

# Ahead of the Curve

June 2, 2017

Market focus this week will be on May's inflation report and April's industrial production

- **Monthly inflation report (May).** On Thursday, at 9:00am, *INEGI* will release its monthly inflation report for May. We are forecasting a 0.14% m/m decrease in the headline index (consensus: -0.12% m/m), while we expect the core index to increase 0.26% m/m (consensus 0.27% m/m). Deflation during the period in question will be explained by the start of summer discounts on electricity tariffs in some regions of the country. However, the fall in energy prices will be partially offset by the upward trend in fresh fruits and vegetables, particularly because of the rise in the price of tomatoes.
- **Industrial production (April).** Next Friday at 9:00am (EDT), *INEGI* will release its monthly industrial production report. We anticipate a 2.3% yoy reduction in total output during April, after the 3.4% gain in the previous month. The contraction will be explained by a calendar effect, as the industrial output was affected by the *Holy Week* holiday that started in April (vs. March in 2015), subtracting working days to the annual comparison.

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**Mexico weekly calendar**

DATE	HOUR (EDT)	EVENT	PERIOD	UNIT	BANORTE-IXE	CONSENSUS	PREVIOUS
Mon 5-Jun	9:00am	<b>Gross fixed investment</b>	March	% yoy	<u>5.5</u>	3.0	-3.1
		Machinery and equipment		% yoy	<u>10.3</u>	--	-1.0
		Domestic		% yoy	<u>8.3</u>	--	9.5
		Imported		% yoy	<u>11.2</u>	--	-5.9
		Construction		% yoy	<u>2.5</u>	--	-4.4
Mon 5-Jun	9:00am	<b>Consumer confidence</b>	May	index	<u>84.5</u>	84.6	83.8
Tue 6-Jun	10:00am	<b>International reserves</b>	2-Jun	US\$ bn	--	--	175.1
Tue 6-Jun	12:30pm	<b>Government weekly auction: 1-, 3-, 6-month CETES; 20y Mbono (Nov'36); 5y Bondes D</b>					
Tue 6-Jun	4:30pm	<b>Citibanamex bi-weekly survey of economic expectations</b>					
Thu 8-Jun	9:00am	<b>CPI inflation</b>	May	% m/m	<u>-0.14</u>	-0.12	0.12
				% yoy	<u>6.14</u>	6.16	5.82
		Core		% m/m	<u>0.26</u>	0.27	0.45
				% yoy	<u>4.77</u>	--	4.72
Fri 9-Jun		<b>Wage negotiations</b>	May	%	<u>4.1</u>	--	3.9
Fri 9-Jun	9:00am	<b>Industrial production</b>	April	% yoy	<u>-2.3</u>	-2.0	3.4
		(sa)		% m/m	<u>0.3</u>	0.3	0.0
		Mining		% yoy	<u>-8.0</u>	--	-9.2
		Utilities		% yoy	<u>-2.0</u>	--	1.2
		Construction		% yoy	<u>-2.1</u>	--	3.8
		Manufactures		% yoy	<u>-0.2</u>	0.7	8.5

Source: Banorte-IXE; Bloomberg

Proceeding in chronological order...

**Consumer confidence will lose ground in May.** On Monday, at 9:00am (EDT), Banxico and *INEGI* will publish its May's monthly survey on consumer confidence, where we expect a 7.1% yoy contraction, with the index reaching 84.5 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 6.17% yoy during the first half of May, as a result of the higher pass-through effect of the accumulated depreciation of the Mexican currency to prices and the increase 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.

**We expect a 5.5% yoy expansion in March's GFI.** On Monday, at 9:00am (EDT), *INEGI* will publish its gross fixed investment (GFI) report. We anticipate GFI up by 5.5% yoy in March. However, it will be explained by the *Holy Week*, that added working days to the annual comparison.

We believe that within the report we will probably see an 8.3% yoy expansion in domestic machinery and equipment. In addition, we expect an 11.2% increase in imported machinery and equipment given that trade balance figures showed a similar result for capital goods imports. Finally, we believe that construction spending grew 2.5% yoy, as a result of the above-mentioned calendar effect.

#### GFI forecasts

% yoy; %-pts

	Mar-17	Mar-16	Jan-Mar, '17	Jan-Mar, '16
Total	5.5	-3.1	0.6	0.6
Machinery and equipment	10.3	-4.9	4.5	0.3
Domestic	8.3	9.0	7.7	8.4
Imported	11.2	-10.5	3.0	-3.2
Construction	2.5	-1.9	-1.8	0.7
Annual contribution	Mar-17	Mar-16	Difference	
Total	5.5	-3.1	8.6	
Machinery and equipment	4.0	-1.9	5.9	
Domestic	1.1	1.0	0.0	
Imported	2.9	-3.0	5.9	
Construction	1.5	-1.2	2.7	

Source: Banorte-Ixe

**Weekly international reserves report.** On Tuesday, at 10:00am (EDT), Banco de Mexico will release its weekly balance report. Last week, net international reserves increased by US\$60 million amounting to US\$175.1 billion. According to Banxico’s report, this figure comes mainly as a result of: (1) US\$54 million dollar sales from Banxico to the Federal Government; and (2) A positive revalorization in central bank assets amounting to US\$114 million. In this context, the Central Bank’s international reserves have diminished by US\$1.4 billion this year (please refer to the table below).

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

	2016	May 26, 2017	May 26, 2017	Year-to-date
	Balance		Flows	
International reserves (B)-(C)	176,542	175,138	60	-1,403
(B) Gross international reserve	178,025	177,012	767	-1,013
Pemex	--	--	299	-551
Federal government	--	--	-20	-824
Market operations	--	--	0	-2,000
Other	--	--	489	2,362
(C) Short-term government's liabilities	1,483	1,874	708	391

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 20-year fixed-rate Mbonos (Nov’36), 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, May 30, 2017)**

	Maturity	Coupon rate, %	To be auctioned <sup>1</sup>	Previous yield <sup>2</sup>
<b>Cetes</b>				
1m	06-Jul-17	--	7,000	6.72
3m	07-Sep-17	--	11,000	7.07
6m	07-Dec-17	--	11,500	7.25
<b>M Bono</b>				
20y	20-Nov-36	10.00	2,000	7.64
<b>Bondes D</b>				
5y	12-May-22	--	4,500	0.20

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 5:30pm (EDT) *Citibanamex* will release its bi-weekly survey of economic expectations, where market participants will focus on analysts’ monetary policy assessments given the hawkish narrative seen in both the Central Bank’s QIR and minutes of the latest monetary policy decisions. Furthermore, analysts will also focus on the inflation forecasts for May (to be published on Thursday, June 8), 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.

**Deflation during May will be explained by decreases in electricity tariffs.**

On Thursday, at 9:00am, *INEGI* will release its monthly inflation report for May. We are forecasting a 0.14% m/m decrease in the headline index (consensus: -0.12% m/m), while we expect the core index to rise 0.26% m/m (consensus 0.27% m/m).

Deflation during the period in question will be explained by the start of summer discounts on electricity tariffs in some regions of the country. However, the fall in energy prices will be partially offset by the upward trend in fresh fruits and vegetables prices, particularly because of the rise in the price of tomatoes.

We expect inflation to be 30bp higher than the observed in same period last year, derived from: (1) 20bp from a higher contribution of fresh fruits and vegetables (10bp vs. -10bp in 2016); (2) 14bp derived from a higher contribution of prices of government regulated prices (13bp vs. -1bp in 2016); (3) 6bp stemming from a higher contribution of other goods prices (8bp vs. 2bp in 2016); (4) 3bp coming from a lower impact of other services prices (0bp vs. 3bp in 2016); and (5) 3bp derived from a lower contribution of energy prices (-53bp vs. -50bp in 2016), as shown in the table below, as shown in the table below.

With these results, annual inflation will stand at 6.14% in May, (previous: 5.82% yoy), while core inflation will be at 4.77% (previous: 4.72% yoy). Moving forward, we will be attentive to the evolution of energy prices and the behavior of the exchange rate, as well as the impact they might have on the price formation dynamic.

**May inflation by components**

% monthly incidence

	Banorte-Ixe forecast 2017	2016	Difference
Headline	-0.14	-0.45	0.30
Core	0.20	0.16	0.03
Goods	0.15	0.09	0.06
Processed foods	0.07	0.07	0.00
Other goods	0.08	0.02	0.06
Services	0.05	0.07	-0.03
Housing	0.04	0.04	0.00
Education	0.00	0.00	0.00
Other services	0.00	0.03	-0.03
Non-core	-0.34	-0.61	0.27
Agricultural	0.09	-0.07	0.167
Fresh fruits and vegetables	0.10	-0.10	0.20
Meat and egg	0.01	0.03	-0.01
Energy and government regulated	-0.44	-0.54	0.10
Energy	-0.53	-0.50	-0.03
Government regulated	0.11	-0.03	0.14

Source: INEGI

**We expect a 2.3% yoy contraction in April’s industrial output.** Next Friday at 9:00am (EDT), *INEGI* will release its monthly industrial production report. We anticipate a 2.3% yoy reduction in total output during April, after the 3.4% gain in the previous month. The contraction will be explained by a calendar effect, as the industrial output was affected by the *Holy Week* holiday that started in April (vs. March in 2015), subtracting working days to the annual comparison.

Taking a look at the breakdown, manufacturing production could post a 0.2% yoy contraction, explained by the adverse calendar effect already mentioned. Using calendar adjusted figures, we expect a 3.7% yoy increase derived from the visible recovery in external demand.

In addition, industrial output during April will be also explained by: (1) The 2.1% yoy fall in construction output, as a result of the lower growth in private construction investment projects derived from the uncertainty surrounding Mexico’s economic outlook, coupled with the contraction in public investment projects given the Federal Government’s fiscal stability plan; and (2) the poor performance of mining activity, where we estimate a 8% yoy decrease.

**Industrial production estimate: April 2017**

% yoy, nsa

	Apr-17	Apr-16	Jan-Apr, '17	Jan-Apr, '16
Total	-2.3	1.6	-0.2	0.4
Mining	-8.0	-3.5	-10.1	-3.3
Utilities	-2.0	4.3	-0.9	1.8
Construction	-2.1	3.5	0.6	1.8
Manufacturing	-0.2	2.4	3.5	1.1

Source: Banorte-ixe

**Wage negotiations will climb 4.1% during May.** On Friday, the Ministry of Labor (MoL) will publish the contractual wage negotiations for May. We expect workers to have negotiated an average increase of 4.1%, above the 3.9% increase seen in April. We believe that the slight pickup in the figure will come as a result of some states implementing the 5.7% increase to workers of the *Federation of Trade Unions of State Workers*. Looking ahead, we believe that the significant increase in the minimum wage last December, coupled with higher inflation –mainly driven by the increase in energy prices- will continue to maintain wage negotiations in higher-than-average levels.

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