Ahead of the Curve

January 20, 2017

Market focus this week will on the inflation report of the first half of January and November's IGAE

- **Bi-weekly inflation report (1H January).** On Tuesday, at 9:00am, *INEGI* will release its bi-weekly inflation report. This report is particularly relevant since it will already consider the impact of several factors on inflation, of which we highlight: (1) The increase in gasoline prices; (2) the rise in the minimum wage; and (3) the FX pass-through effect from the 6% depreciation of the MXN to prices. Considering this, we are forecasting a 1.27% 2w/2w increase in the headline index during the first half of January (consensus: 1.30% 2w/2w). Moreover, for the core index we estimate a 0.36% 2w/2w rise (consensus: 0.26% 2w/2w).
- **Global Economic Activity Indicator (November).** On Tuesday, at 9:00am (EST), *INEGI* will release its monthly global economic indicator for November (GDP monthly proxy), where we expect a 2.9% yoy expansion. We believe that Mexico's economic growth will be explained by a 1.3% expansion in industrial production, coupled with a 3.8% yoy increase in services output. As we had mentioned in our last report, IP's expansion in November was partially explained by the 4.3% increase in manufacturing output. We believe that the 3.8% yoy estimated expansion in services will be explained by the acceleration in private consumption during November.

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Mexico's weekly calendar

DATE	HOUR (EST)	EVENT	PERIOD	UNIT	BANORTE-IXE	CONSENSUS	PREVIOUS
Tue 24-Jan	**9:00am**	**CPI inflation**	1H Jan	% 2w/2w	1.27	1.30	0.13
				% yoy	4.52	4.54	3.36
		Core		% 2w/2w	0.36	0.26	0.05
				% yoy	3.71	--	3.44
Tue 24-Jan	**9:00am**	**Global economic indicator**	November	% yoy	2.9	2.3	1.2
		(sa)		**% m/m**	-0.2	--	0.2
		Primary activities		% yoy	3.8	--	2.6
		Industrial production		% yoy	1.2	--	-1.4
		Services		% yoy	3.8	--	2.7
Tue 24-Jan	**10:00am**	**International reserves**	20-Jan	US$ mn	--	--	174.9
Tue 24-Jan	**12:30pm**	**Government weekly auction: 1-, 3-, 6-month CETES; 5y Mbono (Jun'22); 10y Udibonos (Dec'25)**					
Wed 25-Jan	**9:00am**	**Retail sales**	November	% yoy	8.6	7.9	9.3
Thu 26-Jan	**9:00am**	**Trade balance**	December	US$ mn	-504	-325.0	200.4
		Total exports		% yoy	6.4	--	11.1
		Oil exports		% yoy	44.5	--	6.8
		Non-oil exports		% yoy	4.9	--	11.3
		Total imports		% yoy	5.6	--	5.1

Source: Banorte-IXE; Bloomberg

Proceeding in chronological order...

Inflation in the first half of January will be explained by the increase in gasoline prices. On Tuesday, at 9:00am, *INEGI* will release its bi-weekly inflation report. This report is particularly relevant since it will already consider the impact of several factors on inflation, of which we highlight: (1) The increase in gasoline prices; (2) the rise in the minimum wage; and (3) the FX pass-through effect from the 6% depreciation of the MXN to prices. Considering this, we are forecasting a 1.27% 2w/2w increase in the headline index during the first half of January (consensus: 1.30% 2w/2w). Moreover, for the core index we estimate a 0.36% 2w/2w rise (consensus: 0.26% 2w/2w).

Inflation during the period in question will be explained by the 3.96% 2w/2w increase in the non-core sub index, particularly by pressures on energy prices (+8.8% 2w/2w), driven by the 12. 8% increase in low-grade gasoline and 15.53% for the high-grade gasoline. In addition, we expect an additional 12.6% increase in LP gas prices.

Moreover, core inflation's 0.36% 2w/2w rise will be explained by greater pressures on "processed foods" and "other services" prices. We believe that these increases stem from the FX depreciation pass-through to prices, as well as the minimum wage increase.

With these results, annual inflation is at 4.52% yoy in the first half of January from previous 3.36% while core inflation is at 3.71% from 3.44% yoy.

1H-January inflation by components
% bi-weekly incidence

	Banorte-Ixe	2016	Difference
Total	1.27	0.03	1.24
Core	0.27	0.06	0.21
Goods	0.17	0.07	0.10
Processed foods	0.12	0.05	0.07
Other goods	0.05	0.02	0.03
Services	0.10	-0.01	0.11
Housing	0.02	0.02	0.00
Education	0.02	0.02	0.00
Other services	0.06	-0.05	0.11
Non-core	1.00	-0.03	1.03
Agriculture	0.02	0.02	0.00
Fruits & vegetables	0.01	0.03	-0.02
Meat & eggs	0.02	-0.01	0.02
Energy & government tariffs	0.98	-0.06	1.04
Energy	0.92	-0.11	1.03
Government tariffs	0.06	0.05	0.01

Source: Banorte-Ixe with data from INEGI
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 2.9% yoy expansion in November's IGAE. On Tuesday, at 9:00am (EST), *INEGI* will release its monthly global economic indicator for November (GDP monthly proxy), where we expect a 2.9% yoy expansion. We believe that Mexico's economic growth will be explained by a 1.3% expansion in industrial production, coupled with a 3.8% yoy increase in services output.

As we had mentioned in our last report, IP's expansion in November was partially explained by the 4.3% increase in manufacturing output. In addition, construction output posted a 3.6% growth, despite the 13.6% reduction of public civil engineering construction projects given the fiscal cuts implemented by the Federal Government. By contrast , mining activity fell 9.1% 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 3.8% yoy estimated expansion in services will be explained by the acceleration in private consumption during November. In addition, we believe that all the services that hold a strong correlation with manufacturing activity, such as trade and transportation, will also expand.

Weekly international reserves report. On Tuesday, at 9:00am (EDT), Banco de Mexico will release its weekly balance report. Last week, net international reserves rose by US$176 million amounting to US$174.9 billion on the second week of January. According to Banxico's report, this figure comes mainly as a result of a US$182 million increase due to changes in the valuation of the Central Bank's assets. In this context, the Central Bank's international reserve have diminished by US$1.640 billion this year (please refer to the table below).

Banxico's foreign reserve accumulation details
US$, million

	2015	Jan/13/2017	Jan/13/2017	Year-to-date
	Balance		Flows	
International reserves (B)-(C)	176,542	174,902	176	-1,640
(B) Gross international reserve	178,025	176,749	-1,097	-1,276
Pemex	--	--	321	-47
Federal government	--	--	277	386
Market operations	--	--	-2,000	-2,000
Other	--	--	306	385
(C) Short-term government's liabilities	1,483	1,847	-1,273	364

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 5-year fixed-rate Mbonos (Jun'22), as well as 10-year inflation-linked Udibonos (Dec,25), 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, January 24, 2016)

	Maturity	Coupon rate, %	To be auctioned[1]	Previous yield[2]
Cetes				
1m	23-Feb-17	- -	6,000	5.86
3m	27-Abr-17	- -	10,000	6.31
6m	20-Jul-17	- -	11,500	6.60
M Bono				
5y	9-Jun-22	6.50	8,000	7.25
Udibonos				
10y	4-Dic-25	4.50	4,500	3.00

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

Retail sales will post a 8.4% yoy expansion in November. On Wednesday at 9:00am (EST), *INEGI* will publish its retail sales report for November, where we anticipate an 8.4% yoy expansion. Retail sales' growth will be explained by the favorable performance of durable goods sales. In particular, vehicles sales increased by 22.5% yoy according to *AMIA's* report. In addition, *ANTAD* total store sales posted a 5.5% yoy growth in real terms during the period in question. However, retail sales growth will be bounded by the 7.9% yoy contraction in consumption goods imports.

Exports will show a significant recovery. Finally, on Thursday at 9:00am (EST), Banxico and *INEGI* will make available its preliminary trade report for December, where we expect to see a US$504.3 million deficit. On the exports side, we will probably see a 44.5% yoy expansion of oil exports as a result of the higher prices for the Mexican crude oil basket (+56.1% yoy). In addition, non-oil exports could have increased 4.8% yoy, on the back of a 4.6% hike in manufacturing exports.

On the imports side, we estimate a 5.9% 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 5.9% yoy, while imports of intermediate goods could have increased a scant 1.8% yoy. Finally, we estimate a 1.5% contraction in capital goods imports.

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