Ahead of the Curve

November 1, 2018

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Market focus in October's inflation and industrial production in September

- **Monthly inflation report (October).** We forecast a 0.51 % m/m increase in the headline index and +0.30% at the core level. With these results, 12-month inflation would reach 4.90%, lower than the 5.02% seen in September. Moreover, we forecast core inflation at 3.72% yoy (previous: 3.67%). Inflation will be driven by the end of summer discounts in electricity tariffs in some areas of the country, along some upside pressures in other services. In contrast, we expect a negative contribution from agricultural goods. Looking ahead and despite our forecast suggesting some improvement in terms of inflation dynamics, it is our take that Banxico will remain defensive and will hike the reference rate by 25bps to 8.00% on the meeting to be held on November 15th, particularly considering recent market volatility (*e.g.* Mexican peso weakness) and the outlook of further rate hikes by the Federal Reserve
- **Industrial production (September).** We believe industrial production is poised to finish the quarter on a positive note, estimating a 1.6% yoy increase, consistent with 1.1% growth in 3Q18 according to the preliminary GDP report published last Tuesday. By component, we expect mining at 4.2%, benefitted by a favorable base effect. Manufacturing would grow at 2.2%, fueled by the auto sector. Finally, we see construction falling, albeit at a more moderate pace (-1.2%) when compared to the previous month

Mexico weekly calendar

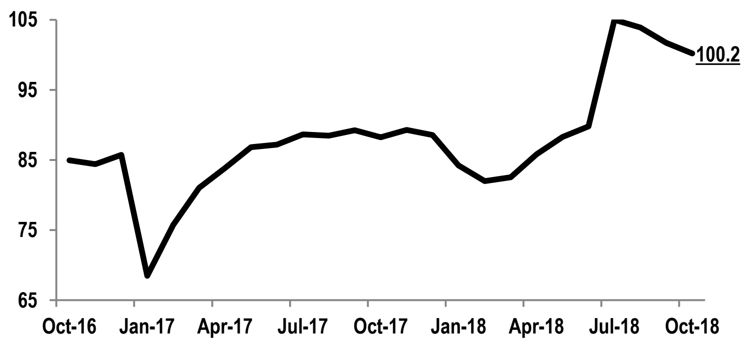
DATE	TIME (ET)	EVENT	PERIOD	UNIT	BANORTE	CONSENSUS	PREVIOUS
Tue 6-Nov	9:00am	**Consumer confidence**	October	index	100.2	--	101.7
Tue 6-Nov	9:00am	**Gross fixed investment**	August	% yoy	-0.4	-0.5	5.0
		Machinary and equipment		% yoy	2.9	--	7.8
		Domestic		% yoy	1.1	--	-2.1
		Imported		% yoy	4.3	--	14.9
		Construction		% yoy	-3.2	--	2.8
Tue 6-Nov	10:00am	**International reserves**	Nov-3	US$ bn	--	--	173.6
Tue 6-Nov	12:30pm	**Government weekly auction: 1-, 3-, 6-, and 12-month Cetes; 30y MBono (Nov'47); 30y Udibono (Nov'46); 5y Bondes D**					
Tue 6-Nov	3:30pm	**Citibanamex bi-weekly survey of economic expectations**					
Thu 8-Nov	9:00am	**CPI inflation**	October	% m/m	0.51	0.51	0.42
				% yoy	4.90	4.91	5.02
		Core		% m/m	0.30	0.31	0.32
				% yoy	3.72	--	3.67
Fri 9-Nov		**Wage negotiations**	October	%	4.0	--	5.8
Fri 9-Nov	9:00am	**Industrial production**	September	% yoy	1.6	1.8	0.2
		Mining		% yoy	4.2	--	-4.0
		Utilities		% yoy	0.9	--	2.6
		Construction		% yoy	-1.2	--	-1.6
		Manufacturing		% yoy	2.2	1.9	2.1

Source: Banorte; Bloomberg

Proceeding in chronological order...

Consumer confidence will continue with a slight downturn in October. We expect confidence to continue falling at a moderate pace in comparison with the previous month, standing at 100.2pts, still above the 100 point psychological threshold for the fourth month in a row. This would continue to be explained by the strong increase in the year-over-year comparison. Which we forecast at 13.6%. In our opinion, confidence remained relatively stable despite the modest depreciation of the Mexican currency in the sample period (going from USD/MXN 18.72 to 19.28 from the 1st to the 20th of October) and the fall in forward-looking indicators such as the non-manufacturing IMEF index. This situation would be partially compensated by an improvement in inflation during the first half of the month (in particular in agricultural and processed foods components), besides the positive figures from economic activity in September, particularly in the manufacturing sector. Moreover, wage negotiations in September remained high, which could also contribute in limiting the decrease in the overall index in terms of its reversion to the mean.

Consumer confidence
Index, nsa

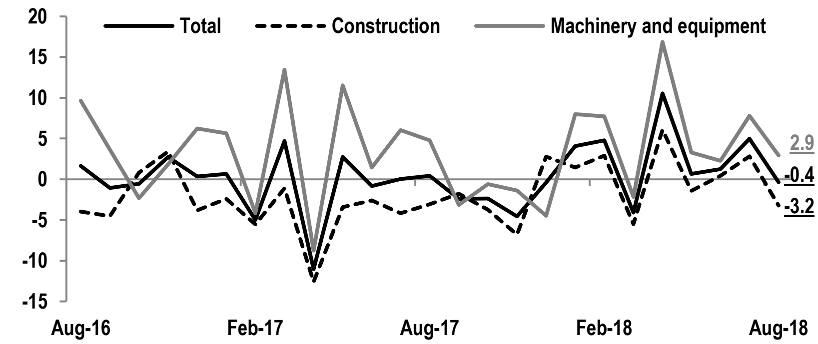


Source: INEGI

GFI to moderate in August after a string of positive prints. We anticipate GFI to post a slight decrease of 0.4% yoy after the strong 5% rebound in July and four consecutive months on the upside. month6.3% yoy rebound in July after a couple of relatively muted figures.

Within the report and using original figures, this contraction would be driven by a relatively strong fall of 1.6% in construction according to the industrial production report. As a result, we anticipate a 3.2% drop in this sub-index of GFI. Moreover, we forecast a more modest advance of 4.3% in imported machinery and equipment based on the signal from capital goods imports in trade balance data, which grew 9.3% in the month. Lastly, in the case of the domestic component, we foresee an increase of only 1.1%.

GFI
% yoy nsa



Source: INEGI, Banorte

Weekly international reserves report. Last week, net international reserves decreased US$52 million, amounting to US$173.6 billion. According to Banxico's report, this figure comes mainly from a negative valuation effect in central bank assets. In this context, the central bank's international reserves have increased US$781 million during 2018 (please refer to the following table).

Banxico's foreign reserve accumulation detail
US$, million

	2017	Oct 26, 2018	Oct 26, 2018	Year-to-date
	Balance		Flows	
International reserves (B)-(C)	172,802	173,582	-52	781
(B) Gross international reserve	175,450	175,982	-65	532
Pemex	--	--	90	-613
Federal government	--	--	-43	255
Market operations	--	--	0	0
Other	--	--	-112	889
(C) Short-term government's liabilities	2,648	2,399	-13	-249

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), 30-year inflation-linked Udibonos (Nov'46), 5-year Bondes D, in addition to the "more traditional" 1-, 3-, 6-, and 12-month zero-coupon Cetes (please refer to the following table). As usual, results will be released at 12:30pm (ET).

Auction specifics (Tuesday, November 6th, 2018)

	Maturity	Coupon rate, %	To be auctioned[1]	Previous yield[2]
Cetes				
1m	06-Dec-18	- -	7,000	7.76
3m	07-Feb-19	- -	11,000	8.24
6m	09-May-19	- -	11,000	8.19
12m	07-Nov-19	- -	12,500	8.20
Bondes D				
5y	01-Nov-23	- -	5,000	0.16
M Bono				
30y	07-Nov-47	8.00	2,000	8.18
Udibono				
30y	08-Nov-46	4.00	300	3.92

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

***Citibanamex* Survey.** Market focus will center on analysts' inflation forecasts for October (to be published on Thursday, November 8th). Furthermore, attention will be on monetary policy assessments, given the proximity of the next meeting, which will take place on Thursday, November 15th. In addition, this publication will contain forecasts for growth and FX.

End of summer discounts in electricity tariffs to impact inflation in October. We forecast a 0.51 % m/m increase in the headline index and +0.30% at the core level. Inflation will be driven by the end of summer discounts in electricity tariffs in some areas of the country, explaining 26bps of the projected increase in the headline. In addition, we are still expecting a relatively strong effect from higher gasoline prices (+5.8bps), along upside pressures in other services (+10.3bps), particularly due to the "Day of the Dead" holiday. In contrast, we expect a negative contribution from agricultural goods due to a considerable decrease in the price of fresh fruits (-5.7bps), and a more moderate fall in meat and egg (-2.7bps).

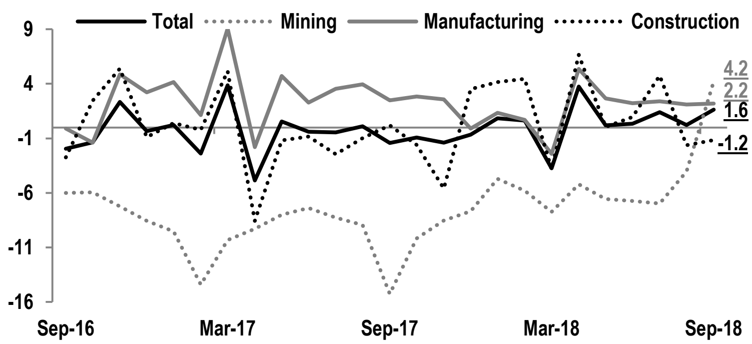
With these results, 12-month inflation would reach 4.90%, lower than the 5.02% seen in September. Moreover, we forecast core inflation at 3.72% yoy (previous: 3.67%). Looking ahead and despite our forecast suggesting some improvement in terms of inflation dynamics, it is our take that Banxico will remain defensive and will hike the reference rate by 25bps to 8.00% on the meeting to be held on November 15th, particularly considering recent market volatility (*e.g.* Mexican peso weakness) and the outlook of further rate hikes by the Federal Reserve.

Wage negotiations could have increased 4% during October on the back of IMSS workers. This figure would stand below the 5.8% increase seen in September. We believe that this increase will be driven by the 3.35% wage growth seen by members of the IMSS union. Nevertheless, wages in the private sector will continue to grow at a rapid pace given the relatively high levels of inflation at the end of 2017 and the first half of 2018, as well as the lagged impacted of the sharp increase in the minimum wage at the end of 2017.

Industrial production is poised to finish the quarter on a positive note. We estimate industrial activity for September at 1.6% yoy, consistent with 1.1% growth in 3Q18 according to the preliminary GDP report published last Tuesday. By component, we expect mining at 4.2%, its first time in positive territory after 30 consecutive months of decline, benefitted by a favorable base effect. In particular, oil and gas output in 2017 plunged by 18.1% and 23.2%, in the same order, heavily impacted by earthquakes and Hurricane Katia. Despite the temporary rebound, it is worth noting that output in both of them remain in a downward trend, particularly in the case of crude oil currently hovering around 1.8 million barrels per day. In this respect, it is likely that mining will remain as a drag to overall industrial activity in coming months.

On the other hand, we expect manufacturing at 2.2% yoy, rounding up a relatively good quarter with an average growth of a similar magnitude. In this regard, the trade balance report showed a very strong performance during the month, picking up by 10.5% yoy, fueled by the auto sector (which comprises around 36% of all manufacturing exports on a 12-month rolling basis). Finally, we still see construction falling on its yearly comparison, albeit at a more moderate pace (-1.2%) when compared to the previous month.

Industrial production
% yoy



Source: INEGI, Banorte

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HOLD	*When the share expected performance is similar to the MEXBOL estimated performance.*
SELL	*When the share expected performance is lower than the MEXBOL estimated performance.*

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