

Ahead of the Curve

December 7, 2018

We expect signs of a deceleration in activity during 4Q18 to continue with the IP report

- Industrial production (October).** We estimate a deceleration of industrial activity to 0.2% yoy from 1.8% in the previous month. With seasonally adjusted figures, this would result in a 1.9% contraction after advancing 1% in September, its strongest print year-to-date. Some signs suggest a weaker performance in three out of four sectors. We estimate a 5.9% contraction in mining, taking into account a steep decline in oil production. In construction, we expect a 0.3% contraction on top of the decrease of 0.7% in the previous month, remaining weak as the sector has been impacted by higher raw material prices. In manufacturing, we expect a deceleration from 2.4% to 1.6%, as both US and local auto production moderated, although exports maintained a relatively strong performance

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Document for distribution among the general public

Mexico weekly calendar

| DATE | TIME (ET) | EVENT | PERIOD | UNIT | BANORTE | CONSENSUS | PREVIOUS |
|------------|-----------|--|----------|---------|-------------|-----------|----------|
| Mon 10-Dec | | Wage negotiations | November | % | <u>5.5</u> | -- | 3.8 |
| Mon 10-Dec | 12:30pm | Government weekly auction: 1-, 3-, and 6-month Cetes; 3y MBono (Dic'21); 3y Udibono (Jun'22) | | | | | |
| Tue 11-Dec | 10:00am | International reserves | Dec-7 | US\$ bn | -- | -- | 173.8 |
| Wed 12-Dec | 9:00am | Industrial production | October | % yoy | <u>0.2</u> | -- | 1.8 |
| | | (sa) | | % m/m | <u>-1.9</u> | -- | 1.0 |
| | | Mining | | % yoy | <u>-5.9</u> | -- | 2.9 |
| | | Utilities | | % yoy | <u>7.2</u> | -- | 3.2 |
| | | Construction | | % yoy | <u>-0.3</u> | -- | -0.7 |
| | | Manufactures | | % yoy | <u>1.6</u> | -- | 2.4 |
| Fri 14-Dec | 10:00am | Banxico's survey of economic expectations | December | | | | |

Source: Banorte; Bloomberg

Proceeding in chronological order...

Wage negotiations could have increased 5.5% in November as the base effect of public workers fades away. In this regard, the 3.8% advance in October was mainly explained by a greater proportion of workers in the public sector who got a raise. Taking this into account and as the usual mix of public and private negotiations normalizes, we expect a higher increase this time around. YTD negotiations have averaged 4.9%, with a 5.7% growth for private workers and 3.4% for public employees. Looking ahead, we believe negotiations could remain relatively high if the adjustment to the minimum wage is similar or greater to those in 2017 or 2018 (around +10%).

Weekly government bond auction. The Ministry of Finance (MoF) –via Banco de Mexico as its financial agent–, will offer 3-year fixed-rate Mbonos (Dec’21), 3-year inflation-linked Udibonos (Jun’22), 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 (Monday, December 10th, 2018)

| | Maturity | Coupon rate, % | To be auctioned ¹ | Previous yield ² |
|----------------|-----------|----------------|------------------------------|-----------------------------|
| Cetes | | | | |
| 1m | 10-Jan-19 | -- | 7,000 | 7.95 |
| 3m | 14-Mar-19 | -- | 11,000 | 8.24 |
| 6m | 06-Jun-19 | -- | 11,000 | 8.48 |
| M Bono | | | | |
| 3y | 09-Dec-21 | 7.25 | 7,500 | 8.68 |
| Udibono | | | | |
| 3y | 09-Jun-22 | 2.00 | UDIS 850 | 4.23 |

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

Weekly international reserves report. Last week, net international reserves decreased by US\$132 million, closing at US\$173.8 billion. According to Banxico’s report, this figure comes mainly from: (1) Payments due to the IMF pertaining to the Flexible Credit Line, amounting to US\$210 million; and (2) a positive valuation effect in central bank assets of around US\$78 million. In this context, the central bank’s international reserves have increased US\$973 million during 2018 (please refer to the following table).

Banxico's foreign reserve accumulation detail

US\$, million

| | 2017 | Nov 23, 2018 | Nov 23, 2018 | Year-to-date |
|---|---------|--------------|--------------|--------------|
| | Balance | | Flows | |
| International reserves (B)-(C) | 172,802 | 173,775 | -132 | 973 |
| (B) Gross international reserve | 175,450 | 176,573 | 1 | 1,123 |
| Pemex | -- | -- | -52 | -611 |
| Federal government | -- | -- | -16 | 374 |
| Market operations | -- | -- | 0 | 0 |
| Other | -- | -- | 68 | 1,361 |
| (C) Short-term government's liabilities | 2,648 | 2,798 | 133 | 150 |

Source: Banco de México

Industrial production expected to moderate in October. We estimate a deceleration of industrial activity to 0.2% yoy from 1.8% in the previous month. With seasonally adjusted figures, this would result in a 1.9% contraction after advancing 1% in September, its strongest print year-to-date. Some signs suggest a weaker performance in three out of four sectors, while in mining we expect the dilution of the favorable base effect in annual terms in the previous print due to the natural disasters in 2017.

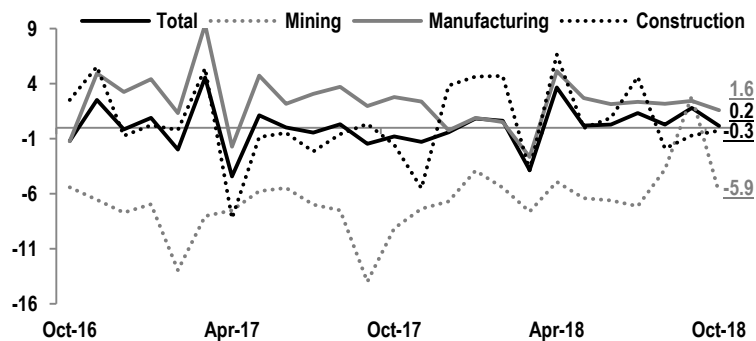
By components and as mentioned before, mining remains on a downtrend. After the 2.9% yoy increase in September (first in a little more than four years and a half), we estimate a 5.9% contraction. This reduction takes into account the fall of 7.4% in oil production (with less than 1.8 million barrels a day, second lowest historical figure) and a 1.5% increase in gas. On the other hand, anecdotal evidence affirms that a negative effect has been felt in the aluminum and steel industry because of US tariffs, which could also affect the rest of the sector.

On the other hand, we also anticipate a more modest advance in manufacturing, from 2.4% in September to 1.6%. The majority of indicators suggest lower dynamism. US manufacturing production grew 3% during the month, less than the previous two prints, while Mexico's auto production fell 0.3%, its first decline since last July. Moreover, the IMEF manufacturing saw lower figures in all of its components, especially new orders, employment and production. Nevertheless, other indicators have stayed relatively positive, including manufacturing exports and intermediate goods imports.

Lastly, we forecast a 0.3% decrease in construction, moderating its decrease relative to the previous month at -0.7% but still weak. In this respect, the National Construction Chamber (CMIC) has stated that they expect the sector to contract in the last quarter of the year, with activity weakened by higher raw material prices (including steel and asphalt, among others). Moreover, credit to sector companies has decelerated, while confidence among businesspeople was also lower after a slight rebound in the previous month.

Industrial production

% yoy



Source: INEGI, Banorte

Banxico's survey of economic expectations. As usual, market focus will center on inflation forecasts. The median for 2018 stands at 4.6% while for 2019 is currently at 3.9%. Moreover, there has been an upward revision in estimates for the medium term, which now forecast inflation at 3.7%. In addition, estimates for the reference rate will also be published. Our expectation is for another 25bps rate hike on December 20th, while consensus expected Banxico to hold as of the previous survey.

Moreover, forecasts for GDP will also be published. In the last survey, economists expected growth at 2.1%, in line with our forecast. For 2019, it was revised down from 2.2% to 1.9%, closer to our 1.8%. Finally, regarding the exchange rate, we could see a marginal upward revision given latest market dynamics and considering that the YE18 forecast stands at USD/MXN 20.25 (Banorte: 20.50) and 2019's is at USD/MXN 20.33 (Banorte: 22.50).

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|-------------|--|
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| HOLD | <i>When the share expected performance is similar to the MEXBOL estimated performance.</i> |
| SELL | <i>When the share expected performance is lower than the MEXBOL estimated performance.</i> |

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