

Ahead of the Curve

September 21, 2018

Inflation for the 1st half of September still impacted by energy prices and July's IGAE picking up on better dynamics in services

- **Bi-weekly inflation report (1H-September).** We are forecasting a 0.36% 2w/2w increase in the headline index, while we expect the core component to climb 0.29%. Inflation during the period will be mainly explained by the increase in energy prices, particularly gasoline, as well as education costs, given the start of the new school-year. With these results, 12-month inflation will stand at 5.02% in the first half of September, higher than the 4.90% seen in August.
- **Economic activity indicator (July).** We expect IGAE to rebound to 2.1% yoy. We forecast a 2.4% contraction in the agricultural sector from a 4.3% fall in June. On the other hand and as already mentioned before, industrial production in July stood at 1.3%. In services, we expect an increase of 2.8% from 1.9% in the previous month.

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Mexico weekly calendar

DATE	HOUR (ET)	EVENT	PERIOD	UNIT	BANORTE	CONSENSUS	PREVIOUS
Mon 24-Sep	9:00am	CPI inflation	1H Sep	% 2w/2w	<u>0.36</u>	--	0.30
				% yoy	<u>5.02</u>	--	5.00
		Core		% 2w/2w	<u>0.29</u>	--	0.09
				% yoy	<u>3.66</u>	--	3.65
Tue 25-Sep	9:00am	Global economic indicator	July	% yoy	<u>2.1</u>	--	1.2
		Primary activities		% yoy	<u>-2.4</u>	--	-4.3
		Industrial production		% yoy	<u>1.3</u>	--	0.2
		Services		% yoy	<u>2.8</u>	--	1.9
Tue 25-Sep	10:00am	International reserves	Sep-21	US\$ bn	--	--	173.6
Tue 25-Sep	12:30pm	Government weekly auction: 1-, 3-, 6-month CETES; 30y Mbono (Nov'47); 5y Bondes D					
Wed 26-Sep	9:00am	Unemployment rate	August	%	<u>3.53</u>	--	3.48
				sa	%	<u>3.32</u>	--
Thu 27-Sep	9:00am	Trade balance	August	US\$ mn	<u>-2,037.3</u>	--	-2,889
		Total exports		% yoy	<u>9.8</u>	--	14.2
		Oil exports		% yoy	<u>28.3</u>	--	34.2
		Non-oil exports		% yoy	<u>8.8</u>	--	12.9
		Total imports		% yoy	<u>7.7</u>	--	17.6
Fri 28-Sep	10:00am	Comercial banking credit	August	% yoy	<u>6.8</u>	--	6.3
		Consumption		% yoy	<u>2.0</u>	--	1.6
		Housing		% yoy	<u>3.8</u>	--	3.8
		Non-banking private firms		% yoy	<u>9.8</u>	--	10.4
Fri 28-Sep	3:30pm	Budget balance	August	MXN bn	--	--	-199.4

Source: Banorte; Bloomberg

Proceeding in chronological order...

Inflation for the 1st half of September will be explained by an increase in energy and education prices. We are forecasting a 0.36% 2w/2w increase in the headline index, while we expect the core component to climb 0.29%. Inflation during the period will be mainly explained by the increase in energy prices, particularly gasoline, as well as education costs, given the start of the new school-year.

With these results, 12-month inflation will stand at 5.02% in the first half of September, higher than the 4.90% seen in August. Moreover, we forecast core inflation at 3.66% yoy (previous: 3.63%). It is worth noting that the next print will contain a base-effect stemming from the suspension of transportation tariffs after the September 19th earthquake, which will push the annual comparison to around 5.15%, to then converge towards our year-end forecast of 4.8%.

We expect IGAE to rebound to 2.1% yoy in July on the back of a stronger performance in services. We forecast a 2.4% contraction in the agricultural sector from a 4.3% fall in June. On the other hand and as already mentioned before, industrial production in July stood at 1.3%, stronger-than-expected by the market as a result of a 4.5% rebound in construction, with manufacturing growing 2.4%. In services, we expect an increase of 2.8% from 1.9% in the previous month. In particular, known figures from internal demand indicators (retail sales, consumption goods imports, consumer and business confidence indexes) suggest a better performance in the last couple of months. Moreover, external demand has stayed positive in spite of uncertainty related to global trade tensions, supported by strong economic activity in the US, which in our view will show up favorably in the transportation component.

Weekly international reserves report. Last week, net international reserves increased by US\$38 million amounting to US\$173.6 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 have increased by US\$752 million during 2018 (please refer to the following table).

Banxico's foreign reserve accumulation detail

US\$, million

	2017	Sep 14, 2018	Sep 14, 2018	Year-to-date
	Balance		Flows	
International reserves (B)-(C)	172,802	173,554	38	752
(B) Gross international reserve	175,450	176,886	139	1,436
Pemex	--	--	-53	-617
Federal government	--	--	-101	599
Market operations	--	--	0	0
Other	--	--	293	1,454
(C) Short-term government's liabilities	2,648	3,332	101	684

Source: Banco de México

Weekly government bond auction. The Ministry of Finance (MoF) –via Banco de Mexico as its financial agent–, will offer 30-year fixed-rate Mbonos (Nov’47), 5-year Bondes D, in addition to the “more traditional” 1-, 3-, and 6-month zero-coupon Cetes (please refer to the table below). As usual, results will be released at 12:30pm (ET).

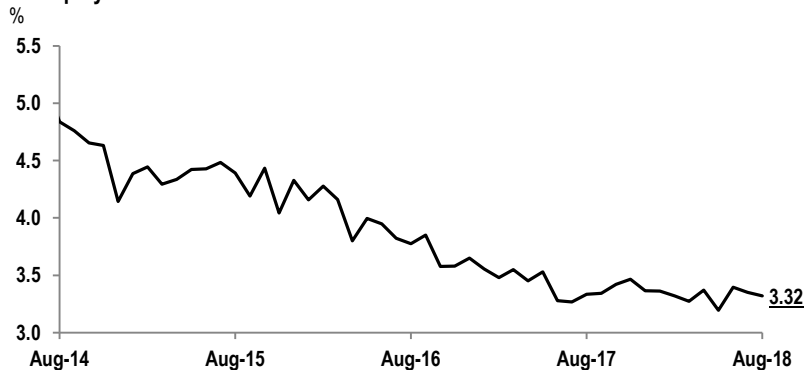
Auction specifics (Tuesday, September 25th, 2018)

	Maturity	Coupon rate, %	To be auctioned ¹	Previous yield ²
Cetes				
1m	25-Oct-18	--	7,000	7.69
3m	27-Dec-18	--	15,000	7.93
6m	28-Mar-19	--	11,500	8.07
Bondes D				
5y	31-Aug-23	--	5,000	0.17
M Bono				
30y	07-Nov-47	8.00	3,000	7.96

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

Stable unemployment rate in August. We estimate an unemployment rate of 3.53% nsa, slightly above the 3.48% observed in July. Nevertheless, using seasonally adjusted figures, the unemployment rate could drift lower to 3.32%, implying a 0.03%-pts decrease from last month’s print. We believe the marginal contraction in the unemployment rate (seasonally adjusted) would be explained by the recent recovery in the rate of formal job creation, which has been supporting unemployment at relatively low levels.

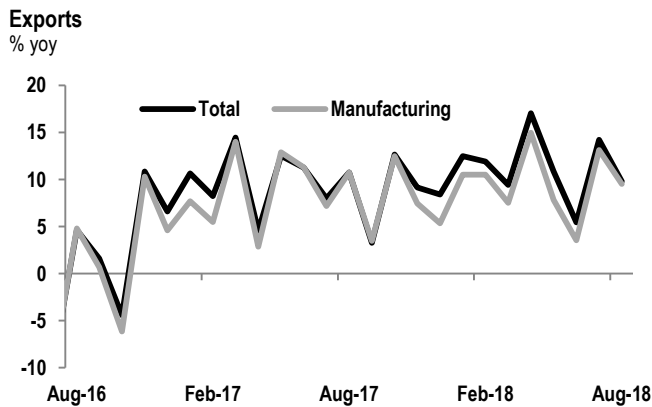
Unemployment rate



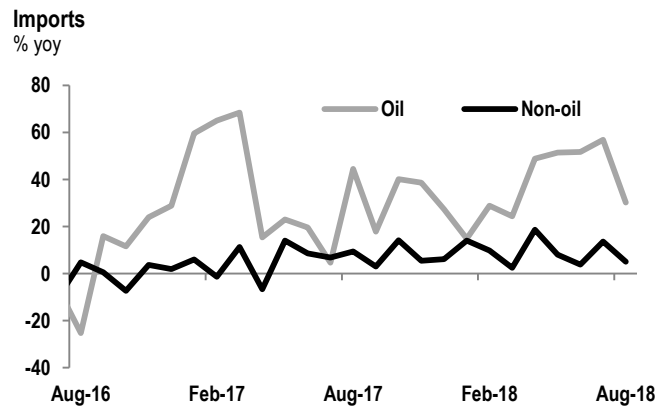
Source: INEGI, Banorte

Auto exports could rebound, but the trade balance deficit will likely prevail as a result of higher gasoline prices. We expect a US\$2,037.3 million deficit. Inside the report, we estimate a 9.6% yoy increase in total exports. The latter would be driven by the 28.3% expansion in oil exports as a result of higher prices for the Mexican crude-oil basket (+38.9% when compared to the same month of the previous year). Nevertheless, export volumes of crude-oil have been moderating according to the 3-month moving average, which we believe will impact the rebound in terms of the annual comparison. On the other hand, we expect manufacturing exports at 9.5% yoy, with a better performance in auto sector exports (according to data already released by AMIA) as well as strong US industrial production data in the previous two months, reflected in higher growth rates in this sector since last June.

Going to imports, we forecast a 7.7% yoy increase, with the component related to oil maintaining relatively high growth rates as international gasoline prices climbed, both in its monthly and yearly comparison. Moreover, we have penciled better dynamics in terms of non-oil consumption goods, which could be driven by the strength of the Mexican peso after the electoral process and after two consecutive months of more modest results. Last but not least, we expect an increase of 4.6% and 13.3% in intermediate and capital goods imports, respectively, moderating after relatively strong prints in recent figures.



Source: INEGI, Banorte



Source: INEGI, Banorte

Banking credit will show a 6.8% yoy increase in August. It is our take that credit to the non-financial sector continued flowing in August. In particular, we estimate a 6.8% yoy expansion in banking credit (in real terms), as a result of a 2% increase in consumer credit, coupled with a 3.7% and 9.8% expansion in mortgage and credit to firms, in the same order.

MoF's monthly 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. 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 42.7% of Mexico's GDP.

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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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