Ahead of the Curve

1H-May inflation and March's retail sales to continue showing the impact from COVID-19

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- **Inflation report (1H-May).** We estimate headline inflation at -0.07% 2w/2w (previous: 0.19%). Inside, core prices would pick up 0.24% (contribution: 18bps). Meanwhile, the non-core index would fall 1.06% (subtracting 25bps). Dynamics during the period would be characterized by strong adjustments both to the downside and upside, influenced by the effects of the COVID-19 pandemic. Nevertheless, we anticipate the typical fall in electricity prices due to the rollout of summer discounts will more than compensate for pressures concentrated on processed foods, the rest of energy –gasolines and LP gas–, and fruits and vegetables. With these, annual inflation would climb to 2.45% from 2.15% in April, likely bottoming out in the previous month. Core inflation would stand at 3.76%, while the non-core would come in at -1.57%.

- **Retail sales (March).** We anticipate a 2.3% y/y contraction, which would break with fourteen positive months in annual terms. Broadly speaking, we observed mixed signals in terms of consumption drivers and performance by sector, in our view highly influenced (directly and indirectly) by shifts in consumer behavior due to the pandemic. Nonetheless, we expect weakness to prevail. With seasonally adjusted figures, sales would fall 1.6% m/m, extending the -1.1% registered in the previous month. Going forward, and like other components of aggregate demand, we expect consumption to be hit the hardest in 2Q20, with our forecast at -16.5% y/y. In our view, higher unemployment, greater cautiousness, and mobility restrictions, among others, will keep affecting meaningfully sales' dynamics. In particular, purchases of non-durables goods and essential items will likely remain positive, albeit not enough to outweigh the strong contraction expected in durable goods

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STARMINE AWARDS FOR REUTERS POLLS FROM REFINITIV

Mexico weekly calendar

DATE	TIME (ET)	EVENT	PERIOD	UNIT	BANORTE	CONSENSUS	PREVIOUS
Tue 19-May	**10:00am**	**International reserves**	May 15	US$ bn	--	--	186.6
Wed 20-May	**4:30pm**	**Citibanamex bi-weekly survey of economic expectations**					
Fri 22-May	**7:00am**	**Retail sales**	March	% y/y	-2.3	--	2.5
		sa		% m/m	-1.6	--	-1.1
Fri 22-May	**7:00am**	**CPI inflation**	1H May	% 2w/2w	-0.07	0.00	0.19
				% y/y	2.45	2.53	2.21
		Core		% 2w/2w	0.24	0.12	0.17
				% y/y	3.76	--	3.61

Source: Banorte; Bloomberg

Proceeding in chronological order...

Weekly international reserves report. Last week, net international reserves decreased by US$13 million, closing at US$186.6 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$5.8 billion during 2020 (please refer to the following table).

Banxico's foreign reserve accumulation details
US$, million

	2019	May 8, 2020	May 8, 2020	Year-to-date
	Balance		Flows	
International reserves (B)-(C)	180,877	186,643	-13	5,766
(B) Gross international reserve	183,028	196,502	356	13,474
Pemex	--	--	0	2,134
Federal government	--	--	355	7,415
Market operations	--	--	0	0
Other	--	--	1	3,925
(C) Short-term government's liabilities	2,151	9,859	369	7,708

Source: Banco de México

Retail sales in March to decline on lower purchases of non-essential items. We anticipate a 2.3% y/y contraction, which would break with fourteen positive months in annual terms. Broadly speaking, we observed mixed signals in terms of consumption drivers and performance by sector, in our view highly influenced (directly and indirectly) by shifts in consumer behavior due to the pandemic. Nonetheless, we expect weakness to prevail as consumers turned more cautious. With seasonally adjusted figures, sales would fall 1.6% m/m, extending the -1.1% registered in the previous month.

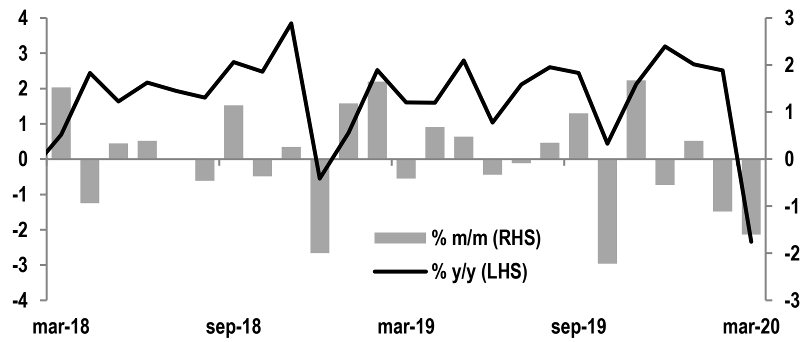
In this respect, ANTAD's same-store sales declined 2.1% y/y in real terms, with the headline masking big differences by type of goods. For example, supermarket sales surged 18.1%, with the bulk comprised of essential items as consumers increased precautionary sales. On the contrary, departmental- and specialized-store sales declined 21.5% and 6.1%, respectively. It should be mentioned that flagship stores in the former category, such as *El Palacio de Hierro*, *Liverpool* and *Sears*, were open most or even the whole period in some states, signaling the decline was mostly demand-driven. The latter also suggests that, as these stores were closed nationwide since the beginning of April, the impact will be stronger in coming months. Reinforcing this trend, vehicle sales plunged 25.5% y/y, with consumers backtracking from spending in durable goods and high-ticket items. In addition, the volume of gasoline sales fell 10.9% y/y (lowest since December 2018), consistent with data from companies such as *Google* and *Apple* that shows a steep decline in mobility since mid-month.

On the contrary, other fundamental data showed more resiliency, in our view helping dampen some downside. Among them we highlight remittances, which in local currency surged 57.8% y/y, aided by both more inflows in dollars and the depreciation of the Mexican peso. Consumer confidence dropped only slightly, from 43.8pts in February to 42.6pts (sa), with most of the adjustment in expectations components –both households' and about the country–, with the assessment of current conditions more stable.

Total payrolls of the formal sector in real terms decelerated but are still positive in the annual comparison, with job losses not enough to outweigh higher wage revisions and downward inflation surprises.

Going forward, and like other components of aggregate demand, we expect consumption to be hit the hardest in 2Q20, with our forecast at -16.5% y/y. In our view, higher unemployment, greater cautiousness among consumers and mobility restrictions, among others, will keep affecting sales' dynamics meaningfully. In particular, and as we have observed in other countries, purchases of non-durables goods and essential items will be more supported and will likely stay positive, albeit not enough to compensate for the strong contraction expected in durable goods.

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



Source: INEGI, Banorte

Inflation to bounce on pressures at the core component. We estimate headline inflation at -0.07% 2w/2w (previous: 0.19%). Inside, core prices would pick up 0.24% (with a contribution of 18bps). Meanwhile, the non-core index would fall 1.06% (subtracting 25bps). Dynamics during the period would be characterized by relatively strong adjustments, both to the downside and upside, influenced by the effects of the COVID-19 pandemic.

Within the non-core component, downward pressures would stem from the typical decline in electricity tariffs as summer discounts continue to kick-in (-38bps), as well as from meat and eggs (-3bps). In the latter, several reports, as well as our price monitoring, point to an additional decrease in chicken and egg prices, reversing some of the steep increases observed in late March. On the contrary, we anticipate a positive contribution from the rest of energy, with gasolines (+8bps) –mainly influenced by higher international reference prices, with the exchange rate relatively stable and without excise tax subsidies– and LP gas (+2bps) up. Meanwhile, fruits and vegetables would show a second consecutive fortnight higher, adding 6bps. Our monitoring suggests upward pressures in some relevant goods such as chilies and tomatoes, with the latter more moderate after the considerable hike in the previous period. On the contrary, onions and lemons showed slight declines.

Going to the core component, the upside bias would be driven by a 12bps estimated contribution in processed foods, which has shown steep increases since early April. We believe this is explained by two main factors: (1) Relative scarcity in some goods driving prices higher, highlighting beer and some cleaning products; and to a lesser extent (2) the passthrough effect from exchange rate depreciation to prices. Other goods would contribute with 3bps, also influenced by these factors although possibly dampened by small sample sizes in some goods (possibly skewing the bi-weekly change to zero) and higher slack. Going into services, we expect a moderate contribution from housing (+1bp), in line with the previous fortnight. Meanwhile, other services would add 3bps, also hit by the lack of prices in some categories and economic slack.

With these results, annual inflation would climb to 2.45% from 2.15% in April, likely bottoming out in the previous month. Core inflation would stand at 3.76% from 3.50%, influenced by both the increase in goods outlined previously and a more challenging base effect. The latter is based on the absence of the typical seasonality pattern in tourism, which did not increase in previous fortnights –triggering a temporary decline in this component– and so it will probably won't fall currently, leading to the contrary effect. The non-core index would increase to -1.57% from -1.96%, impacted by the rebound in gasolines' prices. In this context, we believe inflation will remain below the 3% target in coming months, climbing back towards our 3.2% forecast until the end of the year due to adverse base effects as well as higher passthrough. Nevertheless, it is our take that short-term dynamics will support additional rate cuts in June and August, forecasting two additional 50bps cuts, taking the rate to 4.50%, level where we expect to remain until year-end 2020.

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We, Gabriel Casillas Olvera, Alejandro Padilla Santana, Delia María Paredes Mier, Juan Carlos Alderete Macal, Manuel Jiménez Zaldívar, Marissa Garza Ostos, Tania Abdul Massih Jacobo, Francisco José Flores Serrano, Katia Celina Goya Ostos, Santiago Leal Singer, José Itzamna Espitia Hernández, Valentín III Mendoza Balderas, Víctor Hugo Cortes Castro, Hugo Armando Gómez Solís, Miguel Alejandro Calvo Domínguez, Luis Leopoldo López Salinas, Leslie Thalía Orozco Vélez, Gerardo Daniel Valle Trujillo, and Eridani Ruibal Ortega, certify that the points of view expressed in this document are a faithful reflection of our personal opinion on the company (s) or firm (s) within this report, along with its affiliates and/or securities issued. Moreover, we also state that we have not received, nor receive, or will receive compensation other than that of Grupo Financiero Banorte S.A.B. of C.V for the provision of our services.

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