Ahead of the Curve

Inflation to fall to 3.4% in March on lower non-core prices

- **Inflation report (March).** We estimate the headline index at 0.14% m/m and the core at 0.28%, both lower than the previous month. This would be driven by the non-core index, contracting 0.29% on the back of plunging energy prices, particularly gasoline. On the other hand, we expect some pressures in agricultural goods. In the core component, we also see higher prices in processed foods and other goods, reacting to an increase in costs of some raw materials and precautionary purchases due to COVID-19. On the contrary, the seasonal pickup before the Holy Week holiday would vanish because of the impact that the virus has had in tourism. With this data, annual inflation would decline to 3.44% from 3.70% in February. Specifically, the core component would fall to 3.59%, with the non-core down more significantly, to 2.99%

- **Industrial production (February).** We anticipate a 0.1% y/y advance, which would be its first positive print in 15 months. Nevertheless, this would be due to the leap-year effect, which typically boosts the indicator significantly. As such, and using seasonally-adjusted figures for comparison, we expect modest 0.2% growth, which despite being low we would judge as relatively positive as it would mark its second consecutive month up. The result could be helped by the construction sector and, to a lesser extent, manufacturing. Mining is expected to backtrack after a strong increase in January

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Next week we will not publish this document due to the Holy Week holiday. We will resume its publication on Friday, April 17th

Mexico weekly calendar

DATE	TIME (ET)	EVENT	PERIOD	UNIT	BANORTE	CONSENSUS	PREVIOUS
Sun 5-Apr		**Daylight savings time begins in Mexico**					
Mon 6-Apr	**7:00am**	**Gross fixed investment**	January	% y/y	-9.6	-2.3	-3.0
		sa		% m/m	1.2	--	-1.5
		Machinery and equipment		% y/y	-8.3	--	-0.2
		Construction		% y/y	-10.4	--	-5.0
Tue 7-Apr	**7:00am**	**CPI inflation**	March	% m/m	0.14	0.07	0.41
				% y/y	3.44	3.37	3.70
		Core		% m/m	0.28	0.27	0.36
				% y/y	3.59	--	3.66
Tue 7-Apr	**10:00am**	**International reserves**	Apr-6	US$ bn	--	--	185.5
Wed 8-Apr		**Wage negotiations**	March	**%**	--	--	5.5
Wed 8-Apr	**7:00am**	**Industrial production**	February	% y/y	0.1	--	-1.6
		sa		% m/m	0.2	--	0.3
		Mining		% y/y	3.9	--	5.8
		Utilities		% y/y	1.4	--	0.4
		Construction		% y/y	-4.1	--	-8.6
		Manufacturing		% y/y	0.8	--	-0.9
Thu 9-Apr Fri 10-Apr		**Markets closed due to the *Holy Week* holiday**					

Source: Banorte; Bloomberg

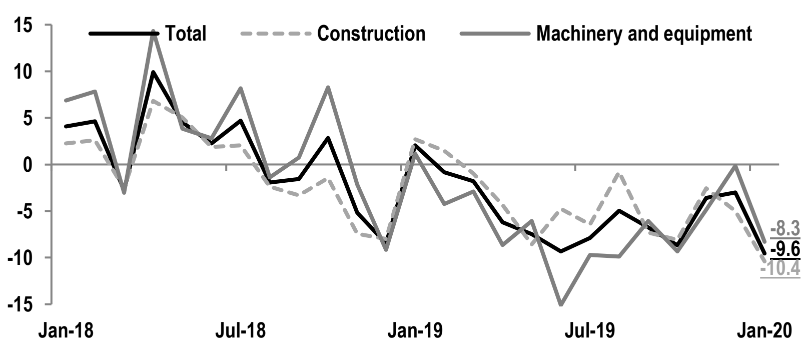
Proceeding in chronological order…

Gross fixed investment to recover some ground in January. We anticipate GFI at -9.6% y/y in January, below the -3.0% of the previous month. Broadly speaking, the magnitude of the decline would be partly influenced by a difficult base-effect, both in construction and machinery and equipment. In this respect and with seasonally-adjusted figures, we expect a 1.2% m/m advance, which despite being relatively high when compared to recent prints, it would not be enough to compensate for the -1.5% decline observed in December. Moreover, with this result the index would keep hovering around levels not seen since late 2013, stressing that investment remained very weak even before the likely impact from the COVID-19 on the outlook, which is likely to be observed from March onwards.

We expect construction at -10.4% y/y. In this sense, the IP report showed this sector dragged by civil engineering, which plunged 17.7% y/y, in part due to low physical investment by the Public Sector, with declined 15.2/ y/y in real terms according to the public finance report. Edification also contracted, at -7.3%, below December's print at -3.1%. Regarding the latter, in our view more closely related to the private sector, business confidence remains low while economic activity disappointed during the period, mostly on a worse-than-expected performance in services. In our view, this combination is still an important headwind for a more sizable pickup in investment.

Regarding machinery and equipment (M&Eq), we estimate an 8.3% decline, marking with this a full year in negative territory. We estimate the imported component to be the weakest again, falling 11.2%, with non-oil capital goods imports within the trade balance report signaling a hefty contraction (-13.6%) despite the relative strength of the Mexican peso against the dollar. Finally, the domestic component would fall 3.2%, also affected by low business confidence levels, a more difficult base effect and no additional working days in the annual comparison.

GFI
% y/y



Source: INEGI, Banorte

Strong dip in March's annual inflation on plunging gasoline prices. We estimate headline inflation in March at +0.14% m/m (previous: 0.41%), with the core component at 0.28% (previous: 0.36%). The latter would add 21bps and the non-core index would advance 0.29% (previous: 0.57%), subtracting 7bps to the headline.

Within the latter, we identified two main drivers: (1) To the downside, a strong decline in energy; and (2) to the upside, pressures in agricultural goods. In the first one, gasoline prices during the second half of the month, –both low- and high-grade– fell strongly, driven by the adjustment in international reference prices that more than compensated for a weaker Mexican peso. Both goods would subtract 31bps. Meanwhile, LP gas would edge marginally up marginally, also reflecting the balancing forces between reference prices and the FX. Going into agricultural products and based on our price monitoring as well as press reports, some goods picked up on the back of the COVID-19 shock, highlighting eggs, corn and lemons. However, we also expect tomatoes to extend the downward trend of the first half, although not enough to compensate for other pressures. All in all, agricultural goods would contribute +22bps.

Within the core component we highlight higher prices in goods, adding 14bps. In processed foods we flag a relevant increase in tortilla prices, driven by higher raw materials (corn), as reported by production chambers and even the *Consumer Protection Agency* (Profeco). This would translate into an 8bps contribution. Other goods would add 5bps, with some possibility of higher prices due to preemptive purchases. In services, housing would add 4bps, in line with its recent trend. However, and more relevant, we anticipate other services to add only 2bps, driven by further declines in airfares, hotels and tourism services. This would happen even with the usual trend of higher prices ahead of the Holy Week holiday, with the outbreak hitting the tourism industry.

With these, annual inflation would decline to 3.44% from 3.70% in February. Core inflation would fall to 3.59% and the non-core would plunge to 2.99%. As such, headline inflation would average 3.5% in 1Q20, above the 3.3% forecasted by Banxico. Despite of the latter, we expect favorable dynamics in the short-term, mostly on lower energy prices and coupled with the additional widening of the output gap. Nevertheless, upward risks may be building up on the back of the potential pass-through effect from the depreciation of the exchange rate along mounting financial stability risks. We believe downside risks will help compensate for the latter, allowing the central bank to keep cutting rates towards our year-end estimate of 5.50%.

Weekly international reserves report. Last week, net international reserves increased by US$1.3 billion, closing at US$185.5 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$4.6 billion during 2020 (please refer to the following table).

Banxico's foreign reserve accumulation details
US$, million

	2019	Mar 27, 2020	Mar 27, 2020	Year-to-date
	Balance		Flows	
International reserves (B)-(C)	180,877	185,509	1,334	4,631
(B) Gross international reserve	183,028	189,314	375	6,286
Pemex	--	--	-491	1,733
Federal government	--	--	-191	1,727
Market operations	--	--	0	0
Other	--	--	1,057	2,826
(C) Short-term government's liabilities	2,151	3,806	-959	1,655

Source: Banco de México

Industrial production in February could be marginally positive in annual terms. We anticipate a 0.1% y/y advance, which would be its first positive print in 15 months. Nevertheless, this would be due to the leap-year effect, which typically boosts the indicator significantly. As such, and using seasonally-adjusted figures for comparison, we expect modest 0.2% growth, which despite low we judge as relatively positive as it would mark its second consecutive month up. The result could be helped by the construction sector and, to a lesser extent, manufacturing. Mining is expected to backtrack after a strong increase in January.

We estimate mining at 3.9% y/y (-3.0% m/m after surging +4.5% in the previous month). Domestic oil production according to the CNH, which aggregates output from both Pemex and private firms, decelerated to 1,722kbpd, with the annual rate slowing down to 1.4%. The situation was similar in gas, moderating to 3.1% from 7.8% previously. Total employment also fell at the margin (-0.9% y/y). The outlook for the sector has complicated as the Mexican oil mix plunges hand-in-hand with international references. In this respect, President López-Obrador stated recently that the strategy will be adjusted to focus in the most profitable fields, a change that will almost certainly impact production levels relative to recent trends.

Construction is anticipated at -4.1% y/y (+1.1% m/m) from -8.6% at the end of last year. Virtually all the upside is foreseen from an acceleration in physical investment layouts by the Public Sector, which surged 4.8% y/y in the period after dipping 15.2% in January. In contrast, we believe the private sector (which makes up for about 69% of total construction based on aggregate supply and demand data) has remained on the sidelines, with high uncertainty and new lows in business confidence in most sectors, including in the "adequate moment to invest component". Going forward, the shock to economic activity is likely to result in a further retracement, while a more complicated outlook for public finances due to the decline in oil prices and lower GDP that could also compromise spending in public investment projects.

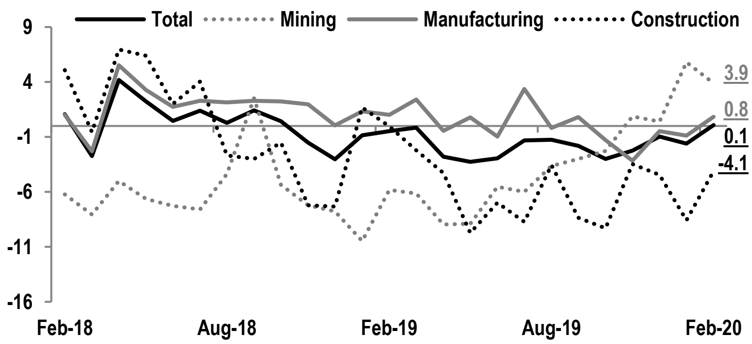
Lastly, we forecast manufacturing at +0.8% y/y (+0.3% m/m). Annual rates in this sector are among those more heavily favored by the leap-year effect. In this respect, auto production surged 4.5% y/y after nine months in contraction, with other reports suggesting additional support from the start of operations late in the month of a second Toyota plant, located in Guanajuato.

Manufacturing exports also accelerated (but not so much intermediate goods imports, likely on the first effects of COVID-19 in China) while US industrial production was basically flat but with its best performance since June 2019. Overall data from the US and Mexico suggest an improvement at the margin, although this will be brief. In this sense, the Coronavirus has had a massive impact in supply chains in both countries and worldwide, with a plethora of companies in diverse industries (including autos) suspending operations to safeguard their employees' health, a situation we believe will hit performance at least in March and April.

All in all, industrial activity is poised to extend its decline for a second consecutive year, exacerbating the contraction in 2019 as supply chains remain heavily disrupted and demand levels are severely damaged due to the pandemic.

Industrial production

% y/y



Source: INEGI, Banorte

Analyst Certification

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