Ahead of the Curve

Banxico will slow down its hiking pace, taking the rate to 10.50%

- **Banxico's monetary policy decision (December 15th).** We expect the central bank to increase the reference rate by 50bps to 10.50% in its last meeting of the year, which would validate our view since September and end a streak of four-decisions hikes of +75bps. As such, accumulated tightening since the cycle began would total 650bps. This moderation in speed would be supported by: (1) Firm expectations of a hike of the same magnitude from the Fed; (2) lower annual headline inflation in recent prints; and (3) relative stability in local financial assets compared to peers. However, and as already flagged by the central bank, it is our take that more restriction is needed as core inflation remains to the upside, which represents a risk for the anchoring of inflation expectations. The vote would not be unanimous, with Deputy Governor Gerardo Esquivel dissenting in support of a 25bps hike. Similar to the previous meeting, we expect the tone to be less *hawkish*, signaling a further moderation in upcoming adjustments, in line with our view

- **Industrial production (October).** We expect the indicator at 2.4% y/y, lower than the 3.9% of the previous month. Using seasonally adjusted figures, we anticipate +2.6% y/y, below the 3.5% within INEGI's *Timely Indicator of Economic Activity*. More importantly, it implies +0.1% m/m, which would not be enough to offset September's 0.2% drop. By sectors, we expect increases in mining (+0.9% m/m) and construction (+0.1%), although with manufacturing down (-0.1%), adding three months of declines. Overall, this result would be consistent with some weakness in the sector going into 4Q22

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Mexico weekly calendar

DATE	TIME (ET)	EVENT	PERIOD	UNIT	BANORTE	CONSENSUS	PREVIOUS
Mon 12-Dec		Markets closed due to Banking Holiday					
Mon 12-Dec	7:00am	Industrial production	October	% y/y	2.4	3.4	3.9
		sa		% m/m	0.1	--	-0.2
		Mining		% y/y	-0.5	--	-2.0
		Utilities		% y/y	4.4	--	6.5
		Construction		% y/y	-2.7	--	-3.8
		Manufacturing		% y/y	4.9	--	8.4
Mon 12-Dec		ANTAD same-store sales	November		--	--	1.5
Wed 14-Dec	10:00am	International reserves	Dec-9	US$ bn	--	--	198.9
Thu 15-Dec		Congress finishes its ordinary session period					
Thu 15-Dec	2:00pm	Banxico's monetary policy decision	Dec-15	%	10.50	10.50	10.00
Fri 16-Dec	10:00am	Banxico's survey of economic expectations	December				

Source: Banorte: Bloomberg

Proceeding in chronological order…

Industry to inch higher in October, albeit still lingering weakness. We expect IP at 2.4% y/y, lower than the 3.9% of the previous month. Using seasonally adjusted figures, we anticipate +2.6% y/y, below the 3.5% within INEGI's *Timely Indicator of Economic Activity*. More importantly, it implies +0.1% m/m, which would not be enough to offset September's 0.2% drop. Overall, this result would be consistent with some weakness in the sector going into 4Q22.

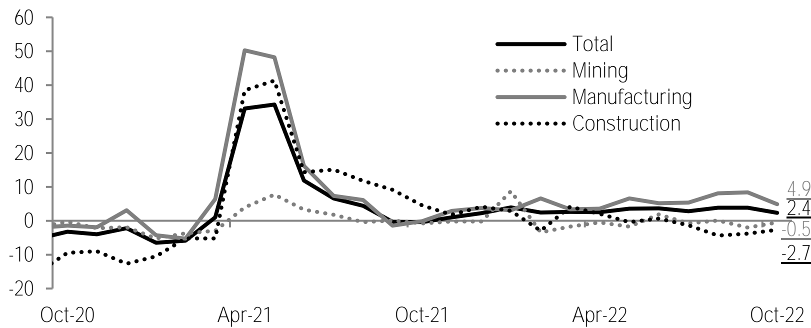
Manufacturing would once again be negative, down 0.1% (-4.9% y/y) and adding three months lower. We believe some key sectors suffered from supply constraints, especially autos (as outlined below). In general terms, IMEF's manufacturing PMI stood at 50.0pts (-0.3pts), noting a decline in 'new orders'. Moreover, domestic exports showed some weakness, both in 'others' (-5.0% m/m) and autos (-2.9%) despite some progress in the US –with manufacturing production up 0.2% sequentially. This is consistent with AMIA auto production, which contracted 7.7% (using our in-house seasonal adjustment model), which is quite negative considering a similar decline in the previous month. Several auto makers reported stoppages in the period, noting VW as the most affected, Ford, and Nissan. Within employment, INEGI reported 207.6 thousand new positions in the sector, relatively in line with seasonal trends.

Construction would advance 0.1% m/m (-2.7% y/y). While this would mean a second consecutive month higher, it still suggests weakness given a string of declines in the five previous periods. Opinion indicators were mixed, with the aggregate trend indicator inching higher, but with confidence lower again. Employment surprised to the downside, with INEGI showing a decline of 131.8 thousand positions. Edification would stay to the downside –with possible outperformance in some investment projects likely dragged by weakness in the residential front, with civil engineering still supported by government projects. Related to the latter, spending in physical investment by the Federal Government shot up 66% y/y in real terms. This likely reflects end-of-year outlays due to budgetary planning, which might not translate outright into activity.

Finally, mining would rebound 0.9% (-0.5% y/y). We expect strength to center in the oil sector, with CNH data suggesting more crude extraction (1,621kbpd vs 1,619kbpd) and gas was practically unchanged, in our view helped by a relatively mild hurricane season. Non-oil could also be positive given a good result in exports (+16.3% m/m), despite an additional setback in prices. Lastly, 'related services' would be more stable, in line with their recent performance.

Going forward, we have had signs of some manufacturing resilience –such as in the IMEF's indicator despite an additional moderation in the sector in the US. However, risks for remaining sectors persist and are tilted to the downside, with uncertainty possibly weighing on them.

Industrial production
% y/y nsa



Source: INEGI, Banorte

Weekly international reserves report. Last week, net international reserves increased by US$846 million, closing at US$198.9 billion (please refer to the following table). This was mainly because of a positive valuation effect in institutional assets. Year-to-date, the central bank's reserves have fallen by US$3.5 billion.

Banxico's foreign reserve accumulation details
US$, million

	2021	Dec 2, 2022	Dec 2, 2022	Year-to-date
	Balance		Flows	
International reserves (B)-(C)	202,399	198,890	846	-3,509
(B) Gross international reserve	207,745	202,403	711	-5,342
Pemex	--	--	0	350
Federal government	--	--	-90	-516
Market operations	--	--	0	0
Other	--	--	802	-5,176
(C) Short-term government's liabilities	5,346	3,513	-135	-1,833

Source: Banco de México

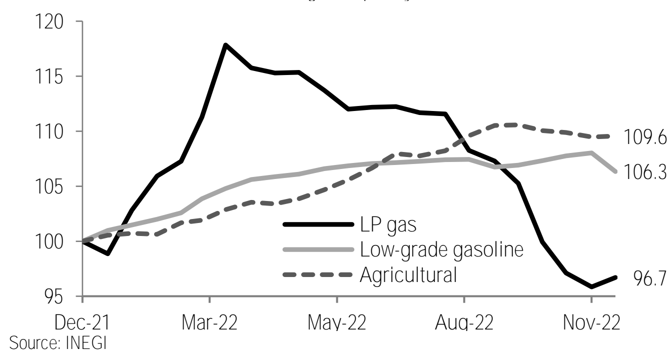
Slowdown in Banxico's hiking pace, taking the rate to 10.50%. We expect the central bank to increase the reference rate by 50bps in its last meeting of the year, which would validate our view since September and end a streak of four-decisions hikes of +75bps. As such, accumulated tightening since the cycle began would total 650bps. Our view is matched by consensus in *Bloomberg's* survey. This moderation in speed would be supported by: (1) Firm expectations of a hike of the same magnitude from the Fed; (2) lower annual headline inflation in recent prints; and (3) relative stability in local financial assets compared to peers. However, and as already flagged by the central bank, it is our take that more restriction is needed as core inflation remains to the upside, which represents a risk for the anchoring of inflation expectations. The vote would not be unanimous, with Deputy Governor Gerardo Esquivel dissenting in support of a 25bps hike. Similar to the previous meeting, we expect the tone to be less *hawkish*, signaling a further moderation in upcoming adjustments, in line with our view.

Regarding the Fed, we expect a 50bps *Fed funds* rate hike to a 4.25%-4.50% range on December 14th. This is widely expected by analysts, investors, and rates futures. The probability of this scenario is practically at 100%, further cemented after the latest speech from Chair Jerome Powell. His key comment was that "*...it makes sense to moderate the pace of our rate increases as we approach the level of restraint that will be sufficient to bring inflation down...*". Domestically, Deputy Governor Jonathan Heath had a similar statement in recent days.

In a *Fortuna* magazine event, he stated that "*…we believe that we can maybe start to slow the rhythm (of increases), though continuing to raise them…*". In this context, and despite all Board members ensuring that domestic decisions do not act mechanically to the Fed –as reiterated in the last Quarterly Report–, we believe that local conditions still warrant some tightening.

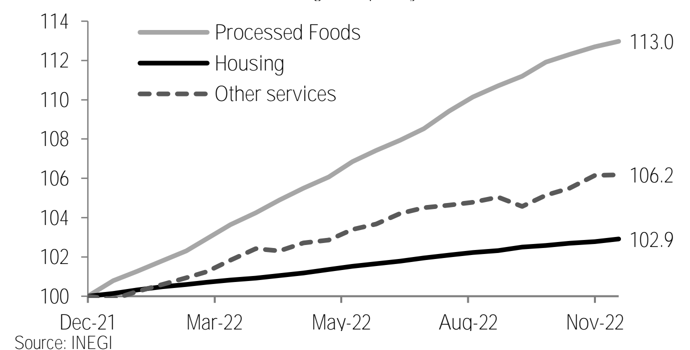
On inflation, available data is mixed. Annual headline inflation dropped further in November –mostly aided by the non-core–, but the core remains to the upside, adding 24 months of increases. The non-core has been helped lately by two factors: (1) A decline in LP gas prices; and (2) a drop in agricultural prices. Gasoline has been more stable, with the subsidy mechanism acting as a shock absorber both to the upside and downside (see chart below, left). We believe risks persist as winter approaches, although global energy markets have been relatively positive in the last few weeks. At the core, processed foods remain the most worrisome, accumulating a YTD expansion of 13.0%. Nonetheless, its pace of growth has slowed down in the last three fortnights. On the contrary, recent announcements –such as additional price hikes by Coca-Cola-FEMSA at the beginning of December– and the minimum wage hike for 2023, still signal potential challenges ahead. In services, housing has moderated significantly, helping the overall figure due to its large weight. Nevertheless, 'other services', especially non-tourism categories, remain under heavy pressure from input costs (chart below, right). Related to this performance, Deputy Governor Heath expressed on *Twitter* that given seasonal distortions, "*…its not clear that the deceleration in core inflation is the start of a new downward trajectory or not…*". In particular, this relates to the effect of the discounts from *El Buen Fin* (Mexico's Black Friday) on the annual rate, given that it took place in different fortnights this year vs. 2021. Given high uncertainty about the outlook, we think the central bank's safest bet is to keep tightening until signals turn more positive.

Non-core inflation: LP gas, low-grade gasoline, and agricultural items
Index 100 = 2H-December 2021, fortnight frequency



Source: INEGI

Core inflation: Processed foods, housing, and 'other services'
Index 100 = 2H-December 2021, fortnight frequency



Source: INEGI

Another point of concern is expectations. While the year-end forecast dropped to 8.4% from 8.5% previously in the latest Banxico survey, 2023 has been stable at 5.1%. More importantly in our view, medium-term expectations remain higher than their pre-pandemic trend (at 4.0% vs. ~3.5%), which in our view supports the need for additional tightening to anchor them more forcefully. Relatedly, forecasts for the headline could be broadly unchanged.

In particular, inflation so far in 4Q22 has averaged 8.1% vs the 8.3% forecast, albeit with a likely pickup by year-end on a less favorable base effect. For the core, an additional upward revision is possible, with the quarter-to-date performance at 8.5% vs an 8.3% estimate.

Banxico: CPI forecasts
% y/y, quarterly average

	2Q22	3Q22	4Q22	1Q23	2Q23	3Q23	4Q23	1Q24	2Q24	3Q24
Headline	7.8*	8.5*	8.3	7.6	5.8	4.7	4.1	3.8	3.4	3.1
Core	7.3*	8.0*	8.3	7.5	6.4	5.2	4.1	3.6	3.2	3.0

Source: Banco de México. *Observed data

On financial markets, we note the performance of the MXN. The currency has averaged around 19.44 per dollar since the last decision, even reaching a new post-pandemic low of 19.15. Nevertheless, it has depreciated in recent sessions, driven by global risk aversion, lower liquidity, and a relatively expensive valuation. Despite of this, it still contrasts with other EM currencies, which have shown more pressures and higher volatility. On rates, the inversion of the yield curve has sharpened on a strong rally in longer-dated securities, following UST curve. In our view, this would allow for a more modest rate hike at the margin. Apart from being in tandem with the Fed, this should keep fostering an orderly behavior of local assets.

All in all, we believe the decision –and the tone of the statement– will maintain the trend towards a less hawkish tilt, likely suggesting that additional hikes could be even smaller than this one. In turn, this could be consistent with some members' signals about the adequate level of the terminal rate. With this in mind, we reiterate our call of two additional 25bps increases each in February and March, taking the reference rate to its estimated terminal level for this cycle by the end of 1Q23 of 11.00%. Afterwards, an easing cycle could begin in late 3Q23, anticipating a level of 10.25% by year-end.

Banxico's survey of expectations. Focus will be on inflation, growth, the reference rate, and exchange rate. On prices, the year-end 2022 median stands at 8.4%, in line with our call. The forecast for 2023 is at 5.1% (Banorte: 5.4%). Meanwhile, we do not see substantial moves in medium and long-term expectations, remaining above target. GDP for 2022 sits at 2.8% (Banorte: 2.7%), while for 2023 it stands at 1.0%, matching our view. Analysts expect the reference rate by the end of the year at 10.50%, with a cut in 2023 to 10.25% –both in line with our expectations. Finally, the exchange rate is forecasted at USD/MXN 19.99 by YE22 (Banorte: 20.70), anticipating a depreciation by the end of 2023 to USD/MXN 20.85 (Banorte: 22.00).

Analyst Certification

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, and Daniel Sebastián Sosa Aguilar 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.
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