

Ahead of the Curve

July 21, 2017

Market focus this week will be on May's IGAE and the inflation report for the first half of July

- Global Economic Activity Indicator (May).** On Monday *INEGI* will release its monthly global economic indicator for May (GDP monthly proxy), where we expect a 3.3% yoy expansion. We believe that Mexico's economic growth will be explained by a 1% increase in industrial production, coupled with a 4.6% yoy growth in services output. As we had mentioned in our last report, IP's expansion in May was partially explained by the 0.8% increase in construction output and the 5% growth in the manufacturing industry. In addition, we believe that the 4.6% yoy estimated expansion in services will be explained by the growth dynamics in the Mexican labor market
- Bi-weekly inflation report (1H-July).** On Thursday, at 9:00am, *INEGI* will release its bi-weekly inflation report for the first half of July. We are forecasting a 0.20% 2w/2w increase in the headline index (consensus: 0.20% 2w/2w), while we expect the core index to rise 0.14% 2w/2w (consensus 0.16% 2w/2w). Inflation during the period in question will be explained by increases in the prices of fresh fruits and vegetables, as well as the prices of other services, particularly those related to travelling due to the vacation season

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Mexico weekly calendar

DATE	TIME (EDT)	EVENT	PERIOD	UNIT	BANORTE-IXE	CONSENSUS	PREVIOUS	
Mon 24-Jul	9:00am	Global economic indicator	May	% yoy	3.3	2.7	-0.7	
		(sa)		% m/m	0.4	--	0.1	
		Primary activities	% yoy	3.9	--	-0.2		
		Industrial production	% yoy	1.0	--	-4.4		
		Services	% yoy	4.6	--	1.4		
Mon 24-Jul	9:00am	CPI inflation	1H July	% 2w/2w	0.20	0.20	0.03	
				% yoy	6.24	6.25	6.30	
		Core	% 2w/2w	0.14	0.16	0.10		
				% yoy	4.87	--	4.85	
Tue 25-Jul	9:00am	Retail sales	May	% yoy	2.9	3.5	1.4	
		(sa)		% m/m	-0.8	-0.5	1.2	
Tue 25-Jul	10:00am	International reserves	21-Jul	US\$ bn	--	--	173.9	
Tue 25-Jul	12:30pm	Government weekly auction: 1-, 3-, 6-months CETES; 3y Mbono (Jun'20); 3y Udidonos (Dec'20)						
Thu 27-Jul	9:00am	Trade balance	June	US\$ mn	-1,256.5	-303.5	-1,079.2	
		Total exports		% yoy	5.8	--	12.9	
		Oil exports		% yoy	-2.0	--	-3.5	
		Non-oil exports		% yoy	6.2	--	13.8	
		Total imports		% yoy	8.0	--	14.7	
Fri 28-Jul	3:30pm	Budget balance	June	MXN bn	--	--	381.7	

Source: Banorte-IXE; Bloomberg

Proceeding in chronological order...

We expect a 3.3% yoy expansion in May's IGAE. On Monday *INEGI* will release its monthly global economic indicator for May (GDP monthly proxy), where we expect a 3.3% yoy expansion. We believe that Mexico's economic growth will be explained by a 1% increase in industrial production, coupled with a 4.6% yoy growth in services output.

As we had mentioned in our last report, IP's expansion in May was partially explained by the 0.8% increase in construction output and the 5% growth in the manufacturing industry. However, mining activity fell 8.3% as a result of the significant contraction in Mexico's oil production, and the lower investment in Mexico's drilling projects.

In addition, we believe that the 4.6% yoy estimated expansion in services will be explained by the growth dynamics in the Mexican labor market. In addition, *IMEF's* non-manufacturing PMI posted a 4.3 points increase, which is probably reflecting a more positive outlook for services.

Inflation during the first half of July will be explained by increases in fresh fruits and vegetables as well as other services. On Thursday, at 9:00am, *INEGI* will release its bi-weekly inflation report for the first half of July. We are forecasting a 0.20% 2w/2w increase in the headline index (consensus: 0.20% 2w/2w), while we expect the core index to rise 0.14% 2w/2w (consensus 0.16% 2w/2w).

Inflation during the period in question will be explained by increases in the prices of fresh fruits and vegetables, as well as the prices of other services, particularly those related to travelling due to the vacation season.

We forecast inflation to be 7.8bp lower than the observed in same period last year, derived from: (1) 11.1bp from a lower contribution of energy prices (-0.1bp vs. 10.6bp in 2016); (2) 10.1bp derived from a lower contribution of government tariffs (0.5 vs. 10.6bp in 2016); (3) 8.9bp stemming from a higher contribution of fresh fruits and vegetables prices (8bp vs.-0.9bp in 2016); and (4) 1.5bp coming from a higher impact of other services (7.5bp vs. 6bp in 2016) as shown in the table below.

With these results, annual inflation will stand at 6.24% in the first half of July, (previous half: 6.33% yoy), while core inflation will be at 4.87% (previous half: 4.85% yoy). Moving forward, we will be attentive to the evolution of energy prices and the behavior of the exchange rate, as well as the impact they might have on the price formation dynamic.

1H-July inflation by components
% bi-weekly incidence

	2017 F	2016	Difference
Headline	0.20	0.28	-0.08
Core	0.10	0.09	0.02
Goods	0.00	0.00	0.00
Processed foods	0.02	-0.01	0.03
Other goods	-0.02	0.01	-0.02
Services	0.10	0.09	0.01
Housing	0.03	0.02	0.00
Education	0.00	0.01	0.00
Other services	0.08	0.06	0.01
Non-core	0.10	0.19	-0.09
Agricultural	0.10	-0.02	0.12
Fresh fruits and vegetables	0.08	-0.01	0.09
Meat and egg	0.02	-0.01	0.03
Energy and government regulated	0.00	0.21	-0.21
Energy	0.00	0.11	-0.11
Government regulated	0.01	0.11	-0.10

Source: Banorte-Ixe, INEGI

Retail sales will post a 2.9% yoy expansion in May. On Tuesday at 9:00am (EDT), *INEGI* will publish its retail sales report for May, where we anticipate a 2.9% yoy expansion, above the 1.4% observed in April, but below the 4% average observed in the first four months of the year. We believe that the moderate growth in retail sales growth will be explained by the scant 1.1% increase in vehicle sales during May, and the 0.4% reduction in *ANTAD*'s same store sales.

Weekly international reserves report. On Tuesday, at 10:00am (EDT), Banco de Mexico will release its weekly balance report. Last week, net international reserves decreased by US\$54 million amounting to US\$173.9 billion. According to Banxico's report, this figure comes mainly as a result of: (1) US\$338 million dollar sales from Banxico to the Federal Government; and (2) a positive revalorization in central bank assets amounting to US\$284 million. In this context, the Central Bank's international reserves have diminished by US\$2.7 billion this year (please refer to the table on the next page).

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

	2016	Jul 14, 2017	Jul 14, 2017	Year-to-date
	Balance		Flows	
International reserves (B)-(C)	176,542	173,877	-54	-2,664
(B) Gross international reserve	178,025	175,930	521	-2,095
Pemex	--	--	210	-166
Federal government	--	--	-258	-2,124
Market operations	--	--	0	-2,000
Other	--	--	569	2,196
(C) Short-term government's liabilities	1,483	2,053	575	570

Source: Banco de México

Weekly government bond auction. On Tuesday, the Ministry of Finance (MoF) –via Banco de Mexico as its financial agent-, will offer 3-year fixed-rate Mbonos (Jun’20), 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 (EDT).

Auction specifics (Tuesday, July 25, 2017)

	Maturity	Coupon rate, %	To be auctioned ¹	Previous yield ²
Cetes				
1m	24-Aug-17	--	7,000	6.99
3m	26-Oct-17	--	11,000	7.06
6m	18-Jan-18	--	11,500	7.17
M Bono				
3y	11-Jun-20	8.00	8,000	6.65
Udibonos				
3yy	10-Dec-20	2.50	750	3.11

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

Exports will continue to recover. On Thursday at 9:00am (EDT), Banxico and INEGI will make available its preliminary trade report for June, where we expect to see a US\$1,256 million deficit. On the exports side, we will probably see a 2% yoy contraction of oil exports, as a result of the lower volume of exports, despite the higher prices for the Mexican crude oil basket (3.4% yoy). In addition, non-oil exports could have increased 6.2% yoy, on the back of a 5.3% hike in manufacturing exports.

On the imports side, we estimate a 8% 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 5.6% yoy, while imports of intermediate goods could have increased 8.2% yoy. Finally, we estimate a 1.9% expansion in capital goods imports.

The MoF’s quarterly report. Finally on Friday, the Ministry of Finance (MoF) will make its quarterly finance report available for the second quarter of the year. On the revenue side, we will be looking at non-oil tax collection, as it will provide additional information about domestic demand behavior, particularly given the volatile dynamics in income tax collection seen in the year. Moreover, the highly changing trend in Mexico’s crude oil basket price, the behavior of oil revenues generated by the Federal Government will be particularly relevant.

In addition, markets will focus on the spending side of the report, in order to assess the execution of the fiscal cut announced by the *MoF* in Mexico’s Fiscal Budget for 2017. Finally, it will be important to evaluate the evolution of public sector debt, which currently represents around 43.7% of Mexico’s GDP.

Disclaimer

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