Ahead of the Curve

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Pickup in inflation for the 1st half of October on electricity and more moderate economic activity in August

- **Bi-weekly inflation report (1H-October).** We forecast a 0.53% 2w/2w increase in the headline and +0.19% in the core component. Inflation will be driven by the end of summer discounts in electricity tariffs in some areas of the country, explaining around 30bps of the projected increase in the headline index. In addition, we are still expecting a relatively strong effect from higher gasoline prices, along some upside in processed foods. With these results, 12-month inflation would reach 5.08% yoy, above the 5.02% seen in September, with core standing at 3.76% (previous: 3.67%)
- **Economic activity indicator (August).** We estimate a 2.2% yoy increase in the *Economic Activity Indicator* (IGAE), lower than the 3.3% observed in July. In our view, this slowdown would be explained by the moderation in industrial production (mainly due to the 1.6% contraction in construction after three consecutive months of gains) and the relative deceleration in manufacturing (from 2.4% in July to 2.1% in August). Considering the latter, we expect services at 3.3% yoy, below the 4.4% registered in the previous print

Mexico weekly calendar

DATE	HOUR (ET)	EVENT	PERIOD	UNIT	BANORTE	CONSENSUS	PREVIOUS
Mon 22-Oct	**4:30pm**	**Citibanamex bi-weekly survey of economic expectations**					
Tue 23-Oct	**9:00am**	**Global economic indicator**	August	% yoy	2.2	--	3.3
		Primary activities		% yoy	1.2	--	1.3
		Industrial production		% yoy	0.2	--	1.3
		Services		% yoy	3.3	--	4.4
Tue 23-Oct	**10:00am**	**International reserves**	Oct-19	US$ bn	--	--	173.6
Tue 23-Oct	**12:30pm**	**Government weekly auction: 1-, 3-, 6-month CETES; 20y Mbono (Nov'28); 5y Bondes D**					
Wed 24-Oct	**9:00am**	**CPI inflation**	1H Oct	% 2w/2w	0.53	--	0.10
				% yoy	5.08	--	5.17
		Core		% 2w/2w	0.19	--	0.18
				% yoy	3.76	--	3.67
Wed 24-Oct	**9:00am**	**Unemployment rate**	September	%	3.50	--	3.47
		sa		%	3.26	--	3.29
Thu 25-Oct	**9:00am**	**Retail sales**	August	% yoy	3.6	--	4.1
		sa		% m/m	-0.7	--	0.6
Fri 26-Oct	**9:00am**	**Trade balance**	September	US$ mn	-1,875.1	--	-2,590.5
		Total exports		% yoy	13.7	--	10.1
		Oil exports		% yoy	54.8	--	47.2
		Non-oil exports		% yoy	11.9	--	8.0
		Total imports		% yoy	12.8	--	9.4

Source: Banorte; Bloomberg

Proceeding in chronological order...

***Citibanamex* Survey.** Market focus will center on analysts' inflation forecasts for the first half of October (to be published on Wednesday, October 24th). Furthermore, attention will be on monetary policy assessments, given the tone of Banxico minutes published last Thursday (October 18th), which in our view reinforced a more hawkish bias. In addition, this publication will contain forecasts for growth and FX.

We expect a slowdown in economic activity in August. We believe that the *Economic Activity Indicator* (IGAE) will post a deceleration relative to last month's figure, standing at 2.2% yoy vs. 3.3% in the previous print. In our view, this slowdown would be explained by the moderation in overall activity as suggested by available figures so far, in particular industrial production at 0.2% vs. 1.3% in July. Looking at the details, the latter's lower dynamism was mainly due to the 1.6% contraction in construction, reversing some after three consecutive months of gains.

In addition, we also observed a relative deceleration in manufacturing, which keeps growing at healthy rates in spite of the uncertainty experienced in recent months about the future of the trade relationship between Mexico and the US. In particular, it went from 2.4% in July to 2.1% in August. In this regard, it is worth noting the strong correlation between manufacturing and services, particularly with transportation, which leads us to expect a slowdown in services to 3.3% yoy (previous: 4.4%). On the contrary, we believe the rest of this component will be supported by the resiliency of private consumption, which remains as the main driver of GDP. All in all, we believe that economic activity will continue growing at a relatively favorable pace, albeit with a more moderate rate of expansion.

Weekly international reserves report. Last week, net international reserves increased by US$258 million, amounting to US$173.6 billion. According to Banxico's report, this figure comes mainly from a positive valuation effect in central bank assets. In this context, the central bank's international reserves have increased US$848 million during 2018 (please refer to the following table).

Banxico's foreign reserve accumulation detail
US$, million

	2017	Oct 12, 2018	Oct 12, 2018	Year-to-date
	Balance		Flows	
International reserves (B)-(C)	172,802	173,649	258	848
(B) Gross international reserve	175,450	176,635	25	1,185
Pemex	--	--	127	-501
Federal government	--	--	-23	651
Market operations	--	--	0	0
Other	--	--	-79	1,035
(C) Short-term government's liabilities	2,648	2,986	-234	338

Source: Banco de México

Weekly government bond auction. The Ministry of Finance (MoF) –via Banco de Mexico as its financial agent–, will offer 20-year fixed-rate Mbonos (Nov'38), 5-year Bondes D, 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 (Tuesday, October 23rd, 2018)

	Maturity	Coupon rate, %	To be auctioned[1]	Previous yield[2]
Cetes				
1m	22-Nov-18	- -	7,000	7.65
3m	24-Jan-19	- -	11,000	7.85
6m	25-Apr-19	- -	11,000	8.05
Bondes D				
5y	31-Aug-23	- -	5,000	0.18
M Bono				
20y	18-Nov-38	8.50	2,500	8.15

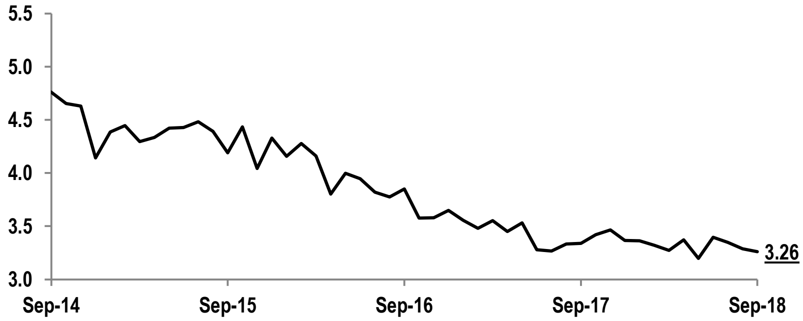
Source: Banorte with data from Banco de México 1. Except for Udibonos, which are expressed in UDI million, everything else is expressed in MXN million. 2. Yield-to-maturity reported for Cetes, Mbonos and Udibonos

End of summer discounts in electricity tariffs to impact inflation in the first half of October. We forecast a 0.53% 2w/2w increase in the headline and +0.19% at the core level. Inflation will be driven by the end of summer discounts in electricity tariffs in some areas of the country, explaining around 30bps of the projected increase in the headline. In addition, we are still expecting a relatively strong effect from higher gasoline prices (+5.7bps), along upside in processed foods (+6bps). In contrast, we expect a null contribution from agricultural goods due to a marginal decrease in the price of fresh fruits (-1bp), which would be offset by an increase of the same magnitude in meat and egg.

With these results, 12-month inflation would reach 5.08%, higher than the 5.02% seen in September. Moreover, we forecast core inflation at 3.76% yoy (previous: 3.67%). It is worth mentioning that the unfavorable base effect due to last year's earthquake (which impacted the previous bi-weekly print) is expected to fade away gradually, as it is our take that this event also had an effect on the path of inflation last year up to the end of 2017. Looking ahead, we believe pressures stemming from energy prices –particularly gasoline and LP gas–, will still be reflected in an upward bias for the headline index, leading it to close the year at 4.8%, above analysts' consensus around 4.5%

Marginal decrease in the unemployment rate in September. We estimate an unemployment rate of 3.50% nsa, slightly above the 3.47% observed in the previous month. This would be consistent with a print of 3.26% using seasonally adjusted figures, implying a marginal decrease of 3bps relative to August. In our view, this modest fall would be driven by the still strong behavior shown by formal job creation. Nevertheless, the pace of growth in its annual comparison has moderated in the last couple of months, suggesting near full-employment conditions. Moreover, we believe stable inflation at the core would also be supportive of relatively low levels for the unemployment rate.

Unemployment rate
%, sa

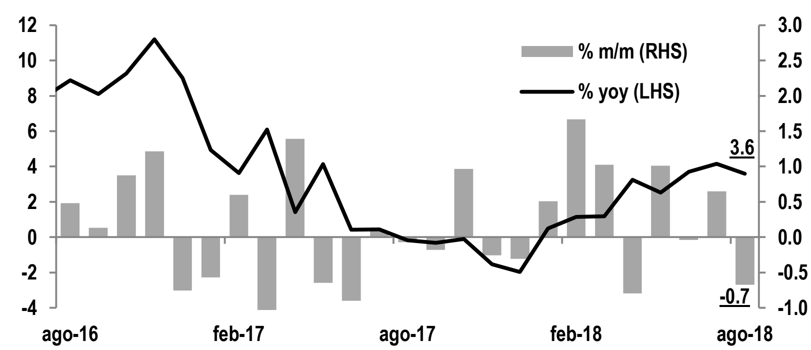


Source: INEGI, Banorte

Slight moderation in August retail sales. We estimate a 3.6% yoy increase, slightly below the 4.1% expansion of the previous print. In our view, the underpinnings behind the slight moderation in retail sales include a relative deceleration in the annual rate of expansion of remittances in local currency (from 17.5% in July to 15.5%) and higher inflation (from 4.8% to 4.9% in the same period).

Despite of the latter, available evidence suggests that consumer fundamentals remain quite healthy. In this respect, both autos and department store sales (as measured by AMIA and ANTAD figures, respectively) showed a relative improvement from previous month figures. Moreover, non-oil consumer goods imports rebounded to positive territory in its yearly comparison in both July and August, suggesting still relatively strong dynamics. Last but not least, consumer confidence has remained high after surging in the aftermath of the election, particularly the expectations components of both households and the country, which could have supported purchases of durable goods.

Retail sales
% yoy (nsa), % m/m (sa)



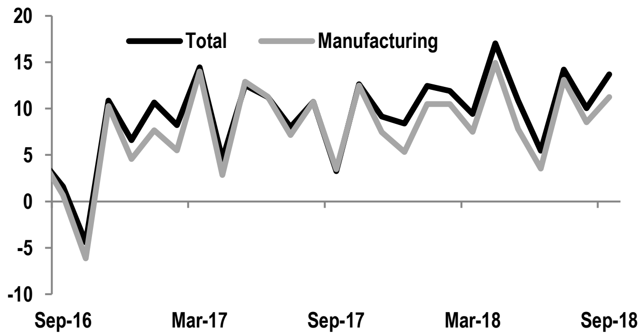
Source: INEGI, Banorte

Oil balance could improve at the margin on stronger exports, but with a modest effect in the overall trade balance. We expect a US$1,875.1 million deficit in September. Inside the report, we estimate a 13.6% yoy increase in total exports. Oil exports are forecasted to increase by 54.7%, a significantly higher figure relative to the previous month (47.2%). This would be driven by a favorable base effect given the steep decline in oil production last year (and, to a lesser extent, in exports) as a result of two events: (1) hurricanes (Katia and Harvey) and; (2) earthquakes in Mexico. Both led to logistic complications either on the Isthmus of Tehuantepec or the Port of Houston.

On the other hand, the Mexican crude-oil basket kept rising at practically the same high pace as the previous month (38.8% yoy). In this respect, we highlight that the average price in September reached US$ 67 per barrel, its highest since October 2014. On the other hand, we expect manufacturing exports at 11.6%, with a higher growth of auto sector exports (according to data already released by AMIA) and still strong US industrial production activity.

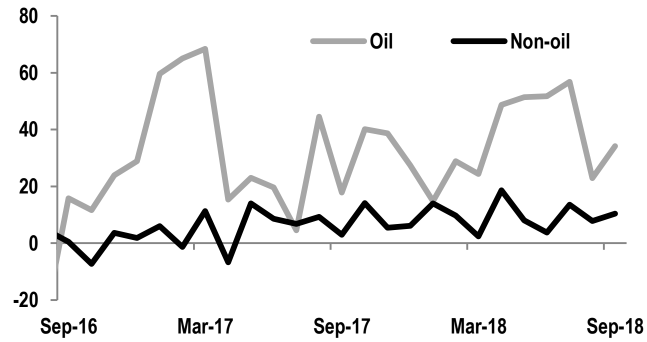
Going to imports, we forecast a 12.7% yoy increase, above the 9.4% expansion in August. Similar to exports, oil-related goods were probably impacted by higher international gasoline prices, particularly by the end of the month. On the other hand, we estimate a 4.1% increase in non-oil consumption goods, which in case it materializes would keep supporting our view of stronger consumer dynamics in 3Q18. Last but not least, we expect an increase of 10.6% and 13.7% in intermediate and capital goods imports, respectively, still at double-digit annual rates but moderating in their monthly comparison.

Exports
% yoy



Source: INEGI, Banorte

Imports
% yoy



Source: INEGI, Banorte

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