

Ahead of the Curve

November 3, 2017

Market focus this week will be on the Banxico's monetary policy announcement and October's inflation

- **Banxico's monetary policy announcement (November).** On Thursday, Banxico will announce its monetary policy decision at 2:00pm (ET), where we do not expect an addition increase of the central bank's reference rate, which currently stands at 7%. It is worth noting that this will be the last monetary policy meeting of Agustín Carstens as Governor of Banco de Mexico. Regarding the monetary policy announcement, although it is likely that the Board will maintain a hawkish tone, where several members allude to the possibility of making upward adjustments to the reference rate, we consider that the reference rate will remain unchanged for the remainder of the year
- **Monthly inflation report (October).** Also on Thursday, at 9:00am, *INEGI* will also release its monthly inflation report for October. We are forecasting a 0.66% m/m increase in the headline index, while we expect the core index to rise 0.26% m/m. 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.

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Mexico weekly calendar

DATE	TIME (ET)	EVENT	PERIOD	UNIT	BANORTE-IXE	CONSENSUS	PREVIOUS
Mon 6-Nov	9:00am	Consumer confidence	October	index	83.9	--	89.2
Tue 7-Nov	9:00am	Gross fixed investment	August	% yoy	0.8	--	-0.1
		Machinery and equipment		% yoy	6.0	--	5.9
		Domestic		% yoy	3.2	--	8.6
		Imported		% yoy	8.1	--	4.0
		Construction		% yoy	-3.3	--	-4.2
Tue 7-Nov	10:00am	International reserves	Nov-3	US\$ bn	--	--	172.8
Tue 7-Nov	12:30pm	Government weekly auction: 1-, 3-, 6-, and 12-month Cetes; 10y MBono (Jun'27); 30y Udibono (Nov'46); 5y Bondes D					
Tue 7-Nov	4:30pm	Citibanamex bi-weekly survey of economic expectations					
Thu 9-Nov	9:00am	CPI inflation	October	% m/m	0.66	--	0.31
				% yoy	6.41	--	6.35
		Core		% m/m	0.26	--	0.28
				% yoy	4.78	--	4.80
Thu 9-Nov	2:00pm	Banxico's monetary policy decision	November	%	7.00	--	7.00
Fri 10-Nov		Wage negotiations	October	%	3.5	--	5.1
Fri 10-Nov	9:00am	Industrial production	September	% yoy	-0.7	--	-0.1
		(sa)		% m/m	-0.5	--	0.3
		Mining		% yoy	-9.0	--	-9.0
		Utilities		% yoy	-2.3	--	-1.4
		Construction		% yoy	0.0	--	-1.3
		Manufacturing		% yoy	2.1	--	3.7

Source: Banorte-IXE; Bloomberg

Proceeding in chronological order...

Consumer confidence affected by Mexico City's earthquake. On Monday at 9:00am (ET), Banxico and *INEGI* will publish its October's monthly survey on consumer confidence, where we expect a 1.3% yoy contraction, with the index reaching 83.9 points. In seasonally adjusted terms, we expect confidence levels to fall 5.9% m/m.

We believe that the reduction in consumer confidence will be explained by the recent earthquake which affected Mexico City, Puebla, Guerrero, and Morelos. It is likely that consumers probably discounted a less favorable future scenario for both the Mexican economy and Mexican households given the economic impact of these events.

Despite that the earthquake in Mexico City and its neighboring states took place on September 19, we believe that the impact will be captured in October's survey, given that consumer confidence survey is collected during the first 20 days of each month, which implies that September's survey didn't depicted the fall in consumers' sentiment after the earthquake.

We expect a 0.8% yoy expansion in August's GFI. On Tuesday at 9:00am (ET), *INEGI* will publish its August's gross fixed investment (GFI) report. We anticipate GFI up by 0.8% yoy. We believe that within the report we will probably see an 8.1% yoy increase in imported machinery and equipment, given that trade balance figures showed a similar growth for capital goods imports.

Moreover, we expect a 3.2% growth in domestic machinery and equipment. Finally, we believe that construction spending fell 3.3% yoy derived from the lower public construction spending observed in the latest industrial production figures.

GFI estimates: August 2017

% yoy; %-pts

%yoy	Aug-17	Aug-16	Jan-Aug, '17	Jan-Aug, '16
Total	0.8	1.7	-1.1	1.5
Machinery and equipment	6.0	9.7	3.8	3.6
Domestic	3.2	10.4	3.2	10.0
Imported	8.1	9.2	4.2	-0.6
Construction	-3.3	-4.0	-4.5	0.1
Annual contribution	Aug-17	Aug-16	Difference	
Total	0.8	1.7	-0.8	
Machinery and equipment	2.7	4.0	-1.3	
Domestic	0.6	1.8	-1.2	
Imported	2.1	2.2	-0.1	
Construction	-1.8	-2.3	0.5	

Source: Banorte-Ixe

Weekly international reserves report. Also on Tuesday, at 10:00am (ET), Banco de Mexico will release its weekly balance report. Last week, net international reserves decreased by US\$165 million amounting to US\$172.8 billion. According to Banxico’s report, this figure comes mainly as a result of a negative valuation effect in central bank assets. In this context, the Central Bank’s international reserves have diminished by US\$3.7 billion this year (please refer to the table in the next page).

Banxico's foreign reserve accumulation detail
US\$, million

	2016	Oct 27, 2017	Oct 27, 2017	Year-to-date
	Balance		Flows	
International reserves (B)-(C)	176,542	172,820	-165	-3,722
(B) Gross international reserve	178,025	177,179	260	-846
Pemex	--	--	254	-544
Federal government	--	--	-26	-2,071
Market operations	--	--	0	-2,000
Other	--	--	32	3,769
(C) Short-term government's liabilities	1,483	4,359	425	2,876

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 10-year fixed rate Mbonos (Jun’27), 30-year inflation-linked Udibonos (Nov’46), and 5-year Bondes D, in addition to the “more traditional” 1-, 3-, 6-, and 12-month zero-coupon Cetes (please refer to the table on the next page). As usual, the results will be released at 12:30pm (ET).

Auction specifics (Tuesday, November 7, 2017)

	Maturity	Coupon rate, %	To be auctioned ¹	Previous yield ²
Cetes				
1m	17-Dec-17	--	7,000	7.03
3m	08-Feb-18	--	11,000	7.13
6m	10-May-18	--	11,500	7.23
12m	11-Oct-18	--	12,500	7.18
Bondes D				
5y	08-Sep-22	--	3,750	0.18
M Bono				
10y	03-Jun-27	7.50	8,500	6.79
Udibono				
30y	08-Nov-46	4.00	UDIS 400	3.74

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

Citibanamex Survey: Market participants will focus on inflation and monetary policy forecasts. Additionally, on Tuesday around 3:30pm (ET) Citibanamex will release its bi-weekly survey of economic expectations, where focus will be on analysts’ inflation forecasts for October. Furthermore, attention will be on monetary policy assessments, considering that Banxico’s next monetary policy announcement will take place on Thursday. In addition, the survey will also contain forecasts for growth and FX estimations for YE17 and YE18. In the first case, we do not expect strong revisions to the median GDP forecast. In the second case, we expect moderate upward revisions to the FX estimates for 2017.

Inflation during October will be explained by increases in electricity tariffs and the rebound in mobile phone and public transportation components.

On Thursday, at 9:00am, *INEGI* will also release its monthly inflation report for October. We are forecasting a 0.66% m/m increase in the headline index, while we expect the core index to rise 0.26% m/m.

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 6bp higher when compared to the same period of last year, derived from: (1) 11bp from a greater contribution of government tariffs (12bp vs. 1bp in 2016); (2) 9bp from a higher impact of energy (47bp vs. 38bp in 2016); and (3) 12bp stemming from a lower contribution of fruits and vegetables (-12bp vs. 0bp in 2016), as shown in the table on the next page.

With these results, annual inflation will stand at 6.41% in October, (previous: 6.35% yoy), while core inflation will be at 4.78% (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.

October inflation by components
% monthly incidence

	2017 P	2016	Difference
Headline	0.66	0.61	0.06
Core	0.20	0.21	-0.01
Goods	0.10	0.14	-0.04
Processed foods	0.05	0.08	-0.03
Other goods	0.05	0.06	-0.01
Services	0.10	0.07	0.03
Housing	0.03	0.03	0.00
Education	0.00	0.00	0.00
Other services	0.07	0.04	0.03
Non-core	0.47	0.39	0.07
Agricultural	-0.13	0.00	-0.12
Fresh fruits and vegetables	-0.12	0.00	-0.12
Meat and egg	-0.01	0.00	0.00
Energy and government regulated	0.59	0.40	0.20
Energy	0.47	0.38	0.09
Government regulated	0.12	0.01	0.11

Source: Banorte-Ixe, INEGI

Banxico's monetary policy announcement – No changes in the reference rate. On Thursday, Banxico will announce its monetary policy decision at 2:00pm (ET), where we do not expect an additional increase of the central bank's reference rate, which currently stands at 7%. It is worth noting that this will be the last monetary policy meeting of Agustín Carstens as Governor of Banco de México. The departure of the Governor responds to his appointment as General Manager of the Bank for International Settlements (BIS). In this sense, Dr. Carstens would be the first Mexican to achieve that position.

Among his greatest achievements at the head of Banxico, we highlight the profound modification in the communication of the central bank with the publication of the minutes of the monetary policy meetings stands out. Additionally, during his period as Governor, annual inflation reached its lowest level in the economic history of our country.

Regarding the monetary policy announcement, although it is likely that the Governing Board will maintain a hawkish tone, where several members will allude to the possibility of making upward adjustments to the reference rate, we consider that the reference rate will remain unchanged for the remainder of the year, since inflation has already reached its maximum level in August and will maintain a downward trajectory for the remainder of the year. In this context, we believe that it is very likely that the complex circumstances will dissipate towards the second half of 2018 and that in conjunction with an inflation trajectory converging towards the objective, there will be a space for an easing cycle. Thus, we continue to anticipate two 50bp cuts in the second half of 2018, with the possibility of a total monetary relaxation cycle of up to 200bp that would occur between 2018 and 2019.

We expect a 0.7% yoy contraction in September's industrial output. On Friday at 9:00am (ET), *INEGI* will release its monthly industrial production report. We anticipate a 0.7% yoy contraction in total output during September, after the 0.1% contraction in the previous month. Taking a look at the breakdown, manufacturing production could post a moderate 2.1% yoy expansion, in the wake of the work stoppage of several workers during the days following the earthquakes.

In addition, industrial output during September will be also explained by: (1) The null expansion in construction output, as a result of the lower growth in private construction investment projects also derived from the work stoppage following the earthquakes, coupled with the contraction in public investment projects given the Federal Government's austerity program; and (2) the poor performance of mining activity, where we estimate a 9% yoy contraction.

Industrial production estimate: September 2017

% yoy nsa; % m/m sa

% yoy	Sep-17	Sep-16	Jan-Sep, '17	Jan-Sep, '16
Total	-0.7	-1.8	-0.5	0.5
Mining	-9.0	-5.8	-9.4	-3.1
Utilities	-2.3	-1.2	-0.7	0.4
Construction	0.0	-2.7	-1.2	1.9
Manufacturing	2.1	0.1	3.3	1.3
%m/m sa	Sep-17	Aug-17	Difference	
Total	-0.5	0.3	-0.8	
Mining	-0.2	-2.0	1.8	
Utilities	-1.2	-0.5	-0.7	
Construction	1.3	-0.1	1.4	
Manufacturing	-1.8	0.6	-2.4	

Source: Banorte-ixe

Wage negotiations will climb 3.5% during October. Finally, on Friday, the Ministry of Labor (MoL) will publish the contractual wage negotiations for October. We expect workers to have negotiated an average increase of 3.5%, below the 5.1% increase seen in September. This figure will be mainly explained by the 3.05% rise to the syndicated workers of the Mexican Social Security Institute (IMSS), which benefited more than 400 thousand workers. However, we believe that negotiations in the private sector will remain relatively high due to two factors: (1) The minimum wage increase that was announced last December; and (2) the elevated inflation observed throughout 2017.

Disclaimer

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