Ahead of the Curve

Focus on inflation and signals of future moves in Banxico's minutes

- **Banxico's Minutes (September 29th).** In the last decision, the Board increased the reference rate by 75bps, taking it to 9.25%. In our opinion, the statement was once again more hawkish at the margin, supported by: (1) The recognition that inflationary shocks "*...will take longer to dissipate...*"; (2) a strong upward revision in inflation estimates; (3) inflation expectations which keep increasing; and (4) the fact that the decision was unanimous once again, considering that the possibility of a dissident vote existed. We will carefully analyze comments around inflation conditions –both current and going forward–, the influence of the Fed's monetary policy, and to a lesser extent, economic activity. In addition, we will be looking over the likely magnitude of the next move (which we expect at +75bps), as well as the terminal level for the reference rate in this cycle (which we put at 11.00% by the end of 1Q23).

- **Industrial production (August).** We expect it at 4.3% y/y, higher than the 2.6% of the previous month. The figure would be boosted by an additional working day in the annual comparison. Correcting for the latter with seasonally adjusted data, we estimate +3.4% y/y. More importantly, this implies a 0.1% m/m expansion, adding six months to the upside. Inside, performance would be mixed, with payback across categories relative to the dynamics of the previous month. As such, mining (+0.9% m/m) and construction (+0.8%) would rebound, with manufacturing lower (-0.9%)

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Mexico weekly calendar

DATE	TIME (ET)	EVENT	PERIOD	UNIT	BANORTE	CONSENSUS	PREVIOUS
Mon 10-Oct		Wage negotiations	September	%	--	--	5.0
Tue 11-Oct	10:00am	International reserves	Oct-7	US$ bn	--	--	196.9
Tue 11-Oct		ANTAD same-store sales	September		--	--	2.5
Wed 12-Oct	7:00am	Industrial production	August	% y/y	4.3	2.9	2.6
		sa		% m/m	0.1	-0.2	0.4
		Mining		% y/y	1.0	--	-0.8
		Utilities		% y/y	3.9	--	2.2
		Construction		% y/y	1.1	--	-1.0
		Manufacturing		% y/y	6.6	4.0	5.1
Thu 13-Oct	10:00am	Banxico's minutes	Sep-29				

Source: Banorte; Bloomberg

Proceeding in chronological order...

Weekly international reserves report. Last week, net international reserves decreased by US$282 million, closing at US$196.9 billion (please refer to the following table). This was mainly explained by a negative valuation effect in institutional assets. Year-to-date, the central bank's international reserves have fallen by US$5.5 billion.

Banxico's foreign reserve accumulation details
US$, million

	2021	Sep 30, 2022	Sep 30, 2022	Year-to-date
	Balance		Flows	
International reserves (B)-(C)	202,399	196,917	-282	-5,482
(B) Gross international reserve	207,745	202,135	-649	-5,609
Pemex	--	--	0	350
Federal government	--	--	-212	845
Market operations	--	--	0	0
Other	--	--	-436	-6,804
(C) Short-term government's liabilities	5,346	5,218	-366	-128

Source: Banco de México

Industry to inch higher in August, with mixed dynamics across categories. We expect IP at 4.3% y/y, higher than the 2.6% of the previous month. The figure would be boosted by an additional working day in the annual comparison. Correcting for the latter with seasonally adjusted data, we estimate +3.4% y/y, which would be higher than INEGI's estimate within the *Timely Indicator of Economic Activity* of 3.1%. More importantly, this implies a 0.1% m/m expansion, adding six months to the upside. Inside, performance would be mixed, with payback across categories relative to the dynamics of the previous month.

Mining would rebound 0.9% m/m (+1.0% y/y), not enough to offset for the -2.5% of July. As has been the case through the year, volatility would continue in 'related services', albeit now expecting an expansion after a sharp 18.7% sequential decline in the previous month. Meanwhile, oil mining would decelerate at the margin, with crude output from Pemex moderating to 1,778kbpd from 1,797kbpd in the previous period. Lastly, non-oil mining could have also moderated, with outflows within the trade balance at -15.9% m/m, while prices fell further after a mild stabilization.

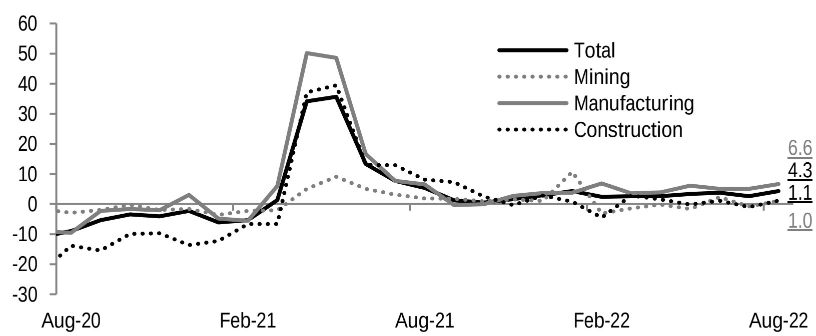
We also anticipate an improvement in construction, up 0.8% m/m (+1.1% y/y), recouping part of the 0.9% contraction of the previous month. Inside, we could see a rebound in both 'specialized work' and civil engineering after declines. Regarding the latter, physical investment by the Federal Government rocketed 52.5% y/y in real terms. However, considering the differences in accounting practices, we think much of the dynamism will not translate to IP figures. More broadly, employment conditions improved in the period, both in IMSS' and INEGI's reports, with the latter showing a net job creation of 57.4 thousand positions. On the contrary, both business confidence and the aggregate trend fell once again, with declines across all subsectors.

Manufacturing would take a step back, down 0.9% (+6.6% y/y), which in our view would be somewhat modest considering an accumulated expansion of 3.3% in the previous four months –especially the +1.6% in July.

We believe that the sector has shown resiliency despite some persistent supply issues, which explains some of the outperformance relative to other categories. Signals for the period were mixed, starting with IMEF's manufacturing PMI, back down to contraction territory to 49.5pts (-1.7pts), dragged by 'inventories', 'new orders', and 'production'. Hard data from the US points to a moderation, with manufacturing output at +0.1% m/m from +0.6% in July, but with broader industrial production falling 0.2%. The trade balance was more mixed, with total sector exports up 1.0%, pushed by the auto sector (+8.6%), but with 'others' at -2.5%. Subtracting some dynamism from the former, AMIA vehicle production grew 0.9% sequentially, modest at the margin. Lastly, and more positively, employment according to INEGI improved sharply by +279.5 thousand positions, albeit not ruling out a seasonal push after the summer holiday.

Going forward, short-term signals for manufacturing seem to be better, both externally and domestically –using [IMEF's latest data](). However, risks ahead are increasing, with additional uncertainty about future performance and persistent price pressures likely weighing on some sectors.

Industrial production
% y/y nsa



Source: INEGI, Banorte

Banxico minutes to show relevant information on factors behind expectations of higher inflation for longer. In the last decision, the Board [increased the reference rate by 75bps, taking it to 9.25%](). In our opinion, the statement was once again more hawkish at the margin, supported by: (1) The recognition that inflationary shocks "*...will take longer to dissipate...*"; (2) a strong upward revision in inflation estimates; (3) inflation expectations which keep increasing; and (4) the fact that the decision was unanimous once again, considering that the possibility of a dissident vote existed. We will carefully analyze comments around inflation conditions –both current and going forward–, the influence of the Fed's monetary policy, and to a lesser extent, economic activity. In addition, we will be looking over the likely magnitude of the next move (which we expect at +75bps), as well as the terminal level for the reference rate in this cycle (which we put at 11.00% by the end of 1Q23).

We believe arguments behind the view of a higher inflation for longer in the statement will be quite interesting. These could include: (1) A more lasting impact from the pandemic on supply chains; (2) that the conflict in Ukraine extends further; and (3) higher commodities prices, among others. It will be especially relevant if they also include domestic factors.

We consider this had a clear influence in the updated to the inflation forecasts, with relevant adjustments through 2023 for both the headline and the core. Given the magnitude of the changes, we do not rule out that the description over the changes is will be longer than before. Meanwhile, we believe that they will keep showing concerns by the increase in short-term expectations, which has extended more modestly to the medium-term ones. In our opinion, all of this supports the need to have a more restrictive stance.

Regarding the relative monetary stance, it is likely that more differences persist among the members. At least one –which we believe will be Jonathan Heath– will continue to support that hikes from the Fed set a ‘floor’ for Banxico’s moves. Most will likely comment that this is just one of the factors –including Irene Espinosa and Galia Borja, and even, Governor Victoria Rodríguez. Finally, Gerardo Esquivel could keep arguing for some of the advantages of decoupling in the short-term. We will also be looking for signals over coming actions, over which Heath and Espinosa seem to have given more information in recent minutes. Nevertheless, comments could be clearer with the goal to consolidate the forward guidance. Regarding the terminal level for the rate, most have limited to stating that they expected that it would reach restrictive territory. According to our calculations, this has already been achieved. Therefore, it will be valuable if they provide further details over how restrictive it would have to be to achieve the central bank’s goals.

Since the decision, participations from members of the Board have been limited, even centering on topics other than monetary policy. We highlight comments from Governor Rodríguez after the meeting. In her participation with *Enfoque Noticias* she stated that “*...for upcoming meetings we will have some hikes to keep fighting inflation...*”. In addition, that “…the effects (from inflation shocks) are taking more time than was anticipated…”, which is consistent with the changes in the statement. Deputy Governor Esquivel participated in a conference from the Dallas Fed, the University of Houston and Banxico. He stated that “…I believe that we should start reducing the pace of adjustments as soon as in our next meeting…”. Regarding the terminal rate he argued that “*...going forward, it is important to send the message that we are close to reaching the terminal value of the interest rate in the current hiking cycle...*”. In our opinion, these comments are consistent with his more dovish stance, which could materialize in a dissenting vote as soon as November.

Considering this, we believe the document will maintain a hawkish tone, supporting our view of more tightening –both in duration and in magnitude–, maintaining a cautious stance. Therefore, we reaffirm our forecast of +125bps in the remainder of the year to 10.50%, with a terminal level of 11.00% by the end of 1Q23.

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We, Alejandro Padilla Santana, Juan Carlos Alderete Macal, Alejandro Cervantes Llamas, Manuel Jiménez Zaldívar, Marissa Garza Ostos, Katia Celina Goya Ostos, Francisco José Flores Serrano, José Luis García Casales, Víctor Hugo Cortes Castro, José Itzamna Espitia Hernández, Carlos Hernández García, Leslie Thalía Orozco Vélez, Hugo Armando Gómez Solís, Yazmín Selene Pérez Enríquez, Cintia Gisela Nava Roa, Miguel Alejandro Calvo Domínguez, Daniela Olea Suárez, José De Jesús Ramírez Martínez, Gerardo Daniel Valle Trujillo, Luis Leopoldo López Salinas, Isaías Rodríguez Sobrino, Paola Soto Leal, Daniel Sebastián Sosa Aguilar and Salvador Austria Valencia 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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