

Ahead of the Curve

November 11, 2016

Market focus this week will on the final revision of the 3Q GDP

- GDP will show a 1.9% yoy expansion in 3Q16.** On Wednesday, at 9:00am (EDT), *INEGI* will publish its GDP report for the third quarter of 2016, where we expect a 1.9% yoy expansion, marginally below the 2% growth reported in *INEGI*'s preliminary GDP report. In seasonally adjusted terms, we expect a 0.9% q/q expansion. Taking a look at the breakdown, we believe that the services sector will show a 3.1% yoy expansion, which would be marginally below the 3.3% yoy growth initially reported by *INEGI*. Moreover, we expect a contraction of 0.7% yoy of industrial activity as a result of the deceleration seen in the manufacturing and mining sectors.

www.banorte.com
www.ixe.com.mx
@analisis_fundam

Delia Paredes

Executive Director of Economic Analysis
delia.paredes@banorte.com

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	TIME (EST)	EVENT	PERIOD	UNIT	BANORTE-IXE	CONSENSUS	PREVIOUS
Mon 21-Nov		Banking holiday: Mexican Revolution					
Tue 22-Nov	3:30pm	Banamex bi-weekly survey of economic expectations					
Tue 22-Nov	12:30pm	Government weekly auction: 1-, 3-, 6-month CETES; 5y Bondes D (Nov'22); 30y Mbonos (Dec'17)					
Wed 23-Nov	9:00am	GDP	3Q16	% yoy	<u>1.9</u>	1.9	2.0
		(sa)		% q/q	<u>0.9</u>	1.0	1.0
		Primary activities		% yoy	<u>7.6</u>	--	4.9
		Industrial production		% yoy	<u>-0.7</u>	--	-1.0
		Services		% yoy	<u>3.1</u>	--	3.3
Wed 23-Nov	9:00am	Global economic indicator	September	% yoy	<u>1.4</u>	2.1	2.9
		(sa)		% m/m	<u>0.1</u>	--	-0.1
		Primary activities		% yoy	<u>9.6</u>	--	9.7
		Industrial production		% yoy	<u>-1.3</u>	--	0.3
		Services		% yoy	<u>2.5</u>	--	4.2
Wed 23-Nov	10:00am	International reserves	18-Nov	US\$ bn	--	--	174.5
Wed 23-Nov	1:30pm	Quarterly inflation report	3Q16				
Thu 24-Nov	9:00am	Retail sales	September	%yoy	<u>7.7</u>	--	8.9
Thu 24-Nov	9:00am	CPI inflation	1H-Nov	% 2w/2w	<u>0.73</u>	0.69	0.60
				% yoy	<u>3.25</u>	3.16	3.06
		Core		% 2w/2w	<u>0.11</u>	0.12	0.08
				% yoy	<u>3.21</u>	--	3.10
Fri 25-Nov	9:00am	Trade balance	October	US\$ mn	<u>-81.9</u>	-433	-1,607.6
		Total exports		% yoy	<u>1.9</u>	--	1.3
		Oil exports		% yoy	<u>9.6</u>	--	5.7
		Non-oil exports		% yoy	<u>1.5</u>	--	1.1
		Total imports		% yoy	<u>-2.1</u>	--	1.7
Fri 25-Nov	10:00am	Current account	3Q16	US\$ bn	<u>-7.9</u>	--	-7.9

Source: Banorte-IXE; Bloomberg

Proceeding in chronological order...

The Good Weekend will start this Friday. *The Good Weekend (El Buen Fin)* will begin this Friday. Recall that *The Good Weekend* was implemented by the Federal Government in 2011 and was intended to simulate the US Black Friday. In this edition, we believe that retail stores could implement greater discounts than the ones observed in the five previous years, given the deceleration observed in private consumption during the third quarter of the year. Given that consumers held back significantly on consumption, we believe that the greater discounts could push up retail sales in November.

Financial markets will remain closed in Mexico on Monday. On the logistics side, and before we start with next week's description, it is worth noting that next week Mexico will experience a short week with a banking holiday on Monday (Nov 21), as the country observes the 106th Anniversary of the Mexican Revolution.

Weekly government bond auction. On Tuesday, the Ministry of Finance (MoF) –via Banco de Mexico as its financial agent-, will offer 5-year Bondes D (Nov'21), 30-year-fixed rate Mbonos (Nov'42), 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, November 22, 2016)

	Maturity	Coupon rate, %	To be auctioned ¹	Previous yield ²	
Cetes					
	1m	22-Dec-16	--	7,000	5.56
	3m	23-Feb-17	--	11,000	5.96
	6m	25-May-17	--	12,000	6.18
Bondes D					
	5y	18-Nov-21	--	4,000	0.20
Mbono					
	30y	13-Nov-42	7.75	1,000	6.55

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

Banamex Survey: Market participants will focus on inflation and monetary policy forecasts. On Tuesday at 4:30pm (EDT) *Banamex* will release its bi-weekly survey of economic expectations, where market participants will focus on analysts' monetary policy assessments given Banxico's 50bps rate hike in November's meeting.

Furthermore, analysts will also focus on the inflation report for the first half of November (to be published on Thursday November 24), 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 do expect strong downward revisions to the median GDP forecast for 2017. In the second case, we expect upward revisions to the FX estimates for 2016 and 2017 given the result of the electoral process in the US.

GDP will show a 1.9% yoy expansion in 3Q16. On Wednesday, at 9:00am (EDT), *INEGI* will publish its GDP report for the third quarter of 2016, where we expect a 1.9% yoy expansion, marginally below the 2% growth reported in *INEGI*'s preliminary GDP report. In seasonally adjusted terms, we expect a 0.9% q/q expansion.

Taking a look at the breakdown, we believe that the services sector will show a 3.1% yoy expansion, which would be marginally below the 3.3% yoy growth initially reported by *INEGI*. In this regard, we have seen a significant recovery in several of the indicators associated with household spending. In particular, the creation of jobs in the formal sector during the period in question has been significantly higher, while domestic trade has accelerated. However, we believe that the lower growth in the Mexican manufacturing industry will have a negative impact on other services associated with this sector, such as transportation.

Regarding industrial activities, manufacturing output expanded a scant 1.2% yoy as a result of the lower growth in the US manufacturing sector, which led to a deceleration of Mexico's manufacturing output and exports. Moreover, construction output posted a null growth, as result of a significant downturn in non-residential construction, and the recovery in private housing construction. However, the current recession in the mining industry (-8.3% yoy) –derived from the contraction in Mexico's oil production– has limited the recovery of industrial activity, which we believe fell 0.7% yoy in 3Q16.

We expect a 1.4% yoy expansion in September's IGAE. Also on Wednesday, at 9:00am (EST), *INEGI* will release its monthly global economic indicator for September (monthly proxy for the GDP). We expect a 1.4% yoy expansion of economic activity (0.1% m/m).

As we had mentioned in our last IP report, the 1.3% yoy contraction in industrial production during September was explained in part by the moderate 0.4% yoy expansion in manufacturing output. Moreover, construction increased 1% yoy as a result of the fall in public investment projects. Finally, given the fall in Mexico's oil production, mining activity posted a 9.7% yoy reduction, now adding 28 consecutive months in contraction.

As we already explained in the GDP section, we believe that growth in September was driven by the performance of the service sector, which we forecast at 2.5% yoy. We highlight that trade has continued to show clear signs of acceleration. Finally, for the agricultural sector, we estimate a 9.6% yoy expansion.

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\$770 million amounting to US \$174.5 billion on November 4. According to Banxico's report, this figure comes mainly as a result of: (1) Dollar sales by Banxico to the Federal Government for US\$1,499 million; along with a (2) Dollar sale by Pemex to Banxico for US\$662. In this context, the Central Bank's international reserves have diminished by US\$2,237 million this year (please refer to the table on the next page).

Banxico's foreign reserve accumulation details

US\$, million

	2015	11/Nov/2016	11/Nov/2016	Year-to-date
	Balance		Flows	
International reserves (B)-(C)	176,735	174,496	-770	-2,237
(B) Gross international reserve	177,597	177,831	-1,079	233
Pemex	--	--	662	3,394
Federal government	--	--	-1,499	211
Market operations	--	--	0	-5,562
Other	--	--	-241	2,192
(C) Short-term government's liabilities	861	3,332	-309	2,470

Source: Banco de México

Banxico's QIR. Banco de Mexico will publish its Quarterly Inflation Report (QIR) for the third quarter of the year on Wednesday around 1:30pm (EST). The release will be accompanied by a press conference led by Governor Carstens. In our view, market participants will focus on three issues: (1) Banxico's assessment regarding the probability of higher financial volatility in local markets derived from the US elections; (2) Banxico's inflationary projections depicted in their traditional *fan charts*; and (3) Banxico's GDP and output gap projections will be particularly interesting to watch after to board members highlighted the uncertainty surrounding its estimation.

In the first case, market participants will focus on Banxico's assessment regarding the probability of higher financial volatility in local markets. Within the last monetary policy *communiqué*, several board members mentioned that: *"Mexico's economic outlook is characterized by a high uncertainty. In addition to the adverse effects that the result of the election in the United States could have on the bilateral relationship with Mexico, we must also consider the possibility of new episodes of volatility associated with various risks that prevail in international markets."*

Market participants will also focus on Banxico's inflation forecasts, which will be depicted in their traditional *fan charts*. In the last QIR, the central bank projected inflation around 3% throughout 2017. However, in their last monetary policy statement, Banxico highlighted that inflation will stay above its target and will likely converge to 3% in 2018.

Finally, we believe that analysts will also focus on the central bank's assessment regarding growth and output gap projection given that in September's monetary policy statement, two board members pointed out some measurement errors in Banxico's potential GDP and mentioned that other economic indicators such as the lower unemployment rate and the recent trend in labor's unitary costs, raises questions about the degree of slack that effectively prevails in the economy.

Inflation in the first half of November will be explained by pressures on electricity tariffs as summer discounts have come to an end. On Thursday, at 9:00am, *INEGI* will release its bi-weekly inflation report. We are forecasting a 0.73% 2w/2w increase in the first half of November. In the core index, we expect an increase of 0.11% 2w/2w.

Inflation in the first half of November will be explained by pressures on electricity tariffs as summer discounts have come to an end while our price monitoring suggests a lateral behavior of agricultural prices.

Nevertheless, we expect this figure to be 20.7bps higher than the observed in same period last year, derived from: (1) 10.8bps stemming from a higher contribution of energy prices (63.2bps vs. 52.5 in 2015); (2) 8.4bps stemming from a higher contribution of services prices (4.6bps vs. -3.9 in 2015). By contrast, we expect (3) a lower contribution agricultural prices (0bps vs. 2.6 in 2015); and (4) -0.2bps stemming from a lower contribution of goods (3.9bps vs. 4.1 in 2015), as shown in the table below.

With these results, annual inflation is at 3.25% yoy in the first half of November from previous 3.06% while core inflation is at 3.21% from 3.1% yoy.

1H-November inflation by components

% bi-weekly incidence

	Banorte-Ixe	2015	Difference
Total	0.73	0.52	0.21
Core	0.08	0.00	0.08
Goods	0.04	0.04	0.00
Processed foods	0.03	0.02	0.01
Other goods	0.01	0.02	-0.01
Services	0.05	-0.04	0.08
Housing	0.02	0.02	0.00
Education	0.00	0.00	0.00
Other services	0.03	-0.06	0.08
Non-core	0.64	0.53	0.11
Agriculture	0.00	0.03	-0.03
Fruits & vegetables	0.00	0.03	-0.03
Meat & eggs	0.00	-0.01	0.01
Energy & government tariffs	0.64	0.52	0.12
Energy	0.63	0.52	0.11
Government tariffs	0.01	0.00	0.01

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.

Retail sales will post a 7.7% yoy expansion in September. On Thursday at 9:00am (EST), *INEGI* will publish its retail sales report for September, where we anticipate a 7.7% yoy expansion. Retail sales' growth will be explained by the favorable performance of durable goods sales. In particular, vehicles sales increased by 18.1% yoy according to *AMIA's* report. In addition, *ANTAD* total store sales posted a 6.2% yoy growth in real terms during the period in question. However, retail sales growth will be bounded by the 7.7% yoy contraction in consumption goods imports –which have a strong correlation with private consumption.

Looking ahead, we believe that retail sales and private consumption will decelerate in the fourth quarter of the year derived from: (1) The significant depreciation of the Mexican currency as a result of the electoral process in the US; (2) the expectation of a lower economic growth in 2017; and (3) the upward trend in core inflation.

Exports will show a marginal recovery. Finally, on Friday at 10:00am (EDT), *INEGI* will make available its trade report for October, where we expect to see a US\$81.9 million deficit. On the exports side, we will probably see a 9.6% yoy expansion of oil exports. In addition, non-oil exports could have increased 1.5% yoy, on the back of a 1.1% hike in manufacturing exports.

On the imports side, we estimate a 3.1% yoy contraction in total imports. Taking a look at the breakdown, we believe that imports consumption goods decreased 9.2% yoy, while imports of intermediate goods could have fallen 0.9% yoy. Finally, we estimate a 0.8% reduction in capital goods imports.

Current account. On Friday (November), at 10:00am, Banxico will publish its balance of payments report for the third quarter of the year. We are forecasting a current account deficit of around US\$7,944 vs the -US\$7,852bn seen last month. According to already reported trade balance figures, trade deficit amounted to US\$8,004million, while net transfers increased on the back of a more dynamic flow of remittances up 5.3%yoy.

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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, National	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 Strategist	juan.alderete.macal@banorte.com	(55) 1103 - 4046
Santiago Leal Singer	Analyst 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	Equity Research Analyst	victorh.cortes@banorte.com	(55) 1670 - 1800
Marissa Garza Ostos	Senior Equity Research Analyst – Conglomerates / Financials/ Mining / Chemistry	marissa.garza@banorte.com	(55) 1670 - 1719
José Itzamna Espitia Hernández	Equity Research Analyst – Airlines / Airports / Cement / Infrastructure / Fibras	jose.espitia@banorte.com	(55) 1670 - 2249
Valentín III Mendoza Balderas	Equity Research Analyst – Auto Parts/ Consumer Discretionary / Real Estate / Retail	valentin.mendoza@banorte.com	(55) 1670 - 2250

Corporate Debt

Tania Abdul Massih Jacobo	Director Corporate Debt	tania.abdul@banorte.com	(55) 5268 - 1672
Hugo Armando Gómez Solís	Analyst, Corporate Debt	hugo.gomez@banorte.com	(55) 1670 - 2247
Idalia Yanira Céspedes Jaén	Analyst, Corporate Debt	idalia.cespedes@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.roldan.ferrer@banorte.com	(55) 5004 - 1454