Ahead of the Curve

Inflation would end 2022 at 7.85% y/y, noting a moderation in recent months

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- **Inflation (December).** We anticipate headline inflation at 0.42% m/m, lower than its five-year average of 0.52%. The figure would be largely influenced by the first half print –highlighting a rebound in 'other goods' after declining because of *El Buen Fin* discounts, as well as lower energy prices. Nevertheless, overall dynamics in the second fortnight would be positive. We anticipate core inflation somewhat high at 0.68% (contribution: +51bps), with the non-core at -0.38% (-10bps). If our estimate materializes, headline inflation would end the year at 7.85% y/y on average from 7.80% in November, highlighting a more challenging base effect. The core would moderate after two years of persistent increases, down to 8.39% from 8.51%. Lastly, the non-core would increase to 6.29% from 5.73%

- **Industrial production (November).** We expect 2.4% y/y, lower than the 3.1% of the previous month, noting a less favorable base effect. Using seasonally adjusted figures, we anticipate +2.2% y/y, below the 3.0% within INEGI's *Timely Indicator of Economic Activity*. This implies -0.4% m/m, which would not be as negative considering an expansion of the same magnitude in October. On the other hand, it would be relatively in line with our view of a deceleration in 4Q22. We expect declines in three of the four sectors, with manufacturing leading lower at -0.9% m/m

Mexico weekly calendar

DATE	TIME (ET)	EVENT	PERIOD	UNIT	BANORTE	CONSENSUS	PREVIOUS
Mon 9-Jan	7:00am	CPI inflation	December	% m/m	0.42	0.39	0.58
				% y/y	7.85	7.84	7.80
		Core		% m/m	0.68	0.65	0.45
				% y/y	8.39	8.35	8.51
Tue 10-Jan	7:00am	Gross fixed investment	October	% y/y	5.7	3.5	3.3
		sa		%m/m	1.1	--	-0.9
		Machinery and equipment		% y/y	13.7	--	14.4
		Construction		% y/y	-0.9	--	-5.3
Tue 10-Jan	7:00am	Private consumption	October	% y/y	5.6	--	6.1
		sa		%m/m	0.3	--	0.4
		Domestic (Goods and services)		% y/y	4.2	--	4.3
		Imported (Goods)		% y/y	14.2	--	18.3
Tue 10-Jan	10:00am	International reserves	Jan-6	US$ bn	--	--	199.1
Tue 10-Jan		Wage negotiations	December	%	--	--	8.2
Wed 11-Jan	7:00am	Industrial production	November	% y/y	2.3	2.8	3.1
		sa		% m/m	-0.4	--	0.4
		Mining		% y/y	-1.1	--	0.4
		Utilities		% y/y	5.0	--	4.5
		Construction		% y/y	0.2	--	-1.1
		Manufacturing		% y/y	3.9	--	5.3

Source: Banorte: Bloomberg

Proceeding in chronological order…

Headline inflation to rebound modestly on a more challenging base. We anticipate headline inflation in December at 0.42% m/m, lower than its five-year average of 0.52%. The figure would be largely influenced by the first half print –highlighting a rebound in 'other goods' after declining because of *El Buen Fin* discounts, as well as lower energy prices. Nevertheless, overall dynamics in the second fortnight would be positive. We anticipate core inflation somewhat high at 0.68% (contribution: +51bps), with the non-core at -0.38% (-10bps). If our estimate materializes, headline inflation would end the year at 7.85% y/y on average from 7.80% in November, highlighting a more challenging base effect. The core would moderate after two years of persistent increases, down to 8.39% from 8.51%. Lastly, the non-core would increase to 6.29% from 5.73%.

Goods would climb 0.8% in the month (+31bps), with most of the adjustment in processed foods (0.9%; +20bps). On top of price increases in sodas in the first fortnight, we now expect some pressures in bread and other flour-based products, with Bimbo announcing an increase across its portfolio of products. Other goods (0.6%; +11bps) would moderate in the second half after rebounding following the discounts. Turning to services, we expect them at 0.6% (+20bps). Within 'other services' (1.0%; +16bps), the increase would be explained by tourism-related categories, considering a substantial increase in the 1st half despite signs of a moderation in the second fortnight. In addition, non-tourism could keep adjusting prices upwards given accumulated cost pressures. Lastly, housing would gain some momentum at 0.3% (+4bps).

Once again, the non-core would be the main driver of a relatively benign result for the headline. Specifically, on the back of lower energy prices (-1.5%; -15bps). Among them, we highlight LP gas, down 4.6% (-8bps) due to both lower international references, as well as a strong MXN most of the period. Gasolines would also fall, with low-grade gasoline at -1.0% (-5bps) despite a pickup in US retail prices in the latter part of the month. Agricultural goods would print at 0.4% (+5bps). Fruits and vegetables would hold most of the blame (0.6%; +3bps), albeit somewhat limited by a moderation in some key goods –such as tomatoes, onions and, to a lesser extent, potatoes– during the second fortnight. Meat and egg would also climb (0.2%; +2bps), with negative news for chicken related to new bird-flu outbreaks. Finally, government tariffs would remain somewhat low at 0.2% (+1bps), awaiting more substantial increases at the beginning of 2023.

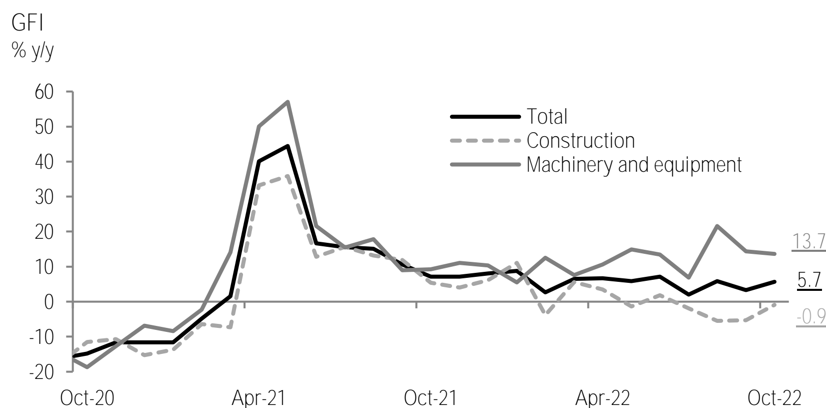
A mild investment rebound in October. We expect GFI at 5.7% y/y (previous: 3.3%), in the tenth month of the year. This translates into +1.1% m/m after the 0.9% contraction of the previous month. Economic activity was somewhat resilient –as portrayed by null expansion (0.0% m/m) in the GDP-proxy IGAE–, which could have provided some support. Despite some positive developments related to nearshoring, higher uncertainty and rising rates could have dampened some of the optimism. In this backdrop, both subsectors would improve, as described below.

Construction would lead at +1.7% m/m (-0.9% y/y). Results within the IP report were favorable, mainly edification (+1.3%), and to a lesser extent, civil engineering (+0.1%). However, most of the boost could come from 'services related to mining' –remembering that infrastructure works such as oil rigs and pipelines are accounted here–, as these grew 14.6% after three months of declines. As such, the split could be somewhat even between the residential and non-residential sectors within GFI. Also important, spending in physical investment by the Federal Government rose 66% y/y in real terms, albeit with negative effects from higher prices (as the figures are deflated with CPI, not PPI) and accounting methods.

Machinery and equipment would come in at 1.0% m/m (13.7% y/y). The expansion would be driven by the domestic component at +2.6%. As such, the increase would be explained largely by a favorable base effect, with signals for the sector still mixed. Specifically, manufacturing output rose just 0.1%, with transportation (-0.3%) and electronic equipment (-1.9%) lower, despite growth in machinery and equipment (+2.1%). The imported component would be tamer at +0.1%, noting a more challenging base (+0.5%). Signals from the trade balance were positive, with a 0.6% increase in capital goods imports. However, the slight appreciation of the MXN could have offset for this.

We believe investment remains in a complex spot, with challenges stemming from an adverse backdrop weighing on other favorable drivers. As such, GFI could likely maintain a flattish performance in coming months, waiting for a more positive outlook for companies to deploy CAPEX more forcefully.

GFI
% y/y



Source: INEGI, Banorte

Consumption to extend higher in October. We expect 5.5% y/y, lower than the 6.1% from the previous month on a more challenging base. More importantly, it +0.3% m/m, quite strong considering the 1.2% accumulated increase in the last three months. Most of the push could have come from stronger fundamentals, with total activity relatively stable, but better retail sales (+0.7% m/m).

By sectors, we anticipate an additional uptick in the domestic sector –which includes goods and services–, up 0.2% m/m (4.2% y/y), likely benefiting from a moderation in non-core prices, especially LP gas. Stronger fundamentals in terms of both employment and remittances should have provided an additional push.

On the contrary, we expect a 0.6% contraction in the imported category – including only goods–, with part of the decline driven by a challenging base effect (+1.4%). The main signal for the sector comes from the trade balance, with a 2.5% m/m decline in non-oil consumption goods imports, in our view hindered by lower prices.

Going forward, more data from *El Buen Fin* suggests that results were somewhat mixed, with some sales coming-in below expectations. However, we expect some of this to be offset by the spillover related to the 2022 FIFA World Cup. The latter seems to be partially supported by IMEF's non-manufacturing indicator, which improved to 53.6pts.

Weekly international reserves report. Last week, net international reserves fell by US$89 million, closing 2022 at US$199.1 billion (please refer to the following table). This was due to: (1) A US$38 million purchase of foreign currency from the Federal Government to Banxico; and (2) a negative valuation effect in institutional assets. This implies that reserves fell by US$3,305 million during 2022.

Banxico's foreign reserve accumulation details
US$, million

	2021	Dec 30, 2022	Dec 30, 2022	Year-to-date
	Balance		Flows	
International reserves (B)-(C)	202,399	199,094	-89	-3,305
(B) Gross international reserve	207,745	201,143	-1,434	-6,601
Pemex	--	--	0	350
Federal government	--	--	-1,319	-1,956
Market operations	--	--	0	0
Other	--	--	-116	-4,996
(C) Short-term government's liabilities	5,346	2,049	-1,346	-3,297

Source: Banco de México

Industry to decline modestly in November, with some payback across categories. We expect IP at 2.4% y/y, lower than the 3.1% of the previous month, noting a less favorable base effect. Using seasonally adjusted figures, we anticipate +2.2% y/y, lower than the 3.0% within INEGI's *Timely Indicator of Economic Activity*. This implies -0.4% m/m, which would not be as negative after an expansion of the same magnitude in October. Nevertheless, it would be relatively in line with our view of a deceleration in 4Q22.

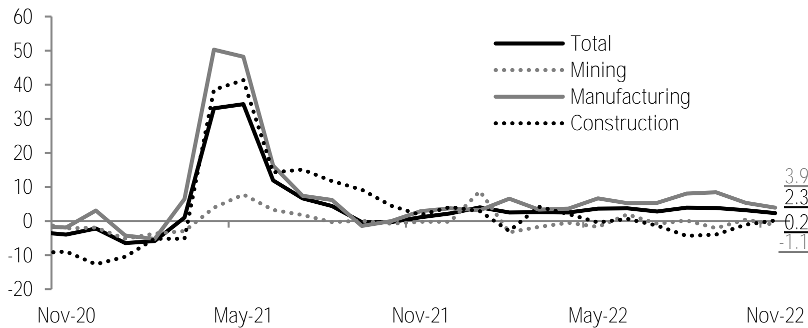
We expect a contraction in three of the four sectors, with manufacturing leading at -0.9% m/m (3.9% y/y). Timely data remains mixed. IMEF's manufacturing indicator improved to 51.1pts (+0.9pts), albeit noting declines in 'production' and 'deliveries'. Domestic exports were weaker again at -0.9% m/m, with declines both in autos (-1.5%) and 'others' (-0.6%). While prices (both of goods and freight) continue backtracking, the result from manufacturing output in the US –at -0.6% m/m– also suggests lower volumes. In autos, local production rebounded 2.5% sequentially according to AMIA, albeit only after a 6.0% drop in October. Lastly, employment according to INEGI improved by 187.6 thousand positions, partly boosted by favorable seasonality.

Mining would backtrack 0.9% m/m (-1.1% y/y). Most of the decline would come from 'services related to the sector', with a relevant payback after the 14.6% expansion seen in October. This would be consistent with wild swings since early in the year.

Meanwhile, we expect more stability in oil, with CNH reporting a slight moderation in output (at 1,607kbpd from 1,621kbpd) but with gas extraction higher. Meanwhile, prices of other minerals halted their decline, which has already been reflected in the trade balance –with non-oil mining exports at +1.1%– and could likely push the sector.

Lastly, construction would come in at -0.2% m/m (0.2% y/y). This would mark the end of a two-month streak higher, with an accumulated expansion of 1.2%. We believe the sector could be benefiting from: (1) A moderation in input costs, as seen in PPI –with monthly declines in September; and (2) continuing nearshoring efforts. The aggregate trend indicator was higher again, but business confidence inched lower. On a more positive note, employment recovered by 65.3 thousand jobs, albeit not enough to offset for the losses of the previous month. Therefore, most of the result correspond to a more challenging base effect.

Going forward, the sector could remain under pressure, with some challenges prevailing for supply chains –with the positive spillover from a China reopening possibly neutralized in the short-term by higher contagions. Timely data is mixed, as reflected by IMEF's manufacturing indicator to 51.8pts (+0.6pts), but with a decline for the same indicator from *S&P Global* for the US to 46.2pts (-1.5pts). In addition, risks remain as uncertainty about economic activity going forward extends further.



Source: INEGI, Banorte

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