

# Ahead of the Curve

August 4, 2017

Market focus this week will be on Banxico's monetary policy announcement and July's inflation report

- **Monetary policy announcement (August).** On Thursday, Banxico will announce its monetary policy decision at 3:00pm (EDT), where we do not expect an addition increase of the central bank's reference rate, which currently stands at 7%. We believe that the key variables for Banxico will be: (1) The dovish stance adopted by the board members in the last monetary policy announcement; and (2) the central bank acknowledged that the balance of risk for inflation didn't show a further deterioration. Since Banxico's Board considers that the impact of the above-mentioned inflationary shocks is temporary, and that the current level of the reference rate is consistent with the convergence of inflation to its 3% target, we maintain our forecast that the monetary authority will maintain the reference rate at 7% throughout the year
- **Monthly inflation report (July).** On Wednesday, at 9:00am, *INEGI* will release its monthly inflation report for July. We are forecasting a 0.32% m/m increase in the headline index (consensus: 0.34%), while we expect the core index to rise 0.26% m/m (consensus: 0.27%). Inflation during the period in question will be explained by increases in the prices of fresh fruits and vegetables along with other services. Moreover, we also anticipate some pressures in the prices of processed foods

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 7-Aug	4:30pm	Citibanamex bi-weekly survey of economic expectations						
Tue 8-Aug	10:00am	International reserves	4-Aug	US\$ bn	--	--	173.4	
Tue 8-Aug	12:30pm	Government weekly auction: 1-, 3-, 6-month CETES; 5y Mbono (Jun'22); 10y Udibonos (Nov'28)						
Wed 9-Aug	9:00am	CPI inflation	July	% m/m	0.32	0.34	0.25	
				% yoy	<u>6.38</u>	6.40	6.31	
		Core		% m/m	0.26	0.27	0.30	
				% yoy	<u>4.92</u>	--	4.83	
Thu 10-Aug		Wage negotiations	June	%	<u>3.9</u>	--	5.2	
Thu 10-Aug	2:00pm	Banxico's monetary policy decision	Ago-10	%	<u>7.00</u>	7.00	7.00	
Fri 11-Aug	9:00am	Industrial production	June	% yoy	<u>0.2</u>	0.2	1.0	
		(sa)		% m/m	<u>0.4</u>	0.4	0.1	
		Mining		% yoy	<u>-7.8</u>	--	-8.3	
		Utilities		% yoy	<u>-2.2</u>	--	-1.9	
		Construction		% yoy	<u>-0.9</u>	--	0.8	
		Manufactures		% yoy	<u>3.8</u>	3.3	5.0	

Source: Banorte-IXE; Bloomberg

Proceeding in chronological order...

**Citibanamex Survey: Market participants will focus on inflation and monetary policy forecasts.** On Monday around 3:30pm (EDT) *Citibanamex* will release its bi-weekly survey of economic expectations, where market participants will focus on analysts' monetary policy assessments, previous to Banxico's monetary policy announcement (to be released Thursday 10). Furthermore, analysts will also focus on the inflation forecasts for July (to be published on Wednesday 9), 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 some marginal revisions to the FX estimates for 2017.

**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\$261 million amounting to US\$173.4 billion. According to Banxico's report, this figure comes mainly as a result of: (1) US\$350 million dollar sales from Banxico to the Federal Government; and (2) a positive revalorization in central bank assets amounting to US\$89 million. In this context, the Central Bank's international reserves have diminished by US\$3.2 billion this year (please refer to the table on the next page).

**Banxico's foreign reserve accumulation detail**

US\$, million

	2016	Jul 28, 2017	Jul 28, 2017	Year-to-date
	Balance		Flows	
International reserves (B)-(C)	176,542	173,360	-261	-3,181
(B) Gross international reserve	178,025	175,685	-932	-2,340
Pemex	--	--	-427	199
Federal government	--	--	-360	-3,058
Market operations	--	--	0	-2,000
Other	--	--	-145	2,519
(C) Short-term government's liabilities	1,483	2,325	-671	841

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 5-year fixed-rate Mbonos (Jun'22), 10-year inflation-linked Udibonos (Nov'28), 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 8, 2017)**

	Maturity	Coupon rate, %	To be auctioned <sup>1</sup>	Previous yield <sup>2</sup>
<b>Cetes</b>				
1m	31-Aug-17	--	7,000	6.99
3m	09-Nov-17	--	11,000	7.10
6m	01-Feb-18	--	11,500	7.15
<b>M Bono</b>				
5y	09-Jun-22	6.50	8,000	6.63
<b>Udibonos</b>				
10y	30-Nov-28	4.00	600	3.31

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 during July will be explained by increases in the prices of fresh fruits and vegetables as well as other services.** On Wednesday, at 9:00am, *INEGI* will release its monthly inflation report for July. We are forecasting a 0.32% m/m increase in the headline index (consensus: 0.34%), while we expect the core index to rise 0.26% m/m (consensus: 0.27%).

Inflation during the period in question will be explained by increases in the prices of fresh fruits and vegetables along with other services. Moreover, we also anticipate some pressures in the prices of processed foods.

We forecast inflation to be 5.8bp higher than the observed in same period last year, derived from: (1) 17.7bp from a higher contribution of fresh fruits and vegetables prices (13bp vs. -4.6bp in 2016); (2) 15.4bp derived from a lower contribution of energy prices (-5.7bp vs. 9.7bp in 2016); (3) 9.6bp stemming from a lower contribution of government tariffs (1.2bp vs. 10.8bp in 2016); (4) 6.4bp coming from a higher impact of meat and egg prices (3.9bp vs. -2.5bp in 2016); and (5) 5.2bp derived from a higher contribution of other services prices (12.3bp vs. 7.2bp in 2016), as shown in the table below.

With these results, annual inflation will stand at 6.38% in July, (previous: 6.31% yoy), while core inflation will be at 4.86% (previous: 4.83% 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.

#### July inflation by components

% monthly incidence

	2017 Forecast	2016	Difference
Headline	0.32	0.26	0.06
Core	0.19	0.13	0.06
Goods	0.03	0.01	0.02
Processed foods	0.06	0.01	0.05
Other goods	-0.03	0.00	-0.03
Services	0.16	0.12	0.05
Housing	0.03	0.04	0.00
Education	0.01	0.01	0.00
Other services	0.12	0.07	0.05
Non-core	0.13	0.13	0.00
Agricultural	0.17	-0.07	0.24
Fresh fruits and vegetables	0.13	-0.05	0.18
Meat and egg	0.04	-0.03	0.06
Energy and government regulated	-0.05	0.20	-0.25
Energy	-0.06	0.10	-0.15
Government regulated	0.01	0.11	-0.10

Source: Banorte-ixe, INEGI

**Wage negotiations will climb 3.9% during July.** On Wednesday, the Ministry of Labor (MoL) will publish the contractual wage negotiations for July. We expect workers to have negotiated an average increase of 3.9%, below the 5.2% increase seen in May. We believe that the deceleration in the figure will come as a result of the wage negotiation of Pemex’s syndicate workers, which obtained a 3.12% increase in the month. Looking ahead, we believe that the significant increase in the minimum wage last December, coupled with higher inflation –mainly driven by the increase in energy prices– will continue to maintain wage negotiations in higher-than-average levels.

**Banxico’s monetary policy announcement – No additional hikes.** On Thursday, Banxico will announce its monetary policy decision at 3:00pm (EDT), where we do not expect an additional increase of the central bank’s reference rate, which currently stands at 7%. We believe that the key variables for Banxico will be: (1) The dovish stance adopted by the board members in the last monetary policy announcement; and (2) the central bank acknowledged that the balance of risk for inflation didn’t show a further deterioration.

In the first case, Banxico’s board members significantly modified the tone of the last *communiqué* showing a dovish bias, where they stressed that: “... *taking into account the transitory nature of the recent inflationary shocks, the time horizon in which the transmission channels of the monetary policy work, as well as the current forecasts for the Mexican economy, the actual level of the reference rate is compatible with the process of efficient convergence of inflation to the 3% target ...*”.

In addition, the monetary authority also acknowledged in the last monetary policy statement that the balance of risk for inflation didn’t show a further deterioration, and highlighted: (1) The restrictive monetary policy implemented since 2015 will continue to influence the behavior of inflation; (2) inflationary pressures derived from the pass-through effect of the depreciation of the Mexican currency to prices, as well as the increase in the prices of energy will fade away in the short run; and (3) the negative output gap, as a result of the downward trend in investment.

Since Banxico’s Board considers that the impact of the above-mentioned inflationary shocks is temporary, and that the current level of the reference rate is consistent with the convergence of inflation to its 3% target, we maintain our forecast that the monetary authority will maintain the reference rate at 7% throughout the year. We also believe that Banxico will be able to initiate an easing cycle in 2018, given that inflation will be converging towards the 3% target, as the above-mentioned inflationary shocks fade.

**We expect a 0.2% yoy expansion in June's industrial output.** Next Friday at 9:00am (EDT), *INEGI* will release its monthly industrial production report. We anticipate a 0.2% yoy increase in total output during June, after the 1% gain in the previous month. Taking a look at the breakdown, manufacturing production could post a 3.8% yoy expansion, explained by the visible recovery in external demand, which has translated into a higher flow of exports.

In addition, industrial output during June will be also explained by: (1) The 0.9% yoy fall in construction output, as a result of the lower growth in private construction investment projects derived from the uncertainty surrounding Mexico's economic outlook, coupled with the contraction in public investment projects given the Federal Government's austerity program; and (2) the poor performance of mining activity, where we estimate a 7.8% yoy decrease.

**Industrial production estimate: June 2017**

% yoy, nsa

	Jun-17	Jun-16	Jan-Jun, '17	Jan-Jun, '16
Total	0.2	0.6	-0.3	0.4
Mining	-7.8	-6.2	-9.9	-4.0
Utilities	-2.2	6.8	-1.4	3.3
Construction	-0.9	3.0	-0.3	2.2
Manufacturing	3.8	1.4	3.6	1.1

Source: Banorte-ixe

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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, 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	hugo.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.cebillos@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
Victor Antonio Roldan Ferrer	Head of Corporate Banking	victor.rolan.ferrer@banorte.com	(55) 5004 - 1454