

Ahead of the Curve

December 15, 2017

Market focus this week will be on October's global economic indicator and inflation for the first half of December

- Global economic indicator (October).** On Thursday, *INEGI* will release its monthly global economic indicator for October (GDP monthly proxy), where we expect a 1.8% yoy expansion, above September's 0.5% growth. As we had mentioned in our last report, IP's contraction in October amounted to 1.1% yoy. Moreover, we believe that services will show a 3.2% yoy expansion.
- Bi-weekly inflation report (1H-Dec).** On Thursday, at 9:00am, *INEGI* will release its bi-weekly inflation report for the first half of December. We are forecasting a 0.39% 2w/2w increase in the headline index, while we expect the core index to rise 0.32% 2w/2w. Inflation during the period in question will be mainly explained by increases in the price of fresh fruits and vegetables, particularly tomatoes.

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Mexico weekly calendar

DATE	HOURL (ET)	EVENT	PERIOD	UNIT	BANORTE-IXE	CONSENSUS	PREVIOUS
Tue 19-Dec	10:00am	International reserves	Dec-15	US\$ mn	--	--	172.4
Tue 19-Dec	12:30pm	Government weekly auction: 1-, 3-, 6-month CETES; 10y Mbono (Jun'27); 5y Bondes D					
Tue 19-Dec	3:30pm	Citibanamex bi-weekly survey of economic expectations					
Wed 20-Dec	9:00am	Retail sales	October	% yoy	<u>-1.5</u>	--	-0.3
		sa		% m/m	<u>-0.1</u>	--	-0.3
Wed 20-Dec	9:00am	Aggregate Demand	3Q16	% yoy	<u>0.6</u>	--	2.7
		Private consumption		% yoy	<u>2.9</u>	--	3.2
		Government consumption		% yoy	<u>0.1</u>	--	0.0
		Gross-fixed investment		% yoy	<u>-0.8</u>	--	-3.1
Thu 21-Dec	9:00am	Global economic indicator	October	% yoy	<u>1.8</u>	--	0.5
		(sa)		% m/m	<u>0.7</u>	--	-0.5
		Primary activities		% yoy	<u>4.1</u>	--	4.3
		Industrial production		% yoy	<u>-1.1</u>	--	-1.2
		Services		% yoy	<u>3.2</u>	--	1.2
Thu 21-Dec	9:00am	CPI inflation	1Q Dec	% 2w/2w	<u>0.39</u>	--	0.04
				% yoy	<u>6.64</u>	--	6.67
		Core		% 2w/2w	<u>0.32</u>	--	0.00
				% yoy	<u>4.80</u>	--	4.95
Fri 23-Dec	9:00am	Unemployment rate	November	%	<u>3.24</u>	--	3.50
		sa		%	<u>3.37</u>	--	3.35
Tue 26-Dec	12:30pm	Government weekly auction: 1-, 3-, 6-month CETES; 5y Mbono (Jun'22); 10y Udibonos (Nov'28)					
Wed 27-Dec	9:00am	Trade balance	November	US\$ mn	<u>-325.6</u>	--	-2,066.0
		Total exports		% yoy	<u>5.0</u>	--	13.2
		Oil exports		% yoy	<u>45.3</u>	--	16.5
		Non-oil exports		% yoy	<u>2.9</u>	--	13.0
		Total imports		% yoy	<u>6.1</u>	--	16.3
Wed 27-Dec	10:00am	International reserves	23-Dec	US\$ bn	--	--	--
Thu 28-Dec	10:00am	Banxico's minutes	December				
Fri 29-Dec	10:00am	Comercial banking credit	November	% yoy	<u>5.4</u>	--	5.8
		Consumption		% yoy	<u>1.5</u>	--	1.7
		Mortgage		% yoy	<u>2.2</u>	--	2.6
		Firms		% yoy	<u>8.4</u>	--	8.9
Fri 29-Dec		Budget balance	November	MXN bn	--	--	108.5

Source: Banorte-IXE; Bloomberg

Proceeding in chronological order...

Weekly international reserves report. On Tuesday, at 10:00am (ET), Banco de Mexico will release its weekly balance report. Last week, net international reserves decreased by US\$172 million amounting to US\$172.4 billion. According to Banxico's report, this figure comes mainly as a result of: (1) US dollar sales from the Central Bank to the Federal Government totaling US\$64 million; and (2) a negative valuation effect in central bank assets of around US\$108 million. In this context, the Central Bank's international reserves have diminished by US\$4.1 billion this year (please refer to the table below).

Banxico's foreign reserve accumulation detail

US\$, million

	2016	Dec 8, 2017	Dec 8, 2017	Year-to-date
	Balance		Flows	
International reserves (B)-(C)	176,542	172,409	-172	-4,133
(B) Gross international reserve	178,025	173,974	-158	-4,051
Pemex	--	--	-204	-767
Federal government	--	--	120	-4,210
Market operations	--	--	0	-2,000
Other	--	--	-73	2,925
(C) Short-term government's liabilities	1,483	1,565	14	81

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 10-year fixed rate Mbonos (Jun'27) and 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 (ET).

Auction specifics (Tuesday, December 19, 2017)

	Maturity	Coupon rate, %	To be auctioned ¹	Previous yield ²
Cetes				
1m	18-Jan-18	--	7,000	7.19
3m	22-Mar-18	--	11,000	7.30
6m	21-Jun-18	--	11,500	7.34
Bondes D				
5y	10-Nov-22	--	3,750	0.18
M Bono				
10y	03-Jun-27	7.50	8,500	7.19

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. Additionally, on Tuesday around 3:30pm (ET) *Citibanamex* will release its bi-weekly survey of economic expectations, where focus will be on analysts' inflation forecasts for the first half of December. Furthermore, attention will be on monetary policy assessments, considering the 25bps increase in Banxico's reference rate as well as the more hawkish tone of the *communiqué*.

In addition, the survey will also contain forecasts for growth and FX estimations for YE17 and YE18. In the first case, we do not expect strong revisions to the median GDP forecast. In the second case, we expect moderate upward revisions to the FX estimates for 2017.

Retail sales will post a 1.5% yoy contraction in October. On Wednesday at 9:00am (ET), *INEGI* will publish its retail sales report for October, where we anticipate a 1.5% yoy contraction, below the 0.3% fall observed in September.

We believe that retail sales contraction will be explained by the 10.2% reduction in vehicle sales. In addition, *ANTAD* same store sales posted a 4% yoy decrease in real terms. By contrast, non-oil consumption goods expanded 11.8% yoy, which will partially compensate the fall in vehicle and *ANTAD* sales.

We estimate a 0.6% yoy expansion in aggregate demand during 3Q17. On Wednesday at 10:00am (ET), *INEGI* will publish its aggregate supply and demand report, where we believe aggregate demand increased 0.6% yoy in the third quarter of the year vs. the 2.7% yoy expansion observed in the previous quarter.

Taking a look at the breakdown, we expect a 2.9% yoy increase in private consumption, while we estimate a 0.8% yoy contraction for gross fixed investment. Moreover, we believe that government spending will likely show a marginal 0.1% yoy increase given the fiscal cuts implemented by the federal government.

We expect a 1.8% yoy expansion in October's IGAE. On Thursday, *INEGI* will release its monthly global economic indicator for October (GDP monthly proxy), where we expect a 1.8% yoy expansion, above September's 0.5% growth. As we had mentioned in our last report, IP's contraction in October was explained by the 10.1% yoy reduction 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 1.7% yoy contraction, which was explained by the 0.6% reduction in building projects, whereas public civil engineering construction projects declined 7.9% yoy, given the austerity program implemented by the Federal Government. By contrast, manufacturing output increased a scant 2.7% yoy.

Moreover, we believe that services will show a 3.2% yoy expansion, as a result of the positive trend in the formal labor market coupled with an above-trend growth in banking credit. However, we believe that the deceleration of retail sales will limit services growth in October.

Inflation during the first half of December will be explained by increases in the prices of fresh fruits and vegetables as well as airfares and tourism services. On Thursday, at 9:00am, *INEGI* will also release its bi-weekly inflation report for the first half of December. We are forecasting a 0.39% 2w/2w increase in the headline index, while we expect the core index to rise 0.32% 2w/2w.

Inflation during the period in question will be mainly explained by increases in the price of fresh fruits and vegetables, particularly tomatoes. Additionally, we expect strong advance in the prices of airfares and tourism services considering the start of December's vacation period.

We forecast inflation to be 3bps lower when compared to the same period of last year, derived from: (1) 9bp from a larger contribution of fresh fruits and vegetables (9bps vs. 0bps in 2016); (2) 8bps from a lower impact of other services (13bps vs. 21bps in 2016); (3) 4bps stemming from a lesser contribution of goods (9bps vs. 13bps in 2016); (4) 4bps derived from a lower impact of meat and egg prices (1bps vs 5 bps in 2016); and (3) 3bp stemming from a bigger contribution of energy (4bps vs. 1bps in 2016), as shown in the table below.

With these results, annual inflation will stand at 6.64% in the first half of December (previous: 6.63% yoy), while core inflation will be at 4.85% (previous: 4.9% yoy). Moving forward, we will focus on the evolution of energy prices and the behavior of agricultural prices, and the impact they might have in Mexico's CPI.

December inflation by components

% bi-weekly incidence

	2017 P	2016	Difference
Headline	0.39	0.42	-0.03
Core	0.24	0.35	-0.11
Goods	0.09	0.13	-0.04
Processed foods	0.04	0.06	-0.02
Other goods	0.06	0.07	-0.01
Services	0.15	0.23	-0.08
Housing	0.02	0.02	0.00
Education	0.00	0.00	0.00
Other services	0.13	0.21	-0.08
Non-core	0.15	0.06	0.08
Agricultural	0.10	0.04	0.06
Fresh fruits and vegetables	0.09	0.00	0.09
Meat and egg	0.01	0.05	-0.04
Energy and government regulated	0.05	0.02	0.03
Energy	0.04	0.01	0.03
Government regulated	0.00	0.01	0.00

Source: Banorte-Ixe, INEGI

Unemployment rate in November will stand at 3.24%. On Friday, *INEGI* will publish its unemployment report for the eleventh month of 2017, in which we estimate an unemployment rate of 3.24% nsa, below the 3.5% observed in October. In seasonally adjusted terms, we believe that the unemployment rate could stand at 3.37% which implies a 0.02%-pts increase from last month's figures.

We believe that the slight rise in the unemployment rate (seasonally adjusted) will be due to the recent deceleration in economic activity. However, looking ahead we believe that the unemployment rate will hover around this levels 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.

Weekly government bond auction. On Tuesday (December 26), the Ministry of Finance (MoF) –via Banco de Mexico as its financial agent–, will offer 5-year fixed rate Mbonos (Jun'22) and 10-year inflation-linked Udibonos (Nov'28), in addition to the “more traditional” 1-, 3-, and 6-month zero-coupon Cetes. As usual, the results will be released at 12:30pm (ET).

Exports will continue to recover. On Wednesday (December 27) at 9:00am (ET), Banxico and *INEGI* will make available its preliminary trade report for November, where we expect to see a US\$325.6 million deficit. On the exports side, we will probably see a 45.3% yoy expansion of oil exports as a result of the higher prices for the Mexican crude oil basket (37.6% yoy). In addition, non-oil exports could have increased 2.9% yoy, on the back of a 2.2% hike in manufacturing exports.

On the imports side, we estimate a 6.1% 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 4.4% yoy, while imports of intermediate goods could have increased 5.5% yoy. Finally, we estimate a 5% expansion in capital goods imports.

Weekly international reserves report. Also on Wednesday (December 27), at 10:00am (ET), Banco de Mexico will release its weekly balance report.

Banxico's minutes – Explaining the 25bps hike. On Thursday (December 28) at 10:00am (ET), Banco de Mexico will publish the minutes of its monetary policy meeting held back on December 14, in which the board decided to increase the reference rate by 25bps to 7.25%. Within the minutes, we expect the discussions to have focused on four issues: (1) The inflation outlook has become more complex given the pressure on the Mexican peso as a result of a pickup in uncertainty regarding NAFTA renegotiation and the Fed's 25bps hike in the Fed Funds rate; (2) Banxico's rate hike aimed to anchor inflation expectations both in the medium and long-term as well as to reinforce its path towards the target; (3) if upside risks for inflation increase, Banxico's Board may take further actions to continue anchoring expectations; and (4) there are no signs of slack in the economy, as evidenced by both the output gap and labor market conditions.

Looking ahead, we believe that Banxico will hike rates by 25bps in February 8. In addition, we do not rule out further increases in a case of heightened volatility and a bleaker inflation outlook. Our forecast rests upon the following factors: (1) Inflation will stand around 200bps above Banxico's target in January; and (2) we expect more volatility of the Mexican peso as a result of the uncertainty regarding NAFTA renegotiation and 2018's electoral process. As volatility of the before-mentioned factors starts to dissipate, it is likely that the Central Bank could cut rates by 50bps in the second half of 2018.

Banking credit will show a 5.4% yoy increase in November. Banco de Mexico will make available its banking credit report on Friday (December 29) at 10:00am (ET). It is our take that banking credit continued flowing in November, albeit at a slower pace. In particular, we estimate a 5.4% yoy expansion in banking credit (in real terms), as a result of increases in the area of 1.5%, 2.2%, and 8.4% yoy in consumer, housing and business credit, respectively.

The MoF's monthly report. Also on Thursday, the Ministry of Finance (MoF) will release its monthly finance report available for the eleventh 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 behavior, particularly given the volatile dynamics in income tax collection seen in the year. Moreover, given the instability in Mexico's crude oil basket price during the year, the behavior of oil revenues generated by the Federal Government will be particularly 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 43.7% of Mexico's GDP.

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