

Ahead of the Curve

June 1, 2018

Market focus this week will be on May's inflation and consumer confidence

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- **Monthly inflation report (May).** On Thursday, at 9:00am, *INEGI* will release its monthly inflation report for May. We are forecasting a 0.23% m/m fall in the headline index, while we expect the core index to increase 0.23% m/m. Inflation during the period in question will be mainly explained by the start of the summer discounts in electricity tariffs in the first half of the month, as well as an additional fall in fresh fruits and vegetables prices. However, these will be partially offset by a higher contribution from processed foods and other energy prices. With these results, annual inflation will stand at 4.43% in May, lower than the 4.55% seen in April. Moreover, we forecast core inflation at 3.66% yoy (previous: 3.71% yoy).
- **Consumer confidence (May).** On Tuesday, at 9:00am (EDT), Banxico and *INEGI* will publish its monthly survey on consumer confidence for the fifth month of 2018, where we expect a 1.3% yoy expansion, with the index reaching 87.7 points. In seasonally adjusted terms, we expect confidence levels to only increase 0.2% in the monthly comparison. We believe that the 0.2% rise in consumer confidence will be explained by: (1) The growth momentum in the Mexican labor market; and (2) inflation's downward trend. However, this will be partially offset by the volatility of the Mexican currency during the month

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Document for distribution among the general public

Mexico weekly calendar

| DATE | HOUR (ET) | EVENT | PERIOD | UNIT | BANORTE | CONSENSUS | PREVIOUS |
|-----------|-----------|---|--------|---------|--------------|-----------|----------|
| Mon 4-Jun | 9:00am | Consumer confidence | May | index | <u>87.7</u> | -- | 85.5 |
| Tue 5-Jun | 10:00am | International reserves | Jun-1 | US\$ bn | -- | -- | 173.1 |
| Tue 5-Jun | 12:30pm | Government weekly auction: 1-, 3-, 6-month CETES; 10y Mbono (Jun'27); 5y Bondes D | | | | | |
| Tue 5-Jun | 4:30pm | Citibanamex bi-weekly survey of economic expectations | | | | | |
| Wed 6-Jun | 9:00am | Gross fixed investment | March | % yoy | <u>-2.6</u> | -- | 4.8 |
| | | Machinery and equipment | | % yoy | <u>-1.7</u> | -- | 3.0 |
| | | Domestic | | % yoy | <u>-3.1</u> | -- | 7.7 |
| | | Imported | | % yoy | <u>-0.4</u> | -- | 1.8 |
| | | Construction | | % yoy | <u>-3.5</u> | -- | 12.0 |
| Thu 7-Jun | 9:00am | CPI inflation | May | % m/m | <u>-0.23</u> | -- | -0.34 |
| | | | | % yoy | <u>4.43</u> | -- | 4.55 |
| | | Core | | % m/m | <u>0.23</u> | -- | 0.15 |
| | | | | % yoy | <u>3.66</u> | -- | 3.71 |
| Fri 8-Jun | | Wage negotiations | May | % | <u>4.8</u> | -- | 4.6 |

Source: Banorte; Bloomberg

Proceeding in chronological order...

Consumer confidence will continue to recover in May. On Tuesday, at 9:00am (EDT), Banxico and *INEGI* will publish its May's monthly survey on consumer confidence, where we expect a 1.3% expansion, with the index reaching 87.7 points. In seasonally adjusted terms, we expect confidence levels to only increase 0.2% in the monthly comparison.

We believe that the 0.2% rise in consumer confidence will be explained by: (1) The growth momentum in the Mexican labor market; and (2) inflation's downward trend. In this regard, headline inflation in the first half of May stood at 4.46% yoy from the 6.78% observed in December. However, this will be partially offset by the volatility of the Mexican currency during the month.

Weekly international reserves report. In addition, on Tuesday, at 10:00am (ET), Banco de Mexico will release its weekly balance report. Last week, net international reserves increased by US\$205 million amounting to US\$173.1 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 increased by US\$316 million during 2018 (please refer to the table below).

Banxico's foreign reserve accumulation detail

US\$, million

| | 2017 | May 25, 2018 | May 25, 2018 | Year-to-date |
|---|---------|--------------|--------------|--------------|
| | Balance | | Flows | |
| International reserves (B)-(C) | 172,802 | 173,118 | 205 | 316 |
| (B) Gross international reserve | 175,450 | 177,786 | 590 | 2,336 |
| Pemex | -- | -- | 335 | -461 |
| Federal government | -- | -- | -65 | 1,833 |
| Market operations | -- | -- | 0 | 0 |
| Other | -- | -- | 320 | 964 |
| (C) Short-term government's liabilities | 2,648 | 4,668 | 385 | 2,020 |

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), 5-year Bondes D, 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 (ET).

Auction specifics (Tuesday, May 29, 2018)

| | Maturity | Coupon rate, % | To be auctioned ¹ | Previous yield ² |
|----------------|-----------|----------------|------------------------------|-----------------------------|
| Cetes | | | | |
| 1m | 05-Jul-18 | -- | 7,000 | 7.48 |
| 3m | 06-Sep-18 | -- | 11,000 | 7.75 |
| 6m | 06-Dec-18 | -- | 11,500 | 7.88 |
| M Bono | | | | |
| 3y | 04-May-23 | -- | 5,000 | 0.16 |
| Udibono | | | | |
| 3y | 03-Jun-27 | 7.50 | 9,000 | 7.54 |

Source: Banorte 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. Also on Tuesday, around 3:30pm (ET) *Citibanamex* will release its bi-weekly survey of economic expectations, where market focus will be on analysts' inflation forecasts for May (to be published on June 7). Furthermore, attention will be on monetary policy assessments, given Banxico's tone in the last monetary policy minutes and its *Quarterly Report*. In addition, the survey will contain forecasts for growth and FX. In the first case we do not expect changes to the 2018 figure. However, MXN estimates might be revised upward given the recent behavior of the Mexican peso.

We expect a 2.6% yoy contraction in March's GFI. On Wednesday at 9:00am (ET), *INEGI* will publish its gross fixed investment (GFI) report for March. We anticipate GFI down by 2.6% yoy, given the *Holy Week* holiday period, which subtracted working days to the annual comparison.

We believe that within the report we will probably see a 0.4% yoy contraction in imported machinery and equipment, given that trade balance figures showed a scant 2.3% yoy increase for capital goods imports. In addition, we expect a 3.1% reduction in domestic machinery and equipment investment.

Finally, we believe that construction investment fell 3.5% yoy given that construction output within the industrial production report showed a similar result (-3.9% yoy).

GFI estimates: March 2018

% yoy nsa; %-pts

| %yoy | Mar-18 | Mar-17 | Jan-Mar, '18 | Jan-Mar, '17 |
|----------------------------|---------------|---------------|-------------------|--------------|
| Total | -2.6 | 4.7 | 2.0 | 0.1 |
| Machinery and equipment | -1.5 | 13.4 | 4.4 | 5.0 |
| Domestic | -3.1 | 12.2 | -0.2 | 3.8 |
| Imported | -0.4 | 14.3 | 7.6 | 5.9 |
| Construction | -3.5 | -1.1 | 0.4 | -3.0 |
| Annual contribution | Mar-18 | Mar-17 | Difference | |
| Total | -2.6 | 4.7 | -7.3 | |
| Machinery and equipment | -0.7 | 5.4 | -6.0 | |
| Domestic | -0.6 | 2.1 | -2.6 | |
| Imported | -0.1 | 3.3 | -3.4 | |
| Construction | -2.0 | -0.7 | -1.3 | |

Source: Banorte

Inflation during May will be explained by the continuing implementation of the summer discounts in electricity tariffs. On Thursday, at 9:00am, *INEGI* will release its monthly inflation report for May. We are forecasting a 0.23% m/m fall in the headline index, while we expect the core index to increase 0.23% m/m.

Inflation during the period in question will be mainly explained by the start of the summer discounts in electricity tariffs in the first half of the month, as well as an additional fall in fresh fruits and vegetables prices. However, these will be partially offset by a higher contribution from processed foods and other energy prices.

We forecast inflation to be 11bps below the figure seen in 2017 as a result of: (1) a greater impact of energy prices (-30bps vs. -53bps in 2017); (2) a smaller participation from agricultural goods (-11bps vs. 11bps in 2017); (3) a lesser contribution of government tariffs (1bps vs. 9bps in 2017); (4) a negative impact of goods 5bps vs. 17bps in 2017); and (5) a greater contribution of other services (8bps vs. 0bps in 2017), as shown in the table on the following page.

With these results, annual inflation will stand at 4.43% in May, lower than the 4.55% seen in April. Moreover, we forecast core inflation at 3.66% yoy (previous: 3.71% 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.

May inflation by components

% Monthly incidence

| | 2018 F | 2017 | Difference |
|---------------------------------|--------|-------|------------|
| Headline | -0.23 | -0.12 | -0.11 |
| Core | 0.17 | 0.21 | -0.03 |
| Goods | 0.05 | 0.17 | -0.12 |
| Processed foods | 0.05 | 0.07 | -0.03 |
| Other goods | 0.00 | 0.09 | -0.09 |
| Services | 0.12 | 0.04 | 0.08 |
| Housing | 0.04 | 0.04 | 0.00 |
| Education | 0.00 | 0.00 | 0.00 |
| Other services | 0.08 | 0.00 | 0.08 |
| Non-core | -0.40 | -0.32 | -0.08 |
| Agricultural | -0.11 | 0.11 | -0.22 |
| Fresh fruits and vegetables | -0.10 | 0.07 | -0.18 |
| Meat and egg | -0.01 | 0.04 | -0.04 |
| Energy and government regulated | -0.30 | -0.44 | 0.15 |
| Energy | -0.30 | -0.53 | 0.23 |
| Government regulated | 0.01 | 0.10 | -0.09 |

Source: Banorte, INEGI

Wage negotiations will climb 4.8% during May. On Friday, the Ministry of Labor (MoL) will publish the contractual wage negotiations for May. We expect workers to have negotiated an average increase of 4.8%, above the 4.6% seen in April. This figure will be mainly explained by a greater number of negotiations in the public sector, particularly those related to education. In addition we believe that dynamism in the private sector will continue, given that in 2018, the average wage negotiation in the sector has been around 5.5%. Looking ahead, we anticipate that wage negotiations will continue to be relatively high, mainly explained by the sharp increase in the minimum wage at the end of 2017 and the high levels of inflation observed at the end of 2017 and at the beginning of 2018.

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