

Ahead of the Curve

May 18, 2018

Market focus this week will be on GDP for 1Q18 and the inflation report for the first half of May

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- **Gross domestic product (1Q18 F).** On Wednesday, *INEGI* will publish GDP for the first quarter of 2018, where we expect it to show a 1.3% yoy expansion, marginally above the 1.2% seen in the preliminary estimation. We highlight that the lower GDP growth will be simply explained by a seasonal effect, since the Easter holiday period reduced the working days in the annual comparison. Controlling for this effect, the Mexican economy will grow around 2.5% yoy (1.2% q/q)
- **Bi-weekly inflation report (1H-May).** On Thursday, at 9:00am, *INEGI* will release its bi-weekly inflation report for the first half of May. We are forecasting a 0.39% 2w/2w fall in the headline index, while we expect the core index to advance 0.15% 2w/2w. Deflation during the period will be mainly explained by the start of the summer discounts in electricity tariffs in some areas in the country, as well as an additional fall in fresh fruits and vegetables prices. However, these will be partially offset by a higher contribution from goods. With these results, annual inflation will stand at 4.36% in the first half of May, lower than the 4.55% seen in April

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Mexico weekly calendar

DATE	TIME (ET)	EVENT	PERIOD	UNIT	BANORTE	CONSENSUS	PREVIOUS
Tue 22-May	9:00am	Retail sales	March	% yoy	<u>0.8</u>	--	1.2
		(sa)		% m/m	<u>0.5</u>	--	1.6
Tue 22-May	10:00am	International reserves	May 18	US\$ bn	--	--	173.1
Tue 22-May	12:30pm	Government weekly auction: 1-, 3-, 6-, 12-month CETES; 30y Mbono (Nov'47); 30y Udibonos (Nov'46); 5y Bondes D					
Tue 22-May	4:30pm	Citibanamex bi-weekly survey of economic expectations					
Wed 23-May	9:00am	GDP	1Q18	% yoy	<u>1.3</u>	--	1.2
		(sa)		% q/q	<u>1.2</u>	--	1.1
		Primary activities		% yoy	<u>5.2</u>	--	5.3
		Industrial production		% yoy	<u>-0.7</u>	--	-1.1
		Services		% yoy	<u>2.1</u>	--	2.1
Wed 23-May	9:00am	Economic activity indicator	March	% yoy	<u>-0.5</u>	--	2.4
		Primary activities		% yoy	<u>8.1</u>	--	8.3
		Industrial production		% yoy	<u>-3.7</u>	--	0.8
		Services		% yoy	<u>0.7</u>	--	2.9
Thu 24-May	9:00am	CPI inflation	1H May	% 2w/2w	<u>-0.39</u>	--	0.00
				% yoy	<u>4.36</u>	--	4.55
		Core		% 2w/2w	<u>0.15</u>	--	0.10
				% yoy	<u>3.72</u>	--	3.71
Fri 25-May	9:00am	Trade balance	April	US\$ mn	<u>-61.3</u>	--	1,917.5
		Total exports		% yoy	<u>16.9</u>	--	10.0
		Oil exports		% yoy	<u>46.7</u>	--	38.9
		Non-oil exports		% yoy	<u>15.3</u>	--	8.5
		Total imports		% yoy	<u>20.5</u>	--	4.5
Fri 25-May	10:00am	Current account	1Q18	US\$ bn	<u>-2,712</u>	--	-3,207

Source: Banorte; Bloomberg

Proceeding in chronological order...

Retail sales will post a 0.8% yoy expansion in March. On Tuesday at 9:00am (ET), *INEGI* will release its report on retail sales in the third month of 2018, where we anticipate a 0.8% yoy expansion, below the 1.2% growth observed in February.

We believe that retail sales expansion will be mainly explained by a greater dynamism in non-durable goods sales, as shown by the 4.6% growth in real terms in *ANTAD* same-store sales. However, vehicle sales posted a 13.4% contraction while non-oil consumption goods decreased 0.7% yoy, which will partially compensate the increase in *ANTAD* sales.

Weekly international reserves report. Also on Tuesday, at 10:00am (ET), Banco de Mexico will release its weekly balance report. Last week, net international reserves grew by US\$51 million amounting to US\$173.1 billion. According to Banxico's report, this figure comes mainly as a result of a positive valuation effect in central bank assets. In this context, the Central Bank's international reserves have increased by US\$310 million during 2018 (please refer to the table below).

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

	2017	May 11, 2018	May 11, 2018	Year-to-date
	Balance		Flows	
International reserves (B)-(C)	172,802	173,111	51	310
(B) Gross international reserve	175,450	177,819	96	2,369
Pemex	--	--	-108	-650
Federal government	--	--	398	2,064
Market operations	--	--	0	0
Other	--	--	-194	956
(C) Short-term government's liabilities	2,648	4,708	45	2,060

Source: Banco de México

Weekly government bond auction. Additionally on Tuesday, the Ministry of Finance (MoF) –via Banco de Mexico as its financial agent–, will offer 30-year fixed rate Mbonos (Nov'47), 30-year inflation-linked Udibonos (Nov'46), 5-year Bondes D, in addition to the “more traditional” 1-, 3-, 6-, and 12-month zero-coupon Cetes (please refer to the table on the following page). As usual, the results will be released at 12:30pm (ET).

Auction specifics (Tuesday, May 22, 2018)

	Maturity	Coupon rate, %	To be auctioned ¹	Previous yield ²
Cetes				
1m	21-jun-18	--	7,000	7.58
3m	23-Aug-18	--	11,000	7.81
6m	22-Nov-18	--	11,500	7.81
12m	19-May-19	--	12,500	7.71
Bondes D				
5y	04-May-23	--	5,000	0.16
M Bono				
30y	07-Nov-47	8.00	3,000	7.53
Udibono				
30y	08-Nov-46	4.00	UDIS 400	3.88

Source: Banorte 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. Also on Tuesday, around 3:30pm (ET) *Citibanamex* will release its bi-weekly survey of economic expectations, where market focus will be on analysts' inflation forecasts for the first half of May (to be published on May 24). Furthermore, attention will be on monetary policy assessments, given Banxico's tone in the last monetary policy statement. In addition, the survey will contain forecasts for growth and FX. In the first case we do not expect changes to the 2018 figure. However, MXN estimates might be revised upward given the recent behavior of the Mexican peso.

Mexico's GDP will stand at 1.3% yoy in 1Q18. On Wednesday, *INEGI* will publish GDP for the first quarter of 2018, where we expect it to show a 1.3% yoy expansion, marginally above the 1.2% seen in the preliminary estimation. We highlight that the lower GDP growth will be simply explained by a seasonal effect, since the Easter holiday period reduced the working days in the annual comparison. Controlling for this effect, the Mexican economy will grow around 2.5% yoy (1.2% q/q).

We consider that the growth of the Mexican economy during the first quarter of the year will be explained by the favorable performance that the services continued to show, reaching an annual growth of 3% yoy sa (2.2% yoy nsa), driven by the above-trend growth in banking credit, and the expansion of the Mexican formal labor market.

Similarly, we consider that the Mexican economy was boosted by the recovery in industrial activity given the higher growth of construction output, derived from the electoral process, which has triggered a higher public expenditure within the federal entities and municipalities concentrated in infrastructure projects. Nevertheless, Mexican manufacturing production has decelerated, while the recession continues in the mining industry. All in all, we consider that industrial production will post a 0.9% yoy growth sa (-0.7% yoy nsa).

We expect a 0.5% yoy contraction in March's IGAE. On Wednesday, *INEGI* will release its monthly global economic indicator for March (GDP monthly proxy), where we expect a 0.5% yoy reduction, given that the figures will be affected by a seasonal effect which reduced working days in the annual comparison.

As we had mentioned in our last report, the 3.7% contraction in industrial production during March was mostly explained by the 7.5% decrease in mining output as well as the 3.9% reduction in construction. Moreover, manufacturing posted a 2.4% decline given the sharp fall in the production of oil and carbon-based products (-33.4% yoy). In addition, utilities fell 2.8% yoy.

Moreover, we believe that services will show a 0.7% yoy expansion (nsa figures), given the seasonal effect previously mentioned. However, recent reports have shown positive figures as a result of the positive trend in the formal labor market coupled with an above-trend growth in banking credit.

Inflation during the first half of May will be explained by the continuing implementation of the summer discounts in electricity tariffs. On Thursday, at 9:00am, *INEGI* will release its bi-weekly inflation report for the first half of May. We are forecasting a 0.39% 2w/2w fall in the headline index, while we expect the core index to advance 0.15% 2w/2w.

Inflation during the period in question will be mainly explained by the start of the summer discounts in electricity tariffs in some areas in the country, as well as an additional fall in fresh fruits and vegetables prices. However, these will be partially offset by a higher contribution from goods.

We forecast inflation to be 5bps below the figure seen in 2017 as a result of: (1) a greater impact of energy prices (-46bps vs. -55bps in 2017); (2) a smaller participation government tariffs (1bps vs. 8bps in 2017); (3) a lesser contribution of fresh fruits and vegetables (-5bps vs. 0bps in 2017); (4) a negative impact of goods (6bps vs. 9bps in 2017); and (5) a greater contribution of other services (4bps vs. 1bps in 2017), as shown in the table on the following page.

With these results, annual inflation will stand at 4.36% in the first half of May, lower than the 4.55% seen in April. Moreover, we forecast core inflation at 3.72% yoy (previous: 3.71% yoy). Moving forward, we will focus on the evolution of energy prices and the behavior of agricultural prices, and the impact they might have in Mexico's CPI.

1H-May inflation by components

% Bi-weekly incidence

	2018 F	2017	Difference
Headline	-0.39	-0.34	-0.05
Core	0.11	0.11	0.00
Goods	0.06	0.09	-0.03
Processed foods	0.03	0.04	-0.01
Other goods	0.03	0.05	-0.02
Services	0.06	0.02	0.03
Housing	0.02	0.01	0.00
Education	0.00	0.00	0.00
Other services	0.04	0.01	0.03
Non-core	-0.50	-0.45	-0.05
Agricultural	-0.04	0.02	-0.06
Fresh fruits and vegetables	-0.05	0.00	-0.05
Meat and egg	0.01	0.02	-0.01
Energy and government regulated	-0.46	-0.47	0.02
Energy	-0.46	-0.55	0.08
Government regulated	0.01	0.08	-0.08

Source: Banorte, INEGI

Strong recovery in oil exports. On Friday at 9:00am (ET), Banxico and *INEGI* will make available their preliminary trade report for April, where we expect to see a US\$61.3 million deficit.

On the exports side, we will probably see a 46.7% yoy expansion of oil exports as a result of the higher prices for the Mexican crude oil basket (34.3% yoy). In addition, non-oil exports could have increased 15.3% yoy, on the back of a 14.5% hike in manufacturing exports.

On the imports side, we estimate a 20.5% yoy expansion in total imports, as a result of the increase in oil related imports. However, taking a look at the breakdown, we believe that non-oil consumption goods imports decreased 0.6% yoy, while imports of intermediate goods could have increased 0.9% yoy. Finally, we estimate a 0.9 % contraction in capital goods imports.

Current account deficit will narrow in the 1Q18 vs 4Q17. Next Friday, at 10:00am (ET), Banxico will release its balance of payments report for the first quarter of the year. We are forecasting a US\$2.712 bn deficit in the current account. According to data already released, trade balance during the period in question amounted to -US\$1,428.3 million, while net transfers increased as a result of 6% y/y increase in remittances.

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