Ahead of the Curve

Attention on central bank releases to gain further clarity on the policy path

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Winners of the award for best economic forecasters for Mexico in 2019, granted by *Refinitiv*

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- **Banxico's Quarterly Report and Minutes.** As usual, attention in the former will center on updated estimates for GDP and inflation. We expect upward revisions to GDP scenarios, based on: (1) Recent positive news about the development of a COVID-19 vaccine: and (2) comments from Governor Díaz de León, stating that data so far has been closer to the most optimistic path ("V-shaped"), which contemplates a 8.8% y/y contraction (Banorte: -9.0%). On inflation, adjustments will be very relevant to understand the rationale for policy decisions ahead. We will likely see a revision higher in the headline for 4Q20 of 10-20bps from the current 3.7%, while also seeing moderate upward adjustments at least in 1Q21 and 2Q21. We consider the path will be key to gauge the timing of when the easing cycle could be resumed. In the minutes, focus will be on who was the dissenter and his/her explanation behind the vote to continue lowering the reference rate, along with specific comments to reassess the relative skew of each member

Mexico weekly calendar

DATE	HOUR (ET)	EVENT	PERIOD	UNIT	BANORTE	CONSENSUS	PREVIOUS
Tue 24-Nov	7:00am	CPI inflation	1H-Nov	% 2w/2w	0.22	0.17	0.16
				% y/y	3.61	3.56	4.09
		Core		% 2w/2w	-0.03	0.09	0.07
				% y/y	3.76	--	3.96
Tue 24-Nov	7:00am	Unemployment rate	October	%	5.03		5.09
Tue 24-Nov	10:00am	International reserves	Nov-20	US$ bn	--	--	194.4
Wed 25-Nov	7:00am	Retail sales	September	% y/y	-8.1		-10.8
		sa		% m/m	2.0		2.5
Wed 25-Nov	10:00am	Current account	3Q20	US$ bn	--	--	0.5
Wed 25-Nov	1:30pm	Banxico's Quarterly Report	3Q20				
Thu 26-Nov	7:00am	GDP	3Q20 (F)	% y/y	-8.7		-8.6
		sa		% q/q	11.9		12.0
		Primary activities		% y/y	7.4	--	7.6
		Industrial production		% y/y	-8.8	--	-8.8
		Services		% y/y	-9.0	--	-8.8
Thu 26-Nov	7:00am	Economic activity indicator	September	% y/y	-5.9		-9.4
		sa		% m/m	1.0		1.1
		Primary activities		% y/y	5.0	--	5.2
		Industrial production		% y/y	-6.2	--	-8.8
		Services		% y/y	-6.5	--	-10.2
Thu 26-Nov	10:00am	Banxico's Minutes					
Fri 27-Nov	7:00am	Trade balance	October	US$ mn	1,954.2		4,384.7
		Exports		% y/y	-3.0	--	3.7
		Imports		% y/y	-9.3	--	-8.5

Source: Banorte: Bloomberg

Proceeding in chronological order…

Benign inflation in 1H-November on "*El Buen Fin*" discounts and favorable dynamics in some non-core components. We expect headline inflation at 0.22% 2w/2w, higher than the 0.16% of the previous fortnight. Nevertheless, this would be quite low relative to recent years, with the 5-year average at 0.70%. In this respect, it should be recalled that this fortnight is seasonally high due to the final reversal of electricity tariff discounts applied during the summer. In turn, we forecast the core at -0.03%, below the latest print of 0.07%. If our forecast materializes, annual inflation would decline to 3.61% from 4.09% in October, returning to Banxico's target range after surpassing it since the second half of August. The core would reach 3.76% (previous: 3.98%). The non-core would fall quite sizably, to 3.15% from 4.42%, aided also by a more benign base effect in energy prices (particularly LP gas) and, to a lesser extent, meat and egg.

Within the latter, we expect electricity to pick up 23.5% 2w/2w, contributing 40bps, above the 24bps estimated for the total of this component. Therefore, we see favorable dynamics in most of the other categories. Specifically, agricultural goods would decline 0.7% (contribution: -7bps). The main driver would be a 2% fall in fresh fruits and vegetables, with some relief after strong pressures in October –in our view, influenced greatly by bad weather–. Our monitoring signals meaningful reversals in relevant goods (in terms of their weight) such as tomatoes, onions and chilies. In contrast, meat and egg would increase 0.6%, with the latter product extending recent increases. In addition, we forecast low- and high-grade gasolines to fall, subtracting 10bps and 1bps, respectively. In this respect, the Mexican peso strengthened, and US gasoline prices declined, driving dynamics despite subsidies to excise taxes staying at zero. Lastly, we see LP gas maintaining an upward trend, with the annual rate very elevated at 12%.

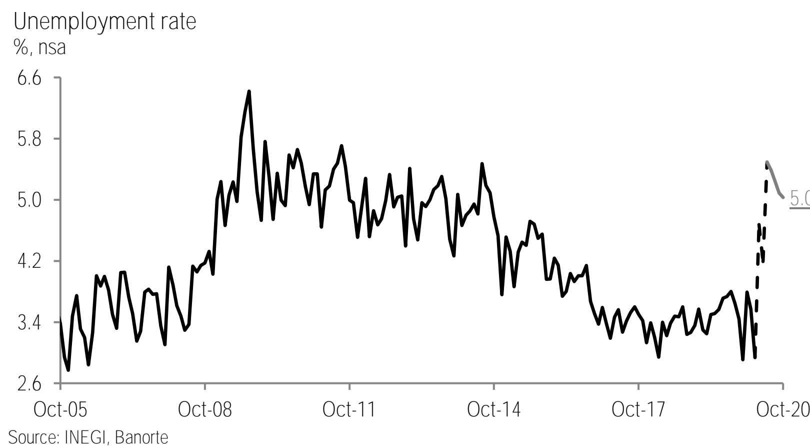
The core would be highly benefitted by "*El Buen Fin*" (Mexico's version of Black Friday). It is important to say that this initiative was lengthened because of social-distancing restrictions, with discounts this year available from November 9th to 20th, as opposed to typically being only in the second half of the month. Therefore, we estimate goods at -0.08% (contribution: -3bps) and services at 0.02% (+1bp), both helped by this factor. In the former, discounts are expected to be concentrated in other goods, forecasted at -0.3%, with processed foods mostly isolated. In turn, services would also be influenced, particularly airfares (despite already pressured margins because of the plunge in demand due to COVID-19) and those related to tourism, albeit with the latter more modestly. Lastly, we believe housing will remain dampened as economic slack remains very wide.

A slight decline in the unemployment rate in October, aided by a seasonal effect. We estimate the unemployment rate at 5.03% (original figures), 6bps lower than the previous month's print. The main driver would be a favorable seasonal effect, considering that since the series exists (2005), the average decline from September to October is around 21bps, with only four out of fifteen years higher. Nevertheless, the adjustment would be more modest due to a further normalization in the composition of the labor force. Seasonally adjusted figures have not been released since the pandemic began. We will remain on the look if INEGI publishes a series, like they did with consumer confidence.

We still recognize important challenges for the forecast, including: (1) The large share of people "available for work" and not in the labor force, seemingly resistant to searching again for a job; and (2) worse epidemiological conditions during the month, with higher cases in the latter part of the period and the deterioration in the traffic-light indicator, which may have impacted some jobs, especially in the informal sector. On a more positive note, IMSS's data showed 200,641 new positions, highest since the start of the pandemic. In addition, the annual comparison of total affiliated people rose to -4.0% from -4.2% in the previous month. Meanwhile, 'employment' components within IMEF indices were mixed, with manufacturing rising considerably and above the 50pts threshold, while in non-manufacturing the signal was opposite, erasing some of the previous month's gains. The latter is somewhat concerning, remembering that a larger share of jobs is in that sector, which could also impact negatively this month's print.

In additional data, we expect the part-time rate to keep declining, albeit at a more modest pace. The participation rate could also extend its move higher, clawing back some share from those "available for work" talked about previously. Regarding informality rates, we could see a slight increase, considering the lag in the previous month and despite a favorable performance in the formal sector. Lastly, we will heed wages, as in our opinion they will be key in order to gauge the potential recovery of domestic demand.

We maintain our view that labor market data will remain distorted by the pandemic, with total employment probably taking some time to recover to levels seen before COVID-19. While there continues to be some optimism about external demand –at least once the new administration in the US takes office–, concerns remain over the pace of the domestic rebound, with still high challenges in key sectors and epidemiological conditions taking a turn for the worse.



Source: INEGI, Banorte

Weekly international reserves report. Last week, net international reserves decreased by US$338 million, closing at US$194.4 billion. According to Banxico's report, this was explained by a negative valuation effect in institutional assets. The central bank's international reserves have expanded by US$13.5 billion so far in 2020 (please refer to the following table).

Banxico's foreign reserve accumulation details
US$, million

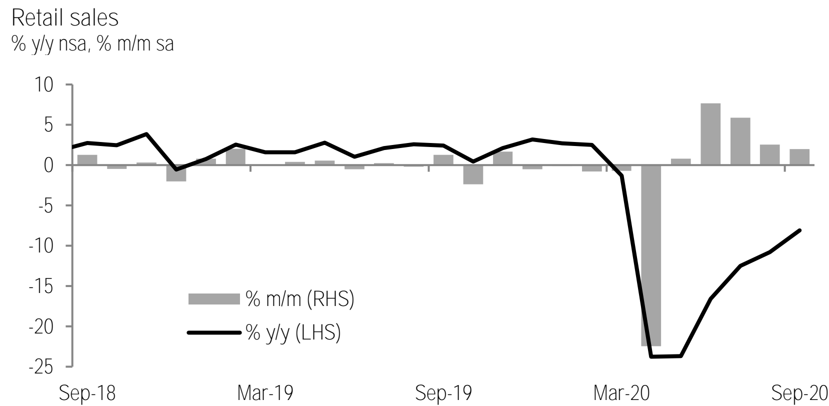
	2019	Nov 13, 2020	Nov 13, 2020	Year-to-date
	Balance		Flows	
International reserves (B)-(C)	180,877	194,361	-338	13,484
(B) Gross international reserve	183,028	198,423	-445	15,396
Pemex	--	--	0	5,149
Federal government	--	--	-121	5,169
Market operations	--	--	0	0
Other	--	--	-324	5,078
(C) Short-term government's liabilities	2,151	4,063	-107	1,912

Source: Banco de México

Retail sales to maintain dynamism in September. We anticipate an 8.1% y/y decline, improving relative to the -10.8% of the previous month. We expect performance to be aided by additional reopening efforts and an improvement in epidemiological conditions in the midst of an extension in pandemic fatigue. In addition, the annual comparison would be benefited by an additional working day relative to the same month of the previous year. With seasonally adjusted figures, activity in monthly terms would increase 2.0%, which we see as very positive considering accumulated gains in the past four months, resulting in a more difficult base effect.

Practically all forward-looking indicators had a better performance. ANTAD's same-store sales declined 4.1% y/y in real terms, above the -6.8% of the previous month. Departmental stores kept improving, probably influenced by the factors outlined above. In contrast, supermarkets decelerated marginally, possibly associated to the gradual normalization in consumption patterns. Reinforcing this signal, vehicle sales stood at -22.8% from -28.7%, respectively. Moreover, non-oil consumption goods imports bounced back to -22.1% y/y from -31.3%. Finally, the volume of gasoline sales printed at -18.6%, 4.9%-pts higher relative August. Consumer fundamentals kept improving, although still weak relative to pre-pandemic levels. In the month, 669.9 thousand jobs were created, mostly in the formal sector, although most associated to somewhat low wages. Remittances strengthened, at 15.1% y/y in USD terms (+27.4% in MXN). On the contrary, consumer credit extended its decline, which will probably limit purchases of high-ticket items, for which people usually rely on financing.

Going forward, signals point to further gains. Among them, ANTAD sales for October printed at -1.2% y/y in real terms. On the details, supermarkets recovered dynamism, while departmental stores retraced at the margin. Consumer confidence for the same period increased again, with relative strength in components measuring households' conditions albeit with purchasing power still tracking behind. On the other hand, we will watch carefully the relative strength in November due to *El Buen Fin* (Mexico's Black Friday) which was extended –from November 9th to 20th– due to the pandemic. This lengthened period of discounts could make it harder to interpret results, as there are still challenges for an adequate seasonal adjustment. Nevertheless, dynamics in November-December (and the full quarter), along other consumer-related indicators, will help assess the degree of the recovery of domestic demand going into next year.

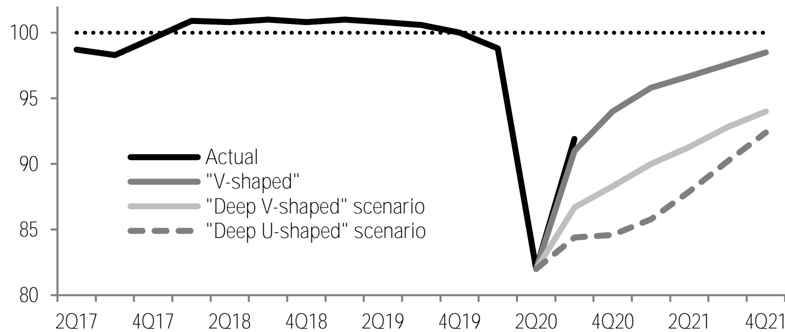


Source: INEGI, Banorte

Banxico's *Quarterly Report* and minutes. The central bank will release its *Quarterly Report* (QR) for 3Q20 on Wednesday –around 1:30pm (ET)– and the minutes of the last monetary policy meeting on Thursday –at 10:00am (ET)–. As usual, attention in the former will center on updated estimates for GDP and inflation. On the latter, we will watch the reasons behind the dissident vote, as well as comments on policy, with even more attention than usual considering the surprise pause taken in the easing cycle in this decision. In our view, this was a clear signal aimed to reaffirm the commitment to the forecast-based inflation targeting regime.

On activity, 3Q20's preliminary GDP print at +12.0%% t/t was slightly better than Banxico's most optimistic forecast in its scenarios –the "V-shaped", at +11.0%– in the last QR (see chart below). It was also considerably better than the worst case, the "Deep U-shaped", which contemplated only a 2.9% expansion. In this context, Governor Alejandro Díaz de León stated last week that he believed the shape and latest data is more like the "V-shaped" and "Deep V-shaped" scenarios. We should remember that these two contemplate full-year contractions of -8.8% and -11.3% y/y, respectively (Banorte: -9.0%). We expect upward revisions to the scenarios, given: (1) Recent positive news about the development of a COVID-19 vaccine; and (2) other comments from the Governor, stating in early October at an IMF panel that activity has been closer to the most optimistic path. We recall that the mid-point of the three scenarios stands at -11.0% y/y, which compares to our -9.0% and consensus at -9.3%. While one way of adjusting the forecast higher would be to select the optimistic path, we think the monetary authority will keep its options open, especially considering that the outlook is still very uncertain, at least for the 2020 winter months and into 2021. Among the risks on the horizon, we expect the monetary authority to elaborate on some, including: (1) Potential changes to the Mexico-US relationship after electoral process in that country; (2) the increase in new cases globally, but especially in Mexico; and (3) the timing of vaccine deployment once it is already widely available. We should also remember that the current mid-point by the central bank for GDP in 2021 is at 3.2%, below our 4.1% but in line with the market.

Banxico GDP forecasts
Index sa, 4Q19 =100



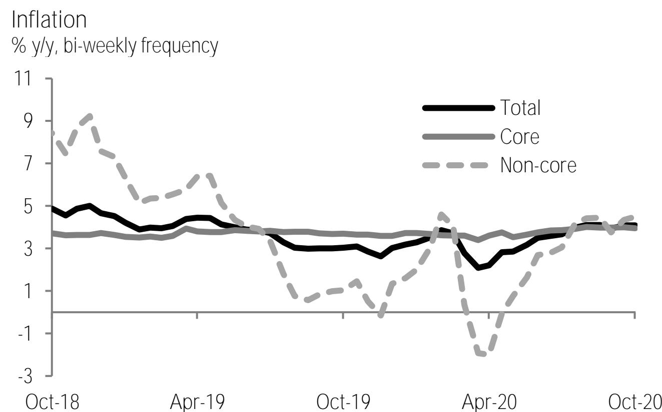
*Note: Actual incorporates 3Q20 preliminary GDP as released by INEGI's, with the index level implied by the annual change in seasonally adjusted figures
Source: Banxico, INEGI

On the output gap, we believe updates will be important, especially given expected changes on growth. Nonetheless, recent communications suggest that "*...ample slack conditions are expected throughout the time frame in which monetary policy operates...*". In this sense, we could see the gap shrink to around -10% of potential GDP, remembering that in 2Q20 it stood at -20.3%. While slack would keep improving as activity recovers, it seems we are still very far away from this being of any concern for the price-formation process. In turn, concerns on inflation are significantly more relevant, in our view with even more weight on Banxico's decisions going forward, as outlined below.

Specifically, the Board is signaling more caution about price dynamics. In our opinion, this was the clear driver behind the pause of the easing cycle, with heightened doubts about the convergence towards the target. We believe the central bank also aimed to reaffirm its mandate as informed by the forecast-based inflation targeting regime. In this respect, we highlight the removal of relevant comments about activity and the financial shock from the section that states the factors to watch for upcoming decisions. Hence, adjustments in inflation forecasts will be very relevant to understand the rationale for policy decisions ahead. The balance of risks remains characterized as uncertain. We expect a similar situation than in the last QR, in which the list was expanded and rearranged relative to the previous statement. In this sense, we also note that there are currently three risks to the upside and three to the downside in the latter document.

Regarding forecasts, the monetary authority mentioned that inflation dynamics remain impacted, in our view by the relative price changes due to the pandemic along other supply shocks –the latter especially affecting the non-core component recently (see chart below, left)–. Overall, they anticipated a "*...slight increase in the foreseen trajectories within the forecast horizon...*" albeit also adding that "*...although for the next 12-24 months are expected to be around 3%...*". Considering this, we will likely see a revision in the headline estimate for 4Q20 of around 10-20bps from the current 3.7% (see table below, right). While this would be a relatively minor adjustment given that inflation stood at 4.09% y/y in October, our forecasts suggest a more favorable performance as soon as in the first half of November and in December. We also see modest upward adjustments, at least in 1Q21 and 2Q21, with the caveat of a very significant base effect starting in March and extending into the second quarter (due to pandemic distortions).

Meanwhile, and following higher prints in 3Q20 and 4Q20, we could see some downward adjustments for late 2021 and more moderate revisions for 2022. We consider the path will be key to gauge the timing of when the easing cycle could be resumed. One option is that the Board waits until headline inflation is back within the target range of 3% +/- 1%. However, there is also the possibility of an earlier action, likely if the outlook suggests a clear downward path with limited risks and/or core inflation declining more rapidly. The addition of the convergence of the latter towards the target as one of the factors to consider ahead –without ruling out that it converges sooner on ample slack, and at least after looking at current estimates–, suggests that the 'reopening of the door' could be even sooner.



Source: INEGI

Inflation forecasts
% y/y, quarterly average

	2020		2021				2022	
	3Q	4Q	1Q	2Q	3Q	4Q	1Q	2Q
Headline								
Banxico (QR 2Q20)	3.9	3.7	3.6	4.2	3.1	2.9	2.8	2.8
Actual	3.9	--	--	--	--	--	--	--
Core								
Banxico (QR 2Q20)	3.9	3.8	3.8	3.5	3.0	2.8	2.7	2.7
Actual	3.9	--	--	--	--	--	--	--

Source: Banxico, INEGI, Banorte

In the minutes, attention will be on who was the dissenter and his/her explanation behind the vote. We think it could have been either by Deputy Governors Jonathan Heath or Gerardo Esquivel. This is mostly based on the comments we think were made by them in the last minutes, both still favoring a continuation of the easing cycle. However, the upcoming minutes will be crucial to determine the path going forward, particularly as we and the market were surprised by the decision. Specifically, the debate under the 'monetary policy' section will be very important to try to reassess the relative skew of each participant. We will match the arguments from the dissenter to one member and work our way to identify those made by the rest of the Board. While we do not see major changes from the hawks (in our view, Deputy Governors Irene Espinosa and Javier Guzmán), we believe adjustments on comments made by Governor Díaz de León –which showed a preference for data-dependency and a cautious approach– as well as from the remaining dovish wing, will shed further light on when the 'pause' might be over. In addition, we will look for comments about macro-financial risks and markets, especially after the US election which led to a favorable reaction in local assets. Lastly, we will search for comments on public finances after the approval of the 2021 Budget and on Pemex, with additional information from the 3Q30 earnings report.

All in all, we think the rate will remain at the current level of 4.25% by year-end, given the current pause and expected inflation. Moreover, we still believe cuts will be back in 2021, albeit uncertain about both the magnitude and timing. In this context, we expect the QR and minutes to be very helpful to assess when easing might resume.

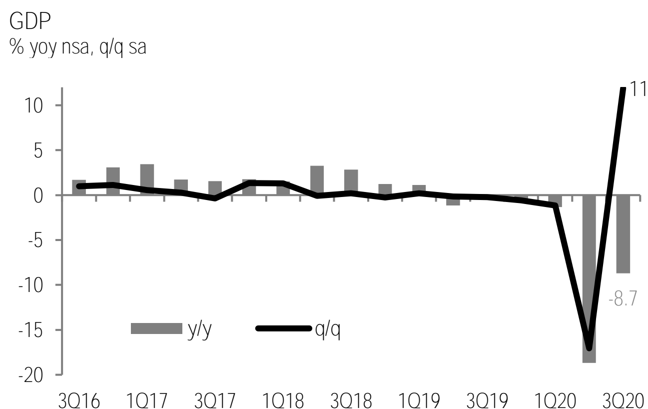
Finally, we have not missed out that there is at least one additional unknown, which is who will replace Deputy Governor Javier Guzmán, which will end his term this year and recalling that his policy skew has been more hawkish.

Mexico's final 3Q20 GDP expected an inch lower on services. We anticipate 3Q20 GDP to be revised around 10bps lower relative to the preliminary estimate, to -8.7% y/y. This would be mainly due to an adjustment lower in services, with the primary sector relatively stable and industry marginally higher. According to our calculations, INEGI's new timely estimate of economic activity, updated this week, would equate to a GDP decline of around 8.6% y/y, in line with the preliminary print. Year-to-date, and using our estimate, the economy would have contracted 9.6% y/y.

The forecast implies that sequential performance –using seasonally adjusted figures– would be revised to +11.9% q/q from +12.0%. By sectors, and consistent with the expected revisions mentioned above, we expect services lower about 30bps to 8.3% q/q (previous: 8.6%), industry up 10bps to 22.1% and the agricultural sector at 7.4%. More importantly though, this would help reinforce the trend of a weaker recovery in domestic relative to external demand. Specifically, services would be close to 9.0% below the level seen in 4Q19 (before the pandemic hit), with industry only about 7.6% lower.

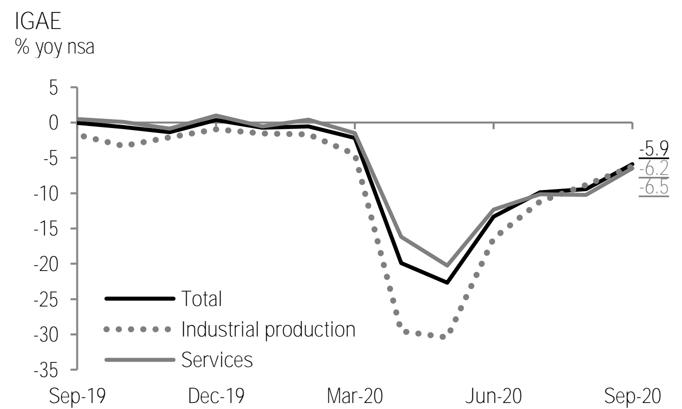
Banning significant revisions to published figures for the first two months of the quarter, this would mean activity grew again in September, albeit at a more modest pace. The monthly GDP-proxy (IGAE) –to be released at the same time– could stand at -5.9% y/y, translating into a 1.0% m/m expansion from 1.1% previously. Nevertheless, this would be slightly lower than INEGI's timely indicator, at -5.5% with original figures which is consistent with the mid-point of -7.0% y/y, seasonally-adjusted (range: -8.5% to -5.5%). Overall, performance was likely benefitted by several drivers, highlighting: (1) Better epidemiological dynamics across the country, albeit with more marginal gains in activity as the reopening of additional businesses is naturally more limited, while the need to comply with social-distancing measures restricts higher capacity utilization; (2) resilient external demand, mainly from the US; and (3) additional gains in employment and consumer confidence levels with strong remittances, helping total payrolls and households' incomes.

GDP
% yoy nsa, q/q sa



Source: INEGI, Banorte

IGAE
% yoy nsa



Source: INEGI, Banorte

By sectors, industry in September was practically in line with the implied figure within the preliminary report, driven by a contraction in construction which was partially offset by higher dynamism in manufacturing and mining.

We expect services at -6.5% y/y in the last month of the quarter, 60bps down from the implied (-5.9%). Our estimate already sees more dynamism at the margin, with activity up 1.3% m/m from 0.4% previously. In this sense and apart from the factors mentioned above, we acknowledge other signs supporting this performance. Among them, strength in manufacturing could help transportation services, particularly cargo given that this component remains heavily impacted by the fall in passenger traffic, including air travel. Regarding the latter, total travelers in the country's airports were down -50.0% y/y, above the -61.5% observed in August and highest since April. We also expect recreational and lodging services to be among those that may have improved the most, with people increasingly fatigued by the pandemic. In this sense, hotel occupancy rates also picked up at the margin relative to the previous month, breaking with its typical seasonality which sees a meaningful decline as the summer season ends. As mentioned above, we also see retail sales advancing sequentially.

Going forward, we warn of some risks and other negative developments that have been building up in 4Q20, suggesting that dynamism is likely to moderate, particularly in domestically-driven sectors. Broadly speaking, we highlight: (1) The recent evolution of COVID-19 cases –both globally and locally– which could lead to new supply-chain disruptions and restrictions to mobility as the 'traffic light' indicator deteriorates, more so as winter approaches; (2) the effects of US election uncertainty –with some reports stating that businesses have been more cautious– and the lack of additional fiscal stimulus in that country, impacting external demand; and (3) some idiosyncratic factors (*e.g.* railway blockades in states such as Chihuahua and Michoacán, additional bad weather in Tabasco and Campeche, regulations generating bottlenecks in international trade). In this respect, IMEF indicators showed a mixed start in 4Q20, with manufacturing still strong but services backtracking some gains in October. On the contrary, recent news about the development of a vaccine from several companies have been very positive (*e.g.* Pfizer/BioNTech, Moderna), which may help boost consumer and business confidence. Nevertheless, we believe this could be more positive going into next year. Uncertainty remains very high, although with hard data so far still consistent with our 2020 and 2021 GDP forecasts of -9.0% and +4.1% y/y, respectively.

October's trade balance potentially distorted by bottlenecks and base effects in autos. We estimate a US$1,954.2 million surplus, below the historical high of +US$6,115.7 million in August, but still quite elevated. Total trade (exports + imports) would stay negative, at -6.2%. We estimate total exports at -3.0% y/y, while imports would decline 9.3%. In our view, one potential source of distortions is that new labeling regulations have resulted in bottlenecks when products arrive at Mexico's customs, according to press reports. Importantly, these started to apply also to intermediate goods' imports since October 1st (except for those made by companies enrolled in special trade programs, such as IMMEX and PROSEC), in addition to consumption goods.

Moreover, it should be recalled that the administration of customs was handed to the Army and the Navy since the beginning of September. In this sense, some logistics companies have stated that inspections have been holding back the flow of goods.

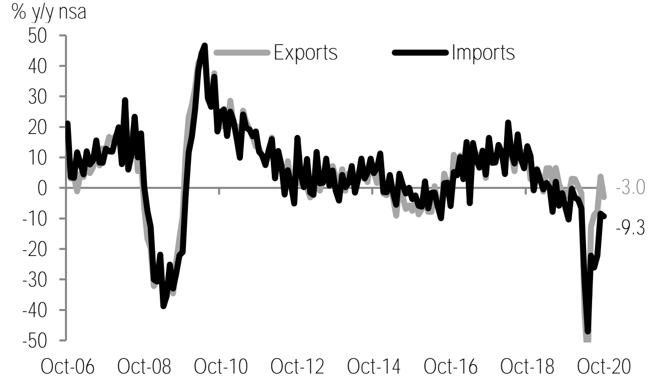
In oil, we estimate a US$1,435.7 million deficit, wider for a second consecutive month. We highlight our view of a relevant impact to both production and trade due to climatological conditions (for details, see our industrial production report). Accordingly, we estimate exports and imports to decline 27.6% y/y and 31.9%, respectively. In the former, available data shows crude oil shipments abroad at their lowest since mid-2018. The Mexican oil mix was also lower at the margin, at 36.46 from 37.56 US$/bbl on average in September. Nevertheless, there were some benefits from a base effect, so the annual comparison stands at -25.3% from -35.4% previously. In the latter, we highlight that US gasoline prices were very similar relative to the previous month, at -28.4%. Meanwhile, gasoline exports by that country showed an uptick, although these may also be somewhat distorted. Despite of the latter, their relatively better performance would help explain a higher oil deficit, with consumption goods at -36.5% y/y and intermediate goods reaching -28.9%.

We estimate a US$3,389.9 million surplus in the non-oil balance, still high by historical standards. We see exports at -1.8% y/y and imports at -6.8%. In the former, agricultural goods abroad would backtrack meaningfully (-12.5%), with price signals within inflation suggesting lower production. In non-oil mining we forecast similar dynamics (-10.6%), also with a more difficult base effect. In manufacturing, we estimate -1.3%, still somewhat strong. We expect autos to surge to 7.3% y/y, helped strongly by a favorable base effect. In this sense, it should be recalled that the sector was hit strongly last year due to the strike of GM workers in the US between September and October. This has already been reflected in AMIA's data on shipments of finished vehicles and the sector's production in the US. On the other hand, non-autos would backtrack -5.6% from +6.8% in the previous month, with less working days in the annual comparison and some payback from September's surge. Despite of this, performance in absolute terms would remain positive, with the ISM also pointing in this direction (including the 'imports' component).

In imports, intermediate goods were likely also influenced by the same base effect in autos –albeit to a lesser extent–, estimated at -3.5% (previous: -4.1%). Consumption goods are projected at -19.9% from -22.1% in September. We remind the reader that this month is typically high in absolute terms, as businesses prepare for the Holiday season. Nevertheless, they could stay limited by still weak signals from domestic demand, apart from not ruling out that this could exacerbate if there is more online shopping due to the pandemic. Broadly speaking, we think a greater part of the impact from the bottlenecks mentioned above could be felt in these two last components. In turn, capital goods would stand at -16.5%, with still low appetite to invest, a relatively stable but weak MXN and a potentially relevant fall relative to the -8.4% in September.

Exports and Imports

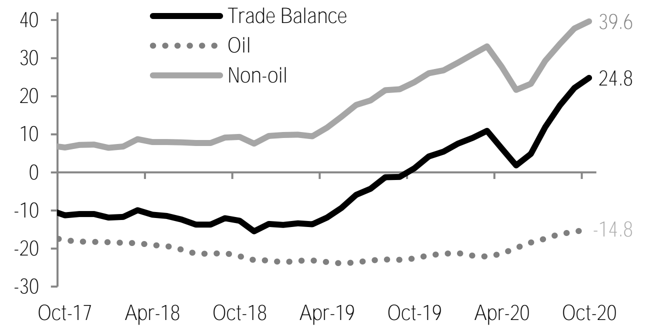
% y/y nsa



Source: INEGI, Banorte

Trade balance

US$ billion, 12-month rolling sum



Source: INEGI, Banorte

Analyst Certification

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Guide for investment recommendations.

	Reference
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HOLD	When the share expected performance is similar to the MEXBOL estimated performance.
SELL	When the share expected performance is lower than the MEXBOL estimated performance.

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