Ahead of the Curve

Core inflation in 1H-July will keep showing a difficult backdrop

July 16, 2021

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- **Inflation (1H-July).** We expect headline inflation at 0.30% 2w/2w (previous: 0.20%), which would be relatively close to the five-year average of 0.29%. Despite of this, we note that several sectors kept showing relevant pressures, despite some relief coming from some favorable seasonal trends along an improvement on drought conditions. In this context, we see the core at 0.23%, contributing 18bps to the total. Meanwhile, the non-core would rise 0.50%, translating to 12bps. If our forecast materializes, annual inflation would stand at 5.68% from 5.88% on average in June. This would mainly come from a less challenging base effect, more than offsetting prevailing pressures. In this sense, the non-core would decline to 9.18% from 10.00%, as energy goods accelerated significantly in 2020. Meanwhile, the core would be more stable, at 4.57% from 4.58%

- ***Timely Indicator of Economic Activity* (June).** This release will include the first estimate for June, along revised figures for May. We expect the forecast for the latter to be revised slightly upwards. This would be driven by data published since –especially the latest IP report–, which was better than expected at the margin. For June there is higher uncertainty, not ruling out a marginal decrease. Although business opinion data kept improving, IMEF's indicators showed a deceleration in the pace of growth. Specifically, we think the recent increase in COVID-19 cases, probably related to the spread of the 'delta' variant, represent an important risk to the recovery

Mexico weekly calendar

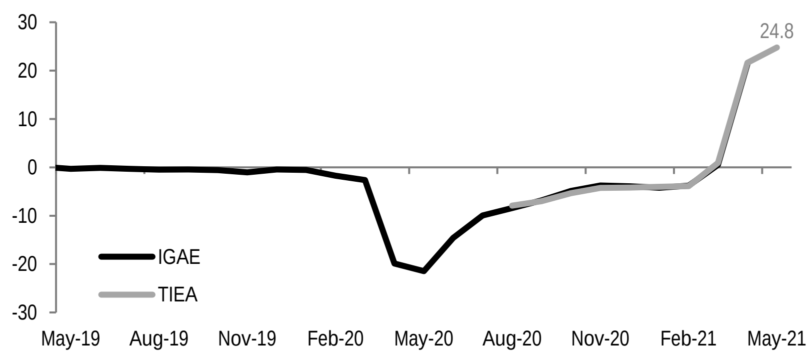
DATE	HOUR (ET)	EVENT	PERIOD	UNIT	BANORTE	CONSENSUS	PREVIOUS
Mon 19-Jul	7:00am	Timely Indicator of Economic Activity (sa)	Junio	% y/y	--	--	24.8
Tue 20-Jul	10:00am	International reserves	Jul-16	US$ bn	--	--	193.2
Tue 20-Jul	4:30pm	Citibanamex bi-weekly survey of economic expectations					
Thu 22-Jul	7:00am	CPI inflation	1H July	% 2w/2w	0.30	0.24	0.20
				% y/y	5.68	5.62	5.74
		Core		% 2w/2w	0.23	0.21	0.21
				% y/y	4.57	--	4.58
Fri 23-Jul	7:00am	Retail sales	May	%	29.3	28.4	30.1
		sa		%	0.5	0.5	-0.4

Source: Banorte; Bloomberg

Proceeding in chronological order…

Uncertainty about the recovery in June. INEGI will release its *Timely Indicator of Economic Activity* for June, along revised figures for May. We recall that April's mid-point forecast stood at 21.6% y/y (using sa figures), very close to the 21.4% in the GDP-proxy (IGAE). We expect May's forecast, currently at 24.8%, to be revised slightly upwards. This is driven by data published since –especially the latest IP report–, which was better than expected at the margin. For June there is higher uncertainty, not ruling out a marginal decrease. Although business opinion data kept improving, IMEF's indicators showed a deceleration in the pace of growth. Specifically, we think the recent increase in COVID-19 cases, probably related to the spread of the 'delta' variant, represent an important risk to the recovery.

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 increased by US$168 million, closing at US$193.2 billion (please refer to the following table). According to Banxico's report, this was explained by a positive valuation effect in institutional assets. So far this year, the central bank's international reserves have declined by US$2.5 billion.

Banxico's foreign reserve accumulation details
US$, million

	2020	Jul 9, 2021	Jul 9, 2021	Year-to-date
	Balance		Lows	
International reserves (B)-(C)	195,667	193,188	168	-2,479
(B) Gross international reserve	199,056	199,081	-12	25
Pemex	--	--	0	449
Federal government	--	--	0	-465
Market operations	--	--	0	0
Other	--	--	-12	42
(C) Short-term government's liabilities	3,389	5,893	-180	2,504

Source: Banco de México

Inflation in 1H-July to remain somewhat high, with relevant pressures in key sectors. We expect headline inflation at 0.30% 2w/2w (previous: 0.20%), which would be relatively close to the five-year average of 0.29%. Despite of this, we note that several sectors kept showing relevant pressures. In this context, we see the core at 0.23%, contributing 18bps to the total. Meanwhile, the non-core would rise 0.50%, translating to 12bps.

Within the former, goods would expand 0.2% (+8bps), with pressures concentrated in processed foods (0.3%; +6bps). After some brief relief in the previous fortnight, we expect tortilla prices to continue climbing, with increases in some other goods (like soda) showing further passthrough from cost pressures. Other goods would edge-up 0.1% (+2pbs), in our view with significant support to the downside from rolling discounts on clothing due to the summer season. Turning to services, these would climb 0.3% (+10bps), surpassing goods as relative prices continue to adjust to the reopening, even when considering the recent increase in cases. Within 'other' (0.5%; +8bps), tourism-related categories –especially airfares– would remain high as the holiday season gathered steam as elementary and middle school students started vacations. Meanwhile, other socially exposed categories such as 'dining away from home' and restaurants could continue adjusting prices on higher costs amid additional leeway to recover some of their margins. Lastly, housing could be also showing some slight signs of a revival, albeit still coming from a low base at 0.1% (+2bps).

At the non-core, energy would rise 0.8%, contributing 8bps. Most of this would come from LP gas (3.0%; +7bps), with relevant pressures from international reference prices and accumulating large increases for at least the past three fortnights. This would more than compensate for a slight appreciation of the MXN, up 1.2% vs. the previous fortnight. We should note that increases in the price of this good have attracted additional attention from the Executive branch and the *Mexican Federal Economic Competition Commission* (COFECE in Spanish). On the contrary, gasoline would be more stable, with more modest increases from abroad and offset by higher subsidies on excise taxes. As such, the total contribution from both low- and high-grade fuels would stand at 1bps. Agricultural goods would climb 0.3% (+4bps). Fruits and vegetables would post a modest 0.2% increase, with improving drought conditions offsetting some adverse seasonality in the period. Rains have started to erase some of the impact in the center and south of the country, while alleviating partially some of the worst hit parts in the north. Our monitoring shows a mixed performance in tomatoes, declines in potatoes and carrots, and increases in onions and lettuce. Meat and egg would climb 0.4%, with some recent gains in poultry and eggs backtracking, albeit with signs of additional increases in beef. Lastly, government tariffs would start to gain some dynamism at 0.2% (+1bps), consistent with what we have seen in the aftermath of other electoral years.

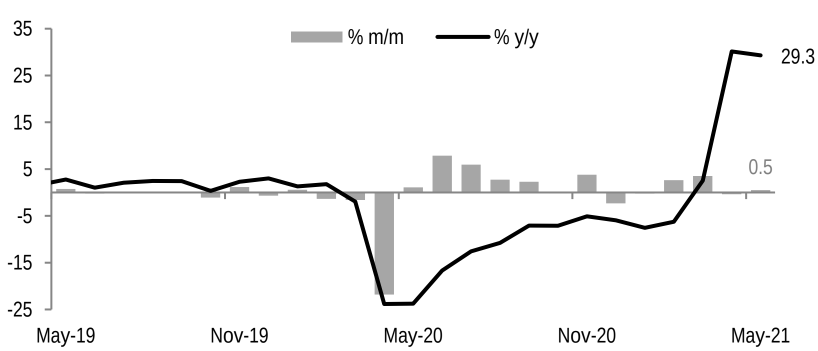
If our forecast materializes, annual inflation would stand at 5.68% from 5.88% on average in June. We should mention this would mainly come from a less challenging base effect, more than offsetting prevailing pressures. In this sense, the non-core would decline to 9.18% from 10.00%, as energy goods accelerated significantly in 2020. Meanwhile, the core would be more stable, at 4.57% from 4.58%. We consider this latter result as consistent with our most recent revision, now expecting the year-end figure at 6.1% from 5.5% previously, while also supporting our call of hikes in Banxico's remaining four decisions this year.

Retail sales to rebound in May on better epidemiological conditions and fundamentals. We expect a 29.3% y/y expansion, still high on a very favorable base effect. Lockdowns in 2020 –at its height in April and May– kept some categories unusually low, especially purchases of non-essential goods. Isolating for this with seasonally adjusted figures to analyze sequential performance, we forecast a 0.5% m/m increase. This would compensate for the -0.4% seen in April, suggesting that the recovery continued. Performance would be driven by an improvement in the virus front as well as better fundamentals, albeit with risks from inflation looming large. We also note that uncertainty about the result could be higher than usual as key advanced data has changed, as detailed below.

Looking at timely data, total sales by ANTAD members rose 28.9% y/y in real terms, below April's 40.9% despite a base effect that was only slightly more challenging. In this respect, and as suggested previously, there is a significant caveat. From May forward, figures no longer include sales figures from *OXXO* stores –specialized locations similar to a *7-Eleven* or gas station stores. Moreover, ANTAD's president, Vicente Yáñez, informed that 3 more associates also stopped providing information (without revealing their identity, as far as we know). As such, this indicator will probably remain skewed in upcoming months. Meanwhile, auto sales stood at 85.7 thousand units, implying a slight sequential uptick. Lastly, non-oil consumption goods imports expanded 12.8% m/m, possibly biased by a positive base effect. In this context, we believe the overall story will be favorable, despite confounding signals about performance.

On fundamentals, both COVID-19 cases and deaths kept trending down, with the 'traffic light indicator' reaching its best levels until that point. Vaccinations gathered steam, which may have also bolstered confidence to go out and spend, as reflected in mobility levels. Employment gains continued, albeit at a slower pace with a net addition of 56.3 thousand new jobs. Possibly more important, remittances reached a new historical high of US$4,514.6 million, boosted by a favorable seasonality as well as better labor market conditions for Mexican migrants in the US. In addition, consumer loans started to show signs of life, albeit still in deep contraction in annual terms. On the contrary, prices maintained a steep upward trend, up 0.2% m/m when it usually drops because of summer discounts in electricity tariffs. Pressures centered on food items, a situation that could take a toll on sales of non-essential goods.

Retail sales
% y/y nsa, % m/m sa



Source: INEGI, Banorte

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