

# Ahead of the Curve

April 21, 2017

Market focus this week will be on 1Q17's GDP and the inflation report for the first half of April

- **Preliminary GDP report (1Q17).** On Friday, *INEGI* will publish its preliminary estimation of GDP. Given the economic figures published for January and February, we believe that the preliminary estimation will show a 2.5% yoy growth for the Mexican economy during 1Q17, above the 2.4% observed in 4Q16. Taking a look at the breakdown, we believe that services will continue to show a favorable performance. By contrast, we expect a significant deceleration in the industrial sector derived from the recession in the mining sector, and the scant growth in construction output
- **Bi-weekly inflation report (1H-Apr).** On Monday, at 9:00am, *INEGI* will release its bi-weekly inflation report for the first half of April. We are forecasting a 0.25% 2w/2w decrease in the headline index (consensus: -0.19% 2w/2w), while we expect the core index to rise 0.20% 2w/2w (consensus 0.10% 2w/2w). Deflation during the period in question will be explained by the start of summer discounts on electricity tariffs in some regions of the country. On top of this, our price monitoring suggests declines in the price of agricultural prices. With these results, annual inflation will stand at 5.51% in the first half of April, (previous: 5.42% yoy), while core inflation will be at 4.69% (previous: 4.63% yoy)

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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**Mexico weekly calendar**

| DATE       | HOUR (EDT) | EVENT  | PERIOD   | UNIT    | BANORTE-IXE | CONSENSUS | PREVIOUS |
|------------|------------|--|----------|---------|-------------|-----------|----------|
| Mon 24-Apr | 9:00am     | CPI inflation  | 1H Apr   | % 2w/2w | -0.25       | -0.19     | 0.28     |
|            |            |  |          | % yoy   | 5.51        | 5.59      | 5.42     |
|            |            | Core   |          | % 2w/2w | 0.20        | 0.12      | 0.29     |
|            |            |  |          | % yoy   | 4.69        | --        | 4.63     |
| Mon 24-Apr | 9:00am     | Global economic indicator  | February | % yoy   | 0.9         | 1.1       | 3.0      |
|            |            | Primary activities   |          | % yoy   | 10.3        | --        | 12.8     |
|            |            | Industrial production  |          | % yoy   | -1.7        | --        | -0.1     |
|            |            | Services   |          | % yoy   | 1.9         | --        | 4.1      |
| Tue 25-Apr | 10:00am    | International reserves   | Apr-21   | US\$ bn | --          | --        | 175.0    |
| Tue 25-Apr | 12:30pm    | Government weekly auction: 1-, 3-, 6-, and 12-month Cetes; 20y MBono (Nov'36); 30y Udibono (Nov'46); 5y Bondes D |          |         |             |           |          |
| Wed 26-Apr | 9:00am     | Retail sales   | February | % yoy   | 1.8         | 3.4       | 4.9      |
|            |            | sa   |          | % m/m   | 0.3         | 0.8       | -1.1     |
| Thu 27-Apr | 9:00am     | Trade balance  | March    | US\$ mn | 1,508.0     | 1,091.5   | 684.4    |
|            |            | Total exports  |          | % yoy   | 12.7        | --        | 7.9      |
|            |            | Oil exports  |          | % yoy   | 42.6        | --        | 69.0     |
|            |            | Non-oil exports  |          | % yoy   | 11.4        | --        | 5.5      |
|            |            | Total imports  |          | % yoy   | 8.2         | --        | 2.8      |
| Fri 28-Apr | 9:00am     | GDP  | 1Q17 (P) | % yoy   | 2.5         | 2.5       | 2.7      |
|            |            | (sa)   |          | % q/q   | 0.5         | 0.5       | 0.7      |
|            |            | Primary activities   |          | % yoy   | 11.5        | --        | 6.4      |
|            |            | Industrial production  |          | % yoy   | 0.2         | --        | 0.0      |
|            |            | Services   |          | % yoy   | 3.4         | --        | 3.4      |
| Fri 28-Apr | 10:00am    | Comercial banking credit   | March    | % yoy   | 7.4         | --        | 7.8      |
|            |            | Consumption  |          | % yoy   | 6.0         | --        | 6.4      |
|            |            | Housing  |          | % yoy   | 5.3         | --        | 5.7      |
|            |            | Non-banking private firms  |          | % yoy   | 8.0         | --        | 8.4      |
| Fri 28-Apr |            | Budget balance   | March    | MXN bn  | --          | --        | -31.5    |

Source: Banorte-IXE; Bloomberg

Proceeding in chronological order...

**Deflation during the first half of April will be explained by decreases in electricity tariffs, as well as lower fresh fruits and vegetables prices.** On Monday, at 9:00am, *INEGI* will release its bi-weekly inflation report for the first half of April. We are forecasting a 0.25% 2w/2w decrease in the headline index (consensus: -0.19% 2w/2w), while we expect the core index to rise 0.20% 2w/2w (consensus 0.10% 2w/2w).

Deflation during the period in question will be explained by the start of summer discounts on electricity tariffs in some regions of the country. On top of this, our price monitoring suggests declines in the price of agricultural prices. However, we continue to expect increases in the processed foods, other goods and other services components.

We expect inflation to be 9bp higher than the observed in same period last year, derived from: (1) 8bp from a higher contribution of fruits and vegetables (-6bp vs. -14bp in 2016); (2) 6bp derived from a higher contribution of prices of other services (7bp vs. 1bp in 2016); and (3) 6bp stemming from a lower contribution of energy prices (-34bp vs. -30bp in 2016), as shown in the table below, as shown in the table below.

With these results, annual inflation will stand at 5.51% in the first half of April, (previous: 5.42% yoy), while core inflation will be at 4.69% (previous: 4.63% 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-April inflation by components**  
% bi-weekly incidence

|                                 | 2017 F | 2016  | Difference |
|---------------------------------|--------|-------|------------|
| Headline                        | -0.25  | -0.34 | 0.09       |
| Core                            | 0.15   | 0.11  | 0.04       |
| Goods                           | 0.06   | 0.08  | -0.02      |
| Processed foods                 | 0.03   | 0.04  | -0.01      |
| Other goods                     | 0.03   | 0.05  | -0.02      |
| Services                        | 0.09   | 0.03  | 0.06       |
| Housing                         | 0.02   | 0.02  | 0.00       |
| Education                       | 0.00   | 0.00  | 0.00       |
| Other services                  | 0.07   | 0.01  | 0.06       |
| Non-core                        | -0.40  | -0.45 | 0.05       |
| Agricultural                    | -0.07  | -0.11 | 0.04       |
| Fresh fruits and vegetables     | -0.06  | -0.14 | 0.08       |
| Meat and egg                    | -0.01  | 0.02  | -0.03      |
| Energy and government regulated | -0.33  | -0.34 | 0.01       |
| Energy                          | -0.34  | -0.30 | -0.04      |
| Government regulated            | 0.01   | -0.04 | 0.04       |

Source: Banorte-Ixe, INEGI

**We expect a 0.9% yoy expansion in February's IGAE.** Also on Monday *INEGI* will release its monthly global economic indicator for February (GDP monthly proxy), where we expect a 0.9% yoy expansion. However, we highlight that February's figure will be explained by the artificial base of comparison given the leap year effect in 2016. Controlling by calendar-adjusted figures, we believe that the economic activity will increase around 2.1% yoy. We believe that Mexico's economic growth will be explained by a 0.1% contraction in industrial production, coupled with a 3.1% yoy increase in services output.

As we had mentioned in our last report, IP's contraction in February was partially explained by the 10.6% yoy reduction in mining activity (calendar-adjusted figures), as a result of the significant contraction in Mexico's oil production, and the lower investment in Mexico's drilling projects. Moreover, construction output posted a 2.8% expansion, while manufacturing output grew 3.3% yoy.

In addition, we believe that the 3.1% yoy estimated expansion in services (calendar-adjusted figures; 1.9% original figures) will be explained by the lower growth dynamics in domestic demand. In this regard, most of February's indicator for consumption, like *ANTAD*'s retail sales suggest that Mexican households spent less, which will be reflected in the services sub-index.

**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\$29 million amounting to US\$175.0 billion. According to Banxico's report, this figure comes mainly as a result of: (1) US\$183 million dollar sales from Banxico to the Federal Government ; and (2) positive changes in valuation of the Central Bank's assets amounting to US\$154 million. In this context, the Central Bank's international reserves have diminished by US\$1.6 billion this year (please refer to the table below).

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

|   | 2016    | Apr 12, 2017 | Apr 12, 2017 | Year-to-date |
|---|---------|--------------|--------------|--------------|
|   | Balance |              | Flows        |              |
| International reserves (B)-(C)          | 176,542 | 174,969      | -29          | -1,572       |
| (B) Gross international reserve         | 178,025 | 176,789      | 42           | -1,236       |
| Pemex                                   | --      | --           | -134         | -614         |
| Federal government                      | --      | --           | -200         | -517         |
| Market operations                       | --      | --           | 0            | -2,000       |
| Other                                   | --      | --           | 376          | 1,895        |
| (C) Short-term government's liabilities | 1,483   | 1,819        | 71           | 336          |

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 20-year fixed-rate Mbonos (Nov'36), 30-year inflation-linked Udibonos (Nov'46), as well as 5-year Bondes D, 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 (Monday, April 10, 2017)**

|                 | Maturity  | Coupon rate, % | To be auctioned <sup>1</sup> | Previous yield <sup>2</sup> |
|-----------------|-----------|----------------|------------------------------|-----------------------------|
| <b>Cetes</b>    |           |                |                              |                             |
| 1m              | 25-May-17 | --             | 7,000                        | 6.47                        |
| 3m              | 27-Jul-17 | --             | 11,000                       | 6.65                        |
| 6m              | 26-Oct-17 | --             | 11,500                       | 6.75                        |
| 12m             | 26-Apr-18 | --             | 12,500                       | 6.90                        |
| <b>M Bono</b>   |           |                |                              |                             |
| 20y             | 20-Nov-36 | 10.00          | 2,000                        | 7.73                        |
| <b>Udibonos</b> |           |                |                              |                             |
| 30y             | 8-Nov-46  | 4.00           | 400                          | 3.70                        |
| <b>Bondes D</b> |           |                |                              |                             |
| 5y              | 17-Mar-22 | --             | 4,500                        | 0.22                        |

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

**Retail sales will post a 1.8% yoy expansion in February.** On Wednesday at 9:00am (EDT), *INEGI* will publish its retail sales report for February, where we anticipate a 1.8% yoy expansion, below the 4.9% observed in January. However, we highlight that February's figure will be explained by the artificial base of comparison given the leap year effect in 2016. Controlling by calendar adjusted figures, we believe that retail sales will increase around 5.5% yoy (0.3% m/m).

February's growth will be explained by the deceleration of non-durable goods sales. In particular, *ANTAD* total store sales posted a 0.7% yoy growth in real terms, while same-store sales decreased 2.1% yoy during the period in question. However, vehicles sales increased by 6.5% yoy according to *AMIA*'s auto report which will offset the deceleration of non-durable goods sales.

**Exports will show a significant recovery.** On Thursday at 9:00am (EDT), *Banxico* and *INEGI* will make available its preliminary trade report for March, where we expect to see a US\$1,508 million surplus. On the exports side, we will probably see a 42.6% yoy expansion of oil exports as a result of the higher prices for the Mexican crude oil basket (43.4% yoy). In addition, non-oil exports could have increased 11.4% yoy, on the back of a 11.9% hike in manufacturing exports.

On the imports side, we estimate a 8.2% yoy expansion in total imports, as a result of the increase in oil related imports. However, taking a look at the breakdown, we believe that non-oil consumption goods imports increased a scant 1.1% yoy, while imports of intermediate goods could have increased 7.3% yoy. Finally, we estimate a 3.1% expansion in capital goods imports.

**Mexico's preliminary GDP will stand at 2.5% yoy in 1Q17.** On Friday, *INEGI* will publish its preliminary estimation of GDP. For this preliminary figure, *INEGI* uses the economic reports published for the first two months of each quarter, and adds the available information for the third month. The missing figures for the last month of the quarter are estimated using econometric models. In this regard, the preliminary estimation of GDP will cover 80% with the direct information available, and will estimate the remaining 20%.

Given the economic figures published for January and February, we believe that the preliminary estimation will show a 2.5% yoy growth for the Mexican economy during 1Q17, above the 2.4% observed in 4Q16.

Taking a look at the breakdown, we believe that services will continue to show a favorable performance (3.4% yoy) driven by the above-trend growth in banking credit, and the expansion of the Mexican formal labor market (4.3% yoy).

By contrast, we expect a significant deceleration in the industrial sector derived from the recession in the mining sector, and the scant growth in construction output given the contraction in public investment projects.

**Banking credit will show a 7.4% yoy increase in Marzo.** Banco de Mexico will make available its banking credit report on Friday at 10:00am (EDT). It is our take that banking credit continued flowing in March. In particular, we estimate a 7.4% yoy expansion in banking credit (in real terms), as a result of increases in the area of 6%, 5.3%, and 8% yoy in consumer, housing and business credit, respectively.

**The MoF's monthly report.** On Friday, the Ministry of Finance (MoF) will make its monthly finance report available for the third month of the year. On the revenue side, we will be looking at non-oil tax collection as it will provide additional information about domestic demand dynamics. However, given the downward trend in Mexico's crude oil basket price in addition to the appreciation of the Mexican currency, the behavior of oil revenues generated by the Federal Government will be specially relevant.

In addition, markets will focus on the spending side of the report, in order to assess the execution of the fiscal cut announced by the *MoF* in Mexico's Fiscal Budget for 2017. Finally, it will be important to evaluate the evolution of public sector debt, which currently represents around 47% of Mexico's GDP.

#### **Disclaimer**

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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        |
| Francisco José Flores Serrano    | Economist, National                     | 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 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 —<br>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 –<br>Conglomerates / Financials/ Mining / Chemistry     | marissa.garza@banorte.com        | (55) 1670 - 1719 |
| José Itzamna Espitia Hernández | Equity Research Analyst – Airlines / Airports /<br>Cement / Infrastructure / Fibras    | jose.espitia@banorte.com         | (55) 1670 - 2249 |
| Valentín III Mendoza Balderas  | Equity Research Analyst – Auto Parts/<br>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  | Analyst, Corporate Debt | hugo.a.gomez@banorte.com | (55) 1670 - 2247 |

**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<br>Finance    | arturo.monroy.ballesteros@banorte.com  | (55) 5004 - 1002 |
| Gerardo Zamora Nanez           | Head of Transactional Banking, Leasing and<br>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 |