

Ahead of the Curve

September 2, 2016

Market focus this week will on the *2017 Economic Package*

- Mexico's Economic Package will be presented on September 8th.** According to the Fiscal Responsibility and Budget Law, the government will submit to Congress, the so-called *Economic Package*, which includes the *Revenue Law*, the *Spending Budget*, and the *General Economic Policy Guidelines*. The Lower-House has until October 20 to approve the Revenue Law, while the Senate has until October 31. In terms of the spending budget, it will be reviewed by the Lower-House, which has until November 15 to approve it. In this regard, we believe that the Federal Government will publish the first draft of the 2017 Economic Package on Thursday
- July's industrial production will fall 0.3% yoy.** On Friday at 9:00am (EDT), *INEGI* will release its monthly industrial production report. We anticipate a 0.3% yoy reduction in total output during July, after the 0.6% increase in the previous month. Taking a look at the breakdown, manufacturing production could post a 0.4% yoy contraction, explained by the 0.3% yoy growth in the US manufacturing sector, coupled with the significant 5.7 points reduction in *IMEF's* PMI survey; and the 9% decline in manufacturing exports

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

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Mexico weekly calendar

DATE	HOURL (EDT)	EVENT	PERIOD	UNIT	BANORTE-IXE	CONSENSUS	PREVIOUS
Tue 6-Sep	9:00am	Consumer confidence	Aug	index	<u>88.1</u>	88.1	88.9
Tue 6-Sep	10:00am	International reserves	2-Sep	US\$ bn	--	--	176.3
Tue 6-Sep	12:30pm	Government weekly auction: 1-, 3-, 6-month CETES; 5y Mbono (Jun'21); 10y Udibono (Dec'25)					
Tue 6-Sep	4:30pm	Banamex bi-weekly survey of economic expectations					
Thu 8-Sep	9:00am	CPI inflation	August	% m/m	<u>0.35</u>	0.33	0.26
				% yoy	<u>2.80</u>	2.76	2.65
		Core		% m/m	<u>0.18</u>	0.20	0.17
				% yoy	<u>2.95</u>	--	2.97
Thu 8-Sep		First draft of Mexico's Economic Package					
Fri 9-Sep		Wage negotiations	August	%	<u>4.5</u>	--	4.4
Fri 9-Sep	9:00am	Industrial production	July	% yoy	<u>-0.3</u>	-0.3	0.6
		(sa)		% m/m	<u>-0.2</u>	-0.1	0.1
		Mining		% yoy	<u>-4.9</u>	--	-5.8
		Utilities		% yoy	<u>6.8</u>	--	7.2
		Construction		% yoy	<u>1.9</u>	--	3.1
		Manufactures		% yoy	<u>-0.4</u>	1.2	1.2

Source: Banorte-IXE; Bloomberg

Proceeding in chronological order...

Consumer confidence will continue to fall in August. On Monday at 9:00am (EDT), Banxico and *INEGI* will publish its August's monthly survey on consumer confidence, where we expect a 2.6% yoy contraction, with the index reaching 88.1 points. In seasonally adjusted terms, we expect confidence levels to fall 1.1% m/m.

We believe that the reduction in consumer confidence will be explained by the uncertainty caused by certain political and economic events in the weeks prior to the survey, which include: (1) The blocks made by the *CNTE* (National Coordinators of Education Workers) that took place in Oaxaca, and the demonstrations in favor of the education workers in several states during July and August; and (2) the increase in core inflation, particularly within goods prices.

Weekly international reserves report. On Tuesday, at 10:00am (EDT), Banco de Mexico will release its weekly balance report. Last week, net international reserves fell by US\$171 million amounting to US \$176.3 billion on August 26. According to Banxico's report, this figure comes mainly as a result of: (1) Dollar sales by Banxico to the Federal Government for US\$41 million; along with a (2) US\$130 million reduction due to changes in the valuation of the Central Bank's assets. In this context, the Central Bank's international reserves have diminished by US\$387 million this year (please refer to the table below).

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

	2015	26/Aug/2016	26/Aug/2016	Year-to-date
	Balance		Flows	
International reserves (B)-(C)	176,735	176,348	-171	-387
(B) Gross international reserve	177,597	177,617	-303	21
Pemex	--	--	-171	2,096
Federal government	--	--	-27	876
Market operations	--	--	0	-5,562
Other	--	--	-105	2,609
(C) Short-term government's liabilities	861	1,270	-132	408

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 5-year fixed-rate Mbonos (Jun’21), as well as 10-year inflation-linked Udibonos (Dec’25), 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, September 6, 2016)

	Maturity	Coupon rate, %	To be auctioned ¹	Previous yield ²
Cetes				
1m	6-Oct-16	--	5,500	4.29
3m	8-Dec-16	--	9,500	4.40
6m	2-Mar-17	--	11,000	4.59
Mbono				
5y	10-Jun-21	6.50	7,500	5.60
Udibonos				
10y	4-Dec-25	4.50	650	2.62

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

Banamex Survey: Market participants will focus on monetary policy forecasts. On Tuesday Friday at 4:30pm (EDT) *Banamex* will release its bi-weekly survey of economic expectations, where market participants will focus on analysts’ monetary policy assessments given the comments made by several Board members regarding the higher probability of demand-side pressures as a result of the recent evolution of the current account deficit and the downward trend in the unemployment rate.

Furthermore, analysts will also focus on the inflation forecasts for August (to be published on Thursday, September 8), as well as on CPI estimations for 2016 and 2017. Moreover, *Banamex* will also publish consensus’ growth and FX forecasts for 2016-17. In the first case, we do not expect strong revisions to the median GDP forecast. In the second case, we expect moderate upward revisions to the FX estimates for 2016.

Mexico’s *Economic Package* will be presented on September 8th. According to the Fiscal Responsibility and Budget Law, the government will submit to Congress, the so-called *Economic Package*, which includes the *Revenue Law*, the *Spending Budget*, and the *General Economic Policy Guidelines*. The Lower-House has until October 20 to approve the *Revenue Law*, while the Senate has until October 31. In terms of the spending budget, it will be reviewed by the Lower-House, which has until November 15 to approve it. In this regard, we believe that the Federal Government will publish the first draft of the *2017 Economic Package* on Thursday.

Inflation in August will be explained by pressures on energy prices along with higher prices of merchandise. On Thursday, at 9:00am, INEGI will release its monthly inflation report. We are forecasting a 0.35% m/m increase in August in line with consensus 0.33% according to Bloomberg. In the core index, we expect an increase of 0.18% m/m below market consensus (0.2%).

Inflation during the period in question will be explained by pressures on energy prices amid higher costs of electricity and gasoline, which more than offset for the declines in LP gas. Moreover, we are still seeing some pressures on merchandise prices, particularly in the processed foods sub-index.

Nevertheless, we expect this figure to be 13.8bps higher than the observed in same period last year, derived from: (1) 18.3bps stemming from a higher contribution of energy prices (19.6bps vs. 1.2 in 2015); (2) a lower contribution government tariffs (0.6bps vs. 2.5 in 2015); and (3) -1.3bps stemming from a lower contribution of services (2.1bps vs. 3.4 in 2015), as shown in the table below.

With these results, annual inflation will be at 2.8% yoy in August from 2.65% while core inflation is at 2.95% from 2.97% yoy.

Inflation by components in August

%monthly incidence

	Banorte-Ixe	2015	Difference
Total	0.35	0.21	0.14
Core	0.14	0.15	-0.01
Goods	0.12	0.12	0.00
Processed foods	0.03	0.03	0.00
Other goods	0.09	0.09	0.00
Services	0.02	0.03	-0.01
Housing	0.03	0.03	0.00
Education	0.05	0.05	-0.01
Other services	-0.06	-0.05	-0.01
Non-core	0.21	0.06	0.16
Agriculture	0.02	0.02	0.00
Fruits & vegetables	0.03	0.04	-0.01
Meat & eggs	-0.01	-0.01	0.01
Energy & government tariffs	0.20	0.04	0.16
Energy	0.20	0.01	0.18
Government tariffs	0.01	0.03	-0.02

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.

August's wage negotiations. On Friday, the Ministry of Labor (STPS) will make its contractual wage negotiations monthly data available. We anticipate workers to have negotiated an annual average wage increase of 4.5% in August. This would be slightly above the 4.3% average observed year-to-date. In this regard, we believe that August's figure was mainly driven by the increase in wage negotiations in the automotive sector, specifically wage increases in the *Volkswagen's Union*; coupled with increases in the mining sector.

We expect a 0.3% yoy contraction in July's industrial output. Finally, on Friday at 9:00am (EDT), *INEGI* will release its monthly industrial production report. We anticipate a 0.3% yoy reduction in total output during July, after the 0.6% increase in the previous month.

Taking a look at the breakdown, manufacturing production could post a 0.4% yoy contraction, explained by: (1) the 0.3% yoy growth in the US manufacturing sector; (2) the 9% yoy increase in Mexico's vehicle production; (3) the significant 5.7 points reduction in *IMEF's* PMI survey; and (4) the 9% decline in manufacturing exports.

Moreover, the 0.3% yoy contraction in industrial output during July will be also explained by the poor performance of mining activity. In this regard, we expect a 4.9% yoy contraction derived from lower oil production and the reduction in the extraction of other minerals. Finally, we believe that construction output will show a moderate 1.9% increase given the lower growth in private construction investment projects, coupled with the reduction in public infrastructure spending, given the recent fiscal cuts announced by the Federal Government.

Industrial production estimates: July 2016

%yoy	Jul-16	Jul-15	Jan-Jul, '16	Jan-Jul, '15
Total	-0.3	1.0	0.5	1.1
Mining	-4.9	-5.6	-3.9	-6.5
Utilities	6.8	3.5	4.5	4.3
Construction	1.9	4.4	2.3	3.9
Manufacturing	-0.4	2.0	1.0	2.9
%m/m sa	Jul-16	Jun-16	Difference	
Total	-0.2	0.1	-0.3	
Mining	0.7	-0.7	1.4	
Utilities	1.1	1.1	0.0	
Construction	0.4	0.4	0.0	
Manufacturing	-1.1	0.4	-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
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 / Specialized Commerce	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/ Consumer Discretionary / Real Estate / Retail	valentin.mendoza@banorte.com	(55) 1670 - 2250
Eugenia Ivonne Arias Medina	Analyst	eugenia.arias.medina@banorte.com	(55) 1670 - 2251

Corporate Debt

Tania Abdul Massih Jacobo	Director Corporate Debt	tania.abdul@banorte.com	(55) 5268 - 1672
Hugo Armando Gómez Solís	Analyst, Corporate Debt	hugoa.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