

Ahead of the Curve

January 19, 2018

Market focus this week will be on November's economic activity and inflation for the first half of January

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- **Economic activity indicator (November).** On Tuesday, *INEGI* will also release its monthly global economic indicator for November (GDP monthly proxy), where we expect a 1.2% yoy expansion, below October's 1.5% growth. As we had mentioned in our last report, IP's contraction in November was explained by the 8.5% yoy fall in mining output, given the decline in oil production in the Gulf of Mexico. Moreover, we believe that services will show a moderate 2.6% yoy expansion, as a result of the deceleration in domestic demand.
- **Bi-weekly inflation report (1H-Jan).** On Wednesday, at 9:00am (ET), *INEGI* will release its bi-weekly inflation report for the first half of January. We are forecasting a 0.29% 2w/2w increase in the headline index, while we expect the core index to rise 0.31% 2w/2w. Inflation during the period in question will be mainly explained by increases in the price of processed foods as well as gasoline. However, these will be mitigated by a fall in the prices of fresh fruits and vegetables as well as airfares and tourism services.

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Mexico weekly calendar

DATE	HOUR (ET)	EVENT	PERIOD	UNIT	BANORTE	CONSENSUS	PREVIOUS
Mon 22-Jan	9:00am	Unemployment rate	December	%	<u>3.24</u>	3.28	3.42
		sa		%	<u>3.53</u>	3.53	3.48
Mon 22-Jan	3:30pm	Citibanamex survey of economic expectations					
Tue 23-Jan	9:00am	Global economic indicator	November	% yoy	<u>1.2</u>	1.3	1.5
		(sa)		% m/m	<u>0.6</u>	--	0.1
		Primary activities		% yoy	<u>2.1</u>	--	3.6
		Industrial production		% yoy	<u>-1.5</u>	--	-1.1
		Services		% yoy	<u>2.6</u>	--	2.7
Tue 23-Jan	10:00am	International reserves	Jan-19	US\$ mn	--	--	173.0
Tue 23-Jan	12:30pm	Government weekly auction: 1-, 3-, 6-month CETES; 5y Mbono (Jun'22); 10y Udibonos (Nov'28)					
Wed 24-Jan	9:00am	CPI inflation	1H Jan	% 2w/2w	<u>0.29</u>	0.35	0.28
				% yoy	<u>5.57</u>	5.62	6.85
		Core		% 2w/2w	<u>0.31</u>	0.24	-0.02
				% yoy	<u>4.77</u>	--	4.83
Thu 25-Jan	9:00am	Retail sales	November	% yoy	<u>-1.0</u>	-0.9	-0.1
		sa		% m/m	<u>0.1</u>	0.3	1.0
Fri 26-Jan	9:00am	Trade balance	December	US\$ mn	<u>147.4</u>	270.0	399.2
		Total ex ports		% yoy	<u>10.9</u>	--	9.2
		Oil ex ports		% yoy	<u>23.0</u>	--	44.7
		Non-oil ex ports		% yoy	<u>10.2</u>	--	7.3
		Total imports		% yoy	<u>10.4</u>	--	8.2

Source: Banorte; Bloomberg

Proceeding in chronological order...

Unemployment rate in December will stand at 3.24%. On Monday, *INEGI* will publish its unemployment report for the last month of 2017, in which we estimate an unemployment rate of 3.24% nsa, below the 3.5% observed in November. However, in seasonally adjusted terms, we believe that the unemployment rate could stand at 3.53% which implies a 0.05%-pts increase from last month's figures.

We believe that the slight rise in the unemployment rate (seasonally adjusted) will be due to the recent deceleration in economic activity. However, looking ahead we believe that the unemployment rate will hover around these levels as a result of the higher growth of external demand that will push forward job creation within the manufacturing industry; and the significant spike in public spending, as a result of the presidential elections, which will result in a higher job creation.

Citibanamex Survey: Market participants will focus on inflation and monetary policy forecasts. On Monday around 3:30pm (ET) *Citibanamex* will release its bi-weekly survey of economic expectations, where focus will be on analysts' inflation forecasts for the first the first half of January (to be published on January 24). Furthermore, attention will be on monetary policy assessments.

In addition, the survey will also contain forecasts for growth and FX estimations. In the first case, we do not expect strong revisions to the median GDP forecast both for 2017 and 2018. In the second case, we will focus on the estimations for YE18.

We expect a 1.2% yoy expansion in November's IGAE. On Tuesday, *INEGI* will also release its monthly global economic indicator for November (GDP monthly proxy), where we expect a 1.2% yoy expansion, below October's 1.5% growth.

As we had mentioned in our last report, IP's contraction in November was explained by the 8.5% yoy fall in mining output, given the decline in oil production in the Gulf of Mexico. In addition, construction fell 5.7% yoy, as a result of the 6.6% reduction in building projects, whereas public civil engineering construction projects declined 6.8% yoy, given the austerity program implemented by the Federal Government. By contrast, manufacturing output increased 2.4% yoy.

Moreover, we believe that services will show a moderate 2.6% yoy expansion, as a result of the deceleration in domestic demand.

Weekly international reserves report. Additionally on Tuesday, at 10:00am (ET), Banco de Mexico will release its weekly balance report. Last week, net international reserves increased by US\$47 million amounting to US\$173 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\$149 million during 2018 (please refer to the table below).

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

	2016	Jan 12, 2018	Jan 12, 2018	Year-to-date
	Balance		Flows	
International reserves (B)-(C)	172,802	172,951	47	149
(B) Gross international reserve	175,450	177,158	2,246	1,709
Pemex	--	--	-156	-560
Federal government	--	--	2,411	2,341
Market operations	--	--	0	0
Other	--	--	-9	-73
(C) Short-term government's liabilities	2,648	4,207	2,199	1,559

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) and 10-year inflation-linked Udibonos (Nov’28), 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, January 23, 2018)

	Maturity	Coupon rate, %	To be auctioned ¹	Previous yield ²
Cetes				
1m	22-Feb-18	--	10,000	7.24
3m	26-Apr-18	--	13,000	7.36
6m	19-Jul-18	--	11,500	7.56
M Bono				
5y	09-Jun-22	6.50	8,500	7.75
Udibonos				
10y	30-Nov-28	4.00	UDIS 700	3.68

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

Inflation during the first half of January will be explained by increases in the prices of processed foods as well as gasoline. On Wednesday, at 9:00am, INEGI will release its bi-weekly inflation report for the first half of January. We are forecasting a 0.29% 2w/2w increase in the headline index, while we expect the core index to rise 0.31% 2w/2w.

Inflation during the period in question will be mainly explained by increases in the price of processed foods as well as gasoline. However, these will be mitigated by a fall in the prices of fresh fruits and vegetables as well as airfares and tourism services.

We forecast inflation to be 122bps lower when compared to the same period of last year, derived from: (1) 117bp from a smaller contribution of energy (123bps vs. 6bps in 2017); (2) 6bps from a greater impact of fresh fruits and vegetables (-5bps vs. -11bps in 2017); (3) 6bps stemming from a lesser contribution of government tariffs (4bps vs. 10bps in 2017); and (4) 6bp due to a smaller impact of other goods (2bps vs. 7bps in 2017), as shown in the table below.

1H-January inflation by components

% bi-weekly incidence

	2017 P	2016	Difference
Headline	0.29	1.51	-1.22
Core	0.23	0.28	-0.05
Goods	0.14	0.20	-0.06
Processed foods	0.12	0.13	-0.01
Other goods	0.02	0.07	-0.05
Services	0.09	0.08	0.01
Housing	0.03	0.03	0.00
Education	0.02	0.02	0.00
Other services	0.04	0.03	0.01
Non-core	0.07	1.23	-1.16
Agricultural	-0.03	-0.10	0.07
Fresh fruits and vegetables	-0.05	-0.11	0.06
Meat and egg	0.03	0.02	0.00
Energy and government regulated	0.09	1.34	-1.25
Energy	0.06	1.23	-1.17
Government regulated	0.04	0.10	-0.06

Source: Banorte, INEGI

With these results, annual inflation will stand at 5.57% in the first half of January, significantly lower than the 6.77% seen in December 2017. Moreover, we forecast core inflation at 4.77% yoy (previous: 4.87% yoy). It is worth noting that the fall in annual inflation will be explained by a base effect given the drastic increase in energy prices in 2017. 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.

Retail sales will post a 1% yoy contraction in November. On Thursday at 9:00am (ET), *INEGI* will publish its retail sales report for November, where we anticipate a 1% yoy contraction, below the 0.1% reduction observed in October. We believe that retail sales contraction will be explained by the 8.5% reduction in vehicle sales. In addition, *ANTAD* same store sales posted a 1.2% yoy decrease in real terms. By contrast, non-oil consumption goods expanded 4.8% yoy, which will partially compensate the fall in vehicle and *ANTAD* sales.

Exports will continue to recover. On Friday at 9:00am (ET), Banxico and *INEGI* will make available its preliminary trade report for December, where we expect to see a US\$147.4 million surplus.

On the exports side, we will probably see a 23% yoy expansion of oil exports as a result of the higher prices for the Mexican crude oil basket (26.1% yoy). In addition, non-oil exports could have increased 10.2% yoy, on the back of a 9.9% hike in manufacturing exports.

On the imports side, we estimate a 10.4% 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 increased 8.5% yoy, while imports of intermediate goods could have increased 10.4% yoy. Finally, we estimate a 2.4% expansion in capital goods imports.

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