Ahead of the Curve

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Price pressures likely persisted in September, justifying Banxico's more hawkish tone

- **Inflation (September).** We expect headline inflation at 0.71% m/m (previous: 0.19%), with an extension higher in price pressures seen during the first half of the period. We see generalized increases, suggesting an even more difficult price backdrop at the margin. The core would stand at 0.52%, with goods still showing relevant adjustments. If our forecast proves right, annual headline inflation would increase to 6.09% from 5.59% in August. The non-core would pick up to 9.57% from 8.14%, respectively. On the other hand, the core would pick up to 4.98% from 4.78% previously, stringing ten months higher. This would be consistent with the upward changes in inflation forecasts and more hawkish tone by Banxico in this week's decision.

- **Gross fixed investment (July).** We estimate a 1.5% m/m rebound, which would be low considering June's -1.8%. This result is broadly consistent with the modest improvement in overall activity, in which conditions were seemingly affected by worsening pandemic conditions, both domestically and at a global scale. Despite a generalized improvement by sector, we believe investment remains in a relatively tight spot, with limits coming from several factors

Mexico weekly calendar

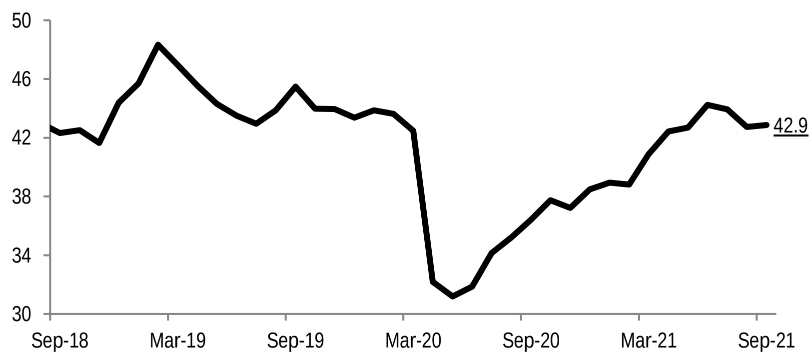
DATE	TIME (ET)	EVENT	PERIOD	UNIT	BANORTE	CONSENSUS	PREVIOUS
Mon 4-Oct	7:00am	Consumer confidence (sa)	September	index	42.9	--	42.7
Tue 5-Oct	10:00am	International reserves	Oct-1	US$ bn	--	--	198.2
Tue 5-Oct	3:30pm	Citibanamex bi-weekly survey of economic expectations					
Wed 6-Oct	7:00am	Gross fixed investment	July	% y/y	14.9	14.8	17.1
		sa		%m/m	1.5	--	-1.8
		Machinery and equipment		% y/y	18.1	--	24.5
		Construction		% y/y	12.1	--	11.5
Wed 6-Oct	7:00am	Private consumption	July	% y/y	--	--	19.1
		sa		%m/m	--	--	-0.8
		Domestic (Goods and services)		% y/y	--	--	16.1
		Imported (Goods)		% y/y	--	--	48.3
Thu 7-Oct	7:00am	CPI inflation	September	% m/m	0.71	0.61	0.19
				% y/y	6.09	6.00	5.59
		Core		% m/m	0.52	0.47	0.43
				% y/y	4.98	--	4.78
Fri 8-Oct		Wage negotiations	September	%	--	--	5.7

Source: Banorte; Bloomberg

Proceeding in chronological order…

Consumer confidence to bounce back slightly in September. We expect confidence at 42.9pts (seasonally adjusted), a modest rebound after falling 1.2pts in August. The main driver would be the improvement in pandemic conditions. In this sense, the number of cases showed a favorable trend after a new high in mid-August, with deaths also moderating and additional progress on vaccinations. Nevertheless, there are several factors which would significantly limit the uptick, especially prevailing price pressures. Specifically, we already observed a significant increase in inflation during the first half –which we estimate extended for the rest of the month (see section below)–. On other indicators such as the exchange rate, we see a muted effect. The latter was mostly stable during the sample period (until the 20th), but with higher volatility since then. Performance would also be dampened by signals of limited economic growth according to IMEF PMIs, albeit with better business confidence.

Consumer confidence
Pts, seasonally adjusted



Source: INEGI

Weekly international reserves report. Last week, net international reserves decreased by US$186 million, closing at US$198.2 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 increased by US$2.5 billion.

Banxico's foreign reserve accumulation details
US$, million

	2020	Sep 24, 2021	Sep 24, 2021	Year-to-date
	Balance		Lows	
International reserves (B)-(C)	195,667	198,216	-186	2,549
(B) Gross international reserve	199,056	211,416	-192	12,360
Pemex	--	--	0	449
Federal government	--	--	-56	59
Market operations	--	--	0	0
Other	--	--	-136	11,852
(C) Short-term government's liabilities	3,389	13,200	-6	9,811

Source: Banco de México

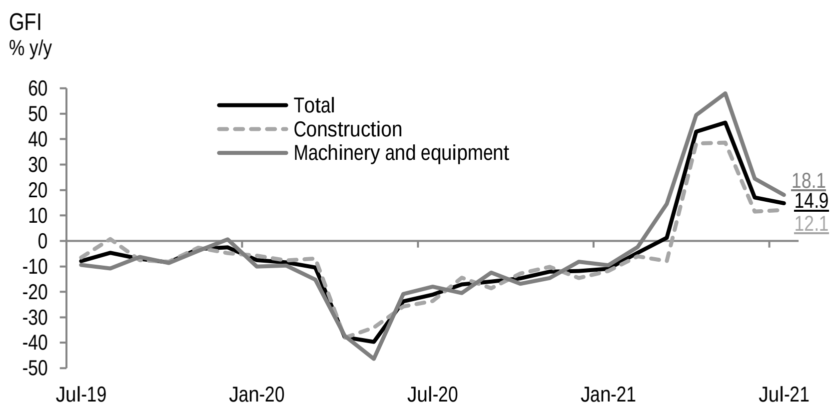
Investment to bounce back in July, albeit still weak in general terms. We expect GFI at 14.9% y/y, once again lower than in the previous month (+17.1%) as the base effect becomes progressively more challenging. More importantly, investment would rebound 1.5% m/m sequentially, low considering June's -1.8%.

This result is broadly consistent with the modest improvement in overall activity, in which conditions were seemingly affected by worsening pandemic conditions, both domestically and at a global scale. Performance across sectors would be positive, with all categories higher.

We estimate construction at +1.1% m/m (+12.1% y/y), not be enough to offset the -2.9% of the previous month. This would be slightly better than in the industrial production report, considering that the latter was dragged by 'related services' which are not accounted for in GFI. Civil engineering was the outperformer, which could result in a better performance of the non-residential sector relative to residential activity. Physical investment by the Federal Government expanded 18.6% y/y in real terms, which despite the caveats, could be favorable. Moreover, the 'adequate moment to invest' component within business confidence edged-up in the sector, supporting our call for an uptick.

Machinery and equipment would expand 4.7% m/m (+18.1% y/y), breaking with a three-month accumulated decline of 4.0%. The outperformer would be the imported component at +5.0% (+19.0% y/y). This would match the expansion in capital goods within the trade balance, despite a slightly negative effect from a very modest appreciation in the MXN, averaging 19.97 per dollar in the period (previous: 20.03). The domestic component would rise 4.5% (+16.7% y/y). Signals from key sectors within manufacturing were positive, including transportation equipment (+0.6% m/m), which in our view had been a hindrance for a stronger performance.

Despite the generalized improvement, we believe investment remains in a tight spot, with limits coming from several factors, including: (1) Increased COVID-19 contagions; (2) disruptions to supply chains and higher input prices; (3) ongoing disputes as part of USMCA; and (4) prevailing idiosyncratic risks.



Source: INEGI, Banorte

Private consumption with a mild rebound in July. We believe activity might show a slight uptick. Although epidemiological conditions kept deteriorating, signals so far suggest that the impact was modest, considering: (1) Modest changes in the 'traffic light' indicator, and therefore, few restrictions; (2) resilient mobility; and (3) the population's adaptation to distancing measures. In addition, fundamentals remained strong or even better, including remittances –with a new historical high–, employment –recovering pandemic losses– and, at the margin, banking credit.

In this context, both tourism and retail indicators showed good dynamism within the GDP-proxy for services. Despite of this, the category barely increased 0.3% m/m, with weakness in some sectors such as professional services. Non-oil consumption goods imports rose 5.6% m/m, extending the +1.3% from June. However, and as mentioned in previous occasions, we are cautious about these figures as they are nominal terms in a backdrop of strong price increases in recent months. Going forward, the short-term outlook is negative, with signs of an important deceleration in August on higher cases, as well as other supply constraints. In addition, conditions for September seem to have remained difficult according to IMEF indicators, with a modest expansion in non-manufacturing.

Broad-based price pressures in September. We expect headline inflation at 0.71% m/m (previous: 0.19%), with an extension higher in price pressures seen during the first half of the period. We see generalized increases, suggesting an even more difficult price backdrop at the margin. The core would stand at 0.52% (contribution: +39bps), with goods still showing relevant adjustments. If our forecast proves right, annual headline inflation would increase to 6.09% from 5.59% in August. The non-core would pick up to 9.57% from 8.14%, in the same order, with a more challenging base effect and higher for the first time since April. On the other hand, the core would pick up to 4.98% from 4.78% previously, stringing ten months higher. This would be consistent with the upward changes in inflation forecasts and more hawkish tone by Banxico in this week's decision.

At the non-core, we see relevant changes higher in energy, up 1.4% m/m (+13bps). This would mostly reflect a very difficult global backdrop for these commodities given scarcity in several regions. LP gas would climb 4.3%, adding 9bps and extending the adjustment in the first half of the month. In this respect, both international prices and the average maximum price increased, with the latter growing 3.3% in the second fortnight. Low-grade gasoline is expected to move up by 0.4% (+2.5bps) despite a gradual increase in subsidies to excise taxes. Apart from these, we also estimate further pressures in agricultural goods (1.6%), mainly in fresh fruits and vegetables (3.6%). Our monitoring showed further moves in key items such as tomatoes and onions. Difficult drought conditions remain in the US southwest, while we do not rule out an additional impact from recent hurricanes in the Gulf of Mexico.

At the core we also see constant pressures. Goods would climb 0.7% –as in August– and services by 0.3%. Within the former we had mixed signals, albeit with a clear upward skew in processed foods; in 'others' we highlight changes to the upside in toilet paper, laundry detergent and school supplies. In the latter, there is an adverse seasonality in tuitions, at 1.3% and probably influenced by the return of in-person classes in the 1st half. On the other hand, we expect a modest decline in the second half in tourism-related categories. Nevertheless, non-tourism would see renewed pressures, still pushed by higher costs and energy prices, especially LP gas.

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We, 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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