

Ahead of the Curve

Assessing Banxico's hiking pace in the latest minutes as well as inflation at the end of 2021

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- Banxico minutes (December).** The central bank will publish the minutes of its [latest policy decision of 2021](#), when it announced a 50bps hike, in line with our call, but higher than what the market and most analysts expected. In our view, the statement's more hawkish bias was very clear, especially on the outlook and risks for prices. We expect the document to reinforce this tone. Once again, it will be key to identify comments by individual Board members. We will focus on the arguments of four out of five members that voted to speed up the pace of the hiking cycle, from 25bps to 50bps. As already known, Deputy Governor Esquivel dissented, favoring a 25bps increase. These arguments will be important because of the addition of the phrase "on this occasion" when referring about the decision to raise it by said magnitude. In our view, its inclusion reinforces the central bank's highly data-dependent mode
- Inflation (December).** We expect headline inflation at 0.40% m/m (previous: 1.15%), extending some of the trends seen in the first half of the month. As such, relevant differences would remain across components, with strong pressures at the core –rising 0.81% m/m (contribution: 60bps)– being partly offset by strong declines in the non-core –down 0.79% (-20bps). In the former, pressures would continue within goods. Meanwhile, the latter would benefit from declines in fresh fruits and vegetables along LP gas. With these results, annual inflation would close the year at 7.39% y/y (previous: 7.38%), being the highest year-end figure since 2000. Meanwhile, the core would rise to 5.94% (previous: 5.67%) –a new high since late 2001– with the non-core lower to 11.87% (previous: 12.61%)

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Mexico weekly calendar

DATE	TIME (ET)	EVENT	PERIOD	UNIT	BANORTE	CONSENSUS	PREVIOUS
Mon 3-Jan	10:00am	Family remittances	November	US\$ mn	<u>4,104.1</u>	4,685.7	4,818.6
Mon 3-Jan	1:00pm	IMEF's PMI survey	December				
		Manufacturing		index	<u>50.6</u>	--	50.3
		Non-manufacturing		index	<u>50.9</u>	--	50.1
Tue 4-Jan	10:00am	International reserves	Dec-31	US\$ bn	--	--	202.3
Wed 5-Jan	7:00am	Consumer confidence (sa)	December	index	<u>46.2</u>	--	45.8
Wed 5-Jan	3:30pm	Citibanamex bi-weekly survey of economic expectations					
Thu 6-Jan	10:00am	Banxico's minutes	Dec-16				
Fri 7-Jan	7:00am	CPI inflation	December	% m/m	<u>0.40</u>	0.50	1.14
				% y/y	<u>7.39</u>	7.51	7.37
		Core		% m/m	<u>0.81</u>	0.80	0.37
				% y/y	<u>5.94</u>	--	5.67

Source: Banorte; Bloomberg

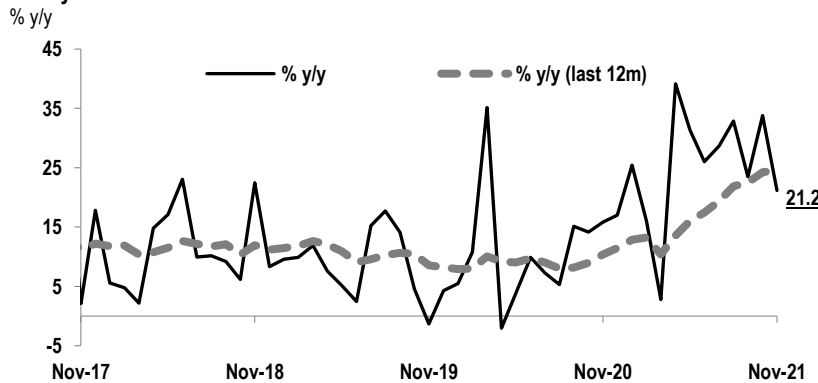
Proceeding in chronological order...

Remittances to maintain a brisk pace of growth in November. We expect remittances at US\$4,104.1 million. While this would be the lowest amount since April, we should note that there is a significant seasonal effect skewing the figure down. In our view, this is likely related to the Thanksgiving holiday and Black Friday sales in the US, which reduce remaining resources to be sent back to our country. However, it would still imply a 21.2% y/y growth, with mainly positive news across several fronts, mainly in the US labor market.

Specifically, the unemployment rate among Hispanics and Latinos in the US fell by about 70bps in the period, from 5.9% in October to 5.2% in November, outpacing improvements in other groups. According to our calculations, the same metric for working-age Mexicans declined to 4.9% from 5.6% in the period, reaching its lowest since December 2019. In absolute terms, migrants rose by 88.7 thousand people, with employees up by 229.8k –including ‘natives’, ‘non-native citizens’, and ‘non-citizens’ (legal or illegal)– while those catalogued as unemployed fell by 111.1k. In our view, this is likely driven by additional strength of the US economy, gathering pace as epidemiological conditions improved in the early part of the month, before taking a turn for the worse through the end of the year. On the migration front, news were mostly negative. Under court rule, the Biden administration reimposed the ‘Remain in Mexico’ policy for new immigrants that was instituted during the Trump administration. In addition, ICE sent over 70 thousand notices to illegal immigrants that were not dutifully processed, which adds uncertainty to their status. In our view, these developments undermine the perception of a more immigrant friendly administration, likely boosting flows. Meanwhile, the exchange rate depreciated to USD/MXN 20.90 from 20.46 in the previous month, possibly incentivizing additional resources.

In our view, remittances will likely maintain a strong pace through the remainder of the year and into 2022, mainly helped by the expectation of a continuation in the recovery of the US economy. However, we flag some relevant risks for dynamism, including: (1) The notable increase in contagion due to the ‘Omicron’ variant, albeit seemingly being less harsh; and (2) uncertainty about the ‘Build Back Better’ spending package as there are not enough votes in the Senate yet to push it through. As such, we maintain our full-year 2021 forecast at US\$49.5-50.5 billion, albeit likely seeing a result near the top of this range.

Family remittances



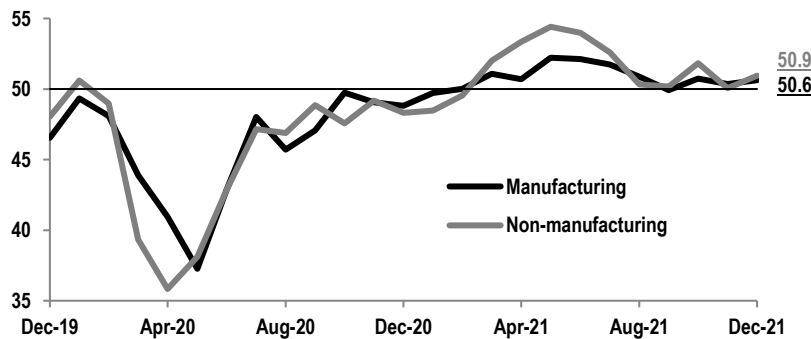
Source: Banxico

IMEF indicators to post a mild rebound in December. After a decrease in November, we expect both indicators to recover some dynamism, strengthening above the 50pts threshold and confirming some recovery of activity in 4Q21. Specifically, we expect a modest advance in the manufacturing PMI of 0.3pts to 50.6pts, with non-manufacturing being stronger by 0.8pts to 50.9pts.

In manufacturing, signals are somewhat mixed. On the exterior, *Markit's* manufacturing PMI for the US in December declined to 57.8pts from 58.3pts. In the report, we highlight comments of some relief in terms of the lack of supplies, albeit with weakness explained by greater costs. In the local front, stoppages due to the lack of semiconductors in the auto industry continued, resulting in detentions from Audi, Mazda and GM, among others. Nevertheless, Volkswagen mentioned that they worked overtime in the last week of December to compensate for suspensions in previous months. Also important, the fact that railway blockades ended the previous month could result in an additional boost as shipments on this way resume.

In non-manufacturing, we believe that the improvement could be stronger, with more positive signals at the margin. Importantly, COVID-19 cases have remained relatively stable at low levels, which has allowed for an additional recovery on mobility. The latter along a boost from the holiday season could result in higher dynamism. In addition, we believe additional improvements in employment conditions in November could boost retail. Finally, price pressures seem to have taken a breather, particularly due to declines in LP gas and fruits and vegetables, albeit with pressures still in core goods.

IMEF indicators
Diffusion indicators, sa



Source: IMEF, Banorte

Weekly international reserves report. Last week, net international reserves decreased by US\$30 million, closing at US\$202.3 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 increased by US\$6.6 billion.

Banxico's foreign reserve accumulation details

US\$, million

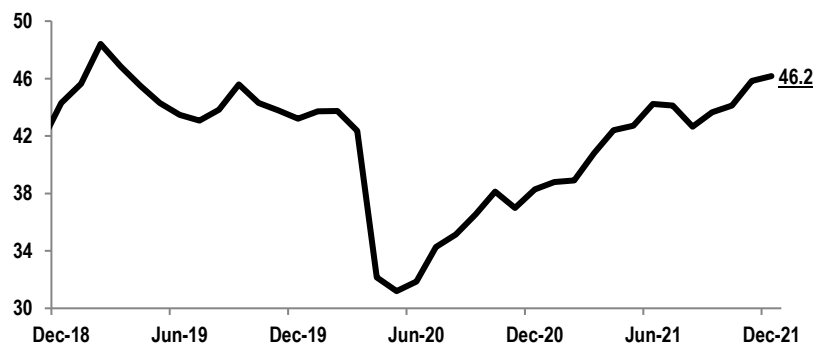
	2020	Dec 24, 2021	Dec 24, 2021	Year-to-date
	Balance		Flows	
International reserves (B)-(C)	195,667	202,273	-30	6,606
(B) Gross international reserve	199,056	207,895	-2,738	8,839
Pemex	--	--	0	1,158
Federal government	--	--	-3,060	-4,789
Market operations	--	--	0	0
Other	--	--	322	12,470
(C) Short-term government's liabilities	3,389	5,621	-2,708	2,232

Source: Banco de México

Consumer confidence to climb further in December. We expect confidence at 46.2pts (seasonally adjusted), better than the 45.8pts from November. We believe that a key condition for the improvement would have been stability in contagions, especially as other countries have experienced an acceleration in cases. As such this has allowed for activities to continue in one of the busiest seasons of the year, especially for retail businesses. Meanwhile, prices seem to have halted some of their upward momentum, mainly benefited by declines in fresh fruits and LP gas, key categories for consumers. However, some concerns remain, including over the overall effect of the ‘Omicron’ variant as it spreads. As such, and also considering previous gains, progress during the month will likely be modest.

Consumer confidence

Pts, seasonally adjusted



Source: INEGI

Keeping an eye on Banxico members’ views about a faster hiking pace in the upcoming minutes. The central bank will publish the minutes of its [latest policy decision of 2021](#), when it announced a 50bps hike, in line with our call, but higher than what the market and most analysts expected. In our view, the statement’s more hawkish bias was very clear, especially on the outlook and risks for prices. We expect the document to reinforce this tone. Specifically, we will watch closely at members’ opinions about the best stance ahead, in a backdrop of: (1) High uncertainty about the economic impact of the ‘Omicron’ variant; (2) expectations of a faster withdrawal of monetary stimulus around the world; and (3) mixed inflation data in the last couple of bi-weekly prints.

Once again, it will be key to identify comments by individual Board members. We will focus on the arguments of four out of five members that voted to speed up the pace of the hiking cycle, from 25bps to 50bps. As already known, Deputy Governor Esquivel dissented, favoring a 25bps increase.

These arguments will be important because of the addition of the phrase “on this occasion” when referring about the decision to raise it by said magnitude. In our view, its inclusion reinforces the central bank’s highly data-dependent mode. In this respect, Governor Díaz de León said they are not committed to a 50bps pace in an interview to Bloomberg. Specifically, he stated that any commitment would be more costly than beneficial. This view may be shared by other members, so it will be very important to try to identify them in the minutes. On the other hand, we recall that the term of Díaz de León as Governor ended on December 31st, with [Victoria Rodríguez Ceja](#) already in her period as the first female Governor of the institution since January 1st.

Going to published data, we highlight inflation for the 1st half of December at 0.10% 2w/2w, below our view and consensus. Although welcome after persistent upward surprises throughout the year, core inflation stood at 0.59%, above expectations and highest for the same period since 1998. This is even more relevant considering: (1) The inclusion in the statement of the persistence of core inflation at high levels; and (2) the stronger rise relative to previous years despite upward adjustments in prices since the previous fortnight after the end of *El Buen Fin* (Mexico’s Black Friday). Both goods and services rose 0.6%, with categories such as ‘autos’ in the former and ‘restaurants’ in the latter among those with the highest pressures. In our view, these categories are still exhibiting adverse and second-round effects from supply chain issues and higher costs in several fronts –raw materials, transportation and energy, among others. On the contrary, the headline benefitted meaningfully from lower prices in LP gas and fresh fruits and vegetables.

In this environment, Deputy Governor Jonathan Heath tweeted after the inflation release that “...*despite headline inflation decelerating at the margin, it is not good news, as the main problem persists...*” (our translation), referring to the upward trend of core inflation. We believe he will keep favoring a 50bps pace, as it is our assessment that he has defended a faster pace with a limited and determined duration, taking care of not derailing the economic recovery.

An additional front will be the views about changing the pace and its effect on market performance, as well as on inflation expectations. In this respect, the Mexican peso has gained 2.52% since the close on December 15th, ~135pb more than the average gain in the currencies that constitute the broad dollar index (BBDXY). This is favorable as a stronger peso lowers local-currency prices of imported goods. The Mbonos’ curve has flattened, with losses of 24bps on average in the front-end (1-3 years), 22bps in the belly (3 to 10 years), and 14bps in longer term tenors (10 to 30 years). On inflation expectations, 3- and 5-year breakevens have increased 19bps on average, remaining above their 12-month average. Regarding analysts and after the decision, consensus in the latest private sector survey (Citibanamex) now sees a 50bps hike in February 2022, in line with our call. Nevertheless, we had marginal changes in the expected level of the reference rate by year-end 2022 and 2023, consistent with an acceleration of the pace, but not of a higher terminal rate. On the other hand, inflation by the end of 2022 remained unchanged at 4.16% (Banorte: 4.40%), with the core marginally down, to 4.0% (Banorte: 4.1%).

All in all, the document –along data releases until the next decision– will keep playing a significant role in shaping monetary policy expectations. We are especially watchful of inflation dynamics at the turn of the year (when several companies adjust prices), the evolution of core inflation and commodity prices globally. We reiterate our view of 125bps in accumulated rate hikes this year, with changes in February (+50bps), June (+25bps), September (+25bps) and December (+25bps), closing the year at 6.75%. Nonetheless, decisions will remain challenging and difficult as the global and local environment keeps posing multiple challenges due to the pandemic, among other factors.

Mixed dynamics across December’s inflation. We expect headline inflation at 0.40% m/m (previous: 1.15%), extending some of the trends seen in the first half of the month. As such, relevant differences would remain across components, with strong pressures at the core –rising 0.81% m/m (contribution: 60bps)– being partly offset by strong declines in the non-core –down 0.79% (-20bps)–. In the former, pressures would continue within goods. Meanwhile, the latter would benefit from falls in fresh fruits and vegetables along LP gas. With these results, annual inflation would close the year at 7.39% y/y (previous: 7.38%), being the highest year-end figure since 2000. Meanwhile, the core would rise to 5.94% (previous: 5.67%) –a new high since late 2001– with the non-core lower to 11.87% (previous: 12.61%).

On monthly dynamics, pressures in the core would remain concentrated in goods, up 0.9% (+36bps). These would be evenly divided across processed foods (0.8%; 16bps) and other goods (1.1%; +20bps). Within both, it is our take that continuing supply issues keep impacting prices, with pressures extending further, especially amid higher demand due to the holiday season, especially for the latter. Meanwhile, services would be more modest, up 0.7% (+24bps). Housing would benefit from a slight seasonal downtrend in the second half, rising 0.2% (+3bps), while education would remain flat (0.0%). Other would climb 1.3% (+21bps), with pressures in tourism related categories –slightly waning in the second half– along more modest adjustments in remaining sectors.

Meanwhile, within the non-core, energy would trend down 2.5% (-26bps), pulled by a steep decline in LP gas. Although we already saw a significant decline in the first half, our monitoring suggests an extension of this, resulting in a total decline of 12.2% m/m (-30bps). This has been mainly driven by lower reference prices, albeit with an additional boost from an appreciation of the MXN in recent days. On the contrary, low-grade gasoline would climb 0.4% (+2bps), with the subsidy to the excise tax declining while international prices recover. Meanwhile, and as already known, electricity went up 0.3% (+1bp). Turning to agricultural goods (0.4%; +4bps), dynamics would be mixed with meat and egg driving the move up at +1.9% (+11bps), with reports of an upward extension in chicken and egg prices. On the contrary, fruits and vegetables would extend lower at -1.3% (-7bps), with our monitoring show additional declines in tomatoes and husk tomatoes in the second fortnight, albeit with some offsetting pressures in onions, avocados, and bananas. Lastly, government tariffs would rise 0.3% (+1bp) after an upward adjustment earlier in the month.

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We, Alejandro Padilla Santana, Juan Carlos Alderete Macal, Alejandro Cervantes Llamas, Manuel Jiménez Zaldívar, Marissa Garza Ostos, Francisco José Flores Serrano, Katia Celina Goya Ostos, José Itzamna Espitia Hernández, Víctor Hugo Cortes Castro, Hugo Armando Gómez Solís, Miguel Alejandro Calvo Domínguez, Luis Leopoldo López Salinas, Leslie Thalía Orozco Vélez and Gerardo Daniel Valle Trujillo, 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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