

Ahead of the Curve

November 17, 2017

Market focus this week will be on GDP for 3Q17 and inflation for the first half of November

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- **Gross Domestic Product (3Q17).** On Friday, *INEGI* will publish its GDP report for the third quarter of 2017, where we expect a 1.7% yoy expansion, marginally above the 1.6% preliminary figure reported by *INEGI*. In seasonally adjusted terms, we expect a null quarterly growth. Taking a look at the breakdown, we believe that services will continue to show a favorable performance (2.7% yoy), however, we expect a 0.7% contraction in the industrial sector
- **Bi-weekly inflation report (1H-Nov.).** On Thursday, at 9:00am, *INEGI* will also release its monthly inflation report for the first half of November. We are forecasting a 0.72% 2w/2w increase in the headline index, while we expect the core index to rise 0.17% 2w/2w. Inflation during the period in question will be explained mainly by the end of the summer discounts on electricity tariffs, as well as pressures on the prices of fruits and vegetables

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Mexico weekly calendar

DATE	TIME (ET)	EVENT	PERIOD	UNIT	BANORTE-IXE	CONSENSUS	PREVIOUS
Mon 20-Nov		Banking holiday: Mexican Revolution					
Tue 21-Nov	12:30pm	Government weekly auction: 1-, 3-, 6-month CETES; 20y Mbono (Nov'36); 5y Bondes D					
Tue 21-Nov	3:30pm	Citibanamex bi-weekly survey of economic expectations					
Wed 22-Nov	10:00am	International reserves	Nov-17	US\$ bn	--	--	173.8
Thu 23-Nov	9:00am	CPI inflation	1H-Nov	% 2w/2w	0.72	--	0.19
				% yoy	6.39	--	6.44
		Core		% 2w/2w	0.17	--	0.13
				% yoy	4.73	--	4.80
Thu 23-Nov	9:00am	Retail sales	September	%yoy	0.9	--	-0.2
		sa		% m/m	0.4	--	0.2
Thu 23-Nov	10:00am	Banxico's minutes	November				
Fri 24-Nov	9:00am	GDP	3Q17	% yoy	1.7	--	1.6
		(sa)		% q/q	0.0	--	-0.1
		Primary activities		% yoy	0.6	--	0.9
		Industrial production		% yoy	-0.7	--	-0.5
		Services		% yoy	2.7	--	2.4
Fri 24-Nov	9:00am	Global economic indicator	September	% yoy	1.2	--	2.3
		(sa)		% m/m	-0.5	--	1.2
		Primary activities		% yoy	3.0	--	2.1
		Industrial production		% yoy	-1.2	--	-0.2
		Services		% yoy	2.3	--	3.8
Fri 24-Nov	10:00am	Current account	3Q17	US\$ bn	-8.9	--	-0.3

Source: Banorte-IXE; Bloomberg

Proceeding in chronological order...

The Good Weekend will start today Friday. *The Good Weekend (El Buen Fin)* will begin this Friday. Recall that *The Good Weekend* was implemented by the Federal Government in 2011 and was intended to simulate the US Black Friday. In this edition, we believe that retail stores could implement greater discounts than the ones observed in the six previous years, given the deceleration observed in private consumption during the third quarter of the year. Given that consumers held back significantly on consumption, we believe that the greater discounts could push up retail sales in November.

Financial markets will remain closed in Mexico on Monday. On the logistics side it is worth noting that next week Mexico will experience a short week with a banking holiday on Monday (Nov 20), as the country observes the 107th Anniversary of the Mexican Revolution.

Weekly government bond auction. On Tuesday, the Ministry of Finance (MoF) –via Banco de Mexico as its financial agent–, will offer 20-year fixed rate Mbonos (Nov’36) and 5-year Bondes D, in addition to the “more traditional” 1-, 3-, and 6-month zero-coupon Cetes (please refer to the table on the next page). As usual, the results will be released at 12:30pm (ET).

Auction specifics (Tuesday, November 21, 2017)

	Maturity	Coupon rate, %	To be auctioned ¹	Previous yield ²
Cetes				
1m	21-Dec-17	--	7,000	7.01
3m	22-Feb-18	--	11,000	7.13
6m	24-may-18	--	11,500	7.25
Bondes D				
5y	10-Nov-22	--	3,750	0.18
M Bono				
20y	20-Nov-36	10.00	2,500	7.44

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

Citibanamex Survey: Market participants will focus on inflation and monetary policy forecasts. Additionally, on Tuesday around 3:30pm (ET) *Citibanamex* will release its bi-weekly survey of economic expectations, where focus will be on analysts’ inflation forecasts for the first half of November. Furthermore, attention will be on monetary policy assessments, considering the tone of Banxico’s last monetary policy announcement, which took place on November 9. In addition, the survey will also contain forecasts for growth and FX estimations for YE17 and YE18. 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 2017.

Weekly international reserves report. On Wednesday, at 10:00am (ET), Banco de Mexico will release its weekly balance report. Last week, net international reserves increased by US\$38 million amounting to US\$172.8 billion. According to Banxico's report, this figure comes mainly as a result of: (1) US dollar sales from the Central Bank to the Federal Government totaling US\$24 million; and (2) a positive valuation effect in central bank assets of around US\$62 million. In this context, the Central Bank's international reserves have diminished by US\$3.7 billion this year (please refer to the table in the next page).

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

	2016	Nov 10, 2017	Nov 10, 2017	Year-to-date
	Balance		Flows	
International reserves (B)-(C)	176,542	172,803	38	-3,739
(B) Gross international reserve	178,025	174,554	-1,873	-3,471
Pemex	--	--	141	-561
Federal government	--	--	-2,046	-4,078
Market operations	--	--	0	-2,000
Other	--	--	33	3,167
(C) Short-term government's liabilities	1,483	1,751	-1,911	268

Source: Banco de México

Inflation during the first half of November will be explained by the end of the summer discounts in electricity tariffs. On Thursday, at 9:00am, *INEGI* will also release its monthly inflation report for the first half of November. We are forecasting a 0.72% 2w/2w increase in the headline index, while we expect the core index to rise 0.17% 2w/2w.

Inflation during the period in question will be explained mainly by the end of the summer discounts on electricity tariffs, as well as pressures on the prices of fruits and vegetables. Moreover, we expect an increase in the other services component considering an increase in airfares and tourism services given the holiday taking place on November 20.

We forecast inflation to be 5bp lower when compared to the same period of last year, derived from: (1) 3bp from a smaller contribution of agricultural goods (3.5bp vs. 6.3bp in 2016); (2) 3bp from a lower impact of other services (5.5bp vs. 8.7bp in 2016); (3) 3bp stemming from a greater contribution of energy (55bp vs. 52bp in 2016); and (4) 2bp as a result of lower prices of goods (5.5bp vs. 7.3bp in 2016), as shown in the table on the next page.

With these results, annual inflation will stand at 6.39% in the first half of November, (previous: 6.37% yoy), while core inflation will be at 4.73% (previous: 4.77% yoy). Moving forward, we will focus on the evolution of energy prices and the behavior of agricultural prices, and the impact they might have in Mexico's CPI.

1H-November inflation by components
% bi-weekly incidence

	2017 P	2016	Difference
Headline	0.72	0.77	-0.05
Core	0.13	0.18	-0.05
Goods	0.06	0.07	-0.02
Processed foods	0.03	0.03	-0.01
Other goods	0.03	0.04	-0.01
Services	0.07	0.10	-0.03
Housing	0.02	0.02	0.00
Education	0.00	0.00	0.00
Other services	0.06	0.09	-0.03
Non-core	0.59	0.59	0.00
Agricultural	0.04	0.06	-0.03
Fresh fruits and vegetables	0.07	0.04	0.02
Meat and egg	-0.03	0.02	-0.05
Energy and government regulated	0.56	0.53	0.02
Energy	0.55	0.52	0.03
Government regulated	0.01	0.00	0.00

Source: Banorte-ixe, INEGI

Retail sales will post a moderate 0.9% yoy expansion in September. On Thursday at 9:00am (ET), *INEGI* will publish its retail sales report for September, where we anticipate a 0.9% yoy expansion, above the -0.2% observed in August.

We believe that retail sales scant growth will be explained by the 11.5% reduction in vehicle sales. In addition, *ANTAD* same store sales posted a 0.7% yoy contraction in real terms. By contrast, non-oil consumption goods expanded 5.2% yoy, which will overcompensate the fall in vehicle and *ANTAD* sales.

Banxico's minutes – The central bank will stay put throughout the rest of the year. Next Thursday at 10:00am (ET), Banco de Mexico will publish the minutes of its monetary policy meeting held back on November 2, in which the board unanimously decided to maintain the reference rate at 7%. Within the minutes, we expect the discussions to have focused on three issues: (1) The relative monetary stance between the Fed and Banxico; (2) The deterioration of the balance of risks for inflation in the horizon in which monetary policy acts, as a result of greater volatility of the exchange rate in response to a possible US exit from NAFTA and an adverse market reaction of the Fed's monetary policy normalization process; and (3) the change in Mexico's GDP base year yields a higher GDP growth within the last three years, which implies that the output gap was marginally positive in 2Q17.

Although we recognize that the probability of a rate hike in December has increased, we believe that Banxico will maintain its monetary stance unchanged for the remainder of the year. However, we now believe that Banxico will reduce the reference rate by 50bps in the second half of the year vs. our previous -100bps forecast. The change in our forecast comes as a result of: (1) four of the five current board members will be present at next year's monetary policy meetings; (2) the Fed's normalization process will continue in 2018; and (3) Mexico's CPI will be measured using a new methodology, which will likely increase headline and core inflation's annual variation in the second half of 2018.

Mexico's GDP will stand at 1.7% yoy in 3Q17. On Friday, *INEGI* will publish its GDP report for the third quarter of 2017, where we expect a 1.7% yoy expansion, marginally above the 1.6% preliminary figure reported by *INEGI*. In seasonally adjusted terms, we expect a null quarterly growth.

Taking a look at the breakdown, we believe that services will continue to show a favorable performance (2.7% yoy) driven by the above-trend growth in banking credit, and the expansion of the Mexican formal labor market (4.4% yoy in the third quarter).

By contrast, we expect a 0.7% contraction in the industrial sector derived from the 3-year recession in the mining sector and the reduction in construction output given the contraction in public investment projects. However, manufacturing output continues to gain momentum as a result of the higher external demand.

We expect a 1.2% yoy expansion in September's IGAE. On Friday, and in addition to the GDP report, *INEGI* will also release its monthly global economic indicator for September (GDP monthly proxy), where we expect a 1.2% yoy expansion, below August's 2.3% growth.

As we had mentioned in our last report, IP's contraction in September was explained by the 15.1% yoy decline in mining output, given the reduction of oil production in the Gulf of Mexico derived from the hurricane season and the earthquake of September 7, which affected the refining capacity in Salina Cruz, Oaxaca. Regarding hurricane season, we highlight the impact that *Harvey* and *Katia* had on Mexico's refining capacity, which derived in a significant reduction in PEMEX oil production, given that inventories were already at maximum levels.

Moreover, we believe that services will show a moderate 2.3% yoy expansion, as a result of the positive trend in the formal labor market coupled with an above-trend growth in banking credit.

We expect a greater current account deficit during the third quarter of the year. On Friday, at 10:00am, Banco de Mexico will publish its balance of payments report for the third quarter of 2017. We are forecasting a current account deficit of around US\$8,984 million. According to already reported trade balance figures, trade deficit amounted to US\$6,130 million, while net transfers increased on the back of a more dynamic flow of remittances up 6.2%yoy.

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