

# Ahead of the Curve

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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

**Saúl Torres**

Analyst, Mexico  
saul.torres@banorte.com

Market focus this week will be on Banxico's Quarterly Inflation report

- Banxico's Quarterly Inflation report.** Banco de Mexico will publish its Quarterly Inflation Report (QIR) for 1Q16 on Wednesday around 1:30pm (EDT). The release will be accompanied by a press conference led by Governor Carstens. In our view, market participants will focus on three issues: (1) Banxico's assessment regarding the implicit risks of the accommodative monetary stance of several central banks to the financial system; (2) Banxico's GDP and output gap projections after the recovery of the Mexican economy and the fiscal measures implemented by the Federal Government during the first quarter; and (3) Banxico's inflationary projections depicted in their traditional *fan charts*
- Bi-weekly inflation report.** On Tuesday, at 9:00am, *INEGI* will release its bi-weekly inflation report. We are forecasting a 0.53% 2w/2w decrease in the first half of May, below market consensus that expects -0.28% according to *Bloomberg*. In the core index, we expect an increase of 0.12% 2w/2w, above market consensus (0.09%). Inflation in the first half of May will once again show the effects of summer discounts in electricity tariffs. This will be offset by pressures that our price monitoring is still suggesting in merchandise prices, although those on agricultural prices have started to ebb away

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**Mexico weekly calendar**

DATE	HOUR (EDT)	EVENT	PERIOD	UNIT	BANORTE-IXE	CONSENSUS	PREVIOUS
Mon 23-May	9:00am	Retail sales	March	% yoy	<u>4.6</u>	4.8	9.6
Tue 24-May	9:00am	CPI inflation	1H May	% 2w/2w	<u>-0.53</u>	-0.28	-0.09
				% yoy	<u>2.48</u>	2.71	2.54
		Core		% 2w/2w	<u>0.12</u>	0.09	0.16
				% yoy	<u>2.95</u>	--	2.83
Tue 24-May	10:00am	International reserves	20-May	US\$ bn	--	--	177.6
Tue 24-May	12:30pm	Government weekly auction: 1-, 3-, 6-, and 12-month Cetes; 20y Mbono (Nov'34); 30y Udibono (Nov'46); 5y Bondes D					
Wed 25-May	9:00am	Trade balance	April	US\$ mn	<u>-1,859</u>	-560	155
		Total exports		% yoy	<u>-8.0</u>	--	-7.5
		Oil exports		% yoy	<u>-42.5</u>	--	-39.6
		Non-oil exports		% yoy	<u>-5.9</u>	--	-5.4
		Total imports		% yoy	<u>-2.6</u>	--	-6.7
Wed 25-May	10:00am	Current account	1Q16	US\$ mn	<u>765</u>	-8,950	-7,698
Wed 25-May	1:30pm	Banxico's quarterly inflation report					
Fri 27-May	9:00am	Unemployment rate	April	%	<u>4.10</u>	4.11	3.74
		sa		%	<u>4.14</u>	4.18	4.19

Source: Banorte-IXE; Bloomberg

Proceeding in chronological order...

**Retail sales will post a 4.6% yoy expansion in March.** On Monday at 9:00am (EDT), *INEGI* will publish its retail sales report for March 2016. We anticipate a 4.6% yoy expansion explained by the favorable performance of durable goods sales. In particular, vehicles sales increased by 11.4% yoy growth according to *AMIA*'s report. Moreover, *ANTAD* total store sales increased 9.2% yoy in real terms during the period in question. However, consumption goods imports - which have a strong correlation with retail sales-, posted a 0.4% yoy reduction.

Looking ahead, we believe that retail sales will continue to show a favorable performance derived from: (1) An improvement in private banking credit; (2) the contained levels of inflation; and (3) the stronger growth dynamics in the Mexican labor market.

**Inflation in the first half of May will once again show the effects of summer discounts in electricity tariffs.** On Tuesday, at 9:00am, *INEGI* will release its bi-weekly inflation report. We are forecasting a 0.53% 2w/2w decrease in the first half of May, below market consensus that expects -0.28% according to *Bloomberg*. In the core index, we expect an increase of 0.12% 2w/2w, above market consensus (0.09%)

Inflation in the first half of May will once again show the effects of summer discounts in electricity tariffs. This will be offset by pressures that our price monitoring is still suggesting in merchandise prices, although those on agricultural prices have started to ebb away.

Nevertheless, we expect this figure to be 0.5bps lower than the observed in same period last year, derived from: (1) lower reduction of agricultural prices (-1bps vs. -8.1 in 2015); (2) 3.9bps stemming from a larger contribution of merchandise prices (4.7bps vs. 0.8 in 2015); (3) 2.3bps stemming from a higher contribution of services inflation (4bps vs. 1.7 in 2015); along with (4) -12.9bps from a lower contribution energy prices (-63.6bps vs. -50.7 in 2015), as shown in the table below.

#### 1H-May inflation by components

% bi-weekly incidence

	Banorte-ixe	2015	Difference
Total	-0.53	-0.53	0.00
Core	0.09	0.03	0.06
Goods	0.05	0.01	0.04
Processed foods	0.02	0.00	0.02
Other goods	0.03	0.01	0.02
Services	0.04	0.02	0.02
Housing	0.01	0.01	0.00
Education	0.00	0.00	0.00
Other services	0.03	0.01	0.02
Non-core	-0.62	-0.57	-0.05
Agricultural	-0.01	-0.08	0.07
Fresh fruits and vegetables	0.02	-0.01	0.03
Meat and egg	-0.03	-0.07	0.04
Energy and government regulated	-0.61	-0.50	-0.11
Energy	-0.64	-0.51	-0.13
Government regulated	0.02	0.00	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

With these results, annual inflation will remain at levels around 2.48% yoy in the first half of May, while core inflation will reach 2.95% from 2.83% yoy.

**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\$79mn amounting to US \$177.6bn on May 13. According to Banxico's report, this figure comes mainly as a result of: (1) Dollar sales by Banxico to the Federal Government for US\$23mn; along with a (2) US\$56mn decrease due to changes in the valuation of the Central Bank's assets. It is worth noting that Pemex is currently the only significant source of reserve accumulation. In this context, the Central Bank has accumulated US\$917mn international reserves this year (please refer to the table below).

**Banxico's foreign reserve accumulation details**

US\$, million

	2015	13/May/2016	13/May/2016	Year-to-date
	Balance		Flows	
International reserves (B)-(C)	176,735	177,653	-79	917
(B) Gross international reserve	177,597	179,733	-499	2,136
Pemex	--	--	-133	2,394
Federal govt	--	--	25	2,384
Market operations	--	--	0	-5,562
Other	--	--	-391	2,919
(C) Short-term government's liabilities	861	2,080	-421	1,218

Source: Banxico

**Weekly government bond auction.** Also on Tuesday, the Ministry of Finance (MoF) –via Banco de Mexico as its financial agent-, will offer 20-year fixed-rate Mbonos (Nov'34), 30-year inflation-linked Udibonos (Nov'46), as well as 5-year BondesD, in addition to the “more traditional” 1-, 3-, 6- and 12- month zero-coupon Cetes (please refer to the table below). As usual, the results will be released at 12:30pm (EDT).

**Auction specifics (Tuesday, May 24, 2016)**

	Maturity	Coupon rate, %	To be auctioned <sup>1</sup>	Previous yield <sup>2</sup>
<b>Cetes</b>				
1m	23-Jun-16	--	5,500	3.81
3m	25-Aug-16	--	9,500	3.87
6m	24-Nov-16	--	11,000	3.94
12m	25-May-17	--	11,000	4.03
<b>Mbono</b>				
20y	23-Nov-34	7.75	2,500	6.46
<b>Udibono</b>				
30y	08-Nov-46	4.00	400	3.69
<b>Bondes D</b>				
5y	20-May-21	--	3,000	0.19

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

**Oil exports will continue to fall in April.** On Wednesday, at 10:00am (EDT), INEGI will make available its trade report for April, where we expect to see a US\$1,859 million deficit. On the exports side, we will probably see a 42.5% yoy contraction of oil exports given the significant fall in exports and prices during the period in question. Moreover, non-oil exports could have decreased 5.9% yoy, on the back of a 6.8% drop in manufacturing exports.

On the imports side, we estimate a 2.6% yoy contraction in total imports. Taking a look at the breakdown, we believe that imports consumption goods decreased 6% yoy, while imports of intermediate goods could have fallen 2.4% yoy. Finally, we estimate a 0.3% reduction in capital goods imports.

**Current account (1Q16): Banorte-Ixe: US\$765million; previous: -US\$7,698mn.** On Wednesday (May 25), at 10:00am, Banxico will publish its balance of payments report for the first quarter of the year. We are forecasting a current account surplus of around US\$765 million. According to already reported trade balance figures, trade deficit amounted to US\$796million, while net transfers increased on the back of a more dynamic flow of remittances up 8.6%yoy. Meanwhile, the balance of tourism showed a surplus amounting to US\$3,262million. In our opinion, external accounts remain solid with current account deficit financed by long term investment flows.

**Banxico's QIR.** Banco de Mexico will publish its Quarterly Inflation Report (QIR) for 1Q16 on Wednesday around 1:30pm (EDT). The release will be accompanied by a press conference led by Governor Carstens. In our view, market participants will focus on three issues: (1) Banxico's assessment regarding the implicit risks of the accommodative monetary stance of several central banks to the financial system; (2) Banxico's GDP and output gap projections after the recovery of the Mexican economy and the fiscal measures implemented by the Federal Government during the first quarter; and (3) Banxico's inflationary projections depicted in their traditional *fan charts*.

In the first case, market participants will focus on Banxico's assessment regarding the implicit risks of the accommodative monetary stance of several central banks. Recall that in their last monetary policy minutes, Banxico highlighted that: *"... the accommodative monetary stance implemented by several central banks in advanced economies [...] could pose significant risks to the stability of the international financial system..."*. In this context, Banxico has acknowledged that they cannot rule out other episodes of increased volatility. The Board of Governors also mentioned that: *"... inflationary risks can be materialized regardless of the Federal Reserve's actions. In this regard, Mexico's monetary policy must be ready to act in a timely and flexible manner, in order to face any obstacles that could endanger the consolidation of inflation's convergence to its permanent 3 percent target..."*.

Market participants will also focus on the central bank's assessment regarding growth and output gap projections after the recovery of the Mexican economy during the first quarter of the year. Recall that in the last QIR published by Banxico, the output gap remained opened throughout 2017. Similarly, we believe that Banxico will highlight the results of the fiscal measures undertaken this year that incorporate: (1) The Federal Government's fiscal cut announced in February 17; (2) the changes in Pemex's fiscal regime; (3) the fiscal cut announced for 2017; (4) the pre-payment of outstanding debt issued by the Federal Government given Banxico's operational surplus transferred to the MoF; and (5) the reduction in the fiscal deficit during the first quarter of the year. However, we also believe that the monetary authority will emphasize in the need to continue with the fiscal consolidation measures.

In this context, we believe that analysts will focus on Banxico's inflation forecasts, which will be depicted in their traditional *fan charts*. In the last QIR, the central bank projected a 3% inflation in the second quarter, and a slightly higher trajectory throughout the year. However, inflation has been constantly lower than Banxico's projections, and it is likely that the Central Bank will revise down their inflation forecast for the year.

Finally, we maintain our view that the central bank will probably hike rates in tandem with the Fed, although we cannot rule out the possibility that Banxico could increase the reference rate more than twice this year. Our base-case scenario for the Fed this year is that the FOMC will hike the Fed funds rate twice this year (25bp in June, and other 25bps in September or December). In this context, we believe that the next move by Banxico is a rate hike: 25bps on 30 June, after the Fed does the same at its meeting on June 15. Nevertheless, we cannot rule out the possibility that the monetary authority hikes more than 50bps this year, in case there is strong evidence of pass-through of exchange rate depreciation to inflation and/or there is a new episode of high volatility in international financial markets.

**Unemployment rate in April will stand at 4.1%.** Finally, on Friday *INEGI* will publish its employment report for the fourth month of 2016, in which we estimate an unemployment rate of 4.1% nsa, above the 3.74% observed in March. In seasonally-adjusted terms, we believe that the unemployment rate could stand at 4.14%, which implies a 0.05%-pts reduction.

It is likely that the unemployment rate in April was positively affected by the better growth dynamics of domestic demand, coupled with a higher growth in the job creation within the manufacturing industry. In this regard, recall that according to the Ministry of Labor, the manufacturing sector created 34,260 new jobs in April, which implies a 4% yoy expansion. Looking ahead, we are still positive on the outlook regarding the recovery of the economic activity, which will have a positive impact on firms' expectations about domestic demand, resulting in a more dynamic labor market.

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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
Rey Saúl Torres Olivares	Analyst	saul.torres@banorte.com	(55) 1670 - 2957
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	marisol.huerta.mondragon@banorte.com	(55) 1670 - 1746
José Itzamna Espitia Hernández	Equity Research Analyst – Airports / Cement / Infraestructure / Fibras	jose.espitia@banorte.com	(55) 1670 - 2249
Valentín III Mendoza Balderas	Equity Research Analyst – Auto parts	valentin.mendoza@banorte.com	(55) 1670 - 2250
María de la Paz Orozco García	Analyst	maripaz.orozco@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	hugo.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.rolan.ferrer@banorte.com	(55) 5004 - 1454