

Ahead of the Curve

March 18, 2016

Market focus this week will on INEGI's bi-weekly inflation report

- **Bi-weekly inflation report.** On Tuesday, at 10:00am, *INEGI* will release its bi-weekly inflation report. We are forecasting a 0.04% 2w/2w increase in the first half of March, below market consensus of 0.19% according to *Banamex* survey. In the core index, we expect an increase of 0.1% 2w/2w, also below consensus (0.18%)

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Mexico weekly calendar

DATE	HOURL (EDT)	EVENT	PERIOD	UNIT	BANORTE-IXE	CONSENSUS	PREVIOUS
Mon 21-Mar		Banking holiday: Anniversary of the birth of Benito Juarez					
Tue 22-Mar	10:00am	CPI inflation	1H-Mar	% 2w/2w	<u>0.04</u>	<u>0.19</u>	-0.05
				% yoy	<u>2.66</u>	--	2.87
		Core		% 2w/2w	<u>0.10</u>	<u>0.18</u>	0.12
				% yoy	<u>2.65</u>	--	2.66
Wed 23-Mar	10:00am	Retail sales	January	% yoy	<u>2.9</u>	<u>4.0</u>	3.4
		sa		% m/m	<u>0.9</u>	--	-1.6
Wed 23-Mar	11:00am	International reserves	18-Mar	US\$ bn	--	--	176.1
Thu 24-Mar		Banking holiday: Good Thursday					
Fri 25-Mar		Banking holiday: Good Friday					
Mon 28-Mar	10:00am	Trade balance	February	US\$ mn	<u>320.5</u>	349.8	-3,441
		Total exports		% yoy	<u>-7.6</u>	--	-7.6
		Oil exports		% yoy	<u>-54.5</u>	--	-49.0
		Non-oil exports		% yoy	<u>-1.9</u>	--	-4.1
		Total imports		% yoy	<u>-4.7</u>	--	-6.2
Tue 29-Mar	10:00am	Global economic indicator	January	% yoy	<u>2.3</u>	2.4	2.6
		(sa)		% m/m	<u>0.1</u>	--	0.0
		Primary activities		% yoy	<u>0.1</u>	--	5.2
		Industrial production		% yoy	<u>1.1</u>	--	0.0
		Services		% yoy	<u>2.9</u>	--	3.8
Tue 29-Mar	11:00am	International reserves	23-Mar	US\$ bn	--	--	--
Tue 29-Mar	1:30pm	Government weekly auction: 1-, 3-, 6-, 12-month CETES; 10y Mbono (Mar'26); 30y Udibonos (Nov'46); 5y Bondes D					
Wed 30-Mar	10:00am	Unemployment rate	February	%	<u>4.17</u>	4.19	4.24
		sa		%	<u>4.32</u>	--	4.30
Wed 30-Mar	4:30pm	Budget balance	February	MXN bn	--	--	-48.2
Thu 31-Mar	11:00am	Comercial banking credit	February	% yoy	<u>12.8</u>	--	12.4
		Consumption		% yoy	<u>9.3</u>	--	8.9
		Housing		% yoy	<u>10.4</u>	--	10.1
		Non-banking private firms		% yoy	<u>16.1</u>	--	15.8
Fri 1-Apr	11:00am	Banxico's minutes	March				
Fri 1-Apr	11:00am	Family remittances	February	US\$ mn	<u>2,091.5</u>	--	1,932.2
Fri 1-Apr	11:00am	Banxico's survey of economic expectations	March				
Fri 1-Apr	2:00pm	PMI's survey (IMEF)	March				
		Manufacturing		index	<u>52.3</u>	--	51.3
		Non-manufacturing		index	<u>51.4</u>	--	50.4
Sun 3-Apr		Mexico's begins Daylight Saving Time (DST)					

Source: Banorte-IXE; Bloomberg

Proceeding in chronological order...

On the logistics side, financial markets will remain closed in Mexico on Monday, Thursday and Friday. Before we start with next week's description, we highlight that Mexico will experience a short week with a banking holiday on Monday -as the country observes the Anniversary of the birth of Benito Juarez, one of Mexico's most important national heroes-, and also on Thursday and Friday (March 24 – 25), given the Holy Week. On the other hand, on Sunday April 3, Mexico will begin its Daylight Saving Time (DST), which implies that Mexico City will once again have a one-hour difference with EDT.

Inflation in the first half of March will be explained by lower energy prices. On Wednesday, at 10:00am, *INEGI* will release its bi-weekly inflation report. We are forecasting a 0.04% 2w/2w increase in the first half of March, below market consensus of 0.19% according to *Banamex* survey. In the core index, we expect an increase of 0.1% 2w/2w, also below market consensus (0.18%).

Inflation in the first half of March will be explained by lower energy prices, particularly on electricity tariffs, while our price monitoring has detected declines in gasoline prices in some border cities. Nevertheless, these declines will be offset by seasonal pressures on services prices, particularly on tourism services on the eve of Easter holiday season.

Nevertheless, we expect this figure to be 14bps lower than the one observed in same period last year, derived from: (1) 4bps stemming from a higher contribution of services inflation (10.5bps vs. 6.5 in 2015); (2) 1.3bps stemming from a higher contribution of agricultural prices (0bps vs. -1.3 in 2015). By contrast, we expect (3) a lower contribution from energy prices (-3.5bps vs. 8.6 in 2015) along with (4) -7.5bps stemming from a lower contribution of merchandise prices (-3bps vs. 4.5 in 2015), as shown in the table below.

With these results, annual inflation will be at 2.66% yoy in the first half of March from 2.87%, while core inflation will remain around 2.65% yoy.

1H-March inflation by components

% bi-weekly incidence

	Banorte-Ixe	2015	Difference
Total	0.04	0.18	-0.14
Core	0.07	0.11	-0.04
Goods	-0.03	0.05	-0.08
Processed foods	-0.03	0.01	-0.03
Other goods	-0.01	0.04	-0.04
Services	0.10	0.06	0.04
Housing	0.01	0.01	0.00
Education	0.00	0.00	0.00
Other services	0.09	0.05	0.04
Non-core	-0.03	0.07	-0.11
Agricultural	0.00	-0.01	0.01
Fresh fruits and vegetables	0.02	0.01	0.01
Meat and egg	-0.02	-0.02	0.00
Energy and government regulated	-0.03	0.09	-0.12
Energy	-0.03	0.09	-0.12
Government regulated	0.00	0.00	0.00

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

Retail sales will post a 2.9% yoy expansion in January. On Wednesday (March 23) at 10:00am (EDT), *INEGI* will publish its retail sales report for January 2016. We anticipate a 2.9% yoy expansion explained by the 15.4% yoy growth in vehicle sales (*AMIA*), which will have a positive impact on the overall growth rate. Moreover, *ANTAD* total store sales increased 8.8% yoy in real terms during the period in question. However, consumption goods imports -which have a strong correlation with retail sales- posted a 5.2% yoy contraction.

Looking ahead, we believe that retail sales will continue to show a favorable performance in 1Q16, derived from: (1) An improvement in private banking credit; (2) the recent downward trend in inflation; and (3) the stronger growth dynamics in the Mexican labor market.

Weekly international reserves report. On Wednesday, at 11:00am (EDT), Banco de Mexico will release its weekly balance report. Last week, net international reserves decreased by US\$4mn amounting to US \$176.1bn on March 11. According to Banxico's report, this figure comes mainly as a result of: (1) Dollar sales by Banxico to the Federal Government for US\$31mn; along with a (2) US\$27mn 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\$642mn international reserves this year (please refer to the table below).

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

	2015	11/Mar/2016	11/Mar/2016	Year-to-date
	Balance		Flows	
International reserves (B)-(C)	176,735	176,094	-4	-642
(B) Gross international reserve	177,597	177,963	-290	367
Pemex	--	--	-398	1,506
Federal govt	--	--	113	2,970
Market operations	--	--	0	-5,562
Other	--	--	-6	1,452
(C) Short-term government's liabilities	861	1,869	-287	1,008

Source: Banxico

Oil exports will continue to fall in February. On Monday (March 28), at 11:00am (EDT), *INEGI* will make available its trade report for February, where we expect to see a US\$320.5 million surplus. On the exports side, we will probably see a 54.5% yoy contraction of oil exports given the significant fall in oil exports and prices during the period in question. Moreover, non-oil exports could have decreased 1.9% yoy, on the back of a 1.7% drop in manufacturing exports.

On the imports side, we estimate a 4.7% yoy contraction in total imports. Taking a look at the breakdown, we believe that imports consumption goods decreased 7.2% yoy, while imports of intermediate goods could have fallen 4.4% yoy. Finally, we estimate a 3.9% reduction in capital goods imports.

We expect a 2.3% yoy expansion in January's IGAE. On Tuesday March 29, at 10:00am (EDT), *INEGI* will release its monthly global economic indicator for January (GDP monthly proxy), where we expect a 2.3% yoy expansion. We believe that IGAE's growth during the first month of 2016 was driven by the performance of the service sector, which we forecast at 2.9% yoy. Similarly, we highlight that industrial production increased a scant 1.1% yoy.

As we had mentioned in our last IP report, the 1.1% yoy expansion in industrial production during January was explained in part by the 1% yoy growth in manufacturing output. However, despite the unfavorable performance within the manufacturing industry, we believe that the recovery of this sector is on the way, and will strengthen in the first half of 2016 given that the significant depreciation of the Mexican currency could trigger a higher growth in Mexico's manufacturing exports of final goods. In this regard, we believe that the recovery of both manufacturing and construction industries will strengthen in 1H16. However, IP's headline figure was also affected by the current recession in the mining industry derived from the significant contraction in Mexico's oil production.

We also believe that the 2.9% yoy estimated expansion in services will be explained by the recovery in private consumption. In particular, *ANTAD*'s retail sales report showed that consumers' spending is gaining momentum, whereas formal job creation has observed a significant recovery in the last 6 months.

Weekly government bond auction. On Tuesday (March 29), the Ministry of Finance (MoF) –via Banco de Mexico as its financial agent-, will offer 10-year fixed-rate Mbonos (Mar'26), 30-year inflation-linked Udibonos (Nov'46), as well as 5-year BondesD, in addition to the “more traditional” 1-, 3-, 6- and 12-month zero-coupon Cetes. The results will be released at 1:30pm (EDT).

Unemployment rate in February will stand at 4.17%. On Wednesday (March 30), *INEGI* will publish its employment report for the second month of 2016, in which we estimate an unemployment rate of 4.17% nsa, below the 4.24% observed in January. In seasonally-adjusted terms, we believe that the unemployment rate could stand at 4.32%, which implies a 0.06%-pts expansion.

It is likely that the job creation in February was affected by the fall in confidence among consumers and firms given the recent volatility in financial markets. However, looking ahead, we are still positive on the outlook regarding the recovery of the economic activity, which will have a significant positive impact on firms' expectations about domestic demand, resulting in a more dynamic labor market.

The MoF's monthly report. On Wednesday (March 30), the Ministry of Finance (MoF) will make its monthly finance report available. On the revenue side, we will be looking at non-oil tax collection as it provides additional information about domestic demand dynamics. Moreover, markets will focus on the spending side of the report, in order to assess the execution of the MXN\$132.3 bn fiscal cut (US\$ 7.6 billion) announced by the MoF on February 17. Finally, it will be important to evaluate the evolution of public sector debt, which currently represents about 46% of GDP.

Banking credit will show a 12.8% yoy increase in February. Banco de Mexico will make available its banking credit report on Thursday (March 31) at 11:00am (EDT). It is our take that banking credit continued flowing in February. In particular, we estimate a 12.8% yoy expansion in banking credit (in real terms), as a result of increases in the area of 9.3%, 10.4%, and 16.1% yoy in consumer, housing and business credit, respectively.

Banxico Minutes – Same message as in the last *communiqué*. On Friday (April 1) at 11:00am EDT, Banco de Mexico will publish the minutes of its monetary policy meeting held back on March 18, in which the board decided to leave the reference rate unchanged at 3.75%, as it was widely expected. In this regard, we believe that the decision was unanimous, and that the discussion during the meeting focused on three issues: (1) Even though Banxico acknowledges the favorable impact that their decision to hike rates –back in February 17th-, has had on domestic markets, they cannot rule out other episodes of increased volatility; (2) they consider that short-term inflation balance of risks has deteriorated, paying particular attention to FX pass-through; however, (3) even though they think that the balance of risks for growth remained unchanged, they perceive some signals of moderation, in particular in household spending.

Family remittances will post a 13.5% yoy expansion. On Friday (April 1), at 11:00am (EDT), Banxico will make its family remittances monthly data available. We expect Mexican workers living abroad -mainly in the US-, to have sent US\$2,091.5 mn to their families in Mexico during February. This would imply a 13.5% yoy expansion.

We believe that remittances in February will benefit from the significant depreciation of the Mexican currency during the first half of the month, given that the flow of remittances in the short-run is very sensitive to high fluctuations in Mexican peso. In particular, and as we have already mentioned throughout our publications, a sharp depreciation may encourage Mexican migrant workers to increase their remittances, given that the purchasing power of the amount remitted is greater in Mexico than in the U.S.

Banxico's survey of economic expectations. On Friday (April 1), at 11:00am (EDT), Banco de Mexico will publish its monthly survey of economic expectations. In our view, market participants' focus will be on three issues: (1) 2016 inflation expectations that currently are at 3.34% (Banorte-Ixe: 2.8%); (2) mid-term inflation expectations—quite important for the central bank's board—that are currently at 3.39% (Banorte-Ixe: 3%); and (3) the analysts' assessments of GDP growth for 2016 given the revisions made by several economists after the fiscal cut announced by the Federal Government (currently at 2.45%; Banorte-Ixe: 2.3%).

March's PMI surveys. Finally on Friday (April 1), *IMEF* (Mexican Institute of Financial Executives) will publish its PMI business confidence indicators for March. We expect manufacturing PMI at 52.3, above the 51.3 observed in February (seasonally adjusted terms). We believe that manufacturing activity was supported by the recovery of consumer spending in Mexico and the significant depreciation of the MXN.

Moreover, we believe that the non-manufacturing PMI will stand at 51.4 points from 50.4 points. In this regard, we believe that the recent upward trend in domestic demand, given the recovery in both the labor market and the household's purchasing power, could have triggered a faster growth within the services, which will be reflected in the non-manufacturing PMI.

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