

Ahead of the Curve

May 19, 2017

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

- **GDP (1Q17).** On Monday, *INEGI* will publish its GDP report for the first quarter of 2017, where we expect a 2.9% yoy expansion, marginally above the 2.7% preliminary figure reported by *INEGI*. In seasonally adjusted terms, we expect a 0.8% q/q expansion. 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
- **Bi-weekly inflation report (1H-May).** On Wednesday, at 9:00am, *INEGI* will release its bi-weekly inflation report for the first half of May. We are forecasting a 0.38% 2w/2w decrease in the headline index (consensus: -0.38% 2w/2w), while we expect the core index to rise 0.14% 2w/2w (consensus 0.13% 2w/2w). Inflation during the period in question will be explained by the start of summer discounts on electricity tariffs in some regions of the country

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Mexico weekly calendar

DATE	TIME (EDT)	EVENT	PERIOD	UNIT	BANORTE-IXE	CONSENSUS	PREVIOUS
Mon 22-May	9:00am	GDP	1Q17	% yoy	<u>2.9</u>	2.7	2.7
		(sa)		% q/q	<u>0.8</u>	0.6	0.6
		Primary activities		% yoy	<u>7.1</u>	--	6.9
		Industrial production		% yoy	<u>0.5</u>	--	0.2
		Services		% yoy	<u>3.9</u>	--	3.7
Mon 22-May	9:00am	Global economic indicator	March	% yoy	<u>4.6</u>	4.1	1.0
		(sa)		% m/m	<u>0.0</u>	--	0.1
		Primary activities		% yoy	<u>5.5</u>	--	-4.3
		Industrial production		% yoy	<u>3.4</u>	--	-1.9
		Services		% yoy	<u>5.3</u>	--	2.3
Mon 22-May	4:30pm	Citibanamex bi-weekly survey of economic expectations					
Tue 23-May	9:00am	Retail sales	March	% yoy	<u>6.1</u>	5	3.6
Tue 23-May	10:00am	International reserves	19-May	US\$ bn	--	--	174.9
Tue 23-May	12:30pm	Government weekly auction: 1-, 3-, 6-, 12-month CETES; 10y Mbono (Jun'27); 30y Udibonos (Nov'46); 5y Bondes D					
Wed 24-May	9:00am	CPI inflation	1H May	% 2w/2w	<u>-0.38</u>	-0.38	0.27
				% yoy	<u>6.12</u>	6.1	6.01
		Core		% 2w/2w	<u>0.14</u>	0.13	0.08
				% yoy	<u>4.74</u>	--	4.72
Wed 25-May	9:00am	Trade balance	April	US\$ mn	<u>-1,450</u>	-1,923	-182.9
		Total exports		% yoy	<u>13.1</u>	--	14.1
		Oil exports		% yoy	<u>46.0</u>	--	34.7
		Non-oil exports		% yoy	<u>11.6</u>	--	13.2
		Total imports		% yoy	<u>10.3</u>	--	15.0
Wed 25-May	10:00am	Current account	1Q17	US\$ bn	<u>-3.80</u>	-6.3	-3.36
Fri 27-May	9:00am	Unemployment rate	April	%	<u>3.49</u>	3.39	3.19
		sa		%	<u>3.57</u>	3.50	3.53

Source: Banorte-IXE; Bloomberg

Proceeding in chronological order...

Mexico's GDP will stand at 2.9% yoy in 1Q17. On Monday, *INEGI* will publish its GDP report for the first quarter of 2017, where we expect a 2.9% yoy expansion, marginally above the 2.7% preliminary figure reported by *INEGI*. In seasonally adjusted terms, we expect a 0.8% q/q expansion.

Taking a look at the breakdown, we believe that services will continue to show a favorable performance (3.9% yoy) driven by the above-trend growth in banking credit, and the expansion of the Mexican formal labor market (4.3% yoy in the first quarter).

By contrast, we expect a significant deceleration in the industrial sector (+0.5% yoy) derived from the recession in the mining sector, and the scant growth in construction output given the contraction in public investment projects. However, manufacturing output continues to gain momentum as a result of the higher external demand.

We expect a 4.6% yoy expansion in March's IGAE. On Monday, and in addition to the GDP report, *INEGI* will also release its monthly global economic indicator for March (GDP monthly proxy), where we expect a 4.6% yoy expansion, above February's 1% growth.

As we had mentioned in our last report, IP's expansion in March was explained by a calendar effect derived from the Holy Week, which added working days to the annual comparison. Controlling for this calendar effect, industrial production was flat in March. Analyzing the calendar-adjusted figures, manufacturing output increased 2.9% yoy. However, construction output rose a scant 0.7%, as a result of the 1.3% growth in building projects, whereas public civil engineering construction projects declined 12.1% yoy, given the fiscal cuts implemented by the Federal Government. In addition, mining activity fell 9.2% derived from the significant contraction in Mexico's oil production.

In addition, we believe that services will show a 5.3% yoy expansion which will also be explained by the above-mentioned calendar effect. Using the calendar-adjusted series, we believe that services increased 3.1% yoy as a result of the positive trend in the formal labor market coupled with an above-trend growth in banking credit.

Citibanamex Survey: Market participants will focus on inflation and monetary policy forecasts. Also on Monday around 5:30pm (EDT) *Citibanamex* will release its bi-weekly survey of economic expectations, where market participants will focus on analysts' monetary policy assessments given the 25bps hike in Banxico's reference rate. In this regard, we now believe that the central bank will increase the reference rate by 75bps within three meetings throughout the remainder of the year (25bps hike in each of the meetings). Of these, the next 25bps hike will probably take place in Banxico's next monetary policy meeting on June 22.

Furthermore, analysts will also focus on the inflation forecasts for the first half of May (to be published on Thursday, May 24), as well as on CPI estimations for 2017. In addition, *Banamex* 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 moderate downward revisions to the FX estimates for 2017.

Retail sales will post a 6.1% yoy expansion in March. On Tuesday at 9:00am (EDT), *INEGI* will publish its retail sales report for March, where we anticipate a 6.1% yoy expansion, above the 3.6% observed in February. We believe that retail sales growth will be explained by the 17.2% increase in vehicle sales. In addition, non-oil consumption goods expanded 6.2% yoy. However, retail sales growth will be bounded by the deceleration in non-durable goods sales. In this regard, *ANTAD* total store sales posted a 1.5% yoy growth in real terms, while same-store sales decreased 2.1% yoy during the period in question.

Weekly international reserves report. On Tuesday, at 10:00am (EDT), Banco de Mexico will release its weekly balance report. Last week, net international reserves increased by US\$25 million amounting to US\$174.9 billion. According to Banxico's report, this figure comes mainly as a result of: (1) US\$6 million dollar sales from Banxico to the Federal Government; and (2) A positive revalorization in central bank assets amounting to US\$31 million. In this context, the Central Bank's international reserves have diminished by US\$1.7 billion this year (please refer to the table below).

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

	2016	May 12, 2017	May 12, 2017	Year-to-date
	Balance		Flows	
International reserves (B)-(C)	176,542	174,869	25	-1,672
(B) Gross international reserve	178,025	176,229	184	-1,796
Pemex	--	--	-19	-653
Federal government	--	--	-212	-613
Market operations	--	--	0	-2,000
Other	--	--	414	1,470
(C) Short-term government's liabilities	1,483	1,359	159	-124

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), 30-year inflation-linked Udibonos (Nov'46), 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 (Tuesday, May 23, 2017)

	Maturity	Coupon rate, %	To be auctioned ¹	Previous yield ²	
Cetes					
	1m	22-Jun-17	--	7,000	6.53
	3m	24-Ago-17	--	11,000	6.82
	6m	23-Nov-17	--	11,500	6.97
	12m	26-Apr-18	--	12,500	6.99
M Bono					
	10y	03-Jun-27	7.50	8,000	7.24
Udibonos					
	30y	08-Nov-46	4.00	400	3.86
Bondes D					
	5y	12-May-22	--	4,500	0.21

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

Deflation during the first half of May will be explained by decreases in electricity tariffs. On Wednesday, at 9:00am, *INEGI* will release its bi-weekly inflation report for the first half of May. We are forecasting a 0.38% 2w/2w decrease in the headline index (consensus: -0.38% 2w/2w), while we expect the core index to rise 0.14% 2w/2w (consensus 0.14% 2w/2w).

Inflation during the period in question will be explained by the start of summer discounts on electricity tariffs in some regions of the country. However, the fall in energy prices will be partially offset by the upward trend in meat and egg as well as processed foods and other goods prices.

We expect inflation to be 10bp higher than the observed in same period last year, derived from: (1) 6bp from a higher contribution of other goods (4bp vs. -2bp in 2016); (2) 3bp derived from a higher contribution of prices of fresh fruits and vegetables (-2bp vs. -5bp in 2016); and (3) -1bp stemming from a lower contribution of other services prices (-1bp vs. 2bp in 2016), as shown in the table below, as shown in the table below.

With these results, annual inflation will stand at 6.12% in the first half of May, (previous: 5.82% yoy), while core inflation will be at 4.74% (previous: 4.72% 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.

May 1H inflation by major subcomponent

Bi-weekly incidence, %

	2017 F	2016	Difference
Headline	-0.38	-0.48	0.10
Core	0.11	0.06	0.04
Goods	0.10	0.03	0.07
Processed foods	0.06	0.04	0.01
Other goods	0.04	-0.02	0.06
Services	0.01	0.04	-0.02
Housing	0.02	0.02	0.00
Education	0.00	0.00	0.00
Other services	-0.01	0.02	-0.03
Non-core	-0.49	-0.55	0.06
Agricultural	0.01	-0.03	0.04
Fresh fruits and vegetables	-0.02	-0.05	0.03
Meat and egg	0.03	0.02	0.01
Energy and government regulated	-0.50	-0.52	0.02
Energy	-0.53	-0.51	-0.02
Government regulated	0.03	0.00	0.03

Source: INEGI, Banorte-Ixe

Exports will continue to recover. On Thursday at 9:00am (EDT), Banxico and *INEGI* will make available its preliminary trade report for April, where we expect to see a US\$1,450.3 million deficit. On the exports side, we will probably see a 46% yoy expansion of oil exports as a result of the higher prices for the Mexican crude oil basket (40.6% yoy). In addition, non-oil exports could have increased 11.6% yoy, on the back of an 11.8% hike in manufacturing exports.

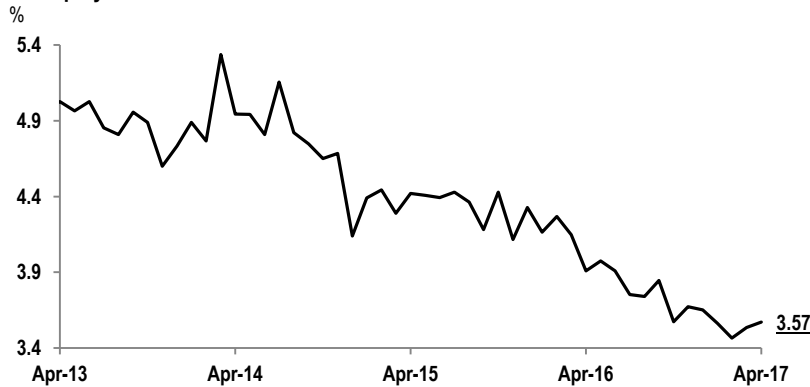
On the imports side, we estimate a 10.3% yoy expansion in total imports, as a result of the increase in oil related imports. However, taking a look at the breakdown, we believe that non-oil consumption goods imports increased a 3% yoy, while imports of intermediate goods could have increased 10% yoy. Finally, we estimate a scant 1.4% expansion in capital goods imports.

The current account deficit will remain relatively unchanged. On Thursday (May), at 10:00am, Banxico will publish its balance of payments report for the first quarter of the year. We are forecasting a current account deficit of around US\$3,805 million. According to already reported trade balance figures, trade deficit amounted to US\$658million, while net transfers increased on the back of a more dynamic flow of remittances up 7% yoy.

Unemployment rate in April will stand at 3.49%. On Friday, *INEGI* will publish its employment report for the fourth month of 2017, in which we estimate an unemployment rate of 3.49% nsa, above the 3.19% observed in March. However, the increase in the unemployment rate would be explained mainly by a seasonal effect, since the employment in certain sectors of the Mexican economy, such as agriculture and mining, have a substantial increase in March. In seasonally adjusted terms, we believe that the unemployment rate could stand at 3.57% which implies a monthly 0.04%-pts increase.

It is likely that April's labor market report will reflect the uncertainty around the future dynamics of the Mexican economy. In particular, the downward trend in public spending has translated in a higher number of unemployed workers, and has already affected private investment projects. In addition, we believe that April's report will also reflect the lower growth dynamics of the formal labor market as a result of the uncertainty surrounding Trump's policies on the Mexican economy.

Unemployment rate



Source: Banorte-ixe with data from INEGI

Disclaimer

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