

Ahead of the Curve

October 26, 2018

We expect 3Q18 GDP at 2.4% yoy, driven by relatively strong services

- **Gross domestic product (3Q18 P).** We are forecasting an economic expansion of 2.4% yoy growth during 3Q18, slightly below the 2.6% observed in the previous quarter. It is worth remembering that the previous quarter was positively skewed by a calendar effect due to the timing of the Easter holiday, which added working days in the annual comparison. By major components, we expect 1.1% growth in both primary activities and industrial production, while services could increase 2.5%.
- **Family remittances (September).** We expect Mexican workers living abroad –mainly in the US–, to have sent US\$2,741.5 million. In our view, remittances will be partly explained by the 2% depreciation of the Mexican peso during the month. Moreover, the US labor market has kept a positive performance, helping Mexican workers. In particular, the number of Mexican employees with citizenship grew 5% yoy.

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Mexico weekly calendar

DATE	HOUR (ET)	EVENT	PERIOD	UNIT	BANORTE	CONSENSUS	PREVIOUS
Sun 28-Oct		Daylight savings time ends in Mexico					
Tue 30-Oct	10:00am	GDP	3Q18 (P)	% yoy	<u>2.4</u>	-	2.6
		(sa)		% q/q	<u>0.7</u>	-	-0.2
		Primary activities		% yoy	<u>1.1</u>	--	1.8
		Industrial production		% yoy	<u>1.1</u>	--	1.3
		Services		% yoy	<u>2.5</u>	--	3.3
Tue 30-Oct	11:00am	International reserves	Oct-26	US\$ bn	--	--	173.6
Tue 30-Oct	1:30pm	Government weekly auction: 1-, 3-, 6-month CETES; 5y Mbono (Dec'23); 10y Udibonos (Nov'28)					
Tue 30-Oct		Budget balance	September	MXN bn	--	--	-230.8
Wed 31-Oct	11:00am	Commercial banking credit	September	% yoy	<u>5.9</u>	--	6.0
		Consumption		% yoy	<u>1.3</u>	--	1.2
		Housing		% yoy	<u>3.8</u>	--	3.8
		Non-banking private firms		% yoy	<u>9.8</u>	--	10.1
Thu 1-Nov	11:00am	Family remittances	September	US\$ mn	<u>2,741.5</u>		2,856.2
Thu 1-Nov	11:00am	Banxico's survey of economic expectations	October				
Thu 1-Nov	2:00pm	PMI's survey (IMEF)	October				
		Manufacturing		index	<u>51.7</u>		51.5
		Non-manufacturing		index	<u>50.9</u>		51.6
Fri 2-Nov		Markets closed due to the celebration of the Day of the Dead					

Source: Banorte; Bloomberg

Proceeding in chronological order...

Mexico's preliminary GDP will stand at 2.4% yoy in 3Q18. On Tuesday, INEGI will publish its preliminary 3Q18 GDP report. INEGI uses the reports already published for the first two months of the quarter and estimates output for the third with the available information released so far.

Considering the latter, we are forecasting an economic expansion of 2.4% yoy growth during 3Q18, slightly below the 2.6% observed in 2Q18. It is worth remembering that the previous quarter was positively skewed by a calendar effect due to the timing of the Easter holiday, which added working days in the annual comparison. By major components, we expect 1.1% growth in both primary activities and industrial production, while services could increase 2.5%.

As usual, services remain as the main driver for growth. In particular, we believe dynamism during the quarter was explained by the relatively strong performance of retail sales. In this regard, ANTAD's same-store sales posted a 0.4% yoy expansion in real terms during 3Q18, in contrast with the -0.1% of the previous quarter. Moreover, vehicle sales moderated their fall, contracting 4.4% vs 5.8% in the previous quarter. We also expect a solid advance in transportation, driven by resiliency in manufacturing as portrayed by the trade balance reports published so far.

On the other hand, industrial production will likely benefit from a benign base-effect in September, given the natural disasters that took place in the same month of the previous year (earthquakes and Hurricane Katia). These had a severe impact in mining output during September 2017. In this regard, we expect oil production to post its first year-over-year increase since October 2013. Additionally, manufacturing will maintain a healthy rate of expansion, albeit at a slower pace than the previous quarter given that, in our opinion, exporting firms brought forward their production plans in previous months due to the uncertainty regarding the trade relationship between Mexico and the US. Nevertheless, this would be at least partially compensated by still strong industrial production in the US, resulting in a relative normalization in output as uncertainty diminished during the quarter.

Weekly international reserves report. Last week, net international reserves decreased US\$15 million, amounting to US\$173.6 billion. According to Banxico's report, this figure comes mainly from a negative valuation effect in central bank assets. In this context, the central bank's international reserves have increased US\$833 million during 2018 (please refer to the following table).

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

	2017	Oct 19, 2018	Oct 19, 2018	Year-to-date
	Balance		Flows	
International reserves (B)-(C)	172,802	173,635	-15	833
(B) Gross international reserve	175,450	176,047	-588	597
Pemex	--	--	-201	-702
Federal government	--	--	-352	299
Market operations	--	--	0	0
Other	--	--	-34	1,001
(C) Short-term government's liabilities	2,648	2,412	-573	-236

Source: Banco de México

Weekly government bond auction. The Ministry of Finance (MoF) –via Banco de Mexico as its financial agent–, will offer 5-year fixed-rate Mbonos (Dec’23), 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 following table). As usual, results will be released at 12:30pm (ET).

Auction specifics (Tuesday, October 30th, 2018)

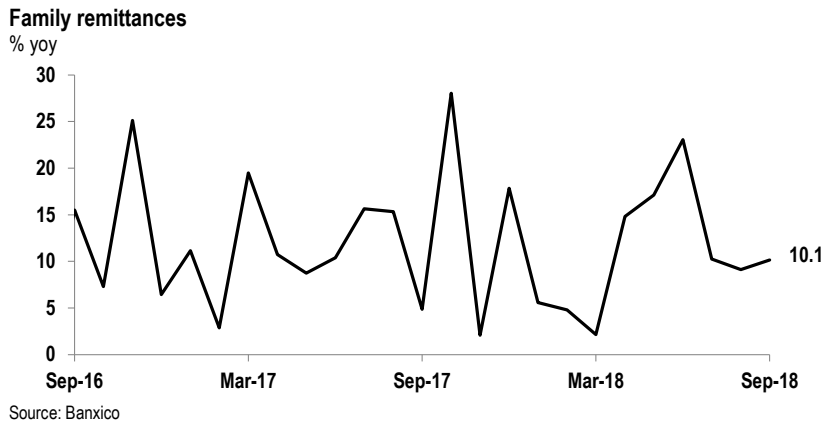
	Maturity	Coupon rate, %	To be auctioned ¹	Previous yield ²
Cetes				
1m	29-Nov-18	--	7,000	7.72
3m	31-Jan-19	--	11,000	7.95
6m	25-Apr-19	--	11,000	8.08
M Bono				
5y	07-Dec-23	8.00	9,000	7.76
Udibono				
10y	30-Nov-28	4.00	800	3.72

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

MoF’s September’s public finance report. In it, we will focus on income and spending dynamics of the Federal Government. On the revenue side, we will be looking at non-oil tax collection, as it will provide additional information about domestic demand. Moreover, data regarding collection of fuel-excise tax (IEPS) will be relevant given the policy to smooth gasoline price variations. In addition, markets will focus on the spending side of the report, in particular vs. 2017, both on the discretionary side as well as with debt servicing costs. Finally, we will evaluate the evolution of public sector debt (as measured by the Historical Balance of Public Sector Borrowing Requirements), which currently represents close to 43.4% of Mexico’s GDP.

Banking credit will show a 5.9% yoy increase in September. It is our take that credit to the non-financial sector continued flowing in September. In particular, we estimate a 5.9% yoy expansion in banking credit (in real terms), as a result of a 1.3% increase in consumer credit, coupled with a 3.8% and 9.8% expansion in mortgage and credit to firms, in the same order.

Family remittances maintain a strong performance in September. We expect Mexican workers living abroad –mainly in the US–, to have sent US\$2,741.5 million in September. In our view, remittances will be partly explained by the 2% depreciation of the Mexican peso during the month. Moreover, the US labor market has kept a positive performance, helping Mexican workers. In particular, the number of Mexican employees with citizenship grew 5% yoy.



Banxico’s survey of economic expectations. Market focus will be on inflation forecasts, particularly that of 2018, which as of last survey stand at 4.5% (Banorte: 4.8%), as well as inflation expectations for the medium and long term. Moreover, attention will also be on monetary policy forecasts, for which we expect a 25bps hike in the remainder of the year, for the reference rate to close the year at 8.00%. In addition, we will be looking into 2018’s GDP forecast, which we expect at 2.1% (consensus: 2.1%). Furthermore, we do not expect strong revisions to FX forecasts (Banorte: USD/MXN 18.60).

We expect a mixed performance in October’s IMEF surveys. We believe that the manufacturing PMI will hold up relatively high at 51.7pts, slightly above the previous month. In this respect, we highlight that the Markit’s manufacturing PMI in the US up to October has stayed at high levels, actually increasing to a maximum since May 2018 after two consecutive months on the upside. Nevertheless, regional indicators are more of a mixed bag. On the other hand, the most forward-looking components in September (new orders and employment) have recently increased, which coupled with less trade uncertainty with the US, suggest that this sector could have maintained a good performance. Lastly, trade balance figures in September showed that manufacturing exports maintain strong dynamics, in particular in the auto sector.

Going to the non-manufacturing index, we estimate a fall to 50.9pts from 51.6pts previously, the latter which corresponds to a four month high. In this sense, we expect some degree of mean reversion, in particular the new orders component, followed to a lesser extent by the production sub index. In our view, consumers have could have been less optimistic at the beginning of 4Q18. First, the Mexican peso has weakened in the last days of October, going from 18.70 at September-end to 19.26 in the first day of the survey’s compilation period, reaching 19.45 as of the time of writing. Second, we have perceived a more cautious stance given an uncertain short-term backdrop, with eyes on the consultation on the New Mexico City Airport and the migrant caravan, among other factors.

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HOLD	<i>When the share expected performance is similar to the MEXBOL estimated performance.</i>
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