BANORTE

Economic Research
Mexico

Ahead of the Curve

We expect an upward revision in 2Q21 GDP, to 1.7% q/q

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- **Banxico minutes (August 12th).** On Thursday, Banxico will publish the minutes of the August 12th meeting, in which, in line with expectations, the Board decided to hike the reference rate by 25bps to 4.50%. As part of the recent changes to the communication strategy, we know that the dissenters were Deputy Governors Galia Borja and Gerardo Esquivel. We will be looking into the reasons behind their vote as well as if they outline factors that could sway them going forward. The latter will also apply for the remaining members, given that the vote was quite closed. We will also be on the look to the discussion on inflation, especially as updated forecasts were presented for the first time in the statement. We will analyze comments about recent dynamics and the balance of risks for the new estimates

- **GDP (2Q21 F).** We anticipate 2Q21 GDP to be revised about 30bps higher relative to the preliminary estimate, which stood at 19.7% y/y. This would be driven by: (1) A downward revision to industry, from 28.2% to 27.9%, given a weaker-than-anticipated performance in June; and (2) more dynamism in services more than compensating for the latter, from 17.1% to 17.7%. Therefore, using seasonally adjusted figures, growth would be at 1.7% q/q, more vigorous than the 1.5% presented originally

Document for distribution among the general public

Mexico weekly calendar

DATE	HOUR (ET)	EVENT	PERIOD	UNIT	BANORTE	CONSENSUS	PREVIOUS
Mon 23-Aug	7:00am	Retail sales	June	%	18.4	19.7	29.7
		Sa		%	-0.3	--	0.6
Tue 24-Aug	7:00am	CPI inflation	1H Aug	% 2w/2w	0.03	0.06	0.24
				% y/y	5.64	5.66	5.86
		Core		% 2w/2w	0.24	0.21	0.13
				% y/y	4.75	--	4.68
Tue 24-Aug	10:00am	International reserves	Aug-20	US$ bn	--	--	193.2
Wed 25-Aug	7:00am	GDP	2Q21 (F)	% y/y	20.0	20.1	19.7
		Sa		% q/q	1.7	1.6	1.5
		Primary activities		% y/y	7.1	--	6.7
		Industrial production		% y/y	27.9	--	28.2
		Services		% y/y	36.7	--	17.1
Wed 25-Aug	7:00am	Economic activity indicator	June	% y/y	13.1	13.6	25.1
		Sa		% m/m	-1.0	-0.3	0.6
		Primary activities		% y/y	10.2	--	10.3
		Industrial production		% y/y	13.5	--	36.4
		Services		% y/y	13.9	--	21.5
Wed 25-Aug	10:00am	Current account	2Q21	US$ bn	--	5.6	-5.1
Thu 26-Aug	7:00am	Unemployment rate	July	%	4.29	4.10	4.02
		Sa		%	4.00	--	3.97
Thu 26-Aug	10:00am	Banxico minutes					
Fri 27-Aug	7:00am	Trade balance	July	US$ mn	1,253.9	--	762.0
		Exports		% y/y	17.1	--	29.1
		Imports		% y/y	43.5	--	52.3

Source: Banorte; Bloomberg

Proceeding in chronological order…

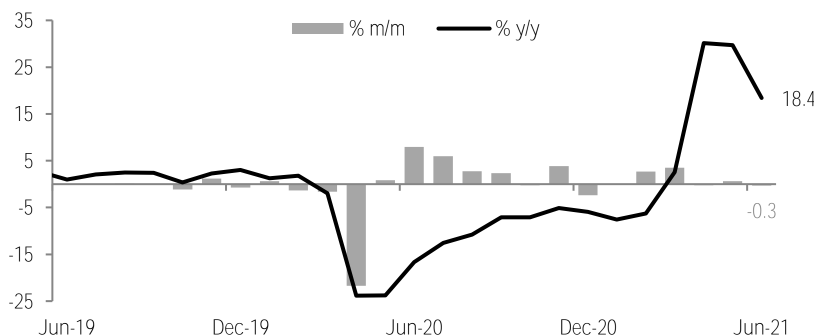
Mild decline in June's retail sales, mostly on payback. We expect an 18.4% y/y expansion (previous: 29.7%), moderating as the base effect starts to become less favorable –as seen in other data– given the start of the reopening in the same month of 2020. Nevertheless, some categories within non-essential goods, especially durables, still showed high distortions given very high uncertainty. Using seasonally adjusted figures we expect a 0.3% m/m decline, modest considering the +0.6% of the previous month. Fundamentals started to show some mixed signals at the margin. This is consistent with the deterioration in the epidemiological front and the imposition of some distancing measures at the end of the period. Despite of this, mobility stayed resilient, supporting performance.

On timely data, total sales by ANTAD members grew 16.3% y/y in real terms. Trying to isolate the pandemic's effect last year, this would still be 4.7% below the same period of 2019, so it is still a low level. Nevertheless, we should recall that this data might be skewed downwards due to changes in the indicator's composition, so we remain cautious about its signal. Meanwhile, non-oil consumption goods imports picked up 0.3% m/m (+71.2% y/y), quite positive after the +13.0% seen in May. Auto sales reached 87,088 units, improving relative to the previous month. Lastly, gasoline sales (in volume) had a marginal deceleration, with the annual rate at 7.6% (previous: 20.5%).

On fundamentals, remittances remained strong, reaching its second-best amount in history. Consumer loans also seem to be recovering. In addition, social program payments like *Sowing Life* (Reforestation) and apprenticeships for young people resumed after the electoral season, which could result in an additional boost. Employment gains continued, centered in primary activities (likely seasonal) as we saw losses in industry and services. The latter might be a challenge as it has likely been the main driver behind the rebound in consumption. Also negative, June's inflation stood at 0.53% m/m, with a large part of the uptick at the core component. At the margin, this could limit gains in non-essential goods.

In this backdrop, we think the recovery trend in sales and consumption will remain. Nevertheless, we do not rule out a deceleration and even modest contractions in coming months given the risks associated to the pandemic and the overall price dynamics of goods relative to services.

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



Source: INEGI, Banorte

Price controls in LP gas will undercut underlying pressures in 1H-August. We expect inflation at 0.03% 2w/2w (previous: 0.24%), which would be low relative to its five-year average of 0.22%. The key driver would be a sharp 0.61% decline in the non-core, subtracting 15bps. In turn, this would be mostly related to recently-enacted maximum prices in LP gas, more than compensating for some pressures in agricultural goods. The core would climb 0.24%, adding 18bps and with continuing increases in food prices, along mixed seasonality trends.

Within the non-core, energy would fall 2.3% (-23bps), with LP gas down 9.5%, equivalent to -25bps. In this respect, the *Energy Regulatory Commission* (CRE in Spanish) set price controls for this good starting on August 1st. This is done via 145 regional prices that will be determined on a weekly basis. The measure is a response to very high price pressures in recent months, influenced by international references but also with ongoing investigations about anti-competitive practices by distributors. Brief strikes by these companies were seen in the period, signaling that the prices set are indeed binding. While adherence is up to them, penalties for not complying are harsh, including the cancellation of sales' permits. Moreover, our monitoring suggests that most providers indeed lowered prices, driving the hefty decline. On the rest of energy, electricity tariffs would edge up 0.6% (1bp), reflecting a higher tariff in the high-consumption tier. Lastly, gasolines would increase quite modestly, with a total contribution of 1bp, aided by a stronger MXN and higher subsidies partly offsetting an increase in global reference prices. Agricultural goods are expected to show modest pressures (0.6%; +7bps), especially in fruits and vegetables, up 1.1% (+5bps). We observed some widespread increases, highlighting chilies, avocadoes, lemons and tomatoes. This would happen despite better drought conditions in most of the country (although still very harsh in the US Southwest). Meat and egg would remain higher at 0.2% (+2bps), with signals of moderation in poultry offset by rising egg prices. On government tariffs, signals so far suggest that a post-electoral increase might not be in the cards, thus expecting them to climb only 0.2% (+1bp).

At the core, goods would pick-up 0.4% (contribution: 16bps). Most would be from 'other' (0.5%; +10bps), heavily impacted by an adverse seasonality related to the end of summer discounts on clothing and shoes, on top of other pressures. Processed foods would remain high, up 0.3% (+6bps), with corn tortillas pushing to the upside again, as well as milk. Reports continue about producers adjusting prices due to higher input costs. Services are estimated at 0.1%, with several seasonal patterns behind. First, education would rise 1.0% (+4bps), driven by the start of classes in college and other higher education institutions. On the contrary, other services would fall 0.1% (-2bps), aided by lower tourism-related categories on the end of the holiday period (as well as possible weakness due to a hit to demand because of COVID-19). We also think the adjustment in LP gas could be a relief to some businesses (especially dining away from home), although the uptrend could continue. Lastly, housing would be quite stable, at 0.1% (+2bps).

If our forecast is right, annual inflation would fall to 5.64% from 5.81% on average in July, with the non-core at 8.42% from 9.39%. More concerning though, the core would maintain an upward bias, at 4.75% from 4.66%. While the one-time drop in LP gas represents a downside risk to our 6.1% year-end forecast, we believe other upside risks are gathering traction, matching out in the end.

Weekly international reserves report. Last week, net international reserves decreased by US$65 million, closing at US$193.2 billion (please refer to the following table). According to Banxico's report, this was explained by a negative valuation effect in institutional assets. So far this year, the central bank's international reserves have declined by US$2.5 billion.

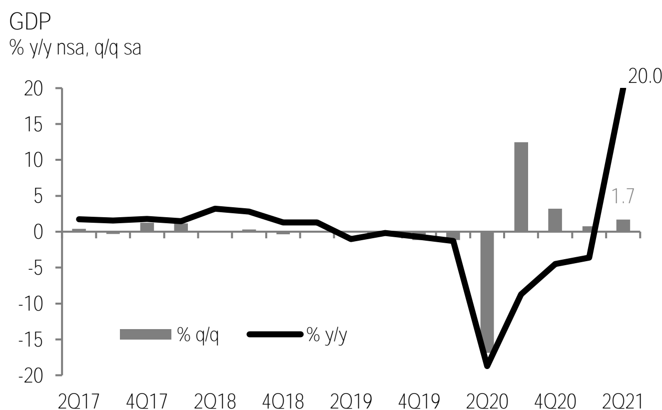
Banxico's foreign reserve accumulation details
US$, million

	2020	Aug 13, 2021	Aug 13, 2021	Year-to-date
	Balance		Lows	
International reserves (B)-(C)	195,667	193,214	-65	-2,454
(B) Gross international reserve	199,056	199,514	-141	458
Pemex	--	--	0	449
Federal government	--	--	-129	332
Market operations	--	--	0	0
Other	--	--	-11	-322
(C) Short-term government's liabilities	3,389	6,301	-76	2,912

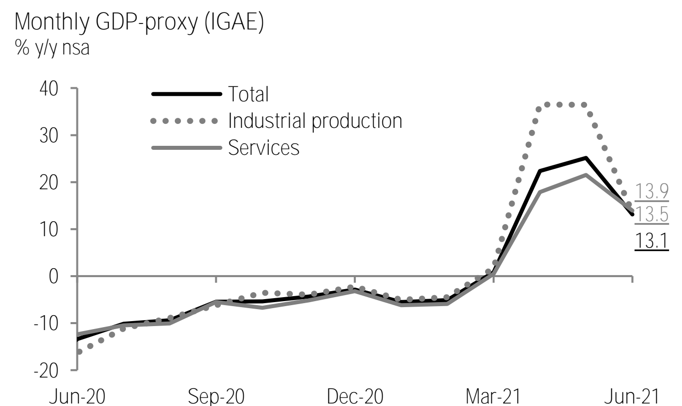
Source: Banco de México

Mexico's final 2Q21 GDP to be revised upwards. We anticipate 2Q21 GDP to be revised about 30bps higher relative to the preliminary estimate, which stood at 19.7% y/y. This would be driven by: (1) A downward revision to industry, from 28.2% to 27.9%, given a weaker-than-anticipated performance in June; and (2) higher dynamism in services more than compensating for the latter, from 17.1% to 17.7%. Therefore, using seasonally-adjusted figures, growth would be at 1.7% q/q, more vigorous than the 1.5% presented originally.

We see better results in June's IGAE (the monthly GDP-proxy) relative to an implied print of 12.3% within preliminary GDP. Specifically, we estimate activity in the period at 13.1% y/y. Nevertheless, with seasonally adjusted figures we calculate growth of 13.2% y/y, which would be significantly lower than the latest estimate by INEGI in its *Timely Indicator of Economic Activity*. Sequentially, this would translate into a 1.0% m/m contraction, backtracking after three consecutive months to the upside. Broadly speaking, data already published shows that industry had a very difficult month, with all three major sectors (mining, construction and manufacturing) down relative to May. Meanwhile, we think services were limited to a modest degree by the initial rise of COVID-19 cases due to 'delta', albeit quite resilient and with a payback only after the positive performance observed since April.



Source: INEGI, Banorte



Source: INEGI, Banorte

Back to quarterly GDP, we expect industry with a 0.3% q/q expansion (+27.9% y/y) lower than the 0.4% of the preliminary report. This would be on the back of weaker-than-implied performance in June, as already stated, which fell 0.5% m/m, lowest so far since the reopening started back in June 2020.

Services would rise 2.3% q/q (17.7% y/y). Apart from accelerating strongly at the margin, they would be 26bps higher when compared to the 2.1% of the preliminary print. We focus on June as we already know what happened the rest of the quarter. In this respect, available data is still scarce and, in our view, mixed. As mentioned above, we see a mild retail sales decline, affected somewhat by epidemiological conditions at the end of the period. More concerning though, INEGI's aggregate trend indicator showed generalized declines among its components, flagging especially the one measuring income (both in services and commerce). Total employment in tertiary activities was up 12.7% y/y from 23.8% in the previous month, with a more difficult base effect. Nevertheless, jobs were shed at the margin, signaling also a possible slowdown. Although the domestic front seemed more challenged, we believe a bright spot was observed in tourism-related services (*e.g.* transportation, lodging, and to a lesser extent, recreational). This would be aided by the summer vacation. In this sense, airline traffic reached 5.7 million passengers during the month, higher than the 5.5 million in May. The hotel occupancy rate reached 45.5%, also above the 40.3% seen previously. The latter is more relevant as historical seasonal patterns suggest less occupancy at the margin. Based on this and other anecdotal information, it is our take that pandemic fatigue and higher vaccinations (especially among US tourists) boosted growth in these sectors. Lastly, we do not rule out some upside in government services, mostly related to the mid-term elections held on June 6th.

We maintain our view of 6.2% GDP growth in full-year 2021 and 3.0% in 2022. In our view, risks for the current period remain balanced. We are relatively concerned that the surge in COVID-19 cases –locally and abroad– reduces the pace of the recovery and exacerbates some ongoing problems, such as those in global trade and supply chains. Nevertheless, mobility has stayed resilient as people are unwilling to enter new lockdowns (and unable due to economic reasons). As such, the pandemic's impact may well be more muted. Although some warning signs have already shown up, the fact is that uncertainty about the evolution of the virus remains very high. Therefore, we think more hard data is needed to assess the state of the recovery given the most recent developments.

Unemployment broadly stable in July. We estimate the unemployment rate at 4.29% (original figures), up 27bps relative to June. Most of this would be driven by seasonality, likely related to the *Summer holiday* period as classes had ended. Correcting for this with seasonally adjusted figures, we see a modest uptick to 4.00% from 3.97% in June. In this sense, performance has been more positive than expected just a couple of months ago. This may be at least partially related to resilient mobility levels despite the uptick in COVID-19 cases, suggesting that the latter's economic impact may be relatively more modest. However, the degree in which working-age people return to the labor force remains very uncertain and has fluctuated considerably. This is important as there are still around 2.4 million people that could return to the labor force –comparing current levels vs. the 2015-2019 average.

While the recovery of the labor force might be dampened by the rise in cases, a clear pattern hasn't emerged to draw stronger conclusions. To us, it looks like pandemic distortions remain a key underlying driver of labor market dynamics.

Sector-related indicators were mixed. On the positive side, employment affiliated to IMSS climbed by 116.5 thousand positions. Adjusting for seasonality the figure stands at +132.0 thousand, close to the +135.1 thousand seen in June. By itself, this is positive. Nevertheless, we are cautious as the trend on the informal sector has been more adverse. We do not rule out this to be linked to recent changes to the *Federal Labor Law*, especially on outsourcing, which was slated to begin formally on August 1st but was delayed one month due to high confusion about its implementation. Businesses may have shifted towards more formality ahead of this deadline, although more data is needed to assess this. It may well result in a change in the relative composition, but not necessarily the total number of employed. On the other hand, related indices within aggregate trend indicators were also favorable, with all four-major sectors (construction, manufacturing, commerce, and private non-financial services) higher at the margin. In contrast, employment components within IMEF indicators were mostly negative, especially non-manufacturing, which fell by 1.1pts to 50.2pts. The same metric for manufacturing was basically unchanged at 51.9pts. Moreover, available data suggests economic weakness, including the outlook for June (see section above).

On complementary indicators, uncertainty about the participation rate remains high, declining in the last two months even with a wider reopening. Hence, we do not rule out a slight rebound. Part-time levels might decrease again, albeit more modestly given additional restrictions. Wages will likely remain up, still boosted by pass-through from minimum wages, but also because of higher inflation.

We believe this month may be key to gauge the initial effect from the 'third wave' of COVID-19 cases, with contagions worsening in August. However, our initial assessment is that the impact is likely to be modest, especially given the government's hesitancy to impose stricter restrictions and accumulated progress on the vaccination front. Going forward, the unemployment rate is poised to remain volatile, with some important one-off effects still in the cards in the very short-term, including the (optional) return to live classes and the start of new restrictions on outsourcing, both from September 1st onwards.

Source: INEGI, Banorte

Banxico minutes to keep focus on inflation, with attention on dissenters' opinions. On Thursday, Banxico will publish the minutes of the August 12th meeting, in which, in line with expectations, the Board decided to hike the reference rate by 25bps to 4.50%. As part of recent changes to the communication strategy, we know that the dissenters were Deputy Governors Galia Borja and Gerardo Esquivel. We will be looking into the reasons behind their vote as well as if they outline factors that could sway them going forward. The latter will also apply for the remaining members, given that the tally was quite close. We will also look to discussions on inflation, especially as they included an update to their forecasts in the statement for the first time. We will analyze comments about recent dynamics and the balance of risks for these new estimates.

Regarding members' opinions after the decision, as far as we know, none of the dissenters held interviews or participated in any event. In fact, the only one who did was Governor Alejandro Díaz de León. As previously, he made the rounds in several outlets immediately after the release, mainly reflecting the content of the statement and speaking on behalf of the institution. Given the lack of additional information, minutes will be even more relevant. We should remember that in the previous minutes, the dissenters were the same. At the time, Deputy Governor Borja mentioned that price pressures "*...will hardly be solved through monetary policy...*" given that they stem from supply shocks and changes in consumption patterns. Meanwhile, Deputy Governor Esquivel mentioned that hiking in said moment might have an adverse effect on expectations. In this sense, we will be looking into possible changes –or confirmation– on these topics. Meanwhile, within the hawkish wing the message that prevailed was concern about the effect that currently high levels of inflation can have on dynamics going forward and on the central bank's credibility. We believe this is likely to remain, despite slight adjustments in the individual opinion of the three remaining members.

Regarding prices, a more exhaustive explanation on the forecasted trajectory, both for the headline and the core, would be very important. In addition, given that it was presented in the decision, we could have even more information than when it was only presented in the *Quarterly Report* (QR). We do not rule out opinions on the matter, both in the direction and magnitude of the adjustments. Another important factor related to this would be the analysis of individual factors behind the change, especially their temporality. Although most members considered that pressures are "transitory", it will be important to see if they expand on this and/or change their views. It would also be relevant if they elaborated on the introduction of a price ceiling to LP gas. Although this could be described only as a downside risk, we do not rule out a deeper analysis in another publication, such as a *grey box* in the next QR (August 31st). On the other hand, we put a relevant weight on the fact that the balance of risks remains skewed to the upside and practically with the same factors as in the previous decision despite the adjustment. We should mention that the trajectory outlined by the bank is still lower relative to our forecasts even after the strong revision, supporting our view that a larger tightening will be necessary.

On activity, we consider that the statement was still optimistic. However, they could elaborate on the risks to the outlook, possibly more uncertain given another wave of COVID-19 contagions. Therefore, they could emphasize again that the recovery will be heterogeneous. In the macro financial front, we expect discussions to continue about risks for public finances and Pemex. They could highlight that the MXN has traded in a relatively tight range and on changes to short- and medium-term rates after the surprise in the last decision. At the margin, we believe these two fronts are likely to maintain a secondary role, with attention centered on the outlook for inflation.

We maintain our view that the tightening cycle has already begun, expecting 25bps hikes in the three remaining meetings of the year. With this, the reference rate would end at 5.25%. Specifically, we consider that the room for maneuver and pause has been reduced even further, considering: (1) A complex outlook for inflation prevailing for longer; and (2) tighter monetary policies in EMs and expectations of less accommodation in AEs, specifically in the US. After this, we would see an additional three increases of the same magnitude in 2022, with two of them at the start of the year, still driven by the factors already listed. The third one would be at the end, influenced by the eventual start of the Fed's hiking cycle. As such, the rate would reach 6.00% by the end of said period.

Trade balance deficit expected in July on auto export weakness. We estimate a US$1,253.9 million deficit. The period's seasonality is biased towards a more negative balance, although we believe the key driver is likely to be a relatively weak print in auto exports, with the sector still challenged by supply constraints. We estimate exports and imports to grow 17.1% y/y and 43.5%, respectively. Apart from the abovementioned issues in manufacturing, rates are influenced by a much more benign base effect in the latter. Specifically, exports rebounded more strongly last year, at the first stages of the reopening. Moreover, we have seen imports recovering more rapidly than anticipated, suggesting a better performance in domestic demand.

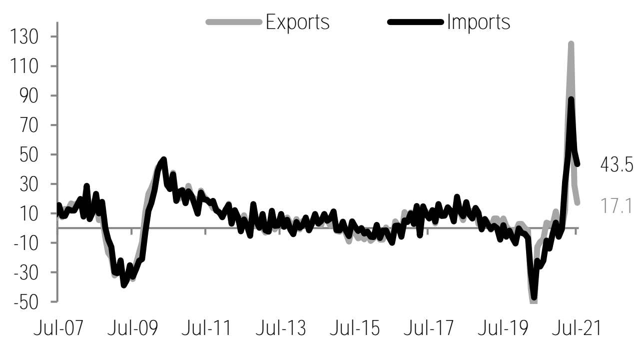
By sectors, we expect a US$2,003.0 million oil balance deficit, widening at the margin for a third month in a row. One of the main drivers would be higher prices again, both for exports and imports. On the former, the Mexican oil mix traded at 68.60 US$/bbl on average, highest since October 2018, with the annual comparison still very elevated (87.6%). However, outgoing volumes seem to have moderated, supporting a larger deficit. In annual terms, it is also relevant that output cuts as part of the OPEC+ agreement ended in July 2020, resulting in a more challenging base effect. Hence, total oil exports would climb 92.6% y/y. Turning to imports, reference prices for gasoline were also sequentially higher, albeit with a more modest annual rate.

Volumes were stronger, consistent with resilient mobility despite an uptick in cases. As far as we know, there were no major disruptions to refining capacity, although there were some issues with loading of outgoing ships and a leak in an underwater gas pipeline near the *Ku-Maloob-Zaap* oilfield, which may have affected both exports and imports. We expect oil imports at +107.4% y/y.

The non-oil balance would come in at a US$749.1 million surplus. Exports are estimated to grow 14.0% y/y and imports 38.2%, with the base effect more beneficial in the latter. Within shipments abroad, agricultural goods would rebound to +25.0%, aided by higher prices as drought conditions in the US remained harsh but in Mexico have improved. Non-oil mining could remain strong as it remains supported by high commodities' prices, standing at 65.4%. More importantly, manufacturing would come in at 12.7%, with diverging results within. We expect autos to fall 5.1%, with a much more challenging base effect, but also highly impacted by ongoing supply shortages. According to AMIA, vehicles sent abroad stood at 202.0 thousand (-23.7% y/y), lowest in little over a year and with a sequential decline of around 32.3 thousand vehicles. This is consistent with additional stoppages, noting VW, GM, Nissan, and Mazda (albeit in the latter related to the yearly retooling). Moreover, the sector in the US also fell according to the industrial production report. On the contrary, we expect 'other' at +22.6%, relatively favorable and benefitted by a meaningful rebound in US manufacturing excluding autos. Nevertheless, the 'imports' component within the US ISM indicator also signaled some caution.

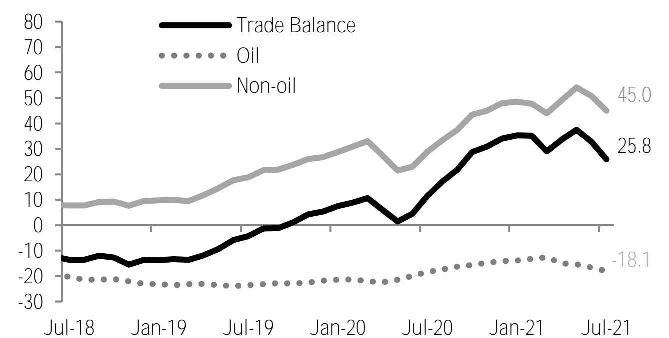
Turning to imports, we highlight that congestions in Chinese ports kept rising, accumulating the biggest backlog since 2019. Nevertheless, export data from said country showed additional dynamism in flows, up +62.9% y/y in June –which is still timely considering delivery times of maritime freight. Hence, a potential impact could be in store, but likely in coming months. For consumption goods we expect +48.3%, not ruling out some deceleration after a positive performance in May and June. Meanwhile, intermediate goods would remain relatively strong, as flagged by the 'exports' component in the US ISM, which accelerated to 65.8pts from 50.7pts in the previous month. Lastly, we forecast capital imports at +26.8%, with a slight rebound after falling 4.2% m/m in June. Specifically, there could be some support from MXN stability as well as further improvements in business confidence. However, the increase might be limited by the new wave in cases and its effect on uncertainty levels.

Exports and Imports
% y/y nsa



Source: INEGI, Banorte

Trade balance
US$ billion, 12-month rolling sum



Source: INEGI, Banorte

Analyst Certification

We, Gabriel Casillas Olvera, Alejandro Padilla Santana, Delia María Paredes Mier, Juan Carlos Alderete Macal, Manuel Jiménez Zaldívar, Marissa Garza Ostos, Francisco José Flores Serrano, Katia Celina Goya Ostos, Santiago Leal Singer, José Itzamna Espitia Hernández, Alik Daniel García Alvarez, Víctor Hugo Cortes Castro, Hugo Armando Gómez Solís, Miguel Alejandro Calvo Domínguez, Luis Leopoldo López Salinas, Leslie Thalía Orozco Vélez, Gerardo Daniel Valle Trujillo and Juan Barbier Arizmendi, certify that the points of view expressed in this document are a faithful reflection of our personal opinion on the company (s) or firm (s) within this report, along with its affiliates and/or securities issued. Moreover, we also state that we have not received, nor receive, or will receive compensation other than that of Grupo Financiero Banorte S.A.B. of C.V for the provision of our services.

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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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