

Ahead of the Curve

June 5, 2015

Market focus this week will on May's inflation report

- May's monthly inflation report.** On Tuesday, at 9:00am, *INEGI* will release its monthly inflation report. We are forecasting a 0.49% m/m decrease in May below market consensus that expects a -0.48% according to *Bloomberg*. In the core index, we expect a 0.12% m/m increase, in line with market consensus. With these results, annual inflation would be at 2.88% yoy in May, from 3.06%; while core inflation will remain at levels around 2.34% yoy
- April's industrial production.** On Thursday, at 9:00am (EDT), *INEGI* will release its monthly industrial production report. We anticipate a 1.4% yoy expansion in total output during the fourth month of the year. Taking a look at the breakdown, we believe that construction output could have expanded 5.1% yoy. Additionally, we believe that manufacturing production could post a 2.3% yoy expansion. However, we believe that the increase in industrial output during April will be limited by the poor performance of mining activity where we expect a 4.5% yoy contraction

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Mexico weekly calendar

DATE	HOUR (EDT)	EVENT	PERIOD	UNIT	BANORTE-IXE	CONSENSUS	PREVIOUS
Tue 9-Jun	9:00am	CPI inflation	May	% m/m	<u>-0.49</u>	-0.48	-0.26
				% yoy	<u>2.88</u>	2.90	3.06
		Core		% m/m	<u>0.12</u>	0.12	0.16
				% yoy	<u>2.34</u>	--	2.31
Tue 9-Jun	10:00am	International reserves	5-Jun	US\$ bn	--	--	193.9
Tue 9-Jun	12:30pm	Government weekly auction: 1-, 3-, 6-month CETES; 10y Mbono (Dec'24); 5y Bondes D					
Wed 10-Jun		Wage negotiations	May	% yoy	<u>4.2</u>	--	4.1
Thu 11-Jun	9:00am	Industrial production	April	% yoy	<u>1.4</u>	1.3	1.7
		(sa)		% m/m	<u>0.4</u>	0.1	0.0
		Mining		% yoy	<u>-4.5</u>	--	-5.3
		Utilities		% yoy	<u>2.6</u>	--	3.0
		Construction		% yoy	<u>5.1</u>	--	5.2
		Manufactures		% yoy	<u>2.3</u>	--	3.1

Source: Banorte-IXE; Bloomberg

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Proceeding in chronological order...

Inflation in May will show the effect of summer discounts on electricity tariffs as well as lower agricultural prices. On Tuesday, at 9:00am, *INEGI* will release its monthly inflation report. We are forecasting a 0.49% m/m decrease in May, below market consensus that expects a 0.48% deflation, according to *Bloomberg*. In the core index, we expect a 0.12% m/m increase in line with market consensus.

Deflation in May will be explained by summer discounts on electricity tariffs, which started in April, along with lower agricultural products prices. Both factors will more than offset the moderate pressures observed in merchandise and services prices.

We expect this figure to be 17.3bps lower than the observed in same period last year, derived from: (1) 8.6bps stemming from a higher contribution of services (6.2bps vs. -2.4 in 2014); (2) 1.9bps stemming from a higher contribution of energy prices (-49.5bps vs. -51.5 in 2014). By contrast, we expect (3) -19.2bps from a lower contribution of agriculture prices (-12.3bps vs. 7.0 in 2014) and (4) -6.8bps stemming from a lower contribution of goods prices (2.8bps vs. 9.6 in 2014), as shown in the table below.

With these results, annual inflation would be at 2.88% yoy in May, from 3.06%; while core inflation will remain at levels around 2.34% yoy.

Inflation by components in May

%monthly incidence

	Banorte-Ixe	2014	Difference
Headline	-0.49	-0.32	-0.17
Core	0.09	0.07	0.02
Goods	0.03	0.10	-0.07
Processed foods	0.01	0.07	-0.07
Other goods	0.02	0.02	0.00
Services	0.06	-0.02	0.09
Housing	0.03	0.03	-0.01
Education	0.00	0.00	0.00
Other services	0.03	-0.06	0.10
Non-core	-0.60	-0.40	-0.20
Agricultural	-0.12	0.07	-0.19
Fresh fruits and vegetables	-0.05	-0.12	0.07
Meat and egg	-0.07	0.18	-0.25
Energy and government regulated	-0.48	-0.48	0.00
Energy	-0.50	-0.51	0.02
Government regulated	0.00	0.02	-0.02

Source: Banorte-Ixe with data from INEGI and Banco de México

Note: Contributions might not add due to the number of decimals allowed in the table. Previous to year 2011, contributions might not add because of the change in CPI-calculation methodology

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 \$401mn amounting to US \$193.9bn on May 29. According to Banxico's report, this figure comes mainly as a result of: (1) Dollar sales by the Central Bank to the Federal Government for US \$5mn; (2) US \$260mn decrease explained by the introduction of Banxico's USD daily auction; along with a (3) US \$136mn decrease due to changes in the valuation of the Central Bank's assets. It is worth noting that Pemex is currently the only significant source of reserve accumulation, given that on November 2011, the FEC (Federal Exchange Commission) decided to shut down the options scheme that Banxico also used to accumulate reserves. In this context, the central bank has accumulated US \$662mn of international reserves this year (please refer to the table below).

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

	2014	29/May/2015	29/May/2015	Year-to-date
	Balance		Flows	
International reserves (B)-(C)	193,239	193,901	-401	662
(B) Gross international reserve	195,682	196,455	58	773
Pemex	--	--	487	4,165
Federal govt	--	--	-49	146
Market operations	--	--	-260	-2,904
Other	--	--	-120	-634
(C) Short-term government's liabilities	2,443	2,554	459	111

Source: Banco de México

Weekly government bond auction. Also on Tuesday, the Ministry of Finance (MoF) –via Banco de Mexico as its financial agent-, will offer 10-year fixed-rate Mbonos (Dec'24) as well as 5-year Bondes D, 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, June 9, 2015)

	Maturity	Coupon rate, %	To be auctioned ¹	Previous yield ²
Cetes				
1m	09-Jul-15	--	5,500	2.97
3m	10-Sep-15	--	9,500	3.10
6m	10-Dec-15	--	11,000	3.20
Mbono				
10y	05-Dec-24	10.00	8,000	5.83
Bondes D				
5y	28-May-20	--	3,000	0.25

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

May's wage negotiations. On Wednesday, the Ministry of Labor (STPS) will make its contractual wage negotiations monthly data available. We anticipate workers to have negotiated an annual average wage increase of 4.2% in May. This would be slightly below the 4.3 % average observed year-to-date. In this regard, we believe that May's figure was mainly driven by the increase in wage negotiations in the education sector, specifically wage increases in the *National Union of Education Workers (SNTE)*; coupled with increases in the government sector; as well as revisions by labor unions of the private sector specially in the automotive and aviation industries.

We expect a 1.4% yoy expansion in April's industrial output. On Thursday, at 9:00am (EDT), *INEGI* will release its monthly industrial production report. We anticipate a 1.4% yoy expansion in total output during the fourth month of the year. Taking a look at the breakdown, we believe that construction output could have expanded 5.1% yoy. We believe that construction has consolidated its recovery given the better growth dynamics in households' durable goods expenditure. Moreover, formal employment generated within this sector has shown a significant recovery in the past year, which supports our view of a more positive perspective regarding the recovery of this sector. This would imply that construction could reach its eleventh positive growth rate after adding 17 consecutive months in contraction.

Additionally, we believe that manufacturing production could post a 2.3% yoy expansion, explained by faster growth in manufacturing exports (3.2% yoy) and vehicle production (14.2% yoy). We believe that in the short run the Mexican manufacturing sector will show better growth prospects, derived from: (1) A stronger external demand, particularly coming from the U.S.; (2) the recent depreciation of the Mexican currency; and (3) the recovery of private consumption in Mexico, which will eventually translate into a higher domestic demand for manufacturing products.

However, we believe that the increase in industrial output during April will be limited by the poor performance of mining activity. In this regard, we expect a 4.5% yoy contraction derived from lower oil production and the reduction in the extraction of other minerals.

Industrial production estimates: April 2015

% yoy	Apr-15	Apr-14	Jan-Apr, '15	Jan-Apr, '14
Total	1.4	-0.9	1.4	1.2
Mining	-4.5	-1.3	-4.9	-0.5
Utilities	2.6	2.3	3.1	2.2
Construction	5.1	-3.8	4.4	-2.1
Manufacturing	2.3	0.1	2.8	3.3
%m/m sa	Apr-15	Mar-15	Difference	
Total	0.4	0.0	0.4	
Mining	-0.3	-1.6	1.3	
Utilities	0.4	0.0	0.4	
Construction	0.5	3.0	-2.5	
Manufacturing	0.9	-1.0	1.9	

Source: Banorte-ixe, INEGI

Disclaimer

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