# Ahead of the Curve

## We expect annual inflation to fall strongly in November

- **Inflation (November).** We estimate the headline at only 0.14% m/m, much lower than the five-year average of 0.80%. The core would decline 0.05%, with non-core prices up 0.73%. This period is usually skewed to the upside due to the end of summer discounts in electricity tariffs, with some relief from *El Buen Fin*. The latter usually happens in the 2nd half of the month, as deals start on the holiday weekend of the Mexican Revolution. Nevertheless, this year it was extended from November 5th until the 20th due to COVID-19, triggering lower prices since the first half. Within the non-core we saw a positive performance in both gasolines and fruits and vegetables, which we expect to extend to the second fortnight. With these results, annual inflation would plunge to 3.40% y/y from 4.09% in October. The core component would fall to 3.69% with the non-core at 2.50%

- **Industrial production (October).** We anticipate a 5.6% y/y decline, better than the -6.2% of the previous month. We note some offsetting effects in this print. First, a negative calendar effect, with one less working day in the annual comparison. However, there is a slightly more favorable base effect. Sequential data would show an acceleration, up 0.5% m/m after stagnating in September (0.0%). This would be quite favorable given the deterioration in epidemiological conditions throughout the month. Renewed dynamism would mainly come from construction halting its sequential decline, up 0.2% m/m. Meanwhile, we expect manufacturing at +1.6% m/m. Lastly, mining would also be modest, standing at +0.3% m/m

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

STARMINE AWARDS FOR REUTERS POLLS FROM REFINITIV



Mexico weekly calendar

| DATE | HOUR (ET) | EVENT | PERIOD | UNIT | BANORTE | CONSENSUS | PREVIOUS |
|---|---|---|---|---|---|---|---|
| Mon 7-Dec | 7:00am | Gross fixed investment | September | % y/y | -15.4 | -- | -17.4 |
| | | Sa | | % m/m | -2.2 | -- | 5.7 |
| | | Machinery and equipment | | % y/y | -12.6 | -- | -20.6 |
| | | Construction | | % y/y | -17.6 | -- | -15.0 |
| Mon 7-Dec | 7:00am | Private consumption | September | % y/y | -- | -- | -14.2 |
| | | sa | | % m/m | -- | -- | 1.8 |
| | | Domestic (Goods and services) | | % y/y | -- | -- | -13.3 |
| | | Imported (Goods) | | % y/y | -- | -- | -21.6 |
| Mon 7-Dec | 3:30pm | Citibanamex bi-weekly survey of expectations | | | | | |
| Tue 8-Dec | 10:00am | International reserves | Dec-4 | US$ bn | -- | -- | 194.3 |
| Wed 9-Dec | 7:00am | CPI inflation | November | % m/m | 0.14 | -- | 0.61 |
| | | | | % y/y | 3.40 | -- | 4.09 |
| | | Core | | % m/m | -0.05 | -- | 0.24 |
| | | | | % y/y | 3.69 | -- | 3.98 |
| Thu 10-Dec | | Wage negotiations | November | % | -- | -- | 4.0 |
| Thu 10-Dec | | ANTAD: Same-store sales | November | % y/y in real terms | -- | -- | -1.2 |
| Fri 11-Dec | 7:00am | Industrial production | October | % y/y | -5.6 | -- | -6.2 |
| | | sa | | % m/m | 0.5 | -- | 0.0 |
| | | Mining | | % y/y | -2.4 | -- | -2.8 |
| | | Utilities | | % y/y | -10.6 | -- | -7.2 |
| | | Construction | | % y/y | -17.1 | -- | -16.1 |
| | | Manufacturing | | % y/y | -1.5 | -- | -3.1 |

Source: Banorte; Bloomberg

Proceeding in chronological order…

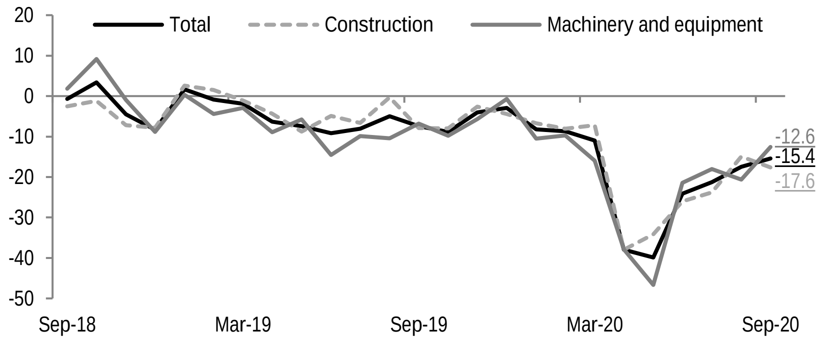
**Investment to pare back some gains in September.** We expect GFI at -15.4% y/y. The period had one more working day and a more favorable base effect, both helping the estimate compared to the -17.4% in August. In this sense, and using seasonally adjusted data, we estimate a 2.2% m/m decline, paring back some of the previous month's gain. This would reaffirm that investment has lagged in the recovery that started with the reopening in June, with the absolute level around 14.5% below the one seen in February, which in turn was already quite low from the maximum registered in mid-2018.

Specifically, we forecast construction at -17.6% y/y, with renewed weakness after the surprise pickup shown in August. This is broadly consistent with the industrial production report, which showed the sector declining by -16.1%, 3.3%-pts lower than said period. The main source of weakness is likely to be the residential sector, with some reversal after surging in August. Nevertheless, we believe this would be a temporary effect, expecting this sector to lead as it has clearly been the most dynamic since the reopening started. In turn, the non-residential sector, more closely related to infrastructure projects, would be stronger at the margin. In this sense, we highlight that physical investment spending by the Federal Government in the period declined 2.3% y/y in real terms, significantly higher than the -17.4% seen previously.

On the other hand, we anticipate Machinery and Equipment (M&Eq.) at -12.6% y/y (previous: -20.6%). This would be driven by the imported component, expected to improve to -9.4% from -19.2% in the previous month. This rebound is based on the signal coming from the trade balance, with capital goods imports at -8.4%. Local currency strength –which is how GFI is measured, as opposed to trade, which is in nominal USD– would aid the print further, trading at 21.68 per dollar on average against 22.20 in the previous month. Nevertheless, this would not be enough to compensate for the effect of accumulated inflation in the last year. Meanwhile, the domestic component will likely lag albeit also stronger at the margin, with an estimate of -16.8%. Signals from industrial production in sectors such as M&Eq., basic metals, and electronical and electric equipment, support our view. Nevertheless, the base-effect in this category is significantly more challenging.

Going forward, we believe the slow pace of this component currently underway will continue despite recent positive news. Among them, we highlight the possibility of stronger business confidence as the development of a vaccine reduces uncertainty. Moreover, there seems to be greater coordination between the private sector and the government to boost infrastructure, as signaled by the first and second investment plans unveiled in recent months –with more announcements expected in the near future–. Despite of this, other more structural factors continue weighing on the outlook. Among them, we note: (1) Insufficient economic growth, particularly in domestic demand; (2) low productivity growth and very high informality levels; (3) concerns about the rule of law and uncertainty about government policies more broadly, as flagged by recent central bank surveys; and (4) damaged companies' balance sheets due to the impact of COVID-19.

GFI
% y/y




Source: INEGI, Banorte

**Private consumption further up in September.** As expected, performance in August showed an additional recovery, standing at -14.2% y/y. In sequential terms, it rose 1.8% m/m. As mentioned at the time, activity was benefited by additional reopening efforts, with shopping malls and other businesses resuming operations in some states. For September, we expect the recovery to extend, with the improvement in epidemiological conditions as one of the main drivers. In this sense, data such as retail sales and non-oil consumption goods imports within the trade balance support this, highlighting an acceleration in the latter. Moreover, within the monthly GDP-proxy (IGAE), nearly all categories within services strengthened sequentially, also supporting our call. Looking ahead, dynamism might have stayed in October and throughout November, the latter boosted by *El Buen Fin* (Mexico's Black Friday).

**Weekly international reserves report.** Last week, net international reserves decreased by US$92 million, closing at US$194.3 billion. According to Banxico's report, this was mainly explained by a negative valuation effect in institutional assets. The central bank's international reserves have expanded US$13.4 billion so far in 2020 (please refer to the following table).

Banxico's foreign reserve accumulation details
US$, million

| | 2019 | Nov 27, 2020 | Nov 27, 2020 | Year-to-date |
|---|---|---|---|---|
| | Balance | | Flows | |
| International reserves (B)-(C) | 180,877 | 194,288 | -92 | 13,411 |
| (B) Gross international reserve | 183,028 | 201,089 | 1,782 | 18,061 |
| Pemex | -- | -- | -548 | 5,149 |
| Federal government | -- | -- | 2,552 | 7,645 |
| Market operations | -- | -- | 0 | 0 |
| Other | -- | -- | -223 | 5,267 |
| (C) Short-term government's liabilities | 2,151 | 6,801 | 1,874 | 4,650 |

Source: Banco de México

**Favorable inflation dynamics in November due to *El Buen Fin* and non-core prices.** We estimate the headline at only 0.14% m/m (previous: 0.61%), much lower than the five-year average of 0.80%. The core component would decline 0.05% (previous: 0.24%), with non-core prices up 0.73% (previous: 1.77%). We should recall that the period is usually skewed to the upside due to the end of the summer discounts in electricity tariffs, albeit with some relief from *El Buen Fin*.

The latter usually happen in the second half of the month, as deals start on the weekend holiday of the anniversary of the Mexican Revolution. Nevertheless, this year it was extended from November 5th until the 20th due to COVID-19, triggering lower prices since the first half. Moreover, within the non-core we saw a positive performance in both gasolines and fruits and vegetables, which were also a significant counterweight for electricity tariffs.

Analyzing the core with more detail, the total monthly contribution would be -4bps. We expect goods at -0.2% m/m, benefited by *El Buen Fin*. Nevertheless, we expect modest pressures in the second half, with deals unofficially extended until November 22nd at some stores. On top of this, there were other discounts related to *Black Friday* and *Cyber Monday*. Therefore, we estimate other goods at -0.6%, with processed foods more stable at +0.1%. In services, housing would remain moderate (+0.1%), highly influenced by slack. 'Other services' would reach +0.2%, with declines in tourism-related categories –also with discounts– not enough to offset pressures in restaurants, dining away from home, and other categories such as professional services.

At the non-core, the total contribution would be +18bps. As already known, electricity tariffs rose 22.7% (+39bps), being the key driver up. Nevertheless, we expect gasolines to extend the downward trend, with low-grade at -4.0% (-19bps) and high-grade at -3.4% (-2bps). Its drivers would be mixed, with the MXN rallying but reference prices climbing, even driving some increases in the latter part of the fortnight. LP gas would be higher at 0.9%, much more moderate relative to October. Turning to agriculture, fresh fruits would fall 2.4%, with strong declines in tomatoes and lemons in the first half. While our monitoring shows more stability, we observed a strong fall in onions, which would drive the index further down. On the contrary, meat and egg would extend higher, up 1.9%, with more pressures in both chicken and eggs.

With these results, annual inflation would reach 3.40% y/y, plunging from 4.09% in October. The core component would fall to 3.69% (previous: 3.98%) with the non-core at 2.50% (previous: 4.42%). Considering information so far, we mark-down our year-end estimate to 3.5% from 3.7%, with the core at 3.8% from 3.9%. This uptick relative to November would be driven by several factors, including: (1) An uptick in gasoline, with higher reference prices abroad and despite exchange rate stability; (2) a rebound after *El Buen Fin* discounts, probably as soon as the first half of November; and (3) a slight recovery in fresh fruits and vegetables. Despite of these dynamics, we expect Banxico to stay on hold in its December 17th meeting, resuming the easing cycle until next year.

**Industrial production to gain back momentum in October.** We anticipate a 5.6% y/y decline, better than the -6.2% of the previous month. We note some offsetting effects about this print. First, a negative calendar effect, with one less working day in the annual comparison (vs. one more in September). However, there is a slightly more favorable base effect, boosting the figure. Sequential data would show an acceleration, up 0.5% m/m after stagnating in September (0.0%). This would be quite favorable given epidemiological conditions throughout the month. We also note this is better than implied by INEGI's Timely Indicator of Economic Activity, which points to a 0.5% m/m contraction in the period.

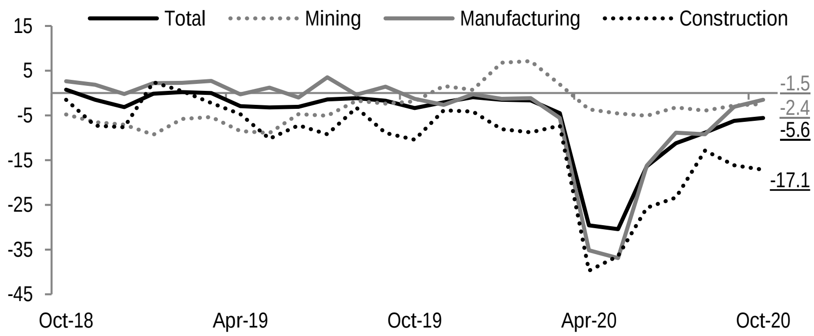
Renewed dynamism would mainly come from construction halting its sequential decline, expanding 0.2% m/m (previous: -5.6%). In annual terms this translates into a 17.1% decline, slightly worse than the -16.1% in September. Both business confidence and the aggregate trend indicator inched up. Within the latter, 'executed works' both from contractors and subcontractors were stronger. In a relevant note, four projects of the first public-private infrastructure plan were slated to begin. Nevertheless, spending from the Federal Government was considerably worse, with physical investment plunging 20.1% y/y in real terms (previous: -2.3%). In addition, reports of flooding in the Dos Bocas refinery likely impacted activity. More generally, employment related to IMSS rose by 24.8 thousand; however, the broader employment report by INEGI showed a decrease of 18.9 thousand. In our opinion, this reinforces that the sector remains weak, reflecting persistent challenges for domestic demand.

Meanwhile, we expect manufacturing at -1.5% y/y, which translates to a 1.6% m/m expansion, building-up on the +2.4% from September. We note that the annual print will be skewed to the upside due to the General Motors strike last year, strongly impacting the auto sector. In this sense, auto production showed total output of 347,829 vehicles (+11.8% y/y), above the 301,426 in the previous month. Positive signals also applied broadly, with IMEF's manufacturing PMI up 2.9pts to 49.6pts. This expansion was driven by the outperformance in 'new orders' and 'production'. Moreover, total manufacturing exports rose 4.8% m/m, with 'others' –which excludes autos– up 2.2%. This is supported by strong external demand, with US manufacturing improving to -3.6% y/y from -5.9%. However, railway blockades remained in Michoacán, situation which we expect to have dampened some optimism. In addition, the transition of Chihuahua from 'oraneco mxge' to 'red' in the epidemiological traffic light indicator is also a concern, remembering that this state is an important manufacturing hub.

Lastly, mining would also be modest, standing at +0.3% m/m (-2.4% y/y). We expect the oil sector to decline slightly, impacted by hurricanes Delta and Zeta. In this sense, crude output data from CNH fell to 1,627 kbpd (previous: 1,644). On the contrary, signals from non-oil mining were better, with these exports rising 66.4% y/y within the trade balance. Finally, employment associated to IMSS was basically unchanged, with 309 jobs created in the month.

Going forward, uncertainty prevails, especially considering the additional deterioration regarding the virus. In this sense, IMEF's manufacturing PMI showed a slight decline of 1.1pts. Meanwhile, regarding external conditions, the ISM manufacturing for November slowed down to 57.5pts from 59.3pts in the previous month, still positive despite its marginal decline. Markit's PMI for the same month picked up to 56.7pts. This also suggests uncertainty abroad. Turning to construction, according to the latest infrastructure plan other works started operations, which should be favorable. Moreover, Mexico City's government has stated that they will continue to push forward its housing programs, mainly focused on building low-income housing in run-down sections of the city. On mining, we could see a slight uptick as the hurricane season starts to unwind and more favorable meteorological conditions set in.

Industrial production
% y/y




Source: INEGI, Banorte

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