

Ahead of the Curve

May 6, 2016

Market focus this week will on April's monthly inflation report

- April's monthly inflation report.** On Monday, at 9:00am, *INEGI* will release its monthly inflation report. We are forecasting a 0.26% m/m contraction in April, basically in line with consensus -0.25% estimate according to *Bloomberg*. In the core index, we expect a 0.21% m/m increase, above market consensus (0.19%). Deflation in April will be explained by the start of summer discounts on electricity tariffs in some regions of the country and lower prices of fruits and vegetables. In this context, our price monitoring shows a strong decline in the prices of products such as tomatoes, onions, and chilies
- Industrial production (March).** Next Thursday at 9:00am (EDT), *INEGI* will release its monthly industrial production report. We anticipate a 3.7% yoy reduction in total output in March, after the 2.6% increase in the previous month. Part of the contraction will be explained by a calendar effect, as the industrial output in March will be affected by the Holy Week holiday that started in March (vs. April in 2015).

www.banorte.com
www.ixe.com.mx
@analisis_fundam

Delia Paredes

Executive Director of Economic Analysis
delia.paredes@banorte.com

Alejandro Cervantes

Senior Economist, Mexico
alejandro.cervantes@banorte.com

Saúl Torres

Analyst, Mexico
saul.torres@banorte.com

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Mexico weekly calendar

DATE	HOUR (EDT)	EVENT	PERIOD	UNIT	BANORTE-IXE	CONSENSUS	PREVIOUS
Mon 9-May	9:00am	CPI inflation	April	% m/m	<u>-0.26</u>	-0.25	0.15
				% yoy	<u>2.60</u>	2.60	2.60
		Core		% m/m	<u>0.21</u>	0.19	0.36
				% yoy	<u>2.82</u>	--	2.76
Tue 10-May	10:00am	International reserves	6-May	US\$ bn	--	--	177.9
Tue 10-May	12:30pm	Government weekly auction: 1-, 3-, 6-month CETES; 10y Mbono (Mar'26); 5y Bondes D					
Tue 10-May		Wage negotiations	April	%	<u>3.3</u>	--	4.5
Tue 12-May	9:00am	Industrial production	March	% yoy	<u>-3.7</u>	-0.9	2.6
				% m/m	<u>-0.5</u>	0.1	-0.1
		Mining	% yoy	<u>-3.6</u>	--	-1.8	
		Utilities	% yoy	<u>3.3</u>	--	3.6	
		Construction	% yoy	<u>-2.8</u>	--	3.5	
		Manufactures	% yoy	<u>-5.1</u>	0.1	3.9	

Source: Banorte-IXE; Bloomberg

Proceeding in chronological order...

Inflation in April will be explained by the start of summer discounts on electricity tariffs. On Monday, at 9:00am, *INEGI* will release its monthly inflation report. We are forecasting a 0.26% m/m contraction in April, basically in line with consensus -0.25% estimate according to *Bloomberg*. In the core index, we expect a 0.21% m/m increase, above market consensus (0.19%).

Deflation in April will be explained by the start of summer discounts on electricity tariffs in some regions of the country and lower prices of fruits and vegetables. In this context, our price monitoring shows a strong decline in the prices of products such as tomatoes, onions, and chilies.

These would be partially offset by pressures on merchandise prices, probably as a result of pass-through from FX depreciation. For services prices, we expect a marginal reduction in the “other services” sub-index as a result of lower airfares and tourism services. With these results, 12-month inflation will be at 2.6% yoy in April, while core inflation could edge-up to 2.82% from 2.76% yoy in March.

Inflation by components in April
% monthly incidence

	Banorte-Ixe	2015	Difference
Headline	-0.26	-0.26	0.00
Core	0.16	0.12	0.04
Goods	0.13	0.10	0.04
Processed foods	0.06	0.03	0.02
Other goods	0.08	0.06	0.01
Services	0.03	0.02	0.01
Housing	0.03	0.03	0.00
Education	0.00	0.00	0.00
Other services	-0.01	-0.02	0.01
Non-core	-0.43	-0.38	-0.05
Agricultural	-0.10	0.02	-0.124
Fresh fruits and vegetables	-0.15	-0.01	-0.14
Meat and egg	0.05	0.03	0.02
Energy and government regulated	-0.34	-0.42	0.08
Energy	-0.31	-0.43	0.13
Government regulated	-0.03	0.00	-0.04

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. Previous to year 2011, contributions might not add because of the change in CPI-calculation methodology

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\$317mn amounting to US \$178bn on April 29. According to Banxico’s report, this figure comes mainly as a result of: (1) Dollar sales by Banxico to the Federal Government for US\$86mn; along with a (2) US\$403mn increase due to changes in the valuation of the Central Bank’s assets. It is worth noting that Pemex is currently the only significant source of reserve accumulation. In this context, the Central Bank has accumulated US\$1,233mn international reserves this year (please refer to the table below).

Banxico's foreign reserve accumulation details

US\$, million

	2015	29/Apr/2016	29/Apr/2016	Year-to-date
	Balance		Flows	
International reserves (B)-(C)	176,735	177,969	317	1,233
(B) Gross international reserve	177,597	182,119	1,810	4,522
Pemex	--	--	-16	3,052
Federal govt	--	--	20	2,472
Market operations	--	--	0	-5,562
Other	--	--	1,805	4,560
(C) Short-term government's liabilities	861	4,150	1,493	3,289

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 (Mar’26) as well as 5-year Bondes D, in addition to the “more traditional” 1-, 3-, and 6- month zero-coupon Cetes (please refer to the table below). The results will be released at 12:30pm (EDT).

Auction specifics (Tuesday, May 10, 2016)

	Maturity	Coupon rate, %	To be auctioned ¹	Previous yield ²
Cetes				
1m	9-Jun-16	--	5,500	3.77
3m	16-Aug-16	--	9,500	3.82
6m	10-Nov-16	--	11,000	3.89
Mbono				
10y	05-Mar-26	5.75	7,000	6.03
Bondes D				
5y	25-Mar-21	--	3,000	0.20

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

April’s wage negotiations. On Tuesday, the Ministry of Labor (*STPS*) will make its contractual wage negotiations monthly data available. We anticipate workers to have negotiated an average wage increase of 3.3% in April. This would be below the 4.3% observed year-to-date. In this context, we believe that April’s figure was mainly driven by the increase in wage negotiations in the services, specifically wage increases in telephonists workers unions, such as the *Mexico’s Union of Telephone Operators (Telmex)*, benefiting 50,000 workers with a 3.2% increase in their salary. Along with wage increases in the automotive sector, such as *Nissan Workers Union* in Morelos, benefiting 1,800 workers with a 4% increase. Finally, we highlight the salary reviews in some unions within the local government’s entities.

We expect a 3.7% yoy contraction in March's industrial output. Next Thursday at 9:00am (EDT), *INEGI* will release its monthly industrial production report. We anticipate a 3.7% yoy reduction in total output in March, after the 2.6% increase in the previous month. Part of the contraction will be explained by a calendar effect, as the industrial output in March was affected by the *Holy Week* holiday that started in March (vs. April in 2015).

Moreover, manufacturing production could post a 5.1% yoy contraction, explained by the adverse calendar effect of the *Holy Week* which affected manufacturing exports (-6.5% yoy) and vehicle production (-11% yoy). Despite March's contraction, we believe that the Mexican manufacturing sector of final goods will show better growth prospects in the second quarter of the year derived from: (1) The still depreciated Mexican currency will eventually translate into a recovery of Mexican exports; and (2) the higher growth of private consumption in Mexico, that will be reflected in a higher domestic demand for manufacturing products.

Finally, we believe that the 3.7% yoy contraction in industrial output during March will be also explained by the poor performance of mining activity. In this regard, we expect a 3.6% yoy contraction derived from lower oil production and the reduction in the extraction of other minerals.

Industrial production estimate: March 2016

%yoy	Mar-16	Mar-15	Jan-Mar, '16	Jan-Mar, '15
Total	-3.7	1.9	0.1	1.7
Mining	-3.6	-5.8	-2.8	-5.6
Utilities	3.3	4.4	2.8	5.8
Construction	-2.8	6.0	1.5	4.4
Manufacturing	-5.1	3.4	-0.2	3.2

%m/m sa	Mar-16	Feb-16	Difference
Total	-0.5	-0.1	-0.4
Mining	-0.4	-0.2	-0.2
Utilities	-0.1	1.2	-1.3
Construction	0.6	-2.5	3.1
Manufacturing	-1.1	0.5	-1.6

Source: Banorte-ixe

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GRUPO FINANCIERO BANORTE S.A.B. de C.V.
Research and Strategy

Gabriel Casillas Olvera	Chief Economist and Head of Research	gabriel.casillas@banorte.com	(55) 4433 - 4695
Raquel Vázquez Godínez	Assistant	raquel.vazquez@banorte.com	(55) 1670 - 2967

Economic Analysis

Delia María Paredes Mier	Executive Director of Economic Analysis	delia.paredes@banorte.com	(55) 5268 - 1694
Alejandro Cervantes Llamas	Senior Economist, Mexico	alejandro.cervantes@banorte.com	(55) 1670 - 2972
Katia Celina Goya Ostos	Senior Global Economist	katia.goya@banorte.com	(55) 1670 - 1821
Miguel Alejandro Calvo Domínguez	Economist, Regional & Sectorial	miguel.calvo@banorte.com	(55) 1670 - 2220
Juan Carlos García Viejo	Economist, International	juan.garcia.viejo@banorte.com	(55) 1670 - 2252
Rey Saúl Torres Olivares	Analyst	saul.torres@banorte.com	(55) 1670 - 2957
Lourdes Calvo Fernández	Analyst (Edition)	lourdes.calvo@banorte.com	(55) 1103 - 4000 x 2611

Fixed income and FX Strategy

Alejandro Padilla Santana	Head Strategist – Fixed income and FX	alejandro.padilla@banorte.com	(55) 1103 - 4043
Juan Carlos Alderete Macal, CFA	FX Strategist	juan.alderete.macal@banorte.com	(55) 1103 - 4046
Santiago Leal Singer	Analyst Fixed income and FX	santiago.leal@banorte.com	(55) 1670 - 2144

Equity Strategy

Manuel Jiménez Zaldivar	Director Equity Research — Telecommunications / Media	manuel.jimenez@banorte.com	(55) 5268 - 1671
Victor Hugo Cortes Castro	Equity Research Analyst	victorh.cortes@banorte.com	(55) 1670 - 1800
Marissa Garza Ostos	Senior Equity Research Analyst – Conglomerates/Financials/ Mining/ Chemistry	marissa.garza@banorte.com	(55) 1670 - 1719
Marisol Huerta Mondragón	Equity Research Analyst – Food/Beverages	marisol.huerta.mondragon@banorte.com	(55) 1670 - 1746
José Itzamna Espitia Hernández	Equity Research Analyst – Airports / Cement / Infrastructure / Fibras	jose.espitia@banorte.com	(55) 1670 - 2249
Valentín III Mendoza Balderas	Equity Research Analyst – Auto parts	valentin.mendoza@banorte.com	(55) 1670 - 2250

Corporate Debt

Tania Abdul Massih Jacobo	Director Corporate Debt	tania.abdul@banorte.com	(55) 5268 - 1672
Hugo Armando Gómez Solís	Analyst, Corporate Debt	hugo.gomez@banorte.com	(55) 1670 - 2247
Idalia Yanira Céspedes Jaén	Analyst, Corporate Debt	idalia.cespedes@banorte.com	(55) 1670 - 2248

Wholesale Banking

Armando Rodal Espinosa	Head of Wholesale Banking	armando.rodal@banorte.com	(55) 1670 - 1889
Alejandro Eric Faesi Puente	Head of Global Markets and Institutional Sales	alejandro.faesi@banorte.com	(55) 5268 - 1640
Alejandro Aguilar Ceballos	Head of Asset Management	alejandro.aguilar.cebillos@banorte.com	(55) 5268 - 9996
Arturo Monroy Ballesteros	Head of Investment Banking and Structured Finance	arturo.monroy.ballesteros@banorte.com	(55) 5004 - 1002
Gerardo Zamora Nanez	Head of Transactional Banking, Leasing and Factoring	gerardo.zamora@banorte.com	(81) 8318 - 5071
Jorge de la Vega Grajales	Head of Government Banking	jorge.delavega@banorte.com	(55) 5004 - 5121
Luis Pietrini Sheridan	Head of Private Banking	luis.pietrini@banorte.com	(55) 5004 - 1453
René Gerardo Pimentel Ibarrola	Head of Asset Management	pimentelr@banorte.com	(55) 5268 - 9004
Ricardo Velázquez Rodríguez	Head of International Banking	rvelazquez@banorte.com	(55) 5004 - 5279
Victor Antonio Roldan Ferrer	Head of Corporate Banking	victor.roltan.ferrer@banorte.com	(55) 5004 - 1454