Ahead of the Curve

Inflationary pressures to continue at the turn of the year

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- **Inflation (1H-January).** We expect inflation at 0.48% 2w/2w (previous: 0.01%), high vs. its 2018-2021 average of 0.28%. Overall, figures tend to be high considering several start-of-the-year adjustments, including those related to excise taxes (impacting energy and some processed foods). Nevertheless, given accumulated pressures in previous months, we expect increases to be more notable. Therefore, we expect the core at 0.35%, with a contribution to the headline of +26bps, centered mainly on goods. Meanwhile, the non-core would climb 0.87% (+22bps), with higher pressures in agricultural items. With these results, annual inflation would moderate to 7.23% from the 7.35% on average seen in December. Similarly, the non-core would adjust lower to 10.58% (previous: 11.74%). Nevertheless, the core would rise to 6.12% (previous: 5.94%), possibly extending higher until February and supporting our expectation of further hikes by Banxico

- **Monthly GDP-proxy (November).** We expect the *Global Economic Activity Indicator* (IGAE) at 1.0% y/y, higher than the -0.7% seen in October. With seasonally adjusted figures, this would translate into 0.3% y/y contraction, as there is one additional working day in the annual comparison. Sequentially, we expect a very modest rebound of just 0.1% m/m after three months of marked weakness. Specifically, we believe the outlook remains challenging, even despite better epidemiological conditions and improving fundamentals. By sectors, industry backtracked 0.1% m/m (+1.6% y/y), while we expect agriculture at -0.3% m/m (1.4% y/y) and services at +0.2% m/m (+1.0% y/y)

Winners of the award for best economic forecasters for Mexico in 2021, granted by *Refinitiv*

STARMINE AWARDS FOR REUTERS POLLS FROM REFINITIV

Mexico weekly calendar

DATE	HOUR (ET)	EVENT	PERIOD	UNIT	BANORTE	CONSENSUS	PREVIOUS
Mon 24-Jan	7:00am	CPI inflation	1H Jan	% 2w/2w	0.48	0.37	0.01
				% y/y	7.23	7.12	7.26
		Core		% 2w/2w	0.35	0.26	0.20
				% y/y	6.12	--	6.00
Tue 25-Jan	7:00am	Economic activity indicator	November	% y/y	1.0	1.0	-0.7
		sa		% m/m	0.1	0.3	-0.2
		Primary activities		% y/y	-1.4	--	-3.0
		Industrial production		% y/y	1.6	--	0.7
		Services		% y/y	1.0	--	-1.2
Tue 25-Jan	10:00am	International reserves	Jan-21	US$ bn	--	--	
Wed 26-Jan	7:00am	Retail sales	November	%	3.1	3.1	5.3
		sa		%	-0.2	0.6	0.3
Thu 27-Jan	7:00am	Trade balance	December	US$ mn	-524.8	0.4	-111.7
		Exports		% y/y	0.4	--	19.2
		Imports		% y/y	18.6	--	29.6
Thu 27-Jan		Budget balance (measured with PSBR)	December	MX$ bn	--	--	-737.7

Source: Banorte; Bloomberg

Proceeding in chronological order...

Inflation in 1H-January to be pushed higher, partly on seasonal trends. We expect inflation at 0.48% 2w/2w (previous: 0.01%), high vs. its 2018-2021 average of 0.28%. Overall, figures tend to be high considering several start-of-the-year adjustments, including those related to excise taxes (impacting energy and some processed foods), as well as other made by both companies and the government (in government tariffs). Nevertheless, given accumulated pressures in previous months, we expect increases to be more notable. Therefore, we expect the core at 0.35%, with a contribution to the headline of +26bps, centered mainly on goods. Meanwhile, the non-core would climb 0.87% (+22bps), with higher pressures in agricultural items.

In greater detail, within the core, goods would rise 0.5% (+21bps), with most of the increase focused on processed foods (0.7%; +16bps). In particular, adjustments to excise taxes on cigarettes and flavored drinks would be reflected here, on top of additional pressures on other goods given higher costs of raw materials, highlighting corn tortillas within our monitoring. Meanwhile, adjustments in other goods (0.3%; +5bps) would be partly offset by the decline in feminine hygiene products, which will no longer be taxed with VAT, along some discounts in clothing. Services would be more modest (0.2%; +6bps) with a favorable seasonality in tourism categories offsetting for increases in other sectors. Specifically, housing 0.2% (+2bps), with education higher by 0.3% (+1bp) given modifications to tuitions for colleges and some high schools. Meanwhile, 'others' would come in at 0.1% (+2bps), aided by the beforementioned seasonality.

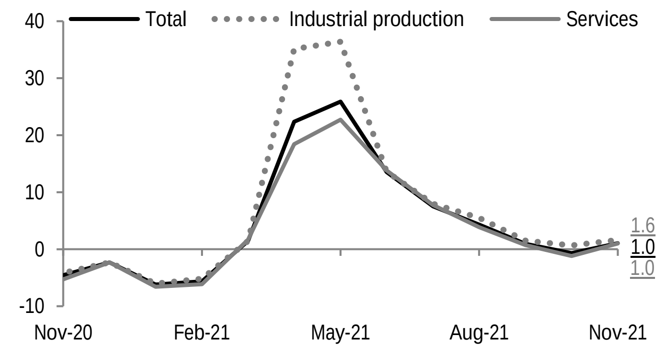
Going to the non-core, agricultural would be the highest at 1.2% (+14bps). Fruits and vegetables would rebound hard (2.1%; +11bps) after recent declines, with reports of relevant hikes in lemons, potatoes, bananas, and onions, among others. This would happen despite signs of declines in chilies and tomatoes. On meat and egg (0.5%; +3bps) pressures would be more moderate, with our monitoring showing mixed signals surrounding chicken and eggs. Energy would climb 0.2% (+2bps), mainly driven by pressures in gasolines. Specifically, we expect low-grade at 1.2% (+bps), explained by both an adjustment to the excise tax (albeit modest given the adjustment on stimulus) as well as pressures on international references. Something similar would happen with the high-grade fuel (1.0%; +1pb). Meanwhile, LP gas would extend lower at -2.1% (-5bps), helped mainly by previous gains and some lag relative to increases in global references. Finally, government tariffs would be pressured by the usual increases in some categories, such as water utilities and property tax. Therefore, we expect them at 1.5% (+6bps).

With these results, annual inflation would moderate to 7.23% from the 7.35% on average seen in December. Similarly, the non-core would adjust lower to 10.58% (previous: 11.74%). Nevertheless, the core would rise to 6.12% (previous: 5.94%), possibly extending higher until February and supporting our expectation of further hikes by Banxico.

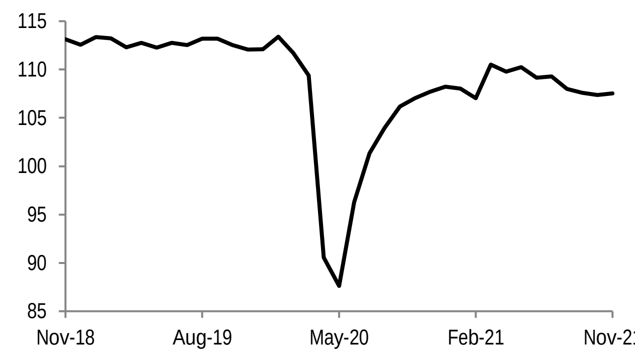
November's GDP-proxy to post a mild improvement. We expect the *Global Economic Activity Indicator* (IGAE) at 1.0% y/y, higher than the -0.7% seen in October. With seasonally adjusted figures, this would translate into 0.3% y/y contraction, as there is one additional working day in the annual comparison. This would stand below the mid-point of INEGI's *Timely Indicator of Economic Activity*, which forecasts a 0.2% increase. Sequentially, we expect a very modest rebound of just 0.1% m/m after three months of marked weakness. Specifically, we believe the outlook remains challenging, even despite better epidemiological conditions and improving fundamentals.

By sectors, industry backtracked 0.1% m/m (+1.6% y/y), lower than anticipated on weakness in construction (-0.6% m/m), adding three months lower. Manufacturing was stable (0.0%), with some positive signs inside such as in transportation equipment. On the contrary, mining was better (0.4%), boosted by improvements across all sectors. We expect agriculture at -0.3% m/m (1.4% y/y), still weak. This would be consistent with signals from prices, showing strong increases in the period, as well as the slight decline in trade balance figures.

Going to services, we expect a modest 0.2% m/m advance (+1.0% y/y). This would be quite low considering an accumulated loss of 3.5% since May. Although conditions regarding the virus had improved, boosting mobility, we believe there are several factors limiting performance. Among them we highlight broad price pressures and a lack of supplies for some sectors, on top of some idiosyncratic factors. Consistent with this, IMEF's non-manufacturing PMI showed a moderation of 1.6pts to 50.4 units, with declines across all categories. Meanwhile, the employment report showed a creation of 53.0 thousand positions in the sector, with gains centered in restaurants and social services. Turning to different sectors, signs are somewhat modest, in line with the general outlook. We expect a deceleration in retail sales (see section below), even despite the seasonality from *El Buen Fin* (Mexico's Black Friday). In tourism, hotel occupancy rates decelerated to 40.1% from 47.2%, slightly higher than suggested by the period's seasonality. Meanwhile, air passenger traffic increased sequentially to 6.4 million, albeit still moderating in the annual comparison (to 66.0% from 70.8%). As such, transportation could benefit from the stability in manufacturing, although with uncertainty over tourism. Turning to more essential sectors, we could see a slight rebound in education and healthcare, same as for the financial sector after recent declines. Lastly, we will be looking into the performance of professional and business support services, especially to determine if this halt their slide which began in June.



Source: INEGI, Banorte



Source: INEGI, Banorte

Weekly international reserves report. Last week, net international reserves increased by US$147 million, closing at US$202.1 billion (please refer to the following table). According to Banxico's report, this was mainly explained by a positive valuation effect in institutional assets. Year-to-date, the central bank's international reserves have fallen by US$299 million.

Banxico's foreign reserve accumulation details
US$, million

	2021	Jan 14, 2022	Jan 14, 2022	Year-to-date
	Balance		Flows	
International reserves (B)-(C)	202,399	202,100	147	-299
(B) Gross international reserve	207,745	210,961	3,995	3,216
Pemex	--	--	0	0
Federal government	--	--	3,724	4,362
Market operations	--	--	0	0
Other	--	--	271	-1,146
(C) Short-term government's liabilities	5,346	8,861	3,849	3,515

Source: Banco de México

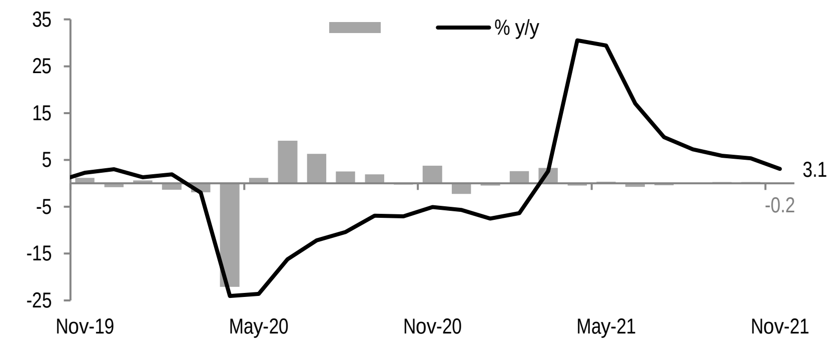
Retail sales to drift lower in November. We expect a 3.1% y/y increase (previous: 5.3%). Sequentially, this would lead to a 0.2% decline, contracting after three consecutive months of modest gains. It is our take that price pressures, which continued during the period, likely affected performance. In addition, discounts during *El Buen Fin* (Mexico's Black Friday) were available for fewer days than in the previous year, a situation that is not likely to be captured in the seasonal adjustment. Meanwhile, inflation data suggests that discounts were less attractive –possibly also related to cost pressures faced by retailers on supply chain issues, including higher costs of raw materials and transportation.

Available data about performance is mostly weak. Same-store and total sales by ANTAD members were at 1.8% and 3.6% y/y in real terms, respectively, both more modest than in October. In our view, food and beverages may well be among the most affected sectors based on the hefty price increases seen in processed foods and fruits and vegetables. In vehicle sales, AMIA showed an uptick in absolute terms, albeit with the annual rate down 13.3% from -9.1% previously, lowest since February when base effects were still a high drag to the annual rate. This is consistent with reports of ongoing challenges to supply chains. In turn, non-oil consumption goods imports have been growing for three months in a row through November, signaling that performance may have been favorable.

Nevertheless, we are especially cautious on this data given price pressures, recalling that they are in nominal terms. Another positive indicator corresponds to gasoline volumes sold, up 13.0% y/y from -1.0%. This is in line with mobility data, which kept trending higher.

On fundamentals, remittances remain as the brightest spot, up a whopping 41.2% y/y in local currency terms at close to $97.5 billion, considering also that the average exchange rate was 2.5% above the level seen in the same period of 2020. In employment, 119.1 thousand positions were created, while the unemployment rate declined at the margin, suggesting a better outlook for consumption.

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



Source: INEGI, Banorte

A modest trade deficit expected in December. We estimate a US$524.8 million deficit, with total exports and imports at 0.4% and 18.6% y/y, respectively. Historically, the period tends towards higher balances as manufacturing activity and consumer goods imports slow down given that inventories are already high in advance of the year-end shopping season. In this sense, annual rates are still highly distorted because of base effects related to the pandemic. Regarding the latter, it is our take that the 'Omicron' variant was still not significantly disruptive to trade flows globally, with restrictions increasing –especially in China– until late in the period and the start of 2022. If we are right, a US$12,606 million deficit would have been seen in full-year 2021, with exports and imports up 17.4% and 31.2%, in the same order. This would be the first yearly deficit since 2018.

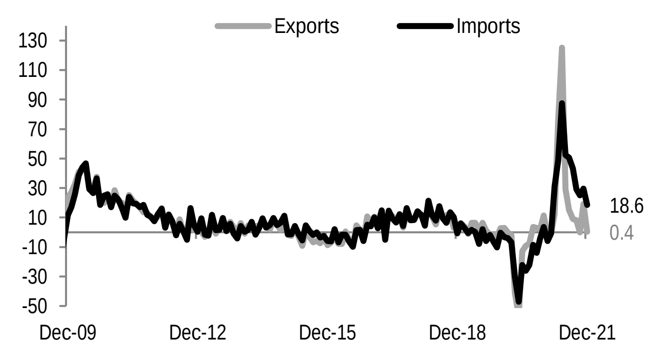
In oil, we pencil in a US$2,143.8 million deficit, weaker at the margin. Both prices and volumes were likely lower, with investors' fears about the impact of the new COVID-19 variant hitting market prices. We see exports at 41.2% y/y, with the Mexican oil mix averaging 66.33 US$/bbl (+47.9% y/y) from 74.82 US$/bbl in the previous month. On purchases abroad, we see a slowdown to 53.9% y/y. US gasoline prices also declined at the margin, albeit more modestly than for oil according to our monitoring. Moreover, US exports to Mexico were also lower. The 12-month balance would have reached a US$24.6 billion deficit, a new historical low that has likely limited MXN gains structurally.

In non-oil, we anticipate a US$1,619.1 million surplus, with exports down 1.6% (first yearly fall since February) and imports higher by 15.2%. In the former, agricultural goods (13.5%) and non-oil mining (23.8%) should remain quite strong, with prices signaling a production rebound in the former and boosting figures in the latter.

Nevertheless, manufacturing (-2.7%) would drag the headline. Specifically, we see a sequential payback in both 'autos' and 'others' given significant gains in November. First, AMIA data still shows weakness, with vehicles sent abroad down 17.3%. In the US, the sector dipped 6.3%, lowest since September. Second, both total IP and manufacturing in the US fell relative to the previous month. Moreover, IMEF's and Markit's PMIs for Mexico showed lower production and new orders. Going to imports, consumption goods (+9.4%) are seasonally weak on inventory adjustments, although Chinese data on exports to our country held up relatively well. Intermediate goods are also significantly lower in the period. Capital goods (+21.1%) could have been relatively resilient, supported by a stronger MXN and a further uptick in business confidence levels.

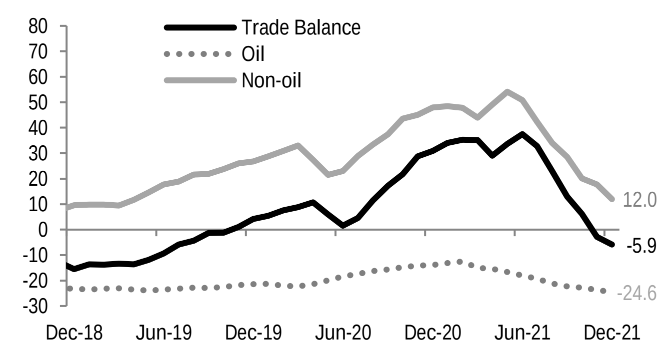
Looking into 2022, we believe trade could keep showing relatively high growth rates. Nevertheless, this is likely to be boosted by high global inflation, which we expect to continue given persistent supply chain disruptions. In this sense, we are cautious of reading too much into this data in terms of its signal for real economic activity. In addition, roadblocks for the approval of new fiscal stimulus in the US is dampening the outlook for GDP growth in said country, likely also resulting in added headwinds for Mexico's external sector.

Exports and Imports
% y/y nsa



Source: INEGI, Banorte

Trade balance
US$ billion, 12-month rolling sum



Source: INEGI, Banorte

MoF's public finance report (Jan-Dec). Attention will center on the Public Balance and Public Sector Borrowing Requirements (PSBR). With this being the last report of the year, comparisons will be made relative to the last quarterly update. Nevertheless, we will be looking into if the MoF includes adjustments for the 2022 estimates, albeit with this being somewhat unlikely. Until November, the PSBR deficit amounted to $737.7 billion, with the traditional public deficit at $449.7 billion. We will also pay attention to revenue and spending dynamics in the annual comparison. Lastly, we will analyze public debt, which stood at MXN$13.0tn in the same period (as measured by the Historical Balance of the PSBR). We should remember that, with this being a quarterly report, we will also pay attention to the accompanying conference call, which will probably take place on Friday, January 28.

Analyst Certification

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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SELL	When the share expected performance is lower than the MEXBOL estimated performance.

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