BANORTE

Economic Research
Mexico

Ahead of the Curve

Inflation in February impacted by pressures in energy at the non-core

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- **Inflation report (February).** We expect headline inflation at 0.64% m/m, below the 0.86% of the previous month. We estimate the core at 0.40%, contributing 28bps to the total and slightly below its five-year average. Inside, goods would continue to drive the increase –especially 'other' given the end of winter discounts on clothing–, with services more muted. The non-core would rise 1.44%, (+36bps), with some of the pressures in energy being offset by lower agricultural prices. If our forecast materializes, annual inflation would pick up to 3.76% from 3.54%, its highest since last October. The core component would be unchanged at 3.84%, with the non-core index up to 3.53% from 2.63%

- **Industrial production (January).** We anticipate a 4.9% y/y decline. This is lower than the -2.1% of the previous month, sharply impacted by a negative calendar effect which subtracted two working days in the annual comparison. Correcting for this (using seasonally adjusted figures), activity would stand at -3.6% y/y better than INEGI's latest estimate of -4.1% within the *Timely Indicator of Economic Activity*. In sequential terms, we anticipate an expansion of 0.3% m/m, accelerating after the 0.1% of the previous month and with eight consecutive months to the upside. We expect manufacturing to remain highest in the annual comparison at -3.4% y/y (-0.5% m/m), followed by mining at -4.9% (-0.2% m/m) and lastly construction at -8.6% (+2.2% m/m)

Mexico weekly calendar

DATE	HOUR (ET)	EVENT	PERIOD	UNIT	BANORTE	CONSENSUS	PREVIOUS
Mon 8-Mar	7:00am	Consumer confidence	February	index	38.9	--	38.4
Tue 9-Mar	7:00am	CPI inflation	February	% m/m	0.64	0.62	0.86
				% y/y	3.76	3.75	3.54
		Core		% m/m	0.4	0.37	0.36
				% y/y	3.84	--	3.84
Tue 9-Mar	10:00am	International reserves	Mar-5	US$ bn	--	--	195.3
Wed 10-Mar		Wage negotiations	February	%		--	3.8
Wed 10-Mar		ANTAD same-store sales	February	% y/y in real terms	--	--	-11.3
Fri 12-Mar	7:00am	Industrial production	January	% y/y	-4.9	-3.1	-2.1
		sa		% m/m	0.3	0.3	0.1
		Mining		% y/y	-4.9	--	-2.5
		Utilities		% y/y	-4.8	--	-4.5
		Construction		% y/y	-8.6	--	-11.6
		Manufacturing		% y/y	-3.4	0.8	2.5
Fri 12-Mar		Job creation associated to IMSS	February	thousands	--	--	47.9

Source: Banorte; Bloomberg

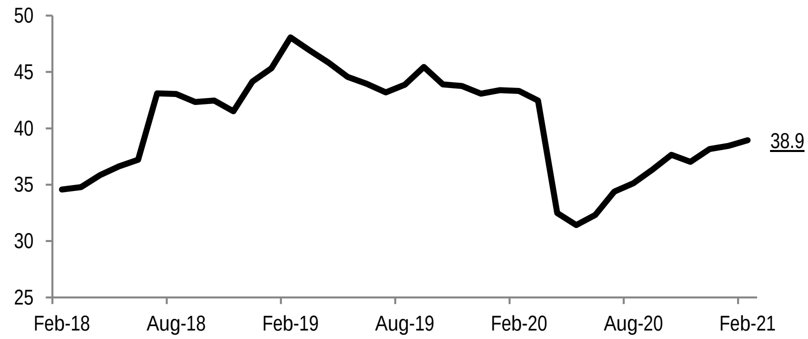
Proceeding in chronological order…

Consumer confidence likely supported on the pandemic's evolution. We expect confidence at 38.9pts (seasonally adjusted) in February, which would be its third consecutive increase. In our view, this would be mainly driven by positive developments at the margin on the pandemic front. Specifically, conditions improved during the second half of the month as informed by the 'traffic light' indicator, with 13 states in the first two weeks in 'red' to 2; in 'orange' from 17 to 21; and in 'yellow' from 2 to 8. We also highlight that: (1) Vaccinations for people aged 60+ started on February 15th; and (2) Mexico City and the State of Mexico started reopening again certain activities since the beginning of the period. This has been reflected already in mobility indicators and the IMEF non-manufacturing indicator, as activity in services picked up. In addition, news that direct transfers from social programs of the administration will be front-loaded will likely be favorable for confidence, albeit possibly more so until next month, when these will be disbursed. The main development agency (INSABI, in Spanish) will make payments for pensions and scholarships corresponding for the months of March-April and May-June in said month, to avoid doing them during the electoral period. This could help households' 'purchasing power' and 'expectations' components the most. Lastly, net presidential approval remained steady at +33pp according to the site *Oraculus,* with upward revisions to the performance in previous months. This indicator remains relevant despite the pandemic, as the president's high popularity is likely linked closely with perceptions about government performance.

On the contrary, we are uncertain about a potentially negative effect from undersupply of electricity and gas in the middle of the month, with the most severe period around days 15th to 18th. It is our take its effect will be limited, mainly on the 'current situation' about the country's conditions. First, it was temporary, while the survey is collected since the first day of the month until the 20th. Second, we take the cue from business confidence for the period, which increased in all sectors. Arguably, businesses would have been even more affected, given that it forced the production shutdowns. An additional indirect effect could be from higher inflation, driven by the increase in energy prices. We believe this could be even more relevant. Nevertheless, raw food prices in the 1st half of February declined significantly, which could have helped compensate for the latter. Lastly, the exchange rate was pressured, from 19.92 to 20.33 per dollar on average. But most of the increase was observed at the end of the sampling period, with the high observed until the 26th at 20.85 per dollar.

All in all, we maintain our view of a gradual improvement in confidence levels, aided by: (1) Expectations of a rebound in economic growth this year; and (2) the continuity of the vaccination process, which could allow for a 'return to normality'. Despite of the latter, there is still ample room to recover relative to pre-pandemic levels, which is likely to take some time to be erased given that the full recovery of labor market conditions is also a long way to be completed.

Consumer confidence
Pts, seasonally adjusted



Source: Banorte with data from INEGI

Inflation in February to reflect additional pressures in energy prices. We expect headline inflation at 0.64% m/m, below the 0.86% of the previous month. We estimate the core at 0.40%, contributing 28bps to the total and slightly below its five-year average. The non-core would rise 1.44%, (+36bps). If our forecast materializes, annual inflation would pick up to 3.76% from 3.54%, its highest since last October. The core would be unchanged at 3.84%, with the non-core index up to 3.53% from 2.63%.

Within the core, the increase would be centered again on goods, rising 0.5% m/m (+20bps). Pressures were more noticeable in the first fortnight, with a strong uptick in other goods given the end of the winter discounts season in clothing and shoes. We expect dynamics to be more modest in the second half, with a total monthly advance for the latter category at 0.6% (+10bps). On the other hand, processed foods would maintain an upward trend, albeit more modest relative to previous years, up 0.4% (+9bps). Services would remain low at 0.2% (+8bps), with education dampened given pandemic distortions (0.0%), not reflecting usual increases due to the return to classes. Other services would grow 0.3%, with the effects from economic slack compensating for higher raw materials (including energy) that impact essential activities, such as dining away from home and restaurants.

Turning to the non-core, pressures would be centered on energy, with a 3.8% m/m increase (+38bps). As mentioned in the previous report, we expect an upward shock in hydrocarbons given harsh weather conditions in the northern border (impacting both Mexico and the US). In this context, we expect a 5.0% increase in LP gas (+11bps), with natural up 3.1% (+1bp). The latter would only reflect an adjustment in the second half. Going to gasoline, we believe the upward trend extended, with the international reference reaching at highs since mid-2019. Despite higher stimulus on excise taxes for low-grade gasoline –averaging 82 cents in the second fortnight–, we expect a total increase of 4.8%. High-grade gasoline would rise more strongly (5.0%), as it was not benefited by the stimulus. The total contribution from gasolines would stand at 27bps. Agricultural goods would decline 0.3% (-4bps). Performance inside would diverge, with fresh fruits and vegetables lower 2.3%, with additional decreases in tomatoes and onions in the second half according to our monitoring, albeit more modest than in the previous period. Meat and egg will likely increase, with reports of additional pressures in eggs and poultry on cold weather in the northern part of the country.

Weekly international reserves report. Last week, net international reserves decreased by US$340 million, closing at US$195.3 billion (please refer to the following table). According to Banxico's report, this was mainly explained by a negative valuation effect in institutional assets. So far this year, the central bank's international reserves have fallen by US$398 million.

Banxico's foreign reserve accumulation details
US$, million

	2020	Feb 26, 2021	Feb 26, 2021	Year-to-date
	Balance		Flows	
International reserves (B)-(C)	195,667	195,269	-340	-398
(B) Gross international reserve	199,056	200,219	-2,310	1,162
Pemex	--	--	0	450
Federal government	--	--	-1,915	2,133
Market operations	--	--	0	0
Other	--	--	-395	-1,421
(C) Short-term government's liabilities	3,389	4,949	-1,970	1,560

Source: Banco de México

Industry to keep growing in January, despite worse COVID-19 conditions. We anticipate a 4.9% y/y decline. This is lower than the -2.1% of the previous month, sharply impacted by a negative calendar effect which subtracted two working days in the annual comparison (vs two more in December). Correcting for this (using seasonally adjusted figures), activity would stand at -3.6% y/y better than INEGI's latest estimate of -4.1% within the *Timely Indicator of Economic Activity*. In sequential terms, we anticipate an expansion of 0.3% m/m, accelerating after the 0.1% of the previous month and stringing eight consecutive months to the upside.

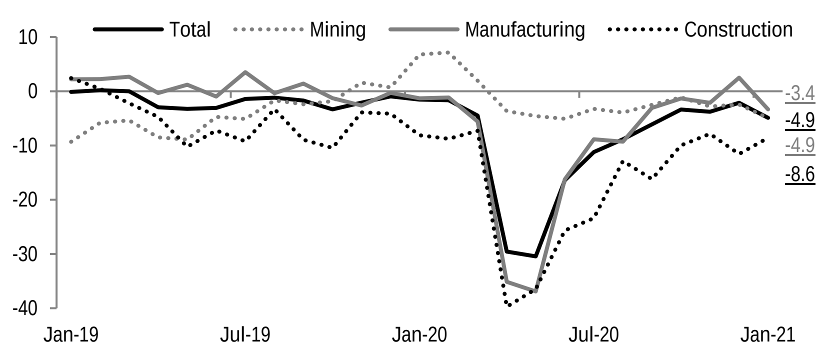
We expect manufacturing to remain highest in the annual comparison (-3.4% y/y), albeit declining relative to the +2.5% in December. In sequential terms this would translate into a 0.5% m/m decline. Trade balance figures support this decline, with total manufacturing exports down 0.7% m/m (-1.5% y/y). Inside, weakness was centered in 'others' at -2.7% (-3.2% y/y), with the auto sector surprising to the upside at +2.7% (+1.7% y/y). This was more positive than data from AMIA and INEGI, which showed a 15.1% y/y decline. On another positive note, US industrial production improved to -0.6% y/y, which suggests that strength abroad continued. Employment figures were mixed, with those from IMSS posting net gains while INEGI's report showed a net loss of 30.7k positions, supporting our call of a sequential decline.

In construction we see -8.6% y/y. However, it would increase 2.2% m/m, driving the whole sector's expansion. Our call of a sequential rise would follow a relevant 2.7% contraction in December. It is our take that worsening epidemiological conditions may not have had a substantial impact as the sector is considered essential. In this backdrop, aggregate trend indicators were broadly up, especially those related to works executed by both contractors and sub-contractors. On the contrary, employment we saw similar dynamics to those in manufacturing. In related news, several reports signaled works in some key government projects, such as the Santa Lucía Airport and the Maya Train, gathered momentum, possibly boosting civil engineering which has been the laggard since the recovery began.

Lastly, we anticipate mining at -4.9% y/y (-0.2% m/m). While overall production in the oil sector was mostly unchanged relative to December, the base effect is more complex, driving the annual figure down. Specifically, oil output reported by CRE stood at 1,648.5kbpd (previous: 1,648.9kbpd), which translates into a 4.4% y/y contraction. Despite some stability, we continue believing the sector faces relevant structural challenges, limiting its potential upside. Meanwhile, signals from the non-oil sector remain favorable, propped-up by rising commodities prices. In our view, this could incentivize producers to boost output to take advantage of current market conditions.

Going forward, the short-term scenario for industry is complex. In out view, electricity blackouts and the lack of natural gas in mid-February will have a specifically adverse effect on this sector. The direct effect on utilities will be sharp, while the spillover on construction and manufacturing will drag all industry down. In this backdrop, most automakers in our country stated that they had to shut down operations because of these disruptions, while surveys from the private sector suggest a widespread impact across businesses. However, the medium-term also carries some challenges with it, with the lack of semiconductors impacting a wide array of industries –including autos–, with insiders seeing a normalization until sometime in the summer. On the flip side, we believe support from the US will continue to be the key driver of the recovery, especially with hopes of a new stimulus plan being approved as soon as this weekend, on top of our expectations of a more dynamic economy this year.

Industrial production
% y/y



Source: INEGI, Banorte

Analyst Certification

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