

Ahead of the Curve

June 3, 2016

Market focus this week will on May's monthly inflation report

- May's monthly inflation report.** On Thursday, at 9:00am, *INEGI* will release its monthly inflation report. We are forecasting a 0.44% m/m decrease in May, below consensus forecast (-0.42% according to Bloomberg). In the core index, we expect an increase of 0.21% m/m, also below market consensus (0.22%). Inflation during the period in question will be explained by the reduction in electricity tariffs during the first half of the month, on the back of the start of summer discounts. In addition, agricultural prices will also show on average a negative variation, as the pressures observed by our price monitoring in the second half of the month will not be enough to offset the declines observed in the first fortnight.
- Industrial production (April).** Next Friday at 9:00am (EDT), *INEGI* will release its monthly industrial production report. We anticipate a 3.1% yoy expansion in total output during April, after the 2% decline in the previous month. Part of the expansion will be explained by a calendar effect, as the industrial output in April will be positively affected by the *Holy Week* holiday that started in March (vs. April in 2015).

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Mexico weekly calendar

DATE	HOOR (EDT)	EVENT	PERIOD	UNIT	BANORTE-IXE	CONSENSUS	PREVIOUS
Mon 6-Jun	9:00am	Consumer confidence	May	index	<u>90.1</u>	89.8	88.9
Tue 7-Jun	10:00am	International reserves	3-Jun	US\$ bn	--	--	177.0
Tue 7-Jun	12:30pm	Government weekly auction: 1-, 3-, 6-month CETES; 30y Mbono (Nov'42); 5y Bondes D					
Tue 7-Jun	4:30pm	Banamex bi-weekly survey of economic expectations					
Thu 9-Jun	9:00am	CPI inflation	May	% m/m	<u>-0.44</u>	-0.46	-0.32
				% yoy	<u>2.6</u>	2.58	2.54
		Core		% m/m	<u>0.21</u>	0.22	0.22
				% yoy	<u>2.93</u>	--	2.83
Fri 10-Jun	9:00am	Industrial production (sa)	April	% yoy	<u>3.1</u>	0.4	-2.0
		Mining		% m/m	<u>0.4</u>	-0.1	-0.2
		Utilities		% yoy	<u>-2.0</u>	--	-5.1
		Construction		% yoy	<u>2.5</u>	--	0.3
		Manufactures		% yoy	<u>3.3</u>	--	-1.0
Fri 10-Jun		Wage negotiations	May	%	<u>5.1</u>	--	-1.5
					<u>3.8</u>	--	4.9

Source: Banorte-IXE; Bloomberg

Proceeding in chronological order...

Consumer confidence will marginally recover 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 2% yoy contraction, with the index reaching 90.1 points. However, in seasonally adjusted terms, we expect confidence levels to increase 0.5% m/m.

We believe that consumer confidence (measured in seasonally adjusted terms) will show a moderate growth given the relative low inflation levels, which will be reflected in a higher growth of consumer's expectations regarding the country's present and future economic outlook, and will also translate in an expansion of the purchasing power component.

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\$329mn amounting to US \$176.9bn on May 27. According to Banxico's report, this figure comes mainly as a result of: (1) Dollar sales by Banxico to the Federal Government for US\$170mn; (2) the payment of the fee for the expansion and renovation of the Flexible Credit Line with the International Monetary Fund for the equivalent of US\$200mn; along with a (2) US\$41mn 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 accumulated US\$259mn international reserves this year (please refer to the table below).

Banxico's foreign reserve accumulation details

US\$, million

	2015	27/May/2016	27/May/2016	Year-to-date
	Balance		Flows	
International reserves (B)-(C)	176,735	176,994	-329	259
(B) Gross international reserve	177,597	179,599	-114	2,002
Pemex	--	--	218	2,692
Federal govt	--	--	-109	2,198
Market operations	--	--	0	-5,562
Other	--	--	-223	2,674
(C) Short-term government's liabilities	861	2,605	215	1,743

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 30-year fixed-rate Mbonos (Nov’42) 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). The results will be released at 12:30pm (EDT).

Auction specifics (Tuesday, Jun 7, 2016)

	Maturity	Coupon rate, %	To be auctioned ¹	Previous yield ²
Cetes				
1m	7-Jul-16	--	5,500	3.80
3m	8-Sep-16	--	9,500	4.13
6m	8-Dic-16	--	11,000	4.33
Mbono				
30y	13-Nov-42	7.75	2,000	6.55
Bondes D				
5y	20-May-21	--	3,000	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

Banamex Survey: Market participants will focus on monetary policy forecasts. On Tuesday at 4:30pm (EDT) *Banamex* will release its bi-weekly survey of economic expectations, where market participants will focus on analysts’ monetary policy assessments given the latest BLS employment report, and the implicit low probability that the Fed will hike rates in June. In this regard, we highlight that Banxico has emphasized several times that Mexico’s monetary policy is tied to the Fed’s policy.

Furthermore, analysts will also focus on the inflation report for May (to be published on Thursday, June 9), as well as on CPI estimations for 2016 and 2017. Moreover, *Banamex* will also publish consensus’ growth and FX forecasts for 2016-17. 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 2016.

Deflation in May, once again on the back of summer discounts on electricity tariffs. On Thursday, at 9:00am, *INEGI* will release its monthly inflation report. We are forecasting a 0.44% m/m decrease in May, above consensus forecast (-0.42% according to *Bloomberg*). In the core index, we expect an increase of 0.21% m/m below market consensus (0.22%).

Inflation during the period in question is explained by the reduction in electricity tariffs during the first half of the month, on the back of the start of summer discounts. In addition, agricultural prices will also show on average a negative variation, as the pressures observed by our price monitoring in the second half of the month will not be enough to offset the declines observed in the first fortnight.

Nevertheless, we expect this figure to be 5.7bps higher than the observed in same period last year, derived from: (1) 6.4bps stemming from a higher contribution of merchandise prices (9.2bps vs. 2.8 in 2015); (2) 6.3bps stemming from a higher contribution of agricultural prices (-6.5bps vs. -12.8 in 2015). By contrast, we expect (3) a lower contribution of energy prices (-54.4bps vs. -49.3 in 2015), and (4) -3.3bps stemming from a lower contribution of government tariffs (-3bps vs. 0.3 in 2015), as shown in the table below.

With these results, annual inflation is at 2.6% yoy in May from 2.67% in April, while core inflation will stand at 2.93% from 2.83% yoy.

Inflation by components in May

% monthly incidence

	Banorte-Ixe	2015	Difference
Total	-0.44	-0.50	0.06
Core	0.16	0.09	0.07
Goods	0.09	0.03	0.06
Processed foods	0.07	0.01	0.07
Other goods	0.02	0.02	0.00
Services	0.07	0.06	0.01
Housing	0.03	0.03	0.01
Education	0.00	0.00	0.00
Other services	0.03	0.03	0.00
Non-core	-0.62	-0.60	-0.02
Agriculture	-0.07	-0.13	0.06
Fruits & vegetables	-0.10	-0.03	-0.08
Meat & eggs	0.03	-0.10	0.13
Energy & government tariffs	-0.57	-0.48	-0.08
Energy	-0.54	-0.49	-0.05
Government tariffs	-0.03	0.00	-0.03

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

We expect a 3.1% yoy expansion in April's industrial output. Next Friday at 9:00am (EDT), *INEGI* will release its monthly industrial production report. We anticipate a 3.1% yoy expansion in total output during April, after the 2% decline in the previous month. Part of the expansion will be explained by a calendar effect, as the industrial output in April will be positively affected by the *Holy Week* holiday that started in March (vs. April in 2015).

Moreover, manufacturing production could post a 5.1% yoy expansion, explained by the positive calendar effect already mentioned. Despite that April's growth will be artificially affected, we believe that the Mexican manufacturing sector of final goods will show better growth prospects in the second quarter of the year derived from: (1) The still depreciated Mexican currency will translate into a recovery of Mexican exports; and (2) the higher growth of private consumption in Mexico, that will be reflected in a higher domestic demand for manufacturing products.

Finally, we believe that the 3.1% yoy expansion in industrial output during April will be also explained by the poor performance of mining activity. In this regard, we expect a 2% yoy contraction derived from lower oil production and the reduction in the extraction of other minerals.

Industrial production estimate: April 2016

%yoy	Apr-16	Apr-15	Jan-Apr, '16	Jan-Apr, '15
Total	3.1	1.7	1.1	1.7
Mining	-2.0	-8.4	-3.0	-6.3
Utilities	2.5	2.7	1.9	5.6
Construction	3.3	5.6	2.4	4.9
Manufacturing	5.1	4.3	2.0	3.4

Source: Banorte-Ixe

April's wage negotiations. Finally, on Friday, the Ministry of Labor (*STPS*) will make its contractual wage negotiations monthly data available. We anticipate workers to have negotiated an average wage increase of 3.8% in April. This would be below the 4.4% observed in year-to-date. In this context, we believe that April's figure was mainly driven by the increase in wage negotiations in the educational sector, specifically wage increases in the *National Union of Education Workers (SNTE)*, benefiting more than 1,700,000 workers with a 3.15% wage increase. Moreover, we highlight the 3.15% wage increase to 70,000 workers of the *Federal Electricity Commission (CFE)*. Finally, we also highlight the salary reviews in some unions workers in the government's entities.

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