Ahead of the Curve

September 1, 2017

Market focus this week will be on Mexico's 2018 *Economic Package* and August's inflation report

- **Mexico's Economic Package will be presented on September 8th.** According to the Fiscal Responsibility and Budget Law, the Federal Government will submit to Congress, the so-called *Economic Package*, which includes the *Revenue Law*, the *Spending Budget*, and the *General Economic Policy Guidelines*. The Lower-House has until October 20 to approve the *Revenue Law*, while the Senate has until October 31. In terms of the *Spending Budget*, it will be reviewed by the Lower-House, which has until November 15 to approve it. In this regard, we believe that the Federal Government will publish the first draft of the 2018 Economic Package on Friday

- **August inflation report.** On Thursday, at 9:00am, *INEGI* will release its monthly inflation report for August. We are forecasting a 0.54% m/m increase in the headline index, while we expect the core index to rise 0.30% m/m. Inflation during the period in question will be explained by increases in the prices of fresh fruits and vegetables. Moreover, we also anticipate some pressures in the prices other goods, as well as energy prices

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Mexico weekly calendar

DATE	HOUR (EDT)	EVENT	PERIOD	UNIT	BANORTE-IXE	CONSENSUS	PREVIOUS
Tue 5-Sep	**9:00am**	**Gross fixed investment**	June	% yoy	-1.0	--	2.3
		Machinary and equipment		% yoy	-1.9	--	9.1
		Domestic		% yoy	2.7	--	-1.4
		Imported		% yoy	-4.2	--	14.2
		Construction		% yoy	-0.4	--	-2.2
Tue 5-Sep	**9:00am**	**Consumer confidence**	Aug	index	86.3	--	88.7
Tue 5-Sep	**10:00am**	**International reserves**	1-Sep	US$ bn	--	--	173.0
Tue 5-Sep	**12:30pm**	**Government weekly auction: 1-, 3-, 6-month CETES; 5y Mbono (Jun'22); 10y Udibono (Nov'28)**					
Tue 5-Sep	**4:30pm**	**Banamex bi-weekly survey of economic expectations**					
Thu 7-Sep	**9:00am**	**CPI inflation**	August	% m/m	0.54	--	0.38
				% yoy	6.71	--	6.44
		Core		% m/m	0.30	--	0.27
				% yoy	5.05	--	4.94
Fri 8-Sep		**First draft of Mexico's Economic Package**					
Fri 8-Sep		**Wage negotiations**	August	%	5.1	--	5.8

Source: Banorte-IXE; Bloomberg

Proceeding in chronological order...

We expect a 1% yoy contraction in June's GFI. On Tuesday, at 9:00am (EDT), *INEGI* will publish its gross fixed investment (GFI) report. We anticipate GFI down by -1% yoy in June. We believe that within the report we will probably see 2.7% yoy expansion in domestic machinery and equipment. By contrast, we expect a 4.2% reduction in imported machinery and equipment, given that trade balance figures showed a similar result for capital goods imports. Finally, we believe that construction spending fell 0.4% yoy, as a result of the Federal Government's austerity program, which has resulted in a lower public expenditure on infrastructure projects.

GFI forecasts
% yoy; %-pts

%yoy	Jun-17	Jun-16	Jan-Jun, '17	Jan-Jun, '16
Total	-1.0	-1.2	-1.3	0.3
Machinery and equipment	-1.9	-2.8	2.4	0.0
Domestic	2.7	8.6	3.7	7.5
Imported	-4.2	-7.8	1.8	-3.3
Construction	-0.4	0.0	-3.7	0.5
Annual contribution	**Jun-17**	**Jun-16**	**Difference**	
Total	-1.0	-1.2	0.2	
Machinery and equipment	-0.8	-1.2	0.4	
Domestic	0.4	1.1	-0.7	
Imported	-1.1	-2.3	1.1	
Construction	-0.2	0.0	-0.3	

Source: Banorte-Ixe

Consumer confidence will lose ground in August. On Tuesday, at 9:00am (EDT), Banxico and *INEGI* will publish its August's monthly survey on consumer confidence, where we expect a 0.2% yoy contraction, with the index reaching 86.3 points. In seasonally adjusted terms, we expect confidence levels to decrease 0.8% m/m.

We believe that consumer confidence (measured in seasonally adjusted terms) will show a moderate contraction, given the upward trend in inflation. In particular, headline inflation reached 6.59% yoy during the first half of August, given the recent spike in agricultural goods prices. However, despite the 0.8% fall in the headline index, it is likely that the report will also show that Mexican consumers are discounting a better economic outlook given the recovery of external demand, which will be reflected in consumers' expectations regarding the households and the country's future economic conditions.

Weekly international reserves report. On Tuesday, at 10:00am (EDT), Banco de Mexico will release its weekly balance report. Last week, net international reserves decreased by US$30 million amounting to US$173 billion. According to Banxico's report, this figure comes mainly as a result of: (1) US$110 million dollar sales from Banxico to the Federal Government; and (2) a positive revalorization in central bank assets amounting to US$80 million. In this context, the Central Bank's international reserves have diminished by US$3.5 billion this year (please refer to the table below).

Banxico's foreign reserve accumulation detail
US$, million

	2016	Aug 25, 2017	Aug 25, 2017	Year-to-date
	Balance		Flows	
International reserves (B)-(C)	176,542	173,032	-30	-3,509
(B) Gross international reserve	178,025	174,448	-6	-3,577
Pemex	--	--	-102	-728
Federal government	--	--	-157	-3,846
Market operations	--	--	0	-2,000
Other	--	--	253	2,997
(C) Short-term government's liabilities	1,483	1,416	24	-68

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 5-year fixed-rate Mbonos (Jun'22), 10-year inflation-linked Udibonos, 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 (EDT).

Auction specifics (Tuesday, September 5, 2017)

	Maturity	Coupon rate, %	To be auctioned[1]	Previous yield[2]
Cetes				
1m	5-Oct-17	- -	7,000	6.91
3m	7-Dec-17	- -	11,000	7.11
6m	01-Mar-18	- -	11,500	7.17
M Bono				
5y	9-Jun-22	6.50	8,000	6.77
Udidonos				
10y	30-Nov-28	4.00	UDIS 600	3.19

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

Citibanamex **Survey: Market participants will focus on inflation and monetary policy forecasts.** Also on Tuesday around 3:30pm (EDT) *Citibanamex* will release its bi-weekly survey of economic expectations, where market participants will focus on analysts' monetary policy assessments, given the central bank's expectations that inflation will converge to its 4% target in 2018. In this regard, we believe that the monetary authority will maintain the reference rate at 7% throughout the year. Looking ahead, we believe that Banxico could start an easing cycle in the second half of 2018 (August) as inflation will start to converge towards the 3% target and most of the uncertainty will be significantly reduced by then. We believe that Banxico has room to reduce the reference rate between 150-200bps over the next two years, from which 100bps could take place in the second half of 2018

Furthermore, analysts will also focus on inflation forecasts for August (to be published on Thursday, September 7), as well as on CPI estimations for 2017. In addition, *Citibanamex* will also publish consensus' growth and FX forecasts for 2017. In the first case, we do not expect strong revisions to the median GDP forecast. In the second case, we expect moderate downward revisions to the FX estimates for 2017.

Inflation during August will be explained by increases in the prices of fresh fruits and vegetables, as well as energy. On Thursday, at 9:00am, *INEGI* will release its monthly inflation report for August. We are forecasting a 0.54% m/m increase in the headline index, while we expect the core index to rise 0.30% m/m.

Inflation during the period in question will be explained by increases in the prices of fresh fruits and vegetables. Moreover, we also anticipate some pressures in the prices other goods, as well as energy prices.

We forecast inflation to be 26bp higher than the observed in same period last year, derived from: (1) 13.2bp from a bigger contribution of fresh fruits and vegetables prices (17.1bp vs. 3.9bp in 2016); (2) 5.4bp derived from a higher contribution of processed foods (6.6bp vs. 1.2bp in 2016); (3) 4.6bp stemming from a higher contribution of meat and egg (4bp vs. -0.7bp in 2016); and (4) 3.1bp derived from a higher contribution of services (4bp vs. 0.9bp in 2016), as shown in the table below.

With these results, annual inflation will stand at 6.71% in August, (previous: 6.44% yoy), while core inflation will be at 5.05% (previous: 4.94% yoy). Moving forward, we will be attentive to the evolution of energy prices and the behavior agricultural prices.

August inflation by components
% monthly incidence

	2017 Forecast	2016	Difference
Headline	0.54	0.28	0.26
Core	0.23	0.14	0.08
Goods	0.19	0.14	0.05
Processed foods	0.07	0.01	0.05
Other goods	0.12	0.12	0.00
Services	0.04	0.01	0.03
Housing	0.03	0.03	0.01
Education	0.06	0.05	0.01
Other services	-0.06	-0.07	0.01
Non-core	0.31	0.14	0.18
Agricultural	0.21	0.03	0.18
Fresh fruits and vegetables	0.17	0.04	0.13
Meat and egg	0.04	-0.01	0.05
Energy and government regulated	0.10	0.10	-0.01
Energy	0.08	0.10	-0.02
Government regulated	0.02	0.00	0.02

Source: Banorte-Ixe, INEGI

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The Lower-House has until October 20 to approve the *Revenue Law*, while the Senate has until October 31. In terms of the *Spending Budget*, it will be reviewed by the Lower-House, which has until November 15 to approve it. In this regard, we believe that the Federal Government will publish the first draft of the *2018 Economic Package* on Friday.

Wage negotiations will climb 5.1% during August. Finally, on Friday, the Ministry of Labor (MoL) will publish the contractual wage negotiations for August. We expect workers to have negotiated an average increase of 5.1%, below the 5.8% increase seen in July, but still above the ten year average of 4.4%. We believe that negotiations will remain relatively high in this month, as well as for the rest of the year due to two factors: (1) The minimum wage increase that was announced last December; and (2) the elevated inflation observed throughout 2017.

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