Ahead of the Curve

We expect a modest sequential recovery in May's IGAE and pressures in inflation for 1H-July

- **Global Economic Activity Indicator (May).** We expect a 20.3% y/y contraction, slightly below the -19.9% observed in April and a new low since the series is available. The main driver for the decline would still be the impact from the COVID-19 pandemic, although also with a more challenging base effect and less working days. Nonetheless, we estimate a modest rebound of 0.5% m/m relative to the previous month. As already published, industrial production plunged 30.7% y/y (-1.8% m/m), with mining struggling as oil output was cut to comply with the OPEC+ agreement. In services, we expect a 17.5% y/y contraction, albeit with a sequential recovery of 0.4%. Signals from timelier data have been mostly stable or slightly positive, including IMEF's non-manufacturing PMI and the aggregate trend indicator surveys for this sector. On the contrary, categories that have been most affected by the pandemic likely remained very weak, along an expected impact from lower employment levels that have likely had an adverse effect on aggregate demand
- **Inflation (1H-July).** We estimate headline inflation at 0.32% 2w/2w, high relative to historical prints for this period, with the core at 0.16% and the non-core at 0.85%. In terms of contribution, the first one would add 12bps with the latter at +20bps. We highlight that recent inflation surprises have been more volatile, particularly with the last two fortnights significantly to the upside. We continue attributing this to direct and indirect effects from the pandemic. With these results, annual inflation would stand at 3.55% from 3.33% in June. The core would tick slightly higher, to 3.75% (previous: 3.71%). In contrast, the non-core would see more a more sizable increase, to 2.95% from 2.16%

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Mexico weekly calendar

DATE	TIME (ET)	EVENT	PERIOD	UNIT	BANORTE	CONSENSUS	PREVIOUS
Tue 21-Jul	10:00am	International reserves	Jul-17	US$ bn	--	--	191.1
Tue 21-Jul	3:30pm	Citibanamex bi-weekly survey of economic expectations					
Wed 22-Jul	7:00am	Retail sales	May	% y/y	-21.6	--	-23.8
		sa		% m/m	3.4	--	-22.4
Thu 23-Jul	7:00am	CPI inflation	1H July	% 2w/2w	0.32	0.24	0.47
				% y/y	3.55	3.47	3.50
		Core		% 2w/2w	0.16	0.15	0.21
				% y/y	3.75	--	3.76
Fri 24-Jul	7:00am	Global economic activity indicator (IGAE)	May	% y/y	-20.3	-20.0	-19.9
		sa		% m/m	0.5	--	-17.3
		Primary activities		% y/y	-5.3	--	1.8
		Industrial production		% y/y	-30.7	--	-29.3
		Services		% y/y	-17.5	--	-16.4

Source: Banorte; Bloomberg

Proceeding in chronological order…

Weekly international reserves report. Last week, net international reserves increased by US$575 million, closing at US$191.1 billion. According to Banxico's report, this was explained by: (1) Sales of US$400 million from the Federal Government to the central bank; and (2) a positive valuation effect in institutional assets of US$175 million. In this context, the central bank's international reserves have increased by US$10.2 billion during 2020 (please refer to the following table).

Banxico's foreign reserve accumulation details
US$, million

	2019	Jul 10, 2020	Jul 10, 2020	Year-to-date
	Balance		Flows	
International reserves (B)-(C)	180,877	191,122	575	10,245
(B) Gross international reserve	183,028	197,079	71	14,051
Pemex	--	--	0	2,619
Federal government	--	--	-99	6,852
Market operations	--	--	0	0
Other	--	--	170	4,580
(C) Short-term government's liabilities	2,151	5,957	-504	3,806

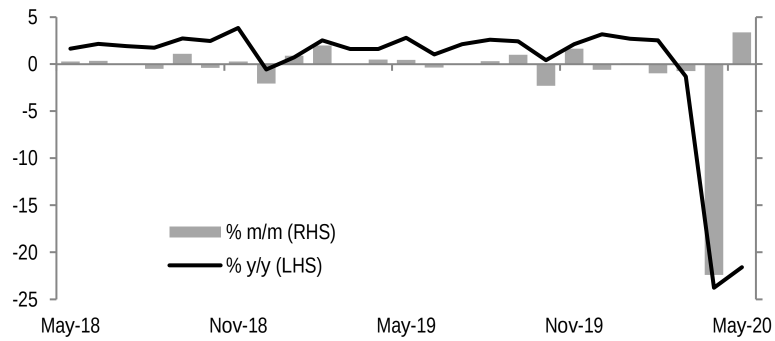
Source: Banco de México

Retail sales to recover modestly in May. We anticipate a 21.6% y/y contraction, not that different from the -23.8% of the previous month, as restrictions because of the pandemic stayed mostly unchanged. Nevertheless, in seasonally adjusted terms, this would result in 3.4% growth, aided quite strongly by the base effect generated because of April's plunge. On a year-to-date basis, this figure would imply an 8.5% y/y contraction.

Most available data suggest a better performance relative to the previous month. Among them, ANTAD's same-store sales declined 21.2% y/y vs -24.5% previously, affected by high uncertainty and maintaining the relative shift in consumption patterns favoring purchases of essential items, along lower disposable income on the back of accumulated job losses since March. Regarding the latter, two positive news include: (1) Net positive job creation –when accounting for both the formal and informal sectors– despite diminished quality affecting total payrolls; and (2) remittances advancing at a strong pace of 26.1% y/y (in nominal peso terms), both due to higher USD amounts and the depreciation of the currency. Auto sales, as a proxy of durables goods' performance, were at -59% vs. -64.5% in April, while gasolines were also better, at -36.2% instead of -40.1% during the same period. Based on goods' inflation in said month, we believe modest support may have resulted from discount programs by retailers (*e.g. Hot Sale*), as they sought to boost demand and protect their market share while rotating inventories and generating cash flows. On the contrary, the main challenge is that non-oil consumption goods imports plunged more heavily when compared to April, standing at -44.6% y/y. Nevertheless, and as stated when the report was released, we do not put much weight into this signal as it is our take that inventory changes played a very big part in explaining trade dynamics in the month.

Going forward, we reiterate our view of lingering weakness, observed more clearly in annual figures. June is likely to show that the sequential recovery extended and could even accelerate at the margin. This would be consistent with the additional reopening of activities and is backed by higher mobility figures. In turn, we think this would be especially helpful for the informal sector –taking into account also that, at least in Mexico City, malls remained closed in that month and at least until July 8th, opening since then at 30% capacity–.

Retail sales
% y/y nsa, % m/m sa



Source: INEGI, Banorte

Inflation to stay somewhat pressured in the first half of July. We estimate headline inflation at 0.32% 2w/2w, high relative to historical prints for this period, with the core at 0.16% and the non-core at 0.85%. In terms of contribution, the first one would add 12bps with the latter at 20bps. We highlight that recent inflation surprises have been more volatile, particularly with the last two fortnights significantly to the upside. We continue attributing this to direct and indirect effects from the pandemic. With these results, annual inflation would stand at 3.55% from 3.33% in June. The core would tick slightly higher to 3.75% (previous: 3.71%). In contrast, the non-core would see more a more sizable increase to 2.95% from 2.16%.

At the core, processed foods would extend their recent upward move, estimated at 0.3% 2w/2w (contribution: 6bps), with our monitoring showing persistent increases in relevant staples such as milk and beans. Moreover, we anticipate other goods higher at the margin (0.1%), with some reports of increases in medical supplies along possible adjustments as shopping malls started to reopen (*e.g.* as in Mexico City, on July 8th). In services, we expect increases in airfares and those related to tourism, albeit modest. We believe Aeromexico's announcement of Chapter 11 bankruptcy protection (on June 30th) did not have any meaningful effect on prices. Excluding these, we note that, in the historical series, this fortnight is relatively elevated, likely related to summer vacations. Although we expect some pressures –as it has also been coupled with higher mobility according to data from *Apple* and *Google*–, it is our take they would be more limited given the prevailing slack in the economy.

At the non-core, we highlight additional price hikes in energy, with this component estimated at 2.0%. As has been the case recently, gasolines would keep trending higher, adding 16bps. This is consistent with our monitoring, with higher prices in the US not fully compensated by a modest appreciation of the peso, while subsidies to excise taxes remain at zero. LP gas would also increase further, albeit at a slower pace. On agricultural goods we see a mixed performance once again, reversing some of its latest sizable moves. Fresh fruits would increase 1.2% (contribution: +6bps) after falling 1.4% in the previous fortnight, with our monitoring showing upward adjustments in goods such as tomatoes, potatoes and apples. On the contrary, meat and egg would fall 0.5%, subtracting 3bps, with some reports of a partial reversal to the downside in chicken and eggs.

May's IGAE would dip slightly further in the annual comparison. We expect the *Global Economic Activity Indicator* (IGAE) at -20.3% y/y, a new low since the series is available. This would happen despite some positive signals, especially in services. Although there are factors that would skew the number lower, such as a more challenging base effect and less working days, the main driver for the decline would still be the impact from the COVID-19 pandemic and efforts to fight it. It should also be remembered that restrictions remained virtually unchanged despite the government's plan to restart the economy, unveiled at the middle of the month. Nonetheless, with seasonally adjusted figures we estimate a modest sequential recovery of 0.5% m/m.

As already published, industrial production plunged 30.7% y/y, below April at -29.3% and partly impacted by the abovementioned effects. This sector actually contracted at the margin, at -1.8% m/m. Mining struggled as oil output was cut to comply with the OPEC+ agreement, while construction and manufacturing were marginally lower.

In services, we expect a 17.5% y/y contraction. Nevertheless, in the monthly comparison, we anticipate a 0.4% increase. In this respect, signals from timelier data have been mostly stable or slightly positive. IMEF's non-manufacturing PMI picked up 4.5pts to 42.1pts, still significantly below the expansion threshold albeit driven by a strong increase in 'production'. INEGI's aggregate trend indicator index on non-financial services (excluding commerce) recovered marginally, to 40.1pts from 36.7pts in April. This same indicator, but for commerce, showed similar results, coming at 45.5pts (previous: 37.1pts). Moreover, and as mentioned in the previous section, we expect a better performance in retail sales.

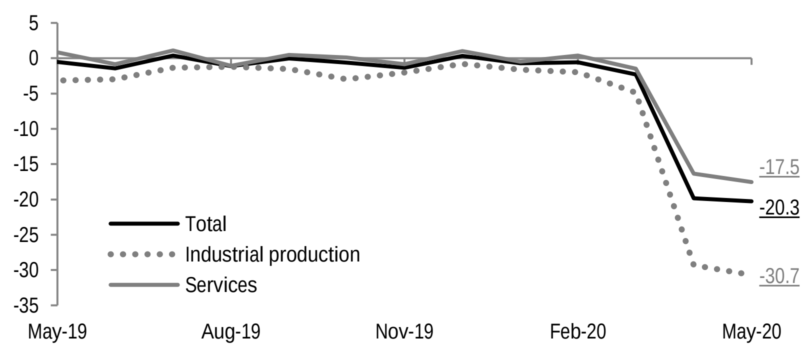
Going to more specific indicators, air passenger traffic in all the country's airports was practically unchanged relative to the previous month, at -93.4% y/y. Coupled with additional weakness in manufacturing exports, this might result in a higher impact on transportation. Regarding lodging and entertainment, hotel occupancy rates averaged 3.1% (vs. 2.8% in April). Meanwhile, *Open Table* data showed that seated diners were still very close to -100% y/y, starting to improve until mid-June. Considering this, on top that the extension of social distancing measures that prohibit massive events such as concerts and sports, we believe these categories will remain very weak.

Taking into account last month's performance in education and healthcare that we thought would be hit, we believe they could continue showing some strength this month. Finally, we will also be looking into professional and financial services, which so far have been resilient, although with still very high uncertainty around them.

On the contrary, employment weakness has persisted, possibly affecting aggregate demand. In this sense, IMSS' data shows a loss of 178.6 thousand formal jobs in services. Nevertheless, these seem to have been compensated by gains in the informal sector, with INEGI's figures showing a net creation of 79.9 thousand jobs –both formal and informal–. Although this increase is favorable, it still suggests a deterioration in overall labor conditions.

Going forward, this print will be key to calibrate our 2Q20 GDP estimate, to be published on July 30th. We believe our expectation for May is consistent with the forecast of a 19.4% y/y decline in the quarter (-12.9% q/q). Specifically, if more dynamism is observed in June –as data so far suggests this will be the case– risks could be tilting slightly to the upside. Nevertheless, we believe the situation in the medium term is still very uncertain and full of challenges, especially as we still lack clear signals of a decrease in the number of new cases, delaying further an additional economic reopening. In this sense, we maintain our estimate of a 9.8% y/y contraction in GDP during 2020.

IGAE
% y/y (nsa)



Source: INEGI, Banorte

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