

Ahead of the Curve

February 5, 2016

Market focus this week will on January's monthly inflation report

- January's monthly inflation report.** On Tuesday, at 9:00am, *INEGI* will release its monthly inflation report. We are forecasting a 0.34% m/m increase in January above market consensus that is forecasting a 0.26% according to *Bloomberg*. In the core index, we expect an increase of 0.21% m/m, in line with market consensus. Inflation during the period in question will be explained by pressures on agricultural prices along with higher merchandise prices. Our price monitoring suggests mixed results on the fruit and vegetable sub-index, with strong reduction in the price of tomatoes, offset by significant increases in other important items, such as onions and zucchinis
- Industrial production (December).** On Thursday, at 9:00am (EST), *INEGI* will release its monthly industrial production report. We anticipate a 0.3% yoy contraction in total output during the last month of 2015. Taking a look at the breakdown, we believe that construction output could have fallen 0.8% yoy. In this regard, construction output has deteriorated as a result of the lower public construction projects. Moreover, we believe that manufacturing production could post a scant 0.6% yoy expansion, explained by a 6.1% yoy contraction in manufacturing exports, a 6.9% yoy expansion in December's vehicle production, and a 0.7% yoy increase in U.S. manufacturing output, which has a strong correlation with Mexico's manufacturing sector. Finally, we believe that the 0.3% yoy decline in industrial output during December will also explained by the poor performance of mining activity. In this regard, we expect a 2.9% yoy contraction derived from lower oil production and the reduction in the extraction of other minerals

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Mexico weekly calendar

DATE	HOUR (EST)	EVENT	PERIOD	UNIT	BANORTE-IXE	CONSENSUS	PREVIOUS	
Tue 9-Feb	9:00am	CPI inflation	January	% m/m	<u>0.34</u>	<u>0.26</u>	0.41	
				% yoy	<u>2.57</u>	<u>2.52</u>	2.13	
				Core	% m/m	<u>0.21</u>	<u>0.21</u>	0.31
				% yoy	<u>2.66</u>	--	2.41	
Tue 9-Feb	10:00am	International reserves	5-Feb	US\$ bn	--	--	175.4	
Tue 9-Feb	12:30pm	Government weekly auction: 1-, 3-, 6-month CETES; 3y Mbono (Dec' 19); 3y Udibonos (Jun'19)						
Wed 10-Feb		Wage negotiations	January	%	<u>3.9</u>	--	4.5	
Thu 11-Feb	9:00am	Industrial production (sa)	December	% yoy	<u>-0.3</u>	<u>0.0</u>	0.1	
				% m/m	<u>-0.4</u>	<u>-0.3</u>	-0.5	
				Mining	% yoy	<u>-2.9</u>	--	-4.3
				Utilities	% yoy	<u>3.9</u>	--	4.9
				Construction	% yoy	<u>-0.8</u>	--	-1.2
				Manufactures	% yoy	<u>0.6</u>	<u>1.0</u>	1.8

Source: Banorte-IXE; Bloomberg

Proceeding in chronological order...

Inflation in January will be explained by pressures on agricultural prices along with higher merchandise prices. On Tuesday, at 9:00am, *INEGI* will release its monthly inflation report. We are forecasting a 0.34% m/m increase in January above market consensus that is forecasting a 0.26% according to *Bloomberg*. In the core index, we expect a 0.21% m/m increase, in line with market consensus.

Inflation during the period in question will be explained by pressures on agricultural prices along with higher merchandise prices. Our price monitoring suggests mixed results on the fruit and vegetable sub-index, with strong reduction in the price of tomatoes, offset by significant increases in other important items, such as onions and zucchinis.

Nevertheless, we expect this figure to be 43.2bps higher than the observed in same period last year, derived from: (1) 29.1bps stemming from a higher contribution of agriculture (21.8bps vs. -7.3 in 2015); (2) 16.3bps stemming from a higher contribution of services prices (6.5bps vs. -9.7 in 2015). By contrast, we expect (3) -7.2bps from a lower contribution energy prices (-10.3bps vs. -3 in 2015) along with (4) 1.8bps stemming from a higher contribution of government tariffs (5.5bps vs. 3.6 in 2015), as shown in the table below.

With these results, annual inflation would be at 2.57% yoy in January from previous 2.13%, while core inflation would be at 2.66% from 2.41% yoy.

Inflation by components in January
% monthly incidence

	Banorte-Ixe	2015	Difference
Headline	0.34	-0.09	0.43
Core	0.16	-0.02	0.18
Goods	0.10	0.07	0.02
Processed foods	0.07	0.07	0.00
Other goods	0.03	0.00	0.02
Services	0.07	-0.10	0.16
Housing	0.04	0.04	0.01
Education	0.02	0.02	0.00
Other services	0.00	-0.16	0.16
Non-core	0.18	-0.07	0.25
Agricultural	0.22	-0.07	0.29
Fresh fruits and vegetables	0.18	-0.18	0.36
Meat and egg	0.04	0.11	-0.07
Energy and government regulated	-0.04	0.01	-0.05
Energy	-0.10	-0.03	-0.07
Government regulated	0.05	0.04	0.02

Source: Banorte-Ixe with data from INEGI and Banco de México

Note: Contributions might not add due to the number of decimals allowed in the table. Previous to year 2011, contributions might not add because of the change in CPI-calculation methodology

Weekly international reserves report. On Tuesday, at 10:00am (EST), Banco de Mexico will release its weekly balance report. Last week, net international reserves increased by US\$672mn amounting to US \$175.4bn on January 29. According to Banxico’s report, this figure comes mainly as a result of: (1) Dollar sales by the Federal Government to the Central Bank for US\$598mn; (2) US\$200mn decrease explained by the Banxico’s USD ordinary auction with minimum price; along with a (3) US\$274mn increase due to changes in the valuation of the Central Bank’s assets. It is worth noting that Pemex is currently the only significant source of reserve accumulation. In this context, the central bank has an accumulated reduction of US\$1,348mn international reserves this year (please refer to the table below).

Banxico's foreign reserve accumulation details
US\$, million

	2015	29/Jan/2016	29/Jan/2016	Year-to-date
	Balance		Flows	
International reserves (B)-(C)	176,723	175,387	672	-1,348
(B) Gross international reserve	177,584	176,321	-1,225	-1,275
Pemex	--	--	-73	-116
Federal govt	--	--	-1,566	239
Market operations	--	--	-200	-2,006
Other	--	--	614	608
(C) Short-term government's liabilities	861	934	-1,897	73

Source: Banco de México

Weekly government bond auction. On Tuesday, the Ministry of Finance (MoF) –via Banco de Mexico as its financial agent-, will offer 3-year fixed-rate Mbonos (Dec’19) as well as 3-year inflation-linked Udibonos (Jun’19), in addition to the “more traditional” 1-, 3-, and 6- month zero-coupon Cetes (please refer to the table below). As usual, the results will be released at 12:30pm (EST).

Auction specifics (Tuesday, February 9, 2016)

	Maturity	Coupon rate, %	To be auctioned ¹	Previous yield ²
Cetes				
1m	10-Mar-16	--	5,500	3.16
3m	12-May-16	--	9,500	3.36
6m	04-Aug-16	--	11,000	3.45
Mbono				
3y	11-Dec-19	5.00	9,000	5.11
Udibono				
3y	13-Jun-19	4.00	800	2.59

Source: Banorte-Ixe with data from Banco de México

1. Except for Udibonos, which are expressed in UDI million, everything else is expressed in MXN million. 2. Yield-to-maturity reported for Cetes, Mbonos and Udibonos

January's wage negotiations. On Wednesday, the Ministry of Labor (*STPS*) will make its contractual wage negotiations monthly data available. We anticipate workers to have negotiated an annual average wage increase of 3.9% in the first month of 2016. This would be below with the 4.1% observed in 2015. In this regard, we believe that January's figure was mainly driven by the increase in wage negotiations in the educational sector, specifically wage increases in universities unions, such as *UNAM (Aapaunam)* with an increase of 3.15% to its workers; *Autonomous University of Aguascalientes (STUAA)* with 4.2%; the *Autonomous University of Chiapas (Staanach)* with 3.15%, and the *University of Veracruz (Setsuv)* with 3.5% increase. Along with wage increases in the radio and television sector, such as the 4.4% wage increase negotiated by the *Union of Workers in the Radio and Television (Stirt)*, benefiting more than 20,000 workers. Finally, we highlight the salary reviews in the *Mexico's Confederation Workers (CTM)*, and in some unions workers in the government's entities.

We expect 0.3% yoy contraction in December's industrial output. On Thursday, at 9:00am (EST), *INEGI* will release its monthly industrial production report. We anticipate a 0.3% yoy contraction in total output during the last month of 2015. Taking a look at the breakdown, we believe that construction output could have fallen 0.8% yoy. In this regard, construction output has deteriorated as a result of the lower public construction projects.

Moreover, we believe that manufacturing production could post a scant 0.6% yoy expansion, explained by a 6.1% yoy contraction in manufacturing exports, a 6.9% yoy expansion in December's vehicle production, and a 0.7% yoy increase in U.S. manufacturing output, which has a strong correlation with Mexico's manufacturing sector. Despite the significant deceleration in manufacturing output, ahead, we believe that the Mexican manufacturing sector of final goods will show better growth prospects, derived from: (1) The strong depreciation of the Mexican currency which will eventually translate into a fast recovery of Mexican exports; and (2) the recovery of private consumption in Mexico, which will translate into a higher domestic demand for manufacturing products.

Finally, we believe that the 0.3% yoy decline in industrial output during December will mainly explained by the poor performance of mining activity. In this regard, we expect a 2.9% yoy contraction derived from lower oil production and the reduction in the extraction of other minerals.

Industrial production estimates

% yoy	Dec-15	Dec-14	Jan-Dec, '15	Jan-Dec, '14
Total	-0.3	3.5	0.9	2.6
Mining	-2.9	-6.1	-5.7	-1.5
Utilities	3.9	7.8	4.0	8.2
Construction	-0.8	6.7	2.6	2.0
Manufacturing	0.6	6.2	2.6	3.9
%m/m sa	Dec-15	Nov-15	Difference	
Total	-0.4	-0.5	0.1	
Mining	0.4	-0.5	0.9	
Utilities	0.5	-0.1	0.5	
Construction	0.5	-1.4	1.9	
Manufacturing	-1.2	-0.4	-0.8	

Source: Banorte-Ixe; INEGI

Disclaimer

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