

Ahead of the Curve

January 5, 2018

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

- Monthly inflation report (December).** On Tuesday, at 9:00am, *INEGI* will release its monthly inflation report for December. We are forecasting a 0.6% m/m increase in the headline index, while we expect the core index to rise 0.46% m/m. Inflation during the period in question will be mainly explained by increases in the price of fresh fruits and vegetables, particularly tomatoes. Additionally, we expect strong advance in the prices of airfares and tourism services considering December's vacation period
- Industrial production (November).** On Thursday at 9:00am (ET), *INEGI* will release its monthly industrial production report. We anticipate 0.8% yoy contraction in total output during November, after the 1.1% reduction in the previous month. Taking a look at the breakdown, manufacturing production could post a 3.1% yoy expansion, while we expect a 2.4% yoy contraction in construction and a 9.5% yoy fall in mining activity.

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Document for distribution among the general public

Mexico weekly calendar

DATE	HOUR (EST)	EVENT	PERIOD	UNIT	BANORTE-IXE	CONSENSUS	PREVIOUS
Mon 8-Jan	3:30pm	Citibanamex survey of expectations					
Tue 9-Jan	9:00am	CPI inflation	December	% m/m	<u>0.60</u>	0.57	1.03
				% yoy	<u>6.78</u>	6.75	6.63
		Core		% m/m	<u>0.46</u>	0.48	0.34
				% yoy	<u>4.91</u>	--	4.90
Tue 9-Jan	10:00am	International reserves	Jan-6	US\$ mn	--	--	172.8
Tue 9-Jan	12:30pm	Government weekly auction: 1-, 3-, 6-month CETES; 3y MBono (Jun'20); 3y Udibonos (Dec'20)					
Wed 10-Jan		Wage negotiations	December	%	<u>5.0</u>	--	5.1
Thu 11-Jan	9:00am	Consumer confidence	December	index	<u>88.7</u>	88.9	89.3
Thu 11-Jan	9:00am	Industrial production	November	% yoy	<u>-0.8</u>	-0.9	-1.1
		(sa)		% m/m	<u>0.9</u>	0.6	-0.1
		Mining		% m/m	<u>-9.5</u>	--	-10.2
		Utilities		% m/m	<u>-3.1</u>	--	-3.2
		Construction		% m/m	<u>-2.4</u>	--	-1.7
		Manufactures		% m/m	<u>3.1</u>	2.7	2.7
Fri 12-Jan	9:00am	Gross fixed investment	October	% yoy	<u>-0.5</u>	0.1	-2.6
		Machinery and equipment		% yoy	<u>4.5</u>	--	-3.3
		Domestic		% yoy	<u>0.9</u>	--	-0.4
		Imported		% yoy	<u>7.3</u>	--	-5.3
		Construction		% yoy	<u>-4.4</u>	--	-2.0

Source: Banorte-IXE; Bloomberg

Proceeding in chronological order...

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 December (to be published on January 9). Furthermore, attention will be on monetary policy assessments, considering the more hawkish tone on Banxico's minutes (published on December 28).

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.

Inflation during December will be explained by increases in the prices of fresh fruits and vegetables as well as airfares and tourism services. On Tuesday, at 9:00am, *INEGI* will release its monthly inflation report for December. We are forecasting a 0.6% m/m increase in the headline index, while we expect the core index to rise 0.46% m/m.

Inflation during the period in question will be mainly explained by increases in the price of fresh fruits and vegetables, particularly tomatoes. Additionally, we expect strong advance in the prices of airfares and tourism services considering December's vacation period.

We forecast inflation to be 13bps higher when compared to the same period of last year, derived from: (1) 10bp from a larger contribution of fresh fruits and vegetables (11bps vs. 1bps in 2016); (2) 7bps from a greater impact of energy (9bps vs. 2bps in 2016); and (3) 4bps stemming from a lesser contribution of meat and egg (4bps vs. 8bps in 2016), as shown in the table below.

December inflation by components

% monthly incidence

	2017 P	2016	Difference
Headline	0.60	0.46	0.13
Core	0.34	0.34	0.00
Goods	0.12	0.12	0.00
Processed foods	0.08	0.08	-0.01
Other goods	0.04	0.04	0.00
Services	0.23	0.22	0.01
Housing	0.03	0.04	-0.01
Education	0.00	0.00	0.00
Other services	0.20	0.18	0.02
Non-core	0.25	0.12	0.13
Agricultural	0.15	0.09	0.06
Fresh fruits and vegetables	0.11	0.01	0.10
Meat and egg	0.04	0.08	-0.04
Energy and government regulated	0.11	0.03	0.07
Energy	0.09	0.02	0.07
Government regulated	0.02	0.01	0.01

Source: Banorte-Ixe, INEGI

With these results, annual inflation will close 2017 at 6.78%, while we expect the core component at 4.91%. For 2018 we forecast year inflation to start a downward path as soon as the first half of January (given the base effect from the increase in energy prices in 2017), finishing the year at 4.3%. 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.

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\$337 million amounting to US\$172.8 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 diminished by US\$3.7billion during 2017 (please refer to the table below).

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

	2016	Dec 29, 2017	Dec 29, 2017	Year-to-date
	Balance		Flows	
International reserves (B)-(C)	176,542	172,802	337	-3,740
(B) Gross international reserve	178,025	175,450	229	-2,575
Pemex	--	--	-336	-120
Federal government	--	--	9	-4,007
Market operations	--	--	0	-2,000
Other	--	--	555	3,551
(C) Short-term government's liabilities	1,483	2,648	-108	1,165

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) and 3-year inflation-linked Udibonos (Dec'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 (ET).

Auction specifics (Tuesday, January 9, 2018)

	Maturity	Coupon rate, %	To be auctioned ¹	Previous yield ²
Cetes				
1m	08-Feb-18	--	11,000	7.25
3m	12-Apr-18	--	14,000	7.35
6m	05-Jul-18	--	11,500	7.54
M Bono				
3y	11-Jun-20	8.00	8,500	7.17
Udibonos				
3y	10-Dec-20	2.50	UDIS 950	3.38

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 climb 5% during December. On Wednesday, the Ministry of Labor (MoL) will publish the contractual wage negotiations for December. We expect workers to have negotiated an average increase of 5%, marginally below the 5.1% seen in November. This figure will be mainly explained by a greater dynamism in the negotiations of the private sector, which have averaged 5.1% from January to November. It is worth noting that the 10.4% minimum wage increase came into effect during this month, which might influence other salary negotiations. Looking ahead we believe that negotiations will remain relatively high due to the minimum wage increase in late 2017.

Consumer confidence will lose ground in December. On Thursday, at 9:00am (ET), Banxico and *INEGI* will publish its December's monthly survey on consumer confidence, where we expect a moderate 3.7% yoy expansion, with the index reaching 88.7 points. However, in seasonally adjusted terms, we expect confidence levels to decrease 0.7% m/m.

We believe that consumer confidence (measured in seasonally adjusted terms) will show a moderate contraction given the upward trend in inflation. In particular, headline inflation reached 6.69% yoy during the first half of December, as a result of the higher pass-through effect of the accumulated depreciation of the Mexican currency to prices. Nevertheless, despite the 0.7% fall in the headline index, it is likely that the report will also show that Mexican consumers are discounting a better economic outlook given the growth momentum in the formal labor market.

We expect a 0.8% yoy contraction in November's industrial output. Also on Thursday at 9:00am (ET), *INEGI* will release its monthly industrial production report. We anticipate 0.8% yoy contraction in total output during November, after the -1.1% reduction in the previous month. Taking a look at the breakdown, manufacturing production could post a 3.1% yoy expansion, as a result of the significant 11.2% increase in vehicle production.

In addition, industrial output during November will be also explained by: (1) The 2.4% yoy contraction in construction output, as a result of the lower growth in private construction investment projects, coupled with the reduction in public investment projects given the Federal Government's austerity program; and (2) the poor performance of mining activity, where we estimate a 9.5% yoy decline.

Industrial production estimate: November 2017

% yoy nsa; % m/m sa

% yoy	Nov-17	Nov-16	Jan-Nov, '17	Jan-Nov, '16
Total	-0.8	2.4	-0.6	0.5
Mining	-9.5	-7.1	-10.0	-3.7
Utilities	-3.1	-1.1	-0.8	0.1
Construction	-2.4	5.4	-1.3	2.3
Manufacturing	3.1	5.0	3.3	1.4
%m/m sa	Nov-17	Oct-17	Difference	
Total	0.9	-0.1	1.1	
Mining	-0.8	4.7	-5.5	
Utilities	0.2	-4.0	4.2	
Construction	0.7	-0.6	1.3	
Manufacturing	1.8	-0.6	2.4	

Source: Banorte-ixe

We expect a 0.5% yoy contraction in October's GFI. On Friday at 9:00am (ET), *INEGI* will publish its October's gross fixed investment (GFI) report. We anticipate GFI down by 0.5% yoy. We believe that within the report we will probably see a 7.3% yoy expansion in imported machinery and equipment, given that trade balance figures showed a similar increase for capital goods imports.

However, we expect a marginal 0.9% growth in domestic machinery and equipment. Finally, we believe that construction spending fell 4.4% yoy given that construction output within the industrial production report showed a similar result.

GFI estimates: October 2017

% yoy; %-pts

%yoy	Oct-17	Oct-16	Jan-Oct, '17	Jan-Oct, '16
Total	-0.5	-0.5	-1.3	1.0
Machinery and equipment	4.5	-2.2	2.9	2.9
Domestic	0.9	0.2	2.6	7.8
Imported	7.3	-4.1	3.2	-0.4
Construction	-4.4	0.8	-4.3	-0.3
Annual contribution	Oct-17	Oct-16	Difference	
Total	-0.5	-0.5	0.0	
Machinery and equipment	2.0	-1.0	3.0	
Domestic	0.2	0.0	0.1	
Imported	1.8	-1.0	2.8	
Construction	-2.5	0.5	-3.0	

Source: Banorte-ixe

Disclaimer

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