

## Ahead of the Curve

October 21, 2016

Market focus this week will on October's first half inflation report

- October's first half inflation report.** On Monday, at 9:00am, *INEGI* will release its bi-weekly inflation report. We are forecasting a 0.43% 2w/2w increase in the first half of October below consensus 0.51% forecast according to Bloomberg. In the core index, we expect an increase of 0.12% 2w/2w below market consensus (0.17%). Inflation during the period in question will be explained by pressures on energy prices, as summer discounts to electricity tariffs come to an end. With these results, annual inflation will stand at 3.02%yoy in the first half of October, while core inflation will edge-up to 3.05% from 3.07% yoy
- August's IGAE.** On Wednesday, at 9:00am (EDT), *INEGI* will release its monthly global economic indicator for August (GDP monthly proxy), where we expect a 2.2% yoy expansion. We believe that Mexico's economic growth in August will be explained by a 0.3% growth in industrial production, a 3.7% yoy increase in services output, and a 3% contraction in agricultural production.

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**Mexico weekly calendar**

DATE	TIME (EDT)	EVENT	PERIOD	UNIT	BANORTE-		
					IXE	CONSENSUS	PREVIOUS
Mon 24-Oct	9:00am	CPI inflation	1H-Oct	% 2w/2w	<u>0.43</u>	0.51	0.17
				% yoy	<u>3.02</u>	3.11	2.97
		Core	% 2w/2w	<u>0.12</u>	0.17	0.15	
			% yoy	<u>3.05</u>	--	3.07	
Mon 24-Oct	9:00am	Unemployment rate sa	September	%	<u>4.06</u>	--	4.00
				%	<u>3.81</u>	--	3.73
Tue 25-Oct	9:00am	Retail sales	August	% yoy	<u>6.4</u>	--	7.9
Tue 25-Oct	10:00am	International reserves	21-Oct	US\$ bn	--	--	173.2
Tue 25-Oct	12:30pm	Government weekly auction: 1-, 3-, 6-month CETES; 10y Mbono (Mar'26); 5y Bondes D					
Wed 26-Oct	9:00am	Global economic indicator (sa)	August	% yoy	<u>2.2</u>	--	2.2
				% m/m	<u>0.6</u>	--	0.3
		Primary activities	% yoy	<u>-3.0</u>	--	3.8	
		Industrial production	% yoy	<u>0.3</u>	--	-1.0	
		Services	% yoy	<u>3.7</u>	--	2.6	
Wed 26-Oct	9:00am	Trade balance	September	US\$ mn	<u>974.7</u>	--	-1,913.2
				% yoy	<u>2.6</u>	--	4.5
		Oil exports	% yoy	<u>-12.2</u>	--	-8.2	
		Non-oil exports	% yoy	<u>3.5</u>	--	5.4	
		Total imports	% yoy	<u>-4.8</u>	--	1.5	
Thu 27-Oct		Budget balance	September	MXN bn	--	--	-202.9

Source: Banorte-IXE; Bloomberg

Proceeding in chronological order...

**Inflation in the first half of October will be explained by pressures on the price of energy, as summer discounts on electricity tariffs come to an end.**

On Monday, at 9:00am, *INEGI* will release its bi-weekly inflation report. We are forecasting a 0.43% 2w/2w increase in the first half of October below consensus 0.51% forecast according to *Bloomberg*. In the core index, we expect an increase of 0.12% 2w/2w below market consensus (0.17%).

Inflation during the period in question will be explained by pressures on energy prices, as summer discounts to electricity tariffs come to an end. In addition, we expect to see some pressure on merchandise prices given the higher pass through from FX depreciation to prices. With these results, annual inflation will stand at 3.02% yoy in the first half of October, while core inflation will edge-up to 3.05% from 3.07% yoy.

**October's first half inflation by components**

% bi-weekly incidence

	2016 F	2015	Difference
Headline	0.43	0.46	-0.03
Core	0.09	0.12	-0.03
Goods	0.05	0.07	-0.02
Processed foods	0.04	0.03	0.01
Other goods	0.02	0.04	-0.03
Services	0.04	0.05	-0.01
Housing	0.01	0.01	0.00
Education	0.00	0.00	0.00
Other services	0.03	0.04	-0.01
Non-core	0.34	0.35	-0.02
Agricultural	0.01	0.00	0.00
Fresh fruits and vegetables	0.01	0.01	0.00
Meat and egg	-0.01	-0.01	0.00
Energy and government regulated	0.33	0.36	-0.03
Energy	0.33	0.36	-0.02
Government regulated	0.00	0.01	-0.01

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.

**Unemployment rate in September will stand at 4.06%.** On Monday, *INEGI* will publish its employment report for the ninth month of 2016, in which we estimate an unemployment rate of 4.06% nsa, above the 4% observed in August, but below the 4.5% observed in September 2015. In seasonally-adjusted terms, we believe that the unemployment rate could stand at 3.81%, which implies a 0.08%-pts increase.

It is likely that September's labor market report will reflect the lower growth dynamics of the Mexican economy. In particular, the downward trend in public spending has translated in a higher number of unemployed workers, and has already affected private investment projects. We believe that these collateral effects will also have a negative impact in the Mexican labor market. Looking ahead, we believe that the labor market will continue to grow, but at a slower pace given the fiscal cuts that the Federal Government will continue to implement throughout the second half of the year.

**Retail sales will post a 6.3% yoy expansion in August.** On Tuesday at 9:00am (EDT), *INEGI* will publish its retail sales report for August, where we anticipate a 6.3% yoy expansion. Retail sales' growth will be explained by the favorable performance of durable goods sales. In particular, vehicles sales increased by 20.8% yoy according to *AMIA's* report. However, *ANTAD* total store sales posted a scant 2% yoy growth in real terms during the period in question. In addition, retail sales growth will be bounded by the 2.5% yoy contraction in consumption goods imports –which have a strong correlation with retail sales.

Looking ahead, we believe that retail sales and private consumption will continue to show a favorable performance in the fourth quarter of the year derived from: (1) An improvement in private banking credit; (2) the contained levels of inflation; (3) the stronger growth dynamics in the Mexican labor market; and (4) the higher growth in remittances inflows.

**Weekly international reserves report.** On Tuesday, at 10:00am (EDT), Banco de Mexico will release its weekly balance report. Last week, net international reserves fell by US\$135 million amounting to US \$175.2 billion on October 14. According to Banxico's report, this figure comes mainly as a result of: (1) Dollar sales by Banxico to the Federal Government for US\$106 million; along with a (2) US\$29 million reduction due to changes in the valuation of the Central Bank's assets. In this context, the Central Bank's international reserves have diminished by US\$1,517 million this year (please refer to the table below).

**Banxico's foreign reserve accumulation details**

US\$, million

	2015	14/Oct/2016	14/Oct/2016	Year-to-date
	Balance		Flows	
International reserves (B)-(C)	176,735	175,219	-135	-1,517
(B) Gross international reserve	177,597	177,893	-471	298
Pemex	--	--	-63	3,707
Federal government	--	--	-127	-325
Market operations	--	--	0	-5,562
Other	--	--	-281	2,477
(C) Short-term government's liabilities	861	2,675	-336	1,813

Source: Banco de México

**Weekly government bond auction.** Also on Tuesday, the Ministry of Finance (MoF) –via Banco de Mexico as its financial agent-, will offer 10-year fixed-rate Mbonos (Mar’26) as well as 5-year Bondes D, 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, October 25, 2016)**

	Maturity	Coupon rate, %	To be auctioned <sup>1</sup>	Previous yield <sup>2</sup>
<b>Cetes</b>				
1m	24-Nov-16	--	5,500	4.67
3m	26-Jan-17	--	9,500	4.81
6m	27-Apr-17	--	11,000	4.97
<b>Mbono</b>				
10y	5-Mar-26	5.75	7,000	5.99
<b>Bondes D</b>				
5y	15-Sep-21	--	3,000	0.21

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

**We expect a 2.2% yoy expansion in August’s IGAE.** On Wednesday, at 9:00am (EDT), *INEGI* will release its monthly global economic indicator for August (GDP monthly proxy), where we expect a 2.2% yoy expansion. We believe that Mexico’s economic growth in August will be explained by a 0.3% growth in industrial production, a 3.7% yoy increase in services output, and a 3% contraction in agricultural production.

As we had mentioned in our last report, IP’s growth was explained by a calendar effect given that August had two additional working days this year. Correcting for this calendar effect, industrial production posted a 0.9% yoy reduction. Taking a look at the breakdown, and using the calendar-adjusted figures, manufacturing output increased 1.2% yoy. However, construction output declined 1.4%, as a result of the 19.1% reduction of public civil engineering construction projects given the fiscal cuts implemented by the Federal Government. In addition, mining activity fell 8.1% as a result of the significant contraction in Mexico’s oil production, and the lower investment in Mexico’s drilling projects.

Moreover, we believe that the 3.7% yoy estimated expansion in services will be explained by the recovery in private consumption. In particular consumers’ spending is gaining momentum, whereas formal job creation has observed a significant recovery in the first eight months of the year.

**Exports will show a marginal increase.** On Wednesday, at 10:00am (EDT), *INEGI* will make available its trade report for September, where we expect to see a US\$974.7 million surplus. On the exports side, we will probably see a 12.2% yoy contraction of oil exports given the fall in oil exports and prices during the period in question. However, non-oil exports could have increased 3.5% yoy, on the back of a 3.2% increase in manufacturing exports.

On the imports side, we estimate a 4.8% yoy contraction in total imports. Taking a look at the breakdown, we believe that imports consumption goods decreased 12.4% yoy, while imports of intermediate goods could have fallen 3.5% yoy. Finally, we estimate a 3% reduction in capital goods imports.

**The MoF's monthly report.** On Friday, the Ministry of Finance (MoF) will make its monthly finance report available for September. 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 fiscal cuts announced by the *MoF*. Finally, it will be important to evaluate the evolution of public sector debt, which currently represents about 48% of Mexico's GDP.

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