

# Ahead of the Curve

July 3, 2015

Market focus this week will on June's inflation report

- June's monthly inflation report.** On Thursday, at 9:00am (EDT), *INEGI* will release its monthly inflation report. We are forecasting a 0.12% m/m increase in June below market consensus that is forecasting a 0.20% according to Bloomberg. In the core index, we expect an increase of 0.18% m/m below market consensus (0.22%). Inflation during the period in question will be explained by pressures on merchandise prices along with higher costs of services, particularly in the first half of the month. With these results, annual inflation will edge down to 2.83% yoy in June from 2.88% while core inflation will remain at 2.3% yoy
- Industrial production.** On Friday, at 9:00am (EDT), *INEGI* will release its monthly industrial production report. We anticipate a 0.1% yoy contraction in total output during the fifth month of the year. Taking a look at the breakdown, we believe that construction output could have expanded 5.6% yoy. However, we believe that manufacturing production could post a scant 0.9% yoy expansion. Finally, we believe that the fall in industrial output during May will be mainly explained by the poor performance of mining activity. In this regard, we expect a 8.9% yoy contraction

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**Mexico weekly calendar**

DATE	HOUR (EDT)	EVENT	PERIOD	UNIT	BANORTE-IXE	CONSENSUS	PREVIOUS
Tue 7-Jul	9:00am	Consumer confidence	June	index	<u>92.4</u>	92.4	92.0
Tue 7-Jul	10:00am	International reserves	3-Jul	US\$ bn	--	--	192.4
Tue 7-Jul	12:30pm	Government weekly auction: 1-, 3-, 6-month CETES; 30y Mbono (Nov'42); 5y Bondes D					
Tue 7-Jul	4:30pm	Banamex bi-weekly survey of economic expectations					
Thu 9-Jul	9:00am	CPI inflation	June	% m/m	<u>0.12</u>	0.20	-0.50
				% yoy	<u>2.83</u>	2.90	2.88
		Core		% m/m	<u>0.18</u>	0.22	0.12
				% yoy	<u>2.30</u>	--	2.33
Fri 10-Jul	9:00am	Industrial production	May	% yoy	<u>-0.1</u>	0.6	1.1
		(sa)		% m/m	<u>-0.8</u>	-0.1	-0.1
		Mining		% yoy	<u>-8.9</u>	--	-8.3
		Utilities		% yoy	<u>3.0</u>	--	1.7
		Construction		% yoy	<u>5.6</u>	--	4.8
		Manufactures		% yoy	<u>0.9</u>	--	3.7
Fri 10-Jul		Wage negotiations	June	%	<u>4.1</u>	--	4.3

Source: Banorte-IXE; Bloomberg

Proceeding in chronological order...

**Consumer confidence will show signs of recovery in June.** On Tuesday, at 9:00am (EDT), Banxico and *INEGI* will publish its June's monthly survey on consumer confidence, where we expect a 1.5% yoy expansion, with the index reaching 92.4 points (vs. 91 in June 2014). We highlight that this could be the eight positive annual growth rate since October 2013. In seasonally adjusted terms, we expect confidence levels to increase 0.8% m/m. We believe that consumer confidence (measured in seasonally adjusted terms) could show visible signs of recovery given the better growth dynamics of private consumption and the downward trend in inflation.

**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 \$779mn amounting to US \$192.4bn on June 26. According to Banxico's report, this figure comes mainly as a result of: (1) Dollar sales by the Central Bank to the Federal Government for US \$153mn; (2) US \$260mn decrease explained by the introduction of Banxico's USD daily auction; along with a (3) US \$366mn decrease 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, given that on November 2011, the FEC (Federal Exchange Commission) decided to shut down the options scheme that Banxico also used to accumulate reserves. In this context, the central bank has an accumulated reduction of US \$836mn international reserves this year (refer to the table below).

**Banxico's foreign reserve accumulation details**

US\$, million

	2014	26/Jun/2015	26/Jun/2015	Year-to-date
	Balance		Flows	
International reserves (B)-(C)	193,239	192,403	-779	-836
(B) Gross international reserve	195,682	193,769	-1,283	-1,913
Pemex	--	--	-529	2,841
Federal govt	--	--	-151	-3
Market operations	--	--	-260	-3,944
Other	--	--	-343	-807
(C) Short-term government's liabilities	2,443	1,366	-504	-1,077

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 (refer to the table below). As usual, the results will be released at 12:30pm (EDT).

**Auction specifics (Tuesday, July 7, 2015)**

	Maturity	Coupon rate, %	To be auctioned <sup>1</sup>	Previous yield <sup>2</sup>
<b>Cetes</b>				
1m	06-Aug-15	--	5,500	3.00
3m	08-Oct-15	--	9,500	3.12
6m	07-Jan-16	--	11,000	3.27
<b>Mbono</b>				
30y	13-Nov-42	7.75	2,500	6.69
<b>Bondes D</b>				
5y	28-May-20	--	4,000	0.24

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 analysts’ monetary policy assessments.** Also on Tuesday at 4:30pm (EDT) *Banamex* will release its bi-weekly survey of economic expectations. In the last survey published by *Banamex* 23 out of 25 analysts surveyed expected a rate hike in 2015. Furthermore, analysts will also focus on June’s inflation forecast (to be published on Thursday, July 9), as well as on CPI estimations for 2015. Moreover, we expect moderate downward revisions to the economic growth estimates.

**Inflation in June will be explained by pressures on the merchandise prices along with higher costs of services.** On Thursday, at 9:00am (EDT), *INEGI* will release its monthly inflation report. We are forecasting a 0.12% m/m increase in June below market consensus that is forecasting a 0.20% according to Bloomberg. In the core index, we expect an increase of 0.18% m/m below market consensus (0.22%).

Inflation during the period in question will be explained by pressures on merchandise prices along with higher costs of services, particularly in the first half of the month. Nevertheless, we expect this figure to be 4.9bps lower than the observed in same period last year, derived from: (1) A higher contribution of merchandise prices (7.2bps vs. 6 in 2014); (2) 0.2bps stemming from a higher contribution of government tariffs (0.6bps vs. 0.3 in 2014). By contrast, we expect (3) a lower contribution services prices (6.6bps vs. 10.1 in 2014) along with (4) -1.5bps stemming from a lower contribution of agricultural prices (-5.1bps vs. -3.6 in 2014), as shown in the table below.

With these results, annual inflation will edge down to 2.83% yoy in June from 2.88% while core inflation will remain at 2.3% yoy.

**Inflation by components in June**  
%monthly incidence

	Banorte-Ixe	2014	Difference
Headline	0.12	0.17	-0.05
Core	0.14	0.16	-0.02
Goods	0.07	0.06	0.01
Processed foods	0.05	0.05	0.00
Other goods	0.02	0.01	0.01
Services	0.07	0.10	-0.03
Housing	0.03	0.03	0.00
Education	0.00	0.01	0.00
Other services	0.03	0.06	-0.03
Non-core	-0.01	0.01	-0.02
Agricultural	-0.05	-0.04	-0.02
Fresh fruits and vegetables	-0.01	-0.06	0.05
Meat and egg	-0.04	0.02	-0.07
Energy and government regulated	0.04	0.05	-0.01
Energy	0.03	0.05	-0.01
Government regulated	0.01	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

**We expect a 0.1% yoy contraction in May's industrial output.** On Friday, at 9:00am (EDT), *INEGI* will release its monthly industrial production report. We anticipate a 0.1% yoy contraction in total output during the fifth month of the year. Taking a look at the breakdown, we believe that construction output could have expanded 5.6% yoy. We believe that construction has consolidated its recovery given the better growth dynamics in households' durable goods expenditure. Moreover, formal employment generated within this sector has shown a significant recovery in the past year, which supports our view of a more positive perspective regarding the recovery of this sector. This would imply that construction could reach its eleventh positive growth rate after adding 17 consecutive months in contraction.

However, we believe that manufacturing production could post a scant 0.9% yoy expansion, explained by a 5.2% yoy contraction in manufacturing exports, a significant deceleration in May's vehicle production (+0.3% yoy), and a 2.3% yoy growth in U.S. manufacturing output, which has a strong correlation with Mexico's manufacturing sector. Despite May's lower growth, we believe that in the next months the Mexican manufacturing sector will show better growth prospects, derived from: (1) A stronger external demand, particularly coming from the U.S.; (2) the recent depreciation of the Mexican currency; and (3) the recovery of private consumption in Mexico, which will eventually translate into a higher domestic demand for manufacturing products.

Finally, we believe that the fall in industrial output during May will be mainly explained by the poor performance of mining activity. In this regard, we expect a 8.9% yoy contraction derived from lower oil production and the reduction in the extraction of other minerals.

**Industrial production estimates: May 2015**

<b>%yoy</b>	<b>May-15</b>	<b>May-14</b>	<b>Jan-May, '15</b>	<b>Jan-May, '14</b>
Total	-0.1	2.0	1.1	1.4
Mining	-8.9	-0.2	-6.4	-0.5
Utilities	3.0	1.2	2.9	2.0
Construction	5.6	-0.3	4.7	-1.8
Manufacturing	0.9	4.1	2.7	3.5

  

<b>%m/m sa</b>	<b>May-15</b>	<b>Apr-15</b>	<b>Difference</b>
Total	-0.8	-0.1	-0.7
Mining	-0.5	-3.6	3.1
Utilities	0.3	-0.2	0.5
Construction	0.6	0.1	0.5
Manufacturing	-2.0	2.0	-4.0

Source: Banorte-Ixe, INEGI

**June's wage negotiations.** On Friday, the Ministry of Labor (STPS) will make its contractual wage negotiations monthly data available. We anticipate workers to have negotiated an annual average wage increase of 4.1% in June. This would be slightly below the average observed year-to-date (4.3%). In this regard, we believe that June's figure was mainly driven by the increase in wage negotiations in the education sector, specifically wage increases in the *National Union of Education Workers* and the *Ministry of Education*; coupled with increases in the government sector; as well as wages revisions by labor unions of the private sector specially in the aviation industry.

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