# Ahead of the Curve

## We expect an additional uptick in August's inflation and July's IP to extend gains

September 4, 2020

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- **Inflation (August).** We estimate headline inflation at 0.37% m/m (previous: 0.66%), with core prices up 0.30% after advancing 0.40% in July. The latter would contribute 23bps, with the non-core more modest at +14pb. The first fortnight was above market expectations again, driven by increases in both components. We expect these pressures to extend in the second half, albeit more modestly. If our forecast materializes, annual inflation would reach 4.02% from 3.62% in July –highest since May 2019–, with the core at 3.95% from 3.85% previously. Thus, both measures would be hovering virtually at the upper bound of Banxico's variability range around the 3% target (+/- 1%), with the short-term backdrop for prices more challenging

- **Industrial production (July).** We anticipate a -11.6% y/y contraction, above the -16.7% seen in the last month. In seasonally adjusted terms we forecast a 6.6% m/m expansion, moderating relative to the +17.9% in June. In this sense, as efforts to reopen continued, it is our take that activity kept gathering momentum, acknowledging a boost from external demand and with domestic-facing sectors lagging. Specifically, we see manufacturing at -10.4% y/y (9.3% m/m), construction at -18.2% (8.9%), and mining at -5.9% (-1.4%)

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Mexico weekly calendar

| DATE | HOUR (ET) | EVENT | PERIOD | UNIT | BANORTE | CONSENSUS | PREVIOUS |
|---|---|---|---|---|---|---|---|
| Mon 7-Sep | 7:00am | Gross fixed investment | June | % y/y | -23.3 | -23.6 | -39.7 |
| | | sa | | % m/m | 20.9 | -- | -4.5 |
| | | Machinary and equipment | | % y/y | -21.0 | -- | -46.7 |
| | | Construction | | % y/y | -24.9 | -- | -33.7 |
| Mon 7-Sep | 7:00am | Private consumption | June | % y/y | -- | -- | -24.8 |
| | | sa | | % m/m | -- | -- | -1.7 |
| | | Domestic (Goods and services) | | % y/y | -- | -- | -23.2 |
| | | Imported (Goods) | | % y/y | -- | -- | -38.3 |
| Mon 7-Sep | 3:30pm | Citibanamex bi-weekly survey of economic expectations | | | | | |
| Tue 8-Sep | 10:00am | International reserves | Sep-4 | US$ bn | -- | -- | 193.3 |
| Wed 9-Sep | 7:00am | CPI inflation | August | % m/m | 0.37 | -- | 0.66 |
| | | | | % y/y | 4.02 | -- | 3.62 |
| | | Core | | % m/m | 0.30 | -- | 0.40 |
| | | | | % y/y | 3.95 | -- | 3.85 |
| Thu 10-Sep | | Wage negotiations | August | % | -- | -- | 5.9 |
| Thu 10-Sep | | ANTAD: Same-store sales | August | % y/y in real terms | -- | -- | -12.3 |
| Fri 11-Sep | 7:00am | Industrial production | July | % y/y | -11.6 | -- | -16.7 |
| | | sa | | % m/m | 6.6 | -- | 17.9 |
| | | Mining | | % y/y | -5.9 | -- | -5.2 |
| | | Utilities | | % y/y | -12.7 | -- | -13.3 |
| | | Construction | | % y/y | -18.2 | -- | -26.1 |
| | | Manufacturing | | % y/y | -10.4 | -- | -16.5 |

Source: Banorte; Bloomberg

Proceeding in chronological order…

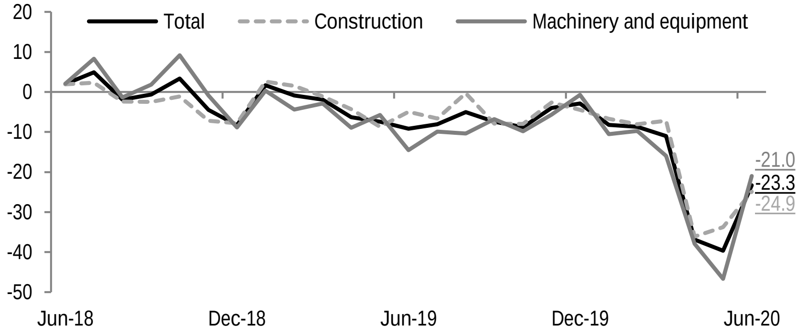
**We anticipate investment to recover sequentially in June.** We expect GFI to decline 23.3% y/y, above the -39.7% of the previous month. Although there is a favorable calendar effect (resulting in additional working days), the main driver behind the rebound would be efforts to restart economic activity. Key industries for this category –such as construction and auto manufacturing– were labeled as essential at the start of the month, resulting in an important boost. In this sense, in monthly terms we expect a 20.9% expansion (using seasonally adjusted figures). Although this might seem to be high, the index would remain around 18% lower relative to the level observed in March.

Construction would climb to -24.9% y/y from June's -33.7%. While there is a slight negative impact from a more challenging base effect, we believe this will be sharply offset by the calendar effect and renewed dynamism from the reopening. In particular, within the last industrial production report, activity in the sector climbed 10.6%-pts, to -26.1% y/y. In the detail, and in line with its designation as essential, the main improvement was in edification, standing at -26.2%. Civil engineering was more muted at -29.2%. Consistent with this performance, public spending in physical investment decelerated in the month to +12.0% y/y in real terms from +48.4%.

Machinery and equipment (M&Eq.) would also be stronger, standing at -21.0% y/y (previous: -46.7%). Relative to May, we believe the recovery will be driven by both the domestic and the imported components. In particular, capital goods imports within the trade balance report came in at -12.3% y/y, a very significant improvement from the -38.3% of the previous month. We believe this is explained by lockdown measures being lifted faster in other parts of the world, including the US and Europe. Moreover, the MXN was stronger in the month, another favorable factor. We expect imported M&Eq. at -15.3% (previous: -40.1%). Finally, in the domestic front we saw a better performance in transportation as activity resumed. Within IP, this component rose significantly to -27.4% y/y from -80.7%. However, the rebound in other relevant categories such as M&Eq manufacturing and electrical/electronic equipment was more moderate. In this sense, we forecast domestic M&Eq. at -27.8% (previous: -56.0%).

Going forward, we believe the recovery will continue, albeit probably at a much more modest pace, as suggested by the latest figures from capital goods imports and physical investment from the Federal Government (at -2.6%). In this sense, and as previously mentioned, we continue to believe that uncertainty about the virus and its implications for the economy will weigh on investment. In addition, and given the effects of the shock so far, the financial position of many businesses has been compromised, which is very relevant for capital spending possibilities.

GFI
% y/y




Source: INEGI, Banorte

**Private consumption might rebound in June.** In May, private consumption posted an additional decline of -24.8% y/y (-1.7% m/m), in line with the broader deceleration we saw in economic activity. In this sense, weakness once again centered on durable and semi-durable goods purchases, consistent with changing consumption patterns as a result not only of the decline in activity and employment but also on specific effects from the pandemic. On the latter, we note that shopping malls were still closed in May, limiting the purchases of some goods and services. Although this situation extended to June –with the reopening taking place until early July in Mexico City and the State of Mexico–, signals from timelier data, such as retail sales, point to a slight rebound. Considering this as well other figures, including relevant categories within IGAE and trade balance, we expect a sequential increase in June, albeit with the annual comparison remaining in negative territory.

**Weekly international reserves report.** Last week, net international reserves increased by US$137 million, closing at US$193.3 billion. According to Banxico's report, this was mainly explained by a positive valuation effect in institutional assets. In this context, the central bank's international reserves have increased by US$12.4 billion so far in 2020 (please refer to the following table).

Banxico's foreign reserve accumulation details
US$, million

| | 2019 | Aug 28, 2020 | Aug 28, 2020 | Year-to-date |
|---|---|---|---|---|
| | Balance | | Flows | |
| International reserves (B)-(C) | 180,877 | 193,267 | 137 | 12,390 |
| (B) Gross international reserve | 183,028 | 198,596 | 220 | 15,569 |
| Pemex | -- | -- | -50 | 3,979 |
| Federal government | -- | -- | 108 | 6,123 |
| Market operations | -- | -- | 0 | 0 |
| Other | -- | -- | 162 | 5,467 |
| (C) Short-term government's liabilities | 2,151 | 5,329 | 84 | 3,179 |

Source: Banco de México

**Attention to the 2021 Budget Proposal.** We will be looking into the presentation of the *2021 Budget* to Congress, remembering that the deadline for its submission is on September 8th. The Budget is integrated by three documents: (1) The *General Economic Policy Criteria* (CGPE in Spanish), with the main macroeconomic and financial forecasts for 2020 and 2021; (2) the Revenue Law; and (3) the Spending Budget.

According to the latest comments from the Minister of Finance, Arturo Herrera, the latter will contemplate a reduced amount, recognizing a more complex scenario due to COVID-19. On revenues, he has commented that a lower amount is being considered for the oil hedge, while not expecting substantial changes to excise taxes on "junk food". We should note that with the presentation before Congress, the approval process for the two latter documents starts formally, with the first one being to be approved on October 31st at the latest by both chambers, while the deadline for the latter is November 15th, only needed to be signed off by the Lower House.

Main deadlines for 2021 Budget

| Deadline | Document |
|---|---|
| September 8 | 2021 Budget Proposal |
| October 20 | Approval of the Revenue Law by the Lower House |
| October 31 | Approval of the Revenue Law by the Senate |
| November 15 | Approval of the Spending Budget by the Lower House |

Source: Ministry of Finance

**Headline and core inflation to pick up towards 4% in August.** We estimate headline inflation at 0.37% m/m (previous: 0.66%), with core prices up 0.30% after advancing 0.40% in July. The latter would contribute 23bps, with the non-core more modest at +14pb. The first fortnight was above market expectations again, driven by increases in both components. We expect these pressures to extend in the second half, albeit more modest in this latter part. If our forecast materializes, annual inflation would reach 4.02% from 3.62% in July –highest since May 2019–, with the core at 3.95% from 3.85% previously. Thus, both measures would be hovering virtually at the upper bound of Banxico's variability range around the 3% target (+/- 1%), with the short-term backdrop for prices more challenging, in line with our view and already reflected in the central bank's latest Quarterly Report.

Within the core, we expect pressures in goods to stay, at 0.4%. Processed foods would contribute 7bps, with our monitoring showing relevant increases in sodas, milk and water, among the most relevant. Other goods have exhibited a relative acceleration since June, which may be related to the reopening of the economy, a situation we have been tracking more closely as a potentially relevant cue. On the other hand, services will remain modest, estimated at almost the same pace as the previous month, of 0.1%. In this category, we highlight that the period's typical seasonality of lower airfares and services related to tourism –given the end of summer vacations and children returning to school– has not been observed this time around on the back of distortions from the pandemic. In this respect, it should be remembered that their corresponding seasonal increase (mostly felt in June) also did not materialize for the same reason. As a result, we estimate these to be virtually flat in the second fortnight, with demand conditions limiting the possibility of higher prices.

In turn, we forecast a 0.59% advance in the non-core component after climbing 1.48% in July. The main driver would be the uptick already seen in agricultural goods in the first fortnight (0.7% 2w/2w). For the second half, our monitoring flags a more mixed performance, with some goods higher –such as onions– due to lingering supply effects because of hurricane Hanna (since the end of July) but with other relevant items, such as tomatoes and bananas, more than compensating to the downside for this. On the other hand, we expect meat and egg to fall 0.5%. Therefore, this category would increase 0.8% m/m. In energy, we estimate a partial reversal of the first half fall in gasoline prices. Although the exchange rate appreciated around 1.8% in the second fortnight, US prices increased on shutdowns of oil industry activity in the Gulf of Mexico due to hurricane Laura. LP gas would increase 1.4% m/m, still with relevant pressures on reference prices. Finally, government tariffs would climb 0.7%, highly driven by the increase to water rights in the first half of the month.

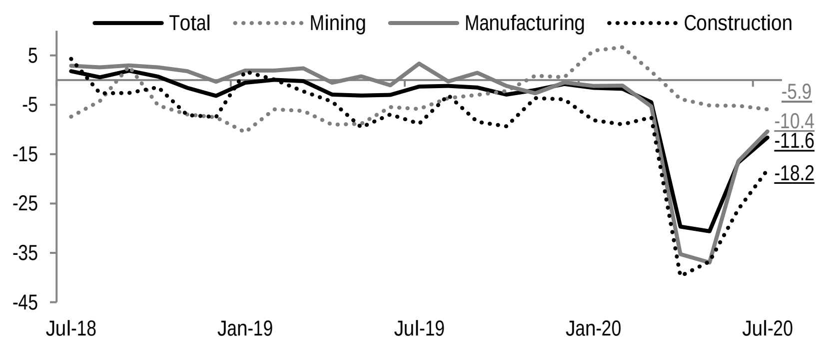
**Industrial production to extend gains in July.** We anticipate a -11.6% y/y contraction, above the -16.7% seen in the last month. It should be noted that there is not a relevant calendar effect in the period, although there is a slightly more challenging base effect. In seasonally adjusted terms, we forecast a 6.6% m/m expansion, moderating relative to the +17.9% seen in June. It is our take that activity kept gathering momentum as efforts to reopen continued, acknowledging also a boost from external demand and with domestic-facing sectors still lagging.

In particular, we expect manufacturing at -10.4% y/y (previous: -16.5%). Sequentially, it would advance 9.3% m/m, building on top of the +26.7% from the previous month. Overall, signals are positive. IMEF's manufacturing PMI climbed 4.8pts to 47.8pts –although declining in August–, with relevant increases in 'new orders' and 'production', which should bode well for activity. Meanwhile, manufacturing exports within the trade balance rose 11.9% m/m (-7.2% y/y), which in our view is very positive after the +83.7% in June. Once again the main driver was autos, which after plunging production in April and May and a still negative print in June, it clawed back to positive territory at +0.7% y/y in July, with 294,946 vehicles produced. US IP was also stronger at -7.7% y/y, 3.2%-pts higher than in June. Meanwhile, IMSS employment actually showed a net creation 48.4 thousand jobs, albeit still considerably below pre-pandemic levels. Finally, and also justifying part of slower growth, 'other manufacturing' exports advanced only 0.4% m/m.

Construction would stand at -18.2% y/y, also improving relative to June (previous: -26.1%). We anticipate support mainly from the private sector, as spending in physical investment from the Federal Government fell 2.6% y/y in real terms. On the contrary, INEGI's data from business confidence and the aggregate trend indicator showed broad increases. Within the latter, gains were concentrated in works executed both as a main contractor as well as a subcontractor. Employment also posted additional gains, with 28.0 thousand new jobs affiliated to IMSS. In this context, we anticipate a 8.9% m/m increase.

Lastly, mining would come in at -5.9% y/y, actually worsening in comparison to the previous month (-5.2%). In monthly terms, this would represent a 1.4% decline, with weakness in the oil sector. According to data compiled to CNH, crude oil production stood at 1,604.7kbpd, lowest since October 1979. This is equivalent to a 4.2% y/y fall, lower than June’s -2.9%. We do not rule out an adverse effect from hurricane Hanna, which struck northeastern states in the latter part of the month. In either case, the sector is already facing considerable challenges, with output down. Meanwhile, non-oil mining could remain relatively more resilient, with exports from this sector at +3.7% y/y (+8.1% m/m).

Industrial production
% y/y




Source: INEGI, Banorte

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|---|---|
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