Ahead of the Curve

Inflation to stay relatively high in 1H-Oct, as well as mixed signals for activity in 3Q21

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- **Inflation (1H-October).** We expect inflation at 0.52% 2w/2w (previous: 0.21%), higher than its 5-year average at 0.49%. The period is characterized by an adverse seasonality due to the start of the rollback of summer discounts to electricity tariffs. However, we identified other key trends both at the core and non-core levels, most of them negative. With these results, headline inflation would stand at 6.10% and the core at 4.99%, both higher than the average in September. As such, these results support our view that additional central bank tightening is needed, with hikes continuing in coming months.

- ***Timely Indicator of Economic Activity* (September).** This release will include the first estimate for September, along revised figures for August. We believe the former, currently at 6.8% (sa), to be revised up. This would be driven by data published since, such as industrial production. For September, signals are mixed. News on the epidemiological front were positive, but other timely figures such as IMEF's PMIs point to a more modest performance

Mexico weekly calendar

DATE	HOUR (ET)	EVENT	PERIOD	UNIT	BANORTE	CONSENSUS	PREVIOUS
Tue 19-Oct	10:00am	International reserves	Oct-15	US$ bn	--	--	198.5
Wed 20-Oct		Deadline for the approval of the Revenue Law by the Lower House					
Wed 20-Oct	7:00am	Timely Indicator of Economic Activity (sa)	September	% y/y	--	--	6.8
Wed 20-Oct	4:30pm	Citibanamex bi-weekly survey of economic expectations					
Thu 21-Oct	7:00am	Retail sales	August	% y/y	5.6	--	9.9
		sa		% m/m	-1.2	--	-0.4
Fri 22-Oct	7:00am	CPI inflation	1H Oct	% 2w/2w	0.52	--	0.21
				% y/y	6.10	--	6.13
		Core		% 2w/2w	0.20	--	0.13
				% y/y	4.99	--	4.93

Source: Banorte; Bloomberg

Proceeding in chronological order...

Weekly international reserves report. Last week, net international reserves decreased by US$78 million, closing at US$198.5 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 increased by US$2.8 billion.

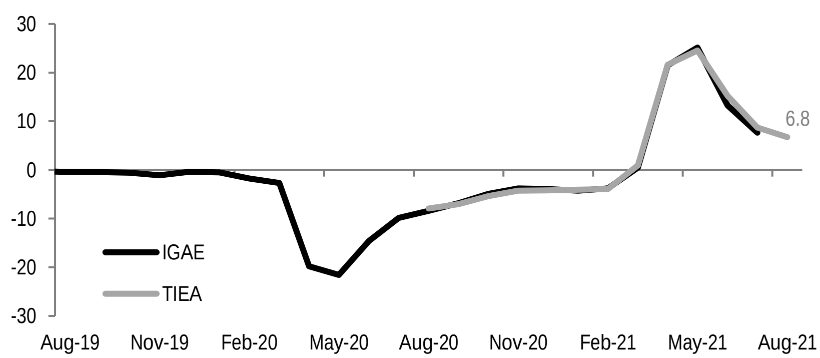
Banxico's foreign reserve accumulation details
US$, million

	2020	Oct 8, 2021	Oct 8, 2021	Year-to-date
	Balance		Flows	
International reserves (B)-(C)	195,667	198,482	-78	2,815
(B) Gross international reserve	199,056	211,686	251	12,630
Pemex	--	--	0	949
Federal government	--	--	-96	-250
Market operations	--	--	0	0
Other	--	--	348	11,930
(C) Short-term government's liabilities	3,389	13,204	330	9,815

Source: Banco de México

***Timely Indicator of Economic Activity* (September).** This release will include the first estimate for September, along revised figures for August. We recall that July's mid-point forecast stood at 8.7% y/y (using sa figures), higher than the 7.7% in the GDP-proxy (IGAE). We expect August's estimate, currently at 6.8%, to be revised up. This would be driven by data published since, such as industrial production. However, considering other signals, we are unsure if this would be enough to result in a sequential uptick in activity in the month. For September, signals are mixed. News on the epidemiological front were positive, with daily cases declining and an improvement in the traffic light indicator. This is also consistent with better dynamics in ANTAD sales and higher mobility. Nevertheless, other timely figures such as IMEF's PMIs point to a more modest performance. As such, we believe that a slight uptick might be in order, albeit likely dependent on the base effect for August's figures.

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



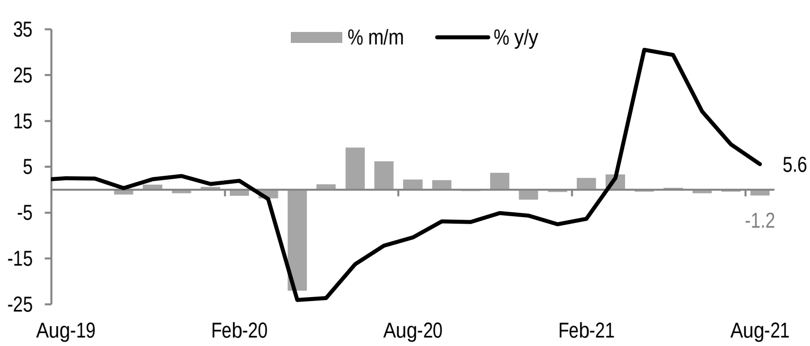
Source: INEGI

Retail sales to extend their move lower in August. We expect a 5.6% y/y increase (previous: 9.9%), with weakness extending on two main factors. First, we recall that the evolution of COVID-19 kept worsening, with new historical highs in daily cases by the end of the month. Second, we believe the persistent rise in inflation is also affecting households' purchasing power, more so as hefty increases have been observed in basic goods that are difficult to substitute (*e.g.* LP gas, processed foods). As a result, we expect a 1.2% m/m decline with seasonally adjusted figures, which would be its third consecutive contraction and even accelerate at the margin.

In this respect, available information is consistent with further declines. Among them, ANTAD's same-store sales dropped 1.0% y/y in real terms –due to supermarkets and departmental stores–, while total sales were only at +0.8%, lowest since February. On the other hand, vehicle sales were only at 76,930 from 78,235 in July, also negative in the yearly comparison at -1.1%. Something similar happened to gasoline volumes sold (-0.4%), which in our view may have been related to higher consumer caution due to the virus. Despite not seeing a sizable effect in mobility levels, we think that the effect of the latter was clearer in consumer confidence. Specifically, it fell for a second month, to 42.6pts from 44.0pts in July, with all components lower albeit highlighting the adjustment in expectations, both at the household and country levels. Moreover: (1) Employment was weaker even though we saw a slight decline in the unemployment rate (sa), with job and labor force losses; (2) non-oil consumption goods imports contracted 5.7% m/m, in our view reinforcing other signals in trade data about the deceleration in domestic demand; and (3) the recovery in banking credit was also more modest.

We still believe that better virus dynamics and strength in other fundamentals (mainly remittances) will help consumption get back on track through the end of the year and reverse recent losses. Nevertheless, lingering doubts about this scenario have picked up, mainly because of price adjustments. In this respect, we also see more difficulties in the short term, leading us to revise higher our year-end inflation forecast to 6.6% from 6.1%. Therefore, we will watch even more closely the behavior of each component to assess the impact that these pressures may well have on performance for the rest of the year.

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



Source: INEGI, Banorte

High inflation in 1H-October on the end of summer discounts to electricity tariffs, albeit also with pressures in processed foods and LP gas. We expect inflation at 0.52% 2w/2w (previous: 0.21%), higher than its 5-year average at 0.49%. The period is characterized by an adverse seasonality due to the start of the rollback of summer discounts to electricity tariffs. However, we identified other key trends both at the core and non-core levels, most of them negative. As such, these would come in at 0.20% and 1.51%, respectively.

With these results, headline inflation would stand at 6.10%, higher than the 6.00% average seen through September. The core would increase further to 4.99% (previous: 4.92%), with a persistent upward trend since late last year. Meanwhile, the non-core would stand at 9.57% (previous 9.37%), boosted by unfavorable trends across the whole category. As such, these results support our view that additional central bank tightening is needed, with hikes continuing in coming months.

Within the non-core, the brunt of the increase would be centered in energy, up 3.9% (+38bps). As previously stated, most of this obeys to the end of summer discounts on electricity tariffs in some regions, resulting in an 18.4% spike in this component (+26bps). However, the persistent adverse trend in LP gas would continue, rising 4.4% (+10pbs). In this context, the price ceiling was pushed higher due to the increase in reference prices, along a depreciation of the MXN in the fortnight. Gasolines would be more modest, helped by a substantial increase on subsidies to excise taxes. As such, both the low- and high-grade components would increase 0.2%, with a total contribution from both of only 1pb. Turning to agricultural goods, we expect a mostly benign performance, at 0.0% (-1bp). On the positive side, meat and egg would fall 0.4% (-3bps), with a seasonal effect in play, backed by positive news in our monitoring on chicken prices. This would be partially compensated by fruits and vegetables (0.4%; +2bps), with a mixed performance across goods. Lastly, government tariffs would remain contained at 0.1%.

Turning to the core, goods would remain high at 0.3% (+13bps), with most of the contribution still from processed foods, up 0.5% (+10bps). Our monitoring showed renewed pressures on key items such as corn tortillas, milk and cooking oil, as well as slight increases in other items. This could be related to higher input costs, both energy (*e.g.* LP gas) as well as packaging materials (*e.g.* plastics, aluminum, etc.). Other goods would be more modest at 0.2% (+3bps), likely aided by a positive seasonality after some increases in the previous fortnight. Services would rise 0.1% (+2bps), with housing stable at 0.1% (+1bp). ‘Other’ would show a mixed performance, highlighting a favorable trend in tourism-related categories due to the *Hot Travel* initiative, which provides discounts in the second week of the period. Remaining categories (*e.g.* restaurants) would be more muted after accumulating relevant pressures for several months by now.

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