

Ahead of the Curve

January 6, 2017

Market focus this week will on December's inflation report and on November's industrial production

- **Monthly inflation (December).** On Monday, at 9:00am (EST), INEGI will release its monthly inflation report. We are forecasting a 0.55% m/m increase in December, above Bloomberg's consensus of 0.52%. In the core index, we expect a 0.5% m/m increase (consensus: 0.48%). With these results, we expect inflation to close the year at 3.46% yoy, while core inflation will stand at 3.49% yoy. For 2017, we expect inflation by year-end to reach 4.7%
- **Industrial production (November).** On Wednesday at 9:00am (EST), INEGI will release its monthly industrial production report. We anticipate a 1.2% yoy expansion in total output during November, after the 1.4% contraction in October. We believe that manufacturing production could post a 3.1% yoy growth, also we expect a 4.9% yoy increase in construction output, while we forecast an 8.3% yoy reduction in mining activity derived from lower oil production and the reduction in the extraction of other minerals.

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Mexico's weekly calendar

DATE	HOOR (EST)	EVENT	PERIOD	UNIT	BANORTE-IXE	CONSENSUS	PREVIOUS
Mon 9-Jan	9:00am	CPI inflation	December	% m/m	<u>0.55</u>	<u>0.52</u>	0.78
				% yoy	<u>3.46</u>	<u>3.43</u>	3.31
		Core		% m/m	<u>0.50</u>	<u>0.48</u>	0.22
				% yoy	<u>3.49</u>	--	3.29
Tue 10-Jan	9:00am	Gross fixed investment	October	% yoy	<u>-0.3</u>	<u>0.3</u>	0.7
				Machinery and equipment	% yoy	<u>-1.6</u>	--
		Domestic		% yoy	<u>8.7</u>	--	13.2
		Imported		% yoy	<u>-6.3</u>	--	2.4
		Construction		% yoy	<u>0.6</u>	--	-2.6
		Wage negotiations		%	<u>4.9</u>	--	4.5
Tue 10-Jan	10:00am	International reserves	6-Jan	US\$ mn	--	--	176.5
Tue 10-Jan	12:30pm	Government weekly auction: 1-, 3-, 6-month CETES; 3y MBono (Jun'20); 3y UdiBonos (Dec'20)					
Wed 11-Jan	9:00am	Industrial production	November	% yoy	<u>1.2</u>	<u>0.5</u>	-1.4
				(sa)	% m/m	<u>-0.3</u>	<u>0.0</u>
		Mining		% m/m	<u>-8.3</u>	--	-9.0
		Utilities		% m/m	<u>1.3</u>	--	1.8
		Construction		% m/m	<u>4.9</u>	--	2.5
		Manufactures		% m/m	<u>3.1</u>	<u>1.6</u>	-0.6

Source: Banorte-IXE

Proceeding in chronological order...

Inflation in December will be explained by pressures on the price of services along with higher prices of agricultural goods. On Monday, at 9:00am (EST), *INEGI* will release its monthly inflation report. We are forecasting a 0.55% m/m increase in December, above *Bloomberg's* consensus of 0.52%. In the core index, we expect a 0.5% m/m increase (consensus: 0.48%).

Inflation during the period in question will be explained by pressures on services prices, mainly in the “*other services*” sub-index, which encompasses air fares and tourism services. The higher prices of these components are usually influenced by the December holiday. We also expect higher agricultural prices, mainly in the “meat and egg” sub-index given the same seasonal effect.

We expect this figure to be 14.8bps higher than the observed in same period last year, derived from: (1) 11.1bps stemming from a higher contribution of services (26.6bps vs. 15.5 in 2015); (2) 6.6bps from a higher contribution of energy prices (2bps vs. -4.5 in 2015); (3) by contrast, we expect -7.1bps from a lower contribution agricultural prices (14.4bps vs. 21.5 in 2015); and (4) 1.1bps stemming from a higher contribution of government tariffs (1.4bps vs. 0.2 in 2015), as shown in the table below.

Inflation by components in December

%monthly incidence

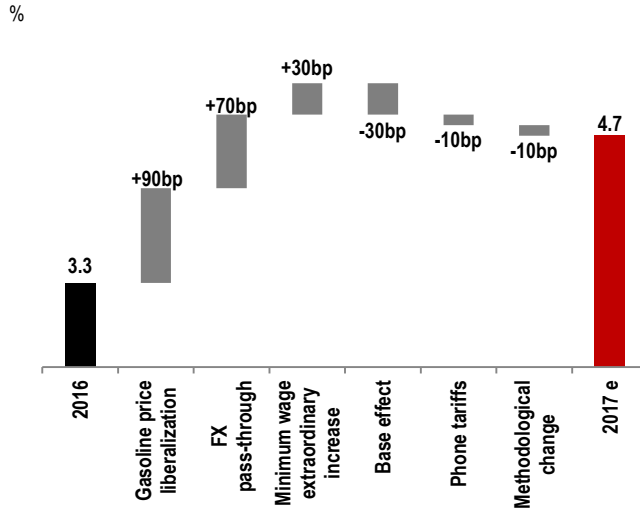
	Banorte-Ixe	2015	Difference
Total	0.55	0.41	0.15
Core	0.37	0.23	0.15
Goods	0.11	0.07	0.03
Processed foods	0.08	0.05	0.02
Other goods	0.03	0.02	0.01
Services	0.27	0.15	0.11
Housing	0.04	0.03	0.00
Education	0.00	0.00	0.00
Other services	0.23	0.12	0.11
Non-core	0.18	0.18	0.00
Agriculture	0.14	0.22	-0.07
Fruits & vegetables	0.05	0.20	-0.15
Meat & eggs	0.09	0.02	0.08
Energy & government tariffs	0.03	-0.04	0.08
Energy	0.02	-0.05	0.07
Government tariffs	0.01	0.00	0.01

Source: Banorte-Ixe with data from INEGI and Banco de México.

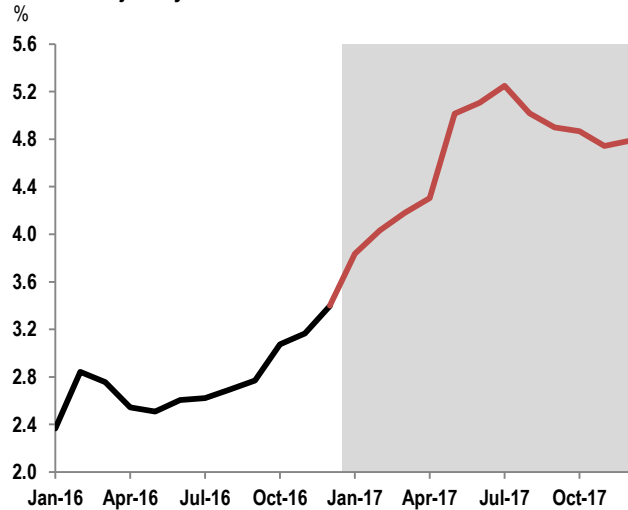
Note: Contributions might not add due to the number of decimals allowed in the table.

With these results, we expect inflation to close the year at 3.46% yoy, while core inflation will stand at 3.49% yoy. For 2017, we expect inflation by year-end to reach 4.7% as a result of: (1) the liberalization of gasoline prices; (2) further FX pass-through due to MXN depreciation to prices; and (3) the increase in the minimum wage (refer to the chart on the next page).

Inflation forecast 2017



Inflation trajectory 2017



Fuente: Banorte-IXE

We expect a 0.9% yoy expansion in October's GFI. On Tuesday at 9:00am (EST), *INEGI* will publish October's gross fixed investment (GFI) report. We anticipate GFI down by -0.3% yoy. We believe that within the report we will probably see a 6.3% yoy reduction in imported machinery and equipment, given that trade balance figures showed a similar decline for capital goods imports. Moreover, we expect an 8.7% growth in domestic machinery and equipment. Finally, we believe that construction spending increased 0.6% yoy derived from the lower public construction spending observed in the latest industrial production figures.

GFI estimates: October 2016

% yoy; %-pts

%yoy	Oct-16	Oct-15	Jan-Oct, '16	Jan-Oct, '15
Total	-0.3	1.1	0.2	5.1
Machinery and equipment	-1.6	4.8	1.0	9.1
Domestic	8.7	6.5	8.7	9.9
Imported	-6.3	4.0	-2.5	8.7
Construction	0.6	-1.3	-0.4	2.7

Annual contribution	Oct-16	Oct-15	Difference
Total	-0.3	1.1	-1.4
Machinery and equipment	-0.6	1.9	-2.5
Domestic	1.1	0.8	0.3
Imported	-1.7	1.1	-2.8
Construction	0.4	-0.8	1.1

Source: Banorte-Ixe

Weekly international reserves report. Moreover, on Tuesday, at 10:00am (EDT), Banco de Mexico will release its weekly balance report. We highlight that this week, the Foreign Exchange Commission (FEC) announced that it had been selling dollars in the FX market. No additional measures or the amount sold were disclosed in the statement. The FEC stated that additional discretionary sales can't be discarded in the case of exceptional market conditions.

Last week, net international reserves increased by US\$257 million amounting to US\$176.5 billion on the last trading day of December. According to Banxico's report, this figure comes mainly as a result of: (1) Dollar sales by Banxico to the Federal Government for US\$13 million; along with a (2) US\$270 million increase due to changes in the valuation of the Central Bank's assets. In this context, the Central Bank's international reserves diminished by US\$194 million this year (please refer to the table below).

Banxico's foreign reserve accumulation details

US\$, million

	2015	30/Dic/2016	30/Dic/2016	Year-to-date
	Balance		Flows	
International reserves (B)-(C)	176,735	176,542	257	-194
(B) Gross international reserve	177,597	178,025	-2,790	428
Pemex	--	--	-2,236	2,621
Federal government	--	--	-83	1,919
Market operations	--	--	0	-5,562
Other	--	--	-472	1,515
(C) Short-term government's liabilities	861	1,483	-3,047	623

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 3-year fixed-rate Mbonos (Jun'20), as well as 3-year inflation-linked Udibonos (Dic'20), 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 10, 2016)

	Maturity	Coupon rate, %	To be auctioned ¹	Previous yield ²
Cetes				
1m	9-Feb-17	--	9,000	5.82
3m	12-Abr-17	--	12,000	6.02
6m	6-Jul-17	--	11,500	6.32
MBono				
3y	11-Jun-20	8.00	8,500	6.45
Udibono				
3y	10-Dic-20	2.50	950	2.58

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

Wage negotiations will accelerate after the minimum wage increase. Also on Tuesday, the Ministry of Labor will release the monthly report for contractual wage negotiations. We estimate an annual average increase of 4.9%, above 2016's average of 4.1%. The increase is mainly driven by the announcement of the 9.8% raise to the minimum wage, which we expect to have an impact not just on this month's negotiations, but on the following months. Some of the negotiations that took place include increases to the government workers in Baja California (+5.7%), the Audi syndicate (+5.8), as well as workers from *Infonavit* (+4%), and several municipal workers around the country.

We expect a 1.2% yoy expansion in November's industrial output. On Wednesday at 9:00am (EST), *INEGI* will release its monthly industrial production report. We anticipate a 1.2% yoy expansion in total output during November, after the 1.4% contraction in October.

Taking a look at the breakdown, we believe that manufacturing production could post a 3.1% yoy growth, explained by: (1) the 0.3% yoy expansion in the US manufacturing sector (NAICS, original figures); (2) the 7.4% yoy increase in Mexico's vehicle production; and (3) the 10.3% yoy increase in manufacturing exports.

In addition, the 1.2% yoy expansion in industrial output during November will be also explained by the 4.9% yoy increase in construction output as a result of the higher growth in private construction investment projects. By contrast, we expect a 8.3% yoy reduction in mining activity derived from lower oil production and the reduction in the extraction of other minerals.

Industrial production estimates: November 2016

% yoy	Nov-16	Nov-15	Jan-Nov, '16	Jan-Nov, '15
Total	1.2	-0.1	0.0	1.0
Mining	-8.3	-4.4	-5.9	-4.6
Utilities	1.3	3.3	3.0	2.4
Construction	4.9	-1.4	1.9	2.9
Manufacturing	3.1	1.9	1.1	2.5

%m/m sa	Nov-16	Oct-16	Difference
Total	0.3	0.1	0.2
Mining	-0.5	-0.1	-0.4
Utilities	-0.4	0.2	-0.5
Construction	0.6	0.8	-0.2
Manufacturing	0.9	0.3	0.6

Source: Banorte-Ixe

Disclaimer

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