# Ahead of the Curve

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www.banorte.com
www.ixe.com.mx
@analisis_fundam

**Alejandro Cervantes**
Senior Economist, Mexico
alejandro.cervantes@banorte.com

**Francisco Flores**
Economist, Mexico
francisco.flores.serrano@banorte.com

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## Market focus this week will be on 2Q17's GDP and Banxico's minutes

- **Gross Domestic Product (2Q17).** On Tuesday, *INEGI* will publish its GDP report for the second quarter of 2017, where we expect a 1.6% yoy expansion, marginally below the 1.8% preliminary figure reported by *INEGI*. In seasonally adjusted terms, we expect a 0.4% q/q expansion. Taking a look at the breakdown, we believe that services will continue to show a favorable performance (3.1% yoy). By contrast, we expect a 1.2% contraction in the industrial sector derived from the 3-year recession in the mining sector. However, manufacturing output continues to gain momentum as a result of the higher external demand

- **Banxico's Minutes (August).** Next Thursday at 10:00am (EDT), Banco de Mexico will publish the minutes of its monetary policy meeting held back on August 10, in which the board decided to maintain the reference rate at 7%. Within the minutes, we expect the discussions to have focused on four issues: (1) The balance of risks for inflation didn't show a further deterioration, given that inflation is close to its peak and will start to fall in the fourth quarter; (2) the restrictive monetary policy implemented since 2015 will continue to influence the behavior of inflation; (3) the appreciation of the Mexican currency; and (4) the balance of risk for growth was changed to "neutral" given the lower probability of an unfavorable outcome in the future prospects of the commercial relation between Mexico and the U.S.

**Mexico weekly calendar**

| DATE | TIME (EDT) | EVENT | PERIOD | UNIT | BANORTE-IXE | CONSENSUS | PREVIOUS |
|---|---|---|---|---|---|---|---|
| **Tue 22-Aug** | **9:00am** | **GDP** | 2Q16 | % yoy | 1.6 | 1.8 | 1.8 |
| | | (sa) | | % q/q | 0.4 | 0.5 | 0.6 |
| | | Primary activities | | % yoy | 0.6 | -- | 0.7 |
| | | Industrial production | | % yoy | -1.2 | -- | -1.0 |
| | | Services | | % yoy | 3.1 | -- | 3.2 |
| **Tue 22-Aug** | **9:00am** | **Global economic indicator** | June | % yoy | 2.14 | 2.3 | 3.06 |
| | | (sa) | | % m/m | 0.3 | -- | 0.2 |
| | | Primary activities | | % yoy | 1.4 | -- | -0.3 |
| | | Industrial production | | % yoy | -0.3 | -- | 1.0 |
| | | Services | | % yoy | 3.7 | -- | 4.4 |
| **Tue 22-Aug** | **10:00am** | **International reserves** | 18-Aug | US$ bn | -- | -- | 173.1 |
| **Tue 22-Aug** | **12:30pm** | **Government weekly auction: 1-, 3-, 6-month CETES; 3y Mbono (Jun'20); 3y Udibonos (Dec'20)** | | | | | |
| **Tue 22-Aug** | **4:30pm** | **Citibanamex bi-weekly survey of economic expectations** | | | | | |
| **Wed 23-Aug** | **9:00am** | **Retail sales** | June | % yoy | 1.3 | 2.9 | 4.1 |
| | | sa | | % m/m | -1.0 | 0.2 | -0.1 |
| **Thu 24-Aug** | **9:00am** | **CPI inflation** | 1H-Aug | % 2w/2w | 0.25 | 0.22 | 0.25 |
| | | | | % yoy | 6.52 | 6.49 | 6.59 |
| | | Core | | % 2w/2w | 0.19 | 0.15 | 0.06 |
| | | | | % yoy | 5.01 | -- | 4.94 |
| **Thu 24-Aug** | **10:00am** | **Banxico's Minutes** | | | | | |
| **Fri 25-Aug** | **9:00am** | **Unemployment rate** | July | % | 3.44 | 3.44 | 3.27 |
| | | sa | | % | 3.24 | 3.30 | 3.30 |
| **Fri 25-Aug** | **10:00am** | **Current account** | 2Q16 | US$ bn | -4.7 | -5.0 | -6.9 |

Source: Banorte-IXE; Bloomberg

## Proceeding in chronological order...

**Mexico's GDP will stand at 1.6% yoy in 2Q17.** On Tuesday, *INEGI* will publish its GDP report for the second quarter of 2017, where we expect a 1.6% yoy expansion, marginally below the 1.8% preliminary figure reported by *INEGI*. In seasonally adjusted terms, we expect a 0.4% q/q expansion.

Taking a look at the breakdown, we believe that services will continue to show a favorable performance (3.1% yoy) driven by the above-trend growth in banking credit, and the expansion of the Mexican formal labor market (4.3% yoy in the second quarter).

By contrast, we expect a 1.2% 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 2.1% yoy expansion in June's IGAE.** On Tuesday, and in addition to the GDP report, *INEGI* will also release its monthly global economic indicator for June (GDP monthly proxy), where we expect a 2.1% yoy expansion, below May's 3.1% growth.

As we had mentioned in our last report, IP's contraction in June was explained by was explained by the 7.5% yoy contraction in mining output, as a result of the significant fall in Mexico's oil production, as well as the lower investment in Mexico's drilling projects. In addition, construction posted a marginal 0.1% yoy gain, which was explained by the 2.6% growth in building projects, whereas public civil engineering construction projects declined 8.4% yoy, given the austerity program implemented by the Federal Government. In addition, manufacturing output increased a scant 2.3% yoy, as a result of a 0.4% contraction in the production of electronic equipment.

Moreover, we believe that services will show a 3.7% yoy expansion, as a result of the positive trend in the formal labor market coupled with an above-trend growth in banking credit.

**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$81 million amounting to US$173.1 billion. According to Banxico's report, this figure comes mainly as a result of: (1) US$239 million dollar sales from Banxico to the Federal Government; and (2) a positive revalorization in central bank assets amounting to US$158 million. In this context, the Central Bank's international reserves have diminished by US$3.4 billion this year (please refer to the table on the next page).

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

| | 2016 | Aug 11, 2017 | Aug 11, 2017 | Year-to-date |
|---|---|---|---|---|
| | Balance | | Flows | |
| International reserves (B)-(C) | 176,542 | 173,129 | -81 | -3,412 |
| (B) Gross international reserve | 178,025 | 175,194 | -418 | -2,831 |
| Pemex | -- | -- | -172 | -129 |
| Federal government | -- | -- | -154 | -3,471 |
| Market operations | -- | -- | 0 | -2,000 |
| Other | -- | -- | -92 | 2,769 |
| (C) Short-term government's liabilities | 1,483 | 2,067 | -337 | 581 |

Source: Banco de México

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

**Auction specifics (Tuesday, August 22, 2017)**

| | Maturity | Coupon rate, % | To be auctioned[1] | Previous yield[2] |
|---|---|---|---|---|
| **Cetes** | | | | |
| 1m | 21-Sep-17 | - - | 7,000 | 6.91 |
| 3m | 23-Nov-17 | - - | 11,000 | 7.12 |
| 6m | 15-Feb-18 | - - | 11,500 | 7.16 |
| **M Bono** | | | | |
| 3y | 11-Jun-20 | 8.00 | 8,000 | 6.82 |
| **Udibonos** | | | | |
| 3y | 10-Dec-20 | 2.50 | 750 | 3.07 |

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.** Also on Tuesday around 3:30pm (EDT) *Citibanamex* will release its bi-weekly survey of economic expectations, where market participants will focus on analysts' monetary policy assessments given the neutral stance adopted by Banxico in their last monetary policy announcement. In this regard, we believe that the monetary authority will maintain the reference rate at 7% throughout the year. Looking ahead, we believe that Banxico could start an easing cycle in the second half of 2018 (August) as inflation will start to converge towards the 3% target and most of the uncertainty will be significantly reduced by then. We believe that Banxico has room to reduce the reference rate between 150-200bps over the next two years, from which 100bps could take place in the second half of 2018

Furthermore, analysts will also focus on the inflation forecasts for the first half of August (to be published on Thursday, August 24), as well as on CPI estimations for 2017. In addition, *Citibanamex* will also publish consensus' growth and FX forecasts for 2017. In the first case, we do not expect strong revisions to the median GDP forecast. In the second case, we expect moderate downward revisions to the FX estimates for 2017.

**Retail sales will post a moderate 1.3% yoy expansion in June.** On Wednesday at 9:00am (EDT), *INEGI* will publish its retail sales report for June, where we anticipate a 1.3% yoy expansion, below the 4.1% observed in May. We believe that retail sales scant growth will be explained by the 5.3% reduction in vehicle sales. In addition, *ANTAD* same store sales posted a 0.9% yoy contraction in real terms. By contrast, non-oil consumption goods expanded 10.2% yoy, which will overcompensate the fall in vehicle and *ANTAD* sales.

**Inflation during the first half of August will be explained by increases in the prices of fresh fruits and vegetables as well as education.** On Thursday, at 9:00am, *INEGI* will release its bi-weekly inflation report for the first half of August. We are forecasting a 0.25% 2w/2w increase in the headline index (consensus: 0.22%), while we expect the core index to rise 0.19% 2w/2w (consensus: 0.15%).

Inflation during the period in question will be explained by increases in the prices of fresh fruits and vegetables. Moreover, we also anticipate some pressures in the prices education, given the end of the summer vacation period.

We forecast inflation to be 6.6bp lower than the observed in same period last year, derived from: (1) 18.4bp from a lower contribution of energy prices (1.7bp vs. 20.1bp in 2016); (2) 9.9bp derived from a lower contribution of other goods prices (0bp vs. 9.9bp in 2016); (3) 9bp stemming from a higher contribution of other services (3.8bp vs. -5.2bp in 2016); (4) 7.3bp derived from a higher contribution of agricultural prices (8bp vs. 0.7bp in 2016); and (5) 4bp coming from a higher impact of processed foods (3.5bp vs. -0.5bp in 2016), as shown in the table below.

With these results, annual inflation will stand at 6.52% in the first half of August, (previous: 6.44% yoy), while core inflation will be at 5.01% (previous: 4.94% yoy). Moving forward, we will be attentive to the evolution of energy prices and the behavior of the exchange rate, as well as the impact they might have on the price formation dynamic.

**1H-August inflation by components**
% bi-weekly incidence

| | 2017 Forecast | 2016 | Difference |
|---|---|---|---|
| Headline | 0.25 | 0.31 | -0.07 |
| Core | 0.14 | 0.10 | 0.04 |
| Goods | 0.04 | 0.09 | -0.06 |
| Processed foods | 0.04 | 0.00 | 0.04 |
| Other goods | 0.00 | 0.10 | -0.10 |
| Services | 0.11 | 0.01 | 0.10 |
| Housing | 0.02 | 0.01 | 0.00 |
| Education | 0.05 | 0.04 | 0.01 |
| Other services | 0.04 | -0.05 | 0.09 |
| Non-core | 0.11 | 0.21 | -0.11 |
| Agricultural | 0.08 | 0.01 | 0.07 |
| Fresh fruits and vegetables | 0.07 | 0.02 | 0.05 |
| Meat and egg | 0.02 | -0.01 | 0.03 |
| Energy and government regulated | 0.03 | 0.21 | -0.18 |
| Energy | 0.02 | 0.20 | -0.18 |
| Government regulated | 0.01 | 0.00 | 0.01 |

Source: Banorte-Ixe, INEGI

**Banxico's minutes – The central bank will stay put throughout the year.** Next Thursday at 10:00am (EDT), Banco de Mexico will publish the minutes of its monetary policy meeting held back on August 10, in which the board decided to maintain the reference rate at 7%. Within the minutes, we expect the discussions to have focused on four issues: (1) The balance of risks for inflation didn't show a further deterioration, given that inflation is close to its peak and will start to fall in the fourth quarter; (2) the restrictive monetary policy implemented since 2015 will continue to influence the behavior of inflation; (3) the appreciation of the Mexican currency, given that the monetary authority emphasized that the exchange rate continues to be one of the main transmission channels of monetary policy; and (4) the balance of risk for growth was changed to "neutral" given the lower probability of an unfavorable outcome in the future prospects of the commercial relation between Mexico and the U.S.

It is likely that the minutes will show the discussion of the board members regarding Mexico's stronger macro-fundamentals, which resulted in the recent changes of Mexico's debt outlook to "stable" from "negative" made by several rating agencies (S&P and Fitch), derived from the Federal Government's austerity program.

Since Banxico's Board considers that inflation will converge to its 3% target towards the end of 2018, there aren't any inflationary pressures stemming from the demand, and the current level of the reference rate is consistent with the convergence of inflation to its 3% target, we still consider that the monetary authority will maintain the reference rate at 7% throughout the year. Looking ahead, we believe that Banxico could start an easing cycle in the second half of 2018 (August) as inflation will start to converge towards the 3% target and most of the uncertainty will be significantly reduced by then. We believe that Banxico has room to reduce the reference rate between 150-200bps over the next two years, from which 100bps could take place in the second half of 2018.

**Unemployment rate in July will stand at 3.44%.** On Friday, *INEGI* will publish its unemployment report for the seventh month of 2017, in which we estimate an unemployment rate of 3.44% nsa, above the 3.27% observed in June. In seasonally adjusted terms, we believe that the unemployment rate could stand at 3.24% which implies a 0.06%-pts reduction.

It is likely that July's labor market report will reflect the higher growth dynamics of the Mexico's domestic demand, particularly reflected in the upward trend of services. Looking ahead, we believe that the unemployment rate will hover around this level as a result of: On the positive side: (1) the higher growth of domestic demand –particularly within the services–, will continue to foster the formal labor market; (2) the recovery of external demand will push forward job creation within the manufacturing industry; and on the downside: (3) the downward trend in public spending has translated in a higher number of unemployed workers, which has already affected private investment projects.

**We expect an improvement on the current account during the second quarter of the year.** On Friday (August), at 10:00am, Banxico will publish its balance of payments report for the second quarter of the year. We are forecasting a current account deficit of around US$4,742 million. According to already reported trade balance figures, trade deficit amounted to US$-135million, while net transfers increased on the back of a more dynamic flow of remittances up 5.1%yoy.

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BANORTE IXE

**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 Godinez | 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 |
| Francisco José Flores Serrano | Economist, Mexico | francisco.flores.serrano@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 Senior Strategist | juan.alderete.macal@banorte.com | (55) 1103 - 4046 |
| Santiago Leal Singer | Strategist 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 | Technical Analysis | victorh.cortes@banorte.com | (55) 1670 - 1800 |
| Marissa Garza Ostos | Equity Research – Conglomerates / Financials/ Mining / Petrochemicals | marissa.garza@banorte.com | (55) 1670 - 1719 |
| José Itzamna Espitia Hernández | Equity Research – Airlines / Airports / Cement / Infrastructure / REITs | jose.espitia@banorte.com | (55) 1670 - 2249 |
| Valentín III Mendoza Balderas | Equity Research – Auto Parts/ Consumer Discretionary / Real Estate / Retail | valentin.mendoza@banorte.com | (55) 1670 - 2250 |
| Itzel Martínez Rojas | Analyst | itzel.martinez.rojas@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 | Senior, Corporate Debt | hugoa.gomez@banorte.com | (55) 1670 - 2247 |
| Gerardo Daniel Valle Trujillo | Analyst, Corporate Debt | gerardo.valle.trujillo@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.ceballos@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 |
| Víctor Antonio Roldan Ferrer | Head of Corporate Banking | victor.roldan.ferrer@banorte.com | (55) 5004 - 1454 |