

Mexico Economics – View from the Top

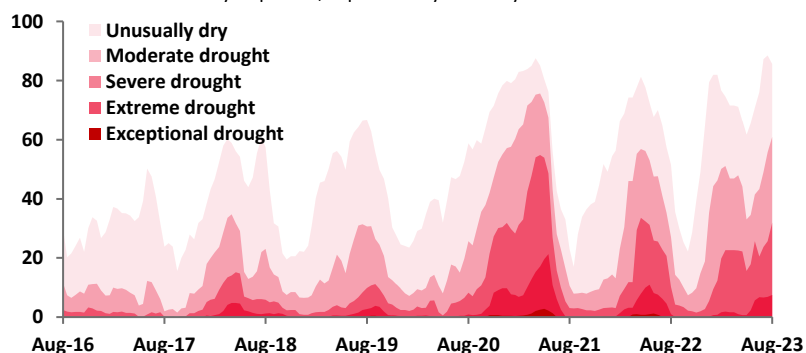
- We expect Banxico to leave the reference rate unchanged at 11.25%, with more key information until the release of the corresponding minutes
- Other releases include August's trade balance, unemployment rate, banking credit, and public finances. We believe they will keep indicating a good performance of the economy into 3Q23

Banxico will maintain its reference rate unchanged at 11.25%. We expect the central bank to extend the pause of the last three meetings. In our view, this would be wise despite an outlook that is becoming more complex for the fulfillment of the mandate. We see challenges on at least three fronts: (1) Higher risks to inflation, especially for the non-core; (2) domestic economic strength that could be inducing demand-side pressures for prices; and (3) uncertainty about the monetary divergence between emerging and advanced economies in coming months. Given the restrictive stance already attained, being patient in assessing the evolution of economic figures and events is prudent. We believe they will keep [the phrase about the 'extended period'](#) and a relatively hawkish tone.

Inflationary conditions are looking more challenging. [Results for the first half of September](#) revealed that Banxico's inflation estimates for 3Q23 have been fairly accurate relative to their latest update, made back in August. However, the outlook has become more challenging, so we expect upward revisions to their forecasts for the following quarters. Among the factors behind this, we identify: (1) A deficit in the global energy market, with [actions from OPEC+](#), supply shocks in various regions (e.g. refinery strikes in Australia, oil rig issues in Norway, refinery maintenance in the US, etc.), as well as optimism about demand, resulting in higher reference prices; (2) more adverse weather, with droughts nationwide close to their worst levels since 2021 (see graph below), and with the potential of additional impacts as *El Niño* phenomenon will continue evolving through the fall and winter; (3) uncertainty about commodity prices, with doubts about the effectiveness of stimulus measures in China, although with at least more positive signs that it may be working according to August's data; (4) persistence to the upside in services within the core, with potential demand pressures (detailed in the next section); and (5) adverse base effects that will boost annual metrics –both for the headline and core. With all this in mind, we think that estimates for headline inflation over the next two to four quarters could rise by around 10 to 20bps, while those for the core could increase by 20 to 30bps over the same horizon.

Droughts in Mexico

% of the national territory impacted, separated by intensity



Source: National Water Commission



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Winners of the 2023 award for best Mexico economic forecasters, granted by *Focus Economics*

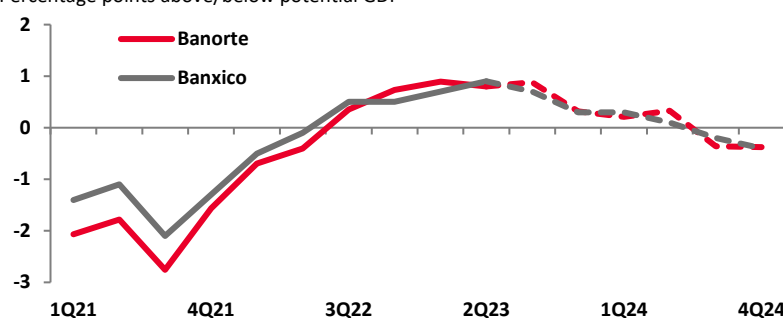


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A stronger economy implies higher risks of demand-side price pressures. One of the most revealing points in Banxico's latest [Quarterly Report](#) was the updated estimates of the output gap, placing it in positive territory. By itself, this condition does not imply higher inflation, but greater upside risks if it is not accompanied by gains in productivity and aggregate supply. In this regard, Deputy Governor Jonathan Heath has emphasized this situation in his comments on the X social network. Add to this a labor market with few signs of slack –hopefully still reflected in August figures, to be released on Thursday– and the high likelihood of double-digit minimum wage growth in 2024, and the backdrop for prices is still very complex. In addition, it is very feasible that domestic strength will extend into next year, considering: (1) [Higher government spending](#) –with Deputy Finance Minister, Gabriel Yorio, elaborating on some details in our *Norte Económico* podcast; (2) a 'soft landing' in the US, helping revenues from remittances, manufacturing and tourism, among others; and (3) investments related to nearshoring, with a delayed impact on supply, but more immediate on households' revenues.

Output gap

Percentage points above/below potential GDP



Source: Banorte with data from Banxico and INEGI

Uncertainty about global monetary divergence. Following the Fed's decision this week –where they left the Fed funds rate unchanged–, we maintain our call of an additional 25bps hike in November. Most relevant was the signal that the rate could remain 'higher for longer' (Banorte: first cut in May 2024). Although this reduces the room to maneuver locally, cuts in other countries, such as Brazil and Chile, may continue to favor inflows to our country. Thus, we believe that the MXN will remain relatively strong against the dollar, which is important for inflation due to its influence on imported goods' prices –expecting August's trade balance on Wednesday. This, despite an initial adjustment of the exchange rate after the [FX Commission's decision](#) to gradually reduce its hedging program.

Given this scenario, Banxico will remain cautious. We reiterate that the first interest rate cut will take place in February 2024, to which consensus has aligned. Nevertheless, the risks of an even longer delay than what we have penciled in have been on the rise.

Calendar of economic events

Date	Time (ET)	Event or indicator	Period	Unit	Banorte	Consensus	Previous
Tue 26-Sep	11:00am	International reserves	Sep-22	US\$ bn	--	--	204.2
Tue 26-Sep	11:00am	Weekly govt. auction: 1-, 3-, 6-, and 24-month Cetes; 5-year Mbono (Mar'29) ; 10-year Udibono (Nov'31) 1-, 3-, and 7-year Bondes F					
Wed 27-Sep	8:00am	Trade balance	August	US\$ mn	-1,704.6	-1,007.5	-881.2
		Exports		% y/y	1.2	--	2.9
		Imports		% y/y	-6.0	--	-7.7
Thu 28-Sep	8:00am	Unemployment rate	August	%	3.17	--	3.13
		Unemployment rate*		%	2.87	--	2.88
Thu 28-Sep	3:00pm	Banxico's monetary policy decision	Sep-28	%	11.25	11.25	11.25
Fri 29-Sep	11:00am	Commercial banking credit	August	% y/y in real terms	5.6	--	5.7
		Consumption		% y/y in real terms	12.5	--	12.6
		Mortgages		% y/y in real terms	5.7	--	5.7
		Corporates		% y/y in real terms	2.1	--	2.0
Fri 29-Sep		Budget balance (measured with PSBR)	August	MX\$ bn	--	--	-608.0

*Seasonally adjusted figures; Source: Banorte with figures from INEGI, Banxico, and Bloomberg

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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 Thalia Orozco Vélez, Hugo Armando Gómez Solís, Yazmín Selene Pérez Enríquez, Cintia Gisela Nava Roa, Miguel Alejandro Calvo Domínguez, José De Jesús Ramírez Martínez, Gerardo Daniel Valle Trujillo, Luis Leopoldo López Salinas, Isaías Rodríguez Sobrino, Juan Carlos Mercado Garduño, Daniel Sebastián Sosa Aguilar, Jazmin Daniela Cuautencos Mora and Andrea Muñoz Sánchez, 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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