Ahead of the Curve

Annual inflation to dip to 2.19% y/y in 1H-April, providing more room for Banxico to cut

April 17, 2020

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- **Inflation report (1H-April).** We estimate headline inflation at -0.65% 2w/2w, with the core at 0.08%. The fall would be driven by the non-core component, estimated at -2.79%. In this respect, it should be reminded that this print is usually low as summer discounts on electricity tariffs start to kick-in. More importantly though, gasoline prices kept falling fast, while agricultural goods will likely extend their move down. Regarding core inflation, we anticipate some pressures in processed foods, which could start resenting the impact of a weaker Mexican peso. In contrast, lower demand would result in the absence of pressures in other goods and services. With these results, annual inflation would dip to 2.16% from 3.25% in March, with a 154bps decline in just three fortnights. The non-core component would reach a new historical low of -1.15% and the core would also fall, to 3.28%

- **Economic activity (February).** We expect the *Global Economic Activity Indicator* (IGAE) at -0.5% y/y, above the -0.8% observed in January. This increase would be mostly due to the leap-year effect in services. Thus, with seasonally adjusted figures we estimate a 0.2% m/m contraction, weakest since last October. As already known, industrial output fell 0.6% m/m, a disappointing result as all major sectors contracted. On the other hand, we estimate services at 0.3% y/y (flat in the monthly comparison). We believe domestically-driven services were not very much impacted by COVID-19, but externally-driven ones may have started to see some initial effects. If this materializes, activity would have been weak even before the shock from the pandemic started to have its full-effect

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Mexico weekly calendar

DATE	HOUR (ET)	EVENT	PERIOD	UNIT	BANORTE	CONSENSUS	PREVIOUS
Tue 21-Apr	10:00am	International reserves	Apr-17	US$ bn	--	--	185.6
Tue 21-Apr	4:30pm	Citibanamex bi-weekly survey of economic expectations					
Thu 23-Apr	7:00am	CPI inflation	1H Apr	% 2w/2w	-0.65	-0.34	-0.78
				% y/y	2.16	2.186	2.79
		Core		% 2w/2w	0.08	0.11	0.14
				% y/y	3.28	--	3.60
Thu 23-Apr	7:00am	Retail sales	February	% y/y	3.9	--	2.7
		sa		% m/m	-0.4	--	0.5
Fri 24-Apr	7:00am	Economic activity indicator	February	% y/y	-0.5	--	-0.8
		sa		% m/m	-0.2	--	0.0
		Primary activities		% y/y	-2.5	--	1.1
		Industrial production		% y/y	-1.9	--	-1.6
		Services		% y/y	0.3	--	-0.5

Source: Banorte; Bloomberg

Proceeding in chronological order...

Weekly international reserves report. Last week, net international reserves increased by US$61 million, closing at US$185.6 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$4.7 billion during 2020 (please refer to the following table).

Banxico's foreign reserve accumulation details
US$, million

	2019	Apr 8, 2020	Apr 8, 2020	Year-to-date
	Balance		Flows	
International reserves (B)-(C)	180,877	185,618	61	4,740
(B) Gross international reserve	183,028	189,887	-1,021	6,859
Pemex	--	--	-65	1,684
Federal government	--	--	104	1,733
Market operations	--	--	0	0
Other	--	--	-1,060	3,442
(C) Short-term government's liabilities	2,151	4,269	-1,082	2,119

Source: Banco de México

Inflation to fall strongly in 1H-April, again mostly on non-core prices. We estimate headline inflation at -0.65% 2w/2w, building on the -0.78% of the previous fortnight. The fall would be driven by non-core prices, expected at -2.79% (subtracting 70bps in terms of contribution) with the core also lower, at 0.08% (previous: 0.14%).

In the former component, we highlight two factors. First, the typical low print of the period as summer discounts on electricity tariffs start to kick-in, so we expect this category to fall 13.6%, resulting in a -28bps contribution. Second, and more importantly, gasoline prices would add to the downside, with our monitoring showing further declines as these goods adjust to lower international prices. In particular, we estimate low-grade gasoline to plunge 7.1% on top of the -14.3% of the previous fortnight, while high-grade would fall more modestly (-5.9%). These two should subtract 41bps to the headline. Moreover, agricultural goods will likely extend their move down, with a mixed performance. In fresh fruits and vegetables, we expect -1.5%, with our monitoring signaling a strong decline in tomatoes, although with modest pressures in others such as avocadoes, chilies and onions. This would be partially compensated by meat and egg (+0.9%), with some reports stating that prices of goods such as chicken and eggs (particularly the latter) have escalated on higher demand during the quarantine.

Core inflation would contribute +6bps to the headline. The contribution of goods would be broadly stable, at +7bps, almost exclusively from processed foods, which may start resenting the impact of a weaker Mexican peso. In contrast, lower demand would lead to the absence of pressures in other goods (contribution: -1bp). Regarding services, we also estimate -1bp, highlighting our expectation of further reductions in airfares (-2.9%) along others related to tourism, with the blame squarely on COVID-19. Overall, this category would be affected by lower demand induced by social distancing measures and the preference for purchases of essential goods.

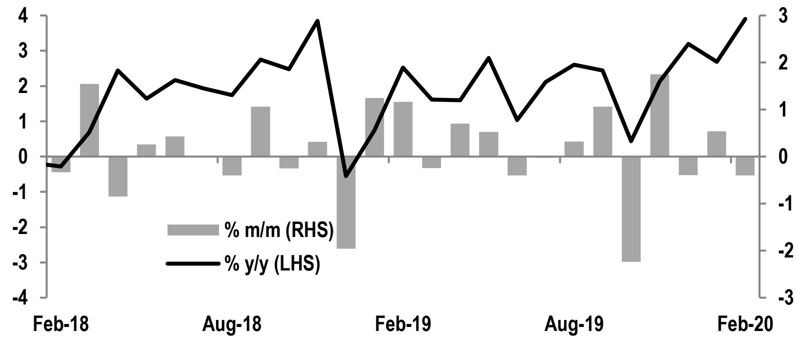
With these results, annual inflation would dip to 2.16% from 3.25% in March, 154bps lower in just three fortnights. The non-core component would reach a new historical low (in bi-weekly frequency) of -1.15%. The core would also fall meaningfully, to 3.28% from 3.60%. It should be mentioned that the latter figure is likely distorted as the pandemic has prevented airlines and tourism services to climb ahead of the Holy Week. Given the lack of seasonality this year, it should increase partially again as soon as the next bi-weekly print. Despite of this, these inflation dynamics have prompted us to expect Banxico to cut the reference rate more aggressively than previously, and also to adjust our year-end inflation forecast lower, to 3.2% from 3.6%.

Strong pick-up in February's retail sales, driven by the leap-year effect. We anticipate a 3.9% y/y advance, accelerating relative to the 2.7% increase seen in January. This would be largely explained by the leap-year effect, which despite not adding one working day in the annual comparison, it did so on the weekend, boosting sales. Nevertheless, with seasonally adjusted figures, sales would fall 0.4% m/m, practically erasing the +0.5% registered in the previous month.

Going back to non-seasonally adjusted figures, the sectors that would be most benefited from this positive effect are supermarket & departmental stores, as they usually get an additional boost from an additional weekend day. In this context, information from ANTAD and Walmart same-store sales support this theory, as they expanded 3.7% and 4.4% y/y in real terms, respectively. In addition, vehicle sales returned to positive for the first time in little over a year, at 0.3%. On the contrary, non-oil consumption goods imports fell 4.6%, possibly skewed in part by the timing of the Chinese New Year, but more so by supply disruptions due to the COVID-19 outbreak.

In this context, we expect a direct impact in sales as soon as March, albeit with the possibility of mixed signals. Specifically, we anticipate a heavy hit to durable goods, as consumers respond to uncertainty postponing this kind of purchases. In this regard, auto sales for the month plunged 25.5% y/y, while orders to close down shopping malls in the latter part of March will also weigh on the figure. On the other hand, precautionary purchases of essential goods helped food, beverages and supermarkets, with ANTAD's breakdown of same-store sales showing the latter surged 18.1% y/y in real terms, while the total was down 2.1%. Moreover, some news from gasoline vendors point to a 40% decline in fuel sales as people stay at home. In this scenario, we expect overall sales to be impacted at least through 2Q20 and extending at least for the rest of the year even if social-distancing measures are lifted if the virus is controlled. We believe uncertainty will remain high, affecting sentiment and durable goods purchases, along second-round effects due to lower employment, wages for workers, and remittances, to name just a few possible impacts.

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



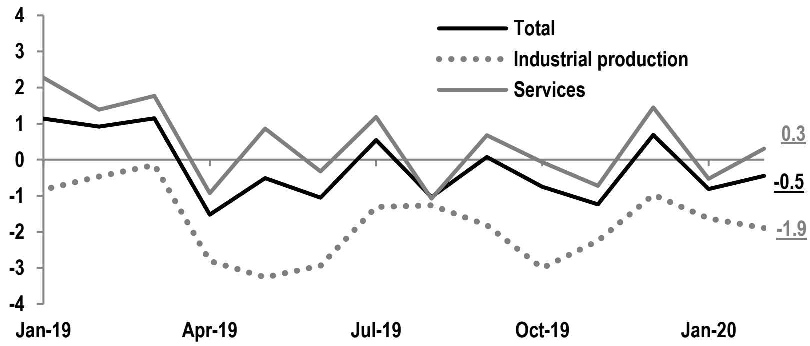
Source: INEGI, Banorte

February IGAE on a weak footing, even before COVID-19. We expect the *Global Economic Activity Indicator* (IGAE) at -0.5% y/y, above the -0.8% observed in December. Nevertheless, a great part of this would be due to the leap-year effect in services (see the section on retail sales above), sector that has been underperforming. Thus, with seasonally adjusted figures we estimate a 0.2% m/m contraction, weakest since last October.

As already known, industrial output fell 0.6% m/m, a disappointing result as all major sectors (mining, construction, and manufacturing) contracted. In our view, this was a mix of both idiosyncratic (specially in mining and oil-and-carbon production) and global factors (with supply chain disruptions concentrated mostly in China at the time). On the other hand, we estimate services at 0.3% y/y (flat in the monthly comparison after falling 0.2% in January). In our view, domestically-driven services were still not very much impacted by COVID-19, but externally-driven ones may have started to see some initial effects. In the former, we highlight retail sales, as already mentioned. Regarding the latter, figures such as the hotel occupancy rate (for tourism-related services) stood at 62%, lowest for the same month in five years. Nevertheless, this was explained at least in part by the increase in infrastructure, with both national and international flight travelers still dynamic. On a more comprehensive basis, employment in services decelerated further, to 2.6% y/y, while the IMEF non-manufacturing indicator returned to contraction territory at 48.6pts after briefly surpassing the 50pts threshold in the previous month, with the most important adjustments in new orders and production.

If this materializes, activity would have been weak even before the shock from COVID-19 started to have its full-effect. In our view, this will have a very sizable impact during the next two months and more modestly afterwards, to say the least, and even if the spread is controlled. We think industrial activity will be first to adjust, with a significant effect in March, with services possibly holding up better. Nevertheless, we warn that advanced figures in the latter sector suggest that the effect was also very important, even with more stringent distancing measures in place only when Mexico declared a sanitary emergency (March 30th) –although educational activities were suspended since the middle of the month–.

IGAE
% y/y (nsa)



Source: INEGI, Banorte

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