

Ahead of the Curve

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Market focus this week will on February's monthly inflation report

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- February's monthly inflation report.** On Wednesday, at 9:00am, *INEGI* will release its monthly inflation report. We are forecasting a 0.45% m/m increase in February, below market consensus that is forecasting a 0.51% according to *Bloomberg*. In the core index, we expect an increase of 0.34% m/m, in line with market consensus. Inflation during the period in question will be explained by pressure on merchandise prices. During the first half of the month, there were strong pressures in merchandise prices ex. food, probably showing an incipient pass-through from FX depreciation to inflation. With these results, annual inflation will edge up to 2.88% yoy in February from previous 2.61%, while core inflation will remain at 2.64% yoy
- Industrial production (January).** On Friday, at 9:00am (EST), *INEGI* will release its monthly industrial production report. We anticipate a 0.6% yoy contraction in total output during the first month of 2016. Taking a look at the breakdown, we believe that construction output could have fallen 2.2% yoy. In this regard, construction output has deteriorated as a result of the lower public construction projects. Moreover, we believe that manufacturing production could post a scant 1.4% yoy expansion. Finally, we believe that the 0.6% yoy decline in industrial output during January will be mainly explained by the poor performance of mining activity. In this regard, we expect a 4.8% yoy contraction derived from lower oil production and the reduction in the extraction of other minerals

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Mexico weekly calendar

DATE	HOUR (EST)	EVENT	PERIOD	UNIT	BANORTE-IXE	CONSENSUS	PREVIOUS
Mon 7-Mar	9:00am	Consumer confidence	February	index	<u>90.1</u>	<u>91.7</u>	92.5
Mon 7-Mar	4:30pm	Banamex bi-weekly survey of economic expectations					
Tue 8-Mar	10:00am	International reserves	4-Mar	US\$ bn	--	--	176.0
Tue 8-Mar	12:30pm	Government weekly auction: 1-, 3-, 6-month CETES; 3y MBono (Dec'19); 3y Udibonos (Jun'19)					
Wed 9-Mar	9:00am	CPI inflation	February	% m/m	<u>0.45</u>	<u>0.51</u>	0.38
				% yoy	<u>2.88</u>	<u>2.94</u>	2.61
		Core		% m/m	<u>0.34</u>	<u>0.34</u>	0.19
				% yoy	<u>2.64</u>	--	2.64
Thu 10-Mar		Wage negotiations	February	%	<u>4.3</u>	--	4.1
Fri 11-Mar	9:00am	Industrial production	January	% yoy	<u>-0.6</u>	<u>0.2</u>	0.0
		(sa)		% m/m	<u>-0.8</u>	<u>0.1</u>	-0.1
		Mining		% yoy	<u>-4.8</u>	--	-4.8
		Utilities		% yoy	<u>2.3</u>	--	2.0
		Construction		% yoy	<u>-2.2</u>	--	-1.4
		Manufactures		% yoy	<u>1.4</u>	<u>1.8</u>	2.5

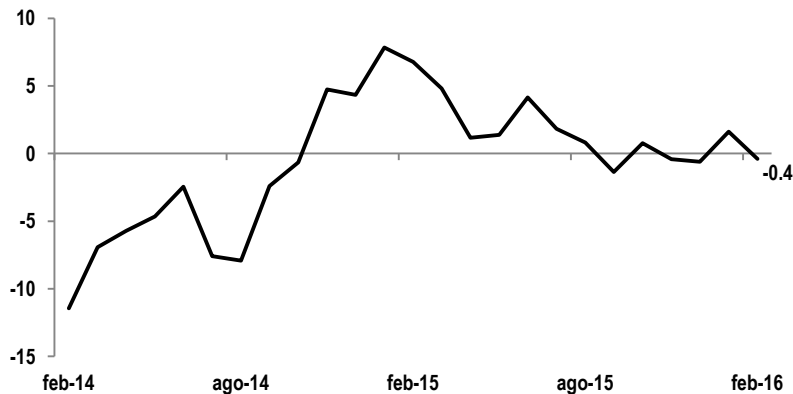
Source: Banorte-IXE; Bloomberg

Proceeding in chronological order...

Consumer confidence will fall given the depreciation of the Mexican currency and the fiscal cut. On Monday, at 9:00am (EST), Banxico and *INEGI* will publish its January's monthly survey on consumer confidence, where we expect a 0.4% yoy contraction, with the index reaching 90.1 points. Moreover, in seasonally adjusted terms, we expect confidence levels to decrease 1.3% m/m.

We believe that consumer confidence (measured in seasonally adjusted terms) will falter given the significant depreciation of the Mexican currency and the fiscal cut of MXN\$ 132.3 billion (US\$ 7.4 billion) announced by the MoF on February 17. We believe that both of these factors will be reflected in a decline of consumer's expectations regarding the country's present and future economic outlook. Moreover, February's fall will be also explained by the hike in annual headline inflation, which will translate in a moderate contraction of the purchasing power component.

Consumer confidence estimate
% yoy



Source: Banorte-Ixe using INEGI's figures

Banamex Survey: Market participants will focus on 2016 estimates. On Monday at 4:30pm (EST) *Banamex* will release its bi-weekly survey of economic expectations, where market participants will focus on analysts' monetary policy assessments after Banxico's rate hike in February. Furthermore, analysts will also focus on the inflation report for February (to be published on Wednesday, March 9), as well as on CPI estimations for 2016 and 2017. Moreover, *Banamex* will also publish consensus' growth and FX forecasts for 2016-17. In the first case, we believe that most economists will discount a lower economic growth for 2016 given the additional fiscal cut announced by the federal government (\$132 billion pesos). In the second case, we expect moderate downward revisions to the FX estimates for 2016.

Weekly international reserves report. On Tuesday, at 10:00am (EST), Banco de Mexico will release its weekly balance report. Last week, net international reserves increased by US\$1,305mn amounting to US \$176bn on February 26. According to Banxico's report, this figure comes mainly as a result of: (1) Dollar sales by the Federal Government to Banxico for US\$1,262mn; along with a (2) US\$43mn increase 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. In this context, the Central Bank has an accumulated reduction of US\$720mn international reserves this year (please refer to the table below).

Banxico's foreign reserve accumulation details

US\$, million

	2015	26/Feb/2016	26/Feb/2016	Year-to-date
	Balance		Flows	
International reserves (B)-(C)	176,735	176,015	1,305	-720
(B) Gross international reserve	177,597	179,719	2,523	2,122
Pemex	--	--	-267	2,304
Federal govt	--	--	2,748	4,168
Market operations	--	--	0	-5,562
Other	--	--	42	1,211
(C) Short-term government's liabilities	861	3,703	1,218	2,842

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 (Dec'19) as well as 3-year inflation-linked Udibonos (Jun'19), 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 (EST).

Auction specifics (Tuesday, March 8, 2016)

	Maturity	Coupon rate, %	To be auctioned ¹	Previous yield ²
Cetes				
1m	07-Apr-16	--	5,500	3.88
3m	09-Jun-16	--	9,500	3.98
6m	01-Sep-16	--	11,000	4.05
Mbono				
3y	11-Dec-19	5.00	9,000	5.05
Udibono				
3y	13-Jun-19	4.00	800	1.98

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

Inflation in February will show an incipient pass-through of FX depreciation to inflation. On Wednesday, at 9:00am, *INEGI* will release its monthly inflation report. We are forecasting a 0.45% m/m increase in February, below market consensus that is forecasting a 0.51% according to *Bloomberg*. In the core index, we expect an increase of 0.34% m/m, in line with market consensus.

Inflation during the period in question will be explained by pressure on merchandise prices. During the first half of the month, there were strong pressures in merchandise prices ex. food, probably showing an incipient pass-through from FX depreciation to inflation. Additionally, while our price monitoring suggest strong declines in certain agricultural products during the second half of the month, they will be offset by increases observed in the first fortnight, particularly in products such as eggs (+ 6.35%), onions (+ 6.23%), Serrano chilies (25.87%) and other chilies (+ 12.56%), according to *INEGI*. Finally, we would probably observe a negative variation coming from gasoline prices as a result of declines in the price of fuel in some border cities.

Nevertheless, we expect this figure to be 26.2bps higher than the observed in same period last year, derived from: (1) 27.9bps stemming from a higher contribution of agricultural prices (19.8bps vs. -8.2 in 2015); (2) 5bps stemming from a higher contribution of merchandise prices (16.3bps vs. 11.3 in 2015). By contrast, we expect (3) a lower contribution of services prices (9.1bps vs. 14.1 in 2015); along with (4) -2.3bps stemming from a lower contribution of energy prices (-2.7bps vs. -0.4 in 2015), as shown in the table below.

With these results, annual inflation will edge up to 2.88% yoy in February from previous 2.61%, while core inflation will remain at 2.64% yoy.

Inflation by components in February

% monthly incidence

	Banorte-Ixe	2015	Difference
Headline	0.45	0.19	0.26
Core	0.25	0.25	0.00
Goods	0.16	0.11	0.05
Processed foods	0.04	0.00	0.04
Other goods	0.12	0.11	0.01
Services	0.09	0.14	-0.05
Housing	0.04	0.04	0.01
Education	0.01	0.02	-0.01
Other services	0.04	0.09	-0.05
Non-core	0.20	-0.07	0.27
Agricultural	0.20	-0.08	0.28
Fresh fruits and vegetables	0.14	-0.12	0.26
Meat and egg	0.05	0.03	0.02
Energy and government regulated	0.00	0.02	-0.02
Energy	-0.03	0.00	-0.02
Government regulated	0.02	0.02	0.00

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

February's wage negotiations. On Thursday, 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 4.3% in the second month of 2016. This would be slightly above with the 4.1% observed in January. In this regard, we believe that February's figure was mainly driven by the increase in wage negotiations in the educational sector, specifically wage increases in universities unions, such as those in *Oaxaca, Baja California, Puebla, Guanajuato, San Luis Potosí* and *Hidalgo*; benefiting with a 3.15% increase to their workers. Along with wage increases in the manufacturing sector, such as the 5.5% wage increase negotiated by *the Maquila Sector Workers in Victoria Tamaulipas*, benefiting more than 1,500 workers; coupled with an increase of 4.2% in the *Union of Journeymen and Maquila Workers of Matamoros*, benefiting more than 30,000 workers. Finally, we highlight the salary reviews in some unions workers in the government's entities.

We expect a 0.6% yoy contraction in January's industrial output. On Friday, at 9:00am (EST), *INEGI* will release its monthly industrial production report. We anticipate a 0.6% yoy contraction in total output during the first month of 2016. Taking a look at the breakdown, we believe that construction output could have fallen 2.2% yoy. In this regard, construction output has deteriorated as a result of the lower public construction projects.

Moreover, we believe that manufacturing production could post a scant 1.4% yoy expansion, explained by a 3.9% yoy contraction in manufacturing exports, a 0.4% yoy expansion in January's vehicle production, and a 1.4% yoy increase in U.S. manufacturing output, which has a strong correlation with Mexico's manufacturing sector. Despite the significant deceleration in manufacturing output, we believe that the Mexican manufacturing sector of final goods will show better growth prospects, derived from: (1) The strong depreciation of the Mexican currency which will eventually translate into a fast recovery of Mexican exports; and (2) the recovery of private consumption in Mexico, which will be reflected in a higher domestic demand for manufacturing products.

Finally, we believe that the 0.6% yoy decline in industrial output during January will be mainly explained by the poor performance of mining activity. In this regard, we expect a 4.8% yoy contraction derived from lower oil production and the reduction in the extraction of other minerals.

Industrial production estimates

%yoy	Jan-16	Jan-15	2015	2014
Total	-0.6	1.1	1.0	2.6
Mining	-4.8	-6.5	-5.8	-1.5
Utilities	2.3	6.7	3.8	8.2
Construction	-2.2	6.4	2.5	2.0
Manufacturing	1.4	1.7	2.9	3.9
%m/m sa	Jan-16	Dec-15	Difference	
Total	-0.8	-0.1	-0.7	
Mining	-0.8	-1.1	0.3	
Utilities	-0.1	-0.8	0.7	
Construction	-0.6	-0.2	-0.4	
Manufacturing	-0.9	0.3	-1.2	

Source: Banorte-Ixe; INEGI

Disclaimer

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