have not been observed since February.

By sector, industrial output edged-up 0.3% m/m, explained by higher dynamism in mining although also aided by both construction and manufacturing. Meanwhile, services would increase 0.3% y/y and 0.1% m/m, reinforcing the positive signal. Known data show a favorable performance, with IMEF's non-manufacturing PMI climbing back to expansion territory at 50.8pts, best in eight months. As mentioned in a previous section, we expect retail sales' strength, with good dynamics in retailers and auto sales. Transportation could have benefited from resiliency in manufacturing. Moreover, tourism-related data were also good, with hotel occupancy rates higher than a year ago and passenger air traffic growing, helping entertainment and lodging services. On the contrary, government services could be impacted by the 3.7% y/y decline in real terms in non-capital spending.

Overall, activity looks to have started 2020 on a stronger footing, even extending to February. Nevertheless, the COVID-19 outbreak and its likely impact both on consumer and business confidence increasingly hitting services, while the oil market and supply chain shock that affect industrial production, have raised strongly the challenges and risks for GDP this year.

IGAE
% y/y (nsa)



Source: INEGI, Banorte

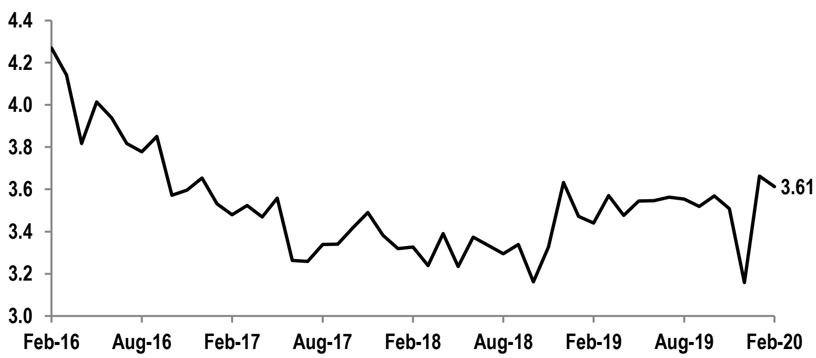
The unemployment rate will improve marginally in January, but remaining relatively high. We estimate the unemployment rate at 3.61% (sa), 5bps below January's print. In line with our expectations, the rate rebounded in the previous month, albeit more so than forecasted. We anticipate a slight retracement, albeit leaving it still high relative to levels seen in 2019.

We highlight the improvement in employment components within IMEF's indicators, both in manufacturing and non-manufacturing. The expansion was clearer in the latter, up 1.6pts to 49.1pts. We could also start seeing some positive signs from the start of hiring for the 2020 Census that began in March.

However, persistence to the upside is still due to lackluster formal employment, which the annual pace of job creation still decelerating despite a net addition of 123,139 new jobs in the month.

Going forward, we believe March could be positive due to additional hiring for the Census. Nevertheless, we need to be wary of the impact from the COVID-19 outbreak as some businesses and factories have started to halt operations. To the best of our knowledge, so far these stoppages have been limited, so the impact could be low. Nevertheless, if the outbreak continues growing and severe social-distancing measures are enacted, pressures to close would mount up, resulting in important job cuts down the road.

Unemployment rate
%, sa



Source: INEGI, Banorte

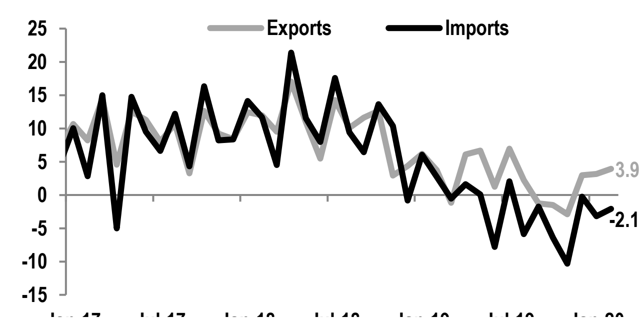
Trade balance to a surplus as imports feel the brunt of supply chain dislocations in China. We estimate a hefty US$3,511.8 million surplus, with the figure starting to show of the effects from the COVID-19 outbreak in China, particularly in non-oil imports. Moreover, we should mention that annual rates are distorted to the upside due to the leap-year effect, something that we estimate will be clearer in exports' performance. In this respect, total exports would increase 3.9% y/y; while imports would fall 2.1%, marking its seventh consecutive months in contraction. Moreover, the period's seasonality is typically of a surplus, in some sense as payback from a typically high deficit in January.

Regarding the oil balance, we see a deficit of US$ 1,108.8 million, with both exports and imports affected by muted volumes and price declines in crude-oil and gasoline. Our monitoring shows a slowdown in Mexico's shipments abroad, while the Mexican oil mix fell sequentially, to US$45.4 per barrel from US$53.9 in January. The latter was a result of pressured international reference prices, as they started to react more forcefully to concerns over the outlook for demand due to the Coronavirus during the second half of the month. This also impacted gasoline prices in the US, although to a less extent.

We estimate oil exports fell 2.4% y/y, with crude-oil back to negative (-5.0%). On the other hand, imports would advance 2.0%, helped by a base-effect and consumption goods (+16.1%), remembering that in the same period of last year, Mexico was in the first stage of the fight against fuel theft that led to gasoline distribution issues in several states.

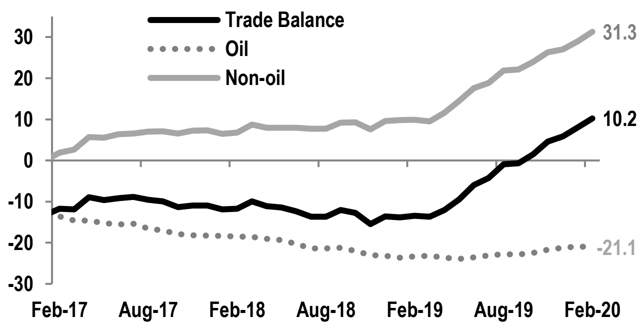
The non-oil balance would show a quite high surplus or US$4,620.1 million, with exports up 4.4% and imports down 2.6%. In the former, available data suggests a still resilient performance in autos, with AMIA figures still down (-1.9%) but higher than in January. The sector in the US advanced 4.2%, highest since September 2018. Other manufacturing would be more modest, with the US ISM and PMI manufacturing both lower at the margin, but with 'imports' in the first one falling strongly. In the latter, we anticipate weakness to be concentrated in intermediate goods (-2.8%). Two main factors would help explain this. First, imports from China are expected to have been weak already as the Chinese New Year took place between January 23rd to 30th. Moreover, this was likely compounded by its extension and the supply disruptions due to the Coronavirus outbreak, a situation that exacerbated during the second half of January through February. Lastly, we expect capital goods remain weak, declining 5.2% y/y. Despite the likely moderation relative to the -13.6% of the previous month, this would be mostly due to a more favorable base effect, with dynamics still weak as suggested by the falling business confidence in more capital intensive industries such as construction and manufacturing, which kept reaching new lows in the period.

Exports and Imports
% yoy



Source: INEGI, Banorte

Trade balance
US$ billion, 12-month rolling sum



Source: INEGI, Banorte

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