Ahead of the Curve

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Market focus this week will be on August's economic activity and the inflation report for the first half of October

- **Economic activity indicator (August).** On Tuesday, *INEGI* will also release its monthly global economic indicator for August (GDP monthly proxy), where we expect a 1.9% yoy expansion, above July's 1% growth. As we mentioned in our last report, IP's contraction in August was explained by the 9.7% yoy reduction in mining output, as a result of the significant fall in Mexico's oil production, as well as the lower investment in Mexico's drilling projects. Moreover, we believe that services will show a 3.7% yoy expansion, as a result of the positive trend in the formal labor market coupled with an above-trend growth in banking credit

- **Bi-weekly inflation report (1H-October).** On Tuesday, at 9:00am, *INEGI* will release its bi-weekly inflation report for the first half of October. We are forecasting a 0.62% 2w/2w increase in the headline index, while we expect the core index to rise 0.17% 2w/2w. Inflation during the period in question will be explained both by the end of the summer discounts on electricity tariffs, as well as the rebound in mobile telephone service and public transportation –particularly subway tariffs–after the suspension of collection from these services in aftermath of the September 19 earthquake. However, these pressures will be mitigated by declines in the prices of agricultural goods.

Mexico weekly calendar

DATE	TIME (EDT)	EVENT	PERIOD	UNIT	BANORTE-IXE	CONSENSUS	PREVIOUS
Tue 24-Oct	**9:00am**	**Global economic indicator**	August	% yoy	1.9	--	1.0
		(sa)		**% m/m**	0.7	--	-0.7
		Primary activities		% yoy	-4.3	--	2.0
		Industrial production		% yoy	-0.5	--	-1.6
		Services		% yoy	3.7	--	2.4
Tue 24-Oct	**9:00am**	**CPI inflation**	1H-Oct	% 2w/2w	0.62	--	-0.17
				% yoy	6.30	--	6.35
		Core		% 2w/2w	0.17	--	-0.04
				% yoy	4.71	--	4.80
Tue 24-Oct	**10:00am**	**International reserves**	20-Oct	US$ bn	--	--	173.2
Tue 24-Oct	**12:30pm**	**Government weekly auction: 1-, 3-, 6-month CETES; 30y Mbono (Nov'47); 5y Bondes D**					
Wed 25-Oct	**9:00am**	**Retail sales**	August	% yoy	0.2	--	0.4
		sa		% m/m	-0.2	--	0.3
Thu 26-Oct	**9:00am**	**Trade balance**	September	US$ mn	-538.0	--	-2,372.5
		Total exports		% yoy	9.3	--	10.3
		Oil exports		% yoy	23.3	--	4.1
		Non-oil exports		% yoy	8.5	--	10.6
		Total imports		% yoy	6.0	--	12.2

Source: Banorte-IXE; Bloomberg

Proceeding in chronological order...

We expect a 1.9% yoy expansion in August's IGAE. On Tuesday, *INEGI* will release its monthly global economic indicator for August (GDP monthly proxy), where we expect a 1.9% yoy expansion, above July's 1% growth.

As we mentioned in our last report, IP's contraction in August was explained by the 9.7% yoy reduction in mining output, as a result of the significant fall in Mexico's oil production, as well as the lower investment in Mexico's drilling projects. With July's figure, mining activity now adds 38 consecutive months in contraction. In addition, construction posted a 1.6% yoy contraction, which was explained by the 2.5% reduction in building projects, whereas public civil engineering construction projects declined 2.4% yoy, given the austerity program implemented by the Federal Government. By contrast, manufacturing output increased 3.3% yoy.

Moreover, we believe that services will show a 3.7% yoy expansion, as a result of the positive trend in the formal labor market coupled with an above-trend growth in banking credit. However, we believe that the scant expansion in retail sales will limit services growth in August.

Inflation during the first half of October will be explained by increases in electricity tariffs and the rebound in mobile phone and public transportation components. On Tuesday, at 9:00am, *INEGI* will also release its bi-weekly inflation report for the first half of October. We are forecasting a 0.62% 2w/2w increase in the headline index, while we expect the core index to rise 0.17% 2w/2w.

Inflation during the period in question will be explained both by the end of the summer discounts on electricity tariffs, as well as the rebound in mobile telephone service and public transportation –particularly in subway tariffs–after the suspension of the collection from these services in the aftermath of the September 19 earthquake. However, these pressures will be mitigated by declines in the prices of agricultural goods.

We forecast inflation to be 13bp higher when compared to the same period of last year, derived from: (1) 15bp from a greater contribution of government tariffs (-3bp vs. 0.9bp in 2016); (2) 6bp from a lower contribution of fresh fruits and vegetables (-7bp vs. -1bp in 2016); (3) 3bp stemming from a higher contribution of other services (7bp vs. 4bp in 2016); and (4) 3bp as a result of greater energy contributions (41bp vs. 38bp in 2016), as shown in the table on the next page.

With these results, annual inflation will stand at 6.30% in the first half of October, (previous: 6.35% yoy), while core inflation will be at 4.71% (previous: 4.8% yoy). Moving forward, we will focus on the evolution of energy prices and the behavior of agricultural prices, and the impact they might have in Mexico's CPI.

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

	2017 P	2016	Difference
Headline	0.62	0.49	0.13
Core	0.13	0.13	0.00
Goods	0.04	0.07	-0.03
Processed foods	0.02	0.04	-0.02
Other goods	0.03	0.03	-0.01
Services	0.09	0.05	0.03
Housing	0.02	0.02	0.00
Education	0.00	0.00	0.00
Other services	0.07	0.04	0.03
Non-core	0.49	0.37	0.12
Agricultural	-0.07	-0.01	-0.06
Fresh fruits and vegetables	-0.05	-0.01	-0.04
Meat and egg	-0.02	0.00	-0.02
Energy and government regulated	0.56	0.38	0.18
Energy	0.41	0.38	0.03
Government regulated	0.15	0.00	0.15

Source: Banorte-Ixe, INEGI

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$313 million amounting to US$172.9 billion. According to Banxico's report, this figure comes mainly as a result of a positive valuation effect in central bank assets. In this context, the Central Bank's international reserves have diminished by US$3.4 billion this year (please refer to the table in the next page).

Banxico's foreign reserve accumulation detail
US$, million

	2016	Oct 13, 2017	Oct 13, 2017	Year-to-date
	Balance		Flows	
International reserves (B)-(C)	176,542	173,186	313	-3,356
(B) Gross international reserve	178,025	177,023	393	-1,002
Pemex	--	--	-1,136	-746
Federal government	--	--	1,767	-1,953
Market operations	--	--	0	-2,000
Other	--	--	-237	3,697
(C) Short-term government's liabilities	1,483	3,838	80	2,354

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'47) and 5 year Bondes D, in addition to the "more traditional" 1-, 3- and 6-month zero-coupon Cetes (please refer to the table on the next page). As usual, the results will be released at 12:30pm (EDT).

Auction specifics (Tuesday, October 24, 2017)

	Maturity	Coupon rate, %	To be auctioned[1]	Previous yield[2]
Cetes				
1m	23-Nov-17	- -	7,000	7.04
3m	25-Jan-18	- -	11,000	7.14
6m	26-Apr-18	- -	11,500	7.27
Bondes D				
5y	08-Sep-22	- -	3,750	0.19
M Bono				
30y	07-Nov-47	8.00	3,500	7.19

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 0.5% yoy expansion in August. On Wednesday at 9:00am (EDT), *INEGI* will publish its retail sales report for August, where we anticipate a 0.2% yoy expansion, marginally below the 0.4% expansion observed in July.

We believe that retail sales' scant expansion will be explained by the 6.5% reduction in vehicle sales. In addition, *ANTAD* same store sales posted a 2.5% yoy decrease in real terms. By contrast, non-oil consumption goods expanded 7.6% yoy, which will partially compensate the fall in vehicle and *ANTAD* sales.

Oil exports will continue to recover. On Thursday at 9:00am (EDT), Banxico and *INEGI* will make available its preliminary trade report for September, where we expect to see a US$538 million deficit. On the exports side, we will probably see a 23.3% yoy expansion of oil exports as a result of higher prices for the Mexican crude oil basket (27.4% yoy). In addition, non-oil exports could have increased 8.5% yoy, on the back of an 8.9% hike in manufacturing exports.

On the imports side, we estimate a 6% 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 edged-up to 8.6% yoy, while imports of intermediate goods could have increased 5.9% yoy. Finally, we estimate a moderate 3.3% expansion in capital goods imports.

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