

# Ahead of the Curve

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Market focus this week will be on INEGI's bi-weekly inflation report

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- INEGI's bi-weekly inflation report.** On Thursday, at 9:00am, (EDT) INEGI will release its bi-weekly inflation report. We are forecasting a 0.61% 2w/2w decrease in the first half of April, below market consensus that expects a 0.20% contraction according to *Bloomberg*. In the core index, we expect an increase of 0.06% 2w/2w, also below market consensus (0.12%). Deflation during the first half of April will be mainly explained by four factors: (1) The start of summer discounts in electricity tariffs in some regions of the country; (2) a reduction in agricultural prices; (3) our weekly price monitoring suggests lower prices of tourism services given the end of the Easter holiday season; and (4) lower energy prices
- February's IGAE.** On Thursday, at 9:00am (EDT), INEGI will release its monthly global economic indicator (IGAE) for February (GDP monthly proxy), where we expect a 3% yoy expansion. We believe that IGAE's growth during the second month of 2015 was driven by the performance of the service sector, which we forecast at 3.5% yoy. Similarly, we highlight that industrial production increased 1.9% yoy as a result of the 4% yoy growth in manufacturing output. Moreover, construction output grew 1.1% yoy. However, IP's headline figure was confined by the current recession in the mining industry –derived from the significant contraction in Mexico's oil production–. We also believe that the 3.5% yoy estimated expansion in services will be explained by the recovery in private consumption. In this regard, INEGI's February's retail sales report will show that consumers' spending is gaining momentum, whereas formal job creation has observed a significant recovery in the last 5 months

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**Mexico weekly calendar**

DATE	HOURL (EDT)	EVENT	PERIOD	UNIT	BANORTE-IXE	CONSENSUS	PREVIOUS
Tue 21-Apr	10:00am	International reserves	17-Apr	US\$ bn	--	--	194.8
Tue 21-Apr	12:30pm	Government weekly auction: 1-, 3-, and 6-month Cetes; 5y MBono (Dec'19); 10y Udibono (Dec'25)					
Tue 21-Apr	4:30pm	Banamex bi-weekly survey of economic expectations					
Thu 23-Apr	9:00am	Global economic indicator	February	% yoy	<u>3.0</u>	2.4	2.0
		Primary activities		% yoy	<u>5.2</u>	--	14.1
		Industrial production		% yoy	<u>1.9</u>	--	0.3
		Services		% yoy	<u>3.5</u>	--	2.5
Thu 23-Apr	9:00am	CPI inflation	1H Apr	% 2w/2w	<u>-0.61</u>	-0.20	0.37
				% yoy	<u>2.86</u>	3.29	3.14
		Core		% 2w/2w	<u>0.06</u>	0.12	0.18
				% yoy	<u>2.26</u>	--	2.45
Fri 24-Apr	9:00am	Retail sales	February	% yoy	<u>4.5</u>	4.9	4.7
		sa		% m/m	<u>0.1</u>	--	2.1

Source: Banorte-IXE; Bloomberg

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Proceeding in chronological order...

**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\$393mn amounting to US\$194.8bn on April 10. According to Banxico's report, this figure comes mainly as a result of: (1) Dollar sales by the Central Bank to the Federal Government for US\$45mn; (2) US\$260mn decrease explained by the introduction of Banxico's USD daily auction; along with a (3) US\$88mn decrease 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, given that on November 2011, the FEC (Federal Exchange Commission) decided to shut down the options scheme that Banxico also used to accumulate reserves. In this context, the central bank has accumulated US\$1,587mn of international reserves this year (please refer to the table below).

**Banxico's foreign reserve accumulation details**

US\$, million

	Foreign Reserve		Breakdown			
	Level	Chg	Pemex	Federal govt <sup>1</sup>	Market operations <sup>2</sup>	Other
<b>2006</b>	67,680					
<b>2007</b>	77,991	10,311	12,899	-4,218	-4,240	5,870
<b>2008</b>	85,441	7,450	22,754	-5,413	-18,674	8,783
<b>2009</b>	90,838	5,397	11,529	6,573	-16,246	3,541
<b>2010</b>	113,597	22,759	16,037	2,338	4,466	-83
<b>2011</b>	142,475	28,878	18,692	2,439	4,614	3,134
<b>2012</b>	163,516	21,116	17,867	2,805	-646	1,089
<b>2013</b>	176,522	13,063	18,100	-1,251	0	-3,788
<b>2014</b>	193,239	16,717	14,500	2,570	-200	-154
<b>10-Apr-15</b>	194,826	1,587	3,000	533	-1,240	-706

Source: Banorte-Ixe, Banco de México; \*Year-to-date

1. Includes short-term government's liabilities

2. Includes Banxico's US dollar sales to Mexican financial institutions as well as the Foreign Exchange Commission's USD Put/MXN Call options

\*Year-to-date

**Weekly government bond auction.** Also on Tuesday, the Ministry of Finance (MoF) –via Banco de Mexico as its financial agent-, will offer 5-year fixed-rate Mbonos (Dec'19) as well as 10-year inflation-linked Udibonos (Dec'25), 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, April 21, 2015)**

	Maturity	Coupon rate, %	To be auctioned <sup>1</sup>	Previous yield <sup>2</sup>
<b>Cetes</b>				
1m	21-May-15	--	5,500	3.00
3m	23-Jul-15	--	9,500	3.08
6m	15-Oct-15	--	11,000	3.22
<b>Mbono</b>				
5y	11-Dec-19	5.00	9,000	5.15
<b>Udibono</b>				
10y	04-Dec-25	4.50	750	2.82

Source: Banco de México

**Banamex Survey: Market participants will focus on analysts' monetary policy assessments.** On Tuesday at 4:30pm (EDT) *Banamex* will release its bi-weekly survey of economic expectations. In the last survey published by *Banamex* all of the analysts surveyed expected a rate hike in 2015. Furthermore, analysts will also focus on 1H-April's inflation forecast (to be published on Thursday, April 23), as well as on CPI estimations for 2015. Finally, we expect moderate downward revisions to the economic growth estimates for 2015.

**We expect a 3% yoy expansion in February's IGAE.** On Thursday, at 9:00am (EDT), *INEGI* will release its monthly global economic indicator for February (GDP monthly proxy), where we expect a 3% yoy expansion. We believe that IGAE's growth during the second month of 2015 was driven by the performance of the service sector, which we forecast at 3.5% yoy. Similarly, we highlight that industrial production increased 1.9% yoy.

As we had mentioned in our last IP report, the 1.9% expansion in industrial production during February was explained in part by the 4% yoy growth in manufacturing output. In this regard, we believe that the recovery of this industry is on the way, and will strengthen in the first half of the year given: (1) A significant recovery in external demand, particularly from the U.S.; (2) Mexico's manufacturing exports have shown solid growth rates; (3) the recent and significant depreciation of the Mexican currency will translate into stronger growth dynamics for the manufacturing exports; and (4) the recent Mexican car industry figures remain strong. In this regard, we believe that the recovery of both manufacturing and construction industries will continue in 1H15.

Moreover, construction output grew 1.1% yoy. We believe that the significant expansion in construction in the last semester reflects the better growth expectations that prevail today in most of Mexico's private firms. In addition, the recovery of households' purchasing power –given the lower inflation levels and the recovery of the Mexican labor market– has led to a significant increase in residential projects. However, IP's headline figure was confined by the current recession in the mining industry –derived from the significant contraction in Mexico's oil production–.

We also believe that the 3.5% yoy estimated expansion in services will be explained by the recovery in private consumption. In this regard, *INEGI's* February's retail sales report will show that consumers' spending is gaining momentum, whereas formal job creation has observed a significant recovery in the last 5 months. Moreover, it is likely that the 4% yoy growth in manufacturing output during February will boost certain subsectors within the services, such as the transport and trade.

**Inflation in the first half of April will be explained by downward pressures on agricultural prices along with the start of summer discounts on electricity tariffs.** On Thursday, at 9:00am, (EDT) *INEGI* will release its bi-weekly inflation report. We are forecasting a 0.61% 2w/2w decrease in the first half of April, below market consensus that expects a 0.20% contraction according to *Bloomberg*. In the core index, we expect an increase of 0.06% 2w/2w, also below market consensus (0.12%).

Deflation during the first half of April will be mainly explained by four factors: (1) The start of summer discounts in electricity tariffs in some regions of the country; (2) a reduction in agricultural prices; (3) our weekly price monitoring suggests lower prices of tourism services given the end of the Easter holiday season; and (4) lower energy prices.

In this regard, we expect this figure to be 42.2bps lower than the observed in same period in 2014, derived from: (1) A lower contribution of agricultural prices (-7bps vs. -5.7 in 2014); (2) we expect -22.6bps from a lower contribution energy prices (-58bps vs. -35.4 in 2014); and, finally (3) a lower contribution of services (0.7bps vs. 14.5 in 2014), as shown in the table below.

With these results, annual inflation will stand at 2.86% yoy in the first half of April from 3.14%, while core inflation will stand at 2.26% from 2.45% yoy.

#### 1H-April inflation by components

% bi-weekly incidence

	Banorte-Ixe	2014	Difference
Total	-0.61	-0.19	-0.42
Core	0.04	0.20	-0.15
Goods	0.04	0.05	-0.02
Processed foods	0.03	0.03	-0.01
Other goods	0.01	0.02	-0.01
Services	0.01	0.14	-0.14
Housing	0.02	0.02	0.00
Education	0.00	0.00	0.00
Other services	-0.01	0.13	-0.14
Non-core	-0.65	-0.40	-0.25
Agricultural	-0.07	-0.06	-0.01
Fresh fruits and vegetables	-0.08	-0.10	0.02
Meat and egg	0.01	0.04	-0.03
Energy and government regulated	-0.58	-0.34	-0.24
Energy	-0.58	-0.35	-0.23
Government regulated	0.00	0.00	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

**Retail sales will post a 4.5% yoy expansion in February.** On Friday (April 24) at 9:00am (EDT), *INEGI* will publish its retail sales report for February 2015. We anticipate a 4.5% yoy expansion explained by the 22% yoy growth in vehicle sales (*AMIA*), which will have a positive impact on the overall growth rate. Moreover, consumption goods imports -which have a strong correlation with retail sales- posted a 2.3% yoy expansion, while *ANTAD* total store sales increased 5.5% yoy in real terms during the period in question.

Looking ahead, we believe that retail sales performance will show a visible recovery in the first half of the year. In particular, private consumption in Mexico will show better growth prospects derived from: (1) A significant improvement in consumer's expectations regarding economic growth; (2) the recent downward trend in inflation; and (3) the stronger growth dynamics in the Mexican labor market.

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