Ahead of the Curve

Inflation to reflect higher energy prices in 1H-January

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- **Inflation (1st half of January).** We expect headline inflation at 0.43% 2w/2w, higher than the 0.19% of the previous fortnight. In addition, we expect the core at 0.20%, contributing 15bps to the total and quite close to its five-year average. Therefore, pressures would be concentrated at the non-core, which we estimate at 1.14% 2w/2w (contribution: +28bps), which would be its highest print since early October. If our forecast materializes, annual inflation would pick up slightly, to 3.25% from 3.15% at the end of last year, with the core pretty much stable at 3.79% (previous: 3.80%). On the other hand, the non-core index would pick up to 1.61% from 1.18%

- **Unemployment rate (December).** We estimate it at 4.05% (original figures), 32bps lower than in November, with seasonal factors at play. Despite of this, we do expect net job losses, with temporary positions usually laid-off as their contracts expire. However, considering the performance within the IMSS's employment report –in which net losses were more modest relative to previous years–, we could see a more limited decline. Meanwhile, we also expect the labor force to shrink –and therefore, a lower participation rate– along a higher number of people both available and unavailable for work within those not in the labor force

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

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Mexico weekly calendar

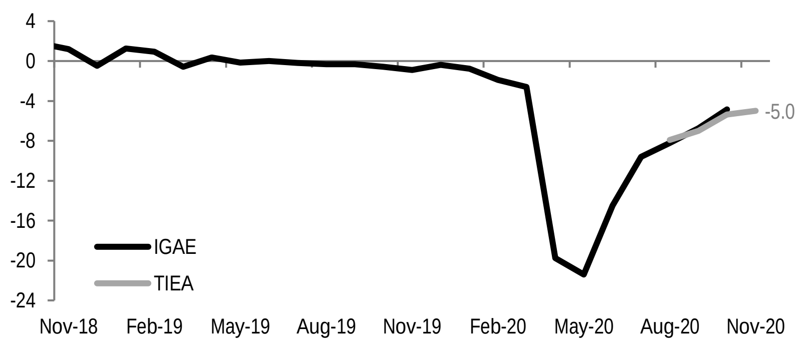
DATE	TIME (ET)	EVENT	PERIOD	UNIT	BANORTE	CONSENSUS	PREVIOUS
Tue 19-Jan	7:00am	Timely Indicator of Economic Activity (sa)	December	% y/y	--	--	-5.0
Tue 19-Jan	10:00am	International reserves	Jan-19	US$ bn	--	--	195.5
Wed 20-Jan	3:30pm	*Citibanamex* survey of economic expectations					
Thu 21-Jan	7:00am	Unemployment rate	December	%	4.05	4.50	4.37
Fri 22-Jan	7:00am	CPI inflation	1H Jan	% 2w/2w	0.43	0.40	0.19
				% y/y	3.25	3.22	0.08
		Core		% 2w/2w	0.20	0.15	3.08
				% y/y	3.79	--	3.80

Source: Banorte; Bloomberg

Proceeding in chronological order…

Activity in December could contract slightly, especially services. On Tuesday, INEGI will release it *Timely Indicator of Economic Activity* for December, along revised figures for November. We should remember that October's mid-point forecast stood at -5.4% y/y (using seasonally adjusted figures), which was ultimately below the -4.9% final print. Considering this, as well as additional data published since then –especially the latest IP report–, we expect November's forecast, currently at -5.0%, to be revised upwards. Meanwhile, we believe December's print could show a slight sequential contraction, mainly considering the deterioration in epidemiological conditions (which resulted in renewed restrictions in some states, including Mexico City and the State of Mexico) along the decline in other key and more timely indicators, such as IMEF indices, among others.

Monthly GDP-proxy (IGAE) and the Timely Indicator of Economic Activity (TIEA)
% y/y sa



Source: INEGI

Weekly international reserves report. Last week, net international reserves decreased by US$149 million, closing at US$195.5 billion. According to Banxico's report, this was mainly explained by a negative valuation effect in institutional assets (please refer to the following table). We note that through 2020, the central bank's international reserves expanded by US$14.8 billion.

Banxico's foreign reserve accumulation details
US$, million

	2020	Jan 8, 2021	Jan 8, 2021	Year-to-date
	Balance		Flows	
International reserves (B)-(C)	195,667	195,518	-149	-149
(B) Gross international reserve	199,056	199,154	98	98
Pemex	--	--	0	0
Federal government	--	--	709	709
Market operations	--	--	0	0
Other	--	--	-611	-611
(C) Short-term government's liabilities	3,389	3,636	247	247

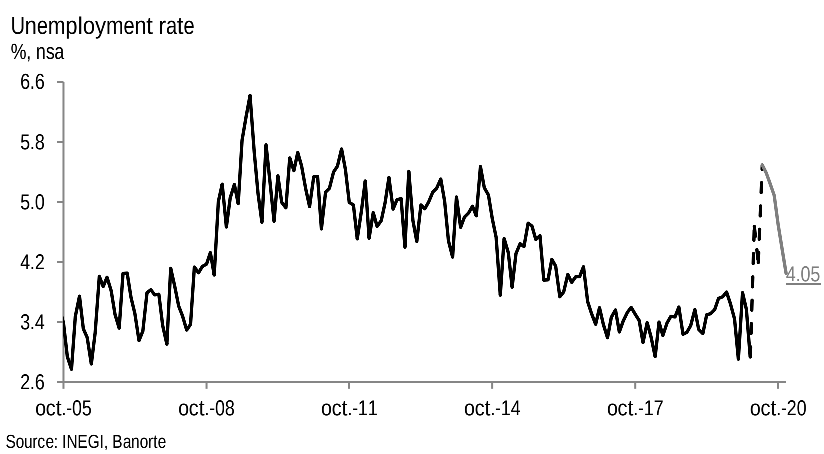
Source: Banco de México

We expect an additional decline in the unemployment rate in December, with seasonal factors at play. We estimate the unemployment rate at 4.05% (original figures), 32bps lower than November. Similar to the last two months, there is an important seasonal effect driving the figure down. Specifically, in thirteen out of the last fifteen years the rate has declined, with an average decrease of 30bps. Despite of this, we do expect net job losses, also responding to seasonal trends, in which temporary positions are usually laid-off as their contracts expire.

However, considering the performance within the IMSS's employment report –in which net losses were more modest relative to previous years–, we could see a more limited decline. Meanwhile, we also expect the labor force to shrink –and therefore, a lower participation rate– along a higher number of people both available and unavailable for work within those not in the labor force.

We will look for distortions that could arise from worsening epidemiological conditions, especially in key population centers such as Mexico City and the State of Mexico, in which non-essential activities were suspended. In this context, 'employment' indices within IMEF's indicators for the month were mixed, with manufacturing marginally up 0.3pts while non-manufacturing declined 0.2pts. This is consistent with benefits for the former as auto production and other categories are catalogued as essential, while in the latter services are more exposed to temporary closures. Considering this, we could see a higher part-time rate, as businesses try to save jobs while complying with sanitary measures. Nonetheless, we still recognize important forecasting challenges, including: (1) A persistently large share of people available for work, still distorting unemployment rate levels; (2) a recovery in informality, which could either work as a shock-absorber when more stringent measures are applied or suffer more as mobility declines; and (3) remaining uncertainty about the future evolution of the virus and the eventual deployment of the vaccine.

All in all, we believe that labor market data will continue to be distorted by the pandemic. In this sense, we believe the recovery of employment will resume soon, albeit probably maintaining a somewhat slow trend, with total levels taking a while to match those seen before the pandemic. While the outlook for external demand seems quite positive, there are still relevant challenges in the domestic front. In addition, as more people cease to be out of the labor force, we could find the unemployment rate reflecting real conditions more accurately.



Inflation in the 1H-January pressured by energy prices. We expect headline inflation at 0.43% 2w/2w, higher than the 0.19% of the previous fortnight. In addition, we expect the core at 0.20%, contributing 15bps to the total and quite close to its five-year average. Therefore, pressures would be concentrated at the non-core, which we estimate at 1.14% 2w/2w, which would be its highest print since early October.

If our forecast materializes, annual inflation would pick up slightly, to 3.25% from 3.15% at the end of last year, with the core pretty much stable at 3.79% (previous: 3.80%). On the other hand, the non-core index would pick up to 1.61% from 1.18%.

Specifically, the non-core component would explain 28bps of the headline. We have seen important signals of higher energy prices, mainly due to the recovery in international benchmarks. In this backdrop, we estimate a 2.6% increase in LP gas, contributing 5.5bps, reaching a new high for the seventh consecutive time in absolute terms and extending the acceleration from the 2nd half of December. Expectations of a global economic recovery and a harsher winter, within a context of higher demand as people stay more time at home, explains a great deal of these pressures. These would not be compensated by a stronger currency, with the Mexican peso appreciating only 0.5% in the period. A similar situation would be seen in gasolines, up 3.9% and 3.6% in low- and high-grade, respectively. Apart from the abovementioned factors, the adjustment in excise taxes at the start of the year and supply restrictions by Saudi Arabia gave prices an additional boost. For agricultural goods, signals are mixed. On fruits and vegetables, we expect a 0.4% decline due to lower prices in onions and tomatoes, albeit compensated partially by other products, such as potatoes. Meat and egg would maintain an upward trend, although more modest when compared to recent fortnights.

At the core we highlight dynamics in goods, which would increase by 0.3%. Inside, processed foods could increase by 0.5% and other goods would be more modest but still positive, at 0.1%. Broadly speaking, several businesses always adjust prices after year-end, apart from several relevant changes in excise taxes for some products. In the latter sense, our monitoring showed increases in some goods such as soda and cigarettes. On the other hand, we see a more modest decline relative to recent years in tourism-related categories (airfares and tourism services), driven by seasonal effects that will probably will be more limited as price hikes in December were not as severe due to the pandemic.

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